
The issue that comes into fore is whether or not the security guard’s salaries, which form part of the Contract Price of the security services rendered by the Security Agency, can be treated as gross income of the Security Agency, which will constitute as part of the taxable gross receipts subject to VAT, whether actually or constructively received.

In view of the clear language of the law and its implementing regulations placing the primary obligation on the Client to pay the salaries of the security guards coupled with the requirement that the monies received by the Security Agency representing salaries shall be earmarked and segregated for the said guards, the amount paid by the Client representing the salaries of the security guards will not form part of the Security Agency’s gross income, and neither will it form part of its taxable gross receipts when actually or constructively received.

The Security Agency must record as part of its gross income the Agency Fee portion of the payment, net of the VAT thereon. Since the security guards’ salaries are tacked in as part of the service fees, the security agency must always recognize that portion of the fees as a LIABILITY. For this purpose, the Contract for Security Services entered into by and between the security agency and its Client must provide for a breakdown of the amount of security services into two components: (1) the Agency Fee, and (2) the Security Guards’ Salaries. If the Contract does not provide for a breakdown of the amount payable to the security agency, the entire amount representing the Contract Price will be taxed as income to the Agency, which must form part of its gross receipts, whether actually or constructively received.

The Client who is engaged in business can claim as a deduction from gross income the total amount paid to the Security Agency, net of the VAT on the Agency Fee. It is allowed to recognize an input tax based on the Agency Fee if the transaction is covered by a VAT Official Receipt issued by the Security Agency. It is also required to withhold and remit the Expanded Withholding Tax (EWT) on the Agency Fee. The portion of the expense pertaining to the security guards salaries will be covered by a Non-VAT Acknowledgment Receipt issued by the Security Agency.

For VAT purposes, the taxable gross receipts of the Security Agency pertains to the amount actually or constructively received by it constituting its gross income. Since only the amount covering the Agency Fee represents its gross income, then that portion alone of the Contract Price, when actually or constructively received, will constitute the Security Agency’s taxable gross receipts. This means that the amount received by the Security Agency, which is segregated, earmarked or set aside for the salaries of the security guards, will not form part of its gross receipts but should be recognized as a LIABILITY. Accordingly, the 12% output tax will only be computed on the Agency Fee which shall in turn be the input tax of its Client.

Only the portion of the payment representing the Agency Fee, if covered by a VAT Official Receipt, will entitle the VAT-registered Client to a claim of input tax credit. This means that the amount of output tax paid by the Security Agency is the amount of input tax available to the Client. The Client cannot claim an input tax on the salary portion of the expense (Security Services) because it pertains to services exempt from VAT. Section 109(I) of the National Internal Revenue Code (NIRC), as amended, specifically exempts from VAT services rendered by individuals pursuant to an employer-employee relationship. The services of the security guards squarely fall under
this category of exempt transaction. This is because, in substance, the Client has the
principal obligation to bear the prescribed wage rates for the security guards as
mentioned, and the Security Agency will be jointly and severally liable therefore only in
the event of the Client’s failure to pay.

Consonant with the provisions of Section 113 of the NIRC, as amended, and as
implemented by Section 4.113-1 of Revenue Regulations (RR) No. 16-2005, the
Security Agency shall issue a VAT Official Receipt for every sale, barter or exchange of
services. The VAT Official Receipt shall cover the entire amount which the Client pays
to the Security Agency representing the compensation of its services (Agency Fee) with
the indication that such amount received includes the VAT. The VAT on the Agency Fee
must always be shown as a separate item in the VAT Official Receipt. The VAT shown
on the VAT Official Receipt will constitute the output tax of the Security Agency and in
turn, the input tax of its Client.

With respect to the security guards’ salaries, which are mandated by law to be
paid by the Client through the Security Agency, the amount so paid representing salaries
must be covered by a Non-VAT Acknowledgement Receipt. This document, coupled
with the notarized certification of the EWT shall be a sufficient substantiation for the
expense that will be claimed as a deduction from gross income by the Client.

As a general 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.”

Insofar as the Agency Fee is concerned, the Client is constituted as the
withholding agent of the EWT following the rule abovementioned. However, with
respect to the portion of the Contract Price representing the amount segregated and
earmarked as salaries of the security guards, the Security Agency shall be the one
responsible for the withholding of the tax on compensation income. This is so because
while it is the Client who claims the payment as an expense, it is the Security Agency that
physically controls the payment to the salaries of the Security guards. However, in order
to comply with the requirement for deductibility under Section 34(K), in relation to
Sections 58 and 81, all of the NIRC, as amended, the Security Agency must furnish its
Client, on or before January 31 of the year following the year of withholding, a Notarized
Certification indicating the names of the guards employed by the Client, their respective
Taxpayer’s Identification Numbers (TINs), the amount of their salaries and the amount of
tax withheld from each. This certification together with the covering Non-VAT
Acknowledgment Receipt must be kept on file by the Client as substantiation for the
claim of the expense.