

Contents

Preface	iii
---------------	-----

Chapter I. — General Principles

1. Definition of taxation	1
2. Purpose of taxation	1
3. Definition of taxes	1
4. Characteristics of taxes	2
5. Underlying theory and basis of taxation	2
6. Nature of the power of taxation	3
7. Aspects of taxation	3
8. Scope of legislative power of taxation	3
9. Basic principles of a sound tax system	4
10. Classification of taxes	4
11. Definition and nature of income tax	6
12. Power to impose income tax	6
13. Functions of income tax	6
14. Situs of income for tax purposes	7
15. Income derived within the State taxable	7
16. History of Philippine income tax law	8
17. The Bureau of Internal Revenue	9
18. Taxes administered by the Bureau	10
19. Sources of our law on income taxation	11
20. Construction of income tax laws	13

Chapter II. — Concept and Items of Income

1. Definition of income	14
2. Sources of income	14
3. Form of income	15
4. Distinctions between income and other terms	15
5. Requisites for income to be taxable	15
6. Where there is a duty to return income received	17
7. Condonation of debt	17
8. Award of damages	18
9. Meaning of gross income	18

10.	Compensation for services.....	19
11.	Definition of terms	19
12.	When income from compensation for services taxable	20
13.	Forms of compensation.....	21
14.	Compensation in kind.....	21
15.	Income from business or commercial transactions, or exercise of a profession	28
16.	Income from farming	28
17.	Income from sales or dealings in property	30
18.	Income in the form of interests	31
19.	Income in the form of rents	32
20.	Income in the form of dividends.....	38
21.	Property dividend	40
22.	Stock dividend.....	41
23.	Computation of gain or loss from sale of stock received as dividends	46
24.	Computation of shares acquired at different dates	49
25.	Computation of gain or loss from sale of shares after receipt of stock dividend.....	50
26.	Declaration and subsequent redemption of a stock dividend.....	51
27.	Sources of dividend payment	53
28.	Income "derived from whatever source"	54

Chapter III. — Exclusions from Income

1.	In general	56
2.	Exclusions under the Tax Code.....	56
3.	Proceeds of life insurance	57
4.	Amount received by insured as return of premium	57
5.	Gifts, bequests, and devises	58
6.	Compensation for injuries or sickness.....	59
7.	Income exempt under treaty	60
8.	Retirement benefits, pensions, gratuities, etc.....	61
9.	Miscellaneous items.....	65

Chapter IV. — Special Treatment of Fringe Benefits

1.	Definition of fringe benefit	68
2.	Coverage	69
3.	Imposition of fringe benefit tax	69
4.	Determination of grossed-up monetary value	70
5.	Determination of amount subject to fringe benefit tax.....	72
6.	Guidelines for valuation of fringe benefits	72
7.	Valuation of housing privilege	73
8.	Valuation of expense account.....	76

9.	Valuation of motor vehicle of any kind.....	78
10.	Valuation of interest on loan at less than market rate.....	82
11.	Valuation of expenses for foreign travel.....	83
12.	Valuation of educational assistance to employee or his dependents	83
13.	Valuation of other expenses	84
14.	Taxation of fringe benefits received by certain individuals	85
15.	Fringe benefits not subject to fringe benefit tax	86
16.	Scope of de minimis benefits	87
17.	Excess of benefits over P90,000 ceiling	88
18.	Tax accounting for fringe benefit and tax due thereon.....	89

Chapter V. — Deductions from Gross Income

A. Preliminary Topics

1.	Definition of deductions.....	93
2.	Time for availing deductions.....	93
3.	Basic principles governing deductions	93
4.	Taxpayer may claim lesser deduction than that allowed by law	94
5.	Kinds of deductions.....	94
6.	Category or type of deductions	95
7.	Ceilings on itemized deductions.....	95
8.	Taxpayers entitled/not entitled to avail of deductions	96
9.	Additional requirements for deductibility of certain payments.....	96
10.	Allowance of deductions of certain payments not withheld or remitted.....	98

B. Business Expenses

1.	In general	98
2.	Requisites for deductibility of business expenses	99
3.	When expense is ordinary and necessary.....	100
4.	Paid or incurred within the taxable year	102
5.	Paid or incurred in carrying on trade or business	102
6.	Supported by proof.....	103
7.	Expenses against public policy or public order	105
8.	Entertainment, amusement, and recreation expenses	105
9.	Requisites in deductibility of expenses	107
10.	Substantiation of expenses	108
11.	Maximum percentage ceiling for expense	109

12.	Requisites for deductibility of compensation payments	110
13.	Test and its practical application.....	111
14.	Factors that may be considered	113
15.	Bonuses to employees.....	114
16.	Pensions and compensations for injuries	114
17.	Travel expenses in general.....	115
18.	Requisites for deductibility of travel expenses.....	115
19.	Meaning of "while away from home"	115
20.	Proof of deductibility of travel expenses.....	116
21.	Cost of materials and supplies.....	116
22.	Expenses for repairs	117
23.	Rentals.....	118
24.	Expenses of farmers.....	120
25.	Advertising expenses.....	121
26.	Expenses allowable to private educational institutions	122

C. Interest Expense

1.	In general	122
2.	Requisites for deductibility	123
3.	Existence of indebtedness	123
4.	Interest for tax delinquency.....	124
5.	Stipulation of interest in writing	124
6.	Non-deductible interest.....	124
7.	Interest on loans between related taxpayers	125
8.	Deductible interest	127
9.	Tax arbitrage scheme	127
10.	Deductibility of interest paid in advance through discount	130
11.	Interest on indebtedness periodically amortized	131
12.	Interest on unpaid taxes.....	132
13.	Optional treatment of interest expense.....	132

D. Taxes

1.	In general	133
2.	Taxes that are deductible	133
3.	Taxes that are not deductible.....	133
4.	Requisites for deductibility	134
5.	Income tax refund or credit	135
6.	Income taxes imposed by a foreign country	135
7.	Taxes assessed against local benefits	135
8.	Rules on deductibility of special assessments	136
9.	Limitations on deductions for foreign income taxes paid	136

E. Tax Credit

1.	Definition of tax credit.....	137
2.	Persons entitled to tax credit	137
3.	Persons not entitled to tax credit.....	137
4.	Distinction between tax deduction and tax credit	138
5.	Meaning of terms	138
6.	Basis of credit for foreign taxes.....	138
7.	Limitations on tax credit	139
8.	Foreign income taxes taken as a deduction	141
9.	Year in which credit may be claimed.....	141
10.	Proof of tax credits.....	142
11.	Conditions for allowance of tax credit	142
12.	Redetermination or adjustment of tax when credit proves incorrect	142

F. Losses

1.	Definition of losses	143
2.	Classification of losses	143
3.	Losses deductible	144
4.	Requisites for deductibility of loss	145
5.	Year to claim deductions for losses.....	145
6.	Closed and completed transaction	146
7.	Where loss compensated for by insurance or other forms of indemnity	147
8.	Where there is reasonable expectation of recovery.....	148
9.	Declaration of casualty loss.....	148
10.	Proof of casualty loss	149
11.	Determination of amount deductible	151
12.	Adjustment of losses	154
13.	Voluntary removal of buildings.....	155
14.	Loss of useful value.....	156
15.	Shrinkage in value of securities.....	157
16.	Securities becoming worthless	158
17.	Wagering losses	159
18.	Abandonment losses in petroleum operations	160
19.	Losses in farming operations	160
20.	Net operating loss carry-over	161
21.	Taxpayers entitled to deduct NOLCO	164
22.	Taxpayers not entitled to deduct NOLCO.....	164
23.	Quarterly and annual availment of NOLCO.....	165
24.	NOLCO in relation to the minimum corporate income tax (MCIT)	165
25.	NOLCO in relation to the Optional Standard Deduction (OSD)	166

G. Bad Debts

1.	Definition of bad debts.....	166
2.	Requisites for deductibility of bad debts	166
3.	Existence of valid and subsisting debt	167
4.	Ascertainment of worthlessness	167
5.	Circumstances affecting worthlessness.....	169
6.	Year in which charge off must be made	170
7.	Amount of debt deductible	170
8.	Deduction by foreign corporations	173
9.	Securities becoming worthless.....	173
10.	Losses from theft or embezzlement	174
11.	Recovery of bad debt previously written-off.....	174
12.	Tax-benefit rule.....	175
13.	Condonation of indebtedness	176

H. Depreciation

1.	Definition of depreciation	177
2.	Necessity and theory of depreciation allowance	177
3.	Persons entitled to claim depreciation allowance.....	177
4.	Requisites for deductibility	179
5.	Reasonableness of allowance.....	179
6.	Depreciable property	180
7.	Assets not subject to depreciation.....	180
8.	Charging off depreciation.....	181
9.	Statement to be attached to return	182
10.	Commencement of depreciation	182
11.	Proper allowance for depreciation	182
12.	Basis of depreciation.....	183
13.	Deductions limited to capital invested	183
14.	Depreciation of intangible property.....	184
15.	Depreciation of patent or copyright	184
16.	Depreciation of drawings and models.....	186
17.	Depreciation of vehicles.....	186
18.	Methods of computing depreciation allowance	188
19.	Adjustments for depreciation	191
20.	Agreement as to useful life on which depreciation rate is based.....	191
21.	Deduction for obsolescence.....	192

I. Depletion

1.	Definition of depletion	192
2.	Theory and purpose of depletion allowance	192
3.	Persons entitled to claim depletion allowance	193
4.	Methods of depletion	193

5.	Allowable cost depletion allowance.....	194
6.	Limitations of allowable cost depletion	195
7.	Manner of computation of cost depletion	196
8.	Determination of mineral content of deposits remaining as of the taxable year.....	197
9.	Accelerated deduction of exploration and development expenditures	199

J. Charitable and Other Contributions

1.	Kinds of charitable contributions	206
2.	Requisites for deductibility	206
3.	Deductible contributions	206
4.	Valuation of donations.....	208
5.	Contributions deductible in full	210
6.	Deductibility of donations	213
7.	Manner of calculation	215
8.	Accreditation	216
9.	Formalities required.....	217
10.	Proof of deductions.....	218
11.	Right of taxpayer to prove contribution without receipt	219

K. Research and Development

1.	In general	219
2.	Amortization of certain research and development expenditures.....	219
3.	Limitations on deduction.....	221

L. Pension Trusts

1.	General rule	221
2.	Requisites for deductibility of payments to pension trusts.....	222
3.	Payments deductible.....	222
4.	Private retirement benefit plan	224
5.	Requisites of a reasonable retirement benefit plan	224

M. Optional Standard Deduction

1.	Option available to taxpayers	226
2.	Other implications of the optional standard deduction.....	227
3.	Determination of OSD for general professional partnership and partners	230

N. Special Deductions

1.	Special rules for deductions	233
2.	Insurance companies	233
3.	Mutual insurance companies	235
4.	Mutual marine insurance companies	235
5.	Assessment insurance companies	236
6.	Estates and trusts	236
7.	Private educational institutions	236

Chapter VI. — Items Not Deductible

1.	General rule	237
2.	Capital expenditures	237
3.	Premiums on life insurance of employees or officers	239
4.	Losses from sales or exchanges of property	239

Chapter VII. — Gains and Losses From Disposition of Property

A. Tax Basis of Property Sold or Exchanged

1.	Measure of gain or loss in general	241
2.	Factors in determining gain or loss	241
3.	Computation of gain or loss.....	242
4.	Basis of property sold or disposed of.....	242
5.	Measure of gain or loss from sale or in exchange of property	243
6.	Gain or loss involving exchange of property	244
7.	Acquisition before to March 1, 1913	244
8.	Acquisition on or after March 1, 1913	246
9.	Readjustment of interest in a general professional partnership	246
10.	Exceptions to the general rule	247

B. Exchanges of Properties in Corporate Readjustments

1.	Definition of terms	248
2.	Non-recognition merely deferred	249
3.	Recognition of gain but not of loss	250
4.	Basis of stock or securities	253

C. Capital Gains and Losses

1.	Classification of assets.....	255
2.	Definition of terms	256
3.	Requisites for recognition of capital gain or loss	257
4.	Kinds of capital asset.....	257
5.	Rules on capital gains or losses of individuals.....	258
6.	Limitation on capital losses	261
7.	Philosophy underlying capital gains and losses.....	263
8.	Rules on capital gains or losses of corporations.....	265
9.	Other capital asset transactions	267
10.	Retirement of bonds.....	267
11.	Gains and losses from short sales	267
12.	Failure to exercise an option.....	269
13.	Securities becoming worthless	269
14.	Distribution in liquidation	270
15.	Taxation of preferred shares surrendered for cancellation or retirement.....	271
16.	Cost and expenses of acquisition and disposition	272

D. Capital Gains Tax on Sale of Real Property

1.	History of the provision	273
2.	Basis of the tax.....	273
3.	Individuals liable to the tax	276
4.	Nature of the tax.....	276
5.	Exemptions from the tax in case of sale of principal residence	281
6.	Filing of capital gains tax return and payment of tax	282
7.	Payment of creditable withholding tax and documentary stamp tax	283
8.	Issuance of Certificate Authorizing Registration/Tax Clearance Certificate	283

E. Dealings in Stocks and Securities

1.	Definition of terms	284
2.	Dealings by a corporation in its own stock.....	285
3.	Sale or retirement of corporate bonds	286
4.	Definition of wash sale	289
5.	Non-deductibility of losses on wash sale	289
6.	Conditions for non-deductibility	289
7.	Meaning of "acquired"	291
8.	Substantially identical stock or securities	291
9.	Treatment of loss on wash sales	291
10.	Basis of stock or securities acquired in wash sales.....	296

9.	Tax on international carriers	382
10.	Tax of offshore banking units	383
11.	Tax on transactions under the expanded foreign currency deposit system.....	383
12.	Dividends received by a nonresident foreign corporation from a domestic corporation	384
13.	Distinctions as to manner of tax computation between domestic and foreign corporations.....	385
14.	Optional standard deduction by corporation.....	385
15.	Minimum corporate income tax on domestic corporations	388
16.	Carry forward of excess minimum corporate income tax.....	389
17.	Relief from the tax under certain conditions.....	390
18.	Definition of terms.....	390
19.	Quarterly and yearly payment of the tax.....	392
20.	Accounting treatment of the excess minimum corporate income tax.....	393
21.	Determination of the minimum corporate income tax for insurance companies	395
22.	MCIT and regular income tax	397

B. Exempt Corporations

1.	Definition of exemption from taxation.....	398
2.	Underlying principles justifying grant of exemption	399
3.	Corporations exempt from income tax.....	399
4.	Characteristics and nature of exempt corporations	400
5.	Tests in determining exemption	408
6.	Inurement of benefit prohibition.....	409
7.	Taxation of exempt organizations	410
8.	Certificate of tax exemption	412

Chapter XI. — Taxation of Partnerships and Partners

1.	Definition of partnership	413
2.	Essential elements of a partnership	413
3.	Classification of partnerships	413
4.	Classification of general partnerships for purposes of taxation.....	414
5.	Tax liability of partnerships and partners	414
6.	Determination of distributive share of partner in net income	416
7.	How distributive shares of partners reported	416
8.	Tax consequences of partnerships considered as corporations	417

9.	Partnership and co-ownership	417
10.	Rules on deductions for GPPs	418
11.	Rules on deposits made by clients and advances made by GPP for expenses.....	418
12.	Rules where deposits/advances received by taxpayers other than GPPs.....	425

Chapter XII. — Taxation of Estates and Trusts

1.	Definition of terms	428
2.	Taxable estates and trusts	429
3.	Gross income of estates and trusts	429
4.	Taxable income of estates and trusts	430
5.	Trust administered in a foreign country	430
6.	Computation of the tax.....	431
7.	Consolidation of income of two or more trusts	431
8.	To whom income of estates and trusts taxable	432
9.	Income received by estates	433
10.	Revocable trusts.....	434
11.	Income for benefit of grantor.....	434
12.	Exemption from tax of employees' trust income	435

Chapter XIII. — Accounting Methods

A. Methods of Accounting

1.	Basic rules	437
2.	General rule and exceptions.....	437
3.	Essential requirements in keeping accounting records.....	438
4.	Methods of accounting	438
5.	Definition of cash basis.....	439
6.	Cash basis taxpayers	439
7.	Exceptions to the cash basis.....	440
8.	Reporting of income by the lessor on improvements made by lessee	440
9.	Constructive receipt of income.....	441
10.	Definition of accrual basis	442
11.	Exceptions to the accrual basis	443
12.	The essence of accrual	443
13.	Rule on deductions under accrual method	444
14.	Definition of hybrid method	445
15.	When hybrid method not applicable.....	445
16.	Definition of crop year basis.....	446
17.	Definition of installment method.....	447
18.	Persons entitled to use installment method.....	448
19.	Definition of terms	449

20.	Installment sales of real property by individuals	449
21.	Filing of returns of installment payments and payment of the tax	450
22.	Deferred payment sale of real property not on installment plan.....	450
23.	Repossession on deferred payment sale	452
24.	Change from accrual to installment method.....	452
25.	Accounting methods for long-term contracts	452
26.	Changes in accounting method	454

B. Inventories

1.	Definition of inventory.....	455
2.	Need for inventories	455
3.	What inventories should include	456
4.	Requirements for use of inventories	456
5.	Consistency in use of inventory	456
6.	Change in inventory method.....	457
7.	Bases of valuation.....	457
8.	Recording of inventories	457
9.	Valuation of particular goods.....	457
10.	Prohibited methods.....	458
11.	Inventories at cost price	459
12.	Inventories at market price/cost	460
13.	Inventories of dealers in securities	460
14.	Inventories of farmers	461
15.	Inventories of miners and manufacturers.....	461
16.	Inventories of retail merchants.....	461

C. Indirect Methods of Determining Income

1.	Definition of tax evasion.....	462
2.	Definition of tax avoidance.....	463
3.	Distinctions between tax evasion and tax avoidance	463
4.	Methods of reconstructing taxpayer's income	463
5.	Benchmarking	464
6.	Percentage method	464
7.	Net worth method explained.....	465
8.	Legality of net worth method	468
9.	Cash expenditures method	468
10.	Bank deposit method	469
11.	Unit and value method	470
12.	Third party information access to records method	471
13.	Other methods of determining unreported income	471

D. Accounting Periods

1.	Definition of accounting period	471
2.	Kinds of accounting period.....	471
3.	General rule and exceptions.....	471
4.	Definition of taxable year	472
5.	Length of taxable year.....	472
6.	Taxpayers under calendar year	473
7.	Taxpayers under the fiscal year basis	473
8.	Returns for less than twelve (12) months period	473
9.	Period in which items of gross income included.....	474
10.	Period for which deductions and credits taken	473
11.	Change of accounting period	473

E. Tax Accounting Among Controlled Taxpayers

1.	Definition of terms	475
2.	Allocation of income and deductions.....	476
3.	Purpose and scope of the law	476
4.	Determination of true net income of controlled taxpayer	477
5.	Transfer pricing guidelines	477

Chapter XIV. — Filing of Returns and Payment of Tax

A. Income Tax Returns

1.	Definition of income tax return.....	479
2.	Classes of income tax returns	479
3.	General requirements of income tax returns	479
4.	Sufficiency of a return	480
5.	Individuals required to file income tax returns	480
6.	Individuals not required to file income tax returns.....	480
7.	Rules on individual returns	481
8.	Date of filing of quarterly income tax return	485
9.	Substituted filing of income tax returns	485
10.	Inspection of individual income tax returns	486
11.	Corporations required to file returns.....	486
12.	Rules on corporation and partnership returns	486
13.	Quarterly income tax return and adjustment return	489
14.	Computation and payment of minimum corporate income tax.....	491
15.	Returns of general professional partnerships	495
16.	Fiduciary returns.....	496

17.	Returns in case of two or more trusts.....	496
18.	Miscellaneous returns	497
19.	Late/out-of-district returns	497
20.	Preparation and submission of financial statements accompanying tax returns	499
21.	Return filed by Commissioner.....	502
22.	Electronic filing and payment system	502
23.	Extension of time to file return.....	504
24.	Disposition of returns	505
25.	Publication of lists of taxpayers and filers	505

B. Payment of Tax

1.	Manual payment	506
2.	Place of payment of tax	508
3.	Rules in the case of large taxpayers	509
4.	Date of payment of tax	511
5.	Late payment of tax under meritorious circumstances	512
6.	Exceptions as regards date of payment.....	513
7.	Termination of taxable period.....	514
8.	Where tax not otherwise collectible from owner of income.....	514
9.	Deductions from income tax shown in return	515
10.	Payment of tax in installments where there are deductions	515

C. Withholding of Income Taxes

1.	Concept of a withholding tax.....	517
2.	Primary reasons for the withholding tax system.....	517
3.	Kinds of withholding of income taxes.....	517
4.	Kinds of withholding tax at source	518
5.	Requisites for withholding tax.....	519
6.	Cases when final withholding tax at source required	519
7.	Cases when creditable withholding tax required	521
8.	Persons required to deduct and withhold creditable withholding tax	522
9.	Obligation imposed upon buyer-payor of income	522
10.	Exemption of seller-payee of income	523
11.	Time of withholding.....	523
12.	Liability of withholding agent.....	524
13.	Exemption from withholding	525
14.	Returns and payments of taxes withheld at source.....	527
15.	Statement to be given to recipient of payment	527
16.	Annual information return.....	528

17.	Income of recipient.....	528
18.	Returns on profits collectible from owner or other person	528
19.	Person entitled to claim for tax credit or refund.....	529
20.	Purpose and scope of withholding on wages	530
21.	Elements of withholding on wages	530
22.	Amounts to be withheld.....	531
23.	Year-end adjustment	532
24.	Liability for tax	532
25.	Statements and returns	533

Chapter XV. — Tax Administration and Procedure

A. Functions and Agencies Involved

1.	Stages and processes	534
2.	Meaning of tax administration	535
3.	Powers of the Bureau of Internal Revenue	535
4.	Powers of the Commissioner	535
5.	Authority of Commissioner to delegate powers vested in him	536
6.	Authority of Commissioner to obtain information, etc	536
7.	Authority of Commissioner to conduct inventory taking surveillance	538
8.	Authority of Commissioner to prescribe presumptive gross sales and receipts	538
9.	Authority of Commissioner to inquire into bank deposit accounts	539
10.	Authority of Commissioner to compromise, abate or cancel tax liability	539
11.	Authority of Commissioner to refund or credit taxes	540
12.	Authority of Commissioner to make assessments	541

B. Assessment of Income Tax

1.	Assessment not generally required	542
2.	When assessment required	543
3.	Definition of assessment	543
4.	Authority to make assessments	544
5.	Requisites for a valid assessment or deficiency tax	544
6.	Nature of assessment	544
7.	Effect of assessment	545
8.	Presumption of correctness	545
9.	Due process requirements in issuance of deficiency tax assessment	546
10.	Protesting of assessment	550
11.	Assessments appealable to the Court of Tax Appeals	552

12.	Finality of assessments	553
13.	Definition of deficiency	554
14.	Prescriptive periods for assessment	557
15.	Rules on waivers of the defense of prescription	558

C. Additions to the Tax

1.	Definition and nature of surcharge.....	559
2.	Definition of delinquency and deficiency	559
3.	Nature of delinquency and deficiency interest.....	559
4.	Payment of surcharge and interest mandatory	560
5.	When surcharge to be imposed	560
6.	When interest to be assessed and collected.....	565
7.	Other additions to the tax	572

D. Collection of Income Tax

1.	Judicial proceedings not essential	573
2.	Remedies available to the government.....	573
3.	Meaning of distraint	574
4.	Kinds of distraint.....	574
5.	Meaning of levy (on real property).....	574
6.	How levy effected	574
7.	Meaning of forfeiture	575
8.	How remedy of forfeiture enforced.....	575
9.	Meaning of tax lien	575
10.	Extent and nature of tax lien	575
11.	Requiring the filing of bonds	576
12.	Making arrest, search, and seizure	576
13.	Deportation of aliens	576
14.	Inspection of books of accounts	577
15.	Prescribing real property values.....	577
16.	Judicial action	578
17.	Criminal action as a remedy	578
18.	Prescriptive periods for collection	579
19.	When period of limitations interrupted.....	580
20.	Purpose of periods of limitation	580

E. Crimes and Other Offenses

1.	Generally.....	581
2.	Attempt to evade or defeat tax.....	582
3.	Failure to file return, supply information, keep record, pay, withhold, remit, and refund tax	582
4.	Penal liability of corporations	582
5.	Penal liability for making false entries, records, or reports	583

6.	Exhibition of notice of place of business	584
7.	Failure to obey summons	585
8.	Declaration under penalties of perjury.....	585
9.	Violations committed by government enforcement officers	586
10.	Other penal provisions	587
Index		588

— oOo —