REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE
Quezon City

Date: August 24, 2015

REVENUE MEMORANDUM CIRCULAR NO. 45-2015

SUBJECT: Clarifying the Withholding of VAT on Government Money Payments for OECF Funded Projects under Exchange of Notes between the Republic of the Philippines and the Government of Japan

TO : All Internal Revenue Officers, Employees and Others Concerned

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This Circular is hereby issued to clarify the Withholding of Value-Added Tax (VAT) on Government Money Payments and Payments to Non-Residents under the Exchange of Notes between the Republic of the Philippines and the Japanese Government for OECF Funded Projects undertaken in the Philippines.

The Exchange of Notes between the Republic of the Philippines and the Government of Japan for OECF Funded Projects undertaken in the Philippines provides for a standard provision, to wit:

> *"The Government of the Republic of the Philippines will, by itself or through its executing agencies assume:*
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> *(a) all fiscal levies and taxes imposed in the Republic of the Philippines on Japanese companies operating as suppliers, contractors and/or consultants with respect to the payment carried out for and the income accruing from the supply of the products and/or services required for the implementation of the projects enumerated in the list; and*
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> *(b) all fiscal levies and taxes imposed in the Republic of the Philippines on the Japanese employees engaged in the implementation of the projects enumerated in the List with respect to their personal income derived from Japanese companies operating as suppliers, contractors, and/or consultants."*

The Record of Discussions to the aforementioned Exchange of Notes went on further to state, to wit:

"6. With reference to subparagraph (2) of paragraph 7 of the Exchange of Notes, the representative of the Japanese Delegation, in view of the Revenue Memorandum Circular No. 42-99 dated June 2, 1999 issued by the Bureau of Internal Revenue, Department of Finance, the Republic of the Philippines, xx xx xxx."

It is noteworthy to mention that the Records of Discussion bears the previous creditable VAT withholding tax system under Republic Act No. 8424[1] and RMC No. 42-99.

On the contrary, on 01 July 2005, Republic Act (RA) No. 9337 was enacted whereby a *final* VAT withholding tax system on government money payments was introduced.

Under a creditable withholding tax system, taxes withheld on certain payments are meant to approximate the tax that is due of the payee on said payments. The liability for the tax rests upon the payee who is mandated by law to still file a tax return, report the tax base, and pay the difference between the tax withheld and the tax due[2].

On the other hand, under a final withholding tax system, the amount of income tax that is withheld by a withholding agent is constituted as a full and final payment of the income tax due from the payee on said income. The liability for the tax primarily rests upon the payor as a withholding agent.

It is clear that Congress intended to treat differently taxable transactions with the government. This is supported by the fact that under the old provision prior to its amendment by RA No. 9337, the 5% tax withheld by the government remains creditable against the tax liability of the seller or contractor.[3]

It is a settled principle of statutory construction that in the event of an irreconcilable inconsistency, the later provision should prevail over the earlier one[4]. Accordingly, RA No. 9337 which provides for the five percent (5%) final withholding VAT on government money payments shall prevail.

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[1] Tax Reform Act of 1997 or the National Internal Revenue Code of 1997.

Section 114. Return and Payment of Value-Added Tax. –

C) Withholding of Creditable 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 from sellers and services rendered by contractors 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 three percent (3%) of the gross payment for the purchase of goods and six percent (6%) on gross receipts for services rendered by contractors on every sale or installment payment which shall be creditable against the value-added tax liability of the seller or contractor: Provided, however, That in the case of government public works contractors, the withholding rate shall be eight and one-half percent (8.5%): Provided, further, That the payment for lease or use of properties or property rights to nonresident owners shall be subject to ten percent (10%) withholding tax at the time of payment. For this purpose, the payor or person in control of the payment shall be considered as the withholding agent.

[2] G.R. No. 168056, ABAKADA Guro Party List, Et al. vs. Eduardo Ermita, et al., September 1, 2005

[3] Ibid.

[4] Philippine National Bank vs. Court of Appeals, G.R. No. I-27117, July 30, 1969

Section 114 (C) of the National Internal Revenue Code (NIRC), as amended by RA No. 9337, otherwise known as the VAT Reform Act of 2005 in providing for the imposition of final withholding VAT states:

> *"SEC. 114. Return and Payment of Value-added Tax. —*
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> *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[5] of this Code, deduct and withhold a final value-added tax 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%)[6] 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."* (Emphasis supplied)

The general rule is that 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, deduct and withhold a final VAT of five percent (5%).

However, in the case of Japanese firms or nationals operating as suppliers, contractors or consultants on and/or in connection with any income that may accrue from the supply of products and/or services to be provided under the OECF funded projects pursuant to the Exchange of Notes, the Government of the Republic of the Philippines will, itself or through the executing agencies or instrumentalities, assume all fiscal levies or taxes imposed in the Republic of the Philippines.

Accordingly, the executing government agency shall assume the five (5) percent final withholding tax by including it in its budget pursuant to **Section 13 of the General Appropriations Act**, which allots a portion of the national budget for the payment of national internal revenue taxes and customs duties arising therefrom, to wit:

> ***"Sec. 13. National Internal Revenue Taxes and Import Duties.*** *The following are deemed automatically appropriated:*
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> *(a) National internal revenue taxes and import duties payable by national government agencies to the National Government arising from foreign donations, grants and loans;*

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[5] The VAT rate was increased to 12 percent beginning **February 1, 2006**, in accordance with the Memorandum of the Executive Secretary to the Secretary of Finance dated January 31, 2006, as circularized by Revenue Memorandum Circular No. 7-2006 (Publishing the Full Text of the Memorandum from Executive Secretary Eduardo R. Ermita dated January 31, 2006 Approving the recommendation of the Secretary of Finance to Increase the Value Added Tax Rate from Ten Percent to Twelve Percent) dated January 31, 2006

[6] Ibid

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The amounts pertaining to such taxes and duties covered by this section shall be considered as revenue and expenditure of the government. Implementation of this section shall be in accordance with guidelines jointly issued by the DOF and DBM."

In view of the foregoing, this Office upholds the validity and application of RA No. 9337 for government money payments under OECF Funded Projects pursuant to an Exchange of Notes between the Republic of the Philippines and the Government of Japan:

1. The Government of the Philippines, itself or through its executing agencies or instrumentalities, shall assume the final withholding VAT at the rate of five percent (5%) of the gross payment thereof under Section 114(C) of the NIRC, as amended. This will be paid out from the fund of the Government of the Philippines, or of its respective government agencies or instrumentalities as a final settlement of the tax due on the income received by Japanese contractors; and

2. The Japanese contractors of OECF Funded Projects cannot include in its billing the whole twelve percent (12%) VAT that will be assumed by the Philippine Government or its instrumentalities or agencies in accordance with the Exchange of Notes.

Consequently, **Revenue Memorandum Circular (RMC) No. 42-99**[7] dated June 2, 1999 no longer finds application to cases or transactions after the effectivity of RA No. 9337. RMCs are issuances that publish pertinent and applicable portions, as well as amplifications of laws, rules, regulations and precedents issued by the BIR and other agencies/offices. Being a mere amplification of the law, if the legal provision on which it is anchored has been amended, then the said RMC cannot find application on transactions which are now covered by the amendatory law.

All internal revenue officers and others concerned are hereby enjoined to strictly implement the provisions of this Circular.

(Original Signed)
KIM S. JACINTO-HENARES
Commissioner of Internal Revenue

[7] Amending **Revenue Memorandum Circular No. 32-99** dated May 03, 1999 entitled, "**Japanese Contractors Undertaking Overseas Economic Cooperation Fund of Japan (OECF) Funded Project are Exempt From the Eight and One Half Percent (8.5%) Creditable VAT Imposed Under Section 114 (C) of the Tax Code of 1997 and to the One Percent (1%) Expanded Withholding Tax Imposed Under Section 2.57.2 (E) of Revenue Regulations No. 2-98 Implementing Section 57(B) of the Tax Code of 1997**."