REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Quezon City

Secs. 24(A), 27(A), 108 of the NIRC of 1997, as amended	
BIR Ruling No. 209-99	
OT-422-2021	
NOV 08 2021	

DU-BALADAD and ASSOCIATES
20th Floor, Chatham House, Rufino Cor. Valero Sts.,
Salcedo Village, 1227, Makati City

Attention: **Atty. Benedicta Du-Baladad**
Managing Partner

Gentlemen:

This refers to request on behalf of your client, Pilipinas Shell Petroleum Corporation ("PSPC" for brevity), for confirmation of your opinion regarding the tax treatment of the Net Operating Fee due to PSPC from its Retailers as well as the Net Operating Fee (NOF) payable by PSPC to its Retailers.

Background:

PSPC is a corporation duly organized and existing under the laws of the Philippines, with principal office address at 156 Valero Street, Salcedo Village, Makati City. It is primarily engaged in the business of importation, processing, treating and refining petroleum products fot the purpose of producing marketable products and the subsequent sale thereof to the public.

Pursuant to its business of selling petroleum products to the public, PSPC owns or leases "Sites" which are part of a large network of petrol filling stations in the Philippines operating under the "Shell" brand. However, PSPC does not operate the Sites on its own. For the operation of petrol filling stations and the sale of petroleum products, PSPC has entered into Retail Business Agreements ("RBA" or "Agreement") with various Retailers. Under the RBA, PSPC wishes the Retailer to arrange for the provision of a range of the Services at the Sites, including delivering Shell's Customer Value Proposition to the high standards, engaging in business at the Sites, and being responsible for the performance of tasks and the discharge of duties as set out in the RBA and the Site Policy and Procedure Manual of Shell.

The Retailer is either a self-employed business person or independent business entity who may engage in the business and provide the services personally and/or via a Nominated Principal. The quality of customer service and the high standards of performance required by Shell from the Retailer will ensure that customers may use Shell petrol filling stations with confidence, knowing that the range, presentation and quality of products and services provided will be of consistently high standard.

PSPC leases (or sublease, as the case may be) to the Retailer the Site on which the petrol filling stations would be located. Under the RBA, the Retailer undertakes to purchase motor fuel from PSPC to be sold at the Site, as well as to purchase and sell CR goods (core range and local range goods sold through the shop at each Site, excluding motor fuel). In consideration for the non-exclusive right to sublease from PSPC, the Retailer pays a fixed monthly rental. In addition, PSPC is entitled to royalty determined as a percentage of all sales of CR goods, the percentage figure varying between different product groups/types. PSPC is likewise entitled for the price for motor fuel, calculated in accordance with the criteria prescribed under the RBA.

Aside from the payment for the rentals, royalties and the price of motor fuels, a NOF is also payable under the RBA. The NOF which is also referred to as the Fair Share Adjustment ("FSA"), is the consideration in addition to any and other amounts payable under the RBA. The NOF, either due to the Retailer or due to PSPC, is computed annually in the applicable business plan for the purpose of making up the difference between the Retailer's earnings according to the applicable business plan, and the retailer's target earnings.

PSPC and the Retailer will devise an annual business plan which will include projections as to the volume of motor fuel and the CR goods likely to be sold at each Site. Based on this plan, PSPC will determine the retailer's target earnings for the relevant ensuing year or part year. Either party will pay NOF depending on the Retailer's achievement of its target earnings. PSPC will receive NOF from the Retailer in case the latter exceeds its target earnings or PSPC will pay the Retailer if the income is less than the target earnings. The NOF is not intended to provide the Retailer with any guarantee of achieving his target earnings, but to serve as the net consideration by which Retailer agrees to engage in business and provide the services.

Based on the foregoing, you now request for confirmation that:

1. The NOF due to PSPC constitutes income subject to the regular corporate income tax of 25%[1] pursuant to Section 27(A) of the National Internal Revenue Code (NIRC) of 1997, as amended, and 12% value added tax (VAT) pursuant to Section 108 of the same Code. The remittance of FSA by the Retailer to PSPC is not generally subject to creditable withholding tax ("CWT"), however, if the Retailer belongs to the top twenty thousand (20,00) private corporations, the FSA shall be subject to 2% CWT, pursuant to section 2.57.2(M) of Revenue Regulations (RR) No. 2-98, as amended; and

2. The NOF due to the Retailer constitutes income subject to 25%[2] income tax for corporations pursuant to Section 27(A), or the graduated tax in Section 24(A) for individuals, and the 12% VAT pursuant to Section 108, all of the NIRC of 1997, as amended. The NOF is subject to 2% CWT since PSPC belongs to the top twenty thousand (20,000) private corporations.

In reply, pleased be informed as follows:

1. Net Operating Fee Due to PSPC

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[1] Effective July 1, 2020 pursuant to Republic Act No. 11534, otherwise known as the Corporate Recovery and Tax Incentives for Enterprises (CREATE) Act
[2] Ibid

As defined under the RBA, the NOF is the consideration, in addition to any and other amounts payable under this agreement, by which Shell and Retailer entered into the Agreement. Under the RBA, there are various services required of the Company for which no fee is provided. The services include providing a training program for the Retailer of his Nominated Principal; supply, installation, and inspection of equipment; conduct of audit to ensure compliance with health, safety, security and environmental standards, among others.

Therefore, if the Retailer exceeds its target earnings, such success is partly due to the various services performed by the Company. Any payment required to be made by the retailer shall therefore be treated as service fees. Effectively, the RBA includes a contingent service remuneration arrangement.

Being a service fee, the NOF due to PSPC constitutes an income on the part of PSPC subject to the regular corporate income tax of 25% pursuant to Section 27(A) of the NIRC of the 1997, as amended, which provides:

> "**SEC. 27.** *Rates of Income Tax on Domestic Corporations.*
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> (A) *In General.* Except as otherwise provided in this Code, an income tax rate of twenty-five percent (25%) effective July 1, 2020, is hereby imposed upon the taxable income derived during each taxable year from all sources within and without the Philippines by every corporation, as defined in Section 22(B) of this Code and taxable under this Title as a corporation, organized in, or existing under the laws of the Philippines.
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> *Provided*, That corporations with net taxable income not exceeding Five million pesos (P5,000,000.00) and with total assets not exceeding One hundred million pesos (P100,000,000.00), excluding land on which the particular business entity's office, plant, and equipment are situated during the taxable year for which the tax is imposed, shall be taxed at twenty percent (20%).
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> In the case of corporations adopting the fiscal-year accounting period, the taxable income shall be computed without regard to the specific date when specific sales, purchases and other transactions occur. Their income and expenses for the fiscal year shall be deemed to have been earned and spent equally for each month of the period.
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> The corporate income tax rate shall be applied on the amount computed by multiplying the number of months covered by the new rate within the fiscal year by the taxable income of the corporation for the period, divided by twelve."

The receipts of the service fees shall also be subject to VAT, pursuant to Section 105 of the NIRC of 1997, as amended, which provides:

> "**SEC. 105.** ***Persons Liable*** – Any person who, in the course of trade or business, sells barters, exchanges, leases goods or properties, renders

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services, and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 106 to 108 of this Code."

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The phrase *"in the course of trade or business"* means the regular conduct or pursuit of a commercial or economic activity, including transactions incidental thereto, by any person regardless of whether or not the person engaged therein is a nonstock, nonprofit private organization (irrespective of the disposition of its net income and whether or not its sells exclusively to members or their guests), or government entity.

"The rule of regularity, to the contrary notwithstanding services as defined in this Code rendered in the Philippines by nonresident persons shall be considered as being rendered in the course of trade or business.

In relation thereto, Section 108 of the NIRC of 1997, as amended, provides as follows:

"**SECTION 108.** ***Value-added Tax on Sale of Services and Use or Lease of Properties.*** –

"*(A) Rate and Base of Tax. – xxx*

"The phrase 'sale or exchange of services' means the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration, including those performed or rendered by construction and service contractors; stock, real estate, commercial and immigration brokers; lessors of property, whether personal or real; warehousing services; lessors or distributors of cinematographic films; persons engaged in milling, processing, manufacturing or repacking goods for others; proprietors, operators or keepers of hotels, motels, rest houses, pension houses, inns, resorts; proprietors of operators of restaurants, refreshment parlors, cafes and other eating places, including clubs and caterers; dealers in securities; lending investors; transportation contractors on their transport of goods or cargoes, including persons who transport goods or cargoes for hire and other domestic common carriers by land relative to their transport of goods or cargoes; common carriers by air and sea relative to their transport passengers, goods or cargoes from one place in the Philippines to another place in the Philippines, sales of electricity by generation companies, transmissions, an distribution companies; services of franchise grantees of electric utilities, telephone and telegraph, radio and television broadcasting and all other franchise grantees except those under Section 119 of this Code and non-life insurance companies (Except their crop insurances) including surety, fidelity, indemnity and bonding companies; and similar services regardless of whether or not the performance thereof calls for the exercise or use of the physical or mental facilities.

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The phrase "*sale or exchange of services*" is so broad to cover all kinds of transactions for which a consideration is expected to be paid from the provision of any kind of service. Hence, unless specifically exempted by law, it is undeniably that the receipts derived from the performance of services shall be subject to VAT.

In *BIR Ruling No. 209-99, dated December 28, 1999*, this Office had the occasion to rule that merchant fees paid by Shell dealers to PSPC for brokering and helping generate higher sale shall be considered as payments for services rendered and are thus subject to VAT prescribed under Section 108 of the NIRC of 1997, as amended.

The NOF received by PSPC constitutes a consideration for services. Accordingly, this is subject to 12% VAT, pursuant to the above-quoted provisions of the NIRC of 1997.

As to whether the transaction is subject to withholding tax, the remittance of NOF/FSA by the retailer to PSPC is not generally subject to creditable withholding tax ("CWT") considering that this type of income payment is not one of those enumerated in the Revenue Regulations No. 2-98 as subject to specific rate of withholding tax. However, if the Retailer belongs to the top twenty thousand (20,000) private corporations, the FSA shall be subject to 2% expanded withholding tax, pursuant to Section 2.57.2(M) of RR No. 02-98, as amended, which provides:

> ***"(M) Income payments made by the top twenty thousand (20,000) private corporations to their local/resident supplier of goods and local/resident supplier of services other than those covered by other rates of withholding tax.*** — Income payments made by any of the top 20,000 private corporations, as determined by the Commissioner, to their local/resident supplier of goods and local/resident supplier, including non-resident aliens engaged in trade or business in the Philippines.
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> Supplier of goods – One percent (1%)
> Supplier of services – two percent (2%)
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> xxx xxx xxx

2. Net Operating Fee Due to the Retailers

In so far as the payment to the Retailer is concerned, the NOF shall serve as consideration by which the Retailer agrees to engage in business and to provide the services. Business, as defined in the RBA means the purchase and sale of motor fuels and CR goods at the Sites. On the other hand, and as defined in the RBA, services means the services to be provided by the Retailer (and/or Nominated Principal), as referred to in the section of the RBA headed "Background", services which PSPC wishes the Retailer to provide include delivering Shell's Customer Value Proposition to the high standards, engaging in business at the Sites, and being responsible for the performance of tasks and the discharge of duties as set out in the RBA and the Company's Manual.

Further, under Section 6.2 of the RBA, the Retailer is required to comply with PSPC's requirements including fostering good relations with customers, embracing and delivering any new or revised customer service initiatives, achieving customer service targets, training and coaching his staff to the require standards, and ensuring that the business, the Retailer and those

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employed or engaged by him meet the standards of presentation, cleanliness and customer service.

From the point of view of the Retailer, therefore, any payment received by it from PSPC would be treated as service fees for undertaking the above services.

Being a service fee and considering that this is an additional income arising from the active pursuit of business, the NOF due to the Retailer shall constitute income subject to 25% income tax for corporations pursuant to Section 27(A) of the NIRC of 1997, as amended, or the graduated tax rates for individuals pursuant to section 24(A) of the same Code.

The RBA clearly provides that the NOF or FSA due to the Retailer is paid in consideration for the services rendered by the latter as Retailer. Considering that the coverage of VAT includes all kinds of sales for services, except those specifically exempted under the NIRC or special laws, the NOF is subject to the 12% VAT pursuant to Section 108 of the NIRC of 1997, as amended.

Income payments made by taxpayers classified as one of the top twenty thousand corporations is subject to 2% creditable withholding tax pursuant to Section 2.57.2(M) of RR No. 2-98, as amended. Since PSPC is classified as one of the top twenty thousand private corporations, its payment of NOF to the Retailers will be subject to the 2% expanded withholding tax.

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be ascertained that the facts are different, then this ruling shall be considered as null and void.

Very truly yours,

CAESAR R. DULAY
Commissioner of Internal Revenue

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