

2012 UP LAW BAR REVIEWER

TAXATION

Taxation Law 1
Taxation Law 2

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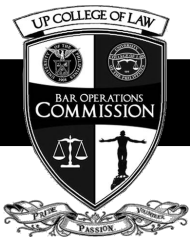
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- I. General Principles of Taxation
- II. National Internal Revenue Code of 1997 as amended (NIRC)

I. General Principles of Taxation

- A. Definition and Concept of Taxation
- B. Nature of Taxation
- C. Characteristics of Taxation
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- L. Requisites of valid tax
- M. Tax as distinguished from other forms of exactions
- N. Kinds of Taxes

A. Definition and Concept of Taxation

TAXATION

- is a mode by which governments make exactions for revenue in order to support their existence and carry out their legitimate objectives.
- a mode of raising revenue for public purpose; the exercise of sovereign power to raise revenue for the expense of the government;
- the act of laying a tax, i.e., the process or means by which the sovereign, through its law-making body, raises income to defray the necessary expenses of government.(1 Cooley 72-73)
- the **process** or means by which the sovereign, through its law-making body, raises income to defray the necessary expenses of government; a method of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must, therefore, bear its burdens, (see 51 Am. Jur. 341; 1 Cooley 72-93.)
- as a **power**, it refers to the inherent power of the state to demand enforced contributions for public purpose or purposes.

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- are enforced proportional contributions from persons and property levied by the law-making body of the State by virtue of its sovereignty for the support of the government and all public needs.
- The enforced proportional and pecuniary contributions from persons and property levied by the law-making body of the state

having jurisdiction over the subject of the burden for the support of the government and public needs.

- *CIR v. Algue*: Taxes are the lifeblood of the government and so should be collected without unnecessary hindrance. On the other hand, such collection should be made in accordance with law as any arbitrariness will negate the very reason for government itself... It is said that taxes are what we pay for civilized society. Without taxes, the government would be paralyzed for lack of the motive power to activate and operate it. Hence, despite the natural reluctance to surrender part of one's hard earned income to the taxing authorities, every person who is able to must contribute his share in the running of the government. The government for its part, is expected to respond in the form of tangible and intangible benefits intended to improve the lives of the people and enhance their moral and material values. This symbiotic relationship is the rationale of taxation and should dispel the erroneous notion that it is an arbitrary method of exaction by those in the seat of power.

Underlying theory and basis of taxation

The power of taxation proceeds upon the **theory** that the existence of government is a *necessity*; that it cannot continue without means to pay its expenses; and that for those means it has the right to compel all citizens and property within its limits to contribute.

The **basis** of taxation is found in the *reciprocal duties of protection and support* between the State and its inhabitants. The State receives taxes that it may be enabled to carry its mandates into effect and perform the functions of government and the citizen pays the portion of taxes demanded in order that he may, by means thereof, be secured in the enjoyment of the benefits of an organized society, (see 51 Am. Jur. 42-43.) This is the so-called *benefits-received principle*. One is compensation or consideration for the other: protection for support and support for protection.

B. Nature of the Power of Taxation

The power to tax, being inherent in an independent state for its existence and survival by the furtherance of its multifarious functions, the same does not require delegation from the Constitution. However, exercise of such power upon the inhabitants is subject to limitations inhabitants is subject to limitations.

The power of taxation is *inherent in sovereignty* as an incident or attribute thereof, being essential to the existence of every government. It exists apart from constitutions and without being expressly conferred by the people (71 Am. Jur. 2d 397-398). Hence, it can be exercised by the government even if the Constitution is entirely silent on the subject.



Constitutional provisions relating to the power of taxation do not operate as grants of the power to the government. They merely constitute limitations upon a power which would otherwise be practically without limit. (1 Cooley 150). While the power to tax is not expressly provided for in our Constitution, its existence is recognized by the provisions relating to taxation (infra).

It is *essentially a legislative function*. Even in the absence of any constitutional provision, the power falls to the legislature as a part of the more general power of law-making. The power to tax is peculiarly and exclusively legislative and cannot be exercised by the executive or judicial branch of the government (1 Cooley 160-161). Hence, only Congress, our national legislative body, can impose taxes. The levy of a tax, however, may also be made by a local legislative body subject to such limitations as may be provided by law. The Constitution expressly grants the power to tax to local government units (see Sec. 5, Art. X, Constitution).

It is *subject to constitutional and inherent limitations*. These limitations are those provided in the fundamental law (e.g., equal protection of the laws, due process of law, rule of uniformity, etc.) or implied therefrom (e.g., public purpose and non-delegation of legislative power which are also inherent limitations), while the rest spring from the nature of the taxing power itself although they may or may not be provided in the Constitution (e.g., territoriality, international comity, and exemption of government entities).

Scope of taxation

Subject to constitutional and inherent restrictions, the power of taxation is regarded as *supreme, unlimited and comprehensive*. The principal check on its abuse rests only on the responsibility of the members of the legislature to their constituents.

Extent of the legislative power to tax

The power of taxation being legislative, all its incidents are naturally within the control of the legislature. Subject to constitutional and inherent restrictions, the legislature has discretion to determine the matters mentioned subsequently.

- (1) *The subjects or objects to be taxed*. - These refer to the coverage and the kind or nature of the tax. They may be persons, whether natural or juridical; property, whether real or personal, tangible or intangible; businesses, transactions, rights, or privileges. A state is free to select the subject of taxation and it has been repeatedly held that that inequalities which result from a singling out of one particular class for taxation or exemption infringe no constitutional limitation so long as such exemption is reasonable and not arbitrary. (see Lutz vs. Araneta, 98 Phil. 148; City of Baguio vs. De Leon, 25 SCRA 938 [1968]; Sison, Jr. vs. Ancheta, 130 SCRA 654 [1984])

Thus, the power to tax carries with it the power to grant exemption therefrom.

- (2) *The purpose or object of the tax so long as it is a public purpose*. - The legislative body can levy a tax or make an appropriation provided it is for a public purpose. Its determination, however, on the question of what is a public purpose is not conclusive. The courts can inquire into whether the purpose is really public or private.

In the final analysis, therefore, the decision on the question is not a legislative but a judicial function. But once it is settled that the purpose is public, the courts can make no other inquiry into the objective of the legislature in imposing a tax (see Pascual vs. Sec. of Public Works, 110 Phil. 331 [1961]), or the wisdom, advisability, or expediency of the tax. (Blunt vs. U.S., 255 Fed. 322.)

Judicial action is limited only to a review where it involves:

- (a) The determination of the validity of the tax in relation to constitutional precepts or provisions. Thus, a tax may be declared invalid because it violates the constitutional requirement of uniformity and equity in taxation; or
 - (b) The determination in an appropriate case of the application of a tax law. (see 1 Cooley 165.) Thus, a court may decide that a tax has been illegally collected where the taxpayer is entitled to tax exemption or his liability has already been extinguished by reason of prescription.
- (3) *The amount or rate of the tax*. - As a general rule, the legislature may levy a tax of any amount or rate it sees fit. If the taxes are oppressive or unjust, the only remedy is the ballot box and the election of new representatives. (see 1 Cooley 178-181.)

According to Chief Justice John Marshall, "the power to tax involves the power to destroy." (McCulloch vs. Maryland, 17 U.S. [4 Wheat.] 316-428, 4L. ed. 579.) To say, however, that the power to tax is the power to destroy is to describe not the purposes for which the taxing power may be used but the extent to which it may be employed in order to raise revenues. (see 1 Cooley 178.) Thus, even if a tax should destroy a business, such fact alone could not invalidate the tax. (84 C.J.S. 46.)

As long as the power is exercised within the bounds of constitutional limitations, a tax cannot be held invalid merely because the power which is manifested by its imposition may involve the power to destroy. (see 51 Am. Jur. 80-81.)



Incidentally, our Constitution mandates that "the rule of taxation shall be uniform and equitable." In a case, our Supreme Court said: "The power of taxation is sometimes called also the power to destroy. Therefore, it should be exercised with caution to minimize injury to the proprietary rights of the taxpayer. It must be exercised fairly, equally and uniformly, lest the tax collector kills the 'hen that lays the golden eggs.' And in order to maintain the general public's trust and confidence in the government, this power must be used justly and not treacherously." (Roxas vs. Court of Tax Appeals, 23 SCRA276, App120, 1968; Philex Mining Corp. vs. Comm. of Internal Revenue, 97 SCAD 777,294 SCRA 687, Aug. 28, 1998.)

- (4) *The manner, means, and agencies of collection of the tax.* - These refer to the administration of the tax or the implementation of tax laws. Having the sole power to tax, the legislature must equally possess the sole power to prescribe the mode or method by which the tax shall be collected, and to designate the officers through whom its will shall be enforced as well as the remedies which the State or the taxpayer may avail in connection therewith. While it is true that executive officials enforce tax laws, their power or authority does not involve the choice of the subjects to be taxed, the definition of the purpose for which the tax is imposed, or the determination of the amount thereof. Furthermore, they must observe and comply with the procedural requirements prescribed in the administration of tax laws.

C. Characteristics of Taxation

- (1) It is an *enforced contribution* for its imposition is in no way dependent upon the will or assent of the person taxed.
- (2) It is generally *payable in the form of money*, although the law may provide payment in kind (e.g. backpay certificates under Sec. 2, R.A. No. 304, as amended);;
- (3) It is proportionate in character or is *laid by some rule of apportionment* which is usually based on ability to pay;
- (4) It is *levied on persons, property, rights, acts, privileges, or transactions*. In each case, however, it is only a person who pays the tax; ; the property is resorted to for the purpose of ascertaining the amount of the tax that must be paid and of enforcing payment in case of default of the taxpayer (84 C.J.S. 36).
- (5) It is *levied by the State which has jurisdiction or control over the subject to be taxed*. This is necessary in order that the tax can be enforced;

- (6) It is *levied by the law-making body of the State*. The power to tax is a legislative power which only the legislature can exercise. The power to tax is also granted to local governments, but subject to such guidelines and limitations as may be provided by law (Sec. 5, Art. X, Constitution); and;
- (7) It is *levied for public purpose*. Taxation involves, and a tax constitutes, a charge or burden imposed to provide public revenue for the support of the government, the administration of the law, or the payment of public expenses. (71 Am. Jur. 2d 344). Revenues derived from taxes cannot be used for purely private purposes or for the exclusive benefit of private persons. (Gaston v. Republic Planters Bank, 158 SCRA 626, March 15, 1988). The "public purpose or purposes" of the imposition is implied in the levy of tax. (see Mendoza v. Municipality, 94 Phil. 1047[1954]), A tax levied for a private purpose constitutes a taking of property without due process of law.

It is also an important characteristic of most taxes that they are commonly required to be paid at regular periods or intervals (see 1 Colley 64) every year,

D. Power of Taxation Compared With Other Powers

See Annex A.

E. Purpose of Taxation

Revenue-raising

Primary purpose of taxation is to provide funds or property with which to promote the general welfare and protection it its citizens (*Ex.* Income tax, percentage tax)

Fees may be properly regarded as taxes even though they also serve as an instrument of regulation... If the purpose is primarily revenue, or if revenue is, at least, one of the real and substantial purposes, then the exaction is properly called a tax. [*PAL v. Edu*]

Non-revenue/special or regulatory

Taxation is often employed as a device for regulation by means of which certain effects or conditions envisioned by governments may be achieved. Thus:

- (1) Taxation can *strengthen anemic enterprises or provide incentive to greater production* through grant of tax exemptions or the creation of conditions conducive to their growth.
- (2) Taxes on imports may be increased to *protect local industries* against foreign competition or decreased to encourage foreign trade.



- (3) Taxes on imported goods may also be used as a *bargaining tool* by a country by setting tariff rates first at a relatively high level before trade negotiations are entered into with another country to enhance its bargaining power.
- (4) Taxes may be increased in periods of prosperity to curb spending power and *halt inflation* or lowered in periods of slump to expand business and *ward off depression*.
- (5) Taxes may be levied to *reduce inequalities in wealth and incomes*, as for instance, the estate, donor's and income taxes, their payers being the recipients of unearned wealth or mostly in the higher income brackets.
- (6) Taxes may be levied to *promote science and invention* (see RA. No. 5448) or to finance educational activities (see RA. No. 5447) or to *improve the efficiency of local police forces* in the maintenance of peace and order through grant of subsidy (see RA.No. 6141.).
- (7) Taxation may be made as an *implement of the police power* to promote the general welfare. By way of illustration, it has been held that the Sugar Adjustment Act is an act enacted primarily under the police power and designed to obtain a readjustment of the benefits derived by people interested in the sugar industry as well as to rehabilitate and stabilize the industry which constitutes one of the great sources of the country's wealth and, therefore, affects a great portion of the population of the country. (see Lutz vs. Araneta, 78 Phil. 148; Republic vs. Bacolod-Murcia Milling Co., 17 SCRA 632 [1966]; see Pres. Decree No. 388.)

As long as a tax is for a public purpose, its validity is not affected by collateral purposes or motives of the legislature in imposing the levy, or by the fact that it has a regulatory effect (51 Am. Jur. 381-382.) or it discourages or even definitely deters the activities taxed. The principle applies even though the revenue obtained from the tax appears very negligible or the revenue purpose is only secondary. (see United States vs. Sanchez, 340 U.S. 42; Tio vs. Videogram Regulatory Board, 151 SCRA 208 [1987])

Taxation is no longer envisioned as merely to raise revenue to support the existence of government; taxes may be levied with a regulatory purpose to provide means for rehabilitation and stabilization of a threatened industry which is imbued with public interest as to be within the police power of the State. The stabilization of oil prices is one of prime concern which the State, via police power, may properly address. [*Caltex v. COA*]

F. Principles of Sound Tax System

- (1) **Fiscal Adequacy** - the sources (proceeds) of tax revenue should coincide with, and approximate the needs of, government expenditures. The revenue should be elastic or capable of expanding or contracting annually in response to variations in public expenditures.
- (2) **Administrative Feasibility** - Tax laws should be capable of convenient, just and effective administration. Each tax should be clear and plain to the taxpayer, capable of uniform enforcement by government officials, convenient as to the time, place, and manner of payment, and not unduly burdensome upon, or discouraging to business activity.
- (3) **Theoretical Justice or Equality** - The tax burden should be in proportion to the taxpayer's ability to pay. This is the so-called ability to pay principle. It also connoted that the contribution of each person towards the expense of the government should be so apportioned such that he would feel neither more nor less inconvenienced from his share of the payment than every other person experiences from his. In other words, taxation should be uniform as well as equitable

Note: The non-observance of the above principles will not necessarily render the tax imposed invalid except to the extent that specific constitutional limitations are violated. (De Leon)

G. Theory and Basis of Taxation

Lifeblood Theory

Taxes are the lifeblood of the government and their prompt and certain availability is an imperious need. [*CIR v. Pineda*]

Taxes are the lifeblood of the government and so should be collected without unnecessary hindrance. It is said that taxes are what we pay for civilized society. Without taxes, the government would be paralyzed for lack of the motive power to activate and operate it. [*CIR v. Algue*]

Necessity Theory

The power of taxation proceeds upon theory that the existence of government is a necessity; that is cannot continue without means to pay its expenses; and that for those means it has the right to compel all citizens and property within its limits to contribute.

The power to tax is an attribute of sovereignty. It is a power emanating from necessity. It is a necessary burden to preserve the State's sovereignty and a means to give the citizenry an army to resist an



aggression, a navy to defend its shores from invasion, a corps of civil servants to serve, public improvement designed for the enjoyment of the citizenry and those which come within the State's territory, and facilities and protection which a government is supposed to provide. [*Phil. Guaranty v. CIR*]

Benefits-Protection Theory (Symbiotic Relationship)

This principle serves as the basis of taxation and is founded on the reciprocal duties of protection and support between the State and its inhabitants. Also called "symbiotic relation" between the State and its citizens.

The eradication of a dreaded disease is a public purpose, but if by public purpose the petitioner means benefit to a taxpayer as a return for what he pays, then it is sufficient answer to say that the only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes. Any other view would preclude the levying of taxes except as they are used to compensate for the burden on those who pay them and would involve the abandonment of the most fundamental principle of government – that it exists primarily to provide for the common good. [*Gomez v. Palomar*]

The obligation to pay taxes rests not upon the privileges enjoyed by, or the protection afforded to, a citizen by the government but upon the necessity of money for the support of the state. For this reason, no one is allowed to object to or resist the payment of taxes solely because no personal benefit to him can be pointed out. [*Lorenzo v. Posadas*]

Jurisdiction over subject and objects

The limited powers of sovereignty are confined to objects within the respective spheres of governmental control. These objects are the proper subjects or objects of taxation and none else.

H. Doctrines in Taxation

Prospectivity of tax laws

General rule: Tax laws are **prospective** in operation. The reason is that the nature and amount of the tax could not be foreseen and understood by the taxpayer at the time the transaction which the law seeks to tax was completed.

Exception: Tax laws may be applied **retroactively** provided it is *expressly declared* or *clearly the legislative intent*. For instance, it has been the universal practice to increase taxes on income already earned; yet notwithstanding this retroactive operation, income taxes have not been successfully assailed as invalid.

Exception to the exception: a tax law should not be given retroactive application when it would be so *harsh and oppressive* for in such case, the constitutional limitation of due process would be violated (*Republic v. Fernandez*).

It is a cardinal rule that laws shall have no retroactive effect, unless the contrary is provided (citing Art. 4 of the Civil Code). [*Hydro Resources v. CA*]

Collection of interest in tax cases is not penal in nature; it is but a just compensation to the State. The constitutional prohibition against *ex post facto* laws is not applicable to the collection of interest on back taxes. [*Central Azucarera v. CTA*]

Though a tax statute may be applied retroactively, legislative intent to that effect should be *perfectly clear* - i.e., the language of the statute clearly demands or presses that it shall have a retroactive effect. [*Lorenzo v. Posadas*]

Non-retroactivity of Rulings (Sec. 246)

General rule: IF REVOCATION, MODIFICATION OR REVERSAL WILL BE PRJUDICIAL TO THE TAXPAYER→ Any revocation, modification, or reversal of any of the rules and regulations promulgated by the Secretary of Finance and rulings and circulars promulgated by the CIR shall NOT be given retroactive effect.

Exceptions:

- (1) Where the taxpayer deliberately misstates or omits material facts from his return or any document required of him by BIR;
- (2) Where the facts subsequently gathered by the BIR are materially different from the facts on which the ruling is based; OR
- (3) Where the taxpayer acted in bad faith.

Imprescriptibility

Unless otherwise provided by the tax itself, taxes are *imprescriptible*. (*CIR v. Ayala Securities Corporation*)

The *National Internal Revenue Code* provides for statute of limitations (see Section 203 and 222) in the assessment and collection of taxes therein imposed.

For the purpose of safeguarding taxpayers from any unreasonable examination, investigation or assessment, our tax law provides a statute of limitations in the collection of taxes. Thus, the law on prescription, being a remedial measure, should be liberally construed in order to afford such protection. As a corollary, the exceptions to the law on prescription should perforce be strictly construed. [*Commissioner v. C.A., G.R.No. 104171 (1999)*]

The *Tariff and Customs Code* does not express any general statute of limitation; it provides, however,



that “when articles have been entered and passed free of duty or final adjustments of duties made, with subsequent delivery, such entry and passage free of duty or settlements of duties will, *after the expiration of one (1) year*, from the date of the final payment of duties, in the absence of fraud or protest or compliance audit pursuant to the provisions of this Code, be final and conclusive upon all parties, unless the liquidation of the import entry was merely tentative.” (Sec. 1603)

The *Local Government Code* prescribes prescriptive periods for the assessment (5 years) and collection (5 years) of taxes. (see Sections 194 and 270, Rep. Act No. 7160).

Double taxation

Means taxing twice for the same tax period the same thing or activity, when it should be taxed once, for the same purpose and with the same kind of character of tax.

Strict sense

In order to constitute double taxation in the strict sense or direct duplicate taxation:

- (1) the same property must be *taxed twice* when it should be taxed once;
- (2) both taxes must be imposed on the *same property or subject matter*;
- (3) for the *same purpose*;
- (4) by the *same State, Government, or taxing authority*;
- (5) within the *same territory, jurisdiction or taxing district*;
- (6) during the *same taxing period*; and
- (7) of the *same kind or character of tax*.

Broad sense

There is double taxation in the broad sense or there is indirect duplicate taxation (not an “obnoxious double taxation,” says the Supreme Court in *Commissioner v. Lednicky*, 11 SCRA 603) if any of the elements for direct duplicate taxation is *absent*.

It extends to all cases in which there is a burden of two or more pecuniary impositions. For example, a tax upon the same property imposed by two different states.

Double taxation, standing alone and not being forbidden by our fundamental law, is not a valid defense against the legality of a tax measure (*Pepsi Cola v. Mun. of Tanauan*) But from it might emanate such defences against taxation as oppressiveness and inequality of the tax.

Constitutionality of double taxation

There is no constitutional prohibition against double taxation in the Philippines. It is something not favored, but is permissible, provided some other constitutional requirement is not thereby violated, such as the requirement that taxes must be uniform. [*Villanueva v. City of Iloilo (1968)*]

Double taxation in its narrow sense is undoubtedly unconstitutional but that in the broader sense is not necessarily so. (*De Leon citing 26 R.C.L 264-265*)

If the tax law follows the constitutional rule on uniformity, making all income, business or property of the same class taxable at the same rate, there can be no valid objection to taxing the same income, business or property twice. [*China Banking Corp. v. CA, G.R.No. 146749 (2003)*]

Modes of eliminating double taxation

- (1) Allowing reciprocal exemption either by law or by treaty;
- (2) Allowance of tax credit for foreign taxes paid
- (3) Allowance of deduction for foreign taxes paid
- (4) Reduction of Philippine tax rate.

Escape from taxation

1. Shifting of tax burden

SHIFTING - is the transfer of the burden of a tax by the original payer or the one on whom the tax was assessed or imposed to someone else. What is transferred is not the payment of the tax but the burden of the tax.

Ways of shifting the tax burden

- (1) Forward shifting - When the burden of the tax is transferred from a factor of production through the factors of distribution until it finally settles on the ultimate purchaser or consumer. Example: VAT, percentage tax
- (2) Backward shifting - When the burden of the tax is transferred from the consumer or purchaser through the factors of distribution to the factor of production. Example: Consumer or purchaser may shift tax imposed on him to retailer by purchasing only after the price is reduced, and from the latter to the wholesaler, and finally to the manufacturer or producer. The tax is shifted to the extent that the price is reduced by reason of the tax.
- (3) Onward shifting - When the tax is shifted two or more times either forward or backward. Thus, a transfer from the seller to the purchaser involves one shift; from the producer to the wholesaler, then to retailer, we have two shifts; and if the tax is transferred again to the purchaser by the retailer, we have three shifts in all.

Taxes that can be shifted

Only indirect taxes may be shifted; direct taxes cannot be shifted.

Meaning of impact and incidence of taxation

Impact of taxation is the point on which a tax is originally imposed. In so far as the law is concerned,



the taxpayer is the person who must pay the tax to the government. He is also termed as the statutory taxpayer - the one on whom the tax is formally assessed. He is the subject of the tax.

Incidence of taxation is that point on which the tax burden finally rests or settle down. It takes place when shifting has been effected from the statutory taxpayer to another.

Relationship between Impact, Shifting, and Incidence of a Tax

The impact is the initial phenomenon, the shifting is the intermediate process, and the incidence is the result. Thus, the impact in a sales tax (i.e. VAT) is on the seller (manufacturer) who shifts the burden to the customer who finally bears the incidence of the tax.

Impact is the imposition of the tax; shifting is the transfer of the tax; while incidence is the setting or coming to rest of the tax.

2. Tax avoidance

The exploitation by the taxpayer of legally permissible alternative tax rates or methods of assessing taxable property or income in order to avoid or reduce tax liability. It is politely called "tax minimization" and is not punishable by law.

Example: A person refrains from engaging in some activity or enjoying some privilege in order to avoid the incidental taxation or to lower his tax bracket for a taxable year.

A taxpayer has the legal right to decrease the amount of what otherwise would be his taxes or altogether avoid them by means which the law permits.

3. Transformation

TRANSFORMATION - method of escape in taxation whereby the manufacturer or producer upon whom the tax has been imposed, fearing the loss of his market if he should add the tax to the price, pays the tax and endeavors to recoup himself by improving his process of production thereby turning out his units of products at a lower cost.

The taxpayer escapes by a transformation of the tax into a gain through the medium of production.

4. Tax evasion

TAX EVASION - is the use by the taxpayer of illegal or fraudulent means to defeat or lessen the payment of a tax. It is also known as "tax dodging." It is punishable by law.

Example: Deliberate failure to report a taxable income or property; deliberate reduction of income that has been received.

Elements of Tax Evasion

- (1) The end to be achieved. Example: the payment of less than that known by the

taxpayer to be legally due, or in paying no tax when such is due.

- (2) An accompanying state of mind described as being "evil," "in bad faith," "willful" or "deliberate and not accidental."
- (3) A course of action (or failure of action) which is unlawful.

Since fraud is a state of mind, it need not be proved by direct evidence but may be inferred from the circumstances of the case. Thus:

- (1) The failure of the taxpayer to declare for taxation purposes his true and actual income derived from his business for two consecutive years has been held as an indication of his fraudulent intent to cheat the government of its due taxes. (*Republic v. Gonzales*, 13 SCRA 633 [1965]).
- (2) The substantial underdeclaration of income in the income tax returns of the taxpayer for four (4) consecutive years coupled with his intentional overstatement of deductions justifies the finding of fraud. (*Perez v. CTA and Collector*, 103 Phil. 1167 [1958]).

Exemption from taxation

Meaning of exemption from taxation

The grant of immunity to particular persons or corporations or to person or corporations of a particular class from a tax which persons and corporations generally within the same state or taxing district are obliged to pay. It is an immunity or privilege; it is freedom from a financial charge or burden to which others are subjected.

Strictly construed against the taxpayer.

General rule: In the construction of tax statutes, exemptions are not favoured and are construed *strictissimi juris* (by the most strict right or law) against the taxpayer. An exemption from the common burden cannot be permitted to exist upon vague implication or inference.

The fundamental theory is that all taxable property should bear its share of the cost and expense of government. Moreover, applying the rule of strict construction to statutory provisions granting tax exemptions (or deductions) would minimize differential treatment and foster fairness and equality of treatment among taxpayers.

Taxation is the rule and exemption, the exception, and therefore, he who claims exemption must be able to justify his claim or right thereto, by a grant expressed in terms "too plain to be mistaken and too categorical to be misinterpreted." If not expressly mentioned in the law, it must at least be within its purview by clear legislative intent.

Nature of tax exemption

- (1) *Mere personal privilege*. Being personal in nature, it cannot be assigned or transferred without the consent of the Legislature. The legislative consent to the transfer may be



given either in the original act granting the exemption or in a subsequent law

- (2) **General rule:** *revocable* by the government.

Exception: It is founded on a contract which is protected from impairment. But the contract must contain the essential elements of other contracts, such as for example, a valid cause or consideration. An exemption provided for in a franchise, however, may be repealed or amended pursuant to the Constitution (see Sec. 11, Art. XII). A legislative franchise is in the nature of a contract.

- (3) Implies a *waiver on the part of the government* of its right to collect taxes due to it, and, in this sense, is prejudicial thereto. Hence, it exists only by virtue of an express grant and must be strictly construed.
- (4) *Not necessarily discriminatory*, provided it has reasonable foundation or rational basis. Where, however, no valid distinction exists, the exemption may be challenged as violative of the equal protection guarantee or the uniformity rule.
- (5) **General rule:** Strict construction against taxpayer claiming exemption.

Exceptions:

- (a) The rule on strict interpretation against the grantees does not apply to tax exemptions in favor of a political subdivision or instrumentality of the government (*Maceda v. Macaraig*), or of charitable, religious, and educational institutions (*De Leon*).
- (b) When the law itself expressly provides for a liberal construction, that is, in case of doubt it shall be resolved in favor of tax exemption. (*De Leon*).
- (c) Exemptions to traditional grantees, such as those in favor of religious and charitable institutions.
- (d) Exemptions from certain taxes granted under special circumstances to special classes of persons. (*Vitug and Acosta*)

Kinds of tax exemption

- (1) **Express or Affirmative** - When certain persons, property, or transactions are, by express provision, exempted from all or certain taxes, either entirely or in part. This exemption may be made by provisions of the Constitution, statutes, treaties, ordinances, franchises, or contracts.
- (2) **Implied or Exemption by Omission** - when a tax is levied on certain classes of persons, properties, or transactions, without mentioning the other classes. Every tax statute, in a very real sense, makes exemptions since all those not mentioned are deemed exempted. The omission may be either accidental or intentional. Exemptions are not presumed, but when

public property is involved, exemption is the rule, and taxation, the exception.

- (3) **Contractual** - agreed to by the taxing authority in contracts lawfully entered into. Subject to non-impairment of contracts. In the real sense of the term and where the non-impairment clause of the Constitution can rightly be invoked, are those agreed to by the taxing authority in contracts, such as those contained in government bonds or debentures, lawfully entered into by them under enabling laws in which the government, acting in its private capacity, sheds its cloak of authority and waives its governmental immunity. Truly, tax exemptions of this kind may not be revoked without impairing the obligations of contracts. These contractual tax exemptions, however, are not to be confused with tax exemptions granted under franchises. A franchise partakes the nature of a grant which is beyond the purview of the non-impairment clause of the Constitution. (*Manila Electric Company v. Province of Laguna*, G.R.No. 131359, May 5, 1999)

Rationale/grounds for exemption

Rationale of Tax Exemption

Such exemption will benefit the body of the people and not particular individuals or private interest and that the public benefit is sufficient to offset the monetary loss entailed in the grant of the exemption.

Grounds for tax exemption

- (1) It may be based on *contract*.
- (2) It may be based on some ground of *public policy*.
- (3) It may be created in a treaty on grounds of *reciprocity* or to *lessen the rigors of international or multiple taxation*.

But: equity is NOT a ground for tax exemption. Thus, the fact that one person may not have been required to pay his tax does not exempt another from the payment of his legal taxes, or legally entitle him to a refund of any taxes which he has paid. Exemption from tax is allowable only if there is a clear provision therefor. While equity cannot be used as a basis or justification for tax exemption, a law may validly authorize the condonation of taxes on equitable considerations.

Revocation of tax exemption

Generally revocable by the government. Contractual tax exemptions, however, may not be unilaterally so revoked by the taxing authority without thereby violating the non-impairment clause of the Constitution

Compensation and Set-off



General rule: Taxes **cannot** be the subject of set-off or compensation (*Republic v. Mambulao Lumber*).

Reasons:

- (1) This would adversely affect the government revenue system (*Philex Mining v. CA*).
- (2) Government and the taxpayer are not creditors and debtors of each other. The payment of taxes is not a contractual obligation but arises out of a duty to pay. (*Republic v. Mambulao*)

Exception: If the claims against the government have been recognized and an *amount has already been appropriated* for that purpose, set-off or compensation may be had. Where both claims have already become **due and demandable as well as fully liquidated**, compensation takes place by operation of law under Art. 1200 in relation to Articles 1279 and 1290 of the NCC, and both debts are extinguished to the concurrent amount. [*Domingo v. Garlitos*]

Doctrine of Equitable Recoupment- a claim for refund barred by prescription may be allowed to offset unsettled tax liabilities. The doctrine FINDS NO application in this jurisdiction. (Collector v. UST).

Compromise

A contract whereby the parties, by making reciprocal concessions avoid litigation or put an end to one already commenced. It involves a reduction of the taxpayer's liability.

Tax amnesty

Definition

A tax amnesty, being a general pardon or intentional overlooking by the State of its authority to impose penalties on persons otherwise guilty of evasion or violation of a revenue or tax law, **partakes of an absolute forgiveness or waiver by the Government of its right to collect what otherwise would be due it**, and in this sense, prejudicial thereto, particularly to give tax evaders, who wish to relent and are willing to reform a chance to do so and become a part of the new society with a clean slate. [*Republic v. IAC (1991)*]

Distinguished from tax exemption

Tax amnesty is an immunity from all criminal and civil obligations arising from non-payment of taxes. It is a general pardon given to all taxpayers. It applies to past tax periods, hence of retroactive application. (*People v. Castañeda, 1988*).

Tax exemption is an immunity from all civil liability only. It is an immunity or privilege, a freedom from a charge or burden of which others are subjected. It

is generally prospective in application. (*Dimaampao, 2005, p. 111*)

Construction and Interpretation of:

1. Tax laws

In case of doubt in the interpretation of statutes levying taxes or duties, such are to be construed **strictly against the government and liberally in favor of the taxpayer.**

2. Tax exemption and exclusion

General Rule

Tax exemptions must be shown to exist **clearly and categorically**, and supported by clear legal provisions. [*NPC v. Albay*]

Claims for an exemption must be able to point out some provision of law creating the right, and **cannot be allowed to exist upon a mere vague implication or inference.** [*Floro Cement v. Gorospe*]

Refunds are in the nature of exemption, and must be construed strictly against the grantee/taxpayer. [*CIR v. CA*]

Exception

- (1) When the law provides for liberal construction
- (2) Exemptions in favor of government, its political subdivisions, and instrumentalities; or in case of property owned by the state or a city or other public corporations (*Maceda v. Macaraig*)
- (3) The rule of strict construction of tax exemption should not be applied to organizations performing strictly religious, charitable, and educational functions.
- (4) Exemptions from certain taxes granted under special circumstances to special classes of persons. (Vitug and Acosta)

3. Tax rules and regulations

The Secretary of Finance, upon recommendation of the CIR, shall promulgate all needful rules and regulations for the effective enforcement of the provisions of the NIRC. (Sec. 244)

Requisites of a valid tax regulation

- (1) Reasonable
- (2) Within the authority conferred
- (3) Not contrary to law
- (4) Must be published in the Official Gazette and filed with the UP Law Center

NOTE: Administrative regulations must always be in harmony with the provisions of the law. In case of discrepancy between the basic law and the implementing rule or regulation, the former prevails.

4. Penal provisions of tax laws



Penal provisions of tax laws must be strictly construed. Where penalties for infringement are imposed, it is not legitimate to stretch the language of a rule, however beneficent its intention, beyond the fair and ordinary meaning of its language.

5. Non-retroactivity of tax laws

General rule: Tax laws are **prospective** in operation.

Exception: Tax laws may be applied **retroactively** provided it is *expressly declared or clearly the legislative intent*.

Exception to the exception: A tax law should not be given retroactive application when it would be so *harsh and oppressive* for in such case, the constitutional limitation of due process would be violated (*Republic v. Fernandez*).

I. Scope and Limitation of Taxation

Inherent Limitations

1. Public Purpose

The test of the constitutionality of a statute requiring the use of public funds is whether the statute is designed to promote the public interest, as opposed to the furtherance of the advantage of individuals, although each advantage to individuals might incidentally serve the public. [*Pascual v. Secretary of Public Works (1960)*]

Taxation may be made the implement of the State's police power. The protection and promotion of the sugar industry is a matter of public concern; the legislature may determine within reasonable bounds what is necessary for its protection and expedient for its promotion. [*Lutz v. Araneta (1955)*]

The public purpose of a tax may legally exist even if the motive which impelled the legislature to impose the tax was to favor one industry over another. [*Tio v. Videogram (1987)*]

Tests in Determining Public Purpose:

- (1) *Duty Test* - Whether the thing to be furthered by the appropriation of public revenue is something which is the duty of the State as a government to provide.
- (2) *Promotion of General Welfare Test* - Whether the proceeds of the tax will directly promote the welfare of the community in equal measure.
- (3) *Character of the Direct Object of the Expenditure* - It is the essential character of the direct object of the expenditure which must determine its validity as justifying a tax and not the magnitude of the interests to be affected nor the degree to which the general advantage of the community, and thus the public welfare, may be ultimately

benefited by their promotion. Incidental advantage to the public or to the State, which results from the promotion of private enterprises or business, does not justify their aid with public money. [*Pascual v. Sec. of Public Works*]

2. Inherently Legislative

Stated in another way, taxation may exceptionally be delegated, subject to such well-settled limitations as -

- (1) The delegation shall not contravene any constitutional provision or the inherent limitations of taxation;
- (2) The delegation is effected either by the Constitution or by validly enacted legislative measures or statute; and
- (3) The delegated levy power, except when the delegation is by an express provision of the Constitution itself, should only be in favor of the local legislative body of the local or municipal government concerned. [*Vitug and Acosta*]

General Rule: *Delegata potestas non potest delegari*. The power to tax is exclusively vested in the legislative body as delegates of the people; and it may not be re-delegated.

With the legislature primarily lies the discretion to determine the

- (1) nature (kind),
- (2) object (purpose),
- (3) extent (rate),
- (4) coverage (subjects) and
- (5) situs (place) of taxation.

The court cannot freely delve into those matters which, by constitutional fiat, rightly rest on legislative judgment. [*Tan v. Del Rosario (1994)*]

Exceptions

- (1) **Delegation to local governments** - LGUs have power to create its own sources of revenue and to levy taxes, fees and charges, subject to such guidelines and limitations as the Congress may provide which, however, must be consistent with the basic policy of local autonomy. [Art X, Sec 5, 1987 Consti]
- (2) **Delegation to the President** to enter into Executive agreements, and to ratify treaties which grant tax exemption subject to Senate concurrence. The Congress may, by law, authorize the President to fix within specified limits, and subject to such limitations and restrictions as it may impose, tariff rates, import and export quotas, tonnage and wharfage dues, and other duties or imposts within the framework of the national development program of the Government. [Art. 6, Sec. 28 (2), 1987 Consti]



(3) Delegation to administrative agencies - Limited to the administrative implementation that calls for some degree of discretionary powers under sufficient standards expressed by law or implied from the policy and purposes of the Act.

Note: Delegation to administrative agencies is really not an exception to the rule as no delegation of the strictly legislative power to tax is involved. The powers which are not legislative include:

- (a) The power to value property for purposes of taxation pursuant to fixed rules;
- (b) The power to assess and collect the taxes; and
- (c) The power to perform any of the innumerable details of computation, appraisal, and adjustment, and the delegation of such details. [*Cervantes v. Auditor General*]

3. Territorial

Meaning of Situs of Taxation

Situs of taxation refers to the place of taxation, or the state or political unit which has jurisdiction to impose tax over its inhabitants.

General Rule: The taxing of a country is limited to persons and property within and subject to its jurisdiction.

Reasons:

- (1) Taxation is an act of sovereignty which could only be exercised within a country's territorial limits.
- (2) This is the result of the concept that taxes are paid for the protection and services provided by the taxing authority which could not be provided outside the territorial boundaries of the taxing State.

Exceptions:

- (1) Where tax laws operate outside territorial jurisdiction. (i.e., Taxation of resident citizens on their incomes derived from abroad.)
- (2) Where tax laws do not operate within the territorial jurisdiction of the State.
- (3) When exempted by treaty obligations.
- (4) When exempted by international comity.

Factors that Determine Situs:

- (1) Nature of the tax;
- (2) Subject matter of the tax;
- (3) Citizenship of the taxpayer;
- (4) Residence of the taxpayer;
- (5) Source of income.

KIND OF TAX	SITUS
Property Tax	
Real property	Where it is located (<i>lex rei sitae</i>)
Tangible Personal property	Where the property is physically located although the owner resides in another jurisdiction.

Intangible personal property	<i>Gen Rule:</i> Domicile of the owner. <i>Mobilia sequuntur personam</i> (movables follow the person) <i>Exceptions:</i> (1) When property has acquired a business situs in another jurisdiction; or (2) When the law provides for the situs of the subject of tax (i.e., Sec 104 NIRC)
Excise Tax	
Income	Source of the income, nationality or residence of the taxpayer (Sec 23 NIRC)
Donor's Tax	Location of the property; nationality or residence of the taxpayer
Estate	Location of the property; nationality or residence of the taxpayer
VAT	Where the transaction is made
Others	
Poll, Capitation or Community Tax	Residence of the taxpayer, regardless of the source of income or location of the property of the taxpayer

4. International Comity

Comity is the respect accorded by nations to each other because they are sovereign equals. Thus, the property or income of a foreign state or government may not be the subject of taxation by another state.

Reasons:

- (1) *In par in parem non habet imperium*. As between equals there is no sovereign. (Doctrine of Sovereign Equality)
- (2) The rule of international law that a foreign government may not be sued without its consent so that it is useless to impose a tax which could not be collected.
- (3) The concept that when a foreign sovereign enters the territorial jurisdiction of another, it does not subject itself to the jurisdiction of the other.

5. Exemption of Government Entities, Agencies, and Instrumentalities

If the taxing authority is the National Government:

General Rule: The government is exempt from tax.

Exception: When it chooses to tax itself. Nothing can prevent Congress from decreeing that even instrumentalities or agencies of the government performing governmental functions may be subject to tax. Where it is done precisely to fulfill a constitutional mandate and national policy, no one can doubt its wisdom. (*Mactan Cebu Airport v Marcos, 1996*)

If the taxing authority is the local government unit:
RA 7160 expressly prohibits LGUs from levying tax on



the National Government, its agencies and instrumentalities and other LGUs.

Constitutional Limitations

1. Provisions Directly Affecting Taxation

Prohibition against imprisonment for non-payment of poll tax

Art III, Sec 20, 1987 Consti- No person shall be imprisoned for debt or non-payment of a poll tax.

Uniformity and equality of taxation

Art VI, Sec 28(1), 1987 Consti- The rule of taxation shall be uniform and equitable. The Congress shall evolve a progressive system of taxation.

- (1) *Uniformity*- All taxable articles or properties of the same class shall be taxed at the same rate.
- (2) *Equity* - The burden of the tax should consider the taxpayer's ability to pay

Taxation does not require identity or equality under all circumstances, or negate the authority to classify the objects of taxation. The classification to be valid, must, be reasonable and this requirement is not deemed satisfied unless: (1) it is based upon substantial distinctions which make real differences; (2) these are germane to the purpose of the legislation or ordinance; (3) the classification applies, not only to present conditions, but, also, to future conditions substantially identical to those of the present; and (4) the classification applies equally to all those who belong to the same class. (*Pepsi-Cola v. Butuan City, 24 SCRA 789*)

Grant by Congress of authority to the President to impose tariff rates

Delegation of Tariff powers to the President under the flexible tariff clause [Art VI, Sec 28(2), 1987 Constitution]

Prohibition against taxation of religious, charitable entities, and educational entities

Art VI, Sec 28, 1987 Constitution - xxx (3) Charitable institutions, churches and personages or convents appurtenant thereto, mosques, non-profit cemeteries, and all lands, buildings, and improvements, *actually, directly, and exclusively used* for religious, charitable, or educational purposes shall be exempt from taxation.

The tax exemption under this constitutional provision covers *real property taxes only*.

In general, special assessments are not covered by the exemption because by nature they are not classified as taxes. [*Apostolic Prefect v. City Treasurer of Baguio*]

To be entitled to the exemption, the petitioner must prove that:

- (1) it is a charitable institution

- (2) its real properties are *actually, directly and exclusively* used for charitable purposes.

Revenue or income from trade, business or other activity, the conduct of which is not related to the exercise or performance of religious, educational and charitable purposes or functions shall be subject to internal revenue taxes when the same is not actually, directly or exclusively used for the intended purposes. (*BIR Ruling 046-2000*)

Test of Exemption	Use of the property, and not the ownership
Nature of Use	Actual, direct and exclusive use for religious, charitable or educational purposes.
Scope of Exemption	<i>Real property taxes</i> on facilities which are (1) actual, (2) incidental to, or (3) reasonably necessary for the accomplishment of said purposes. [<i>Abra Valley College v. Aquino</i>]

The TEST whether an enterprise is charitable or not is whether it exists to carry out a purpose recognized in law as charitable or whether it is maintained for gain, profit, or private advantage.

As a general principle, a charitable institution does not lose its character as such and its exemption from taxes simply because it derives income from paying patients, whether out-patient, or confined in the hospital, or receives subsidies from the government, so long as the money received is devoted or used altogether to the charitable object which it is intended to achieve; and no money inures to the private benefit of the persons managing or operating the institution.

"Exclusive" is defined as possessed and enjoyed to the exclusion of others; debarred from participation or enjoyment; and "exclusively" is defined, "in a manner to exclude; as enjoying a privilege exclusively." If real property is used for one or more commercial purposes, it is not exclusively used for the exempted purposes but is subject to taxation. The words "dominant use" or "principal use" cannot be substituted for the words "used exclusively" without doing violence to the Constitutions and the law. **Solely is synonymous with exclusively.** [*Lung Center of the Philippines v. Quezon City (2004)*]

NOTE: *Lung Center* did not necessarily overturn the case of *Abra Valley College v. Aquino (1988)*. *Lung center* just provided a stricter interpretation of the rule. In *Abra Valley*, the court held: The primary use of the school lot and building is the basic and controlling guide, norm and standard to determine tax exemption, and not the mere incidental use thereof. Under the 1935 Constitution, the trial court correctly arrived at the conclusion that the school building as well as the lot where it is built, should be taxed, not because the second floor of the same is being used by the Director and his family for

residential purposes (incidental to its educational purpose), but because the first floor thereof is being used for commercial purposes. However, since only a portion is used for purposes of commerce, it is only fair that half of the assessed tax be returned to the school involved.

Prohibition against taxation of non-stock, non-profit institutions

Art XIV, Sec 4, 1987 Consti - xxx

(3) **All revenues and assets** of non-stock, non-profit educational institutions used *actually, directly, and exclusively* for educational purposes shall be *exempt from taxes and duties*. Upon the dissolution or cessation of the corporate existence of such institutions, their assets shall be disposed of in the manner provided by law.

Proprietary educational institutions, including those cooperatively owned, may likewise be entitled to such exemptions, subject to the limitations provided by law, including restrictions on dividends and provisions for reinvestment.

(4) Subject to conditions prescribed by law, all grants, endowments, donations, or contributions used *actually, directly, and exclusively* for educational purposes shall be exempt from tax.

This provision covers only non-stock, non-profit educational institutions

The exemption covers internal revenue taxes, custom duties on all revenues and assets of such institutions, and incidental income from facilities located inside the school campus.

However, incomes which are unrelated to school operations are taxable.

Art. VI, sec. 28, par. 3	Art. XIV, sec. 4, par. 3
Charitable institutions, churches and parsonages or convents appurtenant thereto, mosques, non-profit cemeteries, and all lands, buildings, and improvements, <i>actually, directly, and exclusively</i> used for religious, charitable, or educational purposes.	Non-stock, non-profit educational institutions.
Property taxes	Income, property, and donor's taxes and custom duties.

Majority vote of Congress for grant of tax exemption

Art 6, Sec 28, 1987 Consti - xxx

(4) No law granting any tax exemption shall be passed without the concurrence of a majority of all the Members of the Congress.

Basis of the grant: The inherent power of the state to impose taxes carries with it the power to grant tax exemptions.

Exemptions may be created by:

- (1) the Constitution or
- (2) statute subject to constitutional limitations

Vote required for the grant of exemption: Absolute majority of the members of Congress (at least 1/2 plus 1 of ALL the members voting separately)

Vote required for withdrawal of such grant of exemption: Relative majority is sufficient (majority of the quorum)

Grants in the nature of tax exemptions:

- (1) Tax amnesties
- (2) Tax condonations
- (3) Tax refunds

Note:

- (1) The LGU shall have the authority to grant local tax exemption privileges. (Sec. 192, LGC)
- (2) The President of the Philippines may, when public interest so requires, condone or reduce real property taxes and interest. (Sec. 277, LGC)

Prohibition on use of tax levied for special purpose

All money collected on any tax levied for a special purpose shall be treated as a special fund and paid out for such purpose only. If the purpose for which a special fund was created has been fulfilled or abandoned, the balance, if any, shall be transferred to the general funds of the Government.

President's veto power on appropriation, revenue, tariff bills

Art 6, Sec 28, 1987 Constitution -

- (2) The President shall have the power to veto any *particular item or items* in an appropriation, revenue, or tariff bill, but the veto shall not affect the item or items to which he does not object.

Non-impairment of jurisdiction of the Supreme Court

Art VIII, Sec 5 par 2[b], 1987 Consti - The Supreme Court shall have the power to review, revise, modify or affirm on appeal or certiorari, as the laws or the Rules of Court may provide, final judgments and orders of lower courts in all cases involving the legality of any tax, impost, assessment or toll or any penalty imposed in relation thereto.

San Miguel Corp v. Avelino: It is undoubted that under the Constitution, even the legislative body cannot deprive this Court of its appellate jurisdiction over all cases coming from inferior courts where the constitutionality or validity of an ordinance or the legality of any tax, impost, assessment, or toll is in question.



Art VI, Sec 30 of the Constitution provides that ‘no law shall be passed increasing the appellate jurisdiction of the Supreme Court without its advice and concurrence.’”

Scope of Judicial Review in taxation: The Power of Judicial Review in taxation is limited only to the interpretation and application of tax laws. The judicial tribunals have no concern on the wisdom of the taxing act. Its power does not include inquiry into the policy of legislation. Neither can it legitimately question or refuse to sanction the provisions of any law consistent with the Constitution. (*Bisaya Land Transportation Co v. Collector, May 29, 1959*)

Grant of power to the local government units to create its own sources of revenue

LGUs have power to create its own sources of revenue and to levy taxes, fees and charges, subject to such guidelines and limitations as the Congress may provide which, however, must be consistent with the basic policy of local autonomy. [Art X, Sec 5, 1987 Consti]

Flexible tariff clause

Delegation of Tariff powers to the President under the flexible tariff clause [Art VI, Sec 28(2), 1987 Consti]

The flexible tariff clause refers to the authority given to the President, upon the recommendation of NEDA, to adjust the tariff rates under Sec. 401 of the Code in the interest of national economy, general welfare and/or national security.

Exemption from real property taxes

Sec. 28(3), Art. VI, 1987 Constitution: Charitable institutions, churches and personages or convents appurtenant thereto, mosques, non-profit cemeteries, and all lands, buildings, and improvements, actually, directly, and exclusively used for religious, charitable, or educational purposes shall be exempt from taxation.

No appropriation or use of public money for religious purposes

Art VI, Sec 29.

- (1) No money shall be paid out of the Treasury except in pursuance of an appropriation made by law.
- (2) No public money or property shall be appropriated, applied, paid, or employed, directly or indirectly, for the use, benefit, or support of any sect, church, denomination, sectarian institution, or system of religion, or of any priest, preacher, minister, other religious teacher, or dignitary as such, except when such priest, preacher, minister, or dignitary is assigned to the armed forces, or to any penal institution, or government orphanage or leprosarium.
- (3) All money collected on any tax levied for a special purpose shall be treated as a special

fund and paid out for such purpose only. If the purpose for which a special fund was created has been fulfilled or abandoned, the balance, if any, shall be transferred to the general funds of the Government.

2. Provisions Indirectly Affecting Taxation

Due process

Art III, Sec 1, 1987 Consti: “No person shall be deprived of life, liberty, or property without due process of law, nor shall any person be denied the equal protection of the laws.”

Deprivation of life, liberty or property by the government conforms with due process when the ff concur:

- (1) *Substantive Due Process* - An act is done under the authority of a valid law or the Constitution itself.
- (2) *Procedural Due Process* - An act is done after compliance with fair and reasonable methods or procedure prescribed by law.

Due Process in Taxation requirements:

- (1) Tax must be for public purpose
- (2) It must be imposed within taxing authority’s territorial jurisdiction
- (3) Assessment or collection must not be arbitrary or oppressive

When taxpayer may invoke violation of due process: The due process clause may be invoked where a taxing statute is so arbitrary that it finds no support in the Constitution, as where it can be shown to amount to the confiscation of property. (*Sison v. Ancheta*)

Instances of violations of the due process clause:

- (1) If the tax statute amounts to confiscation of property;
- (2) If the subject of confiscation is beyond the jurisdiction of the state;
- (3) If the tax statute is not for a public purpose;
- (4) If the retroactive law is harsh and unreasonable. (*Sison v. Ancheta*)

Equal protection

Art III, Sec 1, 1987 Consti: No person shall be deprived of life, liberty, or property without due process of law, nor shall any person be denied the equal protection of the laws.

All persons subject to legislation shall be treated alike under similar circumstances and conditions both in the privileges conferred and liabilities imposed.

The equal protection clause is subject to reasonable classification. Classification is valid as long as:

- (1) classification rests on substantial distinctions which make real differences,



- (2) classification is germane to achieve the legislative purpose,
- (3) the law applies, all things being equal, to both present and future conditions, and
- (4) the classification applies equally well to all those belonging to the same class.

Religious freedom

Art III, Sec 5, 1987 Consti-. No law shall be made respecting an establishment of religion, or prohibiting the free exercise thereof. (*non-establishment clause*) The free exercise and enjoyment of religious profession and worship, without discrimination or preference, shall forever be allowed. (*free exercise clause*) No religious test shall be required for the exercise of civil or political rights.”

The free exercise clause is the basis of tax exemptions.

License fees on the sale of bibles and religious articles by a non-stock, non-profit missionary organization not for purposes of profit amounts to a condition or permit for the exercise of their right, thus violating the free exercise clause. [*American Bible Society v. City of Manila, L-9637 April 30, 1957*] However, if the activity is for profit or from any of their property, the income is taxable

Non-impairment of obligations of contracts

Art III, Sec 10. No law impairing the obligation of contracts shall be passed.

Not only are existing laws read into contracts in order to fix obligations as between parties, but the reservation of essential attributes of sovereign power is also read into contracts as a basic postulate of the legal order. The Contract Clause has never been thought as a limitation on the exercise of the State's power of taxation save only where a tax exemption has been granted for a valid consideration. [*Tolentino v. Secretary of Finance*]

J. Stages of Taxation

- (1) **Levy** - the act of the Legislature in choosing the persons, properties, rights, or privileges to be subjected to taxation.
- (2) **Assessment and Collection** - the act of executing the law through administrative agencies of the government.
- (3) **Payment** - the act of the taxpayer in settling his tax obligations.
- (4) **Refund** - reimbursement of the tax paid under grounds provided for by law.

K. Definition, Nature, and Characteristics of Taxes

TAXATION - is a mode by which governments make exactions for revenue in order to support their existence and carry out their legitimate objectives.

TAXES - are enforced proportional contributions from persons and property levied by the law-making body of the State by virtue of its sovereignty for the support of the government and all public needs.

NATURE: The power to tax, being inherent in an independent state for its existence and survival by the furtherance of its multifarious functions, the same does not require delegation from the Constitution. However, exercise of such power upon the inhabitants is subject to limitations.

CHARACTERISTICS:

- (1) It is an *enforced contribution* for its imposition is in no way dependent upon the will or assent of the person taxed.
- (2) It is generally *payable in the form of money*, although the law may provide payment in kind;
- (3) It is *laid by some rule of apportionment* which is usually based on ability to pay;
- (4) It is *levied on persons, property, acts, privileges, or transactions*. In each case, however, it is only a person who pays the tax;
- (5) It is *levied by the State which has jurisdiction or control over the subject to be taxed*. This is necessary in order that the tax can be enforced;
- (6) It is *levied by the law-making body* of the State. The power to tax is legislative power which only the legislature can exercise. The power to tax is also granted to local governments, but subject to such guidelines and limitations as may be provided by law;
- (7) It is *levied for public purpose*. Taxation involves, and a tax constitutes, a charge or burden imposed to provide public revenue for the support of the government, the administration of the law, or the payment of public expenses. A tax levied for a private purpose constitutes a taking of property without due process of law.

L. Requisites of a valid tax

- (1) It should be for a public purpose
- (2) The rule of taxation should be uniform
- (3) That either the person or property taxed be within the jurisdiction of the taxing authority
- (4) That the assessment and collection be in consonance with the due process clause
- (5) The tax must not infringe on the inherent and constitutional limitations of the power of taxation

M. Tax as distinguished from other forms of exactions

Tariff

TAXES	TARIFF
All embracing term to	A kind of tax imposed on



include various kinds of enforced contributions upon persons for the attainment of public purposes	articles which are traded internationally
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Toll

TAXES	TOLL
Paid for the support of the government	Paid for the use of another's property.
Demand of sovereignty	Demand of proprietorship
Generally, no limit on the amount collected as long as it is not excessive, unreasonable or confiscatory	Amount paid depends upon the cost of construction or maintenance of the public improvement used.
Imposed only by the government	Imposed by the government or by private individuals or entities.

License fee

TAXES	LICENSE AND REGULATORY FEE
Imposed under the taxing power of the state for purposes of revenue.	Levied under the police power of the state.
Forced contributions for the purpose of maintaining government functions.	Exacted primarily to regulate certain businesses or occupations.
Generally, unlimited as to amount	Should not unreasonably exceed the expenses of issuing the license and of supervision.
Imposed on persons, property and to exercise a privilege.	Imposed only on the right to exercise a privilege
Failure to pay does not necessarily make the act or business illegal.	Failure to pay makes the act or business illegal.
Penalty for non-payment: surcharges or imprisonment (except poll tax).	

Progressive Development Corp v. QC (1989): To be considered a license fee (PRIMARY PURPOSE TEST):

- (1) the imposition questioned must relate to an occupation or activity that so engages the public interest in health, morals, safety and development as to require regulation for the protection and promotion of such public interest;
- (2) the imposition must also bear a reasonable relation to the probable expenses of regulation, taking into account not only the costs of direct regulation but also its incidental consequences as well.

*Note: Taxes may also be imposed for regulatory purposes. It is called **regulatory tax**.*

Fees may be properly regarded as taxes even though they also served as an instrument of regulation. If the purpose is primarily revenue, or if revenue is, at least, one of the real and substantial purposes, then the exaction is properly called a tax. [*PAL v. Edu (1988)*]

Special assessment

TAXES	SPECIAL ASSESSMENT
Imposed regardless of public improvements	Imposed because of an increase in value of land benefited by public improvement. Levied only on land.
Contribution of a taxpayer for the support of the government.	Contribution of a person for the construction of a public improvement
It has general application both as to time and place.	Exceptional both as to time and locality.

Debt

TAXES	DEBT
Based on laws	Generally based on contract, express or implied.
Generally cannot be assigned	Assignable
Generally paid in money	May be paid in kind.
Cannot be a subject of set off	Can be a subject of set off
Non-payment is punished by imprisonment <i>except</i> in poll tax	No imprisonment in case of non-payment (<i>Art. III, Sec. 20 1987 Constitution</i>)
Governed by the special prescriptive periods provided for in the NIRC.	Governed by the ordinary periods of prescription.
Does not draw interest except only when delinquent	Draws interest when it is so stipulated or where there is default.
Imposed only by public authority	Can be imposed by private individual

N. Kinds of Taxes

As to object

- (1) Personal, Poll or Capitation Tax - tax of a fixed amount imposed on persons residing within a specified territory, whether citizens or not, without regard to their property or the occupation or business in which they may be engaged. (i.e. community tax)
- (2) Property Tax - tax imposed on property, real or personal, in proportion to its value or in accordance with some other reasonable method of apportionment. (i.e., real estate tax)



- (3) Privilege/Excise Tax - a charge imposed upon the performance of an act, the enjoyment of a privilege, or the engaging in an occupation.

2. As to burden or incidence

- (1) Direct Taxes - taxes which are demanded from persons who are primarily burdened to pay them (eg. Income, estate, donor's taxes)
- (2) Indirect Taxes - taxes levied upon transactions or activities before the articles subject matter thereof reach the consumers to whom the burden of the tax may ultimately be charged or shifted (eg. VAT)

3. As to tax rates

- (1) Specific Tax - is a tax of a fixed amount imposed by the head or number or by some other standard of weight or measurement. It requires no assessment other than the listing or classification of the objects to be taxed.
- (2) Ad Valorem Tax - is a tax of a fixed proportion of the value of the property with respect to which the tax is assessed. It requires the intervention of assessors or appraisers to estimate the value of such property before the amount due from each taxpayer can be determined.
- (3) Mixed

4. As to purposes

- (1) General Tax - levied for the general or ordinary purposes of the Government
- (2) Special Tax - levied for special purposes

5. As to scope or authority to impose

- (1) National - taxes imposed by the national government. (eg. Internal revenue taxes and customs duties)
- (2) Municipal or Local - taxes imposed by local governments (eg. Business taxes that may be imposed under the Local Govt Code)

6. As to graduation

- (1) Proportional - based on a fixed percentage of the amount of the property receipts or other basis to be taxed. Example: real estate tax.
- (2) Progressive - the rate of which increases as the tax base or bracket increases. Example: income tax.
- (3) Digressive Tax Rate - progressive rate stops at a certain point. Progression halts at a particular stage.
- (4) Regressive - the rate of which decreases as the tax base or bracket increases. There is no such tax in the Philippines.

II. National Internal Revenue Code of 1997 as amended (NIRC)

A. Income Taxation

1. Income Tax Systems
2. Features of the Philippine Income Tax Law
3. Criteria in Imposing Philippine Income Tax
4. Types of Philippine Income Tax
5. Taxable Period
6. Kinds of Taxpayers
7. Income Taxation
8. Income
9. Gross Income
10. Taxation of Resident Citizens, Non-resident Citizens and Resident Aliens
11. Taxation of Non-resident Aliens Engaged in Trade or Business
12. Exclude Non-resident Aliens Not Engaged in Trade or Business
13. Individual Taxpayers Exempt from Income Tax
14. Taxation of Domestic Corporations
15. Taxation of Resident Foreign Corporations
16. Taxation of Non-resident Foreign Corporations
17. Improperly Accumulated Earnings of Corporations
18. Exemption from tax on corporations
19. Taxation of Partnerships
20. Taxation of General Professional Partnerships
21. Taxation on Estates and Trusts
22. Withholding Tax

Income Tax is defined as a tax on all yearly profits arising from property, professions, trades, or offices, or as a tax on the person's income, emoluments, profits and the like (*Fisher v. Trinidad*).

It may be succinctly defined as a tax on income, whether gross or net, realized in one taxable year.

Income tax is generally classified as an *excise tax*. It is not levied upon persons, property, funds or profits but upon the right of a person to receive income or profits.

1. Income Tax Systems

Global Tax System

It does not matter whether the income received by the taxpayer is classified as compensation income, business or professional income, passive investment income, capital gain, or other income. All items of gross income, deductions, and personal and additional exemptions, if any, are reported in one income tax return, and one set of tax rates are applied on the tax base.

Schedular Tax System



Different types of incomes are subject to different sets of graduated or flat income tax rates. The applicable tax rate(s) will depend on the classification of the taxable income and the basis could be gross income or net income.

Semi-schedular or semi-global tax system

The compensation income, business or professional income, capital gain and passive income not subject to final tax, and other income are added together to arrive at the gross income, and after deducting the sum of allowable deductions, the taxable income is subjected to one set of graduated tax rates or normal corporate income tax.

NOTE: The Philippines, under EO 37 (1986) and RA 8424 (1998), follows a semi-schedular and semi-global tax system.

2. Features of the Philippine Income Tax Law

Direct tax

The tax burden is upon the income recipient upon whom the tax is imposed. It is a tax demanded from the very person who, it is intended or desired, should pay it.

Progressive

The tax rate increases as the tax base increases. It is founded on the *ability to pay principle* and is consistent with Sec. 28, Art. VI, 1987 Consti.

Comprehensive

The Philippines has adopted the most comprehensive system of imposing income tax by adopting the citizenship principle, the residence principle, and the source principle. Any of the three principles is enough to justify the imposition of income tax on the income of the income of a resident citizen and domestic corporation that are taxed on a worldwide income.

Semi-schedular or semi-global tax system

The Philippines follows the semi-schedular or semi-global system of income taxation, although certain passive investment incomes and capital gains from sale of capital assets, namely: (a) shares of stock of domestic corporations and (b) real property are subject to final taxes at preferential tax rates.

Of American Origin

Thus, the authoritative decision of the US Courts and officials charged with enforcing US tax laws have peculiar force and persuasive effect for the Philippines. [*Madrigal v. Rafferty*]

3. Criteria in Imposing Philippine Income Tax

a. Citizenship or Nationality Principle

A citizen of the Philippines is subject to Philippine income tax

(a) on his worldwide income, if he resides in the Philippines; or

(b) only on his income from sources within the Philippines, if he qualifies as a nonresident citizen.

b. Residence Principle

A resident alien is liable to pay Philippine income tax on his income from sources within the Philippines but exempt from tax on his income from sources outside the Philippines.

c. Source of Income Principle

An alien is subject to Philippine income tax because he derives income from sources within the Philippines, despite the fact that he has not set foot in the Philippines.

4. Types of Philippine Income Tax

1. graduated income tax on individuals
2. normal corporate income tax on corporations
3. minimum corporate income tax on corporations
4. special income tax on certain corporations
5. capital gains tax on sale or exchange of shares of stock of a domestic corp. classified as capital assets
6. capital gains tax on sale or exchange of real property classified as capital asset
7. final withholding tax on certain passive investment income paid to residents
8. final withholding tax on income payments made to non-residents
9. fringe benefits tax on fringe benefits of supervisory or managerial employees
10. branch profit remittance tax
11. tax on improperly accumulated earnings of corporations

5. Taxable Period

a. Calendar Period

- accounting period from January 1 to December 31

b. Fiscal Period

- accounting period of 12 months ending on the last day of any month other than December

c. Short Period



- accounting period which starts after the first month of the tax year or ends before the last month of the tax year (less than twelve months).

6. Kinds of Taxpayers

Primary Classification	Sub-Classification(s)		
Individuals	Citizens of the Philippines	Residents of the Philippines	
		Not Residents of the Philippines	
	Aliens	Residents of the Philippines	
		Not Residents of the Philippines	Engaged in Trade or Business in the Philippines
			Not Engaged in Trade or Business in the Philippines
		Special Classes of Individuals	Individual Employed by Regional or Area Headquarters and Regional Operating Headquarters of Multinational Companies
	Individual Employed by Offshore Banking Units		
	Individual Employed by a foreign service contractor or by a foreign service subcontractor engaged in petroleum operations in the Philippines		
	Minimum wage earner		
	Estates and Trusts		
Partnerships	General Business Partnership		
	General Professional Partnership		
Co-ownerships			
Corporations	Domestic Corporations		
	Foreign Corporations	Resident Corporations	
		Non-resident Corporations	
	Special Classes of Corporations	Proprietary educational institutions and non-profit hospitals	
		Domestic Depository Bank (Foreign Currency Deposit Units)	
		Resident	

	international carriers
	Offshore Banking Units
	Resident Depository Bank (Foreign Currency Deposit Units)
	Regional or Area Headquarters and Regional Operating Headquarters of Multinational Companies
	Non-resident cinematographic film owners, lessors or distributors
	Non-resident owners or lessors of vessels chartered by Philippine nationals
	Non-resident lessors of aircraft, machinery and other equipment

Definition of Each Kind of Taxpayer

Taxpayer- any person subject to tax.

Person- means an individual, a trust, estate or corporation.

I. Individual	
a. Citizen	
i. Resident	
ii. Non-resident	<p>(1) establishes to the satisfaction of the Commissioner the fact of his physical presence abroad with a definite intention to reside therein.</p> <p>(2) leaves the Philippines during the taxable year to reside abroad, either as an immigrant or for employment on a permanent basis.</p> <p>(3) 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.</p> <p>(4) has been previously considered as nonresident citizen and who arrives in the Philippines at <i>any time during the taxable year</i> to reside permanently in the Philippines shall likewise be</p>

	treated as a nonresident citizen <i>for the taxable year in which he arrives in the Philippines</i> with respect to his income derived from sources abroad until the date of his arrival in the Philippines.	
iii. Overseas Contract Worker	(RR 01-79) One who leaves the Philippines on account of a contract of employment which is renewed from time to time within or during the taxable year under such circumstances as to require him to be physically present abroad most of the time of the taxable year (not less than 183 days).	
b. Aliens		
i. Resident	Individual whose residence is within the Philippines and who is not a citizen thereof.	
ii. Non-resident	<p>Individual whose residence is not within the Philippines and who is not a citizen thereof.</p> <p>(RR 2-1940)</p> <ul style="list-style-type: none"> - An alien actually present in the Philippines who is not a mere transient of sojourner is a resident of the Philippines for purposes of income tax, Whether he is a transient or not is determined by his intentions with regard to the length and nature of his stay. - A mere floating intention indefinite as to time to return to another country is not sufficient to constitute him a transient. - One who comes to the Philippines for a definite purpose which in its nature may be promptly accomplished is a transient, but if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the Philippines, he 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. <p>Loss of residence by alien- An intention to change his residence does not change status; retains status as resident until actual abandonment of residence.</p>	
	Engaged in trade or business	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., regardless of

		whether he actually engages in trade or business herein.
	Not engaged in trade or business	
II. Corporate		
a. Domestic	Created or organized under Philippine Laws	
b. Foreign	A corporation which is not domestic	
	Resident Foreign	Engaged in trade or business within the Philippines
	Non- resident Foreign	Not engaged in trade or business within the Philippines

7. Income Taxation

a. Definition

- Income Tax is defined as a tax on all yearly profits arising from property, professions, trades, or offices, or as a tax on the person's income, emoluments, profits and the like (*Fisher v. Trinidad*).

b. Nature

- Income tax is generally classified as an *excise tax*. It is not levied upon persons, property, funds or profits but upon the right of a person to receive income or profits.

c. General principles

(A) A citizen of the Philippines residing therein is taxable on all income derived from sources within and without the Philippines;

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

(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;

(D) An alien individual, whether a resident or not of the Philippines, is taxable only on income derived from sources within the Philippines;

(E) A domestic corporation is taxable on all income derived from sources within and without the Philippines; and

(F) A foreign corporation, whether engaged or not in trade or business in the Philippines, is taxable only on income derived from sources within the Philippines. (Sec. 23)



Taxpayer	Within	Without
Resident Citizen	√	√
Non-resident Citizen and OCW	√	X
Resident and Non-resident Alien	√	X
Domestic Corporation	√	√
Foreign Corporation	√	X

8. Income

- a. Definition
- b. Nature
- c. When income is taxable
- d. Tests in determining whether income is earned for tax purposes

a. Definition

- All wealth which flows to the taxpayer other than a mere return of capital
- *Conwi v. CTA*: It is an amount of money coming to a person 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 thought of as a flow of the fruits of one's labor.

b. Nature

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

c. When income is taxable

Existence of income

1. There is **INCOME**, gain or profit
 2. **RECEIVED** or **REALIZED** during the taxable year
 3. **NOT EXEMPT** from income tax
- *Madrigal vs. Rafferty (1918)*: The Supreme Court of Georgia expresses the thought in the following figurative language: "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." A tax on income is not a tax on property. "Income," as here used, can be defined as "profits or gains."
 - *A mere increase in the value of property is not income, but merely unrealized increase in capital.* The increase in the value of property is also known as appraisal surplus or revaluation increment.

2) Realization of income

a) Tests of Realization

1. **Realization Test** - no taxable income until there is a *separation from capital of something of exchangeable value*, thereby supplying the

realization or transmutation which would result in the receipt of income.

2. **Claim of right doctrine** - a taxable gain is conditioned upon the *presence of a claim of right to the alleged gain and the absence of a definite unconditional obligation to return or repay* that which would otherwise constitute a gain.

- **Principle of Constructive Receipt of Income** - Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. The income must be credited to the taxpayer *without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made.*

3. **Economic benefit test** - any economic benefit to the employee that increases his net worth is taxable.

4. **Severance test** - As capital or investment is not income subject to tax, the gain or profit derived from the exchange or transaction of said capital by the taxpayer for his separate use, benefit, and disposal is income subject to tax.

b) Actual vis-à-vis Constructive receipt

1. Actual receipt

2. **Constructive receipt** - Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which it is so credited or set apart, *although not actually reduced to possession. To constitute receipt in such case, the income must be credited to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made.*

3) Recognition of income

NOTE: Discussed below in 4(d).

4) Methods of accounting

a) Cash method vis-à-vis Accrual method

Income received follows the cash basis of accounting, where income is recognized when realized and expenses are recognized when paid.

Income realized pertains to the accrual basis of accounting, when recognition of income in the books is when it is realized and expenses are recognized when incurred. It is the right to receive and not the actual receipt that determines the inclusion of the amount in gross income

Examples:

1. interest or rent income earned but not yet received



2. rent expense accrued but not yet paid
3. wages due to workers but remaining unpaid

b) Installment payment vis-à-vis Deferred payment vis-à-vis Percentage completion (in long term contracts)

Installment basis

- a. Sales of dealers in personal property
- Under rules and regulations prescribed by the Sec. of Finance, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income there from 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 contract price.

b. Sales of realty and casual sales of personalty

- In cases of:
 - (1) casual sale or other casual disposition of personal property (other than inventory on hand of the taxpayer at the close of the taxable year) for a price > P1,000, or
 - (2) sale or other disposition of real property, if in either case the initial payments do not exceed 25% of the selling price

c. Sales of real property considered as capital asset by individuals

- Individual who sells or disposes of real property, considered as capital asset and is otherwise qualified to report the gain under (b) above may pay the capital gains tax in installments under rules and regulations to be promulgated by the Sec. of Finance.

d. Change from accrual to installment basis

- Taxpayer must be entitled to benefits under (a) hereof sales of dealers in personal property

Deferred Payment

- If the aggregate initial payments exceed 25% of the selling price, the gain realized should be reported on a deferred payment method.
- The taxable gain or income returnable during the year of sale is the difference between the selling or contract price and the cost of the property, even though the entire purchase price has not been actually received in the year of sale.

	<i>*held as ordinary asset; regardless of amount of percentage of initial payments</i>	<i>If exceeds 25%-- Deferred payment method</i>
<i>Casual Sale</i>	<i>Installment method; Provided:</i> <ol style="list-style-type: none"> 1. <i>Selling price exceeds php1,000</i> 2. <i>Initial payments do not exceed 25% of selling price</i> <p><i>If either of 2 or both conditions not met--Deferred payment method</i></p>	<i>Installment method; Provided, initial payments do not exceed 25% of selling price</i> <i>If exceeds 25%-- Deferred payment method</i>

Percentage of completion

- This method is applicable in the case of a building, installation or construction contract covering a period in excess of one year whereby gross income derived from such contract may be reported upon the basis of percentage of completion
- One of the following methods are used:
 - The costs incurred under the contract as of the end of the tax year are compared with the estimated total contract costs; or
 - The work performed on the contract as of the end of the tax year are compared with the estimated work to be performed.
- 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
 - All expenditures must be deducted, taking into account 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 (Sec. 48)

d. Tests in determining whether income is earned for tax purposes

1. **Realization Test** - no taxable income until there is a separation from capital of something of exchangeable value, thereby supplying the realization or transmutation which would result in the receipt of income.

	<i>Personal Property</i>	<i>Real Property</i>
<i>Dealer</i>	<i>Dealer in personal property who regularly sells in installment plan: Installment method</i>	<i>Installment method; Provided, initial payments do not exceed 25% of selling price</i>

2. **Claim of right doctrine** - a taxable gain is conditioned upon the *presence of a claim of right to the alleged gain and the absence of a definite unconditional obligation to return or repay* that which would otherwise constitute a gain.

- **Principle of Constructive Receipt of Income** - Income which is credited to the account of or *set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax* for the year during which so credited or set apart, although not then actually reduced to possession. The income must be credited to the taxpayer *without any substantial limitation or restriction as to the time or manner of payment or condition* upon which payment is to be made.

3. **Economic benefit test** - any economic benefit to the employee that increases his net worth is taxable.

4. **Severance test** - As capital or investment is not income subject to tax, the gain or profit derived from the exchange or transaction of said capital by the taxpayer for his separate use, benefit, and disposal is income subject to tax.

9. Gross Income

- a. Definition
- b. Concept of income from whatever source derived
- c. Gross Income vis-à-vis Net Income vis-à-vis Taxable Income
- d. Classification of Income as to Source
- e. Sources of income subject to tax
- f. Source rules in determining income from within and without
- g. Situs of Income Taxation
- h. Exclusions from Gross Income
- i. Deductions from Gross Income
- j. Exemption Corporations

a. Definition

GROSS INCOME means all income derived from whatever source, including (but not limited to) the following items: (TRIP CARD GPP)

1. Gross income derived from the conduct of **TRADE** or business or the exercise of a profession
2. **RENTS**
3. **INTERESTS**
4. **PRIZES** and winnings
5. **COMPENSATION** for services in whatever form paid, including, but not limited to fees, salaries, wages, commissions, and similar items
6. **ANNUITIES**
7. **ROYALTIES**
8. **DIVIDENDS**
9. **GAINS** derived from dealings in property
10. **PENSIONS**
11. **PARTNER'S** distributive share from the net income of the general professional partnership (GPP) [Sec 32A, NIRC]

- The term “gross income” whenever used without qualification, is comprehensive, as defined above, and is different from the limited meaning of gross income for purposes of minimum corporate income tax or the gross income tax of corporations.
- Gross income means all income of whatever kind and derived by a taxpayer from whatever source but not including income (exclusions) and items of gross income (passive income) subject to final income tax. (De Leon)
- Gross income means income, gain, or profit subject to income tax. It includes the compensation for personal services, business income, profits, and income derived from any source whatever (whether legal or illegal), unless it is exempt from income tax by law or it is subject to final withholding income tax in accordance with the semi-global or semi-schedular tax system adopted by the Philippines. It is the difference between gross sales/revenue and the cost of goods sold/services. The definition of gross income is broad and comprehensive to include proceeds from sales of transport documents. (Mamalateo)

b. Concept of income from whatever source derived

- “income derived from whatever source” means inclusion of all income not expressly exempted within the class of taxable income under the laws irrespective of the voluntary or involuntary action of the taxpayer in producing the gains, and whether derived from legal or illegal sources (i.e. gambling, extortion, smuggling, etc.).

c. Gross Income vis-à-vis Net Income vis-à-vis Taxable Income

- **GROSS INCOME** means all income derived from whatever source
- **Net income** - Means gross income less deductions and/or personal and additional exemptions (Sec. 31, NIRC)

d. Classification of Income as to Source

1. Gross income and taxable income from sources within the Philippines
2. Gross income and taxable income from sources without the Philippines
3. Income partly within or partly without the Philippines

e. Sources of income subject to tax

1. Compensation income
2. Fringe benefits
3. Professional Income
4. Income from Business
5. Income from Dealings in Property
6. Income tax treatment of capital loss
7. Dealings in real property situated in the Philippines



8. Dealings in shares of stock of Philippine corporations
9. Sale of principal residence

1) 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. [Sec. 78(A)]

It **includes**, but is not limited to salaries and wages, commissions, tips, allowances, bonuses, Fringe Benefits of rank and file EEs and other forms of compensation.

GENERAL RULE: every form of compensation income is taxable regardless of how it is earned, by whom it is paid or the form in which it is received

EXCEPT:

The term **wages** does **NOT** include remuneration paid:

- For *agricultural labor paid entirely in products of the farm* where the labor is performed, or
- For *domestic service* in a private home, or
- For *casual labor not in the course of the employer's trade or business*, or
- For *services by a citizen or resident of the Philippines for a foreign government or an int'l organization*. [Sec. 78(A)]

Compensation income including overtime pay, holiday pay and hazard pay, earned by **MINIMUM WAGE EARNERS** who has no other returnable income are **NOT** taxable and not subject to withholding tax on wages [RA 9504]

Forms of compensation and how they are assessed

a. *Cash* - If compensation is paid in cash, the full amount received is the measure of the income subject to tax.

b. *Medium other than money* - If services are paid for in a medium other than money, the fair market value of the thing taken in payment is the measure of the income subject to tax.

Basic salary or wage

- **Salary** - earnings received periodically for a regular work other than manual labor, such as monthly salary of an employee
- **Wages** - all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash. [Sec. 78A, NIRC]

Honoraria - payments given in recognition for services performed for which the established practice discourages charging a fixed fee.

Fixed or variable allowances i.e. Transportation, Representation, Cost of Living Allowances (COLA)

GENERAL RULE: Fixed or variable transportation, representation or other allowances that are received by a public officer or employee of a private entity, in addition to the regular compensation fixed for his position or office is **COMPENSATION** subject to withholding tax. (Rev. Regs. 2-98)

EXCEPTION: any amount paid specifically, either as advances or reimbursements for travelling, representation and other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred by the employee in the performance of his duties are **NOT COMPENSATION** provided the following conditions are satisfied:

- it is for ordinary and necessary travelling and representation or entertainment expenses paid or incurred by the employee in the pursuit of the employer's trade, business or profession; and
- The employee is required to account or liquidate for the foregoing expenses. (in accordance with the specific requirements of substantiation for each category of expenses pursuant to sec. 34 of the Tax Code)
- The excess of actual expenses over advances made shall constitute taxable income if such amount is not returned to the employer.

Commission - usually a percentage of total sales or on certain quota of sales volume attained as part of incentive such as sales commission.

Fees - received by an employee for the services rendered to the employer including a director's fee of the company, fees paid to the public officials such as clerks of court or sheriffs for services rendered in the performance of their official duty over and above their regular salaries.

Tips and Gratuities - those paid directly to the employee (usually by a customer of the employer) which are not accounted for by the employee to the employer. (taxable income but not subject to withholding tax) [RR NO. 2-98, Sec. 2.78.1]

Hazard or Emergency Pay - additional payment received due to the workers' exposure to danger or harm while working. It is normally added to the basic salary together with the overtime pay and night differential to arrive at gross salary.

Retirement Pay - a lump sum payment received by an employee who has served a company for a considerable period of time and has decided to withdraw from work into privacy. [RR 6-82, Sec. 2b]

- in general, retirement pay is taxable except in the following instances:
 1. SSS or GSIS retirement pays.



2. Retirement pay (R.A. 7641) due to old age provided the following requirements are met:
 - a. The retirement program is approved by the BIR Commissioner;
 - b. It must be a reasonable benefit plan. (fair and equitable)
 - c. The retiree should have been employed for 10 years in the said company;
 - d. The retiree should have been 50 years old or above at the time of retirement; and
 - e. It should have been availed of for the first time.

Separation pay - taxable if VOLUNTARILY availed of. It shall not be taxable if involuntary i.e. Death, sickness, disability, reorganization /merger of company and company at the brink of bankruptcy or for any cause beyond the control of the said official or employee.

Vacation and sick leave

- *Rules in determining whether money received for vacation and sick leave is taxable or not:*
 - a. If paid or availed of as salary of an employee who is on vacation or on sick leave notwithstanding his absence from work, it constitutes TAXABLE income. [RR 6-82, 2d]
 - b. Monetized value of unutilized vacation leave credits of ten (10) days or less which were paid to private employees during the year and the monetized value of leave credits paid to government officials and employees are not subject to income tax and to the withholding tax. [RR no. 2-98, Sec 2.78.1(A)(7)]
 - c. Terminal leave or money value of accumulated vacation and sick leave benefits received by heir upon death of employee is not taxable.

Thirteenth month pay and other benefits

- Not taxable if the total amount received is P30,000 or less. Any amount exceeding P30,000 is taxable. [Sec. 32 (7)e, NIRC]

Overtime Pay - premium payment received for working beyond regular hours of work which is included in the computation of gross salary of employee. It constitutes compensation.

Profit Sharing - the proportionate share in the profits of the business received by the employee in addition to his wages.

Awards for special services - awards for past services or suggestions, etc. Are also compensations.

Beneficial Payments - such as where employer pays the income tax owed by an employee are additional compensation income.

Other forms of compensation - those paid in kind, i.e. insurance premium paid by the employer for

insurance coverage where the heirs of the employee are the beneficiaries is the employee's income.

Withholding Tax on Compensation Income

The income recipient (i.e., EE) is the person liable to pay the tax income, yet to improve the collection of compensation income of EEs, the State requires the ER to withhold the tax upon payment of the compensation income.

2) Fringe Benefits

a) Special treatment of fringe benefits Persons liable

The **Employer** (as a withholding agent), whether individual, professional partnership or a corporation, regardless of whether the corporation is taxable or not, or the government and its instrumentalities

Basic Rule: Convenience of the Employer Rule

- 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 (*Henderson v. Collector*)
- Fringe benefit tax is imposed on fringe benefits received by supervisory and managerial employees. The fringe benefits of rank and file employees are treated as part of his compensation income subject to income tax and withholding tax on compensation.

b) Definition

Fringe benefit means any good, service, or other benefit furnished or granted by an employer, in cash or in kind, in addition to basic salaries, to an individual employee (except rank and file employees) 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 in social and athletic clubs and similar organizations
7. Expenses for foreign travel
8. Holiday and vacation expenses
9. Educational assistance to the employee or his dependents; and
10. Life or health insurance and other non-life insurance premiums or similar amounts on excess of what the law allows.



c) Taxable and non-taxable fringe benefits

Fringe Benefits NOT subject to Tax

1. Fringe benefits *not* considered as *gross income* -
 - a. if it is required or necessary to the business of employer
 - b. if it is for the convenience or advantage of employer
2. Fringe Benefit that is not taxable under Sec. 32 (B) - Exclusions from Gross Income
3. Fringe benefits not taxable under Sec. 33 Fringe Benefit Tax:
 - a. Benefits which are authorized and exempted under special laws, such as the 13th month Pay and Other Benefits with the ceiling of P30,000.
 - b. Contributions of the employer for the benefit of the employee to retirement, insurance and hospitalization benefit plans;
 - c. Benefits given to the Rank and File Employees, whether granted under a collective bargaining agreement or not; and
 - d. The *De minimis* benefits - benefits which are relatively small in value offered by the employer as a means of promoting goodwill, contentment, efficiency of Employees

Note: The term “Rank and File Employees” shall mean all employees who are holding neither managerial nor supervisory position as defined in the Labor Code

In the case of rank and file employees, fringe benefits other than those excluded from gross income under the Tax Code and other special laws, are taxable under the individual normal tax rate.

De minimis benefits (exempt from income tax): RR 13-98

- a) Monetized unused vacation leave credits of private employees not exceeding 10 days during the year and the monetized value of leave credits to government officials and employees (RR 10-00)
- b) Medical cash allowance to dependents of employees not exceeding php750

	ORDINARY ASSET	CAPITAL ASSET
Gain from sale or exchange	Ordinary Gain	Capital Gain
Loss from sale or exchange	Ordinary Loss	Capital Loss
Excess of Gains over the Losses	[goes into computation of] Ordinary Net Income	Net Capital Gain

per employee per semester of Php125 per month

- c) Rice subsidy of Php1500 or one sack of 50-kg rice per month amounting to not more than Php1500 (RR5-08)

- d) Uniforms and clothing allowance not exceeding Php4,000 per annum (RR5-08)
- e) *Actual* yearly medical benefits not exceeding Php10,000 per annum
- f) Laundry allowance not exceeding Php300 per month
- g) Employee achievements awards ,e.g., for length of service or safety achievement, which must be in the form of tangible personal property other than cash or GC with an annual monetary value not exceeding Php10,000 received by the employee under an established written plan which does not discriminate in favor of highly paid employees;
- h) Gifts given during Christmas (not bonus) and major anniversary celebrations not exceeding Php5,000 per employee per annum;
- i) Flowers, fruits, books, or similar items given to employees under special circumstances, e.g., on account of illness, marriage, birth of a baby etc
- j) Daily meal allowance for OT work not exceeding 25% of basic MW

HOUSING

HOUSING PRIVILEGE	FRINGE BENEFIT TAX BASE (MONETARY VALUE)
1. LEASE of residential property for the residential use of employees	MV= 50% of lease payments
2. Assignment of residential property owned by employer for use of employees	MV= [5% (FMV or ZV, whichever is higher) x 50%]
3. Purchase of residential property in installment basis for the use of the employee	MV= 5% x acquisition cost x 50%
4. Purchase of residential property and ownership is transferred in the name of the employee	MV= FMV or ZV, whichever is higher

Non-taxable housing fringe benefit:

1. AFP, Philippine Army, Philippine Navy, Philippine Air Force
2. Situated inside of adjacent to the premises of a business or factory → maximum of 50 meters from perimeter of the business premises
3. **Temporary housing for an employee who stays in housing unit for three months or less**

MOTOR VEHICLE

MOTOR VEHICLE	FRINGE BENEFIT TAX BASE
1. Purchased in the name of the employee	MV= acquisition cost



2. Cash given to employee to purchase in his own name	MV= cash given
3. Purchase on installment, in the name of employee	MV= acquisition cost/ 5 years Where acquisition cost is exclusive of interest
4. Employee shoulders part of acquisition cost, name of employee	MV= amount shouldered by employer
5. Employer maintains fleet for use of the business and of employees	MV= (AC/5) x 50%
6. Employer leases and maintains a fleet for the use of the business and of employees	MV= 50% of rental payment

3) Professional Income

- Refers to fees received by a professional from the practice of his profession, provided that there is NO employer-employee relationship between him and his clients.

4) Income from Business

- Any income derived from doing business
- Doing business:** The term implies a continuity of commercial dealings and arrangements, and contemplates, to that extent, the performance of acts or works or the exercise of some of the functions normally incident to, and in progressive prosecution of, the purpose and object of its organization.

5) Income from Dealings in Property

- Dealings in property such as sales or exchanges may result in gain or loss. The kind of property involved (i.e., whether the property is a capital asset or an ordinary asset) determines the tax implication and income tax treatment, as follows:

Taxable Net Income	=	Ordinary Net Income	+	Net Capital Gains (other than those subject to final CGT)
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a) Types of Properties

Capital v. Ordinary Asset

ORDINARY ASSETS	CAPITAL ASSETS
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	Property held by the taxpayer, whether or not connected with his trade or business which is not an ordinary asset . Generally, they

taxable year.	include:
2. Property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business	1. shares of stock of a domestic corporation not listed in the stock exchange
3. Property used in the trade or business of a character which is subject to the allowance for depreciation\	2. real property of individuals or land/building of corporations
4. Real property used in the trade or business of the taxpayer.	3. other types of assets, including shares of stock of foreign corporation

b) Types of Gains from dealings in property

(1) Ordinary income vis-à-vis Capital gain

If the asset involved is classified as ordinary, the *entire amount* of the gain from the transaction shall be included in the computation of gross income [Sec 32(A)], and the *entire amount* of the loss shall be deductible from gross income. [Sec 34(D)]. (See XI. Allowable Deductions from Gross Income - Losses)

If the property sold is a capital asset, the *rules on capital gains and losses apply* in the determination of the amount to be included in gross income. (See Part V. Capital Gains and Losses).

Note: (HOLDER IS AN INDIVIDUAL) For capital gains on sale of shares not traded in the SE, do not apply the holding period provided in Section 39 (b) of NIRC (entire net capital gains subject to tax regardless of holding period); BUT apply rules on limitation of capital loss; BUT per RR 6-2008, rule on capital loss carry-over would not apply.

Note: Capital losses can only be deducted from capital gains; excess capital losses are to be carried over by INDIVIDUALS in the succeeding taxable year against capital gains.

Note: Ordinary losses may be deducted from capital gains.

(2) Actual gain vis-à-vis Presumed gain

PRESUMED GAIN: In the sale of real property classified as capital asset, the tax base is the gross selling price or fair market value, whichever is higher. The law presumes that the seller makes a gain from such sale. Thus, whether or not the seller makes a profit from the sale of real property, he has to pay 6% capital gains tax.

ACTUAL GAIN: The tax base in the sale of real property classified as an ordinary asset is the actual gain. If the seller incurs a loss from the sale, such loss may be deducted from his gross income during the taxable year. The ordinary gain shall be added to the operating income and the net taxable income shall be subject to the graduated rates (if individual) or to 30% corporate tax or to 2% MCIT.



(3) Long term capital gain vis-à-vis Short term capital gain

HOLDING PERIOD RULE: Only 50% of capital gain or loss taken into account in computing Capital Gains Tax if asset (other than shares not traded thru SE) is held as a long-term capital asset.

Taxpayers Other than a Corporation (i.e., individual taxpayers and taxpayers treated as individuals, such as estates and trusts):

- 100% of capital gain or loss if the capital asset was held for not more than 12 months (short-term capital asset)
- 50% of capital gain or loss if the capital asset has been held for more than 12 months (long-term capital asset)

General Rule: For purposes of computing capital loss and capital gain, the *actual* holding period is taken into account.

Exception: If *securities become worthless* during the taxable year and are capital assets, the loss resulting therefrom shall be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

HOLDING PERIOD RULE does not apply to Corporate Taxpayers - 100% of the capital gain or loss, *regardless of the holding period.*

HOLDING PERIOD RULE does not apply to sale of shares not traded thru stock exchange (Sec. 24 (C) and sale of real property (Sec. 24 (D)(1)) "The provision of Section 39 (b) notwithstanding.."

(4) Net capital gain, Net capital loss

- Net capital gain: excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges
- Net capital loss: excess of the losses from sales or exchanges of capital assets over the gains from such sales or exchanges
- Note:
 - If subject to specific final income tax: specific capital loss can only be deducted from specific capital gain.
 - If not subject to specific final income tax: capital loss and ordinary loss can be deducted from capital gain; BUT capital loss cannot be deducted from ordinary income but may be carried over if taxpayer is an individual.

(5) Computation of the amount of gain or loss

Amount realized from sale or other disposition of property
Less: Basis or Adjusted Basis

NET GAIN (LOSS)

Note: Amount realized from sale or other disposition of property = sum of money received + fair market value of the property (other than money) received

(a) Cost or basis of the property sold

In computing the gain or loss from the sale or other disposition of property, the **BASIS** shall be as follows:

1. *Property acquired by purchase* - its cost, i.e., the purchase price plus expenses of acquisition.
2. *Property which should be included in the inventory* - its latest inventory value [RR-2 sec 136]
3. *Property acquired by devise, bequest or inheritance* - its fair market price or value as of the date of acquisition
4. *Property acquired by gift or donation* - the same as if it would be in the hands of the donor or at last preceding owner by whom it was not acquired by gift, EXCEPT that if such basis is greater than the FMV of the property at the time of the gift then, for the purpose of determining loss, the basis shall be such FMV
5. *Property (other than capital asset) acquired for less than an adequate consideration in money's worth* - a) the amount paid by the transferee for the property; or b) the transferor's adjusted basis at the time of the transfer whichever is greater

(b) Cost or basis of the property exchanged in corporate readjustment

Sales or exchanges resulting in non-recognition of gains or losses:

1. Exchange *solely in kind* in legitimate **mergers and consolidation**; includes:
 - a. Between the corporations which are parties to the merger or consolidation (property for stocks);
 - b. Between a stockholder of a corporation party to a merger or consolidation and the other party corporation (stock for stock);
 - c. Between a security holder of a corporation party to a merger or consolidation and the other party corporation (securities for securities)

SUBSTITUTED BASIS OF STOCK OR SECURITIES RECEIVED:

Original basis of the property, stock or securities exchanged

LESS: (a) money received, if any; and

(b) FMV of the other property received.

ADD: (a) the amount treated as dividend of the shareholder; and

(b) the amount of any gain that was recognized and the exchange.

- The property received as “boot” shall have as basis its FMV
- If as part of the consideration to the transferor, the transferee of property assumes a liability of the transferor or acquires from the latter property subject to a liability, such assumption or acquisition (in the amount of liability), shall be treated as money received by the transferor on the exchange
- The Commissioner may allocate the basis among the several classes of stocks or securities received.

2. Transfer to a **controlled corporation** - exchange of property for stocks resulting in acquisition of corporate control by a person, alone or together with others not exceeding four.

SUBSTITUTED BASIS OF PROPERTY TRANSFERRED:

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.

(c) Recognition of gain or loss in exchange of property

General rule

Upon the sale or exchange of property, the **ENTIRE amount** of the gain or loss shall be recognized.

Exceptions

No gain or loss shall be recognized:

- (a) 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;
 - b. A shareholder exchanges stock in a corporation, which is a party to a 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 another corporation, a party to the merger or consolidation.
- (b) 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 4 persons, gains control of the corporation.

- Stocks issued for services shall not be considered as issued in property.

Meaning of merger, consolidation, control, securities

- Merger and consolidation - shall mean (1) The ordinary merger or consolidation; or (2) The acquisition by one corporation of all or substantially all the properties of another corporation solely for stock
 - Must be undertaken for a bona fide business purpose and not solely for the purpose of escaping the burden of taxation
 - 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
 - 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.
- Securities: bonds and debentures but not “notes” of whatever class or duration
- Control: 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.

Transfer of a controlled corporation: 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 4 persons, gains control of the corporation.

(6) Income tax treatment of capital loss

(a) Capital loss limitation rule (applicable to both corporations and individuals)

General Rule: Losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges.

EXCEPTION for Banks and Trust Companies: If a bank or trust company incorporated under the laws of the Philippines, a substantial part of whose business is the receipt of deposits or the sale of bond, debenture, note, certificate or other evidence of indebtedness, 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.

(b) Net loss carry-over rule (applicable only to individuals)

If an individual sustains in any taxable year a net capital loss, the loss (in an amount not in excess of



the net income for the 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 12 months.

28(B)(5)(c) of this Code and from the regular individual or corporate income tax.”

- Note: Percentage tax paid is DEDUCTIBLE for income tax purposes.

(7) Dealings in real property situated in the Philippines

Persons Liable and Transactions Affected

- Individual taxpayers, estates and trusts*
 - Sale or exchange or other disposition of real property considered as capital assets.
 - Includes "*pacto de retro sale*" and other conditional sale.
- Domestic Corporation*
 - Sale or exchange or disposition of lands and/or building which are not actually used in business and are treated as capital asset.

Rate and Basis of Tax

- A final withholding tax of 6% is based on the gross selling price or fair market value or zonal value whichever is higher.

Note: Gain or loss is immaterial, there being a conclusive presumption of gain.

(8) Dealings in shares of stock of Philippine corporations

1. Persons Liable to the Tax

- Individual taxpayer, whether citizen or alien;
- Corporate taxpayer, whether domestic or foreign; and
- Other taxpayers not falling under (a) and (b) above, such as estate, trust, trust funds and pension funds, among others.

2. Persons not liable

- Dealers in securities
- Investor in shares of stock in a mutual fund company
- All other persons who are specifically exempt from national internal revenue taxes under existing investment incentives and other special laws.

(a) Shares listed and traded in the stock exchange

- $\frac{1}{2}$ of 1% of the gross selling price of the stock
- Note: In the nature of percentage tax and not income tax; exempt from income tax per Section 128 (d):
 - “Any gain derived from the sale, barter, exchange or other disposition of share of stock under this section shall be exempt from taxes imposed in Sections 24(C), 27(D)(2), 28(A)(8)(c), and

(b) Shares not listed and traded in the stock exchange

- Net capital gains derived during the taxable year from sale, exchange, or transfer shall be taxed as follows (on a per transaction basis):
 - Not over P 100,000 - 5%
 - Over P 100,000 - 10%

(9) Sale of principal residence

Disposition of principal residence is exempt from Capital Gains Tax provided:

- Sale or disposition of the old principal residence;
- By natural persons - citizens or aliens *provided* that they are residents taxable under Sec. 24 of the Code (does not include an estate or a trust);
- The proceeds of which is fully utilized in (a) acquiring or (b) constructing a new principal residence within eighteen (18) calendar months from date of sale or disposition;
- Notify the Commissioner within thirty (30) days from the date of sale or disposition through a prescribed return of his intention to avail the tax exemption;
- Can only be availed of only once every ten (10) years;
- The historical cost or adjusted basis of his old principal residence sold, exchanged or disposed shall be carried over to the cost basis of his new principal residence
- If there is no full utilization, the portion of the gains presumed to have been realized shall be subject to capital gains tax.
- Portion of presumed gains subject to CGT: (Unutilized/GSP) x (higher or GSP or FMV)

(10) Passive Investment Income

a) Interest Income

- An earning derived from depositing or lending of money, goods or credits. [VALENCIA, Income Taxation 5th ed. (2009)]
- e.g., Interest income from government securities such as Treasury Bills
- Unless exempted by law, interest income received by the taxpayer, won usurious is subject to income tax.

b) Dividend Income

- A form of earnings derived from the distribution made by a corporation out of its earnings or profits and payable to its stockholders, whether in money or in property.

Cash dividend

Dividends are included in the gross income of the stockholder, unless they are exempt from tax or subject to tax at preferential rate under the NIRC. **Cash dividend and property dividend are subject to income tax.**

Stock dividend

Stock dividend is generally exempt from income tax, EXCEPT:

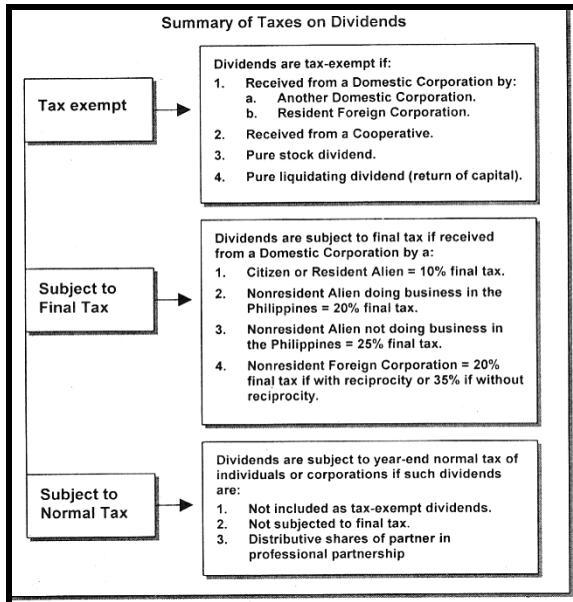
- a. It shall be taxable only if subsequently cancelled and redeemed by the corporation and shares become treasury shares; or
- b. It shall also be taxable if it leads to a substantial alteration in the proportion of tax ownership in a corporation.

Property dividend

Dividends are included in the gross income of the stockholder, unless they are exempt from tax or subject to tax at preferential rate under the NIRC. **Cash dividend and property dividend are subject to income tax.**

Liquidating dividend

Distribution of all the property of a corporation. It is strictly not dividend income, but rather a sale of shares of stock resulting in capital gain or loss. It is **taxable or deductible loss**, depending on whether gain is realized or loss sustained by the stockholder upon the distribution of the corporation of all its assts. The income is subject to ordinary income tax rates and NOT to the FWT on dividends.



c) Royalty Income

- **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 the 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.

d) Rental Income

- Refers to earnings derived from leasing real estate as well as personal property (tangible property). It also includes all other obligations assumed to be paid by the lessee to the third party in behalf of the lessor (i.e. interest, taxes, loans, insurance premiums, etc.) [RR 19-86]
- **Actual rent itself:** included in gross income (taxable); income recognition for tax purposes follows income recognition for accounting purposes
- **Payments by lessee of obligations of lessor to third persons:** considered as additional rent income of the lessor, and therefore included in gross income (taxable).

Lease of personal property

Rental income on the lease of personal property located in the Philippines and paid to a non-resident taxpayer shall be taxed as follows:

	Non-Resident Corporation	Non-Resident Alien
Vessel	4.5%	25%
Aircraft, machineries and other Equipment	7.5%	25%
Other assets	30%	25%

Lease of real property

LESSOR	TAX RATE
Citizen Resident Alien Non-resident alien engaged in trade or business in the Philippines	Net taxable income shall be subject to the graduated income tax rates
Non-resident alien not engaged in trade or business in the Philippines	Rental income from real property located in the Philippines shall be subject to 25% final withholding tax unless a lower rate is imposed pursuant to an effective tax treaty
Domestic Corporation Resident Foreign Corporation	Net taxable income shall be subject to 30% corporate income tax or its gross income will be subject to 2% MCIT
Non-resident Foreign Corporation	Gross rental income from real property located in the Philippines shall be subject to 30% corporate income tax, such tax to be withheld and remitted by the lessee in the Philippines



Tax treatment of:

(a) Leasehold improvements by lessee

➤ *Income from leasehold improvements:*

1. Outright method- income from the leasehold improvement shall be recognized when the improvement is completed at its market value
2. Spread-out method- the estimated book value of the leasehold improvement at the end of the lease is spread over the term of the lease and is reported as income for each year of the lease an aliquot part thereof. →estimated BV at the end of the lease contract/ lease term

If for any reason than a bona fide purchase from the lessee by the lessor, the lease is terminated, so that the lessor comes into possession or control of the property prior to the time originally fixed, lessor received additional income for the year which the lease is to be terminated to the extent of the value of such buildings or improvements when he became entitled to such possession exceeds the amount already reported as income on account of the erection of such building or improvement
 → not appreciation in value due to causes other than premature termination of the lease shall be included
 → entitled to deduction if the B/I are lost or destroyed

(b) VAT added to rental/paid by the lessee

If the lessee is VAT-registered, treat VAT paid as input VAT;

If the lessee is not VAT-registered OR not liable to VAT, treat VAT paid as additional rent expense deductible from gross income.

(c) Advance rental/long term lease

- 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)

Note: Income recognition for income tax purposes should follow income recognition for accounting purposes. If accrual method is employed by lessor,

income is reported as taxable income when earned; if cash basis, when received.

7) Annuities, Proceeds from life insurance or other types of insurance

- Income derived from a capital amount paid to an insurance company.
- The aleatory contract of life annuity binds the debtor to pay an annual pension or income during the life of one or more determinate persons in consideration of a capital consisting of money or other property, whose ownership is transferred to him at once with the burden of the income. [Art. 2021, New Civil Code]
- The annuity payments represent a part that is taxable and not taxable. If part of annuity payment represents interest, then it is a taxable income. If the annuity is a return of premium, it is not taxable.

8) Prizes and awards

- Contest prizes and awards received are generally taxable. Such payment constitutes gain derived from labor.

The **EXCEPTIONS** are as follows:

- 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.
- 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.

9) Pensions, retirement benefit, or separation pay

- paid for past employment services rendered.
- 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. [VALENCIA, Income Taxation 5th ed. (2009)]

10) Income from any source whatever

Forgiveness of indebtedness

- The cancellation or forgiveness of indebtedness may have any of three possible consequences:
 - a. It may amount to payment of income. If, for example, an individual performs services to or for a creditor, who, in consideration thereof, cancels the debt, income in that amount is realized by the debtor as compensation for personal services.
 - b. It may amount to a gift. If a creditor wishes merely to benefit the debtor, and without any consideration therefore, cancels the debt, the amount of the debt is a gift to the debtor and need not be included in the latter's report of income.
 - c. It may amount to a capital transaction. If a corporation to which a stockholder is indebted forgives the debt, the transaction has the effect of a payment of dividend.

Explanation:

- In Case A, the entire amount recovered (P2,000) is included in the computation of gross income in Year 2 because the taxpayer benefited by the same extent. Prior to the write-off, the taxable income was P300,000; after the write-off, the taxable income was reduced to P298,000.
- In Case B, none of the P2,000 recovered would be recognized as gross income in Year 2. Note that even without the write-off, the taxpayer would not have paid any income tax anyway. The "taxable income" before the write-off was actually a net loss.
- In Case C, only P5,000 of the P6,000 recovered would be recognized as gross income in Year 2. It was only to this extent that the taxpayer benefited from the write-off. The taxpayer did not benefit from the extra P1,000 because at this point, the P1,000 was already a net loss.

Recovery of accounts previously written off

Tax Benefit Rule - Bad debts claimed as a deduction in the preceding year(s) but subsequently recovered shall be included as part of the taxpayer's gross income in the year of such recovery *to the extent of the income tax benefit of said deduction.* There is an income tax benefit when the deduction of the bad debt in the prior year *resulted in lesser income and hence tax savings for the company.* (Sec. 4, RR 5-99)

Illustration:

	Case A	Case B	Case C
Year 1			
Gross Income	500,000	400,000	500,000
Less: Allowable Deductions (before write-off of Uncollectible Accounts/Debts)	(200,000)	(480,000)	(495,000)
Taxable Income (Net Loss) before write-off	300,000	(60,000)	5,000
Deduction for Accounts Receivable written off	(2,000)	(2,000)	(6,000)
Taxable Income (Net Loss) after write-off	298,000	(62,000)	(1,000)
Year 2			
Recovery of Amounts Written Off	2,000	2,000	6,000
Taxable Income on the Recovery	2,000	-	5,000

c) Receipt of tax refunds or credit

General rule: a refund of a tax related to the business or the practice of profession, is taxable income (e.g., refund of fringe benefit tax) in the year of receipt to the extent of the income tax benefit of said deduction (i.e., the tax benefit rule applies).

Exceptions: However, the following tax refunds are not to be included in the computation of gross income: **(CAP-IF-FED-VAT)**

1. Philippine income tax, except the fringe benefit tax
2. Income tax imposed by authority of any foreign country, if the taxpayer claimed a credit for such tax in the year it was paid or incurred.
3. Estate and donor's taxes
4. Taxes assessed against local benefits of a kind tending to increase the value of the property assessed (Special assessments)
5. Value Added Tax
6. Fines and penalties due to late payment of tax
7. Final taxes
8. Capital Gains Tax

Note: The enumeration of tax refunds that are not taxable (income) is derived from an enumeration of tax payments that are not deductible from gross income.

If a tax is not an allowable deduction from gross income when paid (no reduction of taxable income, hence no tax benefit), the refund is not taxable.

d) "Income from any source whatever"

Gutierrez v. Collector: The words "income from any source whatever" are broad. These words disclose a legislative policy to include all income not expressly exempted within the class of taxable income under our laws, irrespective of the voluntary or involuntary action of the taxpayer in producing the gains.



f. Source rules in determining income from within and without

The following items of gross income shall be treated as gross income from sources WITHIN the Philippines:

1) Interests

derived from sources within the Philippines, and interests on bonds, notes or other interest-bearing obligation of residents.

Ultimately, the situs of interest income is the residence of the debtor.

2) Dividends

Dividends received:

- i. from a domestic corporation; and
- ii. from a foreign corporation, UNLESS less than 50% of its gross income for the previous 3-year period was derived from sources within the Philippines [in which case it will be treated as income partly from within and partly from without].

The income which is considered as derived from within the Philippines is obtained by using the following formula:

$$\frac{\text{Philippine Gross Income}^* \times \text{Dividend}}{\text{Worldwide Gross Income}^*} = \text{Income Within}$$

NOTE: * of the corporation giving the dividend

As a rule, the situs of dividend income is the residence of the corporation declaring the dividend.

3) Services

Compensation for labor or personal services performed in the Philippines

As a rule, the situs of compensation is the place of performance of the services.

4) Rentals and 5) Royalties

From property **located in the Philippines** or from any interest in such property, *including* rentals or royalties for - (STACKEM)

- i. 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;
- ii. The use of, or the right to use in the Philippines any industrial, commercial or scientific equipment;
- iii. The supply of scientific, technical, industrial or commercial knowledge or information;
- iv. 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 (a), any such equipment as is mentioned in (b) or any such knowledge or information as is mentioned in (c);

- v. 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;
- vi. 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
- vii. 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*.

As a rule, the situs of rental income is the place where the property is located. The situs of royalty income is where the rights is exercised.

6) Sale of real property

Gains, profits and Income from the sale of real property located in the Philippines.

As a rule, the situs of the income from sale of real property is where the realty is located.

7) Sale of personal property

General Rule: Gains, profits and income from the sale of personal property, subject to the following rules:

Place of PURCHASE	Place of SALE	Treatment**
Philippines	Abroad	Income from Without
Abroad	Philippines	Income from Within

** in other words, treated as income from the country in which sold

Exceptions:

1. Gain from the sale of shares of stock in a *domestic corporation*
 - treated as derived entirely from sources within the Philippines *regardless of where the said shares are sold*.
2. Gains from the sale of (manufactured) personal property:
 - a. produced (in whole or in part) by the taxpayer *within* and sold *without* the Philippines, or
 - b. produced (in whole or in part) by the taxpayer *without* and sold *within* the Philippines

- treated as derived partly from sources within and partly from sources without the Philippines.

Place of PRODUCTION	Place of SALE	Treatment
Philippines	Abroad	Partly within, partly without
Abroad	Philippines	Partly within, partly without

8) Shares of stock of domestic corporation

Treated as derived entirely from sources within the Philippines regardless of where the said shares are sold.

g. Situs of Income Taxation

INCOME	SITUS
Interest	Residence of the debtor
Dividends	Residence of the corporation
Services	Place of performance
Rentals	Location of the property
Royalties	Place of exercise
Sale of Real Property	Location of realty
Sale of Personal	A. Tangible 1. Purchase and sale: Location of Sale 2. Manufactured w/in and sold w/o: Partly w/in and partly w/o 3. Manufactured w/o and sold w/in: Partly w/in and partly w/o B. Intangible General rule: Place of Sale Exception: Shares of stock of domestic corporations: Place of incorporation
Shares of Stock of Domestic Corporation	Place of incorporation

h. Exclusions from Gross Income

Exclusions from gross income refer to a flow of wealth to the taxpayer which are not treated as part of gross income, for purposes of computing the taxpayer’s taxable income.

Deductions (and exclusions) have generally been deemed to be a matter of “legislative grace”. They are allowed only where there is a clear provision in the statute for the deduction claimed; and where particular deductions are authorized by the statute, no others may be made. The government is not required to show that there is no provision of the Tax Code which authorizes the deduction. (De Leon)

Note that the taxable “gross income” is affected by exclusions because the latter are omitted from the former and are not reported on the income tax return but it is not affected by deductions because they are subtracted after gross income is determined and are reported on the return. (De Leon)

1) Rationale for the exclusions

The term “*exclusions*” refers to items that are not included in the determination of gross income because:

- (a) They represent return of capital or are not income, gain or profit;
- (b) They are subject to another kind of internal revenue tax;
- (c) They are income, gain or profit that are expressly exempt from income tax under the Constitution, tax treaty, Tax Code, or a general or special law. (Mamalateo)

2) Taxpayers who may avail of the exclusions

Return of capital	All taxpayers since there is no income.
Already subject to internal revenue tax	All taxpayers unless provided that income is to be included.
Express exclusion	As expressly provided.

3) Exclusions distinguished from deductions

Exclusions from gross income refer to a flow of wealth to the taxpayer which are not treated as part of gross income, for purpose of computing the taxpayer’s taxable income.

Deductions, on the other hand, are the amounts which the law allows to be deducted from gross income in order to arrive at net income.

Exclusions pertain to the computation of gross income, while *deductions* pertain to the computation of the net income. (Mamalateo)

4) Exclusion under the Constitution

- a. Income derived by the government or its political subdivisions from the exercise of any essential governmental function
- b. 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.

5) Exclusions under the Tax Code

a) Proceeds of life insurance policies

General rule: The proceeds of life insurance policies paid to heirs or beneficiaries upon the death of the

insured should be treated as indemnity and not as gain or income.

Exceptions: If such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments received by the insured shall be included in gross income.

Reason: An insurance policy is a contract of indemnity. Hence, the proceeds of life insurance are treated more as an indemnity instead of as a gain, profit, or income.

b) Return of premium paid

General rule: 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 is a return of capital and not income.

This refers to the **cash surrender value** of the contract.

Exception: If the amounts received by the insured (when added to the amounts already received before the taxable year under such contract) **exceed the aggregate premiums** or considerations paid (whether or not paid during the taxable year), *then the excess shall be included in gross income.*

c) Amounts received under life insurance, endowment or annuity contracts

Amounts received under life insurance, endowment or annuity contracts are excluded from gross income, but if such amounts (when added to amounts already received before the taxable year under such contract) exceed the aggregate premiums of considerations paid (whether or not paid during the taxable year), then the excess shall be included in gross income.

d) Value of property acquired by gift, bequest, devise or descent

General rule: The value of property acquired by gift, bequest, or devise is excluded from gross income, BUT not the income from such property.

These must be given **GRATUITOUSLY**, otherwise, shall be included in gross income.

Reason: These transactions are already subject to estate or donor's taxes.

NOTE:

- **Income** from such property;
OR
- **Transfers of divided interest** where there is a constraining force of a moral or legal duty, anticipated economic benefit, or when given in return for services
- Shall be **INCLUDED** in gross income.

e) Amount received through accident or health insurance

General rule: Amounts received as compensation for personal injuries or sickness, plus any damages received, whether by suit or agreement on account of such injuries or sickness (i.e. proceeds from Workmen's Compensation Act, Accident/Health Insurance) are in the nature of **INDEMNITY** and are thus excluded from gross income.

Notes:

- "Personal injuries" are limited to physical injuries, not injuries to rights.
- Damages are only exempt if they arise from physical injury or are in the nature of an indemnity. *Thus, damages received which are NOT due to personal injury and in excess of the claimant's actual losses are INCLUDED in gross income.*

f) Income exempt under tax treaty

Income of any kind, to the extent required by any treaty obligation binding upon the Government of the Philippines.

g) Retirement benefits, pensions, gratuities, etc.

- a. **RETIREMENT** benefits under RA 7641 or under a reasonable private benefit plan
- b. **TERMINAL** pay
- c. **BENEFITS** from foreign governments
- d. **VETERANS** benefits
- e. Benefits under the **Social Security Act**
- f. **GSIS** and **SSS** benefits

- a. **RETIREMENT** benefits received under **RA 7641**;
OR
in accordance with a **reasonable private benefit plan (RPBP)**.

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 (i.e. GSIS, SSS,



	terminal pay)]
	Must be approved by BIR

A 'reasonable private benefit plan' means a pension, gratuity, stock bonus or profit-sharing plan maintained by an employer for the benefit of some or all of his employees wherein contributions are made by such employer for the employees for the purpose of distributing to such employees the earnings and principal of the fund thus accumulated (TRUST FUND)

Further, it should be provided in the 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 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 death, sickness, other physical disability or for any cause beyond the control of the employee

- Notes:**
- Sickness must be **life-threatening** or one which renders the employee **incapable of working**
 - Separation of the employee must be **involuntary**. Thus, resignation or avilment of an optional early retirement plan bars a claim under this provision.

BIR Ruling 143-98: The terminal leave pay (amount paid for the commutation of leave credits) of government employees whose employment is coterminous is exempt since it falls within the meaning of the phrase "for any cause beyond the control of the said official or employee" found in Sec. 32(B).

c. BENEFITS from foreign governments

The social security benefits, retirement gratuities, pensions and other similar benefits received by resident or non-resident citizens or aliens permanently residing in the Philippines from foreign government agencies and other institutions

d. VETERANS benefits

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. Social Security Act benefits

Payment of benefits under the Social Security Act, (RA 8282) as amended, i.e., Maternity Benefits

f. GSIS and SSS benefits

Benefits received from or enjoyed under the SSS, benefits received from GSIS including retirement gratuity received by government officials and employees are not taxable. [Sec. 32B6., NIRC; Sec. B1, RR 2-98]

h) Winnings, prizes, and awards, including those in sports competition

PRIZES and awards in sports competitions

All prizes and awards granted to athletes:

1. in local and international sports competitions and
2. sanctioned by their national sports associations.

shall not be included in gross income and shall be tax exempt. [Sec. 32 B7d, NIRC]

PRIZES and awards in charitable, literary, educational, artistic, religious, scientific, or civic achievement (clear sc)

Requisites for non-taxability:

1. Recipient was *selected without any action on his part* to enter the contest or proceeding and
2. Recipient is *not required to render substantial future services* as a condition to receiving the prize or award

6) Under a Tax Treaty

7) Under Special Laws

- a. **Income** subject to final tax;
- b. **PCSO** and lotto winnings;
- c. Income already subjected to final tax, such as gains from shares and real property subject to capital gains tax.
- d. **GAIN** from buying and selling stocks classified as capital asset listed and traded in the PSE;
- e. **FRINGE** benefits already subject to FBT;
- f. **DE MINIMIS** benefits.
- g. Tax Exempt **EMPLOYEE'S TRUST** under Sec. 60B of the NIRC
- h. Tax Exempt **EDUCATIONAL INSTITUTIONS**
- i. **QUALIFIED SENIOR CITIZEN**
- j. Tax Exempt **INVENTORS AND INVENTIONS**
- k. Tax Exempt **COOPERATIVE INCOME**
- l. **BARANGAY MICRO BUSINESS ENTERPRISES (BMBE)**

a. PASSIVE INCOME subject to **FINAL TAX** [Sec. 24 (B) (1)]

Amounts already subject to final tax are no longer subject to income tax. These are withheld by the payor and are no longer form part of gross income.

(IRDPO)

- Interest income on bank deposits
- Royalties
- Dividends from domestic corporations



- Prizes exceeding P10,000
- Other winnings from within RP

Note: Passive income which is NOT subject to final tax shall be INCLUDED in GROSS INCOME (ex. Interest income on loans contracted between private individuals).

INTEREST INCOME

- From ANY CURRENCY bank deposit/any other monetary benefit from deposit substitutes/trust funds/similar arrangements (20%FT)- NRA-ETB;
OR
- Received by a resident individual taxpayer from a depository bank under the FCDU System (7 ½% FT);
OR
- From long-term deposit or investment with at least 5-year maturity (EXEMPT)

Note: The last item is given as a specific exemption for INDIVIDUAL taxpayers EXCEPT non-resident aliens, who are taxed at 25%. Corporations do not enjoy this exemption.

- **ROYALTIES**
 - On books, as well as other literary works and musical compositions (10%FT);
 - Other royalties (20%FT)
- **DIVIDENDS**
 - Cash or property dividends from domestic corporations (10%FT)
- **PRIZES NOT EXCEEDING P10,000.**
 - Prizes amounting to P10,000 or less are included in gross income.
- **Other winnings from within RP**
 - Winnings other than from PCSO and lottery are subject to 20% FT.

- b. PCSO and lotto winnings [Sec. 24 (B)(1)]
- c. Income already subjected to final tax, such as gains from shares and real property subjected to capital gains tax.
- d. **GAIN** from buying and selling stocks classified as capital asset listed and traded in the PSE (Sec. 127)

Notes: The gain from such transaction is given a specific exemption for one who is **not a dealer in securities**. Such gain is exempt from income tax but subject to percentage tax of ½ of 1%.

- e. **FRINGE** benefits already subject to FBT (RR 3-98)

The actual monetary value of fringe benefits received by supervisory and managerial

employees is EXCLUDED from their compensation income.

Benefits received by RANK and FILE employees are allowances NOT subject to FBT and are thus included in compensation income.

The FBT paid thereon is DEDUCTIBLE from the business income of the EMPLOYER.

f. DE MINIMIS benefits (RR 3-98)

Facilities or privileges of relatively small value furnished by an employer to his employees and are as a means of promoting the health, goodwill, contentment, or efficiency of his employees.

These are exempt from fringe benefit tax and compensation income tax.

g. EMPLOYEE'S TRUST

Sec. 60B of the Tax Code specifically exempted employee's trust from income tax, provided the conditions of said section are satisfied.

h. EDUCATIONAL INSTITUTIONS

The following educational institutions are exempt from income tax:

1. Government educational institutions; and
2. Nonstock and nonprofit educational institutions
[Sec. 30, NIRC]

Revenue or income from trade, business or other activity, the conduct of which is not related to the exercise or performance by such educational institutions of their educational purposes or functions shall be subject to internal revenue taxes when the same is not actually, directly or exclusively used for the intended purposes. [BIR Ruling 046-2000]

i. QUALIFIED SENIOR CITIZEN

The income of a qualified senior citizen is exempt from the payment of income tax provided his annual taxable income does not exceed the poverty level of P60,000 per year, except interest income. [BIR Ruling 066-2000; R.A. 7432; BIR Ruling 15-98]

j. INVENTORS AND INVENTIONS

Sec. 5 and 6 of R.A. 7459 (The Inventors and Inventions Act of 1991) provides tax exemption for 10-year period which starts from the date of first commercial sale.

However, prizes received are income earned not attributable to the sale on commercial scale of the invention or technology. The prize to be awarded to the individual inventor shall thus be subject to the final tax of 20%. [BIR Ruling 069-2000]



k. Tax Exempt COOPERATIVE INCOME

Cooperative Incomes derived from transaction with members are NOT subject to tax. However, cooperatives are not exempt from the following:

- a. VAT on its purchases;
- b. 20% final tax on interest income; and
- c. 7.5% tax on foreign currency deposit.

[BIR Ruling 008-2001]

l. BARANGAY MICRO BUSINESS ENTERPRISES (BMBE)

Under R.A. 9178, BMBE shall be exempt from income tax for income arising from the operation of the enterprise.

BMBE refers to any business entity or enterprise engaged in the production, processing or manufacturing of products or commodities, including agro-processing, trading and services, whose total assets including those arising from loans but exclusive of the land on which the particular business entity's office, plant and equipment are situated shall not be more than P3 million.

i. Deductions from Gross Income

Deductions are amounts expressly allowed by law to be deducted from gross income to arrive at taxable income.

It is in the nature of an exemption from taxation; it is strictly construed against the claimant who must point to a specific provision allowing it and has the burden of proving he falls within the purview of such provision. Thus, all deductions must be substantiated.

Deductions are construed strictly against the taxpayer claiming it. He who claims a deduction must point to the specific provision of the statute authorizing it, and he must be able to prove that he is entitled to it. Tax exemptions are looked upon with disfavor. (Western Minolco v. Commissioner)

- If the exemption is not expressly stated in the law, the taxpayer must at least be within the purview of the exemption by clear legislative intent (Commissioner of Customs v. Philippine Acetylene Co.)
- However, if there is an express mention in the law or if the taxpayer falls within the purview of the exemption by clear legislative intent, the rule on strict construction will not apply. (Commissioner v. Anoldus Caprentry Shop)

Conditions for Deductibility of Business Expenses:

1. The expense must be ordinary and necessary
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 profession

4. Supported by adequate invoices or receipts
5. Not Contrary to law, public policy or morals. Operating expenses of illegal or questionable business are deductible, but expenses of an inherently illegal nature, such as bribery and protection payments are not
6. The tax required to be withheld on the amount paid or payable is shown to have been paid to the BIR. (Mamalateo)

j) Return of capital (cost of sales or services)

Income tax is levied by law only on income; hence, the amount representing return of capital should be deducted from proceeds from sales of assets and should not be subject to income tax.

Costs of goods purchased for resale, with proper adjustment for opening and closing inventories, are deducted from gross sales in computing gross income (Sec. 65, Rev. Regs. 2)

a) Sale of inventory of goods by manufacturers and dealers of properties

- In sales of goods representing inventory, the amount received by the seller consists of return of capital and gain from sale of goods or properties. That portion of the receipt representing return of capital is not subject to income tax.

b) Sale of stock in trade by a real estate dealer and dealer in securities

- Real estate dealers and dealers in securities are ordinarily not allowed to compute the amount representing return of capital through cost of sales. Rather they are required to deduct the total cost specifically identifiable to the real property or shares of stock sold or exchanged.

c) Sale of services

- Their entire gross receipts are treated as part of gross income.

TYPE OF TAXPAYER	ALLOWABLE DEDUCTIONS
Individuals with gross income from business/practice profession	Itemized deductions OR Optional Standard Deduction; Premium payments on health/hospitalization insurance [Sec. 34(M)]; Personal/additional exemptions
Individuals earning purely compensation income (except non-resident aliens not engaged in trade or business)	Premium payments on health/hospitalization insurance [Sec. 34(M)]; Personal/additional exemptions
Corporations (except non-resident foreign corporations), general professional	Itemized deductions



partnerships, estates and trusts engaged in business, proprietary educational institutions and hospitals (non-profit), and GOCC	
Estates and Trusts	<p>Computed in the same manner and on the same basis as in the case of an individual, except that, there shall be allowed as deduction in the computation of the taxable income of the estate or trust:</p> <p>a) The amount of income for the taxable year distributed currently by the fiduciary to the beneficiaries; and</p> <p>b) Amount of income collected by guardian of an infant which is to be held and distributed as the court may direct. BUT the amount so allowed as deduction shall be included in computing the taxable income of the beneficiary whether distributed to them or not.</p> <p>c) Amount of the income not previously distributed or credited (hence initially formed part of income of the estate or trust) but subsequently distributed or credited; the amount allowed as deduction shall be included in computing the taxable income of the legatee, heir or beneficiary.</p> <p>Additional P50,000 exemption [Sec. 62]</p>

Resident Alien	Yes	Yes	Yes
Non-resident alien (engaged in trade and business)	Subject to the rule of reciprocity	No	No
Non-resident alien (Not engaged in trade and business)	No	No	No

3) Itemized deductions

- a. Expenses
- b. Interest
- c. Taxes
- d. Losses
- e. Bad Debts
- f. Depreciation
- g. Charitable and other contributions
- h. Contributions to pension trusts

a) Expenses

1. Salaries, wages and other forms of compensation for personal services actually rendered including the grossed-up monetary value of the fringe benefit subjected to fringe benefit tax which tax should have been paid
2. Traveling/Transportation expenses
3. Cost of materials
4. Rentals and/or other payments for use or possession of property
5. Repairs and maintenance
6. Expenses under lease agreements
7. Expenses for professionals
8. Entertainment expenses
9. Political campaign expenses
10. Training expenses

Includes:

- a. Salaries, wages, compensation, including the grossed-up monetary value of fringe benefits subject to FBT
- b. Travel expenses
- c. Rentals
- d. Entertainment, recreation and amusement expenses
- e. Other expenses such as repairs or those incurred by farmers and other persons in agribusiness

Requisites for deductibility:

1. Ordinary AND necessary;
 - ORDINARY- normal and usual in the taxpayer's business
 - 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
2. Paid and incurred during the taxable year;
3. Paid and incurred for the purpose of carrying on the business;

TAX-PAYER	PERSONAL EXEMPTION	ADDITIONAL EXEMPTION	OSD
Resident citizen	Yes	Yes	Yes
Non-resident Citizen	Yes	Yes	Yes



4. Substantiated with official receipts or other proper documents (must show the amount of expense deducted and the connection to the business);
5. Legitimately paid (not a BRIBE, kickback, or otherwise contrary to law, morals, public policy);
6. If subject to withholding tax, proof of payment of such tax must be shown (i.e. FBT on fringe benefits);
7. Amount must be reasonable.

(1) Salaries, wages and other forms of compensation for personal services actually rendered, including the grossed-up monetary value of the fringe benefit subjected to fringe benefit tax which tax should have been paid

1. Bonuses are made *in good faith*.
2. They given *for personal services actually rendered*.
3. They do not exceed a *reasonable compensation for the services rendered*.

(2) Traveling /Transportation expenses

- 1) Expense must be *reasonable and necessary*.
- 2) It must be incurred or paid "*while away from*."
- 3) They must be *incurred or paid in the conduct of trade or business*.

(3) Cost of materials

Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only to the amount that they are actually consumed and used in operation during the year for which the return is made provided that their cost have not been deducted in determining the net income for any previous year.

(4) Rentals and/or other payments for use or possession of property

1. Required as a *condition for continued use or possession*.
2. *For purposes of trade business or profession*.
3. Taxpayer has not taken or is not taking title to the property or has *no equity* other than that of lessee, user, or possessor.

(5) Repairs and maintenance

Expenses for repairs are **deductible** if such repairs are **incidental or ordinary**, that is, made to keep the property used in the trade or business of the taxpayer in an ordinarily efficient operating condition.

Repairs in the nature of **replacement** to the extent that they arrest deterioration and prolong the life of the property are **capital expenditures** and should be debited against the corresponding allowance for depreciation.

(6) Expenses under lease agreements

A reasonable allowance for rentals and/or other payments which are required as a condition for the continued use or possession, for purposes of the trade, business or profession 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, use or possessor is deductible from income tax.

Requisites for deductibility:

1. Required as a condition for continued use or possession;
2. For purposes of the trade, business or possession;
3. Taxpayer has not taken or is not taking title to the property or has no equity other than that of lessee, user, or possessor.

(7) Expenses for professionals

Professional expenses are deductible in the year the professional services are rendered, not in the year they are billed, provided that the "all events" is present.

"All events test" requires:

- Fixing a right to income or liability to pay; and
- The availability of reasonably accurate determinate of such income or liability.

A professional may claim as deductions the cost of supplies used by him in the practice of his profession, expenses paid in the operation and repair of transportation equipment used in making professional calls, dues to professional societies and subscriptions to professional journals. (Mamalateo)

(8) Entertainment expenses

Requisites for deductibility:

1. Reasonable in amount.
2. Incurred during the taxable period.
3. 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 thereof.
4. Not to exceed such ceiling as the Secretary of Finance prescribe (under RR 10-02, in no case to exceed 0.50% of net sales for sellers of goods or properties or 1% of net revenues for sellers of services)
5. Not incurred for purposes contrary to law, morals, public policy or public order.

(9) Political campaign expenses

Contributions to political parties registered with COMELEC are deductible

(10) Training expenses

BIR Ruling 102-97 (Sept. 29, 1997):

Under Section 30 of the Tax Code, as implemented by Sec. 20 of the Revenue Regulations No. 2, organization and pre-operating expenses of a corporation (including training expenses) are considered as capital expenditures and are therefore, not deductible in the year they are paid or incurred. But taxpayers who incur these expenses and subsequently enter the trade or business to which the expenditures relate can *elect to amortize*

these expenditures over a period not less than sixty (60) months.

This rule, however, does not apply to a situation where an existing corporation incurs these same expenditures for the purpose of expanding its business in a new line of trade, venture or activity.

b) Interest

Requisites for deductibility

1. There is an INDEBTEDNESS.
2. The indebtedness is that of the TAXPAYER.
3. The indebtedness is connected with the taxpayer's TRADE, profession, or business.
4. The interest must be legally DUE.
5. The interest must be stipulated in WRITING.
6. The taxpayer is LIABLE to pay interest on the indebtedness.
7. The indebtedness must have been paid or accrued DURING the TAXABLE YEAR.
8. The interest payment arrangement must not be between RELATED taxpayers
9. The interest must not be incurred to finance PETROLEUM operations.
10. In case of interest incurred to acquire property used in trade, business or exercise of profession, the same was **not** treated as a CAPITAL expenditure,

LIMITATION: The taxpayer's allowable deduction for interest EXPENSE shall be reduced by an amount equal to 42% of the interest INCOME subjected to final tax (SEE CHAPTER ON TAXATION OF PASSIVE INCOME); provided, that effective January 1, 2009, the percentage shall be 33%.

Non-deductible interest expense

1. Interest paid in advance by the taxpayer who reports income on cash basis shall only be allowed as deduction *in the year the indebtedness is paid.*
2. If the indebtedness is payable in periodic amortizations, only 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.
3. Interest payments made between related taxpayers.
4. Interest on indebtedness incurred to finance petroleum exploration.

Interest subject to special rules

(a) Interest paid in advance

No deduction shall be allowed if within the taxable year an individual taxpayer reporting income on cash basis incurs an indebtedness on which an interest is paid in advance through discount or otherwise.

- But the deduction shall be allowed in the year the indebtedness is paid

(b) Interest periodically amortized

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

(c) Interest expense incurred to acquire property for use in trade/business/profession

At the option of the taxpayer, interest expense on a capital expenditure may be allowed as:

- A deduction in full in the year when incurred;
- A capital expenditure for which the taxpayer may claim only as a deduction the periodic amortization of such expenditure.

Paper Industries Corp. v. Commissioner, 250 SCRA 434: Should the taxpayer elect to deduct the interest payments against its gross income, the taxpayer cannot *at the same time* capitalize the interest payments. In other words, the taxpayer is *not* entitled to *both the deduction from gross income and the adjusted (increased) basis* for determining gain or loss and the allowable depreciation charge.

Related Taxpayers

1. Between members of the 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, ancestor, and lineal descendants; OR
2. Except in case of distributions in liquidation, between an individual and a corporation more than 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 50% in value of the outstanding stock of each 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 or exchange was, under the law applicable to such taxpayer, a personal holding company of a foreign personal holding company; OR
4. Between the grantor and a fiduciary of any trust; OR
5. Between the fiduciary of a trust and a 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 a beneficiary of such trust.

c) Taxes

TAXES PROPER. Refers to national and local taxes, Does not include amounts representing interest, surcharge, or penalties incident to delinquency.

General Rule: All taxes, national or local, paid or incurred during the taxable year in connection with the taxpayer's profession, trade or business, are deductible from gross income



Exceptions:

1. Philippine income tax, except Fringe Benefit Taxes;
2. Income tax imposed by authority of any foreign country;
 - **Exception to exception:**
When the taxpayer does NOT signify his desire to avail of the tax credit for taxes of foreign countries, **the amount may be allowed as a deduction** subject to the limitations set forth by law.
3. Estate and donor's taxes
4. Taxes assessed against local benefits of a kind tending to increase the value of the property assessed (Special Assessments)
5. Value Added Tax
6. Fines and penalties
7. Final taxes
8. Capital Gains Tax
9. Import duties
10. Business taxes
11. Occupation taxes
12. Privilege and license taxes
13. Excise taxes
14. Documentary stamp taxes
15. Automobile registration fees
16. Real property taxes
17. Electric energy consumption tax under BP 36

Requisites for deductibility

Such TAX must be:

1. Paid or incurred within the taxable YEAR;
2. Paid or incurred in connection with the taxpayer's TRADE, profession or business;
3. Imposed DIRECTLY on the taxpayer.
4. Not specifically EXCLUDED by law from being deducted from the taxpayer's gross income.

Treatments of interests

CIR v. Vda. de Prieto (1960): Although interest payment for delinquent taxes is not deductible as tax under... the Tax Code, the taxpayer is not precluded thereby from claiming said interest payment as **deduction**.

Treatment of special assessment

Special assessments and other taxes assessed against local benefits of a kind tending to increase the value of the property assessed are **non-deductible** from gross income.

(5) Tax credit vis-à-vis deduction

TAX CREDIT - Foreign income taxes paid or incurred which **reduces the Philippine income tax** to be paid.

CIR v. Bicolandia Drug Corp.: An amount subtracted from an individual's or entity's tax liability to arrive at the total tax liability. A tax credit reduces the taxpayer's liability, compared to a deduction which reduces taxable income upon which the tax liability is calculated. A credit differs from deduction to the extent that the former is subtracted from the tax

while the latter is subtracted from income before the tax is computed.

The following may claim tax credits:

1. Resident citizens
2. Domestic corporations
3. Members of general professional partnerships
4. Beneficiaries of estates or trusts

The following may NOT claim tax credits:

1. Non-resident citizens
2. Resident aliens
3. Non-resident aliens
4. Foreign corporations

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. Taxable Income per Foreign Country	x	Phil. Income Tax	=	Per Country Limit
<u>Worldwide Taxable Income</u>				

2. Taxable Income for all Foreign Countries	x	Phil. Income Tax	=	Worldwide Limit
<u>Worldwide Taxable Income</u>				

Note: The second limitation applies where the taxpayer derives income from more than one foreign country.

d) Losses

REQUISITES FOR DEDUCTIBILITY:

1. Loss must be that of the taxpayer (i.e. losses of the parent corp. cannot be deducted by its subsidiary);
2. Actually sustained during the taxable year;
3. Connected with the trade, business or profession;
4. Evidenced by a close and completed transaction;



5. Not compensated for by insurance or other form of indemnity;
6. Not claimed as a deduction for estate tax purposes;
7. In case of casualty, notice of loss must be filed with the Bureau of Internal Revenue *within 45 days from the date of discovery* of the casualty or robbery, theft or embezzlement.

No loss is recognized in the following:

1. Merger, consolidation, or control securities (where no gains are recognized either);
2. Exchanges not solely in kind;
3. Related taxpayers;
 - a. Between members of a family
 - b. 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
 - c. 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;
 - d. Between the grantor and a fiduciary of any trust;
 - e. Between the fiduciary of a trust and the fiduciary of another trust if the same person is a grantor with respect to each trust;
 - f. Between a fiduciary and beneficiary of a trust.
4. Wash sales;
5. Illegal transactions

Other types of losses

(a) Capital losses

Deductible only to the extent of capital gains (except for banks and trust companies)

- a. Incurred in the sale or exchange of capital assets;
- b. Resulting from securities held as capital assets becoming worthless;
- c. Losses from short sales of property;
- d. Losses due to failure to exercise privilege or option to buy or sell property.

(b) Securities becoming worthless

- *Loss in shrinkage in value of stock* through fluctuation in the market is **not deductible** from gross income.

Exception: If the stock of the corporation becomes worthless, the cost or other basis may be deducted by its owner in the taxable year in which the stock became worthless.

(c) Losses on wash sales of stocks or securities

WASH SALE - a sale or other disposition of stock or securities where substantially identical securities are acquired or purchased within a 61-day period, beginning 30 days before the sale and ending 30 days after the sale

GENERAL RULE: Not deductible from gross income

EXCEPT: If by a dealer in securities in the course of ordinary business, it is deductible.

(d) Wagering losses

- Deductible only to the extent of wagering gains. A wager is made when the outcome depends upon CHANCE.

(e) NOLCO (Net Operating Loss Carry Over)

Net operating loss is the excess of allowable deductions over gross income for any taxable year immediately preceding the current taxable year.

NOLCO: Net operating losses which have *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.*

Exception: Mines other than oil and gas wells, where a net operating loss 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.

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: AT LEAST 75% of nominal value of outstanding issued shares is held by or on behalf of the same persons;

or

 AT LEAST 75% of the paid up capital of the corporation is held by or on behalf of the same persons.

Taxpayers Entitled to NOLCO

A. Individuals engaged in trade or business or in the exercise of his profession (including estates and trusts);

Note: An individual who avails of optional standard deduction cannot simultaneously claim deduction of NOLCO. However, the three-year period shall continue to run during such period notwithstanding the election made by the taxpayer.

B. Domestic and resident foreign corporations subject to the normal income tax (e.g., manufacturers and traders) or preferential tax rates under the Code (e.g., private educational institutions, hospitals, and regional operating headquarters) or under special laws (e.g., PEZA-registered companies).

Note: Corporations cannot avail of NOLCO as long as it is subject to Minimum Corporate

Income Tax in any taxable year. However, the three-year period shall continue to run notwithstanding the fact that the corporation paid its income tax under MCIT during such period.

Other Losses:

- a. **Abandonment losses** in petroleum operation and producing well.
- b. **Losses due to voluntary removal of building** incident to renewal or replacements are *deductible* from gross income.
- c. **Loss of useful value of capital assets** due to charges in business conditions is *deductible only to the extent of actual loss sustained* (after adjustment for improvement, depreciation and salvage value)
- d. **Losses from sales or exchanges of property between related taxpayers** are not recognized, but the gains are taxable.
- e. **Losses of farmers** incurred in the operation of farm business are *deductible*.

e) Bad debts

Debts resulting from the worthlessness or uncollectibility, in whole or in part, of amounts due the taxpayer **actually ascertained to be worthless and charged off within the taxable year**

Requisites for deductibility

1. Existing 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 ascertained to be worthless and uncollectible as of the end of the taxable year (taxpayer had **REASONABLY ASCERTAINED** in **GOOD FAITH** using sound business judgment); and
5. Actually charged off in the books of accounts of the taxpayer as of the end of the taxable year

Tax Benefit rule on Bad Debts

Bad debts claimed as deduction in the preceding year(s) but subsequently recovered shall be included as part of the taxpayer's gross income in the year of such recovery the extent of the income tax benefit of said deuction. Also called *the equitable doctrine of tax benefit*.

f) Depreciation

DEPRECIATION - The gradual diminution of the useful value of tangible property resulting from wear and tear and normal obsolescence.

Deduction Allowable:

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

Requisites for deductibility

1. Must be for property used in the **TRADE or business**, or those not being used temporarily during the year
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. Does **NOT EXCEED** the cost of the property.

Methods of computing depreciation allowance

1) Straight-line	$\frac{\text{cost- salvage value}}{\text{estimated life}}$
2) Declining balance	$\text{cost - depreciation} \times \text{Rate}$ estimated life
3) Sum of the years digits (SYD)	$\frac{\text{nth period}}{\text{SYD}} \times \text{cost- salvage}$

g) Charitable and other contributions

Requisites for deductibility

1. Actually paid or made to the **ENTITIES** specified by law;
2. Made within the **TAXABLE** year.
3. It must be **EVIDENCED** by adequate receipts or records.
4. For Contributions Other than Money: The amount shall be **BASED** on the acquisition cost of the property (i.e., not the fair market value at the time of the contribution).
5. For Contributions subject to the statutory limitation: It must not **EXCEED** 10% (individual) or 5% (corporation) of the taxpayer's taxable income before charitable contributions.

Amount that may be deducted

Kinds of Contributions:

1. Contributions deductible in full;
2. Contributions subject to the statutory limit.

1) Contributions Deductible in Full: (FoNG)

- a. **Donations to the Government** - Donations to the Government of the Philippines or to any of its agencies or political subdivisions, including fully-owned government corporations, **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.
- 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 Non-government Organizations** - The term "non-government organization" means a **non-profit domestic corporation**:

- Organized and operated **exclusively** for: (CRWSH Cys ChE Com)
 - 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) Contributions subject to the Statutory Limit (DNGS)

- a. Contributions made to the **Government** or any of its agencies or political subdivisions **exclusively for public purposes** (contributions for non-priority activities)
- b. Contributions made to **accredited domestic corporation or associations** organized exclusively for
 - religious,
 - charitable,
 - scientific,
 - youth and sports development,
 - cultural or
 - educational purposes or
 - for the rehabilitation of veterans
- c. Contributions to **social welfare institutions**
- d. Contributions to **non-government organizations**
 - No part of the net income of which inures to the benefit of any private stockholder or individual

Statutory Limit:

Amount deductible must not be in excess of:

- 10% in the case of an individual, and
- 5% in the case of a corporation,

of the taxpayer's taxable income derived from trade, business or profession before the deduction for contributions and donations.

The amount deductible is the actual contribution or the statutory limit computed, whichever is lower.

h) Contributions to pension trusts

- 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.
- **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.

General Rule: 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, a reasonable amount transferred or paid into such trust in EXCESS of the contributions to such trust made during the taxable year.

Requisites for deductibility

1. It has not been claimed 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.

Premium Paid on Health or Hospitalization Insurance [Sec.34 (M)]

- Amount of premium paid on health and/or hospitalization by an individual taxpayer (head of family or married), for himself and members of his family during the taxable year.

Requisites for Deductibility:

1. Insurance must have actually been taken
2. The amount of premium deductible does not exceed P2,400 per family or P200 per month during the taxable year.
3. That said family has a gross income of not more than P250,000 for the taxable year.
4. In case of married individual, only the spouse claiming additional exemption shall be entitled to this deduction.

The following may avail of the deduction:

1. Individual taxpayers earning purely compensation income during the year.
2. Individual taxpayer earning business income or in practice of his profession.

4) Optional standard deduction

a) Individuals, except non-resident aliens

- May be taken by an INDIVIDUAL in lieu of itemized deductions EXCEPT those earning purely compensation income.
- Amount: **40% of GROSS INCOME.** (under RA 9504, effective July 6, 2008)

Requisites:

1. Taxpayer is a citizen or resident alien;
2. Taxpayer's income is not entirely from compensation;

3. Taxpayer **signifies** in his return **his intention to elect this deduction**; otherwise he is considered as having availed of the itemized deductions.
4. Election is **irrevocable** for the year in which made; however, he can change to itemized deductions in succeeding years.

b) Corporations, except non-resident foreign corporations

The option to elect Optional Standard Deduction granted is now granted to corporations (*domestic and resident foreign* corporations) by virtue of RA 9504.

5) Personal and additional exemption (Republic Act 9504 Minimum Wage Earner Law)

a) Basic personal exemptions

- According to RA 9504 (effective July 6, 2008) basic personal exemption is Fifty thousand pesos (P50,000) for each individual taxpayer, **regardless** whether single, married or head of the family.

* BUT note Sec 35(A) - In the case of **married individuals where only one of the spouses is deriving gross income, only such spouse** shall be allowed the personal exemption.

b) Additional exemptions for taxpayer with dependents

- depends on the number of qualified dependent children
- **Amount allowed as a deduction** → **P25,000** per dependent child, but not to exceed four children (**RA 9504**)
- **Who may claim additional exemptions?**
 - **Married Individuals:** Additional exemptions are claimed by **only one spouse**.
Generally, the spouse who is the **gross compensation earner** is the claimant of the additional exemptions.
 - **Where the husband and wife are both compensation income earners:** the husband is the proper claimant of the additional exemptions EXCEPT if there is an express waiver by the husband in favor of his wife, as embodied in the withholding exemption certificate.
 - **When the spouses have business and/or professional income only:** either may claim the additional exemptions at the end of the year.
 - The wife claims the additional exemptions in the following instances:
 - i. husband has no income
 - ii. husband works abroad
 - iii. **Legally separated spouses:**
Additional exemptions can be

claimed by the spouse with **custody** of the child or children (but the total amount for the spouses shall not exceed the maximum of four). [Sec 35(B), NIRC]

➤ **Who is a dependent for purposes of additional exemptions?**

1. A taxpayer's child, whether legitimate, illegitimate or legally adopted child
2. chiefly dependent for support upon on the taxpayer
3. living with the taxpayer
4. a) not more than 21 years old, unmarried and not gainfully employed
OR
b) regardless of age, is incapable of self-support because of mental or physical defect. (Sec 35 B, NIRC)

NOTE: Only children may be considered "dependent" for purposes of additional exemptions.

➤ **Who may claim personal exemptions?**

- **Citizens** (whether resident or non-resident) and **resident aliens** are allowed to avail of **basic personal and additional** exemptions.
- **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**]

c) Status-at-the-end-of-the-year rule

- **Change of Status** [Sec 35(C), NIRC]
 1. If taxpayer marries during taxable year, taxpayer may claim the corresponding BPE *in full* for such year (i.e., no need to pro-rate the exemption).
 2. If taxpayer should have additional dependent(s) during taxable year, taxpayer may claim corresponding AE *in full* for such year.
 3. If taxpayer dies during taxable year, his estate may still claim BPE and AE for himself and his dependent(s) *as if he died at the close of such year*.
 4. If during the taxable year
 - a. spouse dies or
 - b. any of the dependents dies or marries, turns 21 years old or becomes gainfully employed, taxpayer may still claim same exemptions as if the spouse or any of the dependents died, or

married, turned 21 years old or became gainfully employed *at the close of such year*.

Note: When it comes to change of status, the status beneficial to the taxpayer is used for purposes of claiming deductions as long as the taxpayer achieved such status at any time during the taxable period.

6) Items not deductible

General Rule: In computing net income, no deduction shall be allowed in respect to:

1. *Personal, living or family expenses*
2. Any amount paid out for *new buildings* or for *permanent improvements*, or betterments made to *increase the value of any property or estate*
3. Any amount expended in *restoring property* or in *making good the exhaustion thereof* for which an allowance [for depreciation or depletion] is or has been made
4. Premiums paid on any *life insurance policy* covering the life of any *officer, employee, or person financially interested in the trade or business carried on by the taxpayer*, when the taxpayer is directly or indirectly a beneficiary under such policy.
5. Losses from sales or exchanges of property *between related taxpayers*.
 - a. Between members of the family;
 - b. Between an individual and a corporation
 - more than 50% in value of the outstanding stock of which
 - is owned, directly or indirectly, by or for such individual

Exception: If the loss occurs during distributions in liquidation
 - c. Between two corporations
 - more than 50% in value of the outstanding stock of each 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 or exchange)
 - was a personal holding company or a foreign personal holding company.

Exception: If the loss occurs during distributions in liquidation
 - d. Between the grantor and a fiduciary of any trust;
 - e. Between the fiduciary of a trust and the fiduciary of another trust if the same person is a grantor with respect to each trust;
 - f. Between a fiduciary of a trust and beneficiary of such trust.
6. Interest expense and bad debts between related parties. (See No. 5 for related parties)
7. Losses on *Wash Sales* (except if by dealer in securities in ordinary course of business)
8. *Illegal Expense* such as *Bribes, Kickbacks and Other Similar Payments* made, directly or

indirectly, to an official or employee of the national government/ LGU/ GOCC/ foreign government, or to a private corporation, general professional partnership, or a similar entity.

9. Non-deductible interest - should the taxpayer elect to deduct interest payments against its gross income, he cannot at the same time capitalize such interest and claim depreciation on the undepreciated cost which includes the interest. (PICOP v. Commissioner, G.R. No. 106949-50, Dec. 1, 1995)
10. Non-deductible taxes
11. Non-deductible losses

j. Exempt Corporations (CREB-CLEF-SMB)

- The following organizations shall **not be taxed in respect to income received by them as such (e.g. membership fees):**
 1. **LABOR**, agricultural or horticultural organization not organized principally for profit
 2. **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
 3. A **BENEFICIARY** society, order or association, *operating for the exclusive benefit of the members* such as a fraternal organization operating under the lodge system, or mutual aid association or a non-stock 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 non-stock corporation or their dependents
 4. **CEMETERY** company owned and operated exclusively for the benefit of its members
 5. Non-stock 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 inure to the benefit of any member, organizer, officer or any specific person**
 6. **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 stockholder, or individual
 7. **CIVIC league** or organization not organized for profit but operated exclusively for the *promotion of social welfare*
 8. A non-stock and nonprofit **EDUCATIONAL** institution
 9. Government **EDUCATIONAL** institution
 10. **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

11. *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;

- Note: Notwithstanding the exemptions, *income* of whatever kind and character of the enumerated organizations *from any of their properties*, real or personal, *or from any of their activities conducted for profit regardless of the disposition* made of such income, shall be SUBJECT TO TAX.
- National Power Corporation (NPC) in general is subject to income tax. [RA 9337]

Note: RA 9178 Barangay Micro Business Enterprises (BMBEs) implemented by DO 17-04, April 20, 2004

- BMBEs shall be exempt from income tax for income arising from the operations of the enterprise.
- BMBE is any business entity or enterprise engaged in the production, processing or manufacturing of products or commodities, including agro-processing trading and services, whose total assets including those arising from loans but exclusive of land on which the particular business entity's office, plant and equipment are situated, shall not be more than P3M.

10. Taxation of Resident Citizens, Non-resident Citizens, and Resident Aliens

- a. General Rule: Resident citizens - Taxable on income from all sources within and without the Philippines
- b. Taxation on Compensation Income
- c. Taxation on Business Income/Income from Practice of Profession
- d. Taxation on Passive income
- e. Taxation of capital gains

a. General rule: Resident citizens - Taxable on income from all sources within and without the Philippines

Citizens - Under Sec. 1, Art. IV of the Constitution, the following are citizens of the Philippines:

- a. Those who are citizens of the Philippines at the time of the adoption of the 1987 Constitution
- b. Those whose fathers or mothers are citizens of the Philippines
- c. Those born before Jan. 17, 1973, of Filipino mothers, who elect Philippine citizenship upon reaching the age of majority.
- d. Those who are naturalized in accordance with law.

RESIDENT - a citizen is deemed as a resident of the Philippines unless he qualifies as a non-resident under Sec. 22E of the NIRC;

- taxable for income derived from all sources based on taxable (i.e., net) income

NON-RESIDENT - a citizen of the Philippines who according to Sec. 22 (E), NIRC:

- (1) establishes to the satisfaction of the Commissioner the *fact of his physical presence abroad* with a *definite intention to reside therein*.
 - (2) *Leaves the Philippines during the taxable year to reside abroad*, either as an *immigrant* or for *employment on a permanent basis*.
 - (3) *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) 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 non-resident 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.
- taxable for income derived within the Philippines based on taxable (i.e., net) income
 - The phrase "most of the time" means at least 183 days. His presence abroad, however, need not be continuous.

NOTES:

An **OVERSEAS CONTRACT WORKER** is taxable only on income from sources *within* the Philippines. (Sec. 23 (c))

- **NOTE FURTHER:** A seaman who is a Filipino citizen and who receives compensation for services rendered abroad as member of the complement of a vessel engaged *exclusively* in international trade is treated as an overseas contract worker.
- Length of stay is indicative of intention. A citizen of the Philippines who shall have stayed outside the Philippines for **183 days or more** by the end of the year is a **non-resident** citizen. His presence abroad, however, need not be continuous.

Q: With regard to tax status, can a Filipino be a resident and a non-resident citizen during the same taxable year?

A: General rule: A citizen has only one tax status during the taxable year either as a resident or a non-resident.

Exception: If at the beginning of the year, he citizen derives compensation and/or business or professional income, and sometime later during the same year, he departs from the Philippines as an immigrant or a qualified non-resident citizen or vice versa.

1. Alien



RESIDENT - residence is within the Philippines and who is not a citizen thereof (Sec. 22 (F), NIRC). An alien actually present in the Philippines who is not a mere transient or sojourner is a resident of the Philippines for income tax purposes. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient.

- taxable for income derived within the Philippines based on taxable (i.e., net) income
- **Loss of residence by an alien** - An alien who has acquired residence in the Philippines retains his status as a resident *until he abandons the same and actually departs from the Philippines*.

NON-RESIDENT - residence is NOT in the Philippines and who is not a citizen thereof (Sec. 22 (G), NIRC).

- **Engaged in trade or business in the Philippines (NRAETB)** - is taxable for income derived within the Philippines based on taxable (i.e., net) income
- **Not Engaged in trade or business in the Philippines (NRANETB)** - is taxable for income derived within the Philippines based on *gross* income.

NOTES:

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.

- **Length of stay is indicative of intention.** An alien who shall have stayed in the Philippines for **more than one year** by the end of the taxable year is a **resident alien**.

NOTE FURTHER: An alien who shall come to the Philippines and stay for an aggregate period of **more than one hundred eighty days** during a calendar year shall be considered a **non-resident alien in business** in the Philippines. [Sec. 25(A)(1)]

Length of Stay in the Philippines as Indicative of Intent

Length of Stay (aggregate within the calendar year)	Status
More than 1 year	Resident Alien
More than 180 days up to 1 year	NRAETB
180 days or less	NRANETB

If an alien stays in the Philippines for 180 days or less during the calendar year, he shall be deemed a

non-resident alien engaged in business in the Philippines.

b. Taxation on 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. [Sec. 78(A)]. It **includes**, but is not limited to salaries and wages, commissions, tips, allowances, bonuses, Fringe Benefits of rank and file EEs and other forms of compensation.

1) Inclusions

a) Monetary compensation - If compensation is paid in cash, the *full amount received* is the measure of the income subject to tax.

(1) Regular salary/wage

- **Salary** - earnings received periodically for a regular work other than manual labor, such as monthly salary of an employee
- **Wages** - all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash. [Sec. 78A, NIRC]

(2) Separation pay/retirement benefit not otherwise exempt

- **Retirement Pay** - a lump sum payment received by an employee who has served a company for a considerable period of time and has decided to withdraw from work into privacy. [RR 6-82, Sec. 2b]
 - in general, retirement pay is taxable except in the following instances:
 - SSS or GSIS retirement pays.
 - Retirement pay (R.A. 7641) due to old age provided the following requirements are met:
 - The retirement program is approved by the BIR Commissioner;
 - It must be a reasonable benefit plan. (fair and equitable)
 - The retiree should have been employed for 10 years in the said company;
 - The retiree should have been 50 years old or above at the time of retirement; and
 - It should have been availed of for the first time.

- **Separation pay** - taxable if **VOLUNTARILY** availed of. It shall not be taxable if involuntary i.e. Death, sickness, disability, reorganization /merger of company and company at the brink of bankruptcy or for



any cause beyond the control of the said official or employee

(3) Bonuses, 13th month pay, and other benefits not exempt

- *Tips and Gratuities* - those paid directly to the employee (usually by a customer of the employer) which are not accounted for by the employee to the employer. (taxable income but not subject to withholding tax) [RR NO. 2-98, Sec. 2.78.1]
- *Thirteenth month pay and other benefits*
 - **Not taxable** if the total amount received is **P30,000 or less**. Any amount *exceeding P30,000* is taxable. [Sec. 32 (7)e, NIRC]
- *Overtime Pay* - premium payment received for working beyond regular hours of work which is included in the computation of gross salary of employee. It constitutes compensation.

(4) Director's fees

- *Fees* - received by an employee for the services rendered to the employer including a director's fee of the company, fees paid to the public officials such as clerks of court or sheriffs for services rendered in the performance of their official duty over and above their regular salaries.

b) Non-monetary compensation - If services are paid for in a medium other than money, the fair market value of the thing taken in payment is the measure of the income subject to tax.

(1) Fringe benefit not subject to tax

Fringe benefit means any good, service, or other benefit furnished or granted by an employer, in cash or in kind, in addition to basic salaries, to an individual employee (**except rank and file employees**) 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 in social and athletic clubs and similar organizations
7. Expenses for foreign travel
8. Holiday and vacation expenses
9. Educational assistance to the employee or his dependents; and
10. Life or health insurance and other non-life insurance premiums or similar amounts on excess of what the law allows.

2) Exclusions

a) Fringe benefit subject to tax

Convenience of the ER Rule

- 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 (*Henderson v. Collector*)

b) De minimis benefits

- Facilities or privileges of **relatively small value** furnished by an employer to his employees and are as a means of promoting the health, goodwill, contentment, or efficiency of his employees.
- These are **exempt** from fringe benefit tax and compensation income tax.

c) 13th month pay and other benefits and payments specifically excluded from taxable compensation income

- Gross benefits received by employees of public and private entities provided that the total exclusion shall not exceed P30,000 (amounts in excess are considered compensation income)

Includes:

- Benefits received by government employees under RA 6686
- Benefits received by employees pursuant to PD 851 (13th Month Pay Decree)
- Benefits received by employees not covered by PD 851 as amended by Memorandum Order No. 28 and
- Other benefits such as productivity incentives and Christmas bonus

3) Deductions

a) Personal exemptions and additional exemptions

- **Personal Exemptions** - are arbitrary amounts allowed by law to be deducted from income to cover personal, living, or family expenses of the taxpayer. These deductions are allowed on the theory that the minimum requirements of subsistence of a taxpayer should be free from tax.

Kinds:

1. Basic Personal Exemptions

- According to RA 9504 (effective July 6, 2008) basic personal exemption is Fifty thousand pesos (P50,000) for each individual taxpayer, *regardless* whether single, married or head of the family.

* BUT note Sec 35(A) - In the case of married individuals where only one of the spouses is deriving gross income, only such spouse shall be allowed the personal exemption.

2. Additional Exemptions (AE)

- depends on the number of qualified dependent children

➤ **Amount allowed as a deduction** → P25,000 per dependent child, but not to exceed four children (RA 9504)

➤ **Who may claim additional exemptions?**

- **Married Individuals:** Additional exemptions are claimed by only one spouse.

Generally, the spouse who is the gross compensation earner is the claimant of the additional exemptions.

- Where the husband and wife are both compensation income earners, the husband is the proper claimant of the additional exemptions EXCEPT if there is an express waiver by the husband in favor of his wife, as embodied in the withholding exemption certificate.
- When the spouses have business and/or professional income only, either may claim the additional exemptions at the end of the year.
- The wife claims the additional exemptions in the following instances:
 - husband has no income
 - husband works abroad
 - Legally separated spouses: Additional exemptions can be claimed by the spouse with custody of the child or children (but the total amount for the spouses shall not exceed the maximum of four). [Sec 35(B), NIRC]

➤ **Who is a dependent for purposes of additional exemptions?**

1. A taxpayer's child, whether legitimate, illegitimate or legally adopted child
2. chiefly dependent for support upon on the taxpayer
3. living with the taxpayer
4. a) not more than 21 years old, unmarried and not gainfully employed OR
b) regardless of age, is incapable of self-support because of mental or physical defect. (Sec 35 B, NIRC)

NOTE: Only children may be considered "dependent" for purposes of additional exemptions.

➤ **Who may claim personal exemptions?**

- **Citizens** (whether resident or non-resident) and **resident aliens** are allowed to avail of basic personal and additional exemptions.
- **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**]

➤ **Change of Status** [Sec 35(C), NIRC]

1. If taxpayer marries during taxable year, taxpayer may claim the corresponding BPE *in full* for such year (i.e., no need to pro-rate the exemption).
2. If taxpayer should have additional dependent(s) during taxable year, taxpayer may claim corresponding AE *in full* for such year.
3. If taxpayer dies during taxable year, his estate may still claim BPE and AE for himself and his dependent(s) *as if he died at the close of such year*.
4. If during the taxable year
 - a. spouse dies or
 - b. any of the dependents dies or marries, turns 21 years old or becomes gainfully employed, taxpayer may still claim same exemptions as if the spouse or any of the dependents died, or married, turned 21 years old or became gainfully employed *at the close of such year*.

Note: When it comes to change of status, the status beneficial to the taxpayer is used for purposes of claiming deductions as long as the taxpayer achieved such status at any time during the taxable period.

b) **Health and hospitalization insurance**

➤ **Special deduction for actual premium payments for health and/or hospitalization insurance** taken by an individual taxpayer provided that the following requisites are met:

- a. The taxpayer's family gross income does not exceed P250,000 in a taxable year.
- b. The amount deductible should only be limited to P2,400 per family or P200 per month.

➔ In the case of married taxpayers, only the spouse claiming the additional exemption for dependents shall be entitled to this deduction.

c) **Taxation of compensation income of a minimum wage earner**

(1) **Definition of Statutory Minimum Wage**

STATUTORY MINIMUM WAGE - earner shall refer to rate fixed by the Regional Tripartite Wage and Productivity Board, as defined by the Bureau of Labor and Employment Statistics (BLES) of the Department of Labor and Employment. (Sec.22 GG, as amended by RA 9504)

(2) **Definition of Minimum Wage Earner**

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

(3) Income also subject to tax exemption: holiday pay, overtime pay, night shift differential, and hazard pay

Compensation income including overtime pay, holiday pay and hazard pay, earned by **MINIMUM WAGE EARNERS** who has no other returnable income are NOT taxable and not subject to withholding tax on wages [RA 9504]

c. Taxation of Business Income/Income from Practice of Profession

- All income obtained from doing business and/or engaging in the practice of a profession shall be included in the computation of taxable income.
- This shall be subject to the graduated rates of income.

Not over P10,000	5%
Over P10,000 but not over P30,000	P500+10% of the excess over P10,000
Over P30,000 but not over P70,000	P2,500+15% of the excess over P30,000
Over P70,000 but not over P140,000	P8,500+20% of the excess over P70,000
Over P140,000 but not over P250,000	P22,500+25% of the excess over P140,000
Over P250,000 but not over P500,000	P50,000+30% of the excess over P250,000
Over P500,000	P125,000+32% of the excess over P500,000

d. Taxation of Passive Income

1) Passive income subject to final tax

“Final tax” means tax withheld from source, and the amount received by the income earner is net of the tax already. The *tax withheld* by the income payor is *remitted* by him to the *BIR*. The income having been tax-paid already, it need not be included in the income tax return at the end of the year. These passive income items are as follows:

a) Interest income

- on any currency bank deposit, yield or any other monetary benefit from deposit substitutes, trust funds and similar arrangements - **20%** final tax
- under the expanded foreign currency deposit system (EFCDS) - **7.5%** final tax for residents, exempt if non-residents
- on **long-term deposit** or investment certificates (LTDIC) in banks (e.g., savings, common or individual trust funds, deposit substitutes, investment management accounts and other investments, which have maturity of 5 years or more) - **exempt**
 - Should LTDIC holder *pre-terminate* LTDIC before the 5th year, a final tax shall be imposed on the *entire* income based on the *remaining* maturity:

4 years to less than 5 years	5%
3 years to less than 4 years	12%
less than 3 years	20%

Summary Rules on Interest Income

Interest Income from:	Tax Rate	Payee
Any currency deposit, yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements derived from the Phils	20%	RC, NRC, RA, NRAETB DC, RFC
Long term investment or investment in the form of savings, common or individual trust funds, substitute investment management accounts and other investments evidenced by certificates in such form prescribed by BSP	4 - less than 5 yrs: 5% 3 - less than 4 yrs: 12% less than 3 yrs: 20%	RC, NRC, RA, NRAETB
EFCDS deposits	7.5%	RC, NRC, RA DC, RFC
Foreign currency loans granted by FCDUs to <i>residents</i> other than OBUs banks or other depository under the EFCDS	10%	RC, RA DC, RFC
Foreign currency loans granted by OBUs to residents other than OBUs or local commercial banks, including branches of foreign banks authorized by BSP to transact business with OBUS	10%	RC, RA DC, RFC
Foreign currency loans contracted on or after August 1, 1986	20%	NRFC
Transactions with depository banks under	EXEMPT	NRC, NRA,



FCDs		NRFC
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b) Royalties

From books, literary works, and musical	10%	RC, RA, NRC, NRAETB, DC, RFC
	25%	NRANETB
	30%	NRFC
Other royalties	20%	RC, RA, NRC, NRAETB, DC, RFC
	25%	NRANETB
	30%	NRFC

c) Dividends from domestic corporation

- **cash and/or property dividends** actually or constructively received by an individual from
 - a domestic corporation
 - a joint stock company
 - insurance or mutual fund companies
 - regional operating headquarters of multinational companies
- 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
- share of an individual member or co-venturer in the net income after tax of an association, a joint account, or a joint venture or consortium taxable as a corporation

RATE:
• 10% for residents (RC, RA) and non-resident citizens (NRC);
• 20% for NRAETB (non-resident aliens engaged in trade or business)

- A stock dividend representing the transfer of surplus to capital account shall not be subject to tax.
- 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 that it represents a distribution of earnings or profits. (Sec. 73B, NIRC)
 - In other words, stock dividends are generally not subject to tax as long as there are no options in lieu of the shares of stock.
On the other hand, a stock dividend constitutes income if it gives the shareholder an interest different from that which his former stockholdings represented.]

Summary Rules on Dividends (Cash, Property, Scrip)

TAXPAYER	Dividend paid by a DOMESTIC CORP	Dividend paid by a FOREIGN CORP Note: Sec 42(A) in correlation w/ Sec 23 NIRC.	
		Source within	Source without
RC	10% FT	5-32% BT	EXEMPT
NRC	10% FT		
RA	10% FT		
NRAETB	20% FT		
NRANETB	25% FT		
DC	EXEMPT	30%	
RFC	EXEMPT	5-32% BT	EXEMPT
NRFC	15% FT - w/ tax sparing	30% FT	EXEMPT
	30% FT - w/o tax sparing		

FT - final tax
BT - base tax (form part of gross income subject to graduated rates)

d) Prizes and other winnings

- a. **Winnings, except Philippine Charity sweepstakes / lotto winnings - 20%**
- b. **Prizes exceeding P10,000 - 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).

Summary Rules for Prizes and Winnings (from sources within the Phils)

Taxpayer	Prizes <u>not</u> exceeding P10,000	Winnings from PCSO & Lotto	Prizes exceeding P10,000	Other winnings, regardless of amount
RC, NRC, RA, NRAETB	5-32% BT	EXEMPT	20% FT	

FT - final tax
BT - base tax (form part of gross income subject to graduated rates)

2) Passive income not subject to final tax

- 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 BSP shall be EXEMPT from tax
 - BUT should the holder of the certificate pre-terminate the

deposit or investment before the 5th 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%.

e. Taxation of capital gains

When the asset sold was held as a capital asset, the gain or loss is called a capital gain or loss. When the asset sold was not held as a capital asset (in other words, as an ordinary asset), the gain or loss is called an ordinary gain or loss.

1) Income from sale of shares of stock of a Philippine corporation

a) Shares traded and listed in the stock exchange
 The transaction is exempt from income tax regardless of the nature of business of the seller or transferor. However, it is **subject to the one-half of one percent (1/2 of 1%) stock transaction tax** imposed under Sec. 127(A) of the Tax Code based on the gross selling price or gross value in money of the shares of stock sold or transferred.\

b) Shares NOT listed OR Listed but NOT traded in the stock exchange
 On sale, barter, exchange or other disposition of **shares of stock of a domestic corporation not listed and traded through a local stock exchange**, held as a capital asset:

- On the net capital gain:
 - Not over P100,000 = **Final Tax of 5%**
 - On any amount in excess of P100,000 = **plus Final Tax of 10% on the excess**
- **Key Definitions**
 - Net capital gain: selling price less cost
 - Selling price: consideration on the sale OR fair market value of the shares of stock at the time of the sale, whichever is HIGHER
 - Cost: original purchase price

2) Income from the sale of real property situated in the Philippines

On sale, exchange, or other disposition of **real property in the Philippines**, held as a capital asset:

- On the gross selling price, or the current fair market value at the time of the sale, whichever is higher, a **final tax of 6%**
 The capital gains tax is applied on the **gross selling price**, or

the **current fair market value** at the time of the sale, **whichever is higher**. Any gain or loss on the sale is **immaterial** because there is a **conclusive presumption by law that the sale resulted in a gain**.

EXCEPTION: When sale of residence is not liable for capital gains tax

- a. There is a sale or disposition of their principal residence by natural persons.
- b. The proceeds of the sale are fully utilized in acquiring or constructing a new principal residence within 18 calendar months from the date of sale or disposition.

The Commissioner shall have been duly notified by the taxpayer within 30 days from the date of sale or disposition through a prescribed return of his intention to avail of the tax exemption.

A deposit is made of the 6% capital gain tax otherwise due, in cash or manager's check, in an interest-bearing account with an Authorized Agent Bank (AAB), under an Escrow Agreement between the taxpayer and the Bureau of Internal Revenue that the same shall be released to the taxpayer when the proceeds of the sale shall have been utilized as intended.

The tax exemption can only be availed of once every 10 years

- 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 (CGT). The GSP or FMV 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.

$$\begin{array}{l}
 \text{Unutilized} \\
 \text{amount} \\
 \hline
 \text{GSP}
 \end{array}
 \times
 \begin{array}{l}
 \text{i.e.,} \\
 \text{(higher of GSP} \\
 \text{or FMV)}
 \end{array}
 =
 \begin{array}{l}
 \text{Taxable} \\
 \text{Portion}
 \end{array}$$

- 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

3) Income from the sale, exchange, or other disposition of other capital assets

- The net capital gain or loss is included in the computation of net income subject to schedular rates (5% to 32%).



CATEGORY OF INCOME	RESIDENT		NON-RESIDENT		
	CITIZEN	ALIEN	CITIZEN	NRAETB	NRANETB
	All sources	Within the Philippines	Within the Philippines	Within the Philippines	Within the Philippines
1. Compensation / Business / Profession 2. Prizes of P10,000 or less	Based on Taxable (i.e, Net) Income Schedular Income Tax Rates (Sec. 24, NIRC) (i.e, 5% to 32%)				GIW - 25% Not Applicable
3. Interest from any currency bank deposit , etc., Royalties (other than from books, literary works and musical compositions), Winnings / Prizes (except prizes P10,000 and below)	Gross Income Within the Philippines (GIW) - 20% Final Withholding Tax				
4. Royalties from books, literary works, musical compositions	GIW - 10% Final Withholding Tax				
5. Interest from long-term deposit or investment certificates, which have a maturity of 5 years or more	EXEMPT; However: In case of pre-termination, with remaining maturity of: 4 years to less than 5 years - 5% on entire income 3 years to less than 4 years - 12% on entire income less than 3 years - 20% on entire income				
6. Cash / Property Dividends from a domestic corporation, etc., OR share in the distributable net income after tax of a partnership (except a general professional partnership), etc.	GIW - 10% Final Withholding Tax		GIW - 20%		
7. Interest (Expanded Foreign Currency Deposit System)	GIW - 7.5% Final Withholding Tax		EXEMPT		
8. Winnings on Philippine Sweepstakes / Lotto	EXEMPT				
9. Capital Gains on Sale of Shares of Domestic Corp. (not traded in a domestic stock exchange)	Net Capital Gains within: Not Over P100,000 - 5% Final Tax Amount in Excess of P100,000 - plus 10% Final Tax on the excess				
10. Capital Gains on Sale of Real Property <i>in the Philippines</i>	Gross Selling Price or FMV, whichever is higher - 6% Final Withholding Tax				
11. Sale of Shares of Domestic Corp. (traded in a domestic stock exchange)	½ of 1% of the Selling Price (Stock Transaction Tax) Note: Stock Transaction Tax is <i>not</i> an income tax, but a business (percentage) tax				
12. Sale of Real Property located Abroad 13. Sale of Shares of Foreign Corp 14. Passive Income from Abroad	Schedular Income Tax Rates (Sec. 24, NIRC) (i.e, 5% to 32%)				

COMPUTATIONS

1. *Pure Compensation Income*

	Gross Compensation Income	xx
Less:	Personal & Additional Exemptions and hospitalization/health insurance premium	xx
	Taxable Income	xx
x	Rate	

	Income Tax	xx
Less:	Creditable Withholding Tax on Compensation Income	xx
	Tax Payable	xx

2. *Mixed-Income (i.e., compensation income and business income/income from the practice of profession)*

	Gross Compensation Income	Xx
Less:	Personal & Additional Exemptions and hospitalization/health insurance premium	Xx
	Taxable Compensation Income	Xx
ADD:	Gross Business Income &/or Income from Practice of Profession	Xx
Less:	Allowable Deduction (itemized or optional deduction)	Xx
	Taxable Income	Xx
x	Rate	
	Income Tax	Xx
Less:	Creditable Withholding Tax on Compensation Income/Other Allowable Tax Credit	Xx
	Tax Payable	Xx

3. Pure Business/Professional Income

	Gross Business Income &/or Income from Practice of Profession	Xx
Less:	(a) Allowable Deduction (itemized or optional deduction)	xx
	(b) Personal & Additional Exemptions and hospitalization/health insurance premium	xx
	Total Taxable Income	Xx
x	Rate	
	Income Tax	Xx
Less:	Creditable Withholding Tax on Compensation Income/Other Allowable Tax Credit	Xx
	Tax Payable	Xx

11. Taxation of Non-resident Aliens Engaged in Trade or Business

a. General rules

- Subject to an income tax in the same manner as an individual citizen and a resident alien individual on taxable income from all sources within the Philippines
- NONRESIDENT ALIEN DOING BUSINESS IN THE PHILIPPINES: a non-resident alien individual who shall come to the Philippines and stay therein for an aggregate period of more than 180 days during any calendar year

b. Cash and/or property dividends

The following shall be subject to an income tax of twenty percent (20%) on the total amount thereof:

- Cash and/or property dividends from:
 - A domestic corporation;
 - A joint stock company;

- An insurance or mutual fund company;
- A regional operating headquarter of multinational company;
- 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;
- 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;

- Interests
- Royalties (in any form); and
- Prizes (except prizes amounting to Ten thousand pesos (P10,000) or less which shall be subject to graduated tax) and other winnings (except Philippine Charity Sweepstakes and Lotto winnings);

EXCEPT:

- The following *Royalties* shall be subject to a final tax of ten percent (10%) on the total amount thereof:
 - On books as well as other literary works; and
 - On musical compositions
- Cinematographic films and similar works shall be subject to twenty-five percent (25%) of the gross income
- 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
 - BUT 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 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%.

c. 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 similar tax prescribed on citizens and resident aliens.

- Sale, barter or exchange of Shares of stock in domestic corporation not traded -
 - Net over P100,000 - 5% of net capital gains realized
 - On any amount in excess of P100,000 - 10% of net capital gains realized
- Sale, barter or exchange of real properties - 6% of gross selling price or current FMV whichever is higher

12. Exclude Non-resident Aliens Not Engaged in Trade or Business

1. Alien individuals employed by:
 - a. Regional or Area Headquarters (RAHQ) and Regional Operating Headquarters (ROHQ) established in the Philippines by multinational companies
 - *Multinational company, defined* → 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
 - b. **Offshore Banking Units** established in the Philippines
2. Alien individuals who are *permanent residents of a foreign country* but who are employed and assigned in the Philippines by a *foreign service contractor or by a foreign service subcontractor* engaged in **petroleum operations** in the Philippines
 - Tax Rate and Base - **15% of gross income received as salaries**, wages, annuities, compensation, remuneration and other emoluments, such as honoraria and allowances
 - The same tax treatment shall apply to Filipinos employed and occupying the same positions as those of aliens employed by these multinational companies, offshore banking units and petroleum service contractors and subcontractors.
 - Note that the coverage of the special classification (and the corresponding tax rate) is **limited to income received as wages**. Hence, *any income earned from all other sources within the Philippines* by the alien employees shall be *subject to the pertinent income tax* (example: sale of real property in the Philippines is subject to 6% capital gain tax, imposed on the gross selling price or fair market value of the property at the time of the sale, whichever is higher)

13. Individual Taxpayers Exempt from Income Tax

a. Senior citizens

The income of a qualified senior citizen is **exempt** from the payment of income tax *provided his annual taxable income does not exceed the poverty level of P60,000 per year, except interest income*. [BIR Ruling 066-2000; R.A. 7432; BIR Ruling 15-98]

b. Exemptions granted under international agreements

14. Taxation of Domestic Corporations

- a. Tax payable
- b. Allowable deductions
- c. Taxation of Passive Income
- d. Taxation of Capital Gains
- f. Tax on government-owned or controlled corporations, agencies or instrumentalities

a. Tax payable

1) Regular tax

- a. **Normal Corporate Income Tax Rate: 30%** of net taxable income

	Gross Income
Less	Allowable Deductions
	Taxable Income

NOTE: Tax rate of 30% starting January 1, 2009. Thus, read the facts and determine from what year the income is.

2) Minimum corporate income tax (MCIT)

a) Imposition of MCIT

	Gross Sales
less	Sales Returns
	Sales Returns & Allowances
	Cost of Goods Sold
	MCIT GI

- MCIT is in the nature of a **tax credit**, not an allowable deduction. Its purpose is to prevent corporations from escaping being taxed by including frivolous expenses in their statement of income.
- *Is the Minimum Corporate Income Tax (MCIT) an addition to the regular or normal income tax? No, the MCIT is not an additional tax.* The MCIT is compared with the regular income tax, which is due from a corporation. If the regular income is higher than the MCIT, then the corporation does not pay the MCIT.
- *Who are covered by MCIT?* The MCIT covers domestic and resident foreign corporations which are *subject to the*



regular income tax. The term “regular income tax” refers to the regular income tax rates under the Tax Code. Thus, corporations which are subject to a special corporate tax system do not fall within the coverage of the MCIT.

Those are:

- a) Corporations that are subject to ten percent (10%) preferential tax rate: Schools, hospitals and income of Offshore Banking Units (OBUs), and Foreign Currency Deposit Unit (FCDU) from foreign currency transactions; Regional Operating Headquarters
- b) Firms under special income tax regime such as those under the PEZA law and the Bases Conversion Development Act;
- c) International carriers subject to tax at 2 ½% of their gross Philippine billings;
- d) Newly established corporations or firms which are on their first 3 years of operations are not covered by the MCIT.

Note: For corporations whose operations or activities are partly covered by the regular income tax and partly covered under special income tax system, the MCIT shall apply on operations by the regular income tax system.

- What is “cost of goods sold”? It includes all business expenses DIRECTLY incurred to produce the merchandise to bring them to their present location and use. [Sec. 27(E)(4)]
- MCIT gross income differentiated from the normal tax gross income: the latter would include other incidental income items, such as rent income, interest, gain on sale of assets, certain tax refunds, etc.
- When is the MCIT computed?
 - beginning of the fourth taxable year immediately following the year in which such corporation commenced its business operations, and after incurring a net loss or zero taxable income, or a normal income tax that is lesser than minimum income tax.
- What amount of income tax is paid by the corporation to the BIR?
 - Whichever is HIGHER between the normal tax and the minimum corporate income tax.

Illustration:

E Co., a domestic trading corporation, in its fourth year of operations had a gross profit from sales of P300,000 and net taxable income of P100,000. How much was the income tax paid by the corporation for the year?

MCIT (P300,000 x 2%)	<u>P6,000</u>
Normal income tax (P100,000 x 35%)	<u>P35,000</u>
<i>Income Tax to be paid for the year (whichever is higher)</i>	<u>P35,000</u>

NOTE: The effective rate now is no longer 35%, but 30%.

b) Carry forward of excess minimum tax

- Any excess of the minimum corporate income tax over the normal income tax shall be carried forward and credited against the NORMAL TAX for the three (3) immediately succeeding taxable years. [Sec. 27(E)(2)] In the year to which carried forward, the normal tax should be higher than the MCIT.

Illustration:

A domestic corporation had the following data on computations of the normal tax (NT) and the minimum corporate income tax (MCIT) for five years.

	Yr 4	Yr 5	Yr 6	Yr 7	Yr 8
MCIT	80K	50K	30K	40K	35K
NT	20K	30K	40K	20K	70K

- The excess MCIT over NT carry-forward is shown below:

	Year 4	Year 5	Year 6	Year 7	Year 8
MCIT	80,000	50,000	30,000	40,000	35,000
NT	20,000	30,000	40,000	20,000	70,000
NT is higher	n/a	n/a	40,000	n/a	70,000
Less: MCIT carry-fwd			(40,000) *		(20,000)
From Year 4					(20,000)
From Year 5					
From Year 7					
Tax Due	<u>80,000</u>	<u>50,000</u>	-	<u>40,000</u>	<u>30,000</u>

- Arrow pointing downward means that the normal tax is higher so that there can be an excess MCIT carry-forward against it.

* Cannot carry forward an amount higher than the NT, hence the excess of 60K from Year 4 was reduced to 40K. The unused P20,000 cannot be used in Year 8 because Year 8 was beyond three years from Year 4.

c) Relief from the MCIT under certain conditions

- The **Secretary of Finance** is authorized to suspend the imposition of the minimum corporate income tax on any corporation which suffers **LOSSES**:
 - on account of **prolonged labor dispute** (losses from a strike staged by employees that lasts for more than 6 months and caused the temporary shutdown of operations), or
 - because of **force majeure** (acts of God and other calamity; includes armed conflicts like war or insurgency), or
 - because of **legitimate business reverses** (substantial losses due to fire, robbery, theft or other economic reasons).

Gross Income Tax (GIT)

- The President, upon the recommendation of the Secretary of Finance, may allow **domestic corporations** the option to be taxed at fifteen percent (15%) of gross income, after the following conditions have been satisfied:

Tax effort ratio	20% of GNP
Ratio of IT collection to total tax revenue	40%
VAT tax effort	4% of GNP
Ratio of Consolidated Public Sector Financial Position (CPSFP) to GNP	0.90%
Ratio of the Corporation's Cost of Sales to Gross Sales	Does not exceed 55%

Gross Sales
 less Sales Returns
 Sales Returns & Allowances
 Cost of Goods Sold

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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.

d) Corporations exempt from the MCIT

1. **B**anks and other non-bank financial intermediaries;
2. Insurance companies;
3. **P**ublicly-held corporations;
4. **T**axable partnerships;
5. **G**eneral professional partnerships;
6. **N**on-taxable joint ventures; and
7. **E**nterprises that are registered:
 - a. with the Philippine Economic Zone Authority (PEZA) under R.A. 7916;
 - b. pursuant to the Bases Conversion and Development Act of 1992 under R.A. 7227; and
 - c. under special economic zones declared by law which enjoy payment of special

tax rate on their registered operations or activities in lieu of other taxes, national or local.

Words in regular letters are found in Sec. 29(B)(2) of the NIRC. Words in italics are additions made by the revenue regulation to consolidate Sec. 29 with other pertinent laws.

e) Applicability of the MCIT where a corporation is governed both under the regular tax system and a special income tax system

For corporations whose operations or activities are partly covered by the regular income tax and partly covered under special income tax system, the **MCIT shall apply on operations by the regular income tax system.**

b. Allowable deductions

1) Itemized deductions

1. **B**AD debts;
2. **E**xpenses;
3. **L**osses;
4. **T**axes;
5. **D**epreciation;
6. **I**nterest;
7. **D**epletion of oil and gas wells & mines;
8. **C**haritable and other contributions;
9. **R**esearch and development;
10. **P**ension trusts

2) Optional standard deduction

- Before RA 9504, effective July 6, 2009, OSD only applies to individuals except non-resident alien.
- But by virtue of RA 9504, it now also applies to corporations except non-resident foreign corporation.
- Moreover, the rate was increased from 10% to 40%.

ONE LAST NOTE ON THE APPLICABILITY OF TAX RATES OF DOMESTIC CORPORATIONS: All corporations, agencies, or instrumentalities owned or controlled by the **GOVERNMENT** are **taxable** and shall pay such rate of tax upon their **taxable income** as are imposed on domestic corporations engaged in a similar business, industry, or activity.

EXCEPTIONS (i.e, not taxable):

- Government Service Insurance System (GSIS),
- Social Security System (SSS),
- Philippine Health Insurance Corporation (PHIC),
- Philippine Charity Sweepstakes Office (PCSO)

Note: Exemption for PAGCOR was withdrawn by RA 9337

c. Taxation of Passive Income

1) Passive income subject to tax

a) Interest from deposits and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements and royalties

- on any currency bank deposit, yield or any other monetary benefit from deposit substitutes, trust funds and similar arrangements - 20%

b) Capital gains from the sale of shares of stock not traded in the stock exchange

On sale, barter, exchange or other disposition of *shares of stock of a domestic corporation not listed and traded through a local stock exchange*, held as a capital asset:

- On the net capital gain:
 - Not over P100,000: Final Tax of 5%
 - On any amount in excess of P100,000: plus 10% Final tax on the excess

c) Income derived under the expanded foreign currency deposit system

- under the expanded foreign currency deposit system (EFCDS) - 7.5%

d) Inter-corporate dividends

- Dividends received from another domestic corporation - EXEMPT

e) Capital gains realized from the sale, exchange, or disposition of lands and/or buildings

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 → On the gross selling price, or the current fair market value at the time of the sale, whichever is higher, a **final tax of 6%**

- NOTE: Tax treatment is the same as that of individuals.
- The capital gains tax is applied on the gross selling price, or the current fair market value at the time of the sale, whichever is higher. Any gain or loss on the sale is immaterial because there is a conclusive presumption by law that the sale resulted in a gain.

2) Passive income not subject to tax

- Income derived by a depository bank under the expanded foreign currency deposit system 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 Bangko Sentral ng Pilipinas (BSP) to transact business with foreign currency depository system units and other depository banks under the expanded foreign currency deposit system shall be **exempt from all taxes**
 - EXCEPT: net income from transactions specified by the Secretary of Finance upon

recommendation by the Monetary Board

- BUT: Interest income from foreign currency loans granted by such depository banks under said expanded foreign currency deposit system to residents, other than offshore banking units in the Philippines 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**.

d. Taxation of Capital Gains

1) Income from sale of shares of stock

- a. On sale, barter, exchange or other disposition of *shares of stock of a domestic corporation not listed and traded through a local stock exchange*, held as a capital asset:
 - On the net capital gain:
 - Not over P100,000: Final Tax of 5%
 - On any amount in excess of P100,000: plus 10% Final tax on the excess

2) Income from the sale of real property situated in the Philippine and 3) Income from the sale, exchange, or other disposition of other capital assets

- b. 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 → On the gross selling price, or the current fair market value at the time of the sale, whichever is higher, a **final tax of 6%**
 - NOTE: Tax treatment is the same as that of individuals.
 - The capital gains tax is applied on the gross selling price, or the current fair market value at the time of the sale, whichever is higher. Any gain or loss on the sale is immaterial because there is a conclusive presumption by law that the sale resulted in a gain.

e. Tax on proprietary educational institutions and hospitals

- Tax Rate and Base - 10% on net income (except on income subject to capital gains tax and passive income subject to final tax) within and without the Philippines
- CAVEAT: If gross income from *unrelated trade* or business or other activity **exceeds 50%** of total gross income derived from all sources, the tax rate of 35% shall be imposed on the entire taxable income.
 - *Unrelated trade, business or other activity*- 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.

- *Proprietary educational institution*- any private school maintained and administered by private individuals or groups with an issued permit to operate from the DECS, CHED or TESDA.

f. Tax on government-owned or controlled corporations, agencies or instrumentalities

- The general rule is that GOCCs are **taxable** as any other corporation, except:
 - a. GSIS
 - b. SSS
 - c. PHIC
 - d. PCSO

- **General Rule:** The government is exempt from tax.

Exception: When it chooses to tax itself. Nothing can prevent Congress from decreeing that even instrumentalities or agencies of the government performing governmental functions may be subject to tax. Where it is done precisely to fulfill a constitutional mandate and national policy, no one can doubt its wisdom. (*Mactan Cebu Airport v Marcos, 1996*)

If the taxing authority is the local gov't unit: RA 7160 expressly prohibits LGUs from levying tax on the Nat'l Gov't, its agencies and instrumentalities and other LGUs.

15. Taxation of Resident Foreign Corporations

a. General rule

A resident foreign corporation is a corporation organized under the laws of a foreign country, which is engaged in trade or business in the Philippines.

- A Philippine branch of a foreign corporation duly licensed by the SEC is considered a *resident foreign corporation*. Thus, only the *income of the Philippine branch from sources within the Philippines is subject to Philippine income tax.*
- *Marubeni v. Commissioner:* As 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*. Thus, the income from sources within the Phils. 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 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.

Foreign Investment Act of 1991, Section 3. Definitions.

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d. The phrase "doing business" shall include soliciting orders, service contracts, opening offices, whether called "liaison" offices or branches; appointing representatives or distributors domiciled in the Philippines or who in any calendar year stay in the country for a period or periods totaling one hundred eighty [180] days or more; participating in the management, supervision or control of any domestic business, firm, entity or corporation in the Philippines; and any other act or acts that imply a continuity of commercial dealings or arrangements and contemplate to that extent the performance of acts or works, or the exercise of some of the functions normally incident to, and in progressive prosecution of commercial gain or of the purpose and object of the business organization: Provided, however, That the phrase "doing business" shall not be deemed to include mere investment as a shareholder by a foreign entity in domestic corporations duly registered to do business, and/or the exercise of rights as such investor; nor having a nominee director or officer to represent its interests in such corporation; nor appointing a representative or distributor domiciled in the Philippines which transacts business in its own name and for its own account;

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b. With respect to their income from sources within the Philippines

Resident foreign corporations are subject to any or some of the following:

1. Capital Gains Tax
2. Final Tax on Passive Income
3. Normal Tax [OR] Minimum Corporate Income Tax (MCIT) [OR] Gross Income Tax (GIT)
4. Branch Profit Remittance Tax

c. Minimum corporate income tax

The discussion with respect to this topic (income subject to normal tax, MCIT, or GIT) under the subheading of domestic corporations is equally applicable to resident foreign corporations, both as to concepts and computations, except that RFCs are taxed only on income from sources within the Philippines.

- **NORMAL CORPORATE INCOME TAX RATE** → 30% of net taxable income from *sources within the Philippines* [RA 9337]
- **MINIMUM CORPORATE INCOME TAX (MCIT)** → 2% of MCIT Gross Income from *sources within the Philippines*. The MCIT is imposed on RFCs



under the same conditions as domestic corporations. [Sec. 28(A)(2)]

- **GROSS INCOME TAX (GIT)** → The President, upon the recommendation of the Secretary of Finance, may allow resident foreign corporations the option to be taxed at fifteen percent (15%) of *gross income within the Philippines*, under the same conditions as domestic corporations. [Sec. 28(A)(1)]

d. Tax on certain income

(1) Interest from deposits and yield or any other monetary benefit from deposit substitutes, trust funds and similar arrangements and royalties

- on any currency bank deposit, yield or any other monetary benefit from deposit substitutes, trust funds and similar arrangements - 20%

(2) Income derived under the expanded foreign currency deposit system

- under the expanded foreign currency deposit system (EFCDS) - 7.5%

(3) Capital gain from sale of shares of stock not traded in the stock exchange

On sale, barter, exchange or other disposition of *shares of stock of a domestic corporation not listed and traded through a local stock exchange*, held as a capital asset:

- On the net capital gain:
 - Not over P100,000:

Final Tax of 5%

- On any amount in excess of P100,000: plus Final Tax of 10% on the excess

NOTE: Tax treatment is the same as that of individuals and domestic corporations. The net taxable income from the sale of real property realized by the resident foreign corporation shall be subject to the normal corporate income tax.

(4) Intercorporate dividends

- Dividends received from a domestic corporation - EXEMPT

e. Exclude:

(1) International carrier

- Tax Rate and Base - 2.5% on Gross Philippine Billings (GPB)

What is GPB?

- In the case of *International Air Carriers*, GPB 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

- gross revenue from tickets revalidated, exchanged and/or indorsed to another international airline if the passenger boards a plane in a port or point in the Philippines
- for flights which originate from the Philippines, but transshipment of passenger takes place at any port outside the Philippines on another airline, the gross revenue consisting of only the aliquot portion of the cost of the ticket corresponding to the leg flown from the Philippines to the point of transshipment [RR 15-2002]

Air Canada vs. CIR (CTA Case No. 6572):

- A foreign airline company selling tickets in the Philippines through their local agents shall be considered as resident foreign corporation engaged in trade or business in the country.
- The absence of flight operations within the Philippine territory cannot alter the fact that the income received was derived from activities within the Philippines.
- The test of taxability is the source, and the source is that activity which produced the income.
- In the case of *International Shipping*, GPB 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.

(2) Offshore banking units

- Coverage of the Rule: ONLY income derived by offshore banking units from foreign currency transactions with:
 - nonresidents,
 - other offshore banking units
 - local commercial banks including branches of foreign banks that may be authorized by the Bangko Sentral ng Pilipinas (BSP) to transact business with offshore banking units
- TAX RATE: Exempt from all taxes, *except* net income from such transactions as may be specified by the Secretary of Finance, upon recommendation by the Monetary Board to be subject to the regular income tax payable by banks
 - **EXCEPTION:** Interest income derived 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 only to a final tax at the rate of 10%.

(3) Branch profits remittances

- **Taxable transaction** - any profit remitted by a branch to its head office
- **Tax Rate and Base** - 15% based on the total profits applied or earmarked for remittance without any deduction for the tax component
- **Non-taxable activities** - activities which are registered with the Philippine Economic Zone Authority
- Income **NOT TREATED AS BRANCH PROFITS** unless effectively connected with the conduct of trade or business in the Philippines:
 - i. Interests, dividends, rents, royalties, including remuneration for technical services
 - ii. salaries, wages premiums, annuities, emoluments
 - iii. other fixed or determinable annual, periodic or casual gains, profits, income
 - iv. capital gains received during each taxable year from all sources within the Philippines

NOTES:

- imposed whether the head office of the foreign corporation is located in a tax treaty country, in a tax haven or other non-treaty country.
- imposed only on the profits remitted by a Philippine branch to the head office of a *foreign* corporation.

- **OPTIONAL STANDARD DEDUCTION**

- 40% of its gross income (RA 9504, effective July 6, 2008)

(4) Regional or area headquarters and Regional operating headquarters of multinational companies

- **Regional or area headquarters:** not subject to income tax
- **Regional or area headquarters:** 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.
- | | | |
|--|---------------------|------------------|
| | <i>Regional</i> | <i>operating</i> |
| | <i>headquarters</i> | |

 - 10% of their taxable income
 - a branch established in the Philippines by multinational companies which are engaged in any of the following services:
 - (SMART - BAD - PPL)
 1. general Administration and planning
 2. business Planning and coordination
 3. sourcing and Prourement 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
10. Data processing and communications, and
11. Business development.

16. Taxation of Non-resident Foreign Corporations

a. General rule

35% of the gross income received 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 resulting from the sale of shares of stock of a domestic corporation not listed and traded through a local stock exchange, held as a capital asset.

b. Tax on certain income

(1) Interest on foreign loans

- on **foreign loans** contracted on or after August 1, 1986 - 20%
- under the expanded foreign currency deposit system (EFCDS) - **EXEMPT**

(2) Intercorporate dividends

- (Intercorporate Dividend) - 15%, **AS LONG AS** the country in which the nonresident foreign corporation is domiciled allows a tax credit for taxes "deemed paid" in the Philippines equivalent to 15%
- 20% represents the difference between the regular income tax of 35% on corporations and the 15% tax on dividends
- If the country within which the NRFC is domiciled does NOT allow a tax credit, a final withholding tax at the rate of 35% is imposed on the dividends received from a domestic corporation. [In other words, the dividends are subject to the third kind of tax: Final Tax on [Other] Gross Income from sources within the Philippines.]

(3) Capital gains from sale of shares of stock not traded in the stock exchange

On sale, barter, exchange or other disposition of *real property* or on *shares of stock of a domestic corporation not listed and traded through a local stock exchange*, held as a capital asset:

- On the net capital gain:
 - Not over P100,000 Final Tax of 5%
 - On any amount in excess of P100,000 plus Final Tax of 10% on the excess

NOTE: The gross income from the sale of real property realized by the non-resident foreign corporation shall be subject to a 35% final tax imposed on gross income from sources within the Philippines.



c. Exclude:

(1) Non-resident cinematographic film owner, lessor or distributor

- 25% of gross income from all sources within the Philippines

(2) Non-resident owner or lessor of vessels chartered by Philippine nationals

- 4.5% of gross rentals, lease or charter fees from leases or charters to Filipino citizens or corporations, as approved by the Maritime Authority

(3) Non-resident owner or lessor of aircraft machineries and other equipment

- 7.5% of gross rentals or fees

Summary of Tax Bases and Rates of Special Corporations

QUICK GLANCE

Type of Corporation	Tax Base	Tax Rate
Domestic Corporations		
Proprietary Educational Institutions and Hospitals (Non-profit)	Taxable Income from all sources	10%
Depository Banks (Foreign Currency Deposit Units) ❖ With respect to income derived under the expanded foreign currency deposit system from certain foreign currency transactions	Exempt (except that net income from such transactions is subject to the regular income tax payable by banks)	-
❖ With respect to interest income from foreign currency loans to residents other than offshore units in the Philippines or other depository banks under the expanded system	Amount of interest income	10%
Resident Foreign Corporations		
International Carriers	Gross Philippine Billings	2.5%
Offshore Banking Units ❖ With respect to income derived by offshore banking units from certain foreign currency transactions	Exempt (except that net income from such transactions is subject to the regular income tax payable by banks)	-
❖ With respect to		

interest income derived from foreign currency loans granted to residents other than offshore banking units or local commercial banks	Amount of interest income	10%
Resident Depository Bank (Foreign Currency Deposit Units) ❖ With respect to income derived under the expanded foreign currency deposit system from certain foreign currency transactions	Exempt (except that net income from such transactions is subject to the regular income tax payable by banks)	-
❖ With respect to interest income from foreign currency loans to residents other than offshore units in the Philippines or other depository banks under the expanded system	Amount of interest income	10%
Regional or Area Headquarters	Exempt	-
Regional Operating Headquarters of Multinational Companies	Taxable Income from within the Philippines	10%
Non-resident Foreign Corporations		
Non-resident cinematographic film owners, lessors or distributors	Gross Income from the Philippines	25%
Nonresident Owner or Lessor of Vessels Chartered by Philippine Nationals	Gross Rentals, Lease and Charter Fees from the Philippines	4.5%
Nonresident Owner or Lessor of Aircraft, Machineries and Other Equipment	Gross Rentals, Charges and Fees from the Philippines	7.5%

17. Improperly Accumulated Earnings of Corporations

[Sec. 29, as implemented by RR 2-2001 which prescribes rules governing the imposition of IAET]

- a) **Rule** → There is imposed for each taxable year, in addition to other taxes, a tax equal to **10% of the improperly accumulated taxable income of domestic and closely-held corporations** formed or availed of for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by

permitting the earnings and profits of the corporation to accumulate instead of dividing them among or distributing them to the shareholders.

- b) **Rationale** → It is a tax in the nature of a **PENALTY** to the corporation for the improper accumulation of its earnings, and a **DETERRENT** to the avoidance of tax upon shareholders who are supposed to pay dividends tax on the earnings distributed to them.
- c) **Exception** → 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.
- d) **Composition:** The following constitute accumulation of earnings for the *reasonable needs* of the business: **(ILL ABE)**
 - 1) **ALLOWANCE** for the increase in the accumulation of earnings *up to 100% of the paid-up capital* of the corporation as of Balance Sheet date, inclusive of accumulations taken from other years;
 - 2) Earnings reserved for definite corporate **EXPANSION projects or programs** requiring considerable capital expenditure as approved by the Board of Directors or equivalent body;
 - 3) Earnings reserved for **BUILDING, PLANT or EQUIPMENT ACQUISITION** as approved by the Board of Directors or equivalent body;
 - 4) Earnings reserved for compliance with any **LOAN COVENANT** or pre-existing obligation established under a legitimate business agreement;
 - 5) Earnings required by **LAW** or applicable regulations to be retained by the corporation or in respect of which there is legal prohibition against its distribution;
 - 6) In the case of subsidiaries of foreign corporations in the Philippines, all undistributed earnings intended or reserved for **INVESTMENTS WITHIN THE PHILIPPINES** as can be proven by corporate records and/or relevant documentary evidence.
- e) **Covered Corporations** → Only **domestic and closely-held corporations** are liable for IAET. **Closely-held corporations** are those:
 - 1) at least **50%** in value of the outstanding capital stock; or

- 2) 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.**

To determine whether the corporation is *closely held corporation*, insofar as such determination is based on stock ownership, the following **RULES** shall be applied:

- a. **Stock Not Owned by Individuals.** - Stock owned directly or indirectly by or for a corporation, partnership, estate or trust shall be considered as being owned proportionately by its shareholders, partners or beneficiaries.
- b. **Family and Partnership Ownership.** - An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family, or by or for his partner.

For purposes of this paragraph, the ‘family of an individual’ includes his brothers or sisters (whether by whole or half-blood), spouse, ancestors and lineal descendants.
- c. **Option to Acquire Stocks.** - If any person has an option to acquire stock, such stock shall be considered as owned by such person.

For purposes of this paragraph, an option to acquire such an option and each one of a series of option shall be considered as an option to acquire such stock.
- d. **Constructive Ownership as Actual Ownership.** - Stock constructively owned by reason of the application of (a) or (c) shall, for purposes of applying (1) or (2), be *treated as actually owned* by such person.

But stock constructively owned by the individual by reason of the application of (b) shall **NOT be treated as owned by him** for purposes of again applying such paragraph in order to make another the constructive owner of such stock.

BIR Ruling 025-02 → The ownership of a domestic corporation for purposes of determining whether it is a closely held corporation or a publicly held corporation is ultimately traced to the individual shareholders of the parent company.

Where at least 50% of the outstanding capital stock or at least 50% of the total combined voting power of all classes of stock entitled to vote in a corporation is owned directly or indirectly by at least 21 or more individuals, the corporation is considered as publicly held corporation.

18. Exemption from tax on corporations

[Sec. 30]
(CREB-CLEF-SMB)



- The following organizations shall **not be taxed** in respect to income received by them as such (e.g. membership fees):
1. **LABOR**, agricultural or horticultural organization not organized principally for profit
 2. **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
 3. A **BENEFICIARY society**, order or association, *operating for the exclusive benefit of the members* such as a fraternal organization operating under the lodge system, or mutual aid association or a non-stock 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 non-stock corporation or their dependents
 4. **CEMETERY** company owned and operated exclusively for the benefit of its members
 5. Non-stock 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 inure to the benefit of any member, organizer, officer or any specific person*
 6. **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
 7. **CIVIC league** or organization not organized for profit but operated exclusively for the *promotion of social welfare*
 8. A non-stock and nonprofit **EDUCATIONAL** institution
 9. Government **EDUCATIONAL** institution
 10. **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

11. **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;

ALSO: Regional or Area Headquarters under Sec. 22 (DD) - not subject to income tax

- Notwithstanding the exemptions, income of whatever kind and character of the enumerated organizations from any of their properties, real or personal, or from any of their activities conducted for profit regardless of the disposition made of such income, shall be **SUBJECT TO TAX**.
- National Power Corporation (NPC) in general is subject to income tax. [RA 9337]

19. Taxation of Partnerships

A. Classification of Partnerships for Tax Purposes

1. General Professional Partnerships (GPP) - 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
2. Other Partnerships (or General Co-partnerships) - partnerships wherein all or part of their income is derived from the conduct of trade or business. An ordinary business partnership is considered as a corporation and is thus subject to tax as such.

B. Other Partnerships (or General Co-partnerships)

Rules:

1. The partnership is subject to the same rules on corporations (capital gains tax, final tax on passive income, normal tax, minimum corporate income tax [MCIT] and gross income tax [GIT]), but is not subject to the improperly accumulated earnings tax [IAET]. The partnership must file quarterly and year-end income tax returns.
2. The taxable income of the partnership, less the normal corporate income tax (30%) thereon, is the distributable net income of the partnership.
3. The share of a partner in the partnership's distributable net income of a year 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. [Sec. 73(D)] Such share will be subjected



to a final tax of 10% to be withheld by the partnership. [Sec. 24(B)(2)]

- **Co-ownership:** 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.
- When Co-ownership is not subject to tax
When the co-ownership's activities are limited merely to the preservation of the co-owned property. The co-owners are only liable for income tax in their separate and individual capacities.
- When Co-ownership is subject to tax When the income of the co-ownership is invested by the co-owners in business, the co-owners have in effect constituted themselves into a partnership. In such a case, the co-ownership shall be subject to tax as a corporation.

Automatically converted into an unregistered partnership the moment the said common properties and/or the incomes derived from them 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. [Ona v. CIR, May, 25 1972]

D. Joint Venture and Consortium

A joint venture is created when two corporations, while registered and operating separately, were placed under one sole management which operated the business affairs of said companies as though they constituted a *single entity thereby obtaining substantial economy and profits in operation.*

A joint venture is not taxed as a corporation, and is taxed just like a general professional partnership (meaning, taxed on the individual company's share in the profits).

But, if the joint venture is engaged in any other line of business than construction or energy-related activity with operating contract with the government, the same will be treated as a taxable corporation.

Factors essential to constitute a joint venture

- a. Each party to the venture must make a *contribution*, not necessarily of capital, but by way of services, skill, knowledge, material or money;
- b. *Profits must be shared* among the parties;
- c. There must be a *joint proprietary interest and right of mutual control* over the subject matter of the enterprise;
- d. Usually, there is a *single business transaction*. (BIR Ruling No. 317-92)

Two elements necessary to exempt a joint venture or consortium from tax

- a. The joint venture must be an unincorporated entity formed by two or more persons
- b. The joint venture was formed for the purpose of *undertaking a construction project, or engaging in the petroleum and other energy operations* with operating contract with the government.

20. Taxation of General Professional Partnerships

Rules:

- A GPP as such shall not be subject to the income tax. It is NOT a taxable entity for income tax purposes.
- The partners shall only 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 GPP 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.
- The share of a partner shall be subject to a creditable withholding income tax of 15%. (RR 2- 1998)
- If the partnership sustains a net operating loss, the partners shall be entitled to deduct their respective shares in the net operating loss from their individual gross income.

NOTES:

- **GPP is not a taxable entity**
 - 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. (RR 2- 1998)
- 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. (Mamalateo)

21. Taxation on Estates and Trusts

a) Application

b) Exception

c) Determination of tax

1) Consolidation of income of two or more trusts

- Where, in the case of two or more trusts, the creator of the trust in each instance is the same person, and the beneficiary in each instance is the same, the taxable income of all the trusts shall be consolidated and the tax 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. 60C(2), NIRC]

Requisites:

- (a) 2/more trusts exist
- (b) creator of the trust in each instance is the same person
- (c) beneficiary in each instance is the same

Trust as a Device to Lower Income Tax

- Creating a trust could lower the income tax by splitting the income between two taxpayers, and consequently lowering the taxable income to lower tax bracket.

2) Taxable income

3) Revocable trusts

- **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
 - a. 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
 - b. 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. 63, NIRC]

4) Income for benefit of grantor

- Where any part of the income of a trust
 - a. 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
 - b. 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

- c. 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.* (Sec. 64, NIRC)

5) Meaning of “in the discretion of the grantor”

NOTE: '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.

22. Withholding tax

- a. Concept
- b. Kinds
- c. Withholding on wages
- d. Withholding of VAT
- e. Filing of return and payment of taxes withheld
- f. Final withholding tax at source
- g. Creditable withholding tax
- h. Fringe benefit tax

a. Concept

Withholding tax is a method of collecting income tax in advance from the taxable income of the recipient of income.

Withholding Agent: any person or entity who is required to deduct and remit the taxes withheld to the government.

- a. In general, any juridical person, whether or not engaged in trade or business;
- b. An individual, with respect to payments made in connection with his trade or business. However, insofar as taxable sale, exchange or transfer of real property is concerned, individual buyers who are not engaged in trade or business are also constituted as withholding agents; and
- c. All government offices, including GOCCs, as well as local government units. (Mamalateo)

Duties and Obligations of the Withholding Agent:

- a. To Register - withholding agent is required to register within ten (10) days after acquiring such status with the Revenue District office having jurisdiction where the business is located
- b. To Deduct and Withhold - withholding agent is required to deduct tax from all money payments subject to withholding tax
- c. To Remit the Tax Withheld - withholding agent is required to remit tax withheld at the time prescribed by law and regulations



- d. To File Annual Return - withholding agent is required to file the corresponding Annual Information Return at the time prescribed by law and regulations
- e. To Issue Withholding Tax Certificates - withholding agent shall furnish Withholding Tax Certificates to recipient of income payments subject to withholding (Available, BIR Website)

b. Kinds

1) Withholding of final tax of 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 specific section of the NIRC 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 the NIRC.

2) 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%), which shall be credited against the income tax liability of the taxpayer for the taxable year.

Withholding of Creditable Tax (RR 2-98)

- Under the **creditable withholding tax** system, taxes withheld on certain income payments are **intended to equal or at least approximate** the tax due of the payee on said income.
- The income recipient is still required to file an income tax return, to report the income and/or pay the difference between the tax withheld and the tax due on the income.
- Taxes withheld on income payments covered by the expanded withholding tax and compensation income are creditable in nature.

c. Withholding on wages

1) Requirement for 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.
- **EXCEPTION:** 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.*

2) Tax paid by recipient

- If the employer fails to deduct and withhold the tax 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 shall not relieve the employer from liability for any penalty or addition to the tax otherwise applicable in respect of such failure to deduct and withhold.

3) Refunds or credits

(1) **Employer.** - When there has been an **overpayment of tax**, 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 during any calendar year shall be allowed as a credit to the recipient of such income against the tax imposed under Section 24(A). 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 the Administrative Code of 1987.

4) 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.

5) 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. If the employer fails to withhold and remit the correct



amount of tax as required to be withheld, 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.

d. Withholding of VAT

- On gross payments for the purchase of goods
- On gross payments for the purchase of services
- Payments made to government public works contractors
- Payments for lease or use of property or property rights to non-resident owners

e. Filing of return and payment of taxes withheld

Where to file and pay:

- Authorized agent bank;
- Collection Agent;
- the duly authorized Treasurer of the city or municipality where the employer has his legal residence or principal place of business, or in case the employer is a corporation, where the principal office is located; or
- As Commissioner otherwise permits.

Period for filing and payment:

- The return shall be filed and the payment made within twenty-five (25) days from the close of each calendar quarter.
- 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.

Taxes as Special Fund in Trust: 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.

1) 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.

2) Statements and returns

Every employer required to deduct and withhold a tax shall:

- Furnish to each such employee in respect of his employment a written statement confirming the wages paid by the employer to such employee during the calendar year, and the amount of tax deducted and withheld and such other information as the Commissioner may prescribe
 - 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
- Submit to the Commissioner an annual information return on or before January thirty-first (31st) of the succeeding year containing:
 - A list of employees;
 - The total amount of compensation income of each employee;
 - The total amount of taxes withheld therefrom during the year, accompanied by copies of the written statements furnished to employees, and such other information as may be deemed necessary.

The Commissioner may grant to any employer a reasonable extension of time to furnish and submit the statements and returns required.

f. Final withholding tax at source

- Under the final withholding tax system, the amount of income tax withheld by the withholding agent is constituted as a full and final payment of the income tax due from payee on the said income. The liability for payment of the tax rests primarily on the payor as a withholding agent. Thus, in case of the withholding agent's failure to withhold the tax or in case of under-withholding, the deficiency tax shall be collected from him. The payee is not required to file an income tax return for the particular income, nor is he liable for the payment of the tax. (Sec. 2.57, RR No. 2-98)

Income payments subject to Final Withholding Tax:

a) Income Payments to a Citizen or to a Resident Alien Individual:

- Interest on any peso bank deposit
- Royalties

- Prizes (except prizes amounting to P10,000 or less which is subject to tax under Sec. 25(A)(1) of the Tax Code
- Winnings (except from Philippine Charity Sweepstake Office and Lotto)
- Interest income on foreign currency deposit
- Interest income from long term deposit
- Cash and/or property dividends
- Capital Gains presumed to have been realized from the sale, exchange or other disposition of real property

b) Income Payments to a Non-Resident Alien Engaged in Trade or Business in the Philippines

- On Certain Passive Income
 - cash and/or property dividend
 - Share in the distributable net income of a partnership
 - Interest on any bank deposits
 - Royalties
 - Prizes (except prizes amounting to P10,000 or less which is subject to tax under Sec. 25(A)(1) of the Tax Code.
 - Winnings (except from Philippine Charity Sweepstake Office and Lotto)
- Interest on Long Term Deposits
- Capital Gains presumed to have been realized from the sale, exchange or other disposition of real property

c) Income Derived from All Sources Within the Philippines by a Non-Resident Alien Individual Not Engaged in Trade or Business

- On gross amount of income derived from all sources within the Philippines
- On Capital Gains presumed to have been realized from the sale, exchange or disposition of real property located in the Philippines

d) Income Derived by Alien Individual Employed by a Regional or Area Headquarters and Regional Operating Headquarters of Multinational Companies

e) Income Derived by Alien Individual Employed by Offshore Banking Unit

f) Income of Aliens Employed by Foreign Petroleum Service Contractors and Subcontractors

g) Income Payment to a Domestic Corporation

- Interest from any currency bank deposits and yield or any other monetary benefit from deposit substitutes and from trust fund and similar arrangements derived from sources within the Philippines
- Royalties derived from sources within the Philippines
- Interest income derived from a depository bank under the Expanded Foreign Currency Deposit (FCDU) System
- Income derived by a depository bank under the FCDU from foreign transactions with local commercial banks

- On capital gains presumed to have been realized from the sale, exchange or other disposition of real property located in the Philippines classified as capital assets, including pacto de retro sales and other forms of conditional sales based on the gross selling price or fair market value as determined in accordance with Sec. 6(E) of the NIRC, whichever is higher

h) Income Payments to a Resident Foreign Corporation

- Offshore Banking Units
- Tax on branch Profit Remittances
- Interest on any currency bank deposits and yield or any other monetary benefit from deposit substitute and from trust funds and similar arrangements and royalties derived from sources within the Philippines
- Interest income on FCDU
- Income derived by a depository bank under the expanded foreign currency deposits system from foreign currency transactions with local commercial banks

i) Income Derived from all Sources Within the Philippines by a Non-Resident Foreign Corporation

- Gross income from all sources within the Philippines such as interest, dividends, rents, royalties, salaries, premiums (except re-insurance premiums), annuities, emoluments or other fixed determinable annual, periodic or casual gains, profits and income or capital gains
- Gross income from all sources within the Philippines derived by a non-resident cinematographic film owner, lessor and distributor
- On the gross rentals, lease and charter fees derived by a non-resident owner or lessor of vessels from leases or charters to Filipino citizens or corporations as approved by the Maritime Industry Authority
- On the gross rentals, charter and other fees derived by a non-resident lessor of aircraft, machineries and other equipment
- Interest on foreign loans contracted on or after August 1, 1986

j) Fringe Benefits Granted to the Employee (except Rank and File)

- Goods, services or other benefits furnished or granted in cash or in kind by an employer to an individual employee (except rank and file) such as but not limited to the following:
 - Housing
 - Vehicle of any kind
 - Interest on loans
 - Expenses for foreign travel
 - Holiday and vacation expenses
 - Educational assistance to employees or his dependents
 - Membership fees, dues and other expense in social and athletic clubs or other
 - similar organizations



- Health insurance
- Informers Reward

g. Creditable withholding tax

- Taxes withheld on certain income payments are intended to equal or at least approximate the tax due of the payee on the income.

1) Expanded withholding tax

- a kind of withholding tax which is prescribed on certain income payments and is creditable against the income tax due of the payee for the taxable quarter/year in which the particular income was earned.
- An income payment is subject to the expanded withholding tax if the following conditions concur:
 - An expense is paid or payable by the taxpayer, which is income to the recipient thereof subject to income tax;
 - The income is fixed or determinable at the time of payment;
 - The income is one of the income payments listed in the regulations that is subject to withholding tax;
 - The income recipient is a resident of the Philippines liable to income tax; and
 - The payor-withholding agent is also a resident of the Philippines.

Income payments subject to Expanded Withholding Tax:

- a. Professional fees / talent fees for services rendered by the following:
 - Those individually engaged in the practice of profession or callings
 - Professional entertainers such as but not limited to actors and actresses, singers and emcees
 - Professional athletes including basketball players, pelotaris and jockeys
 - Directors involved in movies, stage, radio, television and musical directors
 - Insurance agents and insurance adjusters
 - Management and technical consultants
 - Bookkeeping agents and agencies
 - Other recipient of talent fees
 - Fees of directors who are not employees of the company paying such fees whose duties are confined to attendance at and participation in the meetings of the Board of Directors
- b. Professional fees, talent fees, etc for services of taxable judicial persons
- c. Rental of real property (in excess of P 10,000) used in business
- d. Rental of personal properties in excess of P 10,000 annually
- e. Rental of poles, satellites and transmission facilities
- f. Rental of billboards

- g. Cinematographic film rentals and other payments
- h. Income payments to certain contractors
 - General engineering contractors
 - General building contractors
 - Specialty contractors
 - Other contractors like:
 - Transportation contractors
 - Filling, demolition and salvage work contractors and operators of mine drilling apparatus
 - Operators of dockyards
 - Persons engaged in the installation of water system, and gas or electric light, heat or power
 - Operators of stevedoring, warehousing or forwarding establishments
 - Printers, bookbinders, lithographers and publishers, except those principally engaged in the publication or printing of any newspaper, magazine, review or bulletin which appears at regular intervals, with fixed prices for subscription and sale
 - Advertising agencies, exclusive of payments to media
 - Independent producers of television, radio and stage performances or shows
 - Independent producers of "jingles"
 - Labor recruiting agencies
 - Persons engaged in the installation of elevators, central air conditioning units, computer machines and other equipment and machineries and the maintenance services thereon
 - Messengerial, janitorial, security, private detective and other business agencies
 - Persons engaged in landscaping services
 - Persons engaged in the collection and disposal of garbage
 - TV and radio station operators on sale of TV and radio airtime, and
 - TV and radio blocktimers on sale of TV and radio commercial spots
 - Persons engaged in the sale of computer services, computer programmers, software developer/designer, etc.
- i. Income distribution to the beneficiaries of estates and trusts
- j. Gross commission or service fees of customs, insurance, stock, real estate, immigration and commercial brokers and fees of agents of professional entertainers
- k. Commission, rebates, discounts and other similar considerations paid/granted to independent and exclusive distributors, medical/technical and sales representatives and marketing agents and sub-agents of multi level marketing companies

- l. Income payments to partners of general professional partnerships
- m. Payments made to medical practitioners through a duly registered professional partnership
- n. Payments for medical/dental/veterinary services thru hospitals/clinics/health maintenance organizations, including direct payments to service providers
- o. Gross selling price or total amount of consideration or its equivalent paid to the seller/owner for the sale, exchange or transfer of real property
- p. Additional income payments to government personnel from importers, shipping and airline companies or their agents
- q. Certain income payments made by credit card companies
- r. Income payments made by the top 10,000 private corporations to their purchase of goods and services from their local/resident suppliers other than those covered by other rates of withholding
- s. Income payments by government offices on their purchase of goods and services, from local/resident suppliers
- t. Tolling fees paid to refineries
- u. Payments made by pre-need companies to funeral parlors
- v. Payments made to embalmers by funeral parlors
- w. Income payments made to suppliers of agricultural products
- x. Income payments on purchases of mineral, mineral products and quarry resources

2) Withholding tax on compensation

- the tax withheld from income payments to individuals arising from an employer-employee relationship.

Compensation is any remuneration received for services performed by an employee from his employer under an employee-employer relationship.

The different kinds of compensation are:

- Regular compensation - includes basic salary, fixed allowances for representation, transportation and others paid to an employee
- Supplemental compensation - includes payments to an employee in addition to the regular compensation such as but not limited to the following:
 - Overtime Pay
 - Fees, including director's fees
 - Commission
 - Profit Sharing
 - Monetized Vacation and Sick Leave
 - Fringe benefits received by rank & file employees
 - Hazard Pay
 - Taxable 13th month pay and other benefits
 - Other remunerations received from an employee-employer relationship

Exemptions from Withholding tax on compensation:

- Remuneration as an incident of employment
- Retirement benefits received under RA 7641
- Any amount received by an official or employee or by his heirs from the employer due to death, sickness or other physical disability or for any cause beyond the control of the said official or employee such as retrenchment, redundancy or cessation of business
- Social security benefits, retirement gratuities, pensions and other similar benefits
- Payment of benefits due or to become due to any person residing in the Philippines under the law of the US administered US Veterans Administration
- Payment of benefits made under the SSS Act of 1954, as amended
- Benefits received from the GSIS Act of 1937, as amended, and the retirement gratuity received by the government employee
- Remuneration paid for agricultural labor
- Remuneration for domestic services
- Remuneration for casual labor not in the course of an employer's trade or business
- Compensation for services by a citizen or resident of the Philippines for a foreign government or an international organization
- Payment for damages
- Proceeds of Life Insurance
- Amount received by the insured as a return of premium
- Compensation for injuries or sickness
- Income exempt under Treaty
- Thirteenth (13th) month pay and other benefits (not to exceed P 30,000)
- GSIS, SSS, Medicare and other contributions

Persons not subject to Withholding Tax on Compensation:

- Any employee whose total compensation income does not exceed the statutory minimum wage of Five Thousand (P 5,000.00) Pesos a month or Sixty Thousand (P 60,000.00) Pesos a year is not subject to Withholding Tax on Compensation.
 - NOTE: Employees, whose total annual compensation do not exceed P 60,000, shall be given two options with which to pay his income tax due as follows:
 - His compensation income shall be subjected to withholding tax, but he shall not be required to file the income return prescribed in Section 51 of the Code (filing of an individual return) except when covered by any of the situations enumerated in Sec. 2.83.4 of Revenue Regulations No. 2-98; or
 - His compensation income shall not be subject to withholding tax but he shall file his annual income tax return and pay

the tax due thereon, annually.

- When the employee has opted to have his compensation income subjected to Withholding tax so as to be relieved of the obligation of filing an annual Income Tax return and paying his tax due on a lump sum basis, he shall execute a waiver in a prescribed BIR Form of his exemption(s) from withholding, which shall constitute the authority for the employers to apply the withholding tax table provided under Revenue Regulations No. 2-98.

h. Fringe benefit tax

A. 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** (The fringe benefit covered by Sec 33 refers to those enjoyed by managerial and supervisory employees.)

Key definitions:

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*.

Examples of fringe benefits:

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 in social and athletic clubs or other similar organizations
7. Expenses for foreign travel
8. Holiday and vacation expenses
9. Educational assistance to the employee or his dependents
10. Life or health insurance and other non-life insurance premiums or similar amounts in excess of what the law allows

B. Tax Rate and Tax Base

- [Generally] 32% of the grossed-up monetary value (GMV)
- GMV represents the whole amount of income realized by the employee.

How GMV is determined

- GMV is determined by dividing the actual monetary value of the fringe benefit by 68% [100% - tax rate of 32%]. For example, the actual monetary value of the fringe benefit is P1,000. The GMV is equal to P1,470.59 [P1,000 / 0.68]. The fringe benefit tax, therefore, is P470.59 [P1470.59 x 32%].

Special Cases:

- For fringe benefits received by non-resident alien not engaged in trade of business (NRANETB), the tax rate is 25% of the grossed-up monetary value (GMV). The GMV is determined by dividing the actual monetary value of the fringe benefit by 75% [100% - 25%].
- For fringe benefits received by alien individuals and Filipino citizens employed by regional or area headquarters, regional operating headquarters, offshore banking units (OBUs), or foreign service contractor, the tax rate is 15% of the grossed-up monetary value (GMV). The GMV is determined by dividing the actual monetary value of the fringe benefit by 85% [100% - 15%].
- What is the tax implication if the employer gives 'fringe benefits' to 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.**

Payor of Fringe Benefit Tax (FBT) - the employer [but the law allows the employer to deduct such tax as a business expense, in determining his taxable income]

C. Fringe Benefits Which Are Not Taxable

[Sec. 33 of the NIRC, consolidated with Sec. 2.33(C) of RR 03-98] [RED CNC]

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
4. **DE MINIMIS** benefits
5. If the grant of fringe benefits to the employee is required by the nature of, or **NECESSARY to the trade, business, or profession** of the employer
6. If the grant of fringe benefits is for the **CONVENIENCE of the employer** [Convenience of the Employer Rule]

NOTES:



De minimis benefits - those which are of relatively small value are offered by the employer as a means of promoting health, goodwill, contentment, or efficiency of his employees, such as the following: (CLAMMP - RUST)

1. Monetized unused **vacation leave credits** of *private employees not exceeding ten (10) days* during the year and the monetized **value of leave credits paid to government officials and employees**;
2. **Medical cash allowance to dependents** of employees *not exceeding P750 per semester or P125 per month*;

BIR Ruling 019-02: To be considered “de minimis” medical allowance, the following conditions must concur:

- a. The amount given to the EE shall be for his own medical expense;
- b. The amount actually given and actually spent shall not exceed P10, 000 in any given calendar year;
- c. The EE must fully substantiate with or in his name the medical allowance to be granted.

3. **Rice subsidy of Php1,500 or one sack of 50-kg rice per month amounting to not more than Php1500 (RR5-08)**;
4. **Uniforms** given to employees by the employer not exceeding **Php4,000 per annum** (RR5-08);
5. **Actual yearly medical benefits** not exceeding **Php10,000 per annum**
6. **Laundry allowance of P300 per month**;
7. **Employee achievements awards** ,e.g., for length of service or safety achievement, which must be in the form of **tangible personal property other than cash or GC** with an annual monetary value **not exceeding Php10,000** received by the employee under an established written plan which does not discriminate in favor of highly paid employees;
8. **Gifts given during Christmas (not bonus) and major anniversary celebrations** not exceeding **Php5,000 per employee per annum**;
9. Flowers, fruits, books, or similar items given to employees under special circumstances, e.g., on account of illness, marriage, birth of a baby etc;
10. Daily meal allowance for OT work not exceeding **25% of basic MW**

- **Tax 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:
- *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 amount).

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

Examples of Convenience of the Employer Rule:

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

2012 UP LAW BAR REVIEWER



TAXATION LAW

Taxation Law 2

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Taxation Law 2

TAXATION LAW

Taxation Law 1
Taxation Law 2

1. Estate Tax
2. Donor's Tax
3. VAT
4. Tax Remedies
5. Organization and Function of BIR
6. Local Taxation
7. Real Property Taxation
8. Tariff and Customs Code
9. Judicial Remedies

1. Estate Tax

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- II. Definition
- III. Nature
- IV. Purpose or object
- V. Time and transfer of property
- VI. Classification of decedent
- VII. Gross estate v. Net estate
- VIII. Determination
- IX. Composition
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- XI. Deductions from estate
- XII. Exclusions from estate
- XIII. Tax credit
- XIV. Exemption
- XV. Filing of notice of death
- XVI. Estate tax return

I. Basic principles

Estate tax laws rest in their essence upon the principle that death of an individual is the generating source from which the taxing power takes its being, and that it is the power to transmit or the transmission from the dead to the living on which the tax is more immediately based. (*Lorenzo v. Posadas, 64 Phil 353*)

I. Definition

- A **graduated tax** imposed upon the privilege of the decedent to transmit property at death and is **based on the entire net estate**.
- Tax on the right to transmit property at death and on certain transfers which are made by the statute the equivalent of testamentary dispositions and is measured by the value of property at time of death

II. Nature

- Estate tax is laid neither on the property nor on the transferor or the transferee. It is an excise tax or privilege tax.

III. Purpose or object

- Its object is to tax the shifting of economic benefits and enjoyment of property from the dead to the living.

Purpose:

1. *Added income* to the government
2. *Benefit received theory* → for services that the government renders in the distribution of the estate
3. *Privilege theory or state partnership* → not a right but a privilege, acquired with the protection of the state
4. *Ability to pay theory* → transfer assets and makes the transferee able to pay/contribute to the governmental income
5. *Redistribution of wealth theory* → receipt of inheritance is a contributing factor to the inequalities in wealth and income, mitigate the evils of inheritance in its original form

IV. Time and Transfer of Properties

- The law in force at the time of death of the decedent governs.
- The accrual of the inheritance tax is distinct from the obligation to pay the same. The tax therefore is upon transmission or the transfer or devolution of property of a decedent, made effective by his death. It is in reality an excise or privilege tax imposed on the right to succeed to, receive, or take property by or under a will or the intestacy law, or deed, grant, or gift to become operative at or after death. The time when the heirs legally succeed to the inheritance may differ from the time when the heirs actually receive such inheritance. (*Lorenzo v. Posadas, 64 Phil 353*)

TAXABLE TRANSFERS

1. **Transfers *Mortis Causa*** - Gratuitous transfers after death, either testate or intestate.
2. **Transfers *Inter Vivos*** - Generally attract donor's tax. However, certain transfers inter vivos are treated as testamentary dispositions and are accordingly included in the computation of the gross estate in order to arrive at the proper estate tax liability.
 - a. Transfers in contemplation of death
 - b. Transfer with retention or reservation of certain rights
 - c. Revocable transfers
 - d. Transfers of property arising under general power of appointment
 - e. Transfers for insufficient consideration

V. Classification of decedent

- The decedent may be classified into citizen, and resident alien and non-resident alien.

"residence"

- It refers to the permanent home, the place to which whenever absent, for business or pleasure, one intends to return, and depends on



facts and circumstances, in the sense that they disclose intent. (*Corre v. Tan Corre*, 100 Phil 321)

- It is, therefore, not necessarily the actual place of residence. The term “residence” and “domicile” are synonymous and are used interchangeably without distinction. (*Collector v. Lara*, 102 Phil 813; *Velilla v. Posadas*, 62 Phil 624).

VI. Gross estate v. Net estate

- Gross Estate:** includes all properties and interests in properties of the decedent at the time of his death
- Net Estate:** value of the estate after all deductions have been made against the gross estate; subject to the graduated tax rates

VALUATION OF THE GROSS ESTATE (Sec. 88)

GENERAL RULE: The properties comprising the gross estate shall be valued based on FAIR MARKET VALUE (FMV) as of the time of death.

Real property - F MV as determined by the Commissioner OR FMV as shown in the schedule of values fixed by the provincial and city assessors, whichever is HIGHER.

Shares of Stock

- Listed shares** - FMV is the arithmetic mean between the highest and lowest quotation at a date of death, OR the date nearest the date of death, if none is available on the date of death itself
- Unlisted shares** - COMMON shares are valued based on BOOK VALUE; while PREFERRED shares are valued at PAR VALUE
- Right to usufruct, use or habitation, annuity** - the probable life of the beneficiary in accordance with the latest basic standard mortality table is to be taken into account, to be approved by the Secretary of Finance, upon recommendation of the Insurance Commissioner.

TAX RATES APPLICABLE:

If the net estate is:

OVER	BUT NOT OVER	TAX IS	PLUS	OF THE EXCESS OVER
	200,000	Exempt		
200,000	500,000	0	5%	200,000
500,000	2 million	15,000	8%	500,000
2 million	5 million	135,000	11%	2 million
5 million	10million	465,000	15%	5 million
10 million	And Over	1,215,000	20%	10 million

VII. Determination of gross estate and Net estate

	Citizen or Resident	Non-resident
1. Real property in the Philippines	Included	Included
2. Real property outside the Philippines	Included	Not Included
3. Tangible personal property in the Philippines	Included	Included
4. Tangible personal property outside the Philippines	Included	Not Included
5. Intangible personal property in the Philippines	Included	Included*
6. Intangible personal property outside the Philippines	Included	Not Included

* unless exempted on the basis of reciprocity

Reciprocity rule (Sec. 104, NIRC)

Note: must be TOTAL reciprocity

There is reciprocity if the foreign country of which the decedent was a citizen and resident at the time of his death:

- did not impose a transfer tax of any character, in respect of intangible personal property of citizens of the Philippines not residing in that foreign country; or
- allowed a similar exemption from transfer tax in respect of intangible personal property owned by citizens of the Philippines not residing in that country

[In sum, both states must exempt nonresidents (citizens of the other state) from transfer taxes in respect of intangible personal property.]

Note:

- For the reciprocity rule to apply, there must be TOTAL reciprocity. [For instance,] in the Philippines, both estate and inheritance taxes are imposed on the estate while in California only inheritance tax is imposed. The reciprocity rule may not be availed of. Reciprocity has to be total. (*CIR v. Fisher*, 110 Phil 686)
- Reciprocity in exemption does not require the “foreign country” to possess international personality in the traditional sense (i.e., compliance with the requisites of statehood). Thus, Tangier, Morocco (*Collector v. Campos-Rueda*, 42 SCRA 23) and California, a state in the American Union (*Collector v. de Lara*, 102 Phil 813) were held to be foreign countries within the meaning of Section 104.



Q: What is the *situs* of intangible personal property?

GR: *situs* is at the domicile or residence of the owner.

Exception:

- When it is inconsistent with the express provisions of statute, or
- Justice does not demand that it should be, as where the property has in fact a *situs* elsewhere.

CASE LAW: *Collector v. Lara* (102 Phil 813) When the owner of personal property, during his lifetime, extended his activities with respect to his interests so as to avail himself of the protection and benefits of the laws of the Philippines, so as to bring his person or property within the reach of the Philippines, *the reason for a single place of taxation no longer obtains. His property in the Philippines enjoys the protection of the government so that the right to collect the estate tax cannot be questioned.*

Q: What are the intangible properties which are considered by law as situated in the Philippines?

- Franchise which must be exercised in the Philippines
- Obligations or bonds issued by any corporation or *sociedad anonima* organized or constituted in the Philippines
- Shares, obligations or bonds issued by any foreign corporation 85% of the business of which is located in the Philippines
- Shares, obligations or bonds issued by any foreign corporation if such shares, obligations or bonds have acquired a business situs in the Philippines
- Shares or rights in any partnership, business or industry established in the Philippines (*Sec. 104*)

VIII. Composition of gross estate

COMPOSITION

THE FOLLOWING PROPERTIES AND INTEREST THEREIN ARE INCLUDED IN THE GROSS ESTATE AT THE TIME OF THE DECEDENT'S DEATH:

1. As to resident (citizen or alien) or citizen (resident or non-resident)
 - a. RP wherever situated
 - b. Tangible PP wherever situated
 - c. Intangible PP wherever situated
2. As to non-resident alien
 - a. RP in the Philippines
 - b. Tangible PP in the Philippines
 - c. Intangible PP in the Philippines subject to rule of reciprocity

IX. Items to be included in gross estate

Decedent's gross estate (*Sec. 85*):

1. Decedent's interest
2. Transfers in contemplation of death

- Term does not refer to the general expectation of death which all entertain.
- The transfers referred to are those impelled by the thought of death (i.e., the motivating factor or controlling motive is the thought of death),
- Regardless of whether the transferor was near the possibility of death or not.

Transfer with retention or reservation of certain rights (*Sec. 85B*)

- It involves cases where the owner transfers his property during life but still retains the economic benefits - the possession or enjoyment of the property, or the power to designate the persons who may exercise such rights.
- By reason of the restriction the transferee is incapable of freely enjoying or disposing of the property until the transferor's death.
- The transfer may be regarded as having been intended to take effect in possession or enjoyment at the transferor's death.

Illustration:

X transfers his property to Y in naked ownership and to Z in usufruct throughout Z's lifetime subject to the condition that if Z predeceases X, the property shall return to X. If X dies during Z's life, the value of the reversionary interest of X at death is includible in his gross estate (see Articles 756-757 of the Civil Code).

The transfer is taxable as intended to take effect at or after death because the possibility of reversion to X makes Z's interest conditional as long as X lives.

Note:

Transfer with retention or reservation of certain rights is grouped by the Tax Code under transfer in contemplation of death.

3. Revocable Transfers

- Transfers where the transferor has reserved the right to alter, amend or revoke such transfer, regardless of WON the power is actually exercised during his lifetime, and WON the power should be exercised by him alone or in conjunction with someone else.
- The power to alter, amend or revoke shall be considered to exist on the date of the decedent's death **EVEN THOUGH**:
 - the exercise of the power is subject to a precedent giving of notice, or
 - the alteration, amendment or revocation takes effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the



decedent's death notice has been given or the power has been exercised.

- o If notice has not been given or the power has not been exercised before the date of his death, such notice shall be considered to have been given, or the power exercised, on the date of his death.

4. Property passing under general power of appointment

Required:

1. Existence of general power of appointment
2. Exercise of such power by the decedent by will or deed in certain cases
3. Passing of property by virtue of such exercise

Gross estate shall include any property passed or transferred under a general power of appointment exercised by the decedent:

- by will, or
- by deed executed in contemplation of, or intended to take effect in possession or enjoyment at, or after his death, or
- by deed under which he has retained (for his life or any period not ascertainable without reference to his death or for any period which does not in fact end before his death):
 - the possession or enjoyment of, or the right to the income from, the property, or
 - the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom

Q: What is a power of appointment?

The power or right to designate by will or by deed the person(s) who shall succeed to, possess or enjoy the property, or the income therefrom, received from the estate of the prior decedent. It involves the person creating the power (donor) and the person to whom is given the right to exercise the power (donee).

Two Kinds of Appointment and their Effects:

Kind of Appointment	Nature	Tax Implications	Effects
General	DONEE has power to appoint any person he chooses who shall possess or enjoy the property without restriction	Makes appointed property, for all legal intents, the property of the DONEE (<u>includible</u> in his estate)	DONEE holds the appointed property with all the attributes of ownership, under the concept of owner
Special	DONEE must	Not includible	DONEE holds the

appoint successor to the property only within a <u>limited</u> group or class of persons	in the gross estate of the DONEE when he dies	appointed property in trust, or under the concept of trustee
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5. Proceeds of life insurance

- Amount receivable by the estate of the deceased, executor or administrator under policies TAKEN OUT BY THE DECEDENT
 1. upon his OWN LIFE (WON insured retained the power of revocation)
 2. receivable by ANY BENEFICIARY (Except: designation is irrevocable)

6. Prior interests

- Apply to transfers, trusts, estates, interests, rights, powers and relinquishment of powers whether made, created, arising, existing, exercised or relinquished BEFORE or AFTER effectivity of the code

7. Transfers for insufficient consideration

- Transfers that are not *bona fide* sales of property for an adequate and full consideration in money or money's worth.
- If *bona fide* sale - no value shall be included in the gross estate [Case A]
- If not a *bona fide* sale - the excess of the fair market value at the time of death over the value of the consideration received by the decedent shall form part of his gross estate. [Case B]
- If *inter vivos* transfer is proven fictitious/simulated - total value of the property at the time of death included in the gross estate.[Case C]
- The transfer of property must fall under any of the following:
 - transfer in contemplation of death;
 - revocable transfer;
 - property passing under a GPA;
 Otherwise the tax imposed is donor's tax.

	Case A	Case B	Case C
FMV, transfer	2,000	1,500	2,500
FMV, death	2,500	2,000	2,000
Consideration Received	2,000	800	0
Value Included in the Gross Estate	0	1,200	2,000

8. Capital of the surviving spouse

- NOT part of the gross estate of the deceased spouse

X. Deductions from estate

QUICK GLANCE:

Resident or citizen decedent	Non-resident decedent	alien
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<p>GROSS ESTATE - all property at the time of death, wherever situated</p>	<p>GROSS ESTATE - includes only that part of gross estate located in the Philippines</p>
<p>DEDUCTIONS</p> <ul style="list-style-type: none"> ▪ funeral expenses ▪ judicial expenses ▪ claims against the estate ▪ claims against insolvents ▪ unpaid mortgage and debt ▪ taxes and losses ▪ transfers for public use ▪ vanishing deductions ▪ <i>family home</i> ▪ <i>standard deduction</i> ▪ <i>medical expenses</i> ▪ <i>amounts received under R.A. 4917</i> ▪ share in conjugal property 	<p>DEDUCTIONS</p> <ul style="list-style-type: none"> ▪ funeral expenses ▪ judicial expenses ▪ claims against the estate ▪ claims against insolvents ▪ unpaid mortgage and debt ▪ taxes and losses ▪ transfers for public use ▪ vanishing deductions ▪ share in conjugal property <p>NOTE: To compute for total allowable deductions of the first six items above, this formula is used:</p> $\frac{\text{Gross Estate, Phils.}}{\text{Gross Estate, World}} \times \text{World expenses, losses, indebtedness, taxes etc.}$

Note:

No deduction shall be allowed in the case of a non-resident decedent not a citizen of the Philippines, unless the executor, administrator, or anyone of the heirs, as the case may be, includes in the return required to be filed under Section 90 of the Code the value at the time of the decedent's death of that part of his gross estate NOT situated in the Philippines. (*Section 86, NIRC*)

The deductions from the gross estate are:

1. Ordinary Deductions
 - a. Expenses, losses, indebtedness, taxes, etc. (ELIT)
 - Funeral expenses;
 - Judicial expenses of testamentary or intestate proceedings;
 - Claims against the estate;
 - Claims against insolvent persons;
 - Unpaid mortgage or indebtedness on property,
 - Taxes;
 - Losses
 - b. Vanishing Deduction
 - c. Transfer for public use
2. Special Deductions**
 - a. Family home;
 - b. Standard deduction;
 - c. Medical Expenses;
 - d. Amount received by heir under RA 4917

** Not available to the estate of non-resident, aliens in the Philippines.

1. Ordinary Deductions

a. Expenses, Losses, Indebtedness and Taxes [ELIT] [fjc cult]

FUNERAL EXPENSES (§86-A1) (max. P200K)

- Allowable deduction is whichever is lower of
 - the actual funeral expenses (WON paid) up to the time of interment, or
 - an amount equal to 5% of the gross estate, but in no case to exceed P200,000.

Note: The unpaid portion of the funeral expenses incurred which is in excess of the P200,000 threshold is NOT allowed to be claimed as a deduction under "claims against the estate" (see 1(c) below). (Sec. 6(A)(1) of RR 02-2003)

Examples of funeral expenses (RR 2-2003, Sec. 6-A1)

- The MOURNING APPAREL of the surviving spouse and unmarried minor children of the deceased, bought and used on the occasion of the burial
- EXPENSES for the deceased's WAKE, including food and drinks
- PUBLICATION CHARGES for death notices
- TELECOMMUNICATIONS EXPENSES incurred in informing relatives of the deceased
- Cost of BURIAL PLOT, TOMBSTONES, MONUMENT or MAUSOLEUM but not their upkeep. In case the deceased owns a family estate or several burial lots, only the value corresponding to the plot where he is buried is deductible
- INTERMENT and/or CREMATION FEES and CHARGES
- All other expenses incurred for the performance of the RITES and CEREMONIES incident to interment

Expenses NOT deductible as funeral expenses

- Expenses incurred AFTER INTERMENT, such as for prayers, masses, entertainment, or the like
- Any portion of the funeral and burial expenses BORNE or DEFRAYED by RELATIVES and FRIENDS of the deceased

Illustrations:

- If five percent (5%) of the gross estate is P220,000 and the amount actually incurred is P215,000, the maximum amount that may be deducted is only P200,000;
- If five percent (5%) of the gross estate is P 100,000 and the total amount incurred is P150,000 where P20,000 thereof is still unpaid, the only amount that can be claimed as deduction for funeral expenses is P100,000. The entire P50,000 excess



amount consisting of P30,000 paid amount and P20,000 unpaid amount can no longer be claimed as FUNERAL EXPENSES. Neither can the P20,000 unpaid portion be deducted from the gross estate as CLAIMS AGAINST THE ESTATE.

JUDICIAL EXPENSES OF TESTAMENTARY AND INTESTATE PROCEEDINGS (§86-A1)

- Allowable deductions are expenses incurred, in the inventory-taking of the assets comprising the gross estate, their administration, the payment of debts of the estate, as well as the distribution of the estate among the heirs,
- DURING THE SETTLEMENT OF THE ESTATE BUT NOT BEYOND THE LAST DAY PRESCRIBED BY LAW, or the extension thereof, FOR THE FILING OF THE ESTATE TAX RETURN (RR 2-2003, Sec. 6-A2)

Examples of judicial expenses

- Fees of executor or administrator
- Attorney's fees
- Court fees
- Accountant's fees
- Appraiser's fees
- Clerk hire
- Costs of preserving and distributing the estate
- Costs of storing or maintaining property of the estate
- Brokerage fees for selling property of the estate

Case Law: *Commissioner v. CA* (328 SCRA 666)
The **notarial fee** paid for the extrajudicial settlement is deductible since such settlement effected a distribution of the estate to the lawful heirs. **Attorney's fees** to be deductible from the gross estate must be essential to the collection of assets, payment of debts or the distribution of property to the persons entitled to it.

CLAIMS AGAINST THE ESTATE (§86-A1)

- **Claims** - debts or demands of a pecuniary nature which could have been enforced against the deceased in his lifetime and could have been reduced to simple money judgments. May arise out of contract, tort or operation of law.
- Fees to litigate case among heirs not deductible

Requisites for deductibility [PVN GF](RR 2-2003, Sec. 6-A3):

- 1) must be a PERSONAL OBLIGATION of the deceased existing at the time of his death (except unpaid funeral expenses and unpaid medical expenses, which are classified into their own separate categories)
- 2) liability must have been contracted in GOOD FAITH and for adequate and full consideration in money or money's worth
- 3) the claim must be a debt or claim which is VALID IN LAW and ENFORCEABLE IN COURT

- 4) indebtedness NOT CONDONED by the creditor or the action to collect from the decedent must not have prescribed.

Dizon v. CTA (2008, Nachura):

Issue: May actual claims of creditors be fully allowed as deductions from the gross estate despite the fact that the said claims were reduced or condoned through compromise agreements entered into by the Estate with its creditors.

Held: **Post-death development should not be considered.**

There is no law, nor do we discern any legislative intent in our tax laws, which disregards the date-of-death valuation principle and particularly provides that post-death developments must be considered in determining the net value of the estate.

It bears emphasis that tax burdens are not to be imposed, nor presumed to be imposed, beyond what the statute expressly and clearly imports, tax statutes being construed *strictissimi juris* against the government.

Any doubt on whether a person, article or activity is taxable is generally resolved against taxation.

Such construction finds relevance and consistency in our Rules on Special Proceedings wherein the term "claims" required to be presented against a decedent's estate is generally construed to mean debts or demands of a pecuniary nature which could have been enforced against the deceased in his lifetime, or liability contracted by the deceased before his death.

Therefore, *the claims existing at the time of death are significant to*, and should be made the basis of, the determination of allowable.

CLAIMS AGAINST INSOLVENT PERSONS (§86-A1)

Deductible from the gross estate, provided that the value of the decedent's interest in the claim is included in the value of the gross estate.

UNPAID MORTGAGES, LOSSES AND TAXES (§86-A1 and RR 2-2003, Sec. 6-A5)

- **UNPAID MORTGAGES** - Deductible from gross estate, provided:
 - That the value of the decedent's interest in the property encumbered by such mortgage or indebtedness is included in the value of the gross estate
 - That the deduction shall be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money's worth, if such unpaid mortgages or indebtedness were founded upon a promise or an agreement.
- **LOSSES** - deductible from the gross estate if ALL of the following conditions are satisfied:

- The losses
- were INCURRED DURING the SETTLEMENT of the estate
 - arose from FIRES, STORMS, SHIPWRECK or OTHER CASUALTIES, or from ROBBERY, THEFT or EMBEZZLEMENT
 - are NOT COMPENSATED BY INSURANCE or otherwise
 - are not claimed as a deduction for income tax purposes in an income tax return
 - were incurred NOT LATER THAN THE LAST DAY FOR PAYMENT OF THE ESTATE TAX (6 months)

- **TAXES** -Deductible from the gross estate IF:
 - They have accrued as of the death of the decedent
 - They were unpaid as of the time of death

Note: This deduction DOES NOT include income tax upon income received after death, or property taxes not accrued before his death, or the estate tax due from the transmission of his estate.

b. Property Previously Taxed (Vanishing Deductions) (§86-A2)

Deduction allowed on the *property left behind* by the decedent which he had acquired previously by inheritance or donation.

Rationale:

Previously, a transfer tax had already been imposed on the property, either the estate tax (if property inherited) or the donor's tax (if property donated).

Now that the recipient of the inheritance or donation has died, the same property will again be subjected to a transfer tax, the estate tax.

Thus, to minimize the effects of a double tax on the same property within a short period of time, i.e. five (5) years, the law allows a deduction to be claimed on the said property.

Example:

Mr. A died in December 2003. In March 2003, Mr. B (Mr. A's father) died and left Mr. A some properties as inheritance. May vanishing deductions be claimed as deductions in computing Mr. A's net taxable estate?

YES, vanishing deductions shall be allowed if the following conditions are met

REQUISITES FOR DEDUCTIBILITY: [PINID]

- 1) **Death** - the present decedent (Mr. A) died within five years from the receipt of the property from a prior decedent (Mr. B) or donor;
- 2) **Identity of the property** - The property with respect to which deduction is sought can be identified as the one received from the prior decedent or the donor, or as the

property acquired in exchange for the original property so received.

- 3) **Inclusion of the property** - The property must have formed part of the gross estate situated in the Philippines of the prior decedent, or the total amount of the gifts of the donor
- 4) **Previous taxation of the property** - the donor's tax on the gift or estate tax on the prior succession (Mr. B's succession) was finally determined and paid
- 5) **No vanishing deduction on the property was allowed to the estate of the prior decedent.** (Illustration of how this requirement may NOT be met: In the example above, if Mr. B received the same properties as a donation from Mr. C in July 2002, a vanishing deduction on the properties was claimed with respect to Mr. B's estate. Thus, no more vanishing deduction may be claimed by Mr. A's estate)

Computation of vanishing deduction

- Using the facts above, assume that Mr. A inherited a car and a house from his father Mr. B.
- The FMV of the car was P120,000 and the FMV of the house was P800,000 at the time of Mr. B's death.
- At the time Mr. A inherited the land, it was subject to a mortgage of P80,000. Mr. A paid P70,000 of the mortgage during his lifetime (leaving a balance of P10,000).
- The FMV of the properties at the time of Mr. A's death were P850,000 for the land and P70,000 for the car.
- Mr. A's gross estate amounted to P3,200,000 while total deductions (excluding medical expenses, standard deductions, family home) amounted to P600,000.

- 1) First, **GET THE VALUE OF THE PROPERTY PREVIOUSLY TAXED (PPT):** compare the values of the property at the time of the prior decedent's death and at the time of the present decedent's death. *The lower amount shall be the initial basis.*
 - (a) *in the example, the value of the PPT shall be P800,000 for the land and P70,000 for the car, for a total of P870,000*

NOTE: The value used on the PPT is significant *only for purposes of computing the amount of vanishing deduction.* The value included in the decedent's gross estate is ALWAYS the fair market value at the time of his death.

- 2) Then, **THE PPT VALUE SHALL BE REDUCED BY ANY PAYMENT MADE BY THE PRESENT DECEDENT ON ANY MORTGAGE** or lien on the property



- (a) Mr. A paid P70,000 of the mortgage. Thus, P870,000 less 70,000 is P800,000
- (b) The P800,000 is known as the **INITIAL BASIS**

3) The **INITIAL BASIS** shall be **FURTHER REDUCED** by an amount equal to:
INITIAL BASIS X Total amount of Gross Estate deductions*

* excluding family home, medical expenses, standard deduction and amounts received under RA 4917

- (a) $800/3200 \times 600,000$ equals 150,000. This will be deducted from P800,000, which gives a balance of P650,000
- (b) The 650,000 is known as the **FINAL BASIS**.

4) Finally, the remaining balance shall be multiplied by the corresponding percentage:

%	If received by inheritance or gift:
100%	within one (1) year prior to the death of the present decedent
80%	More than one year but not more than two years prior to the death of the decedent
60%	More than two years but not more than three years prior to the death of the decedent
40%	More than three years but not more than four years prior to the death of the decedent
20%	More than four years but not more than five years prior to the death of the decedent

- (a) Since Mr. A received the inheritance in March 2003 (within 1 year from his death in December 2003), the balance of P650,000 shall be multiplied by 100%. Thus, the allowable vanishing deduction is P650,000

FORMULA:	
1)	VALUE TAKEN FOR PPT (always the lower values)
	LESS: MORTGAGE (OR LIEN) PAID IF ANY (1 ST deduction)
2)	INITIAL BASIS (IB)
	LESS: 2 ND deduction = IB/GE x Total Deductions less Those exclusions
3)	FINAL BASIS
X	RATES IN s86A-2
4)	VANISHING DEDUCTION in an Estate Tax Return, this is deducted from the Exclusive Properties of the decedent which form part of the gross estate.

b. Transfers for Public Purpose

- The whole amount of all the BEQUESTS, LEGACIES, DEVISES or TRANSFERS to or for the use of the Government of the Republic of the Philippines, or any political

subdivision thereof, for exclusively public purposes shall be deductible from gross estate, provided such amount or value had been included in the gross estate.

2. Special Deductions (FSMA)

a. FAMILY HOME (maximum of P1m)

- It is the dwelling house, including the land on which it is situated, where the husband and wife, or a head of the family, and members of their family reside, as certified to by the Barangay Captain of the locality.
- It is deemed constituted on the house and lot from the time it is actually occupied as the family residence and considered as such for as long as any of its beneficiaries actually resides therein. (Arts. 152 and 153, Family Code) Temporary absence from the constituted family home due to travel or studies or work abroad, etc. does not interrupt actual occupancy. The family home is generally characterized by permanency, that is, the place to which, whenever absent for business or pleasure, one still intends to return. (RR 2-2003, Sec. 6D)

Requisites for Deductibility

- 1) The family home must be the actual residential home of the decedent and his family at the time of his death, as certified by the barangay captain of the locality.
- 2) The total value of the family home must be included as part of the gross estate of the decedent
- 3) Allowable deduction must be in an amount equivalent to the current FMV of the family home as declared or included in the gross estate but in no case shall the deduction exceed P1,000,000

b. STANDARD DEDUCTION (s86-A5) (P1m)

An amount equivalent to One million pesos (P1,000,000) shall be deducted from the gross estate without need of substantiation.

c. MEDICAL EXPENSES (s86-A6) (max. of P500K)

All medical expenses (cost of medicine, hospital bills, doctors' fees, etc.) incurred (whether paid or unpaid)

Requisites for Deductibility:

1. The expenses were incurred by the decedent within one (1) year prior to his death
2. The expenses are duly substantiated with receipts

PROVIDED, that in no case shall the deductible medical expenses exceed Five Hundred Thousand Pesos (P500,000).



Note: Any amount of medical expenses incurred within one year from death in excess of P500,000 CANNOT be claimed as a deduction under "Claims against the estate". (RR 2-2003, Sec. 6-F)

d. **AMOUNTS RECEIVED BY HEIRS UNDER RA 4917** (§86-A7)

Any amount received by the heirs from the decedent's employer as a consequence of the death of the decedent-employee in accordance with RA No. 4917 (this law provides that retirement benefits of private employees shall not be subject to attachment, levy execution or any tax), PROVIDED that such amount is included in the gross estate of the decedent.

XI. Exclusions from estate

Excluded Properties

1. CAPITAL of surviving spouse
2. PROCEEDS of:
 - a. Life insurance policy taken out
 - by the decedent upon his own life,
 - when beneficiary is OTHER THAN the estate, executor or administrator,
 - and designation is IRREVOCABLE (Sec. 85E)

NOTE: The presumption is that the designation is REVOCABLE.

- b. Group life insurance policy taken out by a company for its employees, (law only speaks of policies "taken out by the decedent upon his own life")
- c. Life insurance policies-issued by the GSIS to government officials or employees, as they are exempt by law from taxes of all kinds (PD 1146, as amended)

Thus, the proceeds of insurance under policies taken out by the decedent upon his life shall constitute part of the gross estate if the beneficiary is:

- a. The **estate** of the decedent, his executor or administrator, or
- b. A **third person** (i.e., a person other than the estate, executor or administrator), AND the *designation of the beneficiary is revocable.*

3. **Death** benefits received from the SSS, accruing by reason of death (RA 1161, as amended)
4. Amounts received from the Philippine and the **U.S.** Governments from the *damages* suffered during the last war (RA 227)
5. *Benefits* received by beneficiaries residing in the Philippines under laws administered by the **U.S.** Veterans Administration (RA 360)
6. Properties held in **T**rust by the decedent

7. Transfers by way of *bona fide* Sales
8. Separate or *exclusive property* of the surviving spouse is not deemed part of the gross estate of the decedent spouse. (Sec. 85, NIRC)
9. Net estates which are not in excess of **P200,000** are exempt from estate tax. (Sec. 84, NIRC)

XII. Tax credit for estate tax paid in a foreign country

Tax Credit

It is a remedy against international double taxation. To minimize the onerous effect of taxing the same property twice, tax credit against Philippine estate tax is allowed for estate taxes paid to foreign countries.

Who may avail of tax credit?

Only the estate of a decedent who was a citizen or a resident of the Philippines at the time of his death can claim tax credit for any estate tax paid to a foreign country.

Amount Allowable as tax credit

General Rule:

The estate tax imposed by the Philippines shall be credited with the amounts of any estate tax imposed by the authority of a foreign country.

Limitations:

- a. The amount of the credit in respect to the tax paid to any country shall not exceed the same proportion of the tax against which such credit is taken, which the decedent's net estate situated within such country taxable under the NIRC bears to his entire net estate; (PER COUNTRY BASIS) 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 decedent's net estate situated outside the Philippines taxable under the NIRC bears to his entire net estate. (OVERALL BASIS)

Illustration:

Assume:

Net Estate - Philippines (reduced by all allowable deductions, except standard deduction)	P 1,050,000
Country G Net Estate	300,000
Country H Net Estate	150,000
Tax paid/incurred: Philippines	
Country G	15,000
Country H	5,000
	1,400

(b) Net taxable estate is P500,000 (1,050,000 + 300,000 + 150,000 - 1,000,000 standard



deduction). The Philippine estate tax on P500,000 is P15,000

Solution - Limitation A:

(c) To get tax credit per country under Limitation A, this formula is followed:

Net Estate in a Particular Country	x	Phil. Estate Tax	=	Tax Credit
Net Estate Worldwide				

- (d) The *result* after applying the formula above is compared to the tax actually paid for each foreign country.
- (e) The *lower of the two amounts* for each foreign country will be added to get the total tax credit allowed under Limitation A.

		Amount Allowed whichever is Lower)
Country G (300/1500 x 15,000)	3,000	3,000
Actually paid to Country G	5,000	
Country H (150/1500 x 15,000)	1,500	1,400
Actually paid to Country H	1,400	
Tax credit allowed under Limitation A		P 4,400

Solution - Limitation B:

Net Estate in all Foreign Countries	x	Phil. Estate Tax	=	Tax Credit
Net Estate Worldwide				

- The result after applying the formula above is compared to the tax actually paid in total to foreign countries.
- The lower of the two amounts will be added to get the total tax credit allowed under Limitation B.

		Amount Allowed (Lower)
450/1500 x 15,000	4,500	
Total foreign income taxes paid	6,400	
Tax credit allowed under Limitation B		P 4,500

- Compare the tax credit allowed under Limitation A and Limitation B. The lower of the two amounts is the final allowable tax credit. In this case, the amount computed under Limitation A (4,400) is lower, thus it becomes the final allowable tax credit.
- If there is only one foreign country involved, both Limitations will yield the same answer.

- To get the tax credit allowable, use the formula in Limitation A.
- The resulting amount will be compared to the actual tax paid to the foreign country. The lower amount will be the final allowable tax credit.

(Source: Reyes, *Income Tax Law and Accounting*)

XIII. Exemption from certain acquisitions and transmissions

Exempt Transfers [MTTB] (Sec. 87)

- Merger of the usufruct in the owner of the naked title
- Transmission or delivery of the inheritance or legacy by the fiduciary heirs or legatee to the fideicommissary
- Transmission from the first heirs, legatees or donees in favor of another beneficiary in accordance with the desire of the testator
- All bequests, devises, legacies or transfers to social welfare, cultural and charitable institutions, no part of the income of which inures to the benefit of any individual, provided that not more than 30% of the said bequests, devises, legacies or transfers shall be used for administrative purposes

XIV. Filing of notice of death

A written Notice of Death must be given to the BIR:

- within two (2) months after the death of the decedent or
- within a period after the executor or administrator or executor qualifies as such.
- In all cases of transfers subject to tax or where, though exempt from tax, the gross value of the estate exceeds P20,000. (Sec. 89).

XV. Estate tax return

1. When required

- When the estate is subject to estate tax, OR
- When, though exempt from tax, the gross value of the estate exceeds Two hundred thousand pesos (P200,000), OR
- Regardless of the gross value of the estate, when the said estate consists of registered or registrable property such as real property, motor vehicle, shares of stock or other similar property for which a clearance from the Bureau of Internal Revenue is required as a condition precedent for the transfer of ownership thereof in the name of the transferee.

2. Contents



The executor, or the administrator, or any of the legal heirs, as the case may be, shall file a return under oath in duplicate, setting forth:

- a. The value of the gross estate of the decedent at the time of his death, or in case of a nonresident, not a citizen of the Philippines, of that part of his gross estate situated in the Philippines;
- b. The deductions allowed from gross estate in determining the net taxable estate; and
- c. Such part of such information as may at the time be ascertainable and such supplemental data as may be necessary to establish the correct taxes.
- d. For estate tax returns showing a gross value exceeding Two million pesos (P2,000,000) - there must be a statement duly certified to by a Certified Public Accountant containing the following:
 - Itemized assets of the decedent with their corresponding gross value at the time of his death, or in the case of a nonresident, not a citizen of the Philippines, of that part of his gross estate situated in the Philippines;
 - Itemized deductions from gross estate allowed in Section 86; and
 - The amount of tax due whether paid or still due and outstanding.

2. When filed

General Rule: Filed within six (6) months from the decedent's death.

Exception: The Commissioner shall have authority to grant, in meritorious cases, a reasonable extension not exceeding thirty (30) days for filing the return

3. Where filed

Except in cases where the Commissioner otherwise permits, the return shall be filed with:

- (a) an authorized agent bank (AAB),
- (b) or Revenue District Officer (RDO),
- (c) Collection Officer, or
- (d) duly authorized Treasurer of the city or municipality in which the decedent was domiciled at the time of his death, or
- (e) if there be no legal residence in the Philippines, with the Office of the Commissioner.

Payment of Estate Tax

1. When paid

At the time the return is filed by the executor, administrator or the heirs.

2. Extension of Payment

The Commissioner may allow an extension of payment, if he finds that the payment on the due date of the estate tax or of any part thereof would impose undue hardship upon the estate or any of the heirs:

- (a) extension not to exceed five (5) years, in case the estate is settled judicially,
- (b) or two (2) years in case the estate is settled extrajudicially.

Where the taxes are assessed by reason of negligence, intentional disregard of rules and regulations, or fraud on the part of the taxpayer, no extension will be granted by the Commissioner.

If extension granted, the Commissioner may require the executor, or administrator, or beneficiary, as the case may be, to furnish a BOND in such amount, not exceeding DOUBLE the amount of the tax and with such sureties as the Commissioner deems necessary, conditioned upon the payment of the said tax in accordance with the terms of the extension.

3. Effects of granting an extension

- Payment of the amount in respect of which the extension is granted on or before the date of the expiration of the period of the extension
- Suspension of the running of statute of limitations for deficiency assessment for the period of any extension
- Any amount paid after the statutory due date of the tax, but within the extension period, shall be subject to interest but not to surcharge.

Q: CAN ESTATE TAX BE PAID IN INSTALLMENTS?

Yes. In case the available cash of the estate is not sufficient to pay its total estate tax liability, the estate may be allowed to pay the tax by installment and a clearance shall be released only with respect to the property the corresponding/computed tax on which has been paid. (RR 2-2003)

Q: Who are liable for the payment of estate taxes?

Primarily, the estate, through the executor or administrator.

- Payment shall be made before the delivery of the distributive share in the inheritance to any heir or beneficiary.
- If there are two or more executors or administrators, all of them are severally liable for the payment of the tax.
- The estate tax clearance issued by the Commissioner or the Revenue District Officer (RDO) having jurisdiction over the estate, will serve as the authority to distribute the remaining properties/share in the inheritance to the heir or beneficiary.

Subsidiarily, heirs or beneficiaries, for the payment of that portion of the estate which his distributive share bears to the value of the total net estate.

- The extent of his liability, however, shall in no case exceed the value of his share in the inheritance.

Marcos II v. Court of Appeals: Claims for taxes, whether assessed before or after the death of the deceased, can be collected from the heirs even after the distribution of the properties of the decedent.

They are exempted from the application of the statute of non-claims. The heirs shall be liable therefore, in proportion to their share in the inheritance.



Thus, the Government has two ways of collecting the taxes in question:

- (a) One by going after all the heirs and collecting from each one of them the amount of the tax proportionate to the inheritance received.
- (b) Another remedy (pursuant to the lien created by Section 315 of the Tax Code upon all property and rights to property belong to the taxpayer for unpaid income tax) is by subjecting said property of the estate which is in the hands of an heir or transferee to the payment of the tax due the estate.

The approval of the court, sitting in probate, or as a settlement tribunal over the deceased is not a mandatory requirement in the collection of estate taxes.

ILLUSTRATION:

1. Decedent is an unmarried head of a family

Real and personal properties	5,000,000
family home	2,000,000
Gross estate	7,000,000
Less: Deductions	
Ordinary deductions	
Funeral expenses	200,000
Other deductions	1,300,000
	<u>(1,500,000)</u>
Special deductions	
Family Home	1,000,000
Standard deduction	1,000,000
Medical expenses	500,000
	<u>(2,500,000)</u>
Net taxable estate	3,000,000

Note:

Although the family home is valued at P2 million, the maximum allowable deduction for the family home is P1million only.

Medical expenses are not included in the deductions referred under Section 86(A)(1) of the Code but are treated as a special item of deduction under Section 86(A)(6) of the same Code.

2. Decedent is a married man with a surviving spouse

Family home is exclusive property

	Conjugal	Exclusive	Total
Real & personal properties	5,000,000		5,000,000
Family home		2,000,000	2,000,000
Other exclusive prop		2,500,000	2,500,000
Gross estate	5,000,000	4,500,000	9,500,000
Less: Ordinary			

Deductions			
Funeral expenses	200,000		
Other deductions	1,300,000		
Total			
Conjugal deductions	(1,500,000)		(1,500,000)
Net estate before share			
of spouse	3,500,000	4,500,000	8,000,000
Less Share of surviving spouse			
1/2 of 3,500,000			(1,750,000)
Net Estate before special deductions			6,250,000
Less: Special Deductions			
Family Home			(1,000,000)
Standard Deduction			(1,000,000)
Medical Expenses			(500,000)
Net Taxable Estate			3,750,000

Family home is conjugal or community property

	Conjugal	Exclusive	Total
Real and personal properties	5,000,000		5,000,000
Family home	2,000,000		2,000,000
Other exclusive properties		2,000,000	2,000,000
Gross estate	7,000,000	2,000,000	9,000,000
Less: Ordinary Deductions			
Funeral expenses	200,000		
Other ded'ns	1,300,000		
Total			
Conjugal deductions	(1,500,000)		(1,500,000)
Net estate before share			
of spouse	5,500,000	2,000,000	7,500,000
Less Share of surviving spouse			
(1/2 of 5,500,000)			(2,750,000)
Net Estate before special deductions			4,750,000
Less: Special Deductions			
Family Home			(1,000,000)
Standard Deduction			(1,000,000)
Medical Expenses			(500,000)
Net Taxable Estate			2,250,000

Family home is conjugal property, valued at P1,500,000

	Conjugal	Exclusi	Total
Real and personal properties	5,000,000		5,000,000
Family home	1,500,000		1,500,000



Other exclusive properties	0	2,000,000	2,000,000
Gross estate	6,500,000	2,000,000	8,500,000
Less: Ordinary Deductions	0	000	00
Funeral expenses	200,000		
Other deductions	1,300,000		
Total Conjugal deductions	0	(1,500,000)	(1,500,000)
Net estate before share of spouse	5,000,000	2,000,000	7,000,000
Less Share of surviving spouse	0	000	00
1/2 of 5,000,000			(2,500,000)
Net Estate before special deductions			4,500,000
Less: Special Deductions			00
Family Home			(750,000)
Standard Deduction			(1,000,000)
Medical Expenses			(500,000)
Net Taxable Estate			2,250,000

Note:

Only 750,000 is allowed as a deduction for the family home, considering that it was conjugal property valued at P1,500,000. This value is subdivided into P750,000, which belonged to the decedent, and P750,000, which belonged to the surviving spouse. The part owned by the decedent (P750,000) is compared with the P1,000,000 maximum deduction, the lower of the two amounts being the allowable deduction.

2. Donor's Tax

- I. Basic principles
- II. Definition
- III. Nature
- IV. Purpose or object
- V. Requisites of valid donation
- VI. Transfers which may be constituted as donation
- VII. Transfer for less than adequate and full consideration
- VIII. Classification of donor
- IX. Determination of gross gift
- X. Composition of gross gift
- XI. Valuation of gifts made in property
- XII. Tax credit for donor's taxes paid in a foreign country
- XIII. Exemptions of gifts from donor's tax
- XIV. Computation of Donor's Tax
- XV. Person liable
- XVI. Tax basis

I. Basic principles

The donor's tax is imposed on donations *inter vivos* or those made between living persons to take effect during the lifetime of the donor.

The donor's tax supplements the estate tax by preventing the avoidance of the latter through the device of donating the property during the lifetime of the deceased.

II. Definition

A donor's tax is levied, assessed, collected and paid upon the transfer by any person, resident or nonresident, of the property by gift.

It shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. (Sec. 98)

III. Nature

Donor's tax is not a property tax but an excise tax imposed on the privilege of the owner to give or donate.

IV. Purpose or object

- To supplement estate tax;
- To prevent avoidance of income tax through the device of splitting income among numerous donees, who are usually members of a family or into many trusts, with the donor thereby escaping the effect of the progressive rates of income tax.

V. Requisites of valid donation

- A donation is an act of liberality whereby a person (donor) disposes gratuitously of a thing or right in favor of another (donee) who accepts it. (Art. 725, NCC)

The requisites of a valid donation are:

1. The donor must have CAPACITY
2. There must be an INTENT TO DONATE
3. The donee must ACCEPT the donation

VI. Transfers which may be constituted as donation

- a. Sale/exchange/transfer of property for insufficient consideration

Noteworthy, the element of donative intent is conclusively presumed in transfers of property for less than an adequate or full consideration in money or money's worth.

- b. Condonation/remission of debt where the *debtor did not render service in favor of the creditor*

➤ However, real property considered capital

assets under the Tax Code are excepted from this rule. (Sec 100 in relation to Sec 24(d))

Under Section 24(d), the fair market value itself, if higher than the gross selling price, is the base for computing the capital gains tax imposed upon the sale of such capital assets.

- Thus, what the seller avoids in the payment of the donor's tax, it pays for in the capital gains tax.

c. Gifts given out of gratitude where the consideration is not money or anything of economic value

d. Renunciation in favor of other heirs

- Renunciation by the surviving spouse of his/her share in the ACP/CPG after the dissolution of the marriage in favor of heirs of the deceased spouse or any other person/s - SUBJECT to donor's tax.
- General renunciation by an heir, including the surviving spouse, of his/her share in the hereditary estate left by the decedent - NOT subject to donor's tax.
- Renunciation specifically and categorically in favor of identified heir/s to the exclusion or disadvantage of the other co-heirs in the hereditary estate - SUBJECT to donor's estate. (RR 2-2003).

VII. Transfer for less than adequate and full consideration

Where property, other than real property under Sec. 24(D), is transferred for less than an adequate and full consideration in money or money's worth, then *the amount by which the fair market value of the property exceeded the value of the consideration* shall be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

VIII. Classification of donor

1. Citizens or Residents of the Philippines - all properties located not only within the Philippines but also in foreign countries.
2. Nonresident Alien - all real and tangible properties within the Philippines, and intangible personal property, unless there is reciprocity, in which case it is not taxable

Q: What are the intangible properties which are considered by law as situated in the Philippines?

1. Franchise which must be exercised in the Philippines.
2. Obligations or bonds issued by any corporation or sociedad anonima organized or constituted in the Philippines.

3. Shares, obligations or bonds issued by any foreign corporation 85% of the business of which is located in the Philippines.
4. Shares, obligations or bonds issued by any foreign corporation if such shares, obligations or bonds have acquired a business situs in the Philippines.
5. Shares or rights in any partnership, business or industry established in the Philippines.

Rule on Reciprocity (Sec 104, NIRC)

There is reciprocity if the foreign country of which the decedent was a citizen and resident at the time of his death:

1. Did not impose a transfer tax of any character, in respect of intangible personal property of citizens of the Philippines not residing in that foreign country; or
2. Allowed a similar exemption from transfer tax in respect of intangible personal property owned by citizens of the Philippines not residing in that country.

This rule applies to the transmission by gift of intangible personal property located or with a *situs* within the Philippines of a nonresident alien.

IX. Determination of gross gift

- Gifts of real property and personal property wherever situated belonging to the donor who is either a resident or citizen at the time of the donation; and
- Gifts of real and tangible personal property situated in the Philippines, and intangible personal property with a situs in the Philippines unless exempted on the basis of reciprocity, belonging to the donor who is a non-resident alien at the time of the donation

X. Composition of gross gift

Gross gift shall pertain to all donations *inter vivos*:

- (1) Whether the transfer is in trust or otherwise;
- (2) Whether the gift is direct or indirect;
- (3) Whether the property is real or personal, tangible or intangible.

Resident or Citizen	Non resident Alien
Real property in the Philippines	Real Property in the Philippines
Tangible or Intangible Personal Properties (Within or without the Philippines)	Tangible or Intangible Personal Properties (Within the Philippines) Except: Reciprocity

XI. Valuation of gifts made in property



- If the gift is made in property, the fair market value at that time will be considered the amount of gift.
- **Real Property**
 - taxable base = FMV as determined by the Commissioner of BIR (Zonal Value) or FMV as shown in the latest schedule of values of the provincial and city assessor (Market Value per Tax Declaration), whichever is higher.
 - If there is no zonal value, the taxable base is the FMV that appears in the latest tax declaration.
- **Improvement**
Value of improvement is the construction cost per building permit and/or occupancy permit plus 10% per year after year of construction, or the FMV per latest tax declaration.

XII. Tax credit for donor's taxes paid in a foreign country

- A situation may arise when the property given as a gift is located in a foreign country and the donor may be subject to donor's tax twice on the same property: first, by the Philippine government and second, by the foreign government where the property is situated.
- The remedy of claiming a tax credit is, therefore, aimed at minimizing the burdensome effect of double taxation by allowing the taxpayer to deduct his foreign tax from his Philippine tax, subject to the limitations provided by law.

Who may claim tax credit?

- Tax credit for donor's tax may be claimed only by a resident citizen, non-resident citizen and resident alien.

Q: What are the limitations on the tax credit?

$$1. \frac{\text{NET GIFT (foreign country)}}{\text{ENTIRE NET GIFTS}} \times \text{PHIL DONOR'S TAX}$$

$$2. \frac{\text{NET GIFT(all foreign countries)}}{\text{ENTIRE NET GIFTS}} \times \text{PHIL DONOR'S TAX}$$

Note: The computation of the donor's tax credit is the same as the computation for estate tax credit.

XIII. Exemptions of gifts from donor's tax

- Deductible from gross gifts in order to arrive at the taxable net gifts.
- Not to be treated as exclusions from the gross gifts of the donor.

In the case of gifts made by a RESIDENT:

1. Dowries or donations made:
 - a. On account of marriage
 - b. Before its celebration or within one year thereafter
 - c. By parents to each of their legitimate, recognized natural, or adopted children
 - d. To the extent of the first P10,000.
 - e. However, this exemption may **not** be availed of by a non-resident not a citizen of the Philippines.

Can both parents making a donation to a child in consideration of marriage avail of the P10,000 deduction?

- Yes. If both spouses made the gift, then the gift is taxable one-half to each donor spouse.
- Separate donor's tax returns must be filed; husband and wife are considered as separate and distinct taxpayers for purposes of donor's tax. (Section 12, RR 2-2003)
- However, where there is failure to prove that the donation was actually made by both spouses, the donation is taxable as an exclusive act of the husband (Tang Ho v. BTA, 97 Phil 890), without prejudice to the right of the wife to question the validity of the donation without her consent pursuant to the provisions of the Civil Code and the Family Code. (Section 12, supra)

2. Gifts made to or for the use of the National Government or any entity created by any of its agencies which is not conducted for profit, or to any political subdivision of the said Government

3. Gifts in favor of an educational and/or charitable, religious, cultural or social welfare corporation, institution, accredited non-government organization, trust or philanthropic organization or research institution or organization, *Provided not more than 30% of said gifts will be used by such donee for administration purposes.*

What is a non-profit educational and/or charitable corporation, etc?

It is a school, college or university and/or charitable corporation, accredited NGO, trust or philanthropic organization and/or research institution or organization:

- Incorporated as a non-stock entity,
- Paying no dividends,
- Governed by trustees who receive no compensation, and
- Devoting all its income, whether students' fees or gifts, donations, subsidies or other forms of philanthropy, to the accomplishment and promotion of the purposes enumerated in its Articles of Incorporation

In the case of gifts made by a NONRESIDENT:

1. Gifts made to or for the use of the National Government or any entity created by any of its



agencies which is not conducted for profit, or to any political subdivision of the said Government

2. Gifts in favor of an educational and/or charitable, religious, cultural or social welfare corporation, institution, accredited non-government organization, trust or philanthropic organization or research institution or organization, provided not more than 30% of said gifts will be used by such donee for administration purposes

Other Exemptions common to both

1. Encumbrances on the property donated if assumed by the donee in the deed of donation
2. Donations made to entities exempted under special laws, e.g.:
 - o Aquaculture Department of the Southeast Asian Fisheries Development Center of the Philippines
 - o Development Academy of the Philippines
 - o Integrated Bar of the Philippines
 - o International Rice Research Institute
 - o National Museum
 - o National Library
 - o National Social Action Council
 - o Ramon Magsaysay Foundation
 - o Philippine Inventor's Commission
 - o Philippine American Cultural Foundation
 - o Task Force on Human Settlement on the donation of equipment, materials and services
3. Donations to persons not strangers where the total of such net gifts for the calendar year is not more than P100,000.00

“Net Gifts”

- The net economic benefit from the transfer that accrues to the donee.
- Accordingly, if a mortgaged property is transferred as a gift, but imposing upon the donee the obligation to pay the mortgage liability, then the net gift is measured by deducting from the fair market value of the property the amount of the mortgage assumed. (Section 11, RR 2-2003)

XIV. Computation of Donor's Tax

How is donor's tax computed?

This general formula shall be followed:

Gross gifts made
<u>Less: Deductions from the gross gifts</u>
Net gifts made
<u>Multiplied by applicable rate</u>
<u>Donor's tax on the net gifts</u>

If there were several gifts made during the year, this formula is followed:

Gross gifts made on this date
<u>Less: Deductions from the gross gifts</u>
Net gifts made on this date
<u>Add: all prior net gifts during the year</u>
Aggregate net gifts
<u>Multiplied by applicable rate</u>
Donor's tax on the aggregate net gifts
<u>Less: donor's tax paid on prior net gifts</u>
<u>Donor's tax due on the net gifts to date</u>

TAX RATES APPLICABLE

The applicable donor's tax rate is dependent upon the relationship between the donor and the donee.

1. If the **donee is a stranger to the donor**, the tax rate is equivalent to **30 %** of the net gifts.
 - **A stranger for purposes of the donor's tax**
 - a. a person who is *not a brother, sister* (whether by whole or half-blood), spouse, ancestor or lineal descendant, or
 - b. a person who is *not a relative by consanguinity in the collateral line within the fourth degree of relationship.* (Sec. 99(B))

Note that donations made between business organizations and those made between an individual and a business organization shall be considered as donations made to a stranger (RR 2-2003)

2. If the **donee is not a stranger to the donor**, the tax for each calendar year shall be computed on the basis of the total net gifts made during the calendar year:

Over	But not Over	Tax Is	Plus	Of the Excess Over
0	100,000	Exempt		
100,000	200,000	0	2%	100,000
200,000	500,000	2,000	4%	200,000
500,000	1M	14,000	6%	500,000
1M	3M	44,000	8%	1M
3M	5M	204,000	10%	3M
5M	10M	404,000	12%	5M
10M		1,004,000	15%	10M

Note: A legally adopted child is entitled to all the rights and obligations provided by law to legitimate children, and therefore, a donation to him shall not be considered as a donation made to a stranger.

XV. Person liable

- Every person, whether natural or juridical, resident or non-resident, who transfers or causes to transfer property by gift, whether in trust or otherwise, whether the gift is direct or indirect and whether the property is real or personal, tangible or intangible.

Donor's Tax Return

A. Contents of the Donor's Tax Return

1. Each gift made during the calendar year which is to be included in computing net gifts;
2. The deductions claimed and allowable;
3. Any previous net gifts made during the same calendar year;
4. The name of the donee;
5. Relationship of the donor to the donee;
6. Such further information as the Commissioner may require.

B. When Filed

- Filed within thirty (30) days after the date the gift is made or completed.
- The tax due thereon shall be paid at the same time that the return is filed.

C. Where Filed and Paid

- Unless the Commissioner otherwise permits, it shall be filed and the tax paid to:
 - a. An authorized agent bank
 - b. The Revenue District Officer
 - c. Revenue Collection Officer or
 - d. Duly authorized Treasurer of the city or municipality where the donor was domiciled at the time of the transfer, or
 - e. If there be no legal residence in the Philippines, with the Office of the Commissioner.
- In the case of gifts made by a non-resident, the return may be filed with:
 - a. the Philippine Embassy or Consulate in the country where he is domiciled at the time of the transfer, or
 - b. directly with the Office of the Commissioner.

- Net Taxable Gift:
P25,000 - 10,000 = P15,000
- Tax Due:
None, since P15,000 is below the P100,000 threshold
- Gift pertaining to the daughter-in-law
 - Net Taxable Gift:
P25,000
 - Tax Due:
P25,000 x 30% = P7,500
- Wife - same as above
- Donations to donees not considered strangers for tax purposes were made on:

January 30, 2002 - P 2,000,000
 March 30, 2002 - P 1,000,000
 August 15, 2002 - P 500,000

	After the first donation	After the second donation	After the third donation
Net Taxable Gift	2,000,000	January Donation - P2,000,000 March Donation - 1,000,000 <u>Total P3,000,000</u>	January Donation - P2,000,000 March Donation - 1,000,000 August Donation - 500,000 <u>Total P3,500,000</u>
Corresponding Donor's Tax (refer to schedule)	124,000	P 204,000	P254,000
Tax Due / Payable	124,000	Donor's Tax P 204,000 Less: Tax Previously Paid <u>124,000</u> Tax Due P80,000	Donor's Tax P 254,000 Less: Tax Previously paid (124k+80k) 204,000 Tax Due P50,000

XVI. Tax Basis

The tax for each calendar year shall be computed on the basis of the total net gifts made during the calendar. (Sec. 99)

ILLUSTRATION

1. Donation to son by parents on account of marriage (P100,000):
 - Husband
 - Net Taxable Gift:
P50,000 - 10,000 = P40,000
 - Tax Due:
None, since P40,000 is below the P100,000 threshold
 - Wife - same as above
2. Donation to son and daughter-in-law by parents on account of marriage (P100,000):
 - Husband
 - Gift pertaining to the son

3. VAT

I.	Concept
II.	Characteristics
III.	Impact of tax
IV.	Incidence of tax
V.	Tax credit method
VI.	Destination principle
VII.	Persons liable (Sec. 105)
VIII.	VAT on sale of goods or properties
IX.	Zero-rated sales of goods or properties,

	and effectively zero-rated sales of goods or properties
X.	Transactions deemed sale
XI.	Change or cessation of status as VAT-registered person
XII.	VAT on importation of goods
XIII.	VAT on sale of service and use or lease of properties
XIV.	Zero-rated sale of services
XV.	VAT exempt transactions
XVI.	Input tax and output tax, defined
XVII.	Sources of input tax
XVIII.	Persons who can avail of input tax credit
XIX.	Determination of output/input tax; VAT payable; Excess input tax credits
XX.	Substantiation of input tax credits
XXI.	Refund or tax credit of excess input tax
XXII.	Invoicing requirements
XXIII.	Filing of return and payment
XXIV.	Withholding of final VAT on sales to government

I. Concept

- A. VAT is a percentage tax imposed at every stage of the distribution process on the **sale, barter, or exchange, or lease of goods** or properties, and on the **performance of service** in the course of trade or business, or on the **importation of goods**, whether for business or non-business purposes.
- B. It is a business tax levied on certain transactions involving a wide range of goods, properties, and services, such tax being payable by the seller, lessor, or transferor. The tax is so-called because it is imposed on the value not previously subjected to VAT (De Leon, "The National Internal Revenue Code Annotated," 2000 edition)
- C. It is also an excise tax, or a tax on the privilege of engaging in the business of selling goods or services, or in the importation of goods.
- D. The taxpayer (seller) determines his tax liability by computing the tax on the gross selling price or gross receipt (**output tax**), and subtracting or crediting the earlier VAT on the purchase or importation of goods or on the purchase of service (**input tax**) against the tax due on his own sale.

II. Characteristics

- It is an indirect tax, the amount of which may be shifted to or passed on the buyer, transferee, or lessee of the goods, properties or services. (Sec. 105)
- This rule shall likewise apply to existing contracts of sale or lease of goods, properties or services at the time of the effectivity of RA No. 9337. -RR 16-2005
- This rule shall likewise apply to existing contracts of sale or lease of goods, properties or services at the time of the effectivity of RA No. 9337.

- VAT is a percentage tax imposed by law directly not on the thing or service but on the act (sale, barter, exchange, lease, importation, rendering service)
- It is also an excise tax, or a tax on the privilege of engaging in the business of selling goods or services, or in the importation of goods but unlike excise, it not applied only to a few selected goods
- It is an ad valorem tax the amount is based on the gross selling price or gross value in money of goods and services

Tax is based on the gross selling price or gross value in money of the goods or properties sold, bartered or exchanged or the gross receipts for services or total value or landed cost for imported goods.

Constitutionality of VAT

ABAKADA Guro Party List, et. al. v Ermita (2005):

- The validity of raising the VAT rate from 10% to 12% by the President was upheld by SC.
- The **assailed provisions** of RA 9337 are those that say that the President, upon the recommendation of the Sec. of Finance, shall raise the rate of VAT to 12% when VAT as a percentage of the GDP of the previous year exceeds 2 4/5% and when the deficit as a percentage of the previous year's GDP exceeds 1 ½%.
- This is NOT an undue delegation of legislative power. It is simply a delegation of ascertainment of facts upon which enforcement and administration of the increased rate under the law is contingent.
- It is the ministerial duty of the President to immediately impose the 12% rate upon the existence of any of the conditions specified by Congress.
- **Another assailed provision** is Sec. 8 amending Sec. 110(B), which imposes a limitation on the amount of input tax (70% of the output tax) that may be credited against the output tax.
- The Court says this does not violate due process. The excess input tax, if any, is retained in a business' books of accounts and remains creditable in the succeeding quarter/s.
- In addition, Sec. 112(B) allows a VAT-registered person to apply for the issuance of a tax credit certificate or refund for any unused input taxes, to the extent that such input taxes have not been applied against the output taxes. Such unused input tax may be used in payment of his other internal revenue taxes.
- The input tax is NOT a property or a property right within the constitutional purview of the due process clause.
- A VAT-registered person's entitlement to the creditable input tax is a mere statutory privilege.
- The right to credit input tax as against the output tax is clearly a privilege created by law, a privilege that also the law can remove, or in this case, limit.

[Note: This limitation of creditable input tax has been eliminated by RA 9361, effective December 2006. Please refer to the discussion on input taxes on page 112 of this reviewer.]

- With respect to Sec. 8, amending Sec. 110 (A), which provides for 60-month amortization of the input tax on capital goods purchased: It is **not oppressive, arbitrary, and confiscatory**. The taxpayer is not permanently deprived of his privilege to credit the input tax. For whatever is the purpose, it involves executive economic policy and legislative wisdom in which the Court cannot intervene.
- The tax law is **uniform**: it provides a standard rate of 0% or 10% (or 12% now) on all goods or services. *The law does not make any distinction as to the type of industry or trade* that will bear the 70% limitation on the creditable input tax, 5-year amortization of input tax on purchase of capital goods, or the 5% final withholding tax by the government.
- It is **equitable**: The law is equipped with a threshold margin (P1.5M). Also, basic marine and agricultural products in their original state are still not subject to tax. Congress also provided for mitigating measures to cushion the impact of the imposition of the tax on those previously exempt. Excise taxes on petroleum products and natural gas were reduced. Percentage tax on domestic carriers was removed. Power producers are now exempt from paying franchise tax.
- VAT, by its very nature, is **regressive**. **BUT the Constitution does not really prohibit the imposition of indirect taxes** (which is essentially regressive).
- What it simply provides is that Congress shall “evolve a progressive system of taxation”.
- In *Tolentino v. Sec. of Finance*, the Court said that direct taxes are to be preferred, and as much as possible, indirect taxes should be minimized... but not avoided entirely because it is difficult, if not impossible, to avoid them.

Tolentino v. Guingona:

- Regressivity is not a negative standard for courts to enforce.

What Congress is required by the Consti to do is to “evolve a progressive system of taxation.”

This provision is placed in the Consti as moral incentives to legislation, not as judicially enforceable rights.

- The regressive effects are corrected by the zero rating of certain transactions and through the exemptions.
- The transactions which are subject to VAT are those which involve goods and services which are used or availed of mainly by higher income groups (real properties held primarily for sale to customers, right or privilege to use patent, copyright...)

III. Impact of tax

- The impact of taxation is on the statutory taxpayer, the one from whom the government collects
- The impact of VAT is on the seller upon whom the tax has been imposed.

IV. Incidence of tax

- The incidence of tax is on the one who bears the burden of taxation.
- The incidence of VAT is on the final consumer.

V. Tax credit method

- The tax credit method refers to the manner by which the value added tax of a taxpayer is computed. The input taxes shifted by the sellers to the buyer are credited against the buyer’s output taxes when he in turn sells the taxable goods, properties or services.

VI. Destination principle

- The destination of the goods determines taxation or exemption from tax.

- NO VAT shall be imposed to form part of the cost of goods destined for CONSUMPTION OUTSIDE of the territorial border of the taxing authority.
- Hence, actual export of goods and services from the Phil to a foreign country must be free from VAT.
- Conversely, those destined for use or consumption WITHIN the Phil shall be imposed with the 12% VAT.

Tax Treatment of Sales Made:

- A. Any sale of goods, property or services made by a VAT registered supplier from the Customs Territory* to any registered enterprise operating in the ecozone, REGARDLESS of the class or type of the latter’s PEZA registration, is actually qualified and thus LEGALLY ENTITLED TO THE 0% VAT.
 - Accordingly, all sales of goods or property to such enterprise made by a VAT registered supplier from the Customs Territory shall be treated SUBJECT TO 0% VAT.

* **“Customs Territory”** means the national territory of the Phil OUTSIDE of the proclaimed boundaries of the ECOZONES.

- B. By a VAT-Exempt Supplier from the Customs Territory to a PEZA registered enterprise
 - Sale of goods, property and services by VAT-Exempt supplier from the Customs Territory to a PEZA registered enterprise shall be



treated EXEMPT FROM VAT, *regardless of whether or not the PEZA registered buyer is subject to taxes under the NIRC or enjoying the 5% special tax regime.*

C. By a PEZA Registered Enterprise

- 1) Sale of Goods by a PEZA registered enterprise to a buyer from the Customs Territory (ie domestic sales) -- this case shall be treated as a technical IMPORTATION made by the buyer. Such buyer shall be treated as an IMPORTER thereof and shall be imposed with the corresponding VAT.
- 2) Sale of Services by a PEZA registered enterprise to a buyer from the Customs Territory - this is NOT embraced by the 5% special tax regime, hence, such seller shall be SUBJECT TO 12% VAT.
- 3) Sale of Goods by a PEZA registered enterprise to Another PEZA registered enterprise (ie Intra-ECOZONE Sales of Goods) - this shall be EXEMPT from VAT.
- 4) Sale of Services by ECOZONE enterprise, to Another ECOZONE enterprise (Intra-ECOZONE enterprise Sale of Service)
 - (a) if PEZA registered seller is subject to 5% special tax regime
 - EXEMPT from VAT
 - (b) if PEZA registered seller is subject to taxes under NIRC (ie not subject to 5% special tax regime) - subject to 0% VAT pursuant to “*cross border doctrine*”

VII. Persons liable (Sec. 105)

- A. Any person who, in the course of trade or business,
- (1) sells, barter, exchanges goods or properties,
 - (2) leases goods or properties, and
 - (3) renders services.

- The phrase “*in the course of trade or business*” means:
 - *the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto,*
 - by any person regardless of whether or not the person engaged therein is a non-stock, nonprofit organization
 - irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests, or government entity. (Sec 105)

Exception: When the annual sales do not exceed P1,500,000 - Any person whose gross annual sales and/or receipts do not exceed the amount of One Million five hundred thousand pesos (P1,500,000), and who is not VAT-registered shall pay a tax equivalent to *three percent (3%) of his gross monthly sales or receipts.*

To be subject to 3% percentage tax, the following requisites must be satisfied:

1. The gross annual sales and/or receipts do not exceed P1,500,000.00; and
2. The taxpayer is not a VAT-registered person.

Thus, even if the sales or receipts do not exceed P1,500,00 if the taxpayer decides to become VAT-registered, he shall be subject to value-added tax.

Conversely, even if he does not register if his gross annual sales and/or receipts exceed P1,500,000, he shall be subject to value-added tax.

However, marginal income earners are not subject to business taxes because they are not considered as engaged in trade or business.

A marginal income earner is an individual deriving gross sales or receipts of not exceeding P100,000 during any 12-month period (*Rev. Reg. 11-2000*)

NOTE: The threshold amount has been increased to **One Million Nine Hundred Nineteen Thousand Five Hundred Pesos (P1,919,500)** per RR 16-2011.

- B. Any person who **imports goods**
- RR 16-2005: the importer, whether an individual or corporation and whether or not made in the course of his trade or business, shall be liable to pay VAT.

VIII. VAT on sale of goods or properties

Rate: 12% VAT (beginning 1 February 2006 (*RMC No. 7-06*))

Basis: Gross selling price or gross value in money of the goods or properties.

Who Pays: Paid by SELLER

Goods or properties - all tangible and intangible objects which are capable of pecuniary estimation, including:

1. Real properties held primarily for sale to customers or held for lease in the ordinary course of trade or business;
2. The right or the privilege to use patent, copyright, design, or model, plan, secret formula or process, goodwill, trademark, trade brand or other like property or right;
3. The right or the privilege to use in the Philippines of any industrial, commercial or scientific equipment;
4. The right or the privilege to use motion picture films, films tapes and discs;
5. Radio, television, satellite transmission and cable television time.

Requisites of taxability of sale of goods or properties



The sale of goods (tangible or intangible) must be:

1. an actual or deemed sale of goods or properties for a valuable consideration;
2. undertaken in the course of trade or business;
3. for the use or consumption in the Philippines; and
4. not exempt from value added tax under the Tax Code, special law, or international agreement

Gross Selling Price (GSP) - The total amount of money or its equivalent which the purchaser pays or is obligated to pay to the seller in consideration of the sale, barter or exchange of the goods or properties, excluding the value-added tax. The excise tax, if any, on such goods or properties shall form part of the gross selling price xxx

- 1) The consideration stated in the sales document, or
 - 2) The fair market value (FMV), whichever is the HIGHER of:
 - a) FMV as determined by the Commissioner (zonal value), or
 - b) FMV as shown in schedule of values of the Provincial & City assessors (real property tax declaration)
- If GSP is based on the zonal value or market value of the property, the zonal or market value shall be deemed EXCLUSIVE of VAT.
 - If the VAT is not billed separately, the selling price stated in the sales document shall be deemed to be EXCLUSIVE of VAT.

SALE OF REAL PROPERTY

Person Liable: gross sales/receipts > P1,919,500/year (per RR 16-2011)

1. Any person (natural or juridical) engaged in sale or exchange of real parties
2. Real estate lessors
3. Non-resident lessors (property located in the Philippines)
4. Non-stock, Non-profit organizations
5. Government agencies, instrumentalities, GOCCs

Taxable:

1. On installment plan
2. Pre-selling by real estate dealers
3. Sale of residential lot >P1,919,500 or house/lot for >P3,199,200 (RR 16-2011)
4. Lease of residential units (rent > 12,800/month or >P1,919,500/year)

Not taxable

1. Nor primarily held for sale
2. Low cost or socialized housing
3. Land < P1,919,500
4. House/Lot < P3,199,200
5. Lease (rent < 12,800/month or >P1,919,500/ year)
6. Transmission to a trustee (E: transferred as gift - deemed sale transaction)
7. Transfer to corporation in exchange of shares of stocks

8. Advance payment by the lessee
9. Security deposits for lease agreements

ON INSTALLMENT PLAN (RR 16-2005)
Scope (§ 4.106 - 3)

Installment Plan	Deferred Payment
Initial payment do not exceed 25% of the gross selling price	Initial payment exceeds 25% of the gross selling price
Taxable only on the payment actually or constructively received	Treated as cash sale and the entire selling price is taxable on the month of sale

- Sale of real property by a real estate dealer, the initial payments of which in the year of sale (down payment + all payments actually or constructively received during the year of sale) do not exceed 25% of the gross selling price.

However, in the case of sale of real properties on the deferred-payment basis, not on the installment plan, (meaning the initial payments in the year of sale exceed 25% of the gross selling price), the transaction shall be treated as cash sale which makes the entire selling price taxable in the month of sale.

- The **real estate dealer** shall be subject to VAT on the installment payments, including interest and penalties, actually and/or constructively received by the seller.
- Sale of residential lot exceeding P1.5M, residential house and lot or other residential dwellings exceeding P2.5M, where the instrument of sale is executed on or after July 1, 2005, shall be subject to [12%] VAT.

Where the instrument of sale was executed prior to July 1, 2005, the price needs only to exceed P1M for the installment sale of residential house and lot or other residential dwellings to be subject to 10% VAT.

- Transmission of property to a trustee shall NOT be subject to VAT IF the property is to be merely held in trust for the trustor and/or beneficiary. However, IF the property transferred is originally intended for sale, lease or use in the ordinary course of trade or business AND the transfer constitutes a completed gift, the transfer is subject to VAT as a deemed sale transaction. The transfer is a completed gift if the transferor divests himself absolutely of control over the property, i.e., irrevocable transfer of corpus and/or irrevocable designation of beneficiary.

IX. Zero-rated sales of goods or properties, and effectively zero-rated sales of goods or properties

- A zero-rated sale by a VAT-registered person is a taxable transaction for VAT purposes, but shall not result in any output tax.



➤ **Input tax** on purchases of goods, properties or services related to such zero-rated sale shall be available as **tax credit or refund**. (RR 16-2005)

- **Export sales (IF-GONE) (§ 106, (2))**
 - 1) The sale and actual shipment of goods from the Philippines to a Foreign country AND paid for in acceptable foreign currency or its equivalent in goods or services, AND accounted for in accordance with the rules and regulations of the BSP;
 - 2) Sale of raw materials or packaging materials to a Nonresident buyer for delivery to a resident local export-oriented enterprise to be used in manufacturing, processing, packing or repacking in the Philippines of the said buyer's goods AND paid for in acceptable foreign currency AND accounted for in accordance with the rules and regulations of the BSP
 - 3) Sale of raw materials or packaging materials to Export-oriented enterprise whose export sales exceed seventy percent (70%) of total annual production.
 - Any enterprise whose export sales exceed 70% of the total annual production of the preceding taxable year shall be considered an export-oriented enterprise upon accreditation under the rules & regulations of Export Development Act, RA 7844 (RR 7-95)
 - 4) Sale of Gold to the Bangko Sentral ng Pilipinas (BSP);
 - 5) Those considered export sales under the Omnibus Investment Code of 1987, and other special laws (ex. Bases Conversion & Development Act of 1992)
 - Under Omnibus Investment Code:
 - a) Phil. port FOB value of export products exported directly by a registered export producer;
 - b) Net selling price of export products sold by a registered export producer to another export producer, or to an export trader that subsequently exports the same (only when actually exported by the latter).
 - Constructive Exports:
 - b) sales to bonded manufacturing warehouses of export-oriented manufacturers;
 - c) sales to export processing zones;
 - d) sales to registered export traders operating bonded trading warehouses supplying raw materials in the manufacture of export products;
 - e) sales to diplomatic missions and other agencies and/or instrumentalities granted tax immunities, of locally manufactured, assembled or repacked products, whether paid for in foreign currency or not.

Provided that export sales of registered export traders may include commission income, and that exportation of goods on consignment shall not be deemed export sales until the export products consigned are in fact sold by the consignee, and

Provided finally that sales by a VAT-registered supplier to a manufacturer/producer whose products are 100% exported are considered export sales.

A certification to his effect must be issued by the Board of Investment which shall be good for 1 year unless subsequently re-issued. (RR 16-2005)

- 6) The sale of goods, supplies, equipment and fuel to persons engaged in International shipping or international air transport operations. (added by RA 9337)

Provided, that the same is limited to goods, supplies, equipment and fuel pertaining to or attributable to the transport of goods and passengers from a port in the Phil. directly to a foreign port without docking or stopping at any other port in the Phil., and that if any portion of such fuel, goods, or supplies is used for purposes other than that mentioned here, such portion of fuel, goods, and supplies shall be subject to 12% VAT.

- **Foreign Currency Denominated Sale (FCDS)**
 - 1) Sale to a nonresident of goods, except those mentioned in Sections 149 and 150 (automobiles and non-essential goods like jewelry, perfume, and yachts), assembled or manufactured in the Philippines for delivery to a resident in the Philippines paid for in acceptable foreign currency AND accounted for in accordance with the rules and regulations of the BSP.
 - 2) Sales of **locally manufactured or assembled goods for household and personal use to Filipinos abroad and other non-residents** of the Philippines as well as returning Overseas Filipinos under the Internal Export Program of the government paid for in convertible foreign currency AND accounted for in accordance with the rules and regulations of the BSP shall also be considered export sales.
- **Effectively zero-rated sales → Sales to persons or entities whose exemption under special laws or international agreements to which the Philippines is a signatory effectively subjects such sales to zero rate.**

Examples:

 - a) sales to enterprises duly registered & accredited with the



- i) Subic Bay Metropolitan Authority,
- ii) Philippine Economic Zone Authority (PEZA),
- b) international agreements to which the Phil. is signatory, such as
 - i) Asian Development Bank (ADB),
 - ii) International Rice Research Institute (IRRI)

1. the service is performed in the Philippines;
2. the service falls under any of the categories provided in Section 102(b) of the Tax Code; and
3. it is paid for in acceptable foreign currency that is accounted for in accordance with the regulations of the Bangko Sentral ng Pilipinas.

X. Transactions deemed sale (§ 106, B) [DR TC]

Section 6 of RR 4-2007, dated February 7, 2007:
The term effectively zero-rated sale of goods and properties shall refer to the local sale of goods and properties by a VAT-registered person to a person or entity who was granted indirect tax exemption under special laws or international agreement.

Note: RR 4-2007 removed the distinction between automatic and effectively zero-rated transactions found in prior Revenue Regulations (including RR 16-2005) with respect to prior application.

The following line in RR 16-2005 has been **DELETED** by RR 4-2007: “Other cases of zero-rated sales shall require prior application with the appropriate BIR office for effective zero-rating. Without an approved application for effective zero-rating, the transaction otherwise entitled to zero-rating shall be considered exempt. The foregoing rule notwithstanding, the Commissioner may prescribe such rules to effectively implement the processing of applications for effective zero-rating.”

CIR vs. Seagate Technology (Philippines) February 11, 2005:

- The BIR regulations additionally requiring an approved prior application for effective zero rating cannot prevail over the clear VAT nature of Seagate’s transactions (subject to zero-rating, as an entity registered with the PEZA).
- *Other than the general registration of a taxpayer the VAT status of which is aptly determined, no provision under our VAT law requires an additional application to be made for such taxpayer’s transactions to be considered effectively zero-rated.*
- An effectively zero-rated transaction does not and cannot become exempt simply because an application therefor was not made or, if made, was denied.
- RMC 74-99: Tax Treatment of Sales of Goods and Services Made by Suppliers from Western Territory to a PEZA registered enterprise and Sale Transactions made by PEZA registered enterprises Within and Without the Zone

CIR v. American Express (2005):

The court enumerated the exceptions to the destination principle.

As a **general rule**, the value-added tax (VAT) system uses the destination principle.

However, our VAT law itself provides for a clear exception, under which the supply of service shall be zero-rated when the following requirements are met:

Rate: 12% VAT

Basis: Market value of the goods deemed sold as of the time of the occurrence of the transactions or as the Commissioner shall prescribe

a. Transfer, use or consumption not in the course of business of goods or properties originally intended for sale or for use in the course of business (e.g. when a VAT-registered person withdraws goods from his business for his personal use.- RR 16-2005)

b. Distribution or transfer to:

- (a) Shareholders or investors as share in the profits of the VAT-registered persons; or
- (b) Creditors in payment of debt;

Note: Property dividends which constitute stocks in trade or properties primarily held for sale or lease declared out of retained earnings on or after Jan. 1, 1996 and distributed by the company to its shareholders shall be subject to VAT based on the zonal value or FMV at the time of the distribution, whichever is applicable. (RR 16-2005)

c. Consignment of goods if actual sale is not made within 60 days following the date such goods were consigned

Note: Consigned goods returned by the consignee within the 60-day period are not deemed sold. - RR 16-2005)

d. Retirement from or cessation of business, with respect to inventories of taxable goods existing as of such retirement or cessation.

- With respect to ALL goods on hand, whether capital goods, stock-in-trade, supplies or materials, as of the date of such retirement or cessation, whether or not the business is continued by the new owner or successor.
- Examples are change of ownership of the business (e.g. when a sole proprietorship incorporates, or the proprietor sells his entire business) and dissolution of a partnership and creation of a new partnership which takes over the business. - RR 16-2005)

XI. Change or cessation of status as VAT-registered person (Sec. 106(C))

Rate: 12% (as amended)

Basis: the acquisition cost or the current market price of the goods or properties, whichever is LOWER.

- VAT shall apply to goods disposed of or existing as of a certain date if under the circumstances to be prescribed in rules and regulations to be promulgated by the Secretary of Finance, upon recommendation of the Commissioner, the status of a person as a VAT-registered person changes or is terminated

Under RR 16-2005 § 4.106, B:

a. **Subject to VAT** - applicable to goods/properties originally intended for sale or use in business and capital goods which are existing as of the occurrence of the following:

1. **Change of business activity from VAT taxable status to VAT-exempt status**
2. **Approval of request for cancellation of a registration due to reversion to exempt status**
3. **Approval of request for cancellation of registration due to desire to revert to exempt status after lapse of 3 consecutive years from the time of registration by a person who voluntarily registered despite being exempt under Sec. 109 (2)**
4. **Approval of request for cancellation of registration of one who commenced business with the expectation of gross sales/receipts exceeding P1.5M (P1,919,500 per RR 16-2011) but who failed to exceed this amount during the first 12 months of operation**

b. **Not subject to VAT**

1. **Change of control of a corporation** by the acquisition of the controlling interest of such corporation by another stockholder (individual or corporate) or group of stockholders.

Note: Exchange of goods or properties including the real estate properties used in business or held for sale or for lease by the transferor, for shares of stocks, whether resulting in corporate control or not, is SUBJECT TO VAT (RR 10-11)

2. **Change in the trade or corporate name** of the business
3. **Merger or consolidation of corporations.** The unused input tax of the dissolved corporation, as of the date of merger or consolidation, shall be absorbed by the surviving or new corporation.

XII. VAT on importation of goods

Rate: 12% (as amended)

Basis: total value used by the Bureau of Customs in determining tariff and customs duties, plus customs duties, excise taxes, if any, and other charges,

- Where the customs duties are determined on the basis of the quantity or volume of the goods, the value-added tax shall be based on the landed cost plus excise taxes, if any.

Landed Cost = invoice amount + customs duties + freight + insurance + other charges + excise tax (if any)

Who Pays: Paid by the importer prior to the release of such goods from customs custody (107, A)

a. **Transfer of goods by tax exempt persons (§107, B)**

- If importer is tax-exempt, the subsequent purchasers, transferees or recipients of such imported goods shall be considered as importers who shall be liable for the tax on importation.
- The tax due on such importation shall constitute a lien on the goods superior to all charges or liens on the goods, irrespective of the possessor thereof. (as amended by RA 9337)

XIII. VAT on sale of service and use or lease of properties

Rate: 12% (as amended)

Basis: Gross receipts derived from the sale or exchange of services, including the use or lease of properties. (108, A)

Gross Receipts: the total amount of money or its equivalent representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits and advanced payments actually or constructively received during the taxable quarter for the services performed or to be performed for another person, excluding value-added tax xxx (as amended by RA 9337, underscored parts amended or added by RA 9337)

“**Constructive receipt**” occurs when the money consideration or its equivalent is placed at the control of the person who rendered the service without restrictions by the payor. Examples:

- 1) deposit in banks which are made available to the seller of services without restrictions
- 2) issuance by the debtor of a notice to offset any debt or obligation and acceptance thereof by the seller as payment for services rendered
- 3) transfer of the amounts retained by the contractee to the account of the contractor.

Requisites for taxability

1. The service must be performed or is to be performed in the course of trade or business in the Philippines;
2. For a valuable consideration actually or constructively received; and



3. The service is not exempt under the Tax Code, special law or international agreement
4. Person selling or rendering service is liable to VAT

Lease of Properties:

- Subject to the tax imposed *irrespective of the place where the contract of lease or licensing agreement was executed if the property is leased or used in the Philippines.*

Notes: (unless otherwise indicated, from RR 16-2005)

1. Persons engaged in **milling, processing, manufacturing** or repacking goods for others are subject to VAT, EXCEPT palay into rice, corn into corn grits, and sugarcane into raw sugar
2. For **dealers in securities**, “gross receipts” means gross selling price less cost of the securities sold. RR 7-95: Pre-need companies are considered dealers in securities.
3. **Lending investors:** all persons OTHER than banks, non-bank financial intermediaries, finance companies and other financial intermediaries NOT performing quasi-banking functions who make a practice of lending money for themselves or others at interest
4. Subject to VAT: **Franchise grantees** of electric utilities, telephone and telegraph, radio and/or TV broadcasting and all other franchise grantees (including PAGCOR and its licensees/franchisees)
 - EXCEPT franchise grantees of radio and/or TV broadcasting whose annual gross receipts of the preceding year do not exceed P10M (which shall be subject to 3% franchise tax under Sec. 119, subject to optional registration), and franchise grantees of gas and water facilities (under Sec. 109, subject to 2% franchise tax).
 - With respect to franchise grantees of telephone and telegraph services, amounts received for overseas dispatch, message, or conversation originating from the Philippines are subject to the percentage tax under Sec. 120 and hence exempt from VAT.
5. In a lease contract, the advance payment by the lessee may be:
 - a) a loan to the lessor from the lessee
 - NOT subject to VAT
 - b) an option money for the property
 - NOT subject to VAT
 - c) a security deposit to insure the faithful performance of certain obligations of the lessee to the lessor
 - NOT subject to VAT
 - BUT if the security deposit is applied to rental, it shall be subject to VAT at the time of its application.
 - d) Pre-paid rental: subject to VAT when received, irrespective of the accounting method employed by the lessor.
6. On transportation:

- **All receipts** from service, hire, or operating lease of transportation equipment **not subject to the percentage tax** on domestic common carriers and keepers of garages shall be subject to VAT.

Com mon carrier	Transpor ting	Kind of carrier	Tax Liability
By land	Persons	Domestic	3% percentage tax, Sec. 117
	Goods/ca rgo	Domestic	12% VAT, Sec. 108
By sea	Whether transport ing persons or goods/ca rgo	Domestic	Domestic trip - 12% VAT International trip - zero-rated VAT
		Internatio nal	Doing business in the Philippines 3% percentage tax, Sec. 118 International trip- zero-rated VAT, Sec. 108.B.6
		Domestic	Domestic flight - 12% VAT, Sec. 108 International flight - zero-rated VAT
By air			

7. **Sale of electricity** by generation, transmission, and distribution companies shall be subject to 12% VAT,
 - EXCEPT sale of power or fuel generated through renewable sources of energy, such as, but not limited to, biomass, solar, wind hydropower, geothermal, ocean energy, and other emerging energy sources using technologies such as fuel cells and hydrogen fuels, which shall be subject to 0% rate of VAT (zero-rated).
 - The *universal charge* passed on and collected by distribution companies and electric cooperatives shall be excluded from the computation of gross receipts.
8. **Insurance** and reinsurance commissions, as opposed to premiums, whether life or non-life, are subject to VAT.
 - Non-life insurance *premiums* are subject to VAT.
 - Life insurance *premiums* are NOT subject to VAT, for they are subject to percentage tax.

XIV. Zero-rated sale of services (§ 108, B)

- A zero-rated sale by a VAT-registered person is a **taxable transaction** for VAT purposes, but shall **not result in any output tax**.
- **Input tax** on purchases of goods, properties or services related to such zero-rated sale shall be available as **tax credit or refund**. (RR 16-2005)

- 1) Processing, manufacturing or repacking goods for other persons doing business outside the Philippines which goods are subsequently exported, where the services are paid for in acceptable foreign currency AND accounted for in accordance with the rules and regulations of the BSP
- 2) Services other than those mentioned in the preceding paragraph rendered to a person engaged in business conducted outside the Philippines OR a nonresident person not engaged in business who is outside the Philippines when the services are performed, the consideration for which is paid for in acceptable foreign currency AND accounted for in accordance with the rules and regulations of the BSP
- 3) Services rendered to persons or entities whose **exemption under special laws or international agreements** to which the Philippines is a signatory effectively subjects the supply of such services to zero percent (0%) rate [as amended by RA 9337]
- 4) Services rendered to persons **engaged in international shipping or international air transport operations**, including leases of property for use thereof [as amended by RA 9337];
Provided, however, that the services referred to herein shall not pertain to those made to common carriers by air and sea relative to their transport of passengers, goods or cargoes from one place in the Phil. to another place in the Phil. (the same being subject to 12% VAT under Sec. 108)
- 5) Services performed by **subcontractors and/or contractors** in processing, converting, or manufacturing goods for an enterprise whose export sales exceed seventy percent (70%) of total annual production.
- 6) **Transport of passengers and cargo** by air or sea vessels *from the Philippines to a foreign country* [as added by RA 9337]; (pls see table on page 29) and;
- 7) **Sale of power or fuel generated through renewable sources of energy** such as, but not limited to, biomass, solar, wind, hydropower, geothermal, ocean energy, and other emerging energy sources using technologies such as fuel cells and hydrogen fuels. [as added by RA 9337]
Zero-rating shall **apply strictly to the sale of power or fuel generated through renewable sources of energy**, and shall not extend to the sale of services related to the maintenance or operation of plants generating said power.

RR 4-2007 removed the distinction between automatic and effectively zero-rated transactions

found in prior Revenue Regulations (inc. RR 16-2005) with respect to prior application.

XIV. VAT exempt transactions

a. VAT exempt transactions, in general

- Refer to sale of goods or properties and/or services and the use or lease of properties that is **NOT subject to VAT** (output tax) and the seller is **not allowed any tax credit of VAT** (input tax) on purchases. The person making the exempt sale of goods, properties or services shall not bill any output tax to his customers because the said transaction is not subject to VAT.
- But, the VAT-registered person may elect the exemption not to apply to its sale of goods or properties or services; provided that the election made shall be irrevocable for a period of three (3) years from the quarter the election was made. (109(2))

b. Exempt transaction, enumerated

1. Sale/ import of agricultural, marine food products in original state; of livestock and poultry

- Original state even if they have undergone the simple processes of preparation or preservation for the market, such as freezing, drying, salting, broiling, roasting, smoking or stripping.
- Polished and/or husked rice, corn grits, raw cane sugar and molasses, ordinary salt, AND COPRA shall be considered in their original state;

Livestock or poultry does not include fighting cocks, race horses, zoo animals and other animals generally considered as pets. [RR 16-2005]

Original state - including preservation using advanced technological means of packaging, such as shrink wrapping in plastics, vacuum packing, tetra-pack, and other similar packaging methods. [RR 16-2005]

2. Sale/ import of fertilizers; seeds, seedlings and fingerlings; fish, prawn, livestock and poultry feeds
3. Import of personal and household effects of Phil resident returning from abroad and nonresident citizens coming to resettle in the Philippines
4. Import of professional instruments and implements, wearing apparel, domestic animals, and personal household effects belonging to persons coming to settle in the Philippines, for their own use and not for sale, barter or exchange
5. Services subject to percentage tax
6. Services by agricultural contract growers and milling for others of palay into rice, corn into grits and sugar cane into raw sugar
7. Medical, dental, hospital and veterinary services except those rendered by professionals:

Laboratory services are exempted. If the hospital or clinic operates a pharmacy or drug



store, the sale of drugs and medicine is subject to VAT. [RR 16-2005]

8. Educational services rendered by private educational institutions, duly accredited by DEPED, CHED, TESDA, and those rendered by government educational institutions;

“Educational services” does not include seminars, in-service training, review classes and other similar services rendered by persons who are not accredited by the DepED, CHED, and/or TESDA. [RR 16-2005]

9. Services rendered by individuals pursuant to an employer-employee relationship
10. Services rendered by regional or area headquarters established in the Philippines by multinational corporations which act as supervisory, communications and coordinating centers for their affiliates, subsidiaries or branches in the Asia-Pacific Region and do not earn or derive income from the Philippines
11. Transactions which are exempt under international agreements to which the Philippines is a signatory or under special laws, except those under Presidential Decree No., 529 [*Petroleum Exploration Concessionaires under the Petroleum Act of 1949*]
12. Sales by agricultural cooperatives duly registered with the Cooperative Development Authority to their members as well as sale of their produce to non-members. Exemption includes importation of direct farm inputs, machineries and equipment, including spare parts thereof, to be used directly and exclusively in the production and/or processing of their produce.

Sale by agricultural cooperatives to non-members can only be exempted from VAT if the producer of the agricultural products sold is the cooperative itself. If the cooperative is not the producer (e.g., trader), then only those sales to its members shall be exempted from VAT. [RR 16-2005]

13. Gross receipts from lending activities by credit or multi-purpose cooperatives duly registered with the Cooperative Development Authority
14. Sales by non-agricultural, non- electric and non-credit cooperatives duly registered with the Cooperative Development Authority are exempt BUT their importation of machineries and equipment, including spare parts thereof, to be used by them are SUBJECT to VAT.
15. Export sales by persons who are not VAT-registered
16. Sale of real properties - the ff. sales are exempt:

- (1) Sale of real properties NOT primarily held for sale to customers or held for lease in the ordinary course of trade or business.

However, even if the real property is not primarily held for sale to customers or held for lease in the ordinary course of trade or business but the same is used in the trade or business of the seller, the sale thereof shall be subject to

VAT being a transaction incidental to the taxpayer’s main business. [RR 16-2005]

CS Garments, Inc. v. CIR (CTA Case No. 6520, Jan. 4, 2007)- Transactions that are made incidental to the pursuit of a commercial or economic activity are considered as entered into in the course of trade or business.

CIR v. CA (329 SCRA 237, Mar. 30, 2000): Even a *non-stock, non-profit*, organization or government entity, is liable to pay VAT, even in the absence of profit attributable thereto. The term “in the course of trade or business” requires the regular conduct or pursuit of a commercial or an economic activity, regardless of WON the entity is profit-oriented.

Hence, it is immaterial whether the primary purpose of a corporation indicates that it receives payments for services rendered to its affiliates on a reimbursement-on-cost basis only, without realizing profit, for purposes of determining liability for VAT on services rendered. As long as the entity provides service for a fee, remuneration or consideration, then the service rendered is subject to VAT.

- (2) Sale of real properties utilized for low-cost housing as defined by RA No. 7279, otherwise known as the “Urban Development and Housing Act of 1992” and other related laws, such as RA No. 7835 and RA No. 8763.

“Low-cost housing” refers to housing projects intended for *homeless low-income family beneficiaries*, undertaken by the Government or private developers, which may either be a subdivision or a condominium registered and licensed by the Housing and Land Use Regulatory Board/Housing (HLURB) under BP Blg. 220, PD No. 957 or any other similar law, wherein the unit selling price is within the selling price ceiling per unit of P750,000.00 under RA No. 7279, and other laws, such as RA No. 7835 and RA No. 8763.

- (3) Sale of real properties utilized for socialized housing as defined under RA No. 7279, and other related laws, such as RA No. 7835 and RA No. 8763, wherein the price ceiling per unit is P225,000.00 or as may from time to time be determined by the HUDCC and the NEDA and other related laws.

“Socialized housing” refers to housing programs and projects covering houses and lots or home lots only undertaken by the Government or the private sector *for the underprivileged and homeless citizens* which shall include sites and services development, long-term financing, liberated terms on interest payments, and such other benefits in accordance with the provisions of RA No. 7279 and RA No. 7835 and RA No. 8763.

"Socialized housing" shall also refer to projects intended for the underprivileged and homeless wherein the housing package selling price is within the lowest interest rates under the Unified Home Lending Program (UHLP) or any equivalent housing program of the Government, the private sector or non-government organizations.

- (4) Sale of residential lot valued at P1.5M and below, or house & lot and other residential dwellings valued at P2.5M and below, where the instrument of sale/transfer/disposition was executed on or after July 1, 2005; [to be adjusted every 3 years from Jan 31, 2009];
- If two or more adjacent residential lots are sold or disposed in favor of one buyer, for the purpose of utilizing the lots as one residential lot, the sale shall be exempt from VAT only if the aggregate value of the lots does not exceed P1.5M.
 - Adjacent residential lots, although covered by separate titles and/or separate tax declarations, when sold or disposed to one and the same buyer, whether covered by one or separate Deed of Conveyance, shall be presumed as a sale of one residential lot. [RR 16-2005]
17. Lease of residential units with a monthly rental per unit not exceeding P10K, regardless of the amount of aggregate rentals received by the lessor during the year.
- Lease of residential units where the monthly rental per unit exceeds 10K but the aggregate of such rentals of the lessor during the year do not exceed One Million Five Hundred Pesos P1.5M shall likewise be exempt from VAT, however, the same shall be subjected to three percent (3%) percentage tax.
 - In cases where a lessor has several residential units for lease, some are leased out for a monthly rental per unit of not exceeding P10K while others are leased out for more than P10K per unit, his tax liability will be as follows:
 - d. The gross receipts from rentals not exceeding P10K per month per unit shall be exempt from VAT regardless of the aggregate annual gross receipts.
 - e. The gross receipts from rentals exceeding P10K per month per unit shall be subject to VAT IF the aggregate annual gross receipts from said units only (not including the gross receipts from units leased for not more than P10K) exceeds P1.5M. Otherwise, the gross receipts will be subject to the 3% tax imposed under Section 116 of the Tax Code.
- The term 'residential units' shall refer to apartments and houses & lots used for residential purposes, and buildings or parts or units thereof used solely as dwelling places (e.g., dormitories, rooms and bed spaces) except motels, motel rooms, hotels and hotel rooms.
- The term 'unit' shall mean an apartment unit in the case of apartments, house in the case of residential houses; per person in the case of dormitories, boarding houses and bed spaces; and per room in case of rooms for rent. [RR 16-2005]
18. Sale, importation, printing or publication of books and any newspaper, magazine review or bulletin which appears at regular intervals with fixed prices for subscription and sale and which is not devoted principally to the publication of paid advertisements;
19. Sale, importation or lease of passenger or cargo vessels and aircraft, including engine, equipment and spare parts thereof for domestic or international transport operations; [added by RA 9337]
- The exemption from VAT on the importation and local purchase of passenger and/or cargo vessels shall be limited to those of 150 tons and above, including engine and spare parts of said vessels;

Provided, further, that the vessels to be imported shall comply with the age limit requirement, at the time of acquisition counted from the date of the vessel's original commissioning, as follows:

 - (i) for passenger and/or cargo vessels, the age limit is 15 years old,
 - (ii) for tankers, the age limit is 10 years old, and
 - (iii) for high-speed passenger crafts, the age limit is 5 years old [RR 16-2005]
20. Importation of fuel, goods, and supplies by persons engaged in international shipping or air transport operations; [added by RA 9337]
- Provided, that the said fuel, goods and supplies shall be used exclusively or shall pertain to the transport of goods and/or passenger from a port in the Philippines directly to a foreign port without stopping at any other port in the Philippines;
 - Provided, further, that if any portion of such fuel, goods or supplies is used for purposes other than that mentioned in this paragraph, such portion of fuel, goods and supplies shall be subject to 12% VAT starting Feb. 1, 2006. [RR 16-2005]
21. Services of banks, non-bank financial intermediaries performing quasi-banking functions and other non-bank financial intermediaries; and
22. Sale or lease of goods or properties or the performance of services other than the transactions mentioned in the preceding

paragraphs, the gross annual sales and/or receipts do not exceed the amount of P1,500,000: [to be adjusted every 3 years from Jan 31, 2009]

For purposes of the threshold of P1,5M, the husband and the wife shall be considered *separate* taxpayers. However, the aggregation rule for each taxpayer shall apply.

- For instance, if a professional, aside from the practice of his profession, also derives revenue from other lines of business which are otherwise subject to VAT, the same shall be combined for purposes of determining whether the threshold has been exceeded.
- The VAT-exempt sales shall NOT be included in determining the threshold. [RR 16-2005]

XV. Input tax and output tax, defined

INPUT TAX - the VAT due from or paid by a VAT-registered person in the course of his trade or business on importation of goods or local purchase of goods or services, including lease or use of property, from a VAT-registered person.

- It includes the transitional input tax determined in accordance with Section 111 of this Code.
- It includes input taxes which can be directly attributed to transactions subject to the VAT plus a ratable portion of any input tax which cannot be directly attributed to either the taxable or exempt activity.
- Input tax must evidenced by a VAT invoice or official receipt issued by a VAT-registered person in accordance with Secs. 113 and 237 of the Tax. [RR 16-2005]

OUTPUT TAX - the VAT due on the sale or lease of taxable goods or properties or services by any person registered or required to register under Section 236 of this Code.

XVI. Sources of input tax

- a. Purchase or importation of goods
 - (i) For sale; or
 - (ii) For conversion into or intended to form part of a finished product for sale including packaging materials; or
 - (iii) For use as supplies in the course of business; or
 - (iv) For use as materials supplied in the sale of service; or
 - (v) For use in trade or business for which deduction for depreciation or amortization is allowed under this Code.
- b. Purchase of real properties for which a VAT has actually been paid
- c. Purchase of services in which VAT has actually been paid
- d. Transactions deemed sale
- e. Transitional input tax

- 2% of Beginning inventory of goods, materials and supplies or the actual VAT paid on such goods, materials and supplies (whichever is HIGHTER)

f. Presumptive input tax (§ 111, B)

- Persons or firms engaged in the processing of sardines, mackerel and milk, and in manufacturing refined sugar and cooking oil and packed noodle based instant meals, shall be allowed a presumptive input tax, creditable against the output tax, equivalent to FOUR PERCENT (4%) of the gross value in money of their purchases of primary agricultural products which are used as inputs to their production.

g. Transitional input tax credits allowed under the transitory and other provisions of the regulations

XVII. Persons who can avail of input tax credit

a. Creditable Tax (110(A(2))) -

Input tax on domestic purchase or importation of goods or properties shall be **creditable**:

- (a) **To the purchaser** upon consummation of sale and on importation of goods or properties; and
- (b) **To the importer** upon payment of the value-added tax prior to the release of the goods from the custody of the Bureau of Customs.

- *Provided*, That the input tax on goods purchased or imported in a calendar month for use in trade or business for which deduction for depreciation is allowed under this Code, shall be spread evenly over the month of acquisition and the fifty-nine (59) succeeding months if the aggregate acquisition cost for such goods, excluding the VAT component thereof, exceeds One million pesos (P1,000,000):

- *Provided, however*, That if the estimated useful life of the capital good is *less than five (5) years*, as used for depreciation purposes, then the input VAT shall be **spread over such a shorter period**:

- *Provided, finally*, that in the case of purchase of services, lease or use of properties, *the input tax shall be creditable* to the purchaser, lessee or licensee upon payment of the compensation, rental, royalty or fee.

b. Transitional Tax (111(A))

- Any person liable for VAT or who elects to be a VAT-registered person shall be allowed INPUT TAX in his beginning inventory of goods, materials and supplies



- equivalent to TWO PERCENT (2%) of the value of such inventory; OR
- the actual VAT paid on such goods, materials and supplies, whichever is higher, which shall be creditable against the OUTPUT TAX.

c. Presumptive Input Tax (111(B))–

Persons or firms engaged in the processing of sardines, mackerel and milk, and in manufacturing refined sugar and cooking oil and packed noodle based instant meals, shall be allowed a presumptive input tax, creditable against the output tax, equivalent to FOUR PERCENT (4%) of the gross value in money of their purchases of primary agricultural products which are used as inputs to their production.

"Processing" shall mean pasteurization, canning and activities which through physical or chemical process alter the exterior texture or form or inner substance of a product in such manner as to prepare it for special use to which it could not have been put in its original form or condition. [RR 16-05]

XVIII. Determination of output/input tax; VAT payable; Excess input tax credits

a. Determination of output tax

- If at the end of any taxable quarter, the output tax exceeds the input tax, the excess shall be paid by the VAT-registered person.

b. Determination of input tax creditable (§ 110, C)

- The sum of the excess input tax carried over from the preceding month or quarter and the input tax creditable to a VAT-registered person during the taxable month or quarter shall be **reduced by** the amount of claim for refund or tax credit for value-added tax and other adjustments, such as purchase returns or allowances and input tax attributable to exempt sale.
- The claim for tax credit referred to includes not only those filed with the BIR but also those filed with other government agencies, such as the Board of Investments the Bureau of Customs.

c. Allocation of input tax on mixed transactions

- A VAT-registered person who is also engaged in transactions not subject to VAT shall be allowed to recognize input tax credit on transactions subject to VAT as follows:

23. All the input taxes that can be directly attributed to transactions subject to VAT may be recognized for input tax credit;

Provided, that input taxes that can be directly attributable to VAT taxable sales of goods and services to the Government or any of its political subdivisions, instrumentalities or agencies, including

GOCCs shall not be credited against output taxes arising from sales to non-Government entities; and

- 24. If any input tax cannot be directly attributed to either a VAT taxable or VAT-exempt transaction, **the input tax shall be pro-rated to the VAT taxable and VAT-exempt transactions** and only the ratable portion pertaining to transactions subject to VAT may be recognized for input tax credit.

Illustration: ERA Corporation has the following sales during the month:

Sale to private entities subject to 12%	100,000.00
Sale to private entities subject to 0%	100,000.00
Sale of exempt goods	100,000.00
Sale to gov't. subjected to 5% final VAT w/holding	100,000.00
Total sales for the month	400,000.00

The following were its input taxes (or passed on by its VAT suppliers):

Input tax on taxable goods (12%)	5,000.00
Input tax on zero-rated sales	3,000.00
Input tax on sale of exempt goods	2,000.00
Input tax on sale to government	4,000.00
Input tax on depreciable capital good not attributable to any specific activity (monthly amortization for 60 months)	20,000.00

Step 1: The creditable input tax for the month shall be computed as follows:

Input tax on sale subject to 12%	P5,000.00
Input tax on zero-rated sale	3,000.00
Ratable portion of the input tax not directly attributable to any activity, computed below	
Taxable sales (0% and 12%)	Amount of input tax not directly attributable
Total Sales	x
P200,000.00	P20,000.00
P400,000.00	= P10,000.00

- Total creditable input tax for the month: P18,000.00 (P5,000+P3,000+P10,000)

Step 2: The input tax attributable to sales to government for the month shall be computed as follows:

Input tax on sale to gov't.	P4,000.00
➤ Ratable portion of the input tax not directly attributable to any activity, computed as follows:	
Taxable sales	Amount of input tax not directly attributable
Total Sales	x
P100,000.00	P20,000.00
P400,000.00	= P5,000.00

- Total input tax attributable to sales to government: P9,000.00 (P4,000 + P5,000)

These amounts are not available for input tax credit but may be recognized as cost or expense. That is because as far as sales to government are



concerned, there is a VAT that is finally withheld (at 5%).

Step 3: The input tax attributable to VAT-exempt sales for the month shall be computed as follows:

Input tax on VAT-exempt sales P2,000.00

➤ Ratable portion of the input tax not directly attributable to any activity, computed below:

VAT-exempt sales		Amount of input tax
<u>Total Sales</u>	x	not directly attributable

$$\frac{P100,000.00}{P400,000.00} \times P20,000.00 = P5,000.00$$

➤ Total input tax attributable: P7,000.00
 VAT-exempt sales (P2,000+ P5,000)

These amounts are not available for input tax credit but may be recognized as cost or expense.

d. Determination of the output tax and VAT payable and computation of VAT payable or excess tax credits (§ 110, B)

- If at the end of any taxable month or quarter:
 - the output tax exceeds the input tax, the excess shall be paid by the VAT-registered person.
 - the input tax exceeds the output tax, the excess shall be carried over to the succeeding quarter or quarters:
- *Provided, however,* that any input tax attributable to zero-rated sales by a VAT-registered person may at his option be refunded or applied for a tax credit certificate which may be used in the payment of internal revenue taxes. [RR 16-05]

XIX. Substantiation of input tax credits

RR 16-2005: Substantiation of Input Tax Credits

- (a) INPUT TAXES must be substantiated and supported by the following documents, and must be reported in the information returns required to be submitted to the Bureau:
- (1) For the importation of goods
 - **Import entry** or other equivalent document showing actual payment of VAT on the imported goods.
 - (2) For the domestic purchase of goods and properties
 - **Invoice** showing the information required under Secs. 113 and 237 of the Tax Code.
 - (3) For the purchase of real property
 - **public instrument** i.e., deed of absolute sale, deed of conditional sale, contract/agreement to sell, etc., together with VAT invoice issued by the seller.
 - (4) For the purchase of services

- **official receipt** showing the information required under Secs. 113 and 237 of the Tax Code.

A cash register machine tape issued to a registered buyer shall constitute valid proof of substantiation of tax credit only if it shows the information required under Secs. 113 and 237 of the Tax Code.

- (b) TRANSITIONAL INPUT TAX shall be supported by an **inventory of goods** as shown in a detailed list to be submitted to the BIR.
- (c) Input tax on **"DEEMED SALE" TRANSACTIONS** shall be substantiated with the invoice required.
- (d) **INPUT TAX FROM PAYMENTS MADE TO NON-RESIDENTS** (such as for services, rentals and royalties) shall be supported by a copy of the Monthly Remittance Return of Value Added Tax Withheld (BIR Form 1600) filed by the resident payor in behalf of the non-resident evidencing remittance of VAT due which was withheld by the payor.
- (e) **ADVANCE VAT ON SUGAR** shall be supported by the Payment Order showing payment of the advance VAT.

XX. Refund or tax credit of excess input tax

a. Who may claim for refund/apply for issuance of tax credit certificate (TCC)

1. Zero-Rated Sales (§ 112, A)

- Any VAT-registered person, whose sales are zero-rated or effectively zero-rated may apply for the issuance of a tax credit certificate or refund of creditable input tax due or paid attributable to such sales, except transitional input tax, to the extent that such input tax has not been applied against output tax: [within two (2) years after the close of the taxable quarter when the sales were made]
- **PROVIDED**, however, that in the case of zero-rated sales under Section 106(A)(2)(a)(1), (2) and (B) and Section 108 (B)(1) and (2), the acceptable foreign currency exchange proceeds had been duly accounted for in accordance with the rules and regulations of the Bangko Sentral ng Pilipinas (BSP):
- **PROVIDED**, further, that where the taxpayer is engaged in zero-rated or effectively zero-rated sale and also in taxable or exempt sale of goods of properties or services, and the amount of creditable input tax due or

paid cannot be directly and entirely attributed to any one of the transactions, it shall be allocated proportionately on the basis of the volume of sales.

- *Provided, finally*, that for a person making sales that are zero-rated under section 108 (b)(6), the input taxes shall be allocated ratably between his zero-rated and non-zero-rated sales.

2. Cancellation of VAT Registration. (§ 112, C)

- A person whose *registration has been cancelled due to retirement from or cessation of business*, or due to changes in or cessation of status under Section 106(C) of this Code may, within two (2) years from the date of cancellation, apply for the issuance of a tax credit certificate for any unused input tax which may be used in payment of his other internal revenue taxes.

- Provided, however, that he shall be entitled to a refund if he has no internal revenue tax liabilities against which the tax credit certificate may be utilized.

b. Period to file claim/apply for issuance of TCC (§ 112, D)

- In proper cases, the Commissioner of Internal Revenue shall grant a tax credit certificate/refund for creditable input taxes within one hundred twenty (120) days from the date of submission of complete documents in support of the application filed in accordance with subparagraph (a) above.
- In case of full or partial **denial** of the claim for tax credit certificate/refund as decided by the Commissioner of Internal Revenue,
 - The taxpayer may **appeal** to the Court of Tax Appeals (CTA) within thirty (30) days from the receipt of said denial, otherwise the decision shall become final.
 - However, if **no action** on the claim for tax credit certificate/refund has been taken by the Commissioner of Internal Revenue after the one hundred twenty (120) day period from the date of submission of the application with complete documents, the taxpayer may **appeal** to the CTA within 30 days from the lapse of the 120-day period. [RR 16-2005]

c. Manner of giving refund

Refunds shall be made upon warrants drawn by the Commissioner or by his duly authorized representative without the necessity of being countersigned by the Chairman, Commission on Audit, the provisions of the Administrative Code of 1987 notwithstanding: That refunds shall be subject to post audit by the Commission on Audit. (112(D))

d. Destination principle or Cross-border doctrine

- The destination of the goods determines taxation or exemption from tax. Export sales of goods are subject to zero percent (0%) rate while imports of goods are subject to 12% value added tax.

XXI. Invoicing requirements

a. Invoicing requirements in general

- A VAT-registered person shall issue:
 - (1) A **VAT invoice** for every sale, barter or exchange of goods or properties; and
 - (2) A **VAT official receipt** for every lease of goods or properties, and for every sale, barter or exchange of services.

Only VAT-registered persons are required to print their TIN followed by the word "VAT" in their invoice or ORs. All purchases covered by invoices/receipts other than VAT Invoice/VAT OR shall not give rise to any input tax. [RR 16-05]

Information Contained in the VAT Invoice or VAT Official Receipt:

- (1) **A statement that the seller is a VAT-registered person, followed by his taxpayer's identification number (TIN);**
- (2) The total amount which the purchaser pays or is obligated to pay to the seller with the indication that such amount includes the value-added tax;
- (3) **Provided, that:**
 - (a) The amount of the tax shall be shown as a separate item in the invoice or receipt;
 - (b) If the sale is exempt from value-added tax, the term "VAT-exempt sale" shall be written or printed prominently on the invoice or receipt;
 - (c) If the sale is subject to zero percent (0%) value-added tax, the term "zero-rated sale" shall be written or printed prominently on the invoice or receipt;
 - (d) If the sale involves goods, properties or services some of which are subject to and some of which are VAT zero-rated or VAT-exempt, the **invoice or receipt shall clearly indicate the breakdown of the sale price between its taxable, exempt and zero-rated components**, and the calculation of the value-added tax on each portion of the sale shall be shown on the invoice or receipt;
 - (e) "Provided, That the seller may issue separate invoices or receipts for the taxable, exempt, and zero-rated components of the sale.
- (4) The date of transaction, quantity, unit cost and description of the goods or properties or nature of the service; and
- (5) In the case of sales in the amount of one thousand pesos (P1,000) or more where the sale or transfer is made to a VAT-registered person, the name, business style, if any, address and taxpayer identification number (TIN) of the purchaser, customer or client. xxx

b. Invoicing and recording deemed sale transactions



Transaction	Invoicing Requirement
Transfer, use or consumption not in the course of business of goods or properties originally intended for sale or for use in the course of business	Memorandum entry in the subsidiary sales journal to record withdrawal of goods for personal use
Distribution or transfer to shareholders/investors or creditors	Invoice, at the time of the transaction, which should include all the info prescribed in Sec. 113(B)
Consignment of goods if actual sale is not made within 60 days	Invoice, at the time of the transaction, which should include all the info prescribed in Sec. 113(B)
Retirement from or cessation of business with respect to all goods on hand	An inventory shall be prepared and submitted to the RDO who has jurisdiction over the taxpayer's principal place of business not later than 30 days after retirement or cessation from the business. An invoice shall be prepared for the entire inventory, which shall be the basis of the entry into the subsidiary sales journal. The invoice need not enumerate the specific items appearing in the inventory regarding the description of the goods. If the business is to be continued by the new owners or successors, the entire amount of output tax on the amount deemed sold shall be allowed as input taxes.

c. Consequences of issuing erroneous VAT invoice or VAT official receipt (§ 113, D)

- (1) If a person who is not a VAT-registered person issues an invoice or receipt showing his Taxpayer Identification Number (TIN), **followed by the word "VAT"**, the erroneous issuance shall result to the ff:
- (a) The non-VAT person shall be liable to:
 - (i) the percentage taxes applicable to his transactions;
 - (ii) VAT due on the transactions under Section 106 or 108, without the benefit of any input tax credit; and
 - (iii) a 50% surcharge under Section 248 (B) of this code;
 - (b) The VAT shall, if the other requisite information required under Subsection (B) hereof is shown on the invoice or receipt,

be recognized as an input tax credit to the purchaser under Section 110 of this Code.

- (2) If a VAT-registered person issues a VAT invoice or VAT official receipt for a VAT-exempt transaction, but **fails to display prominently on the invoice or receipt the term "VAT-exempt Sale"**, the issuer shall be *liable to account for the tax imposed in Section 106 or 108 as if Section 109 did not apply*. The purchaser shall be entitled to claim an input tax credit on his purchase. [RR 16-05]

XXII. Filing of return and payment

Vat Returns (§ 114)

- Filed by person liable to pay the VAT
 - Quarterly return** of the amount of his gross sales or receipts within twenty-five (25) days after the close of each taxable quarter prescribed for each taxpayer.
 - The monthly VAT Declarations of taxpayers whether large or non-large shall be filed and the taxes paid not later than the 20th day following the end of each month.

Note: VAT paid on a monthly basis

Final Withholding Tax

As a general rule, withholding tax does not apply on transactions subject to VAT. The exceptions are:

1. Gross payments by the government shall be subject to the 5% final withholding tax;
2. Gross payments by resident VAT-taxpayers to non-resident foreign persons of rentals, royalties, reinsurance premiums, and services done in the Philippines—12% (Sec. 114(c), NIRC)

* Beginning Nov. 1, 2005, when R.A. 9337 became effective, all sales of goods, properties, or services to the government shall be subject to the 5% final withholding tax. The government shall, before making payment on account of each purchase of goods and/or services taxed at 10% or 12% VAT (Sec. 106 and 108) deduct and withhold a final VAT due at the rate of 5% of the gross payment thereof. (Mamalateo, Reviewer on Taxation, 2008)

RR 16-2005: Administrative and Penal Provisions.

- (a) Suspension of business operations. In addition to other administrative and penal sanctions provided for in the Tax Code and implementing regulations, the Commissioner of Internal Revenue or his duly authorized representative may order suspension or closure of a business establishment for a period of not less than five (5) days for any of the following violations:
 - (1) Failure to issue receipts and invoices.
 - (2) Failure to file VAT return as required under the provisions of Sec. 114 of the Tax Code.
 - (3) Understatement of taxable sales or receipts by 30% or more of his correct taxable sales or receipt for the taxable quarter.
 - (4) Failure of any person to register as required under the provisions of Sec. 236 of the Tax Code.



- (b) Surcharge, interest and other penalties. The interest on unpaid amount of tax, civil penalties and criminal penalties imposed in Title XI of the Tax Code shall also apply to violations of the provisions of Title IV of the Tax Code.

XXIII. Withholding of final VAT on sales to government (§ 114, C)

- The **Government** or any of its political subdivisions, instrumentalities or agencies, including GOCCs
 - **shall**, before making payment on account of each purchase of goods and services which are subject to the VAT imposed in Sections 106 and 108 of this Code,
 - **deduct and withhold** a final VAT at the rate of five percent (5%) of the gross payment thereof:
- Provided, That the payment for lease or use of properties or property rights to nonresident owners shall be subject to ten percent (10%) (now 12%) withholding tax at the time of payment.
 - The payor or person in control of the payment is considered as the withholding agent.
 - The VAT withheld shall be remitted within ten (10) days following the end of the month the withholding was made.

[NOTE: This 5% final VAT withheld by the government is an innovation of RA 9337.]

RR 16-2005: The 5% final VAT shall represent the net VAT payable of the seller. The remaining 5% (or 7%, with the raise of VAT to 12%) effectively accounts for the standard input VAT, in lieu of the actual input VAT directly attributable or ratably apportioned to such sales.

(This means that where the 5% final VAT applies, the basic formula of output tax less input tax does not apply.)

- Should actual input VAT exceed 7% (difference between 12% output and 5% withheld by government as final vat payable) of the gross payments, the excess may form part of the sellers' expense or cost.
- On the other hand, if actual input VAT is less than 7% of gross payment, the difference must be closed to expense or cost, in effect reducing it.

However, 12% final VAT shall be withheld with respect to the following:

- 2) Lease or use of properties or property rights owned by non-residents;
- 3) Services rendered to local insurance companies, with respect to reinsurance premiums payable to non-residents; and;
- 4) Other services rendered in the Philippines by non-residents.

4. Tax Remedies

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| <ol style="list-style-type: none"> I. Taxpayer's remedies II. Government remedies III. Statutory offenses and penalties IV. Compromise and abatement of taxes |
|---|

I. Taxpayer's Remedies

A. ASSESSMENT

1) Concept of assessment

- Assess mean to impose a tax; to charge with a tax; to declare a tax to be payable; to apportion a tax to be paid or contributed, to fix a rate; to fix or settle a sum to be paid by way of tax; to set, fix or charge a certain sum to each taxpayer; to settle determine or fix the amount of tax to be paid (84 C.J.S 74-750)
- An assessment is the notice to the effect that the amount therein stated is due from a taxpayer as a tax with a demand for payment of the same within a stated period of time. (Commissioner v. CTA, 27 SCRA 1159)
- An assessment is deemed made when the demand letter or notice is RELEASED, MAILED OR SENT by the BIR to the taxpayer. The law does not require that the taxpayer receive the notice within the three-year or ten-year period. [CIR vs. BAUTISTA (May 27, 1959)]

a) Requisites for valid assessment

- An assessment is issued by the BIR based on findings of fact and/or law. The factual and/or legal bases of the assessment must be stated; otherwise, the assessment is null and void.
- By employing mathematical computations in ascertaining the quantity of finished products, CIR based its assessment on mere inferences and presumptions. *This is not allowed because the assessment must be based on actual facts.* The presumption of correctness cannot be based on another presumption. (CIR v. Island Garments, 153 SCRA 665)
- An assessment must contain not only a computation of tax liabilities but also demand for payment within the prescribed period. (CIR v PASCOR)
- It must be sent to the taxpayer. An assessment is deemed made when the notice to that effect is released, mailed or sent to the taxpayer for the purpose of giving effect to the assessment. (Republic v. Dela Rama)

b) Constructive methods of income determination

- this relies upon circumstantial evidence of determining the correct income or transaction of a taxpayer. "Circumstantial" is that which tends to prove the existence of the disputed



fact by proof of other facts which have a legitimate tendency to lead the mind to a conclusion that the fact exists which is sought to be established. (INDIRECT METHOD)

- **Expenditure Method** → It proceeds on the theory that where the amount of money which a taxpayer spends during a given year exceeds his reported income, and the source of such money is otherwise unexplained, it may be inferred that such expenditures represent unreported income.
- **Percentage Method** → This method is a computation whereby determinations are made by the use of percentages or ratios considered typical of the business under investigation. By reference to similar business or situations, percentage computations are secured to determine sales, gross profit or even net profit.
- **Unit and value Method** → The determination of gross receipts may be computed by applying price and profit figures to the known ascertainable quality of business done by taxpayer

c) Inventory method for income determination (Net worth method)

- This method of reconstructing income based on the theory that if the taxpayer's net worth has increased in a given year in an amount larger than his reported income, he had understated his income for that year.

Formula:

$$\begin{array}{l}
 \text{Increase in Net worth} \\
 \text{Add: Non-deductible Item} \\
 \text{Less: Non-taxable income or receipts} \\
 \text{subjected to final tax transfer taxes} \\
 \hline
 \text{Taxable Net Income} \\
 \text{Less: Personal and additional} \\
 \text{exemptions} \\
 \hline
 \text{NET INCOME SUBJECT TO TAX}
 \end{array}$$

d) Jeopardy assessment

- A tax assessment made by an authorized Revenue Officer without the benefit of complete or partial audit,
- in light of the RO's belief that the assessment and collection of the deficiency tax will be jeopardized by delay caused by the taxpayer's failure to:
 - Comply with audit and investigation requirements to present his books of accounts and/or pertinent records
 - Substantiate all or any of the deductions, exemptions or credits claimed in his return.
- It is usually issued when statutory prescriptive periods for the assessment or collection of taxes are about to

lapse due principally to the taxpayer's fault.

e) Tax delinquency and tax deficiency

- Deficiency is the amount still due and collectible from a taxpayer upon audit or investigation.
- Delinquency is the failure of the taxpayer to pay the tax due on the date fixed by law or indicated in the assessment notice or letter of demand.

2) Power of the Commissioner to make assessments and prescribe additional requirements for tax administration and enforcement

1. EXAMINE RETURNS and DETERMINE TAX DUE (\$5)

- Authorizing the examination of any taxpayer and the assessment of the correct amount of tax, WON a return has been filed by such taxpayer.

Note: Any return filed with the Commissioner shall not be withdrawn, BUT the taxpayer may MODIFY, CHANGE or AMEND such return within three (3) years from the date of filing, provided that no notice for audit or investigation of such return has been actually served on the taxpayer.

2. Conduct INVENTORY-TAKING, SURVEILLANCE and to PRESCRIBE presumptive gross sales and receipts (\$6C)

- **Inventory-taking** - at any time during the taxable year, for the purpose of determining the correct tax liabilities.
- **Surveillance** - done if there is reason to believe that the taxpayer is not declaring his correct income, sales or receipts for tax purposes.
- **Prescribe presumptive gross sales and receipts if:**

- It is found that the taxpayer has failed to issue receipts and invoices, or
- When there is reason to believe that the books of accounts or other records do not correctly reflect the declarations made by the taxpayer

3. TERMINATE Taxable Period (\$6D)

- Terminating taxable period and ordering the immediate payment of the tax for the terminated period and any remaining tax that is unpaid, when the taxpayer is:
 - retiring from business subject to tax, or
 - intending to leave the Philippines or to remove his property therefrom or to hide or conceal his property;
 - performing any act tending to obstruct the proceedings for the collection of the tax for the past or current quarter or year or to render the same totally or



- partially ineffective unless such proceedings are begun immediately
4. PRESCRIBE Real Property Values (§6E)
 - Dividing the Philippines into different zones or areas, and determining the FMV of real properties in each zone or area, upon consultation with competent appraisers from private and public sectors.
 - For the purpose of computing any internal revenue tax, the value of the property shall be **WHICHEVER IS HIGHER OF:**
 - The FMV as determined by the Commissioner, or
 - The FMV as shown in the schedule of values of the provincial and city assessors
 5. INQUIRE into Bank Deposit Accounts (§6F)
 - Notwithstanding any contrary provision of R.A. 1405 (Bank Secrecy Law) and other general or special laws, the Commissioner is authorized to inquire into bank deposits of:
 - A **decedent** to determine his gross estate, and
 - Any **taxpayer who has filed an application for compromise of tax liability** by reason of financial incapacity: the taxpayer **must waive in writing** his privilege under R.A. 1405 and other relevant laws, **before** the Commissioner may inquire into his bank accounts.
 6. ACCREDIT and REGISTER Tax Agents (§6G)
 - Accrediting and registering tax agents (may be individuals or general professional partnerships) based on the following criteria:
 - Professional competence
 - Integrity
 - Moral fitness
 7. PRESCRIBE additional PROCEDURAL OR DOCUMENTARY requirements (§6H)
 - In relation to the manner of compliance of any requirement in connection with the submission or preparation of financial statements accompanying the tax returns.
 8. ACCESS Letter (§5B)
 - Obtaining on a regular basis, from any person **OTHER THAN the person whose tax liability is subject to audit or investigation**, or from any office or officer of the national and local governments, government agencies or instrumentalities, including BSP and GOCCs,
 - **any information** such as, but not limited to, **costs and volumes of production, receipts or sales and gross incomes of taxpayers**, and the names addresses, and financial statements of corporations, mutual

fund companies, insurance companies etc.

Note: This is known as the Third Party Information Rule.

9. INTERPRET Tax LAWS and to DECIDE Tax CASES (§4)
 - Shall be under the exclusive and original jurisdiction of the Commissioner, subject to review by the Secretary of Finance.

RMC 44-01

- **VALIDITY:** A ruling by the BIR Commissioner shall be presumed **VALID** unless *modified, reversed or superseded* by the Secretary of Finance.
- **REVIEW:** A taxpayer who receives an adverse ruling from the Commissioner may, **within thirty (30) days** from the date of receipt of such ruling, seek its review by the Secretary of Finance, either by himself/itself or through his/its duly authorized representative.
- **EFFECT OF REVIEW:** A reversal or modification of the BIR ruling shall terminate its effectivity upon the receipt by the taxpayer or the BIR of written notice of reversal or modification, whichever came earlier.

Note: DOF Order 7-02 added that the Secretary of Finance may review the rulings *MOTU PROPRIO*.

Section 246, NIRC: Non-retroactivity of Rulings

- Any revocation, modification or reversal of any of the rulings or circulars promulgated by the Commissioner shall not be given retroactive application if the revocation, modification or reversal will be **prejudicial to the taxpayers**,

Exceptions:

- a) Where the taxpayer deliberately misstates or omits material facts from his return or any document required of him the BIR;
- b) Where the facts subsequently gathered by the BIR are materially different from the facts on which the ruling is based; or
- c) Where the taxpayer acted in bad faith.

a) Power of the Commissioner to obtain information, and to summon/examine, and take testimony of persons

- In ascertaining the correctness of any return, making a return when none has been made, determining the liability of any person for any internal revenue tax, or in collecting any such liability, the Commissioner is authorized:
 - To examine any book, paper record or other data which may be relevant or material to such inquiry;
 - To obtain on a regular basis from any person or from any office or officer of the national and local



governments, government agencies and instrumentalities any information of corporations, mutual fund companies, insurance companies, regional operating headquarters of multinational companies, joint accounts, associations, joint ventures or consortia and registered partnerships and their members;

- To summon the person liable for tax or required to file a return or any officer or employee of such person or any person having possession, custody or care of the books of accounts and other accounting records containing entries relating to the business, to appear before the Commissioner or his duly authorized representative and to produce such books, accounts or other data and to give testimony
- To take such relevant or material testimony of the person concerned under oath; and
- To cause revenue officers and employees to make a canvass of any revenue district or region and make an inquiry (Sec. 5, NIRC)

3) When assessment is made

a) Prescriptive period for assessment

- If the taxpayer filed a return: internal revenue taxes shall be assessed within three years after the last day prescribed by law for the filing of the return.
- If a return is filed beyond the period prescribed by law, the three-year period shall be counted from the day the return was filed.
- A return filed before the last day prescribed by law for filing shall be considered as filed on the last day. (Sec. 203, NIRC)

NOTE: The period for assessment is within three years from the time the return is filed or from the time the return is due, **WHICHEVER IS LATER.**

(1) False, fraudulent, and non-filing of returns

- If the taxpayer **DID NOT** file a return: internal revenue taxes shall be assessed within ten years after the discovery of the failure to file the return (Sec. 222a, NIRC)
- If the taxpayer filed a **false or fraudulent return with intent to evade tax**: internal revenue taxes shall be assessed within ten years after the discovery of the falsity or fraud (Sec. 222a, NIRC)

➤ The law on prescription, being a remedial measure, should be **LIBERALLY CONSTRUED** in order to afford protection. As a corollary, the exceptions to the law on prescription should be clearly construed.

Hence, negligence or oversight on the part of the BIR cannot prejudice taxpayers, considering that the prescriptive period was precisely intended to give them peace of mind. [CIR v. Goodrich Philippines (1999)]

b) Suspension of running of statute of limitations

- The running of the statute of limitations provided in §203 and §222 shall be suspended for the period: (P-CORN)
 1. During which the commissioner is Prohibited from making the assessment or beginning distraint or levy or a proceeding in court, and for sixty (60) days thereafter
 2. When the taxpayer requests for a Reinvestigation which is granted by the Commissioner
- CIR vs. WYETH** (September 30, 1991)
→ The statutory period of limitation for collection may be interrupted when, by the taxpayer's repeated requests, the government has been, persuaded to postpone collection to make him feel the demand was not unreasonable or that no harassment or injustice was meant by government.

RR 12-85 (Difference between Reconsideration & Reinvestigation)

- **RECONSIDERATION** - refers to a plea of re-evaluation of the assessment on the basis of existing records **WITHOUT NEED OF ADDITIONAL EVIDENCE.** It may involve both question of fact or of law or both
- **REINVESTIGATION** - refers to a plea of re-evaluation of an assessment on the basis of **NEWLY-DISCOVERED EVIDENCE** that a taxpayer intends to present in the reinvestigation. It may also involve a question of fact or law or both.

PHIL GLOBAL COMMUNICATION vs. CIR (October 31, 2006) → A **re-evaluation** of existing records which results from a request for reconsideration does not toll the running of the prescription period for the collection of an assessed tax.

BPI v. CIR (2005): What suspends the running of prescriptive period to assess and collect is a request for reinvestigation **granted** by BIR.

- 3. When the taxpayer Cannot be located in the Address given by him in the return filed upon which a tax is being assessed or collected, **BUT** if the taxpayer informs the Commissioner of any change in address, the running of the statute of limitations shall not be suspended



4. When the warrant of distraint or levy is duly served upon the taxpayer, his authorized representative, or a member of his household with sufficient discretion, and No Property is located
5. When the taxpayer is Out of the Philippines

4) General provisions on additions to the tax

a) Civil penalties

Surcharge

- A civil penalty imposed by law as an addition to the basic tax required to be paid.
- It is a civil administrative sanction provided as a safeguard for the protection of the State revenue and to reimburse the government for the expenses of investigation and the loss resulting from the taxpayer's fraud.
- A surcharge added to the main tax is subject to interest.

Rates of Surcharge:

- There shall be imposed a penalty equivalent to **twenty-five percent (25%)** of the amount due, in the following cases:
 - FAILURE TO FILE ANY RETURN and PAY THE TAX DUE THEREON on the date prescribed; or
 - Filing a return with an internal revenue officer than those with whom the return is required to be filed (except when authorized by the Commissioner); or
 - FAILURE TO PAY THE DEFICIENCY TAX within the time prescribed for its payment in the notice of assessment
 - FAILURE TO PAY THE FULL OR PART of the amount of tax shown on any return required to be filed, or the full amount of tax due for which no return is required to be filed, on or before the date prescribed for its payment. (Sec. 248A, NIRC)
- The penalty shall be **fifty percent (50%)** of the tax or of the deficiency tax, in the following cases:
 - WILLFUL NEGLECT to FILE THE RETURN within the period prescribed
 - A FALSE OR FRAUDULENT RETURN is wilfully made (§248B)
 - *Prima-facie evidence of false or fraudulent return:*
 - substantial under declaration of taxable sales, receipts or income (failure to report sales, receipts or income in an amount exceeding 30% of that declared per return)

- substantial overstatement of deductions (a claim of deduction in an amount exceeding 30% of actual deductions)

b) Interest

- **20% per annum** on any unpaid amount of tax or higher rate prescribed by rules and regulations from the date prescribed for payment until the amount is fully paid.
- **efficiency Interest:** the term 'deficiency' means the amount by which the taxed imposed under the Code exceeds the amount shown on the return filed (§249B)
- **elinquency Interest:** In case of failure to pay:
 - tax due on any return required to be filed, or
 - tax due for which no return is required, or
 - a deficiency tax, or any surcharge or interest thereon on the due date appearing in the notice and demand of the Commissioner, there shall be assessed and collected on the unpaid amount, interest at the rate prescribed until the amount is fully paid, which interest shall form part of the tax. (§249C)

5) Assessment process

a) Tax audit

- In a tax audit, revenue officers examine the books of account and other accounting records of taxpayers to determine the correct tax liability. This is through the issuance of a Letter of Authority.
- **Letter of Authority:** An official document that empowers a Revenue Officer to examine and scrutinize a taxpayer's books of accounts and other accounting records, in order to determine the taxpayer's correct internal revenue tax liabilities.

Q: Who issues the Letter of Authority?

- **Commissioner:** for those units reporting directly to him
- **Regional directors:** for taxpayers covered by his particular region. If the Commissioner has already issued an LA to investigate a particular taxpayer, the Regional director shall desist from issuing another LA for the same taxpayer.

Q: What are the cases which need not be covered by a valid LA?

- Cases involving civil/criminal tax fraud which fall under the jurisdiction of the



tax fraud division of the Enforcement Services, and

- Policy cases under audit by the special teams in national offices

b) Notice of informal conference

- A written notice informing a taxpayer that the findings of the audit conducted on his books of accounts and accounting records indicate that additional taxes or deficiency assessments have to be paid.
- The taxpayer shall then have fifteen (15) days from the date of his receipt of the Notice for Informal Conference to explain his side.

What matters are taken up during the informal conference?

1. Discussion on the merits of the assessment
2. Attempt of taxpayer to convince the examiner to conduct a re-investigation and/or re-examination
3. Evaluate if submission of the waiver of the statute of limitations is necessary→because evaluation may extend beyond three years
4. Taxpayer to advise the examiner if position paper will be submitted

c) Issuance of preliminary assessment notice (PAN)

- A communication issued by the Regional Assessment Division or any other concerned BIR office, informing a taxpayer who has been audited of the findings of the Revenue Officer, following the review of these findings.
- The assessment shall be:
 - in writing, and
 - should inform the taxpayer of the law and the facts on which the assessment is made;
 - Otherwise, the assessment shall be void. (Sec. 228, NIRC)
- If the taxpayer disagrees with the findings in the PAN, he has fifteen (15) days from his receipt of the PAN to file a written reply contesting the proposed assessment.

d) Exceptions to Issuance of PAN

PAN no longer required when:

- (a) The finding for any deficiency tax is the result of MATHEMATICAL ERROR in the computation of the tax as appearing on the face of the return; or
- (b) A DISCREPANCY has been determined between the TAX WITHHELD and the amount ACTUALLY REMITTED by the withholding agent; or
- (c) A taxpayer who opted to claim a refund or tax credit of excess creditable withholding tax for a taxable period was determined to have carried over and automatically applied the same amount claimed

against the estimated tax liabilities for the taxable quarter or quarters of the succeeding taxable year; or

- (d) The EXCISE TAX due on excisable articles has not been paid; or
- (e) An article locally purchased or imported by an exempt person, such as, but not limited to, vehicles, capital equipment, machineries and spare parts, has been sold, traded or transferred to a non-exempt person. (Sec. 228, NIRC)

e) Reply to PAN

- A reply is to contest in writing the findings of the revenue officers contained in a PAN.
 - It is filed within fifteen days from the date of receipt of the PAN.
 - A taxpayer generally does not respond in an adequate manner to the specific findings of the revenue officer.
 - Failure to reply to a PAN makes the taxpayer in default and authorizes the revenue officials to issue the FAN.
- The regulations use the term “reply” to distinguish the written objection(s) against a FAN issued by the BIR, where the generic term “protest” or the specific term “request for reconsideration” or “request for reinvestigation” is utilized.

f) Issuance of formal letter of demand and assessment notice/final assessment notice

- A Final Assessment Notice (FAN) is a declaration of deficiency taxes issued to a taxpayer who fails to respond to a pre-assessment notice within the prescribed period of time, or whose reply to the PAN was found to be without merit.
 - An assessment contains not only a computation of tax liabilities, but also a demand for payment within a prescribed period.
 - The ultimate purpose of assessment is to ascertain the amount that each taxpayer is to pay.
- The formal letter of demand shall be issued by the Commissioner or his duly authorized representative.
- The letter of demand calling for the payment of the taxpayer’s deficiency taxes shall state the FACTS, the LAW, RULES and REGULATIONS or JURISPRUDENCE on which the assessment is based, OTHERWISE, the formal letter of demand or assessment notice shall be VOID. (RR 12-99)

Note:

- A follow-up letter/demand letter for payment of taxes is considered a notice



of assessment. [REPUBLIC vs. CA and NIELSON & CO. (April 30, 1987)]

➤ Where the taxpayer is appealing on the ground that the assessment is erroneous, it is incumbent upon him to prove what is the correct and just liability by a full and fair disclosure of all pertinent data. [BonifacioSy Po v. CTA]

g) Disputed assessment

- The taxpayer or his duly authorized representative may protest administratively against the formal letter of demand and assessment notice within thirty days (30) from date of receipt.

h) Administrative decision on a disputed assessment

- The power to decide disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto, or other matters is vested in the Commissioner, subject to the exclusive appellate jurisdiction of the Court of Tax Appeals.

6) Protesting assessment

a) Protest of assessment by taxpayer

(1) Protested assessment

- To contest an assessment by filing a letter of PROTEST stating in detail his reasons for contesting the assessment.
- When no protest is seasonably made by the taxpayer, the assessment shall become final and unappealable, and thus the tax shall be collectible.

(2) When to file a protest

- Within thirty (30) days by filing a request for reconsideration or reinvestigation from receipt of the assessment.

(3) Forms of protest

- A protest is considered validly made if it satisfies the following conditions:
 - 1) it is made in **writing**, and **addressed to the Commissioner** of Internal Revenue.
 - 2) it **contains** the information required by the rule.
 - 3) It **states** the **FACTS**, applicable **LAW**, **RULES** and **REGULATIONS** or **JURISPRUDENCE** on which his protest is based, otherwise the protest shall be considered void and without force and effect.
 - 4) It is **filed** within the **period prescribed** by law

b) Submission of documents within 60 days from filing of protest

- Within sixty (60) days from filing of the protest, all relevant supporting documents must be submitted, otherwise the assessment shall become final. (§228)

c) Effect of failure to protest

- If the taxpayer fails to file a valid protest against the formal letter of demand and assessment notice within thirty (30) days from date of receipt thereof, the assessment shall become final, executor and demandable. No inquiry can be made thereon on the merits of the original case.

7) Rendition of decision by Commissioner

a) Denial of protest

(1) CIR's actions equivalent to denial of protest

(a) Filing of criminal action against taxpayer

(b) Issuing a warrant of distraint and levy

(2) Inaction by Commissioner

- If the protest is not acted upon within one hundred eighty (180) days from submission of documents, the inaction by the Commissioner is considered as a denial of protest.

8) Remedies of taxpayer to action by Commissioner

a) In case of denial of protest

- If the Commissioner **DENIES THE PROTEST** filed by the taxpayer, he/she may appeal to the Court of Tax Appeals within thirty days from receipt of the decision denying the protest (Sec. 228, NIRC)
 - Where there is a request for reconsideration, final demand letter from BIR is considered a decision on a disputed or protested assessment which is therefore appealable to the CTA. [CIR v. ISABELA CULTURAL CORP. (July 11, 2001)]

When does the 30-day period to appeal in remedy commence to run?

- The 30-day period starts when the taxpayer receives the decision of the Commissioner denying the protest.
- The decision of the Commissioner must categorically state that **his action on the disputed assessment is final**, otherwise period to appeal will not commence to run. [ADVERTISING ASSOCIATES vs. CA (December 26, 1984)]

Note: A Division of the CTA shall hear the appeal. (Sec. 11, RA 1125 as amended by RA 9282 [2004])



b) In case of inaction by Commissioner within 180 days from submission of documents

- If the Commissioner did NOT ACT UPON THE PROTEST within one hundred and eighty days from the time the documents were submitted, the taxpayer may either:
 - Appeal to the CTA within thirty days from the lapse of the 180-day period OR
 - Wait until the Commissioner decides before he elevates the case to the CTA.

Note: A court MAY NOT GRANT AN INJUNCTION to restrain the collection of any national internal revenue tax, fee or charge imposed under the NIRC. (Sec. 218, NIRC)

- **Exception:** Under Section 11 of RA 1125, as amended by RA 9282, **suspension is allowed when the following conditions concur:**

1. it is an appeal to the CTA from a decision of the Commissioner of Internal Revenue or Commissioner of Customs or the Regional Trial Court, provincial, city or municipal treasurer or the Secretary of Finance, the Secretary of Trade and Industry and Secretary of Agriculture, as the case may be, and
2. in the opinion of the Court of Tax Appeals, the collection may jeopardize the interest of the Government and/or the taxpayer.

Q: In case of suspension, what may the taxpayer be required to do?

- Either to *deposit* the amount claimed or to *file a surety bond* for not more than double the amount with the Court.

RCBC v. CIR (2007): In case the Commissioner failed to act on the disputed assessment within the 180-day period from date of submission of documents, a taxpayer can either:

- 1) file a **petition for review** with the Court of Tax Appeals within 30 days after the expiration of the 180-day period; **OR**
 - 2) await the final decision of the Commissioner on the disputed assessments and **appeal** such final decision to the Court of Tax Appeals within 30 days after receipt of a copy of such decision.
- However, these options are **mutually exclusive**, and resort to one bars the application of the other.

If the taxpayer is not satisfied with the CTA Division's ruling, what is his REMEDY?

- **FIRST**, he may file a motion for reconsideration before the same Division of the CTA within fifteen (15) days from notice thereof. (Sec. 11, RA 1125 as amended by RA 9282 [2004])
- **THEN**, a party adversely affected by a resolution of a Division of the CTA on a motion for reconsideration may file a petition for review with the CTA en banc. (Sec. 18, RA 1125 as amended by RA 9282 [2004])

If the taxpayer is not satisfied with the decision of the CTA en banc, what is his REMEDY?

- A party adversely affected by a decision or ruling of the CTA *en banc* may file with the **Supreme Court** a verified petition for review on certiorari pursuant to Rule 45 of the 1997 Rules of Court. (Sec. 19, RA 1125 as amended by RA 9282 [2004])

c) Effect of failure to appeal

- If the taxpayer fails to file an appeal, the assessment shall become final, executory and demandable.

2) Prescriptive periods

Return filed was NOT false or fraudulent	No return filed, or the return was false or fraudulent.
Collection with PRIOR ASSESSMENT - should be made within five years from the date of assessment of the tax. → by distraint or levy, or by judicial proceedings	Collection with PRIOR ASSESSMENT - should be made within five years from the date of assessment (based on §222c) → by distraint or levy, or by judicial proceedings
Collection WITHOUT PRIOR ASSESSMENT - should be made within three years from the date of filing of return or date return is due, whichever is LATER (based on §203) →by judicial proceedings	Collection WITHOUT PRIOR ASSESSMENT - should be made within ten years after the discovery of the falsity, fraud or omission to file a return. →by judicial proceedings

- If tax was assessed within the different period agreed upon by the Commissioner and the taxpayer, it may be collected by distraint or levy or by a proceeding in court within the period agreed upon in writing before the expiration of the 5-yr period. (Sec. 222d, NIRC)

B. COLLECTION

1) Requisites

Q: When may the government avail of the remedies of collection?

- When the assessment shall have become final, executory and demandable.

3) Distraint of personal property including garnishment

- a) Summary remedy of distraint of personal property
Distraint



- involves the SEIZURE by the Government of PERSONAL PROPERTY, tangible or intangible, to enforce the payment of taxes; followed by the PUBLIC SALE of such property, if the taxpayer fails to pay the taxes voluntarily.

What are the kinds of distraint?

- a. *Actual Distraint* - resorted to when there is ACTUAL delinquency in tax payment
- b. *Constructive Distraint* - is a preventive remedy which aims at forestalling a possible dissipation of the taxpayer's assets when delinquency sets in. Hence, no actual delinquency in payment is necessary.

(1) Procedure for distraint and garnishment

- Upon failure to pay the delinquent tax at the time required, the proper officer shall SEIZE and DISTRAINT any GOODS, CHATTELS, or EFFECTS, and the PERSONAL PROPERTY, including STOCKS and other SECURITIES, DEBTS, CREDITS, BANK ACCOUNTS and INTERESTS in and RIGHTS to personal property of the taxpayer in sufficient quantity to satisfy the tax, expenses of distraint and the cost of the subsequent sale.

How are different kinds of personal property distrainted?

1. **Stocks and other securities:** by serving a copy of the warrants of distraint on the taxpayer, AND upon the president, manager, treasurer or other responsible officer of the corporation, company or association which issued the stocks or securities.
2. **Debts and credits:** by leaving with the person owing the debts or having in his possession or under his control such credits, or with his agent, a copy of the warrant of distraint. The person owing the debts shall then pay the Commissioner instead of his creditor (taxpayer) on the strength of such warrant.
3. **Bank accounts:** by serving a warrant of garnishment upon the taxpayer AND upon the president, manager, treasurer or other responsible officer of the bank. The bank shall then turn over to the Commissioner so much of the bank accounts as may be sufficient to satisfy the claim of the Government. (**NOTE:** distraint of bank accounts is called **GARNISHMENT**)

What is the remedy of the taxpayer once the Commissioner or other proper officer issues the warrant of distraint?

- The taxpayer may request that the warrant be lifted. The commissioner may, in his discretion, allow the lifting of the order of distraint. He may ask for a bond as a condition for the cancellation of the warrant. (Sec. 207, NIRC)

(2) Sale of property distrainted and disposition of proceeds

If the taxpayer does not ask for the lifting of the warrant, what shall be done with the seized properties?

- The properties will be SOLD in a PUBLIC SALE, and the procedure shall be as follows:

- (1) The Revenue District Officer or his duly authorized representative (not the officer who served the warrant), shall cause a notification of the public sale to be posted in not less than two (2) public places in the municipality or city (one of which is the Office of the Mayor) where the distraint was made.
 - The notice shall specify the time and place of the sale. The time of sale shall not be less than twenty (20) days after notice to the owner and the publication or posting of such notice.
- (2) At the time of the public sale, the revenue officer shall sell the goods, chattels, or effects, or other personal property, including stocks and other securities so distrainted **at a PUBLIC AUCTION, to the HIGHEST BIDDER for CASH** or with the approval of the Commissioner, through a DULY LICENSED COMMODITY or STOCK EXCHANGES.
- (3) Any **residue** over and above what is required to pay the entire claim, including expenses of sale and distraint, shall be **RETURNED** to the owner of the property sold. Expenses shall be limited to actual expenses of SEIZURE and PRESERVATION of the property pending the sale, no charge shall be imposed for the services of the local internal revenue officer or his deputy. (§209)



- (4) *If the proceeds from the sale of the distrained properties are not sufficient to satisfy the tax delinquency, the Commissioner or his duly authorized representative shall within thirty (30) days after execution of the distraint, proceed with the levy on the taxpayer's real property. (§207B)*

(a) Release of distrained property upon payment prior to sale

May the taxpayer recover his property prior to consummation of the sale?

- YES. If at any time prior to the consummation of the sale all proper charges are paid to the officer conducting the sale, the goods or effects distrained shall be restored to the owner. (Sec. 210, NIRC)

(3) Purchase by the government at sale upon distraint

If the amount offered by the highest bidder is not equal to the amount of the tax or is very much less than the actual market value of the articles offered for sale, the Commissioner or his deputy may purchase the same in behalf of the National Government for the amount of taxes, penalties and costs due. The property so purchased may be resold by the Commissioner or his deputy. (§212)

(4) Report of sale to BIR

Within two (2) days after the sale, the officer making the same shall make a report of his proceedings in writing to the Commissioner and shall himself preserve a copy of such report as an official record. (§211)

(5) Constructive distraint to protect the interest of the government

How is CONSTRUCTIVE distraint effected?

- a. By requiring a taxpayer or any person in possession or control of such property to SIGN a RECEIPT covering the property distrained and obligate himself to PRESERVE THE SAME INTACT and UNALTERED and NOT TO DISPOSE of the same in any manner whatever, without the Commissioner's authority.
- b. If the taxpayer or person in possession or control refuses to sign the receipt, the revenue officer shall prepare a list of the property and leave a copy of such list in the premises where the properties are located, in the presence of two (2) witnesses.

Q: When may property of the taxpayer be placed in constructive distraint?

- The property of a taxpayer may be placed in constructive distraint, if in the Commissioner's opinion:
 - a. the taxpayer is retiring from any business subject to tax;
 - b. the taxpayer is intending to leave the Philippines;
 - c. the taxpayer is intending to remove his property from the Philippines or to hide or conceal his property;
 - d. the taxpayer is planning to perform any act tending to obstruct the proceedings for collecting the tax due or which may be due from him (§206)

Note: In constructive distraint, the property is not actually confiscated or seized by the revenue officer

4) Summary remedy of levy on real property

- The same act of seizure as in distraint, but in this case, **of real property**, an interest in or rights to such property in order to enforce the payment of taxes. The real property under levy shall be sold in a public sale, if the taxes involved are not voluntarily paid following such levy.

How is levy of real property effected?

- (1) After the expiration of time required to pay the delinquent tax, real property may be levied upon, BEFORE, SIMULTANEOUSLY or AFTER the distraint of personal property belonging to the delinquent.

- The IR officer designated by the Commissioner or his duly authorized representative shall prepare a DULY AUTHENTICATED CERTIFICATE showing the name of the taxpayer and the amounts of tax and penalty due from him.
- This certificate shall operate with the force of LEGAL EXECUTION throughout the Philippines.

- (2) The certificate shall contain a description of the property upon which levy is made.

- At the same time, written notice of the levy shall be mailed to or served upon the Register of Deeds of the province or city where the property is located and upon the taxpayer (if he is absent from the Philippines, to his agent or manager of business in respect to which the liability arose or to the occupant of the property in question)

a) Advertisement and sale



(1) Within twenty (20) days after the levy, the officer conducting the proceedings shall proceed to **advertise for SALE the property** or a portion as may be necessary to satisfy the claim and costs of sale. Such advertisement shall cover a period of at least thirty (30) days. The notice shall be posted at the main entrance of the city or municipal all AND in a public and conspicuous place in the barrio or district where the real property lies. The notice must also be published in a newspaper of general circulation in the place where the property is located, once a week for three (3) weeks.

- CONTENTS of notice: statement of amount of taxes, and penalties due, time and place of sale, name of taxpayer, short description of property.

(2) The sale shall be held either at the main entrance of the municipal or city hall or on the premises to be sold. Property will be awarded to the highest bidder. In case the proceeds of the sale exceeds the claim and costs of sale, the excess shall be turned over to the owner of the property. (S213)

(3) If there is no bidder for the real property OR if the highest bid is not sufficient to pay the taxes, penalties and costs, the IR Officer conducting the sale shall declare the property **FORFEITED** to the **GOVERNMENT** in satisfaction of the claim. (Sec. 215, NIRC)

b) Redemption of property sold

(1) At any time before the day fixed for the sale, the taxpayer may discontinue all proceeding by paying the taxes, penalties and interest. (Sec. 213, NIRC)

(2) **Within one (1) year** from the date of sale, the taxpayer or anyone for him, may pay to the Revenue District Officer the total amount of the following:

- public taxes
- penalties
- interest from the date of delinquency to the date of sale
- interest on said purchase price at the rate of fifteen percent (15%) per annum from the date of sale to the date of redemption.

Note: if the property was forfeited in favor of the government, the redemption price shall include only the taxes, penalties and interest plus costs of sale - *no interest on purchase price since the Government did not "purchase" the property anyway, it was forfeited*)

Note: The taxpayer-owner shall not be deprived of possession of the said property and shall be entitled to rents and other income until the expiration of the period for redemption (Sec. 214, NIRC)

c) Final deed of purchaser

- After the period of redemption, a final deed of sale is issued in favor of the purchaser.

5) Forfeiture to government for want of bidder

Forfeiture implies a divestiture of property without compensation in consequence of a default or offense. The effect of forfeiture is to transfer the title of the specific thing from the owner to the government. (De Leon, NIRC Annotated, p. 412)

a) Remedy of enforcement of forfeitures

- Forfeiture of chattels and removable fixtures: enforced by the seizure, sale or destruction of the specific forfeited property.
- Forfeiture of real property: enforced by a judgment of condemnation and sale in a legal action or proceeding civil or criminal as the case may require

(1) Action to contest forfeiture of chattel

- In case of the seizure of personal property under claim of forfeiture, the owner desiring to contest the validity of the forfeiture may, at any time before sale or destruction of the property, bring an action against the person seizing the property or having possession thereof to recover the same, and upon giving proper bond may enjoin the sale; or

after the sale and within six months he may bring an action to recover the net proceeds realized at the sale.

b) Resale of real estate taken for taxes

(RR No. 22-2002)

- All acquired/forfeited properties transferred in the name of the Republic of the Philippines, having passed the one-year redemption period, shall be converted into cash from the date of acquisition or forfeiture.
- The sale of acquired/forfeited real properties shall be by sealed bids in a public auction to be witnessed by a representative of the COA.
- The Notice of Sale of the acquired real properties shall be published once a week for two (2) consecutive weeks in a newspaper of general circulation in the Philippines which must be completed at least 20 days prior to the date of such public auction.
- Unless the Commissioner of Internal Revenue provides otherwise, the Minimum Bid Price/Floor Price shall be the latest fair market value as determined by the Commissioner or the fair market value shown in the latest tax declaration issued by the provincial, city or municipal assessor, whichever is higher, pursuant to Sec. 6(E) of the Tax Code.
- Anyone could bid except foreign nationals, corporate or otherwise, and those qualified under existing laws, rules and regulations, including employees of the Bureau of Internal Revenue.
- Bidders shall be required to post a bond in cash or manager's check in an amount representing 10% of the minimum bid price at least one day before the scheduled public auction.
- Unless the Commissioner allows extension of time to pay, in meritorious cases, the winning bidder shall pay the full amount of his bid cash or manager's check within two days after receipt of notice of award.
- All taxes and expenses relative to the issuance of title shall be borne by the winning bidder.
- The winning bidder shall be responsible at his own expense for the ejection of squatters and/or occupants, if any, of the auctioned property.

- Negotiated or private sale shall be resorted to as a consequence of failed public bidding for two consecutive times.
- Negotiated or private sale shall in all cases be approved by the Secretary of Finance.
- Public auction sale shall be approved by the Commissioner or his authorized representative.
- The Government reserves the right to reject or cancel any or all bids.

c) When property to be sold or destroyed

- Forfeited chattels and removable fixtures - sold in the same manner and under the same conditions as the public notice and the time and manner of sale as are prescribed for sales of personal property distrained for the non-payment of taxes
- Distilled spirits, liquors, cigars, cigarettes, other manufactured products of tobacco and all apparatus used in or about the illicit production of such articles - destroyed by the order of the Commissioner when the sale or use would be injurious to public health or prejudicial to the enforcement of the law
- All other articles subject to excise tax manufactured or removed in violation of the Code, dies for the printing or making of internal revenue stamps and labels - sold or destroyed in the discretion of the Commissioner
- Forfeited property shall not be destroyed until at least 20 days after seizure. (Sec. 225, NIRC)

d) Disposition of funds recovered in legal proceedings or obtained from forfeiture

All judgments and monies recovered and received for taxes, costs, forfeitures, fines and penalties shall be paid to the Commissioner or his authorized deputies as the taxes themselves are required to be paid, and except as specially provided, shall be accounted for and dealt within the same way. (Sec. 226, NIRC)

6) Further distraint or levy

The remedy by distraint of personal property and levy on realty may be repeated if necessary until the full amount due, including all expenses, is collected. (Sec. 217, NIRC)

7) Tax lien

Q: What are tax liens? (Sec. 219, NIRC)

- When a taxpayer neglects or refuses to pay his internal revenue tax liability after demand, the amount so demanded shall be a **lien in favor of the government from the time the assessment was made** by the CIR



until paid with interest, penalties, and costs that may accrue in addition thereto upon ALL PROPERTY AND RIGHTS TO PROPERTY BELONGING to the taxpayer.

- **HOWEVER**, the lien shall not be valid against any mortgagee, purchaser or judgment creditor until NOTICE of such lien shall be filed by the Commissioner in the Office of the Register of Deeds of the province or city where the property of the taxpayer is situated or located.

Q: What is the difference between seizure under forfeiture and a seizure to enforce a tax lien?

- In the former all the proceeds derived from the sale of the thing forfeited are turned over to the Collector of Internal Revenue; in the latter, the residue of such proceeds over and above what is required to pay the tax sought to be realized, including expenses, is returned to the owner of the property. [BPI v. Trinidad]

8) Compromise

a) Authority of the Commissioner to compromise and abate taxes

1. **Compromise** (to reduce the amount of tax payable)

Grounds for a compromise:

- The Commissioner may compromise the payment of any internal revenue tax in the following cases:
 - 1) A REASONABLE DOUBT as to the validity of the claim against the taxpayer exists; or
 - 2) The financial position of the taxpayer demonstrates a clear inability to pay the assessed tax. (FINANCIAL INCAPACITY)

What are the limits of the Commissioner's power to compromise?

- For cases of financial incapacity: a minimum compromise rate equivalent to ten percent (10%) of the basic assessed tax;
- For other cases: a minimum compromise rate equivalent to forty percent (40%) of the basic assessed tax

Note: When the basic tax involved exceeds One Million Pesos (P1,000,000), or where the settlement offered is less than the prescribed minimum rates, the compromise must be approved by the Evaluation Board (composed of the Commissioner and 4 deputy commissioners)

May the Commissioner compromise cases of criminal violations?

- Generally, ALL CRIMINAL VIOLATIONS may be compromised, EXCEPT:
 - a) those cases already filed in court
 - b) those involving fraud

2. **Abatement** (to cancel the entire amount of tax payable)

When may the Commissioner abate or cancel a tax liability?

- The Commissioner may abate or cancel a tax liability when:
 - 1) The tax or any portion thereof appears to be UNJUSTLY or EXCESSIVELY ASSESSED; or
 - 2) The ADMINISTRATION and COLLECTION COSTS do not justify the collection of the amount due. (e.g. when the costs of collection are greater than the amount of tax due)

9) Civil and criminal actions

- Civil and criminal action and proceedings instituted in behalf of the Government under the authority of this Code or other law enforced by the BIR:
 - shall be BROUGHT IN THE NAME OF THE GOVERNMENT of the Philippines
 - shall be CONDUCTED BY LEGAL OFFICERS OF THE BIR

- No civil or criminal action for the recovery of taxes or the enforcement of any fine, penalty or forfeiture under the NIRC shall be filed in court without the APPROVAL OF THE COMMISSIONER approval of the Commissioner. (Sec. 220, NIRC)

Q: How is a criminal action a collection remedy?

- The judgment in the criminal case shall:
 - impose the penalty; and
 - order payment of the taxes subject of the criminal case as finally decided by the Commissioner. (Sec. 205, NIRC)

Q: Is an assessment necessary before filing a criminal charge for tax evasion?

- No, an assessment is not necessary before a criminal charge can be filed. The criminal charge need only be proved by a *prima facie* showing of a wilful attempt to file taxes, such as failure to file a required tax return. [CIR v. Pascor Realty (June 29, 1999)]

a) Suit to recover tax based on false or fraudulent returns

- A proceeding in court for the collection of the tax assessed may be filed without assessment at any time within ten (10) years after the discovery of the falsity, fraud or omission

- Provided, that in a fraud assessment which has become final and executor, the fact of fraud shall be judicially taken cognizance of in the civil or criminal action for the collection thereof. (Sec. 222, NIRC)

Q: Are there tax returns which are false but not fraudulent?

- YES. There must be a distinction between false returns (due to mistakes, carelessness or ignorance) and fraudulent returns (with intent to evade taxes).
- The fraud contemplated by law is actual and not constructive, and must amount to intentional wrongdoing with the sole object of avoiding the tax. [**Aznar v. CTA (1974)**]
- **WAIVER:** The taxpayer and the Commissioner may agree in writing, before the expiration of the time prescribed in Sec. 203, to extend the period of assessment (Sec. 222b, NIRC)
 - The waiver of prescription must be executed properly, otherwise, invalid and results to prescription of the right to assess/collect. [**PHIL JOURNALISTS INC. v. CIR (December 16, 2004)**]
 - Requirements under **RMO 20-90**:
 2. definite agreed date,
 3. date of acceptance indicated, and
 4. taxpayer must be furnished with a copy of the waiver.

C. REFUND

Q: What is the nature of a claim for refund?

- It partakes of the nature of an exemption and is strictly construed against the claimant. The burden of proof is on the taxpayer claiming the refund that he is entitled to the same. [**CIR v. Tokyo Shipping (1995)**]

1) Grounds and requisites for refund

Q: When may taxes be refunded or credited? (UP SEE)

- Taxes may be refunded or credited in the following cases:
 - Taxes Erroneously or illegally assessed or collected
 - Penalties imposed without authority
 - Value of internal revenue Stamps when they are returned in good condition by the purchaser
 - Unused stamps that have been rendered unfit for use (Commissioner may redeem, change or refund their value upon proof of destruction)

- Any sum alleged to have been Excessively or in any manner wrongfully collected

2) Requirements for refund as laid down by cases

- a) Necessity of written claim for refund
- b) Claim containing a categorical demand for reimbursement
- c) Filing of administrative claim for refund and the suit/proceeding before the CTA within 2 years from date of payment regardless of any supervening cause

- The taxpayer must **file a written claim for refund** stating a **categorical demand for reimbursement** before the Commissioner **within two years** from the date of payment. (Sec. 229, NIRC) **[GENERAL RULE]**

NOTE: Under s229, NRIC, there is no exception to the two-year prescription period. The language states that : “no such suit or proceeding shall be filed after the expiration of two (2) years from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment xxx

- **EXCEPTIONS to the rule requiring a claim for refund:** When on the face of the return upon which payment was made, such payment appears clearly to have been **erroneously paid** (e.g. mathematical errors), the Commissioner may refund or credit the tax *even without a written claim* therefor.

Note: A return filed showing an overpayment shall be considered as a written claim for credit or refund. (Sec. 204C, NIRC)

3) Legal basis of tax refunds

- Tax refunds are based on the principle of quasi-contract or solutio indebeti and the pertinent laws governing this principle are found in Art. 2142 and Art. 2154 of the NCC. When money is paid to another under the influence of a mistake of fact, on the mistaken supposition of the existence of a specific fact, where it would not have been known that the fact was otherwise, it may be recovered. The ground upon which the right of recovery rests is that money paid through misapprehension of facts belongs in equity and in good conscience to the person who paid it.
- The government comes within the scope of solution indebeti principle, where that: “enshrined in the basic legal principles is the time honoured doctrine that no person shall unjustly enrich himself at the expense of another. It goes without saying that the Government is not exempt from the application of this doctrine.



4) Statutory basis for tax refund under the Tax Code

Under Sec. 204(C), the Commissioner may—

Credit or refund taxes erroneously or illegally received or penalties imposed without authority, refund the value of internal revenue stamps when they are returned in good condition by the purchaser, and, in his discretion, redeem or change unused stamps that have been rendered unfit for use and refund their value upon proof of destruction. No credit or refund of taxes or penalties shall be allowed unless the taxpayer files in writing with the Commissioner a claim for credit or refund within two (2) years after the payment of the tax or penalty: Provided, however, That a return filed showing an overpayment shall be considered as a written claim for credit or refund.

a) Scope of claims for refund

- Credit or refund taxes erroneously or illegally received or penalties imposed without authority;
- Refund the value of internal revenue stamps when they are returned in good condition by the purchaser; and
- In the Commissioner's discretion, redeem or change unused stamps that have been rendered unfit for use and refund their value upon proof of destruction.

b) Necessity of proof for claim or refund

- No credit or refund of taxes or penalties shall be allowed unless the taxpayer files in writing with the Commissioner a claim for credit or refund within two (2) years after the payment of the tax or penalty.
- A return filed showing an overpayment shall be considered as a written claim for credit or refund.

c) Burden of proof for claim of refund

- Refunds are in the nature of tax exemptions and are construed strictly against the person claiming the same.
 - Tax refunds, like tax exemptions, are construed strictly against the taxpayer and liberally in favor of the taxing authority. In any event, petitioner has not discharged its burden of proof in establishing the factual basis for its claim for a refund and we find no reason to disturb the ruling of the CTA. It has been a long-standing policy and practice of the Court to respect the conclusions of quasi-judicial agencies such as the CTA, a highly specialized body specifically created for the purpose of reviewing tax cases. (United Airlines, Inc. v. CIR, G.R. No. 178788, Sept. 29, 2010)
- The taxpayer is charged with the heavy burden of proving that he has complied with and satisfied all the statutory and

administrative requirements to be entitled to the tax refund.

d) Nature of erroneously paid tax/illegally assessed collected

Q: When are there erroneously paid, or illegally assessed or collected taxes?

- *Taxes are erroneously paid* when a taxpayer pays under a mistake of fact, such as, he is not aware of an existing exemption in his favor at the time that payment is made. *Taxes are illegally collected when payments are made under duress.*

e) Tax refund vis-à-vis tax credit

Q: What is the difference between a tax credit and refund?

- REFUND takes place when there is actual reimbursement.
- TAX CREDIT takes place upon the issuance of a tax certificate or tax credit memo, which can be applied against any sum that may be due and collected from the taxpayer.

f) Essential requisites for claim of refund

- The grant of a refund is founded on the assumption that the tax return is valid, that is, the facts stated therein are true and correct. The deficiency assessment, although not yet final, created a doubt as to and constitutes a challenge against the truth and accuracy of the facts stated in said return which, by itself and without unquestionable evidence, cannot be the basis for the grant of the refund.

To grant the refund without determination of the proper assessment and the tax due would inevitably result in multiplicity of proceedings or suits. If the deficiency assessment should subsequently be upheld, the Government will be forced to institute anew a proceeding for the recovery of erroneously refunded taxes which recourse must be filed within the prescriptive period of ten years after discovery of the falsity, fraud or omission in the false or fraudulent return involved. This would necessarily require and entail additional efforts and expenses on the part of the Government, impose a burden on and a drain of government funds, and impede or delay the collection of much-needed revenue for governmental operations.

Thus, to avoid multiplicity of suits and unnecessary difficulties or expenses, it is both logically necessary and legally appropriate that the issue of the deficiency tax assessment against Citytrust be resolved jointly with its claim for tax refund, to determine once and for all in a single proceeding the true and correct amount of tax due or refundable. (Comm. v. CA and Citytrust, G.R. No. 106611, July 21, 1994 as



cited in *United Airlines, Inc. v. CIR*, G.R. No. 178788, Sept. 29, 2010)

5) Who may claim/apply for tax refund/tax credit

The proper person to claim refund or tax credit is the person on whom the tax is imposed by the statute.

a) Taxpayer/withholding agents of non-resident foreign corporation

- The withholding agent is directly and independently liable for the correct amount of tax that should be withheld and for deficiency assessments, surcharges and penalties.

6) Prescriptive period for recovery of tax erroneously or illegally collected

- The two-year period for prescription starts from the date that tax was paid.

But how shall the date of payment be determined?

- i. If the income tax is withheld at source → the taxpayer is deemed to have paid his tax liability at the end of the taxable year.
- ii. If the income is paid on a quarterly basis → the two-year period is counted from the time of filing the final adjustment return.

CIR vs. TMX SALES (January 16, 1992): When a tax is paid in installments, the prescriptive period should be counted from the date of final payment or the last installment. This rule proceeds from the theory that there is *no payment until the entire tax liability is completely paid. Installments should be treated as advances* or portions of the annual tax due.

7) Other consideration affecting tax refunds

What should the taxpayer do if his claim for refund is denied or is not acted upon by the Commissioner?

- **SITUATION 1:** The Commissioner denies the claim for refund → the taxpayer may appeal to the CTA within thirty (30) days from the receipt of the Commissioner's decision AND within two years from the date of payment.
- **SITUATION 2:** The Commissioner does not act on the claim, and the two-year period is about to lapse → the taxpayer must file a claim before the CTA before the 2-year period lapses, otherwise he may no longer file a claim before the CTA in case the Commissioner renders an adverse decision beyond the 2-year period.

If the Commissioner grants the refund, within what time must it be claimed?

- Within five years from the date such warrant or check was mailed or delivered,

otherwise it shall be forfeited in favor of the government and the amount thereof shall revert to the general fund.

What can be done with a Tax Credit Certificate?

- Tax credit certificates (TCCs) can be applied against all internal revenue taxes, excluding withholding tax. TCCs which remain unutilized after five years from the date of issue shall be considered as invalid, unless revalidated.
- If not revalidated, the amount covered by the TCC shall revert to the general fund.

II. Government Remedies

A. ADMINISTRATIVE REMEDIES

1) Tax lien

- If any person neglects or refuses to pay internal revenue taxes after demand, the amount shall be a lien in favor of the Government of the Philippines from the time when the assessment was made by the Commissioner until paid, with interests, penalties and costs that may accrue in addition thereto upon all property belonging to the taxpayer
- The lien shall NOT be valid against any mortgagee, purchaser or judgment creditor until NOTICE of such lien shall be filed by the Commissioner in the office of the Register of Deeds of the province or city where the property of the taxpayer is situated or located. (Sec. 219)

2) Levy and sale of real property

- After the expiration of the time required to pay the delinquent tax or delinquent revenue, real property may be levied upon, before, simultaneously, or after the distraint of personal property belonging to the delinquent. (Sec. 207(B))

3) Forfeiture of real property to the government for want of bidder

- In case there is no bidder for real property or if the highest bid is for an amount insufficient to pay the taxes, penalties and costs, the Internal Revenue Officer shall declare the property forfeited to the Government in satisfaction of the claim.
 - A return of the proceedings must be made within two (2) days.
 - The Register of Deeds, upon registration of declaration of forfeiture, shall transfer the title of the property forfeited to the Government without the necessity of an order from a competent court. (Sec. 215)

4) Further distraint and levy

- The remedy by distraint of personal property and levy on realty may be repeated if necessary until the full amount



is due, including all expenses, is collected. (Sec. 217)

5) Suspension of business operation

The Commissioner or his authorized representative is empowered to suspend the business operations and temporarily close the business establishment of any person for any of the following violations:

(a) In the case of a VAT-registered Person.

- (1) Failure to issue receipts or invoices;
- (2) Failure to file a value-added tax return as required under Section 114; or
- (3) Understatement of taxable sales or receipts by thirty percent (30%) or more of his correct taxable sales or receipts for the taxable quarter.

(b) Failure of any Person to Register as Required under Section 236. -

The temporary closure of the establishment shall be for the duration of not less than five (5) days and shall be lifted only upon compliance with whatever requirements prescribed by the Commissioner in the closure order. (Sec. 115, NIRC)

6) Non-availability of injunction to restrain collection of tax

- No court shall have the authority to grant an injunction to restrain the collection of any national internal revenue tax, fee or charge imposed by the National Internal Revenue Code. (Sec. 218)

B. JUDICIAL REMEDIES

Civil and criminal actions and proceedings instituted in behalf of the Government shall be brought in the name of the Government of the Philippines and shall be conducted by legal officers of the Bureau of Internal Revenue but no civil or criminal action for the recovery of taxes or the enforcement of any fine, penalty or forfeiture shall be filed without the approval of the Commissioner. (Sec. 220, NIRC)

CIVIL ACTION

- There are two ways by which the civil tax liability of a taxpayer is enforced by the government through civil actions. These are: (1) by filing a civil case for the collection of sum of money with the proper regular court; and (2) by filing an answer to the petition for review filed by the taxpayer with the Court of Tax Appeals.
- When the Commissioner files a civil action for the collection of taxes, it is the Republic of the Philippines that is the party plaintiff and not the Commissioner. But when it is the taxpayer that files a petition for review in the Court of Tax Appeals, the respondent is the Commissioner, not the Republic. (Mamalateo, 2008)

CRIMINAL ACTION

1. General Provisions

- Any person convicted of a crime under the Code shall:
 - be liable for the payment of the tax,
 - be subject to the penalties imposed under the Code.

Note: Payment of the tax due after a case has been filed shall not constitute a valid defense in any prosecution for violation of the provisions under the Code.

- Any person who wilfully aids or abets in the commission of a crime penalized under the Code or who causes the commission of any such offense by another shall be liable in the same manner as the principal.

- If the offender is:

OFFENDER	PENALTY
Not a citizen of the Philippines	he shall be deported immediately after serving the sentence
A public officer or employee	the maximum penalty prescribed for the offense shall be imposed on him shall be dismissed from public office, and perpetually disqualified from holding any public office, to vote, and to participate in any election
CPA	his license shall be automatically revoked or cancelled once he is convicted
Corporations, associations, partnerships etc.	imposed on the partner, president, general manager, branch manager, treasurer, officer-in-charge and employees responsible for the violation

- MINIMUM AMOUNT: The fines imposed for any violation of the Code shall not be lower than the fines imposed herein or twice the amount of taxes, interests and surcharges due from the taxpayer, whichever is higher. (§253)

- All violations of any provision of the Code shall prescribe after five (5) years.

o Criminal Offenses

Sec.	Offense	Who is liable	Penalty
254	Willful attempt to evade or defeat tax.	Any person who willfully attempts in any manner to evade or defeat any tax or the	Fine - P30,000 or 100,000; and Imprisonment - 2 to 4 years; Plus



Sec.	Offense	Who is liable	Penalty
		payment thereof.	other penalties
255	Failure to File Return, Supply Correct and Accurate Information, Pay Tax, Withhold and Remit Tax and Refund Excess Taxes Withheld on Compensation	Any person required to pay any tax, make a return, keep any record, or supply correct and accurate information	Fine - P10,000 or more; and Imprisonment - 1 to 10 years; Plus other penalties
		Any person who attempts to make it appear for any reason that he or another has in fact filed a return or statement, or actually files a return or statement and subsequently withdraws the same return or statement	Fine - P10,000 - 20,000; and Imprisonment - 1 to 3 years; Plus other penalties
257	Making false entries, or records, or reports, or using falsified or fake accountable forms.	Any financial officer or Independent CPA engaged to examine and audit books of accounts of taxpayers under Sec.232 (A) and any person under his direction.	Fine - P50,000 - 100,000; and Imprisonment - 2 to 6 years
258	Unlawful pursuit of business	Any person who carries on any business for which in annual registration fee is imposed without paying the tax as required by law.	Fine - P5,000 - 20,000; and Imprisonment - 6 months to 2 years
		A person engaged in the business	Fine - P30,000 - 50,000; and

Sec.	Offense	Who is liable	Penalty
		of distilling, rectifying, repacking, compounding or manufacturing any article subject to excise tax.	Imprisonment - 1 to 2 years
259	Illegal Collection of Foreign Payments	Any person who knowingly undertakes the collection of foreign payments under Sec. 67 without a license or without complying with the implementing rules and regulations.	Fine - P20,000 - 50,000; and Imprisonment - 1 to 2 years
260	Unlawful Possession of Cigarette Paper in Bobbins or Rolls, Etc.	Any person, manufacturer or importer of cigar or cigarettes	Fine - P20,000 - 100,000; and Imprisonment - 6 years 1 day to 12 years
261	Unlawful Use of Denatured Alcohol	Any person who for the purpose of manufacturing any beverage, uses denatured alcohol or alcohol specially denatured to be used for motive power or withdrawn under bond for industrial uses or alcohol knowingly misrepresented to be denatured to be unfit for oral intake or who knowingly sells or offers for sale such preparations	Fine - P20,000 - 100,000; and Imprisonment - 6 years 1 day to 12 years



Sec.	Offense	Who is liable	Penalty
		containing as an ingredient such alcohol. Any person who unlawfully recovers or attempt to recover by distillation or other process any denatured alcohol or who knowingly sells or offers for sale, conceals or otherwise disposes of alcohol as recovered or redistilled	
262	Shipment or Removal of Liquor/Tobacco Products under False Name or Brand or as an Imitation of any Existing or Known Product Name or Brand	Any person who ships, transports or removes	Fine - P20,000 - 100,000; and Imprisonment - 6 years 1 day to 12 years
263	Unlawful Possession or Removal of Articles Subject to Excise Tax W/o Payment of the Tax	Any person who owns or is found in possession of these articles	Value of goods not > P1,000: Fine - not < than P1,000 not > P2,000, imprisonment of not < 60 days, not > 100 days Value of goods > P1,000, not > than P50,000: Fine - not < than P10,000 not > P20,000, imprisonment of not < 2 years, not > 4 years

Sec.	Offense	Who is liable	Penalty
			Value of goods > P50,000, not > than P150,000: Fine - not < than P30,000 not > P60,000, imprisonment of not < 4 years, not > 6 years Value of goods > P150,000: Fine - not < than P50,000 not > P100,000, imprisonment of not < 10 years, not > 12 years
264	Failure or Refusal to Issue Receipts or Sales or Commercial Invoices, Violations Related to the Printing of Such Receipts or Invoices and Other Violations	Any person who, being required under Section 237 to issue receipts or sales or commercial invoices	Fine - P1,000 - 50,000; and Imprisonment - 2 to 4 years
265	Offenses Relating to Stamps		Fine - P20,000 - 50,000; and Imprisonment 4-8 years
266	Failure to Obey Summons	Any person who being duly summoned to appear to testify, or to appear and produce books of accounts, records, memoranda or other papers, or to furnish information as required under the pertinent provisions of this Code.	Fine - P5,000 - 10,000; and Imprisonment - 1 to 2 years



Sec.	Offense	Who is liable	Penalty
267	Declaration under Penalties of Perjury	Any person who willfully files a declaration, return or statement containing information which is not true and correct as to every material matter	Perjury under the Revised Penal Code
268	Misdeclaration or Misrepresentation of Manufacturers Subject to Excise Tax	Any manufacturer subject to excise tax	Summary cancellation or withdrawal of the permit to engage in business as a manufacturer of articles subject to excise tax
	Forfeiture of Property Used in Unlicensed Business or Dies Used for Printing False Stamps, Etc.	Any person who conducts an unlicensed business	Forfeiture
	Forfeiture of Goods Illegally Stored or Removed	Any person subject to excise tax who fails to store the goods in proper place, or removes goods without payment of excise tax	Forfeiture
274	Penalty for Second and Subsequent Offenses		Maximum of the penalty prescribed for the offense
	Forfeiture of Property Used in Unlicensed Business or Dies Used for Printing False Stamps, Etc.	Any person who conducts an unlicensed business	Forfeiture
	Forfeiture of Goods Illegally Stored or Removed	Any person subject to excise tax who fails to store the goods in	Forfeiture

Sec.	Offense	Who is liable	Penalty
		proper place, or removes goods without payment of excise tax	
274	Penalty for Second and Subsequent Offenses		Maximum of the penalty prescribed for the offense
275	Violation of Other Provisions of the Tax Code or Rules or Regulations in General	Any person who violates any provision of this Code or any rule or regulation promulgated by the Department of Finance for which no specific penalty is provided by law	Fine: not more than P 1,000 or Imprisonment: not more than 6 months, or both
276	Penalty for Selling, Transferring, Encumbering or in any way disposing of property Placed under Constructive Distrain	Any taxpayer, whose property has been placed under constructive distraint	Fine: not less than twice the value of the property but not less than P 5,000 or Imprisonment: 2 years 1 day - 4 years or both
277	Failure to Surrender Property Placed under Distrain and Levy	Any person having in his possession or under his control any property or rights to property, upon which a warrant of constructive distraint or actual distraint and levy has been issued	Fine: P 5,000 or more or Imprisonment: 6 months 1 day - 2 years, or both
278	Procuring Unlawful Divulgence of Trade Secrets	Any person procures an officer or employee of the BIR to divulge any confidential information regarding the business, income or	Fine: not more than P 2,000 or Imprisonment: 6 months - 5 years, or both



Sec.	Offense	Who is liable	Penalty
		inheritance of any taxpayer, knowledge of which was acquired by him in the discharge of his official duties, and which it is unlawful for him to reveal, and any person who publishes or prints in any manner whatever, not provided by law, any income, profit, loss or expenditure appearing in any income tax return	

2. Penalties Imposed on Public Officers

- The law imposes a fine of not less than P50,000 nor more than P100,000 or imprisonment for not less than 10 years nor more than fifteen years on every official, agent or employee of the BIR or of any agency or employee of the Government charged with the enforcement of the Tax Code, who shall: **(CONED- FRAP)**
- Extort or willfully oppress under color of law;
 - knowingly Demand other or greater sums than are authorized by law or receive any fee, compensation or reward, except as by law prescribed, for the performance of any duty;
 - willfully Neglect to give receipts, as by law required, for any sums collected in the performance of duty, or who willfully neglect to perform any of the duties enjoined by law;
 - Conspire or collude with another or others to defraud the revenues or otherwise violate the law;
 - willfully make Opportunity for any person to defraud the revenues, or who do or omit to do any act with intent to enable any other person to defraud the revenues;
 - negligently or by design Permit the violation of the law by any other person;
 - make or sign any False certificate or return in any case where the law requires the

- making by them of such entry, certificate or return;
- having knowledge or information of a violation of any provision of the Code or of any fraud committed on the revenues collectible by the BIR, fail to Report such knowledge or information to their superior officer, or to report as otherwise required by law; or
 - without the authority of law, demand or Accept or attempt to collect, directly or indirectly, as payment or otherwise, any sum of money or other thing of value for the compromise, adjustment or settlement of any charge or complaint for any violation or alleged violation of law. (§235)

Informer's Reward (Sec. 282, NIRC)

- **To whom given:** persons instrumental in the discovery of violations of the NIRC and in discovery and seizure of smuggled goods.
- **Conditions** to qualify for the reward:
 - Person is not an internal revenue official or employee, public official, or employee or relative within 6th degree of consanguinity
 - Voluntarily gives definite and sworn information:
 - Not yet in the possession of BIR
 - Leading to discovery of frauds
 - Resulting in:
 - the recovery of revenues, surcharges and fees and/or
 - conviction of the guilty party.
 - Not refer to a case already pending or previously investigated or examined by the Commissioner or his agents or the SOF or his agents.
- **Amount of reward:** 10% of the revenues, surcharges or fees recovered and/or fine/penalty imposed, or P1,000,000, whichever is LOWER.
 - The same amount shall be given if the offender offered to compromise and such offer has been accepted and collected by the Commissioner.
 - If no revenue, surcharge or fees be actually collected, such person is not entitled to a reward
 - For discovery and seizure of **SMUGGLED GOODS:** The cash reward is 10% of the FMV of the smuggled and confiscated goods, or P1,000,000, whichever is LOWER.
- The cash rewards shall be subject to income TAX at the rate of 10%.
- **Rule of construction:** Statutes offering rewards must be liberally construed in favor of informers and with regard to the purpose for which they are intended, with mere technicality yielding to the substantive purpose of the law. [Penid v. Virata]

III. Statutory Offenses and Penalties

A. CIVIL PENALTIES



1) Surcharge

Susrcharge

- A civil penalty imposed by law as an addition to the basic tax required to be paid.
- It is a civil administrative sanction provided as a safeguard for the protection of the State revenue and to reimburse the government for the expenses of investigation and the loss resulting from the taxpayer's fraud.
- A surcharge added to the main tax is subject to interest.

Rates of Surcharge:

- There shall be imposed a penalty equivalent to **twenty-five percent (25%)** of the amount due, in the following cases:
 - FAILURE TO FILE ANY RETURN and PAY THE TAX DUE THEREON on the date prescribed; or
 - Filing a return with an internal revenue officer than those with whom the return is required to be filed (except when authorized by the Commissioner); or
 - FAILURE TO PAY THE DEFICIENCY TAX within the time prescribed for its payment in the notice of assessment
 - FAILURE TO PAY THE FULL OR PART of the amount of tax shown on any return required to be filed, or the full amount of tax due for which no return is required to be filed, on or before the date prescribed for its payment. (Sec. 248A, NIRC)

- The penalty shall be **fifty percent (50%)** of the tax or of the deficiency tax, in the following cases:
 - WILLFUL NEGLECT to FILE THE RETURN within the period prescribed
 - A FALSE OR FRAUDULENT RETURN is wilfully made (§248B)
 - *Prima-facie evidence of false or fraudulent return:*
 - substantial under declaration of taxable sales, receipts or income (failure to report sales, receipts or income in an amount exceeding 30% of that declared per return)
 - substantial overstatement of deductions (a claim of deduction in an amount exceeding 30% of actual deductions)

2) Interest

a) In General

- There shall be assessed and collected on any unpaid amount of tax, interest at the rate of twenty percent (20%) per annum, or such higher rate as may be

prescribed by rules and regulations, from the date prescribed for payment until the amount is fully paid. (Sec. 249(A), NIRC)

b) Deficiency interest

- Any deficiency in the tax due shall be subject to twenty percent (20%) per annum which shall be assessed and collected from the date prescribed for its payment until the full payment thereof. (Sec. 249(B))

c) Delinquency interest

- In case of failure to pay (1) The amount of the tax due on any return required to be filed; (2) The amount of the tax due for which no return is required; or (3) A deficiency tax, or any surcharge or interest thereon on the due date appearing in the letter of demand and assessment notice, there shall be assessed and collected on the unpaid amount a twenty percent (20%) per annum until the amount is fully paid, which interest shall form part of the tax. (Sec. 249(C))

d) Interest on extended payment

- If any person required to pay the tax is:
 - Qualified and elects to pay the tax on installment but fails to pay the tax or any installment or any part of such amount or installment or before the date prescribed for its payment, OR
 - Where the Commissioner has authorized an extension of time within which to pay a tax or a deficiency tax or any part thereof

There shall be assessed and collected interest at twenty percent (20%) per annum on the tax or deficiency tax or any part thereof unpaid from the date of notice and demand until it is paid. (249(D))

IV. Compromise and Abatement of taxes

A. COMPROMISE

- The Commissioner may compromise the payment of any internal revenue tax in the following cases:
 - 1) A REASONABLE DOUBT as to the validity of the claim against the taxpayer exists; or
 - 2) The financial position of the taxpayer demonstrates a clear inability to pay the assessed tax. (FINANCIAL INCAPACITY)

What are the limits of the Commissioner's power to compromise?



- For cases of financial incapacity: a minimum compromise rate equivalent to ten percent (10%) of the basic assessed tax;
- For other cases: a minimum compromise rate equivalent to forty percent (40%) of the basic assessed tax

Note: When the basic tax involved exceeds One Million Pesos (P1,000,000), or where the settlement offered is less than the prescribed minimum rates,

the compromise must be approved by the Evaluation Board (composed of the Commissioner and 4 deputy commissioners)

May the Commissioner compromise cases of criminal violations?

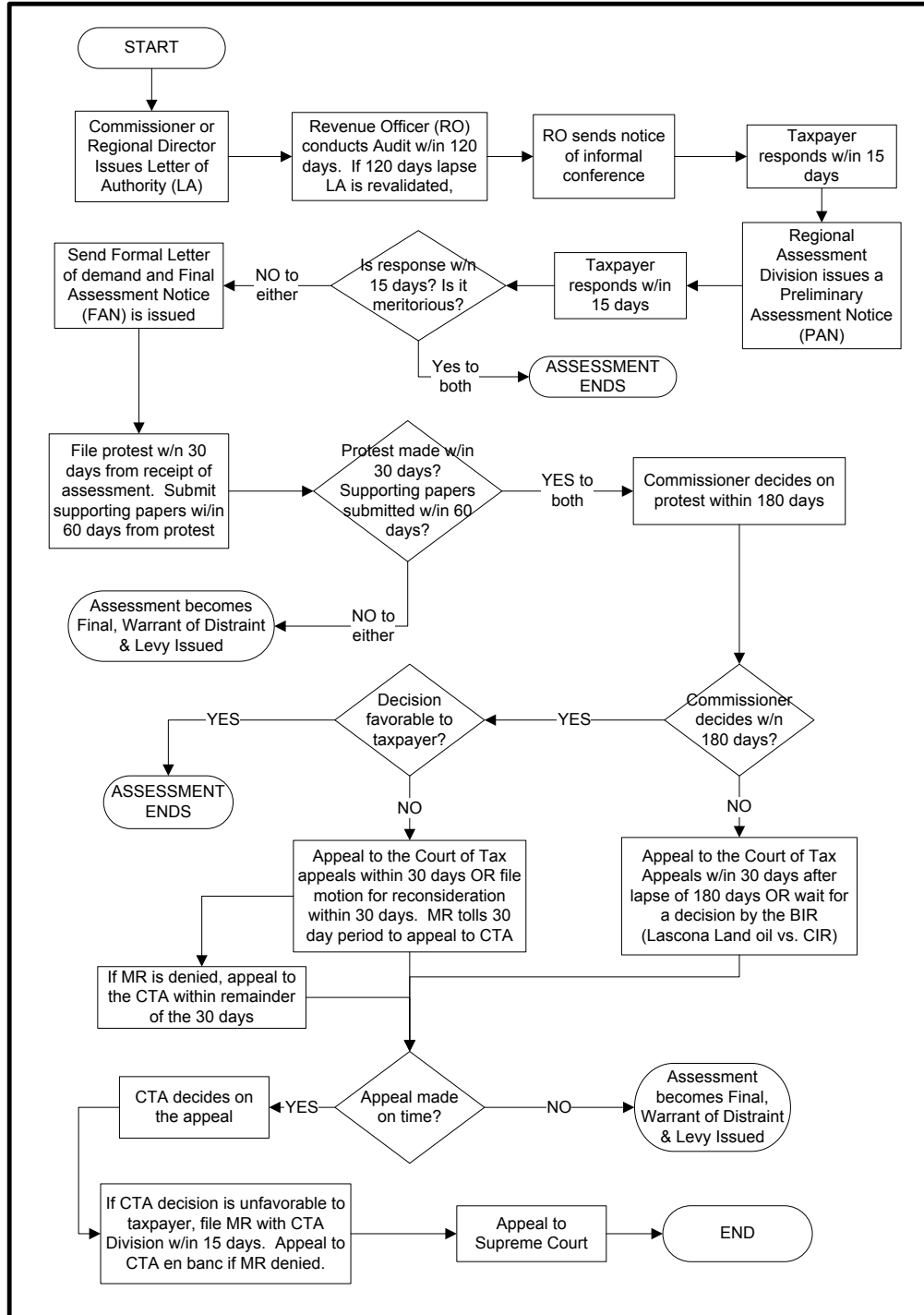
- Generally, ALL CRIMINAL VIOLATIONS may be compromised, EXCEPT:
 - c) those cases already filed in court
 - d) those involving fraud

B. ABATEMENT

- The Commissioner may abate or cancel a tax liability when:
 - The tax or any portion thereof appears to be UNJUSTLY or EXCESSIVELY ASSESSED; or
 - The ADMINISTRATION and COLLECTION COSTS do not justify the collection of the amount due. (e.g. when the costs of collection are greater than the amount of tax due)

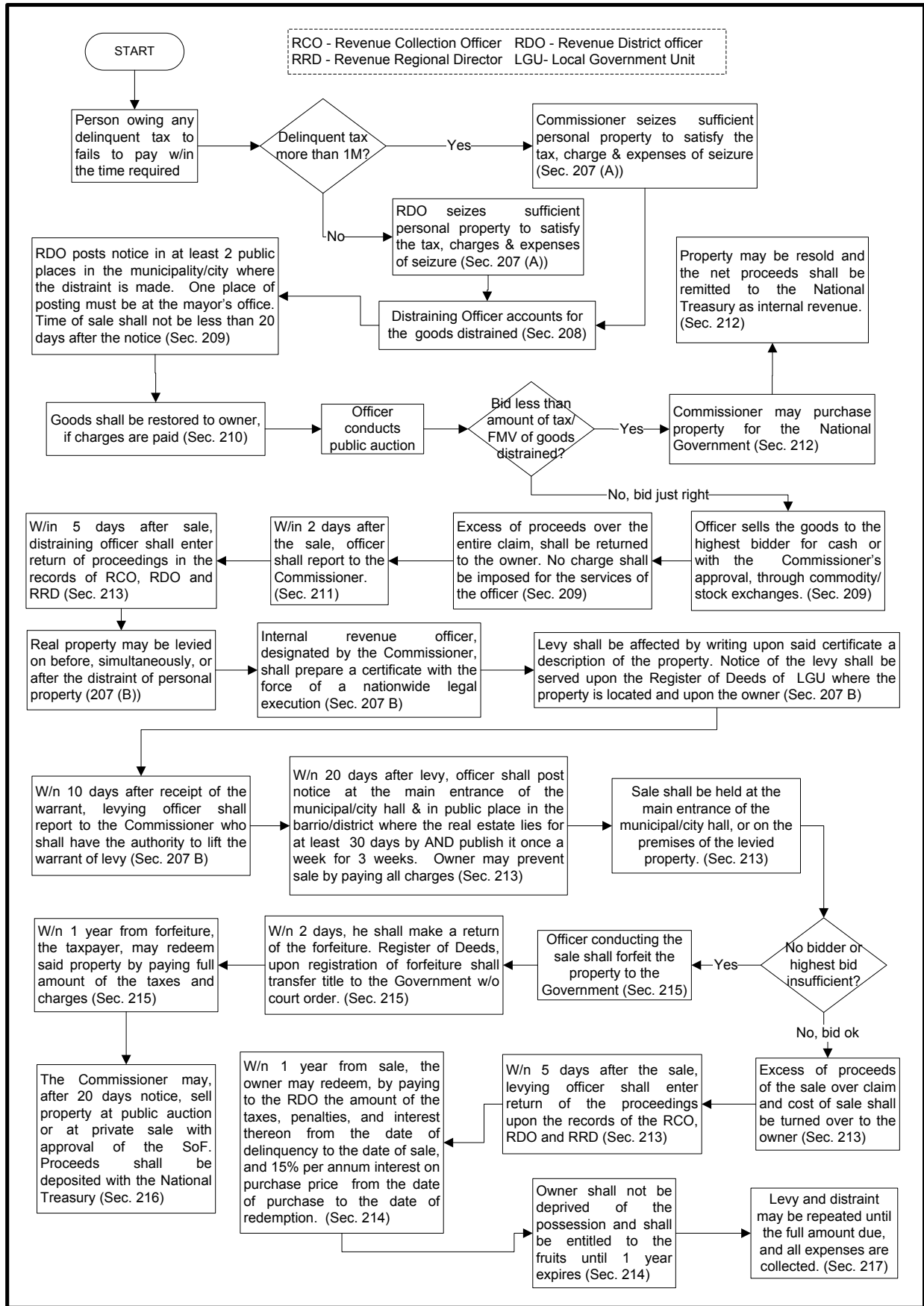


Flowchart I: Taxpayer's Remedies from Tax Assessment-NIRC





Flowchart II: Procedures for Distraint and Levy-NIRC





5. Organization and Function of BIR

- I. Rule-making authority of Secretary of Finance
- II. Power of commissioner to suspend business operation of a taxpayer

I. Rule-making authority of the Secretary of Finance

a. Authority of secretary of finance to promulgate rules and regulations (Sec. 244, NIRC)

- Secretary of Finance, upon recommendation of the Commissioner, shall promulgate all needful rules and regulations for effective enforcement of the provisions of the Code.

b. Specific provisions to be contained in rules and regulations (Sec. 245, NIRC)

- a. The time and manner in which Revenue Regional Director shall canvass their respective Revenue Regions for the purpose of discovering persons and property liable to national internal revenue taxes, and the manner in which their lists and records of taxable persons and taxable objects shall be made and kept;
- b. The forms of labels, brands or marks to be required on goods subject to an excise tax, and the manner in which the labelling, branding or marking shall be effected;
- c. The conditions under which and the manner in which goods intended for export, which if not exported would be subject to an excise tax, shall be labelled, branded or marked;
- d. The conditions to be observed by revenue officers respecting the institutions and conduct of legal actions and proceedings;
- e. The conditions under which goods intended for storage in bonded warehouses shall be conveyed thither, their manner of storage and the method of keeping the entries and records in connection therewith, also the books to be kept by Revenue Inspectors and the reports to be made by them in connection with their supervision of such houses;
- f. The conditions under which denatured alcohol may be removed and dealt in, the character and quantity of the

denaturing material to be used, the manner in which the process of denaturing shall be effected, so as to render the alcohol suitably denatured and unfit for oral intake, the bonds to be given, the books and records to be kept, the entries to be made therein, the reports to be made to the Commissioner, and the signs to be displayed in the business ort by the person for whom such denaturing is done or by whom, such alcohol is dealt in;

- g. The manner in which revenue shall be collected and paid, the instrument, document or object to which revenue stamps shall be affixed, the mode of cancellation of the same, the manner in which the proper books, records, invoices and other papers shall be kept and entries therein made by the person subject to the tax, as well as the manner in which licenses and stamps shall be gathered up and returned after serving their purposes;
- h. The conditions to be observed by revenue officers respecting the enforcement of Title III imposing a tax on estate of a decedent, and other transfers mortis causa, as well as on gifts and such other rules and regulations which the Commissioner may consider suitable for the enforcement of the said Title III;
- i. The manner in which tax returns, information and reports shall be prepared and reported and the tax collected and paid, as well as the conditions under which evidence of payment shall be furnished the taxpayer, and the preparation and publication of tax statistics;
- j. The manner in which internal revenue taxes, such as income tax, including withholding tax, estate and donor's taxes, value-added tax, other percentage taxes, excise taxes and documentary stamp taxes shall be paid through the collection officers of the Bureau of Internal Revenue or through duly authorized agent banks which are hereby deputized to receive payments of such taxes and the returns, papers and statements that may be filed by the taxpayers in connection with the payment of the tax: Provided, however, That notwithstanding the other provisions of this Code prescribing the place of filing of returns and payment of taxes, the Commissioner may, by rules and regulations, require that the tax



returns, papers and statements that may be filed by the taxpayers in connection with the payment of the tax. Provided, however, That notwithstanding the other provisions of this Code prescribing the place of filing of returns and payment of taxes, the Commissioner may, by rules and regulations require that the tax returns, papers and statements and taxes of large taxpayers be filed and paid, respectively, through collection officers or through duly authorized agent banks: Provided, further, That the Commissioner can exercise this power within six (6) years from the approval of Republic Act No. 7646 or the completion of its comprehensive computerization program, whichever comes earlier: Provided, finally, That separate venues for the Luzon, Visayas and Mindanao areas may be designated for the filing of tax returns and payment of taxes by said large taxpayers.

For the purpose of this Section, 'large taxpayer' means a taxpayer who satisfies any of the following criteria:

1. **Value-Added Tax (VAT)** - Business establishment with VAT paid or payable of at least One hundred thousand pesos (P100,000) for any quarter of the preceding taxable year;
2. **Excise tax** - Business establishment with excise tax paid or payable of at least One million pesos (P1,000,000) for the preceding taxable year;
3. **Corporate Income Tax** - Business establishment with annual income tax paid or payable of at least One million pesos (P1,000,000) for the preceding taxable year; and
4. **Withholding tax** - Business establishment with withholding tax payment or remittance of at least One million pesos (P1,000,000) for the preceding taxable year.

Provided, however, That the Secretary of Finance, upon recommendation of the Commissioner, may modify or add to the above criteria for determining a large taxpayer after considering such factors as inflation, volume of business, wage and employment levels, and similar economic factors.

The penalties prescribed under Section 248 shall be imposed on any violation of the rules and regulations issued by the Secretary of Finance, upon recommendation of the Commissioner, prescribing the place

of filing of returns and payments of taxes by large taxpayers.

c. Non-retroactivity of rulings (Sec. 246, NIRC)

Any revocation, modification or reversal of any of the rules and regulations promulgated or any of the rulings or circulars promulgated by the Commissioner shall not be given retroactive application if the revocation, modification or reversal will be prejudicial to the taxpayers, except in the following cases:

- a) Where the taxpayer deliberately misstates or omits material facts from his return or any document required of him by the Bureau of Internal Revenue;
- b) Where the facts subsequently gathered by the Bureau of Internal Revenue are materially different from the facts on which the ruling is based; or
- c) Where the taxpayer acted in bad faith.

II. Power of the Commissioner to suspend the business operation of a taxpayer

The Commissioner or his authorized representative is empowered to suspend the business operations and temporarily close the business establishment of any person for any of the following violations:

(a) In the case of a VAT-registered Person.

- (1) Failure to issue receipts or invoices;
- (2) Failure to file a value-added tax return as required under Section 114; or
- (3) Understatement of taxable sales or receipts by thirty percent (30%) or more of his correct taxable sales or receipts for the taxable quarter.

(b) Failure of any Person to Register as Required under Section 236. -

The temporary closure of the establishment shall be for the duration of not less than five (5) days and shall be lifted only upon compliance with whatever requirements prescribed by the Commissioner in the closure order. (Sec. 115, NIRC)

6. Local Taxation

- I. Fundamental principles
- II. Nature and source
- III. Local taxing authority
- IV. Scope of taxing power
- V. Specific taxing power
- VI. Common limitations
- VII. Collection of business tax
- VIII. Taxpayer's remedies

**IX. Civil remedies****I. Fundamental principles (UEPIPI)**

1. Taxation shall be Uniform in each local government unit;
 - IRR: the uniformity required is only within the territorial jurisdiction of an LGU.
2. Taxes, fees, charges and other impositions shall: (EPUC)
 - i. be Equitable and based as far as practicable on the taxpayer's ability to pay;
 - ii. be levied and collected only for Public purposes;
 - iii. not be Unjust, excessive, oppressive, or confiscatory;
 - iv. not be Contrary to law, public policy, national economic policy, or in the restraint of trade;
 - v. The collection of local taxes, fees, charges and other impositions shall not be let to any Private person;
 - vi. The revenue collected shall Inure solely to the benefit of, the local government unit levying the tax, fee, charge or other imposition unless otherwise specifically provided herein; and,
 - vii. Each local government unit shall, as far as practicable, evolve a Progressive system of taxation. (SEC. 130, LGC)

II. Nature and source of taxing power**a. Grant of local taxing power under the Local Government Code**

- LGUs have the power to create own sources of revenue and to levy taxes, fees, and charges, consistent with local autonomy. Taxes levied accrue exclusively to the local government units. (SEC. 129, LGC)

b. Authority to prescribe penalties for tax violations

- The sanggunian may impose a surcharge not exceeding twenty-five percent (25%) of the amount of taxes, fees or charges not paid on time and an interest at the rate not exceeding two percent (2%) per month of the unpaid taxes, fees or charges including surcharges, until such amount is fully paid but in no case shall the total interest on the unpaid amount or portion thereof exceed thirty-six (36) months. (Sec. 168, LGC)

c. Authority to grant local tax exemptions

- LGUs may, through ordinances duly approved, grant tax exemptions, incentives or reliefs under such terms and conditions as they may deem necessary. (Sec. 192, LGC)

d. Withdrawal of exemptions

- Unless otherwise provided, tax exemptions or incentives granted to, or presently enjoyed by all persons, whether natural or judicial, including government-owned or controlled corporations, except local water districts, cooperatives duly registered under R.A. No. 6938, non-stock and non-profit hospitals and education institutions, are withdrawn upon the effectivity of the Code. (Sec. 193, LGC)

e. Authority to adjust local tax rates

- LGUs shall have the authority to adjust the tax rates as prescribed not oftener than once every five (5) years, but in no case shall the adjustment exceed ten percent (10%) of the rates fixed by the Code. (Sec. 191, LGC)

f. Residual taxing power of local governments

- LGU may exercise the power to levy taxes or charges on ANY base or subject

Required:

1. Not specifically enumerated or taxed under NIRC/LGC
2. Not unjust, excessive, oppressive, confiscatory or contrary to declared national policy
3. Pursuant to an ordinance enacted with public hearing

g. Authority to issue local tax ordinances

- LGUs may exercise the power to levy taxes, fees or charges on any base or subject not taxed under the provisions of the National Internal Revenue Code or other applicable laws.
- The taxes, fees or charges shall not be unjust, excessive, oppressive, confiscatory or contrary to declared national policy.
- The taxes, fees or charges must be levied through an ordinance. (Sec. 186, LGC)

III. Local taxing authority**a. Power to create revenues exercised thru LGUs**

- Exercised by the Sanggunian concerned through an appropriate ordinance. (Sec. 132, LGC)
- Veto powers:
 - Local chief executives of the LGUs, except the Punong Barangay possess veto powers over ordinances or particular items thereof which are either ultra vires or prejudicial to public welfare. His reasons shall be stated in writing. (Sec 55(a), LGC)
 - The Sanggunian may override the veto with a 2/3 vote of all its members.
 - Veto power may only be exercised once.



- The veto doesn't affect items not objected to. (Sec 55(b), LGC)
- Vetoed items shall not take effect unless the sanggunian overrides the veto. If vetoed, corresponding item or items in the appropriations ordinance of the previous year shall be deemed reenacted. The veto doesn't affect items not objected to. (Sec 55(b), LGC)

1. A public hearing must be conducted prior to the enactment of a tax ordinance.

2. Within ten (10) days after the approval of the ordinance, certified true copies of all tax ordinances or revenue measures shall be published in full for three (3) consecutive days in a newspaper of local circulation. In provinces, cities and municipalities where there are no newspapers of local circulation, it must be posted in at least two (2) conspicuous and publicly accessible places. (Sec. 188, LGC)

b. Procedure for approval and effectivity of tax ordinances

IV. Scope of taxing power

LGU	SCOPE OF TAXING POWER
Provinces	May levy only: <ol style="list-style-type: none"> 1. Transfer of Real Property 2. Business of Printing and Publication 3. Franchise Tax 4. Tax on Sand, Gravel and Other Quarry Resources 5. Professional Tax 6. Amusement Tax 7. Annual Fixed Tax for every delivery truck or van
Municipalities	May levy taxes, fees and charges

	not otherwise levied by provinces
Cities	May levy taxes, fees and charges which the province or municipality may impose
Barangays	May levy only: <ol style="list-style-type: none"> 1. Taxes on stores or retailers 2. Service fees or charges 3. Barangay clearance 4. Other fees and charges

- But all LGUs may also impose service fees and charges, public utility charges and toll fees or charges. (Sec. 153-155, LGC)

V. Specific taxing power of local government unit (LGUs)

Power	Province	Municipality	City	Barangay
Tax on Transfer of Real Property	✓ (135)		✓ (151)	
Tax on Business of Printing and Publication	✓ (136)		✓	
Franchise tax	✓ (137)		✓	
Tax on sand, gravel and other quarry resources	✓ (138)		✓	
Professional tax	✓ (139)		✓	
Amusement tax	✓ (140)		✓	
Annual Fixed Tax For Every Delivery Truck or Van of Manufacturers or Producers, Wholesalers of, Dealers, or Retailers in, Certain Products	✓ (141)		✓	
Tax on Business		✓ (143)	✓	
Fees and charges on regulation/licensing of business and occupation		✓ (147)	✓	
Fees for Sealing and Licensing of Weights and Measures		✓ (148)	✓	
Fishery Rentals, Fees and Charges		✓ (149)	✓	
Community Tax		✓	✓	
Tax on Gross Sales or Receipts of Small-Scale Stores/Retailers				✓ (152a)
Service Fees on the use of Barangay-owned properties				✓ (152b)
Barangay Clearance				✓ (152c)
Other Fees and Charges (on commercial breeding of fighting cocks, cockfights, cockpits; places of recreation which charge admission fees; outside ads)				✓ (152d)
Service Fees and Charges (153)	✓	✓	✓	✓
Public Utility Charges (154)	✓	✓	✓	✓
Toll Fees or Charges (155)	✓	✓	✓	✓



Real Property Tax	✓	✓ (within Metro Manila)	✓	
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a. Taxing powers of provinces

TAX IMPOSED	RATE/AMOUNT	BASE	EXEMPTIONS	OTHERS
1) Tax on Transfer of Real Property. Imposed on the sale, donation, barter, or any other mode of transfer of ownership or title to real property	Not more than 50% of 1%	Total acquisition price or fair market value, whichever is higher	Sale, transfer, or other disposition of real property pursuant to R.A. 6657 (Comprehensive Agrarian Reform Law)	Evidence of payment of tax is to be required by Register of Deeds as a requisite to registration; and by the provincial assessor as a condition for cancellation of old tax declaration. Tax must be paid 60 days from the date of execution of deed or from the date of decedent's death.
2) Tax on Business of Printing and Publication. a. Imposed on the business of persons engaged in printing, and/or publication of books, cards, posters, leaflets, handbills, certificates, receipts, pamphlets, and others of similar nature b. Newly started business	Not exceeding 50% of 1% Not exceeding 1/20 of 1%	Gross annual receipts for the preceding calendar year Capital investment	Receipts from printing and/or publishing of books and other reading materials prescribed by the DECS as school texts or references	In the succeeding calendar year, regardless of when business started operating, tax shall be based on <u>gross receipts for preceding calendar year</u> , or any fraction thereof.
3) Franchise Tax. a. Notwithstanding any exemption granted by any law or any other special law, tax may be imposed on business enjoying a franchise b. Newly-started business	Not exceeding 50% of 1% Not more than 1/20 of 1%	Gross annual receipts for the preceding calendar year realized within its territorial jurisdiction Capital investment		In the succeeding calendar year, regardless of when business started operating, tax shall be based on <u>gross receipts for preceding calendar year</u> , or any fraction thereof.



TAX IMPOSED	RATE/AMOUNT	BASE	EXEMPTIONS	OTHERS
4) Tax on Sand, Gravel and Other Quarry Resources. Levied on ordinary stones, gravel, earth and other quarry resources as defined in the NIRC, extracted from public lands or from the beds of seas, lakes, rivers, streams, creeks, and other public waters within its territorial jurisdiction	Not more than 10%	Fair market value in the locality per cubic meter of resources referred to in Column 1		<p>Permit to extract sand, gravel and other quarry resources to be issued exclusively by the provincial governor pursuant to an Ordinance by the Sangguniang Panlalawigan</p> <p>Distribution of proceeds:</p> <ul style="list-style-type: none"> • Province - 30% • Component City/ Municipality where resources were extracted - 30% • Barangay where resources were extracted - 40%
5) Professional Tax. Provinces may levy annual professional tax on each person engaged in the exercise of a profession requiring government examination	Such amount as the Sangguniang Panlalawigan may determine in no case to exceed P300.00		Professionals exclusively employed by the government	<p>To be paid to the province where the profession or a principal office is maintained.</p> <p>A person who pays for professional tax may practice his profession anywhere in the country without being subjected to similar taxes.</p> <p>Employers shall require payment of professional tax as a condition for employment.</p>
6) Amusement Tax. Levied from proprietors lessees, or operators of theaters, cinemas, concert halls, circuses, boxing stadia, and other places of amusement	Not more than 30%	Gross receipts from admission fees	<p>Holding of operas, concerts, dramas, recitals, painting, and art exhibitions, flower shows, musical programs, literary and oratorical presentations</p> <p>Exception to exemption: Pop, rock, or similar concerts</p>	<p>In case of theaters or cinemas, tax shall first be deducted and withheld by their proprietors, lessees and operators</p> <p>Proceeds to be shared equally by the province and municipality where amusement places are located.</p>
7) Annual Fixed Tax For Every Delivery Truck or Van of Manufacturers or Producers, Wholesalers of,	Amount not exceeding P500			Manufacturers, producers, wholesalers, dealers and retailers



TAX IMPOSED	RATE/AMOUNT	BASE	EXEMPTIONS	OTHERS
Dealers, or Retailers in, Certain Products. Imposed on vehicles used for the delivery of distilled spirits, fermented liquors, soft drinks, cigars and cigarettes, and other products as may be determined by the sanggunian, to sales outlets, or consumers in the province, whether directly or indirectly				referred to in column 1 shall be exempt from tax on peddlers

b. Taxing powers of cities

- The City may levy taxes, fees, charges which the province or municipality may impose.
- Those levied and collected by highly urbanized and independent component cities shall accrue to them and distributed in accordance with the provisions of LGC.
- Rates on levy made by the city may exceed the maximum rates allowed for the province or municipality by not more than 50%
 - Exception: Rates of professional and amusement taxes. (Sec. 151, LGC)
 - Cities have the broadest taxing powers, embracing both specific and general powers as provinces and municipalities may impose (Vitug)

c. Taxing powers of municipalities

1) Tax on various types of businesses

	RATE/AMOUNT AND BASE	OTHER INFORMATION
1) Manufacturers, assemblers, repackers, processors, brewers, distillers, rectifiers, and compounders of liquors, distilled spirits, and wines or manufacturers of any article of commerce of whatever kind or nature	In accordance with the schedule in Section 143 (a), NIRC	
2) Wholesalers, distributors, or dealers in any article of commerce of whatever kind or nature	Schedule in Article 143 (b), NIRC	
3) Exporters and on manufacturers, millers, producers, wholesalers, distributor, dealers or retailers of essential commodities enumerated below: (RWC- CLAPS) <ul style="list-style-type: none"> i. Rice and corn ii. Wheat and or cassava flour, meat, dairy products, locally manufactured, processed or preserved food, sugar, salt, and other agricultural, marine, and fresh water products, whether in original state or not iii. Cooking oil and cooking gas iv. Cement v. Laundry soap, detergents, and medicine vi. Agricultural implements, equipment and post-harvest facilities, fertilizers, pesticides, insecticides, herbicides and other farm inputs; vii. Poultry feeds and other animal feeds; viii. School supplies 	Not exceeding 1/2 of rates prescribed in the schedule in Sec 143, NIRC	
4) Retailers	Gross sales or receipts for the preceding	Barangays have the exclusive



	RATE/AMOUNT AND BASE	OTHER INFORMATION
	calendar year of: <ul style="list-style-type: none"> • 400k or less: 2% per annum • more than 400k: 1% per annum 	power to tax gross receipts amounting to: <ul style="list-style-type: none"> • 50k or less: in cities • 30k or less: in municipalities
5) Contractors and other independent contractors	In accordance with the schedule in Sec. 143	
6) Banks and other financial institutions	Not exceeding fifty percent 50% of 1% on the gross receipts of the preceding calendar year from interest, commissions and discounts from lending activities, income from financial leasing, dividends, rentals on property and profit from exchange or sale of property, insurance premium.	IRR: All other income and receipts of banks and financial institutions NOT otherwise enumerated shall be excluded from the taxing authority of the LGU.
7) Peddlers engaged in the sale of any merchandise or article of commerce	Not exceeding P50.00 per peddler annually.	
8) Any business which the sanggunian concerned may deem proper to tax		Catch-all provision. Any business subject to excise, value-added or percentage tax is subject to tax not exceeding two percent (2%) of gross sales or receipts of the preceding calendar year

2) Ceiling on business tax impossible on municipalities within Metro Manila

- Not 50% more than the maximum rates prescribed in Sec 143. (SEC. 144, LGC)

3) Tax on retirement on business

- Upon termination of a business subject to tax under Sec.143 a sworn statement of its gross sales or receipts for the current year shall be submitted. If the tax paid is less than the tax due, the difference shall be paid before the business is considered officially retired. (Sec 145, LGC)

4) Rules on payment of business tax

- Taxes in Sec. 143 shall be paid for every separate or distinct establishment or place where business subject to tax is conducted.
- One line of business is not exempted by being conducted with some other businesses for which such tax has been paid
- The tax on a business must be paid by the person conducting it.
- If a person operates 2 or more businesses mentioned in Sec 143 which are taxed; computation shall be based on:
 - combined total gross sales/receipts IF subject to the SAME tax rate
 - separate reports on gross sales/receipts IF subject to DIFFERENT tax rates

Yamane vs. Lepanto Condo Corp. (Oct. 23, 1995):

- Condominium corporations are not business entities, thus not subject to local business tax. Even though the corporation is empowered to levy assessments or dues from the unit owners, these amounts are not intended for the incurrence of profit by the corporation, but to shoulder the multitude of necessary expenses for maintenance of the condominium.

Ericsson Telecoms vs. City of Pasig. (Nov 2007):

- The issue in this case is whether the local business tax on contractors should be based on *gross receipts* or *gross revenue*. Pasig City assessed deficiency business taxes on Ericsson based on its gross revenue, arguing that *gross receipts* is synonymous with the latter. The Court ruled that business tax must be based on gross receipts, it being different from gross revenue. The right to receive income, and not the actual receipt determines when to include the amount in gross income.

5) Fees and charges for regulation & licensing

- General: As a condition to the conduct of business or profession, the municipality may impose reasonable fees and charges not yet imposed by the province, commensurate with the cost of regulation, inspection and licensing. (Sec.147)
- Specific:
 1. Municipality has power to impose reasonable rates for sealing and licensing of weights and measures



2. The Municipality has exclusive authority to grant fishery privileges in municipal waters. The sangguniang bayan may:
 - a) Grant fishery privileges to erect fish corrals, oysters, mussels or other aquatic beds or bangus fry areas, within a definite zone of the municipal waters, as
 - b) Grant marginal fishermen the privilege to gather, take or catch bangus fry, prawn fry or kawag-kawag or fry of other species and fish from the municipal waters by nets, traps or other fishing gears free of rental, fee, charge or imposition.
 - c) Issue licenses for the operation of fishing vessels of three (3) tons or less
3. The Sanggunian may penalize the use of explosives, noxious or poisonous substances, electricity, muro-ami, and other deleterious methods of fishing and prescribe a criminal penalty therefor (Sec. 149, LGC)

6) Situs of tax collected

- a. *According to the Jurisprudence*

EXCISE TAX: *Allied Thread Co., Inc. v. City Mayor of Manila, L-40296* Tax is imposed on the performance of an act or occupation, enjoyment of a privilege.

The power to levy such tax depends on the place in which the act is performed or the occupation is engaged in; not upon the location of the office.

SALES TAX: *Shell Co., Inc. v. Municipality of Sipocot, Camarines Sur* with respect to sale, it is the place of the consummation of the sale, associated with the delivery of the things which are the subject matter of the contract that determines the situs of the contract for purposes of taxation, and not merely the place of the perfection of the contract.

- b. *According to Sec. 150 of the LGC*, situs shall be determined by the ff. RULES:
RULE 1: In case of persons *maintaining/operating a branch or sales outlet making the sale or transaction*, the tax shall be recorded in said branch or sales outlet and paid to the municipality/city where the branch or sales outlet is located.
RULE 2: Where there is NO branch or sales outlet in the city/municipality where the sale is made, sale shall be recorded in the principal office and the

tax shall be paid to such city/municipality.

RULE 3: In the case of manufacturers, contractors, producers, and exporters having factories, project offices, plants, and plantations, proceeds shall be allocated as follows:

- 30% of sales recorded in the principal office shall be made taxable by the city/municipality where the principal office is located
- 70% shall be taxable by the city/municipality where the factory, project office, plant, or plantation is located

Illustration of Rules 1 to 3:

A company has a principal office in Mandaluyong, while its sales office and factory are in Sta Rosa:

- sales made in Sta Rosa, will be recorded in Sta Rosa
- sales made in Los Baños, Calamba or Cabuyao (i.e. delivered to customers located in those places), will be recorded in Mandaluyong
- aside from sales made in Sta Rosa, Sta Rosa also gets 70% of sales recorded in Mandaluyong, pursuant to Rule 3

RULE 4: In case the plantation is located in a place other than the place where the factory is located, the 70% in Rule 3 will be divided as follows:

- 60% to the city/municipality where the factory is located
- 40% to the city/municipality where the plantation is located

RULE 5: In case of 2 or more factories, plantations, etc. in different localities, the 70% shall be prorated among the localities where the factories, plantations, etc. are located in proportion to their respective volume of production.

Illustration:

A company has a principal office in Valenzuela and has its factory in Bulacan. It also has branches selling merchandise in Muntinlupa, Bacolod, Cebu.

- sales made in Muntinlupa, Bacolod and Cebu will go to the said cities
- sales in all other places which do not have a sales branch shall be distributed as follows: 30% to Valenzuela and 70% to Bulacan

IRR: Where manufacturers employ an independent contractor, the factory/ plant/ warehouse of the contractor is considered the factory/plant/warehouse of the manufacturer.

IRR: The city or municipality where the port of loading is located shall not levy fees unless the exporter maintains in said city or municipality its principal office, a branch, sales office, or warehouse, factory, plant or plantation in which case the rules above apply.

d. Taxing powers of barangays

- The following shall exclusively accrue to the barangays:
 1. Taxes on Stores or Retailers with Fixed Business Establishments.
 - a) RATE: not greater than one percent (1%)
 - b) BASE:
 - In case of cities: gross sales or receipts of the preceding calendar year of P50,000.00 or less
 - In case of municipalities: gross sales or receipts of P30,000.00 or less
 2. Service Fees or Charges. For services rendered in connection with the regulations or the use of barangay-owned properties or facilities such as palay, copra, or tobacco dryers.
 3. Barangay Clearance. A city or municipality cannot issue a permit for business without a clearance from the barangay concerned. The sangguniang barangay may impose a reasonable fee on the clearance.
 4. Other Charges Allowed. (Sec. 152, LGC)
 - a) charges on commercial breeding of fighting cocks, cockfights and cockpits;
 - b) charges on places of recreation which charge admission fees; and

"places of recreation" - include places of amusement where one seeks admission to entertain himself by seeing or viewing the show or performance or those where one amuses himself by direct participation.
 - c) charges on billboards, signboards, neon signs, and outdoor advertisements.

e. Common revenue raising powers

- 1) Service fees and charges
 - LGUs may impose and collect such reasonable fees and charges for services rendered. (Sec. 153, LGC)
- 2) Public utility charges
 - LGUs may fix the rates for the operation of public utilities owned, operated and maintained by them within their jurisdiction. (Sec. 154, LGC)

3) Toll fees or charges

- The sanggunian may prescribe the terms and conditions and fix the rates for the imposition of toll fees or charges for the use of any public road, pier, or wharf, waterway, bridge, ferry or telecommunication system funded and constructed by the local government unit concerned.
- The sanggunian may also discontinue the collection of the tolls when public safety and welfare requires.
- NO toll fees or charges shall be collected from:
 - Officers and enlisted men of the AFP and members of the PNP on mission
 - Post office personnel delivering mail
 - Physically-handicapped
 - Disabled citizens who are sixty-five (65) years or older. (Sec. 155, LGC)

f. Community tax

- Who May Levy (Sec. 156, LGC): Cities or municipalities without need for public hearing.
- Persons Liable (Sec. 157 & 158, LGC)
 1. *Individuals* who are:
 - a) Inhabitants of the Philippines
 - b) Eighteen years of age or over
 - c) Regularly employed on a wage or salary basis for at least 30 consecutive working days during any calendar year
 - d) Either:
 - Engaged in business or occupation
 - Owns real property with an aggregate assessed value of P1,000 or more OR
 - Is required by law to file an income tax return
 2. *Juridical Persons*
 - a) Every corporation no matter how created or organized,
 - b) Whether domestic or resident foreign,
 - c) Engaged in or doing business in the Philippines
- Rates
 1. *Individuals*
 - a) Annual community tax of P5.00 PLUS annual additional tax of P1.00 per P1,000.00 of income regardless whether from business, exercise of profession or property
 - b) Never to exceed P5000
 - c) Husband and wife shall pay a basic tax of P5.00 each PLUS additional tax based on total property owned by them and the



- total gross receipts or earnings derived therefrom.
2. *Juridical Persons*
 - a) Annual community tax of P500.00 PLUS annual additional tax of not more than P10,000.00 according to the ff. schedule:
 - P2.00 for every P5,000 worth of real property in the Philippines owned during the preceding year based
 - P2.00 for every P5,000.00 of gross receipts derived from business in the Philippines during the preceding year.
 - b) Dividends received by a corporation from another corporation shall be deemed part of the gross receipts or earnings for purposes of computing additional tax.
 - Persons Exempt (Sec. 159, LGC)
 - Diplomatic and consular representatives
 - Transient visitors who stay in the Philippines for not more than 3 months
 - Time and Place of Payment
 - a) Place. Where individual resides, or where the principal office of the juridical entity is located. (Sec. 160, LGC)
 - b) Time. Accrues on the 1st day of January of each year to be paid not later than the last day of February of each year
 - c) Penalty. If unpaid within the prescribed period, an interest of 24% shall be added per annum from the due date until payment. (Sec. 161, LGC)
 6. Taxes, fees or charges on Agricultural and aquatic products when sold by marginal farmers or fishermen;
 7. Taxes on business enterprises certified to by the Board of Investments as Pioneer or non-pioneer for a period of 6 and 4 years, respectively from the date of registration;
 8. Excise taxes on articles enumerated under the NIRC, as amended, and taxes, fees or charges on petroleum products;
 9. Percentage or VAT on sales, barter or exchanges or similar transactions on goods or services except as otherwise provided herein;
 10. Taxes on the Gross receipts of transportation contractors and persons engaged in the transportation of passengers or freight by hire and common carriers by air, land or water, except as provided in the Code;
 11. Taxes on premiums paid by way or Reinsurance or retrocession;
 12. Taxes, fees or charges for the Registration of motor vehicles and for the issuance of all kinds of licenses or permits for the driving thereof, except tricycles;
 13. Taxes, fees, or other charges on Philippine products actually Exported, except as otherwise provided;
 14. Taxes, fees, or charges, on Countryside and Barangay Business Enterprises and Cooperatives duly registered under the Cooperative Code of the Philippines; and
 15. Taxes, fees or charges of any kind on the National Government, its agencies and instrumentalities, and local government units. (Sec. 133, LGC)

III. Common limitations on the taxing powers of LGUs

- Unless otherwise provided, the following cannot be levied by the local governments: (IDEC-GAPEP-GRR-ECN):
 1. Income tax, except when levied on banks and other financial institutions;
 2. Documentary stamp tax;
 3. Estate tax, inheritance, gifts, legacies and other acquisitions mortis causa, except as otherwise provided;
 4. Customs duties, registration fees of vessel and wharfage on wharves, tonnage dues, and all other kinds of customs fees, charges and dues except wharfage on wharves constructed and maintained by the LGU concerned;
 5. Taxes, fees or charges on Goods *carried into or out of, or passing through, the territorial jurisdictions of local government units* in the guise of charges for wharfage, tolls for bridges or otherwise, or other taxes, fees, or otherwise

IV. Collection of business tax

a. Tax period and manner of payment

- Based on calendar year, unless otherwise provided.
- May be paid annually or in quarterly instalments. (Sec. 165, LGC)

b. Accrual of tax

- Accrues on the first day of January of each year
- Except: New taxes, fees or charges, or changes in the rates thereof which shall accrue on the first day of the quarter next following the effectivity of the ordinance imposing such new levies or rates. (Sec. 166, LGC)

c. Time of payment

- Within the 20 days of January or of each subsequent quarter. (i.e., Jan 20, Apr 20, July 20, and Oct 20). It may be extended by the sanggunian for justifiable reasons, without surcharges or penalties.



Extension cannot exceed 6 months.
(Sec. 167, LGC)

d. Penalties on unpaid taxes, fees or charges

- Surcharge not exceeding 25% on taxes, fees or charges NOT paid on time; and
- Interest not exceeding 2% per month of the unpaid taxes, fees or charges INCLUDING surcharges, until the amount is fully paid
- In no case shall the total interest exceed 36 months. (Sec. 168, LGC)

e. Authority of treasurer in collection and inspection of books

- All local taxes, fees and charges shall be collected by the local treasurer or their duly authorized deputies (Sec. 170, LGC)
- The local treasurer may, by himself or through his deputies duly authorized in writing, examine the books, accounts, and other pertinent records of any person subject to local taxes, fees and charges in order to ascertain, assess and collect the correct amount of the tax, fee or charge.
 - Examination must be done during business hours, only once for every tax period and shall be certified to by the examining official. (Sec. 171, LGC)

V. Taxpayer's remedies

a. Periods of assessment and collection of local taxes, fees or charges

- Assessment: Within 5 years from the date they become due
- In case of Fraud or Intent to Evade Tax: Within 10 years from discovery of fraud or intent to evade payment. (Sec. 194, LGC)
- Collection: 5 years from the date of assessment by administrative or judicial action.

Instances When Running of Prescription Periods is Suspended

1. When the treasurer is legally prevented from making the assessment or collection
2. When taxpayer requests for reinvestigation and executes a waiver in writing before lapse of the period for assessment or collection.
3. When the taxpayer is out of the country or otherwise cannot be located (Sec. 194 (d), LGC)

b. Protest of assessment

- Within sixty (60) days from the receipt of the notice of assessment, the taxpayer may file a written protest with the local treasurer contesting the assessment; otherwise it shall become final and executory. (Sec. 195, LGC)

c. Claim for refund of tax credit for erroneously or illegally collected tax, fee or charge

- Requires a written claim for refund or credit to be filed with local treasurer before protest is entertained
- Must be brought within 2 years from payment of tax or from the date the taxpayer became entitled to refund or credit (Sec. 196, LGC)

VI. Civil remedies by the LGU for collection of revenues

a. Local government's lien for delinquent taxes, fees or charges

- Non-payment of a tax, fee or charge creates a lien superior to all liens or encumbrances in favor of any other person, enforceable by administrative or judicial action
- The lien may only be extinguished upon full payment of the delinquent local taxes, fees, and charges including related surcharges and interests. (Sec. 173, LGC)

b. Civil remedies, in general

- 1) Administrative action
- 2) Judicial action

c. Procedure for administrative action

1) Dstraint of personal property

- Dstraint - of goods, chattels or effects and other personal property of whatever character, including stocks and other securities, debts, credits, bank accounts, and interest in and rights to personal property

PROCEDURE: (Sec. 175, LGC)

- a. Seizure of personal property
- b. Accounting of distrained goods
- c. Publication of time and place of sale and the articles distrained
- d. Release of distrained property upon payment prior to sale
- e. Procedure of sale
- f. Disposition of proceeds

2) Levy of real property, procedure



- Levy upon real property and interest in or rights to real property

PROCEDURE (Sec. 176, LGC)

- a. Preparation of a duly authenticated certificate by the LGU Treasurer effecting the levy on the real property
- b. Service of written notice of levy to the assessor and Register of Deeds
- c. Annotation of the levy on the tax declaration and the certificate of title

3) Further distraint or levy

- The remedies by distraint or levy may be repeated if necessary until the full amount due, including all expenses, is collected (Sec. 184, LGC)

4) Exemption of personal property from distraint or levy

(ToB-CUPLA)

- Tools and implements necessarily used by the taxpayer in his trade or employment
- one horse, cow, carabao, or other Beast of burden, such as the delinquent taxpayer may select and necessarily used by him in his ordinary occupation
- his necessary Clothing, and that of all his family
- household furniture and utensils necessary for housekeeping and used for that purpose by the delinquent taxpayer, such as he may

select, of a value not exceeding P10,000

- Provisions, including crops, actually provided for individual or family use sufficient for 4 months
- the professional Libraries of doctors, engineers, one fishing boat and net, not exceeding the total value of P10,000 by the lawful use of which a fisherman earns his livelihood
- any material or Article forming part of a house or improvement of any real property

5) Penalty on local treasurer for failure to issue and execute warrant of distraint or levy

- Automatically dismissed from the service after due notice and hearing (Sec. 177, LGC)

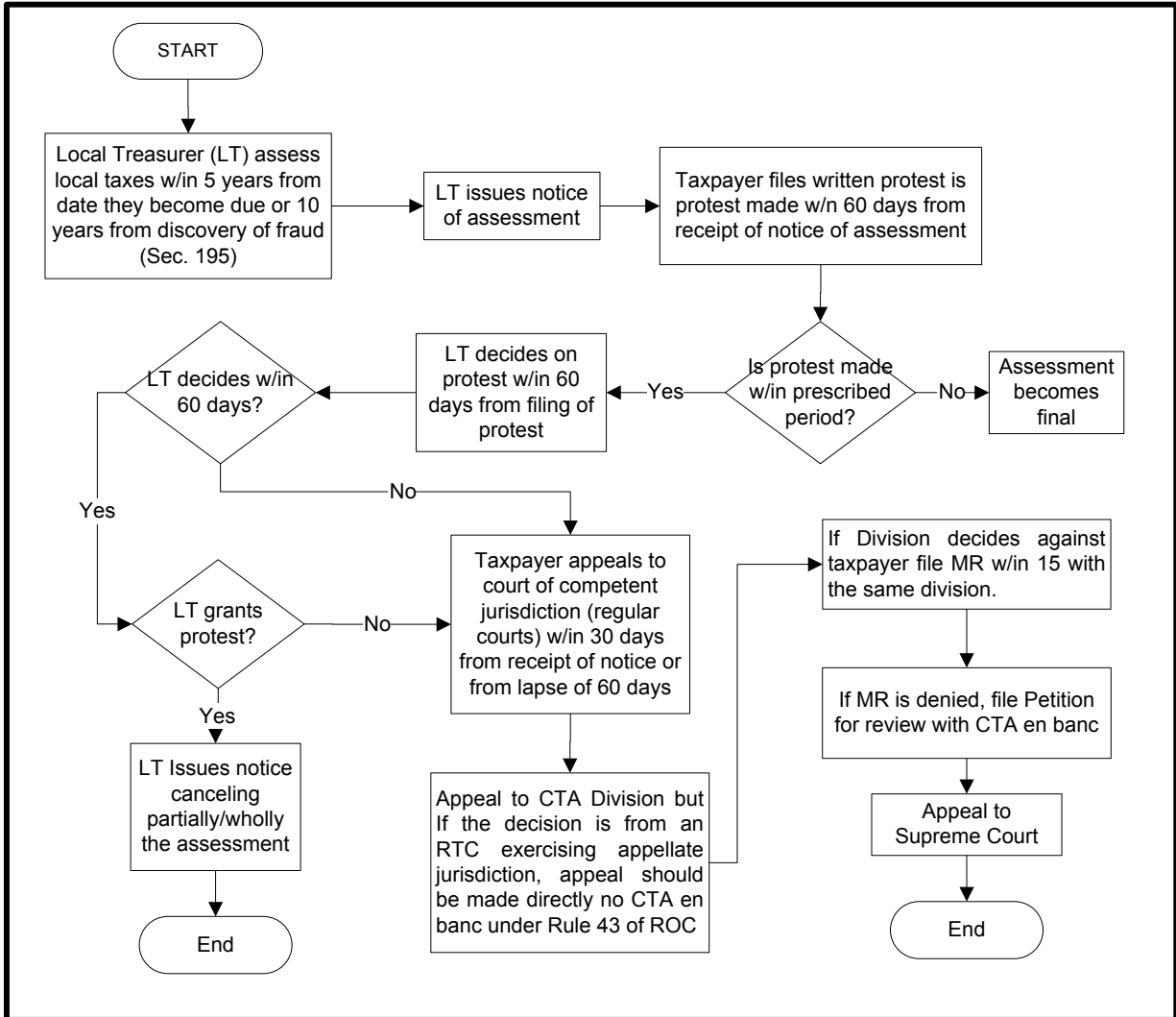
d. Procedure for judicial action

- The local government may institute an ordinary civil action with regular courts of proper jurisdiction for the collection of delinquent taxes, fees, charges or other revenues.
- The civil action shall be filed by the local treasurer. (Sec. 183, LGC)

Valley Trading Co. vs. CFI of Isabela, (1989) LGC does not contain a provision prohibiting courts from enjoining the collection of local taxes. Such lapse may have allowed preliminary injunction under Rule 58, ROC where local taxes are involved.

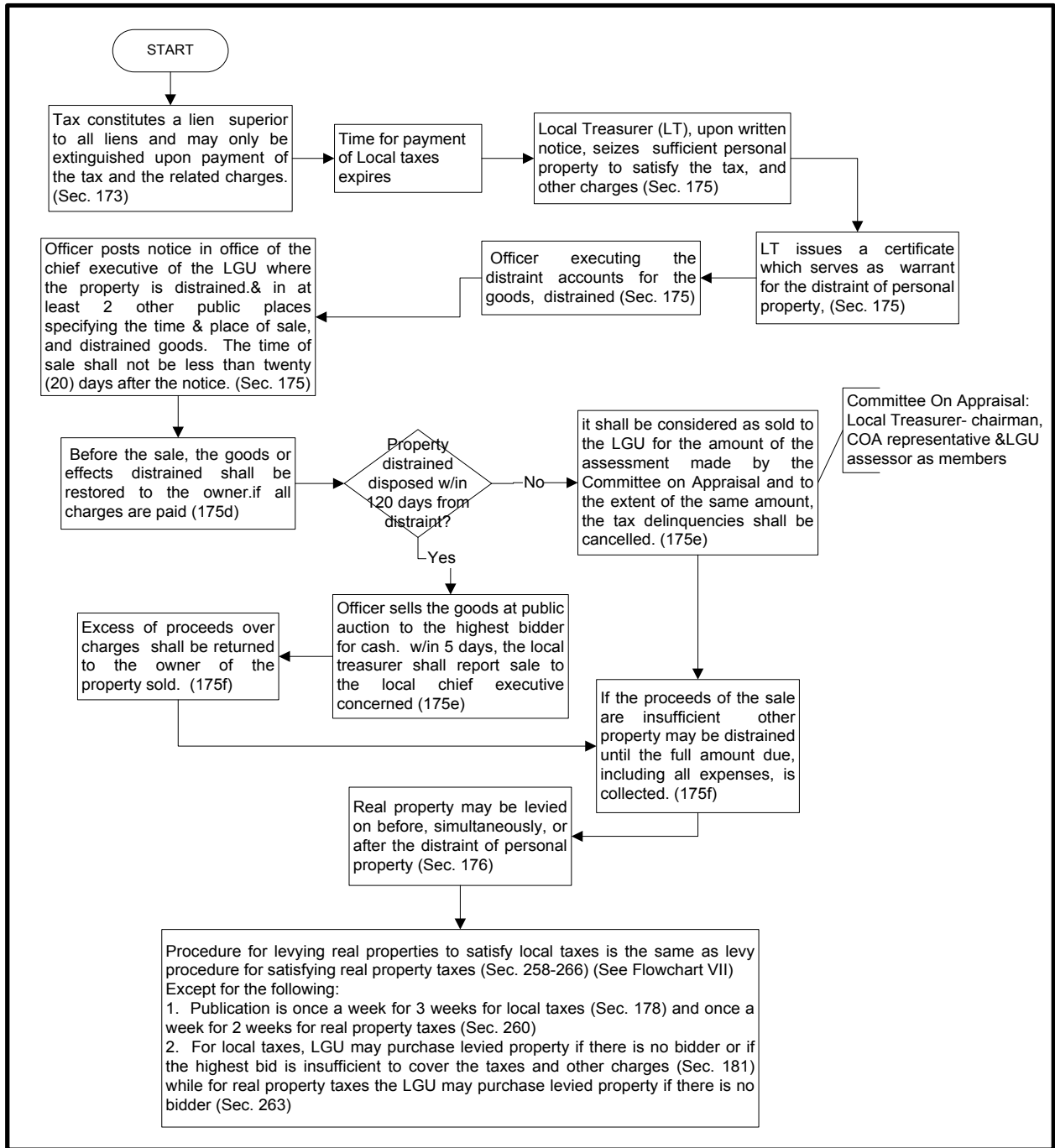


Flowchart III: Taxpayer's Remedies From Assessment of Local Taxes other than Real Property Taxes-Local Government Code





Flowchart IV: Procedure for Distraint and Levy for Purposes of Satisfying Local Taxes-Local Gov't Code





7. Real Property Taxation

- I. Fundamental principles
- II. Nature
- III. Imposition
- IV. Appraisal and Assessment
- V. Collection
- VI. Refund/Credit
- VII. Taxpayer's remedies

I. Fundamental principles

(CAPUE)

1. Current fair market value is the basis for assessment
2. Actual use shall be the basis of classification for assessment
3. Priate persons cannot be left to the appraisal, assessment, levy and collection of real property tax.
4. Uniform classification within each local government unit shall be observed.
5. Equitable appraisal and assessment is required. (Sec. 197, LGC)

II. Nature of real property tax

1. It is a direct tax on the ownership or use of real property
2. It is an ad valorem tax. Value is the tax base
3. It is proportionate because the tax is calculated on the basis of a certain percentage of the value assessed.
4. It creates a single, indivisible obligation
5. It attaches on the property (i.e., a lien) and is enforceable against it.
6. With respect to LGUs, it is levied thru a delegated power

III. Imposition of real property tax

a. Power to levy real property tax

- A province, city or municipality within Metro Manila may levy an annual ad valorem tax on real property such as land, building, machinery and other

Mactan Airport V. MIAA

	Provision involved	SC Ruling
<i>Mactan Airport Authority vs. Marcos (1996)</i>	Sec 133 (o), LGC. LGUs not allowed to levy... (o) taxes/fees/charges of any kind on the national gov't, its	Mactan Airport Authority is a GOCC, not exempt from RPT. Legislature in amending the law

improvements not exempted. (Sec. 232, LGC)

- The rate shall be as follows:
 - Province: not exceeding one percent (1%) of the assessed value of real property; and
 - City or municipality within Metro Manila: not exceeding two percent (2%) of the assessed value of real property. (Sec. 233, LGC)

b. Exemption from real property tax

1. Owned by the Republic of the Philippines or any of its political subdivisions except when beneficial use is granted for a consideration or to a taxable person.
2. Charitable institutions, churches, parsonages, or convents appurtenant thereto, mosques, non-profit or religious cemeteries, and all lands, buildings, and improvements actually, directly and exclusively used for religious, charitable, or educational purposes.
3. Machinery and equipment actually, directly and exclusively used by local Water utilities and GOCCs engaged in the supply and distribution of water and/or generation and transmission of electric power.
4. Real property owned by duly registered Cooperatives as provided for under Republic Act No. 6938 (Cooperative Code of the Philippines).
5. Machinery and equipment used for Pollution control and Environmental protection. (Sec. 234, LGC)

Proof of Exemption

1. Documentary evidence such as affidavits, by-laws, contract, articles of incorporation
2. Given to local assessor
3. Within 30 days from date of declaration
4. Failure to file, will be listed as in Assessment Rolls as taxable

GOCCs

➤ *hilippine Ports Authority vs. City of Iloilo (2003)*: GOCCs are NOT covered by the exemption since the exemption only refers to instrumentalities without personalities distinct from the government.

	agencies, instrumentalities and LGUs.	specifically deleted GOCCS from the enumeration in Sec 234(a).
	Sec 234 (a), LGC. Properties exempt from RPT: (a) real properties owned by the Republic or	



	any of its political subdivisions...	
<i>Manila Airport Authority vs. CA (2006)</i>	Sec 133 (o), LGC Sec 234 (a), LGC	MIAA falls under the term "instrumentality" outside the scope of LGS's local taxing powers under Sec 133(o).

Charitable Institutions

- *LUNG CENTER of the PHILS vs. QUEZON CITY (June 2004)*: A charitable institution doesn't lose its character and its exemption simply because it derives income from paying patients so long as the money received is devoted to the charitable object it was intended to achieve, and no money inures to the benefit of persons managing the institution.
- Property leased to private entities is NOT exempt from RPT, as it is not actually, directly and exclusively used for charitable purposes. Portions of the land occupied by the hospital and portions used for its patients, whether paying or non-paying, are EXEMPT from real property taxes.

IV. Appraisal and assessment of real property tax

a. Rule on appraisal of real property at fair market value

- All real property, whether taxable or exempt, shall be appraised at the CURRENT AND FAIR MARKET VALUE prevailing in the locality where the property is situated. (Sec. 201, LGC)

b. Declaration of real property

- By Owner or Administrator
 - Prepare a sworn statement declaring the true value of the property (whether previously declared or underdeclared, taxable or exempt) which shall be the current and fair market value of the property
 - The declaration must contain a sufficient description of the property to enable the assessor or his deputy to identify the same for assessment purposes
 - File the sworn declaration with the assessor once every three (3) years

during the period from January 1st to June 30th (Sec. 202, LGC)

- By Any Person Acquiring Real Property or Making Improvements
 - Prepare and file with the provincial, city or municipal assessor a sworn statement declaring the true value of the property within **60 days** after acquisition or upon completion or occupancy of the improvement (Sec. 203, LGC)
- By the Assessor upon the refusal or failure by the person required to make a declaration
 - Prepare a sworn declaration of the property in the name of the defaulting owner and assess the property for taxation (Sec. 204, LGC)

c. Listing of real property in assessment rolls

- The local assessor must maintain an assessment roll wherein all real property, whether taxable or exempt, located within the territorial jurisdiction of the local government unit, is listed.
- Real property shall be listed, valued and assessed in the name of the owner or administrator, or anyone having legal interest in the property.
 - Undivided real property: may be in the name of the estate or of the heirs and devisees (in case property of a deceased person) or in the name of one or more co-owners
 - Real property owned by the Republic of the Philippines, its instrumentalities and political subdivisions, if the beneficial use has been granted to a taxable person: in the name of the possessor, grantee or of the public entity if such property has been acquired or held for resale or lease (Sec. 205, LGC)

d. Preparation of schedules of fair market value

- 1) Authority of assessor to take evidence
 - The local assessor or his deputy may summon the owners of the properties to be affected or persons having legal interest therein and witnesses, administer oaths, and take deposition concerning the property, its ownership, amount, nature and value. (Sec. 213, LGC)
- 2) Amendment of schedule of fair market value
 - The local assessor may recommend to the sanggunian concerned amendments

to correct errors in valuation in the schedule of fair market values. The sanggunian shall by ordinance act upon the recommendation within ninety (90) days from receipt thereof. (Sec. 214, LGC)

e. Classes of real property

1. Residential
2. Agricultural
3. Commercial
4. Industrial
5. Mineral
6. Timberland
7. Special - all lands, buildings and other improvements actually, directly and exclusively used for hospitals, cultural, or scientific purposes, and those owned and used by local water districts, and GOCCs rendering essential public services in the supply and distribution of water and/or generation and transmission of electric power (Sec. 216, LGC)

f. Actual use of property as basis of assessment

- Real property shall be classified, valued and assessed on the basis of its actual use regardless of where located, whoever owns it, and whoever uses it.

g. Assessment of real property

1) Assessment levels

- Assessment levels shall be fixed by ordinances of the sanggunian at rates not exceeding those prescribed in Sec. 218

2) General revisions of assessments and property classification

- The local assessor shall undertake a general revision of real property assessments every three (3) years. (Sec. 219, LGC)

3) Date of effectivity of assessment or reassessment

- All assessments or reassessments made after the first (1st) day of January of any year shall take effect on the first (1st) day of January of any year
- Exceptions: reassessments due to 1) partial or total destruction; 2) major change in actual use; 3) great and sudden inflation or deflation of real property values; 4) gross illegality of the assessment when made; or 5) any other abnormal cause shall be made within ninety (90) days from the date of any cause and shall take effect at the beginning of the quarter next following the reassessment. (Sec. 221, LGC)

4) Assessment of property subject to back taxes

- Property declared for the first time: assessed for taxes for the period during which it would have been liable but in no case for more than ten (10) years prior to the date of initial assessment (Sec. 222, LGC)

5) Notification of new or revised assessment

- When real property is assessed for the first time or when an existing assessment is increased or decreased, the local assessor shall within thirty (30) days give written notice of the new or revised assessment to the person in whose name the property is being declared.
 - Notice may be given personally or by registered mail or through the assistance of the punong barangay to the last known address of the person to be served. (Sec. 223, LGC)

h. Appraisal and assessment of machinery

Machinery Value	
New Machinery	Acquisition cost <ul style="list-style-type: none"> ▪ If imported: the acquisition cost includes freight and handling, duties and taxes, plus cost of inland transportation, handling and installation charges at the present site; cost shall be converted to peso cost
Others	Divide the remaining economic life by its estimated economic life and multiply it by the replacement or reproduction cost

V. Collection of real property tax

a. Date of accrual of real property tax

- Real property tax for any year shall accrue on the first day of January. (Sec. 246, LGC)

b. Collection of tax

1) Collecting authority

- The collection of the real property tax, with interest and expenses, shall be the responsibility of the local treasurer. The latter may deputize the barangay treasurer to collect all taxes upon filing of a bond. (Sec. 247, LGC)

2) Duty of assessor to furnish local treasurer with assessment rolls



- The local assessor must furnish the local treasurer on or before the 31st of December each year an assessment roll containing a list of all persons whose real properties have been newly assessed or reassessed and the value of such properties. (Sec. 248, LGC)

3) Notice of time for collection of tax

- On or before the 31st of January or on any date prescribed, the local treasurer shall post the notice of the dates when the tax may be paid without interest at a conspicuous and publicly accessible place at the city or municipal hall. The notice shall also be published in a newspaper of general circulation in the locality once a week for two (2) consecutive weeks. (Sec. 249, LGC)

c. Periods within which to collect real property tax

- within five (5) years from the date they become due
- within ten (10) years from discovery of fraud, in case there is fraud or intent to evade

➤ Instances for suspension of prescription periods

1. local treasurer is legally prevented to collect tax.
2. the owner or property requests for reinvestigation and writes a waiver before expiration of period to collect.
3. the owner of property is out of the country or cannot be located

d. Special rules on payment

1) Payment of real property tax in installments

- Payment of real property tax and the additional tax for the Special Education Fund, without interest, may be made in four (4) equal instalments:
 - 1st : March 31st
 - 2nd : June 30th
 - 3rd : September 30th
 - 4th : December 31st
- This shall not apply to special levies which shall be governed by ordinance of the sanggunian concerned.
- Payments of real property taxes shall first be applied to prior years delinquencies, interests and penalties, if any, and only after the delinquencies are settled may tax payments be credited for the current period. (Sec. 250, LGC)

2) Interests on unpaid real property tax

- In case of failure to pay the basic real property tax or any other tax when due shall subject the taxpayer to the payment of interest at the rate of two (2%) percent per month on the unpaid amount or a fraction thereof until the

delinquent tax shall have been fully paid. But the total interest on the unpaid tax shall not exceed thirty-six (36) months. (Sec. 255, LGC)

3) Condonation of real property tax

- By SANGGUNIAN: in case of general failure of crops or substantial decrease in the price of agricultural or agri-based products or calamity in any LGU (Sec. 276, LGC)
- By the PRESIDENT of the Philippines: when public interest so requires (Sec. 277, LGC)

e. Remedies of LGUs for collection of real property tax

1) Issuance of notice of delinquency for real property tax payment

- Upon the failure to pay the tax when due, the local treasurer shall issue a warrant levying the real property subject to tax. The warrant shall include a duly authenticated certificate showing the name of the owner or person having legal interest therein, description of the property, amount of the tax due and interest thereon.
 - Warrant must be mailed or served to owner or person having legal interest in the property
 - Written notice of levy must be mailed or served to the assessor and the Register of Deeds where the property is located
 - The Register of Deeds must annotate the levy on the tax declaration and certificate of title (Sec. 258, LGC)
- Failure to issue or execute the warrant of levy within one year from the time the tax becomes delinquent or within thirty days from the date of the issuance thereof shall be dismissed from service (Sec. 259, LGC)

2) Local government's lien

- The basic real property tax shall constitute a lien on the property subject to tax, superior to all liens, charges or encumbrances in favour of any person, irrespective of the owner or possessor thereof, enforceable by administrative or judicial action and may only be extinguished upon payment of the tax and the related interests and expenses. (Sec. 257, LGC)

3) Remedies in general

- The LGU may avail of the remedies by administrative action thru levy on real property or by judicial action. (Sec. 256, LGC)



4) Resale of real estate taken for taxes, fees or charges

- The sanggunian may, by ordinance and upon notice of not less than twenty (20) days, sell and dispose of the real property acquired by the LGU for want of bidder. The proceeds of the sale shall accrue to the general fund of the LGU concerned. (Sec. 264, LGC)

5) Further levy until full payment of amount due

- Levy may be repeated if necessary until the full amount due, including all expenses, is collected. (Sec. 265, LGC)

VI. Refund or credit of real property tax

a. Payment under protest

- No protest shall be entertained unless the taxpayer first pays the tax.
 - Protest must in writing
 - Filed within 30 days from payment of the tax to the local treasurer
 - Receipts shall be annotated
- Tax collected shall be held in trust by the treasurer.
- The local treasurer shall decide the protest within 60 days from receipt:
 - If granted: the amount protested shall be refunded or applied as tax credit;
 - If denied or upon lapse of the 60 day period prescribed: denial may be appealed to LBAA

b. Repayment of excessive collections

- When the assessment is illegal or erroneous and the tax is accordingly reduced or adjusted, the taxpayer may file a written claim for refund or credit for taxes and interests with the local treasurer within two (2) years from the date the taxpayer is entitled to such reduction or adjustment. (Sec. 253, LGC)

VII. Taxpayer's remedies

a. Contesting an assessment of value of real property

1) Appeal to the Local Board of Assessment Appeals (LBAA)

- Appeal must be filed within 60 days from the date of receipt of the written notice of assessment
 - By filing a petition under oath in the form prescribed for the purpose

- Copies of tax declarations and other affidavits or documents must be submitted (Sec. 226, LGC)
- The LBAA shall decide the appeal within 120 days from the date of receipt of such appeal
 - The LBAA shall have the power to summon witnesses, administer oaths, conduct ocular inspection, take depositions, and issue subpoena duces tecum and/or subpoena
 - The LBAA must furnish the appellant a copy of the decision of the board. (Sec. 229, LGC)

2) Appeal to the Central Board of Assessment Appeals (CBAA)

- Appeal must be filed within 30 days from the receipt of the decision of LBAA (Sec. 229, LGC)

3) Effect of payment of tax

- Appeal on assessments of real property shall NOT SUSPEND the collection of the corresponding realty taxes on the property involved as assessed by the provincial or city assessor without prejudice to the subsequent readjustment depending upon the final outcome of the appeal. (Sec. 231, LGC)

b. Payment of real property under protest

1) File protest with local treasurer

- No protest shall be entertained unless the tax is first paid. The protest must be in writing and filed within 30 days from payment of the tax to the local treasurer.
 - *Meralco v. Nelia Barlis (G.R. No. 114231, May 18, 2001)*: The trial court has no jurisdiction to issue a writ of prohibition which seeks to set aside the warrant of garnishment over petitioner's bank deposit in satisfaction of real property taxes without paying first under protest the tax assessed and without exhausting available administrative remedies.
- The local treasurer shall decide the protest within 60 days from receipt.

2) Appeal to the LBAA

- Appeal must be filed within 60 days from the date of receipt of denial of protest or upon lapse of 60 days to decide
 - By filing a petition under oath in the form prescribed for the purpose
 - Copies of tax declarations and other affidavits or documents must be submitted (Sec. 226, LGC)
- The LBAA shall decide the appeal within 120 days from the date of receipt of such appeal (Sec. 229, LGC)



3) Appeal to the CBAA

- Appeal must be filed within 30 days from the receipt of the decision of LBAA (Sec. 229, LGC)

4) Appeal to the CTA

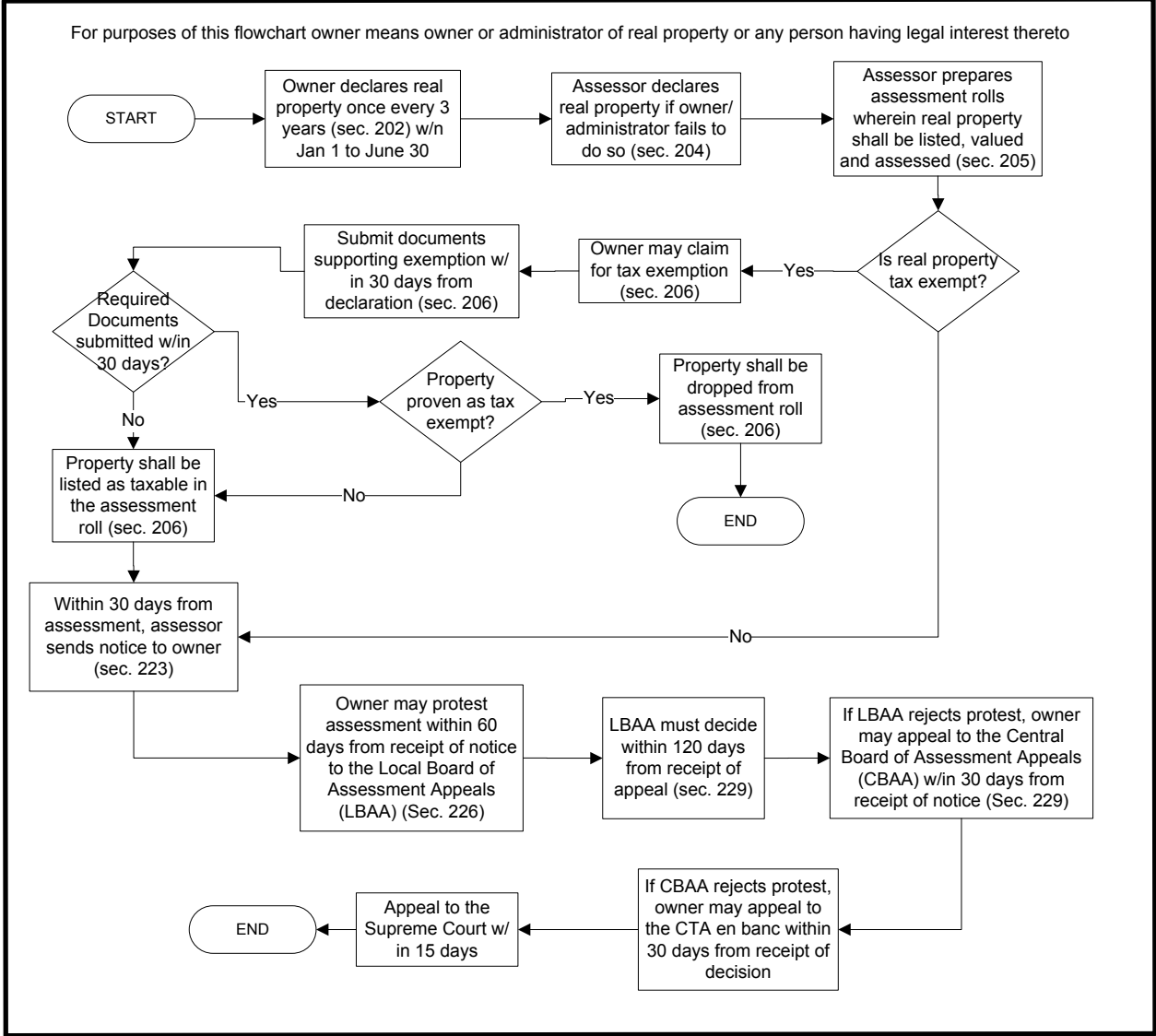
- Appeal must be filed through a petition for review within 30 days from the receipt of the decision of CBAA (Sec. 11, R.A. 1125 as amended)

5) Appeal to the CA

- Appeal must be filed within 30 days from receipt of decision of the CTA (Rule 43)

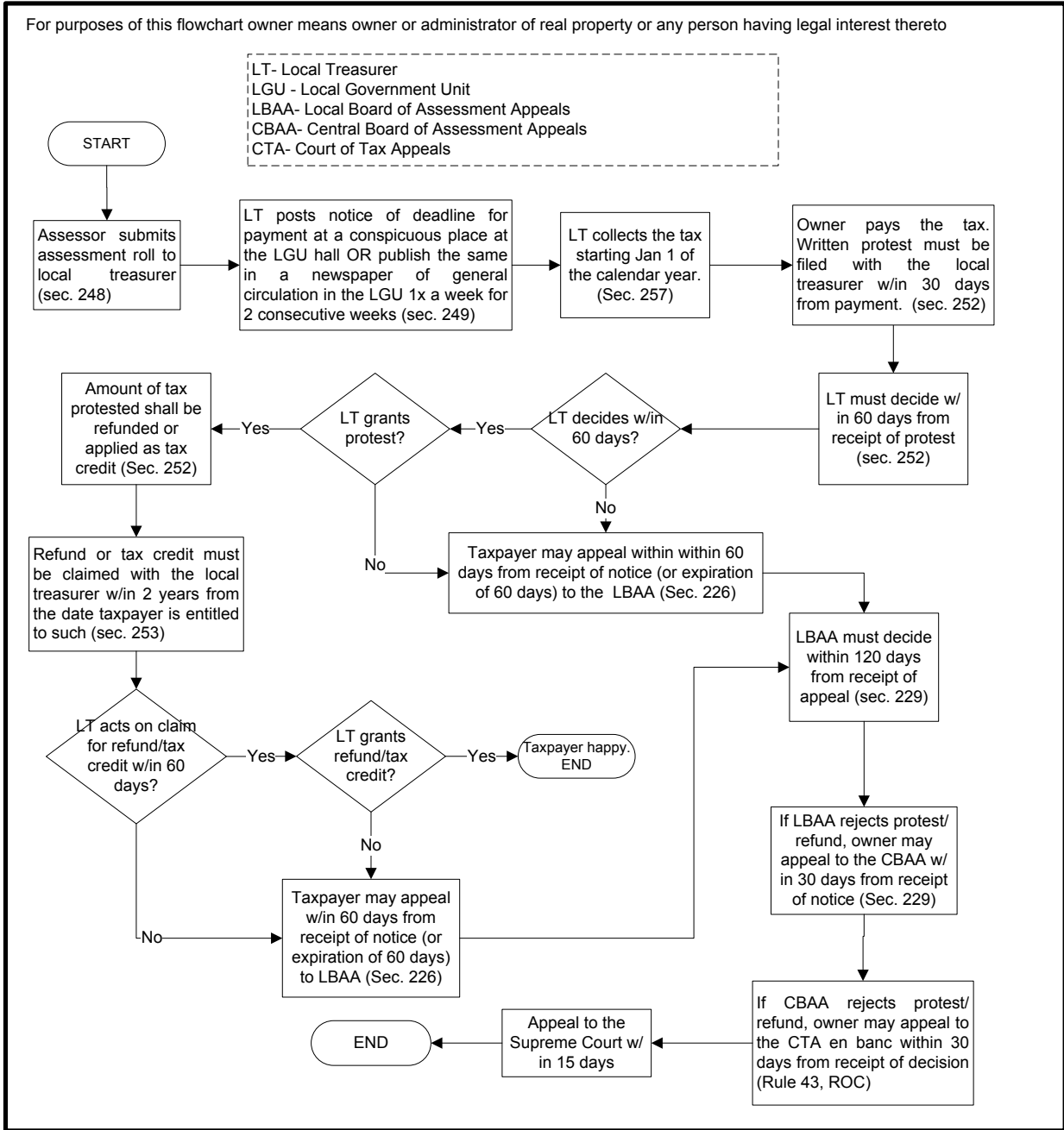


Flowchart V: Procedure for Assessment of Land Value for Real Property Tax Purposes-Local Gov't Code



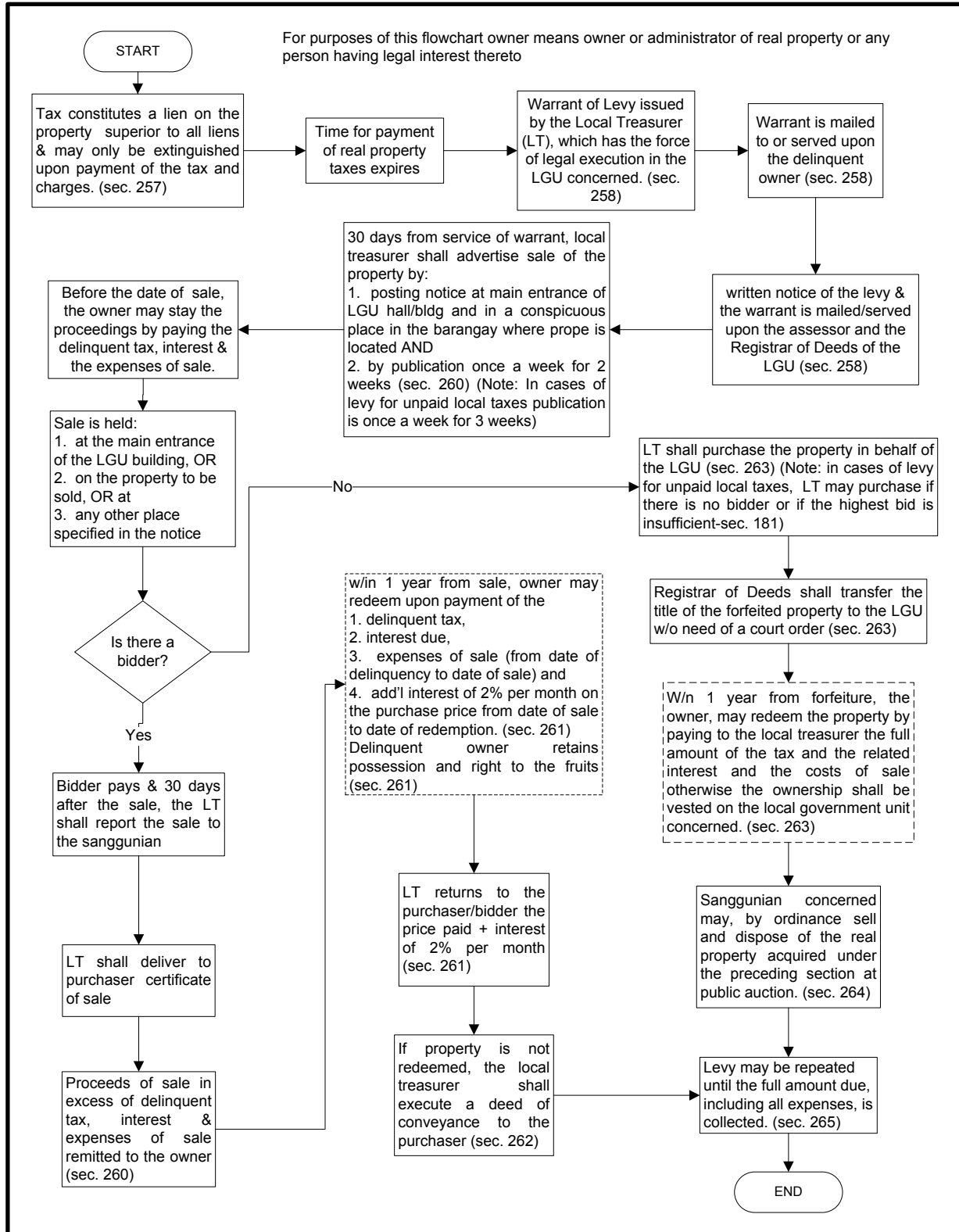


Flowchart VI: Taxpayer's Remedies Involving Collection of Real Property Tax-Loc Gov't Code





Flowchart VII: Procedure for Levy for Purposes of Satisfying Real Property Taxes-Local Gov't Code





8. Tariff and Customs Code

- I. Definition
- II. General Rule
- III. Purpose
- IV. Flexible tariff clause
- V. Requirements of importation
- VI. Importation in violation of TCC
- VII. Classification of goods
- VIII. Classification of duties
- IX. Drawbacks
- XVII. Remedies

I. Tariff and duties, defined

Tariff

- Taxes or list of articles liable to duties
- A list or schedule of articles on which a duty is imposed upon the importation into the country, with the rates at which they are severally taxed. And derivatively, the system of imposing duties or taxes on the importation of foreign merchandise

Custom duties

- Taxes on the importation or exportation of commodities
- Tariff or tax assessed upon the merchandise imported from or exported to a foreign country
 - 1) Export tariff - suspended except on logs
 - 2) Import tariff - articles, when imported from any foreign country, shall be subject to duty upon each importation, even though previously exported from the Philippines, except as otherwise specifically provided under the Code or special laws

II. General rule: All imported articles are subject to duty. Importation by the government taxable.

- All articles, when imported from any foreign country into the Philippines, shall be subject to duty upon each importation, even though previously exported from the Philippines, except as otherwise specifically provided.

III. Purpose for imposition

- For the protection of consumers and manufacturers, as well as Phil. products from undue competition posed by foreign-made products.

IV. Flexible tariff clause

- The flexible tariff clause refers to the authority given to the President, upon the recommendation of NEDA, to adjust the tariff rates under Sec. 401 of the Code in the interest of national economy, general welfare and/or national security.
- The President is empowered to:
 1. increase, reduce or remove existing rates
 2. establish import quota or ban import of any commodity
 3. impose an additional duty not exceeding 10% ad valorem
- The President's power to increase or decrease rates of import duty shall include authority to modify the form of duty.
- Any order of the President shall take effect 30 days after promulgation.
 - Except if the imposition of additional duty is less than 10%, it shall take effect upon the discretion of the President.

V. Requirements of importation

1. Beginning and ending of importation

- Importation begins when the carrying vessel or aircraft enters the jurisdiction of the Philippines with intention to unload therein.
- Importation is deemed terminated upon payment of duties, taxes and other charges due upon the articles, or secured to be paid, at a port of entry and the legal permit for withdrawal shall have been granted, or in case said articles are free of duties, taxes and other charges, until they have legally left the jurisdiction of the customs. (Sec. 1202, TCC)

2. Obligations of importer

a. Cargo manifest

- Every vessel from FOREIGN PORT must have on board a complete MANIFEST of all the cargo
- All the cargo intended to be landed at a port in the Philippines must be described in separate manifests for each port of call
- Shall include:
 - 1) Port of departure
 - 2) Port of delivery
 - 3) Marks, numbers, quantity and description of the packages
 - 4) Names of the consignees
- CANNOT be changed or altered after entry of vessel
EXCEPT:
 - 1) amendment by the master, consignee or agent



- 2) attached to the original manifest
- CANNOT amend the manifest after the invoice and/or entry covering the importation have been received and recorded in the office of the appraiser
EXCEPT:
 - 1) Obvious clerical error or any other discrepancy is committed in the preparation
 - 2) Without fraudulent intent
 - 3) Discovery would not have been made until after examination of the importation is completed
 - Translated into the official language, if written in another language
 - Master shall deliver and mail the cargo manifest to: (endorsed by boarding officer)
 - 1) Chairman
 - 2) COA
 - 3) Collector (Present original)

b. Import entry

- Imported articles must be entered in the customhouse at the port of entry within fifteen days from date of discharge of the last package from the vessel either (a) by the importer, being holder of the bill of lading, (b) by any other holder of the bill of lading in due course, (c) by a customs broker acting under authority from a holder of the bill, or (d) by a person duly empowered to act as agent or attorney-in-fact for such holder. The Collector may grant an extension of not more than fifteen days. (Sec. 1301, TCC)
- All imported articles, **except importation admitted free of duty**, shall be subject to a formal or informal entry.
- Articles of a commercial nature intended for sale, barter or hire, the dutiable value of which is five hundred pesos or less, and personal and household effects or articles, regardless of value, imported in passenger's baggage mail, or otherwise, for personal use, may be cleared on an informal entry whenever duty, tax or other charges are collectible.
- The Collector may, when he deems it necessary for the protection of the revenue, require a formal entry regardless of value.

- A formal entry may be for immediate consumption, or under bond for:
 - a. Placing the articles in warehouse;
 - b. Constructive warehousing and immediate transportation to other ports of the Philippines without appraisalment; or
 - c. Constructive warehousing and immediate exportation. (Sec. 1302, TCC)

c. Declaration of correct weight or value

Classification:

- When article not specifically classified in the Code, the interested party, importer or foreign exporter may submit a sample with full description of component materials in a written request.

Value:

- Upon written application, Collector shall furnish importer within 30 days the latest information as to the DV of articles to be imported.
- Importer must present all pertinent papers and documents, act in good faith and unable to obtain information due to unusual conditions
- Information given is not an appraisal nor is it binding upon the Collector's right of appraisal.
- The declaration, ascertainment or verification of the correct weight of the cargo at the port of loading is the duty or obligation of the master, pilot, owner, officer or employee of the vessel.
- If he omits or disregards this duty and a punishable discrepancy between the declared weight and actual weight of the cargo exists, the inevitable conclusion is that he is negligent or careless. Similarly, if in the exercise or performance of this duty, he is negligent or careless resulting in the commission of excessive discrepancy in the weight of the ship's cargo penalized under the law, carelessness or incompetency is, nonetheless, imputable to him.

d. Liability for payment of duties



- Unless relieved by laws or regulations, the liability for duties, taxes, fees and other charges attaching on importation constitutes a personal debt due from the importer to the government which can be discharged only by payment in full of all duties, taxes, fees and other charges legally accruing. It also constitutes a lien upon the articles imported which may be enforced while such articles are in custody or subject to the control of the government. (Sec. 1204, TCC)

e. Liquidation of duties

- Upon approval by the Collector of the returns of the appraiser and reports of the weights, gauge or quantity, the liquidation shall be made on the face of the entry showing the particulars thereof, initiated by the liquidating clerk, approved by the chief liquidator, and recorded in the record of liquidations.
- A daily record of all entries liquidated shall be posted in the public corridor of the customhouse, stating the name of the vessel or aircraft, the port from which she arrived, the date of her arrival, the name of the importer, and the serial number and date of the entry. A daily record must also be kept by the Collector of all additional duties, taxes and other charges found upon liquidation, and notice shall promptly be sent to the interested parties. (Sec. 1601, TCC)

Tentative and Final Liquidation

1. **Tentative Liquidation.** – If to determine the exact amount due under the law in whole or in part some future action is required, the liquidation shall be deemed to be tentative as to the item or items affected and shall to that extent be subject to future and final readjustment and settlement. The entry in such case shall be stamped "Tentative liquidation". (Sec. 1602, TCC)
2. **Final Liquidation.** – When articles have been entered and passed free of duty or final adjustment of duties made, with subsequent delivery, such entry and passage free of duty or settlement of duties will, after the expiration of one year, from the date of the final payment of duties, in the absence of fraud or protest, be

final and conclusive upon all parties, unless the liquidation of the import entry was merely tentative. (Sec. 1603, TCC)

- **Fractions in the Liquidation.** – A fraction of a peso less than fifty centavos shall be disregarded, and a fraction of a peso amounting to fifty centavos or more shall be considered as one peso. In case of overpayment or underpayment of duties, taxes, surcharges, wharfage and/or other charges paid on entries, where the amount involved is less than five pesos, no refund or collection shall be made. (Sec. 1604, TCC)

f. Keeping of records

1. all importers are required to keep at their principal place of business, in the manner prescribed by regulations to be issued by the Commissioner of Customs and for a period of 3 years from the date of importation, all records of their importations and/or books of accounts, business and computer systems and all customs commercial data including payment records relevant to the verification of the accuracy of the transactions value declared by the importer/customs brokers on the import duty
2. all brokers are required to keep at their principal place of business for a period of 3 years from date of importation copies
 - custom officer authorized by BOC may enter during office hours any premises or place where the records are kept to conduct an audit examination, inspection, verification or investigation
 - officer may make copies or take extracts from any of such documents
 - certified copy may be evidence admissible in all courts as if original

VI. Importation in violation of TCC

1. Smuggling

- In order to prevent smuggling and to secure the collection of the legal duties, taxes and other charges, the customs service shall exercise surveillance over the coast, beginning when a vessel or aircraft enters Philippine territory and concluding when the article imported therein has been legally passed through the customhouse. (Sec. 2202)

- **SMUGGLING:** Any person who shall fraudulently import or bring into the Philippines, or assist in so doing, any article, contrary to law, or shall receive, conceal, buy, sell, or in any manner facilitate the transportation, concealment, or sale of such article after importation, knowing the same to have been imported contrary to law, shall be punished by a fine of not less than six hundred pesos nor more than five thousand pesos and imprisonment for not less than six months nor more than two years and, if the offender is an alien, he shall be deported after serving the sentence.

When the defendant is shown to have or to have had possession of the article in question, such possession shall be deemed sufficient evidence to authorize conviction, unless the defendant shall explain the possession to the satisfaction of the court. (Sec. 3601, TCC)

2. Other fraudulent practices

- Any person who makes or attempts to make any entry of imported or exported article by means of any false or fraudulent invoice, declaration, affidavit, letter, paper, or by means of any false statement, written or verbal, or by means of any false or fraudulent practice whatsoever, or shall be guilty of any willful act or omission by means of whereof the Government might be deprived of the lawful duties, taxes and other charges, or any portion thereof, accruing from the article or any portion thereof, embraced or referred to in such invoice, declaration, affidavit, letter, paper, or statement, or affected by such act or omission (Sec. 3602, TCC)
- Any master, pilot in command or other officer, owner or agent of any vessel or aircraft trading with or within the Philippines and any employee of the Bureau of Customs, who, having cognizance of any fraud upon the customs revenue, shall fail to report all information relative thereto to the Collector, as required by law (Sec. 3603, TCC)
- Any person who willfully conceals or destroys, any invoice, book or paper relating to any article liable to duty, after an inspection thereof has been demanded by the Collector of any Collection district, or at any time conceals or destroys any such invoice, book or paper for the purpose of suppressing any evidence of fraud therein contained (Sec. 3605, TCC)
- Any person who shall willfully break or destroy any seal placed by a customs official upon any car, or other conveyance by land, sea or air, or any compartment thereof (Sec. 3606, TCC)

- Any person who alters, defaces or obliterates any distinctive mark placed by a customs official on any package of warehoused articles (Sec. 3607, TCC)
- Any importer or owner of warehoused articles, or person in his employ, who by contrivance, fraudulently opens the warehouse, or gains access to the articles, except in the presence of the proper official of the customs acting in the execution of his duty (Sec. 3608, TCC)
- Any person who shall fraudulently remove warehoused articles from any public or private warehouse or shall fraudulently conceal such articles in any such warehouse, or shall aid or abet any such removal or concealment (Sec. 3609, TCC)

VII. Classification of goods

1. Taxable importation

- All articles, when imported from any foreign country into the Philippines, shall be subject to duty upon each importation, even though previously exported from the Philippines, except as otherwise specifically provided for in this Code or in other laws. (Sec. 100, TCC)

2. Prohibited importation (POPP-LAW-DING)

- a. Dynamite, gunpowder, ammunitions and other explosives, firearm and weapons of war, and detached parts thereof, except when authorized by law.
- b. Written or printed article in any form containing:
 - 1) any matter advocating or inciting treason, rebellion, insurrection or sedition against the Government of the Philippines
 - 2) forcible resistance to any law of the Philippines
 - 3) containing any threat to take the life of or inflict bodily harm upon any person in the Philippines.
- c. Written or printed articles, photographs, engravings, lithographs, objects, paintings, drawings or other representation of an obscene or Immoral character.
- d. Articles, instruments, drugs and substances designed, intended or adapted for Preventing human conception or producing unlawful abortion, or any printed matter which advertises or describes or gives directly or indirectly information where, how or by whom human conception is prevented or unlawful abortion produced.
- e. Roulette wheels, Gambling outfits, loaded dice, marked cards, machines, apparatus or mechanical devices used in gambling, or in the distribution of money, cigars, cigarettes or other articles when such distribution is dependent upon chance, including jackpot



and pinball machines or similar contrivances.

- f. Lottery and sweepstakes tickets, advertisements thereof and lists of drawings therein.
 - except those authorized by the Philippine Government
- g. Any article manufactured in whole or in part of gold silver or other Precious metal, or alloys thereof, the stamps brands or marks of which do not indicate the actual fineness or quality of said metals or alloys.
- h. Any Adulterated or misbranded article of food or any adulterated or misbranded drug in violation of the provisions of the "Food and Drugs Act."
- i. Marijuana, opium poppies, coca leaves, or any other Narcotics or synthetic drugs which are or may hereafter be declared habit forming by the President of the Philippines, any compound, manufactured salt, derivative, or preparation thereof,
 - Except when imported by the Government of the Philippines or any person duly authorized by the Collector of Internal Revenue for medicinal purposes only.
- j. Opium pipes and parts thereof, of whatever material.
- k. All other articles the importation of which is Prohibited by law. (Sec. 101, TCC)

3. Conditionally-free importation

The following articles shall be exempt from the payment of import duties upon compliance with the formalities prescribed in, or with, the regulations which shall be promulgated by the Commissioner of Customs with the approval of the Secretary of Finance:

- a. Aquatic products (e.g., fishes, crustaceans, mollusks, marine animals, seaweeds, fish oil, roe), caught or gathered by fishing vessels of Philippine registry: Provided, That they are imported in such vessels or in crafts attached thereto: And provided, further, That they have not been landed in any foreign territory or, if so landed, they have been landed solely for transshipment without having been advanced in condition;
- b. Equipment for use in the salvage of vessels or aircrafts, not available locally, upon identification and the giving of a bond in an amount equal to one and one-half times the ascertained duties, taxes and other charges thereon, conditioned for the exportation thereof or payment of the corresponding duties, taxes and other charges within six (6) months from the date of acceptance of the import entry: Provided, That the Collector of Customs may extend the time for exportation or payment of duties, taxes and other charges for a term not exceeding six (6) months from the expiration of the original period;
- c. Cost of repairs, excluding the value of the article used, made in foreign countries upon vessels or

aircraft documented, registered or licensed in the Philippines, upon proof satisfactory to the Collector of Customs (1) that adequate facilities for such repairs are not afforded in the Philippines, or (2) that such vessels or aircrafts, while in the regular course of her voyage or flight was compelled by stress of weather or other casualty to put into a foreign port to make such repairs in order to secure the safety, seaworthiness or airworthiness of the vessel or aircraft to enable her to reach her port of destination;

d. Articles brought into the Philippines for repair, processing or reconditioning to be re-exported upon completion of the repair, processing or reconditioning: Provided, That the Collector of Customs shall require the giving of a bond in an amount equal to one and one-half times the ascertained duties, taxes and other charges thereon, conditioned for the exportation thereof or payment of the corresponding duties, taxes and other charges within six (6) months from the date of acceptance of the import entry;

e. Medals, badges, cups and other small articles bestowed as trophies or prizes, or those received or accepted as honorary distinction;

f. Personal and household effects belonging to residents of the Philippines returning from abroad including jewelry, precious stones and other articles of luxury which were formally declared and listed before departure and identified under oath before the Collector of Customs when exported from the Philippines by such returning residents upon their departure therefrom and during their stay abroad; personal and household effects including wearing apparel, articles of personal adornment (except luxury items), toilet articles, portable appliances and instruments and similar personal effects, excluding vehicles, watercrafts, aircrafts, and animals purchased in foreign countries by residents of the Philippines which were necessary, appropriate and normally used for the comfort and convenience in their journey and during their stay abroad upon proof satisfactory to the Collector of Customs that same have been in their use abroad for more than six (6) months and accompanying them on their return, or arriving within a reasonable time which, barring unforeseen circumstances, in no case shall exceed ninety (90) days before or after the owners' return: Provided, That the personal and household effects shall neither be in commercial quantities nor intended for barter, sale or hire and that the total dutiable value of which shall not exceed two thousand pesos (P2,000.00): Provided further, That the returning residents have not previously received the benefit under this section within one year from and after the last exemption granted: Provided furthermore, That a fifty (50) per cent ad valorem duty across the board shall be levied and collected on the personal and household effects (except luxury items) in excess of two thousand pesos (P2,000.00): And provided, finally, That the personal and household effects (except luxury items) of a returning resident who has not stayed abroad for six

(6) months shall be subject to fifty (50) per cent ad valorem duty across the board, the total dutiable value of which does not exceed two thousand pesos (P2,000.00); any excess shall be subject to the corresponding duty provided in this Code;

g. Wearing apparel, articles of personal adornment, toilet articles, portable tools and instruments, theatrical costumes and similar effects accompanying travelers, or tourists, or arriving within a reasonable time before and after their arrival in the Philippines, which are necessary and appropriate for the wear and use of such persons according to the nature of the journey, their comfort and convenience: Provided, That this exemption shall not apply to articles intended for other persons or for barter, sale or hire: Provided, further, That the Collector of Customs may, in his discretion, require either a written commitment or a bond in an amount equal to one and one-half times the ascertained duties, taxes and other charges conditioned for the exportation thereof or payment of the corresponding duties, taxes and other charges within three (3) months from the date of acceptance of the import entry: And Provided finally, That the Collector of Customs may extend the time for exportation or payment of duties, taxes and other charges for a term not exceeding three (3) months from the expiration of the original period;

g-1. Personal and household effects and vehicles belonging to foreign consultants and experts hired by, and/or rendering service to, the government, and their staff or personnel and families, accompanying them or arriving within a reasonable time before or after their arrival in the Philippines, in quantities and of the kind necessary and suitable to the profession, rank or position of the person importing them, for their own use and not for barter, sale or hire provided that, the Collector of Customs may in his discretion require either a written commitment or a bond in an amount equal to one and one-half times the ascertained duties, taxes and other charges upon the articles classified under this subsection; conditioned for the exportation thereof or payment of the corresponding duties, taxes and other charges within six (6) months after the expiration of their term or contract; And Provided, finally, That the Collector of Customs may extend the time for exportation or payment of duties, taxes and other charges for term not exceeding six (6) months from the expiration of the original period;

h. Professional instruments and implements, tools of trade, occupation or employment, wearing apparel, domestic animals, and personal and household effects belonging to persons coming to settle in the Philippines or Filipinos and/or their families and descendants who are now residents or citizens of other countries, such parties hereinafter referred to as Overseas Filipinos, in quantities and of the class suitable to the profession, rank or position of the persons importing them, for their own use and not for barter or sale, accompanying such persons, or

arriving within a reasonable time, in the discretion of the Collector of Customs, before or after the arrival of their owners, which shall not be later than February 28, 1979 upon the production of evidence satisfactory to the Collector of Customs that such persons are actually coming to settle in the Philippines, that change of residence was bona fide and that the privilege of free entry was never granted to them before or that such person qualifies under the provisions of Letters of Instructions 105, 163 and 210, and that the articles are brought from their former place of abode, shall be exempt from the payment of customs duties and taxes: Provided, That vehicles, vessels, aircrafts, machineries and other similar articles for use in manufacture, shall not be classified hereunder;

i. Articles used exclusively for public entertainment, and for display in public expositions, or for exhibition or competition for prizes, and devices for projecting pictures and parts and appurtenances thereof, upon identification, examination, and appraisal and the giving of a bond in an amount equal to one and one-half times the ascertained duties, taxes and other charges thereon, conditioned for exportation thereof or payment of the corresponding duties, taxes and other charges within six (6) months from the date of acceptance of the import entry; Provided, That the Collector of Customs may extend the time for exportation or payment of duties, taxes and other charges for a term not exceeding six (6) months from the expiration of the original period; and technical and scientific films when imported by technical, cultural and scientific institutions, and not to be exhibited for profit: Provided, further, That if any of the said films is exhibited for profit, the proceeds therefrom shall be subject to confiscation, in addition to the penalty provided under Section Thirty-six hundred and ten as amended, of this Code;

j. Articles brought by foreign film producers directly and exclusively used for making or recording motion picture films on location in the Philippines, upon their identification, examination and appraisal and the giving of a bond in an amount equal to one and one-half times the ascertained duties, taxes and other charges thereon, conditioned for exportation thereof or payment of the corresponding duties, taxes and other charges within six (6) months from the date of acceptance of the import entry, unless extended by the Collector of Customs for another six (6) months; photographic and cinematographic films, undeveloped, exposed outside the Philippines by resident Filipino citizens or by producing companies of Philippine registry where the principal actors and artists employed for the production are Filipinos, upon affidavit by the importer and identification that such exposed films are the same films previously exported from the Philippines. As used in this paragraph, the terms "actors" and "artists" include the persons operating the photographic cameras or other photographic and sound recording apparatus by which the film is made;



k. Importations for the official use of foreign embassies, legations, and other agencies of foreign governments: Provided, That those foreign countries accord like privileges to corresponding agencies of the Philippines;

Articles imported for the personal or family use of the members and attaches of foreign embassies, legations, consular officers and other representatives of foreign governments: Provided, That such privilege shall be accorded under special agreements between the Philippines and the countries which they represent: And Provided, further, That the privilege may be granted only upon specific instructions of the Secretary of Finance in each instance which will be issued only upon request of the Department of Foreign Affairs;

l. Imported articles donated to, or for the account of, any duly registered relief organization, not operated for profit, for free distribution among the needy, upon certification by the Department of Social Services and Development or the Department of Education, Culture and Sports, as the case may be;

m. Containers, holders and other similar receptacles of any material including kraft paper bags for locally manufactured cement for export, including corrugated boxes for bananas, mangoes, pineapples and other fresh fruits for export, except other containers made of paper, paperboard and textile fabrics, which are of such character as to be readily identifiable and/or reusable for shipment or transportation of goods shall be delivered to the importer thereof upon identification, examination and appraisal and the giving of a bond in an amount equal to one and one-half times the ascertained duties, taxes and other charges within six (6) months from the date of acceptance of the import entry;

n. Supplies which are necessary for the reasonable requirements of the vessel or aircraft in her voyage or flight outside the Philippines, including articles transferred from a bonded warehouse in any collection district to any vessel or aircraft engaged in foreign trade, for use or consumption of the passengers or its crew on board such vessel or aircrafts as sea or air stores; or articles purchased abroad for sale on board a vessel or aircraft as saloon stores or air store supplies: Provided, That any surplus or excess of such vessel or aircraft supplies arriving from foreign ports or airports shall be dutiable;

o. Articles and salvage from vessels recovered after a period of two (2) years from the date of filing the marine protest or the time when the vessel was wrecked or abandoned, or parts of a foreign vessel or her equipment, wrecked, abandoned in Philippine waters or elsewhere: Provided, That articles and salvage recovered within the said period of two (2) years shall be dutiable;

p. Coffins or urns containing human remains, bones or ashes, used personal and household effects (not

merchandise) of the deceased person, except vehicles, the value of which does not exceed ten thousand pesos (P10,000.00), upon identification as such;

q. Samples of the kind, in such quantity and of such dimension or construction as to render them unsalable or of no appreciable commercial value; models not adapted for practical use; and samples of medicines, properly marked "sample-sale punishable by law," for the purpose of introducing a new article in the Philippine market and imported only once in a quantity sufficient for such purpose by a person duly registered and identified to be engaged in that trade: Provided, That importations under this subsection shall be previously authorized by the Secretary of Finance: Provided, however, That importation of sample medicine shall be previously authorized by the Secretary of Health that such samples are new medicines not available in the Philippines: Provided, finally, That samples not previously authorized and/or properly marked in accordance with this section shall be levied the corresponding tariff duty.

Commercial samples, except those that are not readily and easily identifiable (e.g., precious and semi-precious stones, cut or uncut, and jewelry set with precious stones), the value of any single importation of which does not exceed ten thousand pesos (P10,000.00) upon the giving of a bond in an amount equal to twice the ascertained duties, taxes and other charges thereon, conditioned for the exportation of said samples within six (6) months from the date of the acceptance of the import entry or in default thereof, the payment of the corresponding duties, taxes and other charges. If the value of any single consignment of such commercial samples exceeds ten thousand pesos (P10,000.00), the importer thereof may select any portion of same not exceeding in value of ten thousand pesos (P10,000.00) for entry under the provision of this subsection, and the excess of the consignment may be entered in bond, or for consumption, as the importer may elect;

r. Animals (except race horses), and plants for scientific, experimental, propagation, botanical, breeding, zoological and national defense purposes: Provided, That no live trees, shoots, plants, moss, and bulbs, tubers and seeds for propagation purposes may be imported under this section, except by order of the Government or other duly authorized institutions: Provided, further, That the free entry of animals for breeding purposes shall be restricted to animals of recognized breed, duly registered in the book of record established for that breed, certified as such by the Bureau of Animal Industry: Provided, furthermore, That certificate of such record, and pedigree of such animal duly authenticated by the proper custodian of such book of record, shall be produced and submitted to the Collector of Customs, together with affidavit of the owner or importer, that such animal is the animal described in said certificate of record and pedigree: And Provided, finally, That the animals and plants



are certified by the National Economic and Development Authority as necessary for economic development;

s. Economic, technical, vocational, scientific, philosophical, historical, and cultural books and/or publications: Provided, That those which may have already been imported but pending release by the Bureau of Customs at the effectivity of this Decree may still enjoy the privilege herein provided upon certification by the Department of Education, Culture and Sports that such imported books and/or publications are for economic, technical, vocational, scientific, philosophical, historical or cultural purposes or that the same are educational, scientific or cultural materials covered by the International Agreement on Importation of Educational Scientific and Cultural Materials signed by the President of the Philippines on August 2, 1952, or other agreements binding upon the Philippines.

Educational, scientific and cultural materials covered by international agreements or commitments binding upon the Philippine Government so certified by the Department of Education, Culture and Sports.

Bibles, missals, prayer books, Koran, Ahadith and other religious books of similar nature and extracts therefrom, hymnal and hymns for religious uses;

t. Philippine articles previously exported from the Philippines and returned without having been advanced in value or improved in condition by any process of manufacture or other means, and upon which no drawback or bounty has been allowed, including instruments and implements, tools of trade, machinery and equipment, used abroad by Filipino citizens in the pursuit of their business, occupation or profession; and foreign articles previously imported when returned after having been exported and loaned for use temporarily abroad solely for exhibition, testing and experimentation, for scientific or educational purposes; and foreign containers previously imported which have been used in packing exported Philippine articles and returned empty if imported by or for the account of the person or institution who exported them from the Philippines and not for sale, barter or hire subject to identification: Provided, That any Philippine article falling under this subsection upon which drawback or bounty has been allowed shall, upon re-importation thereof, be subject to a duty under this subsection equal to the amount of such drawback or bounty.

u. Aircraft, equipment and machinery, spare parts commissary and catering supplies, aviation gas, fuel and oil, whether crude or refined, and such other articles or supplies imported by and for the use of scheduled airlines operating under Congressional franchise: Provided, That such articles or supplies are not locally available in reasonable quantity, quality and price and are necessary or incidental for

the proper operation of the scheduled airline importing the same;

v. Machineries, equipment, tools for production, plants to convert mineral ores into saleable form, spare parts, supplies, materials, accessories, explosives, chemicals, and transportation and communication facilities imported by and for the use of new mines and old mines which resume operations, when certified to as such by the Secretary of Agriculture and Natural Resources upon the recommendation of the Director of Mines, for a period ending five (5) years from the first date of actual commercial production of saleable mineral products: Provided, That such articles are not locally available in reasonable quantity, quality and price and are necessary or incidental in the proper operation of the mine; and aircrafts imported by agro-industrial companies to be used by them in their agriculture and industrial operations or activities, spare parts and accessories thereof;

w. Spare parts of vessels or aircraft of foreign registry engaged in foreign trade when brought into the Philippine exclusively as replacements or for the emergency repair thereof, upon proof satisfactory to the Collector of Customs that such spare parts shall be utilized to secure the safety, seaworthiness or airworthiness of the vessel or aircraft, to enable it to continue its voyage or flight;

x. Articles of easy identification exported from the Philippines for repair and subsequently reimported upon proof satisfactory to the Collector of Customs that such articles are not capable of being repaired locally: Provided, That the cost of the repairs made to any such article shall pay a rate of duty of thirty per cent ad valorem;

y. Trailer chassis when imported by shipping companies for their exclusive use in handling containerized cargo, upon posting a bond in an amount equal to one and one-half times the ascertained duties, taxes and other charges due thereon to cover a period of one year from the date of acceptance of the entry, which period for meritorious reasons may be extended by the Commissioner of Customs from year to year, subject to the following conditions:

1. That they shall be properly identified and registered with the Land Transportation Commission;
2. That they shall be subject to customs supervision fee to be fixed by the Collector of Customs and subject to the approval of the Commissioner of Customs;
3. That they shall be deposited in the Customs zone when not in use; and
4. That upon the expiration of the period prescribed above, duties and taxes shall be paid, unless otherwise re-exported

VIII. Classification of duties



1. Ordinary/Regular duties

- Ordinary or regular duties refer to those that, as a matter of course, are imposed on dutiable articles (Sec. 104, TCC)

a. Ad valorem; Methods of valuation

- The tax rates are based on the cost (FMV) or price of the imported articles, in wholesale quantities in the principal market of the exporting country or the country of origin, including expenses connected with the importation, such as insurance, freight, packaging, loading and unloading charges, but excluding internal excise taxes to be remitted or rebated; or
- In case such value is not ascertainable, the reports of the Revenue or commercial attaches; or
- If still not ascertainable, the domestic wholesale market price in the ordinary course of trade less import duty and not more than 25% for expenses and profits. (Sec. 201, TCC)

1) Transaction value

- Price actually paid or payable for goods when sold for export to Philippines
 - + commissions & brokerage fees
 - + cost of containers
 - + cost of packing (labor, materials)
 - + assists (value of goods and services supplied by the buyer free of charge or at a reduced price for use in connection with the production and sale for export of the good)
 - + royalties & license fees
 - + value of any part of the proceeds of subsequent resale, disposal or use of imported goods that accrue directly or indirectly to seller
 - + cost of transport
 - + loading, unloading, handling
 - + insurance
- Dutiable Value (DV) must NOT include:
 - charges for construction, erection, assembly maintenance or technical assistance undertaken after importation
 - cost of transport after importation
 - duties and taxes of Phil
 - other permissible deduction under WTO Valuation Agreement
- CONDITIONS so the Transaction Value shall be the DV (CREPD)
 1. sale for Export to Phil
 2. no restrictions as to the Disposition or use of goods by buyer except:
 - those imposed by law or Phil authorities
 - limit the geographical area where goods may be resold

- do not substantially affect the value of the goods
3. not be subject to some Condition or consideration for which value cannot be determined
 4. no part of the Proceeds of any subsequent disposal shall accrue to the seller
 5. buyer and seller are not Related or if they are, relationship did not affect the price

➤ DEEMED RELATED IF:

1. They are officers or directors of one another's business;
2. They are legally recognized partners in business;
3. There exists in an er-ee relationship between them;
4. Any person directly or indirectly owns, contrl or hold 5% or more of the outstanding voting stock or shares of both seller and buyer;
5. One of them directly or indirectly controls the other;
6. Both of them are directly or indirectly controlled by a 3rd person;
7. Together they directly or indirectly control a 3rd person; or
8. Related by affinity or consanguinity up to 4th civil degree.

➤ IF RELATED, USE OF TRANSACTION VALUE (TV) ACCEPTABLE IF:

1. circumstances surrounding transaction show that relationship did not influence the price
2. TV closely approximates:
 - TV of unrelated buyers of identical or similar goods
 - Deductive value of identical or similar goods determined according to method #4
 - Computed value of identical or similar goods determined according to method #5

2) Transaction value of identical goods

- The DV shall be the transaction value of identical goods sold for export to the Phil and exported at or about the same time as the goods being valued.
- Identical goods must be same commercial level and substantially same quantity as the goods being valued.

<p><u>Identical goods</u></p> <ul style="list-style-type: none"> • Same in all respects (physical characteristics, quality and reputation) • Produced in the same country as the goods being valued



• Produced by producer of the goods being valued

- excludes imported goods for which engineering, development, artwork, design work, plans and sketches is undertaken in the Phil and provided by the buyer to the producer free of charge or at a reduced rate
- When no identical goods produced by the same person:
 - identical goods produced by different producer in the same country
- If NO identical goods at same commercial level and same quantity,
 - TV of identical goods at a different commercial level and different quantity may be utilized
 - TV shall be adjusted upward or downward to account for the difference

3) Transaction value of similar goods

- The DV shall be the transaction value of similar goods sold for export to the Phil and exported at or about the same time as the goods being valued.
- Similar goods must be same commercial level and substantially same quantity as the goods being valued.

Similar goods

- like characteristics and like component materials
- capable of performing same functions
- commercially interchangeable
- produced in same country
- produced by same producer

- excludes imported goods for which engineering, development, artwork, design work, plans and sketches is undertaken in the Phil and provided by the buyer to the producer free of charge or at a reduced rate
- When no similar goods produced by the same person:
 - similar goods produced by different producer in the same country
- If NO similar goods at same commercial level and same quantity,
 - TV of similar goods at a different commercial level and different quantity may be utilized
 - TV shall be adjusted upward or downward to account for the difference

4) Deductive value

- DV is determined on the basis of sales in the Phil of goods being valued of identical or similar imported goods less

certain expenses resulting from importation and sale of goods.

- Deductive Value is determined by making a deduction from the established price per unit for the aggregate of the ff elements:
 - a. Commissions OR
 - b. additions made in connection with profit and general expenses AND
 - c. transport, insurance and associated costs
 - d. customs duties and other national taxes

	PRICE
Less:	COMMISSIONS/ADDITIONS
Less:	COSTS
Less:	DUTIES/TAXES
<hr/>	
	DEDUCTIVE VALUE

- CONDITIONS:
 1. sold in the Phil in the same condition as imported
 2. sales taken place at or about the same time of importation of good being valued
 3. if no sale took place at or about the time of importation
 - use sales at the earliest date after importation (of the similar or identical good) but before expiration of 90 days
 4. if no sale meet the above conditions, importer may choose the use of sales of goods being valued after further processing

“At or about the same time”

- 45 days prior to and 45 days after importation

5) Computed value

- DV is determined on the basis of cost of production + profit + general expenses reflected in sales from exporting country to the Phil of goods of same class or kind
- DV is calculated by:
 - determining aggregate of relevant **costs, charges and expenses** or value of (1) materials and (2) production or processing costs
 - + **costs** (containers, packing, assists, engineering, artwork, plans and sketches undertaken in Phil and charged to producer
 - + **profits and general expenses**
 - + **cost of transport, insurance and charges** to the port or place of importation

6) Fallback value



- DV cannot be determined using any of the above methods
- Use other reasonable means consistent with principles and general provisions of GATT

b. Specific

- Rates are based on unit of weight number or measurement

2. Special duties**a. Dumping duties**

- When Secretary of Finance receives a petition or has reason to believe that:
 1. A specific foreign article, whether dutiable or duty-free is being sold, or is likely to be sold for exportation to, or in the Philippines at a price less than its normal value
 2. The importation would cause or likely to cause an injury to local industries engaged in the manufacture or production of the same or similar articles or prevent their establishment (Sec. 301, TCC)

b. Countervailing duties

- When an article is granted any bounty, subsidy or subvention upon its production, manufacture or exportation in the country of origin and importation of which is likely to injure an established industry or retard the establishment of industry in Philippines
 - Countervailing Duty: ascertained or estimated amount of bounty, subsidy or subvention
- Injury criterion shall be applied only on imports from countries which adhere to GATT
- If article was allowed a drawback, only the excess of the amount of drawback over the total duties and taxes shall constitute bounty, subsidy, subvention
- When the conditions which necessitated the imposition of countervailing duties have ceased: must discontinue imposition (Sec. 302, TCC)

c. Marking duties

- Special duty of five percent (5%) ad valorem imposed on articles not properly marked, collected by the Commissioner except when such article is exported or destroyed under customs supervision and prior to the final liquidation of the corresponding entry. The purpose is to prevent possible deception of the consumers. (Sec. 303, TCC)

d. Retaliatory/Discriminatory duties

- The President may proclaim new and additional duties in an amount not exceeding 100% ad valorem on articles from country where:

1. imposes an unreasonable charge, exaction not equally enforceable in other laws; or
2. discriminate against the commerce of Phil in such a way that it places Philippine commerce at a disadvantage. (Sec. 304, TCC)

e. Safeguard

- The Secretary shall apply a general safeguard measure upon a positive final determination of the Commission that a product is being imported into the country in increased quantities, whether absolute or relative to the domestic production, as to be a substantial cause of serious injury or threat thereof to the domestic industry; however, in the case of non-agricultural products, the Secretary shall first establish that the application of such safeguard measures will be in the public interest. (Sec. 5, R.A. No. 8800)
- Upon its positive determination, the Commission shall recommend to the Secretary an appropriate definitive measure, in the form of:
 - (a) An increase in, or imposition of, any duty on the imported product;
 - (b) A decrease in or the imposition of a tariff-rate quota (MAV) on the product;
 - (c) A modification or imposition of any quantitative restriction on the importation of the product into the Philippines;
 - (d) One or more appropriate adjustment measures, including the provision of trade adjustment assistance;
 - (e) Any combination of actions described in subparagraphs (a) to (d). (Sec. 13, R.A. No. 8800)

IX. Drawbacks

Drawbacks - in the nature of refund or tax credit:

- a) Fuel used for Propulsion of Vessels engaged in trade with foreign countries or coastwise trade
 - refund or credit not exceeding 99% of duty imposed by law on such fuel
- b) Petroleum oils and oils from bituminous minerals, crude oils imported by non electric utilities and then sold to electric utilities for generation of electric power
 - refund or credit not exceeding 50% of duty imposed by law
- c) Exportation of articles manufactured or produced in Phil (including packing + covering + marking/labeling) of imported materials for which duties have been paid

Conditions:



1. Imported material was actually used in the production of article to be exported.
2. Refund or credit shall not exceed 100% of duties paid on the imported material.
3. No determination by NEDA of the requirement for certification on non-availability of locally produced or manufactured competitive substitutes for the imported material (*This means there are no local substitutes for the material.*).
4. Exportation must be made 1 year after importation of material claim for refund or credit must be made 6 months from exportation.
5. When 2 or more result from the used of same imported material, apportionment shall be made.
 - Every application for drawback must pay P500 for filing, processing and supervision fees.
 - Claims shall be paid by Bureau of Customs within 60 days after receipt of properly accomplished claims. (Sec. 106, TCC)

- if importer wishes to secure release of article for legitimate use
- amount fixed by Collector
- conditioned on payment of appraised value of article and/or fine, expenses, costs

- Article will NOT be released if:
 - prima facie evidence of fraud in the importation]
 - article is prohibited by law
- 2. **Report** to Commissioner and Chairman of Commission of Audit
- 3. written **notice** to owner or importer
 - He shall be given opportunity to be heard;
 - Notification to an unknown owner
 - posting for 15 days in the public corridor of customhouse
 - publication in newspaper
 - other means Collector considers desirable
- 4. Collector shall make a list and particular description and classification of the seized property, appraisal based on local wholesale values by
 - at least 2 appraising officials
 - absent such, 2 competent disinterested citizens
- If within 15 days from notification, no owner or agent is found or appears before Collector
 - property forfeited to Government and sold at auction

X. Remedies

1. Government

a. Administrative/Extrajudicial

1) Search, seizure, forfeiture, arrest

1. Enforcement of Tax Lien

Sec. 1508

- When an importer has an outstanding and demandable account with the Bureau of Customs,
 - Collector shall hold the delivery of the article.
 - Upon notice, he may sell such importation or a portion of it to satisfy the obligation.
- Importer may settle his obligation anytime before the sale.

2. Seizure and Forfeiture

Sec 2205

- WHO: customs official; Fisheries Commissions; Philippine Coast Guard
 - to make seizure of any vessel, aircraft, cargo, animal or any movable property when the same is subject to forfeiture or liable for any fine under the tariff and customs law

Administrative Proceedings

(Secs 2301 - 2316)

- When seizure is made:
 1. Collector shall issue a **warrant for the detention of the property**

Cash bond

SETTLEMENT

- While case is pending, Collector may accept settlement of any seizure case
 - Upon approval of Commissioner
 - Payment of fine (25% - 80% of the landed cost of the article)
 - In case of forfeiture, should pay the domestic market value of the seized article
- Settlement NOT allowed:
 - Fraud in importation
 - Importation prohibited by law
 - Release would be contrary to law

COMPROMISE

- Commissioner may compromise any case subject to approval by Secretary

b. Judicial

1) Rules on appeal including jurisdiction

- The party aggrieved by a ruling of the Commissioner in any matter brought before him upon protest or by his action or ruling in any case of seizure may appeal to the Court of Tax Appeals, in the manner and within the period prescribed by law and regulations.



Unless an appeal is made to the Court of Tax Appeals in the manner and within the period prescribed by laws and regulations, the action or ruling of the Commissioner shall be final and conclusive. (Sec. 2402, TCC)

2. Taxpayer

a. Protest

- written protest
- payment before protest is necessary (amount due + docket fee)
- When: at the time payment of the amount claimed to be due is made within 15 days thereafter
- Form: filed according to RR; point out the particular decision or ruling grounds used as basis for the protest
- Scope: limited to the subject matter of a single adjustment (refers to the entire content of one liquidation including duties, fees, surcharges and fines) or other independent transaction
- Failure to protest will render the action of the Collector final and conclusive except for manifest error
- Upon demand of Collector, the importer shall furnish samples of the articles which are the subject of the protest

b. Abandonment

➤ Article is deemed abandoned when:

1. owner, importer or consignee expressly signifies in writing to Collector his intention to abandon
2. after due notice, fails to file an entry within 30 days from date of discharge of last package from vessel or aircraft
2. written request and notice from importer OR statement of error certified by the Collector

▪ How:

1. Claim made in writing
2. Collector shall verify with the records in his office
3. Certify claim to Commissioner with his recommendation and necessary papers
4. Commissioner shall then cause the claim to be paid if found correct

- If the result of the refund would result to a corresponding refund of the internal revenue taxes on the same importation, Collector shall certify to Commissioner who shall cause the said excess to be paid, refunded or credited in favor of the importer

3. after filing entry, fails to claim his importation 15 days from date of posting of the notice to claim such importation

➤ Effect:

- deemed to have renounced his interest and property rights
- ipso facto deemed property of the Government

➤ Any official or employee who:

- had knowledge of the existence of abandoned article
- custody or charge of such article
- fails to report within 24 hours from time article deemed abandoned shall be punished accdg to sec. 3604 (fine: P5000 - P50,000; imprisonment: 1 yr - 10 yrs, perpetual disqualification to hold public office, vote and participate in election)

c. Abatement and Refund

▪ When:

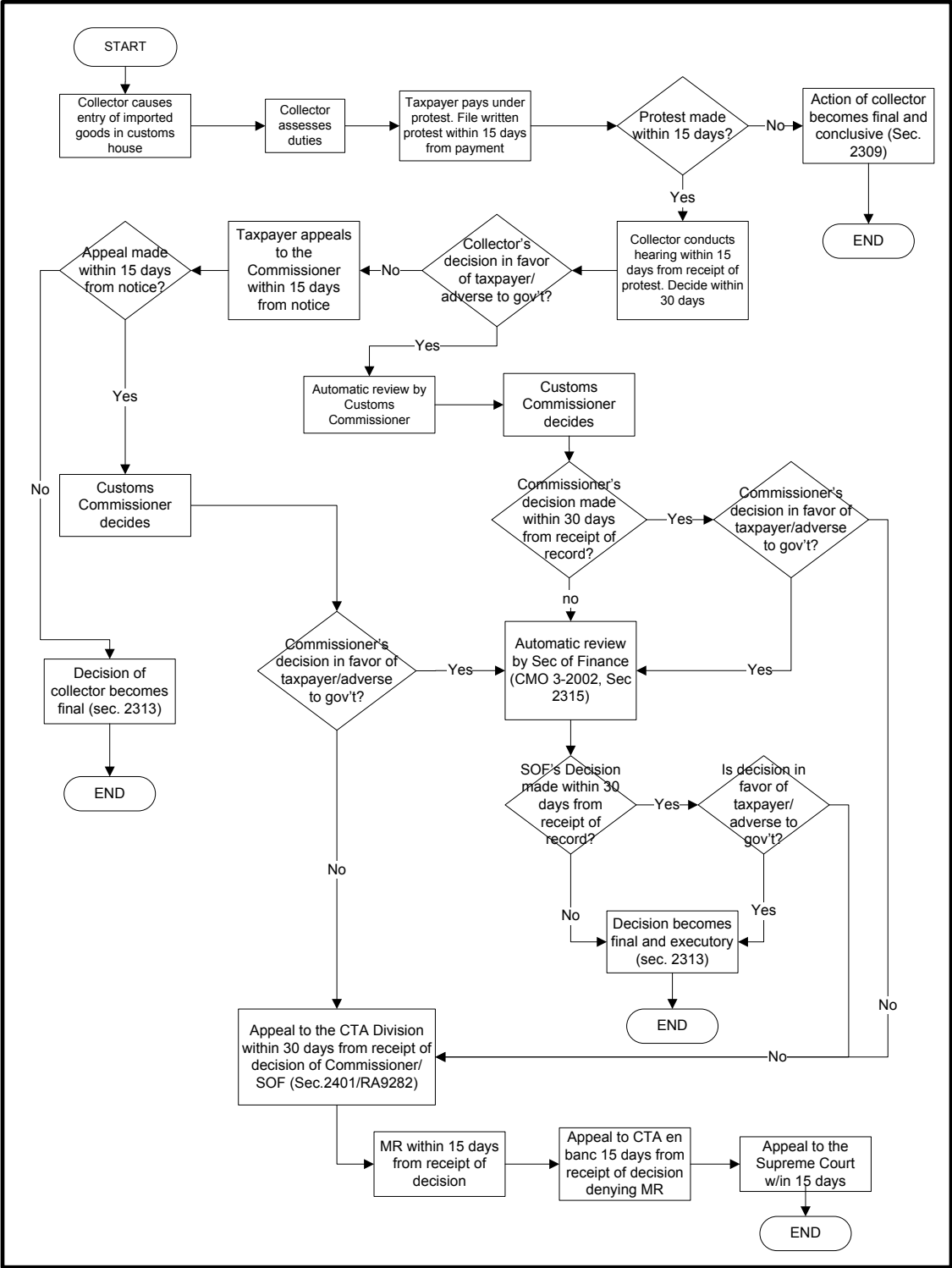
1. manifest clerical error made in invoice or entry
2. error in return of weight, measure and gauge
 - certified, under penalties of falsification or perjury, by examining official
3. error in the distribution of charges on invoices
 - not involving any question of law
 - certified, under penalties of falsification or perjury, by examining official

▪ Conditions

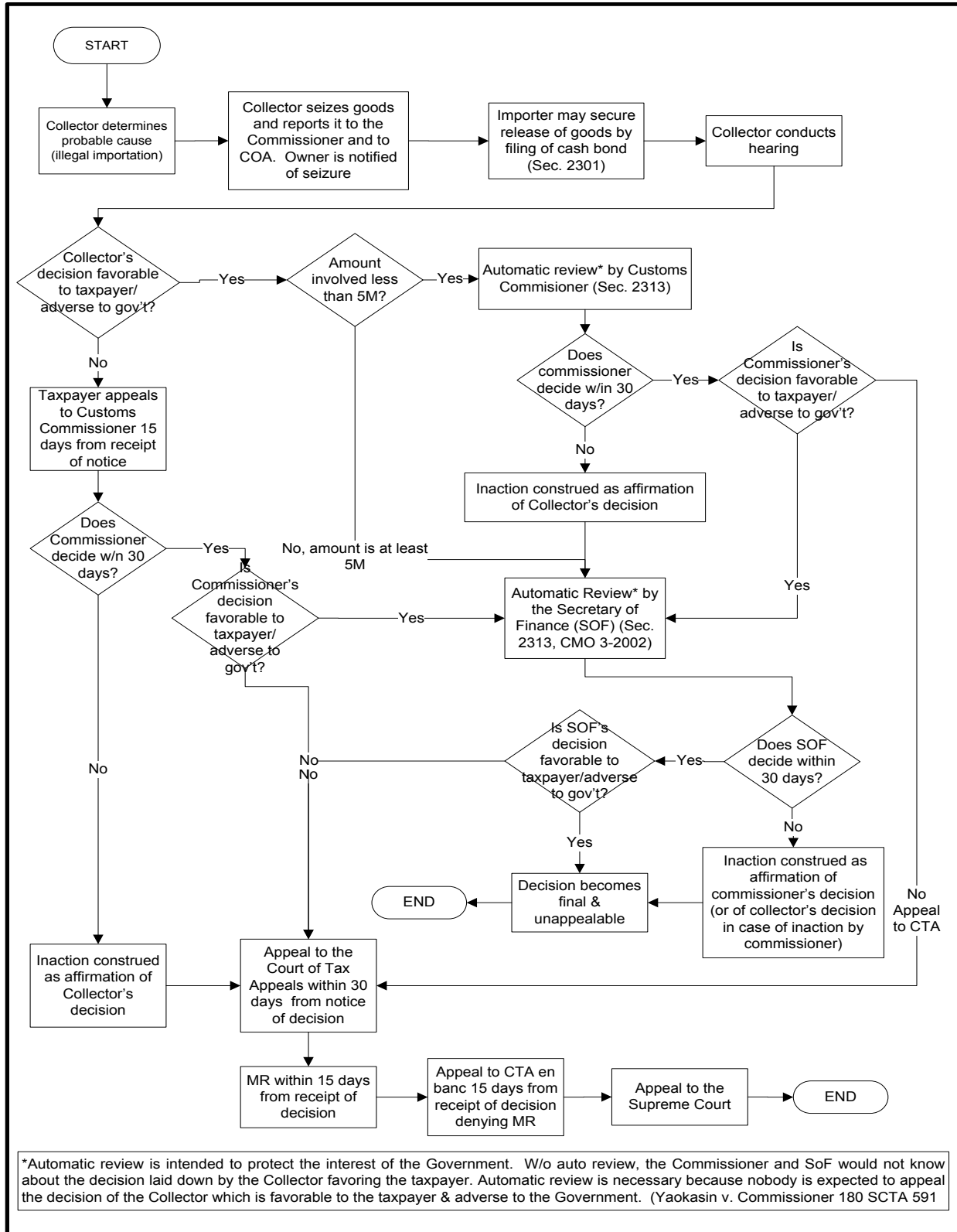
1. errors discovered before payment OR discovered within 1 year after the final liquidation



Flowchart VIII: Taxpayer's Remedies from Customs Assessment-Tariff and Customs Code



Flowchart IX: Remedies from Seizure and Forfeiture Cases-Tariffs and Customs Code



*Automatic review is intended to protect the interest of the Government. W/o auto review, the Commissioner and SoF would not know about the decision laid down by the Collector favoring the taxpayer. Automatic review is necessary because nobody is expected to appeal the decision of the Collector which is favorable to the taxpayer & adverse to the Government. (Yaokasin v. Commissioner 180 SCTA 591)

9. Judicial Remedies

- | |
|---|
| <ul style="list-style-type: none">I. Jurisdiction of the CTAII. Judicial ProceduresIII. Taxpayer's suit |
|---|

I. Jurisdiction of the Court of Tax Appeals

1. Exclusive appellate jurisdiction over civil tax cases

1. Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue or other laws administered by the Bureau of Internal Revenue;
2. Inaction by the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relations thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue, where the National Internal Revenue Code provides a specific period of action, in which case the inaction shall be deemed a denial;
3. Decisions, orders or resolutions of the Regional Trial Courts in local tax cases originally decided or resolved by them in the exercise of their original or appellate jurisdiction;
4. Decisions of the Commissioner of Customs in cases involving liability for customs duties, fees or other money charges, seizure, detention or release of property affected, fines, forfeitures or other penalties in relation thereto, or other matters arising under the Customs Law or other laws administered by the Bureau of Customs;
5. Decisions of the Central Board of Assessment Appeals in the exercise of its appellate jurisdiction over cases involving the assessment and taxation of real property originally decided by the provincial or city board of assessment appeals;
6. Decisions of the Secretary of Finance on customs cases elevated to him automatically for review from decisions of the Commissioner of Customs which are adverse to the Government under

Section 2315 of the Tariff and Customs Code;

7. Decisions of the Secretary of Trade and Industry, in the case of nonagricultural product, commodity or article, and the Secretary of Agriculture in the case of agricultural product, commodity or article, involving dumping and countervailing duties under Section 301 and 302, respectively, of the Tariff and Customs Code, and safeguard measures under Republic Act No. 8800, where either party may appeal the decision to impose or not to impose said duties. (Sec. 7, RA No. 1125 as amended)

a. Cases within the jurisdiction of the Court en banc (Sec. 2, Rule 4, A.M. No. 05-11-07)

The Court en banc shall exercise exclusive appellate jurisdiction to review by appeal the following:

- a. Decisions or resolutions on motions for reconsideration or new trial of the Court in Divisions in the exercise of its exclusive appellate jurisdiction over:
 1. Cases arising from administrative agencies - Bureau of Internal Revenue, Bureau of Customs, Department of Finance, Department of Trade and Industry, Department of Agriculture;
 2. Local tax cases decided by the Regional Trial Courts in the exercise of their original jurisdiction; and
 3. Tax collection cases decided by the Regional Trial Courts in the exercise of their original jurisdiction involving final and executory assessments for taxes, fees, charges and penalties, where the principal amount of taxes and penalties claimed is less than one million pesos;
- b. Decisions, resolutions or orders of the Regional Trial Courts in local tax cases decided or resolved by them in the exercise of their appellate jurisdiction;
- c. Decisions, resolutions or orders of the Regional Trial Courts in tax collection cases decided or resolved by them in the exercise of their appellate jurisdiction;
- d. Decisions, resolutions or orders on motions for reconsideration or new trial of the Court in Division in the exercise of its exclusive original jurisdiction over tax collection cases;
- e. Decisions of the Central Board of Assessment Appeals (CBAA) in the exercise of its appellate jurisdiction over cases involving the assessment and

taxation of real property originally decided by the provincial or city board of assessment appeals;

- f. Decisions, resolutions or orders on motions for reconsideration or new trial of the Court in Division in the exercise of its exclusive original jurisdiction over cases involving criminal offenses arising from violations of the National Internal Revenue Code or the Tariff and Customs Code and other laws administered by the Bureau of Internal Revenue or Bureau of Customs;
- g. Decisions, resolutions or orders on motions for reconsideration or new trial of the Court in Division in the exercise of its exclusive appellate jurisdiction over criminal offenses mentioned in the preceding subparagraph; and
- h. Decisions, resolutions or orders of the Regional trial Courts in the exercise of their appellate jurisdiction over criminal offenses mentioned in subparagraph (f).

b. Cases within the jurisdiction of the Court in divisions (Sec. 3, Rule 4, A.M. No. 05-11-07)

(a) Exclusive original or appellate jurisdiction to review by appeal the following:

1. Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue;
2. Inaction by the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue, where the National Internal Revenue Code or other applicable law provides a specific period for action: Provided, that in case of disputed assessments, the inaction of the Commissioner of Internal Revenue within the one hundred eighty day-period under Section 228 of the National Internal revenue Code shall be deemed a denial for purposes of allowing the taxpayer to appeal his case to the Court and does not necessarily constitute a formal decision of the Commissioner of Internal Revenue

on the tax case; Provided, further, that should the taxpayer opt to await the final decision of the Commissioner of Internal Revenue on the disputed assessments beyond the one hundred eighty day-period abovementioned, the taxpayer may appeal such final decision to the Court under Section 3(a), Rule 8 of these Rules; and Provided, still further, that in the case of claims for refund of taxes erroneously or illegally collected, the taxpayer must file a petition for review with the Court prior to the expiration of the two-year period under Section 229 of the National Internal Revenue Code;

3. Decisions, resolutions or orders of the Regional Trial Courts in local tax cases decided or resolved by them in the exercise of their original jurisdiction;
4. Decisions of the Commissioner of Customs in cases involving liability for customs duties, fees or other money charges, seizure, detention or release of property affected, fines, forfeitures of other penalties in relation thereto, or other matters arising under the Customs Law or other laws administered by the Bureau of Customs;
5. Decisions of the Secretary of Finance on customs cases elevated to him automatically for review from decisions of the Commissioner of Customs adverse to the Government under Section 2315 of the Tariff and Customs Code; and
6. Decisions of the Secretary of Trade and Industry, in the case of nonagricultural product, commodity or article, and the Secretary of Agriculture, in the case of agricultural product, commodity or article, involving dumping and countervailing duties under Section 301 and 302, respectively, of the Tariff and Customs Code, and safeguard measures under Republic Act No. 8800, where either party may appeal the decision to impose or not to impose said duties;

(b) Exclusive jurisdiction over cases involving criminal offenses, to wit:

1. Original jurisdiction over all criminal offenses arising from violations of the National internal Revenue Code or Tariff and Customs Code and other laws administered by the Bureau of Internal Revenue of the Bureau of Customs, where the principal amount of taxes and fees, exclusive of charges and penalties,



claimed is one million pesos or more; and

2. Appellate jurisdiction over appeals from the judgments, resolutions or orders of the Regional Trial Courts in their original jurisdiction in criminal offenses arising from violations of the National Internal Revenue Code or Tariff and Customs Code and other laws administered by the Bureau of Internal Revenue or Bureau of Customs, where the principal amount of taxes and fees, exclusive of charges and penalties, claimed is less than one million pesos or where there is no specified amount claimed;
- (c) **Exclusive jurisdiction over tax collections cases, to wit:**
1. Original jurisdiction in tax collection cases involving final and executory assessments for taxes, fees, charges and penalties, where the principal amount of taxes and fees, exclusive of charges and penalties, claimed is one million pesos or more; and
 2. Appellate jurisdiction over appeals from the judgments, resolutions or orders of the Regional Trial Courts in tax collection cases originally decided by them within their respective territorial jurisdiction.

2. Criminal cases (Sec. 7, RA 1125 as amended)

a. Exclusive original jurisdiction

- Exclusive original jurisdiction over all criminal offenses arising from violations of the National Internal Revenue Code or Tariff and Customs Code and other laws administered by the Bureau of Internal Revenue or the Bureau of Customs: Provided, however, That offenses or felonies mentioned in this paragraph where the principal amount of taxes and fees, exclusive of charges and penalties, claimed is less than One million pesos (P1,000,000.00) or where there is no specified amount claimed shall be tried by the regular Courts and the jurisdiction of the CTA shall be appellate. Any provision of law or the Rules of Court to the contrary notwithstanding, the criminal action and the corresponding civil action for the recovery of civil liability for taxes and penalties shall at all times be simultaneously instituted with, and jointly determined in the same proceeding by the CTA, the filing of the criminal action being deemed to necessarily carry with it the filing of the civil action, and no right to reserve the filling of such civil action

separately from the criminal action will be recognized.

b. Exclusive appellate jurisdiction in criminal cases

- a. Over appeals from the judgments, resolutions or orders of the Regional Trial Courts in tax cases originally decided by them, in their respected territorial jurisdiction.
- b. Over petitions for review of the judgments, resolutions or orders of the Regional Trial Courts in the exercise of their appellate jurisdiction over tax cases originally decided by the Metropolitan Trial Courts, Municipal Trial Courts and Municipal Circuit Trial Courts in their respective jurisdiction.

II. Judicial Procedures

1. Judicial action for collection of taxes

a. Internal revenue taxes

The remedies for the collection of internal revenue taxes, fees or charges, and any increment thereto resulting from delinquency can be through the institution of a civil or criminal action.

The judgment in the criminal case shall not only impose the penalty but shall also order payment of the taxes subject of the criminal case as finally decided by the Commissioner.

The Bureau of Internal Revenue shall advance the amounts needed to defray costs of collection by means of civil or criminal action, including the preservation or transportation of personal property distrained and the advertisement and sale thereof, as well as of real property and improvements thereon. (Sec. 205, NIRC)

NOTE: Please refer to Taxpayer's Remedies (B. Collection))

The Court of Tax Appeals has:

EXCLUSIVE ORIGINAL JURISDICTION in tax collection cases involving final and executory assessments for taxes, fees, charges and penalties.

- **Exception:** Collection cases where the principal amount of taxes and fees, exclusive of charges and penalties, claimed is less than One million pesos (P1,000,000.00) shall be tried by the **proper Municipal Trial Court, Metropolitan Trial Court and Regional Trial Court.**

EXCLUSIVE APPELLATE JURISDICTION in tax collection cases:

- b. Over appeals from the judgments, resolutions or orders of the



Regional Trial Courts in tax collection cases originally decided by them, in their respective territorial jurisdiction.

- c. Over petitions for review of the judgments, resolutions or orders of the Regional Trial Courts in the Exercise of their appellate jurisdiction over tax collection cases originally decided by the Metropolitan Trial Courts, Municipal Trial Courts and Municipal Circuit Trial Courts, in their respective jurisdiction.

b. Local taxes

- The LGU concerned may enforce the collection of delinquent taxes, fees, charges or other revenues by civil action in any court of competent jurisdiction. The civil action shall be filed by the local treasurer. (Sec. 183, LGC)

1) Prescriptive period

Local taxes, fees, or charges may be collected within five (5) years from the date of assessment by administrative or judicial action.

- (a) Local taxes, fees, or charges shall be assessed within five (5) years from the date they became due. No action for the collection of such taxes, fees, or charges, whether administrative or judicial, shall be instituted after the expiration of such period: Provided, That, taxes, fees or charges which have accrued before the effectivity of this Code may be assessed within a period of three (3) years from the date they became due.

- (b) In case of fraud or intent to evade the payment of taxes, fees, or charges, the same may be assessed within ten (10) years from discovery of the fraud or intent to evade payment.

No such action shall be instituted after the expiration of said period: Provided, however, That, taxes, fees or charges assessed before the effectivity of this Code may be collected within a period of three (3) years from the date of assessment.

The running of the periods of prescription provided in the preceding paragraphs shall be suspended for the time during which:

- (1) The treasurer is legally prevented from making the assessment of collection;
- (2) The taxpayer requests for a reinvestigation and executes a waiver in writing before expiration of the period within which to assess or collect; and

- (3) The taxpayer is out of the country or otherwise cannot be located. (Sec. 194, LGC)

2. Civil cases

a. Who may appeal, mode of appeal, effect of appeal

Who may appeal	Period to appeal	Mode of appeal
<p>A party adversely affected by:</p> <ol style="list-style-type: none"> 1. Decision, ruling; or 2. The inaction of the Commissioner of Internal Revenue on disputed assessments or claims for refund of internal revenue taxes, or; 3. By a decision or ruling of the Commissioner of Customs, the Secretary of Finance, the Secretary of Trade and Industry, the Secretary of Agriculture, or a Regional Trial Court in the exercise of its original jurisdiction 	<p>within <u>thirty days</u> after receipt of a copy of such decision or ruling, or expiration of the period fixed by law for the Commissioner of Internal Revenue to act on the disputed assessments</p> <p><i>In case of inaction of the Commissioner of Internal Revenue on claims for refund of internal revenue taxes erroneously or illegally collected - within the two-year period prescribed by law from payment or collection of the taxes.</i></p>	<p>Petition for review as provided in Rule 42 of the Rules of Court.</p> <p>The Court in Division shall act on the appeal.</p>
<p>A party adversely affected by a decision or resolution of a Division of the Court on a motion for reconsideration or new trial</p>	<p>within <u>fifteen days</u> from receipt of a copy of the questioned decision or resolution</p> <p><i>The Court may grant an additional period not exceeding fifteen days from the expiration of the original period within which to file the petition for</i></p>	<p>Petition for review as provided in Rule 43 of the Rules of Court.</p> <p>The Court en banc shall act on the appeal.</p>

	<i>review</i>	
A party adversely affected by a decision or ruling of the Central Board of Assessment Appeals and the Regional Trial Court in the exercise of their appellate jurisdiction	within <u>thirty days</u> from receipt of a copy of the questioned decision or ruling	Petition for review as provided in Rule 43 of the Rules of Court. The Court en banc shall act on the appeal.

1) Suspension of collection of tax

General Rule: No appeal taken to the Court shall suspend the payment, levy, distraint, or sale of any property of the taxpayer for the satisfaction of his tax liability as provided under existing laws.

Exception: Where the collection of the amount of the taxpayer's liability, sought by means of a demand for payment, by levy, distraint or sale of any property of the taxpayer, or by whatever means, as provided under existing laws, may jeopardize the interest of the Government or the taxpayer, an interested party may file a motion for the suspension of the collection of the tax liability

a) Injunction not available to restrain collection

No court shall have authority to grant an injunction to restrain the collection of any national internal revenue tax, fee or charge imposed by the Code. (Sec. 217, NIRC)

2) Taking of evidence

- The Court may receive evidence in the following cases:
 - (a) In all cases falling within the original jurisdiction of the Court in Division pursuant to Section 3, Rule 4 of these Rules; and
 - (b) In appeals in both civil and criminal cases where the Court grants a new trial pursuant to Section 2, Rule 53 and Section 12, Rule 124 of the Rules of Court. (Sec. 2, Rule 12, A.M. No. 05-11-07)
- Taking of evidence by:
 - Justice—
The Court may, motu proprio or upon proper motion, direct that a case, or any issue therein, be assigned to one of its members for the taking of evidence, when the determination of a question of fact arises at any stage of the proceedings, or when the taking of an account is necessary, or when the

determination of an issue of fact requires the examination of a long account. The hearing before such justice shall proceed in all respects as though the same had been made before the Court.

Upon the completion of such hearing, the justice concerned shall promptly submit to the Court a written report thereon, stating therein his findings and conclusions. Thereafter, the Court shall render its decision on the case, adopting, modifying, or rejecting the report in whole or in part, or, the Court may, in its discretion, recommit it to the justice with instructions, or receive further evidence. (Sec. 12, RA No. 1125, as amended; also Sec. 3, Rule 12, A.M. No. 05-11-07)

- Court Official -

In default or ex parte hearings, or in any case where the parties agree in writing, the Court may delegate the reception of evidence to the Clerk of Court, the Division Clerks of Court, their assistants who are members of the Philippine bar, or any Court attorney. The reception of documentary evidence by a Court official shall be for the sole purpose of marking, comparison with the original, and identification by witnesses of such documentary evidence. The Court official shall have no power to rule on objections to any question or to the admission of exhibits, which objections shall be resolved by the Court upon submission of his report and the transcripts within ten days from termination of the hearing. (Sec. 4, Rule 12, A.M. No. 05-11-07)

3) Motion for reconsideration or new trial (Rule 15, A.M. No. 05-11-07)

Who: Any aggrieved party may seek a reconsideration or new trial of any decision, resolution or order of the Court.

- Maybe opposed by:
The adverse party may file an opposition to the motion for

reconsideration or new trial within ten days after his receipt of a copy of the motion for reconsideration or new trial of a decision, resolution or order of the Court.

When: He shall file a motion for reconsideration or new trial within fifteen days from the date he received notice of the decision, resolution or order of the Court in question.

- The Court shall resolve the motion for reconsideration or new trial within three months from the time it is deemed submitted for resolution.

How: The motion shall be in writing stating its grounds, a written notice of which shall be served by the movant on the adverse party.

A motion for new trial shall be proved in the manner provided for proof of motions. A motion for the cause mentioned in subparagraph (a) of the preceding section shall be supported by affidavits of merits which may be rebutted by counter-affidavits. A motion for the cause mentioned in subparagraph (b) of the preceding section shall be supported by affidavits of the witnesses by whom such evidence is expected to be given, or by duly authenticated documents which are proposed to be introduced in evidence.

A motion for reconsideration or new trial that does not comply with the foregoing provisions shall be deemed pro forma, which shall not toll the reglementary period for appeal.

Effect: The filing of a motion for reconsideration or new trial shall suspend the running of the period within which an appeal may be perfected.

Grounds: A motion for new trial may be based on one or more of the following causes materially affecting the substantial rights of the movant:

- (a) Fraud, accident, mistake or excusable negligence which ordinary

prudence could not have guarded against and by reason of which such aggrieved party has probably been impaired in his rights; or

(b) Newly discovered evidence, which he could not, with reasonable diligence, have discovered and produced at the trial and, which, if presented, would probably alter the result.

A motion for new trial shall include all grounds then available and those not included shall be deemed waived.

Restrictions: No party shall be allowed to file a second motion for reconsideration of a decision, final resolution or order; or for new trial.

b. Appeal to the CTA, en banc

No civil proceeding involving matter arising under the National Internal Revenue Code, the Tariff and Customs Code or the Local Government Code shall be maintained, except as herein provided, until and unless an appeal has been previously filed with the CTA and disposed of in accordance with the provisions of this Act.

A party adversely affected by a resolution of a Division of the CTA on a motion for reconsideration or new trial, may file a petition for review with the CTA en banc. (Sec. 18, RA No. 1125 as amended)

c. Petition for review on certiorari to the Supreme Court (Rule 16, A.M. No. 05-11-07)

A party adversely affected by a decision or ruling of the Court en banc may appeal by filing with the Supreme Court a verified petition for review on certiorari within fifteen days from receipt of a copy of the decision or resolution, as provided in Rule 45 of the Rules of Court. If such party has filed a motion for reconsideration or for new trial, the period herein fixed shall run from the party's receipt of a copy of the resolution denying the motion for reconsideration or for new trial.

The motion for reconsideration or for new trial filed before the Court shall be deemed abandoned if, during its pendency, the movant shall appeal to the Supreme Court.

3. Criminal cases



a. Institution and prosecution of criminal actions

1. Institution of criminal action
 - Instituted by the filing an information in the name of the People of the Philippines
 - Those involving violations of the NIRC and other laws enforced by the BIR - Must be approved by the Commissioner of Internal Revenue
 - Those involving violations of the tariff and Customs Code and other laws enforced by the Bureau of Customs - Must be approved by the Commissioner of Customs
 - Shall interrupt the running of the period of prescription
2. Prosecution of criminal action
 - Conducted and prosecuted under the direction and control of the public prosecutor
 - Those involving violations of the NIRC and other laws enforced by the BIR or violations of the tariff and Customs Code and other laws enforced by the Bureau of Customs - The prosecution may be conducted by their respective duly deputized legal officers.

1) Institution on civil action in criminal action

- In cases within the jurisdiction of the Court, the criminal action and the corresponding civil action for the recovery of civil liability for taxes and penalties shall be deemed jointly instituted in the same proceeding. The filing of the criminal action shall necessarily carry with it the filing of the civil action. No right to reserve the filing of such civil action separately from the criminal action shall be allowed or recognized.

b. Appeal and period to appeal

Criminal Case	Period to Appeal	Mode of Appeal
Criminal cases decided by a Regional Trial Court in the	Within fifteen days from receipt of a copy of the	Appeal pursuant to Sec. 3(a) and 6, Rule 122 of the

exercise of its original jurisdiction	decision or final order with the court which rendered the final judgment or order appealed from and by serving a copy upon the adverse party	Rules of Court The Court in division shall act on the appeal.
Criminal cases decided by the Court in Division	Within fifteen days from receipt of a copy of the decision or resolution appealed from. <i>The Court may, for good cause, extend the time for filing of the petition for review for an additional period not exceeding fifteen days.</i>	Petition for review as provided in Rule 43 of the Rules of Court The Court en banc shall act on the appeal.
Criminal cases decided by the Regional Trial Courts in the exercise of their appellate jurisdiction	Within fifteen days from receipt of a copy of the decision or final order appealed from.	Petition for review as provided in Rule 43 of the Rules of Court The Court in Division shall act on the appeal.

1) Solicitor General as counsel for the People and government officials sued in their official capacity

- The Solicitor General shall represent the People of the Philippines and government officials sued in their official capacity in all cases brought to the Court in the exercise of its appellate jurisdiction. He may deputize the legal officers of the Bureau of Internal Revenue in cases brought under the National Internal Revenue Code or other laws enforced by the Bureau of Internal Revenue, or the legal officers of the Bureau of Customs in cases brought under the Tariff and Customs Code of the Philippines or other laws enforced by the Bureau of Customs, to appear in behalf of the officials of said agencies sued in their official capacity: Provided, however, such duly deputized legal officers shall remain at all times under the direct control and supervision of the Solicitor General.

c. Petition for review on certiorari to the Supreme Court

A party adversely affected by a decision or ruling of the CTA en banc may file with the Supreme Court a verified petition for review on certiorari pursuant to Rule 45 of the 1997 Rules of Civil Procedure. (Sec. 19, R.A. No. 1125 as amended)

III. Taxpayer's suit impugning the validity of tax measures or acts of taxing authorities

a. Taxpayer's suit, defined

A "taxpayer's suit" refers to a case where the act complained of directly involves the illegal disbursement of public funds derived from taxation. (Kilosbayan v. Guingona, Jr. (1994))

b. Distinguished from citizen's suit

The plaintiff in a taxpayer's suit is in a different category from the plaintiff in a citizen's suit. In the former, the plaintiff is affected by the expenditure of public funds, while in the latter, he is but the mere instrument of the public concern. (De Castro v. Judicial and Bar Council (2010))

c. Requisites for challenging the constitutionality of a tax measure or act of taxing authority

1) Concept of locus standi as applied in taxation

- **CONCEPT OF LOCUS STANDI:** The doctrine of locus standi is the right of appearance in a court of justice. The doctrine requires a litigant to have a material interest in the outcome of a case. In private suits, locus standi requires a litigant to be a "real party in interest," which is defined as "the party who stands to be benefited or injured by the judgment in the suit or the party entitled to the avails of the suit."

In public suits, this Court recognizes the difficulty of applying the doctrine especially when plaintiff asserts a public right on behalf of the general public because of conflicting public policy issues. On one end, there is the right of the ordinary citizen to petition the courts to be freed from unlawful government intrusion and illegal official action. At the other end, there is the public policy precluding excessive judicial interference in official acts, which may unnecessarily hinder the delivery of basic public services.

The Court has adopted the "direct injury test" to determine locus standi in public suits. In *People v. Vera*, it was held that a person who impugns the validity of a statute must have "a personal and substantial interest in the case such that he has sustained, or will sustain direct injury as a result." The "direct injury test" in public suits is similar to the "real party in interest" rule for private suits under Section 2, Rule 3 of the 1997 Rules of Civil Procedure. (*Planter's Products, Inc. v. Fertiphil Corporation*, G.R. No. 166006, March 14, 2008)

▪ AS APPLIED TO TAXATION:

- It is well-stated that the validity of a statute may be contested only by one who will sustain a direct injury in consequence of its enforcement. Yet, there are many decisions nullifying, at the instance of taxpayers, laws providing for the disbursement of public funds, upon the theory that "the expenditure of public funds by an officer of the State for the purpose of administering an unconstitutional act constitutes a misapplication of such funds," which may be enjoined at the request of a taxpayer. (*Pascual v. Secretary of Public Works* (1960))
- A taxpayer is allowed to sue where there is a claim that public funds are illegally disbursed, or that the public money is being deflected to any improper purpose, or that there is wastage of public funds through the enforcement of an invalid or unconstitutional law. A person suing as a taxpayer, however, must show that the act complained of directly involves the illegal disbursement of public funds derived from taxation. He must also prove that he has sufficient interest in preventing the illegal expenditure of money raised by taxation and that he will sustain a direct injury because of the enforcement of the questioned statute or contract. *In other words, for a taxpayer's suit to prosper, two requisites must be met: (1) public funds derived from taxation are disbursed by a political subdivision or instrumentality and in doing so, a law is violated or some irregularity is committed and (2) the petitioner is directly affected by the alleged act.* (*Mamba v. Lara*, G.R. No. 165109, Dec. 14, 2009)

2) Doctrine of transcendental importance

Recognizing that a strict application of the "direct injury" test may hamper public interest, this Court relaxed the requirement in cases of "transcendental importance" or with "far reaching implications." Being a mere procedural technicality, it has also been held that locus standi may be waived in the public interest. (*Ibid*)

Planters Products, Inc. v. Fertiphil Corp.: Even assuming arguendo that there is no direct injury, We find that the liberal policy consistently adopted by this Court on locus standi must apply. The issues raised by Fertiphil are of paramount public importance. It involves not only the constitutionality of a tax law but, more importantly, the use of taxes for public purpose. Former President Marcos issued LOI No. 1465 with the intention of rehabilitating an ailing private company. This is clear from the text of the LOI. PPI is expressly named in the LOI as the direct



beneficiary of the levy. Worse, the levy was made dependent and conditional upon PPI becoming financially viable. The LOI provided that "the capital contribution shall be collected until adequate capital is raised to make PPI viable."

The constitutionality of the levy is already in doubt on a plain reading of the statute. It is Our constitutional duty to squarely resolve the issue as the final arbiter of all justiciable controversies. The doctrine of standing, being a mere procedural technicality, should be waived, if at all, to adequately thresh out an important constitutional issue.

3) Ripeness for judicial determination

"Ripeness for judicial determination" means that litigation is inevitable or there is no adequate relief available in any other form or proceeding.

CJH Development Corp. v. BIR (GR No. 172457, Dec. 24, 2008) However, CJH is not left without recourse. The Tariff and Customs Code (TCC) provides for the administrative and judicial remedies available to a taxpayer who is minded to contest an assessment, subject of course to certain reglementary periods. The TCC provides that a protest can be raised provided that payment first be made of the amount due. The decision of the Collector can be reviewed by the Commissioner of Customs who can approve, modify or reverse the decision or action of the Collector. If the party is not satisfied with the ruling of the Commissioner, he may file the necessary appeal to the Court of Tax Appeals. Afterwards, the decision of the Court of Tax Appeals can be appealed to this Court.