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

June 13, 2016

REVENUE MEMORANDUM CIRCULAR NO. 61-2016

SUBJECT : Prescribing Policies and Guidelines for Accounting and Recording Transactions Involving "Netting" or "Offsetting"

TO : All Revenue Officials, Employees and Others Concerned

For information and guidance of all concerned, this Circular is being issued to standardize the procedure on the arrangements/practices of offsetting the amounts recognized as accrued/trade receivables against amounts recognized as accrued/trade payables pursuant to Section 6 (H), in relation to Sections 57 (B), 113 and 237, all of the National Internal Revenue Code (NIRC) of the 1997, as amended, and to the definition of gross income and gross receipts under Section 32 (A) and 108, of the same Code, respectively.

BACKGROUND:

It is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper. Hence, under no circumstance is offsetting to be considered appropriate in recording transactions that are subject to a wide range of "netting" arrangements or similar practices, including those with standard commercial provisions that allow parties to "net settle", such as trade receivables and payables.

Questions have been raised about offsetting amounts recognized for transactions for which the net amount of those transactions, rather than the gross amount is reported for accounting/tax purposes. In the absence of definitive policies for reporting assets and liabilities arising from those transactions, various financial reporting practices have developed giving rise to accounting treatments that result in offsetting which adversely affect the complete measurement of an asset or a liability.

TAX CONSEQUENCE:

The practice of offsetting due to/due from and/or payable/receivable transactions of taxpayers and consequently the accounting and recording of the same and its related transactions in the books of the parties is strictly prohibited for taxation purposes. Thus, at all times, the accrued receivables or payables arising from sale or lease of goods or properties or the performance of service, shall be recognized at gross for income and value-added tax or percentage tax purposes.

Income payments subject to creditable or final withholding taxes pursuant to the provisions of Revenue Regulations (RR) No. 2-98, as amended, shall be recorded at gross, regardless of whether the transactions are actually offset or the same provide for net settlement of cash flows. Any amount offset against the income payments by the payor not subjected to creditable or final withholding tax shall not be allowed as deductible expense of the payor pursuant to the provisions of RR No. 12-2013 which disallows claims for deduction of expenses for which the corresponding withholding tax was not remitted.

ILLUSTRATIONS AND ACCOUNTING ENTRIES:

For clarification and to guide the concerned taxpayers in their invoicing and recording of income payments and receipts, hereunder are example of transactions with "netting arrangement" or those providing for net settlement of cash flows, together with the prescribed accounting entries.

ILLUSTRATION NO. 1

Company S is a VAT-registered entity engaged in grocery and supermarket business. Company F also a VAT-registered entity is a manufacturer of food products. F supplies its manufactured food products to S for sale to end-users. Based on an agreement, F is under obligation to pay S service fees for the display of F's food products in S's store premises.

Assuming F sold to S food products worth ₱11,200.00 and issued sales invoice for the same amount. On settlement date, S paid F ₱8,000.00 only (net of ₱3,200.00 service fees pursuant to the said agreement).

Based on the foregoing, S and F should have the following entries in its respective books:

A. To Record Purchase of Goods from F and Recognition of Service Fees/Revenue

RETAILER/BUYER (S)		
	Debit	Credit
Purchases	10,000.00	
Input VAT	1,200.00	
A/P Trade		11,100.00
CWT Payable (10,000 x 1%)		100.00
A/R Trade	3,142.85	
Creditable IT Withheld (2,857.14x2%)	57.15	
Service Fee Income		2,857.14
Deferred VAT Payable (3,200/112% x 12%)		342.86

A. To Record Sale of Goods to S and Recognition of Service Fees/Expense

MANUFACTURER/SELLER (F)		
	Debit	Credit
A/R Trade	11,100.00	
Creditable IT Withheld (10,000x 1%)	100.00	
Sales		10,000.00
Output VAT		1,200.00
Service Expense	2,857.14	
Deferred Input VAT (3,200/112%x12%)	342.86	
A/P Trade		3,142.85
CWT (3,200/112% x 2%)		57.15

B. To Record Settlement of the above transaction

A/P Trade	11,100.00	
Deferred VAT Payable	342.86	
A/R Trade		3,142.85
Output VAT		342.86
Cash		7,957.15

Cash	7,957.15	
A/P Trade	3,142.85	
Input VAT	342.86	
A/R Trade		11,100.00
Deferred Input VAT		342.86

C. To record Remittance of Taxes to the BIR

CWT Payable	100.00	
Output VAT Payable	342.86	
Output VAT (for other vatable transactions)	xxx	
Cash		xxx
Input VAT		1,200.00

Output VAT	1,200.00	
CWT Payable	57.15	
Input VAT		342.86
Cash		914.29

Accordingly, S shall record the purchases at gross amount of ₱10,000.00 instead of ₱8,000.00, that is net of service fee. At the same time, S shall declare the service fee as revenue and shall issue an Official Receipts (O.R.) in the amount of ₱3,200.00 representing the service fee.

Based on the above illustration, F and S may, for example, simulate a transaction to resemble, in form, a discount, when the transaction actually achieves a sale of service. The tax consequences of discount and sale of service differ, in which case, the application of the principle of "substance over form" will ensure that the parties are taxed according to the legal consequences of the sale the transaction effects in substance, instead of the discount that the transaction purports to have in its form. Accordingly, service fees disguised as discount in an agreement that does not express what the parties truly intend, where substance contradicts form, the agreement will be disregarded such that the purported discount shall be considered as income by S subject to creditable withholding tax and VAT.

Furthermore, if the agreement provides for F to give discount to S but in reality the discount is disguised service fee, such discount shall not be allowed as deduction from the gross selling price for VAT purposes since such discount is not the discount as contemplated under the provisions of RR No. 16-2005, as amended.

In all cases, the principle of "substance over form" shall apply in delineating a transaction, hence, service fee disguised as discounts shall be considered as revenue on the part of payor of the income payment notwithstanding the "netting" arrangement or agreement between the payor and the payee.

ILLUSTRATION NO. 2

Companies **G** and **S** are both authorized Telecommunications (TELCO) carriers and are therefore mandated by the National Telecommunications Commission (NTC) to interconnect their telecommunication service networks with one another.

G and **S** are covered by revenue-sharing or fixed rate charge arrangement for charges on voice and data transmissions passing through their respective network, whereby either company shall have a 50% interconnect share as access charge or interconnection fee in every billing.

Assuming **G** (originating or collecting TELCO) billed **M**, a postpaid subscriber of **G** and belonging to the Top 20,000 private corporations, for outgoing call made to Mr. **K**, a postpaid subscriber of **S** (terminating TELCO) for the amount of ₱1,000.00. The bill included the 50% interconnect share of **S**. **M** paid **G** the full amount of the bill and **G** issued the corresponding O.R. to **M**.

The following are the accounting entries in the books of **G**.

A. To Record the Revenue from Outbound Call

	Debit	Credit
A/R from Subscriber	₱ 982.14	
CWT (1,000/112% x 2%)	17.86	
Revenue – Voice Call (1,000/112%)		₱ 892.86
Deferred Output VAT(1,000/112% x12%)		107.14

B. To Record the Access Charge/Interconnection Fee of S

	Debit	Credit
Access Charge Expense – S (1,000 x 50%/1.12)	₱ 446.43	
Deferred Input VAT (1,000x50%/1.12) x 12%	53.57	
Access Charge Payable –**S** (500 *less* 8.93)		₱ 491.07
CWT Payable (500/112% x 2%)		8.93

C. To Record the Collection from subscriber **M**

	Debit	Credit
Cash	₱ 982.14	
Deferred Output VAT	107.14	
A/R from Subscriber		₱ 982.14
Output VAT		107.14

D. To Record the Settlement of Access Charge/Interconnection Fee of S and Receipt of the VAT O.R. from S

	Debit	Credit
Access Charge Payable - S	₱491.70	
Input VAT	53.57	
Cash		₱491.70
Deferred Input VAT		53.57

The following are the accounting entries in the books of S:

A. Recognition of 50% Interconnect Share

	Debit	Credit
A/R Access Charge G	₱500.00	
Interconnect Share		500.00

B. Settlement of Interconnect Share by G

	Debit	Credit
Cash	₱491.70	
CWT	8.93	
A/R Access Charge G		500.00

Based on the above illustration, the interconnection share of S should form part of reported gross revenue of G. However, simultaneous with the accrual of the gross revenue, G shall recognize the corresponding interconnection fee expense and set-up the liability for the same amount due to S. Outright or automatic netting-out or set-off of payments due to other telecommunication companies against the gross revenue of the collecting TELCO shall not be allowed.

In addition, TELCO paying the access charge to another telecommunication company shall compute the withholding tax on the gross amount of the interconnect share of the other TELCO, net of VAT.

ILLUSTRATION No.3

Bank X extended a loan to Company A, thus earned interest income thereon. However, Company A is at the same time a depositor of Bank X.

Assuming Bank X earned ₱1,000,000 interest income from the loan extended to Company A and also in the same period total interest earning of Company A's deposit in Bank X amounted to ₱200,000.

The following are the accounting entries in the books of Bank **X**:

A. Receipt of Interest Income for Loan extended to Company A

	Debit	Credit
Cash	₱1,000,000	
Interest Income		1,000,000

B. To record Percentage Tax (GRT) liability

	Debit	Credit
Percentage Tax (GRT of 5%)	₱50,000	
Cash		50,000

C. Payment of Interest Income on Deposit to Company A

	Debit	Credit
Interest Expense	₱ 200,000	
Cash		160,000
FWT		40,000

Based on the illustration above, Bank **X** under the principle against offsetting or netting for tax purposes cannot report in their current period's percentage tax return an interest income earning of only ₱ 800,000. Bank **X** is under obligation to declare income earning subject to percentage tax in the same reportable period of ₱1,000,000.

All other issuances inconsistent herewith are hereby repealed and modified accordingly.

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

KIM S. JACINTO-HENARES
Commissioner of Internal Revenue

042079

D-