REVENUE MEMORANDUM CIRCULAR NO. 35-2006 issued on June 30, 2006 clarifies the proper Value-Added Tax (VAT) and Expanded Withholding Tax (EWT) treatment of freight and other incidental charges billed by freight forwarders.

For outbound movement of carriers, the freight (exclusive of the commission of the forwarders), together with the accessorial charges and offshore destination charges shall not be considered as forming part of the gross receipts of the forwarders because said charges are not for services rendered by the forwarders but actually by the third-party service providers. Thus, when paid by the clients, they merely constitute amounts held in trust by the forwarders as they are actually intended for the said third-party service providers (i.e., the carriers and foreign forwarders/agents). Thus, for VAT purposes involving outbound movement, only the following shall be considered as forming part of the gross receipts of the forwarders:

a. Local origin charges; and
b. Actual commission income of the forwarders on the freight (as a consideration for the integration of the various services).

In the same manner, for inbound movement of cargoes, the freight (exclusive of the commission of the forwarders), together with the accessorial charges and offshore origin charges shall not be considered as forming part of the gross receipts of the forwarders because they constitute amounts merely held in trust by the forwarders. Thus for VAT purposes involving inbound movement, only the following items shall be considered as forming part of the gross receipts of the forwarders:

a. Local destination charges;
b. Currency Adjustment Factor (CAF); and
c. Actual commission income of the forwarders on the freight (as a consideration for the integration of the various services).

For local movement of cargoes, the entire amount received by the forwarder for the said movement shall be considered as forming part of the gross receipts of the forwarder if the forwarder issues a VAT Official Receipt thereof. The services paid for by the client is the carriage of the cargoes from one destination in the Philippines to another destination in the Philippines with the commitment that the said services, including other accessory services like handling, storage, documentation, etc., will all be performed by the forwarder. This rule will apply even if the forwarder will engage the services of independent contractors to perform some of the services but the said independent contractors issue their VAT Official Receipt to the forwarders (and not to the shippers) who make the payment to them. This is so because the forwarder does not merely act as an intermediary between the client/shipper and other service providers but undertakes to perform all the services of bringing the cargoes from one point in the Philippines to another point in the Philippines. Hence, all expenses paid out of the money received from the client redound to the benefit of the forwarder, which is considered its costs of doing business. Accordingly, the entire funds paid by the client belong to the forwarder thereby making it liable for the VAT on the entire amount received.

For VAT purposes, the freight forwarder shall issue a VAT Official Receipt for the entire amount received from the shipper/client reflecting therein the amount of the VAT. In the event that the third-party service providers will be involved in the carriage of goods, it is the responsibility of the third-party service providers to issue a VAT official
receipt to the freight forwarder who engaged their services so that the latter can properly claim input taxes.

The foregoing rule, notwithstanding if the forwarders engage the services of third-party service providers and the amount payable to them are treated by the forwarders as reimbursable expenses and/or advanced payments and a VAT official receipt is only issued on the services they actually render while the reimbursable expenses are covered by a Non-VAT Acknowledgement Receipt, the amount collected in behalf of these third-party service providers must not form part of the forwarders’ gross receipts.

Reimbursable expenses and/or advanced payments shall not be subject to VAT on the part of the forwarder if the following conditions/procedures are complied with:

a. The reimbursable expenses and/or advance payments, except those incurred for the benefit of the forwarder are receipted separately using Non-VAT Official Acknowledgement Receipts to be issued by the forwarders to the shippers upon collection of the reimbursements or advances previously recorded as RECEIVABLE FOR CASH ADVANCES ON BEHALF OF SHIPPERS, which recording was done upon payment, on behalf of shippers, of the advances to the third-party service providers who issued official receipts in the name of the shippers and not of the forwarders;

b. The third-party service providers to whom the advanced payments or reimbursable expenses of the shippers have been paid by the forwarders, shall issue receipts in the name of the shippers;

c. The forwarders shall record the reimbursable expenses of or the advanced payments on behalf of shippers under the account “RECEIVABLE FOR CASH ADVANCES ON BEHALF OF SHIPPERS”, and

d. For liquidation purposes, the forwarders shall attach the original copy of all said official receipts issued by the third-party service providers in the name of the shippers to the Non-VAT Official Acknowledgement Receipts of the forwarders issued to their shippers upon payment by the latter of the reimbursable expenses.

Accordingly, while in the foregoing scenario, the forwarders shall not be liable for any Output Tax on the collection of the reimbursable expenses or advance payments on behalf of their shippers. Said shippers, however, may be able to claim Input Tax for the services of the third-party service providers that are subject to VAT if the same are receipted by the third-party service providers’ VAT Official Receipts evidencing the latter’s reporting of the same for VAT purposes.

Every VAT-registered forwarder shall, for every sale of service, issue a VAT Official Receipt containing the required information provided in Revenue Regulations (RR) No. 16-2005: Provided, however, that in case of outbound and inbound movements, the forwarders shall be allowed to show separately under one Billing Statement the amounts due (or held in trust) for the third-party service providers and the charges subject to VAT purposes of determining the VAT component due on the said transaction.

In the said Billing Statement, the VAT component due on the commission may likewise be shown separately with the VAT component on the other taxable charges. Upon the Issue of the VAT Official Receipt by the forwarders involving outbound and inbound movements, the amount of VAT component (calculated based on the Billing Statement) shown in the said receipt is the amount of input VAT that may be claimed by
the clients. For administrative convenience, the amount of commission shall be computed at 5% of total freight charges which is the International Air Transport Association (IATA) rate.

The forwarder should issue the following documents to the shipper upon its payment:

a. VAT Official Receipt covering vatable charges; and
b. Non-VAT Acknowledgement Receipt covering non-vatable charges.

For the purpose of computing the actual VAT liability of the forwarders, the Output Tax to be declared in their VAT returns shall be the Output Tax computed based on the actual gross receipts of the forwarders but in no case below 5% of freight cost per billing statement, which was made the basis of the VAT shifted (input tax) to the Shipper.

Thus, for cross-border movement of goods, the actual gross receipts of the forwarders represents actual commissions received plus the other vatable charges, i.e., the local origin/destination charges and CAF, which is determined by deducting from the gross receipts received from the clients, exclusive of the VAT and the amounts held in trust/due to third-party service providers.

However, for Income Tax purposes, the forwarders shall always determine their income tax liability based on actual gross receipts.

As for local movement of goods, the forwarder’s gross receipts will depend on how the entire amount received from the shipper is treated by the forwarder, which is normally reflected in the invoicing procedures they adopted. If the forwarder issues a VAT Official Receipt for the entire amount received from the shipper (including those intended for third-party service providers), the Output Tax shall be computed on the total amount received from the client/shipper. The Official Receipt must separately reflect the VAT computed at 12% of total amount received, exclusive of the VAT.

On the other hand, if the forwarder issues its VAT Official Receipt only for that portion representing its actual services and a Non-VAT Acknowledgment Receipt for the amount payable to third-party service providers, the Output Tax shall be computed only on the amount covered by the VAT Official Receipt in the name of the shipper indicating separately the Output Tax which becomes the Input Tax of the shipper.

The examiner, in the conduct of his audit for cross-border movement of goods, must at all times require the presentation of the covering contract and/or rate agreement by and between the forwarder and the shipping or airline company, as well as other relevant documents which will help in the determination of the actual commission earned by the forwarder. However, for VAT purposes, the BIR adopts the audit policy that forwarders which report commissions (either in the VAT Official Receipts issued to the clients or in the VAT returns filed) of below 5% of total freight charged must be the first priority in the conduct of audit. Likewise, for local movement of goods, the forwarders which shall not report the entire amount as forming part of their gross receipts, if covered by VAT Official Receipt issued by the forwarders, shall be subject to first priority in the conduct of audit.

The Billing Statement and Official Receipt issued by the forwarders in the name of the client shall, in the hands of the clients, be a sufficient proof for claiming a deduction for Income Tax purposes, provided that the proper withholding of tax has been made by the clients.
However, in the hands of the forwarders, all payments to third-party service providers representing actual freight, together with the accessorial charges, and the offshore origin/destination charges, must be covered by Official Receipts issued by the international carrier and the foreign freight forwarder or foreign agent, respectively, in the name of the freight forwarder plus any acceptable proofs of payment and other relevant documents (i.e., billing statements, deposit slips, confirmation/acknowledgment receipts, contracts, summaries/schedules, etc.). Otherwise, any such payments claimed to have been made by the forwarders to the said third-party service providers (which are included in the payments of the clients to the forwarders) but are not covered by the said acceptable proofs and relevant documents, shall be treated as forming part of the gross receipts of the forwarders subject to VAT and not allowed as a deduction for Income Tax purposes.

For Expanded Withholding Tax (EWT) purposes, the forwarders shall not be considered as commercial forwarders or agents subject to 10% withholding tax. Instead, the forwarders shall be treated as other contractors (operator of forwarding establishment), hence, subject to 2% withholding tax.

Insofar as cross-border shipment of goods is concerned, the 2% EWT to be withheld and remitted by the client/shipper shall be based only on the gross commissions received, plus the local origin/destination charges and CAF computed as follows:

a. For services subject to regular VAT rate:
   \[ EWT = \frac{\text{VAT amount} \times 2\%}{\text{Rate of VAT}} \]

b. For services subject to zero-rate:
   \[ EWT = \text{Total compensation for zero-rated services} \times 2\% \]

Where the total compensation (on cross-border shipment) refers to the gross commissions received on the freight paid to airline or shipping companies plus the local origin/destination charges and CAF. For this purpose, the gross commissions deemed to have been received by the forwarders is 5% of the freight paid to the airline or shipping companies.

The payments to third-party service providers are likewise subject to the EWT. The forwarder shall withhold and remit the 2% EWT (in behalf of various shippers) since it is the party which has control over the disbursement of the funds. In addition, the forwarder shall prepare a listing/summary of the shippers/clients indicating therein the amounts charged as freight and accessorial charges (net of commission) which shall be attached to the EWT return filed by the forwarder to the BIR.

Further, it shall be the duty of the freight forwarder to issue, in behalf of the various shippers, the Certificate of Creditable Taxes Withheld (BIR Form No. 2307) to the third-party service provider.

For local transactions, the withholding of the 2% EWT will always fall on the shipper who claims the entire expense for Income Tax purposes. If the forwarder issues its VAT Official Receipt on the entire amount, the entire amount received (exclusive of the VAT) will be reported as its income. As a rule, “all income payments which are required to be subjected to withholding of income tax shall be subject to the corresponding withholding tax rate to be withheld by the person having control over the payment and who, at the same time, claims the expenses.” (Section 5, RR No. 30-03).
However, in case where a portion of the amount received by the forwarder is booked as advances or reimbursable expenses because they are earmarked for payments to third-party service providers, not only the amount covered by the forwarder’s VAT Official Receipts (which amount constitute its gross income) shall be subject to EWT by the shipper, but also the amount covered by the Non-VAT acknowledgment receipt.

Upon making the payments to the third-party service providers (the persons to whom the advance payments have been made by the forwarders), the forwarders shall pay or advance the prescribed amount net of the required EWT, which net amount is the amount that should be requested for reimbursement from the shippers while the retained amount pertaining to the EWT shall be remitted to the BIR by the said shippers.

The Certificate of Tax Withheld (BIR Form No. 2307) shall reflect the name of the shipper as the payor of the billed income payment, the name of the forwarders as the agent of the real payor who is the shipper, and the name of the third-party service provider as the payee of the billed income payment.

To ensure that the proper taxes are deducted and withheld from such payments to third-party service providers, the following conditions/procedures must be complied with:

a. It shall be the responsibility of the forwarders to instruct the third-party service providers to issue the Official Receipts directly in the name of shippers of the forwarders;

b. Upon making the payments to the third-party service providers, the forwarders shall compute and deduct the EWT due on the said payments. At the same time, the forwarder shall issue the Certificate of Tax Withheld (BIR Form No. 2307) for the deducted amount of EWT, which Certificate shall reflect the name of the third-party service provider as the payee of the income payment, the name of the shipper as the real payor of the income payment with parenthetical mention of the name of the forwarder as agent of the shipper, the amount of income payment, the covered period and such other information as required under existing rules and regulations. At this point in time, the third-party service provider shall forward to the forwarder the third-party service provider’s official receipt issued to the shipper reflecting therein the name of the third-party service provider as the issuer of the official receipt, the name of the shipper as the buyer of the service, the nature and description of the transaction, the volume of the transaction, the price of the transaction, the VAT passed on and billed separately, if any, the EWT deducted by the agent of the payor, the net amount paid and such other information as are required under existing rules and regulations.

c. In the subsequent claim for reimbursement of the said payments, the forwarder shall demand from the shippers only the amount actually paid to the third-party service providers (which is already net of the EWT) with instructions to said shippers to remit to the BIR the amount of EWT on the said payments;

d. The forwarders shall attach to their Non-VAT Official Acknowledgement Receipts (reflecting the amount being reimbursed) the original copy of the official receipts issued by the third-party service providers in the name of the shippers of the forwarders; and
e. The time for withholding of the taxes due on said payments to third-party providers shall be governed by the provisions of the prevailing law and regulations on withholding of the tax on income payments reckoned from the time the reimbursement is claimed from the shippers by the forwarders.

With respect to the reimbursement to the forwarders by their shippers of the reimbursable expenses and/or advanced payments of the formers in favor of the latters following the prescribed procedures, the same shall no longer be subject to EWT since these payments do not form part of the gross receipts of the forwarders.

However, for reimbursable expenses and/or advanced payments of expenses redounding to the benefit of the forwarder, and all other reimbursable expenses covered by VAT Official Receipts of the forwarders, the same shall, upon reimbursement by the shippers, form part of the forwarders’ gross receipts and shall therefore be subject to EWT notwithstanding that such reimbursement are for payments of reimbursable expenses and/or advanced payments made by the forwarders on behalf of their shippers.