REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

June 15, 2009

REVENUE MEMORANDUM CIRCULAR NO. 31 - 2009

SUBJECT: Circularizing the Memorandum of the Commissioner Disallowing Bangko Sentral ng Pilipinas Claimed Interest Expense for Taxable Year 2005

TO: All Internal Revenue Officers and Others Concerned

For the information and guidance of all internal revenue officials, employees and others concerned, quoted hereunder is the full text of the Memorandum of the Commissioner dated June 6, 2009 *Disallowing Bangko Sentral ng Pilipinas Claimed Interest Expense for Taxable Year 2005.*

"MEMORANDUM

FOR:	**Arnel SD. Guballa** **Revenue Director – RR 6, Manila**
FROM :	**THE COMMISSIONER**
SUBJECT:	**Disallowance of BSP's Claimed Interest Expense for TY 2005**
DATE:	**June 6, 2009**

This refers to your letter dated May 28, 2009 requesting for clarification as to what ruling will prevail to finally resolve the conflicting interpretations of the BIR and the BSP on the deductibility of interest expense.

Section 34(B)(1) of the Tax Code of 1997 provides as follows:

"(B) Interest[1]. -

(1) In General. - The amount of interest paid or incurred within a taxable year on indebtedness in connection with the taxpayer's profession, trade or business shall be allowed as deduction from gross income: Provided, however, That the taxpayer's otherwise allowable

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[1] **Interest** shall refer to the payment for the use or forbearance or detention of money, regardless of the name it is called or denominated. It includes the amount paid for the borrower's use of money during the term of the loan, as well as for his detention of money after the due date for its repayment. ***(Sec. 2(a), RR 13-2000)***

deduction for interest expense shall be reduced by an amount equal to the following percentages of the interest income subjected to final tax:

Forty-one percent (41%) beginning January 1, 1998;
Thirty-nine percent (39%) beginning January 1, 1999; and
Thirty-eight percent (38%) beginning January 1, 2000."[2]

x x x *x x x* *x x x*

Sections 3 and 4 of Revenue Regulations No. 13-2000 (promulgated on December 29, 2000 to implement the provisions of Section 34(B) of the Tax Code of 1997 on the requirements for the deductibility of interest expense from the gross income of a taxpayer who is engaged in trade, business or in the practice of profession) provide, among others, viz:

"***SEC. 3. Requisites for Deductibility of Interest Expense.*** – In general, **subject to certain limitations**, the following are the requisites for the deductibility of interest expense from gross income, viz:

(a) There must be an indebtedness;
(b) There should be an interest expense paid or incurred upon such indebtedness;
(c) The indebtedness must be that of the taxpayer;
(d) The indebtedness must be connected with the taxpayer's trade, business or exercise of profession;
(e) The interest expense must have been paid or incurred during the taxable year;
(f) The interest must have been stipulated in writing;
(g) The interest must be legally due;
(h) The interest payment arrangement must not be between related taxpayers as mandated in Sec. 34(B)(2)(b), in relation to Sec. 36(B), both of the Tax Code of 1997;
(i) The interest must not be incurred to finance petroleum operations; and
(j) In case of interest incurred to acquire property used in trade, business or exercise of profession, the same was not treated as a capital expenditure.

"***SEC. 4. Rules on the Deductibility of Interest Expense***. –

(a) **General Rule**. – In general, the amount of interest expense paid or incurred within a taxable year on indebtedness in connection with the taxpayer's trade, business or exercise of profession shall be allowed as a deduction from the taxpayer's gross income.

(b) **Limitation.** – The amount of interest expense paid or incurred by a taxpayer in connection with his trade, business or exercise of a profession from an existing indebtedness shall be reduced by an amount equal to the following percentages of the interest income earned which had been subjected to final withholding tax depending on the year when the interest income was earned, viz:

Forty-one percent (41%) beginning January 1, 1998;
Thirty-nine percent (39%) beginning January 1, 1999; and
Thirty-eight percent (38%) beginning January 1, 2000 and thereafter.

This limitation shall apply ***regardless of whether or not a tax arbitrage scheme was entered into by the taxpayer or regardless of the date when the interest bearing loan and the***

[2] R.A. 9337 amended the proviso on the percentages of the interest income to " ***forty-two percent (42%) of the interest income subjected to final tax: Provided, That effective January 1, 2009, the percentage shall be thirty-three percent (33%)".*** R.A. 9337 took effect on November 1, 2005.

date when the investment was made for as long as, during the taxable year, there is an interest expense incurred on one side and an interest income earned on the other side, which interest income had been subjected to final withholding tax. This rule shall be observed irrespective of the currency of the loan contracted and/or in whatever currency the investments or deposits were made."

It was represented that BSP claimed that it is not liable for the deficiency income tax assessment for the year 2005 amounting to P1,224,675,111.92 due to the disallowance of BSP's claimed interest expense equivalent to 38%/42% of its interest income subjected to final withholding tax; that BSP submits that it is not engaged in an interest arbitrage scheme because its investment in government securities, treasury bonds and notes and other securities, as well as other transactions from which it earns interest income and which was subjected to the final tax, are being undertaken in accordance with its legally mandated responsibilities to achieve its primary objective of maintaining price stability; that BSP does not borrow money from different financial institutions for reinvestment purposes but as a monetary tool in its open market operations to mop up or siphon off excess liquidity in the banking system; that BSP should be entitled to claim the full amount of interest expense incurred in the course of its operations; and, that such interest should not be reduced by a portion of the interest income subjected to final tax.

Chapter VI, Article I, Section 125 of RA 7653, otherwise known as the "*New Central Bank Act*" provides that the BSP shall only be exempt from all national internal revenue taxes **for a period of five (5) years** from the approval of the Act, but shall be subject to all taxes thereafter, viz:

> ***"Section 125. Tax Exemptions.*** *— The Bangko Sentral shall be exempt* ***for a period of five (5) years from the approval of this Act*** *from all national, provincial, municipal and city taxes, fees, charges and assessments. (Note: RA 7653 was finally passed by Congress on June 10, 1993.)*
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> *"The exemption authorized in the preceding paragraph of this section shall apply to all property of the Bangko Sentral, to the resources,* ***receipts, expenditures, profits and income of the Bangko Sentral****, as well as to all contracts, deeds, documents and* ***transactions RELATED TO THE CONDUCT OF THE BUSINESS OF THE BANGKO SENTRAL****: Provided, however, That said exemptions shall* ***apply only to such taxes, fees, charges and assessments for which the Bangko Sentral itself would otherwise be liable, and shall not apply to taxes, fees, charges, or assessments payable by persons or other entities doing business with the Bangko Sentral****: Provided, further, That* ***foreign loans and other obligations of the Bangko Sentral shall be exempt, both as to principal and interest, from any and all taxes if the payment of such taxes has been assumed by the Bangko Sentral."***

The law is very clear. It says that if a taxpayer incurred indebtedness plus interest expense connected with his trade or business during the taxable year and also earned interest income which had been subjected to final withholding tax, the amount of interest expense shall be subject to the limitations as provided for by law. It should be stressed that the law did not provide that there is a need for a tax arbitrage in order that the limitation on the deduction of the interest expense can be applied. Besides, the implementing rules itself says that the limitation shall apply ***regardless of whether or not a tax arbitrage scheme was entered into by the taxpayer or regardless of the date when the interest bearing loan and the date when the investment was made for as long as, during the taxable year, there is an interest expense incurred on one side and an interest income earned on the other side, which interest income had been subjected to final withholding tax and that the*** rule shall be observed irrespective of the currency of the loan contracted and/or in whatever currency the investments or deposits were made.

In view thereof, it is our opinion that BIR Ruling No. 006-2000 issued on January 5, 2000 by former Commissioner Beethoven L. Rualo shall prevail over all other rulings issued not in consonance thereto, provided that all the other requirements for the deductibility of the interest expense are fully complied with.

(Original Signed)
SIXTO S. ESQUIVIAS IV
Commissioner of Internal Revenue"

All internal revenue officers, employees and others concerned are hereby enjoined to give this Circular as wide a publicity as possible.

(Original Signed)
SIXTO S. ESQUIVIAS IV
Commissioner of Internal Revenue

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