Quezon City

OT-004-2020

Date: JAN 1 4 2020

Department of Agriculture- Regional Field Office VI
Parola, Fort San Pedro Street
Iloilo City

Attention: **Remelyn R. Recoter**
Executive Director

Gentlemen:

This refers to your letter dated October 14, 2019 relative to the request by the Department of Agriculture-Regional Field Office 6 for legal opinion on the taxability of the sale of 1,585 units of Collapsible Dryer made by GrainPro Phils., Inc., an entity registered with the Subic Bay Metropolitan Authority (SBMA), to the Department of Agriculture, a buyer outside SBMA Freeport Zone.

In reply, please be informed that under Section 105 of the 1997 Tax Code, as amended, any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, and/or imports goods shall be subject to the value-added tax (VAT) imposed under Sections 106 to 108 of the same Code. 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.

Notwithstanding the above provision, there are certain transactions which are VAT-exempt or subject to zero percent (0%) VAT as may be provided under special laws. Under Section 12 of Republic Act (R.A.) No. 7227, as amended by RA No. 9400, otherwise known as the "Bases Conversion and Development Act of 1992", it is provided that the Subic Special Economic Zone shall be considered as a separate customs territory, viz:

> *"SEC. 12. xxx xxx xxx*
>
> *" The Subic Special Economic Zone shall be operated and managed as a separate customs territory ensuring free flow or movement of goods and capital within, into and exported out of the Subic Special Economic Zone, as well as provide incentives such as tax and duty-free importations of raw materials, capital and equipment. However, exportation or removal of goods from the territory of the Subic Special Economic Zone to the other parts of the Philippine territory shall be subject to customs duties and taxes under the Tariff and Customs Code of the Philippines, as amended, the National Internal Revenue Code of 1997, as amended, and other relevant tax laws of the Philippines."*

In discussing the nature of a "separate customs territory", the Supreme Court, in the case of *Commissioner of Internal Revenue vs. Seagate Technology (Philippines)* G.R.153866 dated February 11, 2005, held that "***in such zone is created the legal fiction of foreign territory***." The Court further stated that "***[A]n ecozone --- indubitably a geographical territory of the Philippines --- is, however, regarded in law as foreign***

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soil. This legal fiction is necessary to give meaningful effect to the policies of the special law creating the zone."

Accordingly, since the Subic Freeport Zone is being operated and managed as a separate customs territory in accordance with Section 12 of RA 7227, as amended, there is, likewise, the creation of a legal fiction that it is a foreign territory. Accordingly, goods that are destined for use or consumption within the Clark Freeport Zone are deemed by fiction of law as export goods to a foreign territory or foreign soil, and therefore not within the customs territory. It is well to note that under the "Cross Border Doctrine", no VAT shall be imposed to form part of the cost of goods destined for consumption outside of the territorial border of the taxing authority.[1]

However, while it is true that goods that are destined for use or consumption within the Freeport Zones are VAT-exempt or subject to zero percent (0%) VAT, as the case may be, the same rule does not apply to goods that are destined for use or consumption outside the Freeport Zones or within the customs territory. This has been expounded under Revenue Memorandum Circular (RMC) No. 74-99 dated October 15, 1999 which provides:

> "SECTION 5. Tax Treatment Of Sales Made By A PEZA Registered Enterprise. —
>
> (1) Sale of goods (i.e., merchandise), by a PEZA-registered enterprise, to a buyer from the Customs Territory (i.e., domestic sales).
>
> — This case shall be treated as a technical importation made by the Buyer. Such Buyer shall be treated as an importer thereof and shall be imposed with the corresponding import tax/es (i.e., VAT or VAT plus excise tax, as the case may be), pursuant to Sec. 107, Title IV and Title VI, NIRC, in relation to Sec. 26, R.A. No. 7916, as implemented by Sec. 2, Rule VIII, PART V of the PEZA rules and regulations entitled "Rules and Regulations to Implement Republic Act No. 7916." The registered enterprise's "gross income earned" therefrom shall be subject to the 5% special tax pursuant to Sec. 24 of R.A. No. 7916: Provided, however, that its sales in the Customs Territory do not exceed the threshold allowed or permitted for such sales, pursuant to the pertinent provisions of the PEZA rules and regulations: Provided, further, that for income tax purposes, if such sales should exceed the aforesaid threshold, its income derived from such excess sales shall be imposed with the normal income tax pursuant to the provisions of Title II, NIRC: Provided, further, that in computing for the income tax due on such excess sales, its net income from such excess sales shall be determined in accordance with the method of general apportionment pursuant to the provisions of Sec. 50, NIRC, (i.e., compute its total net income from total sales, then, compute its net income from such excess sales by general apportionment, as follows: Excess sales divided by total sales times total net income from total sales equals net income from excess sales).
>
> (2) Sale of Services by a PEZA Registered Enterprise to a Buyer from the Customs Territory. — This type of transaction is not embraced by the 5% special tax regime governing PEZA-registered enterprises pursuant to R.A. No. 7916, as implemented by the PEZA rules and regulations hence, such seller shall be subject to

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[1] Section 2, Revenue Memorandum Circular No. 74-99

the 10% (now 12%) VAT, pursuant to Section 108 or to the percentage tax, pursuant to Title V, whichever is applicable, and to the normal income tax on income derived therefrom, pursuant to Title II, NIRC. Such income tax shall be computed in accordance with the method of general apportionment provided in the immediately preceding paragraph."

Although the above RMC was issued to discuss the tax consequences of the sales of goods, property and services made by PEZA-registered enterprises within and without the Ecozone, the same finds application in this case considering that PEZA-registered entities and SBMA-registered entities are similarly situated, that is, they are both located in a separate customs territory. Moreover, RMC No. 50-07 also clarified the tax treatment of the sale of goods by a Freeport Zone-registered enterprise to a buyer from the customs territory, to wit:

> "Q8: What is the tax treatment of sale, barter or exchange of goods and properties by Freeport Zone-registered enterprises to a buyer from the customs territory? (i.e. from the Freeport Zone into the Customs Territory)
>
> A8: The sale, barter or exchange shall be treated as a technical importation made by the buyer in the customs territory. The buyer shall be treated as the importer and shall be imposed the corresponding import taxes and duties prior to release of the goods or merchandise from Customs custody. Any unpaid taxes thereon, aside from being the prime liability of the buyer-importer, shall constitute a lien on such goods or merchandise imported from the Freeport Zone."

Based on the foregoing, the sale of goods and services by a SBMA-registered enterprise to the Department of Agriculture, an entity outside the Freeport Zones, is subject to applicable taxes, including VAT, under RMC Nos. 74-99 and 50-07. In such a case, the sale is considered a technical importation and the Department of Agriculture is treated as the importer thereof who shall be liable for the applicable taxes, including VAT.

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 null and void.

Very truly yours,

CAESAR R. DULAY
Commissioner of Internal Revenue

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