CLARIFYING THE TAXABILITY OF INSURANCE COMPANIES FOR MCIT, BUSINESS TAX, AND DOCUMENTARY STAMP TAX PURPOSES

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The primary and predominant business activity of an insurance company is the writing of insurance or the reinsuring of risks underwritten by insurance companies which are subject to the supervision by the Insurance Commission.

Section 2 of Presidential Decree No. 612 (PD 612), otherwise known as the "The Insurance Code"defines the term "doing an insurance business" or "transacting an insurance business" to include: "(a) making or proposing to make, as insurer, any insurance contract: (b) making or proposing to make, as surety, any contract of suretyship as a vocation and not as merely incidental to any other legitimate business or activity of the surety; (c) doing any kind of business, including a reinsurance business, specifically recognized as constituting the doing of an insurance business within the meaning of this Code; (d) doing or proposing to do any business in substance equivalent to any of the foregoing in a manner designed to evade the provisions of this Code. X x x"

In proposing to indemnify another against any loss, damage or liability arising from an unknown or contingent event through the issuance of insurance policies, these companies engaged in the insurance business receive, as consideration for the services rendered, "premium" payment from the insured/policyholder.

The insurance business may pertain to life insurance or non- life insurance business.

Life insurance company is a company which deals with the insurance on human and insurance appertaining thereto or connected therewith. The service likewise includes soliciting group insurance, and health and accident insurance policies which the company is nevertheless authorized to pursue as part of its business activity. Group insurance is essentially a single insurance contract that provides coverage for many individual In its original and most common form, group insurance provides life or health insurance coverage for the employees of one employer. In an accident insurance, the insured's F-neficiary has the burden of proof in demonstrating that the cause of death is due to the covered peril. Once the fact is established, the burden then shifts to the insurer to show any excepted peril that may have been stipulated by the parties. An accident insurance js not thus to be likened to an ordinary life insurance where the insured's death, regardless of the cause thereof, would normally be compensable.

Non-life insurance company, on the other hand, is one which solicits insurance on the security of property such as: marine, fire and casualty insurance companies; surety fidelity, indemnity and bonding companies; and such other persons as may be authorized by the Insurance Commission.

Determination of the Minimum Corporate Income Tax For Life and Non-Life Insurance Companies. - For purposes of computing the gross income on the sale of services which shall be the basis of the 2% Minimum Corporate Income Tax (MC1T) imposed under Section 27(E) and Section 28(A)(2) of the 1997 National Internal Revenue Code (Tax Code), as amended, of life and non- life insurance companies, their gross revenue shall include direct premium and reinsurance assumed (net of returns, cancellations); miscellaneous income; investment income not subject to final tax; released reserve; and, all other items treated as gross income under Section 32 of the said Tax Code, as amended.

Their costs of services or direct cost and identifiable direct revenue-related deductions shall refer to those incurred costs which are exclusively related or otherwise considered indispensable to the creation of the revenue from their business activity as an insurance company, including the generation of investment income not subject to final taxes, and shall be limited to the following:

01. Claims, losses, maturities and benefits net of reinsurance recoveries;
02. Additions required by law to reserve fund; and
03. Reinsurance ceded.

Taxability of the Various Business Activities of Life Insurance Company for Business Tax and Documentary Stamp Tax. -

> (a) Business Tax. - While it may be said that the core revenue source of a life insurance company is the generation of premiums from undertaking life insurance contracts, its business undertakings have slowly evolved and expanded through the years such that aside from the premiums earned from its main activity, its other ancillary services have likewise brought forth other types of revenue like rental income, management fee, interest income, other investment income, renewal and/or re- issuance fees, reinstatement fees, penalties and the like.

With regard to these types of income, the business tax (i.e., whether premium tax, VAT or Gross Receipts Tax) to be imposed will depend on the nature of the activity pursued by the life insurance company in producing such type of income.

> (1) Direct Writings/Premiums-Generally, for the premiums received by a life insurance company in undertaking its insurance activities, the same are subject to premium tax at the rate of five percent (5%) on its direct writings/premiums pursuant to Section 123 of the Tax Code, as amended, to wit:
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> "SEC. 123. Tax on Life Insurance Premiums. — There shall be collected from every person, company or corporation (except purely cooperative companies or associations) doing life insurance business of any sort in the Philip-nines a tax of five percent (5%) of the total premium collected, whether such premiums are paid in money, notes, credits or any substitute for money; but premiums refunded within six (6) months after payment on account of rejection of risk or returned for other reason to a person insured shall not be included in the taxable receipts; nor shall any tax be paid upon reinsurance by a company that has already paid the tax; nor upon premiums collected or received by any branch of a domestic corporation, firm or association doing business outside the Philippines on account of any life insurance of the insured who is a nonresident, if any tax on such premium is imposed by the foreign country where the branch is established nor upon premiums collected or received on account of any reinsurance, if the insured, in case of personal insurance, resides outside the Philippines, if any tax on such premiums is imposed by the foreign country where the original insurance has been issued or perfected; nor upon that portion of the premiums collected or received by the insurance companies on variable contracts [as defined in Section 232(2) of Presidential Decree No. 612], in excess of the amounts necessary to insure the lives of the variable contract owners.
>
> " Xxxxxx xxx"
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> Re- insurance fees, reinstatement fees, renewal fees as well as penalties paid to the life insurance company which are incidental to or in connection with the insurance policy contracts issued are considered akin to premiums, thus, such types of income are also covered by the above-quoted provision of Section 123, subject to the 5% premium tax for the gross amount received on such fees and/or penalties
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> (2) Management Fees, Rental Income, or Other Income from Unrelated Services - Management fees, rental income, or any other income earned by the life insurance company from services which can be pursued independently - of the insurance business activity, are thus not subject to the 5% premium tax imposed under

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> Section 123 above but, rather, the same are treated as income for services that are subject to the imposition of VAT pursuant to Section 108 of the Tax Code, as amended, or to the percentage tax imposed under Section 116 of the same Tax Code, as the case may be.
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> (3) Investment Income-
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> (3.a) Investment Income Realized from the Investment of Premiums Earned, - income realized from investment activities utilizing the premiums earned by the life insurance company from its policyholders is considered merely a part of, incidental to and is necessary to its main business of contracting insurance services.

Such investment income is considered exempt from the further imposition of business tax since the premiums, which have been the source of the funds invested had already been subjected to the imposition of the 5% premium tax pursuant to Section 123 of the Tax Code, as amended.

> (3.b) Investment Income Realized from the Investment of Funds Obtained from Others. - The income earned by the life insurance company whereby it uses the funds solicited and pooled from its policyholders to invest in various marketable securities, instruments, and other financial products, which funds are recognized as liabilities by the life insurance company and which can be withdrawn by the policyholders anytime, is considered as an income earned from performing a quasi-banking function, thus, subject to the gross receipts tax imposed under Section 121 of the Tax Code, as amended.
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> (3.c) Manner of Apportionment to Determine Exempt Investment Income and Investment Income Subject to Gross Receipts Tax-As has been discussed above, investment income that is exempt from the imposition of business tax only pertains to that portion of investment income where the source of the funds used in the investment activities comes from the owned funds (i.e., premiums earned) of the life insurance company.

For that portion of investment income whereby the source of the funds used was solicited from the policyholders for purposes other than the payment of the current premiums due to the life insurance company and where such funds solicited are treated by the life insurance company as liabilities, such income is considered to have been earned from performing quasi-banking function, and therefore, subject to the imposition of gross receipts tax pursuant to Section 121 of the Tax Code, as amended.

In order to determine which portion of the investment income earned for the month is exempt and which portion is taxable, the investment income earned for the month shall be allocated between the following:

(i) liability account balance pertinent the other funds solicited from the policy-holders as of the end of such month; and

(ii) the total premiums earned for the month. Exempt/Non Taxable Investment Income

= Investment x

Item (ii) above

for the month

Sum of items (i) and (ii)

above

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Investment Income Subject to Gross Receipts Tax

= Investment Income x

Item (i) above

for the month

Sum of items (i) & (ii)

above

Example: "Akim Life Assurance Corp.", a life insurance company, during the month of April, realized an investment income amounting to P1,000,000. The investment funds used in generating this income come from both the premiums earned by the company and the other funds solicited from its policyholders.

For the same month, the premiums earned by the company amounted to P30,000,000 while the liability balance of the end of the said month pertinent to the other funds solicited amounted to P20,000,000.

The exempt portion of the investment income and the portion to be subject to the gross receipts tax are determined as follows:

Exempt = P1,000,000 x P30,000,000

= P600,000

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Taxable for Gross Receipts Tax = P1, 000,000 x P20, 000,000

P50,000,000

=P400,000

(b) Documentary Stamp Tax. - With respect to life insurance policies issued by the life insurance company, the same is subject to documentary stamp tax pursuant to Section 183 of the Tax Code, as amended, as quoted hereunder:

"SEC. 183. Stamp Tax on Life Insurance Policies. — On all policies of insurance or other instruments by whatever name the same may be called, whereby any insurance shall be made or renewed upon any life or lives, there shall be collected a documentary stamp tax of Fifty centavos (P0.50) on each Two hundred pesos (P200), or fractional part thereof, of the amount of premium collected.

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For certificates issued, documentary stamp tax is imposed as follows;

SEC. 188. Stamp Tax on Certificates. — On each certificate of damage or otherwise, and on every other certificate or document issued by any customs officer, marine surveyor, or other person acting as such, and on each certificate issued by a notary public, and on each certificate of any description required by law or by rules or regulations of a public office, or which is issued for the purpose of giving information, or establishing proof of a fact, and not other-wise specified herein, there shall be collected a documentary stamp tax of Fifteen pesos (P15.00).

For group insurance policies issued, the premium collected therefrom shall be subject to Section 183 above. For the individual certificates issued to each and every em-P'oyee covered by the group insurance policy, the issuance of such certificate shall be subject to Section 188 above.

However, with regard to health and accident insurance coverage provided, the basis or the payment of documentary stamp tax shall be the provision prescribed by Section 185 of the same Tax Code, viz:

> "SEC. 185. Stamp Tax on Fidelity Bonds and Other Insurance Policies.
>
> — On all policies of insurance or bonds or obligations of the nature ofindemnity for loss, damage or liability made or renewed by any person, association, company or corporation transacting the business of accident, fidelity, employer's liability, plate, glass, steam boiler, burglar, elevator, automatic sprinkler, or other branch of insurance (except life, marine, inland, and fire insurance), and all bonds, undertakings, or recognizances, conditioned for the performance of the duties of any office or position, for the doing or not doing of anything therein specified, and on all obligations guaranteeing the validity or legality of any : bond or other obligations issued by any province, city, municipality, or other public body or organization, and on all obligations guaranteeing the title to any real estate, or guaranteeing any mercantile credits, which may be made or renewed by any such person, company or corporation, there shall be collected a documentary stamp tax of Fifty centavos (PO. 50) on each Four pesos (P4.00), or fractional part thereof, of the premium charged,"

Taxability of the Other Financial Services/Products Sold by the Life Insurance Company in addition to the Life Insurance Policy Solicited. - tn pursuing its main activity of proposing to undertake for a consideration to indemnify another against loss, damage or liability arising from an unknown or contingent event through the issuance of insurance policies upon payment by the insurer of the premium, it, at the same time, offers to its policyholder other financial services/products, which upon acceptance by the policyholder, are made as a rider, clause, warranty or endorsement attached to and formed part of the insurance policy contract issued.

Examples of such financial products are the Variable Unit Link (VUL) and the Premium Deposit Fund (PDF). Variable Unit Link (VUL). - Among the salient features of this financial service/ product are, as follows:

In addition to the life insurance policy contracted, policyholders are made to contribute to a fund set up by the life insurance company;

Of the total amount given by the policyholder for the life insurance policy and the contri bution to be made to such fund, only 2% to 5% represents the premium payment for the life insurance policy, while 95% to 98% of the rest of the amount paid pertains to the amount contributed to the fund;

The contribution to the fund is represented by units of shares;

A fixed amount is set for each unit of share, thus, the percentage of contribution of the policyholder to the fund corresponds to the number of unit of shares he owns therein;

The amount pooled to the fund is then invested in stocks, securities, debt instruments, and other similar passive

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investments, income derived from which are those that are either exempt from tax or subject to final tax

The life insurance company merely acts as fund manager. As such, the fund is not commingled with the owned funds of the said life insurance company;

The life insurance company does not share in the income derived by the fund from the investment activities but rather derives income by charging management fees based on a pertain fixed rate; and

The income earned by the fund together with the contributions made are then distributed t the po I icy holders upon surrender/redemption of units of shares.

The tax consequences insofar as this above financial product/service is concerned are, as follows:

The premiums received on account of the life insurance solicited from the policyholder, being the main business activity of the life insurance company is, in addition to the income tax imposed under Title II of the Tax Code, as amended, subject to the abovementioned business tax/premium tax and DST;

For the management fees earned by the life insurance company in managing the investment portfolio of the VUL fund, such management fees , in addition to the income tax imposed under Title II of the Tax Code, as amended, is subject to VAT pursuant to Section 108 of the Tax Code, as amended, or to the percentage tax imposed under Section 116 of the same Code, as the case may be;

The certificates issued to the policyholder evidencing his contribution to the VUL fund which partake the nature of deeds of trust shall be subject to the imposition of DST prescribed by Section 195 of the Tax Code, as amended; and

For the gain realized by the policyholder from the redemption of his units of shares in the VUL fund, the same must be declared and reported by the said policyholder for income tax purposes.

Premium Deposit Fund (PDF) - Another example of a financial product/service offered by the life insurance company that is made a rider to the life insurance policy contract issued to the policyholder is the premium deposit fund. Among the salient features of the product/service are as follows:

In addition to the life insurance policy contracted, policyholders are made to make deposits for the future premium payment,

Deposits of at least Php500 each may be made to this fund for payment of future premium on the policy;

The fund will be used in investment activities;

Interest shall be credited to the fund annually on each policy anniversary at such rates as the life insurance company may declare each year but never less than the lowest interest e Planing on savings accounts in banks;

That the balance of the deposit inclusive of the interest earned, maybe withdrawn any time at the option of the policyholder; and

And that the insurance company treats such deposits in its books of accounts as liabilities to the policyholders.

The tax consequences insofar as this above financial product/service is concerned" are, as follows:

The premiums received on account of the life insurance solicited from the policyholder being the main business activity of the life insurance company is, in addition to the income tax imposed by the Title li of the Tax Code, as amended, subject to the abovementioned business tax/premium tax and DST;

The investment income earned by the insurance company from the investment activities using the fund, in

addition to the income tax imposed by Title II of the Tax Code, as amended, is subject to the gross receipts tax imposed under Section 121 of the Tax Code as amended;

The instrument issued to the policyholder evidencing deposits made to the premium deposit fund which is treated as liability in the books of accounts of the life insurance companies, is considered as Certificate of Indebtedness subject to the imposition of DST prescribed by Section 179 of the Tax Code, as amended, at the rate of One peso (P1.00) on each Two hundred pesos (P200), or fractional part thereof, of the issue price of any such debt instruments; and

The interest earned by the policyholder from the premium deposit fund is subject to 20% final withholding tax imposed by Sections 24(B)(1); 25(A)(2); 27 (D)(1) and Section 28 (A)(7) of the Tax Code, as amended, which provides that "a final tax at the rate of twenty percent (20%) is imposed upon the amount of interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements."

This is so because a close perusal of the aforementioned features of said fund shows that with the manner the insurance company operates this fund, the same can be likened to the mode by which banks accepts deposits from the public whereby deposits received are apparently booked as liabilities and for such liabilities received, interest payments based on the agreed interest rate are committed to be paid to the depositors which interest and deposit can be withdrawn by said depositors anytime.

Inasmuch as insurance companies transact in the same manner as the business of the banks insofar as the premium deposit fund is concerned, interest paid to their policy-holders earned out of the premium deposit fund very well falls within the purview of what may be considered as "similar arrangements" prescribed for by Tax Code, as amended. Thus, such interest payments are subject to the final withholding tax at the rate of twenty percent (20%).

Taxability of the Non-Life Insurance Company for Business Tax and Documentary Stamp Tax. -

(a) Business Tax. - Pursuant to Section 108 of the Tax Code, as amended, the "gross receipts" of non-life insurance companies (except their crop insurances) is subject to the imposition of VAT which includes the total premiums collected whether such premiums are paid in money, notes, credits or any substitute for money.

Premium received from a health and accident insurance contract underwritten by the non-life insurance companies are likewise included in their “gross receipts” subject to VAT since the same is treated as casualty insurance when issued by the non-life insurance company.

The following non-life insurance companies are subject to VAT on gross premium received beginning January 1,1996:

a. Marine, fire and casualty insurance companies;
b Surety, fidelity, indemnity and bonding companies;
c. Mutual benefit associations;
d. Government-owned or controlled corporations engaged in the business of non-life insurance;
e. Non-stock, non-profit organizations and cooperatives engaged in the business of non-life insurance; and
f. All other persons, whether individual, trust/estate, partnership, association, joint venture, or corporation engaging in the non-life insurance business, such as but not limited to resident foreign persons rendering non-life insurance services in the Philippines in the course of its trade or business.

"Gross Receipts" does not include the following:

i. Premiums refunded within six (6) months after payment on account of rejection of risk or returned for other

reason to the person insured (return premiums);
ii. Premiums on reinsurance of a company that has already paid the tax,
iii. Premiums on account of any reinsurance, if the risk insured against covers property located outside of the Philippines;
iv. Documentary stamp and local taxes passed on by the insurance company to the insured; and
v. VAT passed on to the insured.

(b) Documentary Stamp Tax. -With respect to insurance policies other than health and accident insurance policies issued by the non- life insurance company, the same are subject to documentary stamp taxes pursuant to Section 184 of the Tax Code, as amended, as quoted hereunder, regardless of the fact that policies may have become ineffective due to non payment of the corresponding premiums:

"SEC. 184. Stamp Tax on Policies of Insurance Upon Property. — On all policies of insurance or other instruments by whatever name the same may be called, by which insurance shall be made or renewed upon property of any description, including rents or profits, against peril by sea or on inland waters, or by fire or lightning, there shall be collected a documentary stamp tax of Fifty centavos (P0.50) on each Four pesos (P4.00), or fractional part thereof, of the amount of premium charged: Provided, however, That no documentary stamp tax shall be collected on reinsurance contracts or on any instrument by which cession or acceptance of insurance risks under any reinsurance agreement is effected or recorded.

With regard to health and accident insurance policies issued by the non-life insurance company, the basis for the payment of documentary stamp tax shall be the provision prescribed by Section 185 of the same Tax Code, as amended, viz:

"SEC. 185, Stamp Tax on Fidelity Bonds and Other Insurance Policies. — On ali policies of insurance or bonds or obligations of the nature of indemnity for loss, damage or liability made or renewed by any person, association, company or corporation transacting the business of accident, fidelity, employer's liability, plate, glass, steam boiler, burglar, elevator, automatic sprinkler, or other branch of insurance (except life, marine, inland, and fire insurance), and allbonds, undertakings, or recognizances, conditioned for the performance of the duties of any office or position, for the doing or not doing of anything therein - specified, and on all obligations guaranteeing the validity or legality of any bond or other obligations issued by any province, city, municipality, or other public body or organization, and on all obligations guaranteeing the title to any real estate, or guaranteeing any mercantile credits, which may be made or renewed by any such person, company or corporation, there shall be collected a documentary stamp tax ofFifty centavos (P0.50) on each Four pesos (P4.00), or fractional part thereof, of the premium charged-"

For certificates issued, documentary stamp tax is imposed as follows:

SEC. 188. Stamp Tax on Certificates. — On each certificate of damage or otherwise, and on every other certificate or document issued by any customs officer, marine surveyor, or other person acting as such, and on each certificate issued by a notary public, and on each certificate of any description required by law or by rules or regulations of a public office, or which is issued for the purpose of giving information, or establishing proof6fa fact, and not otherwise specified herein, there shall be collected a documentary stamp tax of Fifteen pesos (P15.00).

Likewise, Certificate of Cover (COC) issued pertinent to motor vehicle insurances shall be subject to the documentary stamp tax imposed under Section 188 above.

All revenue rulings and issuances inconsistent herewith are hereby revoked, amended, or modified accordingly.

All internal revenue officers are hereby enjoined to give this Circular as wide a publicity as possible.

Adopted: 1 April 2008

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