I. BASIC STRUCTURAL AND DEFINITIONAL CONCEPTS

A. Meaning of Income

SEC. 32 Gross Income. -

(A) General Definition. - Except when otherwise provided in this Title, gross income means all income derived from whatever source, including (but not limited to) the following items:

(1) Compensation for services in whatever form paid, including, but not limited to fees, salaries, wages, commissions, and similar items;
(2) Gross income derived from the conduct of trade or business or the exercise of a profession;
(3) Gains derived from dealings in property;
(4) Interests;
(5) Rents;
(6) Royalties;
(7) Dividends;
(8) Annuities;
(9) Prizes and winnings;
(10) Pensions; and
(11) Partner's distributive share from the net income of the general professional partnership.

Baniqued: Income in the NIRC is an enumeration. If it's not found in Sec. 32 is it income? It could be. Including but not limited to is the wording of the law.

Doctor and Lawyer barters services, is that income? Is that taxable? This is very difficult to monitor.

Income means all wealth which flows into the taxpayer other than as a mere return of capital. An example of a mere return of capital is the payment of loans receivable. Income can also mean as a flow of the fruits of one's labor

Income includes earnings, lawfully or unlawfully acquired, without consensual recognition, express or implied, of an obligation to repay and without restriction as their disposition.

As a general rule, mere increase in the value of property is NOT income but merely an unrealized increase in capital. No income is derived by the owner until after the actual sale of the property in excess of its original cost. (De Leon)

*Fisher vs. Trinidad: Income as contrasted with capital or property is to be the test. The essential difference between capital and income is that capital is a fund; income is a flow. A fund of property existing at an instant of time is called capital. A flow of services rendered by that capital by the payment of money from it or any other benefit rendered by a fund of capital in relation to such fund through a period of time is called an income. Capital is wealth, while income is the service of wealth. The fact is that property is a tree, income is the fruit; labor is a tree, income the fruit; capital is a tree, income the fruit.

*Conwi v. CTA: Income may be defined as an amount of money coming to a person or corporation within a specified time, whether as payment for services, interest or profit from investment. Unless otherwise specified, it means cash or its equivalent. Income can also be though of as flow of the fruits of one's labor.

*CIR v. Tours Specialist: W/N amounts received by a local tourist and travel agency included in a package fee from tourists or foreign tour agencies, intended or earmarked for hotel accommodations form part of gross receipts subject to 3% contractor's tax

Gross receipts subject to tax under the Tax Code do not include monies or receipts entrusted to the taxpayer which do not belong to them and do not redound to the taxpayer's benefit. Parenthetically, the room charges entrusted by the foreign travel agencies to the private respondents do not form part of its gross receipts within the definition of the Tax Code. The said receipts never belonged to the private respondent. The private respondent never benefited from their payment to the local hotels. This arrangement was only to accommodate the foreign travel agencies.

*Eisner vs. Macomber: Income may be defined as the gain derived from capital, from labor, or from both combined, including profit gained through sale or conversion of capital.

Mere growth or increment of value in a capital investment is not income; income is essentially a gain or profit, in itself, of exchangeable value, proceeding from capital, severed from it, and derived or received by the taxpayer for his separate use, benefit, and disposal. Id.

A stock dividend, evincing merely a transfer of an accumulated surplus to the capital account of the corporation, takes nothing from the property of the corporation and adds nothing to that of the shareholder. A tax on such dividends is a tax an capital increase, and not on income, and, to be valid under the Constitution, such taxes must be apportioned according to population in the several states.

*James vs. US: The issue before us in this case is whether embezzled funds are to be included in the "gross income" of the embezzler in the year in which the funds are misappropriated. the obvious intent of that Congress to tax income derived from both legal and illegal sources, to remove the incongruity of having the gains of the honest laborer taxed and the gains of the dishonest immune

B. Realization

It is a separation from capital, resulting in receipt of income

*Eisner v. Macomber: A "stock dividend" shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.

*Bachrach v. Seifert: It is true that profits realized are not dividends until declared by the proper officials of the corporation, but distribution of profits, however made, in dividends, and the form of the distribution is immaterial.

*Helvering v. Horst: The decisions and regulations have consistently recognized that receipt in cash or property is not the only characteristic of realization of income to a taxpayer on the cash receipts basis. Where the taxpayer does not receive payment of income in money or property, realization may occur when the last step is taken by which he obtains the fruition of the economic gain which has already accrued to him.

The enjoyment of the economic benefit accruing to him by virtue of his acquisition of the coupons is realized as completely as it would have been if he had collected the interest in dollars and expended them for any of the purposes named

In a real sense, he has enjoyed compensation for money loaned or services rendered, and not any the less so because it is his only reward for them. To say that one who has made a gift thus derived from interest or earnings paid to his donee has never enjoyed or realized the fruits of his investment or labor because he has assigned them instead of collecting them himself and then paying them over to the donee is to affront common understanding and to deny the facts of common experience. Common understanding and experience are the touchstones for the interpretation of the revenue laws.

The power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment, and hence the realization, of the income by him who exercises it.

*CIR v.CTA: However, if a corporation cancels or redeems stock issued as a dividend at such time and in such manner as to make the distribution and cancellation or redemption, in whole or in part, essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock shall be considered as taxable income to the extent it represents a distribution of earnings or profits accumulated.

C. Imputed Income

Imputed income – This reduces administrative difficulty. You cannot expect government officials to monitor everything. Recall the Doctor and Lawyer example, it may be beyond the capacity of the government to assess. As long as the transaction is personal in nature it would be very difficult to monitor.

D. Recovery of Capital Investment

SEC. 40. Determination of Amount and Recognition of Gain or Loss. -

(A) Computation of Gain or Loss. - The gain from the sale or other disposition of property shall be the:
1. excess of the amount realized therefrom
2. over the basis or adjusted basis for determining gain, and

the loss shall be
1. the excess of the basis or adjusted basis for determining loss
2. over the amount realized.

The amount realized from the sale or other disposition of property shall be the sum of money received plus the fair market value of the property (other than money) received.

*Baniqued: There is a land owner, he then asks a building developer to put up a 5 storey town house. There is no payment in cash, but Land owner will give him 2 units in the townhouse. With regard to the contractor, there is compensation for services. What about the landowner, does he derive income? NO. There is a building, an improvement. It is still my capital. When will there be income? When you sell the building.

E. Windfall Receipts

*Commissioner v. Glenshaw: Respondents contend that punitive damages, characterized as "windfalls" flowing from the culpable conduct of third parties, are not within the scope of the section. But Congress applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature.

It would be an anomaly that could not be justified in the absence of clear congressional intent to say that a recovery for actual damages is taxable, but not the additional amount extracted as punishment for the same conduct which caused the injury. And we find no such evidence of intent to exempt these payments.

F. Recovery of Deducted Items: Tax Benefit Principles

*Baniqued: When there's a fire, then the person claims a loss (P50M) in gross income in that year. In the following year, the insurance company pays me my insurance claim. What happens now? Since you made a tax benefit from the deduction, are you under the obligation to report the income? YES, you are obliged to report it as recovery of deducted items: this is the tax benefit principle.

Employer contributes to a retirement fund, then it claims as deduction the retirement contributions. When the contribution is returned to the ER because it was excessive, then it needs to be reported as income by the ER.

G. Indirect Payments

*Baniqued: If the taxes were borne by the buyer (for example, Capital Gains Tax), this would constitute additional income to the seller. If someone else paid it for you, then that is income to you.

When you bear the obligation of someone, that is income to the other person. This is discharge of a party of another obligation, will be an additional income to you.

H. Discharge of Indebtedness Income

*Baniqued: It is important to look at the prime consideration for the condonation of the debt. Look at the circumstances. If it is love, affection, generosity and pure liberality, that is a GIFT (exclusion from gross income).

If the ER condones the debt of the EE, is that income?
If a firm sends its associate abroad for a scholarship, and it was supposed to be a debt. But since the associate is very good, the ER condoned the debt, is that income?

If there is an EE-ER relationship, anything received would be by default would be considered as compensation income UNLESS it is excluded by some statutory provision.

Corporation owes SH P10M, SH says don't pay the debt anymore and just apply it to my equity, for the payment of my subscription.

This is a capital transaction, it is an investment, and is not a taxable event. The debt was not in fact discharged, but was CONVERTED to equity. (debt-equity is a capital transaction)

The only income therein is when later on, you sell your investment for a profit, and then there is gain to you, you have a tax on the capital gains. There is a severance of the fruit.

I. Income from Unlawful Activities

*Baniqued: Generals were found to have stolen hundred of thousands of dollars, is that income? Gen Garcia and Mrs Garcia, they were caught with stolen of millions of dollars. Is this a gain derived from labor? Whether these amounts of money come from lawful or unlawful sources, you can still stand the risk of being assessed, this can be considered income.

*Baniqued: You have a bank, which does not know the whereabouts of the missing depositors, notice was then sent to them to claim the deposits. So after some time, and after prescription has set in, bank lays claim on the deposits, is there income? At what time?

What if you issue me a check because you owe me a million, on my way home I die. You are the only one who knows the million. So now there is a million check that no one encashes, so the proceeds of that uncashed check, is that income?

Law firm got an erroneous remittance of 2.5 million from somewhere, they tried to trace it and they concluded that it was an error. Law firm advised the bank, so may cake sila (Lawfirm ni sir). But what if we used that for the 13th month pay, salary, etc. is it income? Even if you had the intent to repay it? Sir says YES, why not?

*U.S. v. Sullivan: Gains from illicit traffic in liquor are subject to the income tax. The Fifth Amendment does not protect the recipient of such income from prosecution for willful refusal to make any return under the income tax law

J. Amounts Received under Claim of Right

*North American Oil Consolidated v. Burnet: The Supreme Court notes that what is relevant is when Petitioner had the right to receive the income and when it was actually received.

Here, the amount became income of the company the year it was entitled to receive the income. It could not have been income during 1916 when Petitioner had not yet received the income and it was uncertain whether they ever would receive the income.

K. Reimbursement for Wrongful Death of Injury

L. Fringe Benefits

SEC. 33. Special Treatment of Fringe Benefit.-

(A) Imposition of Tax.- A final tax of 32% is hereby imposed on the:
(1) grossed-up monetary value of fringe benefit
(2) furnished or granted to the employee (except rank and file employees as defined herein)
(3) by the employer, whether an individual or a corporation (unless the fringe benefit is required by the nature of, or necessary to the trade, business or profession of the employer, or when the fringe benefit is for the convenience or advantage of the employer).

The tax herein imposed is payable by the employer which tax shall be paid in the same manner as provided for under Section 57 (A) of this Code.

The grossed-up monetary value of the fringe benefit shall be determined by dividing the actual monetary value of the fringe benefit by 68%

Provided, however, That fringe benefit furnished to employees and taxable under Subsections (B), (C), (D) and (E) of Section 25 shall be taxed at the applicable rates imposed thereat*:*

Provided, further, That the grossed -up value of the fringe benefit shall be determined by dividing the actual monetary value of the fringe benefit by the difference between one hundred percent (100%) and the applicable rates of income tax under Subsections (B), (C), (D), and (E) of Section 25.

(B) *Fringe Benefit defined*.- For purposes of this Section, the term *"fringe benefit"* means any **good, service or other benefit furnished** or granted in cash or in kind by an employer to an individual employee (except rank and file employees as defined herein) such as, but not limited to, the following:

(1) Housing;
(2) Expense account;

(3) Vehicle of any kind;
(4) Household personnel, such as maid, driver and others;
(5) Interest on loan at less than market rate to the extent of the difference between the market rate and actual rate granted;
(6) Membership fees, dues and other expenses borne by the employer for the employee insocial and athletic clubs or other similar organizations;
(7) Expenses for foreign travel;
(8) Holiday and vacation expenses;
(9) E**ducational assistance to the employee or his dependents; and**
(10) Life or health insurance and other non-life insurance premiums or similar amounts inexcess of what the law allows.

(C) ***Fringe Benefits Not Taxable***. - The following fringe benefits are not taxable under this Section:

(1) fringe benefits which are authorized and exempted from tax under special laws;
(2) Contributions of the employer **for the benefit of the employee to retirement, insurance and hospitalization benefit plans;**
(3) Benefits given to the rank and file employees, whether granted under a collective bargaining agreement or not; and
(4) De minimis benefits as defined in the rules and regulations to be promulgated by the Secretary of Finance, upon recommendation of the Commissioner.

The Secretary of Finance is hereby authorized to promulgate, upon recommendation of the Commissioner, such rules and regulations as are necessary to carry out efficiently and fairly the provisions of this Section, taking into account the peculiar nature and special need of the trade, business or profession of the employer.

Definition: any good, service or other benefit furnished or granted in cash or in kind by an employer to an individual employee except rank and file employees.

Managerial employee -- one who is vested with the powers or prerogatives to lay down and execute management policies and/or to hire, transfer, suspend, lay-off, recall, discharge, assign or discipline employees.

Supervisory employees -- those who, in the interest of the employer, effectively recommend such managerial actions if the exercise of such authority is not merely routinary or clerical in nature but requires the use of independent judgment.

All employees not falling within any of the above definitions are considered *rank-and-file employees*.

Fringe benefits given to a rank-and-file employee are *treated as part of his compensation income subject to income tax and withholding tax on compensation income*.

Under the regulations, the FBT is actually due from the employee but paid by the employer for and in behalf of the employee. When the employer pays the FBT in behalf of the employee, the tax becomes an additional benefit of the employee subject thereto. Thus the need to gross up the monetary value of the fringe benefit.

The **GMV of fringe benefit granted or furnished by the employer to the employee is deductible from gross income** as an ordinary and necessary business expense, provided the final tax in Section 33 has been paid.

Take note that the exemption of any fringe benefit from the FBT shall not be interpreted to mean exemption from any other income tax. Thus if the fringe benefit is exempted from the fringe benefits tax, the same may however still form part of the employee's gross compensation income which is subject to income tax.

Valuation of Fringe Benefits
If given in property -- Value of the Fringe Benefit is equal to the FMV of the property as determined in Sec. 6(E)

*How to compute if citizen and resident alien:
(1) Divide the actual monetary value by 68%
(2) So if the actual monetary value is P35,000. 35,000/68% = 51,470.59.
(3) 51,470.59 x 32% = 16,470.59

*How to compute if non-resident alien:
(1) Final tax imposed is the applicable rates imposed thereat (25%/15%) on the grossed up monetary value
(2) GMV determined by dividing the AMV by the difference (75%/85%) between 100% and the said applicable tax rates (25%/15%)

**Baniqued: Why do still need fringe benefits tax? When the benefits would be included already in the gross compensation income of the EE? If Congress had not enacted FBT, how would such fringe benefits be treated? Because before there was a huge leakage in the taxable base, even if the ER were supposed to withhold such tax from the EEs, they didn't do it! So the Congress now itemized certain items of FBT.*

Criticism – It is anti-poor. Rank and file is made use to bear the tax, while the supervisory employees and managerial employees are borne by the ER.

Take note of the housing privileges in Housing Privilege. 5% of the FMV, then 50% pa yun. Not the entire amount of the fringe benefit is taxed. Same with motor vehicles (See RR-03-98)

Note, if the company pays for the travel expenses of an employee for a convention/business meeting, just prove that it was for a business purpose (substantiate with the actual occurrence of the convention). Eh pano pag sinama si Misis? Eh di taxable sa kanya yun.

M. Convenience of the Employer Test

Definition. If meals, living quarters, and other facilities and privileges are furnished to an employee for the convenience of the employer, and incidental to the requirement of the employee's work or position, the value of that privilege need not be included as compensation.

Examples.
1. The value of the meals given to the employee is not taxable, if the employer provides the meals for a substantial non- compensatory business purpose (generally, when employee is required to be on duty during the meal period).

2. Lodging is not taxable if the employee must accept the lodging on the employer's business premises as a condition of his employment.

*Collector vs. Henderson: Are the allowances for rental of the apartment furnished by the husband-taxpayer's employer-corporation, including utilities such as light, water, telephone, etc. and the allowance for travel expenses given by his employer-corporation to his wife in 1952 part of taxable income?

The quarters, therefore, that they occupied at the Embassy Apartments consisting of a large sala, three bedrooms, dining room, two bathrooms, kitchen and a large porch, and at the Rosaria Apartments consisting of a kitchen, sala dining room, two bedrooms and a bathroom, exceeded their personal needs. But the exigencies of the husband-taxpayer's high executive position, not to mention social standing, demanded and compelled them to live in amore spacious and pretentious quarters like the ones they had occupied.

That is why his employer-corporation had to grant him allowances for rental and utilities in addition to his annual basic salary to take care of those extra expenses for rental and utilities in excess of their personal needs.

Hence, the fact that the taxpayers had to live or did not have to live in the apartments chosen by the husband-taxpayer's employer-corporation is of no moment, for no part of the allowances in question redounded to their personal benefit or was retained by them.

Baniqued: If the employee benefits from it personally, does that make it taxable? NO. The mere fact that the employee derives some incidental benefit from it, it doesn't mean that it is taxable under the FBT as long as it is primarily for the convenience of the employer.

Last note: It does not follow that because the Fringe Benefits are not subject to FBT that they are not subject to tax at all. It may be that the FB may become part of compensation income and may be subject to income tax.

N. De Minimis Benefits

RR 2-98 Sec. 2.78.1(A)(3) Facilities and privileges of a relatively small value. — Ordinarily, facilities and privileges (such as entertainment, medical services, or so called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as compensation subject to withholding if **such facilities or privileges are of:**
1. relatively small value and are offered or furnished by the employer
2. merely as a means of promoting the health, goodwill, contentment, or efficiency of his employees.

Where compensation is paid in property other than money, the employer shall make necessary arrangements to ensure that the amount of the tax required to be withheld is available for payment to the Commissioner.

T**ax implication of de minimis benefits: EXEMPTED from tax.** However, should the amount of the benefits given be in EXCESS of the ceilings prescribed and the **p30,000 limitation,** the following rules apply:

1. If given to managerial / supervisory employees - The amount in excess of the ceiling prescribed is taxable as a fringe benefit (i.e., there will be a 32% tax imposed on the **grossed-up monetary value *of the residual* amoun**t).

2. If given to rank-and-file employees - The amount in excess of the ceiling prescribed is taxable as s**alary or compensation income**

**Baniqued: Why is it excluded from tax? These are benefits that are trivial, Benefits of relatively small value furnished to EE for their well being.*

II. DEFINITION OF GROSS INCOME

A. Statutory Definition

SEC. 32 Gross Income. -

(A) General Definition. - Except when otherwise provided in this Title, gross income means all income derived from whatever source, including (but not limited to) the following items:

(1) Compensation for services in whatever form paid, including, but not limited to fees, salaries, wages, commissions, and similar items;
(2) Gross income derived from the conduct of trade or business or the exercise of a profession;
(3) Gains derived from dealings in property;
(4) Interests;
(5) Rents;
(6) Royalties;
(7) Dividends;
(8) Annuities;
(9) Prizes and winnings;
(10) Pensions; and
(11) Partner's distributive share from the net income of the general professional partnership.

*Baniqued: This is not intended to be exclusive

B. Compensation for Services

Compensation Income. Income arising from an ER-EE relationship. It means all remuneration for services performed by an EE for his ER, including the cash value of all remuneration paid in any medium other than cash.

Professional income refers to the fees received by a professional from the practice of his profession, provided that there is no employer-employee relationship between him and his clients. This fact is material for purposes of taxation because there is no deduction allowed against compensation income, but allowable deductions may be made from professional income

Baniqued: Lawyers attend board meetings, they receive pansit, per diems, siomai, P4,000, and director bonuses. How are these treated, compensation income or business income? The first thing you should ask is whether there is EE-ER relationship? Ordinarily if you are not an employee, it is a business income.** The withholding tax that would apply is not that applied to EEs but the withholding tax under creditable withholding tax.*

Atty. Espinosa is a full time employees of TV5 for example (Senior VP), they also sit in the board, they also gain per diems, how is this going to be treated? Ask again, is there a EE-ER relationship. YES there is! They are full time employees of the Metro Pacific Group.

C. Income from Business or Exercise of Profession

*Baniqued: Sec. 32(A)(2) these are where most of tax evasion cases are done. In Sec. 32(A)(1) there is no escape because they are withheld at source.

Salaried individuals – income consists only of salary.
Businessman – income consists of income from sale of goods and services.

- Business Income may relate to a sale of goods, properties, or services. It may come from the conduct of trade or business or the exercise of a profession, or gain derived from dealings in property. (De Leon)

Distinction is important since salaried individuals are not entitled to deductions. Businessman have deductions.

What if you are a mixed earner? Then you have your salaries wherein you don't have deductions, but with exemptions. **Then your business expenses can only be deducted from those income derived from business or exercise of profession.**

EXAMPLE: Employee of company X, but I also operate a restaurant/spa. From the business income portion you can claim business expenses/optional standard deduction.

D. Gains from Dealings in Property

Without a sale or disposition, there cannot be a gain derived or an income subject to tax.

**Baniqued: Husband A and B always fight. Hence they went to court to dissolve the community property. Court divided the property to two of them, is that income? This is only a partition of what they already own. It's not income.*

If the marriage is annulled on the ground of psychological incapacity, you are obliged to deliver the presumptive legitime, is that subject to tax? You had no condominium units before, now you have 5! Is that income? ***There is no taxable event. There is no sale or disposition for a valuable consideration to trigger a tax.***

Neighbors, sabay bumili ng lots, real estate developer napagpalit yung titulo ni A and B (tatanga tanga) ***So pumunta yung dalawa sa BIR, mag eexchange kami ni lote, is***

that taxable? The exchange was SOLELY to correct the error. T*here is no sale or disposition for a valuable consideration to trigger a tax.*

When the children all became of age, the trustee were now obliged to deliver all the properties to the children on the trust, is there an income realized by the children? There is owner, ***NONE, the trustee merely acts as a legal owner, and not a beneficial owner, and he is LEGALLY required to give it to the beneficial*** *so technically there is no sale or disposition subject to tax.*

THERE MUST BE A SALE OR DISPOSITION FOR VALUABLE CONSIDERATION. (hence properties received as gift are excluded from gross income)

Example in computing amount realized: You pay me 100,000 and you give me shares of stock valued at another 200,000. AMOUNT REALIZED is P300,000!

What is a BASIS? If I bought a car for P1,000,000 (acquisition cost), then I use it in the practice of my profession, every year I claim 200,000 as depreciation, so my cost in that motor vehicle is ZERO!! what is the basis? ZERO ALSO! That is the adjusted basis. The depreciation allowance would reduce your original basis or original cost.

What if there is a repair on maintenance on the car of P100,000, what then would be the effect of that on the adjusted basis? You then put that on the adjusted basis, it increases. This is a CAPITAL EXPENDITURE, not deducted outright but spread out in 5 years.

I buy a land is P30,000,000, through the years I was claiming deductions for depreciation in the building (you cannot depreciate the land), what is the effect of that depreciation allowance on my original basis? It will REDUCE my original basis. BUT if I introduce improvements on my building, like an elevator, so what is the impact of that modern elevator system? It will be ADDED TO THE ORIGINAL BASIS! That is the ADJUSTED BASIS!

Inheritance, there is estate tax (heirs pay). Transfer by reason of donation, there is donors tax. Donor's tax is based on the FMV of the property donated at the time of the donation.

Why is there a difference? If a property is inherited and acquired by donation? Sa inherited property ***FMV at time of inheritance,*** *sa donation kung ano yung cost nung donor, OR fmv at the time the donation was made for PURPOSE OF LOSS.*

I acquire land P50,000,000 (zonal value) I paid P40,000,000. Basis is P40,000,000. You are forever STUCK WITH A LOW BASIS. The lower your basis is, the higher your gain be, the higher tax you will have to pay.

So is it always good to undervalue the land we are buying? May DOS 250M, tapos ang ibibigay mo sa BIR 175M, okay ba yan? No that is ILLEGAL, conspiring to undervalue the

tax. Even if it is accepted practice it cannot be condoned. Besides if you agree to undervalue and you subsequently sell this property ***you are stuck with a low basis! (of course this does not apply to a capital asset, basis is irrelevant)***

E. Passive Income – Interest, Rent, Royalty and Dividend

1. Interest

Interest income, in general, are included in the gross income of the creditor/depositor UNLESS they are:
(1) Exempt from tax OR
(2) Subject to final tax at preferential rate

Classification of Interest Income
1. Exempt from Income tax
   a. If received from a duly-registered cooperative
   b. BSP prescribed form of investments maturing more than five years
   c. Expanded foreign currency deposit system by nonresident citizens/aliens
   d. Tenant who **paid to a landowner under CARP**

2. Subject to Final Withholding tax
   a. Deposits made in banking institutions is a passive income that is subjected to 20% final tax.

3. Subject to Normal Tax (Earnings derived from lending money, goods, or credits from one person to another without any withholding tax made. Since interest income is earned in the normal conduct of business, this should be included as part of income to be reported in the Annual Income Tax Return. It must be the principal business activity)

Rules on interest income (Mamalateo)
1. Gross interest income from Philippine currency bank deposits and yield or any other monetary benefit from deposit substitutes and from trust funds are subject to 20% final withholding tax, EXCEPT if the depositor is a NRA not engaged in trade which shall be subject to 25%.

2. Gross interest income from foreign currency deposits with an Offshore Banking Unit or Foreign Currency Deposit Unit in the Philippines is subject to a final withholding tax of 7.5%.

If the foreign currency deposit is made with a bank located OUTSIDE the Philippines, the tax

is in accordance to the graduated system if resident citizen, and normal corporate income tax if a corporation. If non-resident etc exempt.

3. Interest income derived from loans and other transactions other than those enumerated above is subject to graduated income tax rates or normal corporate income.

tax rates EXCEPT NRA not engaged is subject to 25% final tax and a non-resident foreign corporation subject to 20% final tax.

4. Interest income from long-term deposit or investment in the form of savings, common or individual trust funds, deposit substitutes, investment management accounts and other investments evidenced by certificates in such form prescribed by the Bangko Sentral ng Pilipinas (BSP) shall be exempt from tax. Should the holder of the certificate pre-terminate the deposit or investment before the fifth (5th) year, a final tax shall be imposed on the entire income based on Sec. 24(B)(1)

2. Rent

Actual rent itself: included in gross income (taxable)
Note: Rental income paid to a non-resident alien or non-resident foreign corporation shall be subject to 25% or 30% final withholding tax.

Obligations of lessor to third parties assumed and paid by the lessee. considered as additional rent income of the lessor, and therefore included in gross income

Advance Rentals: Receipt of advance rentals by the lessor may or may not constitute taxable income to him depending on the true nature of the so-called advance rentals.

> If the advance rental is in the nature of prepaid rent (for the lessee), received by the lessor under a claim of right and without restriction as to use, the entire amount is taxable income of the lessor in the year received.
>
> If the amount received is in the nature of a security deposit for the faithful compliance by the lessee of the terms of the contract, there is no income to the lessor unless the conditions which make the security deposit the property of the lessor occur (i.e., the lessee violates the terms of the lease agreement)

**Baniqued: So you buy a car and it was agreed that you pay in installments for 5 years. After completion of the amortization, the property is sold to the client for a nominal compensation. It is a conditional sale rather than a true lease.*

On the otherhand, 2 years of rent, and then afterwards you have the option to buy the property. If you exercise the option, how do you treat the 2 years of rent? It's a lease.

RR 2 Section 49. Improvements by lessees. - When buildings are erected or improvements made by a lessee in pursuance of an agreement with the lessor, and such buildings or improvements are not subject to removal by the lessee, the lessor may at his option report the income therefrom upon either of the following bases:

(a) The lessor may report as income at the time when such buildings or improvements are completed the fair market value of such buildings or improvements subject to the lease. *(Outright method)*
(b) The lessor may spread over the life of the lease the estimated depreciated value of such buildings or improvements at the termination of the lease and report as income for each of the lease all adequate part thereof. *(Spread-out method)*

3. Royalty

Royalties means payments of any kind received as a consideration for the use of or the right to use any copyright of literary artistic or scientific work.

Royalties can be sold regularly and thus be considered as an active business income subject to the normal corporate income tax or passive income subject to final withholding tax.

RULES ON ROYALTY AS A PASSIVE INCOME

A. ROYALTY PAID BY A DOMESTIC CORPORATION

1. Recipient is a citizen, resident alien, or a non –resident alien engaged in trade or business in the Philippines, or a Resident Foreign Corporation
- Royalty income from sources within the Philippines is subject to 20% final withholding tax. But royalty on books and other literary works and musical compositions is subject to 10% final tax.

2. Recipient is a non-resident alien not engaged in trade or business in the Philippines
- Royalty income from sources within the Philippines is subject to 25% final withholding income tax.

3. Recipient is a non-resident foreign corporation
- Royalty income from sources within the Philippines is subject to 30% final withholding tax.

B. ROYALTY PAID BY A FOREIGN CORPORATION

1. Recipient is a resident citizen and a domestic corporation
- Subject to graduated rates of tax and at a normal corporate income tax

2. Recipient is a non-resident citizen, an alien, and a foreign corporation
- Exempt because they are only liable to income within the Philippines

**Baniqued: Royalty is a valuable property that can be developed and sold on a regular basis for a consideration; in which case, any gain derived therefrom is considered as an active business income subject to normal corporate tax*

It is a special form of rental income for the use of intangible property.

Where a person pays royalty to another for the use of its intellectual property, such royalty is a passive income of the owner thereof subject to withholding tax.

It is valuable property that can be developed and sold on a regular basis for consideration. The gain derived therefrom is active business income subject to the normal corporate income tax.

See Sec 24B – passive income – 20% final withholding tax. If active, 30% in the case of corporation, 32% in case of individual maximum marginal rate

4. Dividend

Dividends comprise any distribution, whether in cash or property, in the ordinary course of business made by a domestic or resident foreign corporation to the stockholders out of its earnings or profits

Dividend is defined as a corporate profit set aside, declared and ordered by the directors to be paid to the stockholders on demand or at a fixed time. Until the cash or property dividend is declared, the corporate profits belong to the corporation and not to the stockholders.

Cash dividend is subject to tax generally. It is valued and taxable to the extent of amount of money received by the stockholder.

Property dividend is a dividend payable in property which may be investments in shares of stocks of a corporation, or real property, or some other property owned by a corporation. Hence property dividend of a corporation are shares of stock of another corporation to which the corporation paying the dividend has investments. Subject to tax generally. The property dividend is valued and taxable to the extent of the FMV received at the time of declaration. (Examples: Shares of stock of another corporation, treasury stock)

Stock dividend is not subject to tax. When declared, it is merely a certificate of stock which evidences the interest of the stockholder in the increased capital of the corporation

RULES ON TAXAION OF DIVIDENDS

1. DIVIDEND IS PAID BY A DOMESTIC CORPORATION

a. Recipient is a citizen, resident alien, or NRA engaged in trade or business)
10% final withholding tax starting January 1, 2000.

b. Recipient is a non-resident alien not engaged in trade or business
Subject to 25% final witholding tax rate

c. Recipient is a domestic corporation or a foreign resident corporation
NOT subject to tax. – It is a device for reducing extra or double taxation of distributed earnings. Since a corporation cannot deduct from its gross income the amount of dividends distributed to shareholders, any distributed earnings are taxed twice:
(1) Initially at the corporate level when they are included in the corporation's taxable income and
(2) at the corporation-shareholder level when they are received as dividend.

d. Recipient is a non-resident foreign corporation
Subject to 15% final withholding tax. With the condition that the country where the NRFC is domiciled shall allow a credit against the tax due from the NRFC taxes deemed to have been paid equivalent to the difference between the regular corporate income tax and the 15% tax on dividends (SEE Sec. 28(B)(5)(b) and Commissioner v. Procter and Gamble.

2. DIVIDEND IS PAID BY A FOREIGN CORPORATION

a. Recipient is a resident citizen or a domestic corporation
Dividend income is subject to Philippine Income tax. (because they are liable anyway at worldwide income) However, the foreign income tax paid or withheld on on such dividend may be credited against the Philippine income taxdue.

b. Recipient is a non-resident citizen or an alien, or a foreign corporation
Dividend income received from a foreign corporation not doing business in the Philippines shall be treated as income from foreign sources, hence EXEMPT if received by these entities.

F. Prizes and Winnings

Prizes from sources within the Philippines are subject to 20% final withholding tax, if received by a citizen, resident alien, or non-resident alien engaged in trade or business in the Philippines (except if less than 10,000 php which is subject to normal tax)

If the recipient is a non-resident alien not engaged in trade or business, subject to 25% final withholding tax.

If the recipient is a corporation (domestic or foreign), prizes and other winnings are added to the corporations operating income and the net income is subject to 30% corporate income tax.

The EXCEPTIONS are as follows:
1. Prizes and awards received in recognition of religious, charitable, scientific, educational, artistic, literary or civic achievements are EXCLUSIONS from gross income if:
a. The recipient was selected without any action on his part to enter a contest or proceedings; and
b. The recipient is not required to render substantial future services as a condition to receiving the prize or award.

2. Prizes and awards granted to athletes in local and int'l sports competitions and tournaments held in the Philippines and abroad and sanctioned by their national associations shall be EXEMPT from income tax.

G. Pensions and Annuities

Pension Stated allowance paid regularly to a person on his retirement or to his dependents on his death

Paid for past employment services rendered. It is a stated allowance paid regularly to a person on his retirement or to his dependents on his death, in consideration of past services, meritorious work, age, loss, or injury. It is generally taxable unless the law states otherwise.– until I am able to recover what I paid, I should not have income

For every annuity you receive part of it is return of premium and the remainder is income – this is not in the CODE. General rule a return of income is not taxable

Annuity is an amount payable yearly or at other regular intervals for a certain or uncertain period (as for years or for life as in life insurance)

H. Partner's Distributive Share in Net Income of a GPP

SEC. 26. Tax Liability of Members of General Professional Partnerships. - A general professional partnership as such shall not be subject to the income tax imposed under this Chapter. Persons engaging in business as partners in a general professional partnership shall be liable for income tax only in their separate and individual capacities.

For purposes of computing the distributive share of the partners, the net income of the partnership shall be computed in the same manner as a corporation.

Each partner shall report as gross income his distributive share, actually or constructively received, in the net income of the partnership

SEC. 73(D) Net Income of a Partnership Deemed Constructively Received by Partners. - The taxable income declared by a partnership for a taxable year which is subject to tax under Section 27 (A) of this Code, after deducting the corporate income tax imposed therein, shall be deemed to have been actually or constructively received by the partners in the same taxable year and shall be taxed to them in their individual capacity, whether actually distributed or not.

A general professional partnership is a partnership formed by persons for the sole purpose of exercising their common profession, no part of the income of which is derived from engaging in any trade or business

The partnership is a mere mechanism or a flow-through entity in the generation of income by, and the ultimate mechanism distribution of such income to the individual partners. (Tan v. Commissioner [Oct. 3, 1994])

But, the partnership itself is required to file income tax returns for the purpose of furnishing information as to the share in the gains or profits which each partner shall include in his individual return.

The share of an individual partner in the net profit of a general professional partnership is deemed to have been actually or constructively received by the partner in the same taxable year in which such partnership net income was earned, and shall be taxed to them in their individual capacities, whether actually distributed or not, at the graduated income tax ranging from 5% to 32%.

Thus, the principle of constructive receipt of income or profit is being applied to undistributed profits of GPPs. The payment [to the partners] of such tax-paid profits in another year should no longer be liable to income tax

There seems to be an unintended benefit granted to the partners of a business partnership who would be taxed at 10% only on the partnership profits actually distributed during the year compared to partners of GPP who would be taxed on their entire share of the GPP

profits whether distributed or not during the same taxable year. BUT, business partnership net income is subject to 30% regular corporate income tax while a GPP is exempt from that. (Mamalateo)

**Baniqued: Sec 32(A)(11) Must be for the exercise of a COMMON PROFESSION, you cannot organize a GPP with different professions, all lawyers, engineers, accountants etc.*

GPP, is a pass through entity, it is not taxable under INCOME TAX PURPOSES, but for VAT purposes the GPP is a VATABLE person. Take note!

Distributive share – their share in the profits if there is a positive sign showing (?)

Q: Suppose GPP makes net income of P10M, external auditors certified P10M. Are the partners obliged to report it whether they received or not? YES. See Sec. 26 and Sec. 73(D) [but this only applies to partnerships not GPP]. Sir in that sense medyo lugi kami kasi wala pa kami nakukuha.

If we register the partnership in the SEC, then it would be like a corporation, it would be taxable like a corporation. Hence distribution of net profits of a partnership to its members is to be treated like a distribution of a DIVIDEND. If a corporation pays 30% income tax, then the partnership also pays 30% income tax.

III. EXCLUSIONS FROM GROSS INCOME

Sec. 32(B) Exclusions from Gross Income. - The following items shall not be included in gross income and shall be exempt from taxation under this title:

(1) Life Insurance – The:
1. proceeds of life insurance policies
2. paid to the heirs or beneficiaries upon the death of the insured,
3. whether in a single sum or otherwise,

BUT if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income.

*El Oriente v. Posadas: Life insurance in such a case is like that of fire and marine insurance, — a contract of indemnity. The benefit to be gained by death has no periodicity. It is a substitution of money value for something permanently lost, either in a house, a ship, or a life.

(2) Amount Received by Insured as Return of Premium - The amount received by the insured, as a return of premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

(3) Gifts, Bequests, and Devises. - The value of property acquired by gift, bequest, devise, or descent:

Provided, however, That income from such property, as well as gift, bequest, devise or descent of income from any property, in cases of transfers of divided interest, shall be included in gross income.

Gifts are exempt since these are already subject to donors tax (De Leon)

*Pirovano v. CIR: Pirovano expected or was promised further compensation over and in addition to his regular emoluments as President and General Manager. The fact that his services contributed in a large measure to the success of the company did not give rise to a recoverable debt, and the conveyances made by the company to his heirs remain a gift or donation. This is emphasized by the directors' Resolution of January 6, 1947, that "out of gratitude" the company decided to renounce in favor of Pirovano's heirs the proceeds of the life insurance policies in question. The true consideration for the donation was, therefore, the company's gratitude for his services, and not the services themselves.

*Commissioner v. Duberstein: In No. 376, Duberstein, an individual taxpayer, gave to a business corporation, upon request, the names of potential customers. The information proved valuable, and the corporation reciprocated by giving Duberstein a Cadillac automobile, charging the cost thereof as a business expense on its own corporate income tax return. The Tax Court concluded that the car was not a "gift" excludable from income.

When determining whether something is a gift for taxation purposes, the critical consideration is the transferor's intention. This is a question of fact that must be determined on a "case-by-case basis". The body that levies the tax must conduct an objective inquiry that looks to "the mainsprings of human conduct to the totality of the fact of each case." On review, the trier of fact must consider all of the evidence in front of it and determine whether the transferor's intention was either disinterested or involved.

Duberstein was considered NOT a gift. Motive was not disinterested, it was for past services and to encourage future references. Stanton was remanded.

**Baniqued: Note the use of the concept of disinterested generosity.*

(4) Compensation for Injuries or Sickness - amounts received, through Accident or Health Insurance or under Workmen's Compensation Acts, as:
1. compensation for personal injuries or sickness,
2. plus the amounts of any damages received, whether by suit or agreement, on account of such injuries or sickness.

These are also in the nature of an indemnity. Note that this is limited to physical injuries and not injuries to rights. These are those received under Accident or Health Insurance or under Workmen's Compensation Acts.

Not taxable: Actual damages, Moral damages, Exemplary damages, Damages for loss of earning capacity, Damages for loss of goods, actual liquidated damages.

Taxable: Compensation for unrealized earnings. Interest for nontaxable damages. Damages for unrealized profits etc.

**Baniqued: Suppose there is an illegal dismissal. Employee says he suffered besmirched reputation, sleepless nights (this is a non physical injury, NOTE). Damages were then. On top of that, there is also backpay. Is there income? Backwages is subject to income because they would be taxable if he could've earned it. What about the damages? It's exempted. Because they compensate him for the injuries. Heartless to tax him for it.*

What if you are an executive in a construction company, then there is an accident, you become permanently disabled. So you are paid damages for the negligence of the employer because of the defective equipment. If the ER pays you 10 years of wages, plus damages of a fixed amount of P10M. Are you exempt from tax? YES. These are amounts received on account of injuries because of the accident, even the backwages, the fact that you are permanently disabled, the fact that it arose from Physical injuries, it is EXEMPT!!

(5) Income Exempt under Treaty. - Income of any kind, to the extent required by any treaty obligation binding upon the Government of the Philippines.

(6) Retirement Benefits, Pensions, Gratuities, etc. -

(a) Retirement benefits received:
1. under Republic Act No. 7641 and
2. those received by officials and employees of private firms, whether individual or corporate, in accordance with a:
    a. reasonable private benefit plan maintained by the employer:
    b. Provided, That the retiring official or employee has been in the service of the same employer for at least ten (10) years and
    c. is not less than fifty (50) years of age at the time of his retirement:

d. Provided, further, That the benefits granted under this subparagraph shall be availed of by an official or employee only once.

For purposes of this Subsection, the term 'reasonable private benefit plan' means:
1. a pension, gratuity, stock bonus or profit-sharing plan
2. maintained by an employer for the benefit of some or all of his officials or employees,
3. wherein contributions are made by such employer for the officials or employees, or both,
4. for the purpose of distributing to such officials and employees the earnings and principal of the fund thus accumulated, and
5. wherein its is provided in said plan that at no time shall any part of the corpus or income of the fund be used for, or be diverted to, any purpose other than for the exclusive benefit of the said officials and employees.

(b) Terminal Pay. Any amount received by an official or employee or by his heirs from the employer as a consequence of separation of such official or employee from the service of the employer because of:
1. death
2. sickness or
3. other physical disability or
4. for any cause beyond the control of the said official or employee.

RA 7641	RPBP
Retiring employee must be in the service of same employer CONTINUOUSLY for at least five (5) years	Retiring employee must be in the service of the same employer CONTINUOUSLY for at least ten (10) years.
Retiring employee must be at least sixty (60) years old at the time of retirement	Retiring employee must be at least fifty (50) years old at the time of retirement
Availed of only once, and only when there is no RPBP	Availed of only once; no other RPBP with same or another employer allowed, [Sec. 32(B)(6)(a)] [But employee who availed of exclusion under an RPBP may still claim exclusions on other grounds (ie. GSIS, SSS, terminal pay)]
	Must be approved by BIR

**Baniqued: Exemption is applied to a reasonable private retirement benefit plan. Memorize the reasonable private benefit plan. At no time shall any part of the corpus (Ito yung pondo*

na pinapaikot) or income (yung perang pinapaikot ininvest to others) of the fund other than for the exclusive benefit of the employees.

What if after 15 or 20 years, the company discovers that a lot of its investments appreciated in value, so they go to bank because they want to get back since sobra na sa retirement ang employees. Is that allowed? YES. There is still enough funds to cover the retiring employees.

If it returns, how does it treated then? If it contributes, it is deducted! So ngayon, sinosoli, so the principle is the TAX BENEFIT PRINCIPLE, it is other income subject to tax. Fairness dictates that it must be recognized as income. Classic example of recovery of deducted items.

So if you want to play safe, huwag ka magpasoli until the company is closing down.

Separation Pay. The sickness must be life threatening, or one which renders the EE incapable of working.

Separation of the employee must be involuntary. Thus resignation bars a claim under this provision. Retrenchment of the EE because of unfavorable business conditions is considered involuntary.

**Baniqued: Bear in mind here the element of involuntariness (retrenchment, redunandancy, illness) Benefits received are exempt.*

What if there is a merger and consolidation, then there is a new management. Then you felt the pressure to leave, because they didn't treat you the same way. Can you claim that the separation benefits are not taxable because involuntary ito? It actually depends if you can substantiate the involuntariness.

(c) The provisions of any existing law to the contrary notwithstanding, social security benefits, retirement gratuities, pensions and other similar benefits received by resident or nonresident citizens of the Philippines or aliens who come to reside permanently in the Philippines from foreign government agencies and other institutions, private or public.

(d) Payments of benefits due or to become due to any person residing in the Philippines under the laws of the United States administered by the United States Veterans Administration.

(e) Benefits received from or enjoyed under the Social Security System in accordance with the provisions of Republic Act No. 8282.

(f) Benefits received from the GSIS under Republic Act No. 8291, including retirement gratuity received by government officials and employees.

(7) Miscellaneous Items. –
(a) Income Derived by Foreign Government - Income derived from investments in the Philippines in loans, stocks, bonds or other domestic securities, or from interest on deposits in banks in the Philippines by
(i) foreign governments,
(ii) financing institutions owned, controlled, or enjoying refinancing from foreign governments, and
(iii) international or regional financial institutions established by foreign governments.

(b) Income Derived by the Government or its Political Subdivisions. - Income derived from any public utility or from the exercise of any essential governmental function accruing to the Government of the Philippines or to any political subdivision thereof.

*Baniqued: How about Government owned or Controlled Corporations, is it exempt? NO. Ang exempt lang PCSO etc. Proprietary functions are also not covered by the exclusion.

In the foreign government income, even if it is exercising a proprietary function, it is still exempt.

(c) Prizes and Awards. - Prizes and awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement but only if:

(i) The recipient was selected without any action on his part to enter the contest or proceeding; and

(ii) The recipient is not required to render substantial future services as a condition to receiving the prize or award.

(d) Prizes and Awards in Sports Competition. - All prizes and awards granted to athletes in local and international sports competitions and tournaments whether held in the Philippines or abroad and sanctioned by their national sports associations.
e) 13th Month Pay and Other Benefits. - Gross benefits received by officials and employees of public and private entities: Provided, however, That the total exclusion under this subparagraph shall not exceed Thirty thousand pesos (P30,000) which shall cover:

(i) Benefits received by officials and employees of the national and local government pursuant to Republic Act No. 6686;

(ii) Benefits received by employees pursuant to Presidential Decree No. 851, as amended by Memorandum Order No. 28, dated August 13, 1986;

(iii) Benefits received by officials and employees not covered by Presidential decree No. 851, as amended by Memorandum Order No. 28, dated August 13, 1986; and

(iv) Other benefits such as productivity incentives and Christmas bonus: Provided, further, That the ceiling of Thirty thousand pesos (P30,000) may be increased through rules and regulations issued by the Secretary of Finance, upon recommendation of the Commissioner, after considering among others, the effect on the same of the inflation rate at the end of the taxable year.

*Baniqued: What if P10,000 is the maximum in de minimis, can you add the excess of P10,000 medical assistance to the 13th month pay aggregate? YES. Yung lumampas lang sa P30,000 yun yung taxable. Any amount in excess of the threshold in the de minimis can be added to the 13th month pay ceiling provided they do not exceed P30,000.

(f) GSIS, SSS, Medicare and Other Contributions. - GSIS, SSS, Medicare and Pag-ibig contributions, and union dues of individuals.

(g) Gains from the Sale of Bonds, Debentures or other Certificate of Indebtedness. - Gains realized from the same or exchange or retirement of bonds, debentures or other certificate of indebtedness with a maturity of more than five (5) years.

*Baniqued: QUESTION IS: Are the income from these bonds really exempt from income tax?

If on the face value of the bond was 1M and you get 10% discount, so you just pay 900,000. This is called a zero coupon bond. (ORIGINAL ISSUE DISCOUNT) So when the bond matures, you will pay me how much? 1M! That discount is in the nature of an interest income. The interest is paid upfront. Wala nang coupon, kasi wala nang ibabayad na interest while the bond is outstanding.

COUPON BOND – There is a coupon attached to it, it pays you interest periodically (quarterly, semi annually etc) While the bonds are outstanding, you pay interest.

Is the interest I am receiving while the bonds are outstanding also exempt? Note gains from sale and exchange. Hindi sinabing INTEREST. Interest is NOT excluded.

(h) Gains from Redemption of Shares in Mutual Fund. - Gains realized by the investor upon redemption of shares of stock in a mutual fund company as defined in Section 22 (BB) of this Code.

Sec. 22(BB) The term 'mutual fund company' shall mean an open-end and close-end investment company as defined under the Investment Company Act.

*Baniqued: What if I invest in a mutual fund? And then I redeem the share in the mutual fund. Is that subject to tax? NO. There is also no requirement of long term or short term. So if I invest today, and next Friday I get out, is that exempt pa rin? YES. There is no requirement of maturity.

Suppose you invest in PNB in their special offer of 12% interest for their anniversary. You cant move it for 5 years. Is that subject to tax? NO. EXEMPT. Legal basis is **Sec. 24(B)(1)**.

DISTINGUISH this from the previous two examples. GAIN from bonds, GAIN from mutual funds. Dito, INTEREST is exempt. What happened to the gain? Wala naming sale or exchange dito, loan ito.

A. Income Already Subjected to Final Tax

B. Earnings of Overseas Filipino Workers

Sec. 23(B) A nonresident citizen is taxable only on income derived from sources within the Philippines.

Sec. 23(C) An individual citizen of the Philippines who is working and deriving income from abroad as an overseas contract worker is taxable only on income derived from sources within the Philippines: Provided, That a seaman who is a citizen of the Philippines and who receives compensation for services rendered abroad as a member of the complement of a vessel engaged exclusively in international trade shall be treated as an overseas contract worker;

Sec. 22(E) The term 'nonresident citizen' means:

(1) A citizen of the Philippines who establishes to the satisfaction of the Commissioner the fact of his physical presence abroad with a definite intention to reside therein.

(2) A citizen of the Philippines who leaves the Philippines during the taxable year to reside abroad, either as an immigrant or for employment on a permanent basis.

(3) A citizen of the Philippines who works and derives income from abroad and whose employment thereat requires him to be physically present abroad most of the time during the taxable year.

(4) A citizen who has been previously considered as nonresident citizen and who arrives in the Philippines at any time during the taxable year to reside permanently in the Philippines shall likewise be treated as a nonresident citizen for the taxable year in which he arrives in the Philippines with respect to his income derived from sources abroad until the date of his arrival in the Philippines.

(5) The taxpayer shall submit proof to the Commissioner to show his intention of leaving the Philippines to reside permanently abroad or to return to and reside in the Philippines as the case may be for purpose of this Section

*Baniqued: You should be a non-resident citizen so that income will be not included in gross income. Suppose that MVP is frustrated with Ateneo, so he migrated back to HK and live there in a more or less permanent basis, so he will become a non-resident citizen, so all his salaries from outside the Philippines are not includible in gross income. Sec. 23(B). Non-resident citizen Sec. 22(E) is defined therein.

Overseas contract workers are taxable only with their income within the Philippines.

Note also that a seaman/seafarer can be considered as an OCW.

Suppose you are a Filipino and assigned by JG summit to HK and stayed there for 3 years. If your salaries in HK are continued to be paid by your Filipino employer? He would still be considered as a non-resident citizenunder Sec. 22(E). And where are the services performed? They are performed in HK, no doubt that the 2 requirements are met.

- Kim Henares says that if a Filipino employer pays, you are not a non-resident citizen. But when asked in the bar, stick to the statute.

The wording of the statute does not make a distinction between highly paid executives or the ordinary worker.

IV. COST OF GOODS SOLD

Sec. 27(A) For purposes of this Section, the term 'gross income' derived from business shall be equivalent to gross sales less sales returns, discounts and allowances and cost of goods sold. "Cost of goods sold' shall include:

1. all business expenses directly incurred
2. to produce the merchandise to bring them to their present location and use.

For a trading or merchandising concern, 'cost of goods' sold shall include:
1. the invoice cost of the goods sold,
2. plus import duties,
3. freight in transporting the goods to the place where the goods are actually sold,
4. including insurance while the goods are in transit.

For a manufacturing concern, 'cost of goods manufactured and sold' shall include:
1. all costs of production of finished goods, such as raw materials used, direct labor and manufacturing overhead, freight cost, insurance premiums and
2. other costs incurred to bring the raw materials to the factory or warehouse.

In the case of taxpayers engaged in the sale of service, 'gross income' means gross receipts less sales returns, allowances and discounts.

*Baniqued: FOR A TRADER → Gross sales – cost of sales (invoice value of the goods purchased), discounts, returns and allowances. = Gross income – Deductions = Net Income x Tax Rate = Tax Due

**Wala itong direct labor, so yung cost of sales is the invoice value of the goods. Difference with a manufacturer is wala silang raw materials.*

FOR A MANUFACTURER → Gross sales – cost of goods sold (raw materials), discounts, returns, allowances = Gross income – Deductions = Net Income x Tax Rate = Tax due.

FOR A CONTRACTOR → Gross receipts – sales returns, discounts or allowances = Gross Income – deductions = net income x tax rate = tax due

**There is no cost of sales here.*

BUT what exactly does cost of goods mean? Direct labor, raw materials, insurance cost, freight if the materials were imported from abroad. Paano naman yung nasa Makati, principal office? Hindi yun direct labor, administrative expenses yun. So there is where you claim the deductions. There is a distinction between cost of goods sold with deductions.

V. DEDUCTIONS FROM GROSS INCOME

SEC. 34. Deductions from Gross Income. Except for taxpayers earning:

compensation income arising from personal services rendered under an employer

employee relationship where no deductions shall be allowed under this Section other than under subsection (M) hereof, in computing taxable income subject to income tax under Sections 24 (A); 25 (A); 26; 27 (A), (B) and (C); and 28 (A) (1), there shall be allowed the following deductions from gross income

A. Ordinary and Necessary Business Expenses

Sec. 34(A) ***Expenses. -***

(1) ***Ordinary and Necessary Trade, Business or Professional Expenses.-*****(a)** ***In General*****.** - There shall be allowed as deduction from gross income all
(1) the ordinary and necessary expenses
(2) paid or incurred during the taxable year
(3) in carrying on or which are directly attributable to, the development, management, operation and/or conduct of the trade, business or exercise of a profession, including:

(i) A reasonable allowance for:
a. salaries, wages, and other forms of compensation for personal services actually rendered,
b. including the grossed-up monetary value of fringe benefit furnished or granted by the employer to the employee:
c. *Provided,* That the final tax imposed under Section 33 hereof has been paid;

(ii) A reasonable allowance for travel expenses, here and abroad, while away from home in the pursuit of trade, business or profession;

(iii) A reasonable allowance for
a. rentals and/or other payments
b. which are required as a condition for the continued use or possession, for purposes of the trade, business or profession, of property
c. to which the taxpayer has not taken or is not taking title or in which he has no equity other than that of a lessee, user or possessor;

(iv) A reasonable allowance for:
a. entertainment, amusement and recreation expenses during the taxable year,
b.that are directly connected to the development, management and operation of the trade, business or profession of the taxpayer, or that are directly related to or in

furtherance of the conduct of his or its trade, business or exercise of a profession
c. not to exceed such ceilings as the Secretary of Finance may, by rules and regulations prescribe, upon recommendation of the Commissioner,
d. taking into account the needs as well as the special circumstances, nature and character of the industry, trade, business, or profession of the taxpayer:

Provided, That any expense incurred for entertainment, amusement or recreation that is contrary to law, morals public policy or public order shall in no case be allowed as a deduction.

(b) *Substantiation Requirements*. - No deduction from gross income shall be allowed under Subsection (A) hereof unless:
the taxpayer shall substantiate with sufficient evidence, such as official receipts or other adequate records:
(i) the amount of the expense being deducted, and
(ii) the direct connection or relation of the expense being deducted to the development, management, operation and/or conduct of the trade, business or profession of the taxpayer.

(c) *Bribes, Kickbacks and Other Similar Payments.* - No deduction from gross income shall be allowed under Subsection (A) hereof for any payment made, directly or indirectly, to an official or employee of the national government, or to an official or employee of any local government unit, or to an official or employee of a government-owned or -controlled corporation, or to an official or employee or representative of a foreign government, or to a private corporation, general professional partnership, or a similar entity, if the payment constitutes a bribe or kickback.

(2) *Expenses Allowable to Private Educational Institutions*. - In addition to the expenses allowable as deductions under this Chapter, a private educational institution, referred to under Section 27 (B) of this Code, may at its option elect either:
(a) to deduct expenditures otherwise considered as capital outlays of depreciable assets incurred during the taxable year for the expansion of school facilities or
(b) to deduct allowance for depreciation thereof under Subsection (F) hereof.

Requisites: An expense must satisfy the following conditions to be deductible from gross income under the category of expenses, in general:

(a) it must be ordinary AND necessary
(b) it must be paid or incurred within the taxable year
(c) it must be in carrying on, or directly attributable to, the development, management,

operation and/or conduct of the trade, business or exercise of profession; and
(d) Substantiated by official receipts or other adequate records.
(e) Withheld with tax and paid to the BIR, if required such as salary expense
(f) Not contrary to law, public policy or morals.

Ordinary - normal and usual in the taxpayers business. It is also ordinary if it is reasonable and common to the particular business of the taxpayer. As long as the expense is attributed to the development, management, operation of the business or exercise of profession, such expense is ordinary.

Necessary- appropriate and helpful in the development of taxpayer's business and are intended to minimize losses or to increase profits. These are the day-to-day expenses.

Trade or Business -- Activity intended to make profit. A regularity in a transaction.

Capital Expenditures **--** are those that benefit not only the current period but also future periods (i.e. purchase of machinery). It is not deductible as a business expense but depreciable under Sec. 34 (F).

Baniqued:** Any expense incurred in the pursuit of trade and business can be deducted as long as they are ordinary and necessary business expenses. Hence, living, family, and personal expenses are NOT deductible.*

it is a case to case determination. Note that reasonableness is inherent in every ordinary and necessary business expense. The test is REASONABLENESS. But it is very difficult to determine if it is reasonable.

What is necessary and ordinary will depend on the circumstances. You're best bet is to look at the cases that the SC has decided.

*CIR vs. General Foods: Advertising is generally of two kinds: (1) advertising to stimulate the current sale of merchandise or use of services and (2) advertising designed to stimulate the future sale of merchandise or use of services. The second type involves expenditures incurred, in whole or in part, to create or maintain some form of goodwill for the taxpayer's trade or business or for the industry or profession of which the taxpayer is a member. If the expenditures are for the advertising of the first kind, then, except as to the question of the reasonableness of amount, there is no doubt such expenditures are deductible as business expenses. If, however, the expenditures are for advertising of the second kind, then normally they should be spread out over a reasonable period of time.

*Hospital de San Juan v. CIR: They wanted to claim as expenses their investments in stock and bonds. SC said that these expenses are not allowed because they are not ordinary and

necessary to its activities. Investments in stock and bonds are incidental in operating a hospital.

*C.M. Hoskins vs. CIR: The conditions precedent to the deduction of bonuses to employees are:

·Payment of bonuses is in fact compensation
·Must be for personal services actually rendered
·Bonuses when added to salaries are reasonable when measured by the amount and quality of services performed with relation to the business of the particular taxpayer

There is no fixed test for determining the reasonableness of a given bonus as compensation. This depends upon many factors.

In the case, Hoskins fails to pass the test. CTA was correct in holding that the payment of the company to Mr. Hoskins of the sum P99,977.91 as 50% share of supervision fees received by the company was inordinately large and could not be treated as an ordinary and necessary expenses allowed for deduction.

The same ruling was also arrived at in Aguinaldo vs. CIR and Kuenzle vs. Streiff.

*Algue vs. CIR: Promotional fee paid to shareholders amounted to 60% of the commission. SC allowed the expense as deductible because they are necessary for reason of the extraordinary efforts by the people. Experimental business project which resulted in new business for the company and results in a lot of profits.

*Zamora vs. Collector: Since promotion expenses constitute one of the deductions in conducting a business, same must testify these requirements. Claim for the deduction of promotion expenses or entertainment expenses must also be substantiated or supported by record showing in detail the amount and nature of the expenses incurred (N.H. Van Socklan, Jr. v. Comm. of Int. Rev.; 33 BTA 544). Considering, as heretofore stated, that the application of Mrs. Zamora for dollar allocation shows that she went abroad on a combined medical and business trip, not all of her expenses came under the category of ordinary and necessary expenses; part thereof constituted her personal expenses. There having been no means by which to ascertain which expense was incurred by her in connection with the business of Mariano Zamora and which was incurred for her personal benefit, the Collector and the CTA in their decisions, considered 50% of the said amount of P20,957.00 as business expenses and the other 50%, as her personal expenses. We hold that said allocation is very fair to Mariano Zamora, there having been no receipt whatsoever, submitted to explain the alleged business expenses, or proof of the connection which said expenses had to the business or the reasonableness of the said amount of P20,957.00. While in situations like the present, absolute certainty is usually no possible, the CTA should

make as close an approximation as it can, bearing heavily, if it chooses, upon the taxpayer whose inexactness is of his own making.

*Collector vs. Jamir: The next question raised by appellant refers to Jamir's claim for car depreciation and salary of his driver in the sums of P800.00 and P1,440.00, respectively. Although petitioner had disallowed one-half (1/2) of these claims, it appearing that the car was used by Jamir for personal and business purposes, the lower court allowed, as deductions, three-fourths (3/4) of said amounts, the car having been used by Jamir "more for business than for personal purpose"

*Atlas Consolidated vs. CIR: We sustain the ruling of the tax court that the expenditure of P25,523.14 paid to P.K. Macker & Co. as compensation for services carrying on the selling campaign in an effort to sell Atlas' additional capital stock of P3,325,000 is not an ordinary expense. The said expense is not deductible from Atlas gross income in 1958 because expenses relating to recapitalization and reorganization of the corporation, the cost of obtaining stock subscription, promotion expenses, and commission or fees paid for the sale of stock reorganization are capital expenditures.

That the expense in question was incurred to create a favorable image of the corporation in order to gain or maintain the public's and its stockholders' patronage, does not make it deductible as business expense. As held in the case of Welch vs. Helvering, efforts to establish reputation are akin to acquisition of capital assets and, therefore, expenses related thereto are not business expense but capital expenditures.

*CIR vs. Soriano Cia: We have held heretofore that expenditures for replacements, alterations, improvements or additions which either prolong the life of the property or increase its value are capital in nature (Alhambra Cigar etc. vs. Collector, etc., G.R. No. L-12026, and L-12131, May 29, 1959) and having arrived at the conclusion that the expenditures referred to above increased the value of the property, the same must be considered as capital expenditures that formed part of the cost of the Taxpayer's Intramuros property

RR 10-2002 Ceilings for Entertainment, Amusement and Recreational Expenses (July 10, 2002)

There shall be allowed a deduction from gross income for entertainment, amusement, and recreation (EAR) expense, in an amount equivalent to the actual EAR expense paid or incurred within the taxable year by the taxpayer,

But in no case shall such deduction exceed 0.50% of net sales (i.e., gross sales less sales returns/allowances and sales discounts) for taxpayers engaged in sale of goods or properties; OR

1.00% of net revenue (i.e., gross revenue less discounts) for taxpayers engaged in sale of services, including exercise of profession and use or lease of properties.

However, if the taxpayer is deriving income from both sale of goods/properties and services, the allowable EAR expense shall in all cases be determined based on an apportionment formula taking into consideration the percentage of the net sales/net revenue to the total net sales/net revenue, but which in no case shall exceed the minimum percentage ceiling provided.

Apportionment formula:

Net Sales/net revenue
x Actual Expense
Total Net sales and net revenue

B. Interest

Sec. 34(B) Interest.-
(1) *In General*. –

The amount of interest:
(1) paid or incurred within a taxable year on
(2) indebtedness in connection with the taxpayer's profession, trade or business
(3) shall be allowed as deduction from gross income:

Provided, however, That the taxpayer's otherwise allowable deduction for interest expense shall be reduced by 42% of the interest income subject to final tax. *Provided* that effective January 1, 2009, the percentage shall be 33%

(2) *Exceptions.* - No deduction shall be allowed in respect of interest under the succeeding subparagraphs:

(a) If within the taxable year an individual taxpayer reporting income on the cash basis incurs an indebtedness on which an interest is paid in advance through discount or otherwise: Provided, That such interest shall be allowed a a deduction in the year the indebtedness is paid:

Provided, further, That if the indebtedness is payable in periodic amortizations, the amount of interest which corresponds to the amount of the principal amortized or paid during the year shall be allowed as deduction in such taxable year;

(b) If both the taxpayer and the person to whom the payment has been made or is to be made are persons specified under Section 36 (B); or

(c)If the indebtedness is incurred to finance petroleum exploration.

(3) Optional Treatment of Interest Expense. - At the option of the taxpayer, interest incurred to acquire property used in trade business or exercise of a profession may be allowed as a deduction or treated as a capital expenditure.

Sec. 36(B) Losses from Sales or Exchanges of Property. In computing net income, no deductions shall in any case be allowed in respect of losses from sales or exchanges of property directly or indirectly -
(1) Between members of a family. For purposes of this paragraph, the family of an individual shall include only his brothers and sisters (whether by the whole or half-blood), spouse, ancestors, and lineal descendants; or
(2) Except in the case of distributions in liquidation, between an individual and corporation more than fifty percent (50%) in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual; or
(3) Except in the case of distributions in liquidation, between two corporations more than fifty percent (50%) in value of the outstanding stock of which is owned, directly or indirectly, by or for the same individual if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale of exchange was under the law applicable to such taxable year, a personal holding company or a foreign personal holding company;
(4) Between the grantor and a fiduciary of any trust; or
(5) Between the fiduciary of and the fiduciary of a trust and the fiduciary of another trust if the same person is a grantor with respect to each trust; or
(6) Between a fiduciary of a trust and beneficiary of such trust.

<u>For interest to be deductible:</u>
(1) Taxpayer must have an indebtedness. Indebtedness is something owed by one who is unconditionally obligated or bound to pay,
(2) The indebtedness must be that of the taxpayer.
(3) Interest must have been paid or incurred during the taxable year in connection with the trade, business or exercise of a profession
(4) Interest must be stipulated in writing
(5) Interest must be legally due
(6) And it must not be between related taxpayers

**Baniqued: There should be indebtedness. There may be cases that there is no loan, but somehow there is a payment made by one taxpayer to another and then the BIR disallows it because there is no indebtedness. There is a problem of characterization.*

For instance, taxpayer invested in a company, documentation is like a loan, may promissory note etc. Circumstances are such that there is no maturity date. Is it a loan? Or is it a dividend since it is conditioned for profits? Is it a loan or an investment? A dividend payment is not deductible, but an interest is deductible.

NOTE, it may be deductible or you have the option to capitalize the interest, and form part of the cost and increasing the basis of the property and having a depreciation deduction because of a higher basis. Moreover, tax is lower when you sell since higher basis.

<u>Tax arbitrage</u>
Aim of the limitation is that it aims to discourage back to back loans where a taxpayer secures a loan from a bank, turns around and invests the loan proceeds in money market placements. However, the limitation applies regardless of whether or not a tax arbitrage scheme was entered into by the taxpayer as long as there is an interest expense incurred on one side and an interest income subject to 20% final tax on the other side

**Baniqued: You incur a loan and the proceeds of the loan are invested in a product where the income is taxed at a preferential/exempt rate. Income is invested at a product preferential rate.*

You borrow a million from a bank, you invest this million, interest is 6% per annum. So you should be paying 60,000 a year in interest. You take that one million and invest it in a trust fund for 5 years and the interest therein is exempt from tax. So dinededuct mo 60,000 a year tapos yung interest na tinatanggap mo dun sa trust fund 0 tax. Benefit of both worlds.

Your interest expense 60,000 should be reduced by 33% of the income received subjected to final tax. The amount coming out of that is the amount allowable as interest expense.

This is a question of proof: Which money did you use in investing in a product? You must use the loan you got to invest somewhere.

Non Deductible Interest Expenses:
1. Between related parties (members of the same family, corporation and its controlling shareholders, grantor and fiduciary of a trust etc.) – This is prone to fabrication.

How about a sibling of an adopted child? Sir says for all intents and purposes you have to be considered a sibling of the legitimate child.

How about between cousins?

2.Interest paid in advance – Utang ako sa'yo, P1M, babayaran kita 3 years from now. Pero yung interest na babayaran ko kinaltas mo na, it is paid upfront. 700,000 na ang makukuha mo. It is only deductible when the indebtedness is PAID, EXCEPT when the indebtedness is paid in installments, so for every amortization you pay, part of that is interest and principal repayment. The interest component of that amortization will be the one allowed as a deduction. SO HOW DO YOU DETERMINE THIS? Madali lang yan, bibigyan ka ng bank ng schedule. May statement ka dyan. Nakabayad ka na ng isang taon, hindi gumalaw ang principal! That means for a long time all you pay is interest. Will the banks computation is controlling? Sir doesn't know. Banks computation was followed before. (Baniqued)

*CIR vs. Palanca: We do not see any element in this case which can justify a departure from or abandonment of the doctrine in the Prieto case above. In both this and the said case, the taxpayer sought the allowance as deductible items from the gross income of the amounts paid by them as interests on delinquent tax liabilities. Of course, what was involved in the cited case was the donor's tax while the present suit pertains to interest paid on the estate and inheritance tax. This difference, however, submits no appreciable consequence to the rationale of this Court's previous determination that interests on taxes should be considered as interests on indebtedness within the meaning of Section 30(b) (1) of the Tax Code. The interpretation we have placed upon the said section was predicated on the congressional intent, not on the nature of the tax for which the interest was paid.

*CIR vs. De Prieto: In conclusion, we are of the opinion and so hold that although interest payment for delinquent taxes is not deductible as tax under Section 30(c) of the Tax Code and section 80 of the Income Tax Regulations, the taxpayer is not precluded thereby from claiming said interest payment as deduction under section 30(b) of the same Code.

C. Taxes

Sec. 34(C) Taxes.-
(1) In General. - Taxes paid or incurred within the taxable year in connection with the taxpayer's profession, trade or business, shall be allowed as deduction, except

(a) The income tax provided for under this Title;

(b) Income taxes imposed by authority of any foreign country; but this deduction shall be allowed in the case of a taxpayer who does not signify in his return his desire to have to any extent the benefits of paragraph (3) of this subsection (relating to credits for taxes of foreign countries);

(c) Estate and donor's taxes; and

(d) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed.

Provided, That taxes allowed under this Subsection, when refunded or credited, shall be included as part of gross income in the year of receipt to the extent of the income tax benefit of said deduction.

(2) Limitations on Deductions. - In the case of a nonresident alien individual engaged in trade or business in the Philippines and a resident foreign corporation, the deductions for taxes provided in paragraph (1) of this Subsection (C) shall be allowed only if and to the extent that they are connected with income from sources within the Philippines.

(3) Credit Against Tax for Taxes of Foreign Countries. - If the taxpayer signifies in his return his desire to have the benefits of this paragraph, the tax imposed by this Title shall be credited with:

(a) Citizen and Domestic Corporation. - In the case of a citizen of the Philippines and of a domestic corporation, the amount of income taxes paid or incurred during the taxable year to any foreign country; and

(b) Partnerships and Estates. - In the case of any such individual who is a member of a general professional partnership or a beneficiary of an estate or trust, his:
1. proportionate share of such taxes of the general professional partnership or the estate or trust paid or incurred during the taxable year to a foreign country,
2. if his distributive share of the income of such partnership or trust is reported for taxation under this Title.

An alien individual and a foreign corporation shall not be allowed the credits against the tax for the taxes of foreign countries allowed under this paragraph.

(4) Limitations on Credit. - The amount of the credit taken under this Section shall be subject to each of the following limitations:

(a) The amount of the credit in respect to the tax paid or incurred to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's taxable income from sources within such country under this Title bears to his entire taxable income for the same taxable year; and

(b) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's taxable income from sources without the Philippines taxable under this Title bears to his entire taxable income for the same taxable year.

(5) Adjustments on Payment of Incurred Taxes. – If:
1. accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or
2. if any tax paid is refunded in whole or in part, the taxpayer shall notify the Commissioner; who shall redetermine the amount of the tax for the year or years affected, and the amount of tax due upon such redetermination, if any, shall be paid by the taxpayer upon notice and demand by the Commissioner, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer.

In the case of such a tax incurred but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the taxpayer to give a bond with sureties satisfactory to and to be approved by the Commissioner in such sum as he may require, conditioned upon the payment by the taxpayer of any amount of tax found due upon any such redetermination. The bond herein prescribed shall contain such further conditions as the Commissioner may require.

(6) Year in Which Credit Taken. - The credits provided for in Subsection (C)(3) of this Section may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books:
1. be taken in the year which the taxes of the foreign country were incurred,
2. subject, however, to the conditions prescribed in Subsection (C)(5) of this Section.

If the taxpayer elects to take such credits in the year in which the taxes of the foreign country accrued, the credits for all subsequent years shall be taken upon the same basis and no portion of any such taxes shall be allowed as a deduction in the same or any succeeding year.

(7) Proof of Credits. - The credits provided in Subsection (C)(3) hereof shall be allowed only if the taxpayer establishes to the satisfaction of the Commissioner the following:

(a) The total amount of income derived from sources without the Philippines;

(b) The amount of income derived from each country, the tax paid or incurred to which is claimed as a credit under said paragraph, such amount to be determined under rules and regulations prescribed by the Secretary of Finance; and

(c) All other information necessary for the verification and computation of such credits.

Requisites for deductibility (taxes)
1. Must be paid or incurred within the taxable year
2. Must be paid or incurred in connection with the taxpayer's trade, profession or business
3. Tax must be imposed directly to the taxpayer.
4. Not specifically excluded by law from being deducted from the taxpayer's gross income.

Taxes means taxes proper and no deduction should be allowed for amounts representing interest, surcharge, or penalties incident to delinquency.
There is no deduction to income tax paid to or accrued in favor of the government of the Philippines.

Indirect Taxes like value added taxes are not deductible by the buyer, because the burden of tax is shifted to the seller. This is because taxes are only imposed to person upon whom they are imposed by law.

TAX CREDIT: Such credit is given to a taxpayer in order to provide relief from too onerous a burden of taxation where the same income is subject to both foreign income tax and the Philippine income tax.

Tax Credit Limitations: The amount of tax credit allowed is equivalent to the tax paid or incurred to a foreign country during the taxable year but not to exceed the following limits:

1) **[Per Country Limit]** The amount of tax credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's taxable income from sources within such country bears to his entire taxable income for the same taxable year; and
2) **[Worldwide Limit]** The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's taxable income from sources without the Philippines taxable bears to his entire taxable income for the same taxable year.

Formula:

1. $\frac{\text{Taxable Income per Foreign Country}}{\text{Worldwide Taxable Income}} \times \text{Phil. Income Tax} = \text{Per Country Limit}$

2. $\frac{\text{Taxable Income for all Foreign Countries}}{\text{Worldwide Taxable Income}} \times \text{Phil. Income Tax} = \text{Worldwide Limit}$

**Baniqued:*

General Rule: All taxes incurred in connection with the pursuit of business is deductible from gross income except:
1. Income tax itself
2. Foreign income tax.
3. Estate Tax. – Trusts and estates are separate taxable persons. While the estate is not yet settled and then it earns income, who pays the tax? No one will pay the tax but the estate itself.
4. Donors Tax
5. Taxes assessed against local benefits – The LGU may introduce a street or any infrastructure which may benefit any property. If the improvement tends to benefit a large number of properties or the entire neighborhood then the taxes will then be allowable.

Foreign Tax Credit – Income tax is paid by a taxpayer to a foreign country is not deductible, that is the general rule. When is it then deductible? If I signify my intention to avail of the credit, I wont be able to get the deduction.

See computations on per country limit and worldwide limit.

Suppose I live in a condo, and the RPT paid in the condominium on the land, hallways, rooftops, elevators etc. My share in that is 25,000. Can I share in the deduction on the RPT I paid? The payor is the condominium, and the tenants are charged their share. Sir says that they can deduct. Your allocable share in the RPT paid by the condominium can be deducted. Association should not claim the deduction!

Suppose that I pay taxes, like RPT, then a year or two later, nagkamali pala then nag-file ka ng refund, so they refund. So what is your obligation when you have refund? Report that as part of gross income because of the principle of tax benefit. Same with bad debt, deducted then you recover it thereafter.

*Mercury Drug vs. CIR: It is worthy to mention that Republic Act No. 7432 had undergone two (2) amendments; first in 2003 by Republic Act No. 9257 and most recently in 2010 by Republic Act No. 9994. The 20% sales discount granted by establishments to qualified senior citizens is now treated as tax deduction and not as tax credit

D. Losses

Sec.34(D)(1) In General.- Losses actually sustained during the taxable year and not compensated for by insurance or other forms of indemnity shall be allowed as deductions:

(a) If incurred in trade, profession or business;

(b) Of property connected with the trade, business or profession, if the loss arises from fires, storms, shipwreck, or other casualties, or from robbery, theft or embezzlement.

The Secretary of Finance, upon recommendation of the Commissioner, is hereby authorized to promulgate rules and regulations prescribing, among other things, the time and manner by which the taxpayer shall submit a declaration of loss sustained from casualty or from robbery, theft or embezzlement during the taxable year: Provided, however, That the time limit to be so prescribed in the rules and regulations shall not be less than thirty (30) days nor more than ninety (90) days from the date of discovery of the casualty or robbery, theft or embezzlement giving rise to the loss.

(c) No loss shall be allowed as a deduction under this Subsection if at the time of the filing of the return, such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

(2) Proof of Loss. - In the case of a nonresident alien individual or foreign corporation, the losses deductible shall be those actually sustained during the year incurred in business, trade or exercise of a profession conducted within the Philippines, when such losses are not compensated for by insurance or other forms of indemnity. The Secretary of Finance, upon recommendation of the Commissioner, is hereby authorized to promulgate rules and regulations prescribing, among other things, the time and manner by which the taxpayer shall submit a declaration of loss sustained from casualty or from robbery, theft or embezzlement during the taxable year: Provided, That the time to be so prescribed in the rules and regulations shall not be less than thirty (30) days nor more than ninety (90) days from the date of discovery of the casualty or robbery, theft or embezzlement giving rise to the loss; and

Requisites for deductibility
1. Loss must be that of the taxpayer. The loss is personal to the taxpayer and is not transferable or usable by another.
2. Actually sustained and charged off within the taxable year.
3. Evidenced by a closed and completed transaction
4. Not claimed as deduction for estate tax purposes
5. If individual, must be connected to his profession, trade or business; or entered into for profit though not connected with his trade or business.

**Baniqued: The loss must be connected with the pursuit of business. And must be sustained during the taxable year. The loss must arise from*
1. Fires
2. Storms
3. Shipwreck
4, casualties

5. Robbery
6. Theft
7. Embezzlement

Note that if you are indemnified, then you cannot claim the loss.

What if you deduct it already then you are indemnified? Then recovery of deducted items applies.

Suppose you are an entrepreneur of a restaurant, your customer then eats a staple wire! Dinemanda ka. Nag settle ka. Can you claim the settlement as deduction from gross income? YES! This is negligence of the employee. Other situations are covered by the losses provision like product liability and negligence of employees.

If there is a pending case, then you settle, is that a closed and completed transaction already?

*Fernandez Hermanos vs CIR – Taxpayer claimed losses from worthless shares of stock. BIR says why did you take the deduction immediately when you still have assets, hence this is not yet a closed and completed transaction. SC says however that the taxpayer had adequate basis to claim the loss, because the company was already insolvent. Technically, the securities are worthless because of the insolvency of the taxpayer company. Writing off the loss was proper.

(3) Net Operating Loss Carry-Over. – The:
(1) net operating loss of the business or enterprise for
(2) any taxable year immediately preceding the current taxable year,
(3) which had not been previously offset as deduction from gross income
shall be carried over as a deduction from gross income for the next three (3) consecutive taxable years immediately following the year of such loss:

Provided, however, That any net loss incurred in a taxable year during which the taxpayer was exempt from income tax shall not be allowed as a deduction under this Subsection:

Provided, further, That a net operating loss carry-over shall be allowed only if there has been no substantial change in the ownership of the business or enterprise in that -

(i) Not less than seventy-five percent (75%) in nominal value of outstanding issued shares., if the business is in the name of a corporation, is held by or on behalf of the same persons; or

(ii) Not less than seventy-five percent (75%) of the paid up capital of the corporation, if the business is in the name of a corporation, is held by or on behalf of the same persons.

For purposes of this subsection, the term "not operating loss" shall mean the excess of allowable deduction over gross income of the business in a taxable year.

Provided, That for mines other than oil and gas wells, a net operating loss without the benefit of incentives provided for under Executive Order No. 226, as amended, otherwise known as the Omnibus Investments Code of 1987, incurred in any of the first ten (10) years of operation may be carried over as a deduction from taxable income for the next five (5) years immediately following the year of such loss. The entire amount of the loss shall be carried over to the first of the five (5) taxable years following the loss, and any portion of such loss which exceeds, the taxable income of such first year shall be deducted in like manner form the taxable income of the next remaining four (4) years.

Net operating loss shall mean the excess of allowable deduction over gross income of the business in a taxable year.

REQUISITES for NOLCO:

1. The taxpayer was not exempt from income tax the year the loss was incurred;
2. There has been no substantial change in the ownership of the business or enterprise wherein:
a. AT LEAST 75% of nominal value of outstanding issued shares is held by or on behalf of the same persons; or
b. AT LEAST 75% of the paid up capital of the corporation is held by or on behalf of the same persons.

A taxpayer who claims the 40% OSD shall not simultaneously claim deduction of the NOLCO. 3 year reglementary period continues to run notwithstanding the fact that the aforesaid taxpayer availed of OSD.

Domestic and foreign corporations taxed during the taxable year with MCIT cannot enjoy the NOLCO. Nevertheless, the 3 year reglementary period still continues to run.

NOLCO cannot be deducted in against compensation income (EE-ER relationship)

Taxpayers entitled to NOLCO
1. Individuals engaged in trade or business or in the exercise of his profession.
2. Domestic and resident foreign corporations subject to normal income tax
3. Special corporations subject to preferential tax

Entities not allowed NOLCO
1. Offshore banking units of a foreign banking corporation

2. Enterprise registered with the Board of investments enjoying Income tax holiday
3. Enterprise registered with PEZA
4. Enterprise registered with BCDA
5. Enterprises engaged in international shipping or air carriage.

*PICOP vs. CA: introduced the carry-over of net operating losses as a very special incentive to be granted only to registered pioneer enterprises and only with respect to their registered operations. The statutory purpose here may be seen to be the encouragement of the establishment and continued operation of pioneer industries by allowing the registered enterprise to accumulate its operating losses which may be expected during the early years of the enterprise and to permit the enterprise to offset such losses against income earned by it in later years after successful establishment and regular operations. To promote its economic development goals, the Republic foregoes or defers taxing the income of the pioneer enterprise until after that enterprise has recovered or offset its earlier losses. We consider that the statutory purpose can be served only if the accumulated operating losses are carried over and charged off against income subsequently earned and accumulated by the same enterprise engaged in the same registered operations.

We do not believe that that single purely technical factor is enough to authorize and justify the deduction claimed by Picop. Picop's claim for deduction is not only bereft of statutory basis; it does violence to the legislative intent which animates the tax incentive granted by Section 7 (c) of R.A. No. 5186. In granting the extraordinary privilege and incentive of a net operating loss carry-over to BOI-registered pioneer enterprises, the legislature could not have intended to require the Republic to forego tax revenues in order to benefit a corporation which had run no risks and suffered no losses, but had merely purchased another's losses.

**Baniqued: 2009, you have a loss of 500, 2010 loss of 1,000, 2011 you have net income, what loss can you apply in year 2011? Do you use up first 2009 or 2010? Logic dictates that the earliest one is the one you use to reduce the net income. You only have 3 years. NOLCO forfeited after 3 years, can you claim that as a loss? NO.*

NOCLO v. MCIT

MCIT is paid because it is bigger than the regular tax due. So hindi nagagamit ang NOLCO. Again, the 3 year bar is inflexible. It does not toll the 3 years.

A sells 50% of his 75% to Y. Y becomes 50% A becomes 25%. Can the corporation claim the NOLCO in its books? NOLCO is still allowable notwithstanding the change of ownership.

What if X corporation merges with Y, what happens to the NOLCO? As a result of the merger all the assets and liabilities of X (A and B has 25% and 75%) are transferred to Y (C owns 50% A and B 25%). Can Y claim the NOLCO? NO. Because the NOLCO will be

disallowed where the company that owns the NOLCO merges or consolidates with another company.

But where the NOLCO remains with it, it can claim deduction. In the latter case, the NOLCO transfers to Y. Y is barred from claiming the NOLCO, because the previous owners who own 75% became 50% nalang. But if the ownership interest of the previous owners do not decrease below 75% it is still allowable.

You will not be able to use the NOLCO if the NOLCO transfers to another entity.

If X(5M NOLCO) merges with Y(profitable entity). Prohibition applies. What if Y got absorbed by X? The profitable entity is the one that is absorbed? Then the prohibition does not kick in. If the NOLCO stays with the entity that generated it, then the NOLCO stays.

Rationale: To prevent corporations from targeting companies with large amounts of NOLCO.

(4) Capital Losses. (a) Limitation. - Loss from sales or Exchanges of capital assets shall be allowed only to the extent provided in Section 39.

(b) Securities Becoming Worthless. - If securities as defined in Section 22 (T) become worthless during the taxable year and are capital assets, the loss resulting therefrom shall, for purposes of this Title, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

Sec. 22(T) The term "securities" means shares of stock in a corporation and rights to subscribe for or to receive such shares. The term includes bonds, debentures, notes or certificates, or other evidence or indebtedness, issued by any corporation, including those issued by a government or political subdivision thereof, with interest coupons or in registered form

(5) Losses From Wash Sales of Stock or Securities. - Losses from 'wash sales' of stock or securities as provided in Section 38.

(6) Wagering Losses. - Losses from wagering transactions shall b allowed only to the extent of the gains from such transactions.

(7) Abandonment Losses. –(a) In the event a contract area where petroleum operations are undertaken is partially or wholly abandoned, all accumulated exploration and development expenditures pertaining thereto shall be allowed as a deduction: Provided, That accumulated expenditures incurred in that area prior to January 1, 1979 shall be allowed as a deduction only from any income derived from the same contract area. In all cases, notices of abandonment shall be filed with the Commissioner.

(b) In case a producing well is subsequently abandoned, the unamortized costs thereof, as well as the undepreciated costs of equipment directly used therein , shall be allowed as a deduction in the year such well, equipment or facility is abandoned by the contractor: Provided, That if such abandoned well is reentered and production is resumed, or if such equipment or facility is restored into service, the said costs shall be included as part of gross income in the year of resumption or restoration and shall be amortized or depreciated, as the case may be.

E. Bad Debts

Sec. 34(E)(1) In General. -
(1)Debts due to the taxpayer
(2)actually ascertained to be worthless and
(3)charged off within the taxable year
except those:
1. not connected with profession, trade or business and
2. those sustained in a transaction entered into between parties mentioned under Section 36 (B) of this Code:

Provided, That recovery of bad debts previously allowed as deduction in the preceding years shall be included as part of the gross income in the year of recovery to the extent of the income tax benefit of said deduction.

(2) Securities Becoming Worthless. - If securities, as defined in Section 22 (T), are ascertained to be:
1. worthless and
2. charged off within the taxable year and
3. are capital assets,

the loss resulting therefrom shall, in the case of a taxpayer other than a bank or trust company incorporated under the laws of the Philippines a substantial part of whose business is the receipt of deposits, for the purpose of this Title, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

Charged off: Phrase means that the amount of money lent by the taxpayer to his debtor had been recorded in his books of account as a receivable has actually become worthless as of the end of the taxable year.

1. Indebtedness due to the taxpayer which is valid and legally demandable;
2. Debt is connected with the taxpayer's trade, business or practice of profession;
3. Debt was not sustained in a transaction entered into between related parties;

4. Actually charged off in the books of accounts of the taxpayer as of the end of the taxable year; and
5. Actually ascertained to be worthless and uncollectible as of the end of the taxable year

"Actually ascertained to be worthless" is not measured by an inflexible formula but by the exercise of sound business judgment. It depends upon the particular facts and the circumstances of the case and the proof of two facts:

1.)Taxpayer had reasonably investigated the relevant facts and had drawn a reasonable inference that the debt is uncollectible;
AND
2.)Good faith. The taxpayer may strike a middle course between pessimism and optimism in determining debts to be worthless. He need not have perfect discernment.

The flight, disappearance, insolvency, or death of the debtor with insufficient properties to pay creditors, may indicate worthlessness of the debt.

A creditor cannot deduct the debt of an insolvent debtor unless all efforts have been exhausted to collect from any solvent guarantor or surety of such debtor.

Non deductible bad debts
1. Bad debts not connected with the profession, trade or business
2. Worthless debts arising from unpaid wages, salaries, rents and similar items of taxable income
3. Bad debts contracted between related taxpayers or members of the family

*Collector vs. Goodrich: You must have collection letters, and you must file a collection case in court in order for the debt to be ascertained to be worthless. Problem is that the BIR requires the taxpayer go into motion of filing a collection case.

*Philex Mining vs. CIR: F: Baguio Gold is the project. Philex was the contractor to operate the mine. If the project is profitable, then they have 50-50 with the profits. The 50% is the compensation of Philex as operator of the mine, like a contract for services to Philex. What happened was the mine did not earn money. Philex said, what about the advance I made, how will you pay? So Baguio Gold made a dacion. There was still a balance. Philex ascertained the unpaid advances as bad debt. BIR says it was a joint venture arrangement, hence it was not a debt but an investment

In a debt there is interest. In equity there is a share in investment. With debt it is deductible in gross income. In equity, dividend payment is not deductible. In equity, the loss of that equity is a capital loss, a loss of investment.

This is a very important case since it distinguishes a joint venture from one that is not. If there is a joint venture, there is no debt. Hence it was an investment or equity.

*Phil Refining Co. vs. CA: The contentions of PRC that nobody is in a better position to determine when an obligation becomes a bad debt than the creditor itself, and that its judgment should not be substituted by that of respondent court as it is PRC which has the facilities in ascertaining the collectibility or uncollectibility of these debts, are presumptuous and uncalled for. The Court of Tax Appeals is a highly specialized body specifically created for the purpose of reviewing tax cases. Through its expertise, it is undeniably competent to determine the issue of whether or not the debt is deductible through the evidence presented before it

F. Cost Recovery: Depreciation and Amortization

Sec. 34(F)(1) There shall be allowed as a depreciation deduction a reasonable allowance for:
1. the exhaustion, wear and tear (including reasonable allowance for obsolescence)
2. of property used in the trade or business.

In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant.

In the case of property held in trust, the allowable deduction shall be apportioned between the income beneficiaries and the trustees in accordance with the pertinent provisions of the instrument creating the trust, or in the absence of such provisions, on the basis of the trust income allowable to each.

(2) Use of Certain Methods and Rates. - The term "reasonable allowance" as used in the preceding paragraph shall include, but not limited to, an allowance computed in accordance with rules and regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner, under any of the following methods:

(a) The straight-line method;
(b) Declining-balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in Subsection (F) (1);
(c) The sum-of-the-years-digit method; and
(d) any other method which may be prescribed by the Secretary of Finance upon

recommendation of the Commissioner.

(3) Agreement as to Useful Life on Which Depreciation Rate is Based. - Where under rules and regulations prescribed by the Secretary of Finance upon recommendation of the Commissioner, the taxpayer and the Commissioner have:
1. entered into an agreement in writing
2. specifically dealing with the useful life and rate of depreciation of any property, the rate so agreed upon shall be binding on both the taxpayer and the national Government in the absence of facts and circumstances not taken into consideration during the adoption of such agreement.

The responsibility of establishing the existence of such facts and circumstances shall rest with the party initiating the modification. Any change in the agreed rate and useful life of the depreciable property as specified in the agreement shall not be effective for taxable years prior to the taxable year in which notice in writing by certified mail or registered mail is served by the party initiating such change to the other party to the agreement:

Provided, however, that where the taxpayer has adopted such useful life and depreciation rate for any depreciable and claimed the depreciation expenses as deduction from his gross income, without any written objection on the part of the Commissioner or his duly authorized representatives, the aforesaid useful life and depreciation rate so adopted by the taxpayer for the aforesaid depreciable asset shall be considered binding for purposes of this Subsection.

(4) Depreciation of Properties Used in Petroleum Operations. - An allowance for depreciation in respect of all properties directly related to production of petroleum initially placed in service in a taxable year shall be allowed under the straight-line or declining-balance method of depreciation at the option of the service contractor.

However, if the service contractor initially elects the declining-balance method, it may at any subsequent date, shift to the straight-line method.

The useful life of properties used in or related to production of petroleum shall be ten (10) years of such shorter life as may be permitted by the Commissioner.

Properties not used directly in the production of petroleum shall be depreciated under the straight-line method on the basis of an estimated useful life of five (5) years.

(5) Depreciation of Properties Used in Mining Operations. - an allowance for depreciation in respect of all properties used in mining operations other than petroleum operations, shall be computed as follows:

(a) At the normal rate of depreciation if the expected life is ten (10) years or less; or
(b) Depreciated over any number of years between five (5) years and the expected life if the latter is more than ten (10) years, and the depreciation thereon allowed as deduction from taxable income: Provided, That the contractor notifies the Commissioner at the beginning of the depreciation period which depreciation rate allowed by this Section will be used.

(6) Depreciation Deductible by Nonresident Aliens Engaged in Trade or Business or Resident Foreign Corporations. - In the case of a nonresident alien individual engaged in trade or business or resident foreign corporation, a reasonable allowance for the deterioration of Property arising out of its use or employment or its non-use in the business trade or profession shall be permitted only when such property is located in the Philippines.

Definition: The gradual diminution of the useful value of tangible property resulting from wear and tear and normal obsolescence. The deduction is to allow taxpayers to recover the acquisition cost of the property used in the practice of profession, business or trade.

The term is also applied to amortization of the value of intangible assets (i.e., patents), the use of which in the trade or business is definitely limited in duration.

Requisites for Deductibility (Depreciation):

1. Must be for property used in the TRADE or business, or those not being used temporarily during the year with
2. A limited USEFUL life.
3. Allowance must be REASONABLE.
4. CHARGED off during the taxable year from the taxpayer's books of accounts.
5. Not EXCEED the cost of the property.

Determining Useful Life
General Rule: the estimated useful life is determined by the taxpayer himself. **Exception:** Where the taxpayer and the Commissioner have entered into an agreement in writing specifically dealing with the useful life and rate of depreciation of any property

*Mamalateo: The necessity for a depreciation allowance arise from the fact that certain property used in the business gradually approaches a point where its usefulness is

exhausted. In the case of tangible property, it applies to that which is subject to wear and tear. The period of depreciation starts when the asset is placed in service.

Intangibles, the use of which in trade or business is definitely limited in duration, may be the subject of a depereciation allowance. (patents, copyrights, franchises.) If not so limited, will not be a proper subject of allowance

If the property is used in business and for personal purposes, depreciation expense must be pro-rated to include only the portion attributable to business use as deductible.

The person who sustains an economic loss from the decrease in property value due to depreciation gets the deduction. Ordinarily, this is the person who owns and has a capital investment in the property.
The period of depreciation starts when the asset is placed in service. It ends when the asset is disposed of, or its usefulness exhausted.
**Baniqued: Who determines the estimated useful life? What we follow actually is BULLETIN F.*

STRAIGHT LINE *= Cost / Estimated Life (Simplest method) → 100 / 5 = 20/year*
DECLINING BALANCE *= Your depreciation allowance is much bigger in the earlier years.*

1st year = P40 – P40
2nd year = 40% x [P100-40] = P24
3rd year = 40% x [P100-40-24] = 14.40

SUM OF THE YEARS DIGITS METHOD

5+4+3+2+1 = 15

5/15 x 100 = P33.33
4/15 x 100 = P26.67

*Consolidated Mines vs. CA: The initial memorandum of the BIR examiner assigned to verify the income tax liabilities of the Company pursuant to the latter's claim of having overpaid its income taxes states the basic reason why the Company's claimed depreciation should be disallowed or re-adjusted, thus: since "..., up to its completion (the incomplete asset) has not been and is not capable of use in the operation, the depreciation claimed could not, in fairness to the Government and the taxpayer, be considered as proper deduction for income tax purposes as the said asset is still under construction

*Basilan Estates vs. CIR: Depreciation commences with the acquisition of the property and its owner is not bound to see his property gradually waste, without making provision out of earnings for its replacement. It is entitled to see that from earnings the value of the

property invested is kept unimpaired, so that at the end of any given term of years, the original investment remains as it was in the beginning. It is not only the right of a company to make such a provision, but it is its duty to its bond and stockholders, and, in the case of a public service corporation, at least, its plain duty to the public. Accordingly, the law permits the taxpayer to recover gradually his capital investment in wasting assets free from income tax. Moreover, the recovery, free of income tax, of an amount more than the invested capital in an asset will transgress the underlying purpose of a depreciation allowance. For then what the taxpayer would recover will be, not only the acquisition cost, but also some profit. Recovery in due time thru depreciation of investment made is the philosophy behind depreciation allowance; the idea of profit on the investment made has never been the underlying reason for the allowance of a deduction for depreciation.

Accordingly, the claim for depreciation beyond P36,842.04 or in the amount of P10,500.49 has no justification in the law.

Limpan vs. CIR: On the third assigned error, suffice it to state that this Court has already held that "depreciation is a question of fact and is not measured by theoretical yardstick, but should be determined by a consideration of actual facts", and the findings of the Tax Court in this respect should not be disturbed when not shown to be arbitrary or in abuse of discretion

G. Depletion

Sec. 34(G) Depletion of Oil and Gas Wells and Mines. -

(1) In General. - In the case of oil and gas wells or mines, a reasonable allowance for depletion or amortization computed in accordance with the cost-depletion method shall be granted under rules and regulations to be prescribed by the Secretary of finance, upon recommendation of the Commissioner.

Provided, That when the allowance for depletion shall equal the capital invested no further allowance shall be granted:

Provided, further, That after production in commercial quantities has commenced, certain intangible exploration and development drilling costs:
(a) shall be deductible in the year incurred if such expenditures are incurred for non-producing wells and/or mines, or
(b) shall be deductible in full in the year paid or incurred or at the election of the taxpayer, may be capitalized and amortized if such expenditures incurred are for producing wells and/or mines in the same contract area.

"Intangible costs in petroleum operations" refers to any cost incurred in petroleum operations which in itself has no salvage value and which is incidental to and necessary for the drilling of wells and preparation of wells for the production of petroleum: Provided, That said costs shall not pertain to the acquisition or improvement of property of a character subject to the allowance for depreciation except that the allowances for depreciation on such property shall be deductible under this Subsection.

Any intangible exploration, drilling and development expenses allowed as a deduction in computing taxable income during the year shall not be taken into consideration in computing the adjusted cost basis for the purpose of computing allowable cost depletion.

(2) Election to Deduct Exploration and Development Expenditures. - In computing taxable income from mining operations, the taxpayer may at his option, deduct exploration and development expenditures accumulated as cost or adjusted basis for cost depletion as of date of prospecting, as well as exploration and development expenditures paid or incurred during the taxable year:

Provided, That the amount deductible for exploration and development expenditures shall not exceed twenty-five percent (25%) of the net income from mining operations computed without the benefit of any tax incentives under existing laws.

The actual exploration and development expenditures minus twenty-five percent (25%) of the net income from mining shall be carried forward to the succeeding years until fully deducted.

The election by the taxpayer to deduct the exploration and development expenditures is irrevocable and shall be binding in succeeding taxable years.

"Net income from mining operations", as used in this Subsection, shall mean gross income from operations less "allowable deductions" which are necessary or related to mining operations. "Allowable deductions" shall include mining, milling and marketing expenses, and depreciation of properties directly used in the mining operations. This paragraph shall not apply to expenditures for the acquisition or improvement of property of a character which is subject to the allowance for depreciation.

In no case shall this paragraph apply with respect to amounts paid or incurred for the exploration and development of oil and gas.

The term "exploration expenditures" means expenditures paid or incurred for the purpose of ascertaining the existence, location, extent or quality of any deposit of ore or other mineral, and paid or incurred before the beginning of the development stage of the mine or deposit.

The term "development expenditures" means expenditures paid or incurred during the development stage of the mine or other natural deposits. The development stage of a mine or other natural deposit shall begin at the time when deposits of ore or other minerals are shown to exist in sufficient commercial quantity and quality and shall end upon commencement of actual commercial extraction.

(3) Depletion of Oil and Gas Wells and Mines Deductible by a Nonresident Alien individual or Foreign Corporation. - In the case of a nonresident alien individual engaged in trade or business in the Philippines or a resident foreign corporation, allowance for depletion of oil and gas wells or mines under paragraph (1) of this Subsection shall be authorized only in respect to oil and gas wells or mines located within the Philippines.

H. Charitable and Other Contributions

Sec. 34(H) Charitable and Other Contributions. -(1) In General. –
Contributions or gifts actually paid or made within the taxable year to, or for the use of:
1. the Government of the Philippines or any of its agencies or any political subdivision thereof exclusively for public purposes, or
2. to accredited domestic corporation or associations organized and operated exclusively for religious, charitable, scientific, youth and sports development, cultural or educational purposes or
3. for the rehabilitation of veterans, or
4. to social welfare institutions, or
5. to non-government organizations, in accordance with rules and regulations promulgated by the Secretary of finance, upon recommendation of the Commissioner,

no part of the net income of which inures to the benefit of any private stockholder or individual in an amount not in excess of ten percent (10%) in the case of an individual, and five percent (5%) in the case of a corporation, of the taxpayer's taxable income derived from trade, business or profession as computed without the benefit of this and the following subparagraphs.

(2) Contributions Deductible in Full. - Notwithstanding the provisions of the preceding subparagraph, donations to the following institutions or entities shall be deductible in full;

(a) Donations to the Government. - Donations to:
1. the Government of the Philippines or to any of its agencies or political subdivisions, including fully-owned government corporations,
2. exclusively to finance, to provide for, or to be used in undertaking priority activities in education, health, youth and sports development, human settlements, science and

culture, and in economic development according to a National Priority Plan determined by the National Economic and Development Authority (NEDA), In consultation with appropriate government agencies, including its regional development councils and private philantrophic persons and institutions:

Provided, That any donation which is made to the Government or to any of its agencies or political subdivisions not in accordance with the said annual priority plan shall be subject to the limitations prescribed in paragraph (1) of this Subsection;

(b) Donations to Certain Foreign Institutions or International Organizations. - donations to foreign institutions or international organizations which are fully deductible in pursuance of or in compliance with agreements, treaties, or commitments entered into by the Government of the Philippines and the foreign institutions or international organizations or in pursuance of special laws;

(c) Donations to Accredited Nongovernment Organizations. - the term 'nongovernment organization' means a non profit domestic corporation:

(1) Organized and operated exclusively for scientific, research, educational, character-building and youth and sports development, health, social welfare, cultural or charitable purposes, or a combination thereof, no part of the net income of which inures to the benefit of any private individual;

(2) Which, not later than the 15th day of the third month after the close of the accredited nongovernment organizations taxable year in which contributions are received, makes utilization directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated, unless an extended period is granted by the Secretary of Finance in accordance with the rules and regulations to be promulgated, upon recommendation of the Commissioner;

(3) The level of administrative expense of which shall, on an annual basis, conform with the rules and regulations to be prescribed by the Secretary of Finance, upon recommendation of the Commissioner, but in no case to exceed thirty percent (30%) of the total expenses; and

(4) The assets of which, in the even of dissolution, would be distributed to another nonprofit domestic corporation organized for similar purpose or purposes, or to the state for public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of said court shall best accomplish the general purpose for which the dissolved organization was organized.

Subject to such terms and conditions as may be prescribed by the Secretary of Finance, the term 'utilization' means:

(i) Any amount in cash or in kind (including administrative expenses) paid or utilized to accomplish one or more purposes for which the accredited nongovernment organization was created or organized.

(ii) Any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes for which the accredited nongovernment organization was created or organized.

An amount set aside for a specific project which comes within one or more purposes of the accredited nongovernment organization may be treated as a utilization, but only if at the time such amount is set aside, the accredited nongovernment organization has established to the satisfaction of the Commissioner that the amount will be paid for the specific project within a period to be prescribed in rules and regulations to be promulgated by the Secretary of Finance, upon recommendation of the Commissioner, but not to exceed five (5) years, and the project is one which can be better accomplished by setting aside such amount than by immediate payment of funds.

(3) Valuation. - The amount of any charitable contribution of property other than money shall be based on the acquisition cost of said property.

(4) Proof of Deductions. - Contributions or gifts shall be allowable as deductions only if verified under the rules and regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner.

**Baniqued: How do you qualify as an NGO? Philippine Council of NGO Certification. It will not register you unless you have a track record of 3 years.*

Is it enough that you give the donation to the NGO? Or are there other requirements? The bulk of the funds must be used for its projects other than administrative expenses.

Note that it can be in cash or in property. You deduct the amount of the case. If its in property, how much would you deduct? If you donated a land to the NGO! Is it FMV or the acquisition cost. IT'S THE COST of the property! So its quite unfair. If you donated a highly appreciated property, lugi ka.

Charitable Contributions to government or foreign organization are fully deductible. Yung iba 5% 10%

UTILIZATION definition, take a look at it. This does not require that the entire amount be fully disbursed on the 15th day of the 3rd month.

I. Research and Development Expenditures

Sec. 34(I) Research and Development.- (1) In General. - a taxpayer may treat:
1. research or development expenditures
2. which are paid or incurred by him during the taxable year
3. in connection with his trade, business or profession as ordinary and necessary expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as deduction during the taxable year when paid or incurred.

(2) Amortization of Certain Research and Development Expenditures. - At the election of the taxpayer and in accordance with the rules and regulations to be prescribed by the Secretary of Finance, upon recommendation of the Commissioner, the following research and development expenditures may be treated as deferred expenses:

(a) Paid or incurred by the taxpayer in connection with his trade, business or profession;
(b) Not treated as expenses under paragraph (1) hereof; and
(c) Chargeable to capital account but not chargeable to property of a character which is subject to depreciation or depletion.

In computing taxable income, such deferred expenses shall be allowed as deduction ratably distributed over a period of not less than sixty (60) months as may be elected by the taxpayer (beginning with the month in which the taxpayer first realizes benefits from such expenditures).

The election provided by paragraph (2) hereof may be made for any taxable year beginning after the effectivity of this Code, but only if made not later than the time prescribed by law for filing the return for such taxable year. The method so elected, and the period selected by the taxpayer, shall be adhered to in computing taxable income for the taxable year for which the election is made and for all subsequent taxable years unless with the approval of the Commissioner, a change to a different method is authorized with respect to a part or all of such expenditures. The election shall not apply to any expenditure paid or incurred during any taxable year for which the taxpayer makes the election.

(3) Limitations on Deduction. - This Subsection shall not apply to:

(a) Any expenditure for the acquisition or improvement of land, or for the improvement of property to be used in connection with research and development of a character which is subject to depreciation and depletion; and

(b) Any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral, including oil or gas.

**Baniqued: Although in the nature of capital expenditures, they can be deducted outright! But the taxpayer has the option to capitalize it still. If the expenditure is for the improvement of land or the building for the research, there is no outright deduction.*

J. Contributions to Employee's Pension Trusts

Sec. 34(J) Pension Trusts. - An employer establishing or maintaining a pension trust to provide for the payment of reasonable pensions to his employees shall be allowed as a deduction (in addition to the contributions to such trust during the taxable year to cover the pension liability accruing during the year, allowed as a deduction under Subsection (A) (1) of this Section) a reasonable amount transferred or paid into such trust during the taxable year in excess of such contributions, but only if such amount:
(1) has not theretofore been allowed as a deduction, and
(2) is apportioned in equal parts over a period of ten (10) consecutive years beginning with the year in which the transfer or payment is made.

A pension plan comprises a fund intended to provide retirement benefits to the employees. It is usually set up after some years of operations when the employer can already provide benefits to employees.

An employer is allowed to deduct from business gross income contributions or payments made to pension trust in accordance with a reasonable private benefit plan

A. This Pertains to PAST SERVICE COST, or the *amount* so transferred is apportioned and deductible in equal parts over a period of ten (10) consecutive years beginning with the year in which the transfer or payment is made.

B. Present service cost is deductible in full in the year transferred or paid into the trust; and is considered as an ordinary and necessary expense under Sec. 34(A)(1).

**Baniqued: Whatever the employer contributes to that pension fund or retirement plan to cover the liabilities for the employees.*

What if you didn't have any retirement plan for 15 years of business. So wala kang dinededuct na contribution. So suddenly you put up a retirement plan for them. You try to cover the years you didn't contribute? NO. That contribution is in the nature of a contribution of a PAST SERVICE LIABILITY. It must be spread out over a period of 10 years. Contribution to cover present liability is FULLY deductible. But past service liability is not deductible outright.

What if after so many years you found out that your fund is over funded. Pwede bang isoli? Yes. As long as the remaining fund is sufficient to cover present liability.

K. Premium Payments on Health / Hospitalization Insurance

Sec. 34(M) ***Premium Payments on Health and/or Hospitalization Insurance of an Individual Taxpayer***. - The amount of premiums not to exceed:
(1) Two thousand four hundred pesos (P2,400) per family or
(2) Two hundred pesos (P200) a month paid during the taxable year for
(3) health and/or hospitalization insurance taken by the taxpayer for himself, including his family,

shall be allowed as a deduction from his gross income:

Provided, That said family has a gross income of not more than Two hundred fifty thousand pesos (P250,000) for the taxable year:

Provided, finally, That in the case of married taxpayers, only the spouse claiming the additional exemption for dependents shall be entitled to this deduction.

Notwithstanding the provision of the preceding Subsections, The Secretary of Finance, upon recommendation of the Commissioner, after a public hearing shall have been held for this purpose, may prescribe by rules and regulations, limitations or ceilings for any of the itemized deductions under Subsections (A) to (J) of this Section:

Provided, That for purposes of determining such ceilings or limitations, the Secretary of Finance shall consider the following factors: (1) adequacy of the prescribed limits on the actual expenditure requirements of each particular industry; and (2) effects of inflation on expenditure levels: *Provided, further,* That no ceilings shall further be imposed on items of expense already subject to ceilings under present law.

L. Substantiation of Deductions

Sec. 34(A)(b) ***Substantiation Requirements*****.** - No deduction from gross income shall be allowed under Subsection (A) hereof unless:
the taxpayer shall substantiate with sufficient evidence, such as official receipts or other adequate records:
(i) the amount of the expense being deducted, and
(ii) the direct connection or relation of the expense being deducted to the development, management, operation and/or conduct of the trade, business or profession of the taxpayer.

*M.E Holding Corporation vs. CA: The CA surely cannot be guilty of gravely abusing its discretion when it refused to consider, in lieu of the unsubmitted additional cash slips, the special record books which are only secondary evidence. The cash slips were the best evidence.

M. Optional Standard Deduction

Sec. 34(L) Optional Standard Deduction—In lieu of the deductions allowed under the preceding Subsection, an individual subject to tax under Section 24, other than a non-resident alien may elect a standard deduction in an amount not exceeding forty percent (40%) of his gross sales or gross receipts, as the case may be.

In the case of a corporation subject to tax under Sec. 27(A) and 28(A)(1), it may elect a standard deduction in an amount not exceeding (40%) of its gross income as defined in Section 32.

Unless the taxpayer signifies in his return his intention to elect the optional standard deduction, he shall be considered as having availed himself of the deductions allowed in the preceding subsections. Such election when made in the return shall be irrevocable for the taxable year for which the return was made.

Provided that an individual who is entitled to and claimed for the optional standard shall not be required to submit with his tax return such financial statements otherwise required under this code.

Provided further that except when the Commissioner otherwise permits, the said individual shall keep such records pertaining to his gross sales or gross receipts, or the said corporation shall keep such records pertaining to his gross income during the taxable year, as may be required by the rules and regulations promulgated by the Secretary of Finance upon recommendation of the Commissioner.

Privilege is NOT available to non-resident aliens and non-resident foreign corporations

*Baniqued: 40% of gross sales and receipts.
Corporation 40% of its gross INCOME.
Individual 40% of its gross SALES or gross receipts.

Why is there a difference in treatment? Sir doesn't know

N. Personal Exemption for Individuals

SEC. 35. Allowance of Personal Exemption for Individual Taxpayer. -
(A) In General. - For purposes of determining the tax provided in Section 24 (A) of this Title, there shall be allowed a basic personal exemption as follows amounting to 50,000 pesos for each individual taxpayer.

In the case of married individual where only one of the spouses is deriving gross income, only such spouse shall be allowed the personal exemption

For purposes of this paragraph, the term 'head of family' means:
1. an unmarried or legally separated man or woman with one or both parents, or with one or more brothers or sisters, or with one or more legitimate, recognized natural or legally adopted children
2. living with and dependent upon him for their chief support,
3. where such brothers or sisters or children are not more than twenty-one (21) years of age, unmarried and not gainfully employed or where such children, brothers or sisters, regardless of age are incapable of self-support because of mental or physical defect.

(B) Additional Exemption for Dependents. - There shall be allowed an additional exemption of Eight thousand pesos P25,000 for each dependent not exceeding four (4).

The additional exemption for dependent shall be claimed by only one of the spouses in the case of married individuals.

In the case of legally separated spouses, additional exemptions may be claimed only by the spouse who has custody of the child or children: Provided, That the total amount of additional exemptions that may be claimed by both shall not exceed the maximum additional exemptions herein allowed.

For purposes of this Subsection, a "dependent" means:
(1) a legitimate, illegitimate or legally adopted child
(2) chiefly dependent upon and living with the taxpayer
(3) if such dependent is not more than twenty-one (21) years of age, (4) unmarried and (5) not gainfully employed OR

if such dependent, regardless of age, is incapable of self-support because of mental or physical defect.

(C) Change of Status. - If the taxpayer:
(1) marries or
(2) should have additional dependent(s) as defined above during the taxable year,
the taxpayer may claim the corresponding additional exemption, as the case may be, in full for such year.

If the taxpayer dies during the taxable year, his estate may still claim the personal and additional exemptions for himself and his dependent(s) as if he died at the close of such year.

If the spouse or any of the dependents dies or if any of such dependents marries, becomes twenty-one (21) years old or becomes gainfully employed during the taxable year, the taxpayer may still claim the same exemptions as if the spouse or any of the dependents died, or as if such dependents married, became twenty-one (21) years old or became gainfully employed at the close of such year.

(D) Personal Exemption Allowable to Nonresident Alien Individual. - A nonresident alien individual engaged in trade, business or in the exercise of a profession in the Philippines shall be entitled to a personal exemption in the amount:

(1) equal to the exemptions allowed in the income tax law in the country of which he is a subject - or citizen,
(2) to citizens of the Philippines not residing in such country,
(3) not to exceed the amount fixed in this Section as exemption for citizens or resident of the Philippines:

Provided, That said nonresident alien should file a true and accurate return of the total income received by him from all sources in the Philippines, as required by this Title.

Exemptions are fixed at arbitrary amounts intended to substitute for personal and living expenses. They are roughly the equivalent of the taxpayer's minimum subsistence and those of his dependents. These deductions are allowed on the theory that the minimum requirements of subsistence of a taxpayer should be free from tax.

Who may claim personal exemptions?
1. Citizens (whether resident or non-resident) and resident aliens are allowed to avail of basic personal and additional exemptions.

2. Non-resident aliens engaged in trade or business are entitled to basic personal exemptions only by way of reciprocity, but not to additional exemptions. [Sec. 35, NIRC]

Limit of BPE Allowed to NRAETB: An amount equal to the exemptions allowed by the non-resident alien's country to Filipino citizens not residing therein but deriving income therefrom, but not to exceed the amount fixed by NIRC.[In other words, whichever is LOWER]

Taxpayers not allowed for Personal Exemption
1. NRA engaged in trade or business without reciprocity clause
2. NRA not engaged in trade or business
3. Corporations
4. Partnerships

Taxpayers entitled to additional exemptions (children qualified as dependents)
1. Resident or non-resident citizens
2. Resident aliens, provided that the qualified dependent children are living with him in the Philippines.

Rules in Claiming Additional Exemptions
1. If only one spouse is deriving taxable income, only said spouse may claim the additional exemption
2. If both spouses earn income during the taxable year, only one of the spouses may claim the additional exemption for dependent qualified children
3. If legally separated from the spouse with a qualified dependent child, the additional exemption is allowed to the spouse with the custody of the child.
4. An unmarried individual with a child out of wedlock who is a recognized natural child can claim the additional exemption.

Status at the end of the year rule – Whatever is the status of the taxpayer at the end of the calendar year shall be used for purposes of determining his personal and additional exemptions. A change of status during the taxable year generally benefits him. Hence, if one of his qualified dependent children dies during the year, the law considers that the child died on the last day of the year. Hence he is entitled to the full amount of the additional exemption.

**Baniqued: If you are a salaried individual, and your compensation is purely compensation income, you still have personal exemptions, though you are not entitled to deductions. 50,000 + 25,000 for every dependent.*

Status at the end of the year rule, A change in the status generally benefits him.

Who can claim the exemptions if both spouses are working? Either, toss coin lang kayo. Only one spouse can claim the exemptions for the dependents.

How about more than 21 years old but are special children? Of course, if you are incapable of self support, you can still be considered as a dependent.

VI. RECOGNITION OF GAINS AND LOSSES FROM SALES OF PROPERTY

A. Requirement of Realization

There has to be a severance or realization of the income from the property that it is derived from. When does realization come in? Sale or Disposition of the share or property. (Baniqued)

B. Computation of Gain or Loss

1. Meaning of Amount Realized

Sec. 40(A) Computation of Gain or Loss. - The gain from the sale or other disposition of property shall be the:
(1) excess of the amount realized therefrom
(2) over the basis or adjusted basis for determining gain,

and the loss shall be:
(1) the excess of the basis or adjusted basis for determining loss
(2) over the amount realized.

The amount realized from the sale or other disposition of property shall be:
1. the sum of money received
2. plus the fair market value of the property (other than money) received;

Sale – a delivery of goods for money
Exchange – a delivery of goods for goods received.

*Mamalateo: There is a sale or exchange when there is an effective and actual transfer of ownership of the property to another as would divest the transferor of the benefits accruing from the ownership of the property., for a valuable consideration.

The tax base in the sale of real property classified as capital asset is the gross selling price or fair market value, whichever is higher. The gain from the sale of the real property is subject to 6% final tax.

The tax base in the sale of real property classified as ordinary asset is the gain, if any. And

if he suffered a loss, such loss may be deducted from the gross income during the taxable year. The ordinary gain will be added to the operating income, and the net taxable income

2. Meaning of Basis

Sec. 40(B) Basis for Determining Gain or Loss from Sale or Disposition of Property. - The basis of property shall be -

(1) The cost thereof in the case of property acquired on or after March 1, 1913, if such property was acquired by purchase; or

(2) The fair market price or value as of the date of acquisition, if the same was acquired by inheritance; or

(3) If the property was acquired by gift, the basis shall be the same as if:

a. it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift,

b. except that if such basis is greater than the fair market value of the property at the time of the gift then, for the purpose of determining loss, the basis shall be such fair market value; or

(4) If the property was acquired for less than an adequate consideration in money or money's worth, the basis of such property is the amount paid by the transferee for the property; or

(5) The basis as defined in paragraph (C)(5) of this Section, if the property was acquired in a transaction where gain or loss is not recognized under paragraph (C)(2) of this Section.

RULES SUMMARIZED

1. If the property was acquired by PURCHASE on or after March 1, 1913, the basis is the ACQUISITION COST.

2. If the property was acquired through INHERITANCE, the basis is the FMV at the date of acquisition.

3.If the property was acquired as GIFT, the basis is the same as it would be in the hands of the donor, OR, the FMV at the time when the gift was made, whichever is lower.

4. If the property was acquired for LESS THAN FULL AND ADEQUATE CONSIDERATION, the

basis is the AMOUNT PAID BY THE TRANSFEREE for the property.

ORDINARY ASSET -- If the property sold is classified as an ordinary asset, income tax due is the normal corporate income tax, or the graduated income tax.

The actual gain from the sale of real property classified as an ordinary asset by an individual or corporation is subject to income tax at the graduated income tax rates or normal corporate income tax. The gain is arrived at by deducting the cost or the adjusted basis of the property sold from the amount realized.

CAPITAL ASSET-- In general, if the real property located in the Philippines is classified as a capital asset, the income tax due from the sale or exchange thereof is the CAPITAL GAINS TAX at 6% of the actual consideration or FMV of the real property at the time of the sale, as determined by the Comissioner whichever is higher.

If the shares of stock of a domestic corporation sold are unlisted, or if the shares of stock of a domestic corporation are listed but NOT traded in the local stock exchange, and they are classified as capital assets because the seller is not a dealer in securities, the CGT is 5% on the first 100,000 then 10% on the excess of 100,000.

Take note that passive investment incomes subject to final withholding taxes are taxed on the gross amount, without any deduction of cost and expenses of sale.

**Baniqued: What does basis mean? Generally your acquisition cost of the property. Suppose you are a new company, then you subscribe to the shares of stock. What is the basis? Your subscription price.*

What if you receive stock dividends? You have 1M shares in a company, then through the years you receive stock dividends amounting to 500K. So what is your cost on the P1.5M shares? Question is what is your cost on that P1.5M shares. Cost here is STILL P1M. The stock dividends is added to the 1M, the 1M should be divided to the 1.5M shares. So the book value of becomes .67 nalang. It reduces the book value of the cost per share.

So what if you are selling just 500K shares which is coincidentally the number of stock dividends you received? Is the cost zero? The original investment of 1M should be prorated with 1.5M. So the stock dividends will acquire its own basis. So you will have to adjust your original share.

If you gain property by donation? What is the basis? The basis in the hands of the donor. Suppose donor bought at10M, but now its worth P3M, donor donates to donee. Donee says basis is the same in the hands of the donor, hence 10M. So if the donee sells it at 3M 5

months later, there is a loss of 7M. But for the purposes of determining loss, basis 10M, FMV is 3M, so with this provision in the tax code the gain is zero and the loss is zero.

What if I act as a trustee in a property? Im a parent, I have minor children, and while I am still alive I make a trust, and put properties in the trust managed by the BPI (I divest ownership), then BPI will transfer the properties when the minor children reach 30 yrs of age. If I transfer the properties to the BPI, is there a tax? YES. There is a transfer of property. DONORS TAX. It's like I am donating these properties to my children! When BPI transfers the property to the children, is that taxable? Is there a donation? There is none!! This is a transfer from the trustee to the beneficiaries.

If X corporation liquidates, then it will cease to exist. What will happen to the assets? It will be distributed. It will become assets of the SH and the owners of the corporation. These are called liquidating dividends! Is this taxable? Is this a sale or exchange of property? For the longest time, it is not taxable because there is nothing may happen but to return investment to the shareholders. Now Kim Henares says as if the corporation sells its assets to its shareholders. Sir: Eh dissolved na nga eh.

Suppose that the shareholders are receiving a condo unit and a parcel of land that are 10M and 5M for example, for a total of P15M. If the basis of A is 1M, which is his subscription to the shares, then the gain is P14M. How is this gain taxed?

Suppose that the corporation is in a capital deficit. So they reduce the capital stock and redeems a part of the shares. So the capital stock of the SH are reduced to 500K from 1M. In exchange for that, they receive a condo unit. Is there a taxable event? It is no different from the first case. It is as if they are selling their shares of stock in consideration of property or cash or both.

C. Definition of Capital Gains and Losses

Sec. 39(A) Definitions. - As used in this Title -

(1) Capital Assets. - the term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include:
1. 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
2. property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or
3. property used in the trade or business, of a character which is subject to the allowance for depreciation provided in Subsection (F) of Section 34; or
4. real property used in trade or business of the taxpayer.

(2) Net Capital Gain. - The term 'net capital gain' means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges.

(3) Net Capital Loss. - The term 'net capital loss' means the excess of the losses from sales or exchanges of capital assets over the gains from such sales or exchanges.

Ordinary assets are those assets primarily used in the ordinary course of business, Examples are:
(1) Inventory intended for sale in the normal course of business
(2) Real property used in business including real property for rent
(3) Assets used in business subject to depreciation, such as equipment

Capital assets generally those assets that are not primarily used in the ordinary course of trade or business. Examples are:
(1) Stock and securities held by taxpayers other than dealer in securities
(2) Interest in partnership and joint venture
(3) Goodwill
(4) Real property not used in trade (residential house)
(5) Investment property

*Arkansas Best Corp vs .Commissioner: We conclude that a taxpayer's motivation in purchasing an asset is irrelevant to the question whether the asset is "property held by a taxpayer (whether or not connected with his business)" and is thus within § 1221's general definition of "capital asset."

*Corn Products Refining Company: Corporation entered into forward contracts (arrangement where you agree to buy X number of products at this price) He sells the surplus corn. Taxpayer says that this is a capital transaction. SC says this is not a capital gain but an ordinary gain. Taxpayers futures activitiy was so vitally important in its business. In short his buying and selling of corn was so integral to the business to protect it from the fluctuations of price.

*Calasanz v. Commissioner: We fail to see that the reasons behind a person's entering into a business-whether it is to make money or whether it is to liquidate-should be determinative of the question of whether or not the gains resulting from the sales are ordinary gains or capital gains. The sole question is-were the taxpayers in the business of subdividing real estate? If they were, then it seems indisputable that the property sold falls within the exception in the definition of capital assets . . . that is, that it constituted 'property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

Here, they subdivided the lot. Introduced improvements, then they sold to other buyers. Then they claimed the entitlements to capital assets. Reason they said they aren't real estate dealers.

SC said, by subdividing it and by introducing improvements, it is now an ordinary asset.

*Tuason v. Lingad: Under the circumstances, petitioner's sales of the several lots forming part of his rental business cannot be characterized as other than sales of non-capital assets. the sales concluded on installment basis of the subdivided lots do not deserve a different characterization for tax purposes.

Tuasons subdivided a land in Manila and sold it to different buyers. Same holding. You transform yourself from an ordinary heir to a dealer when that happens.

**Baniqued: Rojas is a different story, they didn't want to sell or subdivide it. However the government prevailed upon them to sell the lots and subdivide it. So parang agrarian reform. SC said that they are not real estate dealers. The government actually requested them to do that.*

*China Banking vs. CA: shares of stock; like the other securities defined in Section 20(t)[4] of the NIRC, would be ordinary assets only to a dealer in securities or a person engaged in the purchase and sale of, or an active trader (for his own account) in, securities

The exclusionary clause found in the foregoing text of the law does not include all forms of securities but specifically covers only bonds, debentures, notes, certificates or other evidence of indebtedness, with interest coupons or in registered form, which are the instruments of credit normally dealt with in the usual lending operations of a financial institution. Equity holdings cannot come close to being, within the purview of "evidence of indebtedness" under the second sentence of the aforequoted paragraph. Verily, it is for a like thesis that the loss of petitioner bank in its equity in vestment in the Hongkong subsidiary cannot also be deductible as a bad debt. The shares of stock in question do not constitute a loan extended by it to its subsidiary (First CBC Capital) or a debt subject to obligatory repayment by the latter, essential elements to constitute a bad debt, but a long term investment made by CBC.

D. Limitation on Capital Losses

Sec. 39(B) Percentage Taken Into Account. - In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

(1) One hundred percent (100%) if the capital asset has been held for not more than twelve (12) months; and

(2) Fifty percent (50%) if the capital asset has been held for more than twelve (12) months;

Sec. 39(C) Limitation on Capital Losses. - Losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges.

If a bank or trust company incorporated under the laws of the Philippines, a substantial part of whose business is the:
(1) receipt of deposits,
(2) sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form,

any loss resulting from such sale shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

*Jardine Davis vs. CIR: Issue here is that the BIR saying that every transaction is a separate transaction. Hence you can't claim the capital loss immediately. You only claim it at the end of the year in the final consolidated return.

CTA RULING: Sided with Jardine Davis. It's net capital gain, so you can deduct, you don't defer. Capital losses may be offset currently to capital gains. You don't have to wait until the consolidated tax return is filed.

Baniqued: For instance you have investments of shares of stock in company X, assuming that you subscribed to the original capital stock of the company, like 1,000 shares with a par value of a 1,000 each = P1,000,000. Then that is your basis, since you subscribed. X is a profitable company, so when you sell your shares of stock in X, and the 1,000,000 shares is now worth 20,000,000. Hence you gain* ***19,000,000.* *(5% for the first 100,000. then 10% in the next)*

What if it's the reverse, the basis is 20,000,000, and then you sell it for 1,000,000. You have a loss of 19,000,000. Where do you claim the loss? These are capital losses, and you can only deduct capital losses to capital gains.

Eh pano yan nagbayad ka na ng CGT? Note that the capital gain and the capital loss will offset at the end of the calendar year. (note that this happens when the gain is before the loss) Pero what if the loss was the one first? Edi malinaw na 0 yung gain mo, kasi na offset mo yung 19,000,000. Pano kung may pahabol ka pa, tapos kumita ka ng 10,000,000.? Then you have to pay the tax already.

NOTE: For every transaction for every sale of shares of stock, you file a capital gains return. Cumulative yan, lahat ng previous transaction mo din in the year irereport mo yan para malaman mo kung may capital gains ka.

Then at the end of the year irereport mo ulit yan lahat in a consolidated report.

Hence, capital losses cant be claimed from ordinary income, or you claim it along with interest, representation, rent, bad debt etc. This is a separate domain by itself.

But this does not apply to CGT Tax return on Real Property. It is a final return by itself. There is no offsetting.

E. Special Treatment of Sale of Real Property and Shares of Stock

Sec. 24 (C) Capital Gains from Sale of Shares of Stock not Traded in the Stock Exchange. - The provisions of Section 39(B) notwithstanding, a final tax at the rates prescribed below is hereby imposed upon the net capital gains realized during the taxable year from the sale, barter, exchange or other disposition of shares of stock in a domestic corporation, except shares sold, or disposed of through the stock exchange.

Not over P100,000 ……..……5%
On any amount in excess of 100,000 ……. 10%

Sec. 25(A)(3) Capital Gains. - Capital gains realized from sale, barter or exchange of shares of stock in domestic corporations not traded through the local stock exchange, and real properties shall be subject to the tax prescribed under Subsections (C) and (D) of Section 24.

Sec. 24(D) Capital Gains from Sale of Real Property. -
(1)In General. - The provisions of Section 39(B) notwithstanding, a final tax of 6% based on the gross selling price OR current fair market value as determined in accordance with Section 6(E) of this Code, whichever is higher, is hereby imposed upon:

(1)Capital gains presumed to have been realized from the
(2) Sale, exchange, or other disposition of
(3) Real property located in the Philippines,
(4) Classified as capital assets,

Including pacto de retro sales and other forms of conditional sales, by individuals, including estates and trusts:

Provided, That the tax liability, if any, on gains from sales or other dispositions of real property to the government or any of its political subdivisions or agencies or to government-owned or controlled corporations shall be determined either under Section 24 (A) or under this Subsection, at the option of the taxpayer.

De Leon: This is broad enough to cover also involuntary sales. Moreover, only the sale of real property located in the Phils are subject to Capital Gains Tax.

Alternative Taxation: In case of a sale or other disposition of real property to the government or any of its political subdivisions or agencies or to government-owned or controlled corporations, the tax shall be EITHER the year-end tax of the individual (i.e., capital gain to be included in the computation of income subject to schedular rates), OR the capital gain tax of 6%, at the option of the taxpayer

Sec. 24(D)(2) Exception. - The provisions of paragraph (1) of this Subsection to the contrary notwithstanding, capital gains presumed to have been realized from:

(1) The sale or disposition of their principal residence by natural persons,
(2) The proceeds of which is fully utilized in acquiring or constructing a new principal residence
(3) Within eighteen (18) calendar months from the date of sale or disposition,

shall be exempt from the capital gains tax imposed under this Subsection:

Provided, That the historical cost or adjusted basis of the real property sold or disposed shall be carried over to the new principal residence built or acquired:

Provided, further, That the Commissioner shall have been duly notified by the taxpayer within thirty (30) days from the date of sale or disposition through a prescribed return of his intention to avail of the tax exemption herein mentioned:

Provided, still further, That the said tax exemption can only be availed of once every ten (10) years:

Provided, finally, that if there is no full utilization of the proceeds of sale or disposition, the portion of the gain presumed to have been realized from the sale or disposition shall be subject to capital gains tax. For this purpose, the gross selling price or fair market value at the time of sale, whichever is higher, shall be multiplied by a fraction which the unutilized amount bears to the gross selling price in order to determine the taxable portion and the tax prescribed under paragraph (1) of this Subsection shall be imposed thereon.

De Leon: The natural person here does not include an estate or trust. The Principal residence refers to the dwelling house, including the land on which it is situated where members of the family reside.

What if the dwelling house belongs to several co-owners? The said property shall be treated as the Principal Residence of the co-owner actually occupying and using the same as his principal residence.

Fully utilized – Taxpayer has actually commenced with the construction of his new principal residence or has actually entered into a contract for the purchase of his new principal residence within 18 calendar months from date of sale.

When the entire proceeds of sale is not utilized for principal residence, the capital gains tax shall attach.

FORMULA if there is no full utilization:

(1) Unutilized Portion of Gross Selling Price
_____ = % of Non- utilization
GSP

(2) Multiply the % of non-utilization by the GSP or FMV, whichever higher.
(3) Multiply the product in item (2) by the rate of 6%

Sec. 27(D)(2) Capital Gains from the Sale of Shares of Stock Not Traded in the Stock Exchange. - A final tax at the rates prescribed below shall be imposed on net capital gains realized during the taxable year from the sale, exchange or other disposition of shares of stock in a domestic corporation except shares sold or disposed of through the stock exchange:

Not over P100,000 ……. 5%
Amount in excess of P100,000 … 10%

Sec. 27(d)(5) Capital Gains Realized from the Sale, Exchange or Disposition of Lands and/or Buildings. - A final tax of six percent (6%) is hereby imposed on the gain presumed to have been realized on the sale, exchange or disposition of lands and/or buildings which are not actually used in the business of a corporation and are treated as capital assets, based on the gross selling price of fair market value as determined in accordance with Section 6(E) of this Code, whichever is higher, of such lands and/or buildings.

Sec. 28(A)(7)(c) Capital Gains from Sale of Shares of Stock Not Traded in the Stock Exchange. - A final tax at the rates prescribed below is hereby imposed upon the net capital gains realized during the taxable year from the sale, barter, exchange or other

disposition of shares of stock in a domestic corporation except shares sold or disposed of through the stock exchange:

Not over P100,000 ……..……5%
On any amount in excess of 100,000 ……. 10%

F. Non-Recognition on Certain Dispositions

Sec. 40(C) Exchange of Property. -
(1) General Rule. - Except as herein provided, upon the sale or exchange or property, the entire amount of the gain or loss, as the case may be, shall be recognized.

(2) Exception. - No gain or loss shall be recognized if in pursuance of a plan of merger or consolidation -
(a) A corporation, which is a party to a merger or consolidation, exchanges property solely for stock in a corporation, which is a party to the merger or consolidation; or
(b) A shareholder exchanges stock in a corporation, which is a party to the merger or consolidation, solely for the stock of another corporation also a party to the merger or consolidation; or
(c) A security holder of a corporation, which is a party to the merger or consolidation, exchanges his securities in such corporation, solely for stock or securities in such corporation, a party to the merger or consolidation.

No gain or loss shall also be recognized if property is transferred to a corporation by a person in exchange for stock or unit of participation in such a corporation of which as a result of such exchange said person, alone or together with others, not exceeding four (4) persons, gains control of said corporation: Provided, That stocks issued for services shall not be considered as issued in return for property.

(3) Exchange Not Solely in Kind. -

(a) If, in connection with an exchange described in the above exceptions:

(1) an individual, a shareholder, a security holder or a corporation
(2) receives not only stock or securities permitted to be received without the recognition of gain or loss,
(3) but also money and/or property,
the gain, if any, but not the loss, shall be recognized but in an amount not in excess of the sum of the money and fair market value of such other property received:

Provided, That as to the shareholder, if the money and/or other property received has the effect of a distribution of a taxable dividend, there shall be taxed as dividend to the shareholder an amount of the gain recognized not in excess of his proportionate share of the undistributed earnings and profits of the corporation; the remainder, if any, of the gain recognized shall be treated as a capital gain.

(b) If, in connection with the exchange described in the above exceptions, the:

(1) transferor corporation
(2) receives not only stock permitted to be received without the recognition of gain or loss
(3) but also money and/or other property,

then (i) if the corporation receiving such money and/or other property distributes it in pursuance of the plan of merger or consolidation, no gain to the corporation shall be recognized from the exchange, but (ii) if the corporation receiving such other property and/or money does not distribute it in pursuance of the plan of merger or consolidation, the gain, if any, but not the loss to the corporation shall be recognized but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not distributed.

(4) Assumption of Liability. –

(a) If the taxpayer, in connection with the exchanges described in the foregoing exceptions, receives:
(1) stock or securities
(2) which would be permitted to be received without the recognition of the gain if it were the sole consideration,
(3) and as part of the consideration, another party to the exchange assumes a liability of the taxpayer, or acquires from the taxpayer property, subject to a liability,

then such assumption or acquisition shall not be treated as money and/or other property, and shall not prevent the exchange from being within the exceptions.

(b) If the amount of the liabilities assumed plus the amount of the liabilities to which the property is subject exceed the total of the adjusted basis of the property transferred pursuant to such exchange, then such excess shall be considered as a gain from the sale or exchange of a capital asset or of property which is not a capital asset, as the case may be.

(5) Basis -(a) The basis of the stock or securities received by the transferor upon the exchange specified in the above exception shall be the same as the basis of the property,

stock or securities exchanged, decreased by:
(1) the money received, and
(2) the fair market value of the other property received,
and increased by
(1) the amount treated as dividend of the shareholder and
(2) the amount of any gain that was recognized on the exchange:

Provided, That the property received as "boot" shall have as basis its fair market value:

Provided, further, That if as part of the consideration to the transferor, the transferee of property assumes a liability of the transferor or acquires form the latter property subject to a liability, such assumption or acquisition (in the amount of the liability) shall, for purposes of this paragraph, be treated as money received by the transferor on the exchange:

Provided, finally, That if the transferor receives several kinds of stock or securities, the Commissioner is hereby authorized to allocate the basis among the several classes of stocks or securities.

(b) The basis of the property transferred in the hands of the transferee shall be the same as it would be in the hands of the transferor increased by the amount of the gain recognized to the transferor on the transfer.

(6) Definitions. -

(a) The term 'securities' means bonds and debentures but not 'notes" of whatever class or duration.

(b) The term 'merger' or 'consolidation', when used in this Section, shall be understood to mean:
(i) the ordinary merger or consolidation, or
(ii) the acquisition by one corporation of all or substantially all the properties of another corporation solely for stock:

Provided, That for a transaction to be regarded as a merger or consolidation within the purview of this Section, it must be undertaken for:
1. a bona fide business purpose and
2. not solely for the purpose of escaping the burden of taxation:
3. Provided, further, That in determining whether a bona fide business purpose exists, each and every step of the transaction shall be considered and the whole transaction or series of transaction shall be treated as a single unit:
4. Provided, finally , That in determining whether the property transferred constitutes a

substantial portion of the property of the transferor, the term 'property' shall be taken to include the cash assets of the transferor.

(c) The term 'control', when used in this Section, shall mean ownership of stocks in a corporation possessing at least fifty-one percent (51%) of the total voting power of all classes of stocks entitled to vote.

(d) The Secretary of Finance, upon recommendation of the Commissioner, is hereby authorized to issue rules and regulations for the purpose 'substantially all' and for the proper implementation of this Section.

*Mamalateo: The law merely defers the recognition of the gain or the loss at the time of the merger, consolidation, or tax free exchange insofar as the transferor and transferee is the concerned. Thus, upon the subsequent sale or disposition of the property covered by the merger, consolidation or tax-free exchange, the historical cost or basis shall be used for purposes of determining the gain.

**Baniqued Example: Suppose that you own a lot (you bought it at P10,000,000), Then PLDT rented it and used it as a garage for its service vehicles → ORDINARY ASSET. You want to sell the parcel of land, pero mataas yung tax. If you sell (its now valued at 100,000,000. so tax is 90,000,000 x 32%)*

So what if you want to transfer the property to a new corporation, in consideration for it you receive shares of stock and you gain control. No income tax payable, no gain shall be recognized. Gain is not subject to tax. If there is a loss, loss is not deductible. But as a result the shares of stock have a par value 100,000,000.

What if the person sells the shares of stock for 100,000,000 to another corporation? What is his basis? So amount realized is 100,000,000. The basis is called the carry over basis, The basis is 10,000,000 (see above he bought it for 10,000,000) and you have a gain of 90,000,000. so what is the tax? 90,000,000 5-10% lang. See the advantage?

Why 10,000,000 basis only? Because it is the same as the basis of the property, stock or securities exchanged.

Substituted basis – yung dating basis ni A yung magiging basis dun sa shares of stock. The basis in the land becomes the basis in the shares of stock.

Note, if there is a BOOT, the gain will be recognized. See Sec. 40(c)(3), but not in excess of the sum of the money and FMV of such other property received.

BOOT – Anything you receive other than the shares of stock, like you receive cash or property, that is the boot.

Note that here you need to acquire CONTROL. If you don't acquire control then it is taxable! Control is defined as 51% of the total voting power of all classes of stocks.

What about the property? If the property is sold by the corporation what is the basis? P10,000,000. because the basis of the property transferred in the hands of the transferee shall be the same as it would be in the hands of the transferor.

What if you have a proprietorship? Is there an income tax to be paid when the materials from the sole proprietor is transferred to the corporation in exchange of stock, as a result thereof the transferor gains control of the corporation? No gain or loss shall then be recognized.

Compare this with a sole proprietor who wants to sell all the business assets of the corporation, malaki tax mo dito.

Take note that you can incorporate practically everything. You can incorporate a construction business, a washing machine business etc.

If the real properties of X are transferred to Y in a merger, is there a tax in the transfer? NONE. Why? Because under Sec. 40(C)(2) no gain or loss shall be realized.

What about in a consolidation? X and Y disappear with Z as a surviving entity.

De facto merger –Jollibee corporation acquires all of the assets of Dencio's (note, ASSETS only) What does Jollibee give? Shares of stock in the Jollibee corporation. Dencio does not disappear.

This is found in Sec. 40(C)(6)(b) -- all or substantially all the properties of another corporation.

Substantially all means at least 80% of the assets of the corporation of whose assets are acquired.

Here there is no need for control in merger and consolidation, but the one required is that it is only for a BUSINESS PURPOSE. A VALID BUSINESS PURPOSE. So when PLDT wants to acquire Jollibee for some tax benefits, the law will then disregard the non recognition transaction and become taxable.

If PLDT acquires Sun Cellular, there is a valid business purpose, efficiency of operations, centralized management. Cost saving and cost efficient.

SO when is the tax realized? It is merely a tax deferral.

What if a corporation is dissolved or liquidated. What happens in a liquidation? The assets will now go to the shareholders, question now is what is the tax consequence? On its face, there is no sale or exchange, but for tax purposes this is treated as a sale or exchange. So it is as if the SH sold their shares in exchange for assets. So if there is a gain here, how is the gain computed? Ordinary gain na

Suppose that the corporation decreases its capital stock, hence you will return the investment to some of the SH. So in case of redemption, how is the gain treated? It is a sale or exchange. But will the ordinary income tax rates apply? For the longest time, it was CGT. But now it is a capital gain BUT subject to ordinary income tax rates. This is seen in the case of Weis vs. Meer.

*Commissioner v. Rufino: The basic consideration, of course, is the purpose of the merger, as this would determine whether the exchange of properties involved therein shall be subject or not to the capital gains tax. The criterion laid down by the law is that the merger" must be undertaken for a bona fide business purpose and not solely for the purpose of escaping the burden of taxation." We must therefore seek and ascertain the intention of the parties in the light of their conduct contemporaneously with, and especially after, the questioned merger pursuant to the Deed of Assignment of January 9, 1959.

It is clear, in fact, that the purpose of the merger was to continue the business of the Old Corporation, whose corporate life was about to expire, through the New Corporation to which all the assets and obligations of the former had been transferred. What argues strongly, indeed, for the New Corporation is that it was not dissolved after the merger agreement in 1959. On the contrary, it continued to operate the places of amusement originally owned by the Old Corporation and transfered to the New Corporation, particularly the Capitol and Lyric Theaters, in accordance with the Deed of Assignment. The New Corporation, in fact, continues to do so today after taking over the business of the Old Corporation twenty-seven years ago.

G. Preferential Treatment of Capital Gains

Sec. 39(B) Percentage Taken Into Account. - In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:
(1) One hundred percent (100%) if the capital asset has been held for not more than twelve (12) months; and
(2) Fifty percent (50%) if the capital asset has been held for more than twelve (12) months;

Sec. 39(C) Limitation on Capital Losses. - Losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges.

If a bank or trust company incorporated under the laws of the Philippines, a substantial part of whose business is the:
(1) receipt of deposits,
(2) sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form,

any loss resulting from such sale shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

Sec. 39(D) Net Capital Loss Carry-over. - If any taxpayer, other than a corporation, sustains in any taxable year a net capital loss, such loss (in an amount not in excess of the net income for such year) shall be treated in the succeeding taxable year as a loss from the sale or exchange of a capital asset held for not more than twelve (12) months.

VII. DEFINITION OF CORPORATION

Sec. 22(B) the term *"corporation"* shall include:
(1) partnerships, no matter how created or organized,
(2) joint-stock companies,
(3) joint accounts (cuentas en participacion),
(4) association, or
(5) insurance companies,

BUT does not include:
(1) general professional partnerships and
(2) a joint venture or consortium formed for the purpose of undertaking construction projects or engaging in petroleum, coal, geothermal and other energy operations pursuant to an operating consortium agreement under a service contract with the Government**.**

"General professional partnerships" are partnerships formed by persons for the sole purpose of exercising their common profession, no part of the income of which is derived from engaging in any trade or business.

(C) The term *"domestic"*, when applied to a corporation, means created or organized in the Philippines or under its laws.

(D) The term *"foreign",* when applied to a corporation, means a corporation which is not domestic.

General Types of Corporations

1. Domestic Corporation –Created and organized in the Philippines
2. Foreign Corporation – One that is not domestic.
    - α. Resident Foreign Corporation – A foreign corporation engaged in trade or business in the Philippines
    - β. Non- resident Corporation – A foreign corporation not engaged in trade or business in the Philippines

The Philippines adopted the law of incorporation test. Thus for income tax purposes, a corporation registered with the Securities and Exchange Commission which is managed or controlled by foreigners is a domestic corporation, provided that it is organized under the laws of the Philippines.

Partnerships, whether registered or unregistered are treated as corporations. The partners are considered as stockholders and the profits distributed to them are considered as dividends.

There is co-ownership:

1. When two or more heirs inherit and undivided property from a decedent.
2. When a donor makes a gift of an undivided property in favor of two or more donees.

As a general rule, co-ownership is tax exempt: Because the activities of the co-owners are usually intended to preserve property and to collect the income from the property. The income derived by a co-owner from the property shall be reported in his individual tax return regardless of whether such income is actually constructively receive.

**Baniqued: Suppose that your father owns a 2,000 meter lot. If he sells it, what is the tax? 6%. Capital asset. What if the dad and the contractor has an agreement wherein the dad would contribute the lot for something (like a joint venture, partnership or a corporation). SO when the dad contributed the land, is that taxable at all? No. There is no sale.*

What about if they participate in pre-selling? Is that taxable income? There is a realization.

First Q: What did they form? Not a corporation, without SEC approval eh. It may be a partnership. SO how do we tax it? The partnership will be treated like a corporation. That is what the tax code provides.

So the partnership will be taxed at 30%, then the partners when they receive profits, it is taxable at 10%.

What If it is not treated as a corporation, like for example a co-ownership? Only the individual partners will be subject to tax, right?

Example: F contributes land. C joins to contribute financial expertise. They form a joint venture. They create townhouses. 60% to C, 40% to F. Since it is a joint venture, then it is not subject to tax, right?

For the longest time, it was not taxable. However, now, it is taxable already, and treated as a corporation for tax purposes.

Suppose that parents die in a plane crash, they had a 2,000 sq m lot. Child 1 and Child 2 inherited the lot. But since it's too big decided to subdivide it for them to sell. Question, are they considered to have a joint venture that can be taxed as a corporation? In OBILLOS, they said they are merely co-owners.

Co-ownership vs. Partnership – Partnership is treated like a corporation. BUT once co-ownership goes beyond its normal activities it may be treated as a partnership etc. (like subdividing inherited lots and engaging in the business of real estate)

In case of a partnership, the distribution is not called dividends. You have UNITS OF PARTICIPATION, these are for all intents of purposes treated as shares of stock. So any distribution of this is taxed at 10%

Remember the Calasanz and Rojas case, if you actively pursue, and showing an intent to engage in commercial transactions. (Building roads etc.), then that is a joint venture.

As a general rule, a JOINT VENTURE is taxable like a corporation. There are however 2 joint ventures are not taxable like a corporation:
1. JV for construction projects
2. Petroleum, coal, and geothermal etc.

Partnerships as a GRule are taxable as corporations. Exception is General Professional Partnership. Partnership is merely a flow through entity.

But take note, GPP is a VATABLE person. What happens if there is distribution to the partners? Is that VATABLE also? No.

What if there is a tax law firm, then there are accountants there as well too. Pano yan taxable na? Is that still a GPP? For example SJV, has lawyers accountants and engineers. No answer. Bahala na daw si Comm Henares.

*Obillos v. Commissioner: As a general rule, income of co-ownerships is not subject to tax, if the activities of the co-owners are limited to the preservation of the property and the collection of income therefrom. In each case, the co-owner is taxed individually on his distributive share.

For tax purposes, the co-ownership of inherited properties is automatically converted into an unregistered partnership the moment the said common properties and/or the incomes derived therefrom are used as a common fund with intent to produce profits for the heirs in proportion to their respective shares in the inheritance as determined in a project partition either duly executed in an extrajudicial settlement or approved by the court in the corresponding testate or intestate proceeding. The reason for this is simple. From the moment of such partition, the heirs are entitled already to their respective definite shares of the estate and the incomes thereof, for each of them to manage and dispose of as exclusively his own without the intervention of the other heirs, and, accordingly he becomes liable individually for all taxes in connection therewith. If after such partition, he allows his share to be held in common with his co-heirs under a single management to be used with the intent of making profit thereby in proportion to his share, there can be no doubt that, even if no document or instrument were executed for the purpose, for tax purposes, at least, an unregistered partnership

*Pascual v.Commissioner: Petitioners bought two (2) parcels of land in 1965. They did not sell the same nor make any improvements thereon. In 1966, they bought another three (3) parcels of land from one seller. It was only 1968 when they sold the two (2) parcels of land after which they did not make any additional or new purchase. The remaining three (3) parcels were sold by them in 1970. The transactions were isolated. The character of habituality peculiar to business transactions for the purpose of gain was not present. Hence, there is a clear evidence of co-ownership

*Evangelista vs. CIR: Petitioners borrowed money from their father and purchased several lands. For several years, these lands were leased to tenants by the petitioners. In 1954, respondent Collector of Internal Revenue demanded from petitioners the payment of income tax on corporations. Partnership, as has been defined in the civil code refers to two or more persons who bind themselves to contribute money, properly, or industry to a common fund, with the intention of dividing the profits among themselves. Thus, petitioners, being engaged in the real estate transactions for monetary gain and dividing the same among themselves constitute a partnership so far as the Code is concerned and are subject to income tax for corporation.

*Afisco vs. CA: In the case before us, the ceding companies entered into a Pool Agreement or an association that would handle all the insurance businesses covered under their quota-share reinsurance treaty and surplus reinsurance treaty with Munich. The following unmistakably indicates a partnership or an association covered by Section 24 of the NIRC:

(1) The pool has a common fund, consisting of money and other valuables that are deposited in the name and credit of the pool. This common fund pays for the administration and operation expenses of the pool.

(2) The pool functions through an executive board, which resembles the board of directors of a corporation, composed of one representative for each of the ceding companies.

(3) True, the pool itself is not a reinsurer and does not issue any insurance policy; however, its work is indispensable, beneficial and economically useful to the business of the ceding companies and Munich, because without it they would not have received their premiums. The ceding companies share "in the business ceded to the pool" and in the "expenses" according to a "Rules of Distribution" annexed to the Pool Agreement. Profit motive or business is, therefore, the primordial reason for the pool's formation.

VIII. REALLOCATION OF INCOME AND DEDUCTIONS

SEC. 50. Allocation of Income and Deductions. - In the case of:
1. two or more organizations, trades or businesses (whether or not incorporated and whether or not organized in the Philippines)
2. owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion or allocate gross income or deductions between or among such organization, trade or business, if he determined that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organization, trade or business.

*Filinvest case: Parent Company borrows from MB, same interest rate, then lends it at 0% to the subsidiary. Is that tax avoidance or evasion? The parent had a tax benefit from the interest deduction. Another question, can the Commissioner impute income to the parent company?

SC in principle you cannot impute or create income when clearly there is NONE. BIR wanted to impute income to the parent company. Sec. 50 of the NIRC (see the section). "You cannot create income when there is none" There must be income realized before you can impute.

While it has been held that the phrase "from whatever source derived" indicates a legislative policy to include all income not expressly exempted within the class of taxable income under our laws, the term "income" has been variously interpreted to mean "cash received or its equivalent", "the amount of money coming to a person within a specific time" or "something distinct from principal or capital."[44] Otherwise stated, there must be proof of the actual

or, at the very least, probable receipt or realization by the controlled taxpayer of the item of gross income sought to be distributed, apportioned or allocated by the CIR.

Our circumspect perusal of the record yielded no evidence of actual or possible showing that the advances FDC extended to its affiliates had resulted to the interests subsequently assessed by the CIR. For all its harping upon the supposed fact that FDC had resorted to borrowings from commercial banks, the CIR had adduced no concrete proof that said funds were, indeed, the source of the advances the former provided its affiliates.

**Baniqued: If there is a transaction between related parties, it is always suspect. So Sec. 50 is the legal basis for the authority of the Commissioner to adjust to clearly reflect income of a taxpayer.*

Sec. 50, Commissioner has the authority to reallocate income and distribution all the transfer price. In short, can the Commissioner interfere with your business judgment? Not answered.

A. Tax Avoidance vs. Tax Evasion

Toda vs. CIR: X sells to A(person) for 200M – 100M (Acquisition Cost) = 100M x 30%. THEN A sells to the Totoong Buyer for the Totoong Price for 500M. so 500M x 6%. Bali dinaan muna kay A.

The Commissioner argued that the two transactions actually constituted a single sale of the property by CIC to RMI, and that Altonaga was neither the buyer of the property from CIC nor the seller of the same property to RMI. The additional gain of ₱100 million (the difference between the second simulated sale for₱200 million and the first simulated sale for ₱100 million) realized by CIC was taxed at the rate of only 5% purportedly as capital gains tax of Altonaga, instead of at the rate of 35% as corporate income tax of CIC.

Tax avoidance and *tax evasion* are the two most common ways used by taxpayers in escaping from taxation. Tax avoidance is the tax saving device within the means sanctioned by law. This method should be used by the taxpayer in good faith and at arms length. Tax evasion, on the other hand, is a scheme used outside of those lawful means and when availed of, it usually subjects the taxpayer to further or additional civil or criminal liabilities.

Tax evasion connotes the integration of three factors: (1) the end to be achieved, *i.e.,* the payment of less than that known by the taxpayer to be legally due, or the non-payment of tax when it is shown that a tax is due; (2) an accompanying state of mind which is described as being "evil," in "bad faith," "willfull,"or "deliberate and not accidental"; and (3) a course of action or failure of action which is unlawful.

All these factors are present in the instant case. It is significant to note that as early as 4 May 1989, prior to the purported sale of the Cibeles property by CIC to Altonaga on 30 August 1989, CIC received ₱40 million from RMI, and not from Altonaga. That ₱40 million was debited by RMI and reflected in its trial balance as "other inv. – Cibeles Bldg." Also, as of 31 July 1989, another ₱40 million was debited and reflected in RMI's trial balance as "other inv. – Cibeles Bldg." This would show that the real buyer of the properties was RMI, and not the intermediary Altonaga.

B. Meaning of Transfer Pricing

Transfer pricing happens whenever two related companies – that is, a parent company and a subsidiary, or two subsidiaries controlled by a common parent – trade with each other

**Baniqued: Suppose you have a US parent, the income tax rate there is 25%. In the Phils it has a subsidiary Philco., the tax here is 30%. When it sells goods to the subsidiary, where will it book? To its home country since it has a smaller tax rate.*

If title passes in the Philippines, it is 30%. So you are not going to do that. So X will make another company, Y in a jurisdiction that does not charge tax. So they will book all their sales in Y corporation. Para walang tax.

TRANSFER PRICING ITO. Is this tax evasion?

HK income tax rate is 15.5%, Philippines is 30% for corporation. SO there is a big incentive for a foreign corporation to reflect more income in HK rather than reflect a bigger income in the Philippines. Philippine subsidiary will have a very high cost of sales, then your gross profit or gross income will be very small if not nil, hence your tax in Phils is very minimal. And then the profit will be booked in HK. So if you are a common parent of the Philippine company and HK company, you try to reflect the income in HK.

1. Prima Facie Case of Substantial Underdeclaration

Sec. 248(B) In case of:
1. willful neglect to file the return within the period prescribed by this Code or by rules and regulations, or
2. in case a false or fraudulent return is willfully made, the penalty to be imposed shall be fifty percent (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:

Provided, That a substantial underdeclaration of taxable sales, receipts or income, or a substantial overstatement of deductions, as determined by the Commissioner pursuant to

the rules and regulations to be promulgated by the Secretary of Finance, shall constitute prima facie evidence of a false or fraudulent return:

Provided, further:
1. That failure to report sales, receipts or income in an amount exceeding thirty percent (30%) of that declared per return, and
2. a claim of deductions in an amount exceeding (30%) of actual deductions, shall render the taxpayer liable for substantial underdeclaration of sales, receipts or income or for overstatement of deductions, as mentioned herein.

*Baniqued: If you are a businessman, and you underdeclare income of what it actually is by 30%, you are prima facie liable of tax fraud, that could warrant a criminal investigation for tax fraud and a 50% surcharge.. Moreover, if you pad your business expenses/deductions is more than 30%, prima facie din ito.

IX. ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

A. Fiscal Year v. Calendar Year

SEC. 43. General Rule. - The taxable income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with:
1. the method of accounting regularly employed in keeping the books of such taxpayer,
2. but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner clearly reflects the income.

If the taxpayer's annual accounting period is:
1. other than a fiscal year, as defined in Section 22(Q), or
2. if the taxpayer has no annual accounting period, or
3. does not keep books, or
4. if the taxpayer is an individual,
the taxable income shall be computed on the basis of the calendar year.

B. Cash Method v. Accrual Method

SEC. 44. Period in which Items of Gross Income Included. - The amount of all items

of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under Section 43, any such amounts are to be properly accounted for as of a different period.

In the case of the death of a taxpayer, there shall be included in computing taxable income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period.

SEC. 45. Period for which Deductions and Credits Taken. - The deductions provided for in this Title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting the basis of which the net income is computed, unless in order to clearly reflect the income, the deductions should be taken as of a different period.

In the case of the death of a taxpayer, there shall be allowed as deductions for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly allowable in respect of such period or a prior period.

Cash Method: Generally reports income upon cash collection and reports expenses upon payment. If earned from rendering of services, income is to be reported in the year when collected whether earned or unearned. Hence, income is realized upon actual or constructive receipt of cash, and expenses are deductible only upon payment.

Accrual Method: Generally reports income when earned and reports expense when incurred. If earned from sale of goods, income is to be reported in the year of sale, irrespective of collection.

**Baniqued: Cash method: When you actually receive payment, or when you actually pay an expense.*

Accrual method: Follows an all events test, when circumstances are such when your liability or income become fixed or determinable, no need to exact. You just need reasonable certainty/accuracy; that's when you record it.

*Commisioner v. Isabela: They were not billing the clients for 83 84 and 85. and then on 86 that's when the taxpayer wanted the expenses to be declared as deductions. BIR disallowed it, since they were for legal services rendered in 83 84 and 85. Why now only? BIR said you failed to accrue when they were supposed to be accrued. Isabela was denied expense for legal fees. Bec. They claimed it in a taxable period when it was supposed to be for another taxable period.

The requisite that it must have been paid or incurred during the taxable year is further qualified by Section 45 of the National Internal Revenue Code (NIRC) which states that: "[t]he deduction provided for in this Title shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred', dependent upon the method of accounting upon the basis of which the net income is computed

Accounting methods for tax purposes comprise a set of rules for determining when and how to report income and deductions. In the instant case, the accounting method used by ICC is the accrual method.

Revenue Audit Memorandum Order No. 1-2000, provides that under the accrual method of accounting, expenses not being claimed as deductions by a taxpayer in the current year when they are incurred cannot be claimed as deduction from income for the succeeding year. Thus, a taxpayer who is authorized to deduct certain expenses and other allowable deductions for the current year but failed to do so cannot deduct the same for the next year

C. Change of Accounting Period

SEC. 46. Change of Accounting Period. If a taxpayer, other than an individual, changes his accounting period from fiscal year to calendar year, from calendar year to fiscal year, or from one fiscal year to another, the net income shall, with the approval of the Commissioner, be computed on the basis of such new accounting period, subject to the provisions of Section 47.

SEC. 47. Final or Adjustment Returns for a Period of Less than Twelve (12) Months. -

(A) Returns for Short Period Resulting from Change of Accounting Period. - If a taxpayer, other than an individual, with the approval of the Commissioner, changes the basis of computing net income from fiscal year to calendar year, a separate final or adjustment return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31.

If the change is from calendar year to fiscal year, a separate final or adjustment return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year.

If the change is from one fiscal year to another fiscal year, a separate final or adjustment return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year.

(B) Income Computed on Basis of Short Period. - Where a separate final or adjustment return is made under Subsection (A) on account of a change in the accounting period, and in all other cases where a separate final or adjustment return is required or permitted by rules and regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner, to be made for a fractional part of a year, then the income shall be computed on the basis of the period for which separate final or adjustment return is made.

**Baniqued: Calendar year: Jan 1 – Dec. 31*
Fiscal Year: Anything that does not end in Dec. 31.

Can you change from fiscal year to calendar? YES. That is your prerogative, but any change will have to have prior approval of the Commissioner. You have to write the Commissioner a formal letter to change the accounting period.

If you change accounting period, you will have to file a short period return. (Sec. 47) This is because of the overlapping of the periods.

D. Accounting for Long Term Contracts

SEC. 48. Accounting for Long-Term Contracts. - Income from long-term contracts shall be reported for tax purposes in the manner as provided in this Section. As used herein, the term 'long-term contracts' means building, installation or construction contracts covering a period in excess of one (1) year.

Persons whose gross income is derived in whole or in part from such contracts shall report such income upon the basis of percentage of completion. The return should be accompanied by a return certificate of architects or engineers showing the percentage of completion during the taxable year of the entire work performed under contract.

There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied. If upon completion of a contract, it is found that the taxable net income arising thereunder has not been clearly reflected for any year or years, the Commissioner may permit or require an amended return.

E. Instalment Sale vs. Deferred Payment Sale

SEC. 49. Installment Basis. -
(A) Sales of Dealers in Personal Property. - Under rules and regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner, a person who:
1. regularly sells or
2. otherwise disposes of personal property on the installment plan
may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year, which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(B) Sales of Realty and Casual Sales of Personality. - In the case
(1) of a casual sale or other casual disposition of personal property (other than 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), for a price exceeding One thousand pesos (P1,000), or
(2) of a sale or other disposition of real property,

if in either case the initial payments do not exceed twenty-five percent (25%) of the selling price, the income may, under the rules and regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner, be returned on the basis and in the manner above prescribed in this Section.

As used in this Section, the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(C) Sales of Real Property Considered as Capital Asset by Individuals. - An individual who sells or disposes of real property, considered as capital asset, and is otherwise qualified to report the gain therefrom under Subsection (B) may pay the capital gains tax in installments under rules and regulations to be promulgated by the Secretary of Finance, upon recommendation of the Commissioner.

(D) Change from Accrual to Installment Basis. - If a taxpayer entitled to the benefits of Subsection (A) elects for any taxable year to report his taxable income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

$$\frac{\text{Gross Profit}}{\text{Contract Price}} \times \text{Installment Paid} = \text{Reportable Income}$$

*Baniqued: Sales on instalments of motorcycles as a dealer of motorcycles is found in Sec. 49(A).
Formula, for every instalment payment received, multiplied by the gross profit, divided by the contract price.

What about the interest income? It is recognizable by 100%.

What about if the property sold is not by a dealer, then that is called casual sales, if you sell them in instalments, then you can report them in an instalment method. Except this time, when it is a casual sale of personal property, there is a requirement that the initial payments do not exceed 25% of the contract price. If it exceeds 25%, you are no longer entitled to report it in installments, rather it would be considered as a cash sale, report it 100%.

The 25% is reckoned in the year of sale. For as long as not more than 25% of the contract price is paid in the year of sale, then you are entitled to instalment method. Same is true in the sale of real property. Sec. 49(C)

If the sale of real property is in installment and you also paid in installment, can the Commissioner refuse to have a tax clearance certificate since you have not yet paid it fully? Law allows it. But BIR officers are inconsistent, some allow it, some don't.

Initial payments do not include Promissory Notes, it is expess "evidence of indebtedness" is not included.

How about rediscounting of receivables? Does that mean that the seller has received more than 25% of the selling price? Its an entirely different transaction.

What about when the holder of the PN goes to the purchaser itself, and the purchaser gives the face value of the PN? Is that included in the 25%?

What if from day 1 they talked about a scheme already? Circumventing the statutory provision? By making it appear that there is a promissory note, but it's actually in cash. If you can show that that was the intention from day 1, then that's clearly a circumvention.

F. Indirect Methods of Computing Income

Net worth method – Classic case is CJ Corona. Allegation is that he acquired so many properties in Makati. Disparity between net worth and the assets he had. But BIR forgot to take into account the beginning net worth of CJ Corona.

In case of her daughter and her husband, BIR invoked the expenditure method. They were acquiring properties left and right but the income they were reporting cannot justify the expenditures.

*Perez v. CTA: On the application of the net worth method of determining taxable income, used by the collector and upheld by the court below, it must he explained that the method is based upon the general theory that money and other assets in excess of liabilities of a taxpayer (after an accurate and proper adjustment of non-deductible items) not accounted for by his income tax returns, leads to the inference that part of his income has not been reported

X. INCOME TAXATION OF FOREIGN PERSONS

A. Operative Taxing Provisions of NIRC

Section 24. Income Tax Rates. (A) Rates of Income Tax on Individual Citizen and Individual Resident Alien of the Philippines.

(1) An income tax is hereby imposed

(c) On the taxable income defined in Section 31 of this Code, other than income subject to tax under Subsections (b), (C) and (D) of this Section, derived for each taxable year from all sources within the Philippines by an individual alien who is a resident of the Philippines.

Section 25. Tax on Nonresident Alien Individual. -(A) Nonresident Alien Engaged in trade or Business Within the Philippines. -

(1) In General. - A nonresident alien individual engaged in trade or business in the Philippines shall be subject to an income tax in the same manner as an individual citizen and a resident alien individual, on taxable income received from all sources within the Philippines.

A nonresident alien individual who shall come to the Philippines and stay therein for an aggregate period of more than one hundred eighty (180) days during any calendar year shall be deemed a 'nonresident alien doing business in the Philippines'. Section 22 (G) of this Code notwithstanding

Sec. 25(B) Nonresident Alien Individual Not Engaged in Trade or Business Within the Philippines. - There shall be levied, collected and paid for each taxable year

upon the entire income received from all sources within the Philippines by every nonresident alien individual not engaged in trade or business within the Philippines as:
1. interest,
2. cash and/or property dividends,
3. rents,
4. salaries,
5. wages,
6. premiums,
7. annuities,
8. compensation, remuneration, emoluments, or other fixed or determinable annual or periodic or casual gains,
9. profits, and income, and
10. capital gains,
a tax equal to twenty-five percent (25%) of such income.

Capital gains realized by a nonresident alien individual not engaged in trade or business in the Philippines from the sale of shares of stock in any domestic corporation and real property shall be subject to the income tax prescribed under Subsections (C) and (D) of Section 24.

Section 28. Rates of Income Tax on Foreign Corporations. -(A) Tax on Resident Foreign Corporations. -

(1) In General. - Except as otherwise provided in this Code:
1. a corporation organized, authorized, or existing under the laws of any foreign country,
2. engaged in trade or business within the Philippines, shall be subject to an income tax equivalent to 30% of the taxable income derived in the preceding taxable year from all sources within the Philippines

In the case of corporations adopting the fiscal-year accounting period, the taxable income shall be computed without regard to the specific date when sales, purchases and other transactions occur. Their income and expenses for the fiscal year shall be deemed to have been earned and spent equally for each month of the period.

The reduced corporate income tax rates shall be applied on the amount computed by multiplying the number of months covered by the new rates within the fiscal year by the taxable income of the corporation for the period, divided by twelve.

Provided, however, That a resident foreign corporation shall be granted the option to be taxed at fifteen percent (15%) on gross income under the same conditions, as provided in Section 27 (A).

Sec. 28(B) Tax on Nonresident Foreign Corporation. -(1) *In General*. - Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to 30%of the gross income received during each taxable year from all sources within the Philippines, such as interests, dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits and income, and capital gains, except capital gains subject to tax under subparagraphs (C) and (d).

Non-resident alien individuals engaged in business are taxed at a final tax of 25% based on his GROSS INCOME within the Philippines; EXCEPT:
(1) Alien employed by a regional or area headquarters established in the Philippines by a multinational company
(2) Offshore banking units
(3) Petroleum service contractor and subcontractor. They are taxed at 15% of their salaries.

If the NRA is engaged in business in the Philippines, he shall be taxed in the same manner as a Nonresident Citizen, except for the following:

(1) Dividends are subject to 20% on GROSS AMOUNT
(2) Cinematographic Film owner at 20% on GROSS INCOME

X. Resident Alien vs. Non-Resident Alien

Sec. 22(F) The term 'resident alien' means an individual whose residence is within the Philippines and who is not a citizen thereof.

Sec. 22(G) The term 'nonresident alien' means an individual whose residence is not within the Philippines and who is not a citizen thereof.

What makes an alien a resident or non-resident alien is his intention with regard to the length and nature of his stay. Thus:

a. One who comes to the Philippines for a definite purpose which in its very nature may be promptly accomplished is not a resident citizen.
b. One who comes to the Philippines for a definite purpose which in its very nature would require an extended stay, and to that end, makes his home temporarily in the Philippines, becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned. (Sec. 5, RR 2)

Length of stay is indicative of intention.
An alien who shall come to the Philippines and stay for an aggregate period of more than 180 days during a calendar year shall be considered a non-resident alien in business, or in the practice of profession, in the Philippines. [Sec. 25(A)(1)]

Thus, if an alien stays in the Philippines for 180 days or less during the calendar year, he shall be deemed a non-resident alien not doing business in the Philippines, regardless of whether he engages in trade or business therein, if he exceeds, then he shall be doing business.

D. Resident Foreign Corporation vs. Non-Resident Foreign Corporation

Sec. 22(H) The term 'resident foreign corporation' applies to a foreign corporation engaged in trade or business within the Philippines.

Sec. 22(I) The term 'nonresident foreign corporation' applies to a foreign corporation not engaged in trade or business within the Philippines.

E. Source Rules for Various Items of Income

Section 42. Income from Sources Within the Philippines.- (A) Gross Income From Sources Within the Philippines. - The following items of gross income shall be treated as gross income from sources within the Philippines:

(1) Interests. - Interests derived from sources within the Philippines, and interests on bonds, notes or other interest-bearing obligation of residents, corporate or otherwise;

(2) Dividends. - The amount received as dividends:

(a) from a domestic corporation; and
(b) from a foreign corporation, unless:
1. less than fifty percent (50%) of the gross income of such foreign corporation
2. for the three-year period ending with the close of its taxable year preceding the declaration of such dividends or for such part of such period as the corporation has been in existence) was derived from sources within the Philippines as determined under the provisions of this Section;

but only in an amount which bears the same ration to such dividends as the gross income of the corporation for such period derived from sources within the Philippines bears to its gross income from all sources.

(3) Services. - Compensation for labor or personal services performed in the Philippines;

(4) Rentals and royalties. - Rentals and royalties from property located in the Philippines or from any interest in such property, including rentals or royalties for

(a) The use of or the right or privilege to use in the Philippines any copyright, patent, design or model, plan, secret formula or process, goodwill, trademark, trade brand or other like property or right;

(b) The use of, or the right to use in the Philippines any industrial, commercial or scientific equipment;

(c) The supply of scientific, technical, industrial or commercial knowledge or information;

(d) The supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right as is mentioned in paragraph (a), any such equipment as is mentioned in paragraph (b) or any such knowledge or information as is mentioned in paragraph (c);

(e) The supply of services by a nonresident person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any brand, machinery or other apparatus purchased from such nonresident person;

(f) Technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme; and

(g) The use of or the right to use:

(i) Motion picture films;

(ii) Films or video tapes for use in connection with television; and

(iii) Tapes for use in connection with radio broadcasting.

(5) Sale of Real Property. - gains, profits and income from the sale of real property located in the Philippines; and

(6) Sale of Personal Property. - gains; profits and income from the sale of personal property, as determined in Subsection (E) of this Section.

(B) Taxable Income From Sources Within the Philippines. -

(1) General Rule. - From the items of gross income specified in Subsection (A) of this Section, there shall be deducted the expenses, losses and other deductions properly allocated thereto and a ratable part of expenses, interests, losses and other deductions effectively connected with the business or trade conducted exclusively within the Philippines which cannot definitely be allocated to some items or class of gross income: Provided, That such items of deductions shall be allowed only if fully substantiated by all the information necessary for its calculation. The remainder, if any, shall be treated in full as taxable income from sources within the Philippines.

(2) Exception. - No deductions for interest paid or incurred abroad shall be allowed from the item of gross income specified in subsection (A) unless indebtedness was actually incurred to provide funds for use in connection with the conduct or operation of trade or business in the Philippines.

It is important to know the source rules. Simple way of remembering them.

1. *If the income is COMPENSATION FOR SERVICES = PLACE OF PERFORMANCE.*
2. *if INTEREST, the source is the RESIDENCE OF THE OBLIGOR/DEBTOR, regardless of where payment is made*
3. *if ROYALTIES, like a foreign licensor of trademarks, patents, PLACE OF EXPLOITATION of the intellectual property.*
4. *If REAL PROPERTY, Source of the income is the place where the REAL PROPERTY IS LOCATED.*
5. *If PERSONAL PROPERTY – General Rule, passage of title test.*

What if car, Lambourghini is in Philippines, payment outside the Philippines. Generally, in sales of personal property, the source is where title passes. Passage of title test. If Lambourghini passed outside the Philippines, that is not income.

Nagbayaran in Hongkong, Shares of Stock in a Philippine Company, Deed of Sale outside. Regardless of place of payment, where the object is shares of stock, it is PHILIPPINE SOURCE. Hence the general rule on personal property with regard to source rules shall not apply to sales of shares of stock.

6. *Dividends – If paid by Domestic Corporation, then that is Philippine source income even if a credit is made outside the Philippines. Paano pag foreign? Generally no tax, declarant is foreign and recipient is foreign. When will the dividends declared by foreign corporation be considered Filipino? If 50% of its income is derived in the Philippines for the last 3 years. (Sec. 42(A)(2)(b))*

(C) Gross Income From Sources Without the Philippines. - The following items of gross income shall be treated as income from sources without the Philippines:

(1) Interests other than those derived from sources within the Philippines as provided in paragraph (1) of Subsection (A) of this Section;
(2) Dividends other than those derived from sources within the Philippines as provided in paragraph (2) of Subsection (A) of this Section;
(3) Compensation for labor or personal services performed without the Philippines;
(4) Rentals or royalties from property located without the Philippines or from any interest in such property including rentals or royalties for the use of or for the privilege of using without the Philippines, patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises and other like properties; and
(5) Gains, profits and income from the sale of real property located without the Philippines.

(D) Taxable Income From Sources Without the Philippines. - From the items of gross income specified in Subsection (C) of this Section there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expense, loss or other deduction which cannot definitely be allocated to some items or classes of gross income. The remainder, if any, shall be treated in full as taxable income from sources without the Philippines.

(E) Income From Sources Partly Within and Partly Without the Philippines.- Items of gross income, expenses, losses and deductions, other than those specified in Subsections (A) and (C) of this Section, shall be allocated or apportioned to sources within or without the Philippines, under the rules and regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner. Where items of gross income are separately allocated to sources within the Philippines, there shall be deducted (for the purpose of computing the taxable income therefrom) the expenses, losses and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses or other deductions which cannot definitely be allocated to some items or classes of gross income. The remainder, if any, shall be included in full as taxable income from sources within the Philippines. In the case of gross income derived from sources partly within and partly without the Philippines, the taxable income may first be computed by deducting the expenses, losses or other deductions apportioned or allocated thereto and a ratable part of any expense, loss or other deduction which cannot definitely

be allocated to some items or classes of gross income; and the portion of such taxable income attributable to sources within the Philippines may be determined by processes or formulas of general apportionment prescribed by the Secretary of Finance. Gains, profits and income from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the Philippines, or produced (in whole or in part) by the taxpayer without and sold within the Philippines, shall be treated as derived partly from sources within and partly from sources without the Philippines.

Gains, profits and income derived from the purchase of personal property within and its sale without the Philippines, or from the purchase of personal property without and its sale within the Philippines shall be treated as derived entirely form sources within the country in which sold: Provided, however, That gain from the sale of shares of stock in a domestic corporation shall be treated as derived entirely form sources within the Philippines regardless of where the said shares are sold. The transfer by a nonresident alien or a foreign corporation to anyone of any share of stock issued by a domestic corporation shall not be effected or made in its book unless: (1) the transferor has filed with the Commissioner a bond conditioned upon the future payment by him of any income tax that may be due on the gains derived from such transfer, or (2) the Commissioner has certified that the taxes, if any, imposed in this Title and due on the gain realized from such sale or transfer have been paid. It shall be the duty of the transferor and the corporation the shares of which are sold or transferred, to advise the transferee of this requirement.

(F) Definitions. - As used in this Section the words 'sale' or 'sold' include 'exchange' or 'exchanged'; and the word 'produced' includes 'created', 'fabricated,' 'manufactured', 'extracted,' 'processed', 'cured' or 'aged.'

*CIR v. Baier Nickel: "Source" is not a place, it is an activity or property. As such, it has a situs or location, and if that situs or location is within the United States the resulting income is taxable to nonresident aliens and foreign corporations.

The source of an income is the property, activity or service that produced the income. For the source of income to be considered as coming from the Philippines, it is sufficient that the income is derived from activity within the Philippines.

*Alexander Howden vs. Collector: The source of an income is the property, activity or service that produced the income. The reinsurance premiums remitted to appellants by virtue of the reinsurance contracts, accordingly, had for their source the undertaking to indemnify Commonwealth Insurance Co. against liability. Said undertaking is the activity that produced the reinsurance premiums, and the same took place in the Philippines. In the first place, the reinsured, the liabilities insured and the risks originally underwritten by Commonwealth Insurance Co., upon which the reinsurance premiums and indemnity were

based, were all situated in the Philippines. Secondly, contrary to appellants' view, the reinsurance contracts were perfected in the Philippines, for Commonwealth Insurance Co. signed them last in Manila. The American cases cited are inapplicable to this case because in all of them the reinsurance contracts were signed outside the jurisdiction of the taxing State. And, thirdly, the parties to the reinsurance contracts in question evidently intended Philippine law to govern.

F. Special Treatment of Certain Foreign Persons on Some items of Income

Sec. 25(C) Alien Individual Employed by Regional or Area Headquarters and Regional Operating Headquarters of Multinational Companies. - There shall be levied, collected and paid for each taxable year upon:
1. the gross income received
2. by every alien individual employed by
3. regional or area headquarters and regional operating headquarters established in the Philippines by multinational companies as salaries, wages, annuities, compensation, remuneration and other emoluments, such as honoraria and allowances, from such regional or area headquarters and regional operating headquarters, a tax equal to fifteen percent (15%) of such gross income:

Provided, however, That the same tax treatment shall apply to Filipinos employed and occupying the same position as those of aliens employed by these multinational companies.

For purposes of this Chapter, the term 'multinational company' means a foreign firm or entity engaged in international trade with affiliates or subsidiaries or branch offices in the Asia-Pacific Region and other foreign markets.

Sec. 25(D) Alien Individual Employed by Offshore Banking Units. - There shall be levied, collected and paid for each taxable year upon the:
1. gross income received by every alien individual
2. employed by offshore banking units established in the Philippines as salaries, wages, annuities, compensation, remuneration and other emoluments, such as honoraria and allowances, from such off-shore banking units, a tax equal to fifteen percent (15%) of such gross income:

Provided, however, That the same tax treatment shall apply to Filipinos employed and occupying the same positions as those of aliens employed by these offshore banking units.

Sec. 25(E) Alien Individual Employed by Petroleum Service Contractor and Subcontractor. - An Alien individual who is:

1. a permanent resident of a foreign country
2. but who is employed and assigned in the Philippines
3. by a foreign service contractor or by a foreign service subcontractor engaged in petroleum operations in the Philippines

shall be liable to a tax of fifteen percent (15%) of the salaries, wages, annuities, compensation, remuneration and other emoluments, such as honoraria and allowances, received from such contractor or subcontractor: Provided, however, That the same tax treatment shall apply to a Filipino employed and occupying the same position as an alien employed by petroleum service contractor and subcontractor.

Any income earned from all other sources within the Philippines by the alien employees referred to under Subsections (C), (D) and (E) hereof shall be subject to the pertinent income tax, as the case may be, imposed under this Code.

Sec. 28(A)(3) International Carrier. - An international carrier doing business in the Philippines shall pay a tax of two and one-half percent (2 1/2%) on its 'Gross Philippine Billings' as defined hereunder:

(a) International Air Carrier. - 'Gross Philippine Billings' refers to the amount of:
1. gross revenue derived from carriage of persons, excess baggage, cargo and mail
2. originating from the Philippines in a continuous and uninterrupted flight,
3. irrespective of the place of sale or issue and the place of payment of the ticket or passage document:

Provided, That tickets revalidated, exchanged and/or indorsed to another international airline form part of the Gross Philippine Billings if the passenger boards a plane in a port or point in the Philippines:

Provided, further, That for a flight which originates from the Philippines, but transshipment of passenger takes place at any port outside the Philippines on another airline, only the aliquot portion of the cost of the ticket corresponding to the leg flown from the Philippines to the point of transshipment shall form part of Gross Philippine Billings.

(b) International Shipping. - 'Gross Philippine Billings' means gross revenue whether for passenger, cargo or mail originating from the Philippines up to final destination, regardless of the place of sale or payments of the passage or freight documents.

Sec. 28(A)(4) Offshore Banking Units. - The provisions of any law to the contrary notwithstanding, income derived by:
1. offshore banking units
2. authorized by the Bangko Sentral ng Pilipinas (BSP) to transact business with offshore banking units, including any interest income derived from foreign currency loans granted to

residents, shall be subject to a final income tax at the rate of ten percent (10%) of such income.

Any income of nonresidents, whether individuals or corporations, from transactions with said offshore banking units shall be exempt from income tax.

Sec.28(A)(6) Regional or Area Headquarters and Regional Operating Headquarters of Multinational Companies. -

(a) Regional or area headquarters as defined in Section 22(DD) shall not be subject to income tax.

(b) Regional operating headquarters as defined in Section 22(EE) shall pay a tax of ten percent (10%) of their taxable income.

Sec. 28(A)(7) Tax on Certain Incomes Received by a Resident Foreign Corporation. -(a) Interest from Deposits and Yield or any other Monetary Benefit from Deposit Substitutes, Trust Funds and Similar Arrangements and Royalties. - Interest from:
1. any currency bank deposit and yield or
2. any other monetary benefit from deposit substitutes and from trust funds and similar arrangements and
3. royalties derived from sources within the Philippines

shall be subject to a final income tax at the rate of twenty percent (20%) of such interest:

Provided, however, That interest income derived by a resident foreign corporation from a depository bank under the expanded foreign currency deposit system shall be subject to a final income tax at the rate of seven and one-half percent (7 1/2%) of such interest income.

(b) Income Derived under the Expanded Foreign Currency Deposit System. - Income derived by:
1. a depository bank
2. under the expanded foreign currency deposit system from foreign currency transactions
3. with local commercial banks including branches of foreign banks that may be authorized by the Bangko Sentral ng Pilipinas (BSP) to transact business with foreign currency deposit system units, including interest income from foreign currency loans granted by such depository banks under said expanded foreign currency deposit system to residents,

shall be subject to a final income tax at the rate of ten percent (10%) of such income.

Any income of nonresidents, whether individuals or corporations, from transactions with depository banks under the expanded system shall be exempt from income tax.

(c) Capital Gains from Sale of Shares of Stock Not Traded in the Stock Exchange. - A final tax at the rates prescribed below is hereby imposed upon the net capital gains realized during the taxable year from the sale, barter, exchange or other disposition of shares of stock in a domestic corporation except shares sold or disposed of through the stock exchange:

Not over P100,000 ……..……5%
On any amount in excess of 100,000 ……. 10%

(d) Intercorporate Dividends. - Dividends received by a resident foreign corporation from a domestic corporation liable to tax under this Code shall not be subject to tax under this Title.

Sec. 28(B)(2) Nonresident Cinematographic Film Owner, Lessor or Distributor. - A cinematographic film owner, lessor, or distributor shall pay a tax of twenty-five percent (25%) of its gross income from all sources within the Philippines.

Sec. 28(B)(3) Nonresident Owner or Lessor of Vessels Chartered by Philippine Nationals. - A nonresident owner or lessor of vessels shall be subject to a tax of four and one-half percent (4 1/2%) of gross rentals, lease or charter fees from leases or charters to Filipino citizens or corporations, as approved by the Maritime Industry Authority.

Sec. 28(B)(4) Nonresident Owner or Lessor of Aircraft, Machineries and Other Equipment. - Rentals, charters and other fees derived by a nonresident lessor of aircraft, machineries and other equipment shall be subject to a tax of seven and one-half percent (7 1/2%) of gross rentals or fees.

XI. INCOME TAXATION OF ESTATES AND TRUSTS

SEC. 60. Imposition of Tax. -
(A) Application of Tax. - The tax imposed by this Title upon individuals shall apply to the income of estates or of any kind of property held in trust, including:

(1) Income accumulated in trust for the benefit of:
1. unborn or unascertained person or persons with contingent interests, and
2. income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is:
1. to be distributed currently by the fiduciary to the beneficiaries, and
2. income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(B) Exception. - The tax imposed by this Title shall not apply to:
1. employee's trust which forms part of a pension,
2. stock bonus or profit-sharing plan of an employer for the benefit of some or all of his employees IF

(1) contributions are made to the trust by such employer, or employees, or both for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, and
(2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees:

Provided, That any amount actually distributed to any employee or distributee shall be taxable to him in the year in which so distributed to the extent that it exceeds the amount contributed by such employee or distributee.

(C) Computation and Payment. -(1) In General. - The tax shall be computed upon the taxable income of the estate or trust and shall be paid by the fiduciary, except as provided in Section 63 (relating to revocable trusts) and Section 64 (relating to income for the benefit of the grantor).

(2) Consolidation of Income of Two or More Trusts. - Where, in the case of two or more trusts:
1. the creator of the trust in each instance is the same person, and

2. the beneficiary in each instance is the same, the taxable income of all the trusts shall be consolidated and the tax provided in this Section computed on such consolidated income, and such proportion of said tax shall be assessed and collected from each trustee which the taxable income of the trust administered by him bears to the consolidated income of the several trusts.

SEC. 61. Taxable Income. - The taxable income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that:

(A) There shall be allowed as a deduction in computing the taxable income of the estate or trust the:
1. amount of the income of the estate or trust for the taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and
2. the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct,

but the amount so allowed as a deduction shall be included in computing the taxable income of the beneficiaries, whether distributed to them or not.

Any amount allowed as a deduction under this Subsection shall not be allowed as a deduction under Subsection (B) of this Section in the same or any succeeding taxable year.

**This is in addition to the allowable deductions under Section 34 of the Tax Code.*

(B) In the case of:
1. income received by estates of deceased persons during the period of administration or settlement of the estate, and
2. in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated,

there shall be allowed as an additional deduction in computing the taxable income of the estate or trust the amount of the:
1. income of the estate or trust for its taxable year,
2. which is properly paid or credited during such year to any legatee, heir or beneficiary but the amount so allowed as a deduction shall be included in computing the taxable income of the legatee, heir or beneficiary.

(C) In the case of a trust administered in a foreign country, the deductions mentioned in Subsections (A) and (B) of this Section shall not be allowed: Provided, That the amount of any income included in the return of said trust shall not be included in computing the income of the beneficiaries.

SEC. 62. Exemption Allowed to Estates and Trusts. - For the purpose of the tax provided for in this Title, there shall be allowed an exemption of Twenty thousand pesos (P20,000) from the income of the estate or trust. *(50,000 na daw)*

SEC. 63. Revocable Trusts. - Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested:
(1) in the grantor either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or
(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

the income of such part of the trust shall be included in computing the taxable income of the grantor.

SEC. 64. Income for Benefit of Grantor.-(A) Where any part of the income of a trust:
(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be held or accumulated for future distribution to the grantor, or
(2) may, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor, or
(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be applied to the payment of premiums upon policies of insurance on the life of the grantor,

such part of the income of the trust shall be included in computing the taxable income of the grantor.

(B) As used in this Section, the term 'in the discretion of the grantor' means in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question.

SEC. 65. Fiduciary Returns. - Guardians, trustees, executors, administrators, receivers, conservators and all persons or corporations, acting in any fiduciary capacity, shall render:
1. in duplicate, a return of the income of the person, trust or estate for whom or which they act, and
2. be subject to all the provisions of this Title, which apply to individuals in case such person, estate or trust has a gross income of Twenty thousand pesos (P20,000) or over during the taxable year.

Such fiduciary or person filing the return for him or it, shall:
1. take oath that he has sufficient knowledge of the affairs of such person, trust or estate to enable him to make such return and
2. that the same is, to the best of his knowledge and belief, true and correct, and be subject to all the provisions of this Title which apply to individuals:

Provided, That a return made by or for one or two or more joint fiduciaries filed in the province where such fiduciaries reside; under such rules and regulations as the Secretary of Finance, upon recommendation of the Commissioner, shall prescribe, shall be a sufficient compliance with the requirements of this Section.

SEC. 66. Fiduciaries Indemnified Against Claims for Taxes Paid. - Trustees, executors, administrators and other fiduciaries are indemnified against the claims or demands of every beneficiary for all payments of taxes which they shall be required to make under the provisions of this Title, and they shall have credit for the amount of such payments against the beneficiary or principal in any accounting which they make as such trustees or other fiduciaries.

Sec. 22(J) The term 'fiduciary' means a guardian, trustee, executor, administrator, receiver, conservator or any person acting in any fiduciary capacity for any person

Estate is the mass of property, rights and obligations left behind by the decedent upon his death.

Trust is an arrangement created by will or agreement under which title to property is passed to another for conservation or investment with the income therefrom and ultimately the corpus to be distributed in accordance with the directions of the creator as expressed in the instrument.

Two kinds of trust:
1. Irrevocable Trust – Considered a separate taxpayer
2. Revocable Trust -- Where the tax is imposed on the grantor

As a General Rule: The tax shall be paid by the fiduciary. But in revocable trusts and where the income of the trust is for the benefit of the grantor, the income will be part of the computation of the taxable income of the grantor.

**Baniqued: Properties from which income is derived is called corpus.*

When I transfer the properties to you as a trustee, is there a tax? This will trigger the payment of a donor's tax, because this is in nature a donation. Here the intended donee here is the beneficiary. Beneficiary are children, it is a irrevocable trust.

Trustee receives income, is there a tax?
When the trustee transfers the property to the beneficiaries, is there a tax?

The trust is an own taxable entity. It will file its own income tax returns. So what will it report? The income accumulated. The trustee will sign the income tax return on behalf of the trust. Trustee is the one who pays the income tax return.

Can the trustee claim the deductions in Sec. 34? YES. See Sec. 61, it's the same way like an individual.

But there are additional deductions! See Sec. 61. It is only when the trustee is authorized to distribute to the beneficiaries can the trustee be entitled to deduct.

What is the effect of distribution to the income to the beneficiaries, as directed in the trust? It is an allowable deduction. Current distributions to the beneficiaries is deductible in the trust.

Grantor transfers property to the trustee, beneficiary is also me. Is there any tax at all? Is there a donation? There is no donation here because the beneficiary is also you. No donors tax.

Revocable trust: I can take the corpus back at any time, the statutory basis is Sec. 63. Grantor can recover the corpus or any part thereof. Where the income is collected for the benefit of the grantor, the statutory basis is Sec. 64.

Estates: A dies Jan. 1 2013. What tax is payable? Estate tax. 20% maximum. Accrues on the date of death. But paid 6 months later. Is this the tax we are concerned here? NO. Whatever rental income that has accrued from Jan. 1 will form part of the estate is the one concerned.

What if Jan 1 2014 comes, and still there is no settlement. What is the picture like? Who will report the rental income? The administrator. Can it file income tax returns? Yes. Is it entitled to deductions? Yes.

If there is anything distributed to the heir, that is deducted to the estate, and taxable to the beneficiary.

XII. TAX RETURNS, RATES AND PAYMENTS

A. Individual Returns

Section 51. Individual Return. -

(A) Requirements. -

(1) Except as provided in paragraph (2) of this Subsection, the following individuals are required to file an income tax return:

(a) Every Filipino citizen residing in the Philippines;
(b) Every Filipino citizen residing outside the Philippines, on his income from sources within the Philippines;
(c) Every alien residing in the Philippines, on income derived from sources within the Philippines; and
(d) Every nonresident alien engaged in trade or business or in the exercise of profession in the Philippines.

(2) The following individuals shall not be required to file an income tax return;

(a) An individual whose gross income does not exceed his total personal and additional exemptions for dependents under Section 35:

Provided, That a citizen of the Philippines and any alien individual engaged in business or practice of profession within the Philippine shall file an income tax return, regardless of the amount of gross income;

(b) An individual with respect to pure compensation income, as defined in Section 32 (A) (1), derived from sources within the Philippines, the income tax on which has been correctly withheld under the provisions of Section 79 of this Code:

Provided, That an individual deriving compensation concurrently from two or more employers at any time during the taxable year shall file an income tax return:

Provided, further, That an individual whose compensation income derived from sources within the Philippines exceeds Sixty thousand pesos (P60,000) shall also file an income tax return;

(c) An individual whose sole income has been subjected to final withholding tax pursuant to Section 57(A) of this Code; and

(d) An individual who is exempt from income tax pursuant to the provisions of this Code and other laws, general or special.

(3) The forgoing notwithstanding, any individual not required to file an income tax return may nevertheless be required to file an information return pursuant to rules and

regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner.

(4) The income tax return shall be filed in duplicate by the following persons:

(a) A resident citizen - on his income from all sources;
(b) A nonresident citizen - on his income derived from sources within the Philippines;
(c) A resident alien - on his income derived from sources within the Philippines; and
(d) A nonresident alien engaged in trade or business in the Philippines - on his income derived from sources within the Philippines.

(B) Where to File. - Except in cases where the Commissioner otherwise permits, the return shall be filed with an:
1. authorized agent bank,
2. Revenue District Officer,
3. Collection Agent or
4. duly authorized Treasurer of the city or municipality in which such person has his legal residence or principal place of business in the Philippines, or if there be no legal residence or place of business in the Philippines,
5. with the Office of the Commissioner.

(C) When to File. -
(1) The return of any individual specified above shall be filed on or before the fifteenth (15th) day of April of each year covering income for the preceding taxable year.
(2) Individuals subject to tax on capital gains;

(a) From the sale or exchange of shares of stock not traded thru a local stock exchange as prescribed under Section 24(c) shall file a return within thirty (30) days after each transaction and a final consolidated return on or before April 15 of each year covering all stock transactions of the preceding taxable year; and

(b) From the sale or disposition of real property under Section 24(D) shall file a return within thirty (30) days following each sale or other disposition.

(D) Husband and Wife. - Married individuals, whether citizens, resident or nonresident aliens, who do not derive income purely from compensation, shall file a return for the taxable year to include the income of both spouses, but where it is impracticable for the spouses to file one return, each spouse may file a separate return of income but the returns so filed shall be consolidated by the Bureau for purposes of verification for the taxable year.

(E) Return of Parent to Include Income of Children. - The income of unmarried minors derived from properly received from a living parent shall be included in the return of the parent, except
(1) when the donor's tax has been paid on such property, or
(2) when the transfer of such property is exempt from donor's tax.

(F) Persons Under Disability. - If the taxpayer is unable to make his own return, the return may be made by his:
1. duly authorized agent or representative or
2. by the guardian or
3. other person charged with the care of his person or property,

the principal and his representative or guardian assuming the responsibility of making the return and incurring penalties provided for erroneous, false or fraudulent returns.

(G) Signature Presumed Correct. - The fact that an individual's name is signed to a filed return shall be prima facie evidence for all purposes that the return was actually signed by him.

MINIMUM WAGE EARNER – shall refer to a worker in the private sector paid the statutory minimum wage, or to an employee in the public sector with compensation income of not more than the statutory minimum wage in the non-agricultural sector where he/she is assigned. (Sec.22 HH, as amended by RA 9504)

The minimum wage shall be exempt from the payment of income tax on their taxable income: Provided, further, That the holiday pay, overtime pay, night shift differential pay and hazard pay received by such minimum wage earners shall likewise be exempt from income tax

B. Corporation Returns

Section 52. Corporation Returns. -

(A) Requirements. - Every corporation subject to the tax herein imposed, except foreign corporations not engaged in trade or business in the Philippines, shall render:
1. in duplicate,
2. a true and accurate quarterly income tax return and final or adjustment return in accordance with the provisions of Chapter XII of this Title.

The return shall be filed by the:
1. president, vice-president or other principal officer, and
2. shall be sworn to by such officer and by the treasurer or assistant treasurer.

(B) Taxable Year of Corporation. - A corporation may employ either calendar year or fiscal year as a basis for filing its annual income tax return: Provided, That the corporation shall not change the accounting period employed without prior approval from the Commissioner in accordance with the provisions of Section 47 of this Code.

(C) Return of Corporation Contemplating Dissolution or Reorganization. - Every corporation shall, within thirty (30) days after the adoption by the corporation of a resolution or plan for its dissolution, or for the liquidation of the whole or any part of its capital stock, including a corporation which has been notified of possible involuntary dissolution by the Securities and Exchange Commission, or for its reorganization, render a:
1. correct return to the Commissioner,
2. verified under oath,
3. setting forth the terms of such resolution or plan and such other information as the Secretary of Finance, upon recommendation of the commissioner, shall, by rules and regulations, prescribe.

The dissolving or reorganizing corporation shall, prior to the issuance by the Securities and Exchange Commission of the Certificate of Dissolution or Reorganization, as may be defined by rules and regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner, secure a certificate of tax clearance from the Bureau of Internal Revenue which certificate shall be submitted to the Securities and Exchange Commission.

(D) Return on Capital Gains Realized from Sale of Shares of Stock not Traded in the Local Stock Exchange. - Every corporation deriving capital gains from the sale or exchange of shares of stock not traded thru a local stock exchange as prescribed under Sections 24 (c), 25 (A)(3), 27 (E)(2), 28(A)(8)(c) and 28 (B)(5)(c), shall file a return within thirty (30) days after each transactions and a final consolidated return of all transactions during the taxable year on or before the fifteenth (15th) day of the fourth (4th) month following the close of the taxable year.

C. Regular and Preferential Tax Rates

SEC. 24. Income Tax Rates -(A) Rates of Income Tax on Individual Citizen and Individual Resident Alien of the Philippines.

(1) An income tax is hereby imposed:
(a) On the taxable income defined in Section 31 of this Code, other than income subject to tax under Subsections (B), (C) and (D) of this Section, derived for each taxable year from all sources within and without the Philippines be every individual citizen of the

Philippines residing therein;

(b) On the taxable income defined in Section 31 of this Code, other than income subject to tax under Subsections (B), (C) and (D) of this Section, derived for each taxable year from all sources within the Philippines by an individual citizen of the Philippines who is residing outside of the Philippines including overseas contract workers referred to in Subsection(C) of Section 23 hereof; and

(c) On the taxable income defined in Section 31 of this Code, other than income subject to tax under Subsections (b), (C) and (D) of this Section, derived for each taxable year from all sources within the Philippines by an individual alien who is a resident of the Philippines.

The tax shall be computed in accordance with and at the rates established in the following schedule: (see schedule)

Provided, That effective January 1, 1999, the top marginal rate shall be thirty-three percent (33%) and effective January 1, 2000, the said rate shall be thirty-two percent (32%)

For married individuals, the husband and wife, subject to the provision of Section 51 (D) hereof, shall compute separately their individual income tax based on their respective total taxable income: Provided, That if any income cannot be definitely attributed to or identified as income exclusively earned or realized by either of the spouses, the same shall be divided equally between the spouses for the purpose of determining their respective taxable income.

Provided, that minimum wage earners as defined in Section 22(HH) if this Code shall be exempt from the payment of income tax on their taxable income; *Provided further,* that the:
1. Holiday pay
2. Overtime pay
3. Night differential pay, and
4. Hazard pay received by such minimum wage earners
shall likewise be exempt from income tax.

(B) Rate of Tax on Certain Passive Income (1) Interests, Royalties, Prizes, and Other Winnings. -
A final tax at the rate of twenty percent (20%) is hereby imposed upon the:
1. amount of interest from any currency bank deposit and yield or

2. any other monetary benefit from deposit substitutes and from trust funds and similar arrangements;

3. Royalties, except on books, as well as other literary works and musical compositions, which shall be imposed a final tax of ten percent (10%);
4. prizes (except prizes amounting to Ten thousand pesos (P10,000) or less which shall be subject to tax under Subsection (A) of Section 24; and
5. other winnings (except Philippine Charity Sweepstakes and Lotto winnings), derived from sources within the Philippines:

Provided, however, That interest income received by an individual taxpayer (except a nonresident individual) from a depository bank under the expanded foreign currency deposit system shall be subject to a final income tax at the rate of seven and one-half percent (7 1/2%) of such interest income:

Provided, further, That:
1. interest income from long-term deposit or investment in the form of savings, common or individual trust funds, deposit substitutes, investment management accounts and
2. other investments evidenced by certificates in such form prescribed by the Bangko Sentral ng Pilipinas (BSP)
shall be exempt from the tax imposed under this Subsection:

Provided, finally, That should the holder of the certificate pre-terminate the deposit or investment before the fifth (5^{th}) year, a final tax shall be imposed on the entire income and shall be deducted and withheld by the depository bank from the proceeds of the long-term deposit or investment certificate based on the remaining maturity thereof:

Four (4) years to less than five (5) years - 5%;
Three (3) years to less than (4) years - 12%;
and Less than three (3) years - 20%

Prize, differentiated from winnings → A prize is the result of an effort made (e.g., prize in a beauty contest), while winnings are the result of a transaction where the outcome depends upon chance (e.g., betting).

If the foreign currency deposit is made with a bank located outside the Philippines, the interest income is subject to the graduated income tax rates (if depositor is a citizen) and to normal corporate income tax rate (if depositor is a domestic corporation)

(2) Cash and/or Property Dividends - A final tax at the following rates shall be imposed upon the cash and/or property dividends actually or constructively received by:
1. an individual from a domestic corporation or from a joint stock company, insurance or mutual fund companies and regional operating headquarters of multinational companies, or
2. on the share of an individual in the distributable net income after tax of a partnership (except a general professional partnership) of which he is a partner, or
3. on the share of an individual in the net income after tax of an association, a joint account, or a joint venture or consortium taxable as a corporation of which he is a member or co-venturer:

Ten percent (10%) beginning January 1, 2000

(C) Capital Gains from Sale of Shares of Stock not Traded in the Stock Exchange - The provisions of Section 39(B) notwithstanding, a final tax at the rates prescribed below is hereby imposed upon the net capital gains realized during the taxable year from the:
1. sale, barter, exchange or other disposition of shares of stock
2. in a domestic corporation,
except shares sold, or disposed of through the stock exchange

Not over P100,000……. 5%
On any amount in excess of P100,000…… 10%

(D) Capital Gains from Sale of Real Property. - (1) In General. - The provisions of Section 39(B) notwithstanding, a final tax of six percent (6%) based on the:
1. gross selling price or
2. current fair market value as determined in accordance with Section 6(E) of this Code, whichever is higher, is hereby imposed upon
capital gains presumed to have been realized from the:
1. sale, exchange, or other disposition of real property located in the Philippines,
2. classified as capital assets, including pacto de retro sales and other forms of conditional sales, by individuals, including estates and trusts:

Provided, That the tax liability, if any, on gains from sales or other dispositions of real property to the:
1. government or
2. any of its political subdivisions or agencies or
3. to government-owned or controlled corporations
shall be determined either under Section 24 (A) or under this Subsection, at the option of the taxpayer.

De Leon: This is broad enough to cover also involuntary sales. Moreover, only the sale of real property located in the Phils are subject to Capital Gains Tax.

Alternative Taxation: In case of a sale or other disposition of real property to the government or any of its political subdivisions or agencies or to government-owned or controlled corporations, the tax shall be EITHER the year-end tax of the individual (i.e., capital gain to be included in the computation of income subject to schedular rates), OR the capital gain tax of 6%, at the option of the taxpayer

(2) Exception - The provisions of paragraph (1) of this Subsection to the contrary notwithstanding, capital gains presumed to have been realized from the sale or disposition of their principal residence by natural persons, the proceeds of which is fully utilized in acquiring or constructing a new principal residence within eighteen (18) calendar months from the date of sale or disposition, shall be exempt from the capital gains tax imposed under this Subsection: Provided, That the historical cost or adjusted basis of the real property sold or disposed shall be carried over to the new principal residence built or acquired: Provided, further, That the Commissioner shall have been duly notified by the taxpayer within thirty (30) days from the date of sale or disposition through a prescribed return of his intention to avail of the tax exemption herein mentioned: Provided, still further, That the said tax exemption can only be availed of once every ten (10) years: Provided, finally,that if there is no full utilization of the proceeds of sale or disposition, the portion of the gain presumed to have been realized from the sale or disposition shall be subject to capital gains tax.

For this purpose, the gross selling price or fair market value at the time of sale, whichever is higher, shall be multiplied by a fraction which the unutilized amount bears to the gross selling price in order to determine the taxable portion and the tax prescribed under paragraph (1) of this Subsection shall be imposed thereon.

SEC. 25. Tax on Nonresident Alien Individual-
(A) Nonresident Alien Engaged in trade or Business Within the Philippines. -
(1) In General. - A nonresident alien individual engaged in trade or business in the Philippines shall be subject to an income tax in the same manner as an individual citizen and a resident alien individual, on taxable income received from all sources within the Philippines.

A nonresident alien individual who shall come to the Philippines and stay therein for an aggregate period of more than one hundred eighty (180) days during any calendar year shall be deemed a 'nonresident alien doing business in the Philippines'. Section 22 (G) of this Code notwithstanding.

(2) Cash and/or Property Dividends from a Domestic Corporation or Joint Stock Company, or Insurance or Mutual Fund Company or Regional Operating Headquarters or Multinational Company, or Share in the Distributable Net Income of a Partnership (Except a General Professional Partnership), Joint Account, Joint Venture Taxable as a Corporation or Association., Interests, Royalties, Prizes, and Other Winnings. -

1. Cash and/or property dividends from a domestic corporation, or from a joint stock company, or from an insurance or mutual fund company or from a regional operating headquarters of multinational company, or
2. the share of a nonresident alien individual in the distributable net income after tax of a partnership (except a general professional partnership) of which he is a partner, or
3. the share of a nonresident alien individual in the net income after tax of an association, a joint account, or a joint venture taxable as a corporation of which he is a member or a co-venturer;
4. interests;
5. royalties (in any form); and
6. prizes (except prizes amounting to Ten thousand pesos (P10,000) or less which shall be subject to tax under Subsection (B)(1) of Section 24) and
7. other winnings (except Philippine Charity Sweepstakes and Lotto winnings); shall be subject to an income tax of twenty percent (20%) on the total amount thereof:

Provided, however, that:
1. royalties on books as well as other literary works, and royalties on musical compositions shall be subject to a final tax of ten percent (10%) on the total amount thereof:
2. Provided, further, That cinematographic films and similar works shall be subject to the tax provided under Section 28 of this Code:
3. Provided, furthermore, That interest income from long-term deposit or investment in the form of savings, common or individual trust funds, deposit substitutes, investment management accounts and other investments evidenced by certificates in such form prescribed by the Bangko Sentral ng Pilipinas (BSP) shall be exempt from the tax imposed under this Subsection:

Provided, finally, that should the holder of the certificate pre-terminate the deposit or investment before the fifth (5^{th}) year, a final tax shall be imposed on the entire income and shall be deducted and withheld by the depository bank from the proceeds of the long-term deposit or investment certificate based on the remaining maturity thereof:

Four (4) years to less than five (5) years - 5%;
Three (3) years to less than four (4) years - 12%; and
Less than three (3) years - 20%.

(3) Capital Gains. - Capital gains realized from sale, barter or exchange of shares of stock in domestic corporations not traded through the local stock exchange, and real properties shall be subject to the tax prescribed under Subsections (C) and (D) of Section 24.

If the NRA is engaged in business in the Philippines, he shall be taxed in the same manner as a Nonresident Citizen, except for the following:

(1) Dividends are subject to 20% on GROSS AMOUNT
(2) Cinematographic Film owner at 20% on GROSS INCOME

(B) Nonresident Alien Individual Not Engaged in Trade or Business Within the Philippines. - There shall be levied, collected and paid for each taxable year upon the entire income received from all sources within the Philippines by every nonresident alien individual not engaged in trade or business within the Philippines as interest, cash and/or property dividends, rents, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual or periodic or casual gains, profits, and income, and capital gains, a tax equal to twenty-five percent (25%) of such income.

Capital gains realized by a nonresident alien individual not engaged in trade or business in the Philippines from the sale of shares of stock in any domestic corporation and real property shall be subject to the income tax prescribed under Subsections (C) and (D) of Section 24.

(C) Alien Individual Employed by Regional or Area Headquarters and Regional Operating Headquarters of Multinational Companies. - There shall be levied, collected and paid for each taxable year upon the gross income received by every alien individual employed by regional or area headquarters and regional operating headquarters established in the Philippines by multinational companies as salaries, wages, annuities, compensation, remuneration and other emoluments, such as honoraria and allowances, from such regional or area headquarters and regional operating headquarters, a tax equal to fifteen percent (15%) of such gross income: Provided, however, That the same tax treatment shall apply to Filipinos employed and occupying the same position as those of aliens employed by these multinational companies.

For purposes of this Chapter, the term 'multinational company' means a foreign firm or entity engaged in international trade with affiliates or subsidiaries or branch offices in the Asia-Pacific Region and other foreign markets.

(D) Alien Individual Employed by Offshore Banking Units. - There shall be levied, collected and paid for each taxable year upon the gross income received by every alien

individual employed by offshore banking units established in the Philippines as salaries, wages, annuities, compensation, remuneration and other emoluments, such as honoraria and allowances, from such off-shore banking units, a tax equal to fifteen percent (15%) of such gross income: Provided, however, That the same tax treatment shall apply to Filipinos employed and occupying the same positions as those of aliens employed by these offshore banking units.

(E) Alien Individual Employed by Petroleum Service Contractor and Subcontractor - An Alien individual who is a permanent resident of a foreign country but who is employed and assigned in the Philippines by a foreign service contractor or by a foreign service subcontractor engaged in petroleum operations in the Philippines shall be liable to a tax of fifteen percent (15%) of the salaries, wages, annuities, compensation, remuneration and other emoluments, such as honoraria and allowances, received from such contractor or subcontractor: Provided, however, That the same tax treatment shall apply to a Filipino employed and occupying the same position as an alien employed by petroleum service contractor and subcontractor.

Any income earned from all other sources within the Philippines by the alien employees referred to under Subsections (C), (D) and (E) hereof shall be subject to the pertinent income tax, as the case may be, imposed under this Code.

Non-resident alien individuals engaged in business are taxed at a final tax of 25% based on his GROSS INCOME within the Philippines; EXCEPT:
(1) Alien employed by a regional or area headquarters established in the Philippines by a multinational company
(2) Offshore banking units
(3) Petroleum service contractor and subcontractor. They are taxed at 15% of their salaries.

De Leon: The special tax treatements is given to such aliens as an incentive for the establishment of such corporations. BUT this preferential treatment is NOT applicable in a situation where there is no alien employed.

SEC. 27*. Rates of Income tax on Domestic Corporations. -*
(A) *In General.* - Except as otherwise provided in this Code, an income tax of 30% is hereby imposed upon the taxable income derived during each taxable year from all sources within and without the Philippines by every corporation, as defined in Section 22(B) of this Code and taxable under this Title as a corporation, organized in, or existing under the laws of the Philippines:

In the case of corporations adopting the fiscal-year accounting period, the taxable income shall be computed without regard to the specific date when specific sales, purchases and

other transactions occur.Their income and expenses for the fiscal year shall be deemed to have been earned and spent equally for each month of the period.

The corporate income tax rates shall be applied on the amount computed by multiplying the number of months covered by the new rates within the fiscal year by the taxable income of the corporation for the period, divided by twelve

Provided, further, That the President, upon the recommendation of the Secretary of Finance, may effective January 1, 2000, allow corporations the option to be taxed at fifteen percent (15%) of gross income as defined herein, after the following conditions have been satisfied:

(1) A tax effort ratio of twenty percent (20%) of Gross National Product (GNP);
(2) A ratio of forty percent (40%) of income tax collection to total tax revenues;
(3) A VAT tax effort of four percent (4%) of GNP; and
(4) A 0.9 percent (0.9%) ratio of the Consolidated Public Sector Financial Position (CPSFP) to GNP.

The option to be taxed based on gross income shall be available only to firms whose ratio of cost of sales to gross sales or receipts from all sources does not exceed fifty-five percent (55%).

The election of the gross income tax option by the corporation shall be irrevocable for three (3) consecutive taxable years during which the corporation is qualified under the scheme.

For purposes of this Section, the term 'gross income' derived from business shall be equivalent to gross sales less sales returns, discounts and allowances and cost of goods sold *"Cost of goods sold"* shall include all business expenses directly incurred to produce the merchandise to bring them to their present location and use.

For a trading or merchandising concern, *"cost of goods"* sold shall include the invoice cost of the goods sold, plus import duties, freight in transporting the goods to the place where the goods are actually sold, including insurance while the goods are in transit.

For a manufacturing concern, *"cost of goods manufactured and sold"* shall include all costs of production of finished goods, such as raw materials used, direct labor and manufacturing overhead, freight cost, insurance premiums and other costs incurred to bring the raw materials to the factory or warehouse.

In the case of taxpayers engaged in the sale of service, 'gross income' means gross receipts less sales returns, allowances and discounts.

(B) *Proprietary Educational Institutions and Hospitals*. -
1. Proprietary educational institutions and hospitals
2. which are nonprofit
shall pay a tax of ten percent (10%) on their taxable income except those covered by Subsection (D) hereof:

Provided, that if the gross income from unrelated trade, business or other activity exceeds fifty percent (50%) of the total gross income derived by such educational institutions or hospitals from all sources, the tax prescribed in Subsection (A) hereof shall be imposed on the entire taxable income.

For purposes of this Subsection, the term 'unrelated trade, business or other activity' means any trade, business or other activity, the conduct of which is not substantially related to the exercise or performance by such educational institution or hospital of its primary purpose or function.

A *"Proprietary educational institution"* is any:
1. private school maintained and administered by private individuals or groups
2. with an issued permit to operate from the Department of Education, Culture and Sports (DECS), or the Commission on Higher Education (CHED), or the Technical Education and Skills Development Authority (TESDA), as the case may be, in accordance with existing laws and regulations.

*De Leon It must be a non profit and non stock educational institution. The earnings of the school from passive investments, not derived in pursuance of its educational institution are subject to 20% tax. If it is used (1) directly (2) exclusively (3) and actually for its educational purpose or function, then it is exempt from 20% tax.

(C) *Government-owned or Controlled-Corporations, Agencies or Instrumentalities* - The provisions of existing special or general laws to the contrary notwithstanding, all corporations, agencies, or instrumentalities owned or controlled by the Government, except the:
1.Government Service Insurance System (GSIS),
2. the Social Security System (SSS),
3. the Philippine Health Insurance Corporation (PHIC), and
4. the Philippine Charity Sweepstakes Office (PCSO), shall pay such rate of tax upon their taxable income as are imposed by this Section upon corporations or associations engaged in s similar business, industry, or activity.

(D) *Rates of Tax on Certain Passive Incomes. -*
(1) *Interest from Deposits and Yield or any other Monetary Benefit from Deposit Substitutes and from Trust Funds and Similar Arrangements, and Royalties* - A

final tax at the rate of twenty percent (20%) is hereby imposed upon the amount of:
1. interest on currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements received by domestic corporations, and
2. royalties, derived from sources within the Philippines:
3. *Provided, however,* That interest income derived by a domestic corporation from a depository bank under the expanded foreign currency deposit system shall be subject to a final income tax at the rate of seven and one-half percent (7 1/2%) of such interest income.

*De Leon: Note that it does not include prizes and winnings unlike Section 24(B, 1)

(2) *Capital Gains from the Sale of Shares of Stock Not Traded in the Stock Exchange.* - A final tax at the rates prescribed below shall be imposed on net capital gains realized during the taxable year from the sale, exchange or other disposition of shares of stock in a domestic corporation except shares sold or disposed of through the stock exchange:

Not over P100,000…….5%
Amount in excess of P100,000…….10%

(3) *Tax on Income Derived under the Expanded Foreign Currency Deposit System.* - Income derived by a:
1. depository bank
2. under the expanded foreign currency deposit system
3. from foreign currency transactions with nonresidents, offshore banking units in the Philippines, local commercial banks, including branches of foreign banks that may be authorized by the BSP to transact business with foreign currency deposit system units and other depository banks under the expanded foreign currency deposit system shall be exempt from all taxes, except net income from such transactions as may be specified by the Sec. of Finance, upon recommendation by the MB to be subject to the regular income tax payable by banks.

Provided however, that interest income from foreign currency loans granted by such depository banks under said expanded foreign system to residents other than offshore banking units in the Philippines or other depository banks under the expanded system shall be subject to a final tax at the rate of 10%.

Any income of nonresidents, whether individuals or corporations, from transactions with depository banks under the expanded system shall be exempt from income tax.

*De Leon: Corporations, unlike individuals, are not granted tax exemption for long-term deposits

(4) *Intercorporate Dividends*. - Dividends received by a domestic corporation from another domestic corporation shall not be subject to tax.

*De Leon: Dividend exclusion has always been a dominant feature of corporate income tax. It is a device for reducing extra or double taxation of distributed earnings. Since a corporation cannot deduct from its gross income the amount of dividends distributed to its shareholders during the taxable year, any distributed earnings are necessarily taxed twice. (Initially, at the corporate level when they are included as taxable income, and again, at the corporation-shareholder level when they are received as dividend.)

Thus without exclusion, the successive taxation of the dividend as it passes from corporation to corporation would result in repeated taxation of the same income and would leave very little for the shareholder

(5) *Capital Gains Realized from the Sale, Exchange or Disposition of Lands and/or Buildings.* - A final tax of six percent (6%) is hereby imposed on the gain presumed to have been realized on the sale, exchange or disposition of lands and/or buildings which are not actually used in the business of a corporation and are treated as capital assets, based on the gross selling price of fair market value as determined in accordance with Section 6(E) of this Code, whichever is higher, of such lands and/or buildings.

SEC. 28*. Rates of Income Tax on Foreign Corporations. -*
(A) *Tax on Resident Foreign Corporations. - .*
(1) *In General*. - Except as otherwise provided in this Code:
1. a corporation organized, authorized, or existing
2. under the laws of any foreign country,
3. engaged in trade or business within the Philippines, shall be subject to an income tax equivalent to 30% of the taxable income derived in the preceding taxable year from all sources within the Philippines.

In the case of corporations adopting the fiscal-year accounting period, the taxable income shall be computed without regard to the specific date when sales, purchases and other transactions occur. Their income and expenses for the fiscal year shall be deemed to have been earned and spent equally for each month of the period.

The corporate income tax rates shall be applied on the amount computed by multiplying the number of months covered by the new rates within the fiscal year by the taxable income of the corporation for the period, divided by twelve

Provided, however, That a resident foreign corporation shall be granted the option to be taxed at fifteen percent (15%) on gross income under the same conditions, as provided in Section 27 (A).

(2) *Minimum Corporate Income Tax on Resident Foreign Corporations.* - A minimum corporate income tax of two percent (2%) of gross income, as prescribed under Section 27 (E) of this Code, shall be imposed, under the same conditions, on a resident foreign corporation taxable under paragraph (1) of this Subsection.

(3) *International Carrier*. - An international carrier doing business in the Philippines shall pay a tax of two and one-half percent (2 1/2%) on its *"Gross Philippine Billings"* as defined hereunder:

(a) *International Air Carrier.* - *"Gross Philippine Billings"* refers to the amount of gross revenue derived from carriage of persons, excess baggage, cargo and mail originating from the Philippines in a continuous and uninterrupted flight, irrespective of the place of sale or issue and the place of payment of the ticket or passage document: *Provided,* That tickets revalidated, exchanged and/or indorsed to another international airline form part of the Gross Philippine Billings if the passenger boards a plane in a port or point in the Philippines: *Provided, further*, That for a flight which originates from the Philippines, but transshipment of passenger takes place at any port outside the Philippines on another airline, only the aliquot portion of the cost of the ticket corresponding to the leg flown from the Philippines to the point of transshipment shall form part of Gross Philippine Billings.

(b) *International Shipping*. - *"Gross Philippine Billings"* means gross revenue whether for passenger, cargo or mail originating from the Philippines up to final destination, regardless of the place of sale or payments of the passage or freight documents.

(4) *Offshore Banking Units* - The provisions of any law to the contrary notwithstanding, income derived by offshore banking units authorized by the Bangko Sentral ng Pilipinas (BSP) from foreign currency transactions with:
1. nonresidents
2. other offshore banking units
3. local commercial banks, including branches of foreign banks that may be authorized by BSP to transact business with offshore banking units shall be exempt from all taxes except net income from such transactions as may be specified by the Secretary of Finance, upon recommendation of the MB, which shall be subject to regular income tax payable by banks..

Provided however, that any interest income from foreign currency loans granted to residents other than offshore banking units or local commercial banks, including local

branches of foreign banks that may be authorized by the BSP to transact business with offshore banking units shall be subject to a final tax at the rate of 10%.

Any income of nonresidents, whether individuals or corporations, from transactions with said offshore banking units shall be exempt from income tax.

(5) ***Tax on Branch Profits Remittances*****.** - Any profit remitted by a branch to its head office shall be subject to a tax of fifteen (15%) which shall be based on:
1. the total profits applied or earmarked for remittance
2. without any deduction for the tax component thereof (except those activities which are registered with the Philippine Economic Zone Authority).

The tax shall be collected and paid in the same manner as provided in Sections 57 and 58 of this Code: provided, that interests, dividends, rents, royalties, including remuneration for technical services, salaries, wages premiums, annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits, income and capital gains received by a foreign corporation during each taxable year from all sources within the Philippines shall not be treated as branch profits unless the same are effectively connected with the conduct of its trade or business in the Philippines.

To equalize the tax burden on foreign corporations maintaining, on one hand, local branch offices, and organizing, on the other hand, a subsidiary domestic corporation where at least a majority of all the latter's shares of stock are owned by such corporations, the 15% branch profit remittance tax is imposed on the profit actually remitted by the Philippine branch to its head office

Subsidiary v. Branch

A subsidiary is an entity separate and distinct from its stockholders, it can deal with its foreign parent company provided that the transactions are at arms length. There would be no attribution of the income of the subsidiary to the foreign parent company because of the separate entity concept. → They are taxable on WORLDWIDE income at 30%

Philippine branch is merely an extension of the foreign head office. The transactions and income of the Philippine branch may be attributed to the foreign head office based on the single entity concept.--> Taxable on income from sources WITHIN the Philippines at 30% (but there are exempt branches e.g. regional area headquarters and representative offices, and special branches at a rate of 10%)

As a GENERAL RULE, the head office of a foreign corporation is the same juridical entity as its branch in the Philippines following the "single entity concept".

The income from sources within the Philippines of the foreign head office shall thus be taxable to the Philippine branch.

BUT when the head office of a foreign corporation independently and directly invested in a domestic corporation without the funds passing through its Philippine branch, the taxpayer with respect to the tax on the dividend income would be the non-resident foreign corporation itself and the dividend income shall be subject to the tax similarly imposed on non-resident foreign corporations.

Interest paid by the subsidiary on a loan granted by the foreign parent company is deductible from the subsidiary's gross income, while the interest income paid to the foreign parent company shall be subject to final withholding tax.

But interest paid by a Philippine branch on a loan extended by the foreign head office is not deductible from gross income, and the interest income of the foreign head office is not subject to Philippine withholding tax.

**Baniqued: Foreign Corporation may do business in the Philippines in so many ways.*

1. *Subsidiary – Wholly owned or partly owned. This is a Philippine company. When this makes money, it is taxed at 30%. When it remits dividends to the foreign corporation (parent)? 30% UNLESS the tax sparing provision applies. Without distribution of dividends, you are subject to IAET. (Note it does not apply to branches, no IAET to branches)*

2. *Branch – This is a foreign corporation licensed to do business in the Philippines. This is nothing but a foreign corporation that has been issued by the SEC to do business here. When it makes money, how is it taxed? 30%. When it remits profits to the head office (same corporation), there is a Branch Office Remittance Tax 15%. In the past there was no branch profit remittance tax. So they rather put up branches before. This only applies when there is a remittance whether actual or constructive. If there is no remittance at all, it does not apply. Bar exam question: Binaliktad, the branch was from China papasok sa Pilipinas. This is not taxable as branch profit.*

3. *RHQ – This cannot actively engage in trade or business. It cannot earn income. It only acts as a supervisory center for the affiliates of the foreign corporation in the region.*

4. *ROHQ – It is a foreign corporation licensed to do business in the Philippines. It is authorized to do business. 10% on its taxable income.*

Branch profits remittance tax – It only applies to those that are effectively connected with the conduct of its trade or business in the Philippines. Not all profits that are remitted are taxable.

Marubeni Case. Head Office in Japan (doing business in the Philippines as a Resident Corporation) had a branch in the Philippines. Marubeni invested to AG&P(another corporation). AG&P remitted dividends to Marubeni. With respect to the investment of Marubeni to AG&P, it is not a resident foreign corporation. Whereas all profits remitted by the branch will be subject to BPRT. So with respect to the activities with AG&P, it is a non-resident foreign corporation, and with respect to branch, it is a resident foreign corporation.

What if the funds went through the branch? Then AG&P paid dividends to a branch. What's the tax? Exempt. 0%. Intercorporate Dividend eh. When the branch the recieves the dividends, and then remits the dividends to the head office, is it subject to BPRT? Yes. It is part of the business of the branch which manages investments. Compare this structure above.

"which shall be based on the total profits applied or earmarked for remittance without any deduction for the tax component thereof." (This is because someone said that you deduct the 15% first and then the one remitted is the one which will be taxed.)

(6) *Regional or Area Headquarters and Regional Operating Headquarters of Multinational Companies.* -

(a) Regional or area headquarters as defined in Section 22(DD) shall not be subject to income tax.

(b) Regional operating headquarters as defined in Section 22(EE) shall pay a tax of ten percent (10%) of their taxable income.

Sec. 22(DD) The term "regional or area headquarters" shall mean a branch established in the Philippines by multinational companies and which headquarters do not earn or derive income from the Philippines and which act as supervisory, communications and coordinating center for their affiliates, subsidiaries, or branches in the Asia-Pacific Region and other foreign markets.

Sec. 22(EE) The term "regional operating headquarters" shall mean a branch established in the Philippines by multinational companies which are engaged in any of the following services:
(1) general administration and planning;
(2) business planning and coordination;

(3) sourcing and procurement of raw materials and components;
(4) corporate finance advisory services;
(5) marketing control and sales promotion;
(6) training and personnel management;
(7) logistic services;
(8) research and development services and product development;
(9) technical support and maintenance; data processing and communications; and
(10)business development.

(7) *Tax on Certain Incomes Received by a Resident Foreign Corporation.*
- (a)*Interest from Deposits and Yield or any other Monetary Benefit from Deposit Substitutes, Trust Funds and Similar Arrangements and Royalties* - Interest from:
1. any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements and
2. royalties derived from sources within the Philippines shall be subject to a final income tax at the rate of twenty percent (20%) of such interest:

Provided, however, That interest income derived by a resident foreign corporation from a depository bank under the expanded foreign currency deposit system shall be subject to a final income tax at the rate of seven and one-half percent (7 1/2%) of such interest income.

(b) *Income Derived under the Expanded Foreign Currency Deposit System* -
Income derived by a:
1. depository bank
2. under the expanded foreign currency deposit system
3. from foreign currency transactions with nonresidents, offshore banking units in the Philippines, local commercial banks, including branches of foreign banks that may be authorized by the BSP to transact business with foreign currency deposit system units and other depository banks under the expanded foreign currency deposit system shall be exempt from all taxes, except net income from such transactions as may be specified by the Sec. of Finance, upon recommendation by the MB to be subject to the regular income tax payable by banks.

Provided however, that interest income from foreign currency loans granted by such depository banks under said expanded foreign system to residents other than offshore banking units in the Philippines or other depository banks under the expanded system shall be subject to a final tax at the rate of 10%.

Any income of nonresidents, whether individuals or corporations, from transactions with depository banks under the expanded system shall be exempt from income tax.

(c) *Capital Gains from Sale of Shares of Stock Not Traded in the Stock Exchange.* - A final tax at the rates prescribed below is hereby imposed upon the net capital gains realized during the taxable year from the sale, barter, exchange or other disposition of shares of stock in a domestic corporation except shares sold or disposed of through the stock exchange:

Not over P100,000…….. 5%
On any amount in excess of P100,000…….10%

(d) *Intercorporate Dividends*. - Dividends received by a resident foreign corporation from a domestic corporation liable to tax under this Code shall not be subject to tax under this Title.

(B) Tax on Nonresident Foreign Corporation. -
(1) *In General*. - Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-five percent (30%) of the gross income received during each taxable year from all sources within the Philippines, such as interests, dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits and income, and capital gains, except capital gains subject to tax under subparagraphs (C) and (d)

(2) *Nonresident Cinematographic Film Owner, Lessor or Distributor.* - A cinematographic film owner, lessor, or distributor shall pay a tax of twenty-five percent (25%) of its gross income from all sources within the Philippines.

(**3) *Nonresident Owner or Lessor of Vessels Chartered by Philippine Nationals***. - A nonresident owner or lessor of vessels shall be subject to a tax of four and one-half percent (4 1/2%) of gross rentals, lease or charter fees from leases or charters to Filipino citizens or corporations, as approved by the Maritime Industry Authority.

(4) *Nonresident Owner or Lessor of Aircraft, Machineries and Other Equipment.* - Rentals, charters and other fees derived by a nonresident lessor of aircraft, machineries and other equipment shall be subject to a tax of seven and one-half percent (7 1/2%) of gross rentals or fees.

(**5) *Tax on Certain Incomes Received by a Nonresident Foreign Corporation. -***
(a) *Interest on Foreign Loans*. - A final withholding tax at the rate of twenty percent (20%) is hereby imposed on the amount of interest on foreign loans contracted on or after August 1, 1986;

(b) *Intercorporate Dividends* - A final withholding tax at the rate of fifteen percent (15%) is hereby imposed on:

1. the amount of cash and/or property dividends
2. received from a domestic corporation, which shall be collected and paid as provided in Section 57 (A) of this Code,
3. subject to the condition that the country in which the nonresident foreign corporation is domiciled, shall allow a credit against the tax due from the nonresident foreign corporation taxes deemed to have been paid in the Philippines equivalent to twenty percent (15%) which represents the difference between the regular income tax of thirty-five percent (30%) and the fifteen percent (15%) tax on dividends.

The code seeks to promote the inflow of foreign equity investments in the Philippines by reducing the tax cost of earning profits here and thereby increasing the net dividends remittable to the investor. The foreign investor however, would not benefit from the reduction of the Philippine dividend tax rate unless its home country gives it some relief from double taxation.

Accordingly, the Code requires the home or domiciliary country to give the investor corporation a "deemed paid" tax credit at least equal in amount to 20% of dividend tax foregone by the Philippines.

*CIR vs. Proctor and Gamble: The parent-corporation P&G-USA is "deemed to have paid" a portion of the Philippine corporate income taxalthough that tax was actually paid by its Philippine subsidiary, P&G-Phil., not by P&G-USA. This "deemed paid" concept merely reflects economic reality, since the Philippine corporate income tax was in fact paid and deducted from revenues earned in the Philippines, thus reducing the amount remittable as dividends to P&G-USA. In other words, US tax law treats the Philippine corporate income tax as if it came out of the pocket, as it were, of P&G-USA as a part of the economic cost of carrying on business operations in the Philippines through the medium of P&G-Phil. and here earning profits. What is, under US law, deemed paid by P&G- USA are not "phantom taxes" but instead Philippine corporate income taxes actually paid here by P&G-Phil., which are very real indeed.

(c) ***Capital Gains from Sale of Shares of Stock not Traded in the Stock Exchange.*** **-** A final tax at the rates prescribed below is hereby imposed upon the net capital gains realized during the taxable year from the sale, barter, exchange or other disposition of shares of stock in a domestic corporation, except shares sold, or disposed of through the stock exchange:

Not over P100,000……..5%
On any amount in excess of P100,000…… 10%

D. Venue and Date of Filing and Payment

Sec. 51(B) Where to File - Except in cases where the Commissioner otherwise permits, the return shall be filed with an:
1. authorized agent bank,
2. Revenue District Officer,
3. Collection Agent or
4. duly authorized Treasurer of the city or municipality in which such person has his legal residence or principal place of business in the Philippines, or
5. if there be no legal residence or place of business in the Philippines, with the Office of the Commissioner.

(C) When to File. -
(1) The return of any individual specified above shall be filed on or before the fifteenth (15th) day of April of each year covering income for the preceding taxable year.

(2) Individuals subject to tax on capital gains;
(a) From the sale or exchange of shares of stock not traded thru a local stock exchange as prescribed under Section 24(c) shall file a return within thirty (30) days after each transaction and a final consolidated return on or before April 15 of each year covering all stock transactions of the preceding taxable year; and
(b) From the sale or disposition of real property under Section 24(D) shall file a return within thirty (30) days following each sale or other disposition.

SEC. 52. Corporation Returns. -
(A) Requirements. - Every corporation subject to the tax herein imposed, except foreign corporations not engaged in trade or business in the Philippines, shall render, in duplicate, a true and accurate quarterly income tax return and final or adjustment return in accordance with the provisions of Chapter XII of this Title.

The return shall be filed by the:
1. president,
2. vice-president or
3. other principal officer, and shall be sworn to by such officer and by the treasurer or assistant treasurer.

(B) Taxable Year of Corporation. - A corporation may employ either calendar year or fiscal year as a basis for filing its annual income tax return: Provided, That the corporation shall not change the accounting period employed without prior approval from the Commissioner in accordance with the provisions of Section 47 of this Code.

(C) Return of Corporation Contemplating Dissolution or Reorganization. - Every corporation shall, within thirty (30) days after the adoption by the corporation of a:
1. resolution or plan for its dissolution, or

2. for the liquidation of the whole or any part of its capital stock, including a corporation which has been notified of possible involuntary dissolution by the Securities and Exchange Commission, or
3. for its reorganization,

render a correct return to the Commissioner, verified under oath, setting forth the terms of such resolution or plan and such other information as the Secretary of Finance, upon recommendation of the commissioner, shall, by rules and regulations, prescribe.

The dissolving or reorganizing corporation shall, prior to the issuance by the Securities and Exchange Commission of the Certificate of Dissolution or Reorganization, as may be defined by rules and regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner, secure a certificate of tax clearance from the Bureau of Internal Revenue which certificate shall be submitted to the Securities and Exchange Commission.

(D) Return on Capital Gains Realized from Sale of Shares of Stock not Traded in the Local Stock Exchange. - Every corporation deriving capital gains from the sale or exchange of shares of stock not traded thru a local stock exchange as prescribed under Sections 24 (c), 25 (A)(3), 27 (E)(2), 28(A)(8)(c) and 28 (B)(5)(c), shall file a return within thirty (30) days after each transactions and a final consolidated return of all transactions during the taxable year on or before the fifteenth (15th) day of the fourth (4th) month following the close of the taxable year.

SEC. 74. Declaration of Income Tax for Individuals. -
(A) In General. - Except as otherwise provided in this Section, every individual subject to income tax under Sections 24 and 25(A) of this Title, who is receiving:
self-employment income, whether it constitutes the sole source of his income or in combination with salaries, wages and other fixed or determinable income, shall make and file a declaration of his estimated income for the current taxable year on or before April 15 of the same taxable year.

In general, self-employment income consists of the earnings derived by the individual from the:
1. practice of profession or
2. conduct of trade or business carried on by him as a sole proprietor or by a partnership of which he is a member.

Nonresident Filipino citizens, with respect to income from without the Philippines, and nonresident aliens not engaged in trade or business in the Philippines, are not required to render a declaration of estimated income tax.

The declaration shall contain such pertinent information as the Secretary of Finance, upon recommendation of the Commissioner, may, by rules and regulations prescribe.

An individual may make amendments of a declaration filed during the taxable year under the rules and regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner.

(B) Return and Payment of Estimated Income Tax by Individuals. - The amount of estimated income as defined in Subsection (C) with respect to which a declaration is required under Subsection (A) shall be paid in four (4) installments.

The first installment shall be paid at the time of the declaration and the second and third shall be paid on August 15 and November 15 of the current year, respectively.

The fourth installment shall be paid on or before April 15 of the following calendar year when the final adjusted income tax return is due to be filed. cralaw

(C) Definition of Estimated Tax. - In the case of an individual, the term "estimated tax" means:
1. the amount which the individual declared as income tax in his final adjusted and annual income tax return for the preceding taxable year
2. minus the sum of the credits allowed under this Title against the said tax.

If, during the current taxable year, the taxpayer reasonable expects to pay a bigger income tax, he shall file an amended declaration during any interval of installment payment dates.

SEC. 75. Declaration of Quarterly Corporate Income Tax. - Every corporation shall file in duplicate a quarterly summary declaration of its gross income and deductions on a cumulative basis for the preceding quarter or quarters upon which the income tax, as provided in Title II of this Code, shall be levied, collected and paid.

The tax so computed shall be decreased by the amount of tax previously paid or assessed during the preceding quarters and shall be paid not later than sixty (60) days from the close of each of the first three (3) quarters of the taxable year, whether calendar or fiscal year.

SEC. 76. Final Adjustment Return. - Every corporation liable to tax under Section 27 shall file a final adjustment return covering the total taxable income for the preceding calendar or fiscal year.

If the sum of the quarterly tax payments made during the said taxable year is not equal to the total tax due on the entire taxable income of that year, the corporation shall either:

(A) Pay the balance of tax still due; or
(B) Carry-over the excess credit; or
(C) Be credited or refunded with the excess amount paid, as the case may be.

In case the corporation is entitled to a tax credit or refund of the excess estimated quarterly income taxes paid, the excess amount shown on its final adjustment return may be carried over and credited against the estimated quarterly income tax liabilities for the taxable quarters of the succeeding taxable years.

Once the option to carry-over and apply the excess quarterly income tax against income tax due for the taxable quarters of the succeeding taxable years has been made, such option shall be considered irrevocable for that taxable period and no application for cash refund or issuance of a tax credit certificate shall be allowed therefor.

SEC. 77. Place and Time of Filing and Payment of Quarterly Corporate Income Tax. -

(A) Place of Filing.- Except as the Commissioner other wise permits, the quarterly income tax declaration required in Section 75 and the final adjustment return required in Section 76 shall be filed with the:
1. authorized agent banks or
2. Revenue District Officer or
3. Collection Agent or
4. duly authorized Treasurer of the city or municipality having jurisdiction over the location of the principal office of the corporation filing the return or place where its main books of accounts and other data from which the return is prepared are kept.

(B) Time of Filing the Income Tax Return. - The corporate quarterly declaration shall be filed within sixty (60) days following the close of each of the first three (3) quarters of the taxable year.

The final adjustment return shall be filed on or before the fifteenth (15th) day of April, or on or before the fifteenth (15th) day of the fourth (4th) month following the close of the fiscal year, as the case may be.

(C) Time of Payment of the Income Tax. - The income tax due on the corporate quarterly returns and the final adjustment income tax returns computed in accordance with Sections 75 and 76 shall be paid at the time the declaration or return is filed in a manner prescribed by the Commissioner.

E. Creditable and Final Withholding Taxes

SEC. 57. Withholding of Tax at Source. -
(A) Withholding of Final Tax on Certain Incomes. - Subject to rules and regulations the Secretary of Finance may promulgate, upon the recommendation of the Commissioner, requiring the filing of income tax return by certain income payees, the tax imposed or prescribed by Sections 24(B)(1), 24(B)(2), 24(C), 24(D)(1); 25(A)(2), 25(A)(3), 25(B), 25(C), 25(D), 25(E), 27(D)(!), 27(D)(2), 27(D)(3), 27(D)(5), 28 (A)(4), 28(A)(5), 28(A)(7)(a), 28(A)(7)(b), 28(A)(7)(c), 28(B)(1), 28(B)(2), 28(B)(3), 28(B)(4), 28(B)(5)(a), 28(B)(5)(b), 28(B)(5)(c); 33; and 282 of this Code on specified items of income shall be withheld by payor-corporation and/or person and paid in the same manner and subject to the same conditions as provided in Section 58 of this Code.

(B) Withholding of Creditable Tax at Source. - The Secretary of Finance may, upon the recommendation of the Commissioner, require the withholding of a tax on the items of income payable to natural or juridical persons, residing in the Philippines, by payor-corporation/persons as provided for by law, at the rate of not less than one percent (1%) but not more than thirty-two percent (32%) thereof, which shall be credited against the income tax liability of the taxpayer for the taxable year.

(C) Tax-free Covenant Bonds. In any case where bonds, mortgages, deeds of trust or other similar obligations of domestic or resident foreign corporations, contain a contract or provisions by which the obligor agrees to pay any portion of the tax imposed in this Title upon the obligee or to reimburse the obligee for any portion of the tax or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon or to retain therefrom under any law of the Philippines, or any state or country, the obligor shall deduct bonds, mortgages, deeds of trust or other obligations, whether the interest or other payments are payable annually or at shorter or longer periods, and whether the bonds, securities or obligations had been or will be issued or marketed, and the interest or other payment thereon paid, within or without the Philippines, if the interest or other payment is payable to a nonresident alien or to a citizen or resident of the Philippines.

SEC. 58. Returns and Payment of Taxes Withheld at Source. -
(A) Quarterly Returns and Payments of Taxes Withheld. - Taxes deducted and withheld under Section 57 by withholding agents shall be covered by a return and paid to, except in cases where the Commissioner otherwise permits:
1. an authorized Treasurer of the city or municipality where the withholding agent has his legal residence or principal place of business, or
2. where the withholding agent is a corporation, where the principal office is located.

The taxes deducted and withheld by the withholding agent shall be held as a special fund in trust for the government until paid to the collecting officers.

The return for final withholding tax shall be filed and the payment made within twenty-five (25) days from the close of each calendar quarter,

while the return for creditable withholding taxes shall be filed and the payment made not later than the last day of the month following the close of the quarter during which withholding was made:

Provided, That the Commissioner, with the approval of the Secretary of Finance, may require these withholding agents to pay or deposit the taxes deducted or withheld at more frequent intervals when necessary to protect the interest of the government.

(B) Statement of Income Payments Made and Taxes Withheld. - Every withholding agent required to deduct and withhold taxes under Section 57 shall furnish each recipient, in respect to his or its receipts during the calendar quarter or year:
1. a written statement showing the income or other payments made by the withholding agent during such quarter or year, and
2. the amount of the tax deducted and withheld therefrom,

simultaneously upon payment at the request of the payee, but not late than the twentieth (20th) day following the close of the quarter in the case of corporate payee, or not later than March 1 of the following year in the case of individual payee for creditable withholding taxes.

For final withholding taxes, the statement should be given to the payee on or before January 31 of the succeeding year.

(C) Annual Information Return. - Every withholding agent required to deduct and withhold taxes under Section 57 shall submit to the Commissioner an annual information return containing the list of payees and income payments, amount of taxes withheld from each payee and such other pertinent information as may be required by the Commissioner.

In the case of final withholding taxes, the return shall be filed on or before January 31 of the succeeding year, and for creditable withholding taxes, not later than March 1 of the year following the year for which the annual report is being submitted.

This return, if made and filed in accordance with the rules and regulations approved by the Secretary of Finance, upon recommendation of the Commissioner, shall be sufficient compliance with the requirements of Section 68 of this Title in respect to the income payments.

The Commissioner may, by rules and regulations, grant to any withholding agent a reasonable extension of time to furnish and submit the return required in this Subsection.

(D) Income of Recipient. - Income upon which any creditable tax is required to be withheld at source under Section 57 shall be included in the return of its recipient but the excess of the amount of tax so withheld over the tax due on his return shall be refunded to him subject to the provisions of Section 204; if the income tax collected at source is less than the tax due on his return, the difference shall be paid in accordance with the provisions of Section 56.

All taxes withheld pursuant to the provisions of this Code and its implementing rules and regulations are hereby considered trust funds and shall be maintained in a separate account and not commingled with any other funds of the withholding agent.

(E) Registration with Register of Deeds. - No registration of any document transferring real property shall be effected by the Register of Deeds unless the Commissioner or his duly authorized representative has:
1. certified that such transfer has been reported, and
2. the capital gains or creditable withholding tax, if any, has been paid:

Provided, however, That the information as may be required by rules and regulations to be prescribed by the Secretary of Finance, upon recommendation of the Commissioner, shall be annotated by the Register of Deeds in the Transfer Certificate of Title or Condominium Certificate of Title:

Provided, further, That in cases of transfer of property to a corporation, pursuant to a merger, consolidation or reorganization, and where the law allows deferred recognition of income in accordance with Section 40, the information as may be required by rules and regulations to be prescribed by the Secretary of Finance, upon recommendation of the Commissioner, shall be annotated by the Register of Deeds at the back of the Transfer Certificate of Title or Condominium Certificate of Title of the real property involved: Provided, finally, That any violation of this provision by the Register of Deeds shall be subject to the penalties imposed under Section 269 of this Code.

SEC. 79. Income Tax Collected at Source. -
(A) Requirement of Withholding. - Every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with the rules and regulations to be prescribed by the Secretary of Finance, upon recommendation of the Commissioner: Provided, however, That no withholding of a tax shall be required where the total compensation income of an individual does not exceed the statutory minimum wage, or five thousand pesos (P5,000.00) per month, whichever is higher.

(B) Tax Paid by Recipient. - If the employer, in violation of the provisions of this Chapter, fails to deduct and withhold the tax as required under this Chapter, and thereafter

the tax against which such tax may be credited is paid, the tax so required to be deducted and withheld shall not be collected from the employer;

but this Subsection shall in no case relieve the employer from liability for any penalty or addition to the tax otherwise applicable in respect of such failure to deduct and withhold.

(C) Refunds or Credits. -
(1) Employer. - When there has been an overpayment of tax under this Section, refund or credit shall be made to the employer only to the extent that the amount of such overpayment was not deducted and withheld hereunder by the employer.

(2) Employees. -The amount deducted and withheld under this Chapter during any calendar year shall be allowed as a credit to the recipient of such income against the tax imposed under Section 24(A) of this Title.

Refunds and credits in cases of excessive withholding shall be granted under rules and regulations promulgated by the Secretary of Finance, upon recommendation of the Commissioner.

Any excess of the taxes withheld over the tax due from the taxpayer shall be returned or credited within three (3) months from the fifteenth (15th) day of April.

Refunds or credits made after such time shall earn interest at the rate of six percent (6%) per annum, starting after the lapse of the three-month period to the date the refund of credit is made.

Refunds shall be made upon warrants drawn by the Commissioner or by his duly authorized representative without the necessity of counter-signature by the Chairman, Commission on Audit or the latter's duly authorized representative as an exception to the requirement prescribed by Section 49, Chapter 8, Subtitle B, Title 1 of Book V of Executive Order No. 292, otherwise known as the Administrative Code of 1987.

(D) Personal Exemptions. -
(1) In General. - Unless otherwise provided by this Chapter, the personal and additional exemptions applicable under this Chapter shall be determined in accordance with the main provisions of this Title.

(2) Exemption Certificate. -
(a) When to File. - On or before the date of commencement of employment with an employer, the employee shall furnish the employer with a signed withholding exemption certificate relating to the personal and additional exemptions to which he is entitled.

(b) Change of Status. - In case of change of status of an employee as a result of which he would be entitled to a lesser or greater amount of exemption, the employee shall, within ten (10) days from such change, file with the employer a new withholding exemption certificate reflecting the change.

(c) Use of Certificates. - The certificates filed hereunder shall be used by the employer in the determination of the amount of taxes to be withheld.

(d) Failure to Furnish Certificate. - Where an employee, in violation of this Chapter, either fails or refuses to file a withholding exemption certificate, the employer shall withhold the taxes prescribed under the schedule for zero exemption of the withholding tax table determined pursuant to Subsection (A) hereof.

(E) Withholding on Basis of Average Wages. - The Commissioner may, under rules and regulations promulgated by the Secretary of Finance, authorize employers to:
(1) estimate the wages which will be paid to an employee in any quarter of the calendar year;
(2) determine the amount to be deducted and withheld upon each payment of wages to such employee during such quarter as if the appropriate average of the wages so estimated constituted the actual wages paid; and
(3) deduct and withhold upon any payment of wages to such employee during such quarter such amount as may be required to be deducted and withheld during such quarter without regard to this Subsection.

(F) Husband and Wife. - When a husband and wife each are recipients of wages, whether from the same or from different employers, taxes to be withheld shall be determined on the following bases:
(1) The husband shall be deemed the head of the family and proper claimant of the additional exemption in respect to any dependent children, unless he explicitly waives his right in favor of his wife in the withholding exemption certificate.

(2) Taxes shall be withheld from the wages of the wife in accordance with the schedule for zero exemption of the withholding tax table prescribed in Subsection (D)(2)(d) hereof.

(G) Nonresident Aliens. - Wages paid to nonresident alien individuals engaged in trade or business in the Philippines shall be subject to the provisions of this Chapter.

(H) Year-End Adjustment. - On or before the end of the calendar year but prior to the payment of the compensation for the last payroll period, the employer shall determine the tax due from each employee on taxable compensation income for the entire taxable year in accordance with Section 24(A).

The difference between the tax due from the employee for the entire year and the sum of taxes withheld from January to November shall either be withheld from his salary in December of the current calendar year or refunded to the employee not later than January 25 of the succeeding year.

SEC. 80. Liability for Tax. -
(A) Employer. - The employer shall be liable for the withholding and remittance of the correct amount of tax required to be deducted and withheld under this Chapter.

If the employer fails to withhold and remit the correct amount of tax as required to be withheld under the provision of this Chapter, such tax shall be collected from the employer together with the penalties or additions to the tax otherwise applicable in respect to such failure to withhold and remit.

(B) Employee. - Where an employee fails or refuses to file the withholding exemption certificate or willfully supplies false or inaccurate information thereunder, the tax otherwise required to be withheld by the employer shall be collected from him including penalties or additions to the tax from the due date of remittance until the date of payment.

On the other hand, excess taxes withheld made by the employer due to:

(1) failure or refusal to file the withholding exemption certificate; or
(2) false and inaccurate information
shall not be refunded to the employee but shall be forfeited in favor of the Government.

SEC. 81. Filing of Return and Payment of Taxes Withheld. - Except as the Commissioner otherwise permits, taxes deducted and withheld by the employer on wages of employees shall be covered by a return and paid to an:
1. authorized agent bank;
2. Collection Agent, or
3. the duly authorized Treasurer of the city or municipality where the employer has his legal residence or principal place of business, or
4. in case the employer is a corporation, where the principal office is located.

The return shall be filed and the payment made within twenty-five (25) days from the close of each calendar quarter: Provided, however, That the Commissioner may, with the approval of the Secretary of Finance, require the employers to pay or deposit the taxes deducted and withheld at more frequent intervals, in cases where such requirement is deemed necessary to protect the interest of the Government.

The taxes deducted and withheld by employers shall be held in a special fund in trust for the Government until the same are paid to the said collecting officers.

SEC. 82. Return and Payment in Case of Government Employees. - If the employer is the Government of the Philippines or any political subdivision, agency or instrumentality thereof, the return of the amount deducted and withheld upon any wage shall be made by the officer or employee having control of the payment of such wage, or by any officer or employee duly designated for the purpose.

SEC. 83. Statements and Returns. -
(A) Requirements. - Every employer required to deduct and withhold a tax shall furnish to each such employee in respect of his employment during the calendar year, on or before January thirty-first (31st) of the succeeding year, or if his employment is terminated before the close of such calendar year, on the same day of which the last payment of wages is made:
1. a written statement confirming the wages paid by the employer to such employee during the calendar year, and
2. the amount of tax deducted and withheld under this Chapter in respect of such wages.

The statement required to be furnished by this Section in respect of any wage shall contain such other information, and shall be furnished at such other time and in such form as the Secretary of Finance, upon the recommendation of the Commissioner, may, by rules and regulation, prescribe.

(B) Annual Information Returns. - Every employer required to deduct and withhold the taxes in respect of the wages of his employees shall, on or before January thirty-first (31st) of the succeeding year, submit to the Commissioner an annual information return containing:
1. a list of employees,
2. the total amount of compensation income of each employee,
3. the total amount of taxes withheld therefrom during the year, accompanied by copies of the statement referred to in the preceding paragraph, and such other information as may be deemed necessary.

This return, if made and filed in accordance with rules and regulations promulgated by the Secretary of Finance, upon recommendation of the Commissioner, shall be sufficient compliance with the requirements of Section 68 of this Title in respect of such wages.

(C) Extension of time. - The Commissioner, under such rules and regulations as may be promulgated by the Secretary of Finance, may grant to any employer a reasonable extension of time to furnish and submit the statements and returns required under this Section.

*CIR VS. Mirant: The last sentence of Section 76 of the National Internal Revenue Code, stating that "[o]nce the option to carry-over and apply the excess quarterly income tax

against income tax due for the taxable quarters of the succeeding taxable years has been made, such option shall be considered irrevocable for that taxable period and no application for cash refund or issuance of a tax credit certificate shall be allowed therefor," is clear in its mandate. Once the corporation exercises the option to carry-over and apply the excess quarterly income tax against the tax due for the taxable quarters of the succeeding taxable years, such option is irrevocable for that taxable period. Having chosen to carry-over the excess quarterly income tax, the corporation cannot thereafter choose to apply for a cash refund or for the issuance of a tax credit certificate for the amount representing such overpayment.

*Philam Asset Management: These two options under Section 76 are alternative in nature. The choice of one precludes the other. Indeed, in Philippine Bank of Communications v. Commissioner of Internal Revenue, the Court ruled that a corporation must signify its intention -- whether to request a tax refund or claim a tax credit -- by marking the corresponding option box provided in the FAR.

The Tax Code allows the refund of taxes to a taxpayer that claims it in writing within two years after payment of the taxes erroneously received by the BIR. Despite the failure of petitioner to make the appropriate marking in the BIR form, the filing of its written claim effectively serves as an expression of its choice to request a tax refund, instead of a tax credit. To assert that any future claim for a tax refund will be instantly hindered by a failure to signify one's intention in the FAR is to render nugatory the clear provision that allows for a two-year prescriptive period.

In the present case, although petitioner did not mark the refund box in its 1997 FAR, neither did it perform any act indicating that it chose a tax credit. On the contrary, it filed on September 11, 1998, an administrative claim for the refund of its excess taxes withheld in 1997. In none of its quarterly returns for 1998 did it apply the excess creditable taxes. Under these circumstances, petitioner is entitled to a tax refund of its 1997 excess tax credits in the amount of P522,092.

*CIR v. UCPB: If the property is an ordinary asset of the mortgagor, the creditable expanded withholding tax shall be due and paid within ten (10) days following the end of the month in which the redemption period expires. x x x Moreover, the payment of the documentary stamp tax and the filing of the return thereof shall have to be made within five (5) days from the end of the month when the redemption period expires.

*CIR v. PL Management: The Court similarly disagrees in the declaration of the Court of Appeals that to deny the claim for refund of BPI, because of the irrevocability rule, would be tantamount to unjust enrichment on the part of the government. The Court addressed the very same argument in Philam, where it elucidated that there would be no unjust

enrichment in the event of denial of the claim for refund under such circumstances, because there would be no forfeiture of any amount in favor of the government. The amount being claimed as a refund would remain in the account of the taxpayer until utilized in succeeding taxable years, as provided in Section 76 of the NIRC of 1997. It is worthy to note that unlike the option for refund of excess income tax, which prescribes after two years from the filing of the FAR, there is no prescriptive period for the carrying over of the same. Therefore, the excess income tax credit of BPI, which it acquired in 1998 and opted to carry over, may be repeatedly carried over to succeeding taxable years, i.e., to 1999, 2000, 2001, and so on and so forth, until actually applied or credited to a tax liability of BPI.

Inasmuch as the respondent already opted to carry over its unutilized creditable withholding tax of P1,200,000.00 to taxable year 1998, the carry-over could no longer be converted into a claim for tax refund because of the irrevocability rule provided in Section 76 of the NIRC of 1997. Thereby, the respondent became barred from claiming the refund.

However, in view of it irrevocable choice, the respondent remained entitled to utilize that amount of P1,200,000.00 as tax credit in succeeding taxable years until fully exhausted. In this regard, prescription did not bar it from applying the amount as tax credit considering that there was no prescriptive period for the carrying over of the amount as tax credit in subsequent taxable year.

*Benguet v. CIR: Petitioner, as a withholding agent, is burdened by law with a public duty to collect the tax for the government. However, its payroll agent, L.C. Diaz and Company, failed to remit to the BIR the withholding taxes on compensation. Hence, no valid payment of the withholding taxes was actually made by petitioner. Codal provisions on withholding tax are mandatory and must be complied with by the withholding agent.37 It follows that petitioner is liable to pay the disputed assessment.

*CIR v. CTA: May the withholding agent, in such capacity, be deemed a taxpayer for it to avail of the amnesty? An income taxpayer covers all persons who derive taxable income. ANSCOR was assessed by petitioner for deficiency withholding tax under Section 53 and 54 of the 1939 Code. As such, it is being held liable in its capacity as a withholding agent and not its personality as a taxpayer.

In the operation of the withholding tax system, the withholding agent is the payor, a separate entity acting no more than an agent of the government for the collection of the tax in order to ensure its payments; the payer is the taxpayer — he is the person subject to tax impose by law; and the payee is the taxing authority.

In other words, the withholding agent is merely a tax collector, not a taxpayer. Under the withholding system, however, the agent-payor becomes a payee by fiction of law. His (agent) liability is direct and independent from the taxpayer, because the income tax is still imposed on and due from the latter.

The agent is not liable for the tax as no wealth flowed into him — he earned no income. The Tax Code only makes the agent personally liable for the tax arising from the breach of its legal duty to withhold as distinguish from its duty to pay tax since:

the government's cause of action against the withholding is not for the collection of income tax, but for the enforcement of the withholding provision of Section 53 of the Tax Code, compliance with which is imposed on the withholding agent and not upon the taxpayer.

Not being a taxpayer, a withholding agent, like ANSCOR in this transaction is not protected by the amnesty under the decree.

Codal provisions on withholding tax are mandatory and must be complied with by the withholding agent. The taxpayer should not answer for the non-performance by the withholding agent of its legal duty to withhold unless there is collusion or bad faith.

The former could not be deemed to have evaded the tax had the withholding agent performed its duty. This could be the situation for which the amnesty decree was intended. Thus, to curtail tax evasion and give tax evaders a chance to reform, it was deemed administratively feasible to grant tax amnesty in certain instances. In addition, a "tax amnesty, much like a tax exemption, is never favored nor presumed in law and if granted by a statute, the term of the amnesty like that of a tax exemption must be construed strictly against the taxpayer and liberally in favor of the taxing authority.

*CIR vs. BPI: The choice by BPI of the option to carry over its 1998 excess income tax credit to succeeding taxable years, which it explicitly indicated in its 1998 ITR, is irrevocable, regardless of whether it was able to actually apply the said amount to a tax liability. The reiteration by BPI of the carry over option in its ITR for 1999 was already a superfluity, as far as its 1998 excess income tax credit was concerned, given the irrevocability of the initial choice made by the bank to carry over the said amount. For the same reason, the failure of BPI to indicate any option in its ITR for 2000 was already immaterial to its 1998 excess income tax credit.

**Baniqued:*
Regular Tax. 0-32%

Final Tax are not included to be reported in the ITR, but now Kim Henares, subjected to final tax must be reported in the ITR.

Creditable Withholding Tax applies to items of income which are subject to withholding tax according to the rates of the regulations of the BIR. They must be reported in the income tax return and the taxes withheld will be credited to the tax due.

What is this tax due against which I will claim a credit? Is it the 5-32% or is it the final tax? Compute the tax due first. So if the tax due is 14,500. So deduct the creditable withhold sa 14,500. It will be deducted from the tax.

Final taxes are not deductible anywhere in contrast with the Creditable Withholding taxes.

Examples of creditable withholding taxes: Rent of office space, business space.

If you are the agent-payor and you did not withhold, what is the penalty? That income payment will not be allowed as an expense for deductions. 25% surcharge 25% interest per annum. See how costly an error could be?

Juday example. They thought that the tax withheld was a final tax. Di nila alam creditable withholding tax yun. So ayun patay

F. Returns of General Professional Partnerships

SEC. 26. Tax Liability of Members of General Professional Partnerships. - A general professional partnership as such shall not be subject to the income tax imposed under this Chapter.

Persons engaging in business as partners in a general professional partnership shall be liable for income tax only in their separate and individual capacities.

For purposes of computing the distributive share of the partners, the net income of the partnership shall be computed in the same manner as a corporation.

Each partner shall report as gross income his distributive share, actually or constructively received, in the net income of the partnership.

SEC. 55. Returns of General Professional Partnerships. - Every general professional partnership shall file, in duplicate, a return of its income, except income exempt under Section 32 (B) of this Title, setting forth the items of gross income and of deductions allowed by this Title, and the names, Taxpayer Identification Numbers (TIN), addresses and shares of each of the partners.

XIII. MINIMUM CORPORATE INCOME TAX

Sec. 27(E) Minimum Corporate Income Tax on Domestic Corporations. -(1) Imposition of Tax - A minimum corporate income tax of two percent (2%) of the gross

income as of the end of the taxable year, as defined herein, is hereby imposed on:
1. a corporation taxable under this Title,
2. beginning on the fourth taxable year immediately following the year in which such corporation commenced its business operations,
3. when the minimum income tax is greater than the tax computed under Subsection (A) of this Section for the taxable year.

(2) Carry Forward of Excess Minimum Tax. - Any excess of the minimum corporate income tax over the normal income tax as computed under Subsection (A) of this Section shall be carried forward and credited against the normal income tax for the three (3) immediately succeeding taxable years.

(3) Relief from the Minimum Corporate Income Tax Under Certain Conditions. - The Secretary of Finance is hereby authorized to suspend the imposition of the minimum corporate income tax on any corporation which suffers losses on account of:
1. prolonged labor dispute, or
2. because of force majeure, or
3. because of legitimate business reverses.

The Secretary of Finance is hereby authorized to promulgate, upon recommendation of the Commissioner, the necessary rules and regulation that shall define the terms and conditions under which he may suspend the imposition of the minimum corporate income tax in a meritorious case.

(4) Gross Income Defined - For purposes of applying the minimum corporate income tax provided under Subsection (E) hereof, the term:
'gross income' shall mean gross sales less sales returns, discounts and allowances and cost of goods sold

"Cost of goods sold' shall include all business expenses directly incurred to produce the merchandise to bring them to their present location and use.

For a trading or merchandising concern, "cost of goods sold' shall include the invoice cost of the goods sold, plus import duties, freight in transporting the goods to the place where the goods are actually sold including insurance while the goods are in transit.

For a manufacturing concern, cost of "goods manufactured and sold" shall include all costs of production of finished goods, such as raw materials used, direct labor and manufacturing overhead, freight cost, insurance premiums and other costs incurred to bring the raw materials to the factory or warehouse.

In the case of taxpayers engaged in the sale of service, 'gross income' means gross receipts less sales returns, allowances, discounts and cost of services"Cost of services"

shall mean all direct costs and expenses necessarily incurred to provide the services required by the customers and clients including
(A) salaries and employee benefits of personnel, consultants and specialists directly rendering the service and
(B) cost of facilities directly utilized in providing the service such as depreciation or rental of equipment used and cost of supplies: Provided, however, That in the case of banks, "cost of services" shall include interest expense.

CONDITIONS:
(1) The imposition shall begin on the 4th taxable year immediately following the year in which the corporation commenced its business operations (the year it registered with the BIR)
(2) The corporation has zero or negative taxable income OR the minimum income tax is greater than the normal corporate income tax. If equal, taxpayer should pay corporate income tax. The comparison shall be made at the end of the taxable year.

The excess MCIT cannot be credited against any MCIT liability. If no crediting can be made against the normal income tax, the excess MCIT expires after the lapse of the 3 year carry over period.

The regular corporate income tax is a tax on the net profits. The MCIT is in effect a tax on gross profits.

MCIT shall only apply to domestic corporations subject to normal corporate income tax. Hence it does not apply to:
(1) domestic corps operating as proprietary educational institutions, engaged in hospital operations which are non-profit etc.

*Manila Banking v. CIR: Rehabilitated bank, and then it reopened. So does it have a fresh 3 year period? SC allowed it. It is in effect operating all over again. Even if it is not technically new.

*CIR v. PAL: MCIT does not apply since PAL is subject to a special tax rate. Franchise tax in lieu of any or all other taxes.

There is a practice that corporations just declare loss. So there are actually corporations that for 15 years have not paid a single tax. So Congress thought that there should be a minimum income tax.

2% on gross income if the minimum corporate income tax is higher than the normal corporate income tax.

Eh pano pag sinabi nung taxpayer wala din kaming gross sales eh. Pwede ba yun? YES it is possible. There is no MCIT. But the taxpayer should be in some circumstances subjected to investigation.

Note that it only commences 4th year of the operation of the business. This is because the government doesn't expect you to be profitable right away. There is a grace period of 3 years from which you can operate at a loss.

When does operation of business start? BIR or SEC?

Study the carry over, carry over in the next 3 succeeding years if the MCIT exceeds the normal corporate income tax. Note that NOLCO is also 3 years.

MCIT is now applied on a quarterly basis. Pati yung carry over, quarterly na rin, for the next three years, since the corporation files a quarterly income tax return.

XIV. IMPROPERLY ACCUMULATED EARNINGS TAX

SEC. 29. Imposition of Improperly Accumulated Earnings Tax -
(A) In General. - In addition to other taxes imposed by this Title, there is hereby imposed for each taxable year on the improperly accumulated taxable income of each corporation described in Subsection B hereof, an improperly accumulated earnings tax equal to ten percent (10%) of the improperly accumulated taxable income.

(B) Tax on Corporations Subject to Improperly Accumulated Earnings Tax. -

(1) In General - The improperly accumulated earnings tax imposed in the preceding Section shall apply to every corporation formed or availed for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed.

(2) Exceptions - The improperly accumulated earnings tax as provided for under this Section shall not apply to:.

(a) Publicly-held corporations;
(b) Banks and other nonbank financial intermediaries; and
(c) Insurance companies.

(C) Evidence of Purpose to Avoid Income Tax. -
(1) Prima Facie Evidence. - the fact that any corporation is a:
1. mere holding company or
2. investment company shall be prima facie evidence of a purpose to avoid the tax upon its shareholders or members.

(2) Evidence Determinative of Purpose. - The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the tax upon its shareholders or members unless the corporation, by the clear preponderance of evidence, shall prove to the contrary.

(D) Improperly Accumulated Taxable Income - For purposes of this Section, the term 'improperly accumulated taxable income' means taxable income' adjusted by:

(1) Income exempt from tax;
(2) Income excluded from gross income;
(3) Income subject to final tax; and
(4) The amount of net operating loss carry-over deducted;

And reduced by the sum of:

(1) Dividends actually or constructively paid; and
(2) Income tax paid for the taxable year. Provided, however, That for corporations using the calendar year basis, the accumulated earnings under tax shall not apply on improperly accumulated income as of December 31, 1997.

In the case of corporations adopting the fiscal year accounting period, the improperly accumulated income not subject to this tax, shall be reckoned, as of the end of the month comprising the twelve (12)-month period of fiscal year 1997-1998.

(E) Reasonable Needs of the Business - For purposes of this Section, the term 'reasonable needs of the business' includes the reasonably anticipated needs of the business.

This tax is in the nature of a penalty to the corporation for the improper accumulation of its earnings, and as a form of deterrent to the avoidance of tax upon shareholders who are supposed to pay dividends tax on the earnings distributed to them by the corporation

The computation of the tax shall be made on year to year basis. It is not computed on the basis of the total accumulated earnings or profits over the years found at the time of examination or investigation.

Holding Company – A corporation having practically no activities except holding property, and collecting income therefrom or investing therein.

If the activities further include, or consist substantially of buying and selling stocks, securities, real estate, or other investment property so that the income derived not only from the investment yield but also from profits upon market fluctuations, the corporation shall be considered an investment company.

The use of undistributed earnings and profits for the reasonable needs of the business would not generally make the accumulated or undistributed earnings subject to the tax.

What is meant by "*reasonable needs of the business"* is determined by the IMMEDIACY TEST.

Immediacy Test - It states that the "*reasonable needs of the business"* are the

1. immediate needs of the business; and
2. *reasonably anticipated* needs.

How to prove the "*reasonable needs of the business"* → The corporation should prove that there is

1. an immediate need for the accumulation of the earnings and profits; or
2. a direct correlation of anticipated needs to such accumulation of profits.

Covered Corporations → Only domestic and closely-held corporations are liable for IAET.

Closely-held corporations are those:

at least 50% in value of the outstanding capital stock; or

at least 50% of the total combined voting power of all classes of stock entitled to vote

is owned directly or indirectly by or for *not more than 20 individuals*.
Domestic corporations not falling under the aforesaid definition are, therefore, publicly-held corporations.

*Cyanamid vs. CA: In the present case, the Tax Court opted to determine the working capital sufficiency by using the ratio between current assets to current liabilities. The working capital needs of a business depend upon nature of the business, its credit policies, the amount of inventories, the rate of the turnover, the amount of accounts receivable, the collection rate, the availability of credit to the business, and similar factors. Petitioner, by adhering to the "Bardahl" formula, failed to impress the tax court with the required

definiteness envisioned by the statute. We agree with the tax court that the burden of proof to establish that the profits accumulated were not beyond the reasonable needs of the company, remained on the taxpayer. This Court will not set aside lightly the conclusion reached by the Court of Tax Appeals which, by the very nature of its function, is dedicated exclusively to the consideration of tax problems and has necessarily developed an expertise on the subject, unless there has been an abuse or improvident exercise of authority.

*Manila Wine Merchants v. CIR: To determine the "reasonable needs" of the business in order to justify an accumulation of earnings, the Courts of the United States have invented the so-called "Immediacy Test" which construed the words "reasonable needs of the business" to mean the immediate needs of the business, and it was generally held that if the corporation did not prove an immediate need for the accumulation of the earnings and profits, the accumulation was not for the reasonable needs of the business, and the penalty tax would apply

**Baniqued: If a corporation does not pay dividends when it should, the authorities punishes the corporation. But why is the corporation the one imposed with it? Because it is easier to collect from the corporation.*

Indications of improper accumulation: Retained earnings exceed paid up. That is an indication of improper accumulation.
The listing of probable excuses and valid excuses is not exhaustive.

Reasonable needs of a business. Is the passing of a board resolution enough? Like for example they need to have assets for a certain expansion project, where they allocate 25M, entire amount of the retained earnings. Is that enough to justify them to accumulate? NO. YOU SHOULD SHOW PROOF THAT YOU PURSUED THE PLANT EXPANSION. Hence for example, enter contract na with contractors! Pa design mo na yung plant, etc.

Scope. Doesn't include publicly held corporations, banks and other nonblank financial intermediaries, and insurance companies.

Banks and Insurance companies need to be very liquid! Imagine if they always declare dividends.

XV. EXEMPT CORPORATIONS

SEC. 30 Exemptions from Tax on Corporations - The following organizations shall not be taxed under this Title in respect to income received by them as such:

(A) Labor, agricultural or horticultural organization not organized principally for profit;

(B) Mutual savings bank not having a capital stock represented by shares, and cooperative bank without capital stock organized and operated for mutual purposes and without profit;

(C) A beneficiary society, order or association, operating fort he exclusive benefit of the members such as a fraternal organization operating under the lodge system, or mutual aid association or a nonstock corporation organized by employees providing for the payment of life, sickness, accident, or other benefits exclusively to the members of such society, order, or association, or nonstock corporation or their dependents;

(D) Cemetery company owned and operated exclusively for the benefit of its members;

(E) Nonstock corporation or association organized and operated exclusively for religious, charitable, scientific, athletic, or cultural purposes, or
for the rehabilitation of veterans,
no part of its net income or asset shall belong to or inures to the benefit of any member, organizer, officer or any specific person;

(F) Business league chamber of commerce, or board of trade, not organized for profit and no part of the net income of which inures to the benefit of any private stock-holder, or individual;

(G) Civic league or organization not organized for profit but operated exclusively for the promotion of social welfare;

(H) A nonstock and nonprofit educational institution;

(I) Government educational institution;

(J) Farmers' or other mutual typhoon or fire insurance company, mutual ditch or irrigation company, mutual or cooperative telephone company, or like organization of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting its expenses; and

(K) Farmers', fruit growers', or like association organized and operated as a sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of sales, less the necessary selling expenses on the basis of the quantity of produce finished by them;

Notwithstanding the provisions in the preceding paragraphs, the income of whatever kind and character of the foregoing organizations from:

1. any of their properties, real or personal, or
2. from any of their activities conducted for profit regardless of the disposition made of such income,
shall be subject to tax imposed under this Code.

*CIR v. YMCA: The last paragraph of Section 27, the YMCA argues, should be "subject to the qualification that the income from the properties must arise from activities 'conducted for profit' before it may be considered taxable." 23 This argument is erroneous. As previously stated, a reading of said paragraph ineludibly shows that the income from any property of exempt organizations, as well as that arising from any activity it conducts for profit, is taxable. The phrase "any of their activities conducted for profit" does not qualify the word "properties." This makes from the property of the organization taxable, regardless of how that income is used — whether for profit or for lofty non-profit purposes.

Verba legis non est recedendum. Hence, Respondent Court of Appeals committed reversible error when it allowed, on reconsideration, the tax exemption claimed by YMCA on income it derived from renting out its real property, on the solitary but unconvincing ground that the said income is not collected for profit but is merely incidental to its operation. The law does not make a distinction. The rental income is taxable regardless of whence such income is derived and how it is used or disposed of. Where the law does not distinguish, neither should we.