April 19, 2018

BIR RULING NO. 741-18

RMC No. 85-2017

Department of Public Works and Highways
Bonifacio Drive, Port Area
Manila

Attention: *AAA*

Gentlemen :

This refers to your letter dated March 12, 2018 requesting confirmation that the Department Order (D.O.) 197, s. 2016, issued by the Department of Public Works and Highways (DPWH) is compliant with the twelve percent (12%) value-added tax (VAT) requirement and that the five percent (5%) final VAT rate stated therein is sufficient compliance with Revenue Memorandum Circular (RMC) No. 85-2017 and BIR rulings.

It is your position that D.O. 197, s. 2016, is already compliant with RMC 85-2017 since it recognizes the twelve percent (12%) output VAT liability of the contractor. For DPWH infrastructure projects, VAT is divided into two components: a) **seven percent (7%) output VAT** that need not be stated in the Department Order considering that it is fully offset by the **standard seven percent (7%) input VAT**, which is in lieu of the actual input VAT directly attributable or ratably apportioned to such sales; and b) as to the remaining **five percent (5%) output VAT**, it is deemed to be the final output VAT payable by the contractor, hence, the need for it to be stated in D.O. No. 197, s. 2016.

You posit that the DPWH allows the contractors to include the VAT when they submit their bids as long as they do not exceed the ABC for the project. D.O. 197, s. 2016, does not prohibit the contractors to include the VAT in their bids. The contractors are not required to submit the receipts issued to them by their suppliers. Also, the actual input VAT paid by the contractors to their suppliers of materials and other goods that are attributable to their sales to the government is already included in the detailed prices of said materials and other goods as indicated in the ABC.

In effect, the input VAT paid by the contractors to their suppliers on their purchases will be reimbursed to them by the DPWH upon payment of the gross billing, which already includes the seven percent (7%) standard input VAT, as illustrated below:

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A sample Program of Works (POW) [1] prepared by DPWH which will be the basis of the ABC is composed of the following:

BREAKDOWN OF EXPENDITURES

Direct Cost Component	
A.1 Labor Cost	19,163,914.19
A.2 Materials Cost (inclusive of 12% VAT)	443,927,814.83
A.3 Equipment Rental	117,393,071.95
A.4 ESTIMATED DIRECT COST (EDC)	**580,484,800.97**
Indirect Cost Component	
A.5 Overhead, Contingency, Miscellaneous (OCM) 8%	45,061,145.41
A.6 Contractor's Profit (CP) 8%	45,061,145.41
A.7 Total EDC, OCM, and CP	**670,607,901.79**
A.8 Final VAT ***(5% of EDC + OCM + CP)***	33,530,354.59
A.9 TOTAL PROJECT COST (ABC)	704,137,446.38 (as approved)

As shown above, the materials component of the ABC already includes the input VAT because it is based on prevailing market prices. The VAT of the purchase price of the materials will be paid by the contractor to their supplier of materials. In turn, the supplier of materials remits said VAT to the BIR while the contractors report the VAT to the BIR. The VAT component will be reimbursed by DPWH upon payment of gross billings to the contractor. Said VAT is also included in the amount reflected in the ABC.

TOTAL VAT COMPUTATION

First, extract 12% VAT from the total Materials Cost		
Materials Cost (exclusive of 12% VAT) [(A.2.)/1.12]	=	396,364,120.38
12% VAT on Materials Cost (0.12 x 396,364,120.38)	=	47,563,694.45
Then, **Add** the 5% Final VAT (A.8) and the **12% VAT on materials cost**		
TOTAL VAT : 33,530,354.59 + 47,563,694.45	=	**81,094,049.04**
VAT RATE ON PROJECT COST : 81,094,049.04/670,607,091.79	=	**12%**

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Based on the above computation, the twelve percent (12%) VAT requirement has been complied with. The DPWH withholds the five percent (5%) final VAT and the remaining seven percent (7%) effectively accounts for the standard input VAT.

In reply, please be informed as follows:

As a rule, twelve percent (12%) VAT is imposed on every sale of goods and/or services, including sale of goods and/or services to the government, pursuant to Sections 106 and 108 of the National Internal Revenue Code (NIRC) of 1997, as amended. However, with regard to taxable transactions with the government, Section 114 (C) [2] of the NIRC provides that such transactions shall be subject to the withholding of a final output VAT at the rate of five percent (5%).

As clarified in RMC No. 85-2017, the actual input VAT attributable to sales to government cannot be claimed for refund or tax credit because Section 4.114-2 (a) of Revenue Regulations No. 16-2005, [3] which implements Section 114 (C) of the NIRC, already provides for the rules on how the sellers of goods/services can recoup the actual input VAT attributable or ratably apportioned to their sales to the government and how to treat the remaining seven percent (7%) standard input VAT:

> 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 government-owned or controlled corporations (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 exceeds seven percent (7%) of gross payments, the excess may form part of the seller's 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)

It must be clarified, however, that in case the government agency purchasing the goods or service allows its contractors to pass on the actual input VAT which the latter incurred or paid on the goods/services attributable to such government sales, by way of including said actual input VAT to the cost of VATable materials/services in the

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submitted bid price, then, the appropriate VAT rate that should be applied in the government agency's approved budget for the contract (ABC) shall only be five percent (5%). This is to prevent the contractors from availing the seven percent (7%) standard input VAT twice. Increasing the 5% final VAT to 12%, when the contractors have already passed on the actual input VAT incurred, which already includes the 7% standard input VAT, to the cost of materials/services, will have the effect of at least doubling the 7% standard input VAT allowed under Section 114 (c) of the NIRC, as illustrated below:

BREAKDOWN OF EXPENDITURES (using the example above)

Direct Cost Component	
B.1 Labor Cost	19,163,914.19
B.2 Materials Cost (inclusive of 12% VAT)	443,927,814.83
B.3 Equipment Rental	117,393,071.95
B.4 ESTIMATED DIRECT COST (EDC)	580,484,800.97
Indirect Cost Component	
B.5 Overhead, Contingency, Miscellaneous (OCM, 8%)	45,061,145.41
B.6 Contractor's Profit (CP, 8%)	45,061,145.41
B.7 Total of EDC, OCM, and CP	670,607,091.79
B.8 Final VAT (***12% of EDC + OCM + CP***)	80,472,850.99
B.9 TOTAL PROJECT COST	**751,079,942.78**
TOTAL VAT (12% Final VAT + 12% VAT on materials cost) (80,472,850.99 + 47,563,694.45)	**= 128,036,545.44**

VAT RATE ON PROJECT COST: 128,036,545.44/670,607,091.79 = 19%

The above illustration shows that in using five percent (5%) final VAT as per D.O. 197, s. 2016, the total VAT is P81,094,049.04. On the other hand, using the twelve percent (12%) final VAT on the total project cost (A.7) without extracting the twelve percent (12%) VAT component from materials cost results to a total VAT of P128,036,545.44. This is nineteen percent (19%) of the total project cost before applying the VAT (A.7).

Total VAT Comparison

A. Total VAT (12% VAT on materials cost + 5% Final VAT)	=	81,094,049.04

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B.	Total VAT (12% Final VAT + 12% VAT on materials cost) (80,472,850.99 + 47,563,694.45)	=	128,036,545.44
VAT Cost Variance [(A) – (B)]		=	**46,942,496.40**
VAT % Variance based on Total Project Cost before application of 5% Final VAT [((A) – (B))/(A.7)]		=	**7% of the Project Cost**
Total VAT	**128,036,545.44**	=	19%

In sum, if the concerned government agency, as in the case of the DPWH, allows that the cost of contracts will include the amount of VAT to be passed on by the contractors, then, only 5% final VAT is the appropriate percentage to be applied to the ABC of its projects. Notably, and as represented, DPWH allows the contractors to include the VAT when they submit their bids as long as they do not exceed the ABC for the project. D.O. 197, s. 2016, does not prohibit the contractors from including the VAT in their bids.

Based thereon, we hereby opine that D.O. 197, s. 2016 is compliant with the twelve percent (12%) VAT requirement and that the five percent (5%) final VAT rate stated therein is sufficient compliance with RMC No. 85-2017 and related BIR rulings.

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be disclosed 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

Footnotes

1. Data based on actual ABC for Revetment and Dredging Works, Metro Cebu Flood Control Project and Drainage Improvement Project, Central Cluster.
2. Section 114. Return and Payment of Value-Added Tax. —
(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 a **final value-added tax at the rate of five percent (5%)** of the gross payment thereof: . . . [2]
3. Consolidated Value-Added Tax Regulations of 2005, as amended by RR No. 4-2007.

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