FINTECH ALLIANCE
POSITION PAPER

On House Bill No. 7425, "An Act Imposing Value-Added Tax on Digital Transactions in the Philippines, amending for the purpose Sections 105, 108, 109,110, 113, 114, and 236 and Adding a New Section 105-A of the National Internal Revenue Code of 1997, as amended"

The FinTech Alliance respectfully submits, for the consideration of the Senate Committee on Ways and Means, this position paper on House Bill No. 7425 entitled "An Act Imposing Value-Added Tax on Digital Transactions in the Philippines, amending for the purpose Sections 105, 108, 109, 110, 113, 114, and 236 and Adding a New Section 105-A of the National Internal Revenue Code of 1997, as amended" ("HB 7425").

Imposition of VAT

A cursory reading of the amendments proposed seems to imply that the bill is seeking to resolve the inability of the Philippine Government to impose or collect tax on offshore services rendered and on electronic goods sold in the Philippines. To resolve this, the proposed bill introduced amendments to Section 105 of the Tax Code which provides the persons liable for the payment of VAT, imposing an obligation to "nonresident digital service providers" to assess, collect and remit the VAT on transactions going through its platform, and amending Section 108 to include certain digital services.

At the outset, we note that the National Internal Revenue Code of 1997 ("Tax Code") does not discriminate when it comes to the residency of the provider of services or seller of goods. Hence, all sales of goods and services in the Philippines, regardless of the seller's or provider's residency, are VAT-able transactions. This conclusion finds support from the nature of VAT as a consumption tax that adheres to the destination principle. The Supreme Court explained:[1]

> As a general rule, the VAT system uses the destination principle as a basis for the jurisdictional reach of the tax. Goods and services are taxed only in the country where they are consumed.

Reading this with the current provisions on VAT leads us to interpret that if such digital goods and services are deemed to be "consumed" in the Philippines, and provided that no other exemptions are applicable, such transactions would be VAT-able.

[1] *Commissioner of Internal Revenue v. American ExpressInternational, Inc. (Philippine Branch)*, G.R. No. 152609, June 29, 2005.

This means though that the solution required under the circumstances is not to "impose" VAT on these transactions, as it is already existing under the current regime, but rather to clarify the right of the Philippine government to impose VAT on these transactions. This may be done by simply inserting a clause that clarifies the extension of VAT on non-resident entities and persons who sell goods and services to Philippine residents and citizens.

It is conceded that the proposed amendments to Section 105 provide clarity as to the applicable electronic transactions or services but the amendments might bring some unintended consequences. First, the amendments may be interpreted to mean that those newly-included items were not VAT-able under Philippine law which necessitated the amendments. As noted earlier, the destination principle already declares such transactions VAT-able. Indeed, nothing more is needed to expand the scope of VAT to these transaction since the present law includes them. Second, the explicit listing of electronic transactions and services may inadvertently create opportunities for statutory interpretation to support the view that those electronic transactions not mentioned are exempt from VAT. Such interpretations are dangerous because it will create a tax advantage for electronically-mediated transactions as against manually fulfilled goods and services. This discrimination is not intended by the VAT which does not distinguish between any mode of providing the service or selling the goods subject to the tax.

Place of Consumption

Further, it should be noted that despite the fact that it has already been established in our jurisdiction that the VAT system generally[2] adheres to the Destination Principle, there remains an issue as regards the place of consumption considering that such is not clear when it comes to the consumption of digital goods and services. Unlike in transactions involving physical goods, which place of consumption is easily determined, the determination of the place of consumption of digital goods and services is not easily done. Is it the place of business of the service provider, the place where the consumer is residing, or where the server hosting the site being used to perform the service is located? Whether this will be done by specifically providing how to determine the place of consumption, or by listing principles on how to determine this, such an addition will create an impact on which transactions will be considered VAT-able.

Categorizing Digital Goods and Services

Aside from those mentioned above, we also noted a possible issue on the amendments proposed. As it is currently worded, the amendments that were introduced to the proposed bill is effectively categorizing digital goods and services. Although at first glance this might not pose some issues and in fact, would signify the government's intent to impose VAT on online transactions, a closer look reveals that the creation of such categories might cause confusion and give rise to a situation wherein certain services are only vatable when done online, and not when done offline.

[2] There have been decisions of the Supreme Court which state that exempted transactions are also exempted from the application of the Destination Principle.

As previously discussed, it is our position that these services are already covered by the current provisions on VAT. Thus, the introduction of amendments which seem to categorize the digital goods or services might lead to an interpretation that such amendments effectively put those outside such a category outside the definition of a vatable transaction. Because of this, we are of the position that there is a need to re-examine the categories of digital goods and services to ensure that there will be no confusion with respect to the bill's application.

Collection of VAT

Admittedly, the proposals above would not resolve the more pressing issue on the collection of VAT from off-shore actors. At best, the recommendations discussed would only determine the transactions that will be covered but it does not really give a solution to the collection of VAT imposed on digital transactions in cases where the service provider is a nonresident entity or person. Thus, there remains to be a need to provide for the means of collection of VAT.

In the bill, a proposed solution is to oblige nonresident digital service providers, as defined under the bill, to assess, collect and remit VAT on digital transactions. However, we note that the solution proposed might not be entirely appropriate or efficient to solve the problem of collection and enforcement.

First, it was noted that because of the Three Million Peso threshold, the VAT registration of entities that would fall outside of the threshold is effectively voluntary. The BIR is not in a position to determine whether an offshore actor has breached the threshold and therefore is in no position to detect much less enforce a violation of the law.

Second, the proposed bill does not clarify whether the "gross sales or receipts," which is the basis to determine whether an entity falls within or outside the threshold, is computed on the basis of global sales/receipts of merely local or domestic sales/receipts.

Considering such issues, we recommend: a) to study how intermediaries (such as payment gateways, resellers or distributors) can be encouraged to assist in the registration of these nonresident entities or persons. If such intermediaries require such registration from such parties prior to transacting with them, it may encourage registration with the BIR; and b) clarify how to compute "gross sales/receipts" of those that have both domestic and foreign transactions. Notably, the volume and value of such transactions are visible to these intermediaries which can be the source of information for the BIR.

Another recommendation, which we think is more appropriate under the circumstances, is the use of these intermediaries as means of collecting the tax, *e.g.*, as withholding tax agents. Considering that such intermediaries are currently better regulated compared to nonresident foreign entities and persons, it is more convenient if the said intermediaries can become the arm of the Philippine government in the collection of taxes. There should be a need though to ensure that these entities or persons are not too overburdened with compliance requirements so as to ensure a good response from them.

Also, the government can take advantage of the need of the Philippine residents to present proof of payment, something which may only be given or issued by duly registered entities and persons, to claim input VAT, and use this to further encourage the registration of entities as VAT collectors.

We hope that we have adequately explained our position on this matter. We thank you for your time in considering our position paper and hope that through this we have extended some assistance to the Committee's important work.