Recto proposal for 6% growth seen less likely to expand deficit

THE Development Budget Coordination Committee (DBCC) needs to adjust its growth and fiscal targets to lower the risk of a revenue shortfall that would widen the deficit, analysts said.

Finance Secretary Ralph G. Recto had earlier called on the DBCC to adjust its growth targets this year and in the medium term to be "more realistic."

He said the economy could aim for 6% gross domestic product (GDP) growth, but keep 6.5% as an aspirational target.

"If you project a very high GDP, then you're projecting a very high revenue, and if you miss it, your deficit will increase and your debt to GDP will also increase," he told reporters on the sidelines of an Economic Journalists Association of the Philippines event last week.

"Underpromise but overdeliver, that's what I believe," he said.

Last year, the DBCC narrowed its GDP growth target range to 6.5-7.5% from 6.5-8% previously. The economy grew 5.6% in 2023, falling short of the DBCC goal for the year and underperforming the 7.6% expansion in 2022.

The DBCC is also projecting 6.5-8% economic growth from 2025 until 2028.

Economic managers have yet to release a decision on whether they will maintain or revise targets.

To achieve GDP targets, the government should bolster revenue collection and asset privatization, Mr. Recto said.

"We will push not only the BIR [Bureau of Internal Revenue], not only the BoC (Bureau of Customs), the GoCCs (government-owned and -controlled corporations) to pay more dividends... [we are looking] to collect more effectively fees and charges, not only taxes, [and] do some privatization."

Last week, the Finance Secretary proposed the idea to sell and develop the Ninoy Aquino International Airport's 600-hectare property to generate revenues for the government.

Security Bank Corp. Chief Economist Robert Dan J. Roces welcomed the more realistic fiscal targets, citing global and domestic uncertainties.

"The Finance Secretary's adjusted expectations of 6-6.5% reflect a nuanced approach, considering potential shifts in policy to support economic stability and growth, and the potential volatility to markets that these shifts may cause," Mr. Roces said in a Viber message.

Key industries like manufacturing, construction, and services are expected to lead the drive to hit the growth targets, Mr. Roces said.

However, enhanced regulation and ease of doing business should also help stimulate investment and ensure growth, he added.

On the other hand, agriculture and external trade could pose a drag on GDP growth, Mr. Roces said.

"Agriculture and external trade face headwinds that could temper growth, so this will highlight the importance of targeted policy measures to mitigate risks and capitalize on opportunities for sustainable economic advancement."

Agriculture sector has suffered P1.75 billion worth of damage from El Niño, the Agriculture department said last week, with the dry conditions expected to last until the second quarter.

Key exports that suffered negative year-on-year growth in January included wearables, electronic telecommunication products, cathodes and refined copper, and other mineral products.

Albay Rep. Jose Ma. Clemente S. Salceda, who heads the House Committee on Ways and Means, said the government should manage rice prices — which account for one fifth of poor households' spending — to help meet growth targets.

"The more expensive the rice, the less the budget is for other things, the slower economic activity becomes," he said in a Viber chat.

Rice inflation accelerated to 23.7% in February from 22.6% in January and 2.2% a year earlier, according to the Philippine Statistics Authority. — **Beatriz Marie D. Cruz**

Vietnam ride-sharing firm eyes Philippine operations using EVs

A VIETNAM ride-sharing company, Green and Smart Mobility Joint Stock Co. (GSM) has expressed interest in entering the Philippine market this year, according to the Board of Investments (BoI).

In a statement, the BoI said GSM is a private company within the Pham Nhat Vuong group, which also owns conglomerate Vingroup Co.

"The company aims to provide eco-friendly taxi services utilizing VinFast electric cars exclusively in 2024. This electric taxi service underscores GSM's commitment to promote sustainable EV transportation in the region," the BoI said.

According to the investment promotion agency, BoI Executive Director Evariste M. Cagatan and GSM Global Chief Executive Officer Thanh Nguyuen met on March 20.

"The company will be applying for BoI registration and will also apply for green lane (expedited permit processing). The company is still preparing documents for the Securities and Exchange Commission registration application," the BoI said.

The company's planned expansion in the Philippines is expected to be governed by the Energy Efficiency Conservation Act, apart from the various incentive-granting laws.

"The company's planned project is aligned with the government's direction in attracting sustainability-driven investments, particularly in our transition towards electric mobility," the BoI said.

Early this year, officials of VinFast met with Trade Secretary Alfredo E. Pascual on its plan to sell electric vehicles (EVs) through a dealership network targeted to begin operations next month.

Aside from encouraging the Vietnamese company to invest in the EV sector Mr. Pascual also invited the company to look into the country's tourism and healthcare sectors. — **Justine Irish D. Tabile**

BoI pitches green metals investments to US, Canadian, Australian companies

THE Board of Investments (BoI) said on Monday that it has invited US, Canadian, and Australian firms to invest in Philippine green metals and mineral processing operations.

In a statement, the BoI said that the Philippine business delegation made the pitch on the sidelines of the Prospectors & Developers Association of Canada 2024 conference. The conference highlighted the Philippines as a hub for innovation and sustainability-driven industries.

"With its strategic location and abundant human and natural resources, the country aims to emerge as the preferred destination for priority sectors such as electric vehicles (EVs), smart manufacturing, semiconductors and electronics, green metals, high-tech agriculture, renewable energy (RE), and data centers or telecommunications," the BoI said.

It added that the country's abundant mineral resources — approximately 9 million hectares of land with potential for copper, nickel, iron, chromite, cobalt, gold, and rare earth elements — will be needed for the global energy transition.

"Our intention right now is to have our minerals processed locally to supply local industry needs or export higher-value materials," said Ma. Corazon Halili-Dichosa, BoI executive director for industry development services.

The BoI said that the companies the Philippine delegation presented to are from the mining, mineral processing, battery materials, consultancy, and academic sectors.

No commitments were received during the event.

"However, several follow-through meetings are being arranged for companies seeking partnerships in mineral processing. Notably, one company expressed interest in visiting the Philippines in the third quarter," it added.

Also, part of the Philippine business delegation were the Chamber of Mines of the Philippines and the Philippine Nickel Industry Association, which highlighted three major copper-gold projects: King-king, Tampakan, and Silangan.

On March 15, the Philippines, through the Department of Environment and Natural Resources, granted a mineral production sharing agreement to Makilala Mining Co., Inc., which is a subsidiary of Australian exchange-listed exploration and development company Celsius Resources.

The project, called Malinao-Caiguna-Biyog Mining Project, is located in the Cordillera Administrative Region and is the first copper project to be approved in the Philippines in 15 years.

The permit allows the company to undertake exploration for 25 years within the contract area, which covers approximately 2,500 hectares, and is renewable for another 25 years. — **Justine Irish D. Tabile**

OPINION

Further clarifications on taxation of cross-border services

LET'S TALK TAX
SHARMAINE LOUISE SANCHEZ-JIMENEZ

In our previous article, "Taxation of cross-border services," we featured Revenue Memorandum Circular (RMC) No. 5-2024, in which the Bureau of Internal Revenue (BIR) clarified the proper tax treatment of cross-border services in light of the Supreme Court En Banc Decision in Aces Philippines Cellular Satellite Corp. vs. The Commissioner of Internal Revenue (CIR) and provided a new framework for assessing the final withholding tax and the final withholding value-added tax (VAT) on services provided by non-resident foreign corporations (NRFCs) to Philippine businesses.

Let us briefly recall the salient provisions of RMC No. 05-2024 in our previous article.

LIST OF CROSS-BORDER TRANSACTIONS AKIN TO THAT OF ACES VS CIR

The RMC defined cross-border services as those provided by service-based companies operating in various jurisdictions where income earned is allocated to the countries where the services are performed, considering factors such as time spent, resources utilized, or value created in each jurisdiction.

Cross-border services include (i) Consulting services; (ii) IT Outsourcing; (iii) Financial services; (iv) Telecommunications; (v) Engineering and Construction; (vi) Education and Training; (vii) Tourism and Hospitality; (viii) and other similar services. These are services processed or performed overseas, but the result or output is used, utilized, executed, or consumed in the Philippines.

SITUS OF TAXATION FOR CROSS-BORDER SERVICES AND THEIR TAX TREATMENT

The RMC subscribed to the "Benefit-Received Theory" approach in identifying the situs or place of taxation for cross-border services that determines the income tax and VAT treatment. This theory states that the situs of taxation for cross-border services is where the source of income (i.e., property, activity, or service that produced the income) occurs. If the revenue-generating activity occurs within the Philippine territory or if the flow of wealth proceeds from the Philippines, the situs of taxation is in the Philippines.

The RMC further discussed that under the source-based principle of taxation, the jurisdiction where the economic activity occurs should have the right to tax that income, regardless of where the payment is made or received. As such, 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 ensures that income is taxed in the jurisdiction where economic activity occurs and thus prevents tax avoidance.

It is also added in the RMC that where business transactions occur in multiple stages across different taxing jurisdictions, it is 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 is considered, for tax purposes, as sourced within the Philippines, irrespective of where the payment is ultimately received.

Similarly, the RMC applied the same "Benefit-Received Theory" when determining the VAT treatment of such cross-border services. Accordingly, income generated from service fees paid to foreign companies or individuals is subject to VAT if the source of income is within the Philippines, regardless of where the payout is disbursed or physically received. The source of income means that even if the services are conducted or paid for abroad and the activities to be performed in the Philippines are so essential that the entire service transaction cannot be accomplished without them, then the benefit-received theory applies. Hence, revenue-generating activity occurs within the Philippines. This means that 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 a service is considered sourced within the country, and thus, the VAT is applicable. Consequently, payment for such services is subject to final withholding VAT.

REIMBURSABLE OR ALLOCABLE EXPENSES FOR CROSS-BORDER SERVICES

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. Otherwise, it may be considered income (reduction in expenses) as it represents a financial gain or savings for the foreign company, thereby effectively increasing the latter's net income or profit. If, however, the Philippine company derives no benefit therefrom or no income is generated through business activities conducted in the Philippines, reimbursement or the allocation of the expenses by the foreign company in the Philippines may be seen as an attempt to evade taxes or manipulate profits by funneling them to a foreign entity.

ISSUES RAISED IN RMC NO. 5-2024

The RMC attracted various inquiries from taxpayers and other stakeholders since it appears that cross-border services, as well as reimbursable or allocable expenses, albeit entirely rendered outside the Philippines, are considered income sourced within the Philippines, hence subject to final withholding tax and VAT following the "Benefit-Received Theory."

CLARIFICATIONS ON RMC NO. 5-2024

The concerns came to the knowledge of the BIR. Hence, the BIR recently issued RMC No. 38-2024 to address and clarify the issues raised on RMC No. 05-2024. Let's discuss the key clarifications in RMC No. 38-2024.

TAX TREATMENT IN ACES VS CIR DOES NOT AUTOMATICALLY APPLY TO CROSS-BORDER SERVICES

RMC No. 38 clarified that RMC No. 5 just listed the cross-border services and only to highlight that, like the Aces case, these services are likewise performed, rendered, delivered, or supplied by an NRFC to a domestic/resident entity in the Philippines.

The determination of the source of income involves an examination of all the components of the cross-border service agreement involving two tax jurisdictions, taking into account the services to be performed in their entirety, and not singled out or compartmentalized one particular activity as the income-producing activity.

PROPER DETERMINATION OF SOURCE OF INCOME

The guidelines in determining the source of income for cross border services is if the property, activity, or service that produces the income is in the Philippines. Crucial factors to such determination among others are:

1. Whether the cross-border services are dependent on the successful use, consumption, or utilization by the Philippine purchaser of the service for income to be accrued; or
2. Whether the performance of the service depends on the facilities located in the Philippines; or
3. Whether the particular stages occurring in the Philippines are integral to the overall transaction that the business activity would not have been accomplished without it.

AVAILMENT OF TAX TREATY RELIEF

The BIR clarified that once the source of income is established to be within the Philippines using the aforesaid guidelines, then, the affected taxpayer can invoke the application of a particular tax treaty to assert that the income derived or sourced within the Philippines is exempt from income tax for lack of permanent establishment or subject to preferential rates, as the case may be. In short, the application of the benefits of the tax treaty, such as tax exemption of business profits for lack of permanent establishment, presupposes that the situs of the source of income is in the Philippines.

If it is established that the source of income of cross-border services is within the Philippines, the income is subject to VAT (Withholding VAT). Section 105 and 108 of the Tax Code, as amended, provides that services rendered or performed in the Philippines by non-resident foreign corporations are subject to VAT (Withholding VAT).

REIMBURSABLE OR ALLOCABLE EXPENSES

The BIR clarified in RMC No. 38 that cross-border services usually involve related parties, in particular intra-group services like management, financial and administrative services; technical and support services; purchasing, marketing, and distribution services; and other commercial services provided in connection with the nature of the group's business. As these are intra-group services, issues such as whether their pricing of such services is arm's length, may arise. As such, it is deemed necessary to also lay down the basic rules on reimbursable or allocable expenses for services between or among related parties to have a holistic approach insofar as the determination of the proper tax treatment of cross-border services is concerned.

Like any other cross-border service agreement, the source of income of these reimbursable or allocable expenses is not determined by where income is disbursed or physically received, but rather where the business activity that produced such income is actually conducted.

TAKEAWAY

The clarifications provided by RMC No. 38-2024 are a welcome development for taxpayers to understand and apply tax laws concerning cross-border services. However, the RMC was not able to address other crucial issues raised by the general taxpayers and other stakeholders, such as, among others, the application of Section 42 (C)(3) of the Tax Code which provides that compensation for labor or personal services performed outside the Philippines are to be treated as gross income from sources outside the Philippines, and that the imposition of VAT will only warrant if the service is performed in the Philippines. Hopefully, the BIR will shed further light on these matters.

Let's Talk Tax is a weekly newspaper column of P&A Grant Thornton that aims to keep the public informed of various developments in taxation. This article is not intended to be a substitute for competent professional advice.

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