THE PHILIPPINE VALUE ADDED TAX SYSTEM*

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INTRODUCTION

Effective January 1, 1988, the Philippines adopted the value added tax (VAT) system.[1] The VAT is found in Title IV of the National Internal Revenue Code of 1977 as amended (NIRC). This article is an exposition of the basic features of said system and some of the problems that arose out of its implementation.

I. VAT CONCEPTS

A. Definition/Nature of the VAT

VAT is an indirect tax, since it is levied directly on the goods and services supplied to a person. It differs from the so-called direct taxes such as income tax which is imposed directly on persons. Theoretically, VAT is a tax on the value added to goods or services by each separate processor in the production and distribution chain. Actually, and functionally, it is a tax on the increase in the sales price of the goods or services as they pass through that chain. But ultimately, it is a tax on consumption - on the amount spent for the product by the final consumer since it is he who eventually bears the burden of the tax, even though the actual payor of the tax to the government is the manufacturer, processor or distributor.[2]

At its simplest, each processor collects a tax on his sales of goods or services, deducts from the taxes he has collected the amount of taxes he has paid, and remits the difference to the government. If he pays more tax than

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* *The Opinions expressed herein are soley those of the author, and not of the firm he represents.*

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[1] Executive Order 273 (hereinafter referred to as EO 273), July 25, 1987.

[2] AICPA, Value-Added Tax (1975), 2.

he collects, he receives a refund.

VAT may also be defined as a turn-over tax that applies to every sale from the beginning of the production and distribution process up to the ultimate consumer. It has also been defined as a tax on the consumption of goods and services which is proportionate to the price paid by the final consumer of these goods and services.

VAT has also been considered as a tax on transaction. It arises from the performance of a VAT-taxable activity regardless of whether or not the person liable to VAT has realized any gain or profit.[3]

The advantages and disadvantages of a VAT system have been the subject of many discussions that there is no need to review them. Suffice it to say that the EEC countries have adopted VAT and countries in the Asia-Pacific Region are moving towards VAT or a similar system.[4]

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[3] Bureau of Internal Revenue Ruling (hereinafter referred to as BIR Ruling) 592-88, December 19, 1988.

[4] AICPA, *Ibid.*, at 12; The proponents of VAT frequently see its adoption as a means of raising the billions needed by the federal government to finance growing budget deficits and the growing demands of state and local jurisdictions. They note its rapid spread in Europe and believe that it will create a better balance in our tax system citing the following main advantages of VAT:

* Large potential for revenue;
* More stable revenues;
* Neutral in application;
* Encouragement of efficient resource allocation;
* Encouragement of saving;
* Ease of administration;
* Incentive for exports and,
* Contribution to a proper tax mix

The opponents of a federal VAT believe our present tax system works remarkably well and believe it to be capable of raising the needed billions in revenue if loopholes were closed, inequities removed, and the base broadened. They see no need to emulate the European in tax policy, and as Stanley Surrey has stated, "After all, the American Revolution was fought in part to win the right to determine our own tax system." The major deficiencies in the VAT emphasized by its opponents are as follows:

* Too large a revenue potential;
* Lack of counter-cyclical balance;
* Inequitable to new or marginal enterprises;

(continued...)

B. Basic Features of the Philippine VAT System

The basic features of the Philippine VAT System are as follows:

1. The VAT applies to every importation, sale, barter, or exchange of goods and services. This is in contrast with the old system where a manufacturer's sales tax (MST) was generally imposed only on the original sale. Subsequent sales by a person, other than the original seller, were taxed at 1-1/2% of gross selling price without any credit for the MST;

2. The invoice or credit method of determining VAT liability is used. There are three generally recognized methods of determining VAT liability. These are the: (1) invoice or credit method; (2) subtraction method; and (3) addition method.

The invoice or credit method is generally employed by the EEC countries and other countries that have adopted VAT. The other two methods are cumbersome and not nearly or readily subject to administrative supervision and control as the invoice method.

Under the invoice method, the taxpayer multiplies all taxable sales by the applicable VAT rate. From that amount, the taxpayer credits the total VAT paid on purchases of goods and services during the same period and remits the net amount to the Government. The amount of deductible tax paid on purchases would include the full amount of the VAT paid on purchases of capital assets if a consumption type of VAT is adopted.

Under the subtraction method, the taxpayer subtracts from the sum of all taxable sales, the total of purchased goods and services on which he paid VAT and multiplies the result by the applicable VAT. With a consumption type of VAT, the deduction for purchases would include any capital goods.

Under the addition method, the taxpayer adds together all the components that reflect the value added (on which he has not paid VAT) such as wages, rent, interests, and net profit, adjusts these for non-taxable receipts otherwise included in profit, capital purchases and changes in

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[4](...continued)

* Hidden from taxpayers;
* Inflationary effect on prices;
* Difficulties of administration;
* No incentive for exports, and
* Brings regression into the tax mix.

inventory and then applies the VAT rate to that total sum. Such a computation can be made independently of actual VAT collections and payments.[5]

3. The VAT is of the consumption type. This means that the VAT - paid (input tax) on purchases of raw materials, finished goods, capital goods and services can be credited against the VAT (output tax) due on the sale of the goods or services. There are generally three types of VAT: gross product, income and consumption. They differ in their treatment of purchases of capital items.

Under the gross product type, input tax on purchases of goods for resale or of goods for conversion into finished goods for sale will be allowed as a tax credit against the output tax. The purchaser is not allowed to recover or deduct VAT paid on capital items.

Under the income type of VAT, input tax on purchases of capital goods allowable as a tax credit is amortized over the depreciable life of the capital goods. In other words, VAT paid on capital items is not permitted to be offset currently against VAT collected on sales. Instead, the recovery of the VAT is allowed ratably over the life of the recovery of the asset. Thus, if the asset has an expected life of 5 years a business could recover 20% of the VAT paid in the year of purchase and in each of the next four years. In effect, under this type, both purchases of raw materials and depreciation on capital items would be deducted from sales in computing the value added.

Under the consumption type, all input taxes on all business purchases including those on capital goods are creditable. All business purchases, including those for capital assets, would be deductible in computing the firm's value added. Any business in the production chain must pay VAT on the purchase of capital assets but may offset the VAT currently against the VAT collected on sales. This type avoids the need to distinguish between capital and current expenditures or to specify asset lives and depreciation allowances for capital assets.[6]

4. The VAT rate is 10% on the sale of goods and services. Certain transactions are, however, subject to a 0% VAT (the so-called zero-rated transactions).

[5] *Ibid.*, at 23-25.

[6] *Ibid.*, at 2-3.

5. There are exempt transactions.

II. TRANSACTIONS SUBJECT TO VAT

A. General Rule

For a transaction to be subject to the 10% VAT, there must be:

a) A sale or exchange in, or importation to, the Philippines.[7] For example, construction services performed abroad are not subject to VAT. The 10% VAT on importations has replaced the advance sales tax on goods imported for resale or for use as raw materials and the compensating tax on goods imported for use by the importer.

b) The sale, exchange or importation must be off goods or services.

"Goods" means "any movable, tangible objects which are appropriable or transferrable".[8]

The term "sale of services" means the performance of all kinds of services for others for a fee, remuneration or consideration, including those performed or rendered by construction and service contractors; stock, real estate, commercial, customs and immigration brokers; lessors of personal property; lessors or distributors of cinematographic films; persons engaged in milling, processing, manufacturing or repacking of goods for others; and similar services regardless of whether or not the performance thereof calls for the exercise or use of the physical or mental faculties.[9] Examples of services held by BIR as subject to VAT: recapping;[10] commercial brokering,[11] data processing and auditing services even if rendered on a reimbursement of cost basis;[12] security services;[13] research on consumer

[7] BIR Ruling No. 045-88, February 12, 1988.

[8] Revenue Regulations (hereinafter referred to as Rev. Regs.) 5-87 (hereinafter referred to as VAT Regs.), Sec. 2(p).

[9] VAT Regs., Sec. 2(j).

[10] BIR Ruling 287-88, June 29, 1988.

[11] BIR Ruling 051-89, March 30. 1989.

[12] BIR Ruling 112-88, April 21, 1988.

[13] BIR Ruling of February 11, 1988.

products and product testing;[14] advertising agencies;[15] rendering human behavior training and consultancy;[16] and management services.[17]

Sales of intangibles are generally not subject to VAT. Thus, sale of blocked TV time which consists of buying and selling of TV airtime is not subject to VAT since it is neither a sale of services nor a sale of movable and tangible objects.[18] Shares of stock are intangibles.[19] Assignment of receivables arising from sale of goods, being intangibles, is also not subject to VAT.

Sales of real properties are not subject to VAT. Thus, sales of subdivision lots and houses by a real estate developer are not subject to VAT.[20] However, commissions of a real estate broker are subject to VAT.[21] Sales of memorial lots are also not subject to VAT.[22]

Transfer of goods without any commercial value is not subject to VAT since they do not have a "gross selling price".[23] But sales of goods considered as junk or retired are subject to VAT.[24]

c) The sale must be made by a taxable person in the course or furtherance of his trade or business.

Even if a foreign corporation is considered to have no permanent establishment in the Philippines under tax treaty rules, which normally deal only with income taxation, it will be subject to VAT if it engages in the sale

[14] BIR Ruling 033-88, February 10, 1988.

[15] BIR Ruling 085-88, March 8, 1988.

[16] BIR Ruling 246-88, June 8, 1988.

[17] BIR Ruling 250-88, June 7, 1988.

[18] BIR Ruling of May 4, 1988.

[19] Shurdut Investment Corporation v. Bataan Pulp & Paper Mills, Inc., 44752-R, March 13, 1975.

[20] BIR Rulings of May 17, 1988; 190-88 of May 4, 1988, and 362-88 of July 12, 1988.

[21] BIR Ruling of May 17, 1988.

[22] BIR Ruling 101-88, March 16, 1988.

[23] BIR Ruling 531-88, November 8, 1988.

[24] BIR Ruling 260-89, October. 13, 1989.

of goods or performs services in the Philippines,[25] Thus, in the case of a foreign contractor of services, the BIR reasoned out that the VAT is imposed upon the occurrence of a VAT taxable transaction which is the sale of services in the Philippines irrespective of the length of stay of the contractor in the Philippines.[26]

The sale of motor vehicles to the employees is subject to VAT.[27]

The VAT is to be imposed on every importation of goods whether for use in business or not, unless otherwise exempt. Thus, importation of equipment or goods for non-profit purposes of a non-profit corporation is subject to VAT.[28] Likewise, the sale of goods to a buyer which uses them for religious purposes is subject to VAT.[29]

Sales by the Asset Privatization Trust[30] is not subject to VAT since APT is not engaged in trade or business.[31] Likewise, the sale by the National Development Company of foreclosed or transferred assets in line with the privatization policy of the government is not subject to VAT if the same were acquired for a non-VAT activity.[32]

Certain activities have been held by the BIR as not subject to VAT because they are not businesses. Thus, bowling alleys are not subject to VAT in view of bowling's "classification as a sport, and therefore, not a business enterprise".[33] A corporation engaged in a physical fitness program which maintains physical fitness equipment and facilities is not engaged in the sale of services and hence, not subject to VAT although subject to income tax.[34] And so are billiards halls, whether open to the public or only

[25] BIR Rulings 059-89, April 7, 1989; 022-89 of February 15, 1989 and 198-89 of September 8, 1989. But see: BIR Ruling 136-89, July 4, 1989 which states that a non-resident foreign corporation not engaged in trade or business in the Philippine but rendering technical services in the Philippines was not subject to VAT.

[26] BIR Ruling 198-89, September 8, 1989.

[27] BIR Ruling 260-89, October 13, 1989.

[28] BIR Ruling 299-88, July 6, 1988; BIR Ruling 502-88, October 14, 1988.

[29] BIR Ruling 311-88, July 13, 1988.

[30] BIR Ruling 045-88, February 12, 1988.

[31] BIR Ruling 045-88, February 12, 1988.

[32] *Ibid.*

[33] BIR Ruling of March 18, 1988.

[34] BIR Rulings 314-88 of July 13, 1988 and 071-89 of April 12, 1989.

to members who are charged a fee to play billiards.[35] Also, gymnastics is a sport and not a business enterprise; hence, a club engaging in the promotion and development of gymnastics is not subject to VAT.[36]

However, the fact that a corporation is non-profit will not in itself exempt it from VAT if it engages in a VAT-taxable activity. Thus, a non-profit corporation whose activity consists in undertaking for a fee research on consumer product and product testing is engaged in the sale of services subject to VAT.[37] Likewise, a non-profit organization which renders technical assistance to institutions involved in rural development projects on a purely reimbursement scheme of payment for its services was held to be engaged in the sale of services subject to VAT.[38] On the other hand, a corporation engaged in the promotion of fisheries research and development in Asia and publishes the result of researches and proceedings of conferences for dissemination and whose funding comes from contributions/dues of members and from an international research organization is not subject to VAT. It appears that the corporation does not accept any consideration for its technical services.[39]

B. The 10% VAT is not subject to withholding

Under Revised Revenue Regulations 20-86 of October 13, 1986, government offices and instrumentalities including government owned or controlled corporations including provinces, cities and municipalities making payments to private persons shall withhold certain taxes (such as franchise tax and premium tax) due from the said payees on account of such payment.

The 10% VAT, the amount of which cannot be fixed, determined, computed or ascertained (because of the input tax credits) at the time of such payment by the said offices, instrumentalities and agencies is not subject to withholding under said Regulations.[40] However, the 2% tax which will apply, in lieu of VAT, to persons whose gross annual sales do not exceed

[35] BIR Ruling No. 574-88, December 8, 1988.

[36] BIR Ruling of May 11, 1988.

[37] BIR Ruling of February 10, 1988.

[38] BIR Ruling 592-88, December 19, 1988.

[39] BIR Ruling 013-89, January 25, 1989.

[40] Revenue Memorandum Circular (hereinafter abbreviated as RMC) 18-88, March 18, 1988.

P200,000.00 shall be subject to withholding.[41] Unlike the old 4% contractor's tax, the 10% VAT is not to be withheld by the contractee but is to be remitted by the contractor.[42]

Under the Expanded Withholding Tax Regulations (EWT),[43] payments to certain persons, basically those performing services, who are listed in EWT Regulations, are subject to an EWT rate. An April 12, 1989 ruling held that the EWT base shall exclude the VAT.[44] However, in another ruling,[45] the BIR held that the base of the EWT includes the VAT. In view, however, of the fact that the law[46] specifically excludes the VAT from the gross receipts of a person selling services, the April 12, 1989 ruling stands on better legal grounds

C. Deemed sale transactions

For VAT to apply, there must be a sale of goods or services. The following transactions are, however, deemed as "sales":

a) Transfer, use or consumption, not in the course of business of goods originally intended for sale or for use in the course of business.[47] Transfer of goods not in the course of business can take place when the VAT - registered person withdraws goods from his business for his personal use,[48] if in the course of business, such transfer is not deemed a sale. Thus, the giving of free goods to customers to promote sales is not considered as a "deemed sale" and hence, not subject to VAT.[49] In this case, a memorandum entry in the subsidiary sales journal is required to record the withdrawal of the goods.[50]

[41] *Supra.*

[42] BIR Ruling of February 11, 1988.

[43] Rev. Regs. 6-85. May 2, 1985.

[44] BIR Ruling 073-89, April 12, 1989; Ruling of February 11, 1988.

[45] Ruling 564-88, November 29, 1988.

[46] National Internal Revenue Code (Abbreviated as NIRC), Sec. 102 (a), last paragraph.

[47] NIRC, Sec. 100(b)(1).

[48] VAT Regs., Sec. 4(A).

[49] BIR Ruling of April 25, 1988; 245-88 of June 6, 1988.

[50] VAT Regs., Sec. 6(e).

b) Distribution or transfer to shareholders or investors as share in the profits of the business.[51] An example is a property dividend consisting of goods of the payor.

c) Transfer to creditors in payment of debt or obligation.[52]

d) Consignment of goods if actual sale is not made within 60 days following the date such goods were consigned. Consigned goods returned by the consignee within the 60-day period is not deemed sold.[53]

In cases of "deemed sale" under paragraphs (a), (b), (c) and (d) above, the tax base of the 10% VAT is the market value.[54] "Deemed sale" transactions under the above paragraphs (b), (c), and (d), require a VAT invoice to be prepared at the time of the transaction.[55]

e) All goods on hand, whether capital goods, stock in trade, supplies or raw materials, as of the date of retirement from or cessation of business or death of an individual shall be deemed sold as of said date, whether or not the business is continued by the new owner. In the following instances, among others, there is cessation of or retirement from business with respect to the former owner even if the new owner continues the business:

1) Change of ownership of business or incorporation of the business or incorporation of the business of a single proprietorship. It appears that even in cases of tax- free incorporation of a single proprietorship under Section 34(c) (2) of the NIRC, the transfer of goods solely in exchange for stocks of the controlled transferee corporation shall be deemed a sale subject to VAT. Even if the transferor, in a tax-free transfer, is a corporation, it is believed that the transfer of goods for shares of stock shall be subject to VAT. VAT shall not, however, apply to goods transferred pursuant to a merger or consolidation.[56]

2) Dissolution of a partnership and creation of a new partnership which takes over the business.

3) Death of an individual who is VAT-registered.[57]

In case of transactions under (e) above, the VAT base is the acquisition cost or the market price of the goods whichever is lower[58] with respect to goods intended for sale or for use in business, and capital goods existing at the time of such change or cessation under the situations described in Section 9(a) of the VAT Regs.

In the case of retirement from business, an inventory shall be filled with the BIR within 30 days form retirement. The goods are "deemed sold". An invoice shall be prepared for the entire inventory and the VAT therein paid. If the goods are sold, the VAT paid on the inventory shall be allowed as input taxes to the buyer provided the VAT corresponding to the goods sold is separately indicated in the sales invoice.

Example: A, at time of retirement, had inventory of 1,000 pcs. of goods "deemed sold" at a value of P 20,000 with an output tax of P 2,000. After retirement, A sold the entire inventory for P 25,000 to B. The sales invoice of A to B should show the following:

Gross selling price	.....	P 23,000
10% VAT	.....	P 2,000
		P 25,000

In this case, A should not subject the P 25,000 to a VAT of P 2,500. B shall be entitled to an input tax of P 2,000 only and not 1/11 of P 25,000 or P 2,272.73. If A did not separately indicate the passed-on VAT of P 2,000, B shall not be entitled to any input tax.[59] This is the exception to the general rule that for purposes of the input tax and determining VAT base, there is no need to indicate separately the 10% VAT since to get the input

[51] VAT Regs., Sec 4(b).

[52] *Ibid.*

[53] *Ibid.*

[54] VAT Regs., Sec 6(e).

[55] *Ibid.*

[56] VAT Regs., Sec. 5(b)(3); BIR Ruling 106-89, May 1, 1989, which did not expressly rule on the liability to the VAT of goods transferred pursuant to a tax-free transfer to a controlled corporation under Sec. 34(c)(2) of the NIRC.

[57] VAT Regs., Sec. 4(e).

[58] NIRC., Sec. 100(c).

[59] VAT Regs., Sec. 6(e).

tax, the total invoice price is just multiplied by a factor of 1/11.[60]

Generally, deposits on equipment which take the form of security or collateral but which are refundable upon the termination of the service are not subject to VAT when made.[61] However, if such, deposits are forfeited, said amount shall only at that time be subject to VAT.[62]

In the case of returnable containers such as bottles and shells, and tanks, they are not actually sold but deposits are collected to guarantee their return. If they are not returned, the deposits are forfeited. These deposits shall be subjected to VAT at the time made and shall be accounted for in the VAT-quarter on which the deposit was made.[63] In effect, these containers are deemed sold when a deposit is made. Refunds or credits of the deposit, to the customers, shall be treated as sales returns and allowances which means that the deposit shall be deducted from the gross selling price or gross receipt of the taxpayer in the quarter the refund or credit is made.[64]

D. Shifting of the VAT

The shifting of the 10% VAT is a continuing point of dispute between seller and buyer of goods and services. Typical of situation where this controversy arises is where the seller sells goods or services to a buyer which is exempt from VAT such banks, insurance companies, educational institutions, hospitals and restaurants. Since the buyer has no output tax, the VAT being passed on by the seller is of no use as an input tax credit. Thus, the buyer refuses to pay the VAT being shifted to him.

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[60] Please refer to the discussion on methods of billing the VAT, discussed at the latter part of this article.

[61] BIR Ruling 276-88.

[62] *Supra.*

[63] Rev. Regs. No. 3-89, January 5, 1988; BIR Ruling 260-89; October 13, 1989. There is a pending request with the BIR that the rule treating deposits as sales shall apply only to containers which by their nature are considered as more of supplies such those used by softdrink manufacturers where the incidence of breakage or loss is high and may be difficult to keep track of. Containers which by their nature are real capital assets like tanks should not be subject to this rule.

[64] *Supra.*, Sec. 5.

In a series of rulings [65], the BIR held that the persons directly liable for the payment of the VAT is the seller of goods and services. However, since the VAT is an indirect tax, it can be shifted to the buyer. Once shifted to the buyer as an addition to the cost of the goods or services sold, it is no longer a tax but an additional cost which the buyer has to pay in order to obtain the goods or services. The shifting of the VAT does not make the buyer the person directly liable therefore; hence, the tax-exempt status and privilege to avoid the passing on or shifting of the VAT. However, while the VAT can be shifted, it is entirely left to the discretion of the buyer whether to accept or reject the billing of the VAT.[66] If the buyer rejects the additional billing, the recourse of the seller is not to proceed with the sale of the goods or services. Thus, it becomes largely a matter of agreement between seller and buyer whether or not to shift the VAT.

Another situation is where a contract for service, say, a management contract was entered into before January 1, 1988 but which will still be performed thereafter. Before January 1, 1988, the fee was subject to the 4% contractor's tax. For the pre-January 1, 1988, the contractor did not bill the 4% contractor's tax although one can assume that when he agreed to the service fee, he built in the 4% tax. For billings for January 1, 1988 and thereafter, the contractor will likely request for adjustment to cover the 10% VAT. This has usually happened in the case of contractors of government agencies which submitted bids before January 1, 1988 and were awarded after December 31, 1987. The BIR has suggested that the contractee may reasonably grant an adjustment of 6% corresponding to the difference between the 10% VAT and the 4% contractor's tax which has already been built into the contract price.[67]

However, in a later ruling[68] involving request for price adjustments of contractors of the Department of Public Works and Highways, the BIR set aside its June 21, 1988 ruling insofar as it suggested a 6% price adjustment on the ground that in general (except in the case of contract calling for the performance of purely labor without the supply of materials), the effective VAT liability of the contractor (output tax less input tax for

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[65] BIR Rulings 243-88 of June 6, 1988; 308-88 of July 13, 1988; 297-88 of July 6, 1988; 378-88 of August 9, 1988-CCG-48; 462-88 of September 26, 1988; 484-88 of October 10, 1988; 525-88 of November 4, 1988; 541-88 of November 15, 1988; 547-88 of November 16, 1988.

[66] BIR Ruling 289-88, June 29, 1988.

[67] BIR Rulings 226-88, June 21, 1988; 425-88 of August 31, 1988.

[68] Ruling 158-89 of July 31, 1989.

materials supplied by the contractor) is almost equivalent to the 4% tax which is based on gross receipts without any tax credit. However, as pointed out by the BIR,[69] the upward adjustment of the contract price due to the higher rate of VAT is left to the discretion of the parties.

III. DETERMINING THE VAT BASE

A. VAT Base in Sale of Goods

The VAT base is the gross selling price or gross value in money of the goods sold or exchanged.

Gross selling price shall include charges for packaging, delivery and insurance even if separately billed; and excise taxes if goods are subject to excise tax.[70] Thus, even if the withdrawal of alcohol, subject to specific tax, is under bond, i.e., without the prepayment of the specific tax, still in the computation of the 10% VAT, the VAT base shall include the specific tax.[71] On the other hand, in computing the ad valorem excise tax, the tax base shall exclude the VAT.[72] In the case of sales on installment, the issue is whether the VAT base should be based only on the cash price or invoice price of the products sold excluding the finance or carrying charges or should include said charges. The issue of exclusion or inclusion of the finance charges in the VAT base was presented to the BIR but its reply was not definitive.[73] The BIR's reply, however, seems to indicate that the total selling price including finance charges shall be the tax base. [74]

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[69] Ruling 525-88 of November 4, 1988.

[70] VAT Regs., Sec. 2(k).

[71] BIR Ruling 156-88, April 19, 1988. For an illustration as to how the VAT is computed on cars subject to the *ad valorem* excise tax under Section 149 of the Tax Code, see BIR Ruling 114-88 of March 18, 1988.

[72] BIR Ruling 473-88, October 4, 1988.

[73] BIR Ruling 254-88, June 14, 1988.

[74] *Ibid.*,
The BIR's reply is as follows:

> [T]he basis of the 10% value-added tax is the gross selling price of the articles sold which 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 excluding the value-added tax. It (continued...)

Gross selling price shall exclude or be reduced by the following:

1) Amount intended to cover the VAT whether or not separately or correctly indicated in the invoice.

2) Discounts granted and determined at the time of sale which are expressly indicated in the invoice and the amount thereof forms part of the gross sales duly recorded in the books of accounts. There are three requirements for the deductibility of discounts from gross selling price: granted at the time of sale; expressly indicated in the invoice; and discount forms part of the gross sales duly recorded in the books of accounts. Discounts conditioned upon the subsequent happening of an event or fulfillment of certain conditions such as prompt payment or attainment of sales goal shall not be allowed as deductions.[75] Prompt payment discounts do not reduce the VAT base. Following are computations of the VAT-liability where there is a prompt payment discount:

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[74](...continued)
shall include other charges such as packaging, delivery and insurance even if these are separately billed or invoiced as provided in Section 2(k) of Revenue Regulations 5-87. This position of the BIR may find support in *American Rubber Co. v. Collector of Internal Revenue* (G.R. No. L-25965, June 30, 1965, 64 SCRA 569), wherein the Supreme Court defined "actual selling price" or "gross value in money" for purposes of manufacturer's sales tax as the "sum stipulated as the equivalent of the thing sold and also every incident taken into consideration for the fixing of the price, put to the debit of the vendee and agreed to by him. In other words, the tax is based not only on the actual cost of production of the goods and the profit added thereto by the vender to make up its mill or factory price of the merchandise, but also upon each and every incident expense taken into account charged to and paid by the vendee, whether or not the former makes additional profit on these incidental items.

[75] VAT Regs., Sec. 6(c)(a).

Example I:	Price	P 100.00 per case
	Less: 2% prompt payment discount	2.00
	Net Amount	P 98.00 per case
	Add : VAT	9.80
	Payable to Supplier	P 107.80
Example II:	Price	P 100.00 per case
	2% prompt payment discount	2.00
	Net Amount	P 98.00 per case
	Add : VAT	10.00
	Payable to supplier	P 108.00 per case

Example I is not correct while Example II is correct.[76] If in the above examples, instead of a prompt payment discount, a cash discount is given, the VAT should only be P 9.80.

3) Sales returns and allowances for which a proper credit or refund was made during the quarter to the buyer for sales previously recorded as taxable sales. A credit memorandum would be sufficient to support the return.[77]

In case goods sold on installments are repossessed, the goods shall be considered as purchased. For example, an appliance with a sale value (account receivable) of P 1,500 is repossessed and its value at the time of repossession is P1,000. The entry will be a debit to repossessed article of P 1,000, input tax of P 100 and loss on repossession of P 400. There is a credit to account receivable of P 1,500. If the repossessed article is sold, there is a 10% VAT based on actual selling price with a credit for input tax on repossession.[78]

In computing the tax base of the old manufacturer's sales tax, the BIR's position is that all charges such as delivery expenses incurred by seller for the account of the buyer after the ownership of the goods has passed

[76] BIR Ruling 272-88, June 28, 1988.

[77] VAT Regs., Sec.6(c)(A).

[78] BIR Ruling 254-88, June 14, 1988.

from seller to buyer should be excluded.[79] In view of the specific provisions of the VAT Regs.,[80] charges by the seller of goods for delivery expenses incurred even after title to the goods has transferred from seller to buyer should form part of the VAT base even if these amounts are separately billed or invoiced.

B. VAT Base with respect to Sale of Services

a) General rule

The VAT base is the gross receipts which include only cash or its equivalent, actually or constructively received. This means that a seller of services is entitled to compute his output tax on the cash basis as distinguished from a seller of goods which must compute his output tax when there is a sale irrespective of whether or not he has been paid. Gross receipts include amount charged for materials supplied with the services and deposits or advance payments received. VAT is excluded. There is constructive receipt when cash or its equivalent is placed at the control of the seller of services without substantial restrictions by the payor.[81] Customer's deposits are considered as part of the base.[82]

b) Reimbursements

As a general rule, the 10% VAT on sale of services is computed on the basis of gross receipts even if the billings include reimbursements of expenses incurred in rendering the services. Thus, the VAT should be based on the total billings of the person rendering the service, including the due to employees, due to government, depreciation of equipment billed to the payor, supplies and administrative overhead.[83] Likewise, the total billing of a janitorial agency consisting of the basic pay of the janitor, the agency fee of 20% and the consumed supplies is the VAT base.[84] A seller of manpower services bills its client the following: daily salary, 13th month pay,

[79] BIR Ruling of April 15, 1959.

[80] Sec. 2(k).

[81] VAT Regs., Sec. 2(m), 2(n).

[82] BIR Ruling No. 451-88, September 15, 1988.

[83] BIR Ruling 111-88, April 25, 1988.

[84] BIR Ruling 183-88, May 4, 1988.

15% agency fee on the said two amount, SSS and Medicare and leave with pay. The total of these amounts is subject to VAT.[85] The total billings of an agency engaged in promoting new products of manufacturers through the deployment of promotion agents in supermarkets and commercial outlets consisting of basic salary, 13th month and incentive pay, SSS/Medicare contributions, transportation, holiday and day-off plus the agency fee is the VAT base.[86] A security agency which bills its clients its fee and P 40.00 per hour to cover cost of gasoline and oil, salaries and maintenance is subject to VAT on the total amount.[87]

In certain cases, however, amounts representing reimbursements of expenses by the seller of services are excluded from the VAT base. A private employment agency which in addition to its fee bills an amount to cover reimbursements for passport/visa, medical examination, clearances, inoculation, trade and skill testing, airport terminal, performance bond premiums and notarial fees may exclude such reimburseables provided that the said expenses are supported by receipts issued by the supplier or government agency in the name of the worker. The above reimbursements will, however, be included in the VAT base if they are supported by receipts issued in the name of the agency.[88]

That portion of the override commission charged by a ceding insurance company to a reinsurer which was shown to be in the nature of reimbursement of expenses was excluded from the VAT base.[89] Thus, there was a need for the taxpayer to show that the override commission was in fact a reimbursement of expenses in order not to be subject to VAT.[90] Moreover, when the services are performed for others as an insurance broker, the fees are subject to VAT.[91] However, in a May 18, 1989 ruling, the BIR modified the above position.[92] The BIR's new position is that the insurance company deriving the reinsurance overriding commission is not a seller but a buyer of service; hence, it is not liable for VAT since VAT applies only to seller of services. The May 18, 1989 ruling also modified BIR

[85] BIR Ruling 368-88, July 28, 1988.

[86] BIR Ruling 061-88, February 29, 1988.

[87] BIR Ruling 230-88 of June 2, 1988.

[88] BIR Ruling 163-88, April 21, 1988.

[89] BIR Ruling 155-88, April 19, 1988.

[90] *Supra.*

[91] *Supra.*

[92] BIR Ruling 107-89, May 18, 1989.

Ruling 186-88 of May 4, 1988 (which held that a reinsurance contract is different from the insurance contract reinsured and thus, the reinsurer's agent is subject to VAT on the reinsurance commission unless the agent is an individual subject to the occupation tax) by reiterating the position that reinsurance commissions are not subject to VAT since the insurance company deriving the same is a buyer, not a seller, of services.

The Philippine Ports Authority (PPA) is exempt from VAT only on fees and charges arising from the use of government facilities but is subject to VAT on its gross receipts from taxable activities other than the use of government facilities.[93] Thus storage fees, harbor fees, berthing/anchorage fees, usage fees, wharfage fees, lay-up charged by Philippine Port Authority (PPA) should be excluded from VAT base since payment therefore is for the use of government facility which is not a taxable activity.[94] But PPA's share from the gross receipts realized by a third party or contractee in collecting on behalf of PPA, fees and charges on other port-related activities is subject to VAT.[95]

The aggregate of commission on sale of tickets and service fees on sale of local tours is subject to VAT.[96]

The BIR has issued a circular[97] on the VAT liability of travel agents. This circular basically reiterate the rules laid down in the BIR Ruling of January 12, 1988.

The travel agent's VAT base shall not include airline or ship tickets or reimbursement of expenses which shall be limited to passport or visa fees, tour charges, hotel room charges, guide fees, resort fees and meal charges provided that they are supported by receipts issued by supplying company. All other income or receipt is subject to VAT. In the case of tickets sold to travel agents on a net basis, the VAT shall be based on the margin between the selling price to the customer and the net purchase price provided it does not exceed 9% of the gross selling price of the ticket. If it exceeds, the 10% VAT shall be based on the gross selling price.[98] The 9% limitation on the mark-up, however, pertains only to the travel agent's commission on its

[93] RMC 20-88, April 17, 1988.

[94] BIR Rulings 083-88, April 14, 1988; BIR Ruling 031-89, January 20, 1989; RMC 20-88, April 17, 1988.

[95] RMC 20-88, April 17, 1988.

[96] BIR Ruling 047-88, February 15, 1988.

[97] RMC 7-88, February 15, 1988.

[98] *Supra.*

regular ticket sales. If the travel agent extends special services to its clients, it can charge a mark-up higher than 9% and its gross receipts from said services shall be the VAT base.[99]

Advertising agencies are subject to VAT on their gross receipts. The agency's gross commissions constitute the taxable gross receipts. The billings for the share of media are excludable from the VAT base.[100]

The billings of a customs broker will typically include, in addition to the brokerage fee, advances or reimbursements for port fees such as arrastre, wharfage, storage, demurrage, stamps and other government fees and charges. The VAT base shall exclude said reimbursements provided that in issuing receipts for the brokerage bill, the reimbursements should be segregated.[101] A reason given is that these amounts are intended or earmarked for payment to third persons.[102] The billings of a customs broker for trucking services are excludible from the VAT base since these billings are subject to 3% common carrier's tax.[103] However, in a ruling[104] the BIR held that services of a transportation service contractor are subject to VAT since the transportation equipment is not owned by the said contractor pursuant to Sec. 6(g) of VAT Regulations, that all receipts from service, hire or lease of transportation equipment not subject to the 3% carrier's tax are subject to VAT. It is difficult to follow this reasoning since a person can be a common carrier even if it uses transportation equipment leased from others.

IV. ZERO-RATED TRANSACTIONS

A. Distinction between zero-rated & exempt

a) A zero-rated transaction is subject to a 0% VAT. It is thus a taxable transaction for VAT purposes. But the zero-rated seller of good or

[99] BIR Ruling 012-89, January 25, 1989.

[100] BIR Rulings of March 8, 1988 and 059-88 of February 29, 1988.

[101] BIR Ruling of February 22, 1988; Ruling 315-88 of July 13, 1988.

[102] BIR Ruling of 489-88, October 11, 1988; [In the Oct. 11, 1988 ruling, the BIR held that these reimbursements should form part of the base for the expanded withholding tax (EWT). This ruling does not stand on sound legal basis. In BIR Ruling 202-81 of Aug. 28, 1981, these reimbursements were held not subject to the expanded witholding tax (EWT)].

[103] BIR Ruling 315-88, July 13, 1988.

[104] February 22, 1988.

services is entitled to a refund or tax credit (which, if approved by the BIR, can be credited against any internal revenue tax liability) of the input tax paid on his purchases of goods and services.[105]

b) An exempt transaction means that the sale of goods or services is not subject to VAT. Thus, the seller shall not bill separately any output tax to his customers because the transaction is not subject to VAT. The seller is not entitled to a refund or credit of the input tax paid on his purchase of goods and services. The VAT-registered purchaser of goods or services which is VAT-exempt is not entitled to a refund or credit of the input tax paid on his purchase of goods and services. The VAT- exempt is not entitled to any input tax on such purchase nor to a refund or credit of the VAT passed on to him. The VAT becomes an added cost of operations. The VAT exemption of a person does not extend to his supplier of goods and services.[106]

B. Two Types of Zero-Rated Transactions

There are two types of zero-rated transactions: zero-rated and effectively zero-rated.

The distinctions are:

For a sale of goods or services to be zero-rated, it is required only that the seller must be VAT-registered. If the seller is VAT-registered, his sales are automatically zero-rated. As a general rule, there is no need to apply for zero-rated status.[107] In the case, however, of sales of raw materials to a BOI-registered export producer, an application for zero-rated status must be filed with the BIR under Rev. Regs. 2-88.

For a sale of goods or services to be effectively zero- rated, the seller must file an application with the BIR for such a status.[108] There is no automatic zero- rating.

[105] The guidelines for determining the refundable or creditable input taxes attributable to zero-rated transactions are contained in Rev. Regs. 9-89 of December 4, 1989.

[106] BIR Ruling 245-88, June 8, 1988.

[107] BIR Rulings of May 4 and 12, 1988.

[108] VAT Regs., Section 8(d).

C. Zero-Rated Transactions

These transactions are:

a) Export sale of goods, that is, sale and shipment of goods from the Philippines to a foreign country irrespective of the place where title to the goods passes upon submission of proof of exportation and inward remittance of foreign exchange. If the exporter is not VAT-registered, the export is merely exempt.[109]

b) Foreign currency denominated sales (or the so-called internal exports under LOI 1355). They are sales to non- residents of goods manufactured in the Philippines for delivery to residents in Philippines and paid in foreign currency.[110]

c) Processing, manufacturing or repacking goods for other persons doing business outside the Philippines which goods are subsequently exported, where the services are paid for in acceptable foreign currency inwardly remitted to the Philippines.

d) Services other than those mentioned in the preceding sub-paragraphs, the consideration for which is paid for in acceptable foreign currency which is remitted inwardly to the Philippines.

Examples are: Commissions received by a manning or crewing agency under a contract with foreign-owners of Philippine flag vessels paid in foreign currency remitted into the Philippines are subject to 0% VAT.[111] Before, the commissions were subject to a 7% brokers tax and the manning income to a 4% contractor's tax. Charges of suppliers of services rendered to vessels of foreign shipping principals which remit foreign currency to their local agents which use the said currency to pay such suppliers in pesos are also zero-rated. Indent commissions received by branches or subsidiaries from their head offices or affiliates abroad for solicitation of orders from local buyers paid in foreign currency remitted into the Philippines are subject to 0% VAT.[112] Services of trademark and patent agents paid in

[109] BIR Ruling 378-88, August 9, 1988.

[110] VAT Regs., Sec. 8(b).

[111] BIR Ruling 021-88, February 2, 1988.

[112] BIR Ruling 107-88, March 17, 1988

foreign currency by clients remitted into the Philippines are subject to 0% VAT.[113] Recruiting agencies of contractual workers abroad paid in foreign currency remitted into the Philippines are zero-rated.[114]

Under Central Bank (CB) rules, shipping companies doing business in the Philippines are, subject to prior CB approval, authorized to remit abroad their freight collections net of commissions and fees due to their resident agents and reimbursements of advances made by local shipping agents for vessel related expenses. That portion of the freight collections used to pay services rendered to the vessel is deemed inwardly remitted which is a requirement for zero-rating.[115]

e) Indirect or constructive exports. In general, only direct exports, that is, there is a shipment of goods from the Philippines to a foreign country. There appears to be no significant problems of zero-rating with respect to direct exports. However, problems on zero-rating come in when goods are sold or services to produce goods for actual exports. These transactions may be referred to as indirect or constructive exports. Examples are sales of goods by a trader to an export producer who processes the goods into products for exports or sales of goods by an export producer to an export trader which exports the goods "as is". Some of these transactions may qualify for zero-rating or at least exempt.

(1) Transaction by or with enterprises registered with the Export Processing Zone (EPZA)

1.a Local sale of goods and services to an EPZA-enterprise

The VAT Regs. specifically provides that "(d)elivery of imported goods to a customs bonded warehouse, export processing zone or other authorized withdrawals or temporary importation for re-exportation without payment of the vlaue-added tax shall be governed by the respective laws covering such withdrawals or deliveries."[116]

Under the Omnibus Investments Code of 1987[117], foreign or

[113] BIR Ruling 016-88, February 1, 1988.

[114] BIR Ruling 161-88, April 21, 1988.

[115] RMC 47-88, September 12, 1988.

[116] VAT Regs., Sec. 7(b).

[117] Executive Order No. 226.

domestic merchandise, raw materials, supplies, articles, equipment, machineries, spare parts and wares of every description, except those prohibited by law, brought into the Zone to be sold, stored, broken up, repacked, assembled, installed, sorted, cleaned, graded, or otherwise processed, manufactured, mixed with foreign or domestic merchandise whether directly or indirectly related in such activity, shall not be subject to customes and internal revenue laws and regulations.[118] Thus, importation by EPZA-enterprises shall not be subject to VAT. However, the VAT Regulations are not clear as to the treatment of goods locally purchased by EPZA-enterprises.

The Omnibus Investments Code, however, provides that merchandise purchased by an EPZA-enterprise from outside the Zone and subsequently brought into the Zone, shall be considered as export sales and the exporter thereof shall be entitled to the benefits allowed by law for such transaction.[119] Note that the requirement of payment in foreign currency which was found in the old Export Processing Zone Authority Act[120] has been deleted.

BIR Ruling 354-87 of November 9, 1987 specifically states that local sales of merchandise to an EPZA-enterprise shall be considered as export sales. In the case of local sales of raw materials to PHIVIDEC-registered enterprise, they shall be treated as merely exempt, not zero-rated, because the PHIVIDEC law[121] merely states that "raw materials, supplies, articles xxx brought into the (PHIVIDEC) Area and utilized in the production, storing packing and shipment of goods meant for the foreign markets shall be exempt from customs duties, internal revenue taxes."[122]

1.b Sales within the Zone by one EPZA-enterprise to another.

Intra-EPZA sales or sales of goods by and between EPZA-enterprise within the Zone are within the purview of "supplies brought into the zone to be sold" which are not subject to internal revenue laws under the Omnibus Investments Code of 1987[123]. The BIR has ruled that they are

[118] *Ibid.*, Art. 77(1).

[119] *Ibid.*, Art. 77(2).

[120] Presidential Decree No. 66, (as amended), Sec. 17.

[121] Presidential Decree No. 538

[122] BIR Ruling 032-89, January 19, 1989.

[123] Executive Order No. 226, Sec. 77(1).

exempt by virtue of Sec. 103(u) of the NIRC which exempts from VAT, transactions which are exempt under special laws[124]. This appears to be unsound and is not in line with the principles of the June 24, 1988 and January 21, 1989 BIR rulings. If local purchases from outside the Zone by an EPZA-enterprise are export sales, there is no cogent reason why intra-EPZA sales should not also be given the preferential, zero-rated status.

(2) Sales to customs bonded manufacturing warehouse

While the BIR has agreed in principle that local sales of locally manufactured goods to an operator of bonded warehouse "who will use the said products as part of its raw material requirement to produce articles intended exclusively for export and actually exported" are export sales and subject to 0% VAT[125], there has been no definitive position on this issue. However, imported articles whether brought into and withdrawn from private bonded warehouse for exports or entered into and processed in the bonded manufacturing warehouse for exports are exempt from VAT.[126]

(3) Local sales to or by enterprises registered with the Board of Investments (BOI) and enjoying incentives under various investments laws (BOI-registered enterprises)

3.a Sales to BOI-registered export producers

Under Revenue Regulations 2-88 of February 15, 1988, sales to BOI-registered export producers will be zero-rated provided that:

(i) The goods sold are raw materials to be used exclusively by the buyer in the manufacture, processing or repacking of its own registered export product.

(ii) The buyer must be exporting at least 70% of its annual production.

The supplier, who need not be BOI-registered, must file an application with the BIR for zero-rated status.

[124] BIR Ruling 413-88, September 6, 1988.

[125] BIR inter-agency letter, dated Janauary 5, 1988, to Department of Trade and Industry.

[126] BIR Ruling 432-88, September 2, 1988.

Raw materials include apckaging products such as corrugated boxes.[127]

Zero-rating is limited only to sales of raw materials. Thus, the sale of supplies to a BOI-registered export producer shall be subject to the 10% VAT.[128] Likewise, the sale of capital equipment such as industrial sewing machines to such enterprise is subject to a 10% VAT.[129]

BOI-registered contractors and/or sub-contractors performing services suc as processing, converting or manufacturing goods for a BOI-registered exporter shall be merely exempt.[130] Thus, a BOI- registered company which acts as sub-contractor of services for a BOI-registered export producer was held to be exempt, but if it renders sub-contracting services to a non-BOI-registered contractee, it shall be subject to a 10% VAT.[131] It is to be emphasized that with respect to sale of services, both the sub-contractor and export producer must be BOI-registered. Thus, a non-BOI-registered sub-contractor supplying manpower to a BOI-registered export producer is subject to a 10% VAT.[132]

Note that under Rev. Regs. 2-88, the buyer of the goods or services must be a BOI registered export *producer*. If the buyer is an export trader, Rev. Regs. 2-88 shall not apply. Also, if the buyer is a BOI-registered service exporter and subcontracts the job to a non-BOI-registered company, the latter cannot claim zero-rated or exempt status even if the services subcontracted are ultimately exported.[133] If the sub-contractor is BOI-registered, it is exempt from VAT under Article 39(e) of the Omnibus Investments Code of 1987[134] in relation to sec. 103(U) of the NIRC which exmpts from VAT, transactions which are exempt under special laws.[135] Even if the BOI-registered sub-contractor is paid in foreign currency

[127] BIR Rulings of March 1, 1988; 053-89 of March 15, 1989.

[128] BIR Rulings 027-89 of February 1, 1989; 039-89 and 040-89 of February 22, 1989.

[129] BIR Ruling 027-89, February 1, 1989.

[130] BIR Ruling 04-89, March 8, 1989.

[131] BIR Ruling of February 9, 1989.

[132] BIR Ruling 191-89, August 10, 1989.

[133] BIR Ruling 243-88.

[134] Art. 39(e) exempts BOI-registered enterprises from the contractor's tax which had been replaced by the VAT.

[135] *Supra.*

inwardly remitted to the Philippines, it shall only be considered as exempt under Sec. 103(U) of the NIRC. It cannot be zero-rate because it is not and cannot be VAT-registered. According to the BIR, a person who is exempt under Sec. 100(U) of the Tax code cannot opt for VAT registration, and the taxpayer must waive its BOI registration if it desires to be zero-rated for VAT purposes.[136]

If both the service exporter and its sub-contractor are BOI-registered, the BIR held that both are exempt from VAT, not zero-rated, under Sec. 103(U) of the Tax Code in relation to Article 39(e) of the Omnibus Investments Code.[137] Even if the BOI-registered service exporter is paid in foreign currency inwardly remitted to the Philippines, it will not be zero-rated for reasons explained above. It will be merely exempt.

Non-BOI-registered persons supplying services to a BOI- registered service exporter such as lease of equipment and maintenance are subject to VAT.[138]

3.b Sales to Export Trader

Sales of goods to an export trader are considered as domestic sales suubject to 10% VAT.[139] This is true notwithstanding the fact that the trader is BOI-registered. For example: a mining firm (A Co.) sells mineral products to a trader which is a BOI-registered indirect exporter (B C0.). B Co. sells them as raw materials, "as is," to a BOI-registered export producer (C Co.). Sales of A Co. to B Co. are subject to VAT but may be zero-rated upon application with the BIR under Rev. Regs. 2-88.[140]

What about the BOI-registered export producer? In a ruling,[141] the BIR considers the export sales of a such enterprise as zero-rated, not merely exempt. The transaction presented to the BIR was as follows: The buyer (A Co.) is a BOI-registered export producer of abaca pulp which uses abaca fiber as a raw material. A Co. buys the fiber from a primary producer. The sale by the latter to A. Co. is exempt because abaca fiber is still in its

[136] BIR Ruling 351-88, July 21, 1988.

[137] BIR Ruling 243-88.

[138] BIR Ruling 243-88.

[139] BIR Rulings of April 21, 1988; 378-88 of August 9, 1988; 288-88 of June 29, 1988.

[140] BIR Ruling 163-88, May 17, 1988.

[141] Ruling of March 2, 1988.

original state as will be discussed later. A Co. also buys the fiber from a trader. The sale by the trader to A Co. is subject to the 10% VAT but A Co. may file a refund for the input tax. This means that A Co. is zero-rated on its export sales of abaca pulp. If the trader is registered under Rev. Regs. 2-88, then his sales to A Co. shall be zero-rated. The March 2, 1988 ruling did not indicate the investment law under which the BOI-registered export producer was registered. If it was registered under a law which grants exemption from VAT on its export sales, should such enterprise be required to waive its registration before it can be zero-rated? The March 2, 1988 ruling did not say so. In another ruling,[142] a BOI-registered non-pioneer export producer can claim a credit of the 10% VAT passed on by a non-BOI-registered company rendering service to the former. The former was treated as zero-rated.

In the case, however, of a BOI-registered export trader (or BOI-registered service exporter as discussed previously), the BIR requires that he must waive his BOI-registration and register under VAT before he can be zero-rated.

Thus, in a July 21, 1988 ruling, the BIR held that an export trader is zero-rated if its registers as a VAT person. If he is not VAT-registered, he is merely exempt. If the export trader is also BOI-registered enjoying exemption from VAT under investment law it was registered,[143] it is also exempt from VAT under Section 103(U) of the NIRC in relation to Art. 49(b) of PD 1789.[144] However, it is the BIR's position that the export trader cannot straddle between two exemption privileges; hence, it must apply for cancellation of its BOI registration and register as a VAT taxpayer before it can avail of the benefit of zero-rating. It cannot be VAT-registered and thus get zero-rated status unless it waives its BOI-registration.[145] Or, it may maintain its BOI-registration but remain as only exempt from VAT.

This BIR ruling appears to be questionable and should be reviewed. It is not correct to say that a BOI-registered export trader to whom the ruling was issued, is exempt from VAT under a special law, i.e., the

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142 BIR Ruling 191-89, August 10, 1989.

143 For example, under PD 1789, BOI-registered export traders are exempt from specific tax [replaced by excise tax] and sales tax [replaced by VAT] on their export sales and entitled to a tax credit (but no refund) for the specific and sales tax on registered export products purchased from export producers.

144 Sec. 103(u), considers a exempt, transactions exempt under special laws or international agreements.

145 BIR Ruling 351-88, July 21, 1988.

investment incentive law of its registration. An export trader, service exporter or export producer who are all BOI-registered, are exempt from VAT on their export sales not because of the fact of their BOI-registration, but because of the provision of the NIRC which is a general law, namely, Section 103(U) which declares as exempt from VAT export sales of persons who are not VAT-registered. Even if not registered with the BOI, export sales of these persons will still enjoy exemption from VAT based on the said Section 103(V) of the Tax Code.

Moreover, BOI-registered enterprises including pioneer enterprises enjoying exemption from all taxes except income tax on diminishing scale, are allowed under the VAT law to be registered under VAT at the same time. There is no provision in the VAT law which prohibits BOI registered enterprises from registering uunder VAT unless their BOI-registration is waived or given up. As a matter of fact, the VAT law recognizes that a BOI-pioneer enterprise can register under VAT when it provides that if the exempt products of pioneer enterprises are sold domestically to VAT-registered persons, the VAT otherwise due on such products shall be considered as creditable input tax.[146] The term input tax is defined in the NIRC as the VAT paid by a VAT-registered person on importation of goods and local purchases from a VAT-registered person. The implication is that the BOI-registered enterprise selling its tax-exempt product must register under VAT to enable the buyer to calim an input tax "deemed paid" on such exempt product. Also, a pioneer enterprise which no longer enjoys exemption to the full extent (say exempt only to the extent of 50% or 25%) is subject to VAT on the non-exempt portion and must, therefore, register under VAT.

Moreover, from a policy viewpoint, the ruling does not support the Government's program to encourage investments in preferred areas where the Government deems it sound to give incentives to enterprises doing business in said areas of investment because a BOI-registered enterprise will be merely exempt while a non-BOI-registered enterprise will be zero-rated.

Domestic sales by BOI-registered domestic producer of coco shells and husks bought from farmer or primary producers are subject to 10% VAT.[147]

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146 NIRC, Sec. 104.

147 BIR Ruling of August 3, 1988.

D. Effectively zero-rated transactions

These transactions cover sales of goods or services to persons or entities whose exemptions are effectively zero-rated under special laws or international agreements. They refer to exemptions expressly granted under special laws or treaties which are extended not only to the grantee but also to its supplies of goods.

Examples of effectively zero-rated sales are:

In the case of sale of goods or services to a U.S. military facility which is exempt from sales tax (now VAT) under the RP-US Military Bases Agreement, the exemption of the grantee extends to the seller. Thus, a contractor selling services to a U.S. Military Base can apply for zero-rated status.[148] Zero-rated status is extended only to the general contractor. The sub-contractors are subject to the 10% VAT.[149] Thus, a corporate contractor of an engineering consultancy contract with the US Naval Base in Subic is zero-rated provided it is VAT-registered and had applied for zero-rated status.[150]

Executive Order No. 161 provides that goods or services sold directly to the Asian Development Bank shall not be subject to sales tax. The BIR has confirmed that sales of services and goods to the ADB are zero-rated provided that the seller is VAT- registered and has applied for zero-rated status.[151]

Sales to Armed Forces of the Philippines Commissary and Exchange Services (AFCES) are neither effectively zero-rated nor exempt.[152]

Local sales of goods or services to diplomatic agents/embassies are generally neither zero-rated nor exempt. Diplomatic agents are exempt from all taxes except, among others, "indirect taxes of a kind which are normally incorporated in the price of goods or services".[153] Sales to the International

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[148] BIR Ruling 210-88, May 20, 1988.

[149] BIR Ruling of March 1, 1988.

[150] BIR Ruling 425-88, August 31, 1988.

[151] BIR Ruling 383-88, August 9, 1988.

[152] *See* RMC 14-90 of February 9, 1990 quoting Fiscal Incentives Review Board Resolution (Resolution 12-89, dated July 6, 1989) on the withdrawal of the tax exemption privileges of AFCES; BIR Ruling 367-88 of August 3, 1988 held that such sales are effectively zero-rated; But see *contra* BIR Ruling 185-88 of May 4, 1988 which considers such sales as merely exempt.

[153] BIR Ruling 001-88 of January 7, 1988, citing the Vienna Convention on Diplomatic Relations.

Red cross is subject to the 10% VAT,[154] but importations by the International Red Cross are exempt.[155] However, in accordance with the principle of comity of nations and in view of the certification by the Philippine Government that the Philippine Embassy in Spain enjoys exemption from indirect tax in Spain, local purchases of goods shall be effectively zero-rated.[156] If there is no such reiprocity, local sales are not zero-rated such as sales to the Embassies of New Zealand and Singapore.[157] By reason of reciprocity, sales to the following embassies are zero-rated:[158]

1. Australia
2. Austria
3. Canada
4. Italy
5. Japan
6. Nigeria
7. Papua New Guinea
8. People's Republic of China
9. Thailand
10. United States
11. Netherlands
12. Denmark
13. Spain (reiterated)
14. German Democratic Embassy
15. France
16. Sweden

Also, a local supplier of goods and services to the World Bank Resident Mission in the Philippines is effectively zero-rated but not sale of goods and services to its officers and staff.[159] Effective zero-rating is limited to purchases made by embassies in their official capacities and does not apply to individual purchases made by members of the diplomatic staff.[160] However, importations by both the embassy and diplomatic agents are generally exempt from VAT.[161]

V. EXEMPT TRANSACTIONS

Some exempt transactions are:

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[154] BIR Ruling 367-88, August 3, 1988.

[155] BIR Ruling 057-88, February 24, 1988.

[156] BIR Ruling of August 1, 1988.

[157] BIR Ruling 367-88.

[158] *Ibid.*

[159] BIR Ruling 165-88, August 8, 1989.

[160] BIR Ruling 367-88.

[161] BIR Ruling 001-88, January 7, 1988.

A. Sales of non-food agricultural, marine and forest products.[162]

There are two conditions for exemption: First, the seller must be the producer or owner of the land where the products are produced. Second, the products must be in their original state.

Thus, a dealer of split rattan is not exempt.[163] Likewise, sales of tobacco by trading centers and redrying plants are not exempt since they are not the primary producers.[164] Sales by the leaf tobacco planters are exempt from VAT while sales of dealers are subject.[165]

The sale by farmers of coco shells and husks is exempt. But when the buyer cracks and chips them and thereafter sells them to end-users, the sale is subject to VAT because the seller is no longer the primary producer even if the seller is a BOI- registered domestic producer under the Omnibus Investment Code since said Code does not grant exemption from VAT under the circumstances.[166]

A corporation which is engaged in growing and selling flowers to flower shops and other outlets and end-users, putting them in proper receptacles and adding materials such wire, ferns, leaves, ribbon and wood without altering the exterior texture, form or substance of the flowers is selling, as primary producer, non-food agricultural products in their original state and hence, exempt from VAT.[167]

Coagulated rubber latex or cuplump which is rubber juice/sap gathered from the rubber trees and place in a solution of glacial acetic acid to coagulate is still non-food agricultural product in its original state.[168] Logs are still in their original state.[169]

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[162] NIRC, Section 103(a).

[163] BIR Ruling 137-89, July 5, 1989.

[164] BIR Ruling 048-88, February 16, 1988.

[165] BIR Ruling of January 1, 1982.

[166] BIR Ruling 367-88, August 3, 1988.

[167] BIR Ruling 452-88, Septmeber 16, 1988.

[168] BIR Rulings 587-88, December 19, 1988; 532-88, November 9, 1988.

[169] BIR Ruling 417-88, August 26, 1988.

B. Sale of agricultural and marine food products including breeding stock.[170]

The condition is that the food product must be in its original state. As distinguished from non-food product, the exemption applies on all stages of production and distribution.

Products are still in their original state even if they have undergone the simple processes of preparation or preservation for the market such as freezing, drying, salting, smoking or stripping.[171] If chemicals are applied to preserve the products, the latter are no longer considered in their original state. Thus, meat products which are cured in a chemical solution and them smoked are no longer in their original state.[172] The process of skimming milk is not a simple process of preparation or preservation.[173] Examples of products in their original state are rice, corn grits,[174] salted eggs,[175] salt which is neither iodized nor refined,[176] and raw cane sugar. Raw cane sugar was previously interpreted to include raw sugar, washed sugar, blanco directo, plantation-white sugar and refined sugar.[177] However, the BIR revoked this position and effective September 1, 1989, refined sugar is now subject to the 10% VAT.[178] The 10% VAT on the sale of refined sugar shall be paid in advance by the owner/seller to the BIR, through the sugar refineries. The advance VAT payment shall be made prior to or upon issuance of the refined sugar release order or similar instruments. The proprietor or operator of a sugar refinery shall not allow any withdrawal of refined sugar from its premises without prior advance payment of the VAT by the owners/sellers.[179]

Examples of products which are not in their original state: bagasse

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[170] NIRC, Section 103(b).

[171] VAT Regs., Sec. 8(b)(2).

[172] BIR Ruling 447-88, September 15, 1988.

[173] BIR Ruling 477-88, October 4, 1988.

[174] VAT Regs., Sec. 8(b)(2).

[175] BIR Ruling, April 27, 1988.

[176] BIR Ruling 280-88, June 29, 1988.

[177] BIR Rulings: February 18, 1988 and 292-88, July 13, 1988.

[178] BIR Ruling 183-89, August 28, 1989; Revenue Regulations 5-89 which defines raw sugar to exclude washed sugar, *blanco-directo*, plantation white and refined sugar.

[179] Rev. Regs. 7-89, November 8, 1989.

and molasses;[180] and corn starch and cassava flour.[181]

Copra is considered an agricultural food product in its original state and hence, its sale at all stages is exempt.[182] Thus, copra dealers are exempt from VAT. However, copra pellets and crude coconut oil are no longer in their original state but are treated as processed food product.[183] So also is Copra cake.[184] Corn grits, barley and yellow corn which are cereals and by nature are also used as human food are considered as agricultural food products in their original state and hence, exempt from VAT although by destination such article will be used as raw materials for manufacture of animal feeds.[185]

Roasted coffee beans or powdered coffee are still agricultural products in their original state even if placed in bags crudely sealed by knotting the ends of the bag but if packed or placed in bottles or cans and sold, they become manufactured products subject to 10% VAT.[186] Similarly, if meat, fruit, fish, vegetables, spices and other agricultural and marine food products are placed in bottles or cans and sold, they are subject to 10% VAT since they cease to be in their original state.[187] Likewise, if fried and packed in plastics, they are considered as manufactured products.[188] Banana chips which undergo the process of peeling, chopping and sun-drying with no additives and banana powder which undergoes the same process and milling are still in their original state.[189]

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[180] BIR Ruling, May 5, 1988; Sec. 8(b)(2), VAT Regs.

[181] BIR Rulings 129-89, June 16, 1989 revoking BIR Ruling 569-88, December 22, 1988.

[182] BIR Ruling, January 8, 1988 and 328-88 of July 15, 1988.

[183] *Supra.*

[184] BIR Ruling 006-89, January 19, 1989.

[185] BIR Ruling of May 5, 1988.

[186] BIR Ruling, February 2, 1988 and 057-88 of March 6, 1988. In view, however, of the BIR Rulings stating that refined sugar and cassava flour are no longer in their original state, the BIR rulings with respect to powdered coffee is of doubtful validity.

[187] BIR Ruling, March 4, 1988; Ruling 235-88, June 3, 1988; Ruling 505-88 October 14, 1988.

[188] BIR Ruling 092-89, May 2, 1989.

[189] BIR Ruling 361-88, July 28, 1988. In the case of banana powder, please refer to the comments regarding powdered coffee.

Fresh water is agricultural food product in its original state.[190]

D. Sales of fertilizers, pesticides and herbicides, chemicals for the formulation of pesticides; seeds, seedlings and fingerlings; fish, animal and poultry fees; soya bean and fish meals.[191]

The exemption applies on importations and all stages of distribution. Chemicals for the formulation of pesticides are exempt.[192] If the raw materials will be sold to a non-manufacturer of pesticides, the sale will be subject to VAT.[193] Sales of fish, animal and poultry feeds are exempt but raw materials for their formulation are not,[194] unless the raw materials consist of soya bean and fish meals, in which case they are exempt.[195]

In an earlier ruling, the BIR held that household insecticides, including rat poisons are exempt.[196] However, the BIR changed its position. Now, pesticides and herbicides are exempt only if used for agricultural purposes; hence, mosquito coils, while considered as insecticides, are subject to VAT.[197] Also, aerosol, moth balls, magic chalks and chemicals for their formulation although used to kill insects are not used for agricultural purposes, hence subject to VAT.[198] Insecticides to kill rice pests are exempt.[199]

Meal and bone meal are animal feeds; hence, exempt.[200] Prawn feeds are considered as fish feeds.[201] Skimmed milk powder is treated as a feed exempt under Sec. 103(c) of the NIRC.[202]

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[190] BIR Ruling, February 1, 1988.

[191] NIRC., Sec. 103(c).

[192] BIR Rulings 133-88, April 11, 1988 and 033-69 of March 7, 1989.

[193] *Supra.*

[194] BIR Rulings 113-88, March 18, 1988 and 062-88 of February 29, 1988.

[195] BIR Ruling 321-88, July 13, 1988.

[196] BIR Ruling, March 1, 1988.

[197] BIR Rulings 178-89, August 18, 1989 and 49-89 of July 13, 1989.

[198] BIR Ruling 166-89, August 9, 1989.

[199] BIR Ruling 022-88, February 2, 1988.

[200] BIR Ruling 507-88, October 14, 1988.

[201] BIR Rulings 062-88, February 29, 1988 and 493-88 of October 12, 1988.

[202] BIR Ruling 556-88, November 24, 1988.

E. Sale or importation of petroleum products subject to excise tax and raw materials to be used in the manufacture of petroleum products subject to excise tax.

Lubricating oil, processed gas, grease, wax and petrolatum and raw materials to be used in the manufacture of lubricating oil and grease are subject to the 10% VAT in addition to excise tax (if applicable).[203] Sales of liquefied petroleum gas (LPG) is exempt.[204] Thinners which are subject to a 24% ad valorem tax under Sec. 145 (b) (2) of the NIRC are exempt but solvents are subject to VAT.[205]

F. Books and Newspapers.[206]

A. Sale of books

Sales or importation of books is exempt without conditions. As used, the term "books", is a general term and embraces all kinds of books including a school or college class album.[207]

The following are considered as books: comic books, coloring books, activity books;[208] references and library books, children's books, dictionaries.[209] A printer of books cannot bill his customers the 10% VAT since the transaction is exempt.[210]

Imported educational filmstrips are not books.[211] Ring binders and tape recordings of music are subject to VAT.[212]

B. Sale of newspapers, magazines, reviews or bulletins.

[203] NIRC, Section 103(d) and (e).

[204] BIR Ruling, October 29, 1987 and 474-88 of October 4, 1988.

[205] BIR Ruling 041-89, March 20, 1989.

[206] NIRC, Sec. 103(f).

[207] BIR Ruling 548-88, November 16, 1988.

[208] BIR Ruling, November 3, 1987.

[209] BIR Ruling, January 29, 1988.

[210] BIR Rulings 500-88, October 14, 1988 and 235-88 of June 29, 1988.

[211] BIR Ruling 441-88, September 14, 1988.

[212] BIR Ruling 035-89, March 6, 1989.

To be exempt, the following conditions must be present: the newspaper, etc. appear at regular intervals, with fixed prices for subcription and sale, and not devoted principally to advertisements.[213] The "Philippine Daily Inquirer" and "Philippine Daily Globe" are exempt.[214] Examples of magazines are song hit magazines, song hits,[215]and komiks.[216] The sale of news and photo services by a foreign press to subscribers for a fixed price and with no advertisements is exempt.[217]

G. Importation of vessels.[218]

Importation of passenger and/or cargo vessels of more than 10,000 tons, whether coastwise or ocean-going, including engine and spare parts, to be used by importer himself as operator is exempt from VAT. If the vessel is 10,000 tons or less, it shall be subject to 10% VAT, [219]even if the vessel is donated to a non-profit institution.[220] If the vessel is intended for pleasure or sports such as a yacht, the importation is subject to an excise tax of 20% and 10% VAT.

H. Services rendered by persons subject to percentage tax under Title V of the NIRC;[221]

These persons are: operators of hotels;[222] operators of restaurants;[223] common carriers and transportation contractors;[224] dealers in

[213] VAT Regs., Sec. 8(b)(6).

[214] BIR Ruling 238-88, June 6, 1988 and 263-88 of June 27, 1988.

[215] BIR Ruling, November 3, 1987.

[216] BIR Ruling 052-89, March 30, 1989.

[217] BIR Ruling, October 22, 1987.

[218] NIRC., Sec. 103(g).

[219] BIR Ruling 144-88 May 10, 1988, 067-88 of March 7, 1988.

[220] BIR Ruling 105-89, May 16, 1989.

[221] NIRC., Sec. 103(j).

[222] *Ibid.*, Sec. 113.

[223] *Ibid.*, Sec. 114.

[224] *Ibid.*, Sec. 115.

securities and lending investors;[225] franchise holders;[226] persons subject to overseas communications tax;[227] banks and non-bank financial intermediaries;[228] finance companies;[229] insurance companies;[230] agents of foreign insurance companies;[231] persons subject to amusement tax,[232] and tax on winnings;[233] and persons whose gross sales do not exceed P200,000 during a twelve month period and who has not opted to register for VAT and who are therefore subject to a two per cent tax [234]

Let us review some of these persons subject to the percentage tax:

a) Operators of hotels[235]

Operators of hotels, etc. are subject to a tax of 12% of their gross receipts derived from room occupancy. With respect to gross receipts derived by a hotel from other services (non-room occupancy), a determination must be made as to whether the receipts should be subject to ten per cent VAT or other types of percentage tax. Thus, for example, receipts derived from certain hotel operations will be taxed as follows: room occupancy - twelve per cent of gross receipts but exempt from VAT; operation of coffee shop and restaurant - the caterer's tax,[236] but exempt from VAT; housekeeping for hotel guests, laundry/valet services - the ten per cent VAT applies if they do not form part of the base of the twelve per cent tax on room occupancy; sales of gift shop - 10% VAT except sale of newspapers, magazines and books which are exempt; and telephone and telex services are subject to percentage tax on franchise holders or the 10%

[225] *Ibid.*, Sec. 116.

[226] *Ibid.*, Sec. 117.

[227] *Ibid.*, Sec. 118

[228] *Ibid.*, Sec. 119; BIR Ruling 246-88, June 8, 1988.

[229] NIRC., Sec. 120.

[230] *Ibid.*, Sec. 121.

[231] *Ibid.*, Sec. 122.

[232] *Ibid.*, Sec. 123.

[233] *Ibid.*, Sec. 124.

[234] *Ibid.*, Sec. 103(w).

[235] *Ibid.*, Sec. 113.

[236] *Ibid.*, Sec. 114.

overseas communications tax but exempt from VAT.[237]

b) Caterers or operators of restaurants.[238]

If an operator of a restaurant sells processed food product and the selling is merely incidental to its principal business of operating a restaurant, said sales are not subject to VAT but to the caterer's tax. Thus, in BIR Ruling 012-88 of January 28, 1988, the taxpayer (X Co.) operated an eating place with take-out counters. X Co. bakes its ownbread together with other bakery products which it sold. The BIR held that X Co., being an operator of a restaurant, was subject to the four per cent caterer's tax. The take-out counter from which it sold bakery products was considered as incidental to the operation of the eating place which was the main line of business and should not be taxed independently. The sales in the take-out counters were subject to the four percent caterer's tax but exempt from the 10% VAT.

c) Common carriers and transportation contractors.[239]

The term "common carrier" does not include a sea and airfreight forwarder who merely acts as an agent of the carrier and therefore, the freight billings of a forwarder are subject to a 10% VAT.[240] This holding is questionable since the freight, if separately indicated, is really being billed by the forwarder as agent of the carrier and should not therefore be liable for the VAT. What should be subjected to VAT is the fee or commission of the forwarder.

All receipts from service hire, or lease of transportation equipment, not subject to carrier's tax shall be subject to VAT.[241]

d) Other persons subject to percentage tax

Outgoing communication services which are subject to ten per cent percentage tax under Sec. 118 of the NIRC are exempt from VAT.[242]

[237] BIR Ruling 158-88, May 12, 1988.

[238] NIRC., Sec. 114.

[239] *Ibid.*, Sec. 115.

[240] BIR Ruling 139-88, April 15, 1988.

[241] VAT Regs., Sec. 6, last paragraph.

[242] BIR Ruling 030-89, January 12, 1989.

The service of a private person delivering mails and parcels is subject to VAT although the rates for delivery are prescribed by the Government except where the person engaged in such services is a franchise holder.[243]

A person engaged in the burying and selling of pre-need plans is a dealer in securities subject to the six per cent tax but exempt from VAT.[244]

I. Services by agricultural contract growers and milling for others of palay into rice, sugarcane into raw sugar, and corn into grits.[245]

Agricultural contract growers refer to those producing for others poultry, livestock or other agricultural and marine food products in their original state.[246]

J. Medical, dental, hospital and veterinary services.[247]

Laboratory services are exempt.[248] While the services are exempt, the sale of medicines is subject to VAT. Sales of medicines by a hospital operating a pharmacy irrespective of whether sold to inpatients or outpatients are subject to VAT,[249] even if the hospital is a non-stock and non-profit institution.[250] Food served to patients confined in the hospital forms part of medical and hospital services, hence, exempt from VAT and caterer's tax.[251] Sale of health care package including benefits and surgical benefits is exempt.

K. Educational services rendered by institutions accredited by the Department of Education, Culture and Sports (DECS) and those rendered by government educational institutions.[252]

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243 BIR Ruling 248-88, June 20, 1988.

244 BIR Ruling 546-88, November 16, 1988.

245 NIRC., Sec. 103(k).

246 VAT Regs., Sec. 9(b)(11).

247 NIRC., Sec. 103(1).

248 VAT Regs., Sec. 8(b) 12; BIR Ruling of March 1, 1988.

249 BIR Ruling 023-88, February 2, 1988 and 403-88 of August 23, 1988.

250 BIR Ruling 240-88, June 6, 1988.

251 *Supra.*

252 NIRC., Sec. 103(m).

The exemption does not include seminars, in-service rendered by persons not accredited by DECS. Importation of equipment to be used for educational purposes by a non-profit, non-stock educational institution and recommended by DECS for tax and duty- free importation are exempt from VAT.[253]

Under the Constitution,[254] all revenues and assets of non-stock, non-profit schools used actually, directly and exclusively for educational purposes shall be exempt from taxes and duties. Pursuant to this provision, the Department of Finance issued Department Order No. 137-87 which provides that:

> * Non-stock, non-profit educational institutions are exempt from tax on all revenues derived in pursuance of its purpose as an educational institution and used actually, directly, and exclusively for educational purposes. They shall, however, be subject to internal revenue taxes on income from trade, business or other activity the conduct of which is not related to the exercise of performance by such educational institution of its educational purpose or function.
>
> * Revenues derived from and assets used in the operations of cafeterias/canteen, dormitories, bookstores are exempt from taxation provided they are owned and operated by the educational institution as an ancillary activities and the same are located within the school premises.
>
> * Revenues derived from and assets used in the operations of hospitals are exempt from taxation provided they are owned and operated by the educational institution as an indispensable requirement in the operation and maintenance of its medical school/college/institute.
>
> The exemption from all taxes includes VAT.

The BIR confirmed that sales of books, school supplies, uniforms and other school related items (such as car stickers) by school stores located within the school premises to be actually, directly exclusively used for educational purposes are exempt from VAT.[255]

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253 BIR Ruling 010-88, January 28, 1988.

254 Article XIV, Sec. 4(3).

255 BIR Ruling of May 8, 1988.

L. Leasing of real property.[256]

Real estate dealers are exempt but real estate brokers are subject to VAT on their gross compensation. Real estate dealers are no longer subject to a privilege tax since this tax has been repealed by EO 273.

Real property is not limited to land and buildings but may include equipment which by law is considered as real property.[257]

Lease of parking lots[258] and of market stalls[259] are considered as leases of real property; hence, exempt from VAT. Before the effectivity of VAT which replaced the four per cent contractor's tax, lessors of parking spaces were considered as independent contractors and therefore, selling leasing services.[260] Under VAT, the BIR appears to have changed their concept of the nature of the activity of lessors of parking spaces. Lease of storage facilities by a port operator from the Government is lease of real property but the storage charges received by the port operator from the cargo owners using the facilities leased from the Government are subject to VAT.[261]

M. Services performed by persons subject to the occupation tax (except customs brokers) under the Local Tax Code, and professional partnerships.[262]

Customs brokers[263] and insurance brokers are subject to VAT. But insurance agents who are individuals and who are subject to occupation tax are exempt.[264] A corporate life insurance general agent is not subject to the occupation tax and hence, subject to VAT.[265] A company engaged as a general manager of several companies is subject to VAT since the

256 NIRC., Sec. 103(q).

257 Civil Code of The Philippines, Art. 415.

258 BIR Ruling 231-88, June 31, 1988.

259 BIR Ruling 252-88, June 8, 1988.

260 NIRC., Sec. 170(j).

261 BIR Ruling 292-88, July 1, 1988.

262 NIRC., Sec. 103(r).

263 BIR Ruling of February 5, 1988.

264 BIR Ruling 040-89, March 20, 1989.

265 BIR Ruling 318-88, July 13, 1988.

management services are not subject to occupation tax and the taxpayer is a corporation, not a professional partnership.[266]

N. Regional Headquarters.[267]

Services of regional headquarters of multinational corporations are exempt.[268]

O. Transactions which are exempt under special laws or international agreements.[269]

Example of an exemption under a special law is that of a BOI-registered services contractor under Article 39(3) of the Omnibus Investments Code of 1987.[270]

Examples of exempt transactions under international agreements are: Per Headquarters Agreement between the International Committee of the REd Cross and the Philippine Government, importations of articles necessary for its use are exempt.[271] Under the Exchange of Notes between the Government of the Philippines and Japan on projects funded by OECF of Japan, Japanese contractors and suppliers of products and services are exempt from VAT.[272] Also, per Agreement between the Philippines and UNESCO, the Philippines agreed not to subject to duties or other charges in connection with the imposition of educational, scientific and cultural materials. Thus, the importations of educational films classified as such under the UNESCO Agreement are exempt from VAT under Section 103(U) of the NIRC.[273]

However, the BIR has taken the position the production or sale of coal by local coal operators with operating agreements with the Government is subject to VAT since the tax exemption privilege to local producers or

266 BIR Ruling 250-88, June 7, 1988.

267 NIRC., Sec. 103(t).

268 BIR Ruling 256-88, June 24, 1988.

269 NIRC., Sec. 103(u).

270 BIR Ruling 048-89, March 8, 1989.

271 BIR Ruling 057-88, February 24, 1988.

272 BIR Ruling 337-88, July 18, 1988.

273 BIR Ruling 035-89, March 6, 1989.

coal under Presidential Decree 972 was withdrawn by Executive Order 93.[274]

VI. CREDITS FOR INPUT TAX

A. Definitions/General Rules on Crediting

Input tax is the VAT paid by a VAT-registered person in the course of his trade or business on importation of goods or local purchases of goods or services from a VAT-registered person. It shall also include with Section 105 of the NIRC and other transitional input taxes as prescribed by the VAT Regulations.[275]

The input tax is allowed as a credit against the output tax (the VAT due on the sale of goods or services). If output tax exceeds the input tax, there is a VAT payable.

If the input tax credits exceed the output tax, the excess may be carried forward and applied against the output tax in the subsequent quarter or quarters. However, if the excess tax credits is due to or is the result of input taxes (a) paid on purchases of capital goods or (b) paid on purchases of goods or services corresponding to zero-rated sales (such as export sales), the options available to the VAT-registered taxpayer are:

1. Carry-forward and apply agains output taxes in the subsequent quarter or quarters; or
2. Apply for the tax issuance of a tax credit certificate (TCC) which may be used in payment of any internal revenue tax liability; or
3. Apply for a tax refund.

In general, if the excess tax credit does not result from purchases of capital goods or zero-rated sales (e.g., input taxes on importations or purchases of raw materials in one quarter simply exceed the output tax on products sold in the same quarter), the excess *may not* be be the subject of an application for a TCC or a tax refund but may only be carried over to the succeeding quarter or quarters.

B. Various Input taxes

A VAT-registered person shall be entitled to the following input

[274] BIR Ruling 042-89, May 19, 1989.

[275] VAT Regs., Sec. 2(q).

credits:

a) VAT on importations or domestic purchases of goods for sale or for conversion into or intended to form part of a finished product for sale.

b) VAT on importations or domestic purchases of goods for sale or for conversion into or intended to form part of a finished product for sale.

c) VAT on goods for use in the manufacture, processing or production of goods for others, or as materials supplied in the sale of services.

d) VAT on capital goods to be used in the trade or business of the taxpayer.

Capital goods is defined to be good with an estimated useful life greater than one year and which are treated as depreciable assets under Section 29(f) of the NIRC, used directly or indirectly in the production or sale of taxable goods or services.[276]

e) VAT on purchases of services performed in connection with the trade or business of the taxpayer.

f) VAT on transactions treated as "deemed sale" under Section 100(b) of the NIRC.

g) VAT on purchases of goods from pioneer enterprise registered with the Board of Investments as of August 1, 1986,[277] otherwise known as the "input tax deemed paid".

BOI-registered pioneer enterprises registered as such as of August 1, 1986 normally enjoys partial or total exemption from internal revenue taxes products shall be considered as an input tax creditable against output tax.[278]

Under the VAT Regulations, "input tax deemed paid" shall be entered into the subsidiary purchase journal as a memo entry by entering the amount in the debit column of the account "input tax deemed paid."[279]

h) Transitional or presumptive input tax

All VAT-registered persons as of December 31, 1987 shall be allowed to claim as tax credit the following transitional or presumptive input taxes:

[276] VAT Regs., Sec. 2(o).

[277] Date of effectivity of EO 36 which deleted the deemed-paid tax provision, Sec. 104(a), NIRC.

[278] NIRC., Sec. 100(b).

[279] VAT Regs., Sec. 22(b).

(1) The full balance of the deferred sales tax credit (DSTC) account as of December 31, 1987 which is accounted for in accordance with the prescribed regulations;

(2) Presumptive input tax equivalent to eight per cent of the value of inventory as of December 31, 1987 of materials and supplies, other than capital goods, which are not for sale or futher processing but for use in the business in their present condition, the tax on which was not taken up or claimed as DSTC; and

(3) Presumptive input tax equivalent to eight per cent of the value of the inventory as of December 31, 1987 of goods for resale, the tax on which was not taken up or claimed as DSTC.[280]

Input tax credit under item (1) will logically apply only to a manufacturer of articles subject to a manufacturer's sales tax or an importer subject to tax on original sales since only a manufacturer and importer have a DSTC on purchases of raw materials. Said manufacturer or importer may also be entitled to the input tax under item (2) on purchases of materials and supplies, the tax on which does not go into a DSTC. A dealer can avail of the input tax credit under items (2) and (3) since he has no DSTC. The BIR maintains that items (3) applies only to goods purchased for the purpose of resale in their present condition [281]and would thus, apply to a dealer. Sellers of services, however, may be entitled only to the transitional input tax under item (2).

The following shall not be entitled to the transitional or presumptive input tax:

1) Capital Goods existing as of December 31, 1987.[282]

2) Goods subject to excise tax existing as of December 31, 1987.

In a memorandum for the Commissioner of Internal Revenue dated January 11, 1988, the Chief of the VAT Division stated that the reason for the provision allowing an eight per cent transitional or presumptive input tax credit is to recognize the sales tax component of the goods on hand as of December 31, 1987. Since goods subject to excise tax were not liable to sales tax before January 1, 1988,[283] said goods do not qualify for the

[280] EO 273, Sec. 25(a); VAT Regs., Sec. 26 (b).

[281] BIR Ruling 019-89, February 3, 1989.

[282] VAT Regs., Sec. 26(b)(2).

[283] Sec. 167(a), NIRC before its amendment by Executive Order 273.

transitional input tax credit.

Based on the above memorandum of the Chief of the VAT Division, importer of articles subject to excise tax existing in the inventory of the importer as of December 31, 1987 may not also entitled to the transitional input tax.

3) Inventory of goods subject to the 10% manufacturer's sales tax under the previous system but now exempt from VAT such as fertilizer, pesticide, herbicide, books existing as of December 31, 1987.

Thus if a taxpayer is engaged in non-VAT or exempt transactions, his inventories existing as of December 31, 1987 corresponding to such non-registered or exempt activity shall not be entitled to a transitional input tax.[284]

4) Inventory of goods as of December 31, 1987 on which the 3% miller's tax was paid, to be processed into or used in the manufacture of finished products subject to VAT.

A miller, with respect to its inventory, appears to be similarly situated as a manufacturer of excise tax. A miller had no deferred sales tax credit account because no tax credit was allowed against a miller's tax (except in the case of an operator or proprietor of refined sugar). A miller will not also qualify under paragraph (3) of Section 25 of EO 273 because under the VAT Regulations, such paragraph refers only to inventory of traders.

Based on the rationale allowing the transitional input tax which is to give recognition to the sales tax component of inventories, the BIR disallowed the availment of the transitional input tax on the inventory of crude coconut oil existing as of December 31, 1987 since coconut oil was not then subject to sales tax but to a three per cent miller's tax.[285]

A trader of goods subject to the 3% miller's tax is not entitled to the 8% transitional input tax of his inventories of said goods as of December 31, 1987.[286]

Following the BIR's rationale on the use of the transitional input tax, it appears that supplies as of December 31, 1987 on which no sales tax was paid, such as crude oil and gasoline, are not entitled to the transitional input tax.

In the case of returnable containers, the taxpayer is entitled to a presumptive input tax of 8% of the value of the inventory of containers as

[284] BIR Ruling 019-89, February 3, 1989.

[285] BIR Ruling 006-89, January 19, 1989.

[286] BIR Ruling 006-89, January 19, 1989.

of December 31, 1987.[287]

In a ruling,[288] the BIR held that the 20% advances sales tax (AST) paid in January 1988 on machinery parts and supplies existing as of December 31, 1987 by a manufacturer cannot be carried over to the VAT quarters in 1988 because the AST was not chargeable to a deffered sales tax credit account (DSTC). The 20% AST was paid on supplies and equipment, not for raw materials. The ruling appears to be correct in so far as it implies that there is no full crediting since only DSTC account are allowed full credit. It is also correct in so far as it implies that there is no presumptive input tax on equipment which are capital goods. But, it is believed that an 8% presumptive input tax can be claimed on supplies which are (non-capital goods) existing as of December 31, 1987.

In a ruling,[289] the BIR allowed a mining company to claim an 8% presumptive input tax on the imported portion of its materials and supplies inventory as of December 31, 1987.

For income tax purpose, the 8% presumptive input tax will reduce the inventory and thus, the cost of sale.[290] In effect, the said input tax becomes an income item. But, the taxpayer is still ahead since the input tax is a tax credit, the effect of which is a peso to peso payment of taxes.

With respect to service contracts completed on or before December 31, 1987 but payments are received after December 31, 1987, said payments shall still be subject to the 4% contractor's tax provided there is compliance with the conditions specified in Sec. 7(g) of the VAT Regulations which essentially requires an information return and the billing by the contractor of the unpaid amount on or before December 31, 1987. If the contract was executed on or before December 31, 1987 but completed thereafter, payments shall be subject to 10% VAT. The contractor is given a relief by way of a presumptive input tax of 8% of his inventory of materials and supplies existing as of December 31, 1987.[291]

If the sub-contractor is not VAT-registered, the primary contractor is not entitled to any input tax credits on his payments to the former.[292]

An advertising agency's commission income for work already

[287] BIR Rev. Regs., No. 3-89.

[288] 020-89, January 27, 1989.

[289] BIR Ruling 033-89, February 9, 1989.

[290] BIR Ruling 102-88, April 13, 1988.

[291] BIR Ruling 251-88, June 20, 1988; BIR Ruling 0158-89.

[292] BIR Ruling 251-88, June 20, 1988.

completed but not yet billed as of December 31, 1988 is subject to the 10% VAT.[293]

Supplemental agreements entered into after December 31, 1987 relating contracts entered into prior to January 1, 1988 are subject to the 10% VAT.[294]

B. Ratable portion of input tax

If a VAT-registered person is also engaged in other activities not subject to VAT, the input taxes paid for purchases of goods and services which cannot be directly attributed to either operation shall be allocated between the VAT taxable operation and the other exempt operation. The allocation formula shall be the VAT taxable sales or receipts over the total amount of gross sales or receipts during the quarter times the total input tax which cannot be directly attributed to either operation and the result is the creditable input tax.[295]

C. Substantiation of claims for input tax credit

In general, the input tax must be supported by a VAT invoice receipt showing the information required by Sec. 108(a) of the NIRC and the VAT Regulations.[296] Effective January 1, 1990, the VAT invoice must follow the forms and requirements of Revenue Regulations 6-89 of September 15, 1989. These new regulations also require a VAT-person whose gross quarterly sales exceed P2,500,000.00 to attach to his VAT return a summary of his sales and purchases in separate lists. The list shall show the name, address, VAT number of each of his buyer and supplier and the total of his sales and purchases per buyer and supplier. This is quite an onerous burden but it appears that the BIR will be using this for cross-checking purposes.

With respect to the input tax on importation, the import entry or equivalent document showing actual payment of the VAT shall support the credit.

Transitional or presumptive input tax shall be supported with

[293] BIR Ruling 105-88, March 17, 1988.

[294] BIR Ruling 226-88, June 2, 1988.

[295] VAT Regs., Sec. 12.

[296] *See* Revenue Regulations No. 6-89, September 19, 1989; please refer also to pages 179-180.

inventory of unused tax credits duly accounted for in the taxpayer's books of accounts and percentage tax returns and inventory of goods, supported a detailed list submitted to the BIR.[297]

VII. OTHER VAT MATTERS

A. Method of Billing the Output Tax

Under the old manufacture sales tax (MST) system, the MST on the raw materials purchased by the manufacturer can be claimed as a tax credit against the MST on the sale of the finished or processed goods only if the supplier (who must also be a manufacturer) bills the MST as a separate item in his sales invoice.[298]

The VAT system did away with the requirement of separate itemization of the supplier's output tax which will be the input tax of the buyer. The output tax shall simply be computed by multiplying the total invoice price by a factor 1/11 and the result shall be 10% output VAT of the seller.

This is illustrated, as follows:

(1) VAT is separately indicated in the invoice

Example:

"A" sold on account to "B" 100 pieces of merchandise "X" for P1,000.00 plus VAT P100.00 and invoiced as follows:

100 pieces of merchandise "X"	P 1,000.00
10% VAT	100.00
Total	P 1,100.00

In this case the input tax of "B" is P100.00.

(2) VAT is not separately indicated in the invoice

Example:

Using the same facts in No. (1) but the invoice given by "A" to "B" is as follows:

297 VAT Regs., Sec. 15.

298 Sec. 166(a), NIRC before its amendment by Executive Order 273.

100 pieces merchandise "X"	P 1,100.00

In this case "A" should segregate the amount intended to cover the tax. The amount intended to cover the tax is arrived at by multiplying the total invoice amount by 1/11 or:

$$\text{P1,100.00} \times 1/11 = \frac{1{,}000 \times 1}{11} = \text{P } 100.00$$

The resulting figure of P100 is the output tax which should be deducted from P1,100 to arrive at the gross selling price of P1,000.00

(3) VAT is separately but incorrectly indicated in the invoice

Example:

"A" sold on account to "B" 100 pieces of merchandise "X" for P1,050 which he billed as follows:

100 pieces merchandise "X" at P10.50	P 1,050.00
Value Added Tax	50.00
Total	P 1,100.00

In this case the tax shall be computed by multiplying the total invoice amount of P1,100.00 by 1/11 to arrive at the output tax payable by the vendor "A".

$$\frac{\text{P } 1{,}100.00 \times 1}{11} = \text{P100.00}$$

On the part of buyer "B" he should also compute his input tax on the same basis as the computation of the output tax. Thus, "B's" input tax is P100.00

B. Optional Registration

There are only five exempt transactions wherein the taxpayer can waive his VAT-exempt status and opt to VAT-register namely: (1) seller of

non-food agricultural products, etc.;[299] (2) seller of agricultural food products, etc.;[300] (3) sale fertilizers, etc.; [301](4) sale of books and newspaper, etc.; and (5) persons where sales do not exceed P200,000.00 over a 12-month period and who is subject to 2% tax.[302] Thus, seller of chemicals for the formulation of pesticides is exempt from VAT but it may opt to be subjected to VAT and thus, claim an input tax credit on its purchases of raw materials.[303] If a person is engaged in an exempt transaction but the law allows him to opt for voluntary VAT registration and he opted to VAT-register, he must wait for two years after date of registration before he can opt to revert to his former exempt status.[304] However, if his registration under VAT was of the mistaken belief that his transaction is not exempt, he may apply for immediate cancellation of his VAT registration.[305]

If a person is engaged in an exempt transactions under Sec. 103(a), (b), (c), (f) and (w) of the NIRC and at the same time is exporting such exempt goods, he cannot opt to VAT-register his export sales only and remain exempt on his local sales.[306] This ruling can place an exporter in a quandary. To be entitled to zero-rated status, an exporter msut VAT-register. If he registers, he loses his exempt status on his domestic sales but is zero-rated on his exports.[307] If he decides not to register, his local sales remain exempt but his export sales will also be merely exempt and hence he cannot get a refund or credit of his input tax on purchases attributable to his exports. This ruling appears to be unsound and ought to be reviewed.

It is to be emphasized that this rule applies to a situation where the same product is both exported and sold locally. But, a person may engage in two or more activities some of which are VAT-taxable, while the others are exempt or non-VAT-taxable. Registration shall only be for the

[299] NIRC., Sec. 103(a).

[300] *Ibid.*, Sec. 103(b).

[301] *Ibid.*, Sec. 103(c).

[302] *Ibid.*, Sec. 103(W); VAT Regs., Sec. 18(c).

[303] BIR Ruling 055-89, March 15, 1989.

[304] VAT Regs., Sec. 18(c).

[305] BIR Ruling 250-88, June 20, 1988.

[306] BIR Ruling 306-88, July 14, 1988.

[307] BIR Ruling 004-88, January 23, 1988.

VAT-activity.[308]

C. Deductability of Output Tax

The output tax is not a deductible expense from taxable income.[309]This appears to be correct since the output tax passed on to the customer is not recorded as part of sales but is recorded as a liablility account "VAT Payable". Upon payment of the VAT, the liability is simply debited. There is no VAT expense incurred by the seller.

D. Invoices

If a VAT-registered person is engaged in both taxable and exempt operations, he should issue separate invoices or receipts for the taxable and exempt operations. The VAT invoice shall be issued only for sales subject to VAT.[310] Purchases of agricultural and marine food products from marginal farmers and fishermen who do not normally issue sales invoices or official receipts may be invoiced by cash voichers of the buyer.[311]

It is sufficient that the unissued invoices as of December 31, 1987 are stamped with VAT-registration number of user. Thereafter any subsequent printing of receipts or invoices must include VAT number of user.[312]

E. VAT Registration

A person who is engaged in both VAT and non-VAT activity is not required to register his non-VAT activity and secure a non- VAT registration number unless he falls under any of the following: person subject to percentage tax under Title V of the Tax Code; VAT-exempt taxpayers under Sec. 103(a), (b), (c), (f) and (w) of the NIRC who did not opt to VAT-register; taxpayers whose VAT registrations have been cancelled under Sec. 107(c) of the NIRC ; and persons subject to excise tax under Title V of the NIRC who are not subject to VAT. In any of these four

[308] BIR Ruling 004-88, January 23, 1988.

[309] BIR Ruling of May 19, 1989.

[310] VAT Regulations, Sec. 21(a); RMC No. 12-88, March 3, 1988.

[311] BIR Ruling dated May 3, 1988.

[312] BIR Ruling, March 8, 1988.

cases, the person must apply for non-VAT registration.[313]

[313] Rev. Regs. No. 6-88, December 8, 1988.

SECTORAL REPRESENTATION AND CONFIRMATION PROCESS: A CONSTITUTIONAL DILEMMA

CRESENCIO V. ASPIRAS, JR.*

The true grounds of decision are considerations of policy and of social advantage, and it is vain to suppose that solution can be attained merely by logic and general propositions of the law, which nobody disputes.

Oliver Wendell Holmes, Jr., dissenting in Vegalan vs Gunther, 167 Mass. at 106.)

On April 6, 1988 President Aquino appointed the second batch of sectoral representatives namely Teresita Quintos-Deles (women), Al Ignatius Loyola (youth), Bartolome Arteche (peasant), and Rey Magno Teves (urban poor). Their appointments were made pursuant to section 7 of the Transitory provisions of the 1987 Constitution which states: Until a law is passed, the President may fill by appointment from a list of nominees by the respective sectors the seats reserved for sectoral representation in paragraph (2), section 5 of Article VI of this Constitution. Unknown to the sectoral representative-appointees, their appointment would become a harbinger of a constitutional dilemma: Whether their appointment needed the Commission on Appointment's confirmation as a condition precedent to the appointees assumption of office.

On the day the appointees were scheduled to take their oaths of office, several congressmen questioned their assumption of office without the Commission on Appointment's (CA) prior confirmation. Representative Romero demanded that the appointments needed to be confirmed. The House leadership decided then to defer the oath taking, causing the appointees to leave the gallery visibly shaken. This legal impediment to the assumption of office subsequently became the subject of a petition by Deles, *et al* for *mandamus and prohibition* praying that Commission on Appointments be enjoined from subjecting to confirmation the petitioners' appointment as sectoral representatives.[1]

In the decision promulgated on September 4, 1989, the Supreme

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[1] Quintos-Deles, et al v. Commission on Appointments, GR No. 83216, May 20, 1988.