Punongbayan & Araullo

May 2011

Tax brief

Contents

BIR Issuances

Clarification on income tax exemption of interest income from long-term deposits

The Bureau of Internal Revenue (BIR) has issued the following clarifications on the income tax exemption of interest income from long-term deposits or investment certificates.

A. On the legal basis of the exemption from tax of long-term deposits

Under Section 24(B)(1) and 25(A)(2) of the National Internal Revenue Code (NIRC) of 1997, the interest income from long-term deposit or investment in the form of savings, common or individual trust funds, deposit substitutes, investment management accounts and other investments evidenced by certificates in such form prescribed by the Bangko Sentral ng Pilipinas (BSP) shall be exempt from income tax. However, should the holder of the certificate pre-terminate the deposit or investment before the fifth year, a final tax shall be imposed on the entire income and shall be deducted and withheld by the depository bank from the proceeds of the long-term deposits or investment certificate based on the remaining period thereof:

Four years to less than five years - 5%

Three years to less than four years - 12%

Less than three years - 20%

B. On the conditions for entitlement to the exemption from tax

The following characteristics/ conditions should be present to enjoy income tax exemption of interest income from long-term deposits:

1. The depositor or investor is an individual citizen (resident/ non-resident) or a resident/ non-resident alien engaged in trade or business in the Philippines and not a corporation.

2. The long-term deposits or investments certificates should be under the name of the individual and not under the name of the corporation, the bank or the trust department/unit of the bank.

3. The long-term deposits or investments must be in the form of savings, common or individual trust funds, deposit substitutes, investment management accounts, and other investments evidenced by certificates in such form prescribed by the BSP.

4. The long-term deposits or investments must be issued by banks only and not by other financial institutions.

5. The long-term deposits or investments must have a maturity period of not less than five years.

6. The long-term deposits or investments must be in denominations of P10,000 and other denominations as may be prescribed by the BSP.

7. Only the interest income from long-term deposits or investment certificates is covered by the income tax exemption.

8. The income tax exemption does not cover any other income such as gains from trading or foreign exchange.

9. The long-term deposits or investments should not be terminated by the investor before the fifth year; otherwise it shall be subjected to the graduated rates of 5%, 12% or 20% on interest income earnings.

(Revenue Memorandum Circular No. 18-2011, April 12, 2011)

BIR Issuances

Basic standard format for the additional disclosures required under RR 15-2010

The BIR has provided the following basic standard format to guide taxpayers in complying with the additional disclosure requirements under Revenue Regulations No. (RR) 15-2010.

The basic standard format may be modified to make it appropriate to the business peculiarities of concerned taxpayer/s.

RR 15-2010	Proposed notes to the financial statements relative to taxpayers' taxes and licenses
Provisions	In compliance with the requirements set forth by RR 15-2010, hereunder are the information on taxes, duties and license fees paid or accrued during the taxable year.
1. The amount of VAT output tax declared during the year and the account title and amount/s upon which the same was based. If there are zero-rated sales-receipts and/or exempt sales/receipts, a statement to that effect and the legal basis therefor;	The company is a VAT-registered company with VAT output tax declaration of P_____ for the year based on the amount reflected in the Sales Account of P _____ . The company has zero-rated/exempt sales amounting to P _____ pursuant to the provisions of _____ law/ regulations. **Or** The company is a non-VAT registered company engaged in the business of _____ and paid the amount of P _____ as percentage tax pursuant to _____ law/regulations and based on the amount reflected in the Sales/Gross Income Received Account of P _____.
2. The amount of VAT input taxes claimed, broken down into: a. beginning of the year; b. current year's domestic purchases/payments for: i. goods for resale/manufacture or further processing ii. goods other than for resale or manufacture iii. capital goods subject to amortization iv. capital goods not subject to amortization v. services lodged under cost of goods sold vi. services lodged under other accounts	The amount of VAT input taxes claimed are broken down as follows: a. beginning of the year … P _____ b. current year's purchases: i. goods for resale/manufacture or further processing … _____ ii. goods other than for resale or manufacture … _____ iii. capital goods subject to amortization … _____ iv. capital goods not subject to amortization … _____ v. services lodged under cost of goods sold … _____ vi. services lodged under other accounts _____

BIR Issuances

<table>
<tr><th>RR 15-2010</th><th>Proposed notes to the financial statements relative to taxpayers' taxes and licenses</th></tr>
<tr><td>c. claims for tax credit/refund and other adjustments; and
d. balance at the end of the year</td><td>c. claims for tax credit/refund and other adjustments ... _____

(Include here all kinds of adjustments, whether additional sources of inputs or other deductions from available inputs)

d. balance at the end of the year ... P _____</td></tr>
<tr><td>3. The landed cost of imports and the amount of customs duties and tariff fees paid or accrued thereon:</td><td>The landed cost of the company's importations amounted to P _____ for the year, with paid/accrued amount of P _____ as customs duties and P _____ as tariff fees.</td></tr>
<tr><td>4. The amount of excise tax/es, classified per major product category, i.e., tobacco products, alcohol products, automobiles, minerals, oil and petroleum, etc. paid on:

a. locally produced excisable items
b. imported excisable items</td><td>The amount of excise tax/es, classified as follows:

<table><tr><td rowspan="2">Product Category</td><td colspan="2">Excise Tax/es Paid/Accrued</td></tr><tr><td>Locally Produced</td><td>Imported</td></tr><tr><td>Tobacco</td><td></td><td></td></tr><tr><td>Alcohol</td><td></td><td></td></tr><tr><td>Automobiles</td><td></td><td></td></tr><tr><td>Oil/Petroleum</td><td></td><td></td></tr></table></td></tr>
<tr><td>5. Documentary stamp tax (DST) on loan instruments, shares of stock and other transactions subject thereto;</td><td>The DST paid/accrued on the following transactions are:

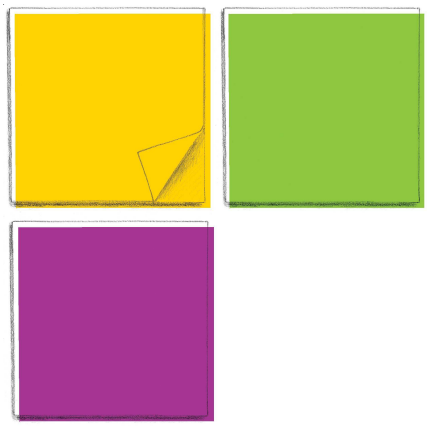
<table><tr><td>Transaction</td><td>Amount</td><td>DST thereon</td></tr><tr><td>Loan instruments</td><td>P</td><td>P</td></tr><tr><td>Shares of stock</td><td>P</td><td>P</td></tr></table></td></tr>
<tr><td>6. All other taxes, local and national, including real estate taxes, license and permit fees lodged under the Taxes and Licenses account both under the Cost of Sales and Operating Expense accounts;</td><td>Other taxes and licenses:
a. <u>Local</u>
Real estate taxes ... P _____
Mayor's permit ... _____
PTR ... _____

b. <u>National</u>
BIR annual registration ... P _____
Percentage taxes ... _____</td></tr>
</table>

BIR Issuances

RR 15-2010	Proposed notes to the financial statements relative to taxpayers' taxes and licenses
7. The amount of withholding taxes categorized into: i. tax on compensation and benefits ii. creditable withholding tax/es iii. final withholding tax/es	The amount of withholding taxes paid/accrued for the year amounted to: i. tax on compensation and benefits P _____ ii. creditable withholding tax/es _____ iii. final withholding tax/es _____
8. Periods covered and amount/s of deficiency tax assessments, whether protested or not;	The company has received a final assessment notice from the Regional Office of _____ covering the taxable year _____ amounting to P _____, inclusive of penalties for deficiency income/VAT/percentage/ withholding tax, which has been protested/agreed upon. (Management may include here their opinion on the probable outcome of their protest, if protested; or the probable outcome of their application for installment/ compromise/abatement, in case of agreed assessment.)
9. Tax cases, and amounts involved, under preliminary investigation, litigation and/or prosecution in courts or bodies outside the BIR.	The company has a RATE case under preliminary investigation of the Department of Justice (DOJ) involving deficiency income tax for taxable year 2008 amounting to P _____.

(Revenue Memorandum Circular No. 17-2011, March 17, 2011)



BIR Rulings

VAT on hotel services to international air carriers

In order to qualify for value-added tax (VAT) zero rating, the services rendered by a VAT-registered person to a person engaged in international air transport operations must pertain or be attributable to the transport of goods and passengers from a port in the Philippines directly to a foreign port without docking or stopping at any port in the Philippines.

The BIR had the occasion to rule that only services rendered to international vessels such as crewing, repair, catering and other similar arrangements are entitled to VAT zero-rating. Hence, applying the same rule, the BIR held that the room accomodations and food and beverage services rendered to persons engaged in international air transport operations do not qualify for VAT zero-rating since they are rendered within the hotel's premises, and as such, cannot be considered as services directly attributable to the transport of goods and passengers from a Philippine port directly to a foreign port. Hence, the services by the hotel should be subject to 12% VAT .

(BIR Ruling No. 099-2011, April 6, 2011)

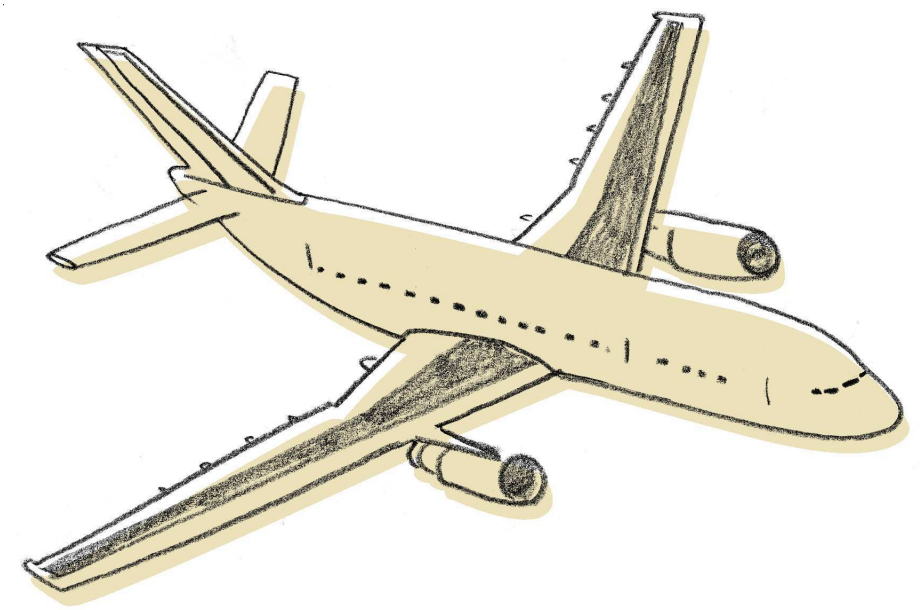
CWT on interest payments by top 10,000 corporations

Interest income payments made by a power-generating company to its affiliate pursuant to a loan agreement to finance the latter's acquisition of its power plant is not subject to 2% creditable withholding tax (CWT) on income payments made by the top 10,000 private corporations under RR 2-98.

Although the payor-company is registered with the BIR as a large taxpayer – which is required under Section 2.57.2 of RR 2-98 to withhold 1% and 2% CWT on income payments made to its local/resident supplier of goods and to its supplier of services, respectively – the lender-affiliate is not a local/resident supplier from which the affiliate-borrower has transacted at least six transactions in the previous or current year. Under Section 2.57.2 of RR 2-98, casual purchase of goods or purchases made by top 10,000 corporations from non-regular suppliers are not subject to withholding tax.

Likewise, the lender is not a bank, quasi-bank, financial institution or lending investor. Hence, the interest payments made by the affiliate-borrower are not subject to 2% CWT under Revenue Memorandum Circular No. 72-04, which imposes a 2% CWT on interest payments made by top 10,000 corporations to banks, quasi-banks, financial institutions and lending investors.

(BIR Ruling No. 110-2011, April 11, 2011)



Court Decisions

DST exemption of FCDUs

Under Presidential Decree No. (PD) 1035, the net income from foreign currency deposit transactions of foreign currency deposit units (FCDUs) is subject to 5% tax in lieu of all other taxes on their transactions. As implemented by RR 10-76, the exemption of FCDUs under PD 1035 covers the payment of documentary stamp tax (DST) on their transactions.

The phrase "in lieu of all taxes," however, was deleted in Sections 27(D)(3) and 28(7)(b) of Republic Act No. (RA) 8424, which took effect on January 1, 1998. Thus, by virtue of such deletion, the Court of Tax Appeals (CTA) held that RR 10-76, which implemented the old law, is no longer applicable. This means that FCDUs no longer enjoy exemption from DST on their transactions by virtue of RA 8424.

The deletion by RA 8424 of the tax exemption of FCDUs is bolstered by the fact that Congress enacted RA 9294 on April 28, 2004, thereby restoring the tax exemption of Offshore Banking Units (OBUs) and FCDUs. According to the CTA, the act of Congress in restoring the tax exemption of FCDUs clearly shows that prior to the effectivity of RA 9294 on May 20, 2004, FCDUs are subject to 10% tax and not exempt from payment of all other taxes.

Considering that the deficiency assessment for DST on FCDU transactions against the taxpayer is for taxable year 2004, starting May 20, 2004 – the date of effectivity of RA 9294 – the CTA held that the taxpayer's FCDU transactions, except net income from transactions as may be specified by the Secretary of Finance, are exempt from all taxes including the assessment for deficiency DST, pursuant to RA 9294, which provides for an all inclusive exemption from all other taxes.

(Union Bank of the Philippines v. Commissioner of Internal Revenue, March 29, 2011, CTA Case No. 7874)

Prior ITAD ruling requirement for tax treaty relief

Any availment of the tax treaty provisions should be preceded by an application for tax treaty relief with the International Tax Affairs Division (ITAD) of the BIR. Otherwise, a taxpayer cannot avail of the preferential tax treatment under Philippine tax treaties.

In filing for requests for tax treaty relief and refund of overpaid final withholding tax (FWT), the taxpayer-refund claimant should comply with all the requirements laid down under Revenue Memorandum Order No. (RMO) 1-2000 (prevailing at the time of transaction and now superseded by RMO 072-10) for applying for tax treaty relief, and Section 229 of the Tax Code for the requirements in filing of administrative and judicial claims for refunds.

In the instant case, the taxpayer-refund claimant filed both its application for relief from double taxation, and claim for refund of its overpaid FWT on cash dividends it paid to its foreign stockholders with the BIR ITAD more than one year from the payment of dividends to its stockholders. As provided under RMO 01-2000, all applications for tax relief with BIR ITAD should be filed at least 15 days before the transaction, i.e., payment of dividends in order to avail of the preferential tax treatment under the Philippine tax treaties. In as much as the taxpayer failed to comply with the 15-day requirement, having filed its application after more than a year from its payment of dividends to its shareholders, the CTA held that the taxpayer-refund claimant cannot avail of the preferential tax rate under the relevant tax treaty.

In addition, the CTA found that the taxpayer-refund claimant did not file an appropriate written claim for refund with the BIR since its alleged claim for refund was considered an application for relief from double taxation filed with the ITAD and not a categorical claim for refund filed with the BIR as required by Section 229 of the Tax Code.

Lastly, the taxpayer-refund claimant never presented the original BIR Form 1601-F but only the amended BIR Form 1601-F (Monthly Remittance Return of Final Income Taxes Withheld) and BIR Form 2306 (Certificate of Tax Withheld at Source). As held by the CTA, it is imperative for the taxpayer to present in evidence the original BIR Form 1601-F to determine the exact date when the FWT was paid to the BIR, while BIR Form 2306 filed by the taxpayer cannot be considered by the CTA since it does not show the fact of payment made to support the FWT remittance. Hence, the taxpayer's claim for refund of its overpaid FWT on dividends it paid to foreign shareholders was denied by the CTA.

(Manila North Tollways Corporation v. Commissioner of Internal Revenue, CTA No. 7864, April 12, 2011)

Court Decisions

DST on lotto tickets

The sale of lotto tickets is subject to DST based on the cost of the ticket, pursuant to Section 190 of the Tax Code, as amended. They are not covered by the exemption granted to horse races and sale of tickets in the horse race sweepstakes from all taxes under the PCSO charter (RA 1169).

Under Section 4 of RA 1169, horse races and sale of tickets in the said sweeptakes are exempt from all taxes, except that each ticket shall bear a twelve-centavo internal revenue stamp. According to the CTA, the express inclusion of horse races and sale of horse race sweeptstakes tickets is a clear exclusion of anything unmentioned as exempt from all taxes.

While the CTA agrees with the principle that if there are inconsistencies between a special law and a general law, the special law will prevail, the CTA held that there is no inconsistency between Section 190 of the Tax Code and the PCSO charter, i.e., RA 1169, which is a special law. Section 4 of RA 1169 is clear that only sweepstakes and horse race tickets are exempt from taxes, thus, the sale of lotto tickets is subject to tax as early as the enactment of RA 1169.

As regards the basis of the DST on sale of lotto tickets, the CTA ruled that Section 190 of the Tax Code expressly provides that the basis of the 10% DST is the cost of the lotto tickets or gross sales, and not the net receipts. The cost of each lotto ticket is P10, which is also equivalent to gross sales of P10 per lotto ticket. Hence, the PCSO liability for DST on sale of lotto tickets should be based on gross sales.

(PCSO v. CIR and Assistant Commissioner of Internal Revenue, Large Taxpayers Service, CTA Case No. 8036, April 15, 2011)

Proof of receipt of an assessment

If a taxpayer denies receipt of assessment from the BIR, it is incumbent upon the latter to prove by competent evidence that the notice of assesment was indeed received by the addressee. In various Supreme Court (SC) decisions, the SC held that the best evidence to prove receipt of an assessment is the registry return card or a certification from the post office.

To prove that assessment notice was indeed received by the taxpayer, the BIR presented as evidence the internal documentation made by its personnel, such as logbook and transmittal slip, which contains the name of the taxpayer, kind of tax assessed, the registry receipt number and the date of mailing, as well as the testimony of its document custodian. Per CTA, the evidence presented by the BIR is insufficient to establish receipt of the assessment notices and demand letters by the taxpayer.

As there was no other proof presented by the BIR to establish that the taxpayer indeed receive the assessment notices, the assessment notices and demand letters were deemed not received by the taxpayer. Not having received them, the taxpayer was not aware of the claimed tax deficiencies, and thus, according to the CTA, proceeding with tax collection without first establishing a valid assessment violates the cardinal principle in administrative investigations that taxpayers should be able to present their case and adduce supporting evidence in support of their defense.

The CTA further held that without such knowledge or information of assessment as evidenced by valid receipt of formal notice and demand for payment, the alleged failure to pay the assessed tax deficiencies cannot be considered willful as to constitute voluntary and intentional infraction of law. Hence, for insufficiency of evidence, the taxpayer was acquitted of its alleged crime of non-payment of deficiency taxes.

(People of the Philippines v. Divino A. Lota c/o AML Marine Industrial Corporation, CTA Criminal Case No. 0-105, April 19, 2011)

DST on credit facilities

A nonstock nonprofit hospital that was designated as borrower signed and executed an omnibus loan and security agreement (OLSA) with lenders composed of banking institutions. In the agreement, each lender bank agreed to provide its respective approved credit line/facility to the hospital. The hospital paid DST for its approved credit line/facility, although it was never implemented and/or availed of and the hospital never made a drawdown on the approved credit line/facility. The hospital filed a claim for refund of its supposedly erroneously paid DST for the credit line facility under OLSA.

Court Decisions

The CTA held that under Section 179 of the NIRC as amended, and Sections 3(B) and 6 of RR 09-94, no DST should accrue on the OLSA since there was no conveyance or delivery of the loaned amount to the borrower. The CTA cited the provisions of Section 3(b) of RR 09-04, which defined for purposes of DST the term "loan agreement" as a contract in writing where one of the parties delivers to another money or other consumable thing, upon the condition that the same amount of the same kind and quality shall be paid. As further provided under Section 3(b) of RR 09-04, the term shall include credit facilities, which may be evidenced by credit memo, advice or drawings.

According to the CTA, for a contract to be considered a loan agreement for purposes of imposing the DST, the same must have the following characteristics: (1) it must be in writing; (2) one of the parties to the contract delivers to the other money or other consumable thing, and (3) such delivery is upon the condition that the same amount of the same kind and quality shall be paid.

Since the lender banks did not deliver any amount or consumable thing to the hospital, the CTA held that no DST should be imposed on the OLSA based on the provisions of Section 3(b) of RR 09-94. Moreover, the CTA maintained that the OLSA does not fall under the category of "credit facilities" that would subject it to DST because the same is not evidenced by any credit memo, advice or drawings as required under RR 09-04. Hence, the CTA directed the BIR to refund to the hospital the DST it erroneously paid on its approved credit line/facility.

(Commissioner of Internal Revenue v. University of Santo Tomas Hospital, Inc., CTA Case No. 7904, April 20, 2011)

SEC Circular

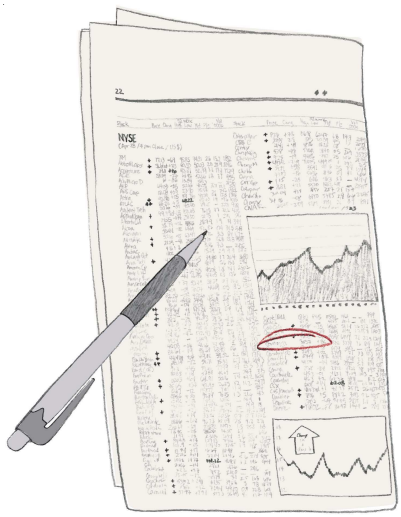
Higher minimum public ownership rule for REIT

The Securities and Exchange Commission (SEC) has increased the minimum public ownership requirement for Real Estate Investment Trusts (REITs) from the original 33.3% to 40% of the outstanding capital stock as provided under the amendments introduced in the provision of the implementing rules and regulations (IRR) of RA 9856.

Under the IRR of RA 9856, a REIT should be a public company. For a public company to be considered a REIT, it should maintain its status as a listed company; upon and after listing, it must have at least 1,000 public shareholders who each own at least 50 shares and who, in the aggregate, own at least 40% of the corporation's outstanding stock at the initial year. As amended, the minimum public ownership requirement shall be increased to 67% within three years from listing.

The SEC has also approved an amendment to the rule on the qualification of property managers of REITs. Under the revised Section 1, Rule 7 of the IRR of REIT, property managers may be exempted by the SEC from the independence requirement from REIT or its promoter/s or sponsor/s upon application and for justifiable reasons.

(SEC Memorandum Circular No. 02, series of 2011, April 27, 2011)



Highlight on P&A services

Corporate restructuring

We render advisory services and assistance on the implementation and in obtaining required government approvals for a client's plan to undergo various types of corporate restructuring arrangements such as increase or decrease of capital stock, conversion of debt to equity, undergoing equity restructuring or quasi-reorganization, dividend declaration or profit repatriation, or any other amendments to a company's Articles of Incorporation and/or By-Laws. We also assist in analyzing, implementing and securing required government approvals for mergers, spin-offs of business units, and tax-deferred exchanges/transfers of properties for shares.

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

If you would like to know more about our corporate restructuring services, please contact:

Tata Panlilio-Ong
Senior Manager, Tax Advisory & Compliance
T + 632 886 5511 ext. 505
F + 632 886 5511 ext. 606
E Tata.Panlilio@ph.gt.com