

# Tax Implications of Republic Act No. 11523<sup>1</sup>- An Act Ensuring Philippine Financial Industry Resiliency Against the COVID-19 Pandemic\*

## I. Salient Features

Republic Act (RA) No. 11523, otherwise known as the “Financial Institutions Strategic Transfer (FIST) Act”, is part of the government’s economic recovery program to mitigate the adverse effects of the Coronavirus-2019 (COVID-19) pandemic. The FIST Act provides a legal framework for the full transfer of banks’ bad loans and assets by allowing them to clean their books and re-channel their resources to improve liquidity in the financial system.

The law established the Financial Institutions Strategic Transfer Corporation (FISTC) as a stock corporation organized in accordance with RA 11232<sup>2</sup>, otherwise known as the “Revised Corporation Code of the Philippines”. The FISTC is not allowed to be incorporated as a one-person corporation and shall be incorporated primarily to invest in or acquire non-performing assets (NPAs) of financial institutions (FIs). Its secondary powers shall include the following:

- a. Engage third parties to manage, operate, collect, and dispose of NPAs acquired from an FI;
- b. Rent, lease, hire, subject to a security interest, mortgage, transfer, sell, exchange, usufruct, secure, securitize, collect rents and profits, and other similar acts concerning its NPAs acquired from an FI;
- c. Restructure debt, condone debt, and undertake other restructuring-related activities in case of non-performing loans (NPLs);
- d. Buy or transfer shares issued by the borrower for the purpose of business reorganization and rehabilitation of the borrower, subject to the provisions of the Revised Corporation Code of the Philippines with respect to the rights of the shareholders of the borrower company, and apply other measures or restructuring techniques with the approval of the Securities and Exchange Commission (SEC);

---

\* Prepared by Michael Angelo T. Tiu, Senior Tax Specialist, with inputs from the Economics Staff and Direct Taxes Branch, reviewed by Jun V. Ocol, Financial Analyst IV, and approved by Ma. Berlie L. Amurao, Chief Tax Specialist, Indirect Taxes Branch.

<sup>1</sup> Approved on 16 February 2021.

<sup>2</sup> Entitled, “An Act Providing for the Revised Corporation Code of the Philippines”, 20 February 2019.

*The NTRC Tax Research Journal is the official publication of the National Tax Research Center. The views and opinions expressed are those of the NTRC and do not necessarily reflect the views and opinions of the Department of Finance, its bureaus and government corporations under its supervision.*

- e. Enter into dation in payment arrangements, foreclose judicially or extrajudicially, and other forms of debt settlement involving NPLs;
- f. Spend funds to renovate, improve, complete, or alter its NPAs acquired from an FI;
- g. Issue equity or participation certificates or other forms of investment unit instruments for the purpose of acquiring, managing, improving, and disposing of its NPAs acquired from an FI;
- h. Borrow money and issue other instruments of indebtedness for the purpose of paying operational and administrative costs;
- i. Guarantee credit, and accept, intervene, or honor the bills of borrowers;
- j. Require from selling FIs a data package which should contain, among others, scans of all pertinent documents and particulars of each property or loan account being sold;
- k. Advance funds to borrowers as may be required for an acquired asset or any debt restructuring agreement pursuant thereto, or under any court order or rehabilitation plan; and
- l. Engage the services of a third-party asset servicing company for the collection and receipt of the debt payments for debts under debt restructuring or business reorganization, management, and disposition of assets of the FISTC in accordance with the rules, procedures, and conditions prescribed by the SEC, or by the courts.

The transfer of NPAs from the FI to a FISTC and from a FISTC to a third party in favor of an FI or in favor of a FISTC is exempt from the following taxes:

- a. Documentary stamp tax (DST) on the transfer of NPAs and dation in payment as may be imposed under Title VII of the National Internal Revenue Code (NIRC) of 1997, as amended by RA 10963, otherwise known as the “Tax Reform for Acceleration and Inclusion (TRAIN) Law”;
- b. Capital gains tax (CGT) imposed on the transfer of lands and/or other assets treated as capital assets as defined under Section 39(A)(1) of the NIRC of 1997, amended;
- c. Creditable withholding income taxes imposed on the transfer of land and/or buildings treated as ordinary assets pursuant to Bureau of Internal Revenue (BIR) Revenue Regulation No. 2-98, as amended; and
- d. Value-added tax (VAT) on the transfer of NPAs as may be imposed under Title IV of the NIRC of 1997, as amended, or gross receipts tax under Title V of the same Code, whichever is applicable pursuant to regulations of the BIR.

The abovementioned transfers of NPAs shall also be subject to the following, in lieu of the applicable fees:

- a. Fifty percent of the applicable registration and transfer fees on the transfer of real estate mortgage and security interest to and from the FISTC, as imposed in accordance with the existing circular of the Land Registration Authority (LRA);
- b. Fifty percent of the filing fees for any foreclosure initiated by the FISTC in relation to any NPA acquired from an FI, as prescribed by the Rules of Court; and
- c. Fifty percent of the land registration fees prescribed under the existing circulars of the LRA.

The transfers from a FISTC to a third party of NPAs acquired by the FISTC within a two-year period, or within such extended period, or transfers by way of dation in payment by a borrower or by a third party to the FISTC shall enjoy the incentives and exemption privileges enumerated above for a period of not more than five years from the date of acquisition by the FISTC.

Moreover, the incentives and exemption privileges given to FIs and FISTC can be extended to any individual at various stages of the transactions as long as they satisfy the following conditions:

- a. The transaction is limited to real and other properties acquired (ROPA) that is either a single-family residential unit or an empty lot, or to NPL secured by real estate mortgage on a residential unit or an empty lot;
- b. There shall only be one transaction consisting of one residential unit or empty lot per individual; and
- c. The two-year transfer period, including its extension, and the five-year entitlement period granted to NPA shall also apply to said single-family unit or empty lot.

The law also aims to encourage the infusion of capital and financial assistance by the FISTC to rehabilitate the financial consumer's business. The following additional tax exemption and privileges of the FISTC shall apply for a period of not more than five years from the date of its acquisition of NPLs:

- a. Income tax on net interest income, DST, and mortgage registration fees on new loans in excess of existing loans extended to borrowers with NPLs which it has been acquired; and
- b. On DST in case of its capital infusion to the borrower with NPLs.

Meanwhile, Section 17 of the FIST Act provides that any loss that an FI incurs as a result of the transfer of an NPA within the two-year period from the effectivity of the law shall be treated as an ordinary loss. The accrued interest and penalties shall not be included as a loss on said loss carry-over from operations, subject to the provisions of the NIRC of 1997, as amended, on net operating loss carry-over (NOLCO). Such loss incurred by the FI from the transfer of NPAs within the two-year period from the effectivity of the law may be carried over for a period of five consecutive taxable years immediately following the year of such loss. For purposes of corporate gain or loss, the carry-over shall be subject to pertinent laws. The tax savings derived by the FIs from the NOLCO shall not be made available for dividend declaration but shall be retained as a form of capital build-up.

## **II. Implications**

The Implementing Rules and Regulations (IRR) of the FIST Act was approved on 26 March 2021 and was effective immediately upon its publication in the Official Gazette or a newspaper of general circulation. The IRR gave the mechanism structure for the SEC, Department of Finance, BSP, BIR, LRA, and the Insurance Commission to implement the FIST Act, which allowed the FISTC to invest or acquire an NPA of a covered FIs, that will serve as a vehicle to improve the liquidity of the country's financial system and to strengthen the financial sectors, especially those companies most affected by the COVID-19 pandemic.

The FIST Act, pursuant to its IRR, only allows the following FIs to transfer their NPAs to FISTCs: (a) BSP; (b) banks; (c) pawnshops; (d) non-stock savings and loan associations; (e) non-bank credit card issuers; (f) other credit-granting institutions supervised by the BSP; (g) financing companies; (h) lending companies; (i) accredited microfinance nongovernment organizations; (j) investment house; (k) insurance companies; (l) government-owned and -controlled corporations (GOCCs); and (m) government financial institutions (GFIs). The covered GOCCs and GFIs in the FIST Act are the Philippine Deposit Insurance Corporation, Land Bank of the Philippines, Development Bank of the Philippines, National Home Mortgage Finance Corporation, Philippine Guarantee Corporation, Home Development Mutual Fund, Social Security System, Government Service Insurance System, Small Business Corporation, and National Housing Authority.

If an FI intends to transfer its NPAs to an FISTC, it shall apply for a Certificate of Eligibility (COE) from the appropriate regulatory authority having jurisdiction over its operations. Nevertheless, Rule 25 of the IRR of the FIST Act states that only assets and loans which have become non-performing on or before 31 December 2022, can be issued a COE.

All sales or transfers of NPAs to a FISTC shall be in the nature of a true sale, wherein the transferor transfers full legal and beneficial title to and relinquishes effective control over the transferred NPAs, and the NPAs are legally isolated and put beyond the reach of the transferor and its creditors.

Under Rule 15.1 of IRR of the FIST Act, the following transactions are exempt from the payment of taxes and are entitled to the fee privileges provided in Section 15 of the FIST Act, to wit:

- a. Transfer of an NPL by an FI to an FISTC;
- b. Transfer of a ROPA by an FI to an FISTC;
- c. Dation in payment (*dacion en pago*) of an NPL by a borrower to an FI;
- d. Dation in payment (*dacion en pago*) of an NPL by a third party, on behalf of a borrower, to an FI;
- e. Transfer of an NPL by an FI to an individual;
- f. Transfer of a ROPA by an FI to an individual;
- g. Transfer of an NPL by a FISTC to a third party;
- h. Transfer of a ROPA by a FISTC to a third party;
- i. Dation in payment (*dacion en pago*) of an NPL by a borrower to a FISTC or an individual;
- j. Dation in payment (*dacion en pago*) of an NPL by a third party, on behalf of a borrower, to a FISTC or an individual;
- k. Transfer of an NPL by an individual to a third party; and
- l. Transfer of a ROPA by an individual to a third party.

Under Section 4(d) of RR 11-2021, the said transactions' tax exemptions are only granted if particular applicable requirements have been complied with.

### **On CGT exemption on the transfer of lands and/or other assets treated as capital assets**

The exemption from the payment of CGT imposed on the transfer of lands and/or other assets treated as capital assets<sup>3</sup> as defined under Section 39(A)(1) of the NIRC of 1997, as amended, minimizes friction costs, both implied and direct, associated with a transaction. Such costs include time, effort, money, and associated tax effects of gathering information and making a transaction<sup>4</sup>. The exemption from the payment of CGT would also facilitate transfers of lands and/or buildings from the FI to a FISTC and from a FISTC to a third party or dation in payment by the borrower or by a third party in favor of an FI or in favor of a FISTC.

### **On creditable withholding income taxes exemption on the transfer of land and/or buildings treated as ordinary assets**

Under Rule 15.3(3) of the IRR of RA 11523, exemptions from the payment of creditable withholding income taxes imposed on the transfer of land and/or buildings treated as ordinary assets pursuant to BIR RR 2-98, as amended, shall not include the exemption from income tax under Title II of the NIRC of 1997, as amended. The transfer by an FI or by a FISTC of its NPA, which is treated as its ordinary asset, shall continue to be subject to the ordinary corporate income tax (CIT) or minimum CIT (MCIT), as the case may be, under the pertinent provisions of the NIRC of 1997, as amended.

Likewise, Rule 16.1(a) of the IRR of RA 11523 provides that an FISTC shall be exempt from income tax on the interest income from new loans in excess of existing loans, which are extended to a borrower with NPL that has been acquired by the FITSC from an FI within a period of not more than two years from the date of effectivity of the law, and which are solely to rehabilitate the borrower's business.

Such exemptions from the payment of creditable withholding income taxes and the income tax on interest income will help banks and other FIs to maintain their financial health temporarily to be effective partners of the national government to "recover as one" from the adverse effects of the COVID-19 pandemic. The exemption from the creditable withholding income taxes does not necessarily mean exemption from the payment of income tax, but only on the withholding of tax, which is an administrative measure on the collection of taxes. This will improve the taxpayer's cash flow and avoid the possibility of claiming a refund or credit in case the amount of creditable income tax withheld exceeds the tax due.

On the other hand, the five-year period to carry over the losses incurred due to the transfer of NPAs by the FI within two years from the effectivity of the law would give the FIs more time to recover such losses through reduced CIT. The provision in the law is longer by two years than the period provided under Section 34(D)(3) of the NIRC of 1997, as amended, which provides that the net operating loss of the business or enterprise for any taxable year immediately preceding the current taxable year shall be carried over as a deduction from gross

---

<sup>3</sup> Section 39(A)(1) of the NIRC of 1997, as amended, defines capital assets as property held by the taxpayer whether or not connected with trade or business, but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property used in the trade or business, of a character which is subject to the allowance for depreciation; or real property used in a trade or business of the taxpayer.

<sup>4</sup> Kagan, J. (2020, December 27). Friction Cost. <https://www.investopedia.com/terms/f/frictioncost.asp>

income for the next three consecutive taxable years immediately following the year of such loss.

However, under Section 6.5 of BIR RR 14-200<sup>5</sup>, domestic and resident foreign corporations subject to the normal income tax rate are liable to the 2% MCIT, if applicable, computed based on gross income, whenever the amount of the MCIT is greater than the normal income tax<sup>6</sup> under Sections 27 and 28 of the NIRC of 1997, as amended<sup>7</sup>. Thus, such FI cannot enjoy the benefit of NOLCO for as long as it is subject to MCIT in any taxable year.

### **DST on the transfer of NPAs and dation in payment**

The DST is a tax upon documents, instruments, loan agreements, and papers evidencing the acceptance, assignment, sale, or transfer of an obligation, right, or property incident thereto and in respect of the transaction so had or accomplished. A DST is in the nature of an excise tax. It is levied on the exercise by persons of certain privileges conferred by law for the creation, revision, or termination of specific legal relationships through the execution of specific instruments.

The aforementioned transactions are exempt from DST subject to certain conditions. Specifically, Section 4(b)(1) of RR 11-2021 provides that any document evidencing the transfer or dation in payment is exempt from the DST as may be imposed under Title VII of the NIRC of 1997, as amended. The conditions vary depending on the transaction. For example, the transfer must be in nature of and approved by the appropriate regulatory authority as a “true sale”, and the transaction must have occurred within a period of not more than two years from the effectivity of the Act, i.e., from 18 February 2021 to 18 February 2023, among others. The exempt transactions are not liable to the DST under Sections 175, 179, 196, and 198 of the NIRC of 1997, as amended (see Table 1).

---

<sup>5</sup> Implementing Section 34(D)(3) of the National Internal Revenue Code of 1997, Relative to the Allowance of Net Operating Loss Carry-Over (NOLCO) as a Deduction from Gross Income, 27 August 2001.

<sup>6</sup> Computed with the benefit of NOLCO if any.

<sup>7</sup> The MCIT rate is 1% effective 01 July 2020 until 30 June 2023, pursuant to Republic Act No. 11534, entitled, “An Act Reforming the Corporate Income Tax and Incentives System, Amending for the Purpose Sections 20, 22, 25, 27, 28, 29, 34, 40, 57, 109, 116, 204 and 290 of the National Internal Revenue Code of 1997, as Amended, and Creating Therein New Title XIII, and for Other Purposes”, 26 March 2021.

**Table 1***Summary of DST on FISTC Transactions*

Section	Document	Taxable unit	Tax due per unit (in Pesos)	% of unit	Taxable base
175	Sales, agreements to sell, memoranda of sales, deliveries, or transfer of shares or certificates of stock	P200 or a fraction thereof	1.50	0.75	Par value
179	All debt instruments	P200.00 or a fraction thereof	1.50	0.75	Issue price of any such debt instruments or a fraction of 365 days for an instrument with a term of less than 1 year
196	Deed of Sale, Conveyances, Donations of Real Property (except grants, patents, or original certificate of adjudication issued by the government)	First 1,000 For each additional P1,000 or fractional part thereof in excess of P1,000	15.00 15.00	1.50 1.50	Consideration or Fair Market Value, whichever is higher (if the government is a party, the basis shall be the consideration)
198	Assignment and renewals of certain instruments	Same as that of the original instruments			

Meanwhile, Section 16 of the FIST Act exempts new loans in excess of existing loans extended to borrowers with NPLs that the FISTC has acquired from the DST. In the case of capital infusion by the FISTC to the borrower with NPLs, the FISTC shall also be exempt from the DST. These exemptions shall be availed only for a period of not more than five years from the date of acquisition of the borrower's NPL by the said FISTC.

As implemented by Section 5(b) of RR 11-2021, any document evidencing the new loans extended in excess of existing loans, which are extended to a borrower with NPL that the FISTC has acquired from an FI from 18 February 2021 to 18 February 2023, shall be exempt from the DST. Likewise, any document evidencing the FISTC's capital infusion to the business of the borrower with an NPL that the said FISTC has acquired from an FI between 18 February 2021 and 18 February 2023 shall be exempt from the DST. Specifically, these transactions may be exempt from the DST on all debt instruments (Section 179) and original issuance of shares of stock (Section 174), among others.

### **VAT or gross receipts tax (GRT) on the transfer of NPAs, whichever is applicable**

Section 4(b)(4) of RR 11-2021 provided the rules of VAT-exemption on the transfer of NPAs from the FI to a FISTC and from a FISTC to a third party or dation in payment or borrower or by a third party in favor of an FI or in favor of a FISTC, as follows:

- a. If the property being transferred was intended for sale, for conversion into or intended to form part of a finished product for sale, for use as supplies in connection with trade or business, or as supplies in the sale of services, by a VAT-registered person, the input tax which can be directly attributed to the said property shall not be allowed as input tax to the transferor's other VATable activities;
- b. If the property being transferred is a capital good used in the trade or business of a VAT-registered person, the input tax on the said property shall be allocated as follows: the depreciated book value of the property over its acquisition cost, multiplied by the input tax directly attributed to the said property shall not be allowed as input tax to the transferor's other VATable activities; and
- c. The amount of the unallowable input taxes as determined in paragraphs (a) and (b) above, if previously debited to "input taxes", shall be charged back to the property.

Meanwhile, if the originators or transferors of the assets are FIs, the transactions are currently subject to GRT under Section 121(C) of the NIRC of 1997, as amended.

### **On the fee privileges on the transfer of NPAs**

In the FIST Act, no local taxes are involved in the provisions concerning tax exemptions and fee privileges. The transfer of NPAs from the FI to the FISTC is subject to local transfer tax under the Local Government Code of 1991, as amended and as provided in the respective local revenue codes of the LGUs.

As already mentioned, the FISTC/SPV is basically the same entity as the previous SPV under RA 9182, as amended by RA 9343; thus, almost the same privileges were granted. Previously, under RA 9343, there were 184 certificates of eligibility (COE) amounting to P49.6 billion issued by the BSP<sup>8</sup>. From these, the transfer of NPAs from FIs to FISTC/SPV, the total revenue forgone from LRA fees is about P5 million based on Circular No. 11-2002, registration

---

<sup>8</sup> Albano, J.M.V. (2010). Assessment of Republic Act No. 9343 entitled, "An Act Amending Republic Act No. 9182, Otherwise Known as the Special Purpose Vehicle Act of 2002 for the Purpose of Allowing the Establishment and Registration of New SPVs and for Other Purposes". *NTRC Tax Research Journal XXII* (6), 9-16.



and transfer fees imposed and collected by LRA. Thus, if the same NPAs were transferred from FISTC/SPV to a third party, there would be an additional P5 million in forgone revenues from LRA fees or a total of P10 million in revenue forgone from LRA fees. Such estimates may, more or less, be the expected revenue forgone under the Act as they provide the same incentive and the procedure of disposing of NPAs.

With regard to the charging of 50% of the filing fees for any foreclosure initiated by the FISTC/SPV in relation to any NPA acquired from an FI, it is noted that the Supreme Court (SC) had held that “the payment of legal fees under Rule 141 of the Rules of Court is an integral part of the rules promulgated by this Court pursuant to its rule-making power under Section 5(5), Article VIII of the Constitution. In particular, it is part of the rules concerning pleading, practice, and procedure in courts. Indeed, payment of legal (or docket) fees is a “jurisdictional requirement”. Since the payment of legal fees is a vital component of the rules promulgated by the SC concerning pleading, practice, and procedure, it cannot be validly annulled, changed, or modified by Congress.”<sup>9</sup> Hence, legislative grants of discounts from the payment of legal fees will not stand.

Despite that banks can still tolerate the burden of continued increase on NPAs before the implantation of the FIST Act, it is hoped that the Act will resolve possible problems that may occur and will further strengthen the financial sector by efficiently disposing of their NPAs, and extending credit to more sectors in need, that will put the Philippines’ economy on a more stable path. Revenue-wise, however, considering fee privileges granted to the FISTCs and/or FIs, the Philippine government coffers may incur revenue loss from fees collected by other fee-collecting government agencies mandated to provide administrative and regulatory services to those FISTCs.

### III. Conclusion

The provisions for tax exemptions and fee privileges under the FIST Act are justified to help the FIs through the provision of the necessary economic assistance to ensure their financial stability, which, in turn, can extend access to credits to more sectors disrupted by the COVID-19 pandemic, and thus stimulate economic recovery of the country. Although the implication of the tax exemptions would inevitably result in revenue loss to the government, it gives economic opportunity to the transactions made by FIs to dispose or settle their NPAs with FISTC, which would eventually positively affect the financial appetite of the said institutions. The tax exemptions in the FIST law also expedite bureaucratic processes, such as there will be no more DST requirements, among others.

However, the drawbacks of the previous SPV laws should be considered in implementing the FIST Act, wherein the intent of the SPV laws was not fully achieved due to external factors. For instance, pricing<sup>10</sup> was one of the obstacles to the success of the previous SPV laws, as banks were unwilling to accept significant losses even though the BSP granted them deferred booking of losses over a period of 10 years. At that time, the average discount

---

<sup>9</sup> Supreme Court of the Philippines 2010, Re: Petition for Recognition of the Exemption of the Government Service Insurance System from Payment of Legal Fees. 11 February 2010.

<sup>10</sup> The considerable gap between the target selling price and bid price of assets marked for disposal.

rates under RA 9343 for NPA sales of banks were quite low, i.e., 50% for NPLs and 35% for ROPA.

In addition, Package 4 of the Comprehensive Tax Reform Program, otherwise to be known as the “Passive Income and Financial Intermediaries Taxation Act” could complement the FIST law since Package 4 intends to make passive income and financial intermediary taxes simpler, fairer, more efficient, and competitive regionally. It also intends to promote a capital movement that can be higher and more sustainable.

Lastly, the given tax exemptions are temporary reliefs or time-bound, performance-based, targeted, and transparent, which are consistent with the thrust of the government in redesigning the country’s tax incentives system.