REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Quezon City

February 1, 2008

REVENUE REGULATIONS NO. 1 - 2008

Subject: **Amending Certain Provisions of Revenue Regulations No. 10-2006 Prescribing the Guidelines and Conditions for the Tax Treatment of Securities Borrowing and Lending Transactions Involving Shares of Stock or Securities Listed in the Philippine Stock Exchange**

To : **The Philippine Stock Exchange Inc., All Internal Revenue Officers and Others Concerned**

SECTION 1. Scope. — Pursuant to Section 244 of the National Internal Revenue Code of 1997, these Regulations are hereby promulgated to amend certain provisions of Revenue Regulations (RR) No. 10-2006 by prescribing the set of procedures to govern the registration of Master Securities Lending Agreement (MSLA) and providing the guidelines for the execution and registration of multilateral MSLAs during the transition period of the Securities Borrowing and Lending (SBL) Program.

SECTION 2. – Section 2 of RR 10-06 is hereby amended to read as follows:

"SECTION 2. Concept of Securities Borrowing and Lending (SBL). - Securities Borrowing and Lending (SBL) is an important element in securities trading and capital market development among emerging markets. It is a vital facility behind the efficient trading settlements and growth of derivatives and options market. SBL exists for both equity and debt securities. For purposes of these Regulations, however, SBL shall be limited to borrowing and lending of shares of stock or securities listed in the PSE unless declared by the Securities and Exchange Commission to be ineligible for borrowing and lending under an SBL Program. SBL Program for other securities listed and traded in other Exchanges shall be covered by a separate Regulation.

SBL involves the lending of shares of stocks or securities by the Lender, who owns or controls them, to the Borrower who needs the shares of stocks/ securities borrowed to support trading strategies or settlement obligations, in exchange for a collateral and the promise to return the equivalent shares of stocks/ securities at the end of the borrowing period. The borrowing period in any agreement cannot be more than two (2) years.

Typically, the Borrower will use or dispose of the shares of stocks/ securities borrowed strictly in connection with a particular purpose or purposes as herein mentioned. Being fungible in nature, the borrowed shares of stocks/securities are transferred from the Lender to the Borrower. For the duration of the borrowing and lending period under the agreement, the Lender temporarily loses ownership of the shares of stock/securities lent but acquires a contractual right to receive all benefits accruing to the shares of stock/securities. The objective is to put the Lender into the same economic position as the Lender would have been had the securities not been lent. This means that in case of corporate actions like stock rights, dividend declarations, and other benefits accruing to the shares of stock, the Borrower would have to "manufacture" the corresponding benefits thereon and return the same to the Lender as if the shares of stock/securities "never left his hands".

Upon demand of the Lender or at the end of the stipulated borrowing period, the Borrower is then obligated to return the equivalent shares of stock/securities and the Lender, in turn, returns the collateral put up by the Borrower. If the borrower fails to return the shares of stock/securities or the Equivalent Shares of Stock/Securities, the Lender/Lending Agent, as part of the SBL transactions, may purchase shares of stock/securities from the stock exchange. In effect, SBL is similar to a simple collateralized cash loan transaction. However, instead of cash, what is borrowed are listed shares of stock/securities and what is provided as collateral is either cash, government or equity securities, or standby letter of credit issued by a bank."

SECTION 3. Section 3 of RR 10-06 is hereby amended to read as follows:

"SECTION 3. Definition of Terms. —

a. Borrowing Period. The period agreed upon by the parties during which an SBL transaction should be outstanding, which period, shall in no case exceed two (2) years from the date of execution of the SBL Confirmation Notice. At the end of this period, the Borrower must return to the Lender the equivalent shares of stock borrowed.

b. Collateral. Cash, government securities, equity securities, or standby letter of credit issued by a bank, provided to the Lender as security in accordance with the rules prescribed by the SEC and/or PSE until the borrowed share/security is returned.

c. Equivalent Shares of Stock/Securities. Shares of stock/securities of the same type or class of issue and of equivalent number to the shares/securities borrowed. The term shall also refer to shares of stock/securities purchased by the Lender/Lending Agent through The Philippine Stock Exchange, Inc. using the collateral of the borrower, conversion, subdivision or consolidation, a take-over, or a rights issue where it is not possible to return such borrowed shares of stock/securities because of a corporate restructuring or similar event subsequent to the date of the SBL.

d. Lender(s)/Lending Agent(s). Any person or entity who lends shares of stock/securities from his pool of assets as principal or from the assets of his client in case of a Lending Agent.

e. Failed Settlement. In the context of regular stock/securities transaction, failed settlement means the failure of the seller to deliver to the buyer the shares/securities subject of the transaction within the required period for settlement.

f. Manufactured Dividend or Benefits. The amount of dividend or other benefits that accrue on the shares of stock/securities that are lent out which the Borrower is obliged to pass on to the Lender in accordance with the terms of the agreement.

g. Mark-to-Market. The practice of periodically re-pricing the shares/securities on loan against the value of the Collateral based on current market prices of the shares of stock/securities and the Collateral.

h. Master Securities Lending Agreement (MSLA). A written contract between the Borrower and the Lender or the Lending Agent embodying the general terms and conditions for the conduct of SBL transactions.

i. Multilateral MSLA. An MSLA entered into by three or more borrowers and Lenders/Lending Agent embodying the general terms and conditions for the conduct of SBL transactions. For purposes of these Regulations, references to MSLA shall also include the Multilateral MSLA.

j. Securities Borrowing and Lending (SBL). The execution of an MSLA and the lending (borrowing) of shares of stock/securities listed in The Philippine Stock Exchange, Inc. from an investor's portfolio or investment account to support trading strategies of the borrower or for purposes specified under these Regulations, and the collateral securing the lending (borrowing), with the commitment by the borrower to return or deliver the equivalent shares/securities to the Lender/Lending Agent at the end of the borrowing period.

k. Short Sale or Short Selling. Any sale of shares of stock/securities that the seller does not own or any sale of a security that will be settled by the delivery of borrowed securities.

l. SBL Confirmation Notice. A notice in a format prescribed by the PSE which is sent by the Lender/Lending Agent to the Borrower to confirm the details of the SBL transaction including, but not limited to, the securities borrowed and terms of the SBL.

m. Trading Participants/Agent Facilitator. – Brokers and/or dealers authorized to operate a trading right in PSE pursuant to PSE rules."

SECTION 4. Section 4 of the same RR is hereby amended to read as follows:

"SECTION 4. Parties to an SBL transaction. - The parties to an SBL transaction are as follows:

a. Borrower. - A Borrower is any person, whether natural or juridical, who obtains shares of stock/securities from a Lender's portfolio or investment account under a MSLA strictly for purposes specified under Section 6 (f) hereof. There are no restrictions on the status and qualifications of a person who enters into an MSLA as a Borrower. Consequently, a Borrower is not necessarily one who is registered or accredited by the PSE.

b. Lender. - A Lender is any person, whether natural or juridical, who lends shares of stock/securities from his/its pool of assets. There are no restrictions on the status and qualifications of a person who enters into an MSLA as a Lender. A foreign lender is contemplated within the definition of a Lender for the purpose of these Regulations.

c. Lending Agent. – A Lending Agent is any juridical person or institution acting on behalf of a client for SBL transactions. A Lending Agent shall comply with all the requirements under SEC Memorandum Circular No. 7 (2006)."

SECTION 5. Section 5 of the RR 10-2006 is hereby amended to read as follows:

"SECTION 5. Tax Treatment of Securities Borrowing and Lending (SBL). - For purposes of these Regulations, the Securities Borrowing and Lending transactions of shares of stock/securities listed in the PSE, as well as the delivery to, and return by, the Lender/Lending Agent of collateral appurtenant thereto or the Equivalent Shares of Stock/Securities, shall not be subject to the stock transaction tax under Section 127 or capital gains tax imposed under Section 24(C), 25(A)(3), 28(A)(7)(c), and 28(B)(5)(c) of the Tax Code, and documentary stamp taxes under Section 176 and Section 199(c) of the National Internal Revenue Code, as amended by RA 9243; provided, that, a valid MSLA is executed by the parties and registered with and approved by the BIR, the SBL Program is in accordance with the rules and regulations of the SEC, and such SBL Program is under the administration and supervision of the PSE. However, all other applicable taxes prescribed by the Tax Code and special laws shall continue to apply.

Unless the terms and conditions of these Regulations are complied with, the borrowing (lending) of shares of stock/securities shall be treated as a disposal (an acquisition) by the lender (Borrower), and the return of borrowed shares/securities shall be treated as an acquisition (disposal) by the Lender (Borrower), in which case, the applicable taxes on the transaction shall be imposed."

SECTION 6. Section 6 of the RR 10-2006 is hereby amended to read as follows:

"SECTION 6. Master Securities Lending Agreement; Basic Requirements. – Prior to the borrowing of shares of stock/securities by the Borrower and negotiating the terms of an SBL, the parties must have entered into an MSLA or Multilateral MSLA. A valid MSLA or Multilateral MSLA contains the following features:

a. **Entitlement of Lender to Certain Stock Rights/Interest -** While there is transfer of the shares of stock/securities to the Borrower, the Lender retains certain rights accruing to the shares of stock/securities lent, such as the right to receive cash, stock dividends or interest which the Borrower is obliged to manufacture or reimburse to the Lender during the borrowing period. These cash, stock dividends or interest which the Borrower is required to manufacture or reimburse to the Lender are otherwise referred to as **"Manufactured Dividends or Benefits"**. The Lender may likewise retain voting rights over the loaned shares of stock/securities while in the possession of the Borrower, if mutually agreed upon by the parties.

   Receipt of the Manufactured Dividends or Benefits shall not be a taxable income of the Lender since it just represents dividends/other benefits that the lender would have received had the share not been loaned pursuant to SBL. However, the payment of such amount by the Borrower shall not be a tax deductible expense. On the other hand, the receipt of cash dividend from the issuing company by the Borrower or Buyer shall be subject to the provisions of existing laws.

b. **Stock recall/return. -** The Lender is entitled to recall the loaned shares of stock/securities in whole or in part. Upon demand or at the end of the Borrowing Period, the Borrower has the corresponding obligation to return the Equivalent Shares of Stock/Securities, *i.e.*, equivalent number of the same class or type of shares of stock/securities, carrying the same rights, and issued by the same company as that of the borrowed shares of stock/securities. The borrower may return the borrowed shares/securities or the Equivalent Shares of Stock/Securities pursuant to Section 18 of SEC Memorandum Circular No. 7 (2006).

c. **Collateral requirement. -** There is no consideration involved in the same manner as a regular buy and sell transaction. Instead, the Borrower merely puts up a collateral in accordance with the rules prescribed by the SEC and/or PSE in order to guarantee his obligations under the MSLA, which collateral may not be necessarily in the form of cash but may also be in the form of government or equity securities or letters of credit.

d. **Borrowing period. -** The period agreed upon by the parties during which the specific SBL transaction under the MSLA is made effective and upon the termination of which, the specific SBL transaction is likewise ended. However, this period shall in no case exceed two (2) years from the date of execution of SBL Confirmation Notice.

e. **Stock and collateral return. -** Upon the expiration of the Borrowing Period, the Borrower is bound to return the Equivalent Shares/Securities as the term is defined herein. Concomitantly, the Lender is required to

return the collateral put up by the Borrower.

f. **Specified purpose(s).** - The purpose or purposes for which the borrowed shares of stock/securities will be used are specified in and accordingly limited by the MSLA, which must be any of the following:

1. **Settlement of sale of Philippine shares of stock/securities effected in the Philippines.** Shares of stock/securities may be borrowed to avoid failure to deliver for the settlement of a sale. This happens when the seller cannot deliver what he owns on time (failed settlement) and therefore would need to borrow in order to fulfill his settlement obligations. The corresponding transaction taxes relative to the sale of shares/securities shall apply to the actual sale of shares/securities.

2. **Settlement of a future sale whether agreed or not at the time the borrowing is effected.** Shares of stock/securities may be borrowed in advance of a sale if it is anticipated that the borrowed shares of stock/securities will be required for settlement of the said future sale. The corresponding transaction taxes relative to the sale of shares of stock shall apply to the actual sale of shares/securities.

3. **Replacement in whole or in part of shares of stock/securities obtained by the Borrower under another SBL agreement.** Where a Lender demands the early return of borrowed shares of stock/securities, a Borrower without a sufficient quantity on hand of the shares of stock/securities demanded to be returned can borrow Equivalent Shares of Stock/Securities from a third party to repay the first Lender. The replacement borrowing may be for the whole, or part only, of the previously borrowed shares of stock/securities. A condition applying to such an arrangement is that the initial borrowing must itself be an SBL within the meaning of these Regulations. Moreover, the second borrowing must also be under an SBL governed by these Regulations.

4. **On-lending of borrowed shares of stock/securities to another Borrower who has effected another SBL agreement** This occurs when an SBL is made by an Agent for on-lending to another Borrower who also effects an SBL. However, the subsequent Borrower must use the Borrowed shares of stock/securities for any of the purposes specified herein. Because of the practical difficulties an intermediary could face in determining how the subsequent Borrower had used the shares of stock/securities, the BIR shall look at an intermediary's borrowings and on-lendings separately. Thus, provided an intermediary borrows for the purpose of on-lending, his borrowing transaction will qualify under a conditional tax-free status. Furthermore, as shares of stock/securities carrying the same rights are fungible, it is not necessary to match each of an intermediary's SBL with each of his on-lendings on a case-by-case basis.

5. **Securities Financing and Collateral Pledging.** Shares of stocks/securities may be used by the Borrower as collateral for obtaining loans. The borrowed shares of stock may, in turn, be used by the Borrower as a commodity to lend to participants in securities market so that the participants can carry out their investments and financing efforts.

6. **Other Authorized Purposes.** Other purposes similar or analogous to the foregoing, or consistent with the objectives of the SBL program as may be determined by the BIR upon favorable recommendation of the SEC and the PSE."

SECTION 7. Section 7 of the same RR is hereby amended to read as follows:

"SECTION 7. Guidelines in the Execution of the MSLA. —

a. The Borrower must obtain the shares of stock/securities for one or more of the specified purposes as defined in Section 6(f) of these Regulations. In this regard, the MSLA may refer to the specified purposes within the meaning of these Regulations. However, an MSLA which permits shares of stock/securities to be borrowed for the Specified purposes as herein defined and some other purposes not defined or authorized by these Regulations shall not qualify as a valid MSLA.

b. A single MSLA may provide for the borrowing and lending of more than one type of shares of stock/securities. However, only shares of stock/securities, the sale and purchase of which are subject to the rules of PSE and SEC, are eligible for SBL transaction. Shares of stock/securities in private companies not listed and traded through the PSE do not fall within the scope of an SBL transaction subject of these Regulations.

c. Every MSLA entered into by a Borrower and a Lender/Lending Agent or by their duly authorized agents must be registered with the BIR upon payment of the prescribed registration fee pursuant to Section 8(b) hereof. Only the Borrower or the Lending Agent is required to register the MSLA to avoid duplication.

d. As a general rule, an MSLA should be entered into by the Borrower for every Lender/Lending Agent. However, in view of the administrative difficulty of executing and registering an MSLA for every borrower, a Multilateral MSLA may be executed and submitted to the BIR by the Lender/Lending Agent or the concerned party with multiple borrowers. This means that instead of executing separate MSLAs for each borrower, the Lender/Lending Agent or the concerned party may execute and register with the BIR a Multilateral MSLA reflecting their undertaking and willingness to be bound by its provisions. It is understood that a Multilateral MSLA shall contain all the features of a valid MSLA, including the delivery of collateral, pursuant to Section 6 hereof.

e. Where an MSLA does not comply with the requirements herein set forth, the BIR shall consider the requirements fulfilled if a copy of the MSLA is accompanied by an executed copy of an addendum duly complying with the deficiency requirement. In such cases, the addendum should be attached to a copy of the MSLA. Only transactions entered into subsequent to the extension of the addendum will be eligible for a conditional tax-free status."

SECTION 8. Section 8 of RR 10-06 is hereby amended to read as follows:

"SECTION 8. Registration of the MSLA or Multilateral MSLA. — The following guidelines shall govern the registration of every MSLA or Multilateral MSLA:

a. Pre-clearance and endorsement of PSE.

1. The borrower or Lending Agent or the concerned party shall submit to the the PSE a letter-request for pre-clearance and favorable endorsement to the BIR of the registration of the MSLA or the Multilateral MSLA. The letter-request shall be accompanied by a copy of the MSLA.

2. Within five (5) working days from receipt of the MSLA or Multilateral MSLA, the PSE shall examine and evaluate the terms and conditions of the MSLA or Multilateral MSLA against the requirements of these Regulations.

3. In the event that the PSE determines that the MSLA does not incorporate all the required terms and conditions under these Regulations, the PSE shall then duly notify in writing the applicant of the said determination, specifying the deficiencies noted in the MSLA.

4. If PSE is reasonably satisfied that the MSLA or Multilateral MSLA incorporates all the required terms and conditions, then the PSE will issue a pre-clearance and favorable endorsement of the MSLA or Multilateral MSLA for registration with the BIR. Thereafter, PSE shall immediately notify the applicant of the fact of pre-clearance and favorable endorsement of the MSLA or Multilateral MSLA to the BIR and advise the applicant to pay the required BIR registration fees before actual processing by the BIR of the application can commence.

b. Payment of Registration Fee. A registration fee of Php 5,000.00 for every MSLA must be paid by the applicant in the General Services Division of the BIR National Office. Provided, however, that for a Multilateral MSLA, the registration fee shall be equivalent to the prescribed registration fee of Php5,000.00 multiplied by the number of signatories to the Multilateral MSLA.

c. Place and Time of Registration. The MSLA or Multilateral MSLA shall be registered in the Law Division of the BIR National Office or in such other office which the Commissioner may hereafter direct, upon filing of Registration Form and payment of the registration fee with the General Services Division at the BIR National Office. Registration of the MSLA or Multilateral MSLA should be made within two (2) weeks if executed in the Philippines and within one (1) month if executed outside the Philippines.

In case parties have valid existing MSLAs executed outside the Philippines prior to the effectivity of these Regulations, the borrower must register the MSLA before entering into the first SBL transaction involving Philippine equity securities.

d. Processing of Registration. The Law Division, or such other office which the Commissioner may hereafter direct, taking into account the pre- clearance and favorable endorsement of PSE, and provided that the required registration fees shall have been paid, shall immediately commence the processing of the application in order to validate whether the MSLA or Multilateral MSLA incorporates the required terms and conditions under these Regulations. The application for registration shall be accompanied by the following documents:

i. Three original or certified true copies of a duly completed MSLA Registration Form (Appendix A);
ii. Three original or certified true copies of the duly-signed and completed MSLA (and its addendum if applicable); if duly notarized abroad, a consularized version of the MSLA and
iii. Three original or certified true copies of Lender's Notification of Execution of MSLA (Appendix B);

The Law Division shall take the appropriate action on the application for registration within five (5) working days from commencement of processing of the application. All applications for registration of MSLAs or Multilateral MSLAs shall be approved by the BIR Assistant Commissioner, Legal Service or any other revenue official duly-authorized by the Commissioner.

e. Approval of MSLA or Multilateral MSLA. Only SBL transactions under an MSLA or Multilateral MSLA duly registered and approved by the BIR shall be entitled to the conditional tax-free status of the said transactions.

f. Failure to Register. Failure to register the MSLA or Multilateral MSLA will make the SBL transaction a sale and purchase of the borrowed shares of stock/securities outside the PSE. Thus, the SBL transaction shall be subject to the corresponding capital gains tax and documentary stamp tax.

g. Duty of the Lender/Lending Agent and Borrower. A Lender under an MSLA must take reasonable care to ensure that the Borrower registers the MSLA or is aware of the requirement to register the MSLA as soon as practicable. Due notice to the borrower may be effected, for example, by stipulating in the MSLA or in the addendum (if applicable), that the Borrower shall register the agreement and its addendum with the BIR or by otherwise informing the Borrower of such registration requirement.

In order not to be assessed the corresponding taxes on the transaction, a Lender/Lending Agent should advise the BIR in writing that it has entered into an MSLA by filling-in the Notification of Execution of MSLA Form (Appendix B). The advice should include particulars of the agreement similar to those shown in the MSLA Registration Form. Said notification shall be submitted upon the registration of the MSLA by the Borrower.

h. Duty of the BIR. It shall be the duty of the Law Division of the BIR National Office to determine whether the registered MSLA conforms to the requirements herein imposed, to recommend the signature of the Commissioner or his duly-authorized representative for the approval or denial of the MSLA registration, to monitor compliance of the parties to the conditions herein prescribed, and to recommend, where appropriate, assessment of the taxes against the parties found to have entered into an SBL transaction in violation of these Regulations."

SECTION 9. Section 9 of RR 10-2006 is hereby amended to read as follows:

"SECTION 9. SBL Deemed Sale –An SBL is deemed a sale and purchase of the borrowed shares of stock/securities (or part of it, as the case may be) when any of the following circumstances is present:

a. There is no Stock Return in whole or in part of the borrowed shares of stock/securities at the end of the borrowing period. A partial stock return is permissible; however, the balance of any borrowed shares of stock/securities that has not been returned at the end of the borrowing period is deemed to have been bought (sold) by the Borrower (Lender);

b. The borrowed shares of stock/securities, or part of it, have been used other than that for the Specified Purposes herein enumerated;

c. The borrower is in default in accordance with the terms provided for in the MSLA for the return of the whole or part of the borrowed shares of stock/securities; provided, that the Lender/Lending Agent may purchase Equivalent Shares of Stock/Securities using the collateral of the borrower from the stock exchange, which purchase is subject to the stock transaction tax under Section 127(a) of the National Internal Revenue Code of 1997, as amended.

d. There is failure to comply with the essential features of a valid MSLA;

e. There is failure to register or there is delayed registration of the MSLA; or

f. SBL transactions were entered into by the parties outside the borrowing period."

SECTION 10. Section 12(a) of RR 10-2006 is hereby amended to read as follows:

"SECTION 12. Compliance Requirements.

a. Record Keeping and Reporting. – The Borrower is required to:

1. Keep SBL ledgers and other books of account in the form prescribed by the Commissioner of Internal Revenue;

2. Enter required particulars of SBL transactions and Stock Return into that that ledger;

3. Prepare and keep an SBL Transaction Report for each specific SBL transaction in accordance with Appendix C or substantially equivalent form;

4. Provide BIR copies of the SBL Transaction Report and the accompanying SBL Confirmation Notice.

Provided, that where a Lending Agent is engaged by the parties for the SBL transactions, the Lending Agent shall be the one to provide the BIR with summary reports of outstanding and liquidated SBL transactions as required in Section 12(c) of RR 10-2006."

SECTION 11. Effectivity. — These Regulations shall take effect immediately after publication in any newspaper of general circulation.

(Original Signed)
MARGARITO B. TEVES
Secretary of Finance

Recommending Approval:

(Original Signed)
LILIAN B. HEFTI
Commissioner of Internal Revenue