Receiving Copy

Board Of Airline Representatives

06 June 2011

HON. RALPH RECTO, Chairman, Senate Panel
HON. HERMILANDO I. MANDANAS, Chairman, House Panel
Oversight Committee on Comprehensive Tax Reform

Re: Clarification on the issues of airline common carriers tax and gross Philippine billings

Dear Senator Recto and Congressman Mandanas,

Thank you for including the issue of the Common Carriers Tax (CCT) and Gross Philippine Billings (GPB) in the agenda of the June 2 oversight committee hearing on the Comprehensive Tax Reform Program. As part of the audience, we heard the exchange of queries and responses between the Oversight Panel and BIR Commissioner Henares. We did not have the opportunity to properly explain the issue during the hearing so we decided to communicate our concerns to the Oversight Committee for your review and consideration of our appeal–to eliminate the burden from these taxes. The administrative measure to allow foreign air carriers to exercise the option to register for Value-Added Tax (VAT) will provide the immediate relief needed by the industry in order to enhance international air connectivity to the Philippines.

I. Our Issue

Foreign air carriers are currently levied with the 3% CCT and 2.5% GPBT (or 1.5% under bilateral tax treaties), computed using only one tax base, that is, the flown revenues from ticket, cargo and excess baggage carried ex- Philippines up to the final destination regardless of the country of sale and/or issuance.

Philippine air carriers are not subject to the same tax regime *in international routes* where they operate and compete with foreign air carriers.

1. Foreign air carriers are subject to the 3% CCT while their Philippine counterparts enjoy VAT zero-rating for *international operations*. The Cathay Pacific case, as discussed below, represents the appeal of the foreign air carriers to be allowed to change tax type from percentage to VAT.

   Sec 236 (H) of the National Internal Revenue Code (NIRC) of 1997 provides for optional VAT registration of VAT-exempt persons (such as foreign air carriers). However, the BIR, under its Revenue Regulations (RR) 16-2005 and Revenue Memorandum Circular (RMC) 46-2008, excludes foreign air carriers from optional VAT registration and limit

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the benefit of zero-rated VAT to domestic or sea carriers. These interpretations were issued despite lack of basis in the NIRC.

Cathay Pacific (CX) Petition and Case

The CX case is an appeal for foreign carriers to be allowed to register for VAT.

In May 4, 2006, CX filed a petition to change tax type from percentage tax to VAT with the BIR. The BIR's last reply was received by CX in August 18, 2006. To date, the BIR has not acted on CX's petition. In 2009, this lack of action prompted CX to petition the Court of Tax Appeals (CTA) to decide on the issue. However, in 2010, the CTA ruled that it lacked jurisdiction to render judgment on the action or lack of action by the BIR. CX filed a petition for review with the CTA En Banc and are just waiting for the decision of the court.

The relevant details on the CX petition and the CTA case (No. 7876) are outlined below:

CX Petition

May 4, 2006	CX applied with BIR Large Taxpayers Service (LTS) Division for change of registration from Non-VAT to VAT taxpayer and change of tax type from percentage tax to VAT.
May 19, 2006	BIR LTS denied CX petition based on RR 16-2005, their interpretation of RA 9337.
July 3, 2006	CX filed with BIR LTS requesting for reconsideration for the denial based on Section 236(H) of the NIRC.
August 18, 2006	CX received letter from BIR LTS that CX request was indorsed to the BIR legal service for appropriate action.
May 15, 2007	CX wrote a letter to Atty. Eufrocina S. Casasola, Vice-Chairman of the VAT Committee of the BIR to follow-up on the resolution of CX request for change of registration from non-VAT to VAT taxpayer.

CX Case

February 4, 2009	CX filed a Petition for Review with the Court of Tax Appeals praying that it is entitled to the option to register as a VAT taxpayer.
September 21, 2010	CTA Third Division promulgated a decision dismissing the Petition for Review for lack of jurisdiction over the subject matter.
October 7, 2010	CX filed motion for reconsideration.
January 4, 2011	CTA issued resolution denying the motion for reconsideration for lack of merit.
February 4, 2011	CX filed petition for review with CTA en banc.
May 16, 2011	CX and the BIR Commissioner filed their respective Memoranda with the CTA *En Banc*.

Hence, the case is now for decision by the CTA *En Banc*.

Interpretation of the Tax Code

We request the Oversight Committee to *consider a review of the interpretation of the 1997 Tax Code (as amended by R.A. 9337) and reflected in the BIR regulations*.

We believe that the provisions of RR No.16-2005 and RMC Circular No.46-2008, to the effect that international air carriers do not have the option to register for VAT, contravene the provisions of the Tax Code, specifically Section 236(H) of the 1997 Tax Code which states that any taxpayer who is not required to register for VAT under subsection (G) of Section 236 of the 1997 Tax Code may elect to register for VAT. These regulations likewise have no basis under the deliberations of Congress in the enactment of R.A. No. 9337.

Under R.A. No.9337, the legislature intended to amend the provision on optional VAT registration by expanding the coverage of persons or entities entitled to optional VAT registration to all persons or entities not mandatorily required to register for VAT. If the legislature intended to allow optional VAT registration under Section 236(H) of the Tax Code only to persons or entities with gross annual sales of less than Php1,500,000.00, which is the BIR's position in RR 16-2005 and RMC 46-2008, R.A. No. 9337 would have just deleted Sections 109(a), (b), (c), and (d) in the enumeration of the persons entitled to optional VAT registration under the Tax Code of 1997 and retained only Section 109(z), now Section 109(V), which pertains to VAT-exempt sales or lease of goods or properties or performance of services with gross annual sales not exceeding Php1,500,000.00.

The deletion by R.A. No. 9337 of the following provision in Section 236(H) of the 1997 Tax Code: "In any case, the Commissioner may, for administrative reasons, deny any application for registration including updates prescribed under Subsection (E) hereof" shows that the legislature took out the authority of the CIR to deny any application for VAT registration even for administrative purposes.

CX (and therefore foreign air carriers) is entitled to register as a VAT taxpayer as a person engaged in "transport of passengers and cargo by air or sea vessels from the Philippines to a foreign country" which was included by R.A. No. 9337 as among the services subject to 0% VAT.

Changing the base of CCT from average to actual fares

We strongly oppose this move by the BIR to address our plight by simply changing the tax base for the following reasons:

(a) Our issue is the lack of level playing field (and not our inability to pass the indirect tax burden to the passengers) in international operations where we compete with

Philippine carriers. This issue will not be addressed by this administrative move by the BIR.

(b) When these taxes are passed on to the passengers, they will increase fares and make foreign air carriers very uncompetitive relative to the Philippine carriers.

(c) The administrative measure will only make the tax computations more complicated and burdensome given the range of itineraries, the complexity of airline pricing and the differences in purchase prices by country, distribution channel and individual distributor within any given channel. How will distributors' margins overseas be accounted for in the computations?

(d) The percentage tax is computed based on the one way allocated airfare of the portion of the ticket originating in the Philippines. Each industry player would have its own distinct proprietary methodology to determine segment or combinations of segment values; the issue is complex.

2. Foreign air carriers pay income taxes regardless of whether their Philippine operations are profitable or not. On the other hand, Philippine carriers are exempted from paying income taxes in other countries. In some cases, they may be subject to income taxes in the foreign countries where they operate but their tax dues are based on profitability of operations (and not simply levied as a fixed percentage of flown revenues from ticket, cargo and excess baggage carried up to the final destination regardless of the country of sale and/or issuance from the foreign city where they operate).

   Outside the four countries that have taken reciprocal action against Philippine carriers because of CCT and GPB, the Philippine carriers are never subject to taxes overseas which are not paid by the home carrier. This is a principle of ICAO (International Civil Aviation Organization) to which the Philippines is a signatory.

   Being based on a gross amount, foreign air carriers operating at a loss in the Philippines are still subject to Philippine tax at the effective rate of 2.5%, or 1.5% (for those with tax treaties). In other words, the GPBT has nothing in common with income tax as internationally practiced since it is a fixed percentage which foreign air carriers have to pay irrespective of the financial results of their Philippine operations.
   In general, foreign air carriers are subject to home country taxes just as their Philippine counterparts are subject to either regular corporate income tax rate of 30% on their taxable income or to the 2% Minimum Corporate Income Tax on their gross income (i.e., gross revenue less direct costs), whichever is higher. But the taxes applied on foreign air carriers in the Philippines create an unfair cost advantage in routes where they compete with Philippine international air carriers. Thus, **the GPBT and CCT cannot be treated alongside the home tax obligations of Philippine air carriers.**

3. Foreign air carriers are not subject to the same tax regimes in other countries where they operate. In effect, the CCT and GPB make the Philippines an expensive destination for adding capacity or mounting new capacity.

   Foreign air carriers are also not subject to "percentage taxes" that are believed to be levied on Philippine carriers in destinations such as China and to be the same as the CCT.

The same is true in the case of income taxes.

The current level of available flights is not enough to service tourism, trade and the OFWs, thus hampering growth. Although there is a strong demand for capacity, airlines are not interested to invest because the financial consequence of the taxes provides for greater returns elsewhere. Air transportation is a capital-intensive industry with very thin margins. Latest forecasts for 2011 are for a 0.7% margin, far less than the 4.5% or 5.5% Philippine taxes on gross amounts; 2011 will be one of the better years.

II. Our Appeal

BAR would like to appeal for a change in interpretation of Section 236(H) of the NIRC in order to remove the CCT burden, which will give immediate relief to the industry for the benefit of tourism, trade and the goal of job creation in the Philippines.

Sincerely yours,

STEVEN CROWDEY
First Vice-Chair

Cc: Senator Franklin Drilon, Member, Oversight Committee
Representative Magtanggol Gunigundo, Member
Representative Giorgidi Aggabao, Member
Representative Mylene Garcia-Albano, Member
Commissioner Kim Jacinto-Henares, BIR