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SyCipLaw TIPS TAX ISSUES AND PRACTICAL SOLUTIONS (International Edition)

SyCipLaw TIP 1:
Before filing their annual income tax returns, corporate taxpayers should familiarize themselves with the amended income tax rates under the CREATE Act as the income tax rates applicable to corporations have been reduced and some amendments take effect retroactively from July 1, 2020.

1. What are the salient provisions on income tax under the Corporate Recovery and Tax Incentives for Enterprises Act, or CREATE Act?

On March 26, 2021, President Rodrigo R. Duterte signed the "Corporate Recovery and Tax Incentives for Enterprises Act" (Republic Act No. 11534, the *CREATE Act*) into law. It will take effect within 15 days from its publication in the Official Gazette or in a newspaper of general circulation.

The CREATE Act further amends certain provisions of the National Internal Revenue Code, as amended (the *Tax Code*). As stated in Section 2 of the CREATE Act, the declared policy of the amendments is to "increase the Philippines' global competitiveness by implementing tax policies instrumental in attracting investments, which will result in productivity enhancement, employment generation, countrywide development, and a more inclusive economic growth, while at the same time maintaining fiscal prudence and stability." The CREATE amends the following income tax provisions of the Tax Code:

(a) Income Tax on Domestic Corporations – effective July 1, 2020, **25%** in general and **20%** for corporations with net taxable income not exceeding PhP5 Million and with total assets not exceeding PhP100 Million, excluding land on which the corporation's office, plant and equipment are situated (currently at 30%).

(b) Income Tax on Foreign Corporations Engaged in Trade or Business in the Philippines – effective July 1, 2020, **25%** (currently at 30%).

(c) Minimum Corporate Income Tax on Domestic Corporations and Foreign Corporations Engaged in Trade or Business in the Philippines – effective only from July 1, 2020 to June 30, 2023, **1%** (currently at 2%).

(d) Income Tax on Regional Operating Headquarters – effective January 1, 2022, regular corporate income tax of **25%** (currently at 10%).

(e) Income Tax on Offshore Banking Units – With the repeal by the CREATE Act of the provision on offshore banking units (*OBUs*), OBUs will be subject to the regular corporate income tax of **25%** on Philippine-sourced income (currently, income derived by OBUs from foreign currency transactions with non-residents, other OBUs, local commercial banks, including branches of foreign banks, is exempt from income tax, while income derived by OBUs from foreign currency loans granted to residents other than OBUs or local commercial banks is subject to income tax at 10%) and income of non-residents from transactions with OBUs will be subject to tax (currently exempt).

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(f) Interest Income derived by Resident Foreign Corporations from a depositary bank under the Expanded Foreign Currency Deposit System – **15%** (currently at 7.5%).

(g) Dividends received by Domestic Corporations from Foreign Sources – **exempt** (subject to certain conditions), otherwise **25%** (currently at 30%).

(h) Capital Gains from Sale by foreign corporations of Shares not Traded in the Stock Exchange – **15%** (currently at 5% for gains up to PhP100,000 and 10% for gains over PhP100,000).

(i) Improperly Accumulated Earnings Tax – **repealed** (currently at 10%).

SyCipLaw TIP 2:
The CREATE Act has made the Philippines more competitive with its neighboring countries in terms of attracting foreign investments! Investors intending to engage in a business which qualifies under the Strategic Investment Priority Plan of the Philippines through an export enterprise or a domestic market enterprise should familiarize themselves with the new fiscal incentives granted under Title XIII of the CREATE Act.

2. What fiscal incentives will be granted under the CREATE Act and who can avail themselves of these incentives?

The CREATE Act introduces in the Tax Code a new Title on Tax Incentives, or Title XIII, which rationalizes tax incentives and will cover Investment Promotion Agencies, which are defined under the CREATE Act as government agencies in charge of promoting investments, granting and administering tax and non-tax incentives, and overseeing the operations of economic zones and freeports. This new law amends certain special laws that grant tax incentives administered by existing Investment Promotion Agencies. To qualify for incentives, the activity has to be under the Strategic Investment Priority Plan which will be approved by the President.

Under Title XIII, the following tax incentives may be granted to registered projects or activities: (a) Income Tax Holiday (*ITH*) period; (b) Special Corporate Income Tax (*SCIT*) Rate; (c) Enhanced Deductions (*ED*) from taxable income; (d) duty exemption on importation of capital equipment, raw materials, spare parts, or accessories; and (e) Value-Added Tax (*VAT*) exemption on importation and VAT zero-rating on local purchases.

Qualified export enterprises may be granted an ITH period of four (4) to seven (7) years, followed by a period of ten (10) years of SCIT, or ED (based on the applicable regular income tax). Qualified domestic market enterprises may be granted an ITH period of four (4) to seven (7) years, followed by a period of five (5) years of ED (based on the applicable regular income tax).

The SCIT is a rate of 5% of gross income earned, and is in lieu of all national and local taxes. On the other hand, the EDs comprise the following: (a) additional deduction of 10% for buildings and 20% for machinery and equipment; (b) additional deduction of 50% of direct labor expense; (c) additional deduction of 100% of research and development; (d) additional deduction of 100% on training expense; (d) additional deduction of 50% on domestic input expense; (e) additional deduction of 50% on power expense; (f) deduction for reinvestment allowance to manufacturing company; and (g) Net Operating Loss Carry Over (*NOLCO*) – the net operating loss of the registered project during the first three (3) years from the start of commercial operations which has not been previously deducted from gross income can be carried over to the next five (5) consecutive taxable years immediately following the year of the loss.

3. What is the Financial Institutions Strategic Transfer (FIST) Act and what are the tax incentives under this new law?

Republic Act No. 11523, or the “Financial Institutions Strategic Transfer (FIST) Act” (the *FIST Act*), seeks to assist banks and financial institutions in dealing with the adverse effects of the COVID-19 pandemic. This law took effect on February 18, 2021 and it provides a legal framework for the full transfer of bad loans and non-performing assets of banks and financial institutions by allowing them to clean their books and re-channel their resources to improve liquidity in the financial system.

Under the FIST Act, the transfer of non-performing assets (*NPAs*) from a financial institution to a Financial Institutions Strategic Transfer Corporation (*FISTC*), and from an FISTC to a third party, or a dation in payment by the borrower or by a third party in favor of a financial institution or an FISTC, will be exempt from the following taxes, when applicable: (a) documentary stamp tax (*DST*); (b) capital gains tax on the transfer of lands and/or other capital assets; (c) creditable withholding tax on the transfer of land and/or buildings treated as ordinary assets; and (d) VAT on the transfer of the NPAs.

SyCipLaw TIP 3:
Banks and financial institutions with NPLs and NPAs should familiarize themselves with the tax incentives and other privileges under the FIST Act as it provides them with an opportunity to dispose of their NPLs and NPAs at lower transaction costs. However, they will have only until February 18, 2023 to transfer the NPLs and NPAs in order to avail themselves of such incentives and privileges.

The following fees are also entitled to a fifty percent (50%) discount: (a) applicable registration and transfer fees on the transfer of real estate mortgage and security interest to and from the FISTC; (b) filing fees on any foreclosure initiated by the FISTC in relation to any NPA acquired from a financial institution; and (c) land registration fees.

The incentives are time bound. For example, transfers of NPAs from financial institutions to an FISTC must be done within two (2) years from the effectivity of the FIST Act, while transfers from a FISTC to third parties are given a five (5)-year window from the acquisition of NPAs to dispose of the same with incentives.

Further, to encourage the infusion of capital and financial assistance by the FISTC for the purpose of rehabilitating a borrower’s business, (a) the FISTC shall be exempt from income tax on net interest income and from DST and mortgage registration fees on new loans to such borrower with non-performing loans (*NPLs*) acquired by the FISTC, and (b) in case of capital infusion by the FISTC to the borrower with NPLs, the FISTC will be exempt from DST. These additional tax exemptions and privileges shall likewise be available for a five (5)-year period from the acquisition of the NPLs.

SyCipLaw TIP 4:
In a claim for input VAT refund or credit attributable to zero-rated sales, the BOI-registered taxpayer must submit VAT invoices, which must be compliant with VAT invoicing requirements, as well as export declarations, bills of lading or airway bills and the like to prove the actual existence of export sales subject to zero percent (0%) VAT; otherwise, the tax refund or credit claim would be denied. A BOI certification, which states that the BOI-registered entity exported 100% of its products, serves only as authority for the seller-supplier of the BOI-registered entity to avail itself of the benefits of zero-rating. It is not, however, considered as sufficient evidence for a BOI-registered entity to prove that its export sales are zero-rated.

4. Is a Board of Investments certification sufficient to support VAT zero-rating of export sales of a BOI-registered entity?

No. In *Philippine Gold Processing and Refining Corp. v. Commissioner of Internal Revenue* (G.R. No. 222904, July 15, 2020), the Philippine Supreme Court ruled that a Board of Investments (*BOI*) certification is insufficient to support a taxpayer’s claim for refund of input VAT attributable to its zero-rated export sales. In this case, the taxpayer is a BOI-registered entity claiming a refund or credit of its input VAT and, as proof of its export sales, it submitted a BOI certification acknowledging that its sales are VAT zero-rated. Petitioner insisted that the BOI certification is sufficient evidence to prove that it exported 100% of its sales in 2009 and to require the submission of invoices showing sales subjected to zero percent (0%) VAT rate would be unnecessary.

Although the Supreme Court stated there is no dispute that the taxpayer is a BOI-registered entity which exports 100% of its products, it declared that it has consistently ruled that the failure to comply with all the documentary and evidentiary requirements, such as the VAT invoicing requirements under tax laws and regulations, is fatal to a claim for input VAT refund. The Supreme Court explained that the BOI certification is required under Revenue Memorandum Order No. 9-2000, which prescribes the conditions for the automatic zero-rating of sales of goods, properties and services made by VAT-registered suppliers to BOI-registered manufacturers-exporters with 100% export sales.

Thus, the BOI certification serves as authority for the seller-supplier to avail itself of the benefits of zero-rating for its sales to BOI-registered buyers, and not the other way around, i.e., the BOI-registered entity may not use the certification as proof of an export sale in its claim for input VAT refund. Instead, such zero-rated sales by a BOI-registered entity must be evidenced by a VAT invoice which must reflect: (a) the Bureau of Internal Revenue (*BIR*) Permit to Print; (b) the VAT-registered Tax Identification Number of the purchaser; and (c) the word "zero-rated" imprinted thereon. Further, the taxpayer must submit export declarations and bills of lading, airway bills, or other similar documents, to prove its export sales.

5. Are sales of goods to a BOI-registered enterprise automatically considered as zero-rated export sales?

No. In *Commissioner of Internal Revenue v. Filminera Resources Corp.* (G.R. No. 236325, September 16, 2020), the Supreme Court ruled that proof of actual exportation of goods sold by a VAT-registered taxpayer to a BOI-registered enterprise is vital for a transaction to be considered as a zero-rated export sale. In other words, sales made to a BOI-registered buyer are considered export sales subject to the zero percent (0%) VAT rate only if the following conditions are met: (a) the buyer is a BOI-registered manufacturer/producer; (b) the buyer's products are 100% exported; and (c) the BOI certified that the buyer exported 100% of its products. For this purpose, a BOI certification is vital for the seller-taxpayer to avail itself of the benefits of zero-rating.

In this case, which involves a claim for input VAT refund in relation to sales made by the claimant in 2010, the seller-taxpayer submitted a BOI certification with a validity period from January 1 to December 31, 2010 to establish that the buyer is a BOI-registered enterprise that exported its total sales volume. However, the BOI certification shows that the BOI-registered entity exported 100% of its total sales volume from January 1 to December 31, 2009.

The Supreme Court explained that the validity period of the BOI certification, which is from January 1 to December 31, 2010, should not be confused with the period identified in the BOI certification when the buyer actually exported 100% of its products, i.e., January 1 to December 31, 2009. In order for its sales to qualify as zero-rated, the BOI must certify that the BOI-registered entity-buyer actually exported its entire product within the covered period expressly provided in the BOI certification.

SyCipLaw Tip 5:
In order to avail itself of VAT zero-rating, a seller to a BOI-registered buyer must ensure that the BOI-registered buyer actually exported such products. Thus, it must obtain a BOI certification that states that the BOI-registered buyer actually exported its products during the period expressly provided in the BOI certification, which period should not be confused with the validity period of the certification. A discrepancy between the period of the actual exportation in the BOI certification and the subject period of sales in the administrative claim of input VAT refund or credit is fatal.

6. What are the requirements to establish that an entity is a non-resident foreign corporation for purposes of VAT zero-rating under Section 108(B)(2) of the Tax Code?

In Commissioner of Internal Revenue v. Deutsche Knowledge Services, Pte. Ltd. (G.R. No. 234445, July 15, 2020), the Supreme Court ruled that in order to claim refund of input VAT for sales subject to VAT zero-rating under Section 108(B)(2) of the Tax Code, the claimant must establish the two components of a client's non-resident foreign corporation (*NRFC*) status, namely: (a) that the customer of the claimant was established under the laws of a country not the Philippines (i.e., it is not a domestic corporation); and (b) that the customer is not engaged in trade or business in the Philippines.

In establishing the foregoing two components of a client's NRFC status, the Supreme Court has ruled that a Securities and Exchange Commission (*SEC*) Certification of Non-Registration (i.e., a SEC negative certification) would show that a customer is a foreign corporation. On the other hand, the articles of foreign association/certificates of incorporation, stating that a client is registered to operate in their respective home countries outside the Philippines, are prima facie evidence that the customer is not engaged in trade or business in the Philippines. The absence of evidence proving either of the two components shall be fatal to a claim for credit or refund of excess input VAT attributable to zero-rated sales.

SyCipLaw Tip 6:
To prove entitlement to VAT zero-rating under Section 108(B)(2) of the Tax Code on a sale to an NRFC, the seller/taxpayer must present the SEC negative certification and articles of foreign association/certificates of incorporation of the NRFC; otherwise, the tax refund or credit claim attributable to zero-rated sales would be denied.

7. How can you avail yourself of the reduced rate of 15% on dividends paid by a domestic corporation to an NRFC?

Under the Tax Code, intercorporate dividends paid by a domestic corporation to an NRFC are subject to the reduced dividend income tax rate of 15%, provided that the country of residence of the NRFC allows a credit against its tax due from the NRFC taxes deemed to have been paid in the Philippines equivalent to 15% (which will be 10% effective retroactively from January 1, 2021, once the CREATE Act takes effect as the regular 30% rate will be reduced to 25% by the CREATE Act). In Revenue Memorandum Order No. 046-2020 (*2020 Tax Sparing RMO*), the BIR outlined the procedure for availment of the reduced dividend rate.

The domestic corporation paying the dividends may remit outright the dividends to the NRFC and apply the reduced rate of 15%, without first securing a ruling from the BIR. Instead, a request for confirmation of the applicability of the reduced dividend rate shall be filed with the BIR's International Tax Affairs Division (*ITAD*) within ninety (90) days from the remittance of the dividends or from the determination by the foreign tax authority of the deemed paid tax credit/non-imposition of tax, whichever is later.

If the request is granted, a certification shall be issued duly signed by the Assistant Commissioner for Legal Service (in lieu of the usual BIR ruling). If the request is denied, a BIR ruling will be issued containing the factual and legal bases for the denial, signed by the Commissioner of Internal Revenue or his authorized representative. The denial can be appealed to the Department of Finance within thirty (30) days from receipt thereof.

SyCipLaw TIP 7:
The reduced rate of 15% may be applied to the cash and/or property dividends declared to an shareholder by a domestic corporation without first having to secure a favorable ruling from the BIR. However, a request for confirmation of the applicability of the 15% rate must be filed subsequent to the remittance of the dividend.

8. Can holders of Philippine Depositary Receipts avail themselves of the tax sparing rate of 15% on intercompany dividends paid by a domestic corporation to an NRFC?

Yes, under certain conditions. Under the 2020 Tax Sparing RMO, dividend payments to Philippine Depositary Receipt (*PDR*) holders may also be entitled to the reduced rate of 15% (instead of the 30% final withholding tax; once the CREATE Act become effective, this will be 25%), provided that (a) the PDR is coupled with a right to purchase the underlying shares, and (b) the said right can be legally exercised.

The RMO describes a PDR as a document that gives the holder (a) the right to purchase the underlying shares at a specified price or the right to the delivery of the sales proceeds of the underlying shares, and (b) entitles its holder to the dividends accruing to the underlying shares.

The BIR clarified in the RMO that, under the Tax Code, "shareholders" include holders of options to purchase shares of stock of a corporation and "dividends" include any distribution made by a corporation to its shareholders out of its earnings or profits and payable to its shareholders. From the foregoing definition, it may be inferred that a holder of a PDR may likewise be considered as a shareholder. Consequently, payments to PDR holders are dividends that can avail of the reduced rate of 15% applicable to dividend payments to NRFCs.

SyCipLaw TIP 8:
It is important to determine whether a right to purchase underlying shares accompanying a PDR can be legally exercised without violating the nationality provisions of the Constitution and special laws as this requirement is specified in the 2020 Tax Sparing RMO. If the ownership of the underlying shares is reserved to Philippine nationals, the foreign PDR holder may not be able to purchase the underlying shares, and thus may only be entitled to the monetary value or sales proceeds thereof. Considering the requirements under the 2020 Tax Sparing RMO, such foreign PDR holders may not be able to avail themselves of the 15% tax sparing rate on dividend payments they receive on the PDRs.

9. Will foreign employees stranded in the Philippines due to the COVID-19 pandemic be subject to Philippine income tax?

Generally, under the tax treaties of the Philippines with other countries, the Philippines may tax the employment income of a non-resident individual if the employee is present for more than 183 days in the Philippines.

In *Revenue Memorandum Circular 83-2020*, the BIR clarified that, when an individual is prevented from leaving the Philippines as a result of the travel restrictions imposed by the government to contain the COVID-19 pandemic, the individual will not be regarded as being present in the Philippines for tax residence purposes for the period after the scheduled day of his/her departure. This is subject to the condition that the individual leaves the Philippines as soon as the circumstances would permit, such as when the travel restrictions and/or quarantine measures have been lifted.

SyCipLaw TIP 9:
Do not discard the confirmed booking or flight itinerary for the cancelled flight of the foreign national employee. A certified true copy of the confirmed booking or flight itinerary for the original flight is one of the documents required to prove that the extended presence in the Philippines was due to COVID-19 travel restrictions.

Therefore, if for example a non-resident alien was sent by their foreign employer to the Philippines to work for a domestic company for a period of ninety (90) days but was unable to leave the country after the ninety (90)-day period due to the travel restrictions and quarantine measures imposed by the Philippine Government, the non-resident alien's tax residence will not change due to such temporary dislocation, even if said non-resident alien is stranded and the total period of his stay in the Philippines exceeds one hundred eighty three (183) days.

To prove that the extended presence in the Philippines was due to COVID-19 travel restrictions, the following documents are required: (a) authenticated sworn certification stating the facts and circumstances of the employee's presence in the Philippines; (b) duly executed contract/s concluded by the employee in the Philippines for the employer; (c) certified true copy of the confirmed booking or flight itinerary for the original flight; (d) certified true copy of the confirmed booking or flight itinerary for the re-booked flight; (e) certified copy of the travel advisory on the cancellation of flight issued by the airline company; (f) certified true copy of boarding pass; and (f) certified true copy of the employee's passport.

SyCipLaw TIP 10:
It would be prudent for any taxpayer who is a resident of the Philippines to regularly obtain a TRC from the BIR if it earns any income offshore. Otherwise, the taxpayer may not able to claim tax treaty benefits available to it in a foreign country and its foreign-sourced income will be taxed by both the Philippines and such foreign country. In addition, the resident taxpayer may not be able to fully utilize as a tax credit against its Philippine income tax, income taxes actually paid in the foreign country.

10. How does one apply for a Philippine Tax Residency Certificate?

The BIR has started to implement stricter rules on the issuance of Tax Residency Certificates (*TRC*) to avoid abuse and misuse thereof. Towards this end, instead of stamping the TRC Forms of the Philippines' tax treaty partners, the BIR designed and issued its own TRC Form (i.e., BIR Form No. 0902) to confirm tax residency in the Philippines.

The streamlined process for issuing TRCs under Revenue Memorandum Order No. 043-20 is as follows: (a) in lieu of a letter request, the applicant shall submit BIR Form No. 0902 together with the required attachments; (b) the case officer shall evaluate the completeness of the documents and inform the applicant of any deficiencies within three (3) working days via email or regular mail; and (c) the application shall be acted upon within fourteen (14) working days from submission of complete documents.

The BIR will then issue the TRC, signed by the Assistant Commissioner for Legal Service. Applications filed with the Revenue District Offices or Large Taxpayers Divisions will be immediately indorsed to the ITAD.

To be entitled to tax treaty benefits and avoid being subjected to the regular tax imposed in the other contracting state, the Philippine tax resident must secure a TRC for presentation to the foreign tax authority. Philippine taxpayers who fail to secure a TRC will not be allowed to claim foreign tax credits in excess of the lower taxes they would have been entitled to on their income from the other contracting state had they invoked the provisions of the applicable treaty and proved residency in the Philippines. In other words, the Philippines will assume that the Philippine taxpayer availed of the benefits under the relevant tax treaty (whether or not the taxpayer availed of such benefits in the foreign country).

By way of illustration, if ABC Corp., a domestic corporation, derives income from Country X and is taxed at the regular rate of 30% when, under the applicable tax treaty, it should have been taxed at the lower rate of 15% on income sourced from Country X had it presented a TRC to Country X, ABC Corp. will be allowed to claim only the amount corresponding to the 15% preferential tax rate as a credit against income taxes due in the Philippines.