June 21, 2019

BIR RULING NO. 358-19

Sec. 48, 1997 Tax Code; RR Nos. 2, 2-98;
RAMO 1-00; BIR Ruling No. 333-14

Bright Future Educational Facilities, Inc.
Km 17 Ortigas Avenue Extension
Cainta, Rizal

Attention: *AAA*

BBB

Gentlemen :

This refers to your letter dated January 19, 2015 requesting on behalf of Bright Future Educational Facilities, Inc. ("BFEFI") for the confirmation on the tax consequences relative to the Build-Lease-Transfer Agreement (the "BLT Agreement") entered into by and between BFEFI and the Department of Education (DepEd).

Based on the documents submitted it is shown that, on October 8, 2012, BFEFI and DepEd entered into the BLT Agreement for the construction of classroom buildings with toilets and the provision of classroom furniture (the "Project"). Under the BLT Agreement, BFEFI shall undertake the Project for a total consideration of Three Billion Four Hundred Forty Five Million Nine Hundred Three Thousand One Hundred Twenty Pesos (PhP3,445,903,120.00) which shall be paid by DepEd as lease payments.

On February 13, 2013, BFEFI, as customer, and BF Corporation, as guarantor, entered into a Receivables Purchase Agreement with the Standard Chartered Bank (the "Bank") whereby BFEFI sold to the Bank the initial receivables of BFEFI from DepEd representing the twenty-four (24) quarter lease rentals under the BLT Agreement.

It is further represented that BFEFI has adopted the accrual method of accounting. Thus, in the assignment of the DepEd receivables, BFEFI adjusted its accounting entry as reflected in its books of accounts by debiting cash and crediting receivables in the partial closing of its receivables for the particular taxable year when the transaction took place.

Based on the foregoing facts, you now request for the confirmation of the following:

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1. That BFEFI can recognize as revenues for the taxable year 2014 the whole proceeds of the purchase by the Standard Chartered Bank of the twenty-four (24) quarters [72 months] worth of lease rentals arising from the Build, Lease and Transfer contract agreement entered into by and between BFEFI and the Department of Education (DepEd).

2. That BFEFI is exempt from the creditable withholding tax on its revenues directly received from the BLT Agreement on account of its registration with the Board of Investments (BOI) under Executive Order No. 226, otherwise known as the "Omnibus Investments Code of 1987."

3. That BFEFI can recognize as revenues the entire contract price of the aforesaid Build, Lease and Transfer contract agreement if BFEFI has already received more than twenty five percent (25%) of the contract price thereof as a result of the assignment of receivables from DepEd to the Standard Chartered Bank.

In reply, please be informed that under Section 48 of the 1997 Tax Code, as amended, it is provided:

> *"SEC. 48. Accounting for Long-term Contracts. — Income from long-term contracts shall be reported for tax purposes in the manner as provided in this Section. As used herein, the term 'long-term contracts' means building, installation or construction contracts covering a period in excess of one (1) year. Persons whose gross income is derived in whole or in part from such contracts shall report such income upon the basis of percentage of completion. The return should be accompanied by a return certificate of architects or engineers showing the percentage of completion during the taxable year of the entire work performed under contract. There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied. If upon completion of a contract, it is found that the taxable net income arising thereunder has not been clearly reflected for any year or years, the Commissioner may permit or require an amended return."*

In the same manner, Section 44 of Revenue Regulations No. 2 provides that —

> *"Section 44. Long-term Contracts. — Income from long-term contracts is taxable for the period in which the income is determined, such determination depending upon the nature and terms of the particular contract. As used herein, the term 'long-term contracts' means building, installation, or construction contract covering a period in excess of one year. Persons whose income is derived in whole or in part from such contracts may, as to such income, prepare their returns upon the following reasons:*
>
> *(a) Gross income derived from such contracts may be reported upon the basis of*

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percentage of completion. In such case there should accompany the return certificate of architects, or engineers showing the percentage of completion during the taxable year of the entire work performed under contract. There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies period for use in connection with the work under the contract but not yet so applied. If upon completion of a contract, it is found that the taxable net income arising thereunder has not been clearly reflected for any year or years, the Commissioner of Internal Revenue may permit or require an amended return.

(b) Gross income may be reported in the taxable year in which the contract is finally completed and accepted if the taxpayer elects as a consistent practice to so treat such income, provided such method clearly reflects the net income. If this method is adopted there should be deducted from gross income all expenditures during the life of the contract which are properly allocated thereto, taking into consideration any material and supplies charged to the work under the contract but remaining on hand at the time of the completion.

Where a taxpayer has filed his return in accordance with the method of accounting regularly employed by him in keeping his books and such method clearly reflects the income, he will not be required to change to either of the methods above set forth. If a taxpayer desires to change his method of accounting in accordance with paragraphs (a) and (b) above, a statement showing the composition of all items appearing upon his balance sheet and used in connection with the method of accounting formerly employed by him, should accompany his return."

Finally, Revenue Audit Memorandum Order (RAMO) No. 1-00 states that —

"II. Accounting Methods

xxx xxx xxx

D. Percentage of Completion Basis is a method applicable in the case of a building, installation or construction contract covering a period in excess of one year whereby gross income derived from such contract may be reported upon the basis of percentage of completion. In determining the percentage of completion of a contract, generally one of the following methods is used:

1. The costs incurred under the contract as of the end of the tax year are compared with the estimated total contract costs; or

2. The work performed on the contract as of the end of the tax year is compared with the estimated work to be performed.

In such case, the return should be accompanied by a certificate of the architect or engineer showing the percentage of completion during the taxable year of the entire work performed under contract. There should be deducted from such

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gross income all expenditures made during the taxable year on account of the contract, account being taken of the materials and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied.

Beginning January 1, 1998 income from long-term contracts are required to be reported using this method only." (Underscoring supplied)

In applying the rationale of the above-mentioned provisions, the Court of Tax Appeals (CTA) in the case of *Sual Construction Corporation vs. Commissioner of Internal Revenue*, CTA Case No. 6342, May 11, 2004, ruled that —

"Before we delve on the above issues, it must be pointed out that petitioner's claim is based on Completed Contract Method of Income Recognition. This accounting method is applicable to contractors in the construction of building, installation of equipment and other fixed assets, or other construction work covering a period in excess of one year. However, under Republic Act No. 8424, which took effect on January 1, 1998, contractors are no longer allowed to adopt this method of reporting their income derived in whole or in part from long-term contracts (Revenue Audit Memorandum Order No. 1-00). As prescribed by Section 48 of R.A. No. 8424, the percentage of completion method is now the only method of accounting recognized for long-term contracts. . ."

In light of the foregoing, BFEFI may now only use the percentage of completion method of accounting relative to the performance of the BLT Agreement pursuant to Section 48 of the Tax Code of 1997, in relation to Section 44 of Regulations No. 2 and RAMO 1-00. In other words, BFEFI cannot recognize as revenues the entire contract price of the BLT Agreement even if BFEFI has already received more than twenty five percent (25%) of the contract price thereof.

Anent the issue on the creditable withholding tax imposed on the revenues derived from the BLT Agreement, please be informed that Section 2.57.5 (B) (2) of Revenue Regulations (RR) No. 2-98, as amended by RR No. 14-02, provides:

"SECTION 2.57.5. Exemption from Withholding. — The withholding of creditable withholding tax prescribed in these Regulations shall not apply to income payments made to the following:

xxx xxx xxx

(B) Persons enjoying exemption from payment of income taxes pursuant to the provisions of any law, general or special, such as but not limited to the following:

xxx xxx xxx

(2) Corporations registered with the Board of Investments, Philippine Export Processing Zones and Subic Bay Metropolitan Authority enjoying exemption from the income tax pursuant to EO 226, as amended, Republic Act No. 7916 and the Omnibus Investments Code of 1987 and RA 7227, as

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amended, respectively;

xxx xxx xxx." (Underscoring supplied)

Based on the foregoing, Section 2.57.5. (B) (2) of RR No. 2-98, as amended, is explicit in its provisions that the creditable withholding tax does not apply to income payments to persons enjoying exemption from payment of income taxes pursuant to the provisions of any law, general or special. Accordingly, since BFEFI is a BOI-registered enterprise, as evidenced by its BOI Certificate of Registration No. 2014-044 dated March 4, 2014, the income payments made to it, directly in connection with its registered activity: Public Private Partnership for School Infrastructure Project-Contract Package A under the Build-Lease-Transfer Agreement with DepEd, shall not be subject to creditable withholding tax prescribed in RR No. 2-98, as amended, for a period of four (4) years beginning from April 2014 or actual start of commercial operations/selling, whichever is earlier, but in no case earlier than the date of its registration. *(BIR Ruling No. 333-2014 dated August 15, 2014)*

It must be emphasized that only the income directly attributable to the revenue generated from the registered project (Public Private Partnership for School Infrastructure Project-Contract Package A) shall be qualified for ITH. ITH availment shall be based on the lease quarterly payments by DepEd for a 4-year period. The firm shall submit certification from DepEd of the lease payments prior to availment of ITH. For this purpose, the enterprise shall submit audited segregated income statements and simplified income statement form as prescribed by the BOI for the registered project. The net income from operations of the registered activity shall be certified under oath by the Chief Executive Officer (CEO) or Chief Financial Officer (CFO).

Moreover, pursuant to Section 4 of Republic Act (RA) No. 10708, [1] BFEFI is required to file its tax returns and pay its tax liabilities, on or before the deadline as provided under the 1997 Tax Code, as amended, using the electronic system for filing and payment of taxes of the BIR. Furthermore, BFEFI shall file with BOI a complete annual tax incentives report of its income-based tax incentives, VAT and duty exemptions, deductions, credits or exclusions from the tax base, as may be provided under E.O. 226, within thirty (30) days from the deadline for filing of tax returns and payment of taxes.

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be ascertained that the facts are different, then this ruling shall be considered null and void.

Very truly yours,

(SGD.) CAESAR R. DULAY
Commissioner of Internal Revenue

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Footnotes

1. An Act Enhancing Transparency in the Management and Accounting of Tax Incentives Administered by Investment Promotion Agencies.

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