

Headline	VAT reforms on PEZA-registered locators		
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VAT reforms on PEZA-registered locators

With the passage of House Bill (HB) No. 5636 in the House of Representative on May 31 and pending deliberation of Senate Bill (SB) No. 1408 in the Senate, much has been discussed about the reforms being proposed on the current National Internal Revenue Code (NIRC). One of the sectors that would be affected by the proposed changes, specifically on the value-added tax (VAT), are the Philippine Economic Zone Authority (PEZA)-registered locators. Let us take a closer look at the proposed changes on the VAT and how they would affect them.

I. Income Tax Holiday (ITH)

TOP OF MIND



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When the PEZA-registered locators are still in the ITH stage, they are generally subject to the 12 percent (VAT) on their sales unless qualified to zero percent VAT on their sale of goods or services subject to certain conditions. This scenario would still remain the same in HB No. 5636 and SB No. 1408 as the applicable sections have not been changed.

However, their purchases may have a different impact under the reforms, depending on the interpretation or implementation that will be made by the Bureau of Internal Revenue (BIR) or by the courts.

On their local purchases of goods, the sale of goods by the local suppliers to PEZA locator is subject currently to zero percent VAT. With the proposed change in the HB No. 5636, it would appear the sale of goods by the local suppliers may be subject to a 12 percent VAT and the said VAT can be passed-on to the PEZA-registered locators. This change shall take effect upon the implementation of the enhanced VAT refund system provided under HB No. 5636 where the refund process (whether granted or denied) would be 90 days only. With regard to purchase of services, the provision which considers the sale of service to the PEZA-registered locators as zero percent VAT sales has not been deleted. Likewise, as to the VAT-exemption on importation of PEZA-registered locators, the relevant provision has not been changed by HB No. 5636.

With the foregoing considered, there is the risk the PEZA-registered locators would shift their purchases of goods from local suppliers to importation of goods from abroad as there would be no imposition of VAT, in case of the latter. This would not result in added cost in their manufactured goods or services. Should this happen, the one greatly affected would be the potential loss of income of our local suppliers of goods.

In SB No. 1408, it is being proposed to delete, in some of the provisions under VAT, the phrase "under special laws." In effect, with the deletion of this phrase, it would mean the sale of goods and services by local suppliers to PEZA-registered locators may be subject to a 12 percent VAT and the VAT can be passed-on to the latter. Unlike in HB No. 5636, there is no similar provision in the Senate Bill on the enjoyment of zero-rating prior to the enhancement of the current VAT refund system.

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Moreover, there is a proposal in SB No. 1408 on the VAT-exempt portion to have the phrase "Transactions which are exempt under special laws" deleted. Should this be effected, would this effectively withdraw the VAT-exemption incentive granted to PEZA-registered locators as far as importation of goods from abroad is concerned? Republic Act (RA) No. 7916, otherwise known as "The Special Economic Zone Act of 1995," grants to PEZA-registered locators exemption from duties and taxes on their importation from overseas.

II. 5 percent preferential income tax rate

When the ITH period expires, pursuant to RA No. 7916, the PEZA-registered locators would be subject to the five percent preferential income tax rate on their gross income, in lieu of local and national taxes. In this case, the sale of goods and services of PEZA-registered locators would be exempt from the 12 percent VAT.

However, as to their purchases, as discussed earlier, with the proposed change in HB No. 5636, the sale of goods by the local suppliers to PEZA locators may be subject to 12 percent VAT which can be passed-on to the PEZA-registered locators. This would also apply to sale of services to PEZA-registered locators where SB No. 1408 seems to subject such sale of services to 12 percent VAT and the VAT can be passed-on to the PEZA-registered locators. Since the sale of goods and services of PEZA-registered locators is already treated VAT-exempt during the five percent preferential income tax rate stage, any VAT passed-on thereto would now form part as cost in the hands of the PEZA-registered locators. VAT refund is allowed only if the passed-on VAT arose from zero-rated or effectively zero-rate sales and not from VAT-exempt sales. Thus, this would certainly affect the pricing of the PEZA-registered locators of their manufactured goods or services.

Again, since the VAT-exemption on importation of PEZA-registered locators has not been changed in HB No. 5636, there could be a shift of purchases of goods locally to overseas. In case of the latter, no VAT on importation can be imposed on the PEZA-registered entities that would increase the price of its manufactured goods or services. Again, should this happen, our local suppliers of goods would be at the disadvantage.

However, should the SB No. 1408 effectively remove the VAT exemption on importation of PEZA-registered locators, it would mean that they would incur the 12 percent VAT on importation which would form part of cost and consequently, increase the price of their manufactured goods and services. This is so since the sale of goods and services of PEZA-registered locators at this stage is considered VAT-exempt.

With the proposed VAT reforms mentioned above, the question is if these would ultimately affect the competitiveness of our PEZA-registered locators in the world market? We trust the wisdom of our lawmakers on these matters to balance the advantages and disadvantages of the VAT reforms they would eventually be enacting. Should the VAT reforms be inevitable, we trust the changes would be clear and not create confusion with the PEZA-registered locators.

A good starting point in clearing the confusion is to identify the legal basis for the current VAT treatment of transactions of PEZA-registered locators. It is submitted that the VAT treatment of such transactions is grounded on the provisions of

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RA No. 7916, which is commonly referred to as the PEZA law. RA No. 7916 grants incentives such as ITH, the five percent preferential tax rate and the VAT exemption of importation by locators. Our lawmakers (and later the implementing agencies) should consider the effect of the proposed changes of the NIRC, which is a general law, to the provisions of RA No. 7916, which is a special law. Additionally, it will be good to look at the scope under RA no. 7916 on the VAT-free importation by PEZA-registered locators.

With respect to the local purchase of goods and services, the provisions of the NIRC sought to be amended by the two bills may seem to remove the basis for entitling such local purchases to the zero rate. However, in practice, the “Cross-Border Doctrine” has been repeatedly mentioned as the basis for zero-rating the purchases of the PEZA-registered locators. What adds to the confusion is that the “Cross Border Doctrine” has been recognized under Revenue Memorandum Circular (RMC) No. 74-99, issued by the BIR in 1999. Notwithstanding the amendment to the VAT provisions of the NIRC by the VAT reforms in 2005, such RMC has been frequently quoted as the basis for the zero-rating.

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