March 13, 2018

BIR RULING NO. 471-18

Sections 27 (C); 32 (B) (7); 79; 105; 108; 114 (C); 236 (B); RR 16-05; BIR Ruling No. 369-11

Aynie E. Mandajoyan-Dizon
OIC-Regional Director
Revenue Region No. 13, Cebu City

Sir :

This refers to your letter dated September 19, 2016 relative to the tax assessments made against the Municipality of Oslob, Cebu for taxable year 2012.

Documents presented show that the Municipality of Oslob (referred herein as "Oslob") is a town located at the southern portion of the island of Cebu and is under the jurisdiction of the Bureau of Internal Revenue-Revenue Region No. 13, Cebu City (BIR RR13). Aside from its Municipality Heritage Park and Enchanting Tumalog Falls, Oslob also boasts of its Whale shark (Butanding) Watching at Barangay Tan-awan. Said municipality is fortunate to have the gentle giants within their premises as it raises substantial income to their locality and resident businessmen. The Butandings in the area drew thousands of tourists every day. Helping the increasing number of tourists are the local fishermen who ferry the tourists to and from the area where the Butandings are. The increasing demands of local fishermen who assist the tourists lead them to organize and register the Tan-awan Oslob Seawarden & Fishermen Association (referred herein as "Fishermen Association") with the BIR.

A taxpayer's letter complaining about the issuance of unregistered receipts by Oslob on its Butanding Watching Activity has prompted BIR RR13 to issue Letter of Authority No. 083-2015-00000002 (eLA 201000021232) against Oslob for all its internal revenue tax liabilities for taxable year 2012. Actual investigation conducted revealed that the total fee from the Butanding Watching Activity that is being collected by Oslob from the tourists is distributed as follows:

Fishermen Association	-	60%
Municipality of Oslob	-	30%
Barangay Tan-awan	-	10%

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Inquiries resulted to discovery of tax liabilities for taxable year 2012 and subsequently, a Preliminary Assessment Notice (PAN) dated December 1, 2015 was served to the Accountant, Treasurer and Mayor of Oslob to apprise them to their tax liabilities. But, unmindful thereof, a Formal Letter of Demand (FLD) dated December 21, 2015 was issued against Oslob on January 13, 2016. Unable to settle its liabilities with the BIR, a Preliminary Collection Letter dated April 26, 2016 and a Warrant of Distraint and/or Levy were served to Oslob on April 26, 2016 and August 24, 2016, respectively.

Based on the foregoing, you now request for a ruling on the following issues, *viz.*:

1. Whether or not Oslob will be held liable to pay its income tax liability on its share from Butanding watching activity?

2. Whether or not Oslob can be held liable to pay its VAT liability?

3. Whether or not Oslob can be held liable to pay its expanded withholding tax liability?

4. Whether or not Oslob can be held liable for deficiency withholding tax on VAT and other percentage taxes?

5. Whether or not Oslob can be held liable to pay withholding tax liability on compensation?

6. Whether or not Oslob can be liable to pay its liabilities on Registration Fees?

In reply thereto, please be informed as follows:

1. Income tax liability of Oslob on its share from Butanding Watching Activity.

The assessment of income tax liability is proper, because: (1) Oslob is not among the government agencies or instrumentalities expressly exempted from income tax; and (2) that the income derived by Oslob from its Butanding Watching Activity was not in the exercise of its essential governmental function but pursuant to its proprietary function.

Section 27 (C) of the 1997 Tax Code, as amended by Republic Act (R.A.) No. 10026 provides:

> *"Section 27(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*

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(GSIS), the Social Security System (SSS), the Philippine Health Insurance Corporation (PHIC), the local water districts (LWD) and the Philippine Charity Sweepstakes Office (PCSO), 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."

Based on the afore-mentioned rule, all corporations, agencies or instrumentalities owned and controlled by the government shall pay such rate of tax upon their taxable income as are imposed upon corporations or associations engaged in a similar business, industry or activity. The exception to this rule, and thus exempt from taxation are the following entities: GSIS, SSS, PHIC, PCSO and the Local Water Districts.

In BIR Ruling No. 369-11 dated October 5, 2011, it has been established that provincial, city and municipal governments are liable to income tax in the performance of their corporate or proprietary functions since the tax exemption privileges, including preferential tax treatment of all government units, *i.e.*, the National Government, its agencies and political subdivisions, as well as government-owned or controlled corporations were withdrawn by Presidential Decree No. 1931 (1984) and Executive Order No. 93 (1987). Hence, Oslob being not included in the exceptions enumerated in Section 27 (C) of the 1997 Tax Code, as amended, is then subject to such rates of *

It is to be noted that governmental functions are those pertaining to the administration of government, and as such, are treated as absolute obligation on the part of the state to perform, while proprietary functions are those that are undertaken only by way of advancing the general interest of society, and merely optional on the government. 1

When the local government unit acts in its proprietary character, it is regarded as having the rights and obligations of a private corporation. Consequently, income received in the exercise of its proprietary powers is subject to income tax in the same manner as other private corporations similarly situated.

From the foregoing, it is clear that the Butanding Watching Activity of Oslob is an exercise of its proprietary function because it does not involve administration and governance of the territory and inhabitants within the municipality. Oslob, having engaged in an activity classified as in the exercise of its proprietary function, is treated as separate entity acting for its own purpose and not a subdivision of the Republic of the Philippines. Accordingly, income derived from such activity, which in the case of Oslob is its 30% share, will not fall under exclusions from gross income under Section 32 (B) (7) (b) of the Tax Code of 1997, as amended, hence, considered as taxable income.

2. VAT liability of Oslob.

Section 105 of the Tax Code of 1997, as amended, provides for the persons liable to VAT, to wit:

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"SEC. 105. Persons Liable. — Any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 106 to 108 of this Code." (underscoring supplied)

Moreover, Section 108 of the 1997 Tax Code, as amended, provides for the tax rate and tax base of VAT on sale of services:

"SEC. 108. Value-added Tax on Sale of Services and Use or Lease of Properties. —

(A) Rate and Base of Tax. — There shall be levied, assessed and collected, a value-added tax equivalent to ten percent (10%) (now 12% per Revenue Memorandum Circular (RMC) No. 7-2006 dated January 31, 2006 and become effective February 1, 2006) of gross receipts derived from the sale or exchange of services, including the use or lease of properties; x x x

xxx xxx xxx

The phrase 'sale or exchange or services' means the performance of all kinds of services in the Philippines, for others for a fee, remuneration or consideration, x x x" (underscoring supplied)

When Oslob provided the tourists with guides to assist them during Butanding Watching and charges a fee, the municipality performs a corporate or private function which is proprietary in nature, and thus, should be held liable to 12% VAT on the total gross receipts it derived from such activity.

3. Expanded withholding tax liability of Oslob.

Section 2.57.2 (N) of Revenue Regulation (RR) No. 2-98 provides:

"(N) Income payments made by the government to its local/resident supplier of goods and local/resident supplier of services other than those covered by other rates of withholding tax. — Income payments, except any single purchase which is P10,000.00 and below, which are made by a government office, national or local, including barangays, or their attached agencies or bodies, and government-owned or controlled corporations, on their purchases of goods and purchases of services from local/resident suppliers. (underscoring supplied)

Supplier of goods — One percent (1%)

Supplier of services — Two percent (2%)

xxx xxx xxx"

Accordingly, it is the obligation of Oslob to withhold one percent (1%) on the income payments given to local supplier of goods and two percent (2%) on the income

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payments given to resident supplier of services. For failing to appropriately withhold the required taxes, Oslob is liable to pay the corresponding expanded withholding taxes.

4. Withholding tax liability on VAT and other percentage taxes of Oslob.

Section 114 (C) of the Tax Code of 1997, as amended, on withholding of VAT provides:

> *"Sec. 114. Return and Payment of Value-added Tax. —*
>
> xxx xxx xxx
>
> *(C) Withholding of Value-added Tax. — The Government or any of its political subdivisions, instrumentalities or agencies, including government-owned or controlled corporations (GOCCs) **shall**, before making payment on account of each purchase of goods and services which are subject to the value-added tax imposed in Sections 106 and 108 of this Code, **deduct and withhold the value-added tax due at the rate of five percent (5%) of the gross payment** thereof: Provided, That the payment for lease or use of properties or property rights to nonresident owners shall be subject to twelve percent (12%) withholding tax at the time of payment. For purposes of this Section, the payor or person in control of the payment shall be considered as the withholding agent."(As amended by RMC No. 7-2006)* (emphasis supplied)

Likewise, Section 4.114-2 of RR No. 16-05 dated September 1, 2005, as amended by RMC No. 7-2006 provides:

> *"Section 4.114-2. Withholding of VAT on Government Money Payments and Payments to Non-Residents. —*
>
> *(a) The government or any of its political subdivisions, instrumentalities or agencies, including government-owned or controlled corporations (GOCCs) **shall**, before making payment on account of each purchase of goods and/or of services taxed at twelve percent (12%) VAT pursuant to Secs. 106 and 108 of the Tax Code, deduct and withhold a final VAT due at the rate of five percent (5%) of the gross payment thereof.*
>
> *The five percent (5%) final VAT withholding rate shall represent the net VAT payable of the seller. The remaining seven percent (7%) effectively accounts for the standard input VAT for sales of goods or services to government or any of its political subdivisions, instrumentalities or agencies including GOCCs, in lieu of the actual input VAT directly attributable or ratably apportioned to such sales. Should actual input VAT attributable to sale to government exceed seven percent (7%) of gross payments, the excess may form part of the sellers' expense or cost. On the other hand, if actual input VAT attributable to sale to government is less than seven percent (7%) of gross payment, the difference must be closed to expense or cost."* (emphasis supplied)

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On the other hand, Section 5.116 of RR No. 2-98 on withholding of percentage tax provides:

> *"Section 5.116. Withholding of Percentage Tax. — Bureaus, offices and instrumentalities of the government, including government-owned or controlled corporations as well as their subsidiaries, provinces, cities and municipalities making any money payment to private individuals, corporations, partnerships and/or associations* ***are required*** *to deduct and withhold the percentage taxes due from the payees on account of such money payments."* (emphasis supplied)

The tenor of the above-quoted provisions on the use of the word "shall" and "are required" connotes a mandatory obligation on the part of Oslob, being a political subdivision of the Republic of the Philippines, to withhold the: (1) VAT due at the rate of five percent (5%) of the gross payment thereof before making payment on account of each purchase of goods and services which are subject to the VAT imposed in Sections 106 and 108 of the 1997 Tax Code, as amended; or (2) percentage tax due at the rate of three percent (3%) on gross money payments, as the case may be. Hence, Oslob is required to withhold the 5% VAT or the 3% other percentage tax, as the case may be, needed to be withheld on its money payments to its local supplier of goods and services.

For failure to properly withhold the VAT or percentage tax before making payments on account of any purchases of goods or services, Oslob is liable to pay the withholding tax on VAT or other percentage taxes.

5. Withholding tax liability on compensation of Oslob.

> *"SEC. 79. Income Tax Collected at Source. —*
>
> *(A) Requirement of Withholding. — Except in the case of a minimum wage earner as defined in Section 22(HH) of this Code, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with the rules and regulations to be prescribed by the Secretary of Finance, upon recommendation of the Commissioner."* (underscoring supplied)

On September 22, 2011 to December 6, 2012, Oslob has a minimum wage requirement of Two Hundred Eighty-Five Pesos (P285.00) and effective December 7, 2012 it has a minimum wage requirement of Three Hundred Seven Pesos (P307.00) under the Regional Tripartite Wages and Productivity Board of the Department of Labor and Employment-Region VII. If from your investigation, no employee is considered a minimum wage earner, then Oslob was properly assessed with a liability of withholding tax on compensation.

6. Oslob's liabilities on Registration Fees.

Section 236 (B), Chapter II of the Tax Code of 1997, as amended, on annual registration fee, provides:

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"SEC. 236. Registration Requirements. —

(B) Annual Registration Fee. — An annual registration fee in the amount of Five hundred pesos (P500) for every separate or distinct establishment or place of business, including facility types where sales transactions occur, ***shall*** *be paid upon registration and every year thereafter on or before the last day of January: Provided, however, that cooperatives, individuals earning purely compensation income, whether locally or abroad, and overseas workers are not liable to the registration fee herein imposed."* (Emphasis supplied)

Oslob for such reason is required to pay the Registration Fee of Five Hundred Pesos (P500.00) annually. For its failure to pay the annual registration fee for taxable year 2012, Oslob is liable to the registration fee amounting to P2,020.62, inclusive of interest.

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 as null and void.

Very truly yours,

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

Footnotes

1. *Social Security System Employees Association vs. Soriano*, 7 SCRA 1016, 1020.

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