

[BIR REVENUE MEMORANDUM CIRCULAR NO. 12-93, January 18, 1993]

ADMINISTRATIVE SETTLEMENT OF "BACK-TO-BACK" LOANS TAX CASES.

**A
BACKGROUND**

A tax minimizing scheme had been discovered in the audit of certain taxpayers. Under the set-up, the taxpayer negotiates a loan in a bank, turns around and invests the proceeds thereof in treasury bills and other money market instruments not necessarily in the same lending bank.

The apparent tax benefit to the borrower-investor lies in the deduction of the interest expense from gross income even as the income earned is subjected to final withholding tax - a 15% margin representing the difference between the 35% corporate income tax on the net income after deduction of interest expense and 20% final withholding tax on the interest earned.

On the ground that the interest expense is paid or accrued on non-business or non-trade indebtedness, it was entirely disallowed (Sec. 29(b), NIRC) giving rise to substantial assessments.

The assessments had been contested and are awaiting resolution. Lately, however, the affected taxpayers have evinced a desire to settle amicably their tax liabilities, if allowed to be credited the taxes withheld on the interest income. Were it not for the fact that the tax on the interest income was collected thru final withholding tax method, only the difference between the non-deductible interest expense and the taxable interest income will be subjected to tax.

**B
ADMINISTRATIVE POLICY**

In order to facilitate the collection of deficiency income taxes due on these contested cases, and to encourage taxpayers similarly situated to come forward and settle their cases before audit and issuance of notice of assessments, the "offer to pay" may be accepted provided that -

1. the offer to pay and actual payment is made not later than March 31, 1993;
2. the basic deficiency tax to be paid shall not be less than the difference between the tax on the disallowed interest expense and the tax withheld on the interest earned; and
3. the interest of 20% per annum shall be added to the deficiency income tax