



TAX LAW FOR BUSINESS
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VAT zero-rating on sale of services to Peza enterprises

The validity of imposing value-added tax (VAT) on sales of goods and services has been consistently upheld by the Supreme Court as a means of addressing the government's budget deficit and debts. The VAT provides the government an avenue for the efficient collection of funds needed to finance its operations and sustain the country's economic growth.

With respect to the imposition of VAT on the sale of services, Section 108 of the New Internal Revenue Code of the Philippines (NIRC), as amended, states that a 12-percent VAT—pursuant to Republic Act (RA) 9337—shall be levied, assessed and collected on the gross receipts derived from the sale or exchange of services, including the use or lease of properties. However, there are certain transactions which subject such sales to zero-percent rating, as in the case of services performed in the Philippines by VAT-registered persons in favor of persons or entities exempted under special laws or international agreements to which the Philippines is a signatory (Section 108 B, NIRC).

An example of the aforementioned special law is The Special Economic Zone Act of 1995 (RA 7916), as amended, which provides that no taxes, local or national, shall be imposed on business establishments operating within the economic zone (ecozone), and that in lieu of paying taxes, 5 percent of the gross income earned by all businesses and enterprises within the ecozone shall be remitted to the national government. The law, in effect, exempts enterprises registered and operating within the ecozone from other direct and indirect taxes such as VAT. Simply put, no indirect taxes may be passed on to enterprises within the ecozone. Consequently, VAT-registered entities within the customs territory can claim VAT zero-percent rating on their sales of services to Philippine Economic Zone Authority (Peza), registered entities. However, does this incentive apply both to services performed within and without ecozone by VAT-registered persons in the customs territory?

Reading from Section 108 of the NIRC, it appears that the law does not make any qualifications as to the place where the services will be rendered for VAT zero-percent rating to apply. To reiterate, the law applies “in case of services performed within the Philippines” to entities such as Peza-registered enterprises. Is it now safe to say that the sales of goods and services fall within the ambit of VAT zero-rating since the law itself states that as long as the services are performed in the Philippines (customs territory) in favor of Peza-registered enterprises? The Bureau of Internal Revenue (BIR) has ruled in the negative, taking into account the purposes and policies enshrined in the passage of the NIRC, as amended, the E-VAT Law, RA 7916, as amended, and the relevant revenue rules, regulations, circulars and memorandums.

In a recent ruling (BIR Ruling DA-202-08) involving the sale of room accommodation, food and beverages services of a hotel located within Metro Manila to Peza-registered enterprises, citing Revenue Regulation 4-2007, the BIR ruled that sales of services by VAT-registered entities from the customs territory to Peza-registered enterprises are entitled to avail themselves of effective VAT zero-rating. The basis is the fact that RA 7916, as amended, considers ecozones as separate customs territories which, by legal fiction, are considered foreign soil. The special tax incentives only apply with respect to the registered enterprise’s operations within the ecozone, and provided further, that the services are rendered in connection with the registered activity/ies of the buyers such as Peza-registered entities. Conversely, if the service is rendered within the customs territory, such sale of service by a VAT-registered person shall be subject to 12-percent VAT regardless of the status of the buyer as ecozone-registered enterprise. This is in consideration of the situs of VAT for sale of services being the place where the service is rendered.

The BIR, in several rulings (BIR Ruling DA-367-07 and DA-277-07), has taken the same stand on the foregoing issue. The rulings find justification on the basis of Section 2 Revenue Memorandum Circular 74-99 dated October 15, 1999, stating that the policy regarding such incentives only applies in respect of the registered enterprise’s operations within the ecozone. Additionally, the VAT system of the Philippines is premised on two principles: the Cross Border Doctrine and the Destination Principle.

Under the Cross Border Doctrine, the ecozone is recognized, by legal fiction, as a foreign territory. Thus, no VAT shall be imposed to form part of the cost of goods destined for consumption outside the territorial border of the taxing authority. In turn, actual export of goods and services from the Philippines to a foreign country must be free of the VAT. As for the Destination Principle, it provides that the onus of taxation is the country where the goods, property or services are destined, used or consumed. Those destined for use or consumption within the Philippines shall be imposed with the 12-percent VAT. Thus, the availment of VAT zero-percent rating on sales of services by VAT-registered persons in the customs territory to Peza-registered entities is limited to those performed within the ecozone.

In interpreting Section 108 of the NIRC, as amended, it must not be read in isolation but in harmony with other laws, rules and regulations related thereto, as well as the principles and purposes underlying their enactment or passage to give effect to the real intention of the law-making body. After all, the incentives provided are akin to exemptions from payment of taxes and should, therefore, be interpreted strictly against the taxpayers.

