Republic of the Philippines
Department of Finance
BUREAU OF INTERNAL REVENUE
Quezon City

April 25, 2014

REVENUE MEMORANDUM CIRCULAR NO. 46-2014

SUBJECT : Clarifying the taxability of Financial Lease for purposes of Documentary Stamp Tax

TO : All Internal Revenue Officers and Others Concerned

This Circular is issued to clarify the taxability of Financial Lease for purposes of Documentary Stamp Tax (DST).

BACKGROUND

Revenue Regulations No. 9-2004 defines Financial Leasing as a mode of **extending credit** through an non-cancellable lease contract under which the lessor purchases or acquires, at the instance of the lessee, machinery, equipment, motor vehicles, appliances, business and office machines, and other movable or immovable property in consideration of the periodic payment by the lessee of a fixed amount of money sufficient to amortize at least seventy percent (70%) of the purchase price or acquisition cost, including any incidental expenses and a margin of profit over an obligatory period of not less than two (2) years during which the lessee has the right to hold and use the leased property with the right to expense the lease rentals paid to the lessor and bears the cost of repairs, maintenance, insurance and preservation thereof, but with no obligation or option on his part to purchase the leased property from the owner-lessor at the end of the lease contract. A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred.

The said definition was copied from Republic Act No. 5980 as amended by Republic Act No. 8556 otherwise known as the "Financing Company Act of 1998".

Section 3 (c) of Republic Act No. 5980 as amended by R.A. 8556 also defined the term **"Credit"** to mean any loan, mortgage, financial lease, deed of trust, advance or discount, conditional sales contract, contract to sell or sale or contract of sale of property or service, either for present or future delivery, under which, part of all or the price is payable subsequent to the making of such sale or contract; any contract, any option, demand, lien or pledge, or to the other

claims against, or for the delivery of, property or money, any purchase, or other acquisition of or any credit upon the security of, any obligation or claim arising out of the foregoing, and any transaction or series of transactions having similar purpose or effect.

Likewise, Section 179 of the National Internal Revenue Code (NIRC), as amended provides:

"SEC. 179. *Stamp Tax on All Debt Instruments.* – On every original issue of debt instruments, there shall be collected a documentary stamp tax of One peso (P1.00) on each Two hundred pesos (P200), or fractional part thereof, of the issue price of any such debt instrument: *Provided*, That for such debt instruments with terms of less than one (1) year, the documentary stamp tax to be collected shall be of a proportional amount in accordance with the ratio its term in number of days to three hundred sixty-five (365) days: *Provided*, further, That only one documentary stamp tax shall be imposed on either loan agreement, or promissory notes issued to secure such loan. For purposes of this section, the term **debt instrument shall mean instruments representing borrowing and lending transactions including <u>but not limited</u>** to debentures, certificates of indebtedness, due bills, bonds, loan agreements, including those signed abroad wherein the object of the contract is located or used in the Philippines, instruments and securities issued by the government or any of its instrumentalities, deposit substitute debt instruments, certificates or other evidences of deposits that are either drawing interest significantly higher than the regular savings deposit taking into consideration the size of the deposit and the risks involved or drawing interest and having a specific maturity date, orders for payment of any sum of money otherwise than at sight or on demand, promissory notes, whether negotiable or non-negotiable, except bank notes issued for circulation." (Emphasis supplied)

CLARIFICATION

Based on the aforementioned definition of a Financial Lease, the same is akin to a debt rather than a lease. A nature of an obligation than a lease of personal property. The mere act of extending credit is already a means of facilitating an obligation or advancing in behalf of the lessee certain property in lieu of cash in exchange for a definitive amortization to be paid to the lessor with profit margin included.

Financial Lease is not only akin to an obligation by definition but also by treatment. In fact, the International Accounting Standard (IAS) on Leases (IAS 17) is in agreement with how finance lease should be treated and recognized. It even requires that a liability be set up in the lessee's books of accounts. Paragraph Nos. 21 and 22 of IAS 17 Leases provides:

"21 *Transactions and other events are accounted for and presented in accordance with their substance and financial reality and not merely with legal form. Although the legal form of a lease agreement is that a lessee may acquire no legal title to the leased asset, in the case of finance leases the substance and financial reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its economic life in return for entering into an obligation to pay for that right an amount approximating, at the inception of the lease, the fair value of the asset and the related finance charge.*

22 *If such lease transactions are not reflected in the lessee's balance sheet, the economic resources and the level of obligation of an entity are understate, thereby distorting financial ratio. Therefore, it is appropriate for a finance lease to be recognized in the lessee's balance sheet* ***both as an asset and as an obligation to pay future lease payments****. At the commencement of the lease term, the asset and the liability for the future lease payments are recognized in the balance sheet at the same amount except for any initial direct costs of the lessee that are added to the amount recognized as an asset."* (Emphasis supplied)

Although documents, transactions or arrangement under financial lease are not specifically mentioned under Section 179 of the NIRC, as amended, it should be remembered that the imposition of the DST under such Section of the NIRC, as amended covers all debt instruments. Therefore, being a nature of an obligation, financial lease is covered under such Section of the NIRC, as amended.

Accordingly, any document, transaction or arrangement entered into under financial lease is subject to the Documentary Stamp Tax (DST) under Section 179 of the National Internal Revenue Code, as amended.

All concerned revenue officials and employees are hereby enjoined to give this Circular as wide as publicity as possible.

This Circular take effect immediately.

(Original Signed)
KIM S. JACINTO-HENARES
Commissioner of Internal Revenue