REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE
National Office Building
Quezon City

Sections 108(A) and 311 the Tax Code; Section 4.180-3 of RR No. 16-2005, as amended; Section 5, Rule 18 of IRR of RA No. 11534 VAT-		419-2022

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

Date: OCT 17 2022

INSURANCE COMMISSION
1071 United Nations Avenue
Manila

Attention: **DENNIS B. FUNA**
Insurance Commissioner

Gentlemen:

This refers to your request for clarification whether: (1) the health maintenance organization ("**HMO**") plans acquired by business export enterprises ("**REEs**") registered with any Investment Promotion Agency ("**IPA**") is subject to twelve percent (12%) Value Added Tax ("**VAT**"); and (2) if yes, such VAT is based only on the payment representing compensation for services of HMOs.

As represented, prior to the effectivity of the Corporate Recovery and Tax Incentives for Enterprises ("**CREATE**") Act,[1], HMO plans acquired by REEs were exempt from twelve percent (12%) VAT; that upon issuance of Revenue Regulations No. 21-2021,[2] these HMO plans are now subject to twelve percent (12%) VAT; and that in the case of *Medicard Philippines v. Commissioner of Internal Revenue,*[3] the Supreme Court ruled that the twelve percent (12%) VAT is based on the total payment representing compensation for services of HMOs.

In reply, please be informed as follows:

HMO plans acquired by REEs are subject to zero percent (0%) VAT

Section 311 of the Tax Code[4] reads as follows:

[1] Republic Act No. 11534, An Act Reforming the Corporate Income Tax and Incentives System, Amending for the Purpose Sections 20, 22, 25, 27, 28, 29, 34, 40, 57, 109, 116, 204 and 290 of the National Internal Revenue Code of 1997, as Amended, and Creating Therein New Title XIII, and for Other Purposes, March 26, 2021.
[2] December 3, 2021.
[3] G.R. No. 222743, April 5, 2017.
[4] As amended by Section 16 of CREATE Law.

"SEC. 311. Investments Prior to the Effectivity of This Act. – Registered business enterprises with incentives granted prior to the effectivity of this Act[5] *shall be subject to the following rules:*

(A) Registered business enterprises whose projects or activities were granted only an income tax holiday prior to the effectivity of this Act shall be allowed to continue with the availment of the income tax holiday for the remaining period of the income tax holiday as specified in the terms and conditions of their registration; Provided, That for those that have granted the income tax holiday but have not yet availed of the incentive upon the effectivity of this Act, they may use the income tax holiday for the period specified in the terms and conditions of their registration.

(B) Registered business enterprises, whose projects or activities were granted an income tax holiday prior to the effectivity of this Act and that are entitled to the five percent (5%) tax on gross income earned incentive after the income tax holiday, shall be allowed to avail of the five percent (5%) tax on gross income earned incentive based on Subsection (C); and

(C) Registered business enterprises currently availing of the five percent (5%) tax on gross income earned granted prior to the effectivity of this Act shall be allowed to continue availing the said incentive at the rate of five percent (5%) for ten (10) years." (Underscoring supplied)

Also, Rule 18 of the amended IRR of CREATE Law[6] states:

"RULE 18. Investments prior to the effectivity of the Act

xxx xxx xxx

SECTION 5. Non-income related tax incentives. *– All registered export and domestic market enterprises that will continue to avail of their existing tax incentives subject to Sections 1, 2 and 3 of this Rule, may continue to enjoy the duty exemption, VAT exemption on importation, and VAT zero-rating on local purchases as provided in their respective IPA registrations; provided, that the duty exemption, VAT-exemption on importation, and VAT zero-rating on local purchases shall only apply to goods and services directly attributable to and exclusively used in the registered project or activity of said registered export enterprises located inside the ecozones and freeports until the expiration of the transitory period; provided, further, that importation of capital equipment, spare parts, and accessories by existing export enterprises and domestic market enterprises registered with the BOI prior to the effectivity of the act shall continue to be subject to duty exemption for a period of five (5) years from date of registration."* (Underscoring supplied)

Prescinding from the above-cited provisions, it is clear that registered business enterprises may continue to avail of the income tax incentives granted to them before the effectivity of the CREATE Law (i.e., income tax holiday (**"ITH"**), five percent (5%) tax on gross income earned incentive after the ITH). However, the income tax incentives may only be availed within the transitory period (For ITH, the remaining period of the ITH as specified

[5] The term "Act" refers to the CREATE Law.

[6] Circularizing Amendments to the IRR of Title XIII of R.A. No. 8424 (NIRC of 1997), as Amended by R.A. No. 11543 (CREATE Act), Revenue Memorandum Circular No. 120-2021, December 13, 2021.

in the terms and conditions of their registration; For 5% gross income tax, for ten (10) years from the effectivity of the CREATE Law or until April 11, 2031[7]).

When it comes to the non-income tax incentives such as the VAT zero-rating, it bears stressing that Section 5, Rule 18 of the amended IRR of CREATE Law expressly states that the VAT zero-rating on local purchases incentive shall only apply to goods and services directly attributable to and exclusively used in the registered project or activity of the export enterprises until the expiration of the transitory period.[8] Hence, while it is true that an REE may still avail of the VAT zero rating, the same is limited only to goods and services directly attributable to and exclusively used in the registered project or activity of said export enterprises.

Section 5, Rule 2 of the amended IRR provides what constitutes "directly and exclusively used in its registered project or activity," to *wit*:

> *"Rule 2*
> *Tax and Duty Incentives*
>
> *SECTION 5. Value-Added Tax (VAT) Zero-Rating and Exemption. – xxx*
>
> *The direct and exclusive use for the registered project or activity refers to raw materials, inventories, supplies, equipment, goods, packaging materials, services, including provision of basic infrastructure, utilities, and maintenance, repair and overhaul of equipment,* ***and other expenditures directly attributable to the registered project or activity*** *without which the registered project or activity cannot be carried out; provided, that the VAT zero-rating on local purchases shall be granted upon the endorsement of the concerned IPA, in addition to the documentary requirements of the BIR."* (Underscoring supplied)

For this purpose, under Questions No. 13 and 14 of Revenue Memorandum Circular ("RMC") No. 24-2022,[9] the Bureau clarified the phrase "direct and exclusive use," to *wit*:

> *"Q13: What is meant by direct and exclusive use in the registered project or activity?*
>
> *A13: Direct and exclusive use in the registered project or activity refers to raw materials, supplies, equipment, goods, packaging materials, services, including provision of basic infrastructure, utilities, and maintenance, repair and overhaul of equipment, and* ***other expenditures directly attributable to the registered project or activity*** *without which the registered project or activity cannot be carried out."*
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> xxx xxx xxx
>
> *Q14: What cost items fall under the "other expenditures" in the preceding question?*

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[7] The CREATE was signed into law on March 26, 2021. It was published on March 27, 2021 and took effect on April 11, 2021; Revenue Memorandum Circular No. 38-2022, April 6, 2022.
[8] Section 5, Rule 18 of the amended CREATE IRR.
[9] Clarifying Issues Relative to Revenue Regulations (RR) No. 21-2021 Implementing the Amendments to the Value-Added Tax (VAT) Zero Rating Provisions Under Sections 106 and 108 of the National Internal Revenue Code of 1997 (Tax Code), in Relation to Sections 294(e) and 295(D), Title XIII of the Tax Code, Introduced by Republic Act 9R/A.) No. 11534 (CREATE Act), and Section 5, Rule 2 and Section 5, Rule 18 of the CREATE Act Implementing Rules and Regulations (CREATE IRR), February 23, 2022.

A14: These are costs that are indispensable to the project or activity, i.e., without which, the project or activity cannot proceed, and these include expenses that are necessary or required to be incurred depending on the nature of the registered project or activity of the export enterprise." (Emphasis and underscoring supplied)

Based on the afore-quoted provisions, purchases of goods and services include the expenditures that are/will be directly and exclusively used in or attributable to the registered project or activity, without which the registered project or activity cannot be carried out. These are expenses that are indispensable to the project or activity, without which, the same cannot be carried out.

In the case of HMO plans acquired by REEs for employees directly involved in the operations of their registered projects or activities and forming part of their compensation package, the same can be considered necessary expenses since providing health benefits is not only an indispensable tool for building a competitive workforce but also ensures continuous and smooth operation of the registered project or activity by having a healthy workforce. Considering the foregoing, it is our opinion, as we hereby rule, that HMO related expenses are considered expenses directly and exclusively used in the registered business or activity of REEs, hence, subject to zero percent (0%) VAT. It must be emphasized, however, that the VAT zero-rating shall not extend to HMO plans procured for employees' dependents, as well as HMO plans for employees NOT directly involved in the operations of the registered projects or activities of the REEs. For this purpose, REEs shall be mandated to submit a report as may be prescribed by the appropriate office of the BIR National Office to ensure that only HMO expenses for qualified employees are given VAT zero rating.

The 12% VAT is computed based on gross receipts excluding those amounts earmarked for third party beneficiaries.

Section 108 (A) of the Tax Code provides that twelve percent (12%) VAT shall be imposed upon the gross receipts derived from the sale of services and defines "gross receipts" as the total amount of money or its equivalent actually or constructively received for the services performed or to be performed for another person, to *wit*:

"SEC. 108. Value-Added Tax on Sale of Services and Use or Lease of Properties. –

(A) Rate and Base of Tax. – There shall be levied, assessed and collected, a value-added tax equivalent to twelve percent (12%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties.

xxx xxx xxx

The term 'gross receipts' means the total amount of money or its equivalent representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits and advanced payments actually or constructively received during the taxable quarter for the services performed or to be performed for another person, excluding value-added tax." (Underscoring supplied)

In relation thereto, Sections 4.180-3 and 4.180-4 of Revenue Regulations ("RR") No. 16-2005,[10] as amended by RR No. 4-2007[11] further explains that the term "gross receipts" excludes those amounts which are earmarked for payment to unrelated third party, to *wit*:

> *"SECTION 4.108-3. Definitions and Specific Rules on Selected Services. —*
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> *xxx xxx xxx*
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> *(k) Health Maintenance Organizations (HMOs) are entities, organized in accordance with the provisions of the Corporation Code of the Philippines and licensed by the appropriate government agency, which arranges for coverage or designated managed care services needed by plan holders/members for fixed prepaid membership fees and for a specified period of time.*
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> *HMO's gross receipts shall be the total amount of money or its equivalent representing the service fee actually or constructively received during the taxable period for the services performed or to be performed for another person, excluding the value-added tax. The compensation for their services representing their service fee, is presumed to be the total amount received as enrollment fee from their members plus other charges received.*
>
> *SEC. 4.108-4. Definition of Gross Receipts. — 'Gross receipts' refers to the total amount of money or its equivalent representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits applied as payments for services rendered and advance payments actually or constructively received during the taxable period for the services performed or to be performed for another person, excluding the VAT,* ***except those amounts earmarked for payment to unrelated third (3rd) party or received as reimbursement for advance payment on behalf of another which do not redound to the benefit of the payor.*** "(Emphasis and underscoring supplied)

Thus, it is clear that those earmarked for payment to unrelated third party/ies shall be excluded from the "gross receipts." For this purpose, a payment is a payment to a third party if the same is made to settle an obligation of another person (i.e., customer or client, to the said third party, which obligation is evidenced by the sales invoice/official receipt issued by said third party to the obligor/debtor such as the customer or client of the payor of the obligation.

Exemption from VAT of amounts earmarked for third party is not novel in the Philippines. In RMC No. 39-2007,[12] it was provided that salaries of the guards received by a security agency from its customers/clients and are earmarked and segregated for the said guards do not form part of the security agency's gross income or taxable gross receipts, to *wit*:

> *"It is now well settled that only receipts which is subject to a taxpayer's unfettered command and which he is free to enjoy at his own option is taxed to him as his income whether he sees fit to enjoy it or not. (Corliss v. Bowers, 281 U.S. 376). In*

[10] Consolidated Value Added Tax Regulations of 2005, September 1, 2005.
[11] Amending Certain Provisions of Revenue Regulations No. 16-2005, As Amended, Otherwise Known as the Consolidated Value-Added Tax Regulations of 2005, February 7, 2007.
[12] Clarifying the Income Tax and VAT Treatment of Agency Fees/Gross Receipts of Security Agencies Including the Withholding of Taxes Due thereon (addressed to all Security Agencies, their Clients, Internal Revenue Officers and Others Concerned), January 22, 2007.

view of the clear language of the law and its implementing regulations placing the primary obligation on the Client to pay the salaries of the security guards coupled with the requirement that the monies received by the Security Agency representing salaries shall be earmarked and segregated for the said guards, the amount paid by the Client representing the salaries of the security guards will not form part of the Security Agency's gross income, and neither will it form part of its taxable gross receipts when actually or constructively received. This peculiarity obviously places the Security Agency on a tax situation different from other service providers." (Underscoring supplied)

In the recent case of *Medicard Philippines, Inc. v. Commissioner of Internal Revenue,*[13] the Supreme Court ruled that the amounts earmarked and eventually paid to the medical service providers do not form part of gross receipts for VAT purposes.

Such being the case, this Office hereby rules that the 12% VAT is computed based on gross receipts excluding those amounts earmarked for payment to unrelated third party in accordance with RR No. 16-2005, as amended.

This ruling is issued on the basis of the foregoing facts as represented. However, if upon investigation it shall 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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[13] Medicard Philippines, Inc. v. Commissioner of Internal Revenue, G.R. No. 222743, April 5, 2017; C.T.A. Case No. 9175, October 28, 2021.