

Republic of the Philippines
HOUSE OF REPRESENTATIVES
Constitution Hills
Quezon City

SIXTEENTH CONGRESS
First Regular Session

House Bill No. **4142**



Introduced by : Rep. Josephine Y. Ramirez-Sato

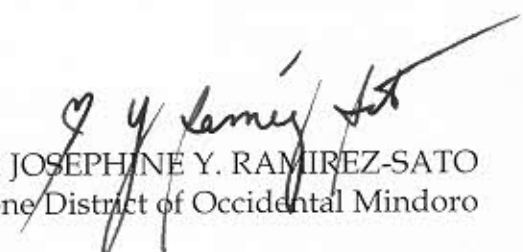
EXPLANATORY NOTE

The Philippine financial sector institutions including their respective financial products at present have varying tax treatment. In a study commissioned by the Capital Market Development Council on the financial sector taxation policy in 2007¹ described taxation in the sector as a competitive factor in investment decisions. Furthermore, the 20% tax on interest income on deposits was a disincentive to save. While there are cases for incentives, these are only given to preferred institutions.

The study further described the financial sector as the most sensitive to distortive taxation. That what may appear to be a small tax on financial transactions can be very high in relation to the value added generated by the sector². In addition, the virtually identical economic activities in the sector are taxed differently resulting in an unjustified bias for or against instruments that have equivalent financial effects but offered by different financial institutions.

This bill aims to help develop the capital market of the Philippines through the promotion of an efficient and neutral taxation system. The passage of this bill is envisaged to level the playing field for various bank deposit transactions and investment instruments issued by different institutions to encourage savings and develop the general capital market. Sound economic policy reform measures such as neutral tax system will help the country attain sustainable economic growth and moving forward to a more competitive Philippines.

Given the potential benefits this measure will give to the country, this proposed measure should be considered and approved by the House of Representatives with all deliberate dispatch.


HON. JOSEPHINE Y. RAMIREZ-SATO
Lone District of Occidental Mindoro

¹ The report is the result of technical assistance provided by the Economic Modernizations through Efficient Reforms and Governance Enhancement (EMERGE) activity supported by USAID.

² Illustrated by the effects of the documentary stamp taxes (DST) on secondary markets for government securities -- The DST rate of PhP0.30 for every PhP200 is large compared to the interest income per peso of government securities held for one week.

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AN ACT AMENDING CERTAIN PROVISIONS OF THE NATIONAL REVENUE CODE OF 1997, AS AMENDED, AND PRESIDENTIAL DECREE NO. 1185 OTHERWISE KNOWN AS THE FIRE CODE OF THE PHILIPPINES, AND FOR OTHER PURPOSES.

Be it enacted by the Senate and House of Representatives of the Philippines in Congress assembled:

ARTICLE I
GENERAL PROVISIONS

Section 1. *Title.* This Act shall be known as "*The Financial Sector Tax Neutrality Act of 2014.*"

Section 2. *Declaration of Policy.* - It is the policy of the State to promote an efficient and neutral taxation system that level the playing field for various bank deposit transactions and investment instruments issued by different institutions to encourage savings and develop the general capital market.

Section 3. Section 22 (L) of the National Internal Revenue Code of 1997, as amended, is hereby further amended to read as follows:

"(L) The term 'shares of stock' shall include shares of stock of a corporation, warrants and/or options [to purchase shares of stock], futures, depository receipts, commodities, exchange traded funds, units of participation in a collective investment product, as well as units of participation in a partnership (except general professional partnerships), joint stock companies, joint accounts, joint ventures taxable as corporations, associations, and recreation or amusement clubs (such as golf, polo or similar clubs), and mutual fund certificates commodities contracts and other securities or investment products listed and traded in a local exchange."

Section 4. Section 22 (Y) of the National Internal Revenue Code, as amended, shall be further amended to exclude from the definition of deposit substitutes reverse

repurchase agreements entered into by and between the *Bangko Sentral ng Pilipinas* (BSP) and any authorized agent bank, as follows:

(Y) The term "deposit substitutes" shall mean:

(i) In the case of banks and non-bank financial intermediaries, an alternative form of obtaining funds other than deposits, through the issuance, endorsement, or acceptance of debt instruments for the borrowers own account, for the purpose of relending or purchasing of receivables and other obligations, or financing their own needs or the needs of their agent or dealer. These instruments may include, but need not be limited to bankers' acceptances, promissory notes, repurchase agreements, excluding reverse repurchase agreements entered into by and between the *Bangko Sentral ng Pilipinas* (BSP) and any authorized agent bank, certificates of assignment or participation and similar instruments with recourse: Provided, however, That debt instruments issued for interbank call loans with maturity of not more than seven (7) days to cover deficiency in reserves against deposit liabilities, including those between or among banks and quasi-banks, shall not be considered as deposit substitute debt instruments.

(ii) In the case of finance companies, other than those specified in (i) above, lending investors, investment houses, trust companies and similar institutions and corporations engaged in commercial, industrial, and other activities, all borrowings to finance its own needs or the needs of its agents thru commercial papers issues as evidences of indebtedness whether registered with the Securities and Exchange Commission of the Philippines, or not, regardless of maturity period and with or without recourse basis.

(iii) In the case of other non-financial companies, including the national and local government and its instrumentalities, all borrowings through the issuance of debt instruments denoted as treasury bonds, treasury bills, treasury notes, and similar instruments.

Section 5. A uniform final tax at the rate of ten percent (10%) shall be imposed upon the amount of interest income derived by individual citizens and individual resident aliens from:

- (a) any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements; or
- (b) any foreign currency bank deposit with a depository bank under the expanded foreign currency deposit system except if the citizen is a non-resident in which case interest income is exempt from income tax); or
- (c) long-term deposit or investment in the form of savings, common or individual trust funds, deposit substitutes, investment management accounts and other investments evidenced by certificates in such form prescribed by the *Bangko Sentral ng Pilipinas* (BSP).

For this purpose, Section 24 of the National Internal Revenue Code, as amended, is hereby further amended as follows:

SEC. 24. Income Tax Rates.

(a) Rate of Tax on Certain Passive Income on Individual Citizens and Individual Resident Aliens.

a.1) Interests, Royalties, Prizes, and Other Winnings. - A final tax at the rate of ten percent (10%) is hereby imposed upon the amount of interest derived by individual citizens and individual resident aliens from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements regardless of denomination and term of the instrument or currency of the investment; royalties on books, as well as other literary works and musical compositions, provided, that royalties on items other than books and literary works and musical compositions, prizes (except prizes amounting to ten thousand pesos (PhP10,000) or less which shall be subjected to tax under Subsection [A] of Section 24); and other winnings (except Philippine Charity Sweepstakes and Lotto winnings), derived from sources within the Philippines shall remain subject to final tax at the rate of twenty percent (20%); and provided, further, that interest income derived by a non-resident individual, whether a citizen or an alien, from a depository bank under the expanded foreign currency deposit system shall remain exempt from income tax.

Section 6. A uniform tax rate of ten percent (10%) shall be imposed upon the amount of interest income derived by domestic and resident foreign corporations from:

- (a)* any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements;
- (b)* any currency bank deposit with a depository bank under the expanded foreign currency deposit system; except if interest income is derived by foreign currency deposit units and offshore banking units from a foreign currency deposit transaction under the expanded foreign currency deposit system in which case the provisions of Subsection (D) (3) of Section 27 and of Subsection (A) (4) and Subsection (A) (7) (b) of Section 28 shall apply.

Section 7. Domestic and resident foreign banks and non-bank financial intermediaries performing quasi-banking functions shall not be subject to the final tax on interest imposed under Subsection (D) (1) of Section 27 and Subsection (7) (a) of Section 28 respectively. Interest derived by such domestic and resident foreign banks and non-bank financial intermediaries performing quasi-banking functions shall form part of their gross income.

Section 8. To effect Sections 6 and 7 of this Act, Sections 27 and 28 of the National Internal Revenue Code, as amended, is hereby further amended as follows:

SEC. 27. Rates of Income tax on Domestic Corporations.

(D) Rates of Tax on Certain Passive Incomes.

(1) Interest from Deposits and Yield or any other Monetary Benefit from Deposit Substitutes and from Trust Funds and Similar Arrangements, and Royalties. - A final tax at the rate of ten percent (10%) is hereby imposed upon the amount of interest derived by domestic corporations from any Philippine Peso or foreign currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements regardless of denomination and term of the instrument or currency of the investment; royalties on books, as well as other literary works and musical compositions; provided, that royalties on items other than books and literary works and compositions, prizes (except prizes amounting to ten thousand pesos (PhP10,000) or less which shall be subject to tax under the subsection (A) of Section 24); and other winnings (except Philippine Charity Sweepstakes and lotto winnings), derived from sources within the Philippines shall remain subject to final tax at the rate of twenty percent (20%); provided, further, that interest income derived by foreign currency deposit units from foreign currency deposit transactions under the expanded foreign currency deposit system shall be subject to the provisions of subsection (D) (3) of Section 27.

Provided, however, that interest income of banks and non-bank financial intermediaries performing quasi-banking functions derived from repurchase agreements, deposit substitutes, and securities shall not be considered passive income subject to tax under this section, but shall instead be subject to tax under Sec. 27 (A).

SEC.28. Rates of Income Tax on Foreign Corporations.

(7) Tax on Certain Incomes Received by a Resident Foreign Corporation.-

(a) Interest from Deposits and Yield or any other Monetary Benefit from Deposit Substitutes, Trust Funds and Similar Arrangements and Royalties. - A final tax at the rate of ten percent (10%) is hereby imposed upon the amount of interest derived by resident foreign corporations from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from the trust funds and similar arrangements regardless of denomination and term of instrument or currency of the investment; royalties on books, as well as other literary works and musical compositions; provided, that royalties on items other than books and literary works and musical compositions, prizes (except prizes amounting to ten thousand pesos (PhP10,000) or less which shall be subject to tax under the subsection (A) of Section 24); and other winnings (except Philippine Charity Sweepstakes and Lotto winnings), derived from sources within the Philippines shall remain subject to final tax at the rate of twenty percent (20%); provided, further, that interest income derived by foreign currency deposit units and offshore banking units from foreign currency deposit transaction under the expanded foreign currency deposit system shall be subject to the provisions of Subsection (A) (4) and Subsection (A) (7) (B), respectively, of Section 28.

Provided, however, that interest income of banks and non-bank financial intermediaries performing quasi-banking functions derived from repurchase agreements, deposit substitutes, and securities shall not be considered passive income under this section, and shall instead form part of their gross corporate income subject to tax under Section 28 (A) (1).

Section 9. *Section 34 of the National Internal Revenue Code*, as amended, is hereby further amended as follows:

SEC. 34. *Deductions from Gross Income*

(B) *Interest*

(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 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;
Thirty-eight percent (38 %) beginning January 1, 2000;
Seventy one percent (71%) beginning January 1, 2011; and
Sixty seven percent (67%) beginning January 1, 2012

Section 10. *Section 37 of the National Internal Revenue Code*, as amended, shall be further amended as follows:

SEC. 37. *Special Provisions Regarding Income and Deductions of Insurance Companies, Whether Domestic or Foreign.*

SEC. 37.1. *Special provisions regarding income and deductions of banks and quasi-banks.* In the case of interest income and trading gains of banks and non-bank financial institutions exercising quasi-banking functions derived from repurchase agreements, deposit substitutes, and securities, all final withholding taxes paid on such instruments, if any, any accrued interest, and other costs of obtaining the instrument may be deducted from other gross income.

Section 11. The seven percent (7%) gross receipts tax on net trading gains of banks and financial intermediaries under Sec. 121 (d) of the National Internal Revenue Code is hereby abolished. Net trading gains derived by banks and non-bank financial intermediaries from foreign currency, debt securities, derivatives, and other financial instruments shall form part of their gross income.

Section 12. *Section 122 of the National Internal Revenue Code*, as amended, is hereby further amended, as follows:

SEC. 122. *Tax on Finance Companies.* There shall be collected a tax of five percent (5 %) on the gross receipts derived by all finance companies, as well as by other financial intermediaries not performing quasi banking functions doing business in the Philippines, from interest, discounts and all other items treated as gross income under this Code:

Provided, however, that gross receipts derived from financial and operating leases by finance companies and financial intermediaries, whether or not performing quasi-banking functions, shall be subject to value added tax according to SEC (e.) 108 (A) (8), and shall conform to BIR guidelines to be issued on the proper use of input VAT credits.

Section 13. *Section 123 of the National Internal Revenue Code, as amended is hereby further amended, as follows:*

SEC. 123. *Tax on Life Insurance Premiums.*

SEC. 123 (A). *Tax on Pre-need companies.* There shall be collected from every Philippine pre-need company or corporation a tax of two percent (2%) of the total premium or total contribution collected, whether such premiums or contributions are paid in money, notes, credits or any substitute for money; but premiums or contributions refunded or returned within six (6) months after payment to the purchaser of a pre-need plan shall not be included in the taxable receipts.

Section 14. *The tax on the sale, barter, or exchange of shares of stock traded through initial public offering under Section 127 (B) of the National Internal Revenue Code is hereby repealed. For this purpose, Section 127 of the National Internal Revenue Code, as amended, is hereby further amended, as follows:*

SEC. 127. *Tax on Sale, Barter or Exchange of Shares of Stock Listed and Traded Through The Local Stock Exchange.*

(A) *Tax on Sale, Barter or Exchange of Shares of Stock Listed and Traded through the Local Stock Exchange.* – There shall be levied, assessed and collected on every sale, barter, exchange or other disposition of shares of stock listed and traded through the local stock exchange other than the sale by a dealer in securities, a tax at the rate of one-fourth of one percent ($1/4$ of 1%) of the gross selling price or gross value in money of the shares of stock sold, bartered, exchanged or otherwise disposed which shall be paid by the seller or transferor.

(C) *Return on Capital Gains Realized from Sale of Shares of Stocks.-*

(1) *Return on Capital Gains Realized from Sale of Shares of Stock Listed* - It shall be the duty of every stock broker who effected the sale subject to the tax imposed herein to collect the tax and remit the same to the Bureau of Internal Revenue within five (5) banking days from the date of collection thereof and to submit on Mondays of each week to the secretary of the stock exchange, of which he is a member, a true and complete return which shall contain a declaration of all the transactions effected through him during the preceding week and of taxes

collected by him and turned over to the Bureau Of Internal Revenue.

Section 15. *Section 13 (b) (4)³ of Presidential Decree No. 1185, otherwise known as the Fire Code of the Philippines* is hereby repealed.

Section 16. *Prospectivity Clause.* The uniform final tax rate often percent (10%) imposed on interest income provided Sections 5, 6, and 7 of this Act shall apply to repurchase agreements, deposit substitutes, and securities issued after the effectivity of this Act.

Section 17. *Repealing Clause.* All laws, executive orders, rules and regulations, and parts thereof which are inconsistent with this Act are hereby repealed or amended accordingly.

Section 18. *Separability Clause.* If for any reason any article or provision of this Act or any portion thereof or application of such article, provision, or portion thereof to any person, group, or circumstance is declared invalid or unconstitutional, the remainder of this Act shall not be affected by such decision.

Section 19. *Effectivity Clause.* - This Act shall take effect fifteen (15) days after its complete publication in the Official Gazette or in at least two (2) newspapers of general circulation, whichever comes earlier.

Approved,

³ PD 1185 Section 13. *Appropriation and Sources of Income.*

Section 13 (b) (4). Two per centum (2%) of all premiums, excluding re-insurance premiums for the sale of fire, earthquake and explosion hazard insurance collected by companies, persons or agents licensed to sell such insurances in the Philippines;