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CLARIFICATION OF THE TAX TREATMENT OF (A) GAINS ON FOREIGN EXCHANGE TRANSACTIONS; AND, (B) SALES OF PRODUCTION “REJECTS AND “SECONDS”, SCRAP, RAW MATERIALS, PACKAGING MATERIALS ...

PEZA MEMORANDUM CIRCULAR NO. 2005-032, September 15, 2005

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On Gains on Foreign Exchange Transactions:

Foreign currency is normally used by Ecozone Export Enterprises for their registered activities, either as the functional currency or as a supplemental currency. On the other hand, it is also used by some Ecozone Export Enterprises for other activities which can be considered as "additional business opportunities" which PEZA has no control of.

The tax treatment of foreign exchange (forex) gains shall depend on the activities from which these arise. Thus, if the forex gain is attributed to an activity with income tax incentive (Income Tax Holiday or 5% Gross Income Tax), said forex gain shall be covered by the same income tax incentive. On the other hand, if the forex gain is attributred to an activity without income tax incentive, said forex gain shall likewise be without income tax incentive i.e., therefore, subject to normal corporate income tax.

The tax treatment of forex gains is illustrated as follows:

Activity Income tax Incentive Tax Treatment of Forex Gain

Registered 1st Project 5% Gross Income Tax 5% Gross Income Tax

Registered 2nd Project

Income Tax Holiday Income Tax Holiday

Other Activities None Normal Corporate Income Tax

On Sales of Production "Rejects" and "Seconds", Scrap Raw Materials, Packaging Materials and Other Production Supplies:

1. All local sales shall be subject to applicable duties and taxes (including VAT) prior to withdrawal thereof from the Ecozone.

2. For purposes of entitlement to income tax incentives (Income Tax Holiday or 5% Gross Income Tax), the following shall apply:

a. Sale of production "rejects" and "seconds" from the registered activity of the Export Enterprise shall be

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considered covered by the registered activity of said Enterprise. Thus, any income derived shall be covered by the applicable income tax incentive, i.e., Income Tax holiday or 5% Gross Income Tax.

b. Sale of recovered waste/scrap generated from processing of raw materials, including used packaging materials and other direct/indirect materials/supplies that have undergone processing/which have been used in production/processing activity registered with PEZA shall likewise be considered covered by the registered activity of an Export Enterprise. Any income derived therefrom shall likewise be covered by the applicable income tax incentive.

c. Sale of unprocessed, unused, obsolete or "off-specs" production inputs (direct/indirect materials/supplies) shall not be covered by the registered activity of an Ecozone Enterprise. Thus, any income derived therefrom shall be subject to normal corporate income tax, provided that the related cost shall be deducted only once for purposes of computing income.

For purposes of proper reckoning of incentives, Ecozone Export Enterprises with multiple activities are required to maintain separate books of accounts for each activity.

Adopted: 15 Sept. 2005

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