



Tax Law  
for  
Business

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## **Peza-registered enterprises and allowable deductions**

THE Philippines recently hosted the 23rd World Economic Forum on East Asia, which was considered by some as an event that showcased the country as one of the fastest-growing economies in Asia. It was also an opportunity to tell the world that the Philippines is a country conducive for business.

Indeed, there are opportunities waiting to be explored in the Philippines. But every sector should do its share in promoting the country as a safe place to do business. This includes strengthening fiscal rules, including the consistency and predictability of tax rules.

One of the things that make the country attractive to businessmen is the availability of special economic and free-port zones. A number of laws have been enacted creating or recognizing the creation of these zones. Duly registered enterprises within these zones are granted certain

fiscal and nonfiscal incentives, including exemption from tax, the enjoyment of preferential tax rates, and the exemption or relaxed application of tariff and customs rules.

For instance, no taxes, local and national, are imposed on enterprises registered with the Philippine Economic Zone Authority (Peza) and operating within a Peza special economic zone. In lieu thereof, 5 percent of the gross income earned shall be paid and remitted to the national government and to the city or municipality where the enterprise is located. Thus, instead of being subjected to the usual income taxes, and other national and local taxes, enterprises operating within the ecozones are subjected to this 5-percent tax on gross income.

The computation of the gross income subject to the 5-percent tax, however, has caused disputes between taxpayers and the tax bureau. Apparently, the Rules and Regulations to Implement Republic Act 7916, or the Peza law, enumerate specific items of costs and expenses allowable as deductions for purposes of computing the gross income. Likewise, the Department of Finance issued Revenue Regulations (RR) 11-05 and earlier regulations that enumerate specific items of costs and expenses allowable as deductions to arrive at the gross income.

Previous rulings of the tax bureau had confirmed that the enumerations under these rules are not exclusive. For as long as the costs can be attributed in producing the goods or in rendering the service, they are treated as direct cost and allowed as deductions in computing the income subject to the 5-percent tax.

The current administration, however, is taking a different view: The allowable deductions enumerated in the rules are exclusive. Proof of this is the issuance of assessments to some taxpayers disallowing the deductions claimed that are not among those enumerated in the rules.

The deductibility of costs other than those specifically listed in the rules is one of the issues resolved by the Court of Tax Appeals (CTA) in CTA Case 8179 (May 21, 2014). In this case, the tax bureau disallowed as deductions certain items of costs of sales/services, citing various laws and rules justifying the disallowance.

On the other hand, it is the taxpayer's position that the enumeration of direct costs under RR 11-05 is not an exclusive or closed list of expenses that may be deducted by Peza-registered enterprises from their gross sales for purposes of computing the 5-percent gross income tax. Instead, the enumeration of direct costs is intended as a guide in determining the items that may be considered direct costs or costs of sales.

The CTA, in agreeing with the taxpayer, declared that the list made under RR 11-2005 is not meant to be all-inclusive, but merely enumerates the expenses that can be considered as direct costs. Peza-registered enterprises may be allowed to deduct expenses that are in the nature of direct costs, even though the same are not included in the list.

The court stated further that the criteria in determining whether or not the item of cost or expense should be part of the direct cost are the direct relation of such an item in the rendition of the Peza-registered services. If the item of cost or expense can be directly attributed in providing the Peza-registered services, then it should be treated as direct cost.

While this case does not directly confirm the earlier rulings by the tax bureau, it does affirm that the allowable deductions enumerated in both RR 11-2005 and the Peza rules and regulations are not exclusive. Other costs and expenses not included in the list may be allowed as deductions. It does not, however, give taxpayers blanket authority to claim any item of costs or expenses as deduction. Taxpayers must be able to show that the costs or expenses being claimed as deductions are necessary to produce the goods or to render the services required by customers.

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