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

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September 12, 2023

REVENUE MEMORANDUM CIRCULAR NO. 19-2024

SUBJECT: Clarifying the Tax Treatment of Interest Expense Paid or Incurred on Indebtedness in Connection with the Taxpayer's Profession, Trade or Business and Other Related Matters

TO: All Internal Revenue Officials, Employees and Others Concerned

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BACKGROUND AND SCOPE:

It has been observed that the differences in the treatment of interest expense in the financial statements and tax returns give rise to several issues and concerns for both the BIR and the taxpayers. In view thereof, this Circular is being issued to assist the taxpayers in their reconciliation efforts by clarifying the tax treatment of interest expense paid or incurred on indebtedness in connection with the taxpayer's profession, trade or business and other related matters.

I. TABULAR LIST OF DIFFERENCES

Particulars	Accounting Treatment	Current Tax Treatment
Interest expense on borrowing arrangements	Interest is recognized as an expense using the effective interest method. Interests incurred directly attributable to the acquisition of a qualifying asset are capitalized as part of the cost of the asset.	Interest can be claimed as a deduction, subject to certain limitations, provided all the criteria are met. Interest incurred to acquire property used in trade, business or exercise of profession may be recognized as an expense in the year incurred or capitalized as part of the cost of the property.
Interest paid in advance by the taxpayer reporting income on cash basis	Interest is recognized as an expense when incurred.	Interest can be claimed as a deduction in the year the indebtedness is paid. If the indebtedness is payable in periodic amortizations, the amount of interest which corresponds to the amount of the principal amortized or paid during the year shall be allowed as deduction in such taxable year.

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Particulars	Accounting Treatment	Current Tax Treatment
Interest expense on indebtedness between related parties	Interest expense is recorded when incurred.	Interest expense is not deductible pursuant to Section 34(B)(2)(b) of the National Internal Revenue Code of 1997, as amended.

II. ACCOUNTING TREATMENT

Interest on Borrowing Arrangements

Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds [Philippine Accounting Standards (PAS) 23.5]. The Philippine Financial Reporting Standards require that interest expense be calculated using the effective interest method.

PAS 23 requires entities to capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. All other borrowing costs are recognized as an expense in the period in which they are incurred (PAS 23.1 and 23.8).

PAS 23 defines a qualifying asset as an asset that necessarily takes a substantial period of time to get ready for its intended use or sale (PAS 23.5). Accordingly, assets that are ready for their intended use or sale when acquired are not qualifying assets and are, therefore, not eligible for interest capitalization (PAS 23.7).

Capitalization of borrowing costs commences when all of the following conditions are met:

a) The entity incurs expenditures for the asset;
b) The entity incurs borrowing costs; and
c) The entity undertakes activities that are necessary to prepare the asset for its intended use or sale (PAS 23.17).

The standard requires capitalization of borrowing costs to cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete (PAS 23.22). An asset is normally ready for its intended use or sale when the physical construction of the asset is complete, even though routine administrative work might still continue (PAS 23.23).

When an entity suspends the activities necessary to prepare an asset for its intended use or sale, capitalization of borrowing costs should also be suspended during the periods in which active development is interrupted. (PAS 23.20 and 23.21).

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III. TAX TREATMENT

Q1: When can interest expense be claimed as a deduction from gross income?

A1: Interest paid or incurred within a taxable year on indebtedness in connection with the taxpayer's profession, trade or business shall be allowed as a deduction from gross income, subject to certain limitations, when the following requisites, provided in Section 34 (B)(2) of the National Internal Revenue Code (NIRC) of 1997, as amended, and as implemented by Revenue Regulations (RR) No. 13-2000 and Section 7(B) of RR No. 5-2021, are met:

1. The indebtedness must be that of the taxpayer;
2. The interest must have been stipulated in writing;
3. The interest must be legally due;
4. 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 NIRC of 1997, as amended;
5. The interest must not be incurred to finance petroleum operations;
6. The interest was not treated as "capital expenditure" if such interest was incurred in acquiring property used in trade, business or exercise of profession; and
7. The interest shall be reduced by an amount equivalent to twenty percent (20%) of interest income subjected to final tax. However, if the final withholding tax rate on interest income of twenty percent (20%) will be adjusted in the future, the interest reduction shall be adjusted accordingly.

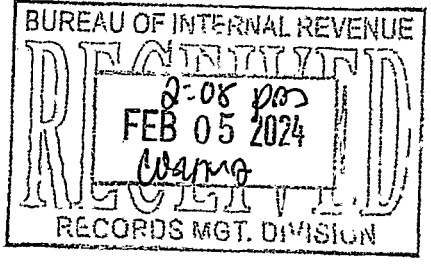
In addition, the taxpayer must have withheld the appropriate tax in order to claim the interest expense as a deduction from the gross income (refer to Q9).

Q2: PAS 23 specifically provides that only borrowing costs directly attributable to "qualifying assets" shall be capitalized. For tax purposes, when shall interest expense be allowed for capitalization?

A2: Only the interest expense directly attributable to the acquisition of any property (*e.g.*, building, car, and machinery) used in trade, business or exercise of profession may be capitalized for tax purposes. Hence, the interest expense incurred in the acquisition of a qualifying asset under PAS 23 may be capitalized for tax purposes only if the asset is used in trade, business or exercise of profession and not if it is intended for sale (*e.g.*, inventories).

Should the taxpayer elect to capitalize the interest expense incurred to acquire property used in trade, business or exercise of profession, which may include a qualifying asset, for tax purposes, the following shall apply:

1. The option to capitalize interest expense shall be irrevocable per specific asset/property.



2. If the loan covers the acquisition of several properties, the interest expense on such loan shall be proportionately capitalized on such properties. For example, if the loan was contracted for the acquisition of a car and machinery, then the interest expense on such loan shall be proportionately capitalized between the car and machinery.
3. If the loan pertains to general borrowings or covers the acquisition of an asset/ property used in trade, business or exercise of profession and qualifying assets intended for sale such as inventories, only the interest expense incurred or paid from the general borrowings directly attributable to the acquisition of the asset/property used in trade, business or exercise of profession may be capitalized by the taxpayer subject to verification by the concerned BIR office upon audit of the taxpayer's tax return. Refer to Illustration A in **Annex A.**
4. If multiple loans were contracted for the acquisition of a single property used in trade, business or exercise of profession, the option to capitalize interest expense shall be applied consistently with all the loans relating to the acquisition of such property.
5. If the interest expense is treated as a capital expenditure, the taxpayer may only claim the periodic depreciation or amortization of such capital expenditure as a deduction from its gross income. The capitalized interest expense shall be depreciated or amortized based on the useful life of the asset. Generally, depreciation or amortization shall commence upon the acquisition of the property. However, if the property is not yet ready for its intended use in the taxpayer's trade, business or exercise of profession, then the depreciation shall commence when the property is already ready for its intended use.

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Q3: When the taxpayer elects to capitalize interest expense incurred or paid to acquire property used in trade, business or exercise of profession and claims periodic depreciation or amortization on such interest expense, can the taxpayer still claim as a deduction from gross income the difference of the periodic depreciation or amortization and the interest expense actually incurred or paid should the latter be greater than the former?

A3: No. The taxpayer may only claim the periodic depreciation or amortization of the capitalized interest expense as a deduction from its gross income.

Illustration:

Interest Expense Paid or Incurred *(a)*	**Depreciable Interest Expense** *(b)*	**Excess of** *(a)* **over** *(b)*	**Tax Treatment of Excess**
₱ 200,000.00	₱ 143,000.00	₱ 57,000.00	Not allowed as deduction from gross income

Q4: Is interest expense deductible in full when claimed as an outright expense?

A4: No. The amount of interest expense paid or incurred on indebtedness in connection with the taxpayer's trade, business or profession shall be reduced by an amount equivalent

to twenty percent (20%) of interest income subjected to final tax pursuant to Section 34(B)(1) of the NIRC of 1997, as amended. However, for corporations subject to the regular corporate income tax rate of twenty percent (20%), the deduction is zero percent (0%) because there is no difference between the tax rates applicable to taxable income and interest income subjected to final tax. The limitation shall apply 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, as long as, during the taxable year, there is an interest expense incurred and an interest income earned that was subjected to final withholding tax. This rule must be observed irrespective of the loan currency and/or the currency in which investments or deposits were made. Refer to Illustration B in **Annex A.**

Q5: For financial reporting and audit purposes, what documents and/or disclosures in relation to interest expense on indebtedness may be submitted and/or disclosed in the Notes to Financial Statements?

A5: For the proper monitoring of interest expense, the following may be submitted and/or disclosed in the Notes to Financial Statements of the taxpayer:

1. A subsidiary ledger detailing the interest expense capitalized or expensed and/or disclosure of interest capitalized or expensed in the Notes to Financial Statements;
2. Disclosure of the principal payments made and the interest expense paid or incurred in the Notes to Financial Statements; and/or
3. Documents that will justify the availment of interest capitalization (*e.g.*, Board Resolution specifying the utilization/allocation of loan proceeds for the general borrowing, year-end certification from the financial institution or creditor, loan documents, and other similar documents).

Q6: What shall be the tax treatment of prepaid interest or interest expense paid in advance?

A6: If within the taxable year an individual taxpayer reporting income on the cash basis incurs an indebtedness on which an interest is paid in advance through discount or otherwise, such interest expense paid in advance shall only be allowed as a deduction in the year when the taxpayer has fully paid the indebtedness. If the indebtedness is payable in periodic amortization, the amount of interest expense that corresponds to the amount of the principal amortized or paid during a certain period shall be allowed as a deduction in such taxable year.

Under the accrual method of accounting, the all-events test shall apply. The test requires that the following requisites be met in the recognition of income or expense:

1. The fixing of a right to income or liability to pay; and
2. The availability of a reasonable accurate determination of such income or liability.[1]

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[1] Commissioner of Internal Revenue v. Isabela Cultural Corporation, G.R. No. 172231, February 12, 2007.

Accordingly, interest expense shall be deducted in the year paid or accrued. However, if a corporation prepays the interest at the loan drawdown date, the prepaid interest shall be amortized over the required period. To fully reflect the revenues generated and expenses incurred, the amortized portion shall be deducted from the prepaid interest as the expense for the taxable year within the required period.

Q7: What shall be the tax treatment of interest expense paid or incurred on intercompany loans?

A7: Interest expense shall not be deductible from gross income if both the taxpayer and the person to whom the payment has been made or is to be made are persons specified under Section 36(B) of the NIRC of 1997, as amended.

Q8: What shall be the tax treatment of costs, other than interest, paid or incurred on borrowing of funds?

A8: For tax purposes, costs such as service fees and commissions paid to banks and/or lending institutions for borrowing of funds shall not be classified as interest expense but as an ordinary and necessary business expense. Such costs shall be allowed as a deduction from gross income in the year paid or incurred.

Q9: What shall be the applicable withholding tax rate/s on interest expense paid or incurred on debt instruments not within the coverage of deposit substitutes?

A9: The interest expense paid or incurred shall be subject to the following withholding tax rates unless otherwise provided by law or regulations:

1. Final withholding tax of twenty-five percent (25%) on interests paid to non-resident aliens not engaged in trade or business in the Philippines;
2. Final withholding tax of twenty percent (20%) on interests from foreign currency loans paid to non-resident foreign corporations, unless entitled to a lower rate under an existing treaty;
3. Final withholding tax of ten percent (10%) on interests from foreign currency loans paid by residents other than offshore banking units in the Philippines or other depository banks under the expanded foreign currency deposit system to depository banks under the expanded foreign currency deposit system; and
4. Creditable withholding tax of fifteen percent (15%) on interests from any other debt instruments not within the coverage of "deposit substitutes" under RR No. 14-2012 paid to persons residing in the Philippines **except** interests paid by top withholding agents strictly arising from individual loans obtained from banks that are **not** securitized, assigned or participated out, as well as interests paid by banks designated as top withholding agents strictly arising from loans made to such banks that are not securitized, assigned or participated out, which shall be subject to a

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creditable withholding tax of two percent (2%) pursuant to Revenue Memorandum Circular No. 84-2012.

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

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

This Circular takes effect immediately.

ROMEO D. LUMAGUI, JR.
Commissioner of Internal Revenue

C (pfrs project)

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