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TAX LAW FOR BUSINESS

*BDB Law's "Tax Law for Business" appears in the opinion section of **Business Mirror** every Thursday.*

Imposition of VAT and excise taxes on goods brought into FEZs is unconstitutional

Remember Revenue Regulations (RR) 2-2012? This was issued during the previous administration purportedly due to rampant smuggling of petroleum and petroleum products, resulting in substantial revenue losses. Based on said regulations, it became mandatory for the government to immediately implement corrective measures to stop this smuggling activity to ensure the collection of correct taxes. Despite the tax and duty- free status of goods brought into free port and economic zones based on existing laws, the regulations required the payment of value-added and excise taxes on all petroleum and petroleum products that are imported and/or brought directly from abroad to the Philippines, including those brought into free port and economic zones (FEZs).

To recover the value-added tax (VAT) and excise tax, the same regulations allow the importer to apply for the refund of the tax payments. However, no claim for refund can be granted unless it is properly shown to the satisfaction of the Bureau of Internal Revenue (BIR) that said petroleum or petroleum products have been sold to a duly registered FEZ locator and have been utilized in the registered activity/operation of the locator, or that such have been sold and have been used for international shipping or air transport operations, or that the entities to which the said goods were sold are statutorily zero-rated for VAT, and/or exempt from excise taxes.

RR 2-2012 was initially questioned before the regional trial court for being unconstitutional, particularly the imposition of VAT and excise taxes on petroleum and petroleum products brought into FEZs. The Court ruled in favor of the petitioners, holding that RR 2012 is unconstitutional because it imposes taxes that, by law, are not due in the first place pursuant to the existing laws, which granted tax and duty-free incentives to FEZ locators. The Court further ruled that a revocation of these incentives by administrative regulations directly contravenes the express intent of Congress. Also, the regulations encroached upon the prerogative to enact, amend, or repeal laws, which the Constitution exclusively granted to Congress.

In GR 210588, which was promulgated in November 2016, the Supreme Court (SC) agreed with the decision of the lower court. Among others, the SC declared that RR 2-2012 illegally imposes taxes upon FEZ enterprises, which by law enjoy tax-exempt status. Likewise, the regulation effectively amended the law and thereby encroaches upon the legislative authority exclusively reserved by the Constitution for Congress.

The SC cited that the law and its implementing rules grant the following: First, the law provides that importations of raw materials and capital equipment into the FEZs shall be tax and duty-free. The specific transaction of importation is exempt from taxes and duties. Second, the law grants FEZ a preferential rate in the payment of income tax, in lieu of all national and local taxes. The tax exemption enjoyed by FEZ enterprises covers internal-revenue taxes imposed on goods brought into the FEZ, including VAT and excise tax.

Further, the Philippine VAT system adheres to the cross-border doctrine. No VAT shall be imposed to form part of the cost of the goods destined for consumption outside the Philippine customs territory. FEZ cannot be directly charged for the VAT on its sales, nor can VAT be passed on to them indirectly as added cost to their purchases. Based on existing laws, enterprises within FEZs are, by legal fiction, foreign territories. They are considered outside the customs territory.

Finally, the SC held that the State's inherent power to tax is vested exclusively in the legislature. The power to tax includes the power to grant tax exemption. Thus, the imposition of taxes, as well as the grant and withdrawal of tax exemptions, shall only be valid pursuant

to a legislative enactment. The enactment of RR 2-2012, being an executive issuance, is a clear violation of doctrine of separation of powers among the departments of the government.

Recently, the BIR issued Revenue Memorandum Circular 38-2017 to circularize the SC decision in GR 210588. With this, the BIR recognized that RR 2-2012 is null and void for being unconstitutional. Indeed, while the commissioner holds the power to interpret, implement and administer tax laws, he cannot go beyond the provisions of the tax laws. We hope that no similar issuance will be made in the future as said actions will always be detrimental to taxpayers.

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