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Client advisory letter

Isla Lipana & Co.
At a glance
Updates, reiterations and clarifications on selected topics

IASB postpones effective date of amendments to IFRS 10 and IAS 28

The International Accounting Standards Board (IASB) has postponed the date when entities must change some aspects of how they account for transactions between investors and associates or joint ventures.

The postponement applies to changes introduced by the IASB in 2014 through narrow-scope amendments to IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates. Those changes affect how an entity should determine any gain or loss it recognizes when assets are sold or contributed between the entity and an associate or joint venture in which it invests. The changes do not affect other aspects of how entities equity account for their investments in associates and joint ventures.

The reason for making the decision to postpone the effective date is that the IASB is planning a broader review that may result in the simplification of accounting for such transactions and of other aspects of accounting for associates and joint ventures.

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Effective date of amendments to IAS 28

What has happened before?

In September 2014 the IASB issued a narrow-scope amendment to IAS 28 and IFRS 10 that was intended to resolve a current inconsistency between the two standards. Based on the amendment, full gain or loss would be recognized by the investor where the non-monetary assets contributed constitute a ‘business’. If the assets do not meet the definition of a business, the gain or loss would only be recognized by the investor to the extent of the other investors’ interests, that is, partial gain or loss recognition.

The planned amendments would only be applied when an investor sells or contributes assets to its associate or joint venture.

In January 2015 the IASB discussed an unintended consequence of this amendment; IAS 28 requires that an entity should recognize as income any excess of the fair value of the net assets of an acquired associate (or JV) over the cost of that associate (or JV) on initial acquisition.

Applying these requirements in the limited circumstances described would result in a re-recognition of the gain eliminated by the September 2014 amendments as income.

The IASB thus decided in January 2015 to amend IFRS 10 to explain that, in these limited circumstances, the cost on initial recognition of the retained investment is the fair value of that investment, and any gains or losses to be eliminated are a subsequent adjustment. This is intended to prevent a reversal of the partial elimination of the gain.

In June 2015 the IASB decided to suspend work on the new amendment and instead address these issues as part of the research project on the equity method of accounting. As a result the IASB proposed indefinite deferral of the application date of the September 2014 amendments.

The implications

In the December 2015 amendment, the Board deferred the effective date of the September 2014 Amendment. This was done by removing the original effective date of 1 January 2016 and indicating that a new effective date will be determined at a future date when the Board finalizes the revisions, if any, that result from the research project. Any future proposal to insert an effective date will be exposed for public comment.

In deferring the effective date of the September 2014 Amendment, the Board continued to allow early application of that amendment. The Board did not wish to prohibit the application of better financial reporting.

Affected entities could continue applying an accounting policy choice in the consolidated financial statements (and in the separate and stand-alone financial statements if such investments are accounted for using the equity method). Where the non-monetary assets sold or transferred to its associate or joint venture constitute a ‘business’, entities could either recognize full gain or loss on the sale or transfer, or the gain or loss only to the extent of the other investors’ interests, that is, partially. The policy chosen should be applied to all other similar transactions.
**Latest on tax rules, compliance and assessment**

**Monitoring of tax perks now a law**

To enhance fiscal accountability and transparency in the grant and management of tax incentives, last 9 December 2015, President Benigno S. Aquino III signed into law RA No. 10708, also known as The Tax Incentives Management and Transparency Act (TIMTA). To attain the objective, below are some salient features of the law:

1. Registered business entities availing of incentives shall file their tax returns and complete annual tax incentives reports to their respective investment promotion agencies (IPAs).

2. The concerned IPAs shall, within 60 days from the deadline of filing tax returns, submit to the BIR their annual incentives reports.

3. The DOF shall monitor tax incentives by creating a single database using the entries reflected in the filed tax returns and incentive reports.

4. The National Economic Development Authority (NEDA) shall conduct a cost-benefit analysis on the investment incentives to determine the impact of the tax incentives to the Philippine economy.

The DOF and DTI in coordination with the NEDA Director General, the Commissioners of the BIR and BOC, and heads of the concerned IPAs, shall promulgate the implementing regulations of the RA within 60 days from effectivity of the law.

(Republic Act No. 10708 approved 9 December 2015)

**Tax sparing rule applies to Australia**

- **Dividends paid to an Australian resident is subject to 15% final tax**

In a ruling, the BIR recognized the application of the tax sparing rule on dividend payment to an Australian resident. The BIR said that because the Australian tax law exempts from tax the dividends from the Philippines, in effect, Australia allows a credit for taxes deemed paid in the Philippines of at least 15%. The BIR cited the *Wander Philippines* case wherein the SC held that such exemption satisfies the condition for the application of the tax sparing rules. As such, the lower dividend tax rate of 15% (normally it is 30%) under the Tax Code shall apply.

(BIR Ruling No. 389-2015 dated 29 October 2015)

**PEZA entity paying 5% GIT not subject to DST**

In November 2015, the CTA, in one case, held that PEZA-registered entities, after their ITH, are only liable to pay 5% tax on gross income earned on their registered activities which is in lieu of payment of national and local taxes. The phrase “in lieu of payment of national and local taxes” means that after paying a 5% gross income tax (GIT), the entity is exempt from payment of local and national taxes, which include the DST.

In this case, while the taxpayer’s DST exemption was acknowledged, the CTA pointed out that whenever one party to the taxable document enjoys exemption from tax, the other party who is not exempt shall be the one liable for the DST. Thus, the CTA said that the DST should have been for the account of the lessor – the other contracting party under the lease agreement. However, for the PEZA-

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2. Section 28(B)(5)(b) of the Tax Code
3. Section 173 of the Tax Code
registered entity’s failure to show copies of DST returns filed by and payment receipts from the lessor, the CTA sustained the deficiency DST assessment against the PEZA-registered entity.

(CTA Case No. 8538 dated 4 November 2015)

**Build-your-own concept is not a sale of real property**

In a case, the CTA did not agree with the BIR’s allegation that the contract to manage and execute the construction of a condominium that adopts the build-to-own/build-your-own concept is a preselling/selling of condominium units.

The CTA scrutinized the terms of the contract and determined the intention of the contracting parties by looking at the manner the contract was implemented. According to the CTA, there was nothing in the contract that would show that there was a transfer of ownership of the condominium units from the project management to the unit owners/investors for the transaction to be considered as a sale of property. The construction funds pooled from the unit owners are actually held in trust by the bank in favor of the unit owners that will be exclusively used for the project construction and land purchase. In other words, the project management appears to have no complete control over the said amount.

The only participation of the project management is to prepare the documents necessary for the transfer of ownership of the land to the condominium corporation and the construction of the condominium units for a professional fee of 4% of the construction fund. The transaction between the project management and the unit owners is actually a sale of services, and not a sale of real property.

(CTA Case Nos. 8358, 8426 and 8489 dated 3 November 2015)

**Either party pays DST but not on bank loans**

- When one of the parties in a taxable transaction subject to DST is a bank, the remittance of the payable DST shall be the responsibility of such bank.

The CTA voided a DST assessment against a taxpayer-corporation on its borrowings from banks. The CTA said that RR No. 09-00 provides that if any of the parties to a transaction subject to DST shall be a bank, the remittance of DST on the loan shall be the responsibility of the lender-bank, and not of the borrower.

**DST assessment computed on year-end balances of intercompany accounts is void**

The CTA also voided a DST assessment which was computed on year-end balances of advances/loans to affiliates as indicated in the audited financial statements. According to the CTA, these amounts do not actually represent new transactions entered into by the corporation within the taxable year. As a rule, deficiency assessments must be based on actual facts and not merely a result of arbitrary computation. Thus, mere presumptions on the balances as basis for DST assessment is void, and would not prevail under judicial scrutiny.

(CTA Case No. 8459 dated 23 November 2015)

**NPC is still subject to franchise tax**

The CTA sustained the franchise tax assessment against the National Power Corporation (NPC). The court was not impressed by the argument of the NPC that its franchise had been cancelled under the Electric Power Industry Reform Act of 2001 (EPIRA Law)\(^4\). Even if NPC’s transmission function had been transferred, the performance of missionary electrification function through its Small Power Utilities Group (SPUG) means that NPC had not fully divested from its transmission function. The CTA pointed out that the NPC’s SPUG operations, responsible for providing power generation in areas that are not connected to the transmission system, are subject to franchise tax. According to the CTA, the requisites to be subject to franchise tax – a) that one has a “franchise” in the sense of a secondary or special franchise and b) that one is exercising its rights or privileges under this franchise within the territory of an LGU – are both satisfied.

(CTA AC No. 117 dated 16 November 2015)

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\(^4\) Republic Act No. 9136, as amended.
No LBT on electric substation—it is neither a branch nor a sales office

A GOCC engaged in the business of transmitting electricity was assessed business tax under a municipal tax ordinance issued by an LGU. However, transmission of electricity does not fall among the enumerated businesses subject to tax under the municipal tax ordinance. The CTA held that an LGU is bound by and can’t go beyond its tax ordinance.

Further, the GOCC has no branch, sales office or a fixed place that conducts operations of the business as an extension of its principal office within the locality of the taxing authority. While electrical substations and transmission assets providing transmission services to customers may be found in different provinces and cities, they are not considered as branch or sales office where taxes accrue. Thus, the situs of taxation for purposes of imposing local business tax was not satisfied.

(CTA AC No. 120 dated 3 November 2015)

The city, not the province, has the authority to collect franchise tax

The CTA denied the attempt of a province to assess franchise tax from a telecommunication company that has several cellular towers installed and maintained in different locations within the province. The CTA said the component city where the taxpayer’s branch office is located, not the province, has the jurisdiction to assess franchise tax against the said taxpayer. The CTA also explained that the province’s use of the presumptive tax assessment to enforce collection of the alleged franchise tax liability has no legal and factual bases, hence invalid.

(CTA EB No. 1137 dated 8 December 2015)

Tax assessment based solely on a Sandiganbayan decision is void

The CTA voided a tax assessment by the BIR that arose from the investigation of the Department of Justice or the Office of the Ombudsman. The CTA stressed that for purposes of tax assessments, findings by another tribunal cannot be deemed as best evidence obtainable pursuant to Section 6(B) of the Tax Code. An assessment for undeclared income made by the BIR, solely based on the court order (Writ of Execution) of the Sandiganbayan in a separate plunder case, cannot be sustained.

(CTA Case No. 7847 dated 23 November 2015)

NAB and TWG to evaluate Computerized Accounting System

By authority of a special order issued by the BIR, the National Accreditation Board (NAB) and the Technical Working Group (TWG) were created to evaluate and approve the applications for accreditation of Computerized Accounting System (CAS), its components and other sales machines/receipting software. The functional roles and responsibilities of both groups are detailed in the order.

(Revenue Special Order No. 581-2015 dated 18 September 2015)
New rules for operating an authorized customs facility

To comply with international standards and ensure the integrity and security of cargo in cross-border trade, the BOC issued guidelines for the establishment and supervision of wharves, container yards, container freight stations, warehouses, examination areas, and other facilities that are located in customs zones and/or in airports and seaports, and used for the temporary handling and storage of imported goods.

Under the new rules, such facilities should meet the requirements for accreditation as an Authorized Customs Facility (ACF). As an ACF, all inventory and management records of imported cargoes handled by the ACF operators shall be maintained in their places of business and shall be subject to inspection by the BOC. The license to operate an ACF shall be valid for three years and may be renewed not later than six months before the expiration of the license.

(Customs Memorandum Order No. 30-2015 dated 15 September 2015)

New rules on transfer of goods from ELSE to Ecozone locators

To ease doing business in the Ecozone, the BOC issued an order clearly setting out the duties and responsibilities of Customs personnel in the transfer of goods from Ecozone Logistics Service Enterprise (ELSE) facilities to Ecozone locators. It covers the roles of Customs officials and the operational processes in the transfer of goods, such as the filing and approving the General Transportation Surety Bond, examining goods, and monitoring transfers.

(Customs Memorandum Order No. 40-2015 dated 28 October 2015)

Mandatory e-processing of transshipments of REZA locators

Starting 1 January 2016, companies located at the Regional Economic Zone Authority (REZA) in the Autonomous Region in Muslim Mindanao (ARMM) are required to file their transshipment entries with the BOC through the Electronic-to-Mobile (e2m) system at the port of discharge. Manual filing is allowed only if the BOC certifies that the e2m system is down for more than two hours.

Accordingly, a REZA locator shall enroll with REZA through accredited Value-Added Service Providers (VASPs) to secure electronic import permits (e-IPs) for the tax and duty-free importation of foreign goods. REZA locators are also required to post a General Transportation Surety Bond with the Bonds Division of that district to secure the transit of goods from a port of discharge to a destination REZA location. Boat notes will no longer be issued for transshipments to REZA zones, nor will they be required to be underguarded.

All transshipments must be secured with a REZA seal when it leaves the port of discharge, and that seal must not be tampered or opened when it arrives in the destination REZA location. The Deputy Collector for Operations shall be responsible in monitoring the arrival of transshipments at their destination REZA locations.

(Customs Memorandum Circular No. 157-2015 dated 10 November 2015)

5 Pursuant to Joint Memorandum Order No. 2-2015 dated 24 July 2015
Regulations on investments in derivatives and limiting the same to forward contracts, swaps

The salient provisions of the circular are as follows:

1. Only insurance/reinsurance companies with a net worth of at least PHP 550,000,000 or more may engage in derivative activities.

2. The aggregate placements in derivatives should not exceed 10% of the total admitted assets of the life insurance company or 20% of the net worth of a non-life insurance/reinsurance company.

3. Prior approval from the IC must be secured before any insurance/reinsurance company engages in derivative activities.

(ICA CL No. 2015-56 dated 14 December 2015)

Defining pre-need life plans and other related contracts & agreements

The circular seeks to provide details on what constitutes a pre-need plan, specifically “life” or “memorial” pre-need plans. Below are the salient provisions.

1. “Pre-need life plan” refers to a contract, which has for its purpose the provision or performance of actual funeral services or payment of a monetary equivalent in case of unrendered funeral services, in consideration of a fixed amount to be paid in full or by installment.

2. A sale of casket and/or urn shall be considered a pre-need life plan in the following instances:
   
a. when the payment period is more than one year
   b. when the casket and/or urn is not delivered within 90 days
   c. any other sale that is structured to conceal the provision of future funeral services or products for payment made in the present.

3. A product is considered a pre-need life plan even if it contains an option for payment of cash or money equivalent of funeral services in case the pre-need company or its accredited servicing mortuary did not perform the funeral services or in case of unrendered funeral services which the contract may specify.

4. The assistance given for the repatriation of remains shall still be considered as insurance coverage.

5. All pre-need life plan contracts and advertisement thereof shall be subject to the approval of the IC.

(ICA CL No. 2015-57 dated 9 December 2015)

HMOs are now under IC

Last 12 November 2015, the Office of the President issued EO No. 192, series of 2015, which became effective on 17 November 2015, transferring the control and supervision of HMOs from DOH to IC. All records and files of HMOs and related thereto should be transferred to the IC by 16 February 2016.

(ICA CL No. 2015-58 dated 14 December 2015)

Glossary

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<th>Term</th>
<th>Definition</th>
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<td>DOH</td>
<td>Department of Health</td>
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<td>EO</td>
<td>Executive Order</td>
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<td>HMO</td>
<td>Health Maintenance Organization</td>
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<td>IC</td>
<td>Insurance Commission</td>
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(ICA CL No. 2015-58 dated 14 December 2015)
Isla Lipana & Co. invests in Integrity

Our firm participated in the Integrity Summit 2015, a day-long gathering of business, government and anti-corruption and good governance advocates held last 9 December 2015 at Makati Shangri-La Hotel.

The Summit, also dubbed as “Investing in Integrity”, marks Integrity Initiative’s fifth year of making integrity everyone’s business. The event enjoin all sectors to heed the urgent call to go beyond fighting corruption towards building systems for integrity and multi-sector circles of integrity. Our firm responded to this call together with seven other corporate entities by accepting the invitation to become founding corporate members of Integrity Initiative, Inc.

Our Chairman and Senior Partner Alex Cabrera joined the representatives of the seven other founding corporate members in signing the memorandum of agreement with Integrity Initiative, Inc. The eight founding corporate members were mentioned by Ramon del Rosario, Chairman of Integrity Initiative Inc. in his speech to welcome His Excellency President Benigno Simeon Aquino III. President Aquino delivered the keynote message in the Summit.

Our delegates to the Summit were Assurance Partners Che Javier, Paul See and Rosell Gomez, Human Capital Director Pam Gregorio, Assurance Directors Coco Echavez and Allan Cao, Deals Executive Director Che De Guzman, Advisory Directors Pam Almario and Veronica Bartolome, Ethics & Business Conduct Director Grace Aries and Markets Senior Manager Dennis Bautista.

The Integrity Initiative Inc. (www.integrityinitiative.com) is a private-led effort to promote good governance, transparent business transactions and implement integrity standards in the Philippines. The Integrity Initiative has validated the firm as Advanced on ethical practices.
PwC prepares clients for 2016 with year-ender tax seminar

Our Tax Department held Stepping up to the challenges of 2016: A seminar on BEPS, tax updates and year-end reminders last 4 December 2015 at the Discovery Primea Hotel, Makati City.

Tax Partner Carlos Carado briefed participants on Base Erosion and Profit Shifting (BEPS) and other latest updates. With new rules focusing on aligning taxation across jurisdictions considering substance, coherence and transparency, taxpayers should be aware of the potential impact to their businesses when tax authorities adopt these revised rules.

To remind taxpayers of year-end and other filing requirements, Tax Partner Lawrence Biscocho shared his expertise on the impact of latest tax compliance and reporting obligations brought about by selected revenue regulations, rulings and circulars issued by the Bureau of Internal Revenue (BIR), as well as decisions of the Court of Tax Appeals and Supreme Court.

Tax Partner Roselle Yu Caraig (in photo, second from left), Assurance Partner Pocholo Domondon (far left) and Tax Senior Manager Theresa San Diego (second from right) then joined Lawrence (far left) in conducting the open forum. The participants received not only their certificates of attendance but also the initial batch of the 2016 Tax Calendar.

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

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