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

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REVENUE MEMORANDUM CIRCULAR NO. 115-2023

SUBJECT : **The Classification of Costs Associated on Franchises, Concessions, Licenses, Rights, Operations Agreements or similar arrangements Granted by the Government to Operate a Public Service, including Public Utility as an Administrative Cost instead of "Direct Cost of Services", for Purposes of Computing the Gross Income to determine the Optional Standard Deduction (OSD) Under Section 34 (L) of the Tax Code of 1997, as Amended by Section 3 of Republic Act No. 9504.**

TO : All Internal Revenue Officers and Others Concerned

As provided under Republic Act No. 11659, public service, including public utility companies' franchises, concessions, licenses, rights, operation agreements or similar arrangements refer to the legal authorization or permission granted by the government or a regulatory body to an entity or individual to provide essential services or operate specific utilities that are considered vital for the public welfare. Public service may include services related to electricity, water supply, natural gas, telecommunications, transportation, toll operation, or other necessary infrastructure.

Pursuant to ***Revenue Regulations (RR) No. 16-08, as amended***, in the computation of Optional Standard Deduction (OSD) the cost of services is defined as all direct costs and expenses necessary to provide services to customers or clients, as hereby quoted:

> *"In the 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" as used herein means amounts actually or constructively received during the taxable year. However, for taxpayers engaged as sellers of services but employing the accrual basis of accounting for their income, the term "gross receipts" shall mean amounts earned as gross revenue during the taxable year.'*

In order to accurately compute the taxable income pursuant to Section 27(A) of National Internal Revenue Code (Tax Code) of 1997, as amended, and for the accurate tax computation and compliance with Section 34(L) of the Tax Code, as amended by Section 3 of Republic Act No. 9504, it is crucial to properly classify the costs associated with franchises, concessions, licenses, rights, operation agreements or similar arrangements (herein referred to as Licenses or Rights) granted by the government to operate a public service including public utility.

Treatment of Concession Fees to Operate Public Services/Utilities

Based on the aforementioned definition of "gross income" and "cost of services" under RR No. 16-08, the costs associated with the Licenses or Rights should be properly classified as administrative costs instead of direct costs of services.

Public service Licenses or Rights are considered intangible assets because they represent legal or contractual rights granted by the government that provide the organization with exclusive privileges or the ability to operate in a specific industry or geographic area.

The cost associated to Licenses or Rights are often capitalized as an intangible asset and amortized over the useful life of the agreement. This means that the costs are spread over the period during which the organization benefits from the exclusive rights granted by the government.

Administrative costs typically include expenses related to the general management and administration of a business or organization, such as legal fees, accounting costs, licensing fees, and other regulatory expenses. Obtaining the licenses or rights to operate a public service usually involves administrative processes, negotiations, and legal formalities, which are more closely related to the administrative aspect of running a business.

While the Licenses or Rights themselves may not be directly tied to the production process or the creation of specific goods or services, they are essential for the organization to operate within a specific industry or market. They provide the legal framework and permissions necessary to conduct business in a certain way or offer specific services. These rights provide the organization with a competitive advantage, market exclusivity, or the ability to operate in a specific industry or geographic area.

By categorizing the costs associated with the Licenses or Rights as an administrative cost, it implies that the expenses associated with acquiring and maintaining the entitlements should not be included as direct costs of services. Instead, they should be considered separately when calculating the gross income for tax purposes. This distinction is crucial as it affects the determination of taxable income and the subsequent application of the OSD. The OSD allows taxpayers to deduct a specified percentage from their gross income, ensuring a fair and reasonable assessment of their tax liability.

All revenue issuances and BIR Rulings inconsistent herewith are hereby considered amended, modified or revoked accordingly.

All internal revenue officers, employees and others concerned are hereby enjoined to strictly implement the provision of this Circular.

This Circular takes effect immediately.

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ROMEO D. LUMAGUI, JR
Commissioner of Internal Revenue
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