29 June 2020

Hon. Salceda, Joey Sarte
House Ways and Means Chairperson
House of Representatives
Republic of the Philippines
Committee Secretary: Ms. Lorena A. Fernandez (Acting)

Subject: Industry Submission on the Act on Fiscal Regime and Taxation of the Digital Economy

On behalf of the Asia Internet Coalition (AIC) and its members, we would like to submit our comments **o**n the Act on Fiscal Regime and Taxation of the Digital Economy in the Philippines. The purpose of this submission is to share industry comments and recommendations on the House Bill No. 6765 ("**HB 6765**") (an Act Establishing a Fiscal Regime for the Digital Economy, Amending for the Purpose Sections 57, 105, 108, and 114 of the National Internal Revenue Code, and for Other Purposes, introduced by Representative Joey Sarte Salceda), and P.S. Res. No. 410 (urging the Senate Committee on Ways and Means and the Appropriate Senate Committees to Conduct an Inquiry, in Aid of Legislation, Into the Possibility of Imposing and Collecting Taxes from Multinational Online Streaming Services and the Digital Economy in General, introduced by Senator Ramon Bong Revilla, JR.).

AIC is an industry association comprised of leading internet and technology companies in the Asia Pacific region with a mission to promote the understanding and resolution of Internet and ICT policy issues in the Asia region. Our members are Google, Facebook, Amazon, Apple, SAP, LinkedIn, Booking.com, Airbnb, Cloudflare, Expedia Group, Grab, LINE, Rakuten, Twitter and Yahoo (Verizon Media). We have worked closely with the governments around the region in relation to the development of ICT policies and in doing so, we have witnessed first-hand the potential for adoption of digital technology and innovation.

We understand that the House Bill (HB) No. 6765, or the "Digital Economy Taxation Act," was filed on 19 May to capture into the tax system the value created by the digital economy. The bill seeks to impose a 12% value-added tax (VAT) on digital advertising services (such as those on search engines and social media platforms), subscription-based services (including music and video streaming subscriptions), services rendered electronically, and transactions made on electronic commerce (e-commerce) platforms. Moreover, the bill would require suppliers of digital services, network orchestrators, and e-commerce platforms to establish a resident agent or representative office to act as a withholding agent in the Philippines.

As responsible stakeholders to help shape the policy environment around the most pressing issue on Digital Taxation, we appreciate the ability to participate in this discussion and the opportunity to provide inputs into the policy-making process in the Philippines. The AIC is of the view that

the proposed Digital Economy Taxation Act should be contextualized against the current tax rules to understand the rationale for the proposal, based which we would like to present issues and recommendations for your considerations. We would also like to emphasize on the ongoing multilateral efforts at unifying tax rules regarding digital economy, such as the one led by the Organization for Economic Co-operation and Development (OECD), to address overlaps with individual state measures and avoid double taxation, considering the borderless nature of such transactions.

As such, please find appended to this letter detailed comments and recommendations, which we would like to respectfully request the Government to consider, which could be a useful feedback for future consultations to determine an optimal approach to implementing an effective Taxation Framework in the Philippines.

Should you have any questions or need clarification on any of the recommendations, please do not hesitate to contact me directly at Secretariat@aicasia.org or +65 8739 1490. Importantly, we would also be happy to offer our inputs and insights on industry best practices directly through virtual meetings and discussions to help shape the dialogue for an effective taxation framework in the Philippines.

Thank you for your time and consideration and we look forward to hearing from you.

Sincerely,

Jeff Paine
Managing Director
Asia Internet Coalition (AIC)

Cc.:

- *Senator Ramon Revilla Jr, Republic of the Philippines*
- *Carlos G. Dominguez III, Secretary of Finance, Republic of the Philippines*
- *Caesar R. Dulay, Commissioner of Internal Revenue, Bureau of Internal Revenue, Department of Finance*

A. General Feedback

1. **Value added tax (VAT):** To the extent cross border supplies of electronically supplied services (digital services) are taxed from a VAT perspective, the focus of the legislation and any subsequent regulations should be on leveraging best practices from other jurisdictions and incorporating key OECD principles of neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility. As such, we recommend VAT to only apply on Business to Consumer (B2C) transactions of digital services as reverse charge VAT applies on Business to Business (B2B) transactions today. Whereby it is furthermore strongly recommended that the differentiation between B2C and B2B can be made based on data that can be digitally verified for large numbers. Any proposed changes to the VAT regime should furthermore be introduced with sufficient time to implement such measures by non-residents without onerous compliance requirements, including putting into effect wider systems changes and configurations, where they are required. At least 12 to 18 months should be allocated for companies to implement the regulatory changes after the full legislation has been published given the following items that companies will be required to scope and consider as part of implementation. Please note that additional time would be needed where complex reporting and invoicing obligations are introduced.

   Moreover, in line with Business at OECD recommendations, we propose the law to allow non-resident taxpayers):

   (i) to VAT register through an online simplified registration procedure involving minimal movement/filing of physical documents and information requested limited to necessary details (e.g. business name, registered address, website and national tax ID) without the need to appoint a local VAT representative
   (ii) to request for input VAT recovery through a regular or simplified VAT return procedure (where zero-rating of exported services does not apply)
   (iii) to file online quarterly VAT returns with limited information included (e.g. tax ID, tax period, currency, taxable amount, tax rate and total tax payable)
   (iv) to make VAT payments from foreign bank accounts and potentially in foreign currency
   (v) to allow for date to be kept offshore and limit this to data strictly necessary for the tax being collected (i.e. type and date of supply and VAT payable)
   (vi) to avoid B2C invoicing requirements or, if nevertheless required, to use simplified electronic receipts with type and date of supply, taxable amount, VAT rate, VAT amount per rate and total taxable amount.

2. **Corporate Tax**: The Philippines government has made progressive steps in improving its investment competitiveness by introducing the Corporate Income Tax and Incentives

Rationalization Act (CITIRA). This sets out to gradually reduce the corporate income tax rates, attract foreign direct investment and create jobs for Filipinos. Some of the provisions within HB 6765 may prove counterproductive to the policy intent of CITIRA and negate the benefits it seeks to achieve.

If the Government of the Philippines intends to pursue new digital tax rules at this time, it would be in the interest of the country and the industry at large, for the Philippines Government to focus changes solely on updating existing VAT rules as mentioned above. Any proposed changes to the corporate income tax, including withholding tax rules, should be deferred until the conclusion of the G20/OECD's ongoing multilateral project to address the tax challenges arising from the digitalization of the global economy by the end of 2020. Any needed changes to the existing international tax framework should be pursued at a global level and not unilaterally by individual countries. This will provide an opportunity to the Philippines to align its CIT rules with international tax norms. Other international bodies such as the IMF have also recommended that governments refrain from introducing fundamental reforms or overhauling existing tax laws systems during the COVID-19 crisis, so as not to compromise the integrity of the system, and risk undermining tax certainty after the current crisis abates. It appears that the provisions of HB 6765 would represent a departure from existing international tax norms and business practices, particularly the requirement that a non-resident is allowed to provide the digital services mentioned in HB 6765 in the Philippines exclusively through a representative office ("**RO**") or an agent in the Philippines. In addition, HB 6765 also deems the RO and agent to be a Philippine resident corporation and derive revenue from provision of the aforesaid digital services. Such proposed rules impose the requirement on non-resident businesses to maintain a RO or an agent in the Philippines that non-residents do not require. Such proposed rules also act as a deterrent for international businesses to invest in the Philippines and deprive the Philippines business community and broader public of the latest innovations, technologies and offerings over the internet.

From the perspective of local medium and small enterprises (MSMEs), cash flow is their lifeline and any withholding tax could have the unintended consequence of affecting their business adversely. This could lead MSMEs to sell on less formal channels, making it more difficult for the government to bring them into the tax net. In addition, tax accountability should be an individual responsibility at the personal level and corporate level as the individual is expected to have a complete understanding of their income sources. Platforms can play a supporting role by reminding its users and educating them on tax filing. However, to track the income tax requirements of millions of sellers will be particularly onerous for platforms, notwithstanding the fact that sellers could be on multiple platforms and/or have multiple sources of income at any one time.

Bearing the above in mind, we respectfully request that Sections 8 and 9 of HB 6765 be removed.

B. Section wise comments and request for clarification

1. General clarifications required

1.1. When is the intended effective date, assuming that it received legislative approval in the House and Senate?

1.2. The intended scope of the rules and transactions that they apply to should be clarified in the rules.

1.3. A public consultation should be undertaken before HB 6765 proceeds further in the legislative process such that business and other stakeholder input can be sought.

2. Section wise comments

2.1. Section 4: It appears that the intention is to increase domestic tax compliance of Filipino taxpayers earning income from network orchestrators. Please clarify how the Philippines anticipates that network orchestrators will be able to comply with the withholding tax obligations set forth in this section and know what rate of tax to withhold? As currently drafted, it appears that the provisions would cast onerous requirements on network orchestrators, especially those not resident in the Philippines, to comply with local withholding tax rules.

It is furthermore unclear if this section only applies if the network orchestrators are collecting the payments for the underlying supply. Where this would not be the case an enormous negative cash-flow burden would be placed on the network orchestrators. Furthermore, can it be clarified that this would only apply where the network orchestrators are collecting the money on behalf of the factual seller of the underlying supply, and not on behalf of e.g. management or parent companies, of whom the amounts collected do not concern their factual income? Finally, we also request the government to clarify on how to proceed when the seller has an agreement with one platform operating on another platform, in this case which of the two platforms will be considered as the liable network orchestrator?

Therefore AIC would like to submit that any withholding requirements should not be pursued as it is outside international norms. It will significantly overcomplicate the bill as it poses significant implementation challenges that will discourage compliance. We would like to emphasize on the following reasons for this recommendation: :

- The platform companies or the network orchestrators will not know what rate to withhold at as it will have no knowledge of what other earnings the seller has, either independently of their activity on the platform or the same activity on different platforms.
- Withholding tax regimes are difficult to implement for global platforms, especially if they include different types of taxes. Income tax and VAT are not linked to each transaction a seller carries out through the platform; rather, those

taxes usually take into account the tax profile of the seller over the platform, exemptions or reduced rates thresholds, credits/favorable balances, etc. Furthermore, withholding regimes also create additional workload for sellers that are correctly calculating and paying their taxes, that already have a system completely set to issue invoices, pay taxes and file returns.

- Not all companies in the same industry will be able to apply the withholding. This distorts the competitive landscape. For example some companies process payments for their sellers (i.e. take payment from the buyer, and pays out to the seller) and other platforms do not (instead, the buyer will pay the seller off the platform, sometimes in cash). The latter group will not be able to withhold tax as they don't process the payments. Therefore, there could be an incentive for sellers to stop using the platforms who withhold tax on payouts and instead use the latter group of platforms which do not process payments. This impacts the business of the platforms that withhold and it does not solve the problem of undeclared income.

2.2. Section 5: For digital services provided by non-resident suppliers, does the government intend to tax B2C transactions only, since B2B transactions will be covered under domestic reverse charge VAT rules? Additionally, how should the "*services rendered in the Philippines by nonresident foreign persons*" be interpreted? More specifically, in case of electronically supplied services, how can one determine if the service is rendered in the Philippines? What is meant by the "*rule of regularity*" in this respect?

2.3. Section 6: Similar to the remark to Section 5, can the government clarify how one can determine if a service "*rendered electronically*" is rendered in the Philippines? Also, is the list of services mentioned to clarify the "sale or *exchange* of services" meant exhaustively? Moreover, will OECD (destination) principles be taken into account to avoid double taxation? Will more information be made available on the tax point?

2.4. Section 7 (A): Is the non-resident supplier or network orchestrator system or e-commerce platform expected to file its own VAT return, or is it expected to file its VAT through the RO and agent in Philippines? Also, can the quarterly VAT return be filed online in English? Finally, what data are to be included in the VAT return?

2.5. Section 7 (B): We recommend to allow non-resident operators to make payments through a foreign bank account and potentially in a foreign currency, in line with OECD recommendations.

2.6. Section 7 (C): This section provides that "*the payment for lease or use of properties or property rights to nonresident owners shall be subject to ten percent (10%) withholding tax at the time of the payment*". *(…) the payor or the person in control of the payment shall be considered as withholding agent*". We understand that this rule is applicable only in case the property is located in the Philippines and a non-resident

owns it, is this correct? Should the VAT withholding also be made on payments made for lease of properties owned by non-resident which are not located within the Philippine territory? Additionally, who is "*the person in control of the payment*"? Is this the bank or financial institution in case of payments done through a credit card or by money transfer, or could this be the network orchestrators where they are involved in the collection?

2.7. Section 7(D): For sale of goods and services on resident network orchestrator system or e-commerce platform where withholding VAT apply today, does the House Bill apply to non-resident network orchestrator system provider or EC platform provider? Does the government expect non-resident system provider / EC platform provider to withhold VAT on resident and non-resident sellers that sell goods and services on the system or platform? If so, can it be clarified that the VAT withholding should only be done where payment is collected on behalf of the factual seller of the underlying supply, and not on behalf of e.g. management or parent companies, of whom the amounts collected do not concern their VAT taxable income? Also what does "membership" in a network orchestrator or an electronic platform mean? Finally, can the government clarify how to proceed when the seller has an agreement with one platform operating on another platform, in this case which of the two platforms will be considered as the liable network orchestrator?

2.8. Sections 8 and 9

These sections require non-resident suppliers (currently of digital advertising services, subscription-based services, e-commerce platforms and network orchestrators) to provide their services in the Philippines only through a RO or an agent in the Philippines. We understand that the intention of the bill is not to cover other digital services (such as cloud or sale of software) which are primarily provided to B2B customers. As highlighted above, such RO or agent would be treated as a Philippines tax resident and the revenue derived from the provision of services by the non-resident suppliers would be deemed generated by the Filipino RO or agent. These provisions compel non-resident suppliers to have a physical presence and tax nexus in the Philippines which is otherwise not required from a business and commercial perspective. This is not in-line with international tax norms and practices, specifically, the OECD's work relating to the taxation of the digitalized economy. Moreover, allocating revenue solely based on registration will not be in line with current Transfer Pricing Principles and will surely lead to double taxation. It has furthermore typically proven difficult and costly for non-resident suppliers to find ROs or agents due to the potential high shared tax liability.

The requirement to maintain a physical presence in the Philippines is not consistent with certain WTO obligations. Section 2 of Article XVI of GATS identifies measures "which a Member shall not maintain or adopt" in "sectors where market-access commitments are undertaken" including requiring "specific types of legal entity or joint

venture through which a service supplier may supply a service." Further, this proposal also contradicts the limited authority granted to representative office under applicable laws/rules (Section 1 (c) of IRR of Republic Act No. 7042). A representative office of a foreign corporation is not allowed to derive any local income and hence, not subject to corporate income tax and VAT.

In addition, seeking to impose tax on non-resident taxpayers on a deemed revenue basis may run contrary to Philippines' tax treaty obligations. We believe that a non-resident taxpayer which is a tax-resident of a country with a tax treaty with the Philippines should not be subject to income tax in the Philippines on a deemed nexus basis. The tax treaty provides the taxing rights and would apply to determine the taxability of the non-resident in the Philippines instead.

In light of the above, we request that Sections 8 and 9 of HB 6765 be removed from the bill.