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

BUREAU OF INTERNAL REVENUE
RECEIVED
1:07 pm
JAN 10 2024
REC... INTERNAL DIVISION

Date ~~10 JAN 2024~~

REVENUE MEMORANDUM CIRCULAR NO. 5-2024

SUBJECT : Further Clarifying the Proper Tax Treatment of Cross-Border Services in Light of the Supreme Court *En Banc* Decision in *Aces Philippines Cellular Satellite Corp. v. Commissioner of Internal Revenue, G.R. No. 226680, dated August 30, 2022*

TO : All Internal Revenue Officers and Others Concerned

This Circular is being issued to further clarify the proper tax treatment of cross-border services in light of the Supreme Court's *En Banc* Decision in *Aces Philippines Cellular Satellite Corp. v. Commissioner of Internal Revenue, G.R. No. 226680, dated August 30, 2022*. The Circular offers a framework for assessing the final withholding tax and final withholding Value-Added Tax (VAT) of the activities of non-resident foreign corporation (NRFC) within the Philippine jurisdiction, allowing the Bureau to make informed determinations based on established legal interpretations. As such, the Court's Decision serves as a valuable reference point for the Bureau in evaluating and addressing tax considerations related to the services rendered by NRFCs, contributing to a clearer understanding of the tax obligations associated with such transactions.

Q1: What are the salient features of the Supreme Court's *En Banc* Decision in Aces Philippines?

A1: The following are the relevant salient features of the Decision of the Supreme Court concerning final withholding tax on income payments abroad. The satellite airtime fee payments in this case were income payments made by Aces Philippines (payor/withholding agent) to Aces Bermuda (payee/income earner), a NRFC, for the satellite airtime services it provided to Aces Philippines:

"xxx xxx xxx

Resolving the issue of whether the satellite air time fee payments to Aces Bermuda is subject to FWT requires a two-tiered approach, where we identify, first, the source of the income and, second, the situs of that source.

BUREAU OF INTERNAL REVENUE
INTERNAL COMMUNICATIONS DIVISION
RECEIVED
JAN 10 2024

A.
Identifying the source

xxx xxx xxx

"Income" refers to the flow of wealth. In ascertaining the income source, We must inquire into the property, activity, or service that produced the income, or where the inflow of wealth originated. It is insufficient to identify just any property, activity, or service. The subject may only be regarded as an income source if the particular property, activity, or service causes an ***increase in economic benefits****, which may be in the form of an inflow or enhancement of assets or a decrease in liabilities with a corresponding increase in equity other than that attributable to a capital contribution. (emphasis and underscoring supplied)*

xxx xxx xxx

The Court agrees with the CTA that the income-generating activity takes place not during the act of transmission but only upon the gateway's receipt of the call as routed by the satellite. The Court identifies the gateway's receipt of the call as the income source as it coincides with (1) the completion or delivery of the service, and (2) the inflow of economic benefits in favor of Aces Bermuda. (underscoring supplied)

(1) The [Philippine] gateway's receipt of the routed call marks the completion or delivery of the service.

In rejecting Aces Philippines' attempt to single out the act of transmission as the income-producing activity, the Court echoes the CTA En Banc's keen observation that "there is a continuous and very real connection" within the components of the Aces System (emphasis and underscoring supplied); and

xxx xxx xxx

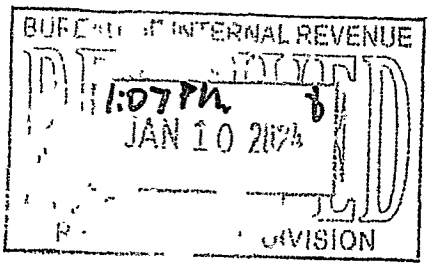
In other words, the satellite air time fees accrue only when the satellite air time is delivered to Aces Philippines (i.e., upon the gateway's receipt of the routed call) and is utilized by the Philippine subscriber for a voice or data call. The accrual of fees payable to Aces Bermuda signifies the inflow of economic benefits. (underscoring supplied)

B.
Identifying the situs

xxx xxx xxx

After having identified the source of income, We now inquire into its situs. It is settled that where the inflow of wealth and/or economic benefits proceeds from, and occurs within Philippine territory, it enjoys protection of the Philippine government. In consideration of such protection, the flow of wealth should share the burden of supporting the government, and thus, is subject to tax.

The following establishes the Philippine situs of Aces Bermuda's income from satellite air time fee payments: (1) the income-generating activity is directly



associated with the gateways located within the Philippine territory; and (2) engaging in the business of providing satellite communication services in the Philippines is a government regulated industry. (underscoring supplied)

xxx xxx xxx

To stress, the income-generating activity (i.e., accrual of satellite airtime fee payments and completion of the principal undertaking) coincides with the receipt of the routed call by gateways located within Philippine territory. That income generation is dependent on the operations of facilities situated in the Philippines contributes to the income's Philippine situs. Verily, the gateways are legally owned by Aces Philippines. Nonetheless, Aces Bermuda has sufficient economic/beneficial interest in these Philippine properties, inasmuch as its Philippine operations are dependent on these local facilities. (underscoring supplied)

xxx xxx xxx

All told, that the main asset is situated in outer space cannot be determinative of the income source and the situs thereof. At this point, it is clear that: (a) Aces Bermuda's income attaches to property operated and maintained in the Philippines, and (b) making Aces Services available to Philippine subscribers, albeit through its local service provider, is an endeavor that requires the intervention of the Philippine government. In the Court's view, it is only fair that this income be subjected to Philippine taxation; to hold Aces Bermuda accountable for its share in compensating the government for the protection it accords to Aces Bermuda's arrangements, operations, and related transactions in the Philippines. (underscoring supplied)

xxx xxx xxx

Aces Philippines failed to establish that the satellite air time fee payments are foreign-sourced.

The rule is that the taxpayer bears the burden of proving that the "income was from sources outside the Philippines and exempt from the application of our income tax law.

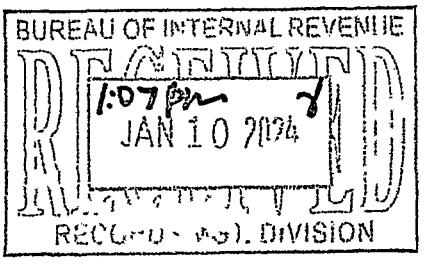
xxx xxx xxx

The statements merely narrated that the satellite is situated in outer space but did not contradict the finding that Aces Bermuda's service is completed and performed in the Philippines. (underscoring supplied)

xxx xxx xxx"

Q2: What are the existing cross-border services akin to that of *Aces vs. CIR*?

A2: International Service Provision (or cross-border services) - A service-based company operates in various countries, providing services to clients. The income earned is



allocated to the countries where the services are performed, taking into accounts factors such as the time spent, resources utilized, or value created in each jurisdiction. The source of income is determined by the location of the business activity rather than the disbursement or receipt of funds.

International service provision includes the following or similar transactions:

1. Consulting Services – A consulting firm based in one country provides advisory or consulting services to clients located in different countries. The firm may offer expertise in various areas such as management, finance, technology, or marketing. The consulting is carried abroad, but the results or outputs are used locally. The payment to the foreign consulting firm is considered an inflow of economic benefits to the foreign company. The income is sourced within the Philippines.

2. IT Outsourcing – A technology company in one country offers IT outsourcing services to businesses located in different countries. This can involve services like software development, system maintenance, network management, or customer support.

3. Financial Services – Banks, investment firms, or insurance companies operating internationally provide financial services to clients across borders. This can include services like asset management, wealth advisory, international banking, or insurance coverage.

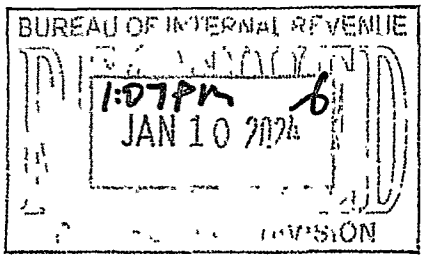
4. Telecommunications – Telecommunication companies offer services such as international calling, data connectivity, or internet services to customers located in different countries. These services enable global communication and connectivity.

5. Engineering and Construction – Engineering and construction firms undertake projects in different countries, providing services like architectural design, project management, infrastructure development, or construction services.

6. Education and Training – Educational institutions or training providers offer international programs, courses, or professional training to students or professionals from various countries. This can involve language courses, academic programs, vocational training, or skill development courses.

7. Tourism and Hospitality – Travel agencies, hotels, online booking application, or tour operators cater to tourists, providing services like, planning, accommodation, transportation, tour packages, or entertainment activities.

8. Other Similar Services – refers to services that are not specifically mentioned above but still follow the same concept of being provided, processed, or performed overseas and then utilized, applied, executed, or consumed within the Philippines.



Q3: Based on the above-discussion by the Court in *Aces Philippines*, how would you establish the situs of taxation for the aforesaid cross-border services?

A3: The revenue-generating activity occurs within the Philippines.

It is settled that the source of income is in the Philippines if the **property, activity or service** that produces the income is in the Philippines. The flow of wealth proceeded from, and occurred within the Philippine territory, enjoying the protection accorded by the Philippine government.

The source of income is not necessarily determined by the location where the payment is disbursed or physically received, but rather by the location where the underlying business activities that produced the income actually took place. This principle is crucial in cases where business transactions occur in multiple stages across different taxing jurisdictions. In such instances, **it becomes imperative to ascertain whether the particular stages occurring in the Philippines are so integral to the overall transaction that the business activity would not have been accomplished without them**. If the income-generating activities in the Philippines are deemed essential, the income derived from these activities would be considered as sourced from the Philippines for tax purposes, irrespective of where the payment is ultimately received. This principle aligns with the **benefits-received theory** in taxation, which submits that the jurisdiction providing the essential services or factors for income generation should be entitled to tax that income.

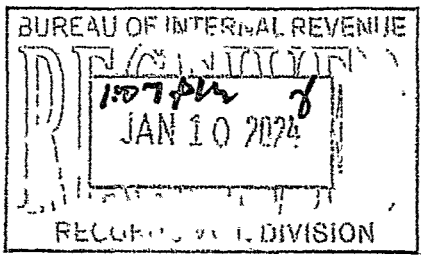
The payment or income generated from service fees paid to the foreign company, including those made through the internet or other electronic means with the use of IT, is considered an inflow of economic benefits in favor of the foreign company.

On the other hand, the utilization of these services indicates that they offer benefits to the local company and are considered necessary to its business operations. The decision to avail these services is made with the intent of their relevance and importance to the local company's operations, reflecting sound judgment at the initial stage before engaging in such services. The outcomes or results of these services are subsequently put into practical use, applied, or utilized within the local country.

Q4: What is the treatment of reimbursable or allocable expenses, especially for cross-border services between or among related parties?

A4: The reimbursable or allocable expenses charged by a foreign corporation in the Philippines should contribute to the value or benefit received by a local company. It includes charges to the local company, with the affiliates abroad facilitating the payment to other affiliates or third parties for common incurred expenses.

The reduction of expenses for a foreign corporation can be considered as income because it represents a financial gain or savings for the company, it effectively increases the foreign corporation's net income or profit. This is because the company is spending



less on its operations, resulting in additional funds that can be used for other purposes or retained as profit. Therefore, the reduction in expenses is viewed as a form of income for the foreign corporation.

Q5: What would be the effect if there are no benefits derived from the cross-border transactions?

A5: If there are no benefits derived by the Philippine company, then the payment becomes unnecessary for regular commercial activity and instead becomes a means of shifting profits to a foreign company. In other words, if the income is not generated through business activities conducted in the Philippines or does not provide any benefits to the local company, then, it may be seen as an attempt to evade taxes or manipulate profits by funneling them to a foreign entity.

The main point here is that the source of income should be determined by the location of the business activity that generates the income, rather than the location of the payout or where it is physically received. This perspective aligns with the principle that income should be taxed in the jurisdiction where the economic activity takes place and where the benefits of that activity are received.

Q6: What do you mean by the phrase, "*the source of income should be determined by the location of the business activity that generates the income, rather than the location of the payout or where it is physically received.*"?

A6: This principle is known as the source-based taxation principle. The jurisdiction where the economic activity occurs should have the right to tax the income derived from that activity, regardless of where the payment is made or received. This ensures that income is taxed in the jurisdiction (Philippines) where the economic activity occurs and, thus. prevent tax avoidance.

By attributing income to the source of the business activity, countries can maintain their tax base and ensure that they can collect taxes on income generated within their jurisdiction. This principle also promotes fairness in taxation by avoiding situations where income is artificially shifted or allocated to jurisdictions with more favorable tax regimes.

Q7: Are revenues generated from service fees paid to foreign companies or individuals, which are considered sources within the Philippines, also subject to VAT?

A7: As propounded above, the source of income is not determined by where the payout is disbursed or physically received, but rather by where the business activity that generated the income took place. Even if the services are conducted or paid abroad, but there are activities to be performed in the Philippines so essential that the entire service transaction cannot be accomplished without them, then, the benefit-received theory applies. This means that the revenue-generating activity actually occurs within the Philippines. The income generated by the foreign company providing the services, which are considered sources within the Philippines, shall be subject to income tax and, consequently to final withholding tax.

BUREAU OF INTERNAL REVENUE
RECEIVED
1:07 PM
JAN 10 2024
RECORDS MGT. DIVISION

In relation to VAT, it is important to note that Section 108(A), in relation to Section 114 of the NIRC of 1997, as amended, plays a significant role in determining the applicability of VAT on payments related to the sale or exchange of services and the use or lease of properties. This provision generally states that a twelve percent (12%) VAT is levied only if the services in question are performed within the Philippines.

The phrase "sale or exchange of services" encompasses a broad range of activities involving the provision of services in the Philippines to others in exchange for a fee, remuneration, or consideration. It includes any service performed within the country for the benefit of another party, whether it involves professional services, consulting, technical assistance, or any other form of service provision.

This includes income generated from service fees paid to foreign companies or individuals which is subject to VAT if the source of that income is within the Philippines. This means that even if the service provider is located outside the country, if the service is utilized, applied, executed or consumed for a recipient within the Philippines, the income payment for such service is considered sourced within the country and, thus, the VAT is applicable. Consequently, payment for such service shall be subject to final withholding VAT.

All internal revenue officers, employees and others concerned are hereby enjoined to give this Circular the widest dissemination and publicity as possible and strictly implement the provision thereof.

This Circular takes effect immediately.

ROMEO D. LUMAGUI, JR
Commissioner of Internal Revenue

BUREAU OF INTERNAL REVENUE
RECEIVED
1:07pm
JAN 10 2024
RECORDS DIVISION