REVENUE REGULATIONS NO. 5-2007 issued on May 7, 2007 prescribes the guidelines and conditions for the tax treatment of Securities Borrowing and Lending (SBL) transactions under the Securities Lending Transactions (SLTs) Program that involves the Fixed-Income Securities Lending Program (FISLP) of the Philippine Dealing and Exchange Corporation (PDEx).

SBL/SLTs shall be limited to borrowing and lending of securities under the FISLP of PDEx as identified in the Regulations, unless declared to be ineligible by the Securities and Exchange Commission (SEC) for borrowing and lending under the SLT Program. SBL or SLT of securities administered by other Exchanges other than PDEx, though duly registered with the SEC, shall be covered by separate Regulations.

For the duration of the SBL/SLTs, the Lender temporarily transfers title over the securities lent but retains a contractual right to receive all benefits accruing to the securities. The objective is to put the Lender in the same economic position as the Lender would have, had the securities not been lent. This means that in case of corporate actions, such as coupon payments paid by the Issuer to the Borrower on the Lent/Borrowed Securities during the duration of the SBL/SLT and other benefits accruing in the same period, the Borrower is contractually required to pass on the same to the Lender, thereby putting the Lender in the same economic position as if the Lent/Borrowed Securities “never left his hands”. In exchange for such securities, the Borrower shall deliver the collateral in the manner prescribed in the Program Rules of PDEx to secure the return of the Lent/Borrowed Securities according to the tenor of the SBL/SLT.

On or before the end of the borrowing period, the Borrower is obligated to return equivalent securities and the Lender, in turn, returns the collateral put up by the Borrower. In effect, an SBL/SLT is similar to a simple collateralized cash loan transaction. However, instead of cash, what is borrowed are securities and what is provided as collateral is either cash, government or equity securities, or a guaranteed letter of credit or assets admitted under these Regulations as eligible collateral.

For purposes of these Regulations, the borrowing and lending of securities under a FISLP of PDEx shall not be subject to the Documentary Stamp Tax under Sec. 115 of the Tax Code, as amended by RA No. 9243. Likewise, the delivery to and return by the Lender of the Collateral in respect thereof shall not be subject to Documentary Stamp Tax, Capital Gains Tax or Income Tax and other taxes, if otherwise applicable; Provided that: (a) a valid Master Securities Lending Agreement (MSLA) is executed by the parties and registered with and approved by the Bureau of Internal Revenue (BIR); (b) the SBL/SLT involving the FISLP of PDEx are in accordance with the rules and regulations of the SEC; (c) the Program is administered and supervised by PDEx; and (d) the terms and conditions of the Regulations and the subsequent issuance/s to be issued to implement the Regulations are complied with.

The SBL/SLTs under a FISLP of PDEx should not fall within the classification of “deposit substitutes” under Section 2(g) of Revenue Regulations (RR) No. 12-80, as amended by RR Nos. 8-81, 17-84 and 3-97, except as otherwise provided in these Revenue Regulations. Furthermore, an SBL/SLT shall also not involve any regular banking unit transactions, such as cash loans, the income of which are subject to the appropriate taxes imposed under the Tax Code, as amended.

However, it is understood that an SBL/SLT conducted under a FISLP of PDEx shall be treated as a deposit substitute transaction or a “sale transaction” and shall be subject to the applicable taxes on the transaction as prescribed by law, if the terms and conditions of these Regulations and the subsequent issuance/s to be issued to implement these Regulations are not strictly complied with.

The taxes on the Manufactured Income shall be as follows:
a. General tax treatment for Manufactured Income - The receipt of Manufactured Income by the Lender from the Borrower shall only be subject to the applicable taxes on the interest income or coupon payment or other benefits paid by the issuer and accruing thereon during the Borrowing Period of the Lent/Borrowed Securities as prescribed by law.

b. Manufactured Income arising from Accrued Interest Income of Lent/Borrowed Securities received from sale of such Securities and from Corporate Action of the Issuer received by the Borrower - Payment of the Manufactured Income to the Lender derived by the Borrower from the sale of the Lent/Borrowed Securities or from a coupon payment by the Issuer of such Securities shall not be treated as a tax-deductible expense.

The receipt of interest income by the Borrower accruing on the collateral shall be subject to Withholding Tax under the Tax Code, as amended.

Prior to any borrowing of debt securities by the Borrower and negotiating the terms of an SBL/SLT, the parties must have entered into an MSLA through execution of their respective Participation Agreements (PAs). A valid MSLA shall contain the following features:

a. Entitlement of Lender to All Income on Lent/Borrowed Securities - While there is transfer of title of the Lent/Borrowed Securities to the Borrower, the Lender continues to retain all the rights accruing thereto, such as the right to receive interest income, which the Borrower is obliged to pass on to the Lender.

b. Entitlement of Borrower to All Income on Collateral - While there is transfer of title over the collateral to the Lender, the Borrower continues to retain ownership and all the rights accruing to the collateral, such as the right to receive interest income or cash stock dividends which the Lender is obliged to pass on to the Borrower.

c. Collateral requirement - There is no consideration involved unlike a regular buy and sell transaction. Instead, the Borrower merely puts up collateral to guarantee his obligations under and in accordance with the MSLA. As it is in the nature of securities to fluctuate in value, the Lent/Borrowed Securities and the Collateral shall be valued periodically using a valuation methodology agreed upon by the parties in the MSLA. Any excess in the collateral required may be released to the Borrower. Any shortfall shall be replenished by the Borrower, in accordance with the terms of the MSLA.

d. Borrowing Period - The period agreed upon by the parties and in accordance with the FISLP of PDeX during which the specific SBL/SLT transaction under the MSLA is made effective and upon the termination of which, the specific SBL/SLT transaction is likewise ended. However, this period shall, in no case, exceed one (1) year from the date of execution of SLT Confirmation Notice.

e. Return of Borrowed Securities and Collateral - On or before the expiration of the borrowing period, the Borrower is bound to return the equivalent of the Lent/Borrowed Securities, in accordance with the requirements provided under the FISLP of PDeX. Concomitantly, the Lender is required to return or cause the return of the collateral.

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

i. Settlement of sale of Philippine securities effected in the Philippines - 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.

ii. Settlement of a future sale whether agreed or not at the time the borrowing is effected - Securities may be borrowed in advance of a sale if it is anticipated that the borrowed securities will be required for settlement of the said future sale such as in a short sale.

iii. Replacement in whole or in part of securities obtained by the Borrower under another SBL/SLT agreement - Where an early return of Lent Securities is required under the FISLP of PDeX, a Borrower without sufficient quantity on hand of the securities can borrow additional securities from a third party to repay the Lender. The replacement borrowing may be for the whole or part only of the previously borrowed securities in accordance with the FISLP. A condition applying to such an arrangement is that the initial borrowing must itself be an SBL/SLT within the meaning of these Regulations.

iv. On-lending of borrowed securities to another Borrower who has effected another SBL/SLT agreement - This occurs when an SBL/SLT is made by an Agent for on-lending to another Borrower who also effects an SBL/SLT, where such an arrangement is authorized under the FISLP of PDeX. However, the subsequent Borrower must use the borrowed securities for any of the specified purpose specified in the Regulations. Because of the practical difficulties an intermediary could face in determining how the subsequent Borrower had used the 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 securities carrying the same rights are fungible, it is not necessary to match each of an intermediary’s SBL/SLT with each of his on-lendings on a case-by-case basis.

v. Other authorized specified purposes - Other purposes similar or analogous to the foregoing, or consistent with the objectives of the SBL/SLT program as may be determined by the BIR upon favorable recommendation of PDeX.

The MSLA shall be valid for as long as the same shall not have been revoked, superseded, or otherwise terminated in effect by the act of the Exchange; and Provided further, that the MSLA shall in no case be construed to be coterminous with any SBL/SLT and/or Participation Agreement (PA).

The following are the guidelines in the execution of the MSLA:

a. The Borrower must obtain the securities for one or more of the specified purposes as defined in the Regulations. In this regard, the MSLA may refer to the specified purposes within the meaning of these Regulations. However, an MSLA which permits securities to be borrowed for 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 securities and shall cover all securities borrowing and lending transaction of the participant under the FISLP of PDeX. However, only securities, the sale and purchase of which are subject to the rules of PDeX, are eligible for SBL/SLT transactions under such Program. Securities not listed in and/or traded through PDeX are not eligible for SBL/SLT transactions. Except to the extent provided for under the FISLP, securities not listed and/or traded through PDeX do not fall within the scope of these Regulations.
c. The Exchange shall register the MSLA with the BIR. The PA under the SBL/SLT Program shall be individually registered by each participant with the BIR upon execution and prior to the first SBL/SLT transaction under the PA, with payment of applicable fees thereon. The PA signifies the enrollment of the participant under the FISLP of PDEx and its agreement to abide and be bound by the MSLA and the said FISLP.

The following guidelines shall govern the registration of the MSLA and Participation Agreements:

a. Requirements prior to entering into an SBL/SLT under a FISLP of PDEx
   a.1 PDEx must provide the BIR with the following:
      i. Three certified true copies of its MSLA;
      ii. A specimen of the PA; and
      iii. The MSLA shall be registered initially prior to operation of the FISLP of PDEx and for every amendment thereafter.
   a.2 The Borrower and Lender must provide the BIR with the following:
      i. Duly executed PA with the conformity of the Exchange;
      ii. The prescribed registration fee of ₱ 5,000.00 for every PA on a per capacity basis. Thus, a participant who undertakes to be a Borrower shall register the Agreement and pay the prescribed fee. Should the same party desire to participate as a Lender, such undertaking shall be covered by a separate PA which requires compliance with the registration requirements as stated herein; and
      iii. Other documents and information that the BIR may require.

   The Borrower’s and Lender’s copy of the PA endorsed with a registration number and duly stamped to acknowledge payment of registration fee, will be returned to the Borrower and Lender endorsed with the approval or denial of the BIR, as the case may be, within 10 working days from receipt. The PA shall not bind PDEx until the participant shall have submitted the BIR-registered PA with PDEx, in such form as the latter shall prescribe.

b. Place and Time of Registration - The MSLA and the PA shall be registered at the Law Division of the BIR National Office or in such other office which the Commissioner of Internal Revenue (CIR) may direct upon filing of Registration Form and payment of the registration fee for the PA with the General Services Division at the BIR National Office. Registration of the duly accomplished PA should be made within 2 weeks if executed in the Philippines and within 1 month if executed outside the Philippines before an SBL/SLT can be effected. The PA shall remain in full force and effect until the same is revoked in accordance with the Program rules; Provided however, that registration fees due shall be paid every year by the Borrower and/or Lender, as the case may be; Provided further, that any interruption/changes in the PA shall be subject to registration and payment of fees.

c. Approval of MSLA and Participation Agreement - Only SBL/SLTs under an MSLA and Participation Agreement duly registered and approved by the BIR pursuant to these Regulations shall be entitled to the tax treatment provided under Sec. 5 of these Regulations.

d. Failure to Register - Failure to register the MSLA and/or PA will make the SBL/SLT transaction and the collateral provided either a sale and purchase transaction or a deposit substitute and therefore subject to the applicable taxes on the type of transaction imposed under the Tax Code, as amended.
e. Duty of the BIR - It shall be the duty of the Law Division of the BIR National Office to determine whether or not the registered MSLA and PA conforms with the requirements imposed, to recommend to the CIR the approval or denial of the MSLA and PA registration, to monitor compliance of the parties with the conditions prescribed in the Regulations, and to recommend, where proper, assessment of the taxes against the parties found to have entered into an SBL/SLT transaction in violation of these Regulations.

An SBL/SLT is deemed as a “Deposit Substitute” when any of the following circumstances is present:

a. The borrowed securities, or part of it, have been used other than for any of the specified purpose in these Regulations.

b. The Borrower or Lender fails to comply with the essential features of a valid MSLA.

c. The PA/s relied upon by the party/ies to the transaction is/are not registered with the BIR.

d. The transaction itself involves regular banking unit transactions that are subject to the appropriate taxes under the Tax Code, as amended.

The SBL/SLT transaction deemed as deposit substitute shall be subject to the applicable taxes on a deposit substitute imposed under Sections 24(B)(1), 25(A)(2), 25(B), 27(D)(1), 28(A)(7)(a) and 28(B)(1) of the Tax Code, as amended, and to other taxes, if otherwise applicable.

An SBL/SLT is deemed as sale and purchase of the borrowed securities, and the collateral as well, when any of the following circumstances is present:

a. There is no return of the Lent Securities or Collateral at the end of the borrowing period.

b. Any actual sale of debt securities subject of the SBL/SLT such as a short sale.

c. The Borrower or Lender fails to comply with the essential features of a valid MSLA.

d. The parties to the transaction are not registered as a securities lender and/or borrower with the BIR as evidenced by their respective PAs.

The SBL/SLT deemed as a sale shall be subject to the applicable taxes on the sale and purchase of securities imposed under Sections 24(C), 25(B), 27(A) and 28(B) of the Tax Code, as amended, and to other taxes, if otherwise applicable.

The following are the requirements to be complied by the Borrower and Lender who have entered into an SBL/SLT transaction:

a. Record Keeping and Reporting

i. Keep SBL/SLT ledgers and other books of account in the form prescribed by the CIR;

ii. Enter required particulars of SBL/SLT transactions and Securities Returns into that ledger;

iii. Provide the BIR with reports of SBL/SLT transactions and the accompanying Confirmation Notices and Securities Returns; and

iv. Prepare and keep an SBL/SLT Report for each specific SBL/SLT. The BIR may require submission of information from PDEx, PDTC and/or any third-party service provider or collateral management system operator to validate the report of the Borrower and Lender or for such other purposes as it may deem necessary to monitor SBL/SLTs under these Regulations.

b. Recording Format - The SBL/SLT ledgers shall be kept in a written form or electronic format where the relevant information can be supplied in a legible hard copy format.
The ledger with respect to each SBL/SLT transaction and related Securities Return should be in a format prescribed by the BIR which shall be subsequently covered by another BIR issuance.

c. Filing of Bi-Annual Summary Report of Outstanding SBL/SLT Transactions and Securities Returns - A bi-annual summary report of outstanding SBL/SLTs and Securities Returns, in the format prescribed by the BIR, must be prepared by PDTC every 6 months and filed with the Law Division of the BIR National Office within 1 month after the end of the covered period.

d. Filing of Annual Reports of Liquidated SBL/SLT Transactions - In addition to the bi-annual summary report, a report of all liquidated SBL/SLTs as of December 31 of each year must be prepared in the format prescribed by the BIR and likewise filed by PDTC with the Law Division of the BIR National Office within 1 month after such date.

In the event that the appropriate taxes and/or tax returns are not paid and/or filed by the taxpayer concerned in the SBL/SLT, such taxpayer will be subject to the penalties provided in the Regulations. These penalties will attach irrespective of whether or not the transaction involving the Lent/Borrowed Securities qualifies as an SBL/SLT or not.

In addition to the civil and criminal liabilities of the taxpayer for violation of the provision of Sec. 127(A) and Sec. 175 of the Tax Code, the following administrative penalties incident to the delinquency or deficiency prescribed under Secs. 248 and 249 of the Tax Code shall be imposed which shall be collected at the same time, in the same manner and as part of the tax:

a. Surcharges

i. 25% surcharge - In case of any failure to make and file a return and pay the tax due thereon as required by these Regulations on the date prescribed; or unless otherwise authorized by the CIR, filing a return with an internal revenue officer other than those with whom the return is required to be filed; or failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment; or failure to pay the full or part of the amount of tax shown on any return required to be filed under the provisions of the Tax Code or of these Regulations, or full amount of the tax due for which no return is required to be filed on or before the date prescribed for its payment, there shall be imposed, in addition to the tax required to be paid, a surcharge equivalent to 25% of the amount due.

ii. 50% surcharge - In case of willful neglect to file the return and/or to pay the tax due within the period prescribed by the Tax Code or these Regulations, or in case a false or fraudulent return is willfully made, the penalty to be imposed shall be 50% of the tax or of the deficiency tax, in case any payment has been made on the basis of such return before the discovery of the falsity or fraud.

b. Interest - There shall be assessed and collected on any unpaid amount of tax, interest at the rate of 20% per annum, or such higher rate as maybe prescribed by the rules and regulations, from the date prescribed for its payment until the full payment hereof.

i. Deficiency interest - Any deficiency in the tax due shall be subjected to interest at the rate of 20%, which interest shall be assessed and collected from the date prescribed for its payment until the full payment thereof.

ii. Delinquency interest - In case of failure to pay the amount of the tax due on the return required to be filed, or a deficiency tax, or any surcharge or interest thereon on the due date appearing in the notice and demand of the CIR, there shall be assessed and collected on the unpaid amount, interest at the rate of the
20% per annum until the amount is fully paid, which interest shall form part of the tax.

c. Failure to File Certain Information Returns - In case of each failure to file an information return, statement or list, or keep any record, or supply any information required by these Regulations on the date prescribed, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall upon notice and demand by the CIR, be paid by the person failing to file, keep or supply the same, ₱ 1,000 for each such failure: Provided, however, that the aggregate amount to be imposed for all such failures during a calendar year shall not exceed ₱ 25,000.