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VAT on service fees billed at cost vs cost reimbursement

THE 2000 case of Commissioner of Internal Revenue v. Court of Appeals and Commonwealth Management and Services Corp., GR 125355, March 30, 2000, set the rule that service fees billed at cost are subject to value-added tax (VAT). In that case, the Court noted that it is immaterial whether the primary purpose of a corporation indicates that it receives payments for services rendered to its affiliates on a reimbursement-on-cost basis only, without realizing profit, for purposes of determining liability for VAT on services rendered. As long as the entity provides service for a fee, remuneration or consideration, then the service rendered is subject to VAT.

In essence, an entity that provides services and is paid for such services is subject to VAT. The VAT is imposed even if payment is based merely on cost, that is, without any mark-up or profit.

Compare this with receipts for reimbursement of actual expenses not arising from the performance of services. This is usual in cases where one taxpayer pays for the costs of another taxpayer and bills the other party who should actually bear the costs. This is also usual in cost-sharing arrangement schemes where common expenses are paid by one taxpayer but shares the costs with other taxpayers. For instance, affiliated companies located in one area incur common expenses, such as utility expenses, rental of the premises and other common purchases. Only one of the entities pay the common costs and seeks reimbursement from the other occupants.

There are a number of rulings holding that reimbursements of expense, by its nature, is not income but return of capital. As a return of capital, it is not income and therefore not subject to tax, such as VAT.

It may also be inferred in a number of decisions of the Court of Tax Appeals that receipts for reimbursements of costs are not income and therefore not subject to tax. However, such receipts should be proven to be mere reimbursements. In CTA Case 8551, October 2, 2015, it was held that a reimbursement should be shown to be based on actual cost and without any mark-up or profit element.

Likewise, in CTA EB Case 1035, February 9, 2016, the Court did not agree with the position taken by the taxpayer that the receipt is not subject to VAT, for failure of the taxpayer to prove that the receipt was a mere reimbursement and that no additional amount of profit had been charged. Also, the taxpayer was not able to show that it did not claim input taxes related to the share of the others in the common expense. The Court emphasized the relevance of this, considering that if the taxpayer claimed the entire input taxes on the shared expenses, then the reimbursement should also be subject to output VAT. Further, the taxpayer issued VAT invoices and official receipts for the supposed reimbursements. The VAT invoices and official receipts included the VAT, which is an output tax on the part of the payee and an input tax of the entities to whom the VAT invoices and official receipts were issued. This makes the payee liable to pay the output VAT.

In sum, receipts for services rendered are subject to VAT even if the billings are based on costs, that is, without any mark-up. On the other hand, receipts for reimbursement of shared costs or costs paid in behalf of another, may not be subject to VAT. However, to pass the test of a non-VATable reimbursement, the recipient must prove that the receipt is indeed purely reimbursement—no mark-up, input tax pertaining to the share of the others on the shared cost was not claimed, VAT is not passed on to the others and reimbursement is not covered by VAT billings/official receipts. This discussion does not intend to cover the taxation of the deposits and advances contemplated in RMC 089-12 and RMC 016-13. Those will be covered in subsequent issues in this column.

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