



PHILIPPINES

NEW VALUE-ADDED TAX (VAT) RULES

The last twelve months were dominated by the passage of Republic Act No. 9337 (R.A. No. 9337), which made significant amendments to the Philippine VAT rules, and also increased the corporate income tax rate from 32% to 35%. The passage of the bill was controversial, as the House of Representatives and the Senate approached the bill with conflicting policy agendas.

The constitutionality of certain provisions of the Act was challenged before the Supreme Court, resulting in the effective date of the law being deferred from the original 1 July 2005. The amendments finally took effect on 1 November 2005. The VAT rate was subsequently increased from 10% to 12% from 1 February 2006.

The key changes introduced by R.A. No. 9337 are outlined below.

- The VAT exemptions for power and petroleum were removed. In conjunction with this, the zero-rating of sales by generating companies under the Electric Power Industry Reform Act of 2001 was repealed. However, the sale of power or fuel generated through renewable sources of energy was made subject to 0% VAT. To mitigate price effects on consumers, the excise taxes on several petroleum products were reduced or removed, and the franchise tax for electric utilities was abolished.
- VAT exemptions were also removed for the sale of non-food agricultural products, marine and forest products and cotton and cotton seeds in their original state, the sale by an artist of his own works, and the sale of services by doctors and lawyers.
- The VAT exemption thresholds were increased for the lease of a residential unit (to P10,000), the sale of a residential lot (to P1.5 million), and the sale of house and lot and other residential dwellings (to P2.5 million).
- The general registration threshold was increased to P1.5 million. Taxpayers must register for VAT if their sales for the previous 12 months (other than their exempt sales) exceeds P1.5 million, or it is reasonable to expect their sales for the next 12 months to exceed P1.5 million. Taxpayers who fail to register for VAT when they are required to do so will be liable to account for 10% VAT on their sales, but will not be entitled to claim input tax credits. Taxpayers whose turnover is less than the exemption threshold may now register voluntarily for VAT, but cannot then deregister for at least three years.
- New invoicing rules apply from 1 January 2006. A VAT official receipt must be issued for a sale of services. A VAT invoice must be issued for a sale of goods. The amount of VAT must now also be shown separately on the VAT invoice or VAT official receipt. For sales of less than P1,000, the name and TIN of the purchaser no longer needs to be shown before a VAT invoice or VAT official receipt may be used to evidence a claim for an input tax credit. A non-VAT-registered person who issues a VAT invoice or VAT official receipt must account for the VAT without the benefit of input tax credits, and is also liable to a 50% fraud penalty.
- The input tax credit on capital goods must be spread over 60 months if more than P1 million (excluding VAT) is spent in a single calendar month. However, if the depreciable life of an asset is less than 60 months, the input VAT is spread over the depreciable life of the asset. Refunds are also no longer available for VAT paid on the purchase or importation of capital goods, unless they are attributable to zero-rated sales.
- Under the law, the input tax claimable in any quarter (other than the amount attributable to zero-rated sales) may not exceed 70% of a taxpayer's output tax for the quarter. However, Revenue Regulations No. 16-05 has read down the effect of the law so that the 70% cap will apply only when input tax for a quarter exceeds output VAT.

- Government contracts involving leases or the use of intellectual property provided by non-residents remain subject to 10% final withholding VAT. Other government contracts for goods and services are now subject to 5% final withholding VAT. As implemented, persons making sales to government are granted a 5% deemed input tax credit in lieu of actual credits. The effect is akin to a VAT-exempt sale, except that there is the additional 5% tax impost.
- Domestic air and sea passenger transportation have been made subject to VAT. A 0% VAT rate applies for international transportation. Sales of goods and services to persons engaged in international transportation should be subject to 0% VAT, while the sale or importation of passenger or cargo vessels and aircraft, as well as related engines, equipment and spare parts, should be VAT-exempt. There are issues, however, with the administrative interpretation of these provisions. Franchise tax for airlines was abolished.
- The corporate tax rate was increased to 35%. A composite rate applies for the 2005 income year, based on the number of months in the year for which each rate applies. For example, taxpayers with a December 31 fiscal year will pay 32.5% for the 2005 year. The corporate tax rate will reduce to 30% on 1 January 2009.
- The gross receipts tax on the non-lending income of banks and non-bank financial intermediaries was increased from 5% to 7%.

ECOZONE REGULATIONS SUSPENDED

Last year's edition of Asia Pacific Tax mentioned that the Bureau of Internal Revenue (BIR) had issued Revenue Regulations No. 2-05, which consolidated the regulations for economic zones. The regulations were criticised because there were concerns about their consistency with the law they purported to implement. As a consequence, the Secretary of Finance instructed the Department of Finance and the BIR to review the concerns. The regulations were suspended by Revenue Memorandum Circular No. 11-05. The Senate is expected to conduct a more extensive review of the incentives framework in 2006.

REVISED SOFTWARE INTERPRETATION

Under Philippine law, as for most countries, the copyright should be distinguished from the product into which copyrighted material is incorporated. For software, this means payments should generally not constitute royalties for tax purposes, unless the payer receives rights to use the copyright (as opposed to being able to use the product that contains copyrighted material).

In 2003, the BIR issued a controversial Circular, purporting to explain the tax treatment of payments for software. Although the Circular did not actually explain how to determine whether payments for software were royalties, it conveyed a strong inference that payments for software should generally be treated as royalties. In addition, the BIR appeared unwilling to issue rulings confirming that payments for software should not be subject to tax if the payer did not receive the right to use the copyright in a software programme.

The BIR revised its position in Revenue Memorandum Circular No. 44-05. The new Circular correctly states the principles for determining whether payments for software should be treated as royalties. Thus, unless an agreement allows the payer to use rights in the copyright, the payment should not be royalties. There are some drafting issues in the new Circular, some of which suggest the BIR has not yet fully accepted how the law should apply, so there may continue to be some practical issues in having software payments taxed correctly. Even so, the new Circular is a positive development, because it indicates that the BIR is prepared to review its interpretations if they appear unsound.

TRANSFER PRICING ON THE HORIZON?

In November 2005, the BIR conducted public consultations on draft transfer pricing regulations. The draft regulations follow the international arm's length principle, and draw heavily from the OECD Transfer Pricing Guidelines and U.S. Transfer Pricing Regulations. It is anticipated that final regulations will be issued in 2006.