REPUBLIKA NG PILIPINAS
KAGAWARAN NG PANANALAPI
KAWANIHAN NG RENTAS INTERNAS

February 8, 2005

REVENUE REGULATIONS NO. 2-2005

SUBJECT: **Consolidated Revenue Regulations Implementing Relevant Provisions of Republic Act No. 7227 otherwise known as "*Bases Conversion and Development Act of 1992*", Republic Act 7916 as amended otherwise known as "*Special Economic Zone Act of 1995*", Republic Act No. 7903 otherwise known as "*Zamboanga City Special Economic Zone Act of 1995*" and Republic Act No. 7922 otherwise known as "*Cagayan Special Economic Zone Act of 1995*" Thereby Amending Revenue Regulations No. 1-95 as amended by Revenue Regulations No. 16-99.**

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

SECTION 1. Scope. - Pursuant to the provisions of Sections 244 and 245 of the National Internal Revenue Code of 1997 as amended, these regulations are hereby promulgated to implement:

1. Sections 12(b) and 12(c) of Republic Act No. 7227 governing businesses and enterprises within the Subic Special Economic and Freeport Zone (SUBIC-ECOZONE);

2. Sections 23, 24, 26, 50 and 51 of Republic Act No. 7916 governing businesses and enterprises within the Special Economic Zones (ECOZONE);

3. Sections 4(e) and 4(f) of Republic Act No. 7903 governing businesses and enterprises within the Zamboanga City Special Economic Zone (ZAMBO-ECOZONE); and

4. Sections 4(b) and 4(c) of Republic Act No. 7922 governing businesses and enterprises within the Cagayan Special Economic Zone and Free Port (CAGAYAN-ECOZONE)

SECTION 2. Definitions - For purposes of these Regulations the terms used herein shall be construed to have the following meanings:

a. ***SUBIC-ECOZONE*** — refers to the Subic Special Economic and Freeport Zone, created under Section 12 of RA No. 7227.

b. ***SUBIC-ECOZONE Registered Enterprise*** — refers to any business entity or concern located within the SUBIC-ECOZONE and duly registered with and/or licensed by the SBMA to operate any lawful economic activity within the SUBIC-ECOZONE.

c. ***SUBIC-ECOZONE Facilities Operator*** — refers to a SUBIC-ECOZONE Enterprise which operates facilities or services within the SUBIC-ECOZONE, including the subleasing of land or other property to other SUBIC-ECOZONE Enterprise

d. ***SBMA*** — refers to the Subic Bay Metropolitan Authority, established and created pursuant to Section 13 of the Republic Act No. 7227

e. ***ECOZONES*** or ***"Special Economic Zones"***- shall refer to selected areas with highly developed or which have the potential to be developed into agro-industrial, industrial, tourist, recreational, commercial, banking, investment and financial centers established in accordance with Sec 5 & 6 of Republic Act No. 7916.

f. ***ECOZONE Registered Enterprise*** – refers to any business entity or concern within the ECOZONE duly registered with and/or licensed by the PEZA to operate any lawful economic activity within the ECOZONE. An ECOZONE Registered Enterprise may be classified as follows:

f.1 ***"ECOZONE Export Enterprise"*** - refers to an individual, association, partnership, corporation or other form of business organization which has been registered with the PEZA to engage in manufacturing, assembling or processing activity falling within the purview of the Act and resulting in the exportation of 100% of its production, unless a lower percentage of its production for exportation is prescribed by the PEZA Board subject to such terms and conditions as the latter may determine.

f.2 ***"ECOZONE Domestic Market Enterprise"*** - refers to an individual, association, partnership, corporation or other form of business organization which has been registered with the PEZA to engage in manufacturing, assembling or processing

activity falling within the purview of the Act resulting in the sale of its finished products in the customs territory or in the non-restricted or authorized areas within the ECOZONE in its entirety or if exporting a portion of its production output, it continually fails to export at least fifty percent (50%) thereof for a period of three (3) years without any justifiable reason in case at least 60% of its working capital is owned by Philippine nationals or in case more than 40% of its working capital is owned by foreign nationals, it continually fails to export at least seventy percent (70%) of its production output for a period of three (3) years without any justifiable reason.

f.3 "***ECOZONE Pioneer Enterprise***" - shall mean an ECOZONE enterprise (1) engaged in the manufacture, processing or production and not merely in the assembly or packaging of goods, products, commodities or raw materials that have not been or are not being produced in the Philippines on a commercial scale or (2) which uses a design, formula, scheme, method, process or system of production or transformation of any element, substance or raw materials into another raw material or finished goods which is new and untried in the Philippines or (3) which produces non-conventional fuels or manufactures equipment which utilizes non-conventional sources of energy or uses or converts to coal or other non-conventional fuels or sources of energy in its production, manufacturing or processing operations: or (4) engaged in the pursuit of agri-export processing zone development or (5) given such status under the Investment Priorities Plan: Provided, That the final product in any of the foregoing instances involves or will involve substantial use and processing of domestic raw materials, whenever available, taking into account the risk and magnitude of investment.

f.4 "***ECOZONE Free Trade Enterprise***" - refers to an individual, association, partnership, corporation or other form of business organization which has been registered with the PEZA to engage in the importation of goods or merchandise within the restricted or free trade area in the ECOZONE tax and duty-free for immediate transshipment or for storage, repacking, sorting, mixing or manipulation and subsequent exportation unless the Board allows the sale thereof in the customs territory subject to the payment of customs duties and internal revenue taxes and to such other terms and conditions as it may determine.

f.5 "***ECOZONE Utilities Enterprise***" - shall refer to a business entity or concern within the ECOZONE duly registered with and/or franchised/licensed by the PEZA with or without the incentives provided under Republic Act No. 6957, as amended, (the Build-Operate-Transfer Law) and/or with or without financial exposure on the part of the PEZA, such as contractors/operators of light and power systems, water supply and distribution systems, communications and transportation systems within the ECOZONE and other similar or ancillary activities as may be determined by the PEZA Board.

f.6 ***"ECOZONE Facilities Enterprise"*** - shall refer to a business entity or concern within the ECOZONE duly registered with and/or franchised/licensed by the PEZA with or without incentives provided under Republic Act No. 6957, as amended, (the Build-Operate-Transfer Law) and/or with or without financial exposure on the part of the PEZA such as contractors/operators of buildings, structures, warehouses, site development and road network, ports, sewerage and drainage system and other facilities for the development, operation and maintenance of the ECOZONE and other similar or ancillary activities as may be determined by the PEZA Board.

f.7 ***"ECOZONE Developer/Operator"*** - refers to a business entity or concern duly registered with and/or licensed by the PEZA to develop, operate and maintain an ECOZONE or any or all of the component IE, EPZ, Free Trade Zone or Tourist/Recreational Center and the required infrastructure facilities and utilities such as light and power system, water supply and distribution system, sewerage and drainage system, pollution control devices, communication facilities, paved road network, administration building and other facilities as may be required by the PEZA. The term shall include the PEZA and/or the Local Government Unit when by themselves or in joint venture with a qualified private entity, shall act as the Developer/Operator of the ECOZONES. As such, they shall be entitled to the same incentives under Rule XIV of these Rules in accordance with the pertinent provisions of Republic Act No.7916 and the Omnibus Investments Code.

f.8 ***"ECOZONE Service Enterprise"*** - shall refer to a business entity or concern within the ECOZONE such as but not limited to those engaged in customs brokerage, trucking/forwarding services, parcel services, janitorial services, security services, insurance, and/or banking services, consultancy services, restaurants or such other services within the ECOZONE as

may be determined by the Board, duly registered and/or licensed by the PEZA whose income derived within the ECOZONE shall be subject to taxes under the National Internal Revenue Code pursuant to Section 25 of the Republic Act No. 7916 as amended by Republic Act No. 8748.

f.9 ***"ECOZONE Tourism Enterprise"*** - shall refer to an individual, association, partnership, corporation or other business organization duly registered with the PEZA proposing to engage in the establishment and operation of tourist-oriented accommodations, restaurants operated as an integral part of a tourism facility (e.g. hotels, resorts, recreational centers), sports and recreational facilities within the ECOZONE.

g. ***Restricted Area*** - shall mean a specific area within the ECOZONE, which has been classified and/or fenced-in as export processing zone, free trade zone or such other similar areas as may be declared by governing Board.

h. ***PEZA*** – shall refer to the Philippine Economic Zone Authority

i. ***ZAMBO-ECOZONE*** – refers to the Zamboanga City Special Economic Zone and Freeport created pursuant to Sec. 3 of the Republic Act No. 7903.

j. ***ZAMBO-ECOZONE Enterprise*** — refers to any business entity or concern within the ZAMBOECOZONE, duly registered with and/or licensed by the ZAMBOECOZONE Authority to operate any lawful economic activity within the ZAMBOECOZONE.

k. ***ZAMBOECOZONE Authority*** – refers to the Zamboanga City Special Economic Zone Authority created under Sec. 5 of Republic Act No. 7903.

l. ***CAGAYAN-ECOZONE*** – refers to the Cagayan Special Economic Zone and Freeport created pursuant to Sec. 3 of the Republic Act No. 7922.

m. ***CAGAYAN-ECOZONE Enterprise*** — refers to any business entity or concern within the CAGAYAN-ECOZONE, duly registered with and/or licensed by the CEZA to operate any lawful economic activity within the CAGAYAN-ECOZONE.

n. ***CEZA*** – refers to Cagayan Economic Zone Authority created under Sec. 5 of Republic Act No. 7922.

o. ***Zone*** – refers to the SUBIC-ECOZONE, ECOZONES, ZAMBO-ECOZONE or CAGAYAN-ECOZONE, as the context may require.

p. ***Resident*** — refers to any individual who is registered and authorized by the SBMA, PEZA, ZAMBOECOZONE Authority or CEZA to establish and maintain a personal residence in the Zone where they are registered.

q. ***Certificate of Registration*** — refers to the certificate issued by the SBMA, PEZA, ZAMBO-ECOZONE Authority or CEZA evidencing the registration of the business entity as an Enterprise in the applicable Zone where registered.

r. ***Certificate of Residency*** — refers to the certificate issued by the SBMA, PEZA, ZAMBO-ECOZONE Authority or CEZA evidencing the registration of an individual as a Resident of the applicable Zone where registered.

s. ***Date of Registration*** – shall refer to the date appearing in the Certificate of Registration or Certificate of Residency

t. ***Customs*** — means the Philippine Bureau of Customs

u. ***Customs Territory*** — refers to the portion of the Republic of the Philippines outside of SUBIC-ECOZONE, ECOZONE, ZAMBO-ECOZONE or the CAGAYAN-ECOZONE, as the case maybe.

v. ***Articles*** — refers to any goods, wares, merchandise and in general, any thing which under the Tariff and Customs Code of the Philippines or other laws may be made or is the subject of importation or exportation.

w. ***Domestic Articles*** — refers to articles which are the growth, produce, or manufacture of the Philippines on which all national internal revenue taxes have been paid, if subject thereto, and upon which no drawback or bounty has been allowed; and articles of foreign origin on which all duties and taxes have been paid and upon which no drawback or bounty has been allowed, or which have previously been entered into Customs Territory free of duties or taxes.

x. ***Foreign Articles*** — refers to articles of foreign origin on which duties and taxes have not been paid, or if paid, upon which drawback or a bounty has been allowed, or which have not previously been entered into Customs Territory; or articles which are the growth, produce, or manufacture of the Philippines on which not all national internal

revenue taxes have been paid, if subject thereto, or if paid, upon which drawback or a bounty has been allowed.

y. ***Transshipment*** — refers to transshipment of articles discharged at ports or airports of entry located in Customs territory destined for delivery and actually delivered to the Zone, and articles coming from the latter intended for export and actually exported thru a Philippine Customs port/airport of entry which may be transported under bond, upon examination, and consigned to the Collector at the port of destination/export who will allow the consignor or consignee, as the case may be, to make entry exportation.

z. ***Retail Sale*** — refers to the sale of articles in the Zone, in small quantities to any person, natural or juridical, for his/her/its own personal use and account and not for resale.

aa. ***Foreign Exchange*** — shall mean any currency other than the Philippine Peso acceptable for international reserve or authorized for international transaction by the Central Bank of the Philippines.

SECTION 3. National Tax Exemption and Incentives to Zone Registered Enterprises - All ECOZONE-registered enterprises, CAGAYAN-ECOZONE registered enterprises and ZAMBO-ECOZONE registered enterprises who are covered by the special tax regime of 5%, including all SUBIC-ECOZONE registered enterprises doing business within the Zone shall enjoy the following:

a. Exemption from national internal revenue taxes on importations of raw materials for manufacture and actually manufactured into finished products, and capital goods and equipment needed for their business operation, within the Zone. Removal of raw materials, capital goods, equipment and consumer items out of the Zone for sale to non-Zone registered enterprises shall be subject to the usual taxes and duties provided for in Republic Act No. 7227 for SUBIC-ECOZONE.

b. Exemption from the national internal revenue taxes, such as gross receipts tax, VAT, ad valorem and excise taxes on their sales of goods and services for which they shall otherwise have been directly liable, except for local sales as discussed in sub-section f of this Section and unless provided for in other laws to the contrary.

c. Exemption from franchise, common carrier or value added taxes and other percentage taxes on public and service utilities and enterprises within the Zone for services rendered within Zone.

d. Preferential tax treatment on income earned/derived from business operations within the Zone or from foreign sources. However, in the case of telecommunications service, the income of the enterprise within the Zone shall be net of the share of the foreign telecommunications company, and in the case of common carriers by land, air or water, only that portion of the income and expenses for the transport of cargoes and passengers within the Zone shall be covered by the preferential income tax treatment and what is not covered shall be subject to the regular corporate income tax.

e. Purchases from enterprises in the Customs Territory of raw materials forming part of finished goods exported by the Zone registered enterprises shall be considered effectively zero-rated or exempt for VAT purposes depending on the fiscal incentives availed of by the Zone registered enterprise. The application of this rule on VAT will however be covered by a separate Revenue Regulations discussing in particular the VAT implications of transaction within, into and outside the Zone.

f. Zone registered enterprises may generate income from sources within the Customs Territory of but up to Thirty Percent (30%) of its total income from all sources only. All of the income of Zone registered enterprises generated from sources within the Customs Territory shall be subject to the internal revenue laws of the Customs Territory and the regular internal revenue taxes and rate imposed for enterprises in the Customs Territory.

   Provided, however, that in the event SUBIC-ZONE registered enterprises shall generate income from sources within the Customs Territory in excess of thirty percent (30%) of its total income from all sources, all of its income shall be subject to the regular internal revenue tax rate imposed for enterprise in the Customs Territory.

g. Carriers who undertake to transship articles to and/or from the Zone to a Customs Bonded warehouse within the Customs Territory shall be bonded in an amount to be determined by the SBMA, PEZA, ZAMBO-ECOZONE Authority or CEZA and Bureau of Customs which shall not be less than fifty thousand (P50,000) pesos conditioned upon the carrier transporting and delivering without delay, and in accordance with rules and regulations in effect in the Customs Territory, to the Collector of Customs at the port of destination/export. The provisions of the Tariff and Customs Code, as amended, on transshipment, and its implementing regulations shall govern cases of transshipment for foreign articles to and/or from the Zone.

h. Articles which are manufactured in the Zone and exported therefrom to a foreign country shall, upon subsequent importation into customs territory, be subject to the laws on importation applicable to like articles manufactured in a foreign country.

Business enterprises operating within the Zone, but which are not registered by or accredited with SBMA, PEZA, ZAMBO-ECOZONE Authority or CEZA shall not be entitled to the preferential tax treatment provided for in Section 12(c) of the Republic Act No. 7227; Section 24 of Republic Act No. 7916; Section 4(f) of Republic Act No. 7903; and Section 4(c) of Republic Act No. 7922.

SECTION 4. Tax and Fiscal Obligation - Pursuant to Section 12(c) of the Republic Act No. 7227; Section 24 of Republic Act No. 7916; Section 4(f) of Republic Act No. 7903; and Section 4(c) of Republic Act No. 7922:

a. Zone registered enterprises doing business within the Zone shall, in lieu of local and national taxes, be liable to the pay 5% of gross income earned, broken down as follows:

RA 7227 **Subic-Ecozone**	**RA 7916** **Ecozones**	**RA 7903** **Zambo-Ecozone**	**RA 7922** **Cagayan-Ecozone**
(1) 3% to the National Government; (2) 1% to the Local Government units affected by the declaration of the Zone; and (3) 1% to the Special Development Fund to be utilize for the development of municipalities outside the City of Olongapo and the Municipality of Subic and other municipalities contiguous to the base area	(1) 3% to the National Government; (2) 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	(1) 2% to the National Governme nt; (2) 2% to the City of Zamboang a; and (3) 1% to the barangay special development fund, which is hereby created, for the development and improvement of the barangays within the City of Zamboanga	(1) 2% to the national government; (2) 1% to the Province of Cagayan; (3) ½% to be shared by municipalities affected by the declaration of the Zone in proportion to their income from business activities within the Zone; and (4) 1 ½% to the CEZA

b. The equivalent amount of tax paid/payable to the National Government of the Philippines shall be considered for purposes of any claim for credit against taxes paid to foreign government by the

foreign corporation accredited by the SBMA, PEZA, ZAMBO-ECOZONE Authority or CEZA to operate within the Zone.

c. Zone registered enterprises operating within the Zone shall be responsible for the safekeeping and accounting of all articles received by them. Articles which are missing or cannot be accounted for in the Zone shall be presumed to have been transferred to the Customs Territory without permit and therefore subject to taxes and duties.

   Articles which are found in the Zone but cannot be accounted for in the records of a zone registered enterprise shall be treated as having been received in the Zone without permit and therefore should be reported to the SBMA, PEZA, ZAMBO-ECOZONE Authority or CEZA and the Bureau of Customs.

d. A zone registered enterprise operating within the Zone shall be constituted as withholding agent for the government (1) if it acts as an employer and its employees receive compensation income subject to the withholding tax under Sec. 72 (a), Chapter X, Title II of the NIRC as implemented by Revenue Regulations No. 12-86 as amended, or (ii) if it makes income payments to individuals or corporations subject to the expanded withholding tax pursuant to Sec. 50 (b) of the NIRC, as amended, and as implemented by Revenue Regulations No. 6-85 as amended; or (iii) if it makes payment/remittance of certain income subject to the final withholding tax under Sec. 50 (a) in relation to Sec. 51 of the NIRC.

e. Interest from any Philippine currency bank deposits and yield or any other monetary benefit from deposit substitutes, and from trust fund and similar arrangements received by a zone registered enterprise engaged in business within the Zone shall be subject to the internal revenue taxes under the National Internal Revenue Code as amended.

SECTION 5. Removal or Withdrawal from the Zone to Customs Territory - Notwithstanding the above-mentioned tax and duty exemptions, foreign articles removed, withdrawn or otherwise disposed to the customs territory, shall be subject to the payment of customs duties and internal revenue taxes as ordinary importations in accordance with the provisions of the Tariff and Customs Code of the Philippines, as amended and National Internal Revenue Code and other applicable laws. Articles removed customs territory will be presumed to be foreign unless there is sufficient evidence presented to satisfy Customs officials that they are domestic articles, as defined in these regulations.

SECTION 6. Service Establishments - On income derived service establishments within the Zone, the following rules shall apply:

a) On income derived within ECOZONES: All income derived by persons and by all service establishments rendering their services within the ECOZONES, whether registered or not with PEZA, which may qualify as ECOZONE Service Enterprise as defined herein shall be subject to all internal revenue taxes under the National Internal Revenue Code, as amended.

However, all service establishments registered with the PEZA as ECOZONE locators which export their services or are rendering their services abroad through the use of information technologies shall remain to enjoy the five percent (5%) preferential tax rate under these revenue regulations, provided that such services are paid in foreign currency inwardly remitted through the Banko Sentral ng Pilipinas.

b) On income derived within SUBIC-ECOZONE, ZAMBO-ECOZONE and CAGAYAN-ECOZONE: all income derived by persons shall be subject to withholding taxes under existing tax laws, rules and regulations. All income derived by service establishments within SUBIC-ECOZONE, ZAMBO-ECOZONE and CAGAYAN-ECOZONE shall be subject to the five percent (5%) preferential tax rate, provided that such services are paid in foreign currency inwardly remitted through the Banko Sentral ng Pilipinas.

SECTION 7. Gross income earned – For purposes of the application of these Regulations "gross income earned" shall refer to gross sales or gross revenue derived from registered business activity within the Zone net of sales discounts, sales returns and allowances minus cost of sales or direct costs but before any deductions for administrative, marketing, selling, operating expenses or incidental losses during a given taxable. For financial enterprises, gross income shall include interest income, gains from sales, and other income.

For purposes of computing the total five percent (5%) tax rate imposed by Republic Act No. 7227, Republic Act No. 7903, Republic Act No. 7922 and Republic Act No. 7916, the cost of sales or direct cost shall consist only of the following cost or expense items which shall be computed in accordance with Generally Accepted Accounting Principles (GAAP):

For SUBIC-ECOZONE, ZAMBO-ECOZONE and CAGAYAN-ECOZONE -

1) **Trading Enterprises:**

- Cost of Sales
  (Cost of Sales which is equal to Inventory beginning plus purchases minus Inventory of goods ending)

2) **Manufacturing enterprises:**

- Direct salaries, wages or labor expenses
- Production supervision salaries
- Raw materials used in the manufacture of products
- Decrease in Goods in Process Account (Intermediate goods)
- Decrease in Finished Goods Account
- Supplies and fuels used in production
- Depreciation of machineries and equipment used in production
- Rent and utility charges associated with building, equipment and warehouses used in production
- Financing charges associated with fixed assets used in production the amount of which were not previously capitalized

3) **Services enterprises:**

- Direct salaries, wages or labor expense
- Service supervision salaries
- Direct materials, supplies used
- Depreciation of machineries equipment used in the rendition of registered services
- Financing charges associated with fixed assets used in the service business the amount of which were not previously capitalized

- Rent and utility charges for buildings and capital equipment used in the rendition of registered services

For ECOZONES under RA No. 7916 -

1. **ECOZONE Export Enterprises, Free Trade Enterprises and Domestic Market Enterprises:**
   - Direct salaries, wages or labor expenses
   - Production supervision salaries
   - Raw materials used in the manufacture of products
   - Decrease in Goods in Process Account (intermediate goods)
   - Decrease in Finished Goods Account
   - Supplies and fuels used in production
   - Depreciation of machinery and equipment used in production
   - Rent and utility charges associated with building, equipment and warehouses used in production
   - Financing charges associated with fixed assets used in production the amount of which were not previously capitalized

2. **ECOZONE Developer/Operator, Facilities, Utilities and Tourism Enterprises:**
   - Direct salaries, wages or labor expense
   - Service supervision salaries
   - Direct materials, supplies used
   - Depreciation of machinery and equipment used in registered activities
   - Financing charges associated with fixed assets used in registered activities the amount of which were not capitalized
   - Rent and utility charges for buildings and capital equipment used in undertaking registered activities

SECTION 8. Repealing Clause – Revenue Regulations No. 1-95 and 16-99 are hereby repealed. Any existing regulations, order or instructions or portions thereof that are inconsistent with these regulations are likewise repealed, amended or modified accordingly.

SECTION 9. Effectivity Clause - These regulations shall take effect fifteen (15) days after publication in a newspaper of general circulation in the Philippines.

(Original Signed)
JUANITA D. AMATONG
Secretary of Finance

Recommending Approval:

(Original Signed)
GUILLERMO L. PARAYNO, JR.
Commissioner of Internal Revenue