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SyCipLaw TIPS

TAX ISSUES AND PRACTICAL SOLUTIONS

1. What are the requirements to claim tax exemption for the procurement, importation, donation, storage, transportation, deployment, and administration of COVID-19 vaccines?

The Secretary of Finance issued Revenue Regulations No. 1-2021 (*RR No. 1-2021*) which implements the tax incentives granted under Republic Act No. 11525, or the "COVID-19 Vaccination Program Act of 2021." RR No. 1-2021 is effective from January 1, 2021.

Based on RR No. 1-2021, the following entities may avail themselves of tax incentives: (a) the National Government, through the Department of Health and the National Task Force Against COVID-19; (b) any of the political subdivisions of the State; and (c) private entities and international humanitarian organizations, such as the Philippine Red Cross (collectively, the *Qualified Entities*). The procurement, importation, donation, storage, transportation, deployment, and administration of COVID-19 vaccines by the Qualified Entities are exempt from value-added tax (*VAT*), excise tax, and donor's tax, as well as other fees for as long as the vaccines are not intended for resale or other commercial use, and are distributed without any consideration from the persons to be vaccinated.

In order to qualify for the tax exemption, the Qualified Entities must present the following: (a) a certified true copy of the COVID-19 vaccine procurement agreement/multiparty agreement, as may be applicable; (b) a certified true copy of the COVID-19 vaccine's Certificate of Product Registration or Emergency Use Authorization issued by the Food and Drug Administration (*FDA*); and (c) a sworn declaration from the taxpayer-buyer/importer/donee that the vaccines are not for resale or other commercial use, and shall be distributed without consideration, in accordance with the COVID-19 Vaccination Program of the National Government. If the vaccines are donated to the Qualified Entities, the latter should also present a certified true copy of the duly accepted Deed of Donation or, for private entities and international humanitarian organizations, Bureau of Internal Revenue (*BIR*) Form 2322 representing a Certificate of Donation.

SyCipLaw TIP 1:
Taxpayers should note that since the procurement of COVID-19 vaccines and the services rendered in relation to their storage, transportation, deployment and administration are not subject to VAT, no VAT should form part of the contract price. Since importations of COVID-19 vaccines by Qualified Entities are also not subject to VAT and excise taxes, an Authority to Release Imported Goods is no longer required prior to their release.

2. How are the amendments under the Corporate Recovery and Tax Incentives for Enterprises (*CREATE*) Act on certain final taxes implemented by the BIR?

Revenue Regulations No. 2-2021 (*RR No. 2-2021*) implements the revised rates of final tax on certain types of income under Republic Act No. 11534, or the CREATE Act, by further amending Revenue Regulations No. 9-98.

RR No. 2-2021 provides that winnings by non-resident aliens engaged in trade or business in the Philippines is subject to a 20% tax, except for their winnings from the Philippine Charity Sweepstakes Office (*PCSO*) games amounting to PhP10,000 or less, which shall be exempt from income tax.

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SyCipLaw TIP 2:
Taxpayers may file a claim for tax refund for taxes withheld if the withholding agents used a higher rate. The claim may be filed with the Revenue District Office/ Large Taxpayer Service having jurisdiction over the withholding agents.

With regard to income payments to resident foreign corporations, RR No. 2-2021 provides that interest on any currency bank deposit and yield or other monetary benefit from deposit substitute and from trust funds is now subject to a final withholding tax of 20%, while a final withholding tax of 15% applies to interest income derived from a depository bank under the expanded foreign currency deposit system.

The rate of capital gains tax on the sale by a resident foreign corporation or a non-resident foreign corporation of shares of stock not traded in the stock exchange is now 15%.

For other Philippine-sourced income derived by a non-resident foreign corporation, a reduced final withholding tax rate of 25% is now imposed on gross income from all sources within the Philippines. While dividends received from a domestic corporation by a non-resident foreign corporation is taxed at 25%, a lower tax of 15% is imposed if the country of the non-resident foreign corporation allows a 10% credit against the tax due from the non-resident foreign corporation, or does not impose any income tax, on dividends by the non-resident foreign corporation from a domestic corporation.

RR No. 2-2021 also provides that purchases made by government-owned and controlled corporations, National Government agencies, local government units, and other government instrumentalities from persons or entities subject to percentage tax are subject to a 1% withholding tax for the period of July 1, 2020 to June 30, 2023.

3. How will the Commissioner of Internal Revenue disclose to the Department of Finance information on entities receiving tax incentives?

Section 20 (B) of the National Internal Revenue Code, as amended (*Tax Code*) provides that the Secretary of Finance may order the Commissioner of Internal Revenue (*CIR*) to furnish the Department of Finance (*DOF*) such specifically identified information related to entities receiving incentives under Title XIII of the Tax Code. Revenue Regulations No. 3-2021 (*RR No. 3-2021*) sets out the procedure on how the Secretary of Finance may order the CIR to submit the said information.

The term "Tax Related and Pertinent Information," according to RR No. 3-2021, "refers to tax returns and any amendments thereof, including those pertinent information which can be associated with, directly or indirectly, to a particular taxpayer, regarding its business income, operations, style or the work or apparatus of any manufacturer or producer."

A DOF officer must file a request for Tax Related and Pertinent Information upon authority of the Secretary of Finance and the request must be addressed to the CIR. Such request must identify:

SyCipLaw TIP 3:
Taxpayers should note that unless the taxpayer consents in writing to a disclosure, the Secretary of Finance and the relevant DOF officers and employees handling the information obtained from the CIR are also covered by the provision on Unlawful Divergence of Trade Secrets in the Tax Code, which provides that subject to certain exceptions under the Tax Code and Republic Act No. 6388, any officer or employee of the BIR "who divulges to any person or makes known in any other manner than may be provided by law information regarding the business, income or estate of any taxpayer, the secrets, operation, style or work, or apparatus of any manufacturer or producer, or confidential information regarding the business of any taxpayer, knowledge of which was acquired by him in the discharge of his official duties," shall be punished upon conviction.

(a) the specific information sought; and (b) the reason or justification for the request of information related to the incentives granted to a particular entity.

All requests from the DOF and responses to such requests should be coursed through the CIR. Without prior written approval of the CIR, no revenue official or employee may provide, in any manner, official information or documents relative to the grant of incentives to the DOF.

SyCipLaw Tip 4:
RR No. 4-2021 provides that the excess unutilized VAT paid due to the inclusion of the VAT-exempt items listed above may be carried over to the succeeding taxable quarters or be charged as part of the cost. If the input VAT can be directly attributed to the goods that are now VAT-exempt, the input VAT may be allowed as part of the cost. For input VAT that cannot be attributed to goods now classified as VAT-exempt, only a ratable portion thereof shall be charged to cost. Note that if the input VAT is allowed as part of the cost, it cannot be fully recovered, unlike in the case of creditable input VAT.

4. What are the new provisions on VAT and percentage tax, and the new corporate income tax rates, under the CREATE Act?

The DOF issued Revenue Regulations No. 4-2021 (*RR No. 4-2021*), which implements the amended provisions on VAT and percentage tax under the CREATE Act, and further amended Revenue Regulations No. 16-2005 (or the *Consolidated VAT Regulations of 2005*). RR No. 4-2021 enumerates the following additional VAT-exempt transactions:

a. Sale, importation, printing, or publication of books, and any newspaper, magazine, journal, review bulletin, or any such educational reading material covered by the United Nations Educational, Scientific and Cultural Organization (*UNESCO*) Agreement on the importation of educational, scientific and cultural materials, including the digital or electronic format thereof; provided that the materials are not dedicated principally to the publication of paid advertisements and are compliant with the requirements set forth by the National Book Development Board;

b. Sale or importation of prescription drugs and medicines for diabetes, high cholesterol and hypertension beginning January 1, 2020;

c. Sale or importation of prescription drugs and medicines for cancer, mental illness, tuberculosis, and kidney diseases beginning January 1, 2021; and

d. Sale or importation from January 1, 2021 to December 31, 2023, of capital equipment, its spare parts and raw materials, necessary for the production of Personal Protective Equipment (*PPE*) components, drugs, vaccines, and medical devices prescribed and directly used for treatment of COVID-19, and drugs for treatment of COVID-19 approved by the FDA for clinical trials, and raw materials directly necessary for its production.

Excess percentage tax payments resulting from the decrease of the tax rate from 3% to 1% starting July 1, 2020 until June 30, 2023 may be carried forward to the succeeding taxable quarter/s by reflecting the excess percentage tax payment under Line 17 of the Quarterly Percentage Tax Return (BIR Form No. 2551Q) on “Other Tax Credit/Payment” and specifying the excess as “Carry-Over Excess Percentage Taxes Paid from Previous Quarter/s.”

Excess or unutilized input taxes as a result of the change of status from VAT to Non-VAT registration may be subject to refund or the issuance of a Tax Credit Certificate, at the option of the taxpayer.

On the other hand, Revenue Regulations No. 5-2021 (*RR No. 5-2021*) enumerates the new corporate income tax rates imposed by the CREATE Act. SyCipLaw’s Tax Department has prepared an article on the new corporate income tax rates in the international edition of its Tax Issues and Practical Solutions (T.I.P.S.) for the month of March, which may be accessed at https://tinyurl.com/SyCipLaw-TIPS-International.

5. How can a domestic corporation apply for the exemption from income tax on foreign-sourced dividends that is provided under the CREATE Act?

Revenue Regulations No. 5-2021 (*RR No. 5-2021*) provides that dividends received by a domestic corporation from a foreign corporation may be exempt from income tax if:

a. The dividends actually received or remitted into the Philippines are reinvested in the business operations of the domestic corporation within the next taxable year from the time the foreign-source dividends were received or remitted;

b. The dividends received are only used to fund the working capital requirements, capital expenditures, dividend payments, investment in domestic subsidiaries, and infrastructure project; and

c. The domestic corporation uninterruptedly and directly holds at least twenty percent (20%) in value of the outstanding shares of the foreign corporation and has held the shareholdings uninterruptedly for a minimum of two (2) years at the time of the dividends distribution. If the foreign corporation has been in existence for less than two (2) years at the time of dividends distribution, the domestic corporation must have continuously and directly held their shares during the entire existence of the foreign corporation.

SyCipLaw Tip 5:
Should the domestic corporation avail itself of the tax exemption, the taxes paid to, or incurred by that corporation in the state where the foreign corporation is located shall not be allowed as a credit or deduction from such domestic corporation's gross income under the Tax Code. In addition, such taxes paid or incurred by the domestic corporation in such foreign state shall not be considered in computing the limitation on credit under the Tax Code.

In order to avail itself of the tax exemption, the domestic corporation must do the following:

a. Submit to the concerned BIR office, within thirty (30) calendar days from the receipt of the dividends, a Sworn Statement or Affidavit of a responsible corporate officer stating: (1) the fact of actual receipt of the dividends; (2) the amount and source of such dividends, including the domestic corporation's shareholdings in the foreign corporation and its holding period at the time of dividend distribution, and (3) a statement that the domestic corporation shall fully comply with the conditions of the exemptions above stated.

b. Attach to the Audited Financial Statement (*AFS*) of the year of receipt of dividend the Independent Auditor's Sworn Statement, which provides: (1) the fact of actual receipt of the remitted dividends; (2) the amount and source of such dividends, including the domestic corporation's shareholdings in the foreign corporation and its holding period at the time of dividend distribution; (3) the fact that the domestic corporation's Board has appropriated or planned to reinvest the dividends in its business operations to fund its working capital requirements, capital expenditures, dividend payments, investment in domestic subsidiaries, or infrastructure project, and (4) a statement that disbursement of the fund (if any) complies with the above requirements.

   A disclosure of the dividends in the AFS shall also be attached to the annual Income Tax Return (*AITR*) on the year of the receipt and the amount of dividend deemed exempt from income tax shall be declared in the reconciliation part of the AITR.

c. Attach to the AITR of the following taxable year, a Sworn Certification by an Independent Auditor on the utilization or non-utilization of the dividends by the corporation. Should the dividends or portion thereof be unutilized, the corresponding income tax due on the time of receipt shall be declared taxable income and surcharges, interest, and penalty, if any, shall apply.

6. What provisions in the CREATE Act were vetoed by the President?

The BIR issued Revenue Memorandum Circular No. 42-2021 (*RMC No. 42-2021*) last March 31, 2021, which sets out the following provisions of the CREATE Act that were vetoed by the Philippine President:

a. Section 109(P), which increases the VAT thresholds to PhP2.5 million for residential lots and PhP4.2 million for house and lot and other residential dwellings.

b. Section 204, which prescribes timelines on credit or refund of taxes or penalties. – The CREATE Act would have amended the Tax Code and provided a ninety (90)-day period from the date of complete submission of documents for the CIR to either grant a refund for taxes or penalties or state in writing the legal and factual basis for the denial of the claim. With the veto, the BIR will have more time to complete its audit.

SyCipLaw Tip 6:
Taxpayers should take note of the vetoed items so as not to confuse them with the provisions of the CREATE Act that are already effective. Taxpayers must also analyze the implications of a partial veto of a provision on the remaining portions of such provisions and other related provisions.

c. The following sections on the new Title XIII on Tax Incentives:

c.1. Section 293(g), which defines investment capital. – The CREATE Act would have defined investment capital as "the value of investment indicated in Philippine currency excluding the value of land and working capital that shall be used to carry out a registered project or activity, except that land shall be included as investment capital for registered real estate development." With the veto, investment capital will be interpreted pursuant to "the measures now used by investment promotion agencies to determine the scale of an investment."

c.2. Portions of Sections 294(B), 295(B), and 296(A and B). – The CREATE Act would have provided for the conditions for a domestic market export enterprise with a minimum investment capital of PhP500 million and one under the Strategic Investment Priority Plan engaged in activities that are classified as critical for availing a Special Corporate Income Tax of 5%. This special rate is no longer available because of the veto.

c.3. Section 296, which would have allowed an additional fourteen (14) to seventeen (17) years of incentives and another ten (10)-year extension for the same activity on top of the original period of incentives.

c.4. Section 297 on the functions of the Fiscal Incentives Review Board (FIRB) under Sections 297(A)(1) and (5), (E), (G), (H), (J), and (K) to be exercised in relation to the grant of tax incentives to registered projects or activities with the total investment capital of more than PhP1 billion. – With the veto, the FIRB will be able to exercise the functions in the said provisions over registered projects or activities with the total investment capital of PhP1 billion or lower.

c.5. Section 296(B), which enumerates activities under paragraphs 9 and 12. – With the veto, activities in certain industries will no longer be subject to tax incentives.

c.6. Section 301, which prescribes the conditions when the President may, "upon request of an Investment Promotion Agency, exempt the latter from the coverage of the provisions of Title XIII of this Code with respect to the review and approval of applications for incentives, or modify the policy on thresholds for Fiscal Incentives Review Board approvals."

c.7. Section 297(B), which prescribes an automatic approval application for tax incentives within twenty (20) days from the date of submission of the application and complete relevant supporting documents to the FIRB or the Investment Promotion Agency.

7. What are the new rules for availing of tax treaty benefits?

The BIR issued Revenue Memorandum Order No. 14-2021 (*RMO No. 14-2021*), which streamlined the procedures and documents for the availment of tax treaty benefits for all types of Philippine-sourced income that are subject to preferential tax treatment under a tax treaty, including dividend, interest, and royalty income which were previously covered by the Certificate of Residence for Treaty Relief (*CORTT*) Form prescribed by RMO No. 8-2017. RMO No. 14-2021 amends other regulations on applying for tax treaty benefits, including RMO Nos. 30-2002, 72-2010, and 8-2017. RMO No. 14-2021 now allows the withholding agent (*WA*) to apply the preferential rate upon the submission of the non-resident income recipient (*NRIR*) of certain documents to the WA, but subject to the WA filing a request for and obtaining a BIR confirmatory ruling after the end of the taxable year.

RMO No. 14-2021 sets out the following process:

a. Prior to receiving income from the WA in the Philippines, the NRIR shall provide the WA the following, which the latter may rely on to determine the appropriate tax rate and tax to withhold: (1) BIR Form No. 0901 or Application Form for Treaty Purposes; (2) Tax Residency Certificate issued by the foreign tax authority; and (3) the relevant provision of the applicable tax treaty on whether to apply a reduced rate of, or exemption from, withholding at source on the income derived by a nonresident taxpayer from all sources within the Philippines.

b. The WA then remits income to the NRIR, in form of dividends, royalty, interest, etc., and withholds tax at either the treaty rate or the regular rate.

c. If the WA applied the treaty rate on the income, the WA must file with the BIR's International Tax Affairs Division (*ITAD*) a request for confirmation on the propriety of the tax rate applied, any time after the payment of withholding tax but shall in no case be later than the last day of the fourth month following the close of each taxable year.

d. If the BIR determines that the rate applied was correct or higher, the BIR will issue a Certificate confirming the NRIR's entitlement to the benefit. If the BIR determines that the rate applied was lower or the NRIR is not entitled to treaty benefits, the BIR will issue a BIR ruling denying the request and the WA must pay the deficiency taxes plus penalties.

e. If, on the other hand, the WA applied the regular rate on the income, the NRIR must file with the ITAD a Tax Treaty Relief Application (*TTRA*) within the same period in order to obtain a tax refund of the excess taxes withheld.

SyCipLaw Tip 7:
Taxpayers must check the detailed list of documentary requirements found in Section 5 of RMO No. 14-2021 for claiming relief from double taxation under a tax treaty. They must also coordinate with, and submit the relevant documents to, the WA in order that the WA can determine whether or not to withhold at the treaty rate or the regular rate.

Taxpayers with pending TTRAs for income earned in 2020 and prior years, including those with Notice of Archiving, are given three (3) months from the receipt of a Final Notice to Submit Additional Documents (*Final Notice*), or from the effectivity of RMO No. 14-2021, whichever is later, to submit the lacking documents. RMO No. 14-2021 was issued on March 31, 2021 and it provides that it will take effect immediately.

Taxpayers who were issued a Notice of Archiving will no longer receive a Final Notice. Failure to submit the requested documents would result in the automatic denial of the TTRA for failure of the non-resident income recipient to substantiate or prove the recipient's entitlement to tax treaty benefits.

Upon the effectivity of RMO No. 14-2021, all pending TTRAs shall be processed following the procedure therein. For dividends, interest, and royalties, the submission of the CORTT Form pursuant to RMO No. 8-2017 shall be discontinued. However, previously submitted CORTT Forms shall still be forwarded to the concerned Revenue District Offices for compliance check.

SyCipLaw Tip 8:
A taxpayer which seeks to enter into a compromise agreement with the CIR should prove that it meets a valid ground to compromise as provided under RR No. 30-2002, as amended by RR No. 8-2004.

8. Can the taxpayer enter into compromise agreements with the CIR during the pendency of the case?

Yes. In *Kepco Philippines Corporation vs. Commissioner of Internal Revenue* (G.R. Nos. 225750-51, July 28, 2020), Kepco Philippines Corporation entered into a compromise agreement with the CIR during the pendency of the case before the Supreme Court. As proof of the settlement, it presented a Certificate of Availment issued by the CIR. It then moved that the case be declared closed and terminated. The Office of Solicitor General (*OSG*) opposed the motion.

The Supreme Court ruled in favor of the termination of the proceedings in view of the compromise agreement. The Supreme Court explained that the power of the CIR to enter into compromise agreements for deficiency taxes is explicit under Section 204(A) of the Tax Code. The Supreme Court also stated that the CIR may compromise an assessment when a reasonable doubt as to the validity of the claim against the taxpayer exists, or the financial position of the taxpayer demonstrates a clear inability to pay the tax. The Supreme Court referred to Revenue Regulations No. 30-2002 (*RR No. 30-2002*), as amended by Revenue Regulations No. 8-2004 (*RR No. 8-2004*), which enumerates the bases for acceptance of the compromise agreement on the ground of doubtful validity.

The Supreme Court ruled that a compromise agreement has the effect of *res judicata* on the parties. As a rule, compromise agreements are favored and those entered into in good faith cannot be set aside except when there is mistake, fraud, violence, intimidation, undue influence, or falsity of documents.

It further ruled that Kepco Philippines Corporation has met the grounds for a valid compromise and properly paid 40% of the basic tax assessed as the compromise amount.

9. What are the requirements in claiming a refund or tax credit of erroneously paid local government taxes under Section 196 of the Local Government Code?

In *International Container Terminal Services, Inc. v. City of Manila* (CTA En Banc Case No. 277, March 10, 2021 and CTA AC No. 11, May 17, 2006), the Court of Tax Appeals *En Banc* (CTA En Banc) provided an exception to the requirement in Section 196 of the Local Government Code that an administrative claim for the refund of erroneously paid local government taxes must first be filed with the local treasurer before filing a court case.

In this case, the taxpayer, after filing an administrative claim for refund for the first three quarters of 1999, no longer filed an administrative claim with respect to its claim for refund beyond the third quarter of 1999. Both claims for refund were anchored on the theory of double taxation. The CTA En Banc ruled that there is no need to comply with the requisite of a prior administrative claim for refund (filed before the local treasurer) as it would be a futile effort, considering that the City of Manila would just deny the same. The City of Manila had manifested their intention to continuously deny the taxpayer's claim for refund, stating that it could not act favorably on the claim for refund until there would have been a final judicial determination of the invalidity of the Manila City Ordinance provision on double taxation.

SyCipLaw Tip 9:
Considering that the Supreme Court has yet to issue a similar ruling, it is prudent to still strictly comply with the express requirements of Section 196 of the Local Government Code for claiming refunds or tax credits for erroneously paid local government taxes, among which is the need to file an administrative claim for refund.

The CTA En Banc also explained that the reckoning point of the two (2)-year period for filing a judicial case is the date the taxpayer becomes entitled to a refund or credit. In this case, the taxpayer only became entitled to a refund or tax credit when the decision on the invalidity of the Manila City Ordinance provision on double taxation became final and executory.

10. Are the payment of fees to foreign corporations for services rendered outside the Philippines subject to income tax and VAT?

No. In *CIR v. NCR Cebu Development Center, Inc.* (CTA En Banc Case No. 2150, February 10, 2021 and CTA Case No. 9255, April 4, 2019), the CTA En Banc ruled that payment of fees to foreign corporations for services rendered outside the Philippines is not subject to income tax (and consequently, to final withholding tax), as well as VAT.

In this case, the taxpayer was assessed deficiency final withholding tax and VAT. The CTA En Banc ruled, however, that the taxpayer was not liable for the same because, according to the Tax Code, "a foreign corporation, whether engaged or not in trade or business in the Philippines, is taxable only on income derived from sources within the Philippines." The CTA added that the taxpayer was able to prove that most of its payees were foreign corporations, as evidenced by their respective Securities and Exchange Commission (*SEC*) Certifications of Non-Registration of Company. The taxpayer was also able to demonstrate that the services performed by such foreign corporations were performed outside the Philippines, as shown by the Certifications on Offshore Services stating that no physical work was conducted in the Philippines, as all the services rendered were performed outside the Philippines and are not effectively connected to a permanent establishment in the Philippines.

SyCipLaw Tip 10:
Fees paid to foreign corporations for services rendered outside the Philippines are not subject to income tax (and consequently, to final withholding tax) as well as VAT. In order to prove that the payee is a foreign corporation, the taxpayer must present an SEC Certification of Non-Registration of Company. On the other hand, to prove that the services were performed abroad, the taxpayer must present a Certification on Offshore Services stating that no physical work was conducted in the Philippines in relation to the services.