Punongbayan & Araullo

November 2011

Tax brief

Contents

02 **BIR Issuances**
- New VAT exemption thresholds
- PERA implementing regulations
- Clarification on taxability of cooperative member's deposits

04 **BIR Rulings**
- VAT on milkfish and its by-products
- VAT on sale of goods to a freeport enterprise
- Tax treatment of PEACe bonds

06 **Court Decisions**
- Counting of two-year prescriptive period on refund of excess CWTs
- Due process requirement in issuance of tax assessments
- Presentation of quarterly ITRs in refund claims

07 **BSP Circular**
- Outsourcing of ATM servicing

08 **Highlight on P&A services**
- Request for tax rulings

BIR Issuances

New VAT exemption thresholds

The Bureau of Internal Revenue (BIR) has increased the threshold amounts for the value-added tax (VAT) exemption of the following transactions pursuant to Sections 109(P), (Q) and (V) of the Tax Code. The new VAT exemption thresholds are as follows:

1. Sale of residential lot with gross selling price not exceeding P1,919,500 (previously P1,500,000)
2. Sale of residential house and lot or other residential dwellings with gross selling price not exceeding P3,199,200 (previously P2,500,000)
3. Sale or lease of goods or properties or the performance of services with gross annual sales and/or receipts not exceeding P1,919,500 (previously P1,500,000)
4. Lease of residential units with a monthly rental per unit not exceeding P12,800, regardless of the amount of aggregate rentals received by the lessor during the year (previously P10,000)

The new thresholds shall take effect starting January 1, 2012.

(Revenue Regulations No. 16-2011, October 28, 2011)

PERA implementing regulations

The BIR has issued the guidelines implementing the tax provisions of Republic Act No. (RA) 9505 - Personal Equity and Retirement Account Act of 2008 - which provides the legal and regulatory framework for the establishment of personal equity retirement account (PERA). PERA is a voluntary retirement account for individuals.

The salient features of the regulations are as follows:

1. On the establishment of PERA

PERA may be opened by an individual who has the capacity to contract and who possesses a tax identification number (TIN). The maximum allowable contribution that can be made to PERA shall not exceed P100,000 per calendar year. If the contributor is an overseas Filipino, the amount should not exceed P200,000 per calendar year. The following are aggregate maximum qualified PERA contributions in one calendar year.

Contributor	Maximum qualified PERA contribution
Unmarried Filipino	P100,000
Married Filipino citizen and both spouses qualify as contributors	P100,000 for each qualified contributor
Married Filipino citizen and only one spouse qualifies as a contributor	P100,000
Unmarried overseas Filipino	P200,000
Married overseas Filipino whose legitimate spouse is neither an overseas Filipino nor a qualified contributor	P200,000
Married overseas Filipino whose legitimate spouse and children (not otherwise disqualified as contributors) of an Overseas Filipino who did not directly open any PERA	P200,000, cumulative for the spouse and children in representation of the overseas Filipino
Married overseas Filipino whose legitimate spouse is also an overseas Filipino	P200,000 for each qualified contributor
Married overseas Filipino whose legitimate children are not overseas Filipinos and are not qualified contributors	P200,000 for the overseas Filipino

BIR Issuances

Contributions to PERA amounting to more than P100,000 or P200,000, as the case may be, shall not be accepted by the administrator under PERA account. However, it may be accepted as other savings/ investment account after appropriate advice is given to the contributor that such shall not be entitled to any benefits under the PERA Law.

2. On the tax treatment of PERA contributions

a. *Individual PERA contributors* - A qualified contributor shall be entitled to a non-refundable and non-transferable tax credit in the amount of 5% of the aggregate qualified PERA contribution in one calendar year. In case the contributor is an overseas Filipino, the tax credit certificate (TCC) shall be issued only to a qualified overseas Filipino self-employed contributor who may claim the 5% tax credit against any national internal revenue tax liabilities.

b. *On the part of the employer* - The qualified employer's contribution to his or its employees' PERA shall not form part of the employee's taxable gross income, hence, it is exempted from the withholding tax on income, whether withholding tax on compensation or fringe benefit tax.

On the other hand, the employer can claim the actual amount of his or its qualified employer's contribution as a deduction from his or its gross income to the extent of the employer's contribution that would complete the maximum allowable PERA contribution of an employee.

3. On the tax treatment of PERA investment income

The investment income of the contributor consisting of all income earned from investments and reinvestments of PERA assets in the maximum allowable amount shall be exempt from 20% final withholding tax on Philippine and foreign currency bank deposits; capital gains on sale, exchange, retirement or maturity of bonds, debentures or other certificates of indebtedness; 10% tax on cash and/or property dividends, constructively or actually received from a domestic corporation (including a mutual fund company); capital gains tax on sale, barter, exchange or other disposition of shares of stock in a domestic corporation; and regular income tax. Non-income taxes such as VAT, percentage tax on persons exempt from VAT, and documentary stamp tax (DST) shall be imposable on PERA investment income.

4. On PERA distribution and withdrawals

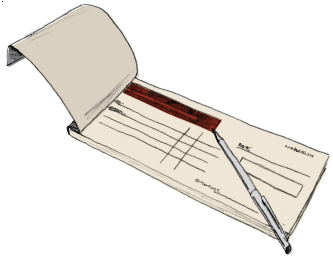
Qualified PERA distributions received by the contributor, or in case of death of the contributor, by the heirs or beneficiaries, whether in lump sum or pension for a definite period or lifetime pension, shall be excluded from gross income in the hands of the heirs or beneficiaries, and shall not be subject to estate tax.

In case of early withdrawals of qualified PERA contributions, such shall be subject to early withdrawal penalties equivalent to the tax incentives enjoyed by the contributor, which shall be reckoned from the date the benefits accrue to the contributor (e.g., on the date the tax credit has been claimed in the tax return, or the date the employer contributed to the employee's PERA account, etc.).

However, the early withdrawal penalties shall not apply in case of transfer of proceeds to another qualified/eligible PERA investment product and/or another administrator within two working days from withdrawal, payment of accident or illness-related hospitalization in excess of 30 days, and payment to a contributor who has been subsequently rendered permanently totally disabled.

A separate revenue memorandum order shall be issued to provide the guidelines and procedure for proper administrative reporting to the BIR of PERA transactions such as contributions, withdrawals and/or termination of PERA accounts, PERA management, and others.

(Revenue Regulations No. 17-2011, October 28, 2011)



BIR Issuances

Clarification on taxability of cooperative member's deposits

The BIR has clarified that based on a Supreme Court (SC) decision *(Dumaguete Cathedral Credit Cooperative v. Commissioner of Internal Revenue, GR 182722, January 22, 2010*), cooperatives are not required to withhold taxes on interest from their members' savings and time deposits.

The SC held that previous BIR ruling (BIR Ruling No. 551-88) exempting members of cooperatives from withholding tax on their interest income from the savings account and time deposits does not apply when cooperative members place their time and savings deposits in a bank. According to the SC, there is nothing in the ruling to suggest that the exemption applies only when deposits are maintained in a bank. Rather, as further held by the SC, the ruling is clear, without any qualification, that since interest from any Philippine currency bank deposit and yield or any other monetary benefit from deposit substitutes are paid by banks, cooperatives are not required to withhold the corresponding tax on the interest from savings and time deposits of their members.

In its ruling, the SC subscribed to the interpretation made by the BIR in BIR Ruling DA-591-2006 (October 5, 2006) that members' deposits with the cooperatives are not currency bank deposits nor deposit substitutes, and therefore, Section 24(B)(1) and Section 27(D)(1), which impose a 20% final withholding tax on interest from bank deposit as well as earnings from deposit substitutes, trust funds and similar arrangements, do not apply to members of cooperatives and to deposits of primaries with federations, respectively.

The SC further held that members of cooperatives deserve a preferential tax treatment pursuant to RA 6938 or the Cooperative Code of the Philippines, as amended by RA 9520. As held by the SC, the interpretation exempting the members of cooperatives from the imposition of the final tax under Section 24(B)(1) of the National Internal Revenue Code (NIRC) is more in keeping with the letter and spirit of our Constitution, which considers cooperatives as instruments of social justice and economic development.

(Revenue Memorandum Circular No. 47-2011, October 5, 2011)

BIR Rulings

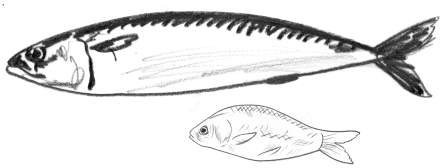
VAT on milkfish and its by-products

Under Section 109(1)(A) of the Tax Code, the sale or importation of agricultural and marine food products in their original state, of livestock and poultry of a kind generally used as or yielding or producing foods for human consumption, and of breeding stock and genetic materials is exempt from VAT.

As implemented by Revenue Regulations No. (RR) 16-05, meat, fruits, fish, vegetables and other agricultural and marine food products are considered in their original state even if they have undergone the simple processes of preparation or preservation for the market, such as freezing, drying, salting, broiling, roasting, smoking, or stripping, including those using advanced technological means of packaging, such as shrink wrapping in plastics, vacuum packing, tetra-pack, and other similar packaging methods.

However, as held by the BIR, the sale of marinated, frozen, and vacuum packed boneless milkfish (*bangus*) by a tuna canning corporation is not considered in its original state. The BIR explained that laws granting exemption should be construed strictly against the taxpayer and liberally in favor of the taxing power. In other words, any exemption from payment of tax must be clearly stated in the language of the law, and cannot be merely implied from the law. Hence, on such basis, the BIR held that the sale of milkfish and its by-products is subject to 12% VAT.

(BIR Ruling No. 348-2011, September 28, 2011)



BIR Rulings

VAT on sale of goods to a freeport enterprise

A VAT-registered information technology (IT) company is subject to 0% VAT on its sale of electronic gaming machines to a freeport zone-registered enterprise. Under Section 3 of Revenue Memorandum Circular No. (RMC) 50-07, sale, barter, exchange or lease of all goods, properties and/or services to a freeport zone-registered enterprise shall be subject to 0% VAT in case the seller is a VAT seller/contractor from the customs territory

The sale of an electronic gaming machine qualifies for VAT zero-rating under RMC 50-07 considering that the equipment was purchased by a freeport zone-registered enterprise from a VAT-registered enterprise from the customs territory. Moreover, the input tax paid attributable to the zero-rated sale may be refunded to the IT company.

To claim VAT refund, the seller must show proof of payment of VAT on the equipment it purchased and subsequently sold to the freeport zone-registered enterprise.

(BIR Ruling No. 352-2011, September 28, 2011)

Tax treatment of PEACe bonds

In response to the query of Department of Finance (DOF) Secretary Cesar Purisima, the BIR issued the following clarifications on the tax treatment of the discount or interest income on the 10-year zero coupon treasury bonds issued by the Bureau of Treasury (BTr), referred to as the Poverty Eradication and Alleviation Certificate (PEACe Bonds).

A. On the tax applicable on interest income from PEACe Bonds

With the rule enunciated in BIR Ruling No. 007-2004, which considered all borrowings of national and local government and its instrumentalities evidenced by debt instruments such as treasury bonds, notes, bills, etc. as deposit substitutes, PEACe Bonds that were issued to RCBC and later to CODE-NGO and subsequent bondholders, regardless of the number of purchasers/lenders at the time of origination/issuance, are considered deposit substitutes and are therefore subject to 20% final withholding tax under Section 27(D)(1) of the Tax Code. The discount (i.e., difference between the face value and purchase price/discounted value of the bond) shall be treated as interest income of the purchaser/holder.

B. On the amount of tax due from the interest income

Considering the legal infirmity of the 2011 rulings, which were all reversed by BIR Ruling No. 007-2004, the BIR held that RCBC should be liable to pay the 20% final withholding tax on interest income it realized from its purchase of PEACe Bonds. According to the BIR, the bank should have paid approximately P1.4 billion (i.e., 20% of the present value of the discount/interest income as of October 18, 2011, discounted at 12.75%, which is approximately P7 billion), in addition to the purchase price of the PEACe Bonds.

The BIR noted, however, that since no final tax was paid by RCBC upon issuance of the PEACe Bonds, RCBC is held liable to pay 20% final tax on the entire P24.3 billion discount, which is the present value of the original discount to date, or approximately P4.86 billion.

C. On the person liable to pay the 20% final withholding tax

The BIR held that based on Section 7 of DOF Department Order No. 141-95, RCBC, as the original purchaser of the PEACe Bonds, should be liable to pay the 20% final withholding tax on the discounts valued at present value on original sale of the bonds. However, considering that RCBC merely acted as the agent or conduit of CODE-NGO – as per the BTr, CODE-NGO is not a Government Securities Eligible Dealer (GSED) – CODE-NGO is the beneficial owner of the PEACe Bonds and all subsequent holders of the bonds shall be liable to pay the 20% final withholding tax due on the discount/interest income realized.

The BIR maintained that RCBC/CODE-NGO and all subsequent holders of the bonds may not invoke the principle of non-retroactivity of revocation, modification or reversal of any rules and regulations, rulings or circulars under Section 246 of the Tax Code to prevent the BIR from collecting the final tax on the original discount/interest income. According to the BIR, the non-retroactivity principle does not apply when the ruling involved is null and void for being contrary to the law, such as previous rulings on the PEACe Bonds.

D. On the manner of collecting the 20% final withholding tax

The final tax on the original issue discount is required to be withheld upfront. Hence, the BTr should withhold the final tax due on interest income from the PEACe Bonds prior to its payment on the date of maturity.

[BIR Ruling Nos. 370-2011 (October 7, 2011) and 378-2011(October 17, 2011)]

Court Decisions

Counting of two-year prescriptive period on refund of excess CWTs

Under Section 204(C) in relation to Section 229 of the NIRC, a taxpayer has two years from the filing of its final adjustment return within which to file a claim for refund (either in the form of cash or tax credit certificate) of its excess creditable withholding taxes (CWTs), both in the administrative and judicial levels.

In case an amended return is filed by the taxpayer, the Court of Tax Appeals (CTA) held that the counting of the two-year prescriptive period should be made from the date of the filing of the original final adjustment return and not from the date of filing of the amended return. Accordingly, to prove its entitlement to refund of its excess CWTs, the taxpayer-refund claimant must present not only its amended return but also its original annual income tax return (ITR).

According to the CTA, the presentation of the original return is important in determining whether the taxpayer filed its claim for refund within the two-year prescriptive period, reckoned from the actual date of filing of the original final adjustment return.

The original return is also necessary to verify if a taxpayer originally opted to be issued a TCC for its unapplied CWT; as provided under Section 76 of the NIRC of 1997, once the option to carry-over and apply the excess quarterly income tax against income tax due for the taxable quarters of the succeeding taxable years has been made, such option shall be considered
irrevocable for that taxable period.

In the instant case, the taxpayer failed to present its amended tax return. Thus, the CTA denied the claim for issuance of TCC for the alleged excess or unutilized CWT.

(Maunsell Philippines, Inc. v. Commissioner of Internal Revenue, CTA Case No. 7860, October 21, 2011)

Due process requirement in issuance of tax assessments

The issuance of a preliminary assessment notice (PAN) is part of the due process requirement in the assessment of taxes; its absence would render nugatory any assessment made by the tax authorities.

The requirement that a taxpayer must first be notified of its deficiency taxes through the issuance of a PAN is provided under Section 228 of the NIRC. This is confirmed under Section 3 of RR 12-99, which provides that if after review and evaluation, it is determined that there exists sufficient basis to assess a taxpayer for deficiency tax or taxes, a PAN showing in detail the facts and the law, rules and regulations, or jurisprudence on which the proposed assessment is based should be issued to the taxpayer.

Hence, in case a taxpayer denies receiving the PAN, it is incumbent upon the BIR to prove the receipt by the taxpayer of the assessment notice. In the instant case, except for the draft PAN that was offered as evidence, no other documentary or testimonial evidence was submitted to prove that the PAN was sent to the taxpayer, either through personal delivery or mail.

The CTA held that the BIR's failure to comply with the notice requirement as laid down under Section 228 of the Tax Code, as amended, and RR 12-99, amounts to the denial of the taxpayer's right to due process, effectively voiding the assessments issued against the taxpayer.

(Unioil v. Commissioner of Internal Revenue, CTA Case No. 8000, October 4, 2011)

Presentation of quarterly ITRs in refund claims

In the case of claims for refund of excess or unutilized CWTs, the presentation of succeeding quarterly and annual ITRs is required to prove that the taxpayer did not carry over or utilize its excess withholding taxes to the succeeding taxable quarters.

It is not enough that the succeeding annual ITR of a taxpayer claiming refund of its excess unutilized CWT is presented. To remove any doubt, the presentation of both the succeeding quarterly and annual ITRs is required to ascertain that the claimed creditable taxes were not carried over to the succeeding periods and were not utilized to pay the taxpayer's income tax liability. Thus, without the quarterly and annual ITRs, a claim for refund of excess/unutilized CWT must necessarily fail.

(Philippine National Bank v. Commissioner of Internal Revenue, CTA Case No. 7760, September 30, 2011)

BSP Circular

Outsourcing of ATM servicing

The Bangko Sentral ng Pilipinas (BSP) has given authority to banks to contract third party service providers to service their offsite and onsite automated teller machines (ATMs). As part of security measures prescribed by the BSP, banks that plan to outsource the servicing of their ATMs must ensure that the servicing of the machines is carried out during business hours.

Service providers shall also be given limited access to the bank premises, and when necessary, bank staff shall accompany the service provider when the latter services the ATMs.

Another security measure is the installation of closed-circuit television at the ATM area to record all activities around the machine.

(BSP Circular No. 739, series of 2010, October 26, 2011)

Highlight on P&A services

Request for tax rulings

We prepare and file, for and on behalf of our clients, requests for rulings to confirm the proper tax treatment of certain business structures and transactions. Requests for rulings are generally required in the case of tax-free exchange of assets for shares of stock; application of preferential rates of withholding taxes on income payments to nonresident aliens and foreign corporations pursuant to tax treaties; entitlement to tax exemption under Section 30 of the Tax Code; and other transactions whose tax treatment is not clearly provided in the Tax Code, implementing regulations, or other issuances of the BIR or the Department of Finance (DOF).

If you would like to know more about our request for tax rulings services, please contact:

Oliver M. Beltran
Manager, Tax Advisory & Compliance
T + 632 886 5511 ext. 508
F + 632 886 5511 ext. 606
E Oliver.Beltran@ph.gt.com

We welcome your suggestions and feedback so that the Tax Brief may be made even more useful to you. Please get in touch with us if you have any comments and if it would help you to have the full text of the materials in the Tax Brief.

Lina Figueroa
Principal, Tax Advisory & Compliance Division
T +632 886-5511 ext. 507
F +632 886-5506 ext. 606
E Lina.Figueroa@ph.gt.com