

REVENUE MEMORANDUM CIRCULAR NO. 35-2022 issued on March 31, 2022 prescribes the tax treatment of Murabahah (Profit Disclosed Sale) and Tawarruq (Commodity Murabahah) as Islamic Banking Arrangements pursuant to the tax neutrality provision of Republic Act No. 11439 (An Act Providing for the Regulation and Organization of Islamic Banks) and as implemented by Revenue Regulations (RR) No. 17-2020.

Gains or profits derived from Islamic banking arrangements, in lieu of interest income under the conventional banking transactions, as referred hereunder are subject to tax. As provided under Section 4.3 of RR No. 17-2020, any reference to interest shall apply to gains or profits received and expenses incurred in Islamic banking arrangements, in lieu of interest income and/or expenses under the conventional banking transactions.

The economic substance of a Murabahah Financing (Profit Disclosed Sale) is equivalent to a conventional mortgage loan. In conventional mortgage loan, the property is purchased by the borrower using the loan proceeds. The ownership is transferred to the borrower who repays the amount plus interest pursuant to the loan agreement. The loan is secured by the property. Under Islamic finance arrangement, the Islamic Banks/ Islamic Banking Unit (IB/IBU) purchases the property and subsequently sells the same to the client at a cost plus an agreed profit margin.

Tax Neutrality (in Murabahah Financing):

	Conventional Mortgage Financing	Islamic Finance Arrangement
Bank/ IB/IBU	Interest income derived from mortgage financing shall be subject to regular Income Tax and Gross Receipts Tax. However, the Withholding Tax herein shall apply whenever the payor is classified as top withholding agent.	Gains or profits derived from Islamic finance arrangement shall be subject to regular Income Tax and Gross Receipts Tax. However, the Withholding Tax herein shall apply whenever the payor is classified as top withholding agent.: <i>Provided</i> , That the <i>effective profit method</i> shall be used in calculating the amortized cost of the subject financial instruments measured at amortized cost and of allocating the income or expense over the relevant period.
Borrower/ Client/ Customer	Interest payments made by the borrower shall not be subject to Withholding Tax. However, the Withholding Tax herein shall apply whenever the payor is classified as top withholding agent.	Gains or profits payments made by the customer shall not be subject to Withholding Tax. However, the Withholding Tax herein shall apply whenever the payor is classified as top withholding agent.
	Mortgage instruments executed shall be subject to Documentary Stamp Tax (DST).	Equivalent Islamic finance instruments executed shall be subject to Documentary Stamp Tax (DST), which shall be computed on the basis of the equivalent amount actually loaned or given at the time of execution of the mortgage, pledge or deed of trust under the conventional mortgage transaction.
	Real Property Finance: Transfer of real property from the seller to the borrower/buyer shall be subject to	Transfer of real property from the vendor to the IB/IBU shall be subject to CGT if the

	Conventional Mortgage Financing	Islamic Finance Arrangement
	Capital Gains Tax (CGT) if the land was held as capital asset or Creditable Withholding Tax (CWT) and Value-Added Tax (VAT) if the land was held as ordinary asset. Additionally, said transfer of real property shall be subject to DST.	land was held as capital asset or CWT and VAT, if applicable, if the land was held as ordinary asset. Additionally, said transfer of real property shall be subject to DST: Provided, however , that transfer of real property from the IB/IBU to the customer/buyer shall be exempt from CGT, CWT, VAT and DST pursuant to Section 4.4 and 4.5 of RR No. 17-2020.
	Car Finance: The sale of car to the borrower shall be subject to VAT.	The sale of car by the vendor to the IB/IBU shall be subject to VAT which shall be reimbursed by the customer.

The economic substance of a Tawarruq (Commodity Murabahah) Financing is equivalent to a conventional cash line facility.

Cash line facility is in general, used to provide for a customer's working capital requirements, or provide for personal consumption, or purchase of assets. It is provided in two ways, namely overdraft facility and revolving credit.

Overdraft is a general cash line facility which is granted to certain agreed limit. The customer can utilize the facility anytime once it is disbursed but cannot exceed the limit prescribed. There is no specific timeline of settlement. Due to its flexibility, the bank usually grants it to selected customers with good credit worthiness.

Tax Neutrality (in Tawarruq Financing):

	Conventional Loan Transaction	Islamic Finance Arrangement
Bank/ IB/IBU	Interest income derived from fixed term interest bearing loan transactions shall be subject to regular Income Tax and Gross Receipts Tax.	Gains or profits derived from Islamic finance arrangement shall be subject to regular Income Tax and Gross Receipts Tax. <i>Provided</i> , That the <i>effective profit method</i> shall be used in allocating the income or expense over the relevant period.
Borrower/ Customer	Interest payments made by the borrower shall not be subject to Withholding Tax. However, the Withholding Tax herein shall apply whenever the payor is classified as top withholding agent.	Gains or profits payments made by the customer shall not be subject to Withholding Tax. However, the Withholding Tax herein shall apply whenever the payor is classified as top withholding agent.
	Loan instruments executed shall be subject to DST.	Equivalent Islamic finance instruments executed shall be subject to DST (which shall be computed on the basis of the equivalent amount actually loaned or given at the time of execution of the loan instruments under the conventional loan transaction)

	Conventional Loan Transaction	Islamic Finance Arrangement
		Supply of commodity and services under a <i>tawarruq</i> or commodity <i>murabahah</i> financing are ignored for tax purposes pursuant to Sections 4.4 and 4.5 of RR No. 17-2020.

Commodity Murabaha financing may also be used for by an IB/IBU to replicate a term deposit product/facility. The same tax treatment applies.

Islamic banks prefer commodity murabahah over other commonly structured deposit products because it sets forth the profit to be earned during the specified period of the deposit. This structure and mechanism is also known today in the Islamic financial market as reverse tawarruq.

Tax Neutrality (Tawarruq in a deposit mobilization structure):

	Conventional Deposit Products	Islamic Finance Arrangement
Bank/ IB/IBU	Interest income, commissions and discounts derived from lending activities shall be subject to regular Income Tax and Gross Receipts Tax.	Gains or profits derived from Islamic finance arrangement shall be subject to regular Income Tax and Gross Receipts Tax: <i>Provided</i> , That the <i>effective profit method</i> shall be used in allocating the income or expense over the relevant period.
Depositor/ Customer	Interest from any peso bank deposit and yield or any monetary benefit from deposit substitute and from trust funds and similar arrangements derived from sources within the Philippines shall be subject to Final Withholding Tax. However, the Withholding Tax herein shall not apply whenever the maturities of instruments from which such income are derived exceed five (5) years.	Gains or profits derived from Islamic deposit products under the concept of Islamic finance arrangement shall be subject to Final Withholding Tax. However, the Withholding Tax herein shall not apply whenever the maturities of instruments from which such gain or profit are derived exceed five (5) years.
		Supply of commodity and services under a <i>tawarruq</i> or commodity <i>murabahah</i> financing are ignored for tax purposes pursuant to Section 4 of RR No. 17-2020.