REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

June 14, 2007

REVENUE MEMORANDUM CIRCULAR NO. 40-2007

SUBJECT : Tax Treatment on the Development Assistance Activities of the United States Agency for International Development (USAID) in the Philippines

TO : All Revenue Officers and Others Concerned

SECTION 1. Purpose – This Circular lays down the coverage of and basis for value-added tax (VAT) zero-rating or exemption and direct tax exemption of the United States Agency for International Development (USAID) and its recognized Implementing Agents in connection with their development assistance activities in the Philippines.

Further, this Circular is issued to prescribe the guidelines for the implementation of the appropriate value-added tax (VAT) treatment on the purchases of goods and services associated with the aforesaid development assistance activities of the USAID.

SECTION 2. Coverage – This Circular covers VAT zero-rating or exemption on the local sale of goods and services to the USAID for its development assistance activities in the Philippines, which are initially contemplated to consist of activities listed in Annex A of this Circular, and direct taxes from which USAID and its recognized Implementing Agents may be exempted, in relation to its development activities, under existing laws and conventions.

VAT and/or ad valorem tax exemptions on the sale of motor vehicles to USAID and its recognized Implementing Agents shall continue to be governed by the provisions of Revenue Memorandum Order No. 22-2004[1], which requires that a separate ruling specifying the model, engine and chassis number and the color of the vehicle shall be secured for the grant of such tax exemptions.[2]

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[1] Entitled *"Value-Added Tax (VAT) Exemption Certificate / Identification Card Issued to Qualified Foreign Embassies and their Qualified Personnel Amending / Modifying RMO 81-99"*, dated May 24, 2004

[2] Part III(A) of Revenue Memorandum Order No. 22-2004

SECTION 3. Definition of Terms –

(a) The 1951 Agreement – shall refer to *The Economic and Technical Cooperation Agreement Between the Government of the United States of America and the Government of the Philippines*.

(b) Development Assistance Activities of the USAID – A set of actions through which inputs, such as commodities, technical assistance, training, or resource transfers, are mobilized to produce specific outputs, such as vaccinations given, schools built, microenterprise loans issued, or policies changed. Activities are undertaken to achieve Strategic or Special Objectives that have been formally approved by and notified to the U.S. Congress[3].

(c) USAID Project – is one or several types of activities that contribute to a given result or set of results. It is a structured undertaking (often involving considerable money, technical assistance, services, personnel and equipment) of limited duration that is developed through various administrative, analytical, and approval processes in order to achieve a tangible objective (such as school construction project, adult literacy project).

(d) USAID Program – refers to an organized set of activities and allocation of resources directed toward a common purpose, objective, or goal undertaken or proposed by an agency in order to carry out the responsibilities assigned to it.

(e) Cognizant Technical Officer (CTO) - The designated USAID official, responsible for monitoring the performance of the Contractor or Recipient and exercising technical cognizance over the USAID contract, grant or cooperative agreement.

(f) Implementing Agents – Implementing agents may either be contractors or recipients as defined below:

(i) Contractor – refers to a non-government organization, commercial for-profit firm or individual (including experts) acting for and on behalf of USAID and carrying out a scope of work for a specific USAID Project or USAID Program.

(ii) Recipient – refers to an individual or an organization receiving direct financial assistance (a grant or cooperative agreement) from USAID to carry out an activity or program. The term includes non-government organizations, public international organizations, other U.S. Government

[3] Taken from the USAID Automated Directives System (ADS) – http://www.usaid.gov/policy/ads/

agencies, public and private institutions of higher education, public and private hospitals, and other quasi-public and private nonprofit organizations. The term may also apply to profit-making organizations that are performing work under a grant or cooperative agreement relationship with USAID.

(g) Value-Added Tax – refers to the value-added tax imposed under Title IV of the National Internal Revenue Code of 1997 (Tax Code of 1997), as amended.

(h) Direct Tax – refers to the tax for which a taxpayer is directly liable on the transaction or business it engages in[4].

SECTION 4. Bases of Appropriate VAT and Direct Tax Treatment -- Article IV, paragraph 1 of 1951 Agreement provides:

"Article IV

Missions

1. *The Government of the Philippines agrees to receive a Special Technical and Economic Mission which will discharge the responsibilities of the Government of the United States of America in the Philippines under this agreement and the Government of the Philippines will,* ***upon appropriate notification from the Ambassador of the United States of America in the Philippines****, consider this Mission and its personnel as part of the Diplomatic Mission of the United States of America for the purpose of enjoying privileges and immunities accorded to that Mission and its personnel of comparable rank. Such Mission shall include but not be limited to experts whose services are made available to implement Article II of this agreement. (emphasis supplied)*

xxx xxx xxx"

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4 As defined in *Tax law and* Jurisprudence by Justice Jose C. Vitug and Judge Ernesto D. Acosta, Second Edition, based on Supreme Court decision entitled *Ernesto M. Maceda vs. Hon. Catalino Macaraig, Jr., in his capacity as Executive Secretary, Office of the President, Hon. Vicente Jayme, etc.* et al., G.R. No. 88291, June 8, 1993 wherein a **direct tax** was defined –

"xxx xxx xxx

Classification or Kinds of Taxes:

According to Persons who pay or who bear the burden:

a. Direct Tax – that where the person supposed to pay the tax really pays it, *WITHOUT* transferring the burden to someone else.

xxx xxx xxx"

Accordingly, tax privileges accorded to the Diplomatic Mission of the United States of America and its personnel shall be extended by the Philippine Government to the Special Technical and Economic Mission (Mission) of the United States of America, tasked to discharge the responsibilities of the Government of the United States of America (USA) in the Philippines under the 1951 Agreement, and its personnel of comparable rank, including experts to implement USAID development assistance activities, upon appropriate Notification from the Ambassador of the USA in the Philippines, in accordance with the 1951 Agreement.

SECTION 5. USAID as the Technical and Economic Mission of the Government of the United States of America – Pursuant to the Notification from the Ambassador to the Philippines of the USA dated December 18, 2006, the USAID is recognized as the Special Technical and Economic Mission of the Government of the United States of America for discharging the responsibilities of the Government of the United States of America under the 1951 Agreement.

For purposes of enjoying the tax privileges, the USAID, its personnel of comparable rank and its Implementing Agents, recognized by the U.S. Embassy under Section 6 hereof as part of USAID for purposes of implementing development assistance activities pursuant to the 1951 Agreement, shall be considered as part of the diplomatic mission entitled to direct tax exemption pursuant to the Vienna Convention on Diplomatic Relations and indirect tax exemption pursuant to the Tax Code of 1997, as amended and its implementing rules and regulations.

SECTION 6. Implementing Agent – For each of USAID's activities, the USA Department of State, through USAID, will select a Contractor or Recipient to serve as its Implementing Agent.

This Bureau shall recognize the selected Implementing Agent, excluding its personnel and staff, as part of the USAID for purposes of implementing USAID development assistance activities and shall be accorded the appropriate tax treatment under the 1951 Agreement as described under Sections 4, 7 and 12 of this Circular, upon receipt of a Note Verbale from the Ambassador of the U.S. Embassy in the Philippines, duly endorsed by the DFA, with the information as to the name of such person or entity, and the start and end dates for which the agency relationship is in effect. The name of the person or entity, i.e., contractor or recipient, and the period for which the agency relationship is in effect shall be duly circularized for the information of all Bureau officials and personnel concerned.

Sale of good and services for non-development assistance activities to the Implementing Agent, as a separate person or entity, shall be taxed in accordance with the provisions of the Tax Code of 1997, as amended or relevant tax treaty, as applicable.

SECTION 7. Appropriate VAT treatment – To the extent that each Implementing Agent is authorized to act for and on behalf of the USAID, the Implementing Agent shall be allowed to make local purchases of supplies, goods and services, for and on behalf of the USAID and avail of the appropriate VAT treatment on the strength of the VAT Exemption Certificate issued by this Bureau to the USAID.

Sale of goods and services by VAT-registered suppliers to USAID, through its implementing agents, shall, in general, be subject to VAT at zero percent (0%), pursuant to Section 106(2)(c)[5] and Section 108(B)(3) [6]of the Tax Code of 1997, as amended, all in relation to the 1951 Agreement. These are implemented by Sec. 4.106-5(c)[7] of Revenue Regulations No. 16-2005[8], as amended by Revenue

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[5] "**SEC. 106.** – ***Value-added Tax on Sale of Good or Properties***. –

(A) xxx xxx xxx

(2) The following sales by VAT-registered persons shall be subject to zero percent (0%) rate:

xxx xxx xxx

(c) Sales to persons or entities whose exemption under special laws or international agreements to which the Philippines is a signatory effectively subjects such sale to zero rate.

xxx xxx xxx"

[6] "**SEC. 108.** – ***Value-added Tax on Sale of Services and Use or Lease of Properties***. –

(A) xxx xxx xxx

(B) Transactions Subject to Zero Percent (0%) rate. – The following services performed in the Philippines be VAT-registered persons shall be subject to zero percent (0%) rate:

xxx xxx xxx

(3) Services rendered to persons or entities whose exemption under special laws or international agreements to which the Philippines is a signatory effectively subjects such supply of services to zero rate.

xxx xxx xxx"

[7] "**SEC. 4.106-5.** ***Zero-Rated Sales of Goods or Properties***.

xxx xxx xxx

The following sales by VAT-registered persons shall be subject to zero percent (0%) rate:

(a) Export Sales. –

xxx xxx xxx

(b) Foreign Currency Denominated Sale. –

xxx xxx xxx

(c) Sales to Persons or Entities Deemed Tax-exempt Under Special law or International Agreement. – Sale of goods or property to persons or entities who are tax-exempt under special laws or international agreements to which the Philippines is a signatory, such as Asian Development Bank (ADB), International Rice Research Insitute (IRRI), etc., shall be effectively subject to VAT at zero-rate."

Regulations No. 4-2007[9] and Section 4.108-5(B)(3)[10] of Revenue Regulations No. 16-2005.

However, since the US Embassy and the USAID may not be passed on with VAT, payments to non-resident seller/supplier of goods and services shall be exempt from VAT.

Non-VAT registered sellers/suppliers who are exempt from VAT under Section 109(1)(V)[11] of the Tax Code of 1997, as amended are, however, subject to percentage tax at the rate of three percent (3%) under Section 116[12] of the same Code, as amended.

SECTION 8. Invoice/Receipt – VAT-registered sellers/suppliers to USAID's Implementing Agents for the programs and projects covered by this Circular must issue a VAT invoice[13]/official receipt[14] for each sale, which shall contain the following information:

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8 Entitled *"Consolidated Value-Added Tax Regulations"*, dated September 1, 2005

9 Entitled *"Amending Certain Provisions of Revenue Regulations No. 16-2005, As amended, Otherwise known as the Consolidated Value-Added Tax Regulations of 2005"*, dated February 2, 2007.

10 "**SEC. 4.108-5. *Zero-Rated Sale of Services*** –

(a) In general. - xxx xxx xxx

(b) Transactions Subject to Zero Percent (0%) VAT Rate. – The following services performed in the Philippines by a VAT-registered person shall be subject to zero percent (0%) VAT rate:

xxx xxx xxx

(3) Services rendered to persons or entities whose exemption under special laws or international agreements to which the Philippines is a signatory effectively subjects the supply of such services to zero percent (0%) rate.

xxx xxx xxx"

11 "**SEC. 109. – Exempt Transactions**. – **(1)** Subject to the provisions of Subsection (2) hereof, the following transactions shall be exempt from the value-added tax:

xxx xxx xxx

(V) Sale or lease of goods or properties or the performance of services other than the transactions mentioned in the preceding paragraphs, the gross annual sales and/or receipts do not exceed the amount of One million five hundred thousand pesos (P1,500,000): Provided, That not later than January 31, 2009 and every three (3) years thereafter, the amount herein stated shall be adjusted to its present value using the Consumer Price Index, as published by the National Statistics Office (NSO);

xxx xxx xxx"

12 "**SEC. 116. *Tax on Persons Exempt from Value-added Tax (VAT).*** — Any person whose sales or receipts are exempt under Section 109(V) of this Code from the payment of value-added tax and who is not a VAT-registered person shall pay a tax equivalent to three percent (3%) of his gross quarterly sales or receipts: *Provided*, That cooperatives shall be exempt from the three percent (3%) gross receipts tax herein imposed."

13 For *goods*

a) Name of the seller and a statement that such seller is a VAT-registered person, followed by his Tax Identification Number (TIN);
b) Name and address of the USAID implementing agent, together with the words, *"USAID, by X Co, the Implementing Agent for (Name of Program / Project)"*;
c) Current and valid VAT Exemption Certificate Number of USAID;
d) The total amount which the purchaser pays or is obligated to pay to the seller, Provided, that—
    i. The amount of the VAT shall be shown as a separate item in the invoice or receipt; or
    ii. The term "ZERO RATED SALE" or "EXEMPT SALE", as appropriate, is written or printed prominently on the face of the invoice/receipt;
e) The date of transaction, quantity, unit cost and description of the goods or properties or nature of the service.

SECTION 9. Reviews & Audits - USAID's Implementing Agents are subject to review and audit, which will include a review of VAT privileges availed of and they shall provide reasonable assurance that only eligible supported costs are being claimed for payment. All such payments must be administratively approved by the USAID Cognizant Technical Officer (CTO), who has reasonable knowledge that the goods and services covered by the VAT invoice/official receipts have been used/received for the USAID Projects/Programs in the Philippines. Additionally, the Implementing Agents will be responsible for monitoring their staff's use of VAT privileges for all eligible sales and shall report any problems or concerns to USAID through their CTO.

As a method of controlling and protecting USAID's eligibility for tax relief privileges, the following procedures shall be followed:

a. As required by the terms of their awards with USAID, the Implementing Agents shall send their vouchers directly to the paying office, the Regional Financial Services Center (RFSC)/Manila of USAID.

    In addition, for VAT zero-rated sale of goods and services claimed under the voucher, the Implementing Agents shall submit to RFSC/Manila their certified disbursement reports, containing the following information:

    i. Invoice/Official Receipt Date
    ii. Amount
    iii. Name and TIN of supplier
    iv. Description of goods/services purchased

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[14] For *services*

All VAT invoices/official receipts in support of the certified reports shall be kept, at the Implementing Agents' respective offices, together with the books of accounts and other accounting records, subject to review or audit any time by any of USAID and/or BIR representatives for the period prescribed under Section 235[15] of the Tax Code;

b. USAID's CTO shall review the eligibility of costs being claimed, including the VAT zero-rated transactions for goods and services, before providing administrative approval on the voucher – a requirement for RFSC/Manila to process and effect payments to the Implementing Agents.

SECTION 10. Verification of Exemption – In the event that VAT-registered seller/supplier does not honor the VAT Exemption Certificate of USAID on behalf of the U.S. Embassy through its Implementing Agent at the point of sale, the Chief of International Tax Affairs Division will render assistance to the USAID and its Implementing Agents in resolving such matters and issue a certification, signed by the Assistant Commissioner of the Legal Service, this Bureau, to confirm the privilege. (See Annex B)

SECTION 11. Imported Materials – Materials imported for use in the implementation of USAID's activities in the Philippines shall be consigned to USAID and not to its Implementing Agent.

Said goods imported into the Philippines by USAID shall likewise be exempt from VAT pursuant to the 1951 Agreement and the Vienna Convention on Diplomatic Relations. However, when such goods are sold, transferred or exchanged in the Philippines to non-exempt persons or entities, the latter shall be considered the importers thereof and shall be liable for VAT due on such importation. The tax due

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[15] "SEC 235. ***Preservation of Books of Accounts and Other Accounting Records.*** — All the books of accounts, including the subsidiary books and other accounting records of corporations, partnerships, or persons, shall be preserved by them for a period beginning from the last entry in each book until the last day prescribed by Section 203 within which the Commissioner is authorized to make an assessment. The said books and records shall be subject to examination and inspection by internal revenue officers: Provided, That for income tax purposes, such examination and inspection shall be made only once in a taxable year, except in the following cases:

(a) Fraud, irregularity or mistakes, as determined by the Commissioner;
(b) The taxpayer requests reinvestigation;
(c) Verification of compliance with withholding tax laws and regulations;
(d) Verification of capital gains tax liabilities; and
(e) In the exercise of the Commissioner's power under Section 5(B) to obtain information from other persons in which case, another or separate examination and inspection may be made. Examination and inspection of books of accounts and other accounting records shall be done in the taxpayer's office or place of business or in the office of the Bureau of Internal Revenue. All corporations, partnerships or persons that retire from business shall, within ten (10) days from the date of retirement or within such period of time as may be allowed by the Commissioner in special cases, submit their books of accounts, including the subsidiary books and other accounting records to the Commissioner or any of his deputies for examination, after which they shall be returned. Corporations and partnerships contemplating dissolution must notify the Commissioner and shall not be dissolved until cleared of any tax liability.

Any provision of existing general or special law to the contrary notwithstanding, the books of accounts and other pertinent records of tax-exempt organizations or grantees of tax incentives shall be subject to examination by the Bureau of Internal Revenue for purposes of ascertaining compliance with the conditions under which they have been granted tax exemptions or tax incentives, and their tax liability, if any."

on such importations shall constitute a lien on the goods, superior to all charges/or liens, irrespective of the possessor of said goods. (Sec. 4.107-1 (c), Revenue Regulations No. 16-2005, as amended)

SECTION 12. Direct Taxes – The USAID, its personnel of comparable rank, and Implementing Agents (excluding its personnel and staff) recognized by the U.S. Embassy as part of the USAID in accordance with the 1951 Agreement, shall be exempt, from direct taxes to be imposed and which arise from the development assistance activities of the USAID, based on the provisions of the Vienna Convention on Diplomatic Relations or relevant treaty.

However, the Implementing Agents shall continue to be liable to income tax and other direct taxes not related to its performance of services in the implementation of the development assistance activities of the USAID.

Further, non-national employees of Implementing Agents shall be subject to income tax pursuant to the provisions of the Tax Code of 1997, as amended, or relevant tax treaty.

SECTION 13. Repealing Clause – Pertinent provisions of Revenue Memorandum Order No. 22-2004 and other relevant revenue issuances which are inconsistent with the provisions of this Circular are hereby revised or amended accordingly, but only insofar as they apply to the subject matter of this Circular.

SECTION 14. Effectivity – This Circular shall take effect immediately.

(Original Signed)
JOSE MARIO C. BUÑAG
Commissioner of Internal Revenue