REPUBLIKA NG PILIPINAS
KAGAWARAN NG PANANALAPI
KAWANIHAN NG RENTAS INTERNAS

July 30, 2007

REVENUE MEMORANDUM CIRCULAR NO. 50-2007

SUBJECT: **Tax Treatment of Sale, Barter or Exchange of Goods or Properties or Sale or Exchange of Services Made by Suppliers from the Customs Territory to Registered Freeport Zone Enterprises in the Subic Freeport Zone (SFZ), the Clark Freeport Zone (CFZ), as well as the Poro Point Freeport Zone (PPFZ), and Vice Versa under Sections 12 and 15 of Republic Act No. 7227, as amended by Republic Act No. 9400.**

TO: **All Internal Revenue Officers and Others Concerned**

SECTION 1. Scope. – This Circular is issued to clarify the tax treatment of the sale, barter or exchange of goods or sale or exchange of services or lease of properties made by suppliers from the customs territory to the registered Freeport Zone enterprises in the Subic Freeport Zone (SFZ), including the Clark Freeport Zone (CFZ), as well as the Poro Point Freeport Zone (PPFZ), and vice versa pursuant to the provisions of Sections 12 and 15 of Republic Act (RA) No. 7227, as amended by RA 9400, in relation to Sections 106(A)(2)(c) and 108(B)(3) of the Tax Code of 1997, as amended by RA 9337, and implemented by Sections 5, 6, 12, and 13 of Revenue Regulations (Rev. Regs.) No. 4-07 amending Sections 4.106-5, 4.106-6, and 4.108-6 of Rev. Regs. No. 16-2005.

SECTION 2. Background. – Pursuant to Sections 12 and 15 of RA 7227, as amended by RA 9400, the foregoing Freeport Zones shall be operated and managed as separate customs territories. The free flow or movement of goods and capital within, into and exported out of the said Freeport Zones, as well as the implementation of tax incentives and duty-free importations of raw materials, goods, and capital equipment shall be ensured. Being a separate customs territories, the exportation or removal of goods from the said Freeport Zones to the other parts of the Philippine territory shall be subject to customs duties and taxes under the Customs and Tariff Code, the Tax Code of 1997, as amended, and other relevant tax laws of the Philippines.

The Supreme Court reiterated the government's policy governing Freeport Zones under RA 7227 of "converting into alternative productive uses, former military reservations and their extensions, as well as providing them incentives to enhance the benefits that would be derived from them in promoting economic and social development." These Freeport Zones therefore, by legal fiction, are regarded as foreign territories. This legal fiction is necessary to give meaningful effect to the policies of the special law creating the said Freeport zone. *(CIR vs. Seagate Technology (Philippines), G.R. No. 153866, February 11, 2005 and CIR vs. Toshiba Information Systems (Philippines) Inc., G.R. No. 150154, August 9, 2005)*

Generally, products manufactured or produced within the SFZ, CFZ, and PPFZ are destined for export to foreign countries. While such products, under certain conditions, may also be sold to buyers in the customs territory, such sales are technically considered *as* importations by such buyers from the customs territory. Since these

Freeport Zones, as defined by law, are considered as separate customs territories, the buyer from the customs territory is treated as an importer and is subject to the corresponding customs duties and import taxes on his purchase of products from within these Freeport Zones.

The Philippine VAT Law adheres to the *"cross border doctrine"* of the VAT system, which basically means that no VAT shall be imposed to form part of the cost of goods destined for consumption outside the territorial border of the Philippine taxing authority. Hence, actual export of goods and services from the Philippines to a foreign country must be free of VAT. Conversely, those goods destined for use or consumption and services to be rendered within the Philippines shall be subject to the 12 % VAT. In explaining the "cross border principle", the Supreme Court ruled that (U)nder the cross border principle of the VAT system being enforced by the Bureau of Internal Revenue (BIR), no VAT shall be imposed to form part of the cost of goods destined for consumption outside of the territorial border of the taxing authority. If exports of goods and services from the Philippines to a foreign country are free of the VAT, then the same rule holds for such exports from the national territory — except specifically declared areas — to an Ecozone, or in this case, a Freeport Zone. (CIR *vs. Seagate and CIR vs. Toshiba; ibid)* -

In another decision *(Coconut Oil Refiners Association, Inc., et. al, vs Hon. Executive Secretary Ruben Torres, BCDA, et. al, G.R. NO. 132527, July 29, 2005),* the Supreme Court held that the provision on the incentives to SFZ, such as tax and duty-free importations of raw materials, goods and capital equipment, should be interpreted within the context and in a manner that would promote in the fullest manner the policy and object of the Legislature. In this decision, the Supreme Court ascertained the clear legislative intent thus: "For as long as the goods remain within the zone, whether we call it an economic zone or a freeport zone, for as long as we say in this law that all goods entering this particular territory will be duty-free and tax-free, for as long as they remain there, consumed there or re-exported or destroyed in that place, then they are not subject to duties and taxes in accordance with the laws of the Philippines."

The said Supreme Court decision specifically upheld that the establishment of duty-free shops within the SFZ which sell consumer items is still well within the policy enunciated in RA 7227, as long as the goods are not brought out of the zone. Hence, even individuals can be entitled to tax and duty free purchases of goods within the SFZ and for as long as these goods are not brought out of the Freeport Zone.

SECTION 3. Clarificatory Questions and Answers. -

Q1: How will the sale, barter or exchange of goods or properties into the Freeport Zone by suppliers/contractors from the Customs Territory be considered?

A1: Such transactions shall be considered as export sales in accordance with RA 7227, as amended by RA 9400, which provides that the Freeport Zones shall be operated and managed as a separate customs territory.

Moreover, Executive Order (EO) No. 226 provides that sales from the Customs Territory to export processing zones are considered as "export sales".

Q2: What will be the treatment of sale, barter, exchange or lease of goods, properties and sale or exchange of services to a registered Freeport Zone enterprise by sellers/contractors from the Customs Territory?

A2: If the seller is a VAT taxpayer, such sale, barter or exchange shall be subject to VAT at zero (0%) percent. If the seller is a non -VAT taxpayer, the transaction shall be exempt from VAT.

Q3: What is meant by a "zero-rated" sale and an "exempt" sale?

A3:. A zero-rated sale of goods, properties and/or services (by a VAT-registered person) is a taxable transaction for VAT purposes, but shall not result in any output tax. However, the input tax on purchases of goods, properties or services, related to such zero-rated sale, shall be available as tax credit or refund in accordance with existing regulations. Under this type of sale, no VAT shall be shifted or passed-on by VAT-registered sellers/suppliers from the Customs Territory on their sale, barter or exchange of goods, properties or services to the subject registered Freeport Zone enterprises.

A VAT-exempt transaction, on the other hand, refers to the sale of goods, properties or services or the use or lease of properties that is not subject to VAT (output tax) under Section 109 of the Tax Code of 1997, and the seller/supplier is not allowed any tax credit of VAT (input tax) on purchases related to such exempt transaction.

Q4: What is the difference between an automatically zero-rated sale and an effectively zero-rated sale?

A4: An automatically zero-rated sale refers to a sale of goods, properties and services to a Freeport Zone-registered enterprise by a VAT-registered seller/supplier that is regarded as either an export sale or a foreign currency denominated sale under Section 106 of the Tax Code of 1997.

An effectively zero-rated sale, on the other hand, refers to the local sale of goods, properties and services by a VAT-registered person to an entity that was granted indirect tax exemption under special laws or international agreements. Since the buyer is exempt from indirect tax, the seller cannot pass on the VAT and therefore, the exemption enjoyed by the buyer shall extend to the seller, making the sale effectively zero-rated.

Q5: What is the coverage of VAT zero-rating?

A5: The zero-rating will cover sale, barter, exchange or lease of all goods, properties and/or services by a VAT-registered seller/contractor from the Customs Territory to a Freeport Zone-registered enterprise and shall include, among others, the following:

a. The sale/supply of ordinary cars, vehicles, automobiles, specialized vehicles or other transportation equipment, provided that these are used exclusively within the subject special Freeport Zones;

b. The lease of properties by VAT-registered lessors, provided that such properties are located within the subject Freeport Zones;

c. The sale/supply of electricity by the National Power Corporation ("NPC") or by any other VAT-registered seller/supplier from the Customs Territory, to any registered Freeport Zone enterprise engaged in the distribution of power or electricity within the subject Freeport Zones; and

d. The sale/supply of services, provided such services are rendered or performed within the Freeport Zone.

Q6: Since the Freeport Zones are considered as foreign soil and therefore, a separate tax jurisdiction, what is the VAT treatment of sale, exchange, barter or lease of goods, properties and/or services by a Freeport Zone-registered enterprise or Resident within the Freeport Zone?

A6: Such sale, exchange, barter or lease of goods, properties and services within the subject Freeport Zones shall be exempt from VAT. The following transactions are covered under this exemption:

a. All transactions between and/or among two registered Freeport Zone Enterprises or Residents;

b. Consumer goods purchased and consumed within the Freeport Zones;

c. Sale/supply of services, including power or electricity, by a Freeport Zone-registered enterprise or resident within the Freeport Zone, regardless of whether or not the buyer or customer is a registered Freeport Zone enterprise or Zone Resident, provided that said power/ electricity or services are rendered, used or consumed within the Freeport Zone; and

d. The lease of properties owned by Freeport Zone-registered enterprises or Residents, provided that such properties are located within the subject Freeport Zones.

Q7: What is the tax treatment for the income of Freeport Zone-registered enterprises derived from sources in the Customs Territory?

A7: Freeport Zone-registered enterprises may generate income from sources within the Customs Territory of up to thirty percent (30%) of its total income from all sources; provided, that should a Freeport Zone-registered enterprise's income from sources within the Customs Territory exceed thirty percent (30%) of its total income from all sources, then it shall be subject to the income tax laws of the Customs Territory; provided further, that in any case, customs duties and taxes must be paid with respect to transactions, receipts, income and sales of articles to the Customs Territory and in the Customs Territory.

Q8: What is the tax treatment of sale, barter or exchange of goods and properties by Freeport Zone-registered enterprises to a buyer from the customs territory? (i.e. from the Freeport Zone into the Customs Territory)

A8: The sale, barter or exchange shall be treated as a technical importation made by the buyer in the customs territory. The buyer shall be treated as the importer and shall be imposed the corresponding import taxes and duties prior to release of the goods or merchandise from Customs custody. Any unpaid taxes thereon, aside from being the prime liability of the buyer-importer, shall constitute a lien on such goods or merchandise imported from the Freeport Zone.

Q9: What is the tax treatment of a sale of service or lease of properties (machineries and equipment) by Freeport Zone-registered enterprises to a customer or lessee from the Customs Territory?

A9: The sale of service shall be exempt from VAT if the service is performed or rendered within the Freeport Zone.

The lease of properties, on the other hand, shall likewise be exempt from VAT if the property is located within the Freeport Zone. However, if the properties (machineries and equipment) leased by the Freeport Zone-registered enterprise is located outside of the Freeport Zone, payments to such enterprise will be considered as royalties and subject to the final withholding VAT of 12%.

Q10: What are the documentary requirements to be submitted by Freeport Zone-registered enterprises to the BIR to be entitled to the tax benefits clarified in this Circular?

A10: 1. Certificate of Registration and Tax Exemption as a Freeport Zone-registered Enterprise;

2. Copies of relevant documentation of the legal status of the business enterprise (Articles of Incorporation, Partnership Agreement, SEC Registration and similar documents) showing, among others, beneficial ownership;

3. If a corporation, partnership or other business enterprise is organized or constituted outside the Philippines, the name, address of the legal agent of the enterprise in the Freeport Zone accompanied by sworn proof of consent of the agent to serve as such;

4. Evidence of the physical location of the business enterprise within the Freeport Zone, such as certificate of title, tax declaration, property deed, lease agreement and similar documents;

5. If previously part of a larger business enterprise doing business elsewhere in the Philippines, evidence of restructuring to exclude all business operations taking place inside the boundaries of the Freeport Zone; and that the unit left to operate inside the Freeport Zone is organized as a separate legal entity.

6. List of assets comprising the investment to be made; and

7. Such other documents as the BIR may require.

SECTION 4. Repealing Clause. — All BIR Rulings or issuances inconsistent herewith, are hereby considered amended, modified or revoked accordingly.

All revenue officials concerned are requested to give this Circular as wide a publicity as possible.

(Original Signed)
LILIAN B. HEFTI
OIC-Commissioner of Internal Revenue