

Headline	Making tax out of nothing at all?		
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TOP OF MIND

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Making tax out of nothing at all?

The Bureau of Internal Revenue (BIR) recently issued Revenue Memorandum Circular (RMC) No. 61-2016 dated June 13, prescribing policies and guidelines for accounting and recording transactions involving “netting” or “offsetting.”

The said RMC “strictly prohibit[s],” for taxation purposes, the accounting and recording practice of offsetting *due to* and *due from* transactions, as well as the practice of offsetting *payables* and *receivables*. Thus, the said issuance provides that accrued receivables or payables arising from sale or lease of goods or properties or the performance of service shall, “at all times,” be *recognized at gross* for income and value-added tax (VAT) or percentage tax purposes. Further, the said RMC states that income payments subject to creditable or final withholding taxes shall be recorded at gross, regardless of whether the transactions are actually offset, or the same provides for net settlement of cash flows. Finally, the RMC provides that any amount offset against the income payment by the payor not subjected to creditable or final withholding tax shall not be allowed as a deductible expense of the payor.

RMC No. 61-2016 includes a prefatory background stating that it is a general principle of accounting that offsetting assets and liabilities in the balance sheet is improper. This background further explains that “under no circumstance” is offsetting to be considered appropriate in recording transactions that are subject to a wide range of “netting” arrangements or similar practices, including those with standard commercial provisions that allow parties to “net settle,” such as trade receivables and payables. Indeed, paragraph 32 of Philippine Accounting Standards (PAS) No. 1 (Presentation of Financial Statements) also states the general rule that an entity shall not offset assets and liabilities or income and expenses, *unless* required or permitted by other standards. It can, therefore, be noted that such a sweeping statement on the part of the BIR regarding the absolute impermissibility of “netting” receivables and payables as a purported general principle of accounting runs counter to the provision of the PAS which, along with the more recent Philippine Financial Reporting Standards (PFRS) and PFRS for Small and Medium-Sized Entities (SMEs), is a source of generally accepted accounting principles in the Philippines. A valid exception to the general accounting rule that assets and liabilities are not to be offset can thus be seen in paragraph 42 of PAS No. 32 (Financial Instruments: Presentation) which states that a *financial asset* and a *financial liability* shall be offset and the net amount presented in the statement of financial position *when, and only when*, an entity: (a) currently has a legally enforceable right to set off the recognized amounts; and (b) intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.

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Lest we be accused of unduly nitpicking at this premise laid out by the BIR in the background portion of the RMC, we must concede the BIR truly has the power to prescribe additional procedural or documentary requirements for tax administration and enforcement, specifically in connection with the submission or preparation of financial statements accompanying the tax returns as provided for by Section 6(H) of the Tax Code.

The BIR has, in fact, previously issued Revenue Regulations (RR) No. 08-2007 which provides for additional compliance requirements in light of mandatory adoption of the PFRS. RR No. 08-2007 states that under the PFRS, the recording and the recognition of business transactions for financial accounting purposes, in a majority of situations, differ from the application of tax rules on the same transactions resulting to disparity of reports for financial accounting vis-a-vis tax accounting. Hence, RR No. 08-2007 states there is a need to reconcile the disparity in a systematic and clear manner to avoid irritants between the taxpayer and the tax enforcer. Accordingly, concerned taxpayers are mandated by RR No. 08-2007 to maintain books and records that would reflect the reconciling items between Financial Statements figures and/or data with those reflected/presented in the filed Income Tax Return (ITR). Considering that a disconnect exists between the accounting treatment mandated by the BIR and a permissible accounting treatment for offsetting by the PAS, one might ask if an additional reconciling item would exist when reconciling the financial net income per books and the taxable net income.

To understand if an additional reconciling item would exist, it is helpful to first be familiar with each of the three illustrations provided by RMC No. 61-2016:

- Company F is a manufacturer that sells its food products to Company S, a retailer, on account; thereafter S pays F *net of a discount* which, according to the BIR, is *actually a service fee* earned by S for displaying F's products at S's stores. In prohibiting the netting of F's receivable and payable for the service fee of S, the BIR effectively eliminates *service fees disguised as a discount* against F's sales – this leads to a separate recognition of an income payment of F to S that should be subjected to expanded withholding tax, thus increasing the collection of the BIR of certain withholding taxes.

- Two telecommunications carriers, Company G and Company S (these are the actual company names used by the BIR in the RMC) have been noted by the BIR to be covered by a *revenue-sharing* or *fixed rate charge agreement* for charges on voice and data transmissions passing through each of their respective networks. Further, we are introduced to Company M who is a Top 20,000 corporation and a G postpaid subscriber as well as to Mr. K who is an S postpaid subscriber. The BIR stated that if G bills M for outgoing calls made to K, the *interconnection share of S* should form *part of the reported gross revenue of G* and simultaneous to the accrual of gross revenue, G shall also recognize the corresponding *interconnection fee expense* and set up a liability for the same amount due to S – hence, the BIR mandates that the outright or automatic netting-out or set-off of payments due to other teleco companies against the gross revenue of the collecting telco “shall not be allowed.” Again, by prohibiting the offsetting of receivables and payables between telcos as well as mandating the recognition of revenues at gross instead at net of revenue-sharing or fixed rate charge, the BIR would effectively increase the collection of certain withholding taxes just by prescribing a different method of recording revenue at gross and setting up

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a separate *access charge expense*.

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(To be continued)