REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Quezon City

RA 8799; RR 16-2008; RR 2-1998; RMC 79-2014	00-000 OT-130-2022 APR 06 2022	

Person to Contact: Chief, Law Division

Tel Nos. 926-5536/927-0963

COL FINANCIAL GROUP, INC.
2401-B East Tower,
Philippine Stock Exchange Centre,
Exchange Road, Ortigas Center,
Pasig City

Attention: **Ms. Catherine L.Ong**
SVP, Chief Financial Officer

Gentlemen:

This refers to your request for confirmation of your opinion that the following costs incurred by the COL Financial Group, Inc. ("COL Financial") form part of its Cost of Sales/Services ("COS"):

1. Salaries, wages and benefits;
2. Outside services;
3. Materials, supplies & faciiities;
4. Depreciation;
5. Rental; and
6. Other office costs

It is represented that COL Financial is a domestic corporation duly organized and existing under Philippine laws. Pursuant to its Articles of Incorporation, it is a service-oriented company, primarily engaged *"in the business of broker and/or dealer of securities of any kind and of every description, whether of domestic or foreign origin, as well as interests in all such securities, and to engage in all activities that may be useful, directly or indirectly, in connection with such business, and in all activities related thereto including online stockbrokerage services through innovative internet technology and the purchase, acquisition, sale, exchange or distribution of such securities or interest in securities and otherwise effecting transactions in such securities, the giving of financial advice, the gathering and distribution of financial and investment information and statistics and acting as financial, commercial or business representative."*

OT - 130 - 2022
APR 06 2022

As a service-oriented corporation, COL Financial necessarily incurs the above-enumerated direct costs in order to provide the services offered to its clients and such items of expense should form part of its costs of sales/services.

In reply, please be informed that the term "Cost of Services" is defined under Section 4 of Revenue Regulations (RR) No. 16-2008, as follows:

> *"In case of sellers of services, the term "gross income" means the "gross receipts" less sales returns, allowances, discounts and cost of services. "**Cost of services"** means **all direct costs and expenses necessarily incurred to provide the services required by the customers and clients including (a) salaries and employee benefits of personnel, consultants and specialists directly rendering the service, and (b) cost of facilities directly utilized in providing the service such as depreciation or rental of equipment used and cost of supplies:** Provided, however, that "cost of services" shall not include interest expense except in the case of banks and other financial institutions. The term "gross receipts" shall mean amounts earned as gross revenue during the taxable year." (Paragraph 5, Section 4, RR No. 16-08) (Emphasis Ours)*

From a plain reading of the afore-cited provision of RR No. 16-2008, it is notable that the business activity or industry of the taxpayer determines whether an item of expense should properly form part of its COS. That the business activity or industry to which the taxpayer belongs is determinative of the items that should properly comprise its COS becomes more evident by the fact that while the foregoing provision excludes interest expense as an item that generally forms part of COS, it makes an exception with respect to banks and financial institutions -- acknowledging that for the said business activity/industry interest expense is inherently necessary to deliver the services required. The items of expense that should form part of an entity's COS is therefore relative and dependent on its line of business or industry which should be taken into consideration in accounting for COS.

As represented, COL Financial is a stockbroker and dealer in securities. Under Republic Act (RA) No. 8799 (otherwise known as "*The Securities Regulation Code*") "broker" and "dealer" of securities is defined in this wise:

> "***Section 3.** Definition of Terms –*
>
> *xxx*
>
> *3.3. **"Broker"** is a person engaged in the business of **buying and selling securities for the account of others.***

*3.4. "Dealer" means any person **who buys/ sells securities for his/her own account** in the ordinary course of business." (Emphasis Ours)*

Considering the nature of COL Financial's business activities, we confirm your opinion, as follows:

1. Salaries, wages and benefits

Salaries, wages and benefits are items of expense which RR 16-2008 expressly recognizes as part of a taxpayer's COS. Paragraph 5, Section 4, of the said Regulations provides in part:

*"In case of sellers of services, the term "gross income" means the "gross receipts" less sales returns, allowances, discounts and cost of services. "**Cost of services**" means all direct costs and expenses necessarily incurred to provide the services required by the customers and clients including **(a) salaries and employee benefits of personnel, consultants and specialists directly rendering the service, xxx**" (Emphasis Ours)*

As represented, COL Financial's COS is comprised of basic pay, allowances, commissions and benefits, as well as remuneration received by its employees pursuant to the Company's Stock Option Plan ("SOP"). The said SOP covers employees as well as senior executives of COL Financial who receive the shares of stock in consideration for services rendered.

Under Section 32 (A) of the 1997 Tax Code, as amended, gross income includes compensation in whatever form paid, including but not limited to fees, salaries, wages commissions and similar items. Section 2.78.1 of Revenue Regulations No. 2-98 ("RR No. 2-98", *Relative to the Withholding on Income Subject to the Expanded Withholding Tax and Final Withholding Tax, Withholding of Income Tax on Compensation, Withholding of Creditable Value-Added Tax and Other Percentage Taxes)* further defines "compensation" as "all remuneration for services performed by an employee for his employer under an employer-employee relationship, unless specifically excluded by the Code". The same cited provision[1] goes further to state that *the name by which the remuneration for services is designated is immaterial* and that as such, salaries, wages, emoluments and honoraria, allowances, commissions, fees, including director's fees (if the director is at the same time an employee of the employer corporation), taxable bonuses and fringe benefits (except those which are subject to fringe benefits tax), thus, if received by employees holding supervisorial and/or managerial position and other senior executives, subject to fringe benefits tax and not considered compensation, taxable pensions and retirement pay, and other income of a similar nature constitute compensation income. Moreover, Section 2.87.1(1)(A) of RR 2-98 explicitly states that:

[1] Paragraph 2, Item (A) Section 2.78.1 of RR No. 2-98.

"SECTION 2.78.1. Withholding of Income Tax on Compensation Income. —

xxx

(A) Compensation Income Defined. —

xxx

*(1) **Compensation paid in kind. — Compensation may be paid in money or in some medium other than money**, as for example, **stocks**, bonds or other forms of property. If services are paid for in a medium other than money, the fair market value of the thing taken in payment is the amount to be included as compensation subject to withholding. If the services are rendered at a stipulated price, in the absence of evidence to the contrary, such price will be presumed to be the fair market value of the remuneration received. If a corporation transfers to its employees its own stock as remuneration for services rendered by the employee, the amount of such remuneration is the fair market value of the stock at the time the services were rendered." (Emphasis ours)*

Since the grant of the stock option under COL Financial's SOP is in consideration for services rendered by its employees, and is not subject to any condition or criteria which must be met by the said employees for the exercise thereof, any income or gain derived by COL Financial employees from their exercise of the stock options is considered as additional compensation subject to income tax and consequently to the withholding tax on compensation. However, if the said stock option is granted to employees holding supervisorial and/or managerial position, the same shall be subject to fringe benefits tax under Section 33 of the 1997 Tax Code, as amended, and as implemented by Revenue Regulations (RR) No. 3-98, as amended.

It is worth mentioning, however, that Revenue Memorandum Circular (RMC) No. 79-2014 provides that "[t]he sale, barter, or exchange of stock options is treated as a sale, barter, or exchange of shares of stock not listed on the stock exchange. Thus, any grant of an option for consideration, or transfer of the option is subject to capital gains tax imposed under Section 24(C) of the 1997 Tax Code, as amended. If the option was granted without any consideration, the cost base of the option for purposes of computing capital gains shall be zero.

On the other hand, if the option is transferred by the grantee/subsequent owner without any consideration, the same shall be treated as a donation of shares of stock subject to donor's tax. The basis shall be the fair market value of the option at the time of the donation.

Accordingly, the salaries, wages and benefits incurred by COL Financial properly form part of COL Financial's COS. The grant, however, of stock option by COL Financial is not part of its COS. Rather, it can be claimed as a deduction, subject to compliance with the requirements of RMC No. 79-2014. With regard to the grant of the stock option, RMC No. 79-2014 provides that the grantor of the stock option cannot claim deductions for the grant of the stock option if no payment was received for the said grant, on the year an option was granted. The grant of stock option will be considered as deductible expense only upon the exercise of the option made by the grantees, but only to the extent of the difference of the book value/fair market value of the shares, whichever is higher, at the time of the exercise of the stock option and the price fixed on the grant date

2. Outside Services

COL Financial represents that this item of cost refers to commissions and referral fees paid to third-party independent contractors in consideration for additional clients who require its services. RR No. 16-2008 expressly provides that salaries and employee benefits of personnel, including direct costs and expenses incurred to consultants and specialists directly rendering the service shall form part of the COS. However, commissions and referral fees paid to third-party independent contractors are not part of COS but can be claimed as deductible expenses under Section 34 of the Tax Code of 1997, as amended, subject to substantiation requirements.

Significantly, paragraph 5, Section 4 of RR No. 16-08 (*Determination of Amount of Optional Standard of Deduction for Corporations)* requires that to be considered as an expense item forming part of COS, the expense should be a *"direct cost or expense necessarily incurred to provide the services required by the customers and clients."*

It is a basic rule in statutory construction or in the interpretation of laws that words and phrases used in the statute, in the absence of a clear legislative intent to the contrary, should be given their plain, ordinary and common meaning. [2] Verily, the commissions and referral fees paid to third parties are "direct costs" incurred by COL Financial – the services rendered by the third-party independent contractors are in connection with the latter's business of buying and selling securities.

3. **Materials, Supplies & Facilities**
4. **Depreciation**
5. **Rental**

The foregoing items comprise of materials, supplies and facilities used in COL Financial's operations, depreciation and rental connected with the use of its corporate

[2] Commissioner of Internal Revenue vs. the Court of Tax Appeals (G.R. No. 107135, February 23, 1999) citing the case of Mustang Lumber Inc. vs. Court of Tax Appeals, 257 SCRA 430 [1996] (citing Ruben E. Agpalo, Statutory Construction, second edition [1990], 131)

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APR 0 6 2022

offices. These are items of expense that inherently form part of a corporation's COS. Thus, the explicit wording of paragraph 5, Section 4 of RR No. 16-08 provides that these form part of COS, *to wit*:

> *"**Xxx Cost of services"** means **all direct costs and expenses necessarily incurred to provide the services required by the customers and clients including** (a) salaries and employee benefits of personnel, consultants and specialists directly rendering the service, and **(b) cost of facilities directly utilized in providing the service such as depreciation or rental of equipment used and cost of supplies; xxx"***

6. **Other Office Costs**

COL Financial's "Other Office Costs" consists of consultancy fees of third party independent consultants, postage and transportation expenses.

In the same vein that "Outside Services" forming part of the COS shall consist only those salaries and employee benefits of personnel, including direct costs and expenses incurred to consultants and specialists directly rendering the service, consultancy fees of third-party independent consultants are excluded as COS.

Considering that COL Financial is a service-oriented corporation, postage and transportation expenses are properly items that form part of its COS. Moreover, these are items of expense that are contemplated by RR No. 16-2008 when it speaks of "cost of facilities" and "cost of supplies" that are directly utilized in providing the service, such items are essential expense items for an entity engaged in the business of stockbrokerage and dealership in securities.

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be disclosed that the facts are different, then this ruling shall be considered as null and void.

Very truly yours,

CAESAR R. DULAY
Commissioner of Internal Revenue

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