

REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE
Quezon City

May 16, 2003

REVENUE MEMORANDUM CIRCULAR NO. 28-2003

SUBJECT : Clarification of Issues on the Imposition of Value-added Tax on Banks, Non-Bank Financial Intermediaries, Finance Companies and Other Financial Intermediaries Not Performing Quasi-Banking Functions

TO : All Internal Revenue Officers and Others Concerned

1-Q. Are income from services performed by banks and other financial institutions (FIs) to PEZA and BOI-registered enterprises, and to persons with VAT Exemption Certificate (VEC) processed pursuant to RMO 81-99 exempt from VAT?

1-A. Income from sale of services to BOI-registered export enterprise with 100% export sales and PEZA-registered/Ecozone export enterprise are subject to VAT at 0% while services rendered to qualified embassies and their personnel with VEC are subject to VAT but the embassy with valid VEC from the BIR may claim refund or tax credit for the VAT passed-on on its purchases. (The validity period of the BOI Certificate of Registration, PEZA Certificate of Registration, and VAT Exemption Certificate is discussed in separate revenue issuances)

2-Q. Are trust funds managed by the banks and other FIs subject to VAT?
(These funds may include common trust funds, investment management agreement, etc?)

2-A. No. The VAT applies only to the fees/compensation which the Trust Department receives for performing the services of managing the trust funds.

3-Q. Is Gross Receipts determined on a cash or accrual basis?

3-A. Generally, "gross receipts" is determined on a cash basis, so that if an income is received, actually or constructively, it is already subject to VAT; or simply put, VAT is imposed on income/deposit/advance payment received regardless of the time or period when it was/is earned.

4-Q. In the cash method, when is the income from discounted loans and investments recognized for VAT purposes?

4-A. *A discounted loan is a loan where the entire interest and principal are paid at maturity. In this case, the VAT shall be paid on maturity. However, if the discounted loan is sold before maturity date, the trading gain arising therefrom is subject to VAT. For the subsequent holder which is likewise a financial institution, the VAT will be based on the difference between the maturity value and the acquisition cost of the securities. Interest on coupon bonds received before maturity of the bonds and any other interest income, for that matter, received before the maturity of the investment/securities shall be taxable in the period of receipt.*

5-Q. In the accrual method, when is the VAT payable by the FI?

5-A. *If a Financial Institution adopts the accrual method, the VAT is payable only upon actual or constructive receipt of the income. The FI, being classified as a seller of service, is not liable to VAT upon accrual of the income.*

6-Q. How do the terms “actually received income” and “constructively received income” in Section 2.10 of RR 12-2003 differ from each other?

6-A. *The term “actually or constructively received amount of income” is equivalent to the economic benefit derived from the income payment. Actual receipt of income happens when actual physical possession of the money or property payment takes place whereas constructive receipt of income occurs when the money consideration or its equivalent is placed at the control of the person who rendered the service without restrictions by the payor. The following are examples of constructive receipts: 1.) deposit in banks which are made available to the seller of services without restrictions; 2.) issuance by the debtor of a notice to offset any debt or obligation and acceptance thereof by the seller as payment for services rendered; and 3.) transfer of the amounts retained by the contractee to the account of the contractor. Hence, where the income payment was subjected to final tax, the amount constructively received corresponding to the final withholding of income tax which was used in extinguishing the recipient’s income tax liability on the income received forms part of the taxable receipt for purposes of computing recipient’s/taxpayer’s VAT liability.*

7-Q. Under the accrual method, can a bank or other FI adjust its VAT payment for income earlier earned and received but later reversed when this loan becomes non-performing?

7-A. *As stated earlier, VAT is payable at the time the income is received. Nonetheless, income collected in advance and taxed upon receipt but subsequently returned for failure to deliver the required service shall be treated as a deduction from gross receipts at the time the previously collected amount is returned.*

8-Q. How is financial intermediation service fee defined and computed?

- 8-A.** *The term “financial intermediation services” refers to the gross interest income received, including discounts received in cash or property, from all lending and investment activities of the financial institution.*
- 9-Q.** Are the income of banks and other FIs from transactions with the Bangko Sentral ng Pilipinas subject to VAT which can be passed-on to BSP.
- 9-A.** *Yes. VAT, being an indirect tax, can be shifted/passed-on to the customer-BSP.*
- 10-Q.** Are the income of banks and other FIs from investments in government securities and commercial papers which are issued respectively by the National government/other government agencies and corporate issuers subject to VAT which can be passed-on to said issuers.
- 10-A.** *Yes. All income of FIs are subject to VAT except transactions specifically exempted under Section 109 of the Tax Code of 1997 and other special laws.*
- 11-Q.** In computing the difference between the value of the foreign currencies sold and foreign currencies purchased, can banks use the net gain or loss of its foreign currency position at the end of each month?
- 11-A.** *Yes. Revenue Regulations No. 12-2003 in Section 3.3 expressly so provides.*
- 12-Q.** Can the gain or loss in a foreign currency position in one month be offset against the loss or gain in another month for purposes of determining the output tax?
- 12-A.** *Yes, provided the months are within the same calendar or fiscal quarter.*
- 13-Q.** Are forex swap differentials part of the net foreign exchange/trading gains or losses, whichever is applicable?
- 13-A.** *Forex swap differentials are part of a foreign exchange transaction.*
- 14-Q.** Is a revaluation gain involving foreign currencies and securities transactions subject to VAT?
- 14-A.** *No, if it is a translation gain or loss for the purpose of book entry or recording and that no actual transaction occurred.*
- 15-Q.** On net trading gains, how is “carrying cost” defined?
- 15-A.** *For VAT purposes, “carrying cost” is the original amount or the cost, net of unearned discount, incurred to acquire the security.*

16-Q. Can banks and other FIs deduct foreclosure expenses (such as legal fees, sheriff fees, etc.) for purposes of determining the gain on ROPOA sales subject to VAT?

16-A. *No, since we are referring to a VAT base, not income tax.*

“Section 3.5. On ROPOA Sales or Sales of Other Properties Acquired Through Foreclosure. – The output tax on ROPOA sales, as well as other properties acquired through foreclosure sale, shall be determined by multiplying by ten percent (10%) the gain, or the difference between the amount realized at the time of sale and the cost thereof which is equivalent to the bid price or unpaid loan value, whichever is lower, at the time of the foreclosure of the property, which gain or difference shall be considered as the gross receipts of the financial institution from the aforesaid transactions.” (Revenue Regulations No. 12-2003)

17-Q. Is the mortgagee-bank/FI liable to VAT on foreclosure of mortgaged property and/or upon consolidation of the foreclosed property in the bank and other FI's books?

17-A. *No. VAT is payable at the time the ROPOA is finally sold or disposed. The VAT base shall be the gain or difference between the amount realized at the time of sale and the cost thereof which is equivalent to the bid price or unpaid loan value, whichever is lower, at the time of foreclosure. Time of foreclosure for this purpose, means the time when the Loan Receivable account is reversed and a ROPOA account is created in the books.*

18-Q. Are ROPOA sales under an SPV program subject to VAT?

18-A. *Subject to the conditions set forth in Sections 15, 16, 17 and 18 of Article IV of Republic Act No. 9182, transfer of ROPOA from FIs to SPV (Special Purpose Vehicle) is exempt from VAT.*

19-Q. When is the gain on ROPOA sold on installment basis subject to VAT?

19-A. *Gain on ROPOA is subject to VAT at the time of sale, not at the time of payment. (regardless of whether the method or mode of payment is cash or installment).*

20-Q. Is income previously exempt from GRT also exempt from VAT? These include dividends, Landbank Agrobonds, HIGC guaranteed loans.

20-A. *No. The only income or transactions that are exempt from VAT are those so exempted by express provision of the law (Section 109 of the Tax Code of*

1997), including special laws. Dividend is subject to GRT (gross receipts tax) at 0% while it is subject to VAT at 10%.

21-Q. Are income earned and subjected to GRT in the previous years (before 2003) but paid and collected in 2003 subject to VAT?

21-A. *If prior to January 1, 2003, GRT was actually paid on the income collected in 2003, then it is no longer subject to VAT.*

22-Q. Are income paid in advance but unearned subject to VAT?

22-A. *Yes, applying the definition for the term “Gross Receipts”.*

23-Q. Can service income which has been subjected to VAT in one period but later becomes uncollectible be deducted from the bank and other FIs VAT liability in another period?

23-A. *No. Such a situation will not arise because VAT liability is determined and collected based on gross receipts (whether such gross receipts is actual or constructive).*

24-Q. Are bad debts recoveries subject to VAT?

24-A. *Yes, on the portion pertaining to past due interest and other charges, but not on the principal amount of loan.*

25-Q. What is the transition period for banks and other FI to implement the VAT regulation?

25-A. *Two months or from January 1 to February 28, 2003 (RR 12-2003).*

26-Q. Can the VAT invoice and receipt covering the client’s transactions with the bank or other FI be issued on a consolidated basis per client?

26-A. *Yes, provided all the information required in Sections 237 and 113 of the Tax Code of 1997 and Section 7 of Revenue Regulations No.12-2003 are reflected in the invoice/receipt and provided further that the specific type of transaction is enumerated individually in the receipt. A charge invoice is issued to customer to evidence sale on account whereas a cash invoice/official receipt is issued to client to evidence cash sale. An official receipt is issued to client to evidence collection of sale on account.*

27-Q. Can a Billing Statement/Statement of Account issued by an FI serve as an Official receipt?

- 27-A.** *A Billing Statement/Statement of Account cannot be considered as an Official Receipt(OR) since an OR is issued only upon receipt of the monetary or property consideration or price which is not yet happening when a Billing Statement is released. Nonetheless, a Billing Statement/Statement of Account can serve or function as a charge invoice provided all the information required in Sections 237 and 113 of the Tax Code of 1997, and Section 7 of Revenue Regulations No. 12-2003 are reflected in the Billing Statement/Charge Invoice.*
- 28-Q.** Can FIs' clients use the input VAT pertaining to transactions during the transition period? Can the FI use the input VAT pertaining to transactions during the transition period?
- 28-A.** *FIs' clients can use the input VAT pertaining to transactions during the transition period provided these transactions are evidenced by BIR-approved and-registered VAT invoice/receipts which separately reflected the passed-on VAT and, only where the input tax was recorded in the books as a separate/independent item from the account where it was sourced. On the other hand, the FI can use the input VAT pertaining to transactions during the transition period if the transactions are evidenced by BIR-approved and-registered VAT invoice/receipts and at the same time the input tax was recorded in the books as a separate/independent item from the account where it was sourced.*
- 29-Q.** Can banks and other FIs forego issuing VAT receipts covering transactions with non-VAT registered clients. In case there are clients who refuse to sign a confidential waiver under RA No. 1405 and the General Banking Act, can the banks and other FIs refuse to issue VAT receipts on affected transactions and remove the identity of said clients in the reports to BIR.
- 29-A.** *Banks and other FIs or any VAT registered person/entity cannot forego the issuance of VAT invoice/receipts with its VAT or non-VAT clients. It is a mandatory requirement under Sections 113 and 237 of the Tax Code of 1997. Failure to do so could mean suspension by the Commissioner of Internal Revenue of the banks' or FIs' business operation and temporary closure of the business establishment, aside from the imposition of other administrative, civil, and criminal sanctions allowed under existing rules. Moreover, FIs, as VAT-taxable entities, are required to comply with the requirements prescribed in Revenue Regulations No. 8-2002 (The submission of the Schedule of Sales, Schedule of Domestic Purchases of Goods and Services, and Schedule of Importation to the home RDO of the taxpayer).*
- 30-Q.** In cases where one consolidated VAT receipt is prescribed (i.e., trading gains, foreign exchange gains, small amounts, ATM fees, returned checks, telegraphic transfers) can the banks and other FIs issue "sub-VAT" receipts to VAT-registered entities who make such a request?

30-A. *No. Issuance of one consolidated VAT receipt per category of transaction is allowed only in those instances enumerated in Revenue Regulations No. 12-2003. The receipts to be issued by banks and other FIs are BIR-approved and-registered VAT Official Receipts. In instances where issuance of consolidated VAT receipt per category of transaction is allowed under the law, request by client for issuance of sub-VAT receipt per client and/or per transaction cannot be granted although a purchase voucher accomplished by the client may be signed by the FI to substantiate client's purchases.*

31-Q. Are interests paid by banks and other FIs to VAT-registered depositors and lenders subject to VAT?

31-A. *No, except if the VAT-registered depositor is a bank or FI because interest is an operating/business income to an FI. It, therefore, follows that in **no instance can a bank or an FI claim an input tax** on its transactions with the said depositors or lenders who are not FIs.*

32-Q. Can banks and other FIs choose to bill either (i) 10% of gross receipts, or (ii) 1/11 of total amount billed and received? Can these invoices/receipts be computer generated?

32-A. *No. Billing should conform with Section 7 of RR 12-2003 which mandates that the VAT component be shown separately.*

Invoices/receipts can be computer-generated provided that the machine which generates such receipt is duly-registered with the BIR.

33-Q. In the meantime that the bank has yet no system-generated VAT invoice/receipt while waiting for the finalization of system redesign, can it be allowed not to issue invoice/receipt?

33-A. *No. In the meantime that the bank is waiting for it to be able to issue system-generated invoice/receipt, it has to issue manually printed invoice/receipt after having secured the required Authority to Print Invoice/Receipt with the Bureau of Internal Revenue following existing rules.*

34-Q. How shall the FI record the interest on loan transaction where the VAT is not passed-on to the client but shouldered by the FI evidenced by an official receipt not separately reflecting the output VAT (e.g., Interest Income of P 100,000 received in cash)?

34-A. *In a situation where the loan by the FI to the client was contracted prior to 2003 and no escalation on interest charges was made as a result of the VAT, the FI shall prepare the following accounting entries:*

<i>Cash</i>	<i>P 100,000.00</i>	
<i>Interest Income</i>		<i>90,909.09</i>
<i>Output VAT Payable (1/11)</i>		<i>9,090.91</i>
<i>To record receipt of cash representing Interest Income and VAT Payable.</i>		

Applying the above entry, the taxable interest income of the bank is only P90,909.09.

35-Q. What details are required in the preparation of the schedules due for submission to the BIR on the due date for the filing of the Quarterly VAT Return?

35-A. *Details of the schedules due for submission on the same date as the due date for filing the Quarterly VAT return are prescribed in Revenue Regulations No. 8-2002. VAT returns with payment are filed with Accredited Agent Banks while returns without payment are supposed to be filed with the BIR. In all instances, the schedules required under RR No. 8-2002 are to be submitted to the concerned BIR office.*

36-Q. Will the requirement of submitting the Schedule of Sales and Schedule of Purchases not violate R.A. 1405 on the confidentiality of bank deposits and the General Banking Law of 2000 on the confidentiality of all matters related to the funds and properties of a bank's client?

36-A. *No. Republic Act No. 1405 (The Law on Secrecy of Bank Deposits) and Republic Act No. 8791 (The General Banking Law of 2000) prevent any unauthorized divulgence of matters pertaining to clients' deposits, funds and properties under custody of the bank only.*

37-Q. In addition to net trading and forex gains and small items, can the following income be reported in one consolidated VAT receipt?

- car fees (annual fees)
- cable and postal charges
- over the counter fees (i.e. cashier checks, manager's checks, lost card charges)
- custodial fees
- trust fees
- telegraphic charges
- commitment on deferred payment bills
- commission on LC, shipping guarantees, standby documentary credits
- safety deposit box rental
- stock transfers fees

- commission in lieu of exchange

37-A. *Yes, provided the provisions of Sections 113 and 237 of the Tax Code of 1997, and those specified in Section 7 of RR 12-2003 are strictly followed, and provided, further, that the specific type of transaction is enumerated individually in the invoice/receipt.*

38-Q. How do banks and other FIs substantiate the 8% transitional input tax?

38-A. *For the FIs to be able to claim the 8% transitional input tax, Section 8 of RR 12-2003 provides that a journal entry be made in the books by debiting the input tax account and crediting the asset account (goods, materials and supplies) which is the source of the input tax and, that the transitional input tax credit which is 8% of the inventory of goods, materials and supplies as reflected in the Inventory List, or the actual VAT paid thereon, whichever is higher, be duly supported with VAT invoices/receipts.*

39-Q. When will the bank recognize the output VAT on interest income from loans and other transactions generating interest income? When is it considered received? Does mere debiting/crediting the account of a client result to receipt? Or is there taxable receipt only when the interest income is recorded in the books?

39-A. *The bank shall recognize the output VAT on interest income when it is actually or constructively received as when the interest is already collected or placed at the free disposal or control of the person earning the income.*

If the bank has taken control over the interest income such as when an existing deposit account of client is debited for the charged bank's interest income, such interest income is considered constructively received upon debiting the deposit account.

Accrual of the interest income in the books of the FI without actual or constructive receipt thereof is not yet a VAT taxable event.

40-Q. RMC 19-2003 allows FIs to file amended 1st quarter VAT returns/pay taxes due thereon without penalty. Until when will this abatement of penalties be allowed?

40-A. *Filing of amended VAT returns and payment of taxes due thereon, if any, without penalties shall be allowed until June 30, 2003.*

41-Q. Aside from Revenue Regulations No. 12-2003, what other Regulations govern the VAT taxation of FI?

41-A. Revenue Regulations No. 7-95, as amended (The Consolidated VAT Regulations).

All revenue officials concerned are requested to give this Circular as wide a publicity as possible.

(Original Signed)
GUILLERMO L. PARAYNO, JR.
Commissioner of Internal Revenue