

CHALLENGES OF LABOR SERVICE COOPERATIVES IN THE ASPECT OF TAXATION

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CHALLENGES OF LABOR SERVICE COOPERATIVES IN THE ASPECT OF TAXATION

- I. Identifying the challenges.
 - II. Finding solutions in response to these challenges.
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I. IDENTIFYING CHALLENGES

1. Labor Service Cooperative branded as unauthorized type of cooperative.
 2. Labor Service Cooperative perceived to be a tax shield.
 3. Tax exemption not favored.
 4. CDA an agency under the Department of Finance.
 5. Lack of appreciation of the BIR on principles, management, and operations of the cooperatives.
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1. Labor Service Cooperative is branded as unauthorized type of cooperative.

- ▶ BIR circularizes the view that labor contracting and other cooperatives similarly created is not authorized by RA 9520 to be organized
(RMC 12-2012 dated 12 March 2012)

(Continuation)

- ▶ This circular of the BIR is now prevalently used to create misimpressions that a cooperative is prohibited to engage in job contracting and sub-contracting arrangements.

(Continuation)

- ▶ BIR uses RMC 2012-12 to deny application for renewal of tax exemption certificates on the ground that cooperatives who are into job contracting and sub-contracting arrangements have not been identified as among those that are authorized to be organized under RA 9520.

2. Cooperative is perceived as a vehicle for tax shield.

- ▶ RMC 2012-12 was issued pursuant to a request of the Commissioner of the BIR dated 09 January 2012 to look into complaints that cooperatives registered as labor contracting, construction, professional, mining, and other cooperatives similarly created were used as a tax shield.

(Continuation)

- ▶ Context with which the tax shield is used in the BIR letter connotes that there is fraudulent intent to use cooperative as a vehicle to evade paying taxes.

(Continuation)

▶ As distinguished from a tax shield definition in business which is ---

“the reduction in income taxes that results from taking an allowable deduction from taxable income”

(Wikipedia)



Continuation...

- ▶ Revenue Officers in proper cases may disregard the separate juridical personality of the cooperative where it serves but as a shield for tax evasion and treat the person who actually may take the benefits of the transactions as the person accordingly liable (see principle in *Liddell & Co. vs. The Collector of Internal Revenue*, June 30, 1961, G.R. No. L - 9687). This is similar to the doctrine of piercing the veil of corporate entity.

3. Tax exemption is not favored.

- ▶ “Taxes are the lifeblood of the nation and as such their collection cannot be curtailed by injunction or any like action; otherwise, the state shall be crippled in dispensing the needed services to the people, and its machinery gravely disabled.”

(Camp John Hay Development

Corporation vs. Central Board of
Assessment Appeals, G.R. No. 169234,
October 2, 2013)

(Continuation)

- ▶ The governing principle is that tax exemptions are to be construed in *strictissimi juris* against the taxpayer and liberally in favor of the taxing authority; and **he who claims an exemption must be able to justify his claim by the clearest grant of statute.** (COMPAGNIE FINANCIERE SUCRES ET DENREES vs. Commissioner of Internal Revenue (G.R. No. 133834 August 28, 2006))

(Continuation)

- ▶ A claim for exemption from tax payments must be clearly shown and be based on language in the law too plain to be mistaken. Taxation is the rule; exemption therefrom is the exception.

(Davao Oriental Electric Cooperative, Inc. vs. The Province of Davao Oriental, G.R. No. 170901, January 20, 2009)

3.1 Tax exemption is not automatic

- a.) Withholding agents shall require entities claiming tax exemption to present a tax exemption certificate. Otherwise, the entity shall be subject to payment of appropriate withholding taxes due on the transaction.

(see RMC 8-2014 dated February 6 2014).

3.1 Tax exemption is not automatic (Continuation)

- ▶ b.) The tax exemption certificate must explicitly recognize the grant of tax exemption, as well as corresponding exemption from withholding tax (supra.)

No deduction shall be allowed notwithstanding payments of withholding tax at the time of the audit investigation or reinvestigation/reconsideration in cases where no withholding of taxes was made in accordance with Sections 57 and 58 of the NIRC

(see RR 12-2013 dated 12 July 2013).

3.2 Taxable cooperatives are subject to withholding tax.

- ▶ Revenue Regulations 2-98 as amended, implementing Sections 57 and 58 of the NIRC prescribes the withholding taxes for *income payments* to certain payees including contractors.
- ▶ In order that an amount received will form part of gross receipts, the same should constitute the gross income of the taxpayer when received or earned.
(*Pronounced rationale behind RMC 39-2007*).

3.3 The Basis of Withholding Tax per current BIR opinion

- ▶ Withholding tax of taxable cooperatives is 2% of gross income payment including salaries and statutory benefits of contractual workers.

(See BIR Ruling DA-(C-018)-075-10;
BIR Ruling DA-C-019-090-10).

(Continuation)

- ▶ Basis of withholding taxes cannot be similar to the one enjoyed by security agencies, which is 2% of agency fee.

Reasons are the following:

1. The salaries are technically being paid for by the principals or clients of the security agency. (*see Section 6 of RA 6727*)

(Continuation)

- ▶ (2) The Security Agency does not own the funds earmarked as salaries of the security guards (RA 5487 as amended known as *Organization and Operation of Private Security Agencies and Company Security Forces Throughout the Philippines*)
- ▶ (3) RMC Circular 39-2007 limits the coverage of 2% withholding to the agency fee, excluding salaries. The rule is based on the premise that in order for an amount received to form part of gross receipts whether for VAT or income tax, it must constitute the gross income of the taxpayer when received or earned.

3.4 The Effects of BIR opinion

a. Cash flow reduction in business management and operations.

Funding for statutory reserves would become a problem.

b. BIR gets to accumulate huge amount of tax refunds per annum.

Sample Computation

Service Fees				100%
Less: Costs and Expenses				70%
Net Surplus				30%
Less: Statutory reserve funds				9%
Net surplus after deducting statutory reserves				21%
Patronage Refund			14%	
Interest on Share Capital			7%	
Tax Base				7%
Income tax rate				30%
Income tax due				2%
Withholding tax CREDIT				
	2% of gross receipts			20%
REFUNDABLE AMOUNT				18%

(Continuation)

c. Cooperative would resort to filing of claims for refund, a long and tedious process.

Cooperative should expect a loss of 30% of the total refund, not to mention the possible assessment that normally goes along with the filing of the claim.

4. CDA is an agency under the Department of Finance

- ▶ CDA is an agency attached to the Office of the President (see RA 6938, E.O. 95) under the supervision of the Department of Finance;
- ▶ Mandate of the Department of Finance is *to formulate, institutionalize, and administer fiscal policies in coordination with other concerned subdivisions, agencies and instrumentalities of the government* (see Executive Orders 127, 127-A, and 292);

(Continuation)

- ▶ Fiscal policy is the use of government expenditure to influence economic development. (Wikipedia)
 - ▶ BIR is known to have a strong clout with the Department of Finance (DOF).
 - ▶ The powers of the BIR under existing laws include the following:
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- a. The power to interpret the provisions of the Tax Code and other tax laws shall be **under the exclusive and original jurisdiction of the Commissioner**, subject to review by the Secretary of Finance
(see Section 4, Tax Reform Act of 1997).

(Continuation)

- b. The power to decide disputed assessments, **refunds of internal revenue taxes**, fees or other charges, penalties imposed in relation thereto, or other matters arising under this Code or other laws or portions thereof administered by the **Bureau of Internal Revenue is vested in the Commissioner, subject to the exclusive appellate jurisdiction of the Court of Tax Appeals** (see Section 4, supra.)

5 Lack of appreciation of the BIR on the principles, management, and operations of the Cooperatives.

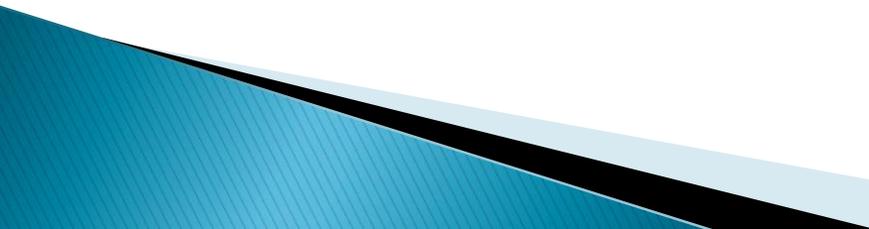
- ▶ BIR personnel appear to be lost about the true identity of cooperatives.
 - ▶ BIR personnel appear to be not familiar with the intricacies of cooperative accounting and taxation.
 - ▶ BIR personnel prefer to assess to meet collection targets.
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II. FINDING SOLUTIONS IN RESPONSE TO THE CHALLENGES

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1. CDA and Congress recognize labor service cooperatives as a type of cooperative authorized by law to be established
 2. Step up education and compliance with rules and regulations of CDA and Tax Code to eradicate false perception
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(Continuation)

3. While tax exemption is not favored, cooperatives deserve a preferential tax treatment pursuant to RA 6938 as amended by RA 9520 subject to clear cut conditions
 4. Taxable labor service cooperatives should pursue that basis of 2% withholding tax is the administrative fee net of salaries and statutory benefits
 5. CDA should have a peculiar place in the table of organization under the Office of the President
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1. CDA and Congress recognize labor service cooperatives as a type of cooperative authorized by law to be established

- ▶ New IRR clearly recognizes Labor Service Cooperatives as among the types of cooperatives identified under RA 9520.

(Continuation)

New IRR sought to implement "ART. 23. *Type and Categories of Cooperatives.* – (1) *Types of Cooperatives – Cooperatives may fall under any of the following types:*

▶(e) *Service Cooperative is one which engages in medical and dental care, hospitalization, transportation, insurance, housing, labor, electric light and power, communication, professional and other services;*

and

▶"(t) *Workers Co-operative is one organized by workers, including the self-employed, who are at same time the members and owners of the enterprise. Its principal purpose is to provide employment and business opportunities to its members and manage it in accordance with co-operative principles"*

(Continuation)

- ▶ New IRR defines labor service cooperative as one that is engaged in providing a specific labor, job, or service to a principal under a contracting or sub-contracting arrangements as defined under existing laws and in accordance with the cooperative principles set forth under the Philippine Cooperative Code of 2008 (RA9520).
- ▶ Even in the absence of the new IRR, CDA has recognized in Memorandum Circular 2012-12 issued in June, 2012 the organization of labor service cooperatives authorized to engaged in contracting and sub-contracting arrangements.

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- ▶ BIR RMC 12-2012 is anchored on CDA Memorandum dated January 09, 2012. The Memorandum was apparently clarified in CDA Memorandum Circular 2012-12 dated June, 2012. With the advent the new IRR, BIR RMC 12-2012 appears to have no more basis.

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- ▶ A memorandum circular of the bureau head could not operate to vest a taxpayer with a shield against judicial action because there are no vested rights to speak of respecting a wrong construction of the law by the administrative officials and such wrong interpretation could not place the Government in estoppel to correct or overrule the same (*see Banco de Oro vs. Bureau of Internal Revenue GR No. 198756 dated January 13, 2015*)



RECOMMENDATIONS:

- ▶ Labor Service Cooperatives should request CDA to make representations with the BIR to withdraw or amend RMC 12-2012.
 - ▶ CDA to facilitate a dialogue with the BIR to confirm its position that RMC 12-2012 has no more basis and therefore should be withdrawn or at least modified to take out labor service cooperatives as among those types of cooperatives that have not been identified under RA 9520.
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(Continuation)

- ▶ Challenge the validity of any resolution denying application for renewal of tax exemption. Rules on exhaustion of administrative remedies need to be observed before filing a petition with the Court of Tax Appeals.

2. Step up education and compliance with rules and regulations of CDA and Tax Code to eradicate false perception

- ▶ Determining factor on income taxation
- ▶ The accumulated reserves AND undivided net surplus should not exceed Php10,000,000 REGARDLESS of whether the cooperative is dealing with both members and non members;
- ▶ The accumulated reserves AND undivided net surplus EXCEEDS Php10,000,000 but the cooperative does business transactions with MEMBERS only
- ▶ (see Section 8 of JIRR of DOF and CDA implementing Articles 60 and 61 of RA 9520)

Continuation...

Determining factor On Value Added Tax

- ▶ On cooperatives transacting with members- Exempt from all national internal revenue taxes including VAT (Section 8 of the Joint Implementing Rules and Regulations dated 05 February 2010)
- ▶ On cooperatives transacting with non-members-VATABLE unless exempt as defined under NIRC as amended by RA 9337 as follows:

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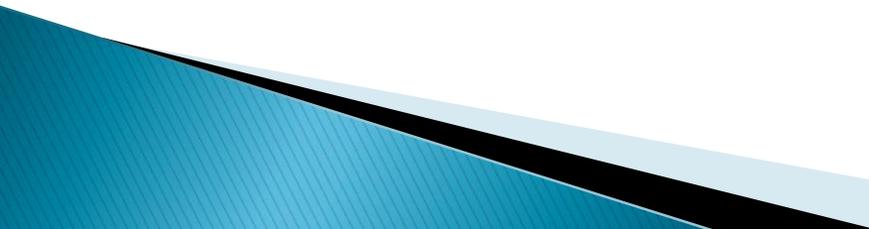
- ▶ "SEC. 109. *Exempt Transactions.* - (1) Subject to the provisions of subsection (2) hereof, the following transactions shall be exempt from the value-added tax:
- ▶ "(N) Sales by non-agricultural, non-electric and non-credit cooperatives duly registered with the Cooperative Development Authority: Provided, That the share capital contribution of each member does not exceed Fifteen thousand pesos (P15,000) and regardless of the aggregate capital and net surplus ratably distributed among the members;
- ▶ Cooperatives should never exceed the share capital contribution of each member beyond Php15,000

(Continuation)

Tax shield allegation in the negative sense is a serious charge. The burden of proof lies with the taxing authority. An investigation must be conducted first and evidence in place before the charge progresses.

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Requisites in the conduct of investigation of the cooperative's books of accounts and other accounting records:

- ▶ RMC 19-2010 mandates that all internal revenue officers are required to obtain prior authorization from the CDA before commencing tax audit. CDA has 20 days from receipt of the request within which to provide the requested authority.
 - ▶ Purpose of the investigation is to ascertain compliance with the conditions under which they have been granted tax exemptions and their tax liabilities (section 16, JIRR).
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- ▶ Letter of Authority/Letter-notice has been issued by the Commissioner or his authorized representatives.
 - ▶ LOA is served within the validity period of the LOA/Letter-notice.
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Understanding the concept of cooperatives dealing with members and non-members as prescribed under Sections 6, 7, 8, and 9 of the Joint Implementing Rules and Regulations.

For example, All income of cooperatives not related to the main/principal business/es under its Articles of Cooperation shall be subject to all the appropriate taxes under the NIRC, as amended. This is applicable to all types of cooperatives whether dealing purely with members or both members and non-members (see Section 9 of the Joint Implementing Rules, supra).

RECOMMENDATIONS

- ▶ Education and training should be strengthened to equip the cooperatives to handle proper accounting, and handling of transactions with tax implications.
 - ▶ It must be a mandatory element in the education and training curriculum of directors and officers of labor service cooperatives.
 - ▶ CDA should promote tax awareness among cooperative members.
 - ▶ Cooperatives who are tax exposed should be prepared for a tax audit.
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3. While tax exemption is not favored, cooperatives deserve a preferential tax treatment pursuant to RA 6938 as amended by RA 9520 subject to clear cut conditions

- ▶ Cooperatives, including their members, deserve a preferential tax treatment because of the vital role they play in the attainment of economic development and social justice. Thus, although taxes are the lifeblood of the government, the State's power to tax must give way to foster the creation and growth of cooperatives. To borrow the words of Justice Isagani A. Cruz: The power of taxation, while indispensable, is not absolute and may be subordinated to the demands of social justice (see *Dumaguete Cathedral Credit Cooperative vs. Commissioner of Internal Revenue* G.R. No. 182722, January 22, 2010)

Continuation...

- ▶ The legislative intent to give cooperatives a preferential tax treatment is apparent in Articles 61 and 62 of RA 6938, which read:

ART. 61. *Tax Treatment of Cooperatives.* — Duly registered cooperatives under this Code **which do not transact any business with non-members** or the general public shall not be subject to any government taxes and fees imposed under the Internal Revenue Laws and other tax laws. Cooperatives not falling under this article shall be governed by the succeeding section.

ART. 62. *Tax and Other Exemptions.* — **Cooperatives transacting business with both members and nonmembers** shall not be subject to tax on their transactions to members. Notwithstanding the provision of any law or regulation to the contrary, such cooperatives dealing with nonmembers shall enjoy the following tax exemptions; x x x.

Continuation...

- ▶ **Joint Implementing Rules and Regulations defines the tax exemption benefits granted to cooperatives, to wit:**
- ▶ **Section 7. TAX EXEMPTIONS OF DULY REGISTERED COOPERATIVES WHICH TRANSACT BUSINESS WITH MEMBERS ONLY.** - Duly registered cooperatives dealing/**transacting business with members only shall be exempt from paying any taxes and fees**, including but not limited to:
 - ▶ a) Income Tax imposed by Title II of the NIRC, as amended;
 - ▶ b) Value-Added Tax (VAT) imposed under Title IV of the NIRC, as amended;
 - ▶ c) Percentage Tax imposed under Title V of the NIRC, as amended;
 - ▶ d) Donor's Tax imposed under Title III of the NIRC, as amended, on donations to duly accredited charitable research and educational institutions and reinvestment to socio-economic projects within the area of operation of the cooperatives:

Continuation...

- ▶ X x x
- ▶ f) Documentary Stamp Tax imposed under Title VII of the NIRC, as amended, provided, however, that the other party to the taxable document/transaction who is not exempt shall be the one directly liable for the tax;
- ▶ g) Annual Registration Fee of P500.00 under Section 236(B) of the NIRC, as amended;
- ▶ h) All taxes on transactions with insurance companies and banks, including but not limited to 20% final tax on interest deposits and 7.5% final income tax on interest income derived from a depository bank under the expanded foreign currency deposit system; and

Continuation...

- ▶ **Section 8. TAXABILITY/EXEMPTION OF DULY REGISTERED COOPERATIVES WHICH TRANSACT BUSINESS WITH MEMBERS AND NON-MEMBERS.**
- ▶ a) Cooperatives with accumulated reserves and undivided net savings of not more than Ten Million (Php10,000,000.00) -- Exemption- from all national internal revenue taxes for which these cooperatives are liable as enumerated under Section 7 of this Joint Rules and Regulations.
- ▶ b) Cooperatives with accumulated reserves and undivided net savings of more than Ten Million Pesos (Php10,000,000.00) –
- ▶ b.1) Business transactions with members – **Business activities engaged in by such cooperatives with its members** where said cooperative generates revenues shall be exempt from all national internal revenue taxes for which it is liable as enumerated in Section 7 of this Joint Rules and Regulations;

Continuation...

- ▶ b.2) Business transactions with non-members – Cooperatives with accumulated reserves and undivided net savings of more than Php10,000,000.00 which transact with non-members shall:
 - ▶ b.2.1) Pay the following taxes at the full rate:
 - ▶ b.2.1.1) Income Tax – On the amount allocated for interest on capitals: Provided, That the same tax is not consequently imposed on interest individually received by the members. The tax base for all cooperatives liable to income tax shall be the net surplus arising
 - ▶ from the business transactions with non-members after deducting the amounts for the statutory reserve funds as provided for in the Cooperative Code and other laws.

Recommendations

- ▶ Secure a dialogue with the BIR to educate them about the tax benefits granted by law to cooperatives
 - ▶ Challenge the validity of any assessments with the Court of Tax Appeals
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4. Withholding tax taxable cooperatives should be based on administrative fees

- ▶ Withholding tax on job contracting cooperatives should be based on administrative fees

Justification:

- ▶ Salaries and statutory benefits form part of reimbursable costs which should not be treated as part of the gross income of the contractor (Department Order 18-A).

(Continuation)

Section 9 of D0 18-A provides that:

Required contracts under these Rules:

(b) Service Agreement between the principal and the contractor. The Service Agreement shall include the following:

▶ii. The place of work and terms and conditions governing the contracting arrangement, to include the agreed amount of the services to be rendered, the standard administrative fee of not less than ten percent (10%) of the total contract cost.

X x x

▶vii. The term or duration of engagement. The Service Agreement must conform to the DOLE Standard Computation and Standard Service Agreement, which form part of these Rules as Annexes “A” and “B”.

Annex A of D0 18-A has defined the Standard Computation of total contract cost as follows:

A. REIMBURSABLE COSTS:

- ▶ Payable directly to servicemen
- ▶ Salaries X X X
- ▶ Night differential premium X X X
- ▶ ECO LA X X X
- ▶ 13th month pay X X X
- ▶ SIL X X X
- Sub total

(Continuation)

B. Payable to the Government employee share

▶ SSS Premium	X X X
▶ Philhealth Premium	X X X
▶ ECC Insurance Premium	X X X
▶ Pag-ibig Fund contribution	X X X
▶ Sub total	
TOTAL REIMBURSABLE COSTS	X X X
▶ ADMINISTRATIVE FEE (10%)	X X X
▶ TOTAL CONTRACT	X X X

Continuation...

New IRR for Labor Service Cooperatives and Workers cooperative has virtually adopted the provisions of DO 18-A regarding the items that are treated as reimbursable costs. Section 9 thereof even provides the following:

- ▶ *Reimbursable costs as herein defined shall not form part of the income of the contractor. It shall be treated as a refund by the principal of the funds advanced by the contractor.*

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- ▶ Revenue Regulations 2-98 as amended implementing Sections 57 and 58 of the NIRC prescribes the withholding taxes for income payments to certain payees.
 - ▶ In order that an amount received will form part of gross receipts, the same constitute the gross income of the taxpayer when received or earned (Pronounced Rationale behind RMC 39-2007).
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(Continuation)

- ▶ It is settled that only receipts which is subject to a taxpayer's unfettered command which he is free to enjoy at his own option is taxed to him as his income whether he sees fit to enjoy it or not (Corliss v. Bowers, 281 U.S. 376).
- ▶ The principal and the contractor are both employers who are jointly and severally liable for violation of the Labor Code including non payment of wages (D0 18-A).

(Continuation)

- ▶ Withholding of taxes based on gross payment results in undue diminution of the full enjoyment of tax benefits punishable under Article 140 paragraph 3 of RA 9520 making the basis excessive in nature. Excessive tax policies violates rights to due process of the cooperative.

Continuation...

▶ It may be granted that the interpretation of the Commissioner of Internal Revenue in charge of executing the 1997 National Internal Revenue Code is an authoritative construction of great weight, but the principle is not absolute and may be overcome by strong reasons to the contrary. If through a misapprehension of law an officer has issued an erroneous interpretation, the error must be corrected when the true construction is ascertained (*see Banco De Oro et al. vs. Bureau of Internal Revenue G.R. No. 198756*)

Continuation...

- ▶ While administrative agencies, such as the Bureau of Internal Revenue, may issue regulations to implement statutes, they are without authority to limit the scope of the statute to less than what it provides, or extend or expand the statute beyond its terms, or in any way modify explicit provisions of the law. Indeed, an quasi-judicial body or administrative agency for that matter cannot amend an act of Congress. Hence, in case of a discrepancy between the basic law and an interpretative or administrative ruling, the basic law prevails (*Commissioner of Internal Revenue vs. The Insular Life Assurance Co. , Ltd, G.R. No. 197192 dated June 4 2014*)

RECOMMENDATIONS

- ▶ With the assistance of CDA, have a dialogue with the BIR Commissioner to clarify the tax base for contractors engaged in job contracting and sub-contracting arrangements
 - ▶ Secure a ruling from the BIR to get a solid basis of withholding tax base in case a cooperative becomes taxable
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(Continuation)

- ▶ File claims for tax refund on the ground that the basis of withholding is erroneous
 - ▶ In the meantime, withhold taxes based on gross payment pursuant to RR 2-98 as amended by RR No. 17-2003
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5. CDA should have a peculiar place in the Office of the President.

- ▶ The Office of the President should give proper recognition to cooperatives pursuant to the constitutional mandate that guarantees protection of Cooperatives. Section 15, Article XII of the Constitution considers cooperatives as instruments for social justice and economic development.

Continuation...

- ▶ Section 10 of Article II of the Constitution declares that it is a policy of the State to promote social justice in all phases of national development.
- ▶ Section 2 Article XIII of the Constitution states that the promotion of social justice shall include the commitment to create economic opportunities based on freedom of initiative and self-reliance.

(see Dumaguete Cathedral Credit Cooperative vs. Commissioner of Internal Revenue, *supra*.)

Recommendations

- ▶ Dialogue with Congress especially at this point that there is a pending bill seeking to amend or repeal RA 6939
 - ▶ Dialogue with the Department of Finance so they would appreciate the role of the CDA a lot better
 - ▶ Secure a joint orientation training with the BIR to familiarize them with the principles, laws, rules, and regulations governing cooperatives.
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THANK YOU!