

In the Service of Our Foreign Debt—
Republic Act No. 9337: The E-Vat Law
*Jose U. Cochingyan III **

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Cite as 50 ATENEO L.J. 349 (2005).

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*Lex plus laudatur quando ratione probatur.*¹

1. BLACK'S LAW DICTIONARY 1654 (7th ed. 1999) ("The law is more praised when it is consonant with reason.").

I. PROLOGUE

By the time I would have finished this speech, the government would have borrowed more than P21 million. We borrow at a rate of P1,060,000 per minute. To pay our debt, P1.2 million is gone from the Treasury every 60 seconds.²

These words were not an allusion to the length of the speech but rather it was a cry of alarm to the rate that the Philippine national debt has been growing. The speech was delivered by Sen. Ralph G. Recto³ to sponsor Senate Bill No. 1950⁴ proposing principally amendments to the Value-Added Tax (VAT) Law. In his spiel for a new VAT Law, Sen. Recto welded the value-added tax to the national debt, thus:

We borrow recklessly knowing full well that those who will come after us will foot the bill. We refuse to live within our means so borrow against future income...

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Our refusal to pay taxes, or compel their collection, will perpetuate this cycle, and guarantee that the next generation will be an indentured one.

And if that happens, our children will remember us, not with a debt of gratitude, but simply for the debt we left them.

Many years from now, I fear that Aquilino Pimental V, Frankie Pangilinan II, or Richard the Third of Olongapo will berate us from across the ages as they file pass our portraits on the way to the Session Hall of the same Senate of their forebears to grapple with a fiscal crisis whose seeds we planted.

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Thus, the liberation of our grandchildren from crushing debt begins when we start living within our means, when we start funding our needs with revenues instead of borrowing, when we stop making many national *vale* that are payable in 30 annual *gives*.

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2. SENATE JOURNAL 722, 13th Cong., 1st Reg. Sess., Senate Sess. No. 67 (Mar. 7, 2005).
 3. Sen. Ralph G. Recto chaired the Committee on Ways and Means.
 4. An Act Amending Sections 27, 28, 34, 106, 108, 109, 110, 111, 112, 113, 114, 116, 117, 119, 125, 148, 151, 236, 237 and 288 of the National Internal Revenue Code of 1997, as Amended, and for Other Purposes (2005).

We have started to create a better future for our children when we passed a law that increased the tax on sin products and another one that would make honest men out of taxmen.

Now we are about to take the third and hardest step on our journey to fiscal salvation. The proposal at hand will raise the biggest revenue, and spare no one.

The VAT is so pervasive that it precedes our stay in this world and lingers on after we are gone. We are brought out into this world in value added-taxed carriages and are laid to rest in value added-taxed coffins.

If tax is the membership tax to a government, then a citizen pays his dues in the form of VAT many times in a day from the moment he flushes the value-added taxed-water down the toilet in the morning to the time the brushes his teeth with a value added-toothpaste at night.

The omnipresent trait of the VAT stems from the fact that it is a consumption tax and man, well, is a consumption animal.

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Nobody can escape from VAT. *Ka Roger* may evade the military, avoid income tax and pay no franchise tax, but the long arm of VAT picks his pocket even in his mountain hideout because each time he buys a cellcard or a *Lucky Me*, he pays a VAT.⁵

Sen. Recto's speech encapsulates what was uppermost in the minds of our legislators when they enacted R.A. No. 9337,⁶ popularly referred

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5. SENATE JOURNAL 722-23, 13th Cong., 1st Reg. Sess., Senate Sess. No. 67 (Mar. 7, 2005) (The mention of "the tax on sin products" refers to R.A. No. 9334 (2004) and the phrase "make honest men out of taxmen" refers to R.A. No. 9335 (2005), otherwise known as the "Attrition Act of 2005." These two laws are the commencement of a series of legislated revenue measures designed to combat the deficit that has been funded by national debt.).
 6. An Act Amending Sections 27, 28, 34, 106, 107, 108, 109, 110, 111, 112, 113, 114, 116, 117, 119, 121, 148, 151, 236, 237 and 288 of the National Internal Revenue Code of 1997, as Amended, and for Other Purposes, Republic Act No. 3997 (R.A. No. 9337 was passed by the House of Representatives and the Senate on May 11, 2005 and May 10, 2005 respectively and was approved by Pres. Gloria Macapagal-Arroyo on May 24, 2005. The law was published on May 27, 2005 in the *Malaya* and *Daily Tribune*.).

to as the E-VAT Law.⁷ It was in the end a call for a legislative chorus to tax the citizenry in order to rein in the national debt.

The passage of this law was not an easy one such that Sen. Juan Ponce Enrile remarked:

All my years in the Senate, I can hardly recall a more contentious piece of legislation than the one before us this afternoon. We spent many months discussing it in the Ways and Means Committee, and many months more debating it on the floor of the Senate. When we finally voted on it, there were recriminations. And when we finally met with our counterparts from the House in the bicameral conference, we spent weeks of further discussion before an acceptable version was finally hammered out.⁸

R.A. No. 9337 took effect on 1 July 2005.⁹ Prior to that, on 30 June 2005, Revenue Regulations No. 14-2005 otherwise known as the “Consolidated Value-Added Tax Regulations of 2005” dated 22 June 2005 was released through the BIR’s website.¹⁰ The new law, however, was frozen by a temporary restraining order from the Supreme Court within less than 24 hours from the time it took effect.¹¹ As a consequence, the Bureau of

7. Abbreviation for “Expanded Value-Added Tax Law.”

8. SENATE JOURNAL 187, 13th Cong., 1st Reg. Sess., Senate Sess. No. 83 (May 10, 2005) (Sen. Enrile voted against the bill).

9. R.A. No. 9337, § 26.

SEC. 26. *Effectivity Clause.* – This Act shall take effect on July 1, 2005.

10. Issued pursuant R.A. No. 9337, § 23.

SEC. 23. *Implementing Rules and Regulations.* – The Secretary of Finance shall, upon the recommendation of the Commissioner of Internal Revenue, promulgate not later than June 30, 2005, the necessary rules and regulations for the effective implementation of this Act. Upon issuance of the said rules and regulations, all former rules and regulations pertaining to value-added tax shall be deemed revoked.

11. The temporary restraining order dated July 1, 2005 was issued in the cases of *Association of Pilipinas Shell Dealers, Inc. v. Purisima*, G.R. No. 168461 (Petition for Certiorari filed June 29, 2005) and *Escudero v. Purisima*, G.R. No. 168463 (Petition for Certiorari filed June 30, 2005). The following cases were also filed: *Pimentel v. Executive Secretary Eduardo Ermita*, G.R. No. 168207 (Petition for Certiorari filed June 9, 2005) and *Abakada Guro Party*

Internal Revenue (BIR) was constrained to issue Revenue Memorandum Circular No. 30-2005 dated 2 July 2005 deferring the implementation of Revenue Regulation No. 14-2005. Revenue Memorandum Circular No. 30-2005 declares that:

In line with the TRO, the Bureau shall revert the VAT status of concerned taxpayers to their registration status prior to July 1, 2005 and make the necessary notification. All Taxpayers shall be liable for the taxes and the tax rates they were subject to prior to the effectivity of Republic Act No. 9337 on July 1, 2005.

In a peculiar turn of events, on 12 July 2005 the Supreme Court Resolution directed former Finance Secretary Cesar Purisima to show cause why he should not be held in contempt of the Court for a statement, attributed to him by the press, that the President had a hand in the issuance of the temporary restraining order.¹²

On 1 September 2005, the Supreme Court upheld the validity of the law and dismissed the petitions seeking to have the law declared unconstitutional. Thus, it ruled that “[t]he Court cannot strike down a law as unconstitutional simply because of its yokes.... There being no constitutional impediment to the full enforcement and implementation of R.A. No. 9337, the temporary restraining order issued by the Court on July 1, 2005 is LIFTED upon finality of [the] decision.”¹³ In the meantime, former Finance Secretary Cesar Purisima was found to be contumacious and fined for failing to deny the statements attributed to him by the press in a timely manner, thereby casting doubt on the integrity of the Supreme Court.¹⁴

List (formerly AASJAS) Officers Samson Alcantara v. Hon. Executive Secretary Eduardo Ermita, G.R. No. 168056 (Petition for Certiorari filed May 27, 2005). Belatedly filed was the case of *Garcia v. Hon. Executive Secretary Eduardo Ermita*, G.R. No. 168730 (Petition for Certiorari filed July 20, 2005).

12. *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita*, G.R. No. 168056, Sep. 1, 2005.

13. *Id.* (*bold emphasis omitted*).

14. *Id.* In imposing a fine of Php20,000 on the former Finance Secretary Cesar Purisima, the Supreme Court stated that:

At the time the reports came out, Purisima did not controvert the truth or falsity of the statements attributed to him. It was only after the Court issued the show-cause order that Purisima saw it fit to deny having uttered these statements.

Soon thereafter, on 18 October 2005, the Supreme Court lifted its temporary restraining order and denied with finality a subsequent motion for reconsideration, thereby removing any further impediment to the E-VAT Law. The Supreme Court in so doing declared that:

[T]he assailed provisions of R.A. No. 9337 already involve legislative policy and wisdom. So long as there is a public end for which R.A. No. 9337 was passed, the means through which such end shall be accomplished is for the legislature to choose so long as it is within constitutional bounds.¹⁵

On 21 October 2005, the BIR released through its website Revenue Regulations No. 16-2005 dated 1 September 2005, which is the revised

By then, it was already impressed upon the public's mind that the issuance of the TRO was the product of machinations on the Court by the executive branch.

If it were true that Purisima felt that the media misconstrued his actions, then he should have immediately rectified it. He should not have waited until the Court required him to explain before he denied having made such statements. And even then, his denials were made as a result of the Court's show-cause order and not by any voluntary act on his part that will show utter regret for having been "misquoted." Purisima should know that these press releases placed the Court into dishonor, disrespect, and public contempt, diminished public confidence, promoted distrust in the Court, and assailed the integrity of its Members. The Court already took a beating before Purisima made any disclaimer. The damage has been done, so to speak.

15. *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita*, G.R. No. 168056, Oct. 18, 2005 (this was the resolution denying motion for reconsideration).

version of the Consolidated Value-Added Tax Regulations of 2005.¹⁶ The new regulations took effect on 1 November 2005.¹⁷

The principal objective of this article is hardly ambitious. It is merely to enumerate to the reader the new provisions introduced by the E-VAT Law and to narrate the deliberations in Congress regarding a few of these changes. The article draws its material mostly from the records of the Bicameral Conference Committee since it was at this stage when the law went through its final paces, the *Final Passage*, so to speak. The committee was formed by both Houses to reconcile “disagreeing provisions” of the several versions of the tax measures coming from both Houses of Congress. “The creation of such conference committee was apparently in response to a problem, not addressed by any constitutional provision, where the two houses of Congress find themselves in disagreement over changes or amendments introduced by the other house in a legislative bill.”¹⁸ It was the report of this committee that was approved by both Houses to become the E-VAT Law. It is therefore hoped that the narration here may, at the very least, give the reader an insight on the rationale of our legislators for the law for purposes of discussion and study.

16. See Consolidated Value Tax Regulations of 2005, at <ftp://ftp.bir.gov.ph/webadmin1/pdf/26116RR%2016-2005.pdf> (last accessed Oct. 20, 2005). A day before, an unnumbered version was electronically released by a newspaper, Business World, at <http://www.bworldonline.com/BW102005/vatirr.php>. The regulations were reportedly revised “after business and tax experts cited some provisions that needed to be ‘revisited.’” See also Felipe F. Salvosa II, *Implementing Rules Out*, BUSINESS WORLD, Oct. 20, 2005, at S1/1.

17. Bureau of Internal Revenue, Rev. Reg. No. 16-2005, Effectivity Clause (Sep. 1, 2005).

18. *Abakada*, G.R. No. 168056, Sep. 1, 2005 (The Court went on to say, “Note that in the present petitions, the issue is not whether provisions of the rules of both houses creating the bicameral conference committee are unconstitutional, but whether the bicameral conference committee has strictly complied with the rules of both houses, thereby remaining within the jurisdiction conferred upon it by Congress.”).

II. THE FINAL PASSAGE

A. The Front-End Deficit Reduction and the Debt Spiral

The Bicameral Conference Committee relied on resource speakers from the Department of Finance to help bring focus into the discussions on the E-VAT proposals. The Department of Finance was not only the source of data on the incremental revenues that may be raised in the event of a 100% collection of the value-added tax but also provided a summary of how the versions of the House and Senate differed from each other.¹⁹ This reliance on the Executive Branch for this piece of legislation is only *apropos* as the tax measure is an administration bill and “it would be best for the alter egos of the President to state their position” for the consideration of the legislators.²⁰

Indeed, the urgency felt by the Executive Branch for this tax measure is such that to improve its law of averages all the three proposed bills from both Houses were certified by Pres. Gloria Macapagal-Arroyo “to meet the public emergency *arising* from the urgent need to generate fresh domestic funds for the country’s development programs and projects,”²¹ “to optimize revenue collection efficiency in the face of the country’s serious financial problems by removing existing distortions in the Value-Added Tax (VAT) system and breaks in the VAT chain while taking into consideration the net impact thereof on vulnerable socio-economic sectors,”²² and “of broadening the tax base by plugging the loopholes in the existing VAT system, simplifying its collection through a uniform rate and expanding the

19. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 63-104 (Senate Version, Apr. 15, 2005) (Usec. Noel Banoan, Department of Finance, gave the briefing in this instance).*

20. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 72 (Senate Version, Apr. 21, 2005) (statement of Sen. Ralph Recto).*

21. Letter from Pres. Gloria Macapagal-Arroyo certifying H.B. No. 3555 (Jan. 7, 2005) pursuant to PHIL. CONST. art. VI, § 26(2).

22. Letter from Pres. Gloria Macapagal-Arroyo certifying H.B. No. 3705 (Feb 8, 2005) pursuant to PHIL. CONST. art. VI, § 26(2).

coverage making its effects more equitable and just on the country's so-called sensitive sectors."²³

On the other hand, all throughout the Bicameral Conference Committee hearings figures were bandied about on how much revenue may be raised from the various amendatory provisions of the E-VAT Law. At one session the computation was almost akin to counting chickens before the eggs are hatched, no doubt because what was being discussed was after all a tax measure, thus:

THE CHAIRMAN (SEN. RECTO). Mr. Chairman, yesterday we agreed that the five-year on capex is common to both Houses and we agree in principle to adopt this practice. Similarly, Mr. Chairman, we agreed yesterday to increase the minimum VAT pay, the effect of which will be 3 percent and in effect, we have agreed roughly yesterday in monetary terms, 37.5 billion. Considering that the House is at 12, the House would have theirs.

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THE CHAIRMAN (SEN. RECTO). Okay. May we request the secretariat, or maybe in this case, the secretariat of both panels, to add now what we've agreed on basically, 15 million the minimum VAT; 22.582 for the five-year capex. As far as the Senate version is concerned, 'no, 526 million for lawyers; 1.631 billion for doctors; 739 million for non-food agricultural products. And we start discussing petrol. Okay. And then we ask the secretariat to compute this and to give us the number, 'no.

So, let's start with petroleum. Mr. Chairman, based on the DOF presentation, the House at 4 percent will have 6.123 billion. The Senate in that presentation, is 9.328 billion. Now, I'd like to put on record that the Senate includes, more or less, a 40 percent increase in efficiency. And just for the sake – so that *mabilis iyong discussion natin*, Mr. Chairman, let us bring this down to 14.560 billion because that is the actual number without any improved efficiency. Okay?²⁴

The then Secretary of Finance, Cesar Purisima, puts the points of the VAT advocates into perspective when he laid out the objective for

23. Letter from Pres. Gloria Macapagal-Arroyo certifying S.B. No. 1950 (Mar. 11, 2005) pursuant to PHIL. CONST. art. VI, § 26(2).

24. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 9-11 (Senate Version, Apr. 19, 2005).*

the revenue measure as one that will allow for a “front-end deficit reduction” to counter the debt spiral, thus:

First, let me explain the position that the Philippines finds itself in right now. We are in a position where 90 percent of our revenue is used for debt service. So, for every peso of revenue that we currently raise, 90 goes to debt service. That’s interest plus amortization of our debt. So, clearly, this is not a sustainable situation. That’s the first fact.

The second fact is that our debt to GDP level is way out of line compared to other peer countries that borrow money from that international financial markets [*sic*]. Our debt to GDP is approximately equal to our GDP. Again, that shows you that this is not a sustainable situation.

The third thing that I’d like to point out is the environment that we are presently operating in is not as benign as what it used to be the past five years.

What do I mean by that?

In the past five years, we’ve been lucky because we were operating in a period of basically global growth and low interest rates. The past few months, we have seen an inching up, in fact, a rapid increase in the interest rates in the leading economies of the world. And, therefore, our ability to borrow at reasonable prices is going to be challenged. In fact, ultimately, the question is our ability to access the financial markets.

When the President made her speech in July last year, the environment was not as bad as it is now, at least based on the forecast of most financial institutions. So, we were assuming that raising 80 billion would put us in a position where we can then convince them to improve our ability to borrow at lower rates. But conditions have changed on us because the interest rates have gone up. In fact, just within this room, we tried to access the market for a billion dollars because for this year alone, the Philippines will have to borrow 4 billion dollars. Of that amount, we have borrowed 1.5 billion. We issued last January a 25-year bond at 9.7 percent cost. We were trying to access last week and the market was not as favorable and up to now we have not accessed and we might pull back because the conditions are not very good.

So given this situation, we at the Department of Finance believes [*sic*] that we really need to front-end our deficit reduction. Because it is deficit that is causing the increase of the debt and we are in what we call a debt spiral. The more debt you have, the more deficit you have because interest and debt service eats and eats more of your revenue. We need to get out of this debt spiral. And the only way, I think, we

can get out of this debt spiral is really have a front-end adjustment in our revenue base.²⁵

Quite realistically, the so-called front-end deficit reduction program was not expected to wipe out the deficit, but it is to improve the Philippines' access to financial markets and to lessen the deficit and thereby reduce our need to borrow.²⁶ Thus, it was further explained:

Now, the VAT is not expected to wipe out deficit. I don't think anyone is expecting us to wipe out our deficit. I think what they are expecting us to do is to change the direction, get out of that cycle of deficit to a more virtuous cycle where we can then go for more development, and the key really is front-ending that deficit reduction to around 3 percent, and the only way that we can do that is with big measures like VAT. There are no other measure on the table that would give us that kind of up-front benefit. Clearly, our improvement in the efficiency of tax collection and custom duties collection can generate that much. But these things take time. It cannot be done overnight. It takes structural changes, investment in people and changes in values and it will have to be done over a period of time, but we need the revenues.²⁷

This argument did not go well with some of our legislators who questioned the objectives of the tax measure as one which will not

25. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 17-18 (Senate Version, Apr. 21, 2005) (statement of Sec. Cesar Purisima, Department of Finance) (cited with approval in *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita, G.R. No. 168056, Sep. 1, 2005*).*

26. *See Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 50 (Senate Version, Apr. 19, 2005) (statement of Sec. Cesar Purisima, Department of Finance).*

27. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 21 (Senate Version, Apr. 21, 2005) (statement of Sec. Cesar Purisima, Department of Finance).*

really cure the debt and deficit vicious cycle, but rather such argument is merely palliative, thus:

SEN. GORDON. Can I just clarify?

You are saying that assuming this is approved, we are just going to simply run in order to stay in place or even lower than that?

MR. PURISIMA. We will reduce the rate at which we're falling behind.

SEN. GORDON. So, we're [*sic*] still be falling behind?

MR. PURISIMA. Yes.

SEN. GORDON. So why don't you speak frankly and tell us what you really need? If you really need to front-end a certain amount of money, then we must tell our people that this has got to be done. Why are we saying, well, we just want to try and get us near to running in order to stay in place. We are supposed to do what needs to be done. If you can convince this Committee that this is what needs to be done, then we will follow your lead.

MR. PURISIMA. I gave a very narrow answer to your question, Mr. Senator, let me explain.

I was just answering it in reference to the fact that our deficit last year was P233 billion. So 80 or 100 or 120 billion more revenue would reduce that deficit but would still be in deficit. That is why it is important that once we do this, then we now have a case to go to our multilateral partners and our donor country friends to help us consolidate this gain because they realize that we cannot do it on our own. But they want to see us step forward and make a major statement that we're really trying to get out of the deficit cycle we're in. So they come in and help us consolidate and at the same time, we're hoping that...

SEN. GORDON. Mr. Chairman, I'm just very concerned with the way this thinking is taking us. In other words, this is just going to reduce the deficit rate. And we're going into an inchoate situation where out of expectancy that the foreign lenders will look with favor upon us because you have done this, they will be able to lend us money to tide us over. In other words, this is all tiding us over. We're not fixing the problem. We're simply applying a little bit of band aid.²⁸

28. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 24-26 (Senate Version, Apr. 21, 2005) (exchange between Sen. Richard Gordon and Sec. Cesar Purisima, Department of Finance).*

It was in effect a question of whether or not we should “bite the bullet” now to avoid a specter whose name our leaders dare not utter, the Argentinean meltdown. Indeed, there were those who felt that the public’s access to the subject must be “protected by a bodyguard of lies.”

SEN. GORDON. ...What will happen if we do not bite the bullet now? Let’s say they do not lend us money or they increase the rates, what would be the effect? Are we merely postponing the obvious?

If you increase the rates or for that matter *hindi na tayo pinahiram, ano’ng scenario sa publiko?* [we are no longer allowed to borrow, what then is the public scenario?] What’s gonna happen to our country?

MR. PURISIMA. Well, in a worst-case scenario, you will have – I’m just looking whether there’s press, you know. You will have a meltdown.

SEN. GORDON. Let the press know, for Christ sake. I mean, excuse me. But if the public doesn’t know what’s going to happen, how are they going to bear and support this burden that you are trying to impose on them? ...

REP. LOCSIN. Some things unfortunately – what’s the expression, “the truth must be protected by a bodyguard of lies.” There are things in a government – in a serious government of a country; we just can’t let the public know everything. Right?

SEN. GORDON. I can’t believe I’m hearing that from my good friend.²⁹

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SEN. GORDON. ... Is it going to be Argentina? Is it going to be what? What is it going to be? Not just Argentina, what is it going to be on the streets?

MR. PURISIMA. The options to our people is [sic] worse than the option that we’re proposing right now. Because in a scenario where you have a meltdown, the foreign currency, the exchange rate between the peso and the dollar will be the adjustment mechanism. And since we import about half of our needs, so, for every peso devaluation, it’s a 20 billion cost. So in a meltdown, we are going to talk about P30-P40 devaluation of the peso. So, you multiply that by 20,

29. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 49-50 (Senate Version, Apr. 25, 2005) (exchange between Sen. Richard Gordon, Rep. Teodoro Locsin, Jr., and Sec. Cesar Purisima, Department of Finance).*

that's 800 billion in pain to our people as compared to the pain we are proposing right now which is only between 60 and at best 156 billion. And that is why; we have been proposing a controlled route toward the resolution of our problems.³⁰

Finally, the proposed bills for the E-VAT Law sailed through the Bicameral Conference Committee and became R.A. No. 9337. While its passage was not without misgivings that the tax measure may not be the appropriate solution to the debt spiral, its objectives were well recognized as two fold: to fix the deficit and then arrange the debts with the Philippines' creditors.³¹ The proposition was to "achieve fiscal consolidation which would require the reduction of our fiscal deficit from where it is now to around zero by 2009 or 2010." Corollary to this proposition is the averment of our monetary authority that there is a need to generate savings for the economy in order to "effectively replace the need to borrow."³² The law was enacted in the backdrop of the chilling image of the Philippines' financial situation as portrayed by the Executive Branch and "Congress passed the law hoping for rescue from an inevitable catastrophe."³³

At the Bicameral Conference Committee hearings, the debt service was reported to be at approximately one third of the national budget³⁴

30. *Id.* at 52.

31. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 80 (Senate Version, Apr. 21, 2005) (statement of Sen. Joker Arroyo).*

32. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 83 (Senate Version, Apr. 21, 2005) (statement of Gov. Amando Tetangco, *Bangko Sentral ng Pilipinas*).*

33. *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita, G.R. No. 168056, Sep. 1, 2005.*

34. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 84 (Senate Version, Apr. 25, 2005) (statement of Sec. Cesar Purisima, Department of Finance).*

and up to 90% of the government's revenues.³⁵ The national debt was estimated at roughly five trillion pesos, at least half of it owed to foreign lenders.³⁶ It is in this vein that the tax measure was viewed as one which may improve the Philippines' creditworthiness at the international financial markets.³⁷ In discussing the various provisions of the measure, references were made on how specific provisions will be perceived by our foreign creditors, such as the exemptions enjoyed by our "richest corporations"³⁸ or how a banker in the United States will

35. *Id.* at 80.

36. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 82 (Senate Version, Apr. 21, 2005)* (This was the response of Sen. Ralph Recto and Gov. Amando Tetangco, *Bangko Sentral ng Pilipinas*, to queries of Sen. Joker Arroyo (citing figures released by the Department of Finance, where the outstanding government debt was reported at Php3.891 trillion as of the end June 2005, of this amount Php 2.035 trillion or 52% of the total is owed to domestic lenders and foreign debt amounted to Php 1.856 trillion or 48% of the total). The Bicameral Conference Committee hearings took place in the weeks of April 2005.).

See Felipe F. Salvosa II, *Outstanding gov't debt tallied at P3.89 trillion as of end-June*, BUSINESS WORLD, Sep. 7, 2005, at S1/1. *See also* *Bangko Sentral ng Pilipinas, Philippine External Debt Rises in June*, at <http://www.bsp.gov.ph/news/2005-10/news-10032005a.htm> (last accessed Nov. 30, 2005). (The *Bangko Sentral ng Pilipinas* reports that: "As of end-June 2005, the country's outstanding external debt approved/registered by the *Bangko Sentral ng Pilipinas* stood at US\$56.0 billion, up by about US\$0.7 billion or 1.3 percent from the US\$55.4 billion level in March 2005." The exact figure reported for foreign debt is US\$56.047 billion as of end June 2005 and US\$55,352 billion as of end March 2005.).

37. *See Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 17-18 (Senate Version, Apr. 21, 2005)* (statements made by Sec. Cesar Purisima, Department of Finance).

38. *See Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st*

view the provision on input VAT spread over five years on capital equipment.³⁹ Rep. Jesli Lapus, Chairman of the House Committee on Ways and Means, observed that: "The executive and - what we're doing here is largely also trying to live up to or trying to please third parties, 'no, the markets, the rating agencies and the creditors."⁴⁰

It was the time of the year when the tropical sun gazed brightly upon our nation, and under the cool dark shadows of our foreign creditors a tax measure conceived by the Executive Branch was pressed upon the Legislature to be transformed into law.

B. Distinguishing the E-VAT Law from Senate Bill No. 1950

R.A. No. 9337 consolidates the proposals from the House of Representatives, House Bill No. 3555⁴¹ and House Bill No. 3705⁴² with Senate Bill No. 1950. The bills themselves are products of several permutations. In the case of Senate Bill No. 1950, it was in substitution of Senate Bill Nos. 1337,⁴³ 1834,⁴⁴ and 1873,⁴⁵ taking into consideration House Bill Nos. 3555 and 3705.⁴⁶

Reg. Sess. 147 (Senate Version, Apr. 18, 2005) (statement made by Rep. Teodoro Locsin, Jr.).

39. See *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 97 (Senate Version, Apr. 21, 2005) (statement made by Sen. Sergio Osmeña III).*

40. *Id.* at 111.

41. An Act Restructuring the Value-added tax, Amending for the Purpose Title IV of the National Revenue Code of 1997, as Amended, and for Other Purposes, House Bill No. 3555, 13th Cong. (2005) (enacted).

42. An Act Amending Sections 106, 107, 108, 109, 110, and 111 of the National Internal Revenue Code of 1997, as Amended, and for Other Purposes, House Bill No. 3705, 13th Cong. (2005) (enacted).

43. An Act Allocating Fifty Percent of Value-Added Tax Collections to Health, Education and Agriculture, Thereby Amending the National Internal Revenue Code of 1997, as Amended, House Bill No. 1337, 13th Cong. (2005).

House Bill No. 3705 proposed a multi-tiered value-added tax regime ranging from 4% to 12%. It also modified the exemptions, for instance, retaining VAT exemption for doctors and lawyers when providing services to the indigent or the urban poor. House Bill No. 3555 increased the value-added tax rate to a single 12%. On the other hand, Senate Bill No. 1950 was far more ambitious and comprehensive in scope as it covered not only the value-added tax and the administration thereof but also corporate tax, percentage taxes, excise tax on petroleum products, and the disposition of incremental revenues from the new taxes.⁴⁷

The Supreme Court found nothing odd in this. Asking the rhetorical question: "Is the introduction by the Senate of provisions not dealing directly with the value-added tax, which is the only kind of tax being amended in the House bills, still within the purview of the constitutional provision authorizing the Senate to propose or concur with amendments to a revenue bill that originated from the House?" In response to its own question the Supreme Court noted that "the sections introduced by the Senate are germane to the subject matter and purposes of the [H]ouse bills, which is to supplement our country's fiscal deficit, among others. Thus, the Senate acted within its power to propose those amendments."⁴⁸ The High Tribunal elaborates:

Notably therefore, the main purpose of the bills emanating from the House of Representatives is to bring in sizeable revenues for the government to supplement our country's serious financial problems, and improve tax administration and control of the leakages in

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44. An Act Amending Sections 109 of the National Internal Revenue Code of 1997, as Amended, and for Other Purposes, House Bill No. 1834, 13th Cong. (2005).
 45. An Act Increasing the Rate of the Value-added tax, Amending for the Purpose Sections 106, 107, 108 and 114 of the National Internal Revenue Code of 1997, as Amended, and for Other Purposes, House Bill No. 1873, 13th Cong. (2005).
 46. SENATE COMM. ON WAYS AND MEANS, S. COMM. REP. NO. 16, 13th Cong., 1st Reg. Sess. (Mar. 7, 2005) (sponsored by Sen. Ralph G. Recto).
 47. See H.B. NOS. 3555 and 3705, 13th Cong. (2005) (enacted) and S.B. No. 1950, 13th Cong. (2005) (enacted).
 48. *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita*, G.R. No. 168056, Sep. 1, 2005.

revenues from income taxes and value-added taxes. As these [H]ouse bills were transmitted to the Senate, the latter, approaching the measures from the point of national perspective, can introduce amendments within the purposes of those bills. It can provide for ways that would soften the impact of the VAT measure on the consumer, *i.e.*, by distributing the burden across all sectors instead of putting it entirely on the shoulders of the consumers.⁴⁹

R.A. No. 9337 was forged at the Bicameral Conference Committee using the Senate version of the bill, *i.e.*, Senate Bill No. 1950 as the “working draft.”⁵⁰ After all, Senate Bill No. 1950 was already “in consideration” of House Bill Nos. 3555 and 3705.⁵¹ By the time the Bicameral Conference Committee completed its work, there was only a hint of the provisions of the bills originating from the House. It would in fact be a challenge to search R.A. No. 9337 for the provisos from the House Bills.⁵² On the other hand, Senate Bill No. 1950 was on the whole reproduced in R.A. No. 9337 both in terms of how the legislative tax measure was structured and the very provisions itself.

There were only two provisions in Senate Bill No. 1950 that did not survive the amendatory review of the Bicameral Conference Committee and these are:

(a) The proposal to subject proprietors, lessees or operators of cabarets and night or day clubs to the value-added tax in lieu of the amusement tax of 18% was deleted.⁵³

(b) The “*no pass through*” provisions of the value-added tax on electricity by generation companies and services of transmission and

49. *Id.*

50. SENATE JOURNAL 172, 13th Cong., 1st Reg. Sess., Senate Sess. No. 83 (May 10, 2005) (from Sen. Recto’s sponsorship speech to the Senate on the Bicameral Conference Committee Report).

51. SENATE COMM. ON WAYS AND MEANS, S. COMM. REP. NO. 16, 13th Cong., 1st Reg. Sess. (Mar. 7, 2005) (sponsored by Sen. Ralph G. Recto).

52. *See* H. B. Nos. 3555 and 3705, 13th Cong., 1st Reg. Sess. (2005). *Cf.* R.A. NO. 9337 (2005).

53. S.B. No. 1950 §§ 5 & 16, 13th Cong., 1st Reg. Sess. (2005) (provisions to amend NIRC §§ 108(A) ¶ 2 & 125(b)).

distribution companies and electric utilities in favor of residential end-users was deleted in the final version of the law.⁵⁴

The deletion of the “*no pass through*” provisions may have caused a sigh of relief to electric generation, transmission, distribution, and utility companies and its officers as the provision contains stringent fines and penalties for its violation.⁵⁵ More importantly, the

54. *Id.* (provisions to amend NIRC § 108(A) ¶ 2).

55. The proposed *no pass-on* provision reads:

Provided, that the vat on the sales of electricity by generation companies, and services of transmission companies and distribution companies, as well as those of franchise grantees of electric utilities shall not apply to residential end-users: provided, that the value-added tax herein levied shall be absorbed and paid by the generation, transmission and distribution companies concerned. The said companies shall not pass on such tax payments to NAPOCOR or ultimately to the consumers, including but not limited to residential end-users, either as cost or in any other form whatsoever, directly or indirectly.

The president or the chief executive officer or the responsible officer and any member of the board of directors of the companies concerned who knowingly agreed, consented, condoned the violation shall be subject to a fine of not less than two million pesos (P2,000,000.00).

For the second offense, the above mentioned parties shall be fined not less than three million pesos (Php3,000,000) or imprisoned for not more than six months at the discretion of the court.

For the third and succeeding offenses, the above mentioned parties individually shall be fined not less than four million pesos (Php4,000,000) and imprisoned for not more than one year, in addition, the license to do business of the companies concerned shall be revoked and the president or the chief executive officer or the officer and the members of the board responsible therefore shall; if foreigners, be deported.

H. B. No. 3705 also has its own version of the “*no pass through*” provision. It was a milder version as it contains no fines and penalties and is only up to the level of power generation but also includes petroleum products. *See* H.B. No. 3705 §§ 1 & 3 (proposing amendments to NIRC §§ 106(A) & 108); *See also Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S.*

simultaneous VAT on power with the imposition of a “*no pass through*” provision was deemed “disastrous” for the power sector. The losses from the no pass through provisions will have to be absorbed by the power sector which already constitutes 30% of the deficit of the entire government. Thus, Energy Secretary Lotilla pointed out that whatever amounts that may be raised with the new VAT Law will be negated by the huge losses resulting from the “*no pass through*” provisions.⁵⁶

The other significant revisions to Senate Bill No. 1950 that involve other than a mere re-wording are:

(a) The simple retention of value-added tax at 10% was modified by retaining the tax at 10% with a standby authority to the President to increase the tax to 12% on 1 January 2006 after certain macro-economic conditions are met as will be discussed later in this article.⁵⁷

(b) The cap on goods subject to depreciation for which the input tax are to be spread over a period of five years was raised from Php660,000 to Php1,000,000.⁵⁸

Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 5 (House Version, May 10, 2005) (statement of Rep. Jesli Lapus, Chairman of the House Committee on Ways and Means). (Note that the panels from each House prepared its own minutes of the Bicameral Conferences. This Article cites from the Senate version except for the conference on May 10, 2005.).

56. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means*, 13th Cong., 1st Reg. Sess. 55-56 (Senate Version, Apr. 21, 2005) (exchange between Rep. Arnulfo Fuentabella and Secretary Rafael Lotilla, Department of Energy).
57. S.B. No. 1950 §§ 4, 5, & 6, 13th Cong. 1st Reg. Sess. (2005). *Cf.* R. A. NO. 9337 §§ 4, 5, & 6 (2005) (amending NIRC §§ 106(A) ¶ 1, 107(A), 108(A) ¶ 1). Rep. Jesli Lapus, Chairman of the House Committee on Ways and Means described the 12% VAT rate as the essence or backbone of the House version of the bill. He then declared that the House has been successful in “getting the 12%” increased rate in the VAT even if it is effective only on January 1, 2006 (68 JOURNAL OF THE HOUSE OF REPRESENTATIVES 14, 13th Cong., 1st Reg. Sess. (May 10-11, 2005)).
58. *Id.* § 7. *Cf.* R.A. NO. 9337 § 8 (2005) (amending NIRC § 110(A)(2) ¶ 2). Sen. Ralph Recto explained in the Bicameral Conference Committee that the Php660,000 figure in S. B. No. 1950 was an “arbitrary” figure. *See Bicameral*

(c) The cap on creditable input tax was reduced from the 90% originally proposed to 70%.⁵⁹

(d) Cancellation for optional registration for value-added tax may not be done after three years instead of the two originally proposed.⁶⁰

(e) The final version of the law from the Bicameral Conference Committee spelled out a clear schedule for the disposition of the incremental revenues from the new value-added taxes and the excise taxes from alcohol and tobacco taxes under R.A. No. 9334.⁶¹ The version of the Senate Bill No. 1950 submitted to the Bicameral Conference Committee mentioned the allotment of Php15,000,000 from the incremental revenues from the new value-added taxes for educating the public on the new E-VAT Law, which provision found itself into the new law.⁶²

The work of the Bicameral Conference Committee received the constitutional nod of the Supreme Court, thus:

Under the provisions of both the Rules of the House of Representatives and Senate Rules, the Bicameral Conference Committee is mandated to settle the differences between the disagreeing provisions in the House bill and the Senate bill. The term "settle" is synonymous to "reconcile" and "harmonize." To reconcile or harmonize disagreeing provisions, the Bicameral Conference Committee may then (a) adopt the specific provisions of either the House bill or Senate bill, (b) decide that neither provisions in the House bill or the provisions in the Senate bill would be carried into the final form of the bill, and/or (c) try to arrive at a compromise between the disagreeing provisions.

Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 74 (Senate Version, Apr. 18, 2005).

59. *Id.* (amending NIRC § 110(B)).

60. *Id.* § 19. *Cf.* R.A. NO. 9337 § 19 (2005) (amending NIRC § 236 (H) & (I)).

61. R.A. NO. 9337 § 20 (2005) (inserting into NIRC § 288(C) & (D)). R.A. No. 9334 increased excise taxes on alcohol and tobacco products, popularly known as the "sin taxes." *See* SENATE JOURNAL 722-23, 13th Cong., 1st Reg. Sess., Senate Sess. No. 67 (Mar. 7, 2005).

62. S.B. No. 1950 § 21, 13th Cong., 1st Reg. Sess. (2005); S.B. No. 1950 § 19, 13th Cong. 1st Reg. Sess. (2005). *Cf.* R.A. NO. 9337 § 20 (2005) (inserting into NIRC § 288(E)).

In the present case, the changes introduced by the Bicameral Conference Committee on disagreeing provisions were meant only to reconcile and harmonize the disagreeing provisions for it did not inject any idea or intent that is wholly foreign to the subject embraced by the original provisions.

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Thus, all the changes or modifications made by the Bicameral Conference Committee were germane to subjects of the provisions referred to it for reconciliation. Such being the case, the Court does not see any grave abuse of discretion amounting to lack or excess of jurisdiction committed by the Bicameral Conference Committee.⁶³

Nevertheless, it cannot be denied that the gist of R.A. No. 9337 is a product of Senate Bill No. 1950 albeit with the joint review of both Houses through the Bicameral Conference Committee. Indeed, when Senator Recto submitted the Bicameral Conference Committee Report to the Senate for ratification, he “explained that almost 95% of the reconciled version was based on the Senate version and the only difference was that certain provisions proposed by the House were incorporated therein.”⁶⁴ This fact, however, did not prevent R.A. No. 9337 from becoming the law of the land. The Supreme Court ratiocinated:

To construe [the Constitution’s “no amendment rule”] in a way as to proscribe any further changes to a bill after one house has voted on it would lead to absurdity as this would mean that the other house of Congress would be deprived of its constitutional power to amend or introduce changes to said bill. [Furthermore,] Art. VI, Sec. 26 (2) of the Constitution cannot be taken to mean that the introduction by the Bicameral Conference Committee of amendments and modifications to disagreeing provisions in bills that have been acted upon by both houses of Congress is prohibited.⁶⁵

63. *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita*, G.R. No. 168056, Sep. 1, 2005 (citations omitted).

64. SENATE JOURNAL 177, 13th Cong., 1st Reg. Sess., Senate Sess. No. 83 (May 10, 2005) (sponsorship speech of Sen. Recto to the Senate on the Bicameral Conference Committee Report).

65. *Abakada*, G.R. No. 168056, Sep. 1, 2005.

The “no amendment rule,” that is, art. 6, § 26 (2) of the Constitution, provides that:

III. CORPORATE TAXATION

A. New Corporate Tax Rate

There is the realization that the popular name “E-VAT Law” for R.A. No. 9337 is a misnomer as soon as one is confronted with the first sections of the law which deals with corporate taxes. The amendments provide for an increase in the corporate income tax from 32% to 35% for domestic, resident foreign, and non-resident foreign corporations upon its effectivity.⁶⁶ However, effective 1 January 2009 the corporate income tax will be lowered to 30%.⁶⁷ This provision causes one to pause as the public discussion on the law has been centered on value-added taxes; hence it was dubbed the “E-VAT Law.” The explanation proffered is that this is a form of “burden sharing because the fiscal salvation of this country should not be borne by consumers alone and should be a burden sharing between industry, commerce, business and the consumer even temporarily for business for a three-year period.”⁶⁸ The reduction of the tax to 30% is, on the other hand, a recognition that at

No bill passed by either House shall become a law unless it has passed three readings on separate days, and printed copies thereof in its final form have been distributed to its Members three days before its passage, except when the President certifies to the necessity of its immediate enactment to meet a public calamity or emergency. Upon the last reading of a bill, no amendment thereto shall be allowed, and the vote thereon shall be taken immediately thereafter, and the yeas and nays entered in the Journal.

66. As of this writing, regulations are still to be released on the new corporate taxes, but the BIR has indicated that the new corporate tax rate will take effect on Nov. 1, 2005 (Felipe F. Salvosa II, et al., *Firms brace for higher corporate income tax*, BUSINESS WORLD, Oct. 25, 2005, at S1/1).
67. NIRC §§ 27(A) ¶ 1, 28(A)(1), & 28(B)(1) (1997), amended by R.A. No. 9337 §§ 1 & 2 (2005), respectively.
68. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means*, 13th Cong., 1st Reg. Sess. 47-48 (Senate Version, Apr. 15, 2005) (statement of Sen. Ralph Recto). See also SENATE JOURNAL 727, 13th Cong., 1st Reg. Sess., Senate Sess. No. 67 (Mar. 7, 2005) (sponsorship speech of Sen. Ralph Recto).

35% the Philippines has become less competitive as having the highest corporate income tax rate in the region.⁶⁹

For non-resident foreign corporations appropriate amendments were introduced into the proviso on final withholding taxes on inter-corporate dividends to reflect the new tax rate.⁷⁰ However, it would

69. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 19* (Senate Version, Apr. 25, 2005) (exchange between Sen. Ralph Recto and Sec. Cesar Purisima, Department of Finance) (during the Senate deliberations it was noted by Sen. Recto that the Philippines's corporate income tax rate at 32% is among the highest in Asia comparing the Philippines to the following countries: India, 35%; Vietnam, 32%; Australia, 30%; China, 30%; Indonesia, 30%; Japan, 30%; Thailand, 30%; Malaysia, 28%; Cambodia, 20%; and Hong Kong 17.5%. (SENATE JOURNAL 817-18, 13th Cong., 1st Reg. Sess., Senate Sess. No. 72 (Mar. 16, 2005)).

70. NIRC § 28(B)(5)(b) (1997), *amended by* R.A. NO. 9337 § 2 (2005).

The amendment reads:

(b) Intercorporate Dividends. — A final withholding tax at the rate of fifteen percent (15%) is hereby imposed on the amount of cash and/or property dividends received from a domestic corporation, which shall be collected and paid as provided in Section 57(A) of this Code, subject to the condition that the country in which the nonresident foreign corporation is domiciled, shall allow a credit against the tax due from the nonresident foreign corporation taxes deemed to have been paid in the Philippines equivalent to twenty percent (20%), which represents the difference between the regular income tax of thirty-five percent (35%) and the fifteen percent (15%) tax on dividends as provided in this subparagraph: Provided, That effective January 1, 2009, the credit against the tax due shall be equivalent to fifteen percent (15%), which represents the difference between the regular income tax of thirty percent (30%) and the fifteen percent (15%) tax on dividends;

Note however that the tax imposed on cash and/or property dividends is 10% for individual citizens and individual resident aliens under Section 24 (B)(2) of the NIRC.

appear that in most instances inter-corporate dividends to non-resident foreign corporations would be covered by tax treaty.⁷¹

B. How to Apply a New Corporate Income Tax Rate to the Balance of a Fiscal Year

In the case of corporations adopting the fiscal-year accounting period, the old proviso on how the taxable income should be computed in the advent of a new corporate income tax rate was retained. Consequently, the taxable income shall be computed without regard to the specific date when specific sales, purchases and other transactions occur. The income and expenses for the fiscal year shall be deemed to have been earned and spent equally for each month of the year. Hence, the new corporate income tax rate shall be applied by multiplying the number of months covered by the new rate within the fiscal year by the taxable income of the corporation for the period divided by twelve.⁷²

C. PAGCOR

The Philippine Amusement and Gaming Corporation (PAGCOR) was dropped from the enumeration of government owned or controlled corporations which are not covered by the corporate income tax.⁷³ The Bicameral Conference Committee discussions on this subject were mired on whether or not to include corporate income taxes as germane to the E-VAT Law.⁷⁴ Nevertheless its inclusion was argued on the

71. The Philippines currently has tax treaties with 38 countries: Australia; Austria; Bahrain; Bangladesh; Belgium; Brazil; Canada; Chile; China; Czech Republic; Denmark; Finland; France; Germany; Hungary; India; Indonesia; Israel; Italy; Japan; Korea; Malaysia, Netherlands; New Zealand; Norway; Pakistan, Romania; Russian Federation; Singapore; Spain; Sweden, Switzerland; Thailand, Turkey; United Kingdom; United States of America; Vietnam; and Yugoslavia.

72. NIRC § 27(A) ¶ 2 (1997).

73. *Id.* § 27(C) (1997), amended by R.A. NO. 9337 § 1 (2005).

74. See Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 149-159 (Senate Version, Apr. 18, 2005); and Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and

question of sparing a rich corporation from taxation, otherwise the Philippines would have a difficulty explaining PAGCOR's exemption to its foreign creditors.⁷⁵ Another observation is that PAGCOR's revenues that are remitted to various government agencies and projects specified by special laws are outside the appropriation process. Consequently, including PAGCOR into the coverage of the corporate income tax will allow 35% of its income to enter into the budgetary process.⁷⁶ The benefits of having PAGCOR's revenues enter into the official revenue through the corporate income tax was confirmed by the Executive Branch through then Finance Secretary Purisima. However, he also added that the Executive Branch's idea for PAGCOR is "to separate the regulatory and operating components of its operations." Thus, from the viewpoint of the Executive Branch the preference to include PAGCOR in the corporate income tax system is with the end in mind of eventually selling PAGCOR's operations to a private entity and to reserve the functions of regulation to the government similar to the Macao model.⁷⁷

Under PAGCOR's current franchise, "[n]o tax of any kind or form, income or otherwise, as well as fees, charges or levies of whatever nature, whether National or Local, shall be assessed and collected [from PAGCOR]; nor shall any form of tax or charge attach in any way to the earnings of [PAGCOR], except a Franchise Tax of five percent (5%) of the gross revenue or earnings derived by [PAGCOR] from its operation under [the] Franchise."⁷⁸ The law granting its franchise is thus amended by rendering PAGCOR subject to the regular corporate income tax as well as the franchise tax of 5% of its gross revenues or earnings.

Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 34 (Senate Version, Apr. 19, 2005).

75. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means*, 13th Cong., 1st Reg. Sess. 147 (Senate Version, Apr. 18, 2005) (statement of Rep. Teodoro Locsin).

76. *Id.* at 145-46 (statement of Sen. Osmeña).

77. *Id.* at 148 (statement of Sec. Cesar Purisima, Department of Finance).

78. Presidential Decree No. 1869 § 13(2) (1983).

D. Allowable Deductions for Interest Expenses

As a consequence of the new corporate income tax rate, the allowable deductions for interest expense subject to final taxes were adjusted upon its effectivity. As a result, simultaneous with the effective date of the new corporate income tax rate of 35%, the taxpayer's otherwise allowable deduction for interest expense shall be reduced by 42% of the interest income subjected to final tax. Effective 1 January 2009, this percentage shall be reduced to 33% simultaneous with the reduction of the corporate income tax to 30%.⁷⁹

E. Depository Banks Exempt from Tax on Income Derived under Expanded Foreign Currency Deposit System

Income derived by a depository bank under the expanded foreign currency deposit system from foreign currency transactions with non-residents, offshore banking units in the Philippines, local commercial banks including branches of foreign banks are now exempt from all taxes. However, interest income from foreign currency loans granted by such depository banks under said expanded system to residents other than offshore banking units in the Philippines or other depository banks under the expanded system shall be subject to a final tax at the rate of 10%. Any income of nonresidents, whether individuals or corporations, from transactions with depository banks under the expanded system shall be exempt from income tax.⁸⁰

79. NIRC § 34(B)(1) (1997), amended by R.A. NO. 9337 § 3 (2005).

80. *Id.* §§ 27(D)(3), 28(A)(4), and 28(A)(7)(b) (1997), amended by R.A. NO. 9337 §§ 1 & 2 (2005).

The original provision under NIRC § 27(D)(3) (1997) reads:

(3) Tax on Income Derived under the Expanded Foreign Currency Deposit System. - Income derived by a depository bank under the expanded foreign currency deposit system from foreign currency transactions with local commercial banks, including branches of foreign banks that may be authorized by the *Bangko Sentral ng Pilipinas* (BSP) to transact business with foreign currency depository system units and other depository banks under the expanded foreign currency deposit system, including interest income from foreign currency loans granted by such depository banks under said expanded foreign currency deposit system to

IV. THE VAT RATE

A. VAT: *The Basics*

The value-added tax is a fairly recent phenomenon of taxation. Its birth place is in France where it was supposed to have been first levied in 1948,⁸¹ and was invented by Maurice Lauré, joint director of the French tax authority.⁸² While a form of value-added tax was said to exist in the Philippines in the past, the formal debut of the value-added tax in the Philippines was in 1987 by way of Executive Order No. 273 enacted under the legislative authority of the revolutionary government headed by President Corazon C. Aquino.⁸³ “The law that originally imposed the VAT in the country, as well as the subsequent amendments of that law, has been drawn from the tax credit method. Such method adopted the mechanics and self-enforcement features of the VAT as first implemented and practiced in Europe and subsequently adopted in

residents, shall be subject to a final income tax at the rate of ten percent (10%) of such income.

The original provision under NIRC, § 28(A)(4) (1997) reads:

(4) *Offshore Banking Units.* - The provisions of any law to the contrary notwithstanding, income derived by offshore banking units authorized by the *Bangko Sentral ng Pilipinas* (BSP) to transact business with offshore banking units, including any interest income derived from foreign currency loans granted to residents, shall be subject to a final income tax at the rate of ten percent (10%) of such income.

Any income of nonresidents, whether individuals or corporations, from transactions with said offshore banking units shall be exempt from income tax.

81. World Bank, *World Development Report 2005: A Better Investment Climate for Everyone* 106, at http://siteresources.worldbank.org/INTWDR2005/Resources/07_WDR_Ch05.pdf. (last accessed Nov. 30, 2005).
82. Wikipedia, *Value-added Tax*, at http://en.wikipedia.org/wiki/Value-added_tax (last accessed Dec. 1, 2005).
83. See *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita*, G.R. No. 168056, Sep. 1, 2005.

New Zealand and Canada.”⁸⁴ “The VAT is said to have eliminated privilege taxes, multiple rated sales tax on manufacturers and producers, advance sales tax, and compensating tax on importations. The framers of E.O. 273 claim that it is principally aimed to rationalize the system of taxing goods and services; simplify tax administration; and make the tax system more equitable, to enable the country to attain economic recovery.”⁸⁵

The value-added tax is by its nature a regressive tax⁸⁶ and is a uniform tax with a range from 0% to a regular value-added tax rate. It is an indirect tax on consumption that may be shifted or passed on from one party to another in a transaction,⁸⁷ in which case, the seller or transferor is the one statutorily liable for the tax.⁸⁸ It is, after all, a tax on the value added by every seller.⁸⁹

B. Legislating an Elevated VAT Rate

One of the controversial constitutional questions on the E-VAT Law for its alleged undue delegation of the legislative power of taxation⁹⁰ concerns the proviso wherein the President, upon the recommendation of the Secretary of Finance, shall; effective 1 January 2006, raise the rate of value-added tax to 12%, after any of the following conditions has been satisfied:

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84. Commissioner of Internal Revenue (CIR) v. Seagate Technology (Philippines), 451 SCRA 132, 142 (2005) (citing DEOFERIO JR. & MAMALATEO, THE VALUE-ADDED TAX IN THE PHILIPPINES 34 (2000)).
 85. Kapatiran ng mga Naglilingkod sa Pamahalaan ng Pilipinas, Inc. v. Bienvenido Tan, 163 SCRA 371, 379 (1988).
 86. *Abakada*, G.R. No. 168056, Sep. 1, 2005.
 87. See *Seagate*, 451 SCRA at 141, 145 (citing NIRC §§ 105 to 109 (1997) and HECTOR S. DE LEON, THE FUNDAMENTALS OF TAXATION 132 (12th ed. 1998)).
 88. Bureau of Internal Revenue, Rev. Reg. No. 16-2005, § 4-105-2 (Sep. 1, 2005) (in the case of importation, however, the said section provides that the importer is the one who is liable for the value-added tax).
 89. Kapatiran ng mga Naglilingkod sa Pamahalaan ng Pilipinas, Inc. v. Bienvenido Tan, 163 SCRA 371, 378 (1988).
 90. See *Abakada*, G.R. No. 168056, Sep. 1, 2005.

1. Value-added tax collection as a percentage of Gross Domestic Product (GDP) of the previous year exceeds $2\frac{4}{5}\%$; or
2. National government deficit as a percentage of GDP of the previous year exceeds $1\frac{1}{2}\%$.

For the remainder of calendar year 2005, the VAT will remain at 10%.⁹¹

A multi-tiered value-added tax regime was discussed, but a single VAT rate was deemed best for purposes of improving the "VAT chain" and to plug the leakages.⁹² There was a grudging acknowledgement from the proponents of the single rate VAT that the multi-rate VAT system was done to soften the impact on the consumer, but it was felt that a single rate system was easier for the taxpayer to comply with and easier for the tax administrator to collect.⁹³

At the Bicameral Conference Committee, the Senate's view of retaining the value-added tax at 10% was justified as a more prudent option wherein the tax base is expanded and the "leaks" in taxation "plugged" by removing the exemptions rather than increasing the value-added tax.⁹⁴ It was also noted that an increase to 12% would

91. NIRC §§ 106(A) ¶ 1, 107(A), 108(A) ¶ 1 (1997), amended by R.A. No. 9337 §§ 4, 5, & 6 (2005) (note that §§ 106(D)(1) & 108(C) have been deleted).

92. See *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 113* (Senate Version, Apr. 15, 2005) (statement of Sen. Ralph Recto) (House Bill No. 3705 proposed a multi-tiered value-added tax regime ranging from 4% to 12%).

93. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 23* (Senate Version, Apr. 18, 2005) (statement of Sen. Ralph Recto).

94. See *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 120-22* (Senate Version, Apr. 21, 2005) (statement of Sen. Ralph Recto).

make the Philippines the country with the highest value-added tax with the exception of China.⁹⁵ It has already been observed at the Senate that “the average VAT rate in the region is 10.4%, with China on top at 17.5%; Thailand, 7%; and Singapore, the lowest at 3%.”⁹⁶

The effect of a higher 12 percent value-added tax rate on the less advantaged members of the socio-economic strata was also considered. It was the conclusion that the effect of an increased VAT rate on the poorest of the poor would be “minimal” because as a tax on consumption it will tax the poor the least since the poor consume the least. The following exchange between a legislator and the then finance secretary illustrates this:

REP. CUA. ...Number 1, Mr. Chairman. I think one of the points that need to be answered very clearly by the department, or by the Executive rather, is what is really the effect of increasing VAT rate from 10 to 12 percent? Nominally it means a two percent increase which is supposed to be passed on by businesses to the consumer. So what is really the effect of a two percent VAT rate increase upon the consumer? And if we are to stratify income levels, which of these income levels would really be adversely affected by this increase of two percent from 10 to 12?

Because a paper was prepared by the UP School of Economics and they were saying that in terms of VAT payments, they are saying that the poorest 25 percent of our populace accounts for 4.6 percent of VAT payment. The poorest 25 percent of our population only accounts for 4.6 percent and the poorest 50 percent accounts for only 17.1 percent. That means to say 100 percent minus 17.1 which would be 83 percent of the total VAT payment are really paid for by the 50 percent in our -- the upper 50 percent. In fact, 40 percent of the total VAT payment is actually paid for by the richest 10 percent.

So, one, I would like to find whether you agree with these figures because, in effect, what this shows is that the effect on the poorest 25 percent is only very minimal. So, can you confirm that? And going back

95. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 20 (Senate Version, Apr. 25, 2005) (exchange between Sen. Ralph Recto and Sec. Cesar Purisima, Department of Finance).*

96. SENATE JOURNAL 817, 13th Cong., 1st Reg. Sess., Senate Sess. No. 72 (Mar. 16, 2005).

to my first question, what is really the real effect on the consumer, maybe in terms of inflation, of this increase from 10 to 12 percent?

MR. PURISIMA. Thank you, Mr. Congressman.

On the effect on prices, 10 to 13 percent increase, for example, for sardines that's costing 10.30 would just result in a 2 percent increase of the 10.30 or 19 cents. That's assuming it's been subjected to a VAT of 10 percent VAT already before. For a product that was not subjected to a VAT of 10 percent before, then the increase would be 12 percent. On the transport sector, the estimate is, it will increase the minimum fare by 25 cents, an increase to 12 percent VAT as a result of – subjecting to VAT, fuel.

There was also a study by NEDA given the consumption basket of those who earns P60,000 or less, that the impact on them is about .2 percent increase in their cost of consumption. And the primary reason for this low number is that a lot of them buy items that will still be exempt. Because remember, 40 percent of the goods would still be exempt in the name of agricultural products, for example. Unprocessed agricultural products will still not be subjected to VAT, although there will be an indirect increase as a result of increase in transportation and other cost.

The number – I don't have that analysis with me right now. I can provide it to you, Mr. Congressman, but I do agree with your analysis because VAT really is a consumption tax. So, those who consume more actually will bear more of the burden in this case.⁹⁷

In the final and enacted version of the tax measure, the retention of the value-added tax at 10% with the stand-by authority to increase to 12% was a compromise between the Senate and House versions of the proposed tax measure using the previous year as a benchmark for the adjustment from 10% to 12%.⁹⁸ It was recalled that both Malacañang

97. See *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 120-22 (Senate Version, Apr. 21, 2005)* (exchange between Rep. Junie Cua and Sec. Cesar Purisima, Department of Finance).

98. 68 JOURNAL OF THE HOUSE OF REPRESENTATIVES 14, 13th Cong., 1st Reg. Sess. (May 10-11, 2005) (statement of Rep. Jesli Lapus, Chairman of the Committee on Ways and Means). He described the provision as a "win-win" compromise despite the trade-offs" and went on to point out that "to

and the House wanted a 12% VAT, so the conferees to the Bicameral Conference agreed on a standby authority.⁹⁹

The standby authority was explained at the Senate thus:

On who is being threatened to be punished under the first condition, Senator Recto explained that if it is not a punishment but a reward system, an incentive to the Chief Executive to be able to raise the VAT to 12%.

On the second condition, Senator Recto clarified that it stemmed from the financial values that his parents taught him: not to spend more than what one earns. He explained that the national government is spending more than what it earns that, in international standards, should be about 3% of GDP. He clarified that a deficit of more than P75 billion would allow the President to increase the VAT to 12% but this would mean government has to borrow P75 billion and the debt stock, again would increase.¹⁰⁰

The Supreme Court cited the Executive Branch's explanation on the philosophy behind the alternative conditions in this manner:

1. VAT/GDP Ratio > 2.8%

The condition set for increasing VAT rate to 12% have economic or fiscal meaning. If VAT/GDP is less than 2.8%, it means that government has weak or no capability of implementing the VAT or that VAT is not effective in the function of the tax collection. Therefore, there is no value to increase it to 12% because such action will also be ineffectual.

2. Nat'l Gov't Deficit/GDP > 1.5%

The condition set for increasing VAT when deficit/GDP is 1.5% or less means the fiscal condition of government has reached a relatively sound position or is towards the direction of a balanced budget position. Therefore, there is no need to increase the VAT rate since the fiscal house is in a relatively healthy position. Otherwise stated, if the

say that this is essentially a Senate version, is to undermine the competence of the Bicameral Committee constituted by the House."

99. SENATE JOURNAL 177, 13th Cong., 1st Reg. Sess., Senate Sess. No. 72 (May 10, 2005) (statement from Sen. Recto's sponsorship speech to the Senate on the Bicameral Conference Committee Report) (he also stated that while he wanted a higher hurdle rate, he was not able to get his way).

100. *Id.* at 178.

ratio is more than 1.5%, there is indeed a need to increase the VAT rate.¹⁰¹

The Supreme Court, in addressing the petitioners' fears of an ambiguous and "fluctuating VAT," found the provision to require no statutory construction or interpretation. The Court noted that the provision does not empower the President to reverse itself after the VAT is raised to 12% and that if any of the two conditions once fulfilled will render the increase of the value-added tax to 12% as mandatory and irreversible.¹⁰² The Court found the proviso in question to have passed the test of what is "permissible delegation,"¹⁰³ thus:

The case before the Court is not a delegation of legislative power. It is simply a delegation of ascertainment of facts upon which enforcement and administration of the increase rate under the law is contingent. The legislature has made the operation of the 12% rate effective January 1, 2006, contingent upon a specified fact or condition. It leaves the entire operation or non-operation of the 12% rate upon factual matters outside of the control of the executive.

No discretion would be exercised by the President. Highlighting the absence of discretion is the fact that the word *shall* is used in the common *proviso*. The use of the word *shall* connotes a mandatory

101. *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita*, G.R. No. 168056, Sep. 1, 2005 (citing Respondent's Memorandum, pp. 168-69).

102. *Id.*

103. *Id.*

The Court enunciated the following requisites for a showing that the delegation to be valid:

It is valid only if the law (a) is complete in itself, setting forth therein the policy to be executed, carried out, or implemented by the delegate; and (b) fixes a standard — the limits of which are sufficiently determinate and determinable — to which the delegate must conform in the performance of his functions. A sufficient standard is one which defines legislative policy, marks its limits, maps out its boundaries and specifies the public agency to apply it. It indicates the circumstances under which the legislative command is to be effected. Both tests are intended to prevent a total transference of legislative authority to the delegate, who is not allowed to step into the shoes of the legislature and exercise a power essentially legislative (*citations omitted*).

order. Its use in a statute denotes an imperative obligation and is inconsistent with the idea of discretion. Where the law is clear and unambiguous, it must be taken to mean exactly what it says, and courts have no choice but to see to it that the mandate is obeyed

Thus, it is the ministerial duty of the President to immediately impose the 12% rate upon the existence of any of the conditions specified by Congress. This is a duty which cannot be evaded by the President. Inasmuch as the law specifically uses the word *shall*, the exercise of discretion by the President does not come into play. It is a clear directive to impose the 12% VAT rate when the specified conditions are present. The time of taking into effect of the 12% VAT rate is based on the happening of a certain specified contingency, or upon the ascertainment of certain facts or conditions by a person or body other than the legislature itself.

x x x

There is no undue delegation of legislative power but only of the discretion as to the execution of a law. This is constitutionally permissible.¹⁰⁴

Hence, a provision that was born out of political compromise to a legislative impasse on the VAT rate was baptized by the Supreme Court as constitutional.

C. How to Compute the Output Tax with the New VAT Rate

Sections 106 (D)(1) and 108 (C) of the National Internal Revenue Code (NIRC) providing that the value-added tax shall be computed by multiplying the total amount stated in the invoice or official receipt by one-eleventh (1/11) has been deleted.¹⁰⁵ This could be the obvious result of the amendment of the value-added tax to 12%. The deleted sections 106(D)(1) and 108(C) of the NIRC are the basis of Revenue Regulations No. 08-99 (1999) which states that "VAT registered taxpayers who are required... to issue receipts or sales or commercial invoices are no longer allowed to separately bill the value-added tax corresponding thereto. The amount appearing in the sales invoices/receipts is thus deemed inclusive of the value-added tax due thereon."¹⁰⁶ Not only has this regulation been superseded by the

104. *Id.*

105. R.A. No. 9337 §§ 4 & 6 (2005) deletes NIRC §§ 106(D)(1) & 108(C) (1997).

106. Bureau of Internal Revenue, Rev. Reg. 08-99 (1999).

deletion of the cited sections but also by the amendments in section 113 of the Code requiring that the VAT receipt or invoice should state the total amount which the purchaser pays or is obligated to pay to the seller with the indication that such amount includes the value-added tax and that the amount of the tax shall be shown as a separate item in the invoice or receipt.¹⁰⁷ In addition, the law now allows for a breakdown of the amounts stated in the VAT receipt or invoice showing which amounts are subject to the value-added tax and which amounts are not and showing the calculation therefor.¹⁰⁸

In which case, the determination of what would be subject to the output tax should take into consideration the new structure of the VAT receipt or invoice introduced by the amendments. In the end, the statutory definition of gross receipts and gross selling price that have survived the amendment by the E-VAT Law could be combined with the new provisions, thus:

1. The gross selling price, total value or the gross receipts are subject to the output tax which is the regular value-added tax rate.¹⁰⁹
2. The gross selling price “means the total amount of money or its equivalent which the purchaser pays or is obligated to pay to the seller in consideration of the sale, barter or exchange of the goods or properties, *excluding* the value-added tax. The excise tax, if any, on such goods or properties shall form part of the gross selling price.”¹¹⁰
3. In the case of importations the total value shall be that “used by the Bureau of Customs in determining tariff and customs duties, plus customs duties, excise taxes, if any, and other charges, such tax to be paid by the importer prior to the release of such goods from customs custody.”¹¹¹

107. NIRC § 113(B)(2)(a) (1997), *new provision inserted by* R.A. NO. 9337 § 11 (2005).

108. *Id.* § 113(B)(2)(d) (1997), *new provision inserted by* R.A. NO. 9337 § 11 (2005).

109. *See Id.* §§ 106(A) ¶ 1, 107(A), & 108(A) ¶ 1 (1997), *amended by* R.A. NO. 9337 §§ 4, 5, & 6 (2005).

110. *Id.* § 106(A) ¶ 2 (1997) (*emphasis supplied*).

111. *Id.* § 107(A).

4. The gross receipts “means the total amount of money or its equivalent representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits and advanced payments actually or constructively received during the taxable quarter for the services performed or to be performed for another person, *excluding* value-added tax.”¹¹² In the case of constructive receipt, this occurs when the consideration, either in money or its equivalent, is placed in the control of the person who rendered the service without restrictions by the payor.¹¹³
5. The total amount in the invoice or receipt is no longer automatically subject to a value-added tax computation. This will depend on how the amounts are recorded, that is, if the items in the VAT invoice or receipt have been properly identified as subject to and includes the value-added tax or is zero rated, effectively zero rated or exempt or if erroneously included in the total amount of the receipt or invoice.¹¹⁴

Consequently, the general rule is that the output tax is computed by multiplying the gross selling price, as in the case of sale of goods or properties, or gross receipts, for sellers of services, by the regular rate of VAT.¹¹⁵ This general rule is a consequence of the definition of gross selling price and gross receipts as one that *excludes* the value-added tax.¹¹⁶ However, where the total amount in the invoice or receipt includes both the gross selling price or the gross receipts and the VAT, even if the amount of VAT is erroneously billed in the invoice or receipt, the total invoice or receipted amount

[s]hall be presumed to be comprised of the gross selling price/gross receipts plus the correct amount of the VAT. Hence, the output tax shall be computed by multiplying the total invoice [or receipt] amount

112. *Id.* § 108(A) ¶ 4 (1997) (*emphasis supplied*).

113. Bureau of Internal Revenue, Rev. Reg. No. 16-2005, § 4.108-4 ¶ 2 (Sep. 1, 2005).

114. NIRC § 113(B)(2) (1997), *new provision inserted by* R.A. NO. 9337 § 11 (2005).

115. Bureau of Internal Revenue, Rev. Reg. No. 16-2005, § 4.110-6 ¶ 1 (Sep. 1, 2005).

116. NIRC §§ 106(A) ¶ 2 & 108(A) ¶ 3 (1997).

by a fraction using the rate of VAT as numerator and one hundred percent (100%) plus rate of VAT as denominator.¹¹⁷

Applying the axioms above, the invoiced or receipted amount where said amount is inclusive of both the value-added tax and the gross selling price or the gross receipts shall be multiplied by 10% and divided by 110% to compute the output VAT where the regular VAT rate is at 10%, to wit:

$$\begin{array}{l} \text{Invoiced/Receipted Amount} \\ \text{where VAT is included} \end{array} \times \frac{10\%}{(100\% + 10\%)} = \text{OUTPUT TAX}$$

In the case where the regular VAT rate is at 12% the invoiced or receipted amount where it is inclusive of both the value-added tax and the gross selling price or the gross receipts, the amount shall be multiplied by 12% and divided by 112% to compute the output VAT, thus:

$$\begin{array}{l} \text{Invoiced/Receipted Amount} \\ \text{where VAT is included} \end{array} \times \frac{12\%}{(100\% + 12\%)} = \text{OUTPUT TAX}$$

In terms of whole number numerators and denominators in a fraction type of computation, at a VAT rate of 12% the output tax can be computed by using a fraction of three over twenty-eight ($\frac{3}{28}$). This is as opposed to the case where the regular VAT rate is at 10% and the computation of the output tax would be computed using the fraction of one over eleven ($\frac{1}{11}$) as provided in the law prior to its amendment. In both cases, the fractions are to be applied against a receipted/invoiced amount where there is an indication that the amount includes the value-added tax or where the value-added tax has been erroneously included.

¹¹⁷Bureau of Internal Revenue; Rev. Reg. No. 16-2005 § 4.110-6 ¶ 2 (Sep. 1, 2005) (*alteration inserted*).

V. EXPANDING THE COVERAGE OF THE VAT

In general, the lifting of exemptions was designed to “bring about some efficiency gains and “plug” the “leakages” in the VAT system. The idea was to “complete the VAT chain and collect it earlier in the chain.” The lifting of exemptions can supposedly result in a revenue gain.¹¹⁸ The elimination of exemptions “will give “fast-acting relief” to the fiscal woes of government. Sectors presently exempted can provide infusion of funds to the government, fast.”¹¹⁹

A. First in the VAT Chain, Power and Petroleum

The most controversial expansion of the coverage of the value-added tax is with respect to power and petroleum. These are:

1. Sales of electricity by generation companies, transmission, and distribution companies; services of franchise grantees of electric utilities.¹²⁰
2. Sales by electric cooperatives duly registered with the Cooperative Development Authority or National Electrification Administration, relative to the generation and distribution of electricity as well as their importation of machineries and equipment, including spare parts, which shall be directly used in the generation and distribution of electricity.¹²¹
3. Sale or importation of coal and natural gas, in whatever form or state, and petroleum products (except lubricating oil, processed gas, grease, wax and petrolatum) subject to excise tax imposed under Title VI of the NIRC of 1997.¹²²

118. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 19 (Senate Version, Apr. 18, 2005) (statement of Sen. Ralph Recto).*

119. SENATE JOURNAL 725, 13th Cong., 1st Reg. Sess., Senate Sess. No. 67 (Mar. 7, 2005) (sponsorship speech of Sen. Ralph Recto).

120. NIRC § 108(A) ¶ 2 (1997), amended by R.A. NO. 9337 § 7 (2005).

121. *Id.* § 109(1) (1997), amended by R.A. NO. 9337 § 7 (2005) (deletes § 109(s) as numbered in immediate prior amendment under R.A. NO. 9238 § 2 (2004)).

122. *Id.* (deletes § 109(e) of the Code immediately prior to the amendment).

4. Sale or importation of raw materials to be used by the buyer or importer himself in the manufacture of petroleum products subject to excise tax, except lubricating oil, processed gas, grease, wax and petrolatum.¹²³

The options on taxing power companies or a higher VAT rate was raised at the Bicameral Conference Committee:

SEN. ENRILE. Suppose we adopt a single rate, 10 percent, and remove all exemptions except power and do not reduce excise tax, what will be the position of the government? Will that solve the problem?

Second scenario, second question. Suppose we adopt a 12 percent rate, exempt power, do not reduce any tax but no exemption except power from VAT, would that solve the problem? No, no exemption. Apply the whole system.

x x x

MR. PURISIMA. I'm sorry, Senator.

My answer to your question, sir, is I believe the second option that you presented which was 12 percent with a lifting of exemption on all except power is better than the first option of 10 percent lifting all exemptions.

x x x

And that's why the Senate, I think a little prudent that instead of increasing the rate, let's just expand the base and unplug the leaks.¹²⁴

Hence, there appears to be a strong bias towards the inclusion of power in the coverage of the value-added tax. The value-added tax on the electricity was described both a "fairness issue" and in order to impose the value-added tax at the "beginning of the chain," thus:

THE CHAIRMAN (SEN. RECTO). Let me point this out.... Today, as a consumer, you do pay a VAT on electricity and petroleum. Insofar as electricity is concerned, it is 65 percent of consumers in effect are paying a VAT on electricity. With regard to petroleum, it is 45 percent. Meaning to say, today, if we eat here in this hotel 10 percent of your

¹²³. *Id.* (deletes § 109(f) of the Code immediately prior to the amendment).

¹²⁴. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 31, 33 (Senate Version, Apr. 21, 2005).*

bill, you pay a VAT 10 percent on the gross receipt. Okay. Part of this, was the electricity that this hotel used, the petroleum that this hotel used, so on and so forth. So there was a fairness issue in the debates in the Senate that, for example, if consumers are paying a VAT already on electricity and power, okay, it would be better then that we VAT them all the way, number one, instead of exempting them....

Number two, the Senate also debated this in such a way that if...

x x x

Also debated this in such a way that we are more efficient to VAT those beginning in the chain which is basically power and petroleum. Instead of monitoring thousands and thousands of transactions, thousands and thousands of VATable registered persons, we can collect more efficiently from a few companies and a few transactions.¹²⁵

On the other hand, petroleum products were included within the scope of the value-added tax because it was believed to be a means to address the efficiency in tax collection and to concentrate collection on the “three sisters which are Shell, Caltex, and Petron” as these companies would normally pay what is due to the government.¹²⁶ The premise is that these large oil companies are multinational companies that are publicly listed in New York with good tax compliance and as the first in the chain in the VAT system will result in the advance collection of the tax by the government.¹²⁷ The VAT on petroleum products was likened to the GPS creating a paper trail for the collection of the tax.¹²⁸ It was pointed out that there are two chances of collecting the value-added tax on petroleum products, that is, “at importation,

125. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 19 (Senate Version, Apr. 19, 2005).*

126. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 42-43 (Senate Version, Apr. 18, 2005) (statement of Rep. Danilo Suarez).*

127. *Id.* at 44 (statement of Sen. Ralph Recto).

128. *Id.* at 36 (statement of Sen. Ralph Recto).

when it enters our territory; and ultimately, when it's sold to the ultimate consumer at the gasoline station."¹²⁹

Also, the value-added tax on petroleum products was believe to be superior to the system of excise taxes as it is was more "buoyant" being based on value. This is unlike excise taxes on petroleum products which are based on volume and hence if prices go up one cannot collect more if volume is the same. On the other hand, a value-added tax on petroleum products will provide government with increased tax collections if the prices go up.¹³⁰ It was also noted that "as a percentage of GDP, excise tax collections on petroleum products is half of what it used to be."¹³¹

In sum, "[t]he advantage of capturing the VAT from the upstream industries such as fuel and power is that only a few players will be monitored, thus the ease of collection and the least leaks, which are not possible in a diffused VAT base setup."¹³²

B. The VAT Moves on Transport

In the case of transportation industry, the value-added tax was expanded to include the following:

1. Domestic common carriers by air and sea relative to their transport of passengers.¹³³
2. Importation of passenger and/or cargo vessels of more than five thousand tons (5,000), whether coastwise or ocean-going,

129. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 69 (Senate Version, Apr. 25, 2005) (statement of Sec. Cesar Purisima, Department of Finance).*

130. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 46 (Senate Version, Apr. 18, 2005) (statement of Sen. Ralph Recto).*

131. *Id.* at 47 (statement of Sen. Ralph Recto).

132. SENATE JOURNAL 725, 13th Cong., 1st Reg. Sess., Senate Sess. No. 67 (Mar. 7, 2005) (sponsorship speech of Sen. Ralph Recto).

133. NIRC § 108(A) ¶ 2 (1997), amended by R.A. NO. 9337 § 7 (2005).

including engine and spare parts of said vessel to be used by the importer himself as operator thereof.¹³⁴

In the case of domestic common carriers, it was included in the coverage of the VAT since domestic cargo is already subject to VAT. While there was a concern raised that this may make the domestic tourism industry less competitive as compared to those offered by neighboring countries, it was decided that a VAT bill should be “neutral.” It was pointed out that the issue of assisting the tourism industry with fiscal incentives can be discussed at the appropriate time.¹³⁵

C. Inedible Agricultural Products Added to the VAT Coverage

Two items on agriculture that was previously specifically exempted are now included in the coverage of the value-added tax law, to wit:

1. Sale of nonfood agricultural products; marine and forest products in their original state by the primary producer or the owner of the land where the same are produced.¹³⁶
2. Sale of cotton and cotton seeds in their original state; and copra.¹³⁷

The one common thread in these items was that they are all inedible “agricultural” products. Contemplated in this section are items such as lumber or flowers. Cotton seeds were also included in the lifting of the exemption on the understanding that these are inedible. The discourse on this subject by the Bicameral Conference Committee could be a matter for scholarly reflection and is thus reproduced hereunder:

134. *Id.* § 109(1) (1997), amended by R.A. NO. 9337 § 7 (2005) (deletes § 109(g) of the NIRC immediately prior to the amendment).

135. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 98-103 (Senate Version, Apr. 18, 2005) (exchange between Sen. Richard Gordon, Sen. Ralph Recto, Rep. Jesli Lapus, and Usec. Oscar Palabyab of the Department of Finance).*

136. NIRC § 109(1) (1997), amended by R.A. NO. 9337 § 7 (2005) (deletes § 109(a) of the Code immediately prior to the amendment).

137. *Id.* (deletes § 109(b) of the Code immediately prior to the amendment).

THE CHAIRMAN (SEN. RECTO). The Senate non-food agricultural products, non-food are VATable like lumber, Mr. Chairman. The House retains the exemptions for non-food. Could we agree that non-food agricultural products be VATable?

I see Congressman Teves and Congressman Locsin nodding their heads, and Congressman Javier. So we have an agreement here? Page 6?

THE CHAIRMAN (REP. LAPUS). There is a question, *ano daw 'yung mga* [what are the] non-food example?

THE CHAIRMAN (SEN. RECTO). Well basically, *hindi nakakain* [non-edibles].

THE CHAIRMAN (REP. LAPUS). Horticulture, flowers?

THE CHAIRMAN (SEN. RECTO). Yes. Cut flowers. So, next Valentine's Day, you pay VAT on your flowers when you send it to your girlfriends and to your wife. Okay?

REP. VILLAFURETE. Among the exemptions is copra, for example. But copra is convertible into food and non-food.

THE CHAIRMAN (SEN. RECTO). In the Senate, copra is still exempted.

REP. VILLAFUERTE. So, it's not understood, *ha*, copra is exempted.

THE CHAIRMAN (SEN. RECTO). Yes. It is not understood, it is in the Senate version. Copra continues to be exempt, okay?

So, we agree to VAT non-agricultural products. Okay? Very good. Non-food agricultural products.

So, we have a number of agreements already, Mr. Chairman.

THE CHAIRMAN (REP. LAPUS). What about cotton and cotton seeds?

THE CHAIRMAN (SEN. RECTO). Fertilizer is not VATable.

THE CHAIRMAN (REP. LAPUS). Mr. Chairman, *'yong* cotton and cotton seeds -

THE CHAIRMAN (SEN. RECTO). I don't think that cotton and cotton seeds is edible, so they are VATable.

THE CHAIRMAN (REP. LAPUS). Hindi, we have not discussed that, we have not - we skipped that.

THE CHAIRMAN (SEN. RECTO). Under the Senate, we're VATing them.¹³⁸

D. Collateral Damage: Of Artist, Doctors and Lawyers – The Similarity Between Oil Paintings and Cooking Oil

Three types of services that were previously exempt from the value-added tax are now no longer exempt. These are:

1. Sale by the artist himself of his works of art, literary works, musical compositions and similar creations, or his services performed for the production of such works;¹³⁹
2. Services rendered by doctors of medicine duly registered with the Professional Regulation Commission (PRC);¹⁴⁰ and
3. Services rendered by lawyers duly registered with the Integrated Bar of the Philippines (IBP).¹⁴¹

Just the year before the enactment of the E-VAT Law, R.A. No. 9238 took effect and exempted doctors and lawyers from the coverage of the value-added tax.¹⁴² “In March 1923, in an interview with *The New York*

138. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 115-117 (Senate Version, Apr. 18, 2005) (exchange between Sen. Ralph Recto, Rep. Jesli Lapus, and Rep. Luis Villafuerte).*

139. NIRC § 109(1) (1997), *amended by* R.A. NO. 9337 § 7 (2005) (deletes § 109(n) of the NIRC immediately prior to the amendment).

140. *Id.* (deletes § 109(bb) as numbered in immediate prior amendment under R.A. NO. 9238 § 2 (2004)). The VAT exemption for doctors and lawyers was inserted by the amendatory provisions under Section 2 of R.A. No. 9238, which lapsed into law without the signature of the President in accordance with Section 27(1) of the Constitution.

141. *Id.* (deletes § 109(cc) as numbered in immediate prior amendment under R.A. NO. 9238 § 2 (2004)).

142. An Act Amending Certain Sections of the National Internal Revenue Code Of 1997, as Amended, by Excluding Several Services from the Coverage of the Value-Added Tax and Re-Imposing the Gross Receipts Tax on Banks and Non-Bank Financial Intermediaries Performing Quasi-Banking

Times, the British mountaineer George Leigh Mallory was asked why he wanted to climb Mount Everest, and replied, 'Because it's there.'¹⁴³ In the same month 82 years later, the very same answer might as well have been given to the question as to why remove the VAT exemption of doctors and lawyers. Thus, on 15 March 2005, Sen. Ralph Recto "clarified [before the Senate] that the only reason why the doctors and lawyers were included in the measure is that everyone should be treated equally."¹⁴⁴

In another vein, there was a lighthearted discussion on the subject of art at the Bicameral Conference Committee which should be of interest to the artist and the writer of literature who is now covered by the value-added tax:

REP. LOCSIN. Mr. Chairman, together with that could you explain the expansion of the VAT to works of art, literary works and musicals? I'm just curious because you have a very good reason for it. In fact, the exemption on books already has -- of course, I will again do that because most of my friends are in the book business. But the exemption of books has been questioned already abroad because most of the books produced are really garbage. So they pander to the lowest taste and there's really --

I think, right in the books that Senator Osmeña has been sending me, there's an increasing opinion if it should be VATted. Why did you do that for works of art and literary works.

THE CHAIRMAN (SEN. RECTO). Yes. Two things, Congressman Locsin. In the first place, there is a threshold in the Senate of 1.5 million. So if you're an artist struggling and your gross sales is not 1.5, you're not VATable because there's a threshold. *But fundamentally, if cooking oil is VATable why not oil paintings, okay?*

REP. LOCSIN. Don't repeat that outside.

THE CHAIRMAN (SEN. RECTO). Okay? And that's why we're VATing oil painting. Okay?

Functions and Other Non-Bank Financial Intermediaries Beginning January 1, 2004, Republic Act No. 9238 (2003).

143. AskOxford.com, *A Quote from George Leigh Mallory*, at <http://www.askoxford.com/worldofwords/quotations/quotefrom/mallory/?view=uk> (last accessed Dec. 1, 2005).

144. SENATE JOURNAL 799, 13th Cong., 1st Reg. Sess., Senate Sess. No. 71 (Mar. 15, 2005).

REP. VILAFUERTE. The writings of a columnist if professionally paid is not literary at all, is it? (Laughter)

THE CHAIRMAN (SEN. RECTO). Okay...¹⁴⁵

Hence, the value-added tax on works of art, literary works, musical compositions and similar creations.

VI. THE PERCENTAGE TAX AND THE EXCISE TAX: AN EXERCISE IN MITIGATING THE EXPANDING VAT

A. Percentage Taxes

The following items have been removed from the coverage of percentage taxes, to wit:

1. Air or water transport is now excluded from percentage taxes.¹⁴⁶
2. Electric Utilities is likewise excluded from percentage taxes.¹⁴⁷

¹⁴⁵. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 117-18 (Senate Version, Apr. 18, 2005) (emphasis supplied).*

¹⁴⁶. NIRC § 117 ¶ 1 (1997), *amended by* R.A. No. 9337 § 14 (2005) (the percentage tax for air and water transport under this section of the National Internal Revenue Code was 3% of the quarterly gross receipts prior to the amendment introduced by R.A. No. 9337).

¹⁴⁷. *Id.* § 119 ¶ 1 (1997), *amended by* R.A. No. 9337 § 7 (2005). Prior to the amendment introduced by R.A. No. 9337, the percentage tax for air and water transport under this section of the National Internal Revenue Code was 2% on the gross receipts derived from the business covered by the law granting the franchise. R.A. No. 9337 also reworded the last portion of the section to read: "however, radio and television broadcasting companies has an option, irrevocable once exercised, to be subject to VAT." This portion prior to the amendment reads: "however, That radio and television broadcasting companies referred to in this Section shall have an option to be registered as a value-added taxpayer and pay the tax due thereon: Provided, further, That once the option is exercised, it shall not be revoked."

In the meantime, the gross receipts derived from services within the Philippines by banks and non-bank financial intermediaries on royalties, rentals of property, real or personal, profits, from exchange and all other items treated as gross income under the NIRC and on net trading gains within the taxable year on foreign currency, debt securities, derivatives, and other similar financial instruments has been increased from 5% to 7%.¹⁴⁸

B. Excise Taxes

Excise taxes on certain products have been reduced as follows:

1. Naphtha, regular gasoline and other similar products of distillation, per liter of volume capacity, Php4.35, down from Php4.80 prior to R.A. No. 9337.¹⁴⁹
2. Kerosene, per liter of volume capacity, zero (Php0.00) as compared to Php0.60 prior to the amendment.¹⁵⁰ *Provided*, that kerosene, when used as aviation fuel, shall still be subject to the same tax prior to the E-VAT Law on aviation turbo jet fuel Php3.67, such tax to be assessed on the user thereof.¹⁵¹
3. Diesel fuel oil, and on similar fuel oils having more or less the same generating power, per liter of volume capacity, zero (Php0.00) down from Php1.63 prior to the amendment.¹⁵²
4. Bunker fuel oil, and on similar fuel oils having more or less the same generating power, per liter of volume capacity, zero (Php0.00) down from Php0.30 prior to the amendment.¹⁵³

148. *Id.* § 121 ¶ 1 (c), (d) (1997), amended by R.A. NO. 9337 § 16 (2005).

149. *Id.* § 148(e) (1997), amended by R.A. NO. 9337 § 17 (2005).

150. *Id.* § 148(h).

151. *See Id.* § 148(g).

152. *Id.* § 148(i).

153. *Id.* § 148(l).

5. Locally extracted natural gas and liquefied natural gas shall not be subject to the excise tax down from 2% prior to the amendment.¹⁵⁴

The inclusion of the excise tax to the E-VAT Law is to temper the impact of the inclusion of petroleum products to a single rate value-added tax instead of either exempting petroleum products altogether or providing a lesser value-added tax rate under a multi-rate value-added tax system. R.A. No. 9337 removes excise taxes from socially sensitive petroleum products, i.e., bunker oil, diesel and kerosene. Nevertheless, a distinction was made for aviation fuel and gasoline which are still subject to excise taxes.¹⁵⁵ It has also been argued that levying a value-added tax on petroleum products which is based on value is superior to the excise tax which is based on volume.¹⁵⁶

VII. CLARIFYING THE ZERO-RATING AND VAT EXEMPTIONS

The Supreme Court had occasion to explain the difference between “zero-rating” and value-added tax exemptions. The difference may sound academic to some since in terms of computation the effect of zero rating and exemption are the same. However, the “extent of relief that results from either one of them is not.”

In the case of zero-rated transactions, these “generally refer to the export sale of goods and supply of services. The tax rate is set at zero. When applied to the tax base, such rate obviously results in no tax chargeable against the purchaser. *The seller of such transactions charges no output tax, but can claim a refund of or a tax credit certificate for the VAT previously charged by suppliers.*”¹⁵⁷ Hence, a zero-rated transaction

154. *Id.* § 151(A)(2) ¶ 2 (1997), amended by R.A. NO. 9337 § 18 (2005).

155. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 26-34 (Senate Version, Apr. 18, 2005) (deliberation between Sen. Ralph Recto, Rep. Jesli Lapus, Rep. Arnulfo Fuentabella, and Rep. Exequiel Javier).*

156. *Id.* at 46-47 (statement of Sen. Ralph Recto).

157. *CIR v. Seagate Technology (Philippines)*, 451 SCRA 132, 143 (2005) (citing DEOFERIO JR. & MAMALATEO, *supra* note 84, at 190; HECTOR S. DE LEON, *supra* note 87, at 133) (*emphasis supplied*).

is a taxable transaction that does not result in an output tax but the input taxes on purchases related to such zero-rated sale shall be subject to a tax credit or refund.¹⁵⁸

Zero-rated transactions should be compared and contrasted with *effectively zero-rated* transactions. Zero-rated transactions

refer to the sale of goods or supply of services to persons or entities whose exemption under special laws or international agreements to which the Philippines is a signatory effectively subjects such transactions to a zero rate. Again, as applied to the tax base, such rate does not yield any tax chargeable against the purchaser. The seller who charges zero output tax on such transactions can also claim a refund of or a tax credit certificate for the VAT previously charged by suppliers.¹⁵⁹

Characteristic of an *effectively zero-rated* transaction is that it is a *local* sale of goods or services.¹⁶⁰ In the case of an *effectively zero-rated* sale of goods or properties a constructive export can be read into local sales to persons or entities who in turn sell to (1) export-oriented enterprises; (2) persons engaged in international shipping or international air transport operations; (3) non-residents of manufactured/assembled goods paid for in foreign currency; or (4) tax exempt persons.¹⁶¹ In the case of *effectively zero-rated* sale of services, these refer to sale to persons or entities that in turn render services to (1) tax exempt persons; (2) persons engaged in international shipping or air transport; or (3) to subcontractors/contractors who are export oriented enterprises.¹⁶² In either case, the VAT regulations directs the concerned taxpayer to seek prior approval or prior confirmation from

158. See Bureau of Internal Revenue, Rev. Reg. No. 16-2005, § 4.106-5 ¶ 1, 4.108-5(a) (Sep. 1, 2005).

159. *Seagate*, 451 SCRA at 144 (citing NIRC §§ 106(A)(2)(C) & 108(B)(3) (1997); DEOFERIO JR. & MAMALATEO, *supra* note 84, at 215).

160. Bureau of Internal Revenue, Rev. Reg. No. 16-2005, § 4.106-6 ¶ 1, 4.108-6 (Sep. 1, 2005).

161. *Id.* § 4.106-6 ¶ 1 (note that export-oriented enterprises are those whose export sales exceed 70% of total annual production (NIRC § 106(A)(2)(a)(3) (1997))).

162. Bureau of Internal Revenue, Rev. Reg. No. 16-2005, § 4.108-6 (Sep. 1, 2005).

the appropriate offices of the BIR to determine that a transaction is qualified for *effective zero-rating*.¹⁶³

On the other hand, an *exempt transaction* has been defined by the Supreme Court as a transaction that

involves goods or services which, by their nature, are specifically listed in and expressly exempted from the VAT under the Tax Code, without regard to the tax status — VAT-exempt or not — of the party to the transaction. *Indeed, such transaction is not subject to the VAT, but the seller is not allowed any tax refund of or credit for any input taxes paid.*¹⁶⁴

Hence, input taxes attributable to exempt transactions should be treated as part of cost or expense.¹⁶⁵ In general, the exempt nature of a transaction means no output or input taxes can be passed on or claimed in such transactions. The Supreme Court had occasion to explain this feature of the exempt transaction, to wit:

An exemption means that the sale of goods, properties or services and the use or lease of properties is not subject to VAT (output tax) and the seller is not allowed any tax credit on VAT (input tax) previously paid. The person making the exempt sale of goods, properties or services shall not bill any output tax to his customers because the said transaction is not subject to VAT. Thus, a VAT-registered purchaser of goods, properties or services that are VAT-exempt, is not entitled to any input tax on such purchases despite the issuance of a VAT invoice or receipt.”¹⁶⁶

163. *Id.* § 4.106-6 ¶ 2, 4.108-6.

164. *Seagate*, 451 SCRA at 145 (citing NIRC §§ 106(A)(2)(C) & 108(B)(3) (1997); DEOFERIO JR. & MAMALATEO, *supra* note 84, at 132) (*emphasis supplied*).

165. Bureau of Internal Revenue, Rev. Reg. No. 16-2005, § 4.110-4 ¶ 2 (Sep. 1, 2005).

166. *CIR v. Cebu Toyo Corporation*, 451 SCRA 447, 461 (2005) (citing CRISPIN P. LLAMADO, ET AL., PHILIPPINE TAXES ON TRANSFER AND BUSINESS 205 (1998)). *See also* Rev. Reg. No. 16-2005, § 4.109-1(A) (Sep. 1, 2005):

(A) *In general.* – “VAT-exempt transactions” refer to the sale of goods or properties and/or services and the use or lease of properties that is not subject to VAT (output tax) and the seller is not allowed any tax credit on VAT (input tax) previously paid.

Conversely, the failure to indicate or display prominently the term “VAT-exempt sale” on a VAT invoice or receipt by a VAT registered seller in a VAT exempt transaction will render the seller liable to the value-added tax.¹⁶⁷

Thus, the distinction between zero-rating and exemption, which are “computationally the same” concepts, may be summarized as follows:

1. A zero-rated sale is a taxable transaction but does not result in an output tax while an exempted transaction is not subject to the output tax;
2. The input VAT on the purchases of a VAT-registered person with zero-rated sales may be allowed as tax credits or refunded while the seller in an exempt transaction is not entitled to any input tax on his purchases despite the issuance of a VAT invoice or receipt.
3. Persons engaged in transactions which are zero-rated, being subject to VAT, are required to register while registration is optional for VAT-exempt persons.¹⁶⁸

Without any intention of muddling the subject, it should be noted that there is a further distinction between an exempt *transaction* and an exempt *party*. The exempt party is “a person or entity granted VAT exemption under the Tax Code, a special law or an international agreement to which the Philippines is a signatory, and by virtue of which its taxable transactions become exempt from the VAT. Such party is also not subject to the VAT, *but may be allowed a tax refund of or credit for input taxes paid, depending on its registration as a VAT or non-VAT taxpayer.*”¹⁶⁹

A. Additional Goods/Services Zero Rated

The following goods and services are now included among those subject to zero percent (0%) VAT (zero-rating) and were not zero-rated prior to the amendments introduced by R.A. No. 9337:

The person making the exempt sale of goods, properties or services shall not bill any output tax to his customers because the said transaction is not subject to VAT.

¹⁶⁷. NIRC § 113(B)(2)(b), (D)(2) (1997), *amended by* R.A. NO. 9337 § 10 (2005).

¹⁶⁸. *Cebu Toyo Corporation*, 451 SCRA at 462.

¹⁶⁹. *Seagate*, 451 SCRA at 145 (citing DEOFERIO JR. & MAMALATEO, *supra* note 84, at 132-133) (*emphasis supplied*).

1. The sale of goods, supplies, equipment and fuel to persons engaged in international shipping or international air transport operations.¹⁷⁰
2. Transport of passengers and cargo by air or sea vessels from the Philippines to a foreign country.¹⁷¹ provided that in the event of an application for the issuance of a tax credit certificate or refund of creditable input tax due or paid attributable to such sales, the input taxes shall be allocated ratably between zero-rated and non-zero-rated sales.¹⁷²
3. Sale of power or fuel generated through renewable sources of energy such as, but not limited to, biomass, solar, wind, hydropower, geothermal, ocean energy, and other emerging energy sources using technologies such as fuel cells and hydrogen fuels.¹⁷³

The provision on renewable sources of energy was referred to as the *Angara Amendment* and its obvious “intent is to encourage the development of alternative sources of energy such as solar, wind or wave, as well as the development of ethanol from sugar and bio-diesel from coconut oil, both of which the Philippines has plenty, in the light of the projections that fossil oil will cost \$100 per barrel in five years.”¹⁷⁴

170. NIRC § 106(A)(2)(a)(6) (1997), amended by R.A. NO. 9337 § 4 (2005).

171. *Id.* § 108(B)(6) (1997), new provision per amendment under R.A. NO. 9337 § 6 (2005).

172. *Id.* § 112(A) (1997), amended by R.A. NO. 9337 § 10 (2005). The amendment added the following phrase on the cited provision on refunds and tax credits: “*Provided, finally, That for a person making sales that are zero-rated under Section 108(B)(6), the input taxes shall be allocated ratably between his zero-rated and non-zero-rated sales.*” See also *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means*, 13th Cong., 1st Reg. Sess. 103 (Senate Version, Apr. 18, 2005) (exchange between Sen. Richard Gordon, Sen. Ralph Recto, and Rep. Luis Villafuerte).

173. *Id.* § 108(B)(7) (1997), new provision per amendment under R.A. NO. 9337 § 6 (2005).

174. SENATE JOURNAL 40, 13th Cong., 1st Reg. Sess., Senate Sess. No. 40 (Apr. 12, 2005) (statement of Sen. Edgardo Angara).

B. Additional Exempt Transactions

The following transactions are now included among the list of exempt transactions under section 109 of the NIRC:

1. Sale, importation or lease of passenger or cargo vessels and aircraft, including engine, equipment and spare parts thereof for domestic or international transport operations.¹⁷⁵
2. Importation of fuel, goods and supplies by persons engaged in international shipping or air transport operations.¹⁷⁶

C. Expansion of Some Exemptions

There are two existing exempt transactions where the exemption was expanded further, these are:

1. Educational services that are exempt from VAT now include those rendered by private educational institutions duly accredited by the Technical Education and Skills Development Authority (TESDA), in addition to the already previously exempt educational services rendered by private educational institutions accredited by Department of Education (DepEd) and the Commission on Higher Education (CHED).¹⁷⁷
2. The exemption from VAT of gross receipts from lending activities by credit or multi-purpose cooperatives duly registered with the Cooperative Development Authority is

175. NIRC § 109(1)(S) (1997), *new provision per amendment under R.A. NO. 9337 § 7* (2005).

176. *Id.* § 109(1)(T) (1997), *new provision per amendment under R.A. NO. 9337 § 7* (2005).

177. *Id.* § 109(1)(H) (1997), *amended by R.A. NO. 9337 § 7* (2005) (renumbered). This proviso was § 109(m) as per immediate prior amendment under R.A. NO. 9238 § 2 (2004).

now *no* longer limited to lending operations to its members.¹⁷⁸

In the meantime, for transactions which are exempt under international agreements to which the Philippines is a signatory or under special laws, the exception that does not enjoy the exemption is now limited to petroleum exploration concessionaires who enjoy exemption on customs duties and compensating tax under Presidential Decree No. 529. Exceptions in the previous law that was deleted were those under Presidential Decree No. 66 on export processing zones and Presidential Decree No. 1590 which is the law granting the franchise to Philippine Airlines.¹⁷⁹

The extension of the VAT exemption of the credit cooperatives to lending to non-members was justified by the fact that lending by itself is not subject to the value-added tax. First, it was noted that banks are not subject to the value-added tax although banks and financial intermediaries pay a gross receipts tax. Second, “people who go to credit cooperatives to borrow are non-bankable to begin with.” The presumption was that a person who goes to the credit cooperative will neither have the income tax return nor the collateral usually required by the banks. Hence, it was only “proper” that as lending by banks are not subject to the value-added tax then more so should the lending by credit cooperatives to a non-member.¹⁸⁰

D. Clarifying/Expanding Zero-Rating for Some Services

The following services prior to the amendment enjoyed similar zero rating but have now been clarified or expanded by the new law:

178. *Id.* § 109(i)(M) (1997) as amended by R.A. No. 9337 § 7 (2005) (renumbered). This proviso was § 109(t) as per immediate prior amendment under R.A. No. 9238, § 2 (2004).

179. *Id.* § 109(i)(K) (1997) as amended by R.A. No. 9337 § 7 (2005) (renumbered). This proviso was § 109(q) as per immediate prior amendment under R.A. No. 9238 § 2 (2004). See Presidential Decree No. 66 (1972), Presidential Decree No. 590 (1974), and Presidential Decree No. 1590 (1978).

180. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 110 (Senate Version, Apr. 18, 2005) (proposal came from Rep. Luis Villafuerte).*

1. Services other than processing, manufacturing or repacking rendered to a person engaged in business conducted outside the Philippines or to a non-resident person not engaged in business who is outside the Philippines when the services are performed, the consideration for which is paid for in acceptable foreign currency and accounted for in accordance with the rules and regulations of the *Bangko Sentral ng Pilipinas* (BSP).¹⁸¹
2. Services rendered to persons engaged in international shipping or international air transport operations, including leases of property for use thereof.¹⁸²

The intent with respect to the proviso on services rendered to persons outside the Philippines is to zero-rate services that are consumed outside of the country even if the services were done locally such as those being done by call centers or legal services,¹⁸³ such as lawyer's research that is conducted in the Philippines and sent to a client in Hongkong.¹⁸⁴ This provision was a subject of much debate when the BIR applied to it the *Destination Principle* for its interpretation and implementation, to wit:

1. Under the Value-Added-Tax (VAT) System, exemption from VAT and Zero Percent (0%) are distinguished, as follows:

"...zero rating should be used when the authorities really wish to ensure that a product is to be free of VAT. Using an exemption for VAT means that the tax is borne by the trader, and if that trader sells to the public, he must pass on the tax on input to the public in his price or cut

181. NIRC § 108(B)(2) (1997) as amended by R.A. No. 9337 § 6 (2005) (the emphasized portion was inserted by the new law).

182. *Id.* § 108(B)(4) (1997) as amended by R.A. No. 9337 § 6 (2005). The proviso prior to the amendment limited the zero rating to services rendered to vessels engaged exclusively to international shipping. The amendment thus expanded the coverage.

183. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 13-14 (House Version, May 10, 2005) (statement of Sen. Sergio Osmeña III).*

184. SENATE JOURNAL 40, 13th Cong., 1st Reg. Sess., Senate Sess. No. 74 (Apr. 12, 2005) (exchange between Sen. Sergio Osmeña III and Sen. Ralph Recto).

payments to his factors of production (capital and labor). This suggests that countries that generally wish to pass on to the consumer the benefits of VAT-free goods and services should be allowed to use the zero rate." [Value-added tax International Practice and Problems, Allan A. Tait, International Monetary Fund, Washington, D.C., 1988, p. 51].

Our VAT law, which was first adopted and promulgated under EO No. 273 effective January 1, 1998, basically adhered to the Consumption Type VAT Regime and, in general, follows the destination principle, viz:

"When considering a VAT, an important decision to be made by a country concerns what regime to adopt for international trade: the origin principle (exports taxable, imports exempt), or the destination principle (export exempt, imports taxable)." [Value-Added-Tax VAT by Antonio Carlos Rodriguez, Harvard Law School, 1995, citing Shoup (1986) on destination principle, viz: "the country taxes all valued-added, at home and abroad, of goods that have as their destination the consumers of that country. Exports are exempt, imports are taxable. This is comparable with the consumption type VAT ."]

Accordingly, the onus of taxation under our VAT system is in the country where goods, property or services are destined and consumed. This is the reason why under our VAT Law, goods, property or services destined to or consumed in the Philippines are subject to the 10% VAT whereas exports are zero-rated. (Sections 105 and 108, Tax Code of 1997).

The sales of services subject to zero percent (0%) VAT under Section 108(B)(2), of the Tax Code of 1997, are limited to such sales which are destined for consumption outside of the Philippines in that such services are tacked-in as part of the cost of goods exported. The zero-rating also extends to project studies, information services, engineering and architectural designs and other similar services sold by a resident of the Philippines to a non-resident foreign client because these services are likewise destined to be consumed abroad. The phrase "project studies, information services, engineering and architectural designs and other similar services" does not include services rendered by travel agents to foreign tourists in the Philippines following the doctrine of *ejusdem generis*, since such services by travel agents are not of the same class or of the same nature as those enumerated under the aforesaid section.

Considering that the services by your client to foreign tourists are basically and substantially rendered within the Philippines, it follows that the onus of taxation of the revenue arising therefore, for VAT purposes, is also within the Philippines. For this reason, it is our considered opinion that the tour package services of your client to

foreign tourists in the Philippines cannot legally qualify for zero-rated (0%) VAT but rather subject to the regular VAT rate of 10%.¹⁸⁵

The application of the *Destination Principle* as enunciated in the afore-cited ruling was rejected in several cases by the Court of Appeals. Thus in the case of *Commissioner of Internal Revenue v. Burmeister and Wain Scandinavian Contractor Mindanao, Inc.*,¹⁸⁶ the Court held that:

Section 108(B)(2) of the Tax Code is clear. In order for services which were performed in the Philippines to enjoy zero-rating, these must comply only with two requisites, to wit: (1) payment in acceptable foreign currency and (2) accounted for in accordance with the rules and regulations of the BSP.

A cursory reading of Section 4.102-2(b)(2) would reveal, however, that these go far beyond merely providing details to carry into effect Section 108(B)(2) of the Tax Code. This is indicated by the additional phrase "as well as services by a resident to a non-resident foreign client, such as project studies, information services, engineering and architectural designs and other similar services". In effect, this phrase adds not just one (1) but two (2) requisites: (a) services must be rendered by a resident to a non-resident; and (b) these must be in nature of project studies, information services, etc.

Thus, if petitioner would be sustained, we would have an incongruous situation. A taxpayer may have satisfied the requirements of the basic law for zero-rating, but fails to satisfy either of the two (2) additional requirements imposed in the administrative regulations. Clearly this situation cannot be allowed.

Petitioner argues that according to VAT Ruling No. 040-98, our VAT law in general follows the destination principle, (i.e., exports exempt, imports taxable). In effect, petitioner would have this Court believe that even if the additional requirements contained in Section 4.102-2(b)(2) are not found anywhere in Section 108(B)(2), then these may still be justified, as all VAT laws adhere to the destination principle.

Firstly, it is undeniable that the additional requisites in Section 4.102-2(b)(2) are not based on the basic law. Even if the petitioner sets forth an underlying principle, however laudable, it is basic that in case of doubt, the terms of the statute will be controlling. In other words, if

185. Bureau of Internal Revenue, VAT Ruling No. 040-98 (Nov.23, 1998).

186. CIR v. Burmeister and Wain Scandinavian Contractor Mindanao, Inc. CA-G.R. SP No. 66341, Apr. 16, 2002.

the “destination principle” cannot be found in the express terms of Section 108(B)(2), then it should not be applied here.

Moreover, if indeed the “destination principle” underlies and is the basis of the VAT laws, then petitioner’s proper remedy would be to recommend an amendment of Section 108(B)(2) to Congress. In the absence of such amendatory law, however, petitioner is bound to apply the terms of the basic law. Petitioner can not resort, as it has done in the instant case, to administrative legislation.¹⁸⁷

The decision in the *Burmeister* case was reiterated by the Court of Appeals in *Commissioner of Internal Revenue v. Placer Dome Technical Services (Philippines), Inc.*,¹⁸⁸ thus:

Accordingly, petitioner cannot make VAT Ruling 040-98 its basis to disqualify respondent’s services from zero-rating.

BIR rulings have been aptly described as “the best guess of the moment... sort of an information service to the taxpayer” and are “not binding on the courts”. Verily, “(w)hen an administrative agency renders an opinion or issues a statement of policy, it merely interprets a pre-existing law and the administrative interpretation is at best advisory for it is the courts that finally determine what the law means. Thus an action by an administrative agency may be set aside by the judicial department if there is an error of law, abuse of power, lack of jurisdiction or grave abuse of discretion clearly conflicting with the letter and spirit of the law.”¹⁸⁹

In the meantime the *Destination Principle* was recognized by the Supreme Court in the case of *Seagate* in relation “to the exportation of goods, [where] automatic zero rating is primarily intended to be enjoyed by the seller who is directly and legally liable for the VAT, making such seller internationally competitive by allowing the refund or credit of input taxes that are attributable to export sales.”¹⁹⁰ In any case with the amendments to section 108(B)(2) introduced by R.A. No.

187. *Id.* See CIR v. American Express International, Inc.-Philippine Branch, CA-G.R. SP No. 62727, Feb. 28, 2002.

188. CIR v. Placer Dome Technical Services (Philippines), Inc., CA-G.R. SP No. 71458, June 30, 2004.

189. *Id.*

190. CIR v. Seagate Technology (Philippines), 451 SCRA 144 (2005) (citing NIRC §§ 106(A)(2)(C) & 108(B)(3) (1997); DEOFERIO JR. & MAMALATEO, *supra* note 84, at 189).

9337, at least the BIR's insistence that the services must be rendered by a resident to a non-resident is now in effect. Hence, this proviso's requisites for the application of zero rating are now as follows: (1) services other than processing, manufacturing or repacking; (2) *rendered to a person engaged in business conducted outside the Philippines or to a nonresident person not engaged in business who is outside the Philippines when the services are performed*, (3) the consideration for which is paid for in acceptable foreign currency and accounted for in accordance with the rules and regulations of the *Bangko Sentral ng Pilipinas* (BSP).¹⁹¹

E. Increasing Exemption Thresholds on Items Normally Covered by VAT

The following transactions are normally covered by the value-added tax if conducted in the course of trade or business. However, by increasing the minimum amounts before these items can be subject of the value-added tax, R.A. No. 9337 effectively creates additional exemptions, to wit:

1. Sales of residential lot valued at Php1,500,000 and below, and house and lot, and other residential dwellings valued at Php2,500,000 and below are now exempt.¹⁹²
2. Exempt leases of a residential unit have been increased from a monthly rental not exceeding to Php10,000.¹⁹³
3. Sale or lease of goods or properties or the performance of services that would otherwise be subject to VAT are now exempt if the gross annual sales and/or receipts do not exceed the amount of Php1,500,000.¹⁹⁴

191. NIRC § 108(B)(2) (1997), *amended by* R.A. NO. 9337 § 6 (2005).

192. *Id.* § 109(I)(P) (1997), *amended by* R.A. NO. 9337 § 7 (2005) (renumbered). This proviso was § 109(w) as per immediate prior amendment under R.A. NO. 9238 § 2 (2004).

193. *Id.* § 109(I)(Q) (1997), *amended by* R.A. NO. 9337 § 7 (2005) (renumbered). This proviso was § 109(x) as per immediate prior amendment under R.A. NO. 9238 § 2 (2004).

194. *Id.* § 109(I)(V) (1997), *amended by* R.A. NO. 9337 § 7 (2005) (renumbered). This proviso was § 109(z) as per immediate prior amendment under R.A. NO. 9238 § 2 (2004).

The foregoing exemptions will be adjusted to its present value using the Consumer Price Index not later than January 31, 2009 and every three (3) years thereafter.¹⁹⁵

On sales and leases of real property, the amendments results in a substantial increase from the threshold prior to the amendment of Php1,000,000 for the sale of house and lot and other residential dwellings and Php8,000 a month for exempt leases. As regards residential lots, there was no exemption prior to the amendment unless such residential lots were not primarily held for sale to customers or held for lease in the ordinary course of trade or business.¹⁹⁶ The threshold was increased due to the fact that despite the indexation provisions in the law the threshold has remained the same since 1997. The figures for the threshold on exempt leases, on the other hand, were linked to the figures for sales of residential real estate.¹⁹⁷

With respect to the annual gross annual sales and/or receipts that are subject to the value-added tax, prior to R.A. No. 9337, the cap was Php550,000. The increase in the minimum threshold, especially with respect to the annual gross sales or receipts was based, among others, on the Pareto Law.¹⁹⁸ It was posited that the total VAT collections came

195. *Id.* § 109(1)(V) (1997), amended by R.A. No. 9337 § 7 (2005) (renumbered). This proviso was § 109(z) as per immediate prior amendment under R.A. No. 9238 (2004).

196. *See Id.* § 109(w) & (x) (1997).

197. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 136-44 (Senate Version, Apr. 18, 2005).*

198. Vilfredo Pareto, 1848-1923, is an Italian economist, to whom it has been attributed with creating "a mathematical formula to describe the unequal distribution of wealth in his country. In the late 1940's, Dr. Joseph M. Juran inaccurately attributed the 80/20 Rule to Pareto, calling it Pareto's Principle...or Pareto's Law as it is sometimes called...." (*Pareto's Principle - The 80-20 Rule*, at <http://management.about.com/cs/generalmanagement/a/Pareto081202.htm>. *See also* Vilfredo Pareto, at <http://cepa.newschool.edu/het/profiles/pareto.htm>).

The so-called Pareto principle (also known as the *80-20 rule*, the *law of the vital few* and the *principle of factor sparsity*) states that for many

from the upper 20% of the taxpayers estimated at some 3000 taxpayers.¹⁹⁹ Another justification for the increase in the threshold was the realization that professionals will have some difficulty in administering the value-added tax.²⁰⁰ In any case, the legislature retained the old proviso requiring the payment of three percent (3%) of the gross quarterly sales or receipts of any person who is exempt from the payment of the value-added tax because the said person's gross annual sales and/or receipts do not exceed the amount of Php1,500,000. This is provided that such person is not VAT-registered. On the other

phenomena 80% of consequences stem from 20% of the causes. The idea has rule-of-thumb application in many places, but it is commonly misused.... The principle was suggested by management thinker Joseph M. Juran.... (Since J. M. Juran adopted the idea, it might better be called "Juran's assumption."). The assumption is that most of the results in any situation are determined by a small number of causes.... Such a statement is testable, is likely to be approximately correct, and may be helpful in decision making. The principle is often misconstrued because of the coincidence that $80 + 20 = 100$: it could just as well read that 80% of the consequences stem from 10% of the causes. Many people would reject such an "80-10" rule, but it is mathematically meaningful nevertheless.... Certain common applications of the principle misunderstand the original intent and are not, by themselves, credible. For instance: "20% of individuals in an organization perform 80% of the work." Or: "20% of our advertising creates 80% of our increased sales." (available at http://en.wikipedia.org/wiki/Pareto_principle (last accessed Dec. 1, 2005)).

199. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 117 (Senate Version, Apr. 15, 2005) (Rep. Joey Salceda cited the Pareto Law and Sen. Ralph Recto confirmed the concept of collecting from the "top 20 percent decile").*

200. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 134 (Senate Version, Apr. 18, 2005).*

hand, cooperatives shall be exempt from the three percent (3%) gross receipts tax.²⁰¹

VIII. INPUT TAXES

The E-VAT Law introduced changes on input taxes in four areas:

1. Input tax claims for depreciable goods
2. A 70% cap on crediting of input taxes
3. A reduction in transitional input tax
4. An increase in presumptive input tax

Putting all this in perspective, the Supreme Court citing Section 110 (A) of the NIRC distinguished input tax from output tax with greater clarity, when it explained that:

Input tax... [is] the value-added tax due *from* or *paid* by a VAT-registered person on the importation of goods or local purchase of good and services, including lease or use of property, in the course of trade or business, from a VAT-registered person, and *Output Tax* is the value-added tax *due* on the sale or lease of taxable goods or properties or services by any person registered or required to register under the law.²⁰²

The Philippine VAT system generally allows the crediting of the input tax against the output tax.²⁰³ The input tax is actually a form of tax credit where no tax is paid prior to the availment of such credit.²⁰⁴ Included in the term input tax is the transitional input tax and the presumptive input tax.²⁰⁵ Under the Consolidated Value-Added Tax Regulations of 2005 the following persons may avail of the input tax credit:

201. NIRC § 116 (1997) as amended by R.A. NO. 9337 § 13 (2005). This provision existed prior to the E-VAT Law. It's inclusion in the E-VAT Law is due to the renumbering of section 109(z) to section 109(I)(V) under the new law.

202. *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita*, G.R. No. 168056, Sep. 1, 2005.

203. NIRC § 110 (1997).

204. *CIR v. Central Luzon Drug Corporation*, 456 SCRA 414, 431 (2005).

205. Bureau of Internal Revenue, Rev. Reg. No. 16-2005, § 4.110-1 ¶ 1 (Sep. 1, 2005).

1. The importer upon payment of the value-added tax prior to the release of goods from the custody of the Bureau of Customs;
2. The purchaser of domestic goods or properties upon consummation of the sale; or
3. The purchaser of services or the lessee or licensee upon payment of the compensation, rental, royalty or fee.²⁰⁶

The input tax is a mere statutory privilege and a VAT registered person's entitlement thereto may be subject of valid legislation restricting or expanding its credibility because an input tax is neither a property nor a property right within the purview of the due process clause of the Constitution.²⁰⁷ As observed by the Supreme Court:

Under the previous system of single-stage taxation, taxes paid at every level of distribution are not recoverable from the taxes payable, although it becomes part of the cost, which is deductible from the gross revenue. When Pres. Aquino issued E.O. No. 273 imposing a 10% multi-stage tax on all sales, it was then that the crediting of the input tax paid on purchase or importation of goods and services by VAT-registered persons against the output tax was introduced. This was adopted by the Expanded VAT Law (R.A. No. 7716), and The Tax Reform Act of 1997 (R.A. No. 8424). The right to credit input tax as against the output tax is clearly a privilege created by law, a privilege that also the law can remove, or in this case, limit.²⁰⁸

On the contention that the restrictions against creditability of input taxes are discriminatory against certain types of businesses, the Supreme Court has this to say:

Petitioners point out that the limitation on the creditable input tax if the entity has a high ratio of input tax, or invests in capital equipment, or has several transactions with the government, is not based on real and substantial differences to meet a valid classification.

The argument is pedantic, if not outright baseless. The law does not make any classification in the subject of taxation, the kind of property, the rates to be levied or the amounts to be raised, the methods of assessment, valuation and collection. Petitioners' alleged distinctions

206. *Id.* § 4.110-2 (Sep. 1, 2005).

207. *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita*, G.R. No. 168056, Sep. 1, 2005.

208. *Id.* (citing E.O. 273 §§ 1, 5 & 110(B)).

are based on variables that bear different consequences. While the implementation of the law may yield varying end results depending on one's profit margin and value-added, the Court cannot go beyond what the legislature has laid down and interfere with the affairs of business.

The equal protection clause does not require the universal application of the laws on all persons or things without distinction. This might in fact sometimes result in unequal protection. What the clause requires is equality among equals as determined according to a valid classification. By classification is meant the grouping of persons or things similar to each other in certain particulars and different from all others in these same particulars.²⁰⁹

Finally on the allegation that limitations on input tax credibility is regressive and therefore unconstitutional, the Supreme Court stated:

Progressive taxation is built on the principle of the taxpayer's ability to pay. This principle was also lifted from Adam Smith's *Canons of Taxation*, and it states:

I. The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.

Taxation is progressive when its rate goes up depending on the resources of the person affected.

The VAT is an antithesis of progressive taxation. By its very nature, it is regressive. The principle of progressive taxation has no relation with the VAT system inasmuch as the VAT paid by the consumer or business for every goods bought or services enjoyed is the same regardless of income. In other words, the VAT paid eats the same portion of an income, whether big or small. The disparity lies in the income earned by a person or profit margin marked by a business, such that the higher the income or profit margin, the smaller the portion of the income or profit that is eaten by VAT. *A converso*, the lower the income or profit margin, the bigger the part that the VAT eats away. At the end of the day, it is really the lower income group or businesses with low-profit margins that is always hardest hit.

Nevertheless, the Constitution does not really prohibit the imposition of indirect taxes, like the VAT. What it simply provides is that Congress shall "evolve a progressive system of taxation."²¹⁰

209. *Id.*

210. *Id.*

A. Input Tax Claims for Depreciable Goods

R.A. No. 9337 now requires that the input tax on depreciable goods be depreciated over its period of depreciation, provided that its aggregate acquisition cost, excluding the VAT component, exceeds Php1,000,000. In which case:

1. The input tax on goods purchased or imported in a calendar month for use in trade or business for which deduction for depreciation is allowed under the NIRC shall be spread evenly over the month of acquisition and the 59 succeeding months if the aggregate acquisition cost for such goods, exclusive of VAT, exceeds Php1,000,000.²¹¹
2. If the estimated useful life of the capital good (with an aggregate acquisition cost, exclusive of VAT, exceeds Php1,000,000) is less than five years, as used for depreciation purposes, then the input VAT shall be spread over such a shorter period.²¹²
3. Conversely, if the aggregate acquisition cost for such goods, excluding the VAT component, do *not* exceed Php1,000,000, the total input taxes will be allowable as credit against the output tax in the month of acquisition.²¹³

In the meantime, the input tax from the depreciation or amortization of automobiles, aircrafts and yachts used in trade or business may be creditable against output tax.²¹⁴ Also in the case of zero rated sales for the transport of passengers and cargo by air or sea vessels from the Philippines to a foreign country,²¹⁵ in the event of an application for the issuance of a tax credit certificate or refund of

²¹¹. NIRC § 110(A)(2)(b) (1997), *amended by* R.A. No. 9337 § 8 (2005).

²¹². *Id.*

²¹³. *See* Rev. Reg. No. 16-2005, § 4.110-3 ¶ 2 (Sep. 1, 2005).

²¹⁴. NIRC § 110 (A)(1)(a)(v) (1997), *amended by* R.A. No. 9337 § 8 (2005). Prior to this amendment the provision reads: "(v) For use in trade or business for which deduction for depreciation or amortization is allowed under this Code, *except automobiles, aircraft and yachts.*" The underscored and italicized portion was deleted by the E-VAT Law.

²¹⁵. NIRC § 108(B)(6) (1997), *new provision per amendment under* R.A. No. 9337 § 6 (2005).

creditable input tax due or paid attributable to such sales, the input taxes shall be allocated ratably between zero-rated and non-zero-rated sales.²¹⁶

The deferment of the crediting of the input VAT has been criticized as a distortion of the VAT system as it compels business entities in making a five-year, interest-free loan to the government which is a constraint on capital expenditures on operations and inventories.²¹⁷ The proposal has also been criticized as a disincentive to investment of much needed capital equipment by even the then Finance Secretary who was the Administration's advocate of the E-VAT Law:

MR. PURISIMA. In fact, if I have my way, I would not propose this particular provision because we are in a country that's underinvested in capital equipment. In fact, what we'd like to do is encourage more people to invest in capital equipment so that we can have a more competitive economy that would ultimately create the necessary jobs that our people need. This serves as a disincentive to that effort to try and encourage more people to invest in capital equipment.²¹⁸

On the other hand, Congress

justified its move by saying that the provision was designed to raise an annual revenue of 22.6 billion. The legislature also dispelled the fear that the provision will fend off foreign investments, saying that foreign investors have other tax incentives provided by law, and citing the case of China, where despite a 17.5% non-creditable VAT, and foreign investments were not deterred.²¹⁹

²¹⁶ *Id.* § 112(A) (1997), amended by R.A. NO. 9337 § 10 (2005) (The amendment added the following phrase on the cited provision on refunds and tax credits: "Provided, finally, That for a person making sales that are zero-rated under Section 108(B)(6), the input taxes shall be allocated ratably between his zero-rated and non-zero-rated sales.").

²¹⁷ SENATE JOURNAL 68, 13th Cong., 1st Reg. Sess., Senate Sess. No. 75 (Apr. 13, 2005) (statement of Sen. Mar Roxas).

²¹⁸ *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 19 (Senate Version, Apr. 25, 2005) (statement of Sec. Cesar Purisima, Department of Finance).*

²¹⁹ *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita*, G.R. No. 168056, Sep. 1, 2005 (citing statements of Sen. Ralph Recto

On the constitutional front, the Supreme Court refrained from intervening in this matter as it “involves economic policy and legislative wisdom.” In any case, the Court noted that the spread of 60 months “only poses a delay in the crediting of the input tax” and does not permanently deprive a taxpayer of his privilege to credit the input tax.²²⁰

B. The Madrigal-Enrile Amendment: 70% Credit Cap on Input Tax

One important and rather controversial feature to the VAT law introduced by R.A. No. 9337 is that the input tax inclusive of input VAT carried over from the previous quarter that may be credited in every quarter shall not exceed 70% of the output VAT. Hence, in no case shall the allowable input tax on a quarterly VAT Return exceed 70% of the output tax due.²²¹ The undiluted meaning of this statutory provision is that the taxpayer has to remit a *minimum value-added tax payable of 30% of the total output tax due* on each VAT quarterly return filed.²²² The resulting minimum value-added tax would then be 3% of gross sales or receipts.

A 90% cap on the input VAT credit was first proposed *in behalf of Senator Madrigal* and would result in a minimum required VAT payment of 1% of gross sales or receipts.²²³ At the Bicameral

during his sponsorship speech (SENATE JOURNAL 726, 13th Cong., 1st Reg. Sess., Senate Sess. No. 67 (Mar. 7, 2005)) and his statements as recorded in SENATE JOURNAL 803, 13th Cong., 1st Reg. Sess., Senate Sess. No. 71 (Mar. 15, 2005).).

220. *Id.*

221. NIRC § 110(B) (1997), *amended by* R.A. No. 9337 § 8 (2005).

222. *See* Bureau of Internal Revenue, Rev. Reg. No. 14-2005, §§ 4.110-5, 4-110-6 ¶ 3 (June 22, 2005) (Cited provisions are from the discarded version of the consolidated VAT regulations. The section in the regulation on the minimum VAT payable of 30% of output tax was substantially modified in the revised version of the VAT regulations as will be discussed later. (Rev. Reg. No. 16-2005, particularly under Sections 4.110-5, 4-110-6 ¶ 3, and 4-110-7)).

223. SENATE JOURNAL 67-69, 13th Cong., 1st Reg. Sess., Senate Sess. No. 75 (Apr. 13, 2005) (Sen. Ralph Recto made the proposal in behalf of Sen. Maria Ana Consuelo “Jamby” Abad Santos Madrigal. Sen. Madrigal eventually voted

Conference Committee, the 1% minimum VAT payment initially proposed was deemed to be “too low.”²²⁴ It was then noted that under the law prior to E-VAT Law amendments it was already provided that a taxpayer with gross sales below the then threshold of Php550,000 is required to pay a tax of 3% of gross sales.²²⁵ The House panel then suggested reducing the credit cap from 90% to 80%,²²⁶ which would have resulted in a 2% minimum VAT. The rhetorical question was then posed by Senator Enrile, “Why do you suggest 2 percent? Why not 3 percent to make it in *pari passu* with the existing rates for non-VAT entities?”²²⁷ This was deemed to be “even better”²²⁸ Subsequently, after

against the passage of R.A. No. 9337, declaring that the E-VAT law will kill the golden goose that lays the golden eggs. (See SENATE JOURNAL 187, 193-97, 13th Cong., 1st Reg. Sess., Senate Sess. No. 83 (May 10, 2005)).

224. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 94 (Senate Version, Apr. 15, 2005) (statement of Rep. Jesli Lapus).*

225. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 108 (Senate Version, Apr. 15, 2005) (Sen. Ralph Recto’s observation based on section 116 of the NIRC).*

226. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 60 (Senate Version, Apr. 18, 2005) (the proposal came from Rep. Luis Villafuerte).*

227. *Id.* at 61 (Sen. Enrile voted against the passage of R.A. No. 9337 alleging that his other proposals were, by and large, not adopted in the measure. (See SENATE JOURNAL 187-188, 13th Cong., 1st Reg. Sess., Senate Sess. No. 83 (May 10, 2005).).

228. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 “Value-Added Tax,” Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 61 (Senate Version, Apr. 18, 2005) (statement of Rep. Jesli Lapus).*

considering the impact and the numbers involved, both panels agreed to reduce the input VAT credit cap to 70%.²²⁹

The imposition of a limitation on the amount of input tax that may be claimed was the subject of the petition filed in Supreme Court questioning the constitutionality of the E-VAT Law. The Court aside from declaring the input tax as a mere statutory privilege also observed that the 70% limitation on its credibility is not absolute. “[T]he excess input tax, if any, is retained in a business’s books of accounts and remains creditable in the succeeding quarter/s.”²³⁰ While it is true that “[i]t ends at the net effect that there will be unapplied/unutilized inputs VAT for a given quarter. It does not proceed further to the fact that such unapplied/unutilized input tax may be credited in the subsequent periods as allowed by the carry-over provision of Section 110(B) or that it may later on be refunded through a tax credit certificate under Section 112(B).”²³¹ Moreover, arguments on the adverse impact of the 70% cap were dismissed by the Supreme Court on the ground that such “still remains theoretical” and “the Court must only deal with an existing case or controversy that is appropriate or ripe for judicial determination, not one that is conjectural or merely anticipatory.”²³² The High Tribunal elaborates:

The impact of the 70% limitation on the creditable input tax will ultimately depend on how one manages and operates its business. Market forces, strategy and acumen will dictate their moves. With or without these VAT provisions, an entrepreneur who does not have the ken to adapt to economic variables will surely perish in the competition. The arguments posed are within the realm of business, and the solution lies also in business.²³³

In the meantime, the revised version of the Consolidated Value-Added Tax Regulations of 2005 appears to attempt to soften the impact of the 70% input tax credit cap by limiting the cap’s application only to cases where the input tax, inclusive of the previous quarter’s input tax,

229. *See Id.* at 60-66.

230. *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita*, G.R. No. 168056, Sep. 1, 2005 (citing provisions of the NIRC).

231. *Id.*

232. *Id.*

233. *Id.*

exceeds the output tax. The result is that whenever the output tax exceeds the input tax, the taxpayer may enjoy the full credit for the input tax for the quarter. Thus, the regulations provide:

SEC. 4.110-7. VAT Payable (Excess Output) or Excess Input Tax.

(a) If at the end of any taxable quarter the output tax exceeds the input tax, the excess shall be paid by the VAT-registered person.

Illustration: For a given taxable quarter ABC Corp. has output VAT of 100 and input VAT of 80. Since output tax exceeds the input tax for such taxable quarter, all of the input tax may be utilized to offset against the output tax. Thus, the net VAT payable is $100 - 80 = 20$.

(b) If the input tax inclusive of input tax carried over from the previous quarter exceeds the output tax, the input tax inclusive of input tax carried over from the previous quarter that may be credited in every quarter shall not exceed seventy percent (70%) of the output tax; Provided, That, the excess input tax shall be carried over to the succeeding quarter or quarters; Provided, however, that any input tax attributable to zero-rated sales by a VAT-registered person may at his option be refunded or applied for a tax credit certificate which may be used in the payment of internal revenue taxes, subject to the limitations as may be provided for by law, as well as, other implementing rules.

Illustration: For a given taxable quarter XYZ Corp. has output VAT of 100 and input VAT of 110. Since input tax exceeds the output tax for such taxable quarter, the 70% limitation is imposed to compute the amount of input tax which may be utilized. The total allowable input tax which may be utilized is 70 (70% of the output tax). Thus, the net VAT payable is $100 - 70 = 30$. The unutilized input tax amounting to 40 is carried over to the succeeding month.²³⁴

It will be interesting to see how the 70% cap on the crediting of input tax will be subsequently implemented both in relation to the cited provision limiting its application to cases where input taxes exceed output taxes and in relation to the provision that any excess of input taxes may be carried over in the succeeding quarter or quarters. Aggressive implementation by the tax authorities limiting input tax crediting to the four quarters of an accounting period is not unknown.²³⁵ On this subject, the Bicameral Conference Committee

234. Bureau of Internal Revenue, Rev. Reg. No. 16-2005 § 4-110-7 (Sep. 1, 2005).

235. Observation of the Author. *See also* VAT Ruling No. 022-04 (Sep. 13, 2004). This VAT ruling restricted to the accounting year the carry over of

deliberations, with all its colloquial flavor, should leave no doubt as to the interpretation of the carry forward provision, to wit:

REP. JAVIER. *Saan si Miniong? Miniong.*

THE CHAIRMAN (REP. LAPUS). Is there any reaction from our panel?

REP. JAVIER. Mr. Chairman, may I ask some questions, 'no. So, even if you have an excess tax...

SEN. OSMENA. Carry over.

REP. JAVIER. Carry over. You don't pay any output VAT, 'no, you pay a minimum VAT of one or two or three percent as the case may be. So, this will be in effect be a gross sales tax.

SEN. OSMENA. No. Because you can still carry over the three percent.

THE CHAIRMAN (SEN. RECTO). You can still recover it.

SEN. OSMENA. Still recover it.

REP. JAVIER. Until when?

SEN. OSMENA. Forever.

THE CHAIRMAN (SEN. RECTO). You can still recover it.

REP. JAVIER. Until you have a piling up of tax credits later on.

SEN. OSMENA. If you're always — have a bigger input VAT and output VAT. Now, you and I know that eventually that inventory will be consumed and sold.²³⁶

C. Transitional Input Tax Credits

An incident for a transitional input tax credit arises when a taxpayer who is not liable to the value-added tax becomes liable for the value-

creditable withholding value-added tax of PLDT. While what is involved is essentially an output tax of the taxpayer, the ruling illustrates how the concept of the accounting year is applied to the claims for value-added tax credits. The ruling is more fully discussed in relation to withholding tax for government/GOCC purchases in of the latter part of this Article.

²³⁶. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 62-63 (Senate Version, Apr. 18, 2005) (exchange between Rep. Exequiel Javier, Sen. Sergio Osmeña, Sen. Ralph Recto, and Rep. Jesli Lapus) (emphasis supplied).*

added tax either by election or a change in circumstances. R.A. No. 9337 has *reduced* the transitional input tax from 8% to 2%. The transitional input VAT credits is the input VAT allowed to a person who either becomes liable to VAT upon exceeding the turn-over of Php1,500,000 or elects to be a VAT registered person equivalent to 2% of the beginning inventory of goods, materials and supplies or the actual VAT paid on such goods, materials and supplies, whichever is higher.²³⁷ The beginning inventory to which a taxpayer may be entitled to a transitional input VAT shall refer to inventory on hand as of the effectivity of the VAT registration on the following:

1. goods purchased for resale in their present condition;
2. materials purchased for further processing, but which have not yet undergone processing;
3. goods which have been manufactured by the taxpayer;
4. goods in process for sale; or
5. Goods and supplies for use in the course of the taxpayer's trade or business as a VAT registered person.²³⁸

The value allowed on the inventories for purposes of income taxes shall be the basis for the computation of the transitional input tax but excluding therefrom the goods that are exempt from the value-added taxes under section 109 of the NIRC.²³⁹

D. Presumptive Input Tax Credits

The presumptive input tax credit is a legal fiction whereby a tax credit is recognized by law for purchases of VAT exempt goods where the seller of the exempt goods pays no output tax. In this case, the law presumes input taxes for primary agricultural products used in the processing or manufacture of socially sensitive goods or products

237. See NIRC § 111(A) (1997), amended by R.A. NO. 9337 § 9 (2005) and Rev. Reg. No. 16-2005, § 4.111-1, ¶ 2 (Sep. 1, 2005). Franchise grantees of radio and television broadcasting whose threshold are Php10,000,000 is excluded by Rev. Reg. No. 16-2005 § 4.111-1, ¶ 1 (Sep. 1, 2005).

238. Bureau of Internal Revenue, Rev. Reg. No. 16-2005 § 4.111-1 ¶ 1 (Sep. 1, 2005).

239. *Id.* § 4.111-1 ¶ 2.

specified by the statute. Under R.A. No. 9337, the presumptive input tax has been *increased* from 1½% to 4% of the gross value in money of purchases of primary agricultural products which are used as inputs to their production by persons/firms entitled to the presumptive input tax credits. R.A. No. 9337 also added persons/firms engaged in packed noodle-based instant meals processing as among those who can enjoy the presumptive input tax. Other persons/firms who are entitled to the presumptive input tax under the law prior to the amendments under R.A. No. 9337 are still entitled to the presumptive input tax. These are those engaged in processing of sardines, mackerel and milk, and in manufacturing refined sugar, and cooking oil.²⁴⁰

E. Apportioning Input Taxes in Mixed Transactions

The last regulatory attempt to define how input taxes are to be apportioned in mixed transactions was in 1989, hence the new guidelines on the subject are appropriate in the light of the passage of the E-VAT Law. Nevertheless, prior regulations can assist in the understanding of the mixed transaction when it stated that:

Where the taxpayer is engaged in zero-rated or effectively zero-rated sale, as well as in taxable domestic and exempt sale of goods and services, and the amount of the allowable input tax paid cannot be directly and entirely attributed to any one of the transactions, it shall be allocated proportionately to each category of transaction."²⁴¹

The general rule as expressed in the Consolidated Value-Added Tax Regulations of 2005 is that the crediting of input taxes "includes input taxes which can be directly attributed to transactions subject to the VAT plus a ratable portion of any input tax which cannot be directly attributed to either the taxable or exempt activity."²⁴² Consequently, the revised guidelines on the apportionment of input tax credits on mixed transactions are:

1. All the input taxes that can be directly attributed to the transactions subject to VAT may be recognized for the input tax credit.

240. NIRC § 111(B)(1), 1 (1997), *amended by* R.A. NO. 9337 § 9 (2005).

241. Bureau of Internal Revenue, Rev. Reg. No. 9-89 § 3 (1989).

242. Bureau of Internal Revenue, Rev. Reg. No. 16-2005 § 4.110-1, ¶ 2 (Sep. 1, 2005).

2. Input taxes that can be directly attributed to value-added taxable sales of goods and services to the Government or any political subdivisions, instrumentalities or agencies, including government-owned or controlled corporations shall not be credited against output taxes arising from sales to non-government entities.
3. If any input tax cannot be directly attributed to either a VAT taxable or VAT-exempt transaction, the input tax shall be pro-rated to the VAT taxable and VAT-exempt transactions and only the ratable portion pertaining to transactions subject to VAT may be recognized for input tax credit.²⁴³

IX. ADMINISTRATION OF THE VAT, MAKING THE VAT GPS WORK

Changes and refinements were enacted covering invoicing, registration to withholding taxes in order to institute better tracking and implementation systems for the value-added taxes. The

[b]eauty and integrity of the VAT chain... [is that the tax collector can] rely on a chain of invoices and receipts that can leave an audit trail. Tax compliance by self-confession does not apply on VAT, as the latter requires records of transactions. VAT can be likened to a GPS that can track purchases, sales and taxes from point of production to point of consumption.²⁴⁴

A. Commercial Documentation

R.A. No. 9337 formalizes documentation requirements for transactions subject to value-added taxes. Thus, a VAT-registered person must now issue:

1. A *VAT invoice* for every sale, barter or exchange of *goods or properties*; and
2. A *VAT official receipt* for every lease of goods or properties, and for every sale, barter or exchange of *services*.²⁴⁵

243. *Id.* § 4.110-4, ¶ 1.

244. SENATE JOURNAL 727, 13th Cong., 1st Reg. Sess., Senate Sess. No. 67 (Mar. 7, 2005) (sponsorship speech of Sen. Ralph Recto).

245. NIRC § 113(A) (1997), amended by R.A. No. 9337 § 11 (2005).

B. Issuance of Receipts or Sales or Commercial Invoices

The E-VAT Law reworded the general rules on issuance of receipts and invoices. Under the new law, in general,

[a]ll persons subject to an internal revenue tax shall, for each sale and transfer of merchandise or for services rendered valued at twenty-five pesos (Php25.00) or more, issue duly registered receipts or sale or commercial invoices, prepared at least in duplicate, showing the date of transaction, quantity, unit cost and description of merchandise or nature of service: *Provided, however,* That where the receipt is issued to cover payment made as rentals, commissions, compensation or fees, receipts or invoices shall be issued which shall show the name, business style, if any, and address of the purchaser, customer or client.

The original of each receipt or invoice shall be issued to the purchaser, customer or client at the time the transaction is effected, who, if engaged in business or in the exercise of profession, shall keep and preserve the same in his place of business for a period of three (3) years from the close of the taxable year in which such invoice or receipt was issued, while the duplicate shall be kept and preserved by the issuer, also in his place of business, for a like period.²⁴⁶

^{246.} *Id.* § 237 ¶¶ 1 & 2 (1997), amended by R.A. NO. 9337 § 20 (2005). The italicized passages below have been deleted by the E-VAT Law from the section below:

SEC. 237. Issuance of Receipts or Sales or Commercial Invoices.
- All persons subject to an internal revenue tax shall, for each sale or transfer of merchandise or for services rendered valued at Twenty-five pesos (P25.00) or more, issue duly registered receipts or sales or commercial invoices, prepared at least in duplicate, showing the date of transaction, quantity, unit cost and description of merchandise or nature of service: *Provided, however, That in the case of sales, receipts or transfers in the amount of One hundred pesos (P100.00) or more, or regardless of the amount, where the sale or transfer is made by a person liable to value-added tax to another person also liable to value-added tax; or where the receipt is issued to cover payment made as rentals, commissions, compensations or fees, receipts or invoices shall be issued which shall show the name, business style, if any, and address of the purchaser, customer or client: Provided, further, That where the purchaser is a VAT-registered person, in addition to the information herein required, the invoice or receipt shall further show the Taxpayer Identification Number (TIN) of the purchaser.*

C. Information Contained in a VAT Invoice/Receipt

With respect to VAT invoices/receipts, R.A. No. 9337 now requires a whole slew of data that such invoice/receipt must contain. These requirements must be studied carefully for proper implementation. Thus the following information shall be indicated in the VAT invoice or VAT official receipt:

1. A statement that the seller is a VAT-registered person, followed by his Taxpayer's Identification Number (TIN);
2. The total amount which the purchaser pays or is obligated to pay to the seller with the indication that such amount includes the value-added tax: *Provided, That*:
 - (a) The amount of the tax shall be shown as a separate item in the invoice or receipt;
 - (b) If the sale is exempt from value-added tax, the term 'VAT-exempt sale' shall be written or printed prominently on the invoice or receipt;
 - (c) If the sale is subject to zero percent (0%) value-added tax, the term 'zero-rated sale' shall be written or printed prominently on the invoice or receipt;
 - (d) If the sale involves goods, properties or services some of which are subject to and some of which are VAT zero-rated or VAT-exempt, the invoice or receipt shall clearly indicate the break-down of the sale price between its taxable, exempt and zero-rated components, and the calculation of the value-added tax on each portion of the sale shall be shown on the invoice or receipt: *Provided, That* the seller may issue separate invoices or receipts for the taxable, exempt, and zero-rated components of the sale.
3. The date of transaction, quantity, unit cost and description of the goods or properties or nature of the service; and

The original of each receipt or invoice shall be issued to the purchaser, customer or client at the time the transaction is effected, who, if engaged in business or in the exercise of profession, shall keep and preserve the same in his place of business for a period of three (3) years from the close of the taxable year in which such invoice or receipt was issued, while the duplicate shall be kept and preserved by the issuer, also in his place of business, for a like period.

4. In the case of sales in the amount of One thousand pesos (P1,000) or more where the sale or transfer is made to a VAT-registered person, the name, business style, if any, address and Taxpayer Identification Number (TIN) of the purchaser, customer or client.²⁴⁷

This provision adopts and improves previous regulations on issuance of VAT invoices/receipts addressing the problems of leakages in the value-added tax system arising from transactions of a VAT-registered person who is engaged in the sale of both taxable and exempt goods, properties or services.²⁴⁸

However, the statutory provision left open the matter of reimbursements to regulatory and/or administrative clarification. As a rule the fact that a sum received on a “no-profit, reimbursement-of-cost-only” basis does not by itself remove it from the ambit of the value-added tax since “VAT is a tax on transactions, imposed at every stage of the distribution process on the sale, barter, exchange of goods or property, and on the performance of services, even in the absence of profit attributable thereto.”²⁴⁹ However, when reimbursements of expenses are in the nature of a return of capital these cannot be construed as income of the recipient and is not subject to the value-added tax.²⁵⁰ In the case of reimbursement-at-cost transactions, “expenses which are incurred by the advancing party for the benefit and for the account of the party accommodated can be considered reimbursable expenses not forming part of gross receipts of the advancing party subject to tax.” This is because “the party seeking reimbursement does not sell, barter, exchange, nor lease any food or property and neither does it render any service to the party accommodated” insofar as regards the amounts sought to be reimbursed.²⁵¹ Hence, there are instances where a VAT registered person may receive money or consideration from its customers or clients either as a reimbursement for amounts paid to third persons or as an advance for the same purpose. In such instances the BIR has recognized that such payments are not subject to the value-added tax.

247. *Id.* § 113(B) (1997), *new provision inserted by amendment under R.A. No. 9337* § 11 (2005).

248. *See* Rev. Memorandum Circular No. 61-03 (2003).

249. *CIR v. Court of Appeals*, 329 SCRA 237, 243-44 (2000).

250. Bureau of Internal Revenue, BIR Ruling No. DA-176-04 (Apr. 6, 2004).

251. Bureau of Internal Revenue, BIR Ruling No. DA-304-04 (June 2, 2004).

Examples of such payments considered as valid reimbursements not subject to the output tax are:

1. The collection by a franchisor of an advertising fee equivalent to 1% of the gross income of its franchisee was deemed to be a mere reimbursement of the advertising fees paid to advertising agency and in which case it is the advertising agency that is liable to VAT and not the franchisor.²⁵²
2. Reimbursement at cost of utility bills paid in behalf of unit owners by a condominium association.²⁵³
3. Reimbursement of freight and other charges from a supplier.²⁵⁴
4. Face value of vouchers for employee benefits issued by a service company for distribution by its client companies. In this case, service company shall not be subject to the value-added tax on the face value of the vouchers.²⁵⁵
5. Liquidation of out-of-pocket expenses/advances incurred by professionals, such as lawyers, which they later bill to their clients.²⁵⁶
6. In the case of travel agencies, the price of airline or ship tickets or the reimbursement of expenses which shall be limited to passport and visa fees for all types of passengers and hotel room charges, bus and/or car tour charges, guide fees, resort fees and meal charges for tourists provided that all the said expenses are properly supported by receipts issued by the supplying company or establishment.²⁵⁷

Recently, the BIR has taken a negative view of reductions on gross sales/receipts being made on items classified as reimbursements or

252. Bureau of Internal Revenue, BIR Ruling No. DA-121-05 (Apr. 6, 2005).

253. Bureau of Internal Revenue, BIR Ruling No. DA-304-04 (June 2 2004).

254. Bureau of Internal Revenue, BIR Ruling No. DA-176-04 (Apr. 6, 2004).

255. Bureau of Internal Revenue, VAT Ruling No. 038-02 (June 21, 2002).

256. Bureau of Internal Revenue, Revenue Memorandum Circular 06-03, A-35 (Jan. 15, 2003).

257. Bureau of Internal Revenue, VAT Ruling No. 003-88 (Jan. 12, 1988).

payments to third party “despite the fact the amount invoiced or receipted to their customers are the full amount or inclusive of said reimbursements.” As a result, the Bureau declared that such an amount “appearing in the sales invoices/receipts is thus deemed inclusive of the value-added tax due thereon” and thus considered subject to output tax at one eleventh of the total receipt.²⁵⁸ Such a stance may now be deemed superseded by the deletion of the one-eleventh computation for the output tax in the NIRC.²⁵⁹ Consequently, it is now opportune to further clarify by way of regulation how to invoice or receipt valid reimbursements in the light of the new provision²⁶⁰ requiring a breakdown of the amounts stated in the VAT receipt or invoice showing which amounts are subject to the value-added tax and which amounts are not and showing the calculation therefor. One method to consider is to have the VAT registered advancing party to record in the receipt or invoice issued that the amount indicated is not a VAT transaction but a reimbursement with supporting documentation evidencing the same as a reimbursement. The recording of such reimbursement in the advancing party’s receipt or invoice may include the receipt/invoice number of the third party paid or, if there be none, a description of the valid verifiable document evidencing payment to a third party.

D. More Stringent Consequence for Issuing Erroneous VAT Invoice or VAT Official Receipt

R.A. No. 9337 imposes more stringent consequences for issuing a VAT invoice/receipt erroneously. To wit:

(1) If a person who is not a VAT-registered person issues an invoice or receipt showing his Taxpayer Identification Number (TIN), followed by the word ‘VAT’:

(a) The issuer shall, in addition to any liability to other percentage taxes, be liable to:

(i) The [VAT] without the benefit of any input tax credit; and

258. Bureau of Internal Revenue, Rev. Memorandum Circular No. 70-04 (Nov. 10, 2004). The circular sought to clarify Rev. Reg. 08-99 (1999) which cites Sections 106(D)(1) and 108(C) of the NIRC which has now been deleted by R.A. NO. 9337 §§ 4 & 6 (2005).

259. R.A. NO. 9337 §§ 4 & 6 (2005) (*deletes* NIRC §§ 106(D)(1) & 108(C)).

260. Referring to NIRC § 113(B)(2)(d) (1997), *new provision inserted by amendment under* R.A. No. 9337 § 11 (2005).

(ii) A fifty percent (50%) surcharge [as a civil penalty];

(b) The VAT shall, if the other requisite information... is shown on the invoice or receipt, be recognized as an input tax credit to the purchaser...

(2) If a VAT-registered person issues a VAT invoice or VAT official receipt for a VAT-exempt transaction, but fails to display prominently on the invoice or receipt the term 'VAT-exempt sale', the issuer shall be liable to account for the [VAT] as if [the exemption provided by law] did not apply.²⁶¹

This provision supersedes the provision in the last paragraph of section 109²⁶² of the NIRC which simply provides that:

[A]ny person whose sale of goods or properties or services which are otherwise not subject to VAT, but who issues a VAT invoice or receipt therefor shall, in addition to his liability to other applicable percentage tax, if any, be liable to the tax imposed in Section 106 or 108 without the benefit of input tax credit, and such tax shall also be recognized as input tax credit to the purchaser under Section 110, all of this Code.

Consequently, while the rules are essentially the same prior to the amendment, R.A. No. 9337 introduces the new feature of a surcharge of 50% by way of a civil penalty for the erroneous issuances of VAT receipts or invoices.

E. Transitional Period on VAT Invoices/Receipts

Taxpayers may continue to issue VAT invoices and VAT official receipts commencing from the time the E-VAT Law takes effect up to 31 December 2005, in accordance with BIR administrative practices that existed as of 31 December 2004.²⁶³ Thus, unused non-VAT invoices and receipts should be properly stamped with the date when the VAT registered person became registered as such with the phrase "VAT-registered as of November 1, 2005." For transactions that remain exempt, the phrase "non-VAT registered as of (date)" should be

261. NIRC § 113(D) (1997), *new provision inserted by amendment under* R.A. No. 9337 § 11 (2005).

262. Deleted by R.A. No. 9337, § 9 (2005).

263. NIRC § 113(E) (1997), *amended by* R.A. No. 9337 § 11 (2005).

stamped on the existing receipts or invoices.²⁶⁴ For exempt services billed prior to the effectivity of R.A. No. 9337, but which remain uncollected after the law's effectivity, an information return must be filed 60 days from the effectivity of R.A. No. 9337 detailing the clients or customers that have been billed and attaching the billings in order that these may still be considered VAT exempt, otherwise these will be considered gross receipts subject to VAT.²⁶⁵

F. Withholding Tax for Government/GOCC Purchases

The final VAT to be withheld by the government or government owned or controlled corporations on account of each purchase of goods and services which are subject to the value-added tax imposed in Sections 106 and 108 of the NIRC have been simplified to a flat rate of 5% as opposed to the previous 3% for goods, 6% for services and 8.5% for public works. Moreover, the word "final" was inserted to make it a "final value-added tax."²⁶⁶ This was to attain simplicity so that remittances will improve and to treat all government suppliers equally. Hence a single rate for withholding of "only 5 percent which is creditable because that's how VAT operates."²⁶⁷ The insertion of the word "final" means the tax is now a full payment of the tax payable on the transaction as opposed to it being creditable. The Supreme Court refrained from exploring the rationale for this provision except to say that "[i]t is clear that Congress intended to treat differently taxable transactions with the government."²⁶⁸ In any case, we can draw the following rules in this regard from the Consolidated Value-Added Tax Regulations of 2005:

264. See Bureau of Internal Revenue, Rev. Reg. No. 16-2005, Transitory Provisions (b); Effectivity Clause (Sep. 1, 2005).

265. *Id.* Transitory Provisions (c).

266. NIRC § 114(C) (1997), amended by R.A. No. 9337 § 12 (2005).

267. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 80 (Senate Version, Apr. 18, 2005) (statement of Sen. Ralph Recto) (the proposal came from Rep. Luis Villafuerte).*

268. *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita*, G.R. No. 168056, Sep. 1, 2005.

1. The 5% final value tax withheld shall represent the net value-added tax payable of the seller.
2. The balance or difference between the tax withheld and the regular value-added tax rate effectively accounts for the “standard input VAT” for sales of goods or services to [the] government or any of its political subdivisions, instrumentalities or agencies including GOCCs, in lieu of the actual input VAT directly attributable or ratably apportioned to such sales.
3. In the event that the actual input tax exceed the standard input VAT the excess shall form part of the sellers’ cost.
4. Conversely, if the actual input VAT is less than the standard input VAT, the difference must be treated as the income of the seller.²⁶⁹

In this regard, BIR has taken the position that creditable value-added taxes withheld by the government or government owned or controlled corporations can only be claimed when credited to a taxable year and within an accounting period spread over twelve months or four quarters. In the event of a belated claim, this cannot prosper *sans* an amendment of the applicable returns. This axiom was well illustrated in a recent VAT ruling involving Philippine Long Distance Telephone Company (PLDT) who belatedly received the Certificates of Creditable Tax Withheld at Source (BIR Form No. 2307) from its withholding agents which includes more than 800 government agencies nationwide, only after or subsequent to the filing dates of the required returns. As a result, in 2002 PLDT “failed to utilize at the appropriate time such withheld taxes, either as input taxes or withholding tax credits.”²⁷⁰ PLDT argued that the input taxes represented in these certificates may still be used as input tax credits thus:

1. The Tax Code does not provide a prescriptive period within which excess input VAT can be carried-over to the

269. See Bureau of Internal Revenue, Rev. Reg. No. 16-2005, § 4.114-2 (a), ¶ 2 (Sep. 1, 2005) (the VAT regulations refer to the difference between the tax withheld and the regular value-added tax as the “remaining five percent (5%)” which would no longer be correct should the value-added tax rate be increased to 12%).

270. VAT Ruling No. 022-04 (Sep. 13, 2004).

succeeding quarter or quarters, and therefore, the same may be carried-forward continuously. Section 110(B) of the Tax Code enables VAT-registered sellers to carry-over to the succeeding quarter or quarters the excess input VAT over the output VAT of the present quarters.

2. The excess income tax paid by the taxpayer prospectively may be carried forward indefinitely, pursuant to Section 76 of the Tax Code. Excess income taxes paid as shown in the taxpayers' final adjustment returns can be credited against the income tax liabilities of the succeeding taxable years.
3. Consistent with the tenets of justice and fairness, sellers-payees should be allowed to apply as tax credits, the taxes withheld and remitted to the BIR by the customers-payors, and should not be prejudiced, therefore, by the tardiness of the payors in submitting the BIR Forms No. 2317.
4. It is not administratively feasible for PLDT to amend previously filed returns to include creditable taxes covered by belatedly issued certificates of withheld taxes.²⁷¹

In rejecting PLDT's arguments the BIR ratiocinated as follows:

The withholding of taxes at source is a collection system that has been adopted in this jurisdiction in order to ensure that income and transactions during a taxable period or year are properly subjected to taxes. Hence, persons, whether juridical or natural, are mandated by law to act as withholding agents in the collection and remittance of said taxes to government at the designated time and place. Similarly, taxpayers have the legal obligation to pay the correct amount of taxes on their income and transactions during a taxable period or year, according to the provisions of law, rules and regulations.

The withholding tax system was devised for two main reasons: first, to provide the taxpayer a convenient manner to meet his probable income tax liability; and second, to ensure the collection of the income tax which could otherwise be lost or substantially reduced through failure to file the corresponding returns. To these, a third reason may be added: to improve the The Tax Code provides for a two-year prescriptive period for the claim of refunds or credits of taxes. In proper cases, the Commissioner shall grant a refund or issue the tax credit certificate for creditable input taxes for zero-rated or effectively zero-rated transactions, as well as capital goods, within one hundred

²⁷¹. *Id.*

twenty (120) days from the date of submission of complete documents in support of the application filed in accordance with Subsections (A) and (B) of Section 112 of the Tax Code. In this regard, the Tax Code provides a two-year prescription period within which such applications shall be made. (Section 112, Tax Code) Outside of these transactions, the Tax Code provides a general two-year prescriptive period for the taxpayer to file a written claim for the refund or credit of taxes erroneously or illegally received, as well as penalties imposed by the BIR without authority. A return that shows an overpayment shall be considered as a written claim for credit or refund. (Section 204, Tax Code).

As a means to ensure that taxpayers are correctly filing the amount of taxes due from them, the BIR is authorized to assess a taxpayer for deficiency taxes, within three (3) years, in general, from the last day for the filing of or from the date of the filing of the return according to the provisions of Section 203 of the Tax Code. Within this period of time, also, the taxpayer is required to preserve its books of accounts and other accounting records, the efficient management of which is best left for the taxpayer and its accounting, credit or finance department, at the very least, to undertake. To guide the taxpayers, however, the Secretary of Finance, upon the recommendation of the Commissioner of Internal Revenue, has issued and duly promulgated Revenue Regulations pursuant to Section 244 and 245 of the Tax Code, including Section 245(i) thereof, in order to implement the above-stated and cited tax provisions.

Good faith on the part of the taxpayer, in respect of its failure to timely receive its certificates of creditable withholding taxes from its income-payors and customers or clients who are designated withholding agents of government, is not an acceptable argument and is definitely not sufficient to justify its request. Taxes are paramount, and their efficient and timely collection, as much as their proper monitoring, are overriding considerations in the present case. The law, rules and regulations on the matter of withholding taxes and the obligations of the withholding agents are clearly set out and are already beyond quibbling at this time.²⁷²

Consequently, the BIR ruled against PLDT's claim for input tax credit as follows:

1. There cannot be a carry-over of withheld taxes that have not obviously been credited as yet in any given taxable year.

²⁷². *Id.* (emphasis supplied).

2. Withheld taxes, whether these are VAT or income taxes, can only be deducted from items of income or credited against output taxes, for the given and corresponding taxable period or year.
3. The taxpayer must file a written claim for refund or credit of taxes remitted by its withholding tax agents within the two-year prescription period provided in Section 204 of the Tax Code if it does not, in the alternative, amend its returns to reflect belatedly received certificates of creditable withheld taxes on unreported items of income, or of creditable input taxes that have not been deducted from output taxes in the case of VAT, during the taxable period or year involved, whichever case may be applicable.²⁷³

G. Cancellation of Value-Added Tax Registration

R.A. No. 9337 now provides that a VAT-registered person may cancel his registration for VAT if:

1. He makes written application and can demonstrate to the Commissioner's satisfaction that his gross sales or receipts for the following twelve (12) months, other than those that are exempt under Section 109(A) to (U) of the National Internal Revenue Code, will not exceed One million five hundred thousand pesos (P1,500,000), or
2. He has ceased to carry on his trade or business, and does not expect to recommence any trade or business within the next twelve (12) months.

The cancellation of registration will be effective from the first day of the following month.²⁷⁴

H. Persons Required to Register for Value-added Tax

Under R.A. No. 9337, the following persons are required to register for VAT:

(1) Any person who, in the course of trade or business, sells, barter or exchanges goods or properties, or engages in the sale or exchange of services, shall be liable to register for value-added tax if:

²⁷³. *Id.*

²⁷⁴. NIRC § 236(F)(2) (1997), amended by R. A. NO. 9337 § 19 (2005).

(a) His gross sales or receipts for the past twelve (12) months, other than those that are exempt under Section 109(A) to (U) under the National Internal Revenue Code, have exceeded One million five hundred thousand pesos (P1,500,000); or

(b) There are reasonable grounds to believe that his gross sales or receipts for the next twelve (12) months, other than those that are exempt under Section 109(A) to (U) of the National Internal Revenue Code, will exceed One million five hundred thousand pesos (P1,500,000).

(2) Every person who becomes liable to be registered as stated above shall register with the Revenue District Office which has jurisdiction over the head office or branch of that person, and shall pay the annual registration fee of Php500. If he fails to register, he shall be liable to pay the tax as if he were a VAT-registered person, *but without the benefit of input tax credits for the period in which he was not properly registered.*²⁷⁵

I. Optional Registration for Value-added Tax of Exempt Person

Any person who is not required to register for value-added tax may elect to register for value-added tax by registering with the Revenue District Office that has jurisdiction over the head office of that person, and paying the annual registration fee of Php500. Any person who elects to register when he is not required to do so shall not be entitled to cancel his registration for the next three (3) years.²⁷⁶

J. Only One TIN Number for Corporations

For purposes of the tax on corporations, any person who has registered value-added tax as a tax type shall be referred to as a “*VAT-registered person*” who shall be assigned only one Taxpayer Identification Number (TIN).²⁷⁷

275. *Id.* § 236(G) (1997), amended by R.A. NO. 9337 § 19 (2005) (*emphasis supplied*).

276. *Id.* § 236(H)(1) (1997), amended by R.A. NO. 9337 § 19 (2005).

277. *Id.* § 236(H)(2) (1997), amended by R.A. NO. 9337 § 19 (2005).

X. INCREMENTAL REVENUES

A. Incremental Revenues from Value-added Tax

The local government where the value-added tax is collected is entitled to 10% of the excess of the increase in collections for the immediate preceding year.²⁷⁸ Republic Act No. 9337 now imposes a restriction on the manner of disposition on half of the local government's share of value-added taxes. Thus, under the new law, 50% of the local government unit's share from the incremental revenue from the value-added tax shall be allocated and used exclusively for the following purposes:

1. Fifteen percent (15%) for public elementary and secondary education, to finance the construction of buildings, purchases of school furniture and in-service teacher trainings;
2. Ten percent (10%) for health insurance premiums of enrolled indigents as a counterpart contribution of the local government to sustain the universal coverage of the national health insurance program;

278. *Id.* § 283. The provision reads:

SEC. 283. *Disposition of National Internal Revenue.* — National internal revenue collected and not applied as hereinabove provided or otherwise specially disposed of by law shall accrue to the National Treasury and shall be available for the general purposes of the Government, with the exception of the amounts set apart by way of allotment as provided for under Republic Act No. 7160, otherwise known as the Local Government Code of 1991.

In addition to the internal revenue allotment as provided for in the preceding paragraph, fifty percent (50%) of the national taxes collected under Sections 106, 108 and 116 of this Code in excess of the increase in collections for the immediately preceding year shall be distributed as follows:

- (a) Twenty percent (20%) shall accrue to the city or municipality where such taxes are collected and shall be allocated in accordance with Section 150 of Republic Act No. 7160, otherwise known as the Local Government Code of 1991; and
- (b) Eighty percent (80%) shall accrue to the National Government.

3. Fifteen percent (15%) for environmental conservation to fully implement a comprehensive national reforestation program; and
4. Ten percent (10%) for agricultural modernization to finance the construction of farm-to-market roads and irrigation facilities.

Such allocations shall be segregated as separate trust funds by the national treasury and shall be over and above the annual appropriation for similar purposes.²⁷⁹

B. Funds Allocated for Public Information on VAT

Php15,000,000 shall be allocated for a Public Information and Education Program to be administered by the BIR, explaining clearly to businesses their registration, invoicing and reporting requirements under the value-added tax rules. Such program should include seminars and visits to taxpayers to familiarize them with the tax, and the development and publication of easy-to-read guides on the value-added tax.²⁸⁰

C. Incremental Revenues from the Excise Tax on Alcohol and Tobacco Products

The incremental revenue from the excise tax on alcohol and tobacco products starting January 2005 shall be allocated as follows:

(1) Two and a half percent (2.5%)... shall be remitted directly to the Philippine Health Insurance Corporation for the purpose of meeting and sustaining the goal of universal coverage of the National Health Insurance Program; and

(2) Two and a half percent (2.5%)... shall be credited to the account of the Department of Health and constituted as a trust fund for its disease prevention program.

Th[is] earmarking... shall be observed for five (5) years starting from January 2005.²⁸¹

279. *Id.* § 288(D) (1997), as amended by R.A. NO. 9337, § 21 (2005).

280. *Id.* § 288(E) (1997), as amended by R.A. NO. 9238 § 3 (2004) and as further amended by R.A. NO. 9337, § 21 (2005).

281. *Id.* § 288(C) (1997), as amended by R.A. NO. 9337, § 21 (2005).

XI. FRANCHISES OF DOMESTIC AIRLINES

R.A. No. 9337 has effectively amended the provisions of laws on the franchise tax of Philippine Airlines, Inc., Cebu Air, Inc., Aboitiz Air Transport Corporation, Pacific Airways Corporation, Air Philippines, and any other domestic airlines having a franchise agreement with the Government by providing that:

1. The franchise tax is abolished;
2. The franchisee shall be liable to the corporate income tax;
3. The franchisee shall register for value-added tax for value-added tax... on its sale of goods, property or services and its lease of property; and
4. The franchisee shall otherwise remain exempt from any taxes, duties, royalties, registration, license, and other fees and charges, as may be provided by their respective franchise agreement.²⁸²

XII. A TAXING SUMMATION

The Tax Reform Act of 1997 was drafted in the spirit of economic reform and liberalization prevailing at that time. It was for this reason that the current Tax Code lays down a State Policy²⁸³ that rests the nation's taxation on four stout macro-economic pillars, to wit:

1. The promotion of sustainable economic growth through the rationalization of the Philippine internal revenue tax system, including tax administration,
2. Equitable relief to the greater number of taxpayers in order to improve levels of disposable income and increase economic activity,

282. R.A. NO. 9337 § 22 (2005). The provisions of P.D. No. 1590 on the franchise tax of Philippine Airlines, Inc., R.A. No. 7151 on the franchise tax of Cebu Air, Inc., R.A. No. 7583 on the franchise tax of Aboitiz Air Transport Corporation, R.A. No. 7909 on the franchise tax of Pacific Airways Corporation, R.A. No. 8339 on the franchise tax of Air Philippines, or any other franchise agreement or law pertaining to a domestic airline to the contrary notwithstanding.

283. An Act Amending the National Internal Revenue Code, as Amended, and for Other Purposes, Republic Act No. 8424, § 2 (1997).

3. The creation of a robust environment for business to enable firms to compete better in the regional as well as the global market, and
4. The State ensures that Government is able to provide for the needs of those under its jurisdiction and care.

As such the Tax Reform Act of 1997 stands unique as compared to all other previous codifications of Philippine tax laws. No previous tax code made any statement as to a state policy, much less any declaration relating taxation to the economy.²⁸⁴

The proponents of R.A. No. 9337 can credibly insist that by addressing directly the debt and deficit cycle the law in a most straightforward manner deals with the nation's economic concerns. There is indeed much to say about the law's many good points, chief of which is that it maximizes the advantages of the value-added tax system. That the law made its entrance amidst so much resentment and contentiousness may be attributed to a climate of high fuel prices, bad business, increasing poverty and political turbulence. We might even say that it is a good law at a bad time.

Reading through the Bicameral Conference Committee hearings and the Senate deliberations one can see that the law went through a road paved with good intentions. The primary and overriding intention was to raise revenues to meet debt payments egged on by a belief that there was a need for urgent action. The pleasure of the financial markets²⁸⁵

284. See NIRC OF 1993; NIRC OF 1977, P.D. NO. 1158 (1977); Commonwealth Act No. 466 (1939); & INTERNAL REVENUE CODE OF 1904, Act No. 1189 (1904).

285. See *Supreme Court ruling on EVAT boost share prices*, THE PHILIPPINE STAR, Sep. 3, 2005, at B-2 (reporting that share prices got a "boost" from the Supreme Court's decision affirming the constitutionality of the E-VAT Law in the case of *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita*, G.R. No. 168056, Sep. 1, 2005)); Reuters, *Court's VAT ruling lifts peso, sovereign bonds*, BUSINESS WORLD, Oct. 19, 2005, at S2/1 (reporting on strengthening of the Philippine peso and sovereign bonds after the Supreme Court subsequently dismissed the motion for reconsideration with finality in the case of *Abakada Guro Party List (Formerly AASJAS) Officers v. Executive Secretary Ermita*, G.R. No. 168056, Sep. 1, 2005).

and our foreign creditors²⁸⁶ with the E-VAT Law is evident. In contrast, foreign bankers and rating agencies are clear in their disapproval of any legislative, executive, or judicial obstacle to the passage or implementation of the E-VAT Law.²⁸⁷ The watchful eye of our foreign creditors on the E-VAT Law could also be a result of the perception that the Executive Branch has promoted the law as the centerpiece of its fiscal reform program.²⁸⁸ Indeed, the law's constitutionality and successful implementation is closely linked with the ability to access

286. See *Merrill Lynch upgrades RP dollar bonds to 'overweight,'* MANILA BULLETIN, Sep. 4, 2005, at B-1 (reporting that "Merrill Lynch upgraded its recommendation on Philippine sovereign dollar bonds to "overweight" from "market weight" after the country's top court ruled an expansion of a value-added (VAT) was legal").

287. See Paolo Romero, *'Investors won't welcome suspension' of EVA,* THE PHILIPPINE STAR, Sep. 22, 2005, at 12 (reporting that Singapore based DBS Group, Southeast Asia's largest bank, warned "that the international financial community would react negatively to any move to suspend the implementation of the expanded value-added tax (EVAT) on power and oil by the Philippine government."). See also Mike Moran, *"Philippines: Moodys delivers a harsh verdict,"* AME INFO, Feb. 20, 2005, at <http://www.ameinfo.com/54259.html> (last accessed Dec. 1, 2005) (earlier in February 2005, prior to the passage of the VAT law, the Philippines was downgraded two notches by Moodys when the E-Vat Law proposals were encountering heavy opposition in Congress); Nikkin L. Beronilla, *"Can GMA Hang on There Until 2010?,"* INSTITUTE FOR POPULAR DEMOCRACY, July 19, 2005, at <http://www.ipd.ph/features/2005/GMAHang.html> (last accessed Dec. 1, 2005) ("More than a week after the freezing of e-VAT, the three international credit rating agencies (Moody's, S&P and Fitch) delivered a credit rating downgrade. This sounds harmless but a downgrade raises the interest rate on new money that the government has to borrow.").

288. Karen L. Lema & Lema F. Salvosa, *Gov't warned full VAT implementation crucial,* BUSINESS WORLD, Oct. 14-15, 2005, at S1/1 (Quoting from World Bank's country director for the Philippines, Joachim von Amsberg who warned that backing out from full implementation of the E-VAT Law would be "bad for the country's image." It was also reported that the International Monetary Fund (IMF) was "disheartened by the VAT's law's prospects," and IMF's "resident representative Reza Baqir said fund directors fear the delay in the VAT's implementation might jeopardize the country's growth prospects and the government's medium-term fiscal goals.").

more foreign credit.²⁸⁹ But this brings up the question of why a law designed as a response to public debt is an incentive to foreign bankers to lend more thereby increasing public debt. In fact how effective the law can be in addressing the debt issue has been raised on the basis of doubts on its revenue projections.²⁹⁰ Also obvious alternatives, such as the repeal of the “Poison Pill Provision” fixing the excise tax classification of cigarettes based on the average net retail price in October 1, 1996, does not appear to have been considered at all.²⁹¹ The

289. See Jeffrey O. Valisno & Paul C. H. How, *More World Bank funds linked to VAT*, BUSINESS WORLD, Sep. 15, 2005, at S-1. (The World Bank “pledged to provide as much as US\$1.8 billion in loans to the Philippines over the next three years if the Arroyo administration succeeds in implementing the expanded value-added tax (VAT) law.” This is a significant increase in lending which is at US\$120-150 million annually at the time of the news report.).

290. See SENATE JOURNAL 180-82, 13th Cong., 1st Reg. Sess., Senate Sess. No. 83 (May 10, 2005) (comments of Sen. Alfredo Lim expressing concern that the computation on revenue impact is wrong *citing* experts like former Finance Secretaries Camacho, Vicente Jaime, Jesus Estanislao, Ernesto Leung, Roberto Ocampo and also *citing* a column of economist Solita Collas-Monsod entitled “*Adding Insult to Injury*,” reproduced in full and read into the record of the Senate.).

See also SENATE JOURNAL 58-60, 13th Cong., 1st Reg. Sess., Senate Sess. No. 75 (Apr. 13, 2005) (comments of Senator Alfredo Lim *citing* a column of economist Solita Collas-Monsod entitled “*Not Quite Fit the Bill*” and which were reproduced in full in the records of the session of Apr. 13, 2005 as cited). (During the voting of the bill, both articles of economist Solita Collas-Monsod, namely “*Adding Insult to Injury*” and “*Not Quite Fit the Bill*” as well as a document entitled “*Revenue Impact of the Proposed Tax Rate Schedule*” was formally placed in the record of the Senate by Sen. Alfredo Lim as he was explaining his vote (SENATE JOURNAL 190, 13th Cong., 1st Reg. Sess., Senate Sess. No. 83 (May 10, 2005)).

291. See SENATE JOURNAL 60, 13th Cong., 1st Reg. Sess., Senate Sess. No. 75 (Apr. 13, 2005). Sen. Alfredo Lim proposed the repeal or amendment of the provision on excise taxes on cigarettes under the code as amended by the sin tax laws *citing* the economist Solita Collas-Monsod he noted that the government can collect 22 to 30 billion pesos by the simple repeal or amendment of this provision. The provision, referred to as the “Poison Pill,” reads:

The classification of each brand of cigarettes based in its average net retail price as of October 1, 1996, as set forth in

irony to this debate is the existence of a study that the E-VAT Law may not be needed after all to rein in the deficit.²⁹² While our debts are indeed overwhelming and revenues must be raised to meet the nation's financial needs, a law must still find its appeal in reason.

Speaking of finance minister half a globe away, an economist remarked that what the man "understood is that the key is to improve the climate for doing business" and that running the economy is not all about tax collection or simply setting monetary policy.²⁹³ It would

Annex 'D', including the classification of brands for the same products which, although not set forth in said Annex 'D', were registered and were being commercially produced and marketed on or after October 1, 1996, and which continue to be commercially produced and marketed after the effectivity of this Act, shall remain in force until revised by Congress (NIRC, § 145(C)(4) ¶ 10, as amended by R.A. No. 9334 (2004)).

See also SENATE JOURNAL 182, 190, 13th Cong., 1st Reg. Sess., Senate Sess. No. 83 (May 10, 2005). Sen. Alfredo Lim, in explaining his "no" vote to R.A. No. 9337, reiterated his call for the repeal or amendment of the Poison Pill provision declaring, "I may sound [like] a broken record or may even be chastised for being *makulit* or persistent in insisting on my proposal to repeal, in not amend... the infamous "poison pill provision" So be it!" (*Id.* at 190).

292. Donnabelle Gatdula, *RP doesn't need' EVAT to rein in deficit – NY research firm*, THE PHILIPPINE STAR, Aug. 22, 2005, at B-1 (citing a recent study by the New York based research firm Bears Stearns & Co. Inc. of emerging markets which said it expects the Philippine government to meet its budget deficit target without the revenues from the E-VAT Law and that the improving fiscal performance may lead investors to reconsider their views on the E-VAT Law; cited in Lawrence Agcaoili, *Bear Stearns sees lower deficit even without VAT*, MANILA STANDARD ONLINE, July 8, 2005, at http://www.manilastandardtoday.com/?page=business03_july08_2005 (last accessed Dec. 1, 2005) (reporting that "New York-based investment bank Bear, Stearns & Co. Inc. is optimistic the administration of President Gloria Macapagal Arroyo will manage to reduce the budget gap to P150 billion this year even without the implementation of the controversial expanded value-added tax (E-VAT) law").

293. Mac Margolis, *Saving Grace*, NEWSWEEK INTERNATIONAL EDITION, July 4, 2005, at 38, available at <http://msnbc.msn.com/id/8359068/site/newsweek> (last accessed Dec. 1, 2005) (Princeton University economist Jose Alexandre Scheinkman speaking of Brazil's Finance Minister Antonio Palocci). (A few months later, in a mirror of events in the Philippines, Brazil finds itself in the midst of a political turmoil on alleged vote buying of politicians by the

appear that this finance minister has introduced into his country what we already knew in 1997 but have forgotten eight years later with the passage of R.A. No. 9337. This is the axiom that taxation is an essential tool for stimulating the economy and that there is more to taxation than just raising revenues to meet expenses. The E-VAT Law's focus on debt servicing may have clouded the objectives for a sustainable and robust economy. Likewise, the arguments that the effects of an increase in the value-added tax will be "minimal" on the poor because they consume less may sound callous to many and is inconsonant with the current tax code's objective of equitable relief to the greatest number of taxpayers. These and other questions are matters of legislative wisdom that the Supreme Court will not answer but they will always weigh against the law.

A cap on input VAT does target businesses with marginal profits, when on the contrary these are the businesses that an economy may actually prefer to nurture. Also, with the full implementation of the 70% cap, it will no longer be possible for vendors to render assistance to certain types of buyers by selling goods at cost, such as the sale of school books to students. Consider further the fact that socially sensitive products have thin profit margins as these are customarily traded in large volumes. Therefore, the cap on input tax credit can cause an increase in the prices of processed food products, clothing, and other similar mass consumer goods on top of the increases that will arise from the value-added tax on power and petroleum.

Some relief is provided by the newly issued VAT regulations restricting the 70% credit cap to cases where the input tax, inclusive of the input tax from the previous quarter, exceeds the output tax of a given quarter. The regulation thus extends full credit for the input tax

ruling party. Inevitably, a comparison with the Philippines is made. Despite the political scandal and the fact that it is the biggest debtor among developing nation, the Brazilian economy continues to enjoy investor confidence and is paying less interest on its debts. While the Philippines has a higher economic growth rate, there is a reportedly better rate of foreign investment inflows to Brazil. This has been attributed to Brazil's fiscal austerity which has resulted in what was aptly called a "responsibility dividend." (William Pesek Jr., *Some Brazilian Pointers for the Philippines*, BLOOMBERG.COM, Sep. 22, 2005, at http://www.bloomberg.com/apps/news?pid=10000039&sid=aw5gKW_3spBs&refer=columnist_pesek (last accessed Dec. 1, 2005)).

whenever the output tax exceeds the input tax for the quarter.²⁹⁴ This appears to be a tacit admission of the adverse impact of the cap. Moreover, this perplexing regulatory interpretation of the 70% input tax cap only exposes its weak logical and mathematical underpinnings. The mitigating restriction on the cap will now mean that businesses that are in the red will have to pay a minimum output tax of 30%, which translates to a 3% tax on gross in addition to the minimum corporate tax of 2% of gross income.²⁹⁵ Meanwhile, businesses that are relatively profitable with output taxes exceeding input taxes by less than 30% will pay proportionately less.

On the other hand, the relief is also illusory. A taxpayer with margins consistently less than 30% will only have to have one losing quarter to be perennially subject to the minimum 30% output tax. This is because once the input tax is in excess of output tax in one quarter, the input tax equivalent to at least 30% of the quarter's total output tax will be carried over to the next quarter to be included in the computation of that quarter and from there to the succeeding quarters, and the mitigating restriction will quickly be negated by the rapid build up of the input tax credits. A curious facet of the 70% credit cap is that the two senators who on record proposed and refined the amendment voted against the passage of the E-VAT Law. The fact that the initial proposal of a minimum 1% of gross on a 90% input tax credit cap was made "in behalf of" the proposing senator by another senator gives this amendment a rather interesting color. This is flavored by the rhetorical question "why not 3%?" which brought the input tax credit cap to its current 70%.²⁹⁶

294. Bureau of Internal Revenue, Rev. Reg. No. 16-2005, § 4-110-7 (Sep. 1, 2005).

295. NIRC §§ 27(E) & 28(A)(2) (1997).

296. The original cap of 90%, effectively a 10% cap or a 1% payable on gross sales/receipts, was proposed "in behalf of" Sen. Maria Ana Consuelo "Jamby" Abad Santos Madrigal by Sen. Ralph Recto. (SENATE JOURNAL 67-69, 13th Cong., 1st Reg. Sess., Senate Sess. No. 75 (Apr. 13, 2005).). She eventually voted against the passage of R.A. No. 9337, declaring that the E-VAT Law will kill the golden goose that lays the golden eggs. (See SENATE JOURNAL 187, 193-197, 13th Cong., 1st Reg. Sess., Senate Sess. No. 83 (May 10, 2005). Sen. Juan Ponce Enrile, on the other hand, proposed that the cap be decreased to 70%. When the proposed 1% on gross as the minimum payable was discussed with a suggestion to raise it to 2%, he queried: "Why do you

On another vein, the five year spread on depreciation on input taxes on capital equipment can only discourage investment in a country where capital investments is badly needed. This was pointed out to the Bicameral Conference Committee by one of the administration's staunchest advocate for the expanded value-added tax amendments.²⁹⁷ Raising corporate taxes in conjunction with an expansion of a value-added tax system is a contradiction of systems with two different objectives. The value-added tax being a simplified tax system based on gross while the corporate tax is on net profits. This is not to mention that at 35% the Philippines will be having the highest corporate income tax in the region, a fact that the legislature was well aware of.²⁹⁸

As regards the value-added tax on professionals, putting doctors and lawyers within the value-added tax system so soon after they have just been removed from it does not speak well of a stable legal system. Targeting the medical profession in particular with so many doctors

suggest 2 percent? Why not 3 percent to make it in *pari passu* with the existing rates for non-VAT entities?" (*Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 61 (Senate Version, Apr. 18, 2005).*). Sen. Enrile voted against the passage of R.A. No. 9337 alleging that his other proposals were, by and large, not adopted in the measure. (See SENATE JOURNAL 187-88, 13th Cong., 1st Reg. Sess., Senate Sess. No. 83 (May 10, 2005)).

297. *Bicameral Conference Committee on the Disagreeing Provisions of S.B. No. 1950 and H.B. Nos. 3705 and 3555 "Value-Added Tax," Before the S. Comm. on Ways and Means and the H. Comm. on Ways and Means, 13th Cong., 1st Reg. Sess. 19 (Senate Version, Apr. 25, 2005)* (then Sec. Cesar Purisima of the Department of Finance commented that he would not propose the provision spreading the crediting of input tax on capital equipment to five years as it is a disincentive to investments).

298. Sen. Recto observed that the Philippines' corporate income tax rate at 32% is already among the highest in Asia comparing the Philippines to the following countries: India, 35%; Vietnam, 32%; Australia, 30%; China, 30%; Indonesia, 30%; Japan, 30%; Thailand, 30%; Malaysia, 28%; Cambodia, 20%; and Hong Kong, 17.5%. (SENATE JOURNAL 817-18, 13th Cong., 1st Reg. Sess., Senate Sess. No. 72 (Mar. 16, 2005)).

leaving our shores to become nurses²⁹⁹ does not seem to be in the exercise of legislative wisdom or executive prudence. Most of our lawyers, auditors, doctors have the ability to enter into a mid-level position abroad and procure an income, the intellectual stimulation and a quality of life that is superior to that enjoyed in a high ranking position in the Philippines. The Philippines competes with the rest of the world for our professionals and we may just be taxing the Filipino professional out of existence. Furthermore, a professional whether they be lawyers, doctors, auditors or even entertainers have almost no input taxes and a professional fee is almost 100% value added. We should also consider that the inelastic nature of professional fees does not automatically allow the value-added tax to be passed on to clients. Hence, subjecting a professional's income to a value-added tax on its gross income and later on a tax on its net income is effectively double taxation. More importantly, the value-added tax system was introduced into the Philippines to replace several types of taxes on businesses.³⁰⁰ As such, the value-added tax is primarily a tax on consumption on transactions arising from the conduct of trade or business.³⁰¹ In contrast, the practice of a profession is neither a trade nor a business, nor can one say that one "consumes" a professional's services. A professional's fees are his wages and wages are not subject to value-added taxes.³⁰²

Finally, our lawmakers deigned to put art, literature, and music within the ambit of the value-added tax.³⁰³ A nation finds its soul in its art and culture. But are we to tax even our souls? Indeed, this is a pound of flesh for our bankers.

299. See Sheila Crisostomo, *WHO: RP must address exodus of health professionals*, THE PHILIPPINE STAR, September 20, 2005, at 8 (The World Health Organization recently confirmed "that while the exodus of medical professionals from the Philippines has always long been a problem, the rate at which they are leaving the country seems to have accelerated.").

300. See *Kapatiran ng mga Naglilingkod sa Pamahalaan ng Pilipinas, Inc. v. Bienvenido Tan*, 163 SCRA 371, 378 (1988) ("The VAT is said to have eliminated privilege taxes, multiple rated sales tax on manufacturers and producers, advance sales tax, and compensating tax on importations.").

301. See NIRC § 105 (1997).

302. See *Id.* § 105(I) (1997), *renumbered by* R.A. No. 9337 § 7 (2005).

303. *Id.* § 109(1) (1997), *amended by* R.A. No. 9337 § 7 (2005) *deletes* § 109(n) of the NIRC immediately prior to the amendment.

However, despite these provisions, we cannot conclude that R.A. No. 9337 is per se “wrong,” but the context in which the law was enacted may have glossed over the correlation of an unwieldy tax system vis-à-vis the extensive underground economy.

In an attempt to define the informal economy, an economist has described it as one that “includes unreported income from the production of legal goods and services, either from monetary or barter transactions – hence all economic activities which would generally be taxable were they reported to the state [tax] authorities.”³⁰⁴ It was then observed that “[i]n almost all studies it has been found out, that the increase of the tax and social security burdens is one of the main causes for the increase of the informal economy.”³⁰⁵ The consequence of which is that “[a]n increase in the informal economy leads to reduced state revenues which in turn reduces the quality and quantity of publicly provided goods and services.”³⁰⁶

This view was confirmed in the World Bank Development Report for 2005 where it was explained that when it is costly to comply with regulations, enterprises will have an incentive to evade these costs through informality, that is, by burrowing into the underground economy. In which case, “[t]he answer is not simply to apply greater efforts to enforce all existing regulations.” Regulations must be well considered otherwise it “may just put a disproportionate burden on poor entrepreneurs in the informal economy and lead to perverse results.”³⁰⁷ Consequently,

304. Friedrich Schneider, *Size and Measurement of the Informal Economy in 110 Countries Around the World*, at 3, July 3, 2002, available at http://rru.worldbank.org/Documents/PapersLinks/informal_economy.pdf (last accessed Dec. 1, 2005). Schneider admits however that “[i]n general, a precise definition *Seems* quite difficult, if not impossible as the informal economy develops all the time according to the ‘principle of running water’: it adjust to changes in taxes, to sanctions from tax authorities and to general moral attitudes, etc.”

305. *Id.* at 25.

306. *Id.* at 32.

307. WORLD BANK, *WORLD DEVELOPMENT REPORT 2005: A BETTER INVESTMENT CLIMATE FOR EVERYONE* 100, at http://siteresources.worldbank.org/INTWDR2005/Resources/07_WDR_Ch05.pdf (last accessed Dec. 1, 2005). (The url refers to Chapter 5 entitled

[c]rafting better tax policies for the investment climate requires governments to recognize the tradeoffs between efficiency, equity, and *pragmatic implementation* concerns, and the impact of tax policies have on the incentives of firms to invest productively, create jobs and so contribute to a growing tax base over time. *A first step is to ensure the tax burden is no higher than necessary, including by keeping the size of the state in check and striving for more efficiency in public spending.*³⁰⁸

A “more nuanced approach” has been advised in addressing the underground economy. While vigorous enforcement action against large companies has been cited as an option, other alternatives should be considered. Primarily, the simplification of tax structures and administration and reducing impediments to joining the formal economy was suggested, especially in countries “where administrative capacity is limited or control of corruption is weak.”³⁰⁹ Stating the obvious, the World Bank report noted that red tape and corruption in tax administration can “weaken the incentives to comply with taxes and contribute to leakages.”³¹⁰ The report also warns that “small firms may not be viable if they have to comply with all taxes and regulations” and “[f]orcing them to comply might simply result in them closing down, with adverse impact on poverty.”³¹¹ Finally, there is some food for thought in the caution against adopting solutions that have been successful in other countries as a “universal salve.”³¹²

The latest World Bank comparative study of the climate for doing business in 155 economies ranks the Philippines at 113, which places

“Regulation and Taxation.” The main page of the report is at <http://web.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTWDRS/EXTWDR2005/0,,menuPK:477681~pagePK:64167702~piPK:64167676~theSitePK:477665,00.html> (last accessed Dec. 1, 2005) for the 2005 report itself, and an index for World Development Reports in general can be found in its main page at <http://web.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTWDRS/0,,contentMDK:20227703~pagePK:478093~piPK:477627~theSitePK:477366,00.html> (last accessed Dec. 1, 2005).

308. *Id.* at 109-10 (*emphasis supplied*).

309. *See Id.* at 110.

310. *Id.* at 109.

311. *Id.* at 110.

312. *Id.* at 111.

the country near the bottom of the list. The report notes that a medium sized Philippine business has to make 62 tax payments in a year which translates to 46.4% of its gross profits.³¹³ This compares poorly with the

313. *World Bank, Doing Business in 2006: Creating Jobs*, at <http://www.doingbusiness.org/ExploreEconomies/Default.aspx?economid=153> (last accessed Dec. 1, 2005) (also reported in Jeffrey O. Valisno, *Businesses in RP pay the most number of taxes*, BUSINESS WORLD, Sep. 15, 2005, at S1/1). The World Bank report makes several common assumptions about the business to make the data comparable across countries, these are:

1. Is a limited liability, taxable company. If there is more than one type of limited liability company in the country, the most popular limited liability form among domestic firms is chosen. Information on the most popular form is obtained from incorporation lawyers or the statistical office.
2. Started operations on January 1, 2003. At that time the company purchased all the assets shown in its balance sheet and hired all its workers.
3. Operates in the country's most populous city.
4. Is 100% domestically owned and has 5 owners, all of whom are natural persons.
5. Has a start-up capital of 102 times income per capita at the end of 2003.
6. Performs general industrial or commercial activities. Specifically, it produces ceramic flowerpots and sells them at retail. It does not participate in foreign trade (no import or export) and does not handle products subject to a special tax regime, for example, liquor or tobacco.
7. Owns 2 plots of land, 1 building, machinery, office equipment, computers and 1 truck and leases another truck.
8. Does not qualify for investment incentives or any special benefits apart from those related to the age or size of the company.
9. Has 60 employees -- 4 managers, 8 assistants and 48 workers. All are nationals, and one of the managers is also an owner.
10. Has a turnover of 1,050 times income per capita.
11. Makes a loss in the first year of operation.

average for the East Asia and Pacific region of 28 tax payments in a year comprising 31.2% of gross profit.³¹⁴ In addition, heavy surcharges of 25% which automatically accrue upon non-payment plus a usurious interest rate of 20% per annum,³¹⁵ in addition to criminal liability³¹⁶ prevents an erring taxpayer from making amends and the higher corporate taxes prescribed by R.A. No. 9337 will only create more resistance.³¹⁷ The estimate of our informal sector by the World Bank at 43.4% of the gross national income (GNI)³¹⁸ should not come as a

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12. Distributes 50% of its profits as dividends to the owners at the end of the second year.
 13. Sells one of its plots of land at a profit during the second year.
 14. Is subject to a series of detailed assumptions on expenses and transactions to further standardize the case.

On taxes the common assumption is “the total number of taxes paid and withheld, the method of payment or withholding, the frequency of payment or withholding and the number of agencies involved for this standardized case during the second year of operation. It takes into account electronic filing. Where electronic filing is allowed, the tax is counted as paid once a year even if the payment is more frequent.” On the other hand, “[t]he taxes withheld but not paid by the company are not included. Payable taxes are presented as a share of gross profit (defined as sales minus cost of goods sold and labor costs)” (See <http://www.doingbusiness.org/Methodology/PayingTaxes.aspx> (last accessed Dec. 1, 2005)).

³¹⁴

<http://www.doingbusiness.org/ExploreTopics/PayingTaxes/CompareAll.aspx> (last accessed Dec. 1, 2005).

³¹⁵ NIRC § 248, 249 (1997).

³¹⁶ *Id.* § 253 - 257 (1997).

³¹⁷ *Id.* §§ 27(A)1, 28(A)(1) & 28(B)(1) (1997), amended by R.A. No. 9337 §§ 1 & 2 (2005) respectively.

³¹⁸

<http://www.doingbusiness.org/ExploreEconomies/Default.aspx?economyid=153> (last accessed Dec. 1, 2005) (from a World Bank report entitled: “DOING BUSINESS IN 2006: CREATING JOBS,” at <http://www.doingbusiness.org/> (last accessed Dec. 1, 2005)). The World Bank measured output in the informal economy as a share of gross national income *citing* as a source for its figures on the informal economy the paper by the economist Friedrich Schneider earlier cited in this Article in note 304. (Friedrich Schneider, Size

surprise except perhaps that some may surmise that the percentage may actually be larger. This estimate has since been updated to 45.6% of GDP.³¹⁹

We need to take a fresh look into our taxation system. A country with a large underground economy can indeed benefit from a simplified value-added tax system. But this must come hand in hand with reforms to make our tax laws friendlier to compliance. While it is true that a good tracking system and an iron hand enforcement may help capture a number of tax evaders, it may also drive an informal economy even deeper underground and result in capital flight. The witch hunt against the productive wealth generating members of our society can leave us an economy suffering from diminished consumption for new homes and other purchases and an economic landscape strewn with businesses closed by ruinous penalties and an *intelligentsia* drained of its professional talents. We may call this a necessary cleansing of the culture of tax evasion and bid those who leave good riddance, but this may be too heavy a cost for our fragile economy to bear.

In the meantime, the current tax regime punishes those who comply with higher taxes and more stringent tax audits from the tax authorities. The tax bureaucracy is such that businesses complain that the more they report the more they are audited and penalized. The legislators crafted R.A. No. 9337 on the premise that it is easier to collect taxes from the compliant large corporate tax payers. Where both legislative initiative and executive implementation tolls those who comply and pay the most, inequity and market distortions are created to the detriment of the economy. More importantly, striking against those who comply is inconsistent with the avowed objective of expanding the tax base. It works against the credibility of a tax system

and Measurement of the Informal Economy in 110 Countries Around the World (July 2002, http://rru.worldbank.org/Documents/PapersLinks/informal_economy.pdf (last accessed Dec. 1, 2005)).

319. Friedrich Schneider, The Size of the Shadow Economies of 145 Countries all over the World: First Results over the Period 1999 to 2003, at 17 (December 2004), *at* http://www.iza.org/index_html?lang=en&mainframe=http%3A//www.iza.org/iza/en/webcontent/personnel/photos/index_html%3Fkey%3D206&topSelect=personnel&subSelect=fellows (last accessed Dec. 1, 2005). (The latest estimate is for the period 2002-03.).

and the tax collector. It also strikes fear among those in the underground economy and prevents them from surfacing. If the goal is to collect from the large and compliant taxpayers then let us leave the tax system alone and let it go on as before, but if we truly desire to expand the tax base and create a new attitude for tax compliance, then it is time to approach the matter from a different angle.

In a serious pursuit of the underground economy, one must allow it to surface intact and free from fear of ruinous penalties. Let it come forward, allow it to spend and invest and increase economic activity for the greater benefit of all. To do this the reasons for tax evasion and the corruption and extortion that goads and compels it must be minimized. A radical reduction of both corporate and individual income taxes, the elimination of instances of double taxation and a tax amnesty for both private citizens and corporations and public officials are measures that can coax out the underground economy. In addition, incentives for new investments patterned after those granted to economic zone enterprises and incentives for investment in real estate and publicly listed companies may be considered for wealth that has surfaced from amnesty programs in order to maximize their potential. Simultaneous with this, a reliable value-added tax tracking system, even with a higher rate will not only be acceptable but may even be welcomed. Expanding the tax base is akin to selling any product or service, to introduce it to a highly resistant market one must offer market friendly inducements.

The points raised in this summation are not a novelty to the Executive Branch, and the Administration should not be bashful with its own proposed revenue measures towards this direction.³²⁰ The

320. The Administration of Pres. Gloria Macapagal Arroyo has a six year development plan with a menu of recommended revenue measures that includes a general amnesty program where a taxpayer may pay 3% of net worth to avail of a tax amnesty, gross income taxation for corporations and self-employed individuals of 10% to 15%, and even an antidote against the Poison Pill Provision by proposing the indexation of excise taxes on alcohol and tobacco to their real value since 1997. All of these are part of an overall strategy of restoring fiscal strength by means of both cost-cutting and revenue measures via legislative and executive action. (The six year development plan is entitled Medium-Term Philippine Development Plan, 2004-2010 (See <http://www.neda.gov.ph/ads/mtpdp/MTPDP2004-2010/PDF/MTPDP2004-2010.html> (last accessed Dec. 1, 2005)). Chapter 7 of the plan entitled "Fiscal Strength" contains the strategy to address the fiscal problem of the government (See

taxpayer-friendly features of such proposals can be expanded and improved, and a spirited advocacy of these measures through the Legislature would do well to restrain some of the contentiousness against the E-VAT Law. Indeed, such measures should have been done as a package with the E-VAT Law. The E-VAT Law cannot stand in isolation of all other revenue measures, just as the reduction of debt cannot by itself be deemed an exercise of fiscal responsibility.

There is a need to review this overpowering fixation on the ratings of our foreign creditors and to convince instead our own countrymen to invest both taxes and equity into our system. In the same manner, greater determination and sincerity must be applied to increase integrity and to diminish prodigality in government spending. A government that can not be held accountable for its expenditures can not inspire its citizenry to be held accountable for the wealth that they have earned by honest toil. Only through a renewed confidence in our own government and economy emanating from our own people can we create a better environment for investments and the employment that it will generate. So many measures and still no treasure, perhaps it is time for a new approach for a sustainable and robust economy, this time in the service of our nation.