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

Sections 173, 183, 184 and 188, Tax Code; RA No. 10963, RA No. 11534, RR No. 3-2023; RMC No. 24-2022; RMC No. 137-2022
BIR Ruling No. OT-184-2021
OT- 032-2024
JUN 05 2024

GOVERNMENT SERVICE INSURANCE SYSTEM
Financial Center
Pasay City, Metro Manila 1308

Attention: **JOSE ARNULFO A. VELOSO**
President and General Manager

Gentlemen:

This refers to your request on behalf of the Government Service Insurance System ("**GSIS**") for clarification on the following:

1. Tax treatment (including documentary stamp tax ("**DST**") of insurance policies issued by the GSIS to the Investment Promotion Agencies ("**IPAs**") and their respective locators pursuant to Republic Act ("**RA**") No. 11534, otherwise known as the Corporate Recovery and Tax Incentives for Enterprises ("**CREATE**") Act[1] and various rules and regulations related thereto; and

2. Documents needed to allow value added tax ("**VAT**") zero percent (0%) rate or exemption and DST exemption for the insurance policies issued by the GSIS to the IPAs and their locators in line with the implementation of CREATE and various rules and regulations related thereto.

Background:

1. GSIS (Taxpayer Identification Number:) is a social insurance institution created under Commonwealth Act No. 186, as amended, and operating under its present Charter, RA No. 8291, otherwise known as the GSIS Act of 1997.

[1] 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. IPAs are mandated to purchase insurance policies from the GSIS by virtue of the latter's Charter.

3. On July 1, 2021, the GSIS resumed the collection of DST on all its regular insurance policies issued to Government Agencies in accordance with Sections 173, 183, 184 and 188 of the National Internal Revenue Code of 1997, as amended ("**Tax Code**").

4. By virtue of RA No. 10963, otherwise known as the Tax Reform for Acceleration and Inclusion ("**TRAIN**") Law, the GSIS also started to impose VAT on insurance policies it issued to the IPAs and their locators.

5. IPAs and their locators are invoking zero percent (0%) VAT rate on the premiums paid to the GSIS by virtue of their preferential tax of five percent (5%) on gross income earned in lieu of all national and local taxes considering that these premiums are considered local purchases that are directly and exclusively used in the locators' registered project or activity.

6. Clark Development Corporation ("**CDC**"), in particular, invokes its exemption through Revenue Memorandum Circular ("**RMC**") No. 32-2022,[2] or pursuant to Section 2 of RA No. 9400[3] which states that "no national or local taxes shall be imposed on registered business enterprises within the CFZ and in lieu of such taxes, a 5% tax on gross income earned shall be paid by all registered business enterprises within the CFZ."

In reply, please be informed as follows:

I. Insurance acquired by IPAs from GSIS are subject to DST and VAT

Section 294 of the Tax Code provides that the tax incentives of income tax holiday ("**ITH**") and five percent (5%) of gross income earned in lieu of all national and local taxes ("**SCIT**") only apply to business enterprises registered with the IPAs, to *wit:*

> *"SECTION 294. Incentives. — Subject to the conditions and period of availment in Sections 295 and 296, respectively, the following types of tax incentives may be granted to registered projects or activities:*
>
> *(A) Income Tax Holiday (ITH);*
>
> *(B) Special Corporate Income Tax (SCIT) rate – For export enterprise, a tax rate equivalent to five percent (5%) effective July 1, 2020, based on the gross income earned, in lieu of all national and local taxes.*

[2] Clarifying the Tax Treatment of the Philippine Amusement and Gaming Corporation (PAGCOR), its Licensees and Contractees, March 29, 2022.
[3] An Act Amending Republic Act No. 7227, as Amended, Otherwise Known as the Basis Conversion and Development Act of 1992, and for Other Purposes, March 20, 2007.

The period of availment of the special corporate income tax shall be subject to the conditions set under paragraphs (a) and (b) of Section 296 of this Act:" (Underscoring supplied)

Nowhere can we find a specific provision in Tax Code which expressly exempts IPAs from the payment of national or local taxes. If the Legislature intended to exempt them from the payment of taxes, it could have done so in the most clear and unequivocal terms.

The applicable provision on the taxability of IPAs, being government instrumentalities is found in Section 27 (C) of the Tax Code, which provides, to *wit*:

"SECTION 27. Rates of Income Tax on Domestic Corporations. —

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(C) Government-owned or -Controlled Corporations, Agencies or Instrumentalities. -- The provisions of existing special or general laws to the contrary notwithstanding, all corporations, agencies, or instrumentalities owned or controlled by the Government, except the Government Service Insurance System (GSIS), the Social Security System (SSS), the Home Development Mutual Fund (HDMF), the Philippine Health Insurance Corporation (PHIC) and the local water districts, shall pay such rate of tax upon their taxable income as are imposed by this Section upon corporations or associations engaged in a similar business, industry, or activity." (Underscoring supplied)

The above provision which imposes tax on taxable income derived by government owned and controlled corporations, agencies and instrumentalities, except the GSIS, SSS, PHIC and local water districts, applies to IPAs in the absence of any statutory provision expressly granting tax exemption. It cannot be overemphasized that tax exemptions are construed in *strictissimi juris* against the taxpayer and liberally in favor of the taxing authority. It cannot be deduced by mere implication. Thus, he who claims an exemption from his share of the common burden of taxation must justify his claim by showing that the Legislature intended to exempt him by words too plain to be beyond doubt or mistake.[4]

Furthermore, while Section 32(B)(7)(b) of the Tax Code excludes from gross income and exempts from taxation the income derived by the government or its political subdivision from any public utility or from the exercise of any essential governmental functions accruing to the Government of the Philippines or to any political subdivisions thereof, the said provision does not apply to IPAs. In BIR Ruling No. 038-2002,[5] this Office had ruled that Section 32 (B) (7) (b) of the Tax Code does not apply to a government instrumentality, *viz.*:

"An "instrumentality" refers to "any agency of the National Government, not integrated within the department framework, vested with special functions or jurisdiction by law, endowed with some if not all corporate powers, administering special funds, and enjoying operational autonomy, usually through

[4] City of Iloilo, et al. vs. Smart Communications, Inc., G.R. No. 167260, February 27, 2009; BIR Ruling No. 313-15, September 15, 2015.
[5] November 5, 2002

a charter. This term includes regulatory agencies, chartered institutions and government-owned and controlled corporations. xxx

The exception provided under Section 32(B)(7)(b) of the Tax Code of 1997 where income derived from the exercise of any essential governmental function accruing to the Government of the Philippines or to any political subdivision thereof, shall be excluded from gross income subject to income tax, is not applicable to DFP.

If Section 32(B)(7)(b) intended to extend the exception to the agencies and instrumentalities of the National Government, then it should have restated the wording of the law to include the same. And yet, the legislature used the phrase "Government of the Philippines" in Section 32(B)(7)(b) while Section 27(C) expressly mentioned "instrumentalities." Nothing can actually prevent Congress from decreeing that even instrumentalities or agencies of the Government performing governmental functions may be subject to tax. Where it is done precisely to fulfil a constitutional mandate and national policy, no one can doubt its wisdom." (Underscoring supplied)

Based on the above disquisitions, unless otherwise expressly exempt under existing laws, rules or regulations, it can be deduced that the five percent (5%) SCIT incentive does not apply to IPAs even before the passage of CREATE Law. Consequently, all income earned by IPAs are subject to internal revenue taxes, including, income tax, DST and VAT.

With regard to the payment of DST on the insurance policies acquired by IPAs from the GSIS, please note that under Section 173 of the Tax Code, whenever one party to the taxable document enjoys exemption from DST, the other party thereto who is not exempt shall be the one directly liable for the same. Accordingly, since GSIS is tax-exempt party from the DST by virtue of Section 39 of Republic Act No. 8291,[6] the IPAs (unless otherwise exempt under existing laws, rules and regulations) are the ones directly liable for the same.

Concerning the payment of VAT, it bears emphasis that Section 86 (r) of RA No. 10963,[7] otherwise known as the Tax Reform for Acceleration and Inclusion ("**TRAIN**") law, provides for the repeal of the VAT exemption of certain government-owned and/or -controlled corporations ("**GOCCs**"), state universities and colleges ("**SUCs**") and other government instrumentalities ("**GIs**"), including the GSIS.[8] Hence, the sale of insurance by GSIS to IPAs are all subject to VAT.

II. Liability for DST and VAT of Registered Business Enterprises ("RBEs")

To reiterate, under Section 294 of the Tax Code, the tax incentives of ITH and five percent (5%) SCIT in lieu of all national and local taxes only apply to business enterprises (whether export or domestic enterprises) registered with the IPAs. Please note that the

[6] Government Service Insurance System Act of 1997; BIR Ruling No. OT-184-21, May 20, 2021.
[7] Approved on December 19, 2017 and made effective on January 1, 2018.
[8] FIRB Resolution No. 008-20, October 22, 2020.

"national taxes" referred to under the 5% SCIT regime covers only direct internal revenue taxes such as DST.

Regarding the payment of DST on the insurance policies acquired by registered export enterprises ("**REEs**") and domestic market enterprises ("**DMEs**") from the GSIS, please note that under Section 173 of the Tax Code, whenever one party to the taxable document enjoys exemption from DST, the other party thereto who is not exempt shall be the one directly liable for the same. If both are exempt, then neither parties shall be liable for the DST.

Applying the foregoing to this case, considering that GSIS is a tax-exempt party from the DST by virtue of Section 39 of Republic Act No. 8291,[9] the rule shall be as follows:

1. if the acquiring REEs and/or DMEs are under the ITH regime, then such REEs and/or DMEs are the ones directly liable for the DST; and

2. if the acquiring REEs and/or DMEs are under the 5% SCIT regime, then such REEs and/or DMEs are not liable for the DST.

Under scenario number 2 above, neither the GSIS or the acquiring REEs and/or DMEs shall be liable for the DST.

When it comes to VAT, Section 5, Rule 2 of the Implementing Rules and Regulations ("**IRR**")[10] of the CREATE Law, as amended,[11] provides that REEs are granted VAT zero-rating incentive on their local purchases of goods and services that are directly and exclusively used in its registered project or activity for a maximum period of seventeen years from the date of registration, unless otherwise extended under the Strategic Investment Priority Plan ("**SIPP**"), to *wit*:

> *"Rule 2*
> *Tax and Duty Incentives*
>
> *SECTION 5. Value-Added Tax (VAT) Zero-Rating and Exemption. – The VAT exemption on importation and VAT zero-rating on local purchases shall only apply to goods and services directly and exclusively used in the registered project or activity of export enterprises, for a maximum period of seventeen (17) years from the date of registration, unless otherwise extended under the SIPP.*
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> *The direct and exclusive use in 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*

[9] Government Service Insurance System Act of 1997; BIR Ruling No. OT-184-21, May 20, 2021.
[10] Implementing Rules and Regulations of Title XIII of Republic Act No. 8424, Otherwise Known as the "National Internal Revenue Code of 1997," as Amended by Republic Act No. 11534 or the "Corporate Recovery and Tax Incentives for Enterprises (CREATE) Act, June 22, 2021.
[11] RMC No. 120-2021, December 31, 2021.

necessary for 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,[12] the Bureau clarified that the phrase "direct and exclusive use" referred to as:

"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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Q14: What cost items fall under the "other expenditures" in the preceding question?

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 includes 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 order to efficiently and effectively implement the foregoing, the Secretary of Finance recently issued Revenue Regulations ("**RR**") No. 3-2023[13] which provides for a negative list of goods and services that are NOT considered as "directly and exclusively used

[12] 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.

[13] Amending Certain Provisions of Revenue Regulations (RR) No. 16-2005, as Amended by RR No. 21-2021, to Implement Sections 294(E) and 295(D), Title XIII of the National Internal Revenue Code of 1997, as Amended by R.A. No. 11534(CREATE Act), and Section 5, Rule 2 and Section 5, Rule 18 of the CREATE Act Implementing Rules and Regulations, as Amended, April 20, 2023.

in the registered project or activity. Hence, all purchases of goods and services not falling within the said list shall be considered as "directly and exclusively" used in the registered project or activity, and therefore, may avail of the VAT zero-rating incentive.

With regard to the local purchases of insurance on either asset or employees, the same may be allowed to avail of the VAT zero-rating incentive, provided that they can be attributed directly and exclusively to the registered project or activity of the REE.[14]

Accordingly, if the insurance acquired by REEs from GSIS are for assets that are directly and exclusively used in the registered project or activity, then the same is entitled to the VAT zero-rating incentive. Otherwise, the same shall be subject to VAT at twelve percent (12%) rate.

On the other hand, if the insurance acquired by REEs from GSIS are for employees directly involved in the operations of their registered projects or activities and forming part of their compensation package, the same shall be entitled to the VAT zero rating incentive as well 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, hence, it can be considered necessary expenses.[15] It must be emphasized, however, that the VAT zero-rating shall not extend to insurance procured for employees NOT directly involved in the operations of the registered projects or activities of the REEs.

If the purchased insurance policies are used in both the registered project or activity and administrative operations, the REE shall adopt a method to best allocate the same. If a proper allocation could not be determined, said services shall be subject to twelve percent (12%) VAT.[16]

For DMEs, pursuant to Q&A No. 16 of RMC No. 24-2022, its local purchases of goods or services are subject to twelve percent (12%) VAT, to *wit*:

> *"Q16: Are there RBEs not entitled to avail the VAT zero-rating on their purchases of goods and/or services?*
>
> *A16: Yes. RBEs which are categorized as Domestic Market Enterprises are not entitled to VAT zero-rating on local purchases. Sale of goods or services to a registered domestic market enterprise shall be subject to VAT at 12%. xxx"* (Underscoring supplied)

Therefore, the insurance acquired by DMEs from GSIS for all its assets (whether directly and exclusively used in the registered project or activity or not) and employees (whether directly involved in the operations of their registered projects or activities and forming part of their compensation package or not) are subject to twelve percent (12%) VAT.

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[14] RR No. 3-2023.
[15] Revenue Memorandum Circular No. 137-2022, Clarificatory Guidelines on the Availment of VAT Zero Rate (0%) on Health Maintenance Organization (HMO) Plans Acquired by Registered Export Enterprises (REEs) and Prescribing the Uniform Template of 'Detailed Information' Thereof, October 14, 2022.
[16] RMC No. 137-2022; RR No. 3-2023.

However, it should be clarified that if the acquiring DME is under the 5% SCIT regime, the VAT passed on to it by its VAT-registered local supplier shall form part of its cost or expense.[17]

III. Supporting documents

As to the documents needed to allow the DST exemption and availment of VAT zero rating incentive on the insurance policies purchased by the IPAs and their locators from the GSIS in line with the implementation of CREATE and various rules and regulations related thereto, please see below:

For DST, the parties need to present to the Bureau the insurance policies purchased by the IPAs and/or its locators. Also, if the purchaser is an REE or DME, any document showing whether it is under the ITH or 5% SCIT regime.

On the other hand, for the availment of the VAT zero-rating incentive, pursuant to RR No. 3-2023, the VAT zero-rating on local purchase of goods and services shall be availed of on the basis of the VAT zero-rating certification to be issued by the concerned IPA. This is however without prejudice to the conduct of post audit investigation/verification by the Bureau that the goods and/or services are indeed directly and exclusively used by the REE in its registered project or activity.

We hope you find the foregoing in order. If you have any questions or clarifications, please do not hesitate to contact us.

Very truly yours,

ROMEO D. LUMAGUI, JR.
Commissioner of Internal Revenue

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[17] Q&A No. 17, RMC No. 24-2022.