ISSN 2094-1226/April 2013

Decline in banking M&A is a fundamental shift p2 | *A challenging year ahead for miners* p3

Client advisory letter

In this issue

pwc

Isla Lipana & Co.

Decline in banking M&A is a fundamental shift, not just a cyclical downturn

Economic growth and Europe's debt crisis are radically changing banking M&A

Research from PwC has found that recent years' decline in banking M&A is not simply due to a cyclical downturn but represents a radically changed economic and regulatory environment.

The sovereign debt crisis in Europe will continue to affect banking M&A for as long as it continues. The political and economic uncertainty emanating from the eurozone is making it harder to predict future impairments, agree on valuations, arrange funding and gain shareholder approval. The crisis is also having a significant impact on deal confidence, and thus frustrating M&A.

The picture is less gloomy in the USA but some banking institutions still have significant restructuring ahead of them. Those in stronger financial shape are well placed to expand overseas. Asia-Pacific and Latin America will be the most attractive regions for outbound M&A, as the growth in middle income consumers and the rapidly expanding corporate sector demands more services.

High growth economies are now homes to some of the world's largest and increasingly influential banks. A far broader range of institutions are initiating transactions than in the years leading up to the financial crisis. Increasingly, banks from high growth economies are becoming more active acquirers, both in their home markets and abroad, and are establishing their own approaches including partnerships and distribution agreements.

Nick Page, transaction services partner at PwC, said:

"The total number and value of global banking M&A transactions has declined steadily over the past few years. Banking deals have consistently accounted for the majority of financial services M&A over the past decade. The decline in banking M&A over the past three years – or, excluding government-led deals, over the past five years – is not just a cyclical downturn, there are permanent changes taking place.

Asia-Pacific

Supported by rapid economic expansion, increasing middle-class demand for banking products and a growing high-net-worth segment, Asia-Pacific is likely to remain the most active region for banking M&A. Domestic deals will continue to drive M&A, as banks respond to increasing competition and the need for greater operational and capital efficiency.

Cautiously optimistic – a challenging year ahead for miners: PwC report

After a slow and cautious 2012, mining M&A activity is expected to continue at a moderate and equally cautious pace in 2013 as metal prices stabilize and companies bet on a continued rise in commodity demand from countries such as China, according to the latest *Mining Deals* report by PwC.

It is also expected that this year, mega-mergers will be placed on the shelf while mining companies seek to prove that they are being prudent with shareholder dollars and are able to realise positive results on significant acquisitions made in the past few years.

Tim Goldsmith, global mining leader, PwC, said: "In 2013, expect deal activity to continue at moderate levels, well behind the frenzied pace of 2011.

"Miners will have their eyes on opportunities, but will consider risk factors such as rising costs, resource nationalism and potential political ramifications of buying and selling assets. The appetite for controversy is decreasing as miners are wary of joining the list of highly publicized write-offs from past deals, both friendly and hostile."

Considerations for the mining industry for the year ahead also include growing China. China will continue to locate resources to meet its rapidly expanding economy, which is driven by its growing middle-class spending more money on consumer goods, as well as continued infrastructure spending. Also, China has increased its foreign investment targets, specifically in the gold and copper space - boding well for future commodity demand.

There were 1,803 transactions in 2012 – the lowest level since 2005. Deal volume in 2012 also decreased more than 30% as compared to 2,605 transactions in 2011. The value of mining deals also slipped in 2012, as compared to 2011, with the total amounting to US$110bn in 2012 (including the US$54bn value of the Glencore-Xstrata merger which was announced last February and has now nearly cleared all regulatory approvals). Without this merger, deal value falls to US$56bn – compared to a total deal value of US$149bn in 2011.

Excluding the Glencore - Xstrata merger, Canadian-based mining companies were the most active on the M&A scene (29%), followed by the UK (11%), Australia (9%) and China (9%).

Tim Goldsmith, global mining leader, PwC, said: "The deals market was strong in early 2012 but the second quarter saw a volume drop that slowly recovered over the rest of the year. Given the bargains to be had, the lack of funds available to junior miners and the seniors selling assets, we expect the recovery to continue gradually this year.

"2013 will be all about asset rationalization and deal activity will be driven mainly by senior miners looking to divest none-core assets and looking to de-risk projects through joint ventures.

"It's also shaping up to be another interesting year for commodity markets as investors are waiting anxiously to see which companies have the capability to take advantage of the next big opportunity."

Gold and copper continue to thrive

According to the report, gold and copper dominated M&A activity in 2012 as miners with cash took advantage of lower valuations to fund future growth. Together, the two metals accounted for half of the top 20 deals last year, even before considering their mix in the diversified metal mergers.

Tim Goldsmith, global mining leader, PwC, said: "Gold and copper are both popular metals for different reasons. Investors are turning to gold as a hedge against inflation and general economic uncertainty, while copper is considered a bet on the future health of the global economy as the metal is used in everything from plumbing and power to automobiles."

Other commodities of interest include uranium as producers take advantage of prices that have been depressed since the March 2011 Fukushima nuclear facility disaster in Japan. Iron ore also appeared a few times among the top 20 deals of 2012, particularly among steelmakers looking to boost access to this metal.

Bureau of Internal Revenue

Revenue Regulation (RR)

Amended definition of the term "fair market value" of unlisted shares

This RR amends the definition of "fair market value" (FMV) of shares not listed and traded in the stock exchange as used in RR No. 6-2008. FMV of unlisted shares was previously defined as the book value of the shares of stock as shown in the financial statements duly certified by an independent certified public accountant nearest to the date of sale. Under its new definition, FMV of unlisted shares shall refer to the value of the shares of stock at the time of sale. The value of the shares shall be determined using the Adjusted Net Asset Method wherein, assets and liabilities are adjusted to fair market values. The net adjusted asset minus the liability values is the indicated value of the equity. For this purpose, the appraised value of the real property at the time of sale shall be the higher of –

1. the FMV as determined by the CIR
2. the FMV shown in the schedule of value fixed by the Provincial and City Assessors
3. the FMV as determined by the Independent Appraiser.

(RR No. 6-2013 dated 11 April 2013)

Tax treatment of sale of jewelry, gold and other metallic minerals to a nonresident alien individual not engaged in trade or business in the Philippines or to a nonresident foreign corporation

Under RR No. 6-2012 dated 2 April 2012, sale of gold and other metallic minerals to other persons or entities, including the BSP, is subject to income tax, excise tax, and VAT. However, it has been observed that jewelry, gold, and other metallic minerals are being sold to alien individuals or foreign entities that come to the Philippines for a limited period of time for purposes of purchasing in cash jewelry, gold, and other metallic minerals, without the proper payment of taxes due thereon. In view of the impracticality of monitoring the taxation of persons engaged in this activity, the BIR prescribed a mode of collection which essentially requires the advance payment of business and income taxes and actual payment of excise tax in the manner prescribed in this regulation, briefly summarized as follows:

1. Sellers of jewelry, gold, and other metallic minerals shall pay business tax (12% VAT or 3% percentage tax), income tax (5% of gross payment), and excise tax (2% of actual market value or actual consideration paid by the buyer to the seller), if applicable, in advance through the assigned Revenue Collection Officers (RCO) of the RDO having jurisdiction over the place where the subject transaction occurs regardless of whether or not the sellers are duly registered with the BIR.

2. The advance payments shall be credited against the actual business tax (12% VAT or 3% percentage tax, as the case may be) and income tax due from the sellers for the taxable period for which such advance payments were remitted to the BIR.

3. The advance payment of business tax and income tax shall be evidenced by duly validated copy of BIR Form No. 0605 and ROR issued by the RCOs which shall constitute as the proof for credit of the advance payment of taxes and shall be attached to the corresponding tax returns of the taxpayer.

4. Non-resident alien individuals not engaged in trade or business in the Philippines or non-resident foreign corporations are mandated to maintain a record of the transactions which shall contain the date of the transaction, name of the seller, TIN of the sellers, if available, and amount received by the sellers; and to require the seller to sign an order slip or any similar

Glossary

BIR - Bureau of Internal Revenue
BSP - Bangko Sentral ng Pilipinas
CIR - Commissioner of Internal Revenue
FMV - Fair Market Value
RCO - Revenue Collection Officers
RDO - Revenue District Office
RR - Revenue Regulation
VAT- Value Added Tax

document to evidence the amount received by the seller, which shall be the basis of the Revenue Officers in recording the transaction and assessing the correct tax due.

5. Owners and operator of hotels, inns, or establishment where the alien individuals or foreign corporate buyers conduct the purchase transaction are required to advise in writing the concerned RDO immediately after having acquired knowledge of the buying event, stating the name of the alien individuals and/or entity; nationality; passport number; intended number of days of stay in the hotel, inn or establishment; place, date and time of the buying event; and TIN of the non-resident foreign corporation, if already registered. Non-compliance with this mandate shall result in the imposition of corresponding penalties on the operator of the hotel, inn, or establishment.

6. RCOs and the Special Investigation Division (SID) of the BIR shall be tasked to conduct the necessary surveillance and monitoring of these transactions.

(RR No. 5-2013 dated 21 March 2013)

Revenue Memorandum Order (RMO)

Revised guidelines and procedures in the issuance of Subpoena Duces Tecum (SDT) and prosecution of related cases for non-compliance

Section 5 of the NIRC grants the CIR the authority to obtain information, summon and examine as well as take the testimony of persons in ascertaining the correctness of any return or in determining the liability of any person for any internal revenue tax, or in collecting any such liability, or simply in evaluating tax compliance. To ensure full and effective implementation of this authority and other provisions of the NIRC (Sections 14 and 266), new guidelines were issued to further delineate and update the procedure for the issuance the SDT, briefly summarized as follows:

1. This RMO shall apply to (i) persons liable for tax or required to file a return or any officer or employee of such person, or any person having possession, custody, or care of the books of accounts and other accounting records containing entries relating to the business of the person liable for tax; and (ii) any office or officer of the national and local governments, government agencies and instrumentalities, including the BSP and GOCCs.

2. A written notice to the persons above-mentioned requiring them to provide the information or the pertinent books and records shall be issued by the authorized revenue official (i.e., Head of the RO/Large Taxpayers Audit Division/Special investigation Division concerned or any other officer duly delegated by the CIR, e.g., Head of the Letter Notice Task Force).

3. If the information requested is not furnished within the prescribed period or the information furnished is incomplete, the concerned revenue officer conducting the investigation shall request for the issuance of the SDT through a Memorandum Report from the appropriate revenue offices as indicated in the RMO.

4. The SDT shall be issued only if found to be meritorious. It shall be served by the revenue officers assigned to investigate the case or any internal revenue officer authorized for this purpose, within three (3) working days from receipt by said concerned revenue officer. Service of the SDT shall be by personal delivery to the concerned party at his/her registered or known address or wherever he may be found, e.g., place where business activities of the party are concluded or his/her place of residence. If personal service is impractical, substituted service or by mail shall be allowed.

5. The SDT shall have a corresponding serial number to be placed on the upper right portion of the SDT using the following format: (*Office Code-year of Issuance – Series Number, which shall begin from 01 for the first SDT, to be followed by the corresponding digit in numerical order for subsequent SDTs issued*)

6. The date of the SDT shall be the date when it was officially signed and compliance date for the submission of the books and records requested shall be set on the 14th day from the date of issuance of the SDT.

7. The concerned revenue officers must be present during the appointed time, date, and place indicated in the SDT to check the completeness of the documents

Glossary

BIR - Bureau of Internal Revenue
BSP - Bangko Sentral ng Pilipinas
CIR - Commisioner of Internal Revenue
GOCC - Government-Owned or Controlled Corporations
NIRC - National Internal Revenue Code of 1997, as amended
NPS - Notice Payment Schedule
RCO - Revenue Collection Officers
RDO - Revenue District Office
RMO - Revenue Memorandun Order
ROR - Revenue Official Receipts
SID - Special Investigation Division
SDT - Subpoenas Duces Tecum
TIN - Tax Identification Number

submitted. If found complete, the documents shall be consolidated with the records of the case and shall be returned back to the appropriate revenue office for continuation of the investigation. On the other hand, in case of non or partial compliance, a conference shall be conducted on the 5th working day from the date set for compliance between the assigned action lawyer and the revenue officers who shall work jointly for the criminal prosecution of the person who disobeyed the SDT.

8. Compliance with the SDT is mandatory and cannot be waived through payment of the administrative penalty.

9. Within seven (7) working days from end of the conference, the action lawyer shall prepare a Letter-Complaint addressed to the Office of the Prosecutor, recommending the criminal prosecution of the erring person, together with the Complaint-Affidavit and supporting evidentiary documents. The Letter-Complaint and supporting documents shall be routed to the concerned revenue offices for evaluation and approval. The approved documents shall be signed by the following signatories: (i) Regional Director (for SDTs issued by the Revenue Regions), and (ii) the Deputy Commissioner for Legal and Inspection Group (for SDTs issued by the Enforcement and Advocacy Service and the Large Taxpayer's Service) in accordance with Revenue Delegated Authority Order No. 2-2007.

10. Upon approval of the Letter-Complaint and supporting documents, they shall be immediately filed with the Office of the Prosecutor having jurisdiction over the case for criminal prosecution.

11. Once the case Complaint-Affidavit has been filed with the Prosecutor's Office, no prosecuting officer of the BIR shall cause the withdrawal or dismissal of the case, notwithstanding the subsequent submission of documents indicated in the SDT.

This RMO takes effect immediately

(RMO No. 10-2013 dated 22 April 2013)

Policies, guidelines and procedures implementing the Mobile Revenue Collection Officers System (MRCOS)

The BIR has implemented the MRCOS in order to address leakages in tax collection and distortions of collection data that are attributable to the current procedures in the acceptance, processing, remittance and reporting of tax and non-tax collections by RCOs, Special Collecting Officers (SCOs) and other authorized Collection Officers (COs). The MRCOS aims to equip the RCOs, SCOs, and COs with a tool for the issuance of an acknowledgement, tax and/or a non-tax official receipt to a taxpayer or other concerned payee; and at the same time, provide a facility for real-time recording and automatic generation of reports of all collection/return filing transactions, racking of actual remittance of collections to the authorized depositary banks, and ensure timely reconciliation of collection data with the Bureau of Treasury.

(RMO No. 8-2013 dated 27 March 2013)

Guidelines prescribing the endorsement of fraud cases discovered in the processing and issuance of CARs and TCLs

The BIR has noted a proliferation of anomalous ONETT-related incidents particularly in connection with the issuance of CARs and TCLs (covering transactions subject to final capital gains tax on sale of real properties considered as capital assets; capital gains tax on the net capital gain on the sale, transfer, or assignment of shares of stock not traded in the Stock Exchange; expanded withholding tax on the sale of real properties considered as ordinary asset; donor's tax; estate tax and other taxes including DST related to such transactions), in specified Regional Offices. The anomalous incidents include the use of fake CARs and TCLs, manipulations of Tax Declarations of real properties, under declaration of consideration in sale and other transactions, and misrepresentation as to the transferor's status (e.g., making it appear as living when in fact dead or single when in fact married). In order to ensure the proper payment and collection of taxes due and the issuance and use of valid CARs and TCLs, specific guidelines need to be observed.

If evidence of fraud is discovered in the course of processing or evaluating new applications for CARs and TCLs, or those that been previously issued, the case shall immediately be referred to the SID of the Revenue Region for investigation under the RATE Program. In the case of transactions involving properties valued at PHP10m or more, or series of fraudulent transactions deemed perpetrated by the same group of persons, the case shall be transmitted to the National Investigation Division (NID), with a copy of the

Glossary

BIR - Bureau of Internal Revenue
CAR – Certificates Authorizing Registration
CIR - Commisioner of Internal Revenue
CO - Collecting Officers
DST - Documentary Stamp Tax
MRCOS - Mobile Revenue Collection Officers System
NID - National Investigation Division
ONETT - One-time Transaction
RATE - Run Against Tax Evaders
RCO - Revenue Collection Officers
RDO - Revenue District Office
RMC - Revenue Memorandum Circular
RMO - Revenue Memorandum Order
RR - Revenue Regulation
SCO - Special Collecting Officers
SDT - Subpoenas Duces Tecum
SID - Special Investigation Division
TCL - Tax Clearance

report on the initial findings furnished to the Office of the Deputy Commissioner for Legal and Inspection Group, and for Operations Group.

In the case of transactions and transfers within the jurisdiction of Revenue Region 1, the CARs and TCLs shall be signed/approved by the CIR upon the recommendation of the concerned RDOs or ARDOs.

(RMO No. 7-2013 dated 12 March 2013)

Revenue Memorandum Circular (RMC)

Guidelines on taxation of compensation income of Philippine nationals and alien individuals employed by foreign governments/embassies/diplomatic missions and international organizations situated in the Philippines

This RMC was issued to clarify the apparent ambiguity in the proper tax treatment of compensation income of employees of foreign government, embassies, diplomatic missions, and international organizations (collectively referred to as foreign entities); as well as the withholding tax implications. In a nutshell, the RMC provides as follows:

1. The immunity from withholding taxes granted to the above-mentioned foreign entities situated in the Philippines on the basis of international comity as embodied in several international agreements to which the Philippines is a signatory, refers actually to immunity from being constituted as withholding agents of the Philippine Government. Such immunity is likewise embodied in Section 2.78.1(B)(5) of RR No. 2-98, as amended, which exempts from the withholding tax system the remunerations paid by foreign governments and international organizations to their employees who are residents or nationals of the Philippines. Hence, compensation paid by these foreign entities to their employees shall be exempt from withholding tax, but not necessarily from income tax which shall already be the personal liability of the individual employee, if applicable.

2. Most international agreements which grant immunity from withholding tax to foreign entities also grant tax exemption to their officials and employees who are foreign nationals and/or non-Philippine residents in respect to their salaries and emoluments. Nevertheless, such tax exemption granted to employees of these foreign entities shall apply only to those individuals who are expressly and unequivocally identified in the applicable international agreement or law, and shall not extend to those not specifically mentioned as tax exempt. This means that the compensation paid to employees of foreign entities who are not expressly granted exemption under the applicable law or international agreement shall be subject to Philippine income tax, but exempt from withholding tax because their employer is exempt from the obligation to withhold tax.

3. It shall be incumbent upon the taxable employees to report their compensation and subject the same to the regular income tax rate on individuals on or before 15 April of each year in accordance with Section 24 of the NIRC. Affected employees who failed to file their annual income return for the taxable year 2012 are allowed up to 15 May 2013 to file their returns and pay the taxes due on their compensation, without surcharge, interest and compromise, penalty, provided their respective employers filed a Summary List of their employees who are not tax exempt as of 31 December 2012 before 10 May 2013, as provided under RR No. 7-2013.

4. This RMO also enumerates the specific individuals who are exempt from income tax as mentioned in the existing international agreements to which the Philippines is a signatory.

(RMC No. 31-2013 dated 12 April 2013)

Strict implementation of the electronic filing of tax returns and electronic payment of taxes under RR No. 9-2011

This memorandum mandates large taxpayers and non-large taxpayers identified by the BIR to file their tax returns and pay their taxes through the EFPS. The coverage of EFPS has been expanded to include:

- Corporations with complete computerized system
- Corporations with paid-up capital stock of PHP10,000,000.00 and above
- Taxpayers joining public bidding pursuant to EO No. 398, as implemented by RR No. 3-05
- Enterprises enjoying fiscal incentives granted by other government agencies pursuant to special laws

Any manual filing of tax returns and payment of taxes, other than those authorized by the BIR, shall be considered a violation of Section 275 of the NIRC. EFPS taxpayers who filed their tax returns or paid their taxes manually shall

Glossary

ADB - Asian Development Bank
BIR - Bureau of Internal Revenue
EFPS - Electronic Filing and Payment System
EO - Executive Order
NIRC - National Internal Revenue Code of 1997, as amended
RHQ - Regional Areal Headquarters
ROHQ - Regional Operating Headquarters
RMC - Revenue Memorandum Circular
RMO - Revenue Memorandum Order
RR - Revenue Regulation
RHQ - Regional Headquarters
TCL - Tax Clearance
VAT - Value added Tax

Glossary

BIR - Bureau of Internal Revenue
DA - Department of Agriculture (?)
DST - Documentary Stamp Tax
ECTS - Electronic Toll Collection System
MTCS - Manual Toll Collection System
NIRC - National Internal Revenue Code of 1997, as amended
PE - Permanent Establishment
RP - Republic of the Philippines
RMC - Revenue Memorandum Circular
VAT - Value added Tax

pay a compromise penalty of PHP1,000.00 for the first and second offense. The third and subsequent offenses shall be strictly penalized under Section 275 of the NIRC.

(RMC No. 30-2013 dated 1 April 2013)

BIR Rulings

Filipino employees of the Asian Development Bank are not entitled to the 15% tax provided under Section 25(C) of the NIRC

In BIR Ruling No. 029-99 dated 11 March 1999, the BIR opined that salaries and emoluments received by Filipino officers and employees of the Asian Development Bank (ADB) are entitled to the 15% preferential income tax granted to Filipino employees of Regional Area Headquarters (RHQ) or Regional Operating Headquarters (ROHQ) occupying the same position as alien employees of said multinational companies, as provided under Section 25(C) of the NIRC.

A new ruling was recently issued by the BIR revoking this ruling. Comparing the differences in the nature, functions and purpose of the ADB on one hand, and the RHQs/ROHQs of multinational companies, on the other hand, the BIR concluded that ADB is neither an RHQ nor an ROHQ. Consequently, there is no statutory basis for allowing the Filipino officers and staff of the ADB to avail of the option to be taxed at the 15% preferential rate. The Filipino officers and staff of the ADB shall be subject to the regular graduated income tax rates on individuals provided under Section 24(A) of the NIRC.

(BIR ITAD Ruling No. 113-2013 dated 15 April 2013)

Installation of substantial equipment in the Philippines by a Malaysian resident is deemed a PE under the RP-Malaysia Tax Treaty

Domestic Company is the operator of the Manila-Cavite Toll Expressway R1 Extension. It entered into two contracts, onshore and offshore, with a Malaysian company involving the installation of the Manual Toll Collection System (MTCS) at the Manila-Cavite Toll Expressway R1 Extension. MTCS is a cash collection system which does not use the Electronic Toll Collection System (ETCS) (the use of electronic cards and electronic passes) and which can co-exist with the said system provided the proper devices are installed at the toll plazas. Both contracts required the installation of certain equipment in the Philippines. Based on the certification issued by the Domestic Company, four personnel of the Malaysian company came to the Philippines to perform services under the two contracts for an aggregate period of 45 days.

The service fees paid by the domestic company to the Malaysian company were treated as business profits and as such, are taxable in the Philippines to the extent that they are attributable to a permanent establishment (PE) in the Philippines, as provided under Article 7 of the RP-Malaysia Tax Treaty. Article 5 of the same treaty further defined a PE as including, among others, the use or installation of substantial equipment in the Contracting State by, for, or under a contract with, an enterprise of the other Contracting State.

Applying this provision, the BIR opined that since the Malaysian company had installed substantial equipment in the Philippines to implement the MTCS of the toll plazas in the Manila-Cavite Toll Expressway R1 Extension, the Malaysian company is deemed to have a PE under Article 5(4)(b) of the RP-Malaysia Tax Treaty. Accordingly, all payments made by the domestic company to the Malaysian company under both the onshore and offshore contracts shall be subject to Philippine income tax pursuant to Article 7(1) of the treaty. For tax purposes, the Malaysian company shall be treated as a foreign corporation engaged in trade or business in the Philippines under Section 28(B)(1) of the NIRC. As such, it shall be subject to the regular corporate income tax of 30% based on net income, i.e., gross income less related executive and general administrative expenses, as allowed under Article 7(3) of the RP-Malaysia Tax Treaty.

Lastly, the service fees under the two contracts shall also be subject to the 12% VAT.

(BIR ITAD Ruling No. 098-2013 dated 8 April 2013)

Accumulated and unapplied input VAT arising from zero-rated transactions may be treated as deductible expense for income tax purposes only in cases of denied claim for refund or tax credit

A domestic company is engaged in the importing, exporting, buying, selling, assembling and repacking of goods on wholesale basis, and rendering of marketing research and promotional sales work for its principal, which are classified as VAT zero-rated. In the course of its business, the company had obtained passed-on VAT from its purchases of goods and services, which has remained unutilized because majority of the company's transactions are zero-rated. In order to benefit from this unused input VAT, the company instead of filing a claim for refund or tax credit under Section 110(B) in relation to Section 112(A) of the NIRC, decided to write off the input VAT from its books and claim the operation expense as deduction from gross income using as basis BIR Ruling No. DA-636-2006 dated 27 October 2006 and RMC No. 42-2003, which allows this option.

The BIR ruled that the company's proposition that unapplied input taxes may be treated outright as deduction expense for income tax purposes has no legal basis. Sections 110(B) and 112(A) of the NIRC, as amended, clearly provides that unutilized input taxes attributable to zero-rated sales can only be recovered through the filing of an application for refund or tax credit with the BIR. Any other mode of recovery is not supported by any provision of the NIRC. Moreover, the discussion provided under RMC No. 42-2003 which allows the unutilized input taxes to be claimed as deduction from gross income apply only in cases where the taxpayer's claim for refund or tax credit was denied. RMC No. 42-2003 cannot be invoked in the present case since the company did not file a claim for refund or tax credit, but proceeded to expense outright the unused input VAT for income tax purposes. By doing so, the company failed to justify its entitlement to the deduction in compliance with the basic principle of statutory construction that tax exemptions must be construed strictly against the taxpayer and liberally in favor of the taxing authority.

(BIR Ruling No. 133-2013 dated 4 April 2013)

The conduct of a short workshop in the Philippines by a US company does not create a PE in the Philippines under the RP-US Tax Treaty

A domestic general professional partnership (GPP) entered into a service agreement with a non-resident company based in the United States (US). Under the service agreement, US Company will conduct through its employees/personnel, a two-day course/workshop in the Philippines on pipeline regulations and standards in the US, to be attended by members and invited guests of GPP. The GPP submitted a certification that the course/workshop was actually held in the Philippines for three days and was conducted by two of the US Company's officers who stayed in the Philippines for a total of five days.

The BIR confirmed that the service fee paid by GPP to the US Company is considered business profits and as such, shall be taxed in the Philippines only if it is attributed to a PE in the Philippines. Since the services performed by the US Company in the Philippines did not exceed the threshold of 183 days to constitute a PE in the Philippines, plus the fact that US Company is not engaged in trade or business in the Philippines to which a branch, office or fixed place of business can be attributed, the service fee for conducting the course/workshop is exempt from Philippine income tax pursuant to Article 8(1) of the RP-US Tax Treaty. However, because the course/workshop was conducted in the Philippines, the service fee shall be subject to 12% VAT.

(BIR Ruling ITAD No. 076-13 dated 21 March 2013)

Glossary

BIR - Bureau of Internal Revenue
GPP - General Professional Partnership
ILA - Installment Loan Agreement
NIRC - National Internal Revenue Code of 1997, as amended
PE - Permanent Establishment
PN - Promissory Note
RA - Republic Act
RMC - Revenue Memorandum Circular
SC - Supreme Court
VAT - Value added Tax

Remuneration paid to a foreign teacher is exempt from Philippine income tax under the RP-Vietnam Tax Treaty

A Vietnamese resident was invited to teach in a Philippine educational institution under an Overseas Hire Contract for a period of two years. The BIR confirmed that the salaries paid to the Vietnamese professor under this contract are exempt from Philippine income tax based on Article 21(1) of the RP-Vietnam Tax Treaty. Under this provision, an individual resident of Vietnam who is present in the Philippines for the primary purpose of teaching, giving lectures or conducting research at a university, college, school or educational institution or scientific research institution accredited by the Philippine government, shall be exempt from Philippine income tax for a period of two years from date of his/her arrival in the Philippines.

(BIR Ruling ITAD No. 070-13 dated 14 March 2013)

Service fees for acting as joint arrangers and agents of loan are considered business profits under RP-Japan Tax Treaty

A domestic corporation contracted an Installment Loan Agreement (ILA) with various foreign lending institutions based in Japan in each of their respective capacities as lenders, guarantor and joint arrangers, security agent, and paying agent. The ILA required the domestic corporation to pay to the lender banks interest on the loan amortizations, and service fees in their capacities as joint arrangers and agents.

The BIR ruled that the interest payments made to the Japanese lenders on the date of filing of the tax treaty relief application and thereafter, shall be subject to the 10% preferential tax rate under Article 11(2) of the RP-Japan Tax Treaty. Moreover, the service fees paid to the Japanese lenders for acting as joint arrangers and agents are in the nature of business profits and as such, shall be taxed only if attributed to a PE in the Philippines. Since the Japanese lenders have no fixed place of business in the Philippines nor do they furnish consultancy services in the Philippines, the services fees are exempt from Philippine income tax under Articles 5 and 7 of the RP-Japan Tax Treaty.

(BIR Ruling ITAD No. 053-13 dated 8 March 2013)

Court decisions

Supreme Court (SC)

Incidental transactions, though isolated, may still be subject to 12% VAT

Company MII is a VAT-registered partnership principally engaged in the business of converting steam into electricity for eventual sale. Company MII owns a motor vehicle, which forms part of the company's property, plant, and equipment. The motor vehicle was later sold after it has been fully depreciated in the books. Company MII was later assessed for deficiency VAT on this transaction.

Under Section 105 of the NIRC, as amended, VAT shall be imposed on the sale of goods and services undertaken in the "regular pursuit or conduct of business, including transactions incidental thereto". Clearly under this provision, even transactions incidental to the principal business of the taxpayer shall also be subject to VAT; and incidental transactions may include isolated transactions. In other words for VAT purposes, an isolated transaction can also be deemed an incidental transaction subject to VAT.

Company MII's motor vehicle was considered isolated but incidental since the motor vehicle was used in the conduct of its business. As such, the sale is subject to VAT under Section 105 of the NIRC.

(G.R. Nos. 193301 and 194637 dated 11 March 2013)

Filing of claim for refund of excess input VAT is governed by Section 112(A) and (C) and not Section 229 of the NIRC; "Excess" input VAT is not "excessively" collected tax

The SC consolidated three cases involving three different domestic corporations, Companies A, B, and C, where all three of them filed separate claims for refund and/or tax credit for their respective excess input taxes related to their zero-rated transactions. One major issue raised in this case is the applicable prescriptive period to file a claim for refund/tax credit of excess input taxes, i.e., whether it should be filed within the two-year prescriptive period stated under Section 229 of the NIRC or the two-year prescriptive period stated in Sections 100(B) and 112(A) of the NIRC.

The SC held that in the case of a claim for refund/credit of excess input VAT, the applicable provision is Sections 100(B) and 112(A) of the NIRC and not Section 229 of the NIRC which clearly applies to refund of erroneous taxes paid. In a claim for refund or credit of "excess" input VAT under Section 100(B) and Section 112(A), the input VAT is not "excessively" collected as understood under Section 229 because at the time the input VAT is collected the amount paid is correct and proper. The term "excess" input VAT simply means that the input VAT available as credit exceeds the output VAT, not that the input VAT is excessively collected. Thus, the taxpayer who legally paid the input VAT cannot claim for credit or refund as "excessively" collected under Section 229. As the Court held in a 2008 case *(G.R. No. 172129, 12 September 2008, 565 SCRA 154)*, Section 229 should "apply only to instances of erroneous payment or illegal collection of internal revenue taxes." Thus, the filing of a claim for tax credit or refund of excess input VAT shall be governed by Section 112(A), not Section 229 of the NIRC.

(G.R. Nos. 187485, 196113, 197156 dated 12 February 2013)

The two-year prescriptive period refers to administrative claim for refund and not judicial claim; the 30-day period to appeal to the CTA need not necessarily fall within that 2-year prescriptive period

The SC further held that unlike in Section 229 where the 30-day period to appeal to the CTA should also fall within the 2-year prescriptive period, in Section 112(A), the 30-day period to appeal to the CTA need not fall within the 2-year prescriptive period as long as the administrative claim is filed with the BIR within that 2-year period. Following the verba legis doctrine, Section 112(A) clearly, plainly, and unequivocally provides that the taxpayer "may, within 2 years after the close of the taxable quarter when the sales were made, apply for the issuance of a tax credit certificate

Glossary

CTA - Court of Tax Appeals

NIRC - National Internal Revenue Code of 1997, as amended

VAT - Value added Tax

SC - Supreme Court

SCRA - Supreme Court Reports Annotated

or refund of the creditable input tax due or paid on such sales." Simply stated, the taxpayer may apply with the CIR for a refund or credit "within 2 years", which means at anytime within two years.

In addition, the two-year prescriptive period in Section 112(A) does not refer to the filing of the judicial claim with the CTA but to the filing of the administrative claim with the CIR. The theory that the 30-day period must fall within the two-year prescriptive period adds a condition that is not found in the law. The taxpayer can file his administrative claim for refund or credit at anytime within the two-year prescriptive period. If he files his claim on the last day of the two-year prescriptive period, his claim is still filed on time. The CIR will have 120 days from such filing to decide the claim. If the CIR decides the claim on the 120th day, or does not decide on that day, the taxpayer still has 30 days to file his judicial claim with the CTA.

(G.R. Nos. 187485, 196113, 197156 dated 12 February 2013)

Observation of 120+30 day rule to file judicial claim is mandatory and jurisdictional

Failure to comply with the 120-day waiting period violates the doctrine of exhaustion of administrative remedies. Such violation renders the CTA petition premature, thus without a cause of action, consequently, to lack of jurisdiction on the part of the CTA.

The charter of the CTA, expressly provides that it has jurisdiction to review on appeal "decisions of the [CIR] in cases involving x x x refunds of internal revenue taxes." It also provides that if the CIR fails to decide within "a specific period" required by law, such "inaction shall be deemed a denial" of the application for tax refund or credit. In other words, it is the CIR's decision, or inaction "deemed a denial," that the taxpayer can take to the CTA for review. Without a decision or an "inaction x x x deemed a denial" of the CIR, the CTA has no jurisdiction over a petition for review.

Conclusively, observance of the 120+30 day rule is mandatory and jurisdictional. Since Company A failed to comply with the 120-day mandatory period, this rendered the Petition for Review it filed with the CTA void. The void petition for review cannot be legitimized by the Court because Article 5 of the Civil Code provides that acts executed against provisions of mandatory or prohibitory laws shall be void, except when the law itself authorizes their validity. In this particular case, there is no law authorizing the petition's validity.

(G.R. Nos. 187485, 196113, 197156 dated 12 February 2013)

Exception to the 120-30 day rule

Although strict compliance with the 120+30 day rule is mandatory and jurisdictional, this rule admits of one exception, i.e., the period from the date of issuance of BIR Ruling No. DA-489-03 on 10 December 2003, which ruled that the taxpayer need not wait for the lapse of the 120-day period before it could seek judicial relief with the CTA by way of Petition, up to the issuance of the 2010 decision *(G.R. No. 184823, 632 SCRA 422)* on 06 October 2010 which reiterated the mandatory and jurisdictional nature of the 120+30 day periods.

The SC explained that BIR Ruling No. DA-489-03 is a general interpretative rule because it was a response to a query made, not by a particular taxpayer, but by a government agency tasked with processing tax refunds and credits, that is, the One Stop Shop Inter-Agency Tax Credit and Drawback Center of the DOF. Since the CIR has exclusive and original jurisdiction to interpret tax laws, taxpayers who acted in good faith should not be prejudiced by an erroneous interpretation by the CIR, particularly on a difficult question of law. Section 246 of the NIRC clearly states that any revocation, modification, or reversal of the rules issued by the CIR shall not be given retroactive effect if said revocation, modification, or reversal will be prejudicial to the taxpayers. This provision espouses the doctrine of equitable estoppel.

BIR Ruling No. DA-489-03 cannot be given retroactive effect because it is in the first place, an erroneous interpretation of the law. Prior to its issuance, the BIR held that the 120-day period was mandatory and jurisdictional, which is the correct interpretation of the law, and therefore, no taxpayer can claim that it was misled by the BIR into filing a judicial claim prematurely. Lastly, a claim for tax refund or credit, like a claim for tax exemption, is strictly construed against the taxpayer.

Hence, since BIR Ruling No. DA-489-03 cannot be given retroactive effect, Company A cannot claim any benefit from this ruling since it filed its judicial claim with the CTA prematurely on 10 April 2003, which was before the issuance of said ruling on 10 December 2003. On the other hand, by virtue of the doctrine of equitable estoppel, Company B can validly claim the benefit of said ruling since it filed its judicial claim with the CTA after the issuance of BIR Ruling No. DA-489-03.

(G.R. Nos. 187485, 196113, 197156 dated 12 February 2013)

Glossary

BIR - Bureau of Internal Revenue
CTA - Court of Tax Appeals
CIR - Commisioner of Internal Revenue
DA - Department of Agriculture (?)
DOF - Department of Finance
VAT - Value added Tax
SC - Supreme Court
SCRA - Supreme Court Reports Annotated

Court of Tax Appeals (CTA)

Premature filing of a claim for refund or the non-exhaustion of administrative remedies is not jurisdictional and, at the most, only renders the case susceptible of dismissal for lack of cause of action and such defense is waivable

Company R filed an administrative claim for refund with the BIR, of its excess and unutilized input VAT paid on its domestic purchases of goods and services and importations attributable to its zero-rated sales, for two taxable years. Simultaneously, Company R also filed a Petition for Review with the CTA on the same day. In other words, Company R immediately filed its judicial claim without waiting for the decision of the BIR on the claim or the lapse of the 120-day period given to the CIR to act on the claim as prescribed under Section 112(C) of the NIRC, as amended.

The CTA resolved the case in favor of Company R with the following decision.

Under Section 112(C) of the NIRC, a taxpayer has 30 days from receipt of the decision denying the claim for refund or issuance of TCC or after the expiration of the 120-day period from the date of submission of complete documents, to appeal the decision or the inaction of the CIR with the CTA. Any judicial appeal made before the occurrence of these two scenarios is considered a violation of the doctrine of exhaustion of administrative remedies, which is fatal to one's cause of action. However, failure to exhaust administrative remedies merely renders the action premature, i.e., the cause of action is not ripe for judicial determination, but does not affect the jurisdiction of the court. This means that while non-exhaustion of administrative remedies or premature filing may be a ground for dismissal of the case for lack of cause of action, such defense is waivable or may be considered waived if not pleaded either in a motion to dismiss or in the Answer as provided under Section 1, Rule 9 of the Rules of Court, except in cases of lack of jurisdiction, litis pendentia, res judicata, and prescription.

In the present case, Company R's premature filing of the Petition for Review was considered a violation of the doctrine of exhaustion of administrative remedies. Notwithstanding this, however, the CTA did not dismiss the case because the CIR was deemed to have waived the defense of non-exhaustion by its failure to raise this issue in a motion to dismiss or allege it in her Answer as one of her special and affirmative defenses. Accordingly, the CTA proceeded to hear the case which eventually resulted in the partial approval of Company R's claim for refund.

(CTA Case No. 7896 dated 22 February 2013)

Period to assess and collect local taxes should be made within five years from the date they become due

Company N was assessed deficiency franchise tax for the taxable years 2001 to 2007 through the LGU's assessment letter dated 18 March 2008. The assessment was validly protested, but denied at the LGU level and later elevated to the CTA. One of the issues raised was prescription.

The CTA ruled that the assessments for deficiency franchise tax for the years 2001, 2002 and 2003 have already prescribed under Section 194(a) of the LGC, which provides that local taxes, fees, or charges shall be assessed within five (5) years from the date they became due. Under Section 167 of the LGC, local taxes become due within the first twenty (20) days of January or of each subsequent quarter as the case may be. Based on these provisions the periods for assessing Company N for franchise tax for the years 2001 to 2003 should have been sent not later than 20 January 2008. Since the assessment notice of the LGU was issued only on 18 March 2008, the LGU can no longer pursue the assessment and collection of taxes for said periods.

(CTA Case AC No. 84 dated 1 March 2013)

Glossary

CTA - Court of Tax Appeals

LGC - Local Government Code

LGU - Local Government Unit

NIRC - National Internal Revenue Code of 1997, as amended

VAT - Value added Tax

SC - Supreme Court

SCRA - Supreme Court Reports Annotated

Executive issuances

Securities and Exchange Commission (SEC)

Transition to new and amended Philippine Financial Reporting Standards

All corporations that are required to submit interim financial statements are allowed to present the prescribed information and to recognize the impact of the following standards in their interim financial statements starting with the period ended 30 June 2013

- PAS 27 (Amended) – Separate Financial Statements
- PAS 28 (Amended) – Investments in Associates and Joint Ventures
- Amendments to PFRS 1 (Government Loans) and PFRS 7 (Disclosures – Offsetting Financial Assets and Financial Liabilities)
- PFRS 10 – Consolidated Financial Statements
- PFRS 11 – Joint Arrangements
- PFRS 12 – Disclosure of Interests in Other Entities
- PFRS 13 – Fair Value Measurement

The interim financial statements as of 30 March 2013 shall contain the following disclosures: (1) whether or not the above standards are applicable to the company; and (2) if yes, whether or not the company is currently evaluating the impact based on audited figures as of 31 December 2012.

The Memorandum shall be effective starting 1 January 2013.

(SEC Memorandum Circular No. 6 Series of 2013 issued 23 April 2013)

Glossary

AAB - Authorized Agent Banks
BSP - Bangko Sentral ng Pilipinas
MORB - Manual of Regulations for Banks
MORNBFI - Manual of Regulations for Non-Bank Financial Institutions
PAS - Philippine Accounting Standards
PFRS - Philippine Financial Reporting Standards
SEC - Securities and Exchange Commission
SRC - Securities Regulation Code

Bangko Sentral ng Pilipinas (BSP)

Amendments to Foreign Exchange Regulations

Certain provisions of the Manual of Regulations on Foreign Exchange Transaction under Circular No. 645 dated 13 February 2009 were amended pursuant to this BSP Circular. The amendments basically cover the rules prescribing the limits on foreign exchange that may be sold between and among AABs; by AABs forex corps to AABs; and by individuals/entities other than AABs/AAB-forex corps; and the required documents to support such sale. Moreover, the Circular also mandates the seller/remitter of foreign exchange to ensure that applicable Philippine taxes related to the: a) sale of foreign exchange; b) remittance of foreign exchange; and c) the underlying foreign exchange transaction have been paid and that the remittance is net of such taxes. Submission to the seller/remitter of receipts evidencing payment of the applicable taxes shall be necessary.

(BSP Circular No. 794 series of 2013 dated 18 April 2013)

Amendment aligning the familial restrictions applicable to independent directors of banks and non-bank financial institutions with the existing provision of the SRC

The provision on the familial restrictions applicable to independent directors of banks and non-bank financial institutions under the MORB and MORNBFI has been amended to align it with the existing provision of the SRC. The amendment basically clarified that an independent director of a bank or non-bank financial institution must be one who is not a relative, legitimate or common-law, of any director, officer or, majority shareholder of the bank or any of its related companies. For this purposes, relatives refer to the spouse, parent, child, brother, sister, parent-in-law, son/daughter-in-law, and brother/sister-in-law.

(BSP Circular No. 793 Series of 2013 dated 8 April 2013)

Continued on page 15

Meet us

Alex Cabrera on "Failon Ngayon"

Failon Ngayon, an investigative magazine and public service show broadcast on ABS-CBN TV Channel 2, featured Tax Managing Partner and Markets Leader Atty. Alex Cabrera in its Saturday, 27 April 2013 episode.

Alex shared his opinion as the show tackles the issue of the casino and online gaming market in the Philippines and in other countries and how our neighboring Asian governments have significantly curbed down gambling addiction among their locals. This is the second time Alex sat down with the show's research team to talk on a hot topic like the casino and online gaming industry and its effect on the community.

Veteran broadcaster Ted Failon hosts the show which is also aired on Channel 8 on SkyCable every Saturday from 4.45pm to 5:45pm.

Isla Lipana & Co. tabulates adobo Design Awards 2013

The adobo Design Awards (aDA) competition is an annual event that aims to recognize and honor the works of enthusiasts, practitioners, freelancers and students of design and advertising. aDA is now on its fourth year.

It brought together the biggest names in the world of advertising, illustration, graphic design, topography, animation and art for a night of festivity and recognition.

Isla Lipana & Co. served as official aDA tabulators for the second time. A**ssurance & Markets Director Allan Cao** led a team of auditors **(Assurance Associates Lucille Concepcion, Jasmine Umali, Chris Ancheta, Ren Ramirez)** and was assisted by **Markets Managers Rocky Saldajeno, Maila Villadelgado and Dennis Bautista.**

This year's jury included industry heavyweights: Merlee Jayme of DM9JaymeSyfu; Brian Tenorio of Design for Development (in photo, middle); Gary Amante of BBDO Guerrero; and Thomas Yang of DDB Singapore.

The 2013 aDA, with "Manila Pop Culture" as its theme, held its awarding ceremony 26 April 2013 at the Ayala Museum, Greenbelt 5, Makati City.

Taking the most number of awards was M&C Saatchi Kuala Lumpur, which won in several categories and received a total of nine awards. TBWA\Santiago Mangada Puno came in second garnering seven awards. Grabbing the top prize was Leo Burnett Manila's "Nightlife" entry, with the Best in Show award in the Design for Good category.

The adobo Design Awards is sponsored by adobo magazine, the country's premiere advertising and brand communications publication which gives special focus on culture and design.

Executive issuances

Continued from page 13

Social Security System (SSS)

Guidelines on voluntary payment of contributions for members 65 years old or over with less than 120 monthly contributions

This Circular sets forth the guidelines on the voluntary payment of contribution by SSS members who are 65 years old or over, with less than the required 120 monthly contributions, to qualify them for retirement pension. The guidelines generally provide as follows:

1. SSS members who are 65 years old or over prior to 01 April 2013 shall be allowed to continue paying contributions until they complete the required 120 monthly contributions for retirement pension provided they signify such intention to pay the lacking contribution by filing the Application for Voluntary Payment of Contributions from 01 April 2013 to 01 July 2013.

2. SSS members who will turn 65 years old on or after 01 April 2013 shall be allowed to pay the lacking contributions to complete the required contributions for retirement pension subject to certain conditions, e.g., they have been initially covered at age 55 or less; must have contributed at least 80 monthly contributions, including deemed paid contributions, at age 65; must signify their intention to pay the lacking contributions by filing the Application for Voluntary Payment of Contributions within the month following the 65th birthday of the member.

3. The option to pay voluntarily ceases upon completion of the required number of contributions. Payments in excess of 120 monthly contributions prior to the semester of contingency shall be refunded.

4. No contributions shall be applied retroactively.

(SSS Circular No. 2013-003 effective 1 April 2013)

Talk to us

For further discussion on the contents of this issue of the *Client Advisory Letter*, please contact any of our partners.

Alexander B. Cabrera
Managing Tax Partner
T: +63 (2) 459 2002
alex.cabrera@ph.pwc.com

Lawrence C. Biscocho
T: +63 (2) 459 2007
lawrence.biscocho@ph.pwc.com

Carlos T. Carado II
T: +63 (2) 459 2020
carlos.carado@ph.pwc.com

Malou P. Lim
T: +63 (2) 459 2016
malou.p.lim@ph.pwc.com

Fedna B. Parallag
T: +63 (2) 459 3109
fedna.parallag@ph.pwc.com

Request for copies of text

You may ask for the full text of the *Client Advisory Letter* by writing our Tax Department, Isla Lipana & Co., 29th Floor, Philamlife Tower, 8767 Paseo de Roxas, 1226 Makati City, Philippines. T: +63 (2) 845 2728. F: +63 (2) 845 2806. Email lyn.golez@ph.pwc.com.

www.pwc.com/ph