

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

REVENUE MEMORANDUM CIRCULAR NO. 62-2003

SUBJECT : Providing Guidelines for Documentary Stamp Tax Evaluation on Cash-Settled Securities Swap Transactions under the Memorandum of Agreement for Cash-Settled Securities Swap Transactions (CSST) among the *Bangko Sentral ng Pilipinas*, Bureau of Treasury, Bankers Association of the Philippines and Investment Houses Association of the Philippines

TO : All Internal Revenue Officers and Others Concerned

Section 1. Purpose

This Revenue Memorandum Circular is issued to provide the guidelines in the documentary stamp tax evaluation of cash-settled swap transactions under the Memorandum of Agreement for Cash-Settled Securities Swap Transactions (CSST) among the *Bangko Sentral ng Pilipinas* (BSP), Bureau of Treasury (BTR), Bankers Association of the Philippines (BAP) and Investment Houses Association of the Philippines (IHAP).

Section 2. Background

In the MOA, the following terms and conditions of **Cash-Settled Securities Swap Transactions** (CSST) have been agreed upon to lay the basis for a more structured system of transactions by and among BAP member banks and participating member financial institutions:

1. **Cash-Settled Securities Swap Transaction** (CSST) is an agreement entered into between financial institutions, and between financial institutions and the *Bangko Sentral ng Pilipinas* (BSP), to simultaneously buy or sell government securities spot and sell or buy comparable securities at a pre-determined future date and price with the same counter-party. For this purpose, “comparable securities” refer to any government securities having more or less the following features:
 - a. the same credit risk;
 - b. similar cash flow and/or similar settlement price;
 - c. similar maturity and tenor range which, for T-bills, is within the range of acceptable deviation of plus or minus seven (7) days from the maturity date of the original security, and for fixed rate treasury notes (“FXTNs”), is within the range

of acceptable deviation of plus or minus one (1) month from the maturity date of the original security.

2. Financial institutions participating in the cash-settled securities swap transactions (CSST), as qualified by the Bankers Association of the Philippines (BAP), are duly certified by the BAP to the Bureau of Internal Revenue (BIR) to have satisfied all of the following five criteria:
 - a. Banks and other institutions with a quasi-banking license;
 - b. Banks and other institutions with demand deposit accounts (DDAs) with the BSP;
 - c. Registered RoSS, *i.e.*, *Registry of Scripless Securities*, participants and subscribers to any electronic trading platform currently linked with RoSS;
 - d. Traders who have passed the BAP-sponsored accreditation program; and,
 - e. Banks and other institutions with a risk management system assessed to be sound and effective, as certified by its Board of Directors or equivalent management committee in case of foreign banks.
3. The National Government is the main issuer of government securities through periodic auctions of Treasury Bills (TBs) and Fixed Rate Treasury Notes (FXTNx) in order to finance its budget. For purposes of the CSST, the underlying or transacted securities shall be all Philippine peso-denominated government securities issued by the BSP and the Republic of the Philippines (“ROP”) and registered with the Registry of Scripless Securities (“RoSS”) only. Only bank-owned or registered securities are eligible as underlying securities, but when the counterparty is the BSP, only ROP securities can be used as underlying securities.
4. Any restriction regarding specific types of security must be agreed to and identified by the parties at the point of trade, and all underlying securities shall be lodged in the trading portfolio.
5. The RoSS is the central securities clearinghouse for all government securities and acts as an intermediary only insofar as transmitting to BSP the trade settlement instructions of the transacting parties. The standard convention for the RoSS, as may be amended from time to time, shall be provided by the Bureau of Treasury (BTr).
6. The transactional and legal manner of settlement shall be through the established settlement procedures of RoSS for both securities and cash payments. Thus, the participants shall transmit their securities trades only through any electronic trading platform linked with the RoSS, but manual submission of trades shall be allowed only if a participant encounters a technical problem in its trading platform that is confirmed by the Service Provider to the BTr. The BTr facilitates the transfer of securities from the seller to the buyer electronically through the RoSS.
7. Transacting parties shall have a settlement account with the BSP and shall explicitly agree to service their cash settlement of scripless securities transactions. They shall

also have their RoSS security accounts with the BTr for the settlement of their securities sale transactions, a DDA with the BSP, and a subscription with any available electronic trading platform currently linked with the RoSS.

8. The spot buyer and the forward buyer shall have no recourse against the spot seller and forward seller, as the case may be, in the event that the issuer fails to redeem or pay on, the transacted security.
9. The standard tenors for CSSTs are one (1) week, two (2) weeks and one (1) month, and the maximum bid/offer spread is fifty (50) basis points, net of the value-added tax.
10. The value date is the trade date + 1 business day or “*value tomorrow*,” or also classified as “*value spot*.”
11. The forward price is fixed by mutual agreement of the parties at the time of the first or spot transaction.
12. Settlement risk limits shall be individually established by the participants for their counterparties for the sale and purchase of government securities, both for spot and forward legs of the transaction. Pre-settlement limits shall also be set for spot and forward transactions.
13. The participating institutions’ trading, booking, recording, documentation, transmission, settlement and confirmation of all CSST transactions, including back-up system, shall be in accordance with applicable laws, regulations and guidelines as herein, or in the future may be, provided.

Section 3. Evaluation of CSST

3.1. CSST not a deposit substitute.

Section 180 of the Code imposes a documentary stamp tax (DST) on “deposit substitute debt instruments,” which are defined in Section 22(Y) of the same Code as follows:

“The term ‘**deposit substitutes**’ shall mean an alternative form of obtaining funds from the public (the term ‘**public**’ means borrowing from twenty (20) or more individual or corporate lenders at any one time), other than deposits, through the issuance, endorsement, or acceptance of debt instruments for the borrower’s own account, for the purpose of relending or purchasing of receivables and other obligations, or financing their own needs or the needs of their agent or dealer. These instruments may include, but need not be limited to, bankers’ acceptances, promissory notes, repurchase agreements, including reverse repurchase agreements entered into by and between the Bangko Sentral ng Pilipinas (BSP) and any authorized agent bank, certificates of

assignment or participation and similar instruments with recourse: x x x”
(underscoring supplied)

Based on this definition, the chief feature of a deposit substitute is “borrowing.” Without borrowing, there is no deposit substitute.

The sale of a debt instrument is deemed “borrowing” if the seller assumes liability to pay what in essence is a loan, by whatever name it is called and whatever be its form. The liability may be either primary or subsidiary. Primary liability refers to the obligation to pay back the purchase price (loan). There is a subsidiary liability if there is recourse against the seller in case the person primarily liable under the underlying instrument fails to pay. For this reason, “deposit substitutes” include certificates of assignment or participation “with recourse.” Of course, if the seller is, by stipulation, already primarily liable – as where he has the firm obligation to buy back the very same debt paper he has sold – it is superfluous to talk of transfer “with or without recourse.” Where, however, there is indeed no liability to pay, either primary or subsidiary, there is no borrowing or debt that can give rise to a deposit substitute.

There appears to be no borrowing or debt instrument involved in CSST. Thereunder, the seller in either spot or forward transaction simply conveys through straightforward sale specific government securities to the buyer, who thereby acquires absolute title thereto, including the plenary right of free disposal. As there is no borrowing, there is no debt with respect to which the seller can be primarily bound. Nor is the seller subsidiarily bound to respond in case the issuer of the underlying securities defaults, hypothetically assuming that the Philippine Government, as issuer of the securities sold, could default. Precisely, the sale of securities under the CSST is always “without recourse.” (See MOA, Sec. 1.1, 2nd paragraph.)

The Code also considers a “repurchase agreement” a deposit substitute because it is in essence a loan transaction, under which the very thing sold serves as security, to be returned to the borrower (seller) upon repayment of the loan disguised as purchase price. The obligation of the seller to buy back the thing sold and pay its price, with or without interest, is his primary liability. The original buyer’s obligation to return the very thing sold and the fact that he does not have free disposal thereof because he has to return it to seller, would tend to negate the existence of a sale. Hence, a repurchase agreement is considered a debt instrument constituting a deposit substitute.

In the CSST, however, the sale – be it *spot* or *forward* – is unconditional and without recourse. There is an absolute transfer of title to the underlying securities, such that the spot buyer acquired full ownership thereof with the plenary right to freely dispose of the securities he has bought. This is the reason why the MOA stipulates that “only bank-owned securities, *i.e.*, excluding those held by the bank under trust accounts, safekeeping or under custodianship, are eligible as underlying securities. (Section 5, 3rd paragraph, MOA) The spot buyer’s commitment under the forward leg of the CSST is simply to sell to the spot seller different but comparable government securities.

It follows that the CSST is not a deposit substitute. And since the CSST does not fall under any other class of documents listed in Section 180 of the Code, it is not subject to DST thereunder.

3.2 DST treatment of transfer of government securities through CSST.

Generally, conveyance of security in the secondary market is not subject to DST. (Revenue Memorandum Circular No. 13-87) There are two exceptions: (a) where the security transferred is a quasi-capital instrument under Sec. 176 of the Code; and, (b) where the secondary transfer of underlying security is wrapped in a package that constitutes a deposit substitute, in which case, the *issuance* of the package (transfer document) is subject to DST under Sec. 180. This is akin to the issuance of a “certificate of assignment or participation” where the underlying debt instrument or participation is transferred “with recourse,” which makes it a deposit substitute.

In the CSST, however, the conveyance, whether *spot* or *forward*, is always without recourse. (Sec. 1.1 MOA) Hence, the conveyance of government securities through CSST is not subject to DST.

Section 4. Accounting Entries –

The following accounting entries for CSSTs must be strictly complied with for the purpose of exemption from Documentary Stamp Tax under this Revenue Memorandum Circular.

1.1 On Spot Date

BANK A - AS SELLER

BANK B - AS BUYER

For Both Treasury Bills and Fixed Rate Treasury Notes:

Dr Spot Cash Receivable
Cr Spot Sale of Securities

Dr Spot Purchase of Securities
Cr Spot Cash Payable

1.2. On Spot Settlement Date

BANK A - AS SELLER

BANK B - AS BUYER

1.2.1. For Treasury Bills:

Dr Spot Sale of Securities
Cr Spot Cash Receivable

Dr Spot Cash Payable
Cr Spot Purchase of Securities

Dr Cash
Cr Trading Account
Securities - TBills
Cr. Prepaid Tax

Dr Trading Account Securities - TBills
Dr Prepaid Tax
Cr Due BSP/Cash

Dr Forward Purchase of
Securities

Dr Forward Cash Receivable

Cr Forward Cash Payable

Cr Forward Sale of Securities

1.2.2. For Fixed Rate Treasury Notes:

Dr Spot Sale of Securities
Cr Spot Cash Receivable

Dr Spot Cash Payable
Cr Spot Purchase of Securities

Dr Cash
Dr Prepaid Tax
Cr Trading Account
Securities-FXTN
Cr Accrued Interest
Receivable

Dr Trading Account Securities-FXTN
Dr Accrued Interest Payable
Cr Due BSP/Cash
Cr Prepaid Tax

Dr Forward Purchase of Securities
Cr Forward Cash Payable

Dr Forward Cash Receivable
Cr Forward Sale of Securities

1.3. On Forward Date

BANK A - AS BUYER

BANK B - AS SELLER

1.3.1. For Treasury Bills

Dr Forward Cash Payable
Cr Forward Purchase of
Securities

Dr Forward Sale of Securities
Cr Forward Cash Receivable

Dr Trading Account Securities -
TBills
Dr Prepaid Tax
Cr Due BSP/Cash

Dr Cash
Dr Trading Gain/Loss
Cr Trading Account Securities-
TBills
Cr Prepaid Tax
Cr Interest Income
Cr Gain on Sale of Securities
Cr Tax Expense

1.3.2. For Fixed Rate Treasury Notes (FXTNs)

Dr Forward Cash Payable
Cr Forward Purchase of Securities

Dr Forward Sale of Securities
Cr Forward Cash Receivable

Dr Trading Account Securities - FXTN

Dr Cash

Dr Accrued Interest Receivable
Cr Due BSP
Cr Prepaid Tax

Dr Prepaid Tax
Dr Trading Gain/Loss
Dr Gain on Premium/Discount
Cr Trading Account Securities-
FXTN
Cr Tax Expense

Section 5. Effectivity - This Circular shall take effect immediately.

(Original Signed)
GUILLERMO L. PARAYNO
Commissioner of Internal Revenue