REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Secs. 34(D) and 105, Tax Code	000-00 OT-4 0	6 - 2 0 2 2

Person to Contact: Chief, Law & Legislative Division
Tel Nos. 926-55-36/927-09-63

Date: OCT 0 7 2022

SyCip Gorres Velayo & Co.
6760 Ayala Avenue
1226 Makati City

Attention: **Atty. Fidela I. Reyes**
Partner, Tax Services

Gentlemen:

This refers to your request on behalf of your client, **YOKOHAMA TIRE PHILIPPINES, INC.** ("YTPI" or the "Company") for confirmation that the insurance proceeds received and will be received in the future as indemnification for loss due to the fire in its plant and to be used to rebuild and replace its destroyed properties is not part of its taxable income, and is not likewise subject to the 12% value-added tax (VAT).

Background

1. YTPI, with Taxpayer Identification Number (TIN) , with registered address at IE5, Clark Freeport Zone, Pampanga, Philippines, is a corporation registered and incorporated with the Securities and Exchange Commission on April 30, 1996.

2. Its primary purpose is to produce, process, manufacture, purchase, import, export or otherwise acquire, own, sell, dispose of and generally deal in, and to render any service in respect of, automobile, truck and aircraft tires, tubes and other articles produced in whole or in part from rubber, both natural and synthetic, compounds thereof, substitutes therefor, substances having properties or uses similar thereto; and to manufacture, import, export and sell tire manufacturing equipment and tools, and all other rubber goods and automotive and aircraft parts and accessories.

3. YTPI is a registered entity of the Clark Freeport Zone. As such, it enjoys the income tax incentive of five percent (5%) tax on its gross income earned, in lieu of national and local taxes. It is also entitled to tax exemption and duty-free importation of various equipment, tools, parts and chemical compound for the use of manufacturing of rubber tires and other rubber goods and automotive and aircraft parts and accessories necessary and directly related to its business activities.

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4. The Company entered into an insurance contract with Malayan Insurance Company, Inc. ("Malayan Insurance") through the Industrial All Risks Insurance Policy No. , which has an insurance period from March 9, 2017 to March 9, 2018.

5. This insurance policy covers the various assets of the Company located in IE5, East Plant, Clark Special Economic Zone, Clarkfield, Pampanga from all risks of sudden and accidental physical loss or damage to the properties insured unless caused by an excluded peril.

6. On May 14, 2017, a fire occurred in the Phase III-East Plant of YTPI's registered address in Clarkfield, Pampanga. As a result, various assets – building, machinery, inventories, and other equipment were destroyed.

7. On June 28, 2017, or forty-five (45) days after the fire occurred, YTPI filed a "Declaration of Loss Arising from Casualty" with the BIR Revenue District Office No. 124 Excise LT Audit Division II. Based on the declaration, the net book value of the assets destroyed by fire amounted to – the acquisition cost being with an accumulated depreciation of . The assets destroyed are particularly described as follows:

Description of Property	Declared Cost of Property (USD)	Accumulated Depreciation (USD)	Net Book Value (USD)
1. Inventories		-	
2. Building			
3. M/C & Equipment			
4. Construction in Progress		-	
5. Other consumables		-	

8. The loss suffered by the Company due to the fire was covered and compensated by Malayan Insurance. Pursuant to the insurance policy, Malayan Insurance shall indemnify YTPI on the basis of the reinstatement of the property destroyed or damaged. Reinstatement was defined as where property is destroyed, the rebuilding of any buildings or replacement by similar property of any other property, in either case is a condition equal to but not better or more extensive than its condition when new; or where property is damaged, the repair of the damage and the restoration of the damaged portion of the property to a condition substantially the same as but not better or more extensive than its condition when new.

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9. Pursuant to the insurance policy and based on the survey of the damaged assets in the fire, Malayan Insurance estimates that the reinstatement cost to rebuild and replace the properties destroyed to a condition equal or substantially the same as but not better or more extensive that its condition when new amounts to at least USD.

10. On January 10, 2018, the Company received USD) as partial compensation for the damaged assets. On October 16, 2018, the Company received an additional USD . On February 28, 2019, the Company received another USD This brings the total amount of insurance proceeds received by the Company to USD . It is estimated that the Company will receive additional USD within the next two (2) years, bringing the total insurance coverage to USD

11. Using the insurance proceeds received by the Company from Malayan Insurance, YTPI will rebuild and replace its destroyed properties. Based on the quotations from various suppliers and contractors, YTPI had contracted to spend at least USD to replace the damaged building and machineries of YTPI to continue its business operations in the Phase III-East Plant of the Company. It is expected that YTPI will incur additional expenses within the next two (2) years to completely replace the damaged assets.

In reply, please be informed as follows:

Excess of insurance proceeds over net book value of insured assets is subject to income tax.

Section 34(A)(1)(a) and (D) of the National Internal Revenue Code (Tax Code) of 1997, as amended, provides that all losses actually sustained during the taxable year not compensated by insurance or otherwise are deductible from gross income. Thus, in order that losses to property connected with the trade, business or profession can be claimed as deductions for income tax purposes, the law requires that the loss (1) must be actually sustained and written off in the taxable year; (2) is not compensated by insurance or other forms of indemnity; and (3) must be evidenced by closed and completed transactions.

On the other hand, in case of casualty losses compensated by insurance, Item II (B)(3) of Revenue Memorandum Order (RMO) No. 031-09, prescribing the policies and guidelines that shall govern the declaration of casualty losses incurred by taxpayers, and the reporting of such losses, states:

"II. Policies and Guidelines

xxx xxx xxx

B. Requisites for Deductibility

x x x x x x x x x

3. The recovery of casualty losses through insurance claims shall be governed by the guidelines set forth in Revenue Regulations (RR) No. 12-77. Moreover, the amount of loss that shall be compensated by insurance coverage should not be claimed as a deductible loss.

   3.1. **If the insurance proceeds exceed the net book value of the damaged assets, such excess shall be subject to the regular Income Tax**, but not to the Value-Added Tax, since the indemnification is not an actual sale of goods by the insured company to the insurance company." (Emphasis and underscoring supplied)

Applying the foregoing, the amount of loss that is compensated by insurance coverage should not be claimed as a deductible loss. Moreover, the excess of insurance proceeds, used by YTPI to construct a new building and purchase new assets as replacement for the damaged ones, over the net book value of the damaged assets shall be subject to the regular income tax under Section 27 (A) of the Tax Code, as amended.

The insurance proceeds to indemnify insured's loss is not subject to VAT.

Section 105 of the Tax Code, as amended, provides:

"Sec. 105. Person Liable. – Any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders 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.

x x x x x x x x x

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

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This Office had occasion to rule **that indemnification is not an actual sale of goods** by the insured company to the insurance company, to wit:

> "Although HPI will be indemnified by the insurance companies for the value of the damaged assets, such indemnification cannot be regarded as actual sale of goods by HPI to the insurance companies. The indemnification arises because of the happening of a fortuitous event. Besides, HPI is engaged in the sale of cement manufacturing assets. Thus, the insurance proceeds shall not form part of HPI's gross sales for VAT purposes as the receipt of the insurance proceeds is not in the regular course of HPI's business."[1]

Inasmuch as indemnification cannot be regarded as an actual sale of goods, the insurance proceeds derived/will be derived by YTPI due to the destruction of its insured assets shall not form part of its gross sales for VAT purposes pursuant to Section 105 of the Tax Code, as amended.

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

Very truly yours,

LILIA CATRIS GUILLERMO
Commissioner of Internal Revenue

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[1] BIR Ruling DA-084-2007 dated February 12, 2007