April 30, 2018

BIR RULING NO. 750-18

RA No. 7916; *CIR vs. Seagate Technology (Phils.)*, G.R. 153866; *CIR vs. Toshiba Information Equipment (Phils.), Inc.*, G.R. No. 150154; BIR Ruling No. 199-13; BIR Ruling No. 422-14

SCPA Properties, Inc.
Lima Technology Center Special Economic Zone,
Purok I, Brgy. Bugtong na Pulo, Lipa City,
Batangas 4217

Attention: *AAA*

Gentlemen :

This refers to your letter dated March 21, 2013, requesting on behalf of SCPA PROPERTIES, INC. for the issuance of a VAT zero-rated Certificate and exemption from withholding tax on account of your registration with the Philippine Economic Zone Authority (PEZA).

It is represented that SCPA PROPERTIES, INC., with Taxpayer's Identification Number (TIN) 000-000-000-000, is a PEZA-registered Ecozone Facilities Enterprise with Registration Certificate No. 12-11-F dated September 5, 2012, to operate and maintain two (2) existing factory buildings with a total floor area of 25,804.78 square meters, constructed on a 48,550 square meters lot located at the Lima Technology Center-Special Economic Zone (LTC-SEZ), for lease/sale to PEZA-registered export enterprises.

In reply, please be informed as follows:

1. The lease of the two (2) factory buildings being operated and maintained by SCPA PROPERTIES, INC. at the Lima Technology Center-Special Economic Zone (LTC-SEZ) to PEZA-registered export enterprises is considered as VAT-exempt.

SCPA PROPERTIES, INC. and its lessees are all PEZA-registered enterprises under the 5% GIT regime, and are therefore exempt from national and local taxes on their registered activities pursuant to Section 24 of Republic Act (R.A.) No. 7916, as amended:

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"SEC. 24. Exemption from National and Local Taxes. — Except for real property taxes on land owned by developers, no taxes, local and national, shall be imposed on business establishments operating within the ECOZONE. In lieu thereof, five percent (5%) of the gross income earned by all business enterprises within the ECOZONE shall be paid and remitted as follows:

(a) Three percent (3%) to the National Government;

(b) Two percent (2%) which shall be directly remitted by the business establishments to the treasurer's office of the municipality or city where the enterprise is located."

The leasing services being rendered by SCPA PROPERTIES, INC. are within the PEZA special economic zone and are all within the scope of its PEZA-registered activities. Accordingly, such leasing services by SCPA PROPERTIES, INC. is considered as being performed or rendered in foreign territory or foreign soil, and therefore not within the Customs Territory.

In this regard, Section 8 of Republic Act (R.A.) No. 7916, as amended, provides that:

"SEC. 8. ECOZONE to be Operated and Managed as Separate Customs Territory. — The ECOZONE shall be managed and operated by the PEZA as separate customs territory.

xxx xxx xxx."

In discussing the nature of a "separate customs territory," the Supreme Court in the case of *Commissioner of Internal Revenue vs. Seagate Technology (Philippines), G.R. 153866 dated February 11, 2005*, the Court held that *"in such zone is created the legal fiction of foreign territory."* The Court further ruled that *"[A]n ecozone — indubitably a geographical territory of the Philippines — is, however, regarded in law as foreign soil. This legal fiction is necessary to give meaningful effect to the policies of the special law creating the zone."* Moreover, in the case of *Commissioner of Internal Revenue vs. Toshiba Information Equipment (Phils.), Inc., G.R. No. 150154 dated August 9, 2005*, the Supreme Court ruled as follows:

"This Court agrees, however, that PEZA-registered enterprises, which would necessarily be located within ECOZONES, are VAT-exempt entities, not because of Section 24 of Rep. Act No. 9716, as amended, which imposes the five percent (5%) preferential tax rate on gross income of PEZA-registered enterprises, in lieu of all taxes; but, rather, because of Section 8 of the same statute which establishes the fiction that ECOZONES are foreign territory."

Section 8 of Rep. Act No. 7916, as amended, mandates that the PEZA shall manage and operate the ECOZONES as a separate customs territory; thus, creating the legal fiction that the ECOZONE is a foreign territory. Accordingly, the leasing of the two

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(2) factory buildings by SCPA PROPERTIES, INC. to PEZA-registered export enterprises, which services are performed exclusively at the Lima Technology Center-Special Economic Zone (LTC-SEZ), are deemed by fiction of law as being performed or rendered in foreign territory or foreign soil, and therefore not within the Customs Territory. Accordingly, such sale of services shall be exempt from VAT.

2. SCPA PROPERTIES, INC., being an Economic Zone Facilities Enterprise is exempt from the payment of withholding tax.

Section 2.57.5 (B) (2) of Revenue Regulations No. 2-98, as amended, is explicit in its provisions that the expanded 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. PEZA-registered enterprises are granted certain preferential tax treatment under Section 24 of Republic Act No. 7916 which provides that any provision of existing laws, rules and regulations to the contrary notwithstanding, no taxes, local and national shall be imposed on business establishments operating within the ECOZONE. *(BIR Ruling No. 422-14 dated October 23, 2014)*

SCPA PROPERTIES, INC., however, is liable to the payment of five percent (5%) of the gross income earned, in lieu of all taxes, national or local.

Further, Section 2 (nn), Rule I of the implementing Rules of RA No. 7916 defines the term "gross income" as follows:

> "(nn) "Gross Income" for purposes of computing the special tax due under Section 24 of the Act refers to gross sales and gross revenues derived from business activity within the ECOZONE, net of sales discounts, sales returns and allowances and minus costs of sales or direct costs but before any deduction is made for administrative expenses or incidental losses during a given taxable period. The allowable deductions from "gross income" are specifically enumerated under Section 2, Rule XX of these Rules."

The definition of "gross income" limits the application of the preferential tax rate of 5% to income derived from the registered activity by an ECOZONE enterprise. Thus, any income derived by a registered enterprise that is not related to its registered activity is not entitled to the preferential tax rate of 5%. Instead, such income derived from an unregistered activity shall be subject to regular internal revenue tax as provided under Section 1 (1st par.) of Revenue Regulations No. 20-02.

Accordingly, since SCPA PROPERTIES, INC. is a PEZA-registered enterprise enjoying the 5% preferential tax incentive, all payments received by it from its lessees, which are PEZA-registered export enterprises, derived from its registered activities are exempt from the withholding tax.

It must be emphasized, however, that SCPA PROPERTIES, INC. is constituted as withholding agent for the government. As such, it is required to withhold the tax on compensation income of its employees or the withholding tax on income payments to

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persons subject to tax pursuant to Section 57 of the Tax Code of 1997, as amended.

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 as represented 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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