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SyCipLaw TIPS TAX ISSUES AND PRACTICAL SOLUTIONS (International Edition)

1. Attracting More Foreign Businesses in the Philippines

On March 2, 2022, the President signed into law Republic Act (*R.A.*) No. 11647 which amends the three-decade old Foreign Investments Act of 1991 (*FIA*). R.A. No. 11647 aims to attract, promote, and welcome productive foreign investments in activities where foreign investment is allowed under the Philippine Constitution and relevant laws. This law encourages foreign investors to invest in the Philippines and is geared towards making it more competitive with neighboring countries in the ASEAN region.

The amendments under R.A. No. 11647 primarily seek to open the Philippines by lessening barriers for the entry of foreign investments to drive the country's economic growth and to help the Philippines recover from the adverse effects of the COVID-19 pandemic. Thus, R.A. No. 11647 allows foreign investors to invest in up to 100% of a domestic enterprise unless participation of foreigners is prohibited or limited as provided under the Philippine Constitution and other relevant laws.

Following the reduction in the required minimum paid-up capital for foreign-owned corporations intending to engage in retail trade business in the Philippines pursuant to R.A. No. 8762, as amended by R.A. No. 11595, R.A. No. 11647 provides that micro and small domestic market enterprises (*MSEs*) with paid-in capital of less than US$200,000.00 shall only be limited to Philippine nationals. A domestic market enterprise is an enterprise which produces goods for sale or renders services to the domestic market entirely or if exporting a portion of its output fails to consistently export at least 60% thereof. Under the Magna Carta for Micro, Small and Medium Enterprise, micro, small and medium enterprises are engaged in industry, agribusiness and/or services. A domestic market enterprise is considered micro if its total assets is not more than PhP3,000,000.00 and it is considered small if its total assets is more than PhP3,000,000.00 but not more than PhP15,000,000.00.

Foreign nationals may also be allowed to organize an MSE with a minimum paid-in capital of US$100,000.00 if (i) the MSE uses advanced technology; or (ii) the MSE is endorsed as a start-up or start-up enabler; (iii) a majority of the MSE's direct employees are Filipinos, but the number of employees must not be less than 15. Prior to this amendment, the FIA requires at least 50 Filipino direct employees and does not include endorsement as start-up or start-up enabler to qualify for the reduced minimum paid-up capital of US$100,000.00. If the enterprise has been granted fiscal incentives and also employs foreigners, it shall implement an understudy or skills development program to facilitate the transfer of technology or skills to Filipinos.

SyCipLaw TIP 1:

The Philippine government has approved amendments not only to the FIA, but also to other special laws such as the Retail Trade Liberalization Act, the Public Service Act, the Revised Corporation Code and the Tax Code. The government likewise launched innovations such as the online filing system of the SEC to make the processing of the registration of Philippine entities faster and more convenient to the applicants pursuant to the Ease of Doing Business and Efficient Government Service Delivery Act of 2018. These amendments and innovations implemented by the government signify its efforts to develop a more competitive investment environment and to make it easier for foreign investors to set up their business in the Philippines. We suggest that foreign investors intending to invest in the Philippines seek advice on their proposed investments to help them navigate the current investment regime in the Philippines.

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Foreign investors are likewise allowed to invest in, and own 100% of, export enterprises, provided that the products and services do not fall within the Lists A and B of the Foreign Investment Negative List. Export enterprises that are registered with the Board of Investment (*BOI*) must submit required reports to ensure its compliance with the BOI's export requirements. Non-compliance with the BOI's requirements will subject the export enterprise to a compliance order from the Securities and Exchange Commission (*SEC*) or the Department of Trade or Industry to reduce its sales to the domestic market to not more than 40% of its total production and risk of cancellation of its business registration in the Philippines.

R.A. No. 11647 also establishes the Inter-Agency Investment Promotion Coordination Committee (*IIPCC*), a body that integrates all promotion and facilitation efforts to encourage foreign investments in the country. The IIPCC is mainly responsible for the development of a comprehensive and strategic medium-and-long-term Foreign Investment Promotion and Marketing Plan (*FIPMP*) consistent with the strategic investment priorities plan under the National Internal Revenue Code, as amended (*Tax Code*). The FIPMP is designed to coordinate all investment plans and programs under the BOI, Philippine Economic Zone Authority (*PEZA*), other IPAs, local government units, and other agencies. This function is consistent with the main purpose of creating IIPCC, which is to ensure an integrated and uniform approach to manage foreign investments.

2. Does the rule on the amortization of VAT paid on capital goods with acquisition cost exceeding One Million Pesos apply also to claims for refund of unutilized input VAT or does it apply only when the input VAT is creditable against output VAT?

In *Taganito Mining Corporation v. Commissioner of Internal Revenue* (G.R. No. 216656, April 26, 2021), the Supreme Court ruled that if the purchase or importation of depreciable goods are directly attributable to zero-rated sales, and their acquisition cost exceeds P1,000,000.00, the amortization rule applies without distinction as to whether (i) the input value-added tax (*VAT*) will be credited against the output VAT or (ii) if the input VAT will be refunded in the case of zero-rated transactions with no output tax from which input tax may be credited against.

In interpreting Sections 110 and 112(A) of the Tax Code, the Supreme Court explained that a law must not be read in truncated parts; its provisions must be read in relation to the whole law. Construing the provisions together, if the purchase or importation of depreciable goods are directly attributable to zero-rated sales, and their acquisition cost exceeds P1,000,000.00, the amortization rule applies. According to the Supreme Court: *"other than the hairsplitting distinction and play on words, petitioner did not present a convincing argument for the piecemeal construction of Section 110 (B). Petitioner cannot be allowed to select and choose which provisions apply to benefit its purpose."*

SyCipLaw TIP 2:

The case emphasizes that being statutory in nature, a taxpayer's right to refund depends on the limitations provided by law. The burden of proof is upon the claimant to prove the factual basis of its claim as tax refunds are strictly construed against the taxpayer.

Notably, under the Tax Reform for Acceleration and Inclusion (*TRAIN*) Law, the amortization of input VAT on purchased or imported capital goods will no longer apply beginning January 1, 2022. Therefore, starting this year, the related input VAT on capital goods may be fully recognized outright and be claimed as input tax credits against output tax during the month when the capital goods are purchased or imported, regardless of whether the aggregate acquisition cost in a calendar month exceeds One Million Pesos. As the law does not distinguish, the deletion of the amortization rule should also apply to claims for refund of unutilized input VAT.

The Supreme Court upheld the decision of the Court of Tax Appeals (*CTA*) that there was nothing in the law which states that the amortization rule applies only when the input VAT is creditable against the output VAT. The law did not qualify that the amortization rule does not apply to claims for refund or applications for tax credit certificate. Since the law did not distinguish, the amortization of input VAT also applied to claims for refund or tax credit of unutilized input VAT such that unamortized input VAT may not yet be ripe for refund.

Moreover, as discussed by the Supreme Court, the 60-month amortization of input tax under Section 110 (A) only delays but does not permanently deprive a taxpayer from crediting the input tax. Such provision was upheld as a valid limitation to the right of crediting input tax against output tax pursuant to "executive economic policy and legislative wisdom."

3. Can a decision of the Regional Trial Court in a case for the determination of the respective shares in local business taxes of two municipalities encompassing a corporation's power plant facilities be decided on appeal by the Court of Appeals?

No. In *Municipality of Villanueva vs. Steag State Power, Inc.,* (G.R. No. 214260, May 3, 2021), the Supreme Court held that the subject matter of the complaint before the Regional Trial Court (*RTC*) is the correct local business taxes that may be imposed against the corporation, as such, the court which has the authority to review the ruling of the RTC is the CTA.

Section 7 of R.A. No. 9282, otherwise known as the Law Creating the CTA, explicitly provides that a review of the decision of the RTC regarding local taxes should be filed before the CTA. Therefore, the appeal lodged by the Municipality of Villanueva in the case before the Court of Appeals was wrong. Since no proper appeal or petition for review is filed to question the correctness of the decision of the RTC, it has become final and executory.

SyCipLaw TIP 3:

A judgment rendered by a court without jurisdiction is null and void and may be attacked anytime. It creates no rights and produces no effect. Hence, taxpayers must always be careful in choosing the proper forum – bearing in mind that a decision of a court or tribunal without jurisdiction is a total nullity.

4. In a transaction involving the sale of land, may parties stipulate who between the buyer and the seller will bear the burden of paying the relevant taxes relating to the sale's execution and registration?

Yes. In *Domato-Togonon v. Commission on Audit* (G.R. No. 224516, July 6, 2021), the Supreme Court ruled that the parties may decide on who between them would bear all the expenses of the sale's execution and registration. However, such an agreement must be stipulated in their contract. Otherwise, the general rule is that the seller must bear all the expenses.

In this case, the heirs of Plomillo (*Seller*) sold a parcel of land to the Local Government of Koronadal City (*City Government*). The parties agreed to a price of PhP22,000,000.00, provided that the City Government shoulders all the expenses of the execution and registration of the sale. However, the agreement to shoulder all such expenses did not appear in the Deed of Absolute Sale. Rather, the agreement was merely mentioned in a Resolution passed by the City Government. Thus, the Commission on Audit (*COA*) issued a notice of disallowance for the payment of the expenses, including, among others, capital gains tax, documentary stamp tax, estate tax, and local transfer taxes. Concerned individuals from the City Government appealed this notice of disallowance. However, the COA Legal and Adjudication Office and the COA itself denied the appeal.

The Supreme Court upheld the COA's decision to issue the notice of disallowance.

Article 1487 of the Civil Code provides that "[t]he expenses for the execution and registration of the sale shall be borne by the vendor, unless there is a stipulation to the contrary." Here, the Deed of Absolute Sale did not have any stipulation on the expenses for the sale's execution and registration being shouldered by the buyer. Thus, the Seller must bear the expenses.

Among the expenses involved in the transaction are capital gains tax, documentary stamp tax, and local taxes on transfer of real property. The Supreme Court stated that capital gains tax "is regarded as a tax on passive income and is therefore the seller's liability, not the buyer['s]." With respect to documentary stamp tax, the liability to pay falls on any of the parties; however, "when one of them enjoys exemption from paying documentary stamp taxes, the liability falls on the other party who is not tax-exempt." Meanwhile, the local taxes on transfer of real property are likewise for the seller's account.

SyCipLaw TIP 4:

When parties enter into transactions involving the sale of land, they must clearly indicate in their contract (*i.e.* in the deed of absolute sale) who between the buyer and the seller would bear the expenses of the sale's execution and registration, such as, among others, documentary stamp tax, and local taxes on transfer of real property. Absent any stipulation in the contract, the seller must bear all the expenses of the sale's execution and registration.

Accordingly, absent any contrary agreement in their contract, the Sellers are duty bound to pay the taxes, fees, or charges relating to the transfer of real property. Moreover, the Supreme Court held that any agreement to shoulder transfer expenses must appear in the contract itself, such as the Deed of Absolute Sale, and cannot be embodied in a Resolution passed by the City Government since this is contrary to the Local Government Code's (*LGC's*) limitation on the taxing power of local governments. Thus, the COA was correct to issue a notice of disallowance with respect to the amounts that the City Government paid relating to the taxes, fees, and charges in the subject transaction.

However, the decision did not rule on whether, as a matter of law, the local government could have validly assumed payment of taxes had the contract explicitly provided for the same. Section 133 (o) of the LGC prohibits the local governments from imposing "taxes, fees or charges of any kind on the National Government, its agencies and instrumentalities, and local government units." In this case, the Supreme Court made a statement to the effect that "[t]he prohibition under Section 133 (o) cannot be circumvented by entering into a contract and assuming responsibility for the payment of taxes and fees. What cannot be legally done directly cannot be done indirectly." This casts doubt on whether the local government, if a party to a contract of sale involving a parcel of land, can properly assume the burden of paying the relevant transfer taxes. However, this portion of the decision may be considered as *obiter dictum,* which are statements that are not necessary to resolve the issue at hand, and are not considered as binding precedent.

5. May the court impose civil liability for a violation of Section 255 of the Tax Code, as amended, based on the computation of deficiency taxes in the absence of an assessment from the Commissioner of Internal Revenue?

Yes. In *People of the Philippines v. Rebecca S. Tiotangco* (CTA EB Crim. No. 080 [CTA Crim. Case Nos. O-599, O-601, O-603 and O-604], February 3, 2022), the CTA ruled that civil liability may be imposed even without an assessment from the Commissioner of Internal Revenue (*CIR*).

In this case, Tiotangco was charged with violating Section 255 of the Tax Code for her failure to supply correct and accurate information in her Quarterly VAT Returns. A complaint was filed against her before the Department of Justice (*DOJ*), and it included a computation of the alleged deficiency VAT. The CTA First Division absolved Tiotangco of her civil liabilities, but convicted her for three counts of violating Section 255 of the Tax Code. Section 255 provides that any person who willfully fails to pay the taxes, make the tax return, keep record, or supply correct and accurate information, or withhold or remit taxes withheld, or refund excess taxes withheld on compensation, shall be punished by a fine of not less than PhP10,000.00 and suffer imprisonment.

On appeal, the prosecution asserted that the CTA First Division erred when it ruled that an assessment is necessary before civil liability may be imposed and that the computation of unreported income cannot be used as basis for the determination of the said civil liability.

The CTA *En Banc* ruled that an assessment is not necessary before the civil liability of Tiotangco may be imposed. Even without the assessment, the CIR, upon the filing of the criminal action against Tiotangco, already acceded to the computation and amount of VAT liabilities as reflected in the complaint. It is clear in Section 222(a) of the Tax Code that a proceeding in court for the collection of tax may be filed without an assessment in case of a false return.

However, the CTA *En Banc* ruled that while an assessment is not necessary before the civil liability may be imposed, it is still incumbent upon the prosecution to provide competent evidence on which the amount of such liability may be based. Here, the CTA *En Banc* found that the computations are not sufficient to determine Tiotangco's civil liability as the computations were mere estimates and included other taxable periods not included in the criminal action. Thus, the CTA *En Banc* ruled that the absence of a precise computation prevented it from imposing civil liability.

SyCipLaw TIP 5:

Taxpayers should endeavor to provide correct and accurate information in their tax returns to avoid violating Section 255 of the Tax Code. Note that a taxpayer can still be held liable for civil liabilities even without an assessment from the Bureau of Internal Revenue (*BIR*), on top of the penalties provided in Section 255 of the Tax Code.

A motion for reconsideration of the decision is currently pending.

CTA decisions, while persuasive, do not become the law of the land, unlike decisions of the Supreme Court.

6. May a landowner of the lot, where the warehouse building was constructed by the lessee without the former's knowledge and consent, be held liable for the taxes of the building?

No, if it is evident that the land and the warehouse building are separately identifiable properties and pertain to different owners. In *Leticia V. Lim v. Office of the City Treasurer of Dumaguete, et. al* (CTA EB No. 2056 [CBAA Case No. V-42-2018], February 22, 2022), the CTA *En Banc* ruled that the person liable for tax delinquency is generally the owner of the property.

In this case, Lim is an owner of the land which was leased to Cheng Lei Ti (*Cheng*). The latter constructed a warehouse building on Lim's land. The City Treasurer issued a Notice of Delinquency in the name of Cheng for the unpaid real property taxes (*RPT*) on the warehouse building. Lim paid Cheng's RPT liability under protest and then filed a claim for refund or tax credit. The application was denied by the City Treasurer and the Local Board of Assessment Appeals on appeal.

The CTA *En Banc* ruled that Cheng, as the owner of the warehouse building, is liable for the RPT as "[i]t is well settled that in real estate taxation, the unpaid tax attaches to the property." It is evident that the land and the warehouse building are separately identifiable properties and may therefore pertain to different owners. Thus, the determination of the owner of the warehouse building is in order. In this case, while it is undisputed that Lim is the owner of the land where the warehouse building was erected, the case records is bereft of any indication that Lim similarly owns the warehouse building. The facts of the case support the finding that Cheng is the owner of the warehouse building and, thus, he is liable for the RPT.

However, the City Treasurer is not obliged to refund the real property taxes paid by Lim. The Supreme Court, in *National Grid Corporation of the Philippines vs. Ofelia M. Oliva, in her official capacity as the City Treasurer of Cebu* (G.R. No. 213157 and 213158, August 10, 2016), held that a person, who has an interest in the payment of RPT and who paid the RPT liabilities of another, should demand a refund, not from the City Treasurer, but from the person on whom the amount of taxes redounded to his/her benefit. The Supreme Court cited Article 1236 of the Civil Code in *National Grid Corporation of the Philippines*. It provides that "[w]hoever pays for another may demand from the debtor what he has paid, except that if he paid without the knowledge or against the will of the debtor, he can recover only insofar as the payment has been beneficial to the debtor."

Here, Lim is the owner of the land where the warehouse building was constructed, and he has an interest in the payment of the RPT thereon. The City Treasurer is bound to accept Lim's payment of the unpaid taxes due on the subject warehouse building. Thus, guided by the pronouncement in *National Grid Corporation of the Philippines*, Lim's payment of the RPT on the subject warehouse building made Cheng indebted to Lim. Accordingly, Lim's remedy is to demand reimbursement from Cheng, and not to seek a refund from the City Treasurer.

SyCipLaw TIP 6:

Lessors of land should inform their lessees that if the latter constructs a building thereon, the latter will be liable for the payment of the RPT of the building. If the lessors need to pay the RPT, they must demand reimbursement from their lessees. The appropriate provisions for this should be included in the lease agreement to protect the interests of the lessor.

CTA decisions, while persuasive, do not become the law of the land, unlike decisions of the Supreme Court.

7. Work-around procedures and guidelines in relation to the implementation of the TRAIN Law amendment to the Amortization of Input VAT on Purchases or Importations of Capital Goods

SyCipLaw TIP 7:

VAT taxpayers should take note of the guidelines under RMC 21-2022. While the VAT declaration forms have not been updated, VAT taxpayers can already apply the new rule under Section 110(A)(2) of the Tax Code effective January 1, 2022 and should observe the BIR's guidelines on how to fill up the relevant information in the VAT declaration forms to avoid confusion in the input VAT treatment.

Prior to the TRAIN Law, Section 110(A)(2) of the Tax Code provides that the input tax on goods purchased or imported for use in trade or business should be spread evenly up to 60 months (if the estimated useful life of the capital good is 5 years or more) if the aggregate acquisition cost for such goods, excluding the VAT, exceeds PhP1,000,000.00. With the amendments under the TRAIN Law, the amortization of the input VAT is allowed only until December 31, 2021 and taxpayers with unutilized input VAT on capital goods purchased or imported are now allowed to apply the same as scheduled until fully utilized.

However, notwithstanding the effectivity of the amendment starting January 1, 2022, the Quarterly and Monthly VAT Declaration forms (BIR Form Nos. 2550Q and 2550M pertaining to, respectively) have not yet been revised to reflect the changes in the treatment on the input VAT on the purchases or importations of capital goods.

Thus, the BIR issued Revenue Memorandum Circular (*RMC*) No. 21-2022 to guide taxpayers in filing the said VAT declaration forms under the new rules. RMC No. 21-2022 illustrates how the taxpayers should fill in the information in the schedules to the VAT declaration forms, as well as guidance to taxpayers using the forms under the Electronic Filing and Payment System and eBIR system which automatically computes the balance of the input VAT to be carried over to succeeding periods.

RMC No. 21-2022 provides that for purchases or importations of capital goods made before January 1, 2022, the taxpayer must continue to fill out Schedule 3(B) under BIR Form Nos. 2550Q and 2550M to allow such taxpayer to amortize the unutilized input VAT until full utilization thereof. However, if the purchased or imported capital good is sold or transferred within 5 years or prior to the exhaustion of the amortizable input tax, the entire unamortized input tax can be claimed as input tax credits during the month or quarter when such sale or transfer was made.

8. Effect of continuing the Work-From-Home Arrangement on the Fiscal Incentives of Registered Business Enterprises in the Information Technology-Business Process Management Sector

On August 2, 2021, the Fiscal Incentives Review Board (*FIRB*) adopted Resolution No. 19-21 which allows all registered business enterprises (*RBE*) in the Information Technology-Business Process Management (*IT-BPM*) sector to continue implementing work-from-home (*WFH*) arrangements as a temporary measure to support the recovery of registered business enterprises during the COVID-19 pandemic until March 31, 2022 without adverse effects on their fiscal incentives, subject to the following conditions:

(a) employees under a WFH arrangement shall not exceed 90% or 75%, as the case may be, of the total workforce of the RBE;

(b) equipment (i.e., laptops or computers) of the RBE outside the ecozone should not exceed the number of its employees under WFH arrangement;

(c) posting of bond for all equipment situated outside the ecozone;

(d) required revenue from export shall still be maintained; and

(e) compliance with reportorial requirements and site inspection, as may be required by the FIRB or IPA.

Prior to the expiration of the period allowing WFH arrangements for the IT-BPM enterprises, the PEZA requested the FIRB for an exemption of its IT-BPM enterprises from the conditions imposed under FIRB Resolution No. 19-21. However, the FIRB denied PEZA's request for exemption under FIRB Resolution No. 23-21 and provided that non-compliance with the conditions under FIRB Resolution No. 19-21 will result in the suspension of the income tax incentive applied to the revenue corresponding to the month of non-compliance.

The BIR then issued RMC No. 23-2022 setting out the procedure for compliance and the computation of the income tax due from non-compliant RBEs. The non-compliant RBEs must pay income tax at the rate of 25% or 20% on the taxable net income during the months of non-compliance. The non-compliant RBEs must voluntarily make the income tax payments. In the absence of any voluntary payments or if the voluntary payments are not sufficient, the non-compliant RBEs may be subjected to an audit.

On March 31, 2022, PEZA issued an advisory informing all registered enterprises under the direct supervision of the Zone Office-NCR that wish to avail of the 70% onsite and 30% WFH arrangement starting April 1, 2022 to submit a letter request to the Office of the Director General no later than April 8, 2022.

SyCipLaw TIP 8:

IT-BPM enterprises that wish to continue availing themselves of tax incentives granted under their registration with the IPAs may have no choice but to comply with the 100% on-site directive of the FIRB. Tax incentives are construed strictly against the taxpayer; thus, the taxpayer must prove that it has satisfied all conditions necessary to avail itself of the tax incentives that have been granted to it. While the PEZA appears to support the adoption of a hybrid work arrangement by granting a letter of authority (*LOA*) allowing registered IT-BPM enterprises to continue implementing WFH arrangements, it remains to be seen if the BIR will view the adoption of the 70-30 work arrangement as non-compliance with the FIRB Resolution Nos. 19-21 and 23-21 despite a LOA issued by PEZA. On February 21, 2022, the FIRB issued Resolution No. 003-22 denying PEZA's request to operate under WFH arrangement without the 10% onsite requirement until September 12, 2022. IT-BPM enterprises may have practical and business considerations to continue implementing a WFH set up, the current law and regulations require the enterprises to conduct their activities within the boundaries of the economic zones where they are located in order to be entitled to tax incentives. A change in the law has to be considered in order to allow RBEs operating in economic zones or freeport zones to implement alternative work arrangements that will not affect their fiscal incentives.

9. Clarifications on Revenue Regulations No. 21-2021 on VAT zero-rated transactions under the CREATE Act

Prior to the Corporate Recovery and Tax Incentives for Enterprises (*CREATE*) Act, the Philippines adhered to the cross-border doctrine where Ecozones and Freeport zones are considered as foreign territories, even if they are situated within the Philippines. In effect, the sale of goods and services by a VAT-registered seller to registered enterprises in Ecozones and Freeport zones are treated as constructive export subject to 0% VAT. However, in RMC No. 24-2022, the BIR declared that the cross-border doctrine has been rendered ineffectual and inoperative for VAT purposes under the CREATE Act. This confirms the BIR's position on whether the cross-border doctrine will still apply notwithstanding that economic zones and freeport zones are recognized and managed as separate customs territories under the law creating them and such provisions were not repealed by the CREATE Act.

Based on current law and regulations, only goods and services that are directly and exclusively used in the registered project or activity of RBEs qualify for VAT zero-rating on local purchases.

Direct and exclusive use

Under Revenue Regulations (*RR*) No. 21-2021, "direct and exclusive use in the registered project or activity" refers to "raw materials, supplies, equipment, goods. packaging materials, services, including provision of basic infrastructure, utilities, and maintenance, repair and overhaul of equipment, and other expenditures directly attributable to the registered project or activity without which the registered project or activity cannot be carried out." RMC No. 24-2022 further clarified that expenses for administrative purposes are excluded from the definition and that registered export enterprises should adopt a method for allocating local purchases between those used in the registered export enterprise's registered project or activity and for administrative purposes. If the local purchases are used in both the registered export enterprise's registered project or activity and for administrative purposes and the proper allocation cannot be made, the local purchase will be subject to the 12% VAT.

RMC No. 24-2022 also defined the term "*other expenditures"* as costs that are indispensable to the project or activity which include expenses that are necessary or required to be incurred depending on the nature of the registered project or activity of the export enterprise. The RMC expressly mentions that services for administrative expenses such as legal, accounting, and other related services are not considered expenses directly attributable to and exclusively used in the registered project or activity.

We note that, similar to the definition of "direct and exclusive use" in the amendment to the implementing rules of the CREATE Act, RMC No. 24-2022 also uses the term "directly attributable" to describe what is meant by other expenditures that are "directly and exclusively used" in a registered export enterprise's registered project or activity. The use of the term "directly attributable to and exclusively used" appears to be less restrictive than the term "direct and exclusive use" and could cover a broader range of expenditures. However, we note that the term "attributable" is not found in the CREATE Act. Thus, it is still not clear how the BIR will view the VAT treatment of local purchases during audit if a registered export enterprise claims that a local purchase of goods or services is VAT zero-rated since it is directly attributable to its registered project or activity.

SyCipLaw TIP 9:

Registered export enterprises and their suppliers may still have concerns regarding the implementation of the changes to the VAT incentives brought about by the TRAIN Law and the CREATE Act with the issuance of RMC No. 24-2022. Registered export enterprises would likely wish to be able to avail themselves of the VAT incentive and may be more inclined to argue that an expenditure qualifies for VAT zero-rating, while suppliers may be more inclined to adopt a cautious approach since the wrong VAT treatment can result in deficiency VAT assessments against the suppliers. The RMC also does not provide much by way of guidance where a service incurred is arguably related or is attributable to a registered activity. For example, legal advice sought in connection with a lease contract of a registered export enterprise located in an ecozone or research and development costs incurred for the enhancement of a registered project or activity would appear to be directly used in the registered business or activity of the enterprise. In the meantime, affected taxpayers will have to be guided by the rules and procedures set out in RMC No. 24-2022 to minimize non-compliance issues.

Supporting documents

Prior to the transaction, a registered export enterprise must provide its suppliers with a photocopy of its (i) BIR Certificate of Registration (BIR Form No. 2303); (ii) Certificate of Registration and VAT certification issued by the concerned IPA; and (iii) a sworn declaration stating that the goods and/or services being purchased shall be used directly and exclusively in the registered export enterprise's registered project. The suppliers must also secure prior approval from the BIR in order that their sales to the registered export enterprises will be accorded the VAT zero-rating. Without the prior approval of the BIR, the suppliers run the risk that their VAT zero-rated sales will be disallowed. The suppliers will also be required to submit the approved application for VAT zero-rating if they file a claim for refund of input VAT under Section 112(A) of the Tax Code.

Input VAT recovery

In cases where VAT is erroneously passed on by a local supplier to a registered export enterprise, the latter can seek reimbursement from the former and the previously issued invoice or receipt to the registered export enterprise must be returned to the local supplier for cancellation and replacement.

If VAT is paid or incurred for purchases not directly and exclusively used in the registered project or activity of the registered export enterprise, the registered export enterprise may (i) claim the VAT as an input VAT credit under Section 110 if it is also enjoying the income tax holiday incentive; (ii) file a claim for VAT refund upon expiration of its VAT registration if the registered export enterprise has no sales subject to VAT; or (iii) charge the VAT to cost or expense account if it is non-VAT registered.

If the RBE is categorized as a Domestic Market Enterprises (*DME*), the DME is not entitled to VAT zero-rating on its local purchases. Sales of goods or services to a registered DME are subject to 12% VAT. The registered DME may recover the input VAT by (i) deducting the input VAT against its output VAT, if VAT-registered; (ii) filing a claim for refund if it has zero-rated sales; or (iii) charge the VAT to cost or expense account if it is non-VAT-registered.

VAT treatment on the sale of goods and services during the effectivity of RR 9-2021

RMC No. 24-2022 also seeks to clarify the VAT treatment for the sale of goods and services during the effectivity of RR No. 9-2021 (i.e., from June 27, 2021 to June 30, 2021) and sales during the effectivity of RR No. 9-2021 but covered by the retroactive application of RR No. 21-2021 (i.e., from July 1, 2021 to July 27, 2021). RR No. 9-2021 implemented the TRAIN Law provision subjecting to 12% VAT certain transactions that were previously subject to 0% VAT. For sales of goods and services that transpired from June 27, 2021 to June 30, 2021, such sales should be subject to l2% VAT. If the sales transpired from July 1, 2021 to July 27, 2020, the seller and the purchaser have the option to treat the transaction as either subject to 12% VAT or revert the transaction from being subjected to 12% VAT to 0% VAT.