BUREAU OF INTERNAL REVENUE
RECORDS MGT. DIVISION
DEC 28 2012
11:30am
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December 27, 2012

REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

REVENUE MEMORANDUM CIRCULAR NO. 89-2012

SUBJECT : Clarifying the Tax Implications and Recording of Deposits/Advances Made by Clients of General Professional Partnerships for Expenses

TO : All Internal Revenue Officers and Others Concerned

I. Background

It is common business practice for General professional partnerships (herein after referred to as "Firm"), such as accounting firms or law firms: (1) to require their clients (herein after referred to as "Client") to deposit a sum of money to them to be used to cover necessary expenses; and/or (2) to pay in advance the necessary expenses on behalf of their Client. The deposits shall thereafter be liquidated by the Firm, while the advances made by Firm shall thereafter be paid by the client. When the Firm bills the Client for the professional fees, such deposits is taken into account in the computation.

However, since the Official Receipts/Invoices covering these expenses incurred on behalf of the Client are issued by the third-party establishments in the name of the Firm, instances occur when these expenses are claimed as deductions to gross income by both the Firm and the Client. As a result, the same expense is twice claimed as deductions contrary to the provisions of the Tax Code.

Accordingly, this circular is being issued to provide guidelines to be observed in accounting and recording such deposits/advances, as well as liquidation and payment of the pertinent expenses.

II. Policies and Guidelines

1. Service Income of General Professional Partnerships

When the Firm receives cash deposits or advances from the Client, the Firm shall issue a corresponding Official Receipt. This amount received shall be

booked as Income of the Firm. They shall form part of the Firm's Gross Receipts and subject to Value-added Tax (VAT), if applicable.

2. Claim for Deduction of Expenses

The Firm shall record the expenses it incurred and paid on behalf of the Client as its own expenses for income tax purposes if the official receipt/invoice issued by the third-party establishments is in the name of the Firm.

Accordingly, all these expenses, supported by *Official Receipts/Invoices* issued by third-party establishments in the name of the Firm, may be claimed by the latter as deductions from its gross income. Conversely, these expenses *may not be claimed as deductions from* the gross income of the Client.

On the other hand, all payments made by the Client to the Firm shall be allowed as deduction from its gross income as professional fee/s provided that they are duly substantiated by Official Receipts issued by the Firm pursuant to Section 34 (A)(1) of the Tax Code.

The Firm and Client, however, are not precluded from availing of the Optional Standard Deduction (OSD) provided under the existing tax laws, rules and regulations.

III. SUMMARY OF TRANSACTIONS/ PRO-FORMA ENTRIES

A. TREATMENT WHEN THE CLIENT MAKES A DEPOSIT FOR NECESSARY EXPENSES

1. *Receipt and Recording of the Deposit*

Upon receipt of the deposit/advances, the Firm shall issue an Official Receipt. If the Firm is utilizing a cash basis of accounting, it shall treat and record the same as Service Income. On the other hand, if the Firm is using accrual basis of accounting, it shall book deposit/advances as Unearned Income/Liability.

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Accounting entries in the Books of the Firm

a) Cash Accounting:

	Dr.	Cr.
Cash	xxx	
Service Income		xxx
Output VAT		xxx

b) Accrual Accounting:

	Dr.	Cr.
Cash	xxx	
Deposits from Clients		xxx
Output VAT		xxx

In turn, upon making deposit/advances for the necessary expenses, if the Client is using a cash basis of accounting, it shall treat such deposit/advances as an outright expense. However, if the Firm is using an accrual basis of accounting, such deposit/advances shall be treated as deferred expense/pre-payments.

Accounting entries in the Books of the Client

a) Cash Accounting:

	Dr.	Cr.
Professional Fees	xxx	
Input VAT	xxx	
Cash		xxx

b) Accrual Accounting:

	Dr.	Cr.
Deposits to Professional Firms	xxx	
Input VAT	xxx	
Cash		xxx

2. *Payments made to third-party establishments*

When the deposit is used or spent for the necessary expense and the Official Receipt/invoice is issued in the name of the Firm, the latter shall record the same as follows:

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Accounting entries in the Books of the Firm

a) Cash Accounting:

	Dr.	Cr.
Expenses	xxx	
Input VAT	xxx	
Cash		xxx

b) *Accrual Accounting*:

	Dr.	Cr.
Expenses	xxx	
Input VAT	xxx	
Cash		xxx
Deposits from Clients	xxx	
Service Income		xxx

If the deposit is not sufficient to cover the expenses and the Firm makes the necessary advances, *the Firm shall record a receivable from the Client as* follows:

	Dr.	Cr.
Accounts Receivable - Client	xxx	
Service Income		xxx

3. *Liquidation of the deposit and expenses*

Upon liquidation of the deposit and expenses, the Firm shall make a summary computation of all the expenses incurred.

If the deposit/s previously provided by the Client exceeds the total expenses and such excess is returned by the Firm to the Client, the Firm shall record such *liquidation (return of the excess) as follows:*

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Accounting entries in the Books of the Firm

a) Cash Accounting:

	Dr.	Cr.
Service Income	xxx	
Input VAT	xxx	
Cash		xxx

b) Accrual Accounting:

	Dr.	Cr.
Deposits from Clients	xxx	
Input VAT	xxx	
Cash		xxx

On the other hand, the Client, upon receipt of the excess deposit, shall record such liquidation as follows:

Accounting entries in the Books of the Client

a) Cash Accounting:

	Dr.	Cr.
Cash	xxx	
Professional Fee/s		xxx
Output VAT		xxx

b) Accrual Accounting:

	Dr.	Cr.
Professional Fee/s	xxx	
Cash	xxx	
Deposits to Professional Firms		xxx
Output VAT		xxx

If the actual expenses exceed the amount of deposits provided by the Client, the Client shall pay the Firm for such balance and the latter shall issue an Official Receipt upon receipt of the cash and shall record such payment as follows:

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Accounting entries in the Books of the Firm

a) Cash Accounting:

	Dr.	Cr.
Cash	xxx	
Service Income		xxx
Output VAT		xxx

b) Accrual Accounting:

	Dr.	Cr.
Cash	xxx	
Accounts Receivable - Clients		xxx
Output VAT		xxx

The Client shall record the above transaction as follows:

Accounting entries in the Books of the Client

a) Cash Accounting:

	Dr.	Cr.
Professional Fee/s	xxx	
Input VAT	xxx	
Cash		xxx

b) Accrual Accounting:

	Dr.	Cr.
Professional Fee/s	xxx	
Input VAT	xxx	
Deposits to Professional Firms		xxx
Cash		xxx

B. TREATMENT WHEN NO DEPOSIT FOR NECESSARY EXPENSES IS MADE BY THE CLIENT: THE FIRM ADVANCES FOR THE NECESSARY EXPENSES ON BEHALF OF THE CLIENT AND BILLS THE LATTER FOR THE SAME

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1. *Payments made to third-party establishments on behalf of the Client*

When the Firm advances for the expenses on behalf of the Client and the Official Receipt/Invoice issued by third party establishments is in the name of the Firm, the latter shall record the same as follows:

Accounting entries in the Books of the Firm

a) Cash Accounting:

	Dr.	Cr.
Expenses	xxx	
Input VAT	xxx	
Cash		xxx

b) Accrual Accounting:

	Dr.	Cr.
Expenses	xxx	
Input VAT	xxx	
Cash		xxx
Accounts Receivable - Clients	xxx	
Service Income		xxx

2. *Collection of the Expenses made on behalf of the client*

The Firm shall make a summary computation of all the expenses made on behalf of the Client and shall bill the Client for the same. Upon receipt of the entire amount billed, the Firm shall issue an Official Receipt and shall record the transaction as follows:

Accounting entries in the Books of the Firm

a) Cash Accounting:

	Dr.	Cr.
Cash	xxx	
Service Income		xxx
Output VAT		xxx

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b) Accrual Accounting:

	Dr.	Cr.
Cash	xxx	
Accounts Receivable- Clients		xxx
Output VAT		xxx

The Client shall record such payment, whether cash or accrual accounting, as follows:

Accounting entries in the Books of the Client

	Dr.	Cr.
Professional Fee/s	xxx	
Input VAT	xxx	
Cash		xxx

All revenue officials and employees are enjoined to give this Revenue Memorandum Circular as wide a publicity as possible.

This circular shall take effect immediately.

KIM S. JACINTO-HENARES
Commissioner of Internal Revenue

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