

taxbrief

Punongbayan & Araullo 

In this Issue

- Definition of gross income earned for ecozone enterprises (*p 2*)
- Consolidated VAT regulations of 2005 (*p 2*)
- Clarifications on the verification of ITRs and FS of bank borrowers and co-makers (*p 5*)
- Clarifications on VAT on the petroleum industry (*p 5*)
- Deferment of the implementation of RR 10-2005 (*p 5*)

BIR RULINGS

- Interest income of ecozone firms subject to regular tax rates (*p 6*)
- CWT on specialty contractors (*p 6*)
- When advance payments are not subject to VAT (*p 6*)

- Tax treatment of joint ventures for construction projects (*p 6*)
- Taxation of bonds issued by ADB (*p 7*)
- Sale of goods in transit outside the Philippines (*p 7*)

COURT OF TAX APPEALS DECISIONS

- Income tax on demurrage fees collected by international carriers (*p 7*)
- Allocation of expenses to an agent of foreign shipping companies (*p 7*)
- VAT on canteen and catering services of an agricultural cooperative (*p 7*)
- Authority of the Courts to take judicial notice of court records (*p 8*)
- VAT official receipt is the required support for input VAT from services (*p 8*)

Definition of gross income earned for ecozone enterprises

Revenue Regulations (RR) Nos. 11-2005, 12-2005 and 13-2005 suspended the effectivity of the following sections of RR 2-2005:

- Section 3 - National tax exemption and incentives to zone-registered enterprises
- Section 4 - Tax and fiscal obligations
- Section 7 - Service establishments

Sections 1 and 2 (scope and definitions) and Section 6 (tax treatment of removal or withdrawal of merchandise from the zones to the customs territory) have been retained.

Section 7 (definition of gross income earned for purposes of determining the 5% tax on gross income) has been restated for enterprises registered pursuant to the Philippine Economic Zone Act (RA 7916), Bases Conversion and Development Authority Act (RA 7227), Cagayan Special Economic Zone Act (RA 7922), and Zamboanga City Special Economic Zone Act (RA 7903).

(Revenue Regulations Nos. 11-2005, 12-2005 and 13-2005, June 23, 2005)

Consolidated VAT regulations of 2005

Pursuant to the mandate under Republic Act (RA) No. 9337 and the Tax Code of 1997, the Consolidated Value-Added Tax Regulation of 2005 was issued to replace all existing regulations, issuances and rulings issued by the Bureau of Internal Revenue (BIR) pertaining to value-added tax (VAT) and to implement the VAT amendments under RA 9337. The regulations covered the following major titles:

1. Nature and characteristics of VAT and persons liable to the tax
2. VAT on sale of goods or properties
3. VAT on importation of goods
4. VAT on sale of services and use or lease of properties
5. VAT-exempt transactions
6. Sources and disposition of input taxes
7. Invoicing requirements
8. Filing of returns and payment of VAT
9. Withholding VAT
10. Penalties
11. Registration rules
12. Transitory provisions

The more important changes in the VAT law and the regulations are highlighted below:

VAT rate and coverage

1) The 10% VAT rate is retained with a stand-by authority

for the President effective January 1, 2006, to increase the rate to 12% if either of the following conditions holds:

- a) VAT to Gross Domestic Product (GDP) ratio exceeds 2.8%.
 - b) National Government deficit to GDP ratio exceeds 1.5%.
- 2) The following transactions, which were previously exempt or zero-rated, shall be subject to VAT:
- a) Sale of electricity by generation, transmission and distribution companies. The base of the VAT shall be the total amount charged by the generation and transmission companies. At the distribution level, the VAT shall be applied to the total amount charged, net of the universal charge. The following have been repealed:
 - i) Zero-rating of generation companies under Section 6 of the Electric Power Industry Reform Act (EPIRA)
 - ii) VAT exemption of the National Power Corporation under Section 13 of RA 6395
 - iii) VAT-exemption of electric cooperatives under Section 109 including their importation of machineries and equipment
 - iv) 3% franchise tax on electric utilities under Section 119
 - b) Sale of nonfood agricultural products, and marine and forest products in their original state by primary producer or owner of the land (copra reclassified as agricultural food product is still VAT-exempt)
 - c) Sale of cotton and cotton seeds in their original state
 - d) Sale or importation of coal and natural gas, in whatever form or state
 - e) Sale or importation of petroleum products subject to excise tax, including raw materials for their production
 - f) Importation of passenger and/or cargo vessels of more than 5,000 tons, whether coastwise or ocean-going, including engine and spare parts (All importations of vessels are now VATable except for transport operators. See enhanced exemption.)
 - g) Sale by the artist of his works of art, literary works, musical compositions and similar creations, or his services performed for the production of such works
 - h) Services rendered by doctors of medicine

- i) Services rendered by lawyers
- 3) The following transaction, previously subject to percentage/franchise tax, shall be subject to VAT:
 - a) Common carriers by air and sea relative to their transport of passengers from one place in the Philippines to another place in the Philippines
 - i) The 3% common carriers tax under Section 117 on transport of passengers by domestic carriers by air and sea has been repealed. Domestic carriers by air and sea shall now be fully under VAT.
 - ii) Franchise taxes of domestic air carriers under their charters have been abolished.
 - iii) Domestic land carriers are still subject to VAT on transport of cargo and to the common carriers tax on transport of passengers.
 - 4) The list of exemptions under Section 109 has been expanded/enhanced to include:
 - a) Gross receipts on lending activities of credit or multi-purpose cooperatives including those whose lending operations extend to non-members (previously covered only cooperatives lending exclusively to members)
 - b) Educational institutions accredited by the Technical Education and Skills Development Authority (TESDA)
 - c) Sale, importation or lease of passenger or cargo vessels and aircraft, including engines, equipment and spare parts for domestic or international transport operations
 - d) Importation of fuel, goods and supplies by persons engaged in international shipping or air transport operations
 - e) Sales and services subject to exemption thresholds
 - i) Sale of residential lot valued at PhP1.5 million or lower, and house and lot and other residential dwellings valued at PhP2.5 million or lower (previously PhP1,000,000). The new exemption threshold shall apply only to contracts signed after the new law takes effect.
 - ii) Lease of residential units with a monthly rental per unit not exceeding PhP10,000 (previously PhP8,000)
 - iii) Sale of goods and services with gross annual sales/receipts not exceeding P1.5 million (previously PhP550,000). In lieu of the VAT, the 3% percentage tax applies.
 - 5) The list of zero-rated sales under Sections 106 and 108 was expanded to include the following:
 - a) Sale of goods, supplies/fuel and services (including leases of property) to international shipping or air transport companies (previously specified only sale of services to international shipping vessels)
 - b) Transport of passengers and cargo by air or sea vessels from the Philippines to a foreign country by domestic carriers
 - c) Sale of power or fuel generated through renewable sources of energy including biomass, solar, wind hydropower, geothermal, ocean energy, and other emerging energy sources using technologies such as fuel cells and hydrogen fuels
 - 6) The regulations clarify that pre-need companies and health maintenance organizations (HMOs) shall be considered dealers in securities. VAT shall be based on their actual receipts on contract price without any deduction.
 - 7) The 10% VAT shall also apply on overseas dispatch messages or conversations that originate in the Philippines and that are subject to the overseas communication tax payable by the person who availed of the services.
 - 8) Laboratory services shall be covered by exempt medical services. Pharmacy sales of a hospital or clinic shall be subject to VAT.
 - 9) Section 108(B)(2) was amended to clarify that other services paid for in acceptable foreign currency and accounted for in accordance with the rules of Bangko Sentral ng Pilipinas (BSP) subject to zero percent rate should be performed for a person engaged in business conducted outside the Philippines, or to a nonresident person not engaged in business who is outside the Philippines when the services are performed.
 - 10) The regulations further provide that sale of goods and services to companies registered with the Philippine Economic Zone Authority (PEZA) or the Subic Bay Metropolitan Authority (SBMA) and operating inside the restricted area or secured perimeter of the zone shall be subject to effective zero-rating. That is, prior approval of the BIR is required before the transaction can qualify for zero-rating. Furthermore, the enterprise should be an export enterprise, an export producer or a 70% manufacturer-exporter.
 - 11) Optional VAT coverage
 - a) A VAT-registered person with VAT-exempt transactions shall have the option to be subject to 10%

VAT on exempt sales under Section 109. The option shall be irrevocable for three years. The option was previously available only to exporters of food and non-food agricultural and marine food products, cotton seeds, copra, fertilizers, seeds, seedlings, fingerlings and animal feeds.

- b) Optional registration for persons not required to register for VAT (with exempt sales not exceeding/not expected to exceed PhP1.5 million over the past/next 12 months) is irrevocable for three years

Input taxes

- 1) Input tax for capital goods if total acquisition cost net of VAT exceeds PhP1 million in one month, shall be spread over 60 months or the useful life of the asset, whichever is shorter. Depreciable capital goods that are constructed or assembled shall be deemed acquired on the month of completion of the capital good. Hence, crediting of input VAT shall begin only on the month of completion. The option to apply for refund/tax credit certificate (TCC) for input taxes from capital goods has been withdrawn.
- 2) In any quarter, the amount of input VAT that can be credited against output VAT shall not exceed 70% of the output VAT. The limitation shall cover all categories of input taxes, including those carried over from previous quarters, transitional input taxes and presumptive input taxes. Excess input tax credit may be carried forward indefinitely or applied for tax credit or refund when the taxpayer cancels his VAT registration or retires his business.
- 3) TCCs issued for input taxes arising from zero-rated transactions shall not be transferable and shall be used only by the taxpayer entitled to the refund for payment of taxes to which he is directly liable.
- 4) Presumptive/transitional input tax credits
 - a) The optional transitional input tax credit allowed on beginning inventories of persons becoming liable to VAT is reduced from 8% to 2%.
 - b) The presumptive input tax credit for manufacturers of sardines, mackerel, milk, refined sugar, cooking oil and, under the new law, packed noodle-based instant meals is increased from 1.5% to 4%.

Withholding VAT

- 1) The withholding VAT on government purchases was unified to 5% and converted to final tax (previously 3%, 6% and 8.5% creditable withholding VAT). The sellers shall continue to invoice and declare VAT at 10%. However, they shall be allowed a standard input VAT

equivalent to 50% of the output VAT. The result is a net VAT payable of 5%. Actual input taxes in excess of the standard input shall be expensed as part of the cost of sales or service. Any excess of the standard input tax over the actual input taxes shall form part of the seller's income subject to tax.

Invoicing requirements

- 1) The law and the regulations clarify the requirement for the issuance of a VAT invoice for sale of goods or properties and a VAT official receipt for sale of services or lease of goods or properties.
- 2) The following information is required in the VAT invoice or official receipt:
 - a) A statement that the seller is VAT-registered followed by his taxpayer's identification number (TIN)
 - b) The amount of tax shown as a separate item
 - c) The words "VAT EXEMPT SALE" written or printed prominently if sale is VAT-exempt
 - d) The words "ZERO-RATED SALE" written or printed prominently if sale is subject to zero percent
 - e) Option to issue combined or separate invoices/receipts if sale is a combination of VATable and VAT-exempt sale. If combined, the invoice or receipt should indicate the breakdown of the sale price between the taxable and the exempt component and the calculation of the VAT.
 - f) Date of transaction, quantity, unit cost and description of the goods or properties or the nature of the service
 - g) Name, business style, address and TIN of the purchaser, for sales to VAT-registered persons or sales amounting to PhP1,000 or more (This requirement previously applied to sales of at least PhP100 and sales where, regardless of amount, the purchaser is a VAT-registered person.)
 - h) A non-VAT person who issues a VAT invoice/official receipt shall be subject to a 50% surcharge on the tax due, in addition to payment of 20% interest per annum and 10% VAT without the benefit of any input tax. If a VAT-registered person issues a VAT invoice/official receipt for a VAT-exempt sale without the words "VAT-EXEMPT SALE," the sale shall be subject to 10% VAT. In both cases, the purchaser shall be allowed to recognize an input tax credit if the invoice/official receipt contains the required information.

Transitory provisions

- 1) The transitional input tax shall be 2% of the value of the beginning inventory or actual VAT paid on such goods, materials or supplies, whichever is higher. To avail of the transitional input tax credits, an inventory of such goods, materials and supplies on hand as of June 30, 2005 (or prior to the effectivity of the VAT on the taxpayer or transaction) should be filed with the Revenue District Office (RDO). A journal entry should be made in the books to debit input tax and credit the inventory account.
- 2) Unused invoices/receipts by persons shifting from VAT to non-VAT or from non-VAT to VAT may be used if properly stamped with "VAT-registered as of ____" or "Non-VAT-registered as of ____."
- 3) Until December 31, 2005, VAT invoices/official receipts may continue to be issued pursuant to the invoicing rules in effect as of December 2004.
- 4) From July 1, 2005, to December 31, 2005, the determination of VAT payable with a 70% limit on input tax shall be determined in the quarterly VAT return for the last quarter of tax year 2005 or, in case of taxpayers on fiscal year basis, in the quarterly VAT return where VAT for December 2005 is included.
- 5) The BIR will issue Revenue Memorandum Circulars to clarify the implementing rules for certain industry groups.

(Revenue Regulations No. 14-2005, June 28-2005)

Clarifications on the verification of ITRs and FS of bank borrowers and co-makers

Under RR 4-2005, bank borrowers and their co-makers are required to submit to the bank their BIR-received income tax returns (ITR) and financial statements (FS), pursuant to Circular No. 472 of the BSP. The following clarifications are issued to implement the requirements:

1. The ITR filed through the electronic filing and payment system (EFPS) with the corresponding reference number shall be deemed duly stamped and received by the BIR.
2. To be considered acceptable by the BSP, the FS of corporations with total assets exceeding PhP15 million should be audited by an external auditor accredited by the Securities and Exchange Commission (SEC). This rule takes effect at the start of calendar year 2005.
3. Banks may verify EFPS-filed ITRs through the BIR

Contact Center or the BIR Portal.

4. For manually-filed ITRs and FS, the bank should fax the documents together with the BIR-prescribed Authenticity Verification Request Form to the BIR Contact Center. The results of the verification shall be made known to the bank via telephone call.

(Revenue Memorandum Order No. 15-2005)

Clarifications on VAT on the petroleum industry

Beginning July 1, 2005, the sale of indigenous petroleum, as well as the importation and sale of the following, shall be subject to VAT:

1. Crude oil
2. Coal
3. Natural gas in whatever form or state
4. Raw materials for the manufacture of petroleum products, including intermediate products
5. Refined petroleum products such as processed gas, naphtha, regular gasoline and other similar products of distillation, unleaded premium gasoline, aviation turbo jet fuel, aviation gas, kerosene, diesel fuel oil (and similar fuel oils having more or less the same generating power), liquefied petroleum gas, asphalts, and bunker fuel oil

Excise tax paid under the old rates on inventory on hand as of midnight of June 30, 2005, can no longer be refunded even if the product is sold after July 1.

Subject to compliance with certain reportorial requirements, refiners, dealers, importers and traders of petroleum products shall be entitled to transitional input tax credit equivalent to 2% of the value of inventory of goods, materials and supplies as of midnight of June 30, 2005, attributable to the transaction that will be newly subject to VAT or the actual VAT paid thereon, whichever is higher, except if such input taxes have already been claimed as expense for income tax purposes.

(Revenue Memorandum Circular No. 29-2005, June 29, 2005)

Deferment of the implementation of RR 10-2005

Pursuant to the Temporary Restraining Order (TRO) issued by the Supreme Court (SC) on July 1, 2005, the implementation of RR 10-2005 has been deferred until the TRO is lifted. The following rules shall apply:

1. All taxpayers shall revert to their VAT status prior to July 1, 2005.

2. VAT collected for which VAT invoices/official receipts have been issued shall be declared in the monthly VAT return and remitted in accordance with existing rules.
3. Non-VAT invoices stamped as VAT invoice pursuant to RR 14-2005 shall be stamped with "No VAT on input allowed" in red ink. A line shall also be drawn across the previously stamped "VAT-Registered as of _____."
4. In the case of VAT invoices that have been stamped "Non-VAT registered as of _____," a red line shall also be drawn across the word "Non."

(Revenue Memorandum Circular No. 30-2005, July 2, 2005)

BIR RULINGS

Interest income of ecozone firms subject to regular tax rates

Interest income from foreign currency deposits derived by enterprises registered under the Bases Conversion and Development Act and the Philippine Economic Zone Act shall be subject to final income tax at the rate of 7.5% under the Tax Code.

Incentives granted to an ecozone enterprise apply only to its registered operations. Income from its unregistered activities shall be subject to the regular tax rates.

(BIR Ruling No. 1-2005, June 16, 2005)

CWT on specialty contractors

When employees of a company that qualifies under the definition of specialty contractors perform engineering and other services for a client company under a service contract for engineering services, the professional fees they receive shall be subject to the 2% creditable withholding tax (CWT) applicable to specialty contractors, not to the 10% or 15% CWT applicable to technical and management consultants. A "specialty contractor" is one whose operations pertain to the performance of construction work requiring special skills and whose principal contracting business involves using specialized building trades or crafts.

(BIR Ruling No. 218-2005, May 4, 2005)

When advance payments are not subject to VAT

Amounts received by a company from its clients representing advance payment to third parties for expenses to be incurred in the projects shall not be subject to income tax and VAT. Such monies are merely entrusted to the company for payment to

third parties without any benefit to the company. Moreover, the amounts are invoiced directly by the payees in the name of the client and are not covered by official receipts of the company.

In one of its decisions, the SC ruled that gross receipts subject to tax do not include monies or receipts entrusted to the taxpayer which do not belong to them and do not redound to their benefit.

(BIR Ruling No. DA 238-2005, June 1, 2005)

Tax treatment of joint ventures for construction projects

A joint venture or consortium formed for the purpose of undertaking construction projects pursuant to an operating or consortium agreement is not subject to the regular corporate income tax. Hence, gross payments to the joint venture are also exempt from the CWT. The joint venture will only be required to file an annual information return in lieu of the quarterly and final corporate income tax returns.

An unincorporated non-taxable joint venture may register as a VAT taxpayer with the RDO where its principal place of business is located. It is likewise required to maintain and register its books of accounts and receipts, even though it is not a separate entity, for income tax purposes.

The co-venturers shall be individually liable for the payment of corporate income tax on their respective earnings derived from the joint venture project. Gross sales or receipts separately invoiced by them and not covered by the invoice issued by the joint venture to the third party shall be subject to the 10% VAT. To enable the joint venture to credit against its output VAT the input VAT derived from the separate domestic purchases of goods and services by the co-venturers, the invoice or receipts issued by the third parties or subcontractors must be issued to the consortium. The invoice must indicate the following:

Sold to (name of co-venturer) as member of the _____ Joint Venture.

Description of Articles	Unit Price	Total
Xxx	xxx	xxx

For the specific scope of work of (name of joint venture/consortium member) for the (name of project).

The VAT official receipts must state the following:

Received the amount of _____ as payment for services to (name of joint venture/consortium member) as member of the _____ Joint Venture for its specific scope of work in the (name of project).

The VAT invoices/receipts must comply with the invoicing requirements under Section 113 of the Tax Code to qualify as support for input tax credits. Any unutilized input VAT of the joint venture cannot be treated and recognized as cost by the co-venturers for income tax purposes. They can be applied only for tax credit or refund.

(BIR Ruling No. DA-240-2005, June 1, 2005)

Taxation of bonds issued by ADB

The Asian Development Bank (ADB) is accorded certain rights, immunities and privileges in its Charter, including immunity from taxation and customs duties on its assets, property, income, operations and transactions. ADB shall also be exempt from any obligation for the payment, withholding or collection of any tax or duty. Hence, if ADB issues peso-denominated bonds for purposes of its peso-lending and investment operations in the Philippines, it cannot be required to withhold any tax on interest income payable to its bondholders. This exemption shall extend to paying agents acting for and on behalf of ADB with respect to the bonds.

The issuance of bonds by ADB shall also be exempt from the documentary stamp tax (DST), even on the part of a non-exempt bondholder. ADB's exemption covers the transaction itself. Therefore, the Tax Code provision that requires the shifting of the DST liability to the other non-exempt party shall not apply.

Transfer of the bonds in the secondary market by way of simple delivery to the buyer is no longer subject to DST, unless the transfer of the instrument involves a renewal or issuance of a new instrument in the name of the transferee.

(BIR Ruling No. DA-247-2005, June 8, 2005)

Sale of goods in transit outside the Philippines

When merchandise is sold while in transit or outside the Philippines, the buyer shall be deemed the owner of the goods upon landing in the Philippines. The VAT liability on the importation shall therefore be borne by the buyer. The shipping documents should indicate the seller as the owner of the goods and the buyer as the consignee.

(BIR Ruling No. DA-264-2005, June 17, 2005)

COURT OF TAX APPEALS DECISIONS

Income tax on demurrage fees collected by international carriers

International carriers doing business in the Philippines are subject to the percentage tax on Gross Philippine Billings. Other income not within the coverage of gross Philippine billings shall be subject to the regular corporate income tax. Demurrage fees collected for the extended use of the containers while in the Philippines may be considered rental income proceeding from the Philippine territory. Hence, demurrage fees charged by international carriers from consignees in the Philippines shall be subject to the regular corporate income tax.

(Maersk-Filipinas, Inc., Steamship Company of Svendborg, and Steamship Company of 1912 v. Commissioner of Internal Revenue, CTA Case No. 6567, June 24, 2005)

Allocation of expenses to an agent of foreign shipping companies

A domestic company that acts as general agent in the Philippines for international shipping companies, although it is not a branch, may be properly allocated a share in the Electronic Data Processing (EDP) system expenses of the shipping companies and all their line agencies abroad. The EDP system is necessary and indispensable to the business of a general agent of international shipping companies. The system supports the documentation and monitoring of the status of the cargoes.

It is not necessary for the agency agreement to clearly specify the basis for the allocation and the extent of the EDP expenses to be charged to the general agent. It is sufficient that the agreement stipulates that the general agent shall share in the EDP expenses and that the certification of the external auditors competently shows the allocated EDP costs based on actual system usage measured in seconds.

(Maersk-Filipinas, Inc., Steamship Company of Svendborg, and Steamship Company of 1912 v. Commissioner of Internal Revenue, CTA Case No. 6567, June 24, 2005)

VAT on canteen and catering services of an agricultural cooperative

Gross receipts of an agricultural multi-purpose cooperative from canteen and catering sales/services are exempt from VAT.

Sales by an agricultural cooperative duly registered with the Cooperative Development Authority to its members are exempt from VAT, pursuant to Section 109(r) of the 1997

Tax Code. The law does not specify which types of sales by agricultural cooperatives to its members are included in the law. Any exchange of goods or services for an agreed amount of money is considered a sale. Hence, sales from the canteen and catering services of agricultural cooperatives should qualify for VAT exemption.

Although the BIR states that such sale is not the sale that is contemplated by law, there is no specific provision of law cited to support this position. Furthermore, a cooperative's provision of canteen and catering services to its members is consistent with its primary objectives: to provide goods and services to its members to enable them to attain increased income and savings, investments, productivity, and purchasing power.

(DA-Region O2 Multi Purpose Cooperative v. Commissioner of Internal Revenue, CTA Case No. 6781, June 29, 2005)

Authority of the Courts to take judicial notice of court records

The Courts may take judicial notice of matters that should be known to judges because of their judicial functions. Hence, the Court of Tax Appeals (CTA) cannot simply deny a claim for refund on grounds that the succeeding year's income tax return was not presented as evidence to prove that the excess taxes were not utilized in the succeeding years. The CTA could have easily taken judicial notice of the contested document attached in another case involving the same parties and subject matter that the CTA was well-aware of.

The SC remanded the case to the CTA for the proper determination of the amount that may be refunded.

(Calamba Steel Center, Inc. v. Commissioner of Internal Revenue, GR No. 151857, April 28, 2005)

VAT official receipt is the required support for input VAT from services

A purchase of service and claim for the related input tax should be supported by a VAT official receipt. Otherwise, a claim for refund of input taxes arising from such purchase shall be denied.

Although Section 113 of the Tax Code refers to the requirement for a VAT "invoice or official receipt" suggesting the use of the alternative, the Tax Code has other provisions (Section 108 c) that prescribe that VAT on sales of services shall be based on the total amount indicated in the official receipt. The law does not provide an alternative to the official receipt.

(Jideco Manufacturing Philippines, Inc. v. Commissioner of Internal Revenue, CTA EB No. 53 Re: CTA Case No. 6552, June 7, 2005)

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We welcome your suggestions and feedback so that the Tax Brief may be 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.

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