The Tax System of the Philippines

I. Personal Income Tax

1. Who are Liable?

General Treatment of Taxation of Individuals

Under Section 23 of the National Internal Revenue Code of the Philippines (NIRC), as amended, the general principles of income taxation concerning individuals are as follows:

1.) A citizen of the Philippines residing therein is taxable on all income derived from sources within and without the Philippines;
2.) A non-resident citizen is taxable only on income derived from sources within the Philippines;
3.) 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; and
4.) An alien individual, whether a resident or not of the Philippines, is taxable only on income derived from sources within the Philippines.

The term non-resident citizen is defined under Section 22(E) of the NIRC as:

a) A citizen of the Philippines who establishes to the satisfaction of the Commissioner the fact of his physical presence abroad with a definite intention to reside therein; or
b) A citizen of the Philippines who leaves the country during the taxable year to reside abroad, either as an immigrant or for employment on a permanent basis; or
c) A citizen of the Philippines who works and derives income from abroad and whose employment theretofore requires him to be physically present abroad most of the time during the taxable year; or
d) A citizen who has been previously considered as non-resident 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.

For this purpose, the taxpayer shall submit proof to the Commissioner to show his intention of leaving the Philippines to reside permanently abroad or to return to and reside in the Philippines as the case may be.

2. Income Subject to Tax

As explicitly provided under the NIRC, Taxable Income refers to the pertinent items of gross income, less the deductions and/or personal and additional exemptions, if any, authorized for such types of income by the NIRC or other special laws.

Under Section 32(A), Gross Income means all income derived from whatever source, including (but not limited to) the following items:

a) Compensation for services in whatever form paid, including, but not limited to fees, salaries, wages, commissions, and similar items;
b) Gross income derived from the conduct of trade or business or the exercise of a profession;
c) Gains derived from dealings in property;
d) Interests;
e) Rents;
f) Royalties;
g) Dividends;
h) Annuities;
i) Prizes and winnings;
j) Pensions; and
k) Partner's distributive share from the net income of the general professional partnership.

3. Capital Gains

**Capital Gains Tax** is a tax imposed on the gains earned or presumed to have been realized by the seller from the sale, exchange, or other disposition of capital assets located in the Philippines, including pacto de retro sales and other forms of conditional sale.

There are two (2) types of capital gains tax under the Philippine Tax System:

1.) **Capital Gains from Sale of Shares of Stock not Traded in the Stock Exchange.**

A final tax at the rates prescribed below is imposed upon the net capital gains realized during the taxable year from the sale, barter, exchange or other disposition of shares of stock in a domestic corporation, except shares sold or disposed of through the stock exchange:

- Not over P100,000.00 - five percent (5%) final tax
- Amount in excess of P100,000.00 - ten percent (10%)

2.) **Capital Gains from Sale of Real Property.**

A final tax of six percent (6%) is imposed on the gain presumed to have been realized on the sale, exchange, or disposition of real property located in the Philippines which are not actually used in the trade or business and are treated 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 by the Commissioner of the Bureau of Internal Revenue or as shown in the schedule of values of the Provincial and City Assessors), whichever is higher.

However, capital gains from the sale or disposition of a principal residence, the proceeds of which is fully utilized in acquiring or constructing a new principal residence within eighteen (18) calendar months from the date of sale or disposition, shall be exempt from the capital gains tax.

4. Taxation of Employer-Provided Stock Option

A stock option granted by an employer is an incentive to an employee carrying a right to buy a certain amount of shares in the employer company at a predetermined price, usually at lower than the market price of the shares. Considering that a stock option grant does not give an outright benefit to an employee but merely a right to exercise the option, the act of granting a stock option is not taxable. However, the exercise of the stock option at a price lower than the market value of the shares of stock gives rise to a taxable event for the person exercising the option. In reality, the price at which the stock is purchased is not at exercise price but at market value, and that the difference between the market value and the exercise price is borne by the employer, for the benefit of its employee exercising the option. Hence, such employee actually receives a benefit from the employer to the extent of the difference between the market value
of, and the exercise price paid by the employees for the stocks. The benefit shall be considered as additional taxable compensation income.

5. Deduction

Under Section 34 of the NIRC, except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationships where the only deduction provided that the gross family income does not exceed P250,000 per family is the premium payment on health and/or hospitalization insurance, a taxpayer may opt to avail any of the following allowable deductions from gross income:

a.) Optional Standard Deduction - An amount not exceeding 40% of the gross sales or gross receipts shall be allowed as deduction in lieu of the itemized deduction. This type of deduction shall not be allowed for non-resident aliens engaged in trade or business. An individual who opts to avail of this deduction need not submit the Account Information Return (AIF)/Financial Statements; or

b.) Itemized Deductions - There shall be allowed as deduction from gross income all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on or which are directly attributable to, the development, management, operation and/or conduct of the trade, business or exercise of a profession including a reasonable allowance for salaries, travel, rental and entertainment expenses.

Itemized deductions include also interest, taxes, losses, bad debts, depreciation, depletion, charitable and other contributions, research and development, pension trust, premium payments on health and/or hospitalization insurance.

In addition, under Section 35, individuals who are either earning compensation income, engaged in business or deriving income from the practice of profession are entitled to personal and additional exemptions as follows:

a.) Personal Exemptions

For single individual or married individual judicially decreed as legally separated with no qualified dependents……………………..P 50,000.00
For head of family……………………………………………………………….P 50,000.00
For each married individual ……………………………………….P 50,000.00

In case of married individuals where only one of the spouses is deriving gross income, only such spouse will be allowed to claim the personal exemption.

b.) Additional Exemptions

For each qualified dependent, a P25,000.00 additional exemption can be claimed but only up to four (4) qualified dependents. The additional exemption can be claimed by the husband who is deemed the head of the family, unless he explicitly waives his right in favor of his wife, or by the spouse who has custody of the child or children in case of legally separated spouses.

The maximum amount of P2,400.00 premium payments on health and/or hospitalization insurance can be claimed if the family gross income yearly is not more than P250,000. For married individuals, the spouse claiming the additional exemptions for the qualified dependents shall be the one entitled to this deduction.
6. Rates

The individual income tax derived from compensation, business, trade or exercise of profession shall be computed in accordance with and at the rates established in the following schedule:

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

For married individuals, the husband and wife shall compute separately their individual income tax based on their respective total taxable income. If any income cannot be definitely attributed to or identified as income exclusively earned or realized by either of the spouses, the same shall be divided equally between the spouses for the purpose of determining their respective taxable income.

The income tax payable by individuals shall be computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Income</td>
<td>P ___________</td>
</tr>
<tr>
<td>Less: Allowable Deductions (Itemized or Optional)</td>
<td>___________</td>
</tr>
<tr>
<td>Net Income</td>
<td>P ___________</td>
</tr>
<tr>
<td>Less: Personal &amp; Additional Exemptions</td>
<td>___________</td>
</tr>
<tr>
<td>Net Taxable Income</td>
<td>P ___________</td>
</tr>
<tr>
<td>Multiply by Tax Rate (5 to 32%)</td>
<td>___________</td>
</tr>
<tr>
<td>Income Tax Due</td>
<td>P ___________</td>
</tr>
</tbody>
</table>

A final tax is imposed on the following classes of passive income derived from sources within the Philippines:

(a) 20% final tax on royalties (except on books, as well as other literary works and musical compositions which shall be subject to 10% final tax;
(b) 20% final tax on interest on bank deposits and yield or any other monetary benefit from deposit substitutes and trust funds and similar arrangements
(c) 7.5% final tax on interest under the expanded foreign currency deposit system
(d) Interest income for long term deposit or investment in the form of savings, common or individual trust funds, deposit substitutes, investment management accounts and other evidences by certificates in such form prescribed by the Bangko Sentral ng Pilipinas shall be exempt from tax, however, should the holder of the certificate preterminate 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 depositary bank from the proceeds of the long-term deposit or investment certificate based on the remaining maturity thereof:
   For less than 3 years ....................... 20%
   For 3 years to less than 4 years ..........12%
   For 4 years to less than 5 years ..........5%
(e) 20% final tax on prizes (except prizes amounting to P10,000.00 or less which shall be subject to ordinary graduated tax rates)
(f) Interest from long term deposits (5 years or more)
(g) 10% final tax on cash and/or property dividends actually and constructively received from a domestic corporation or joint stock company, insurance or mutual fund companies, regional operating headquarters of a multinational company, or on the share of an individual in the distributable net income after tax of a partnership (except a general professional partnership), association, joint account, or a joint venture or consortium taxable as a corporation.

(h) ½ of 1% stock transaction tax for sale of shares of stock of domestic corporations listed in and sold through, the local stock exchange.

7. Tax Filing and Payment Procedure

The Income Tax Return of individuals liable for income tax is required to be filed in triplicate (two copies for the Bureau of Internal Revenue and one copy for the taxpayer) with the Authorized Agent Bank (AAB) of the place where taxpayer is registered or required to be registered. In places where there are no AABs, the return shall be filed directly with the Revenue Collection Officer or duly Authorized Treasurer of the city or municipality in which such person has his legal residence or principal place of business in the Philippines, or if there is none, the filing of the return shall be made at the Office of the Commissioner.

The return of any individual shall be filed on or before the fifteenth (15th) day of April of each year covering income for the preceding taxable year.

For individuals subject to tax on capital gains, filing of the returns shall be as follows:

a.) For the sale or exchange of shares of stock not traded thru a local stock exchange, return shall be filed within thirty (30) days after each transaction and a final consolidated return on or before April 15 of each year covering all stock transactions of the preceding taxable year; and

b.) For the sale or disposition of real property classified as capital asset, return shall be filed within thirty (30) days following each sale or other disposition.

Married individuals, whether citizens, resident or non-resident aliens, who do not derive income purely from compensation, shall file a return for the taxable year to include the income of both spouses, but where it is impracticable for the spouses to file one return, each spouse may file a separate return of income but the returns so filed shall be consolidated by the Bureau for purposes of verification for the taxable year.

8. Tax Treaties

The Philippines has thirty-seven (37) effective tax treaties. The following tax treaties and their dates of effectivity as as follows:

<table>
<thead>
<tr>
<th>Country</th>
<th>Date of Effectivity</th>
<th>Date and Venue of Signature</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Australia</td>
<td>January 1, 1980</td>
<td>May 11, 1979, Manila, Philippines</td>
</tr>
<tr>
<td>2. Austria</td>
<td>January 1, 1983</td>
<td>April 4, 1981, Vienna, Austria</td>
</tr>
<tr>
<td>5. Belgium</td>
<td>January 1, 1981</td>
<td>October 2, 1976, Manila, Philippines</td>
</tr>
<tr>
<td>7. Canada</td>
<td>January 1, 1977</td>
<td>March 11, 1976, Manila, Philippines</td>
</tr>
<tr>
<td>8. China</td>
<td>January 1, 2002</td>
<td>November 18, 1999, Beijing, China</td>
</tr>
</tbody>
</table>
Income taxes imposed by the domestic laws of the Contracting States, including substantially similar taxes that may be imposed later, in addition to, or in place, are covered by the tax treaties. In the Philippines, this is generally limited to Title II (Tax on Income) of the NIRC, as amended.

II. Corporate Income Tax

1. Income Subject to Tax

The income of corporations, no matter how created or organized, including partnerships, is subject to income tax. Domestic corporations receiving income from sources within and outside the Philippines, foreign corporations receiving income from sources within the Philippines and taxable partnerships are required to file income tax returns. The return shall be filed, with the tax payment, on or before the 15th day of the fourth month following the close of the taxpayer's
taxable year. The return shall be filed with any Authorized Agent Bank (AAB) located within the territorial jurisdiction of the Revenue District Office where the taxpayer is required to register/which has jurisdiction over the location of the principal office of the “Corporation” filing the return.

**Normal Rate of Income Tax**

The regular rates of corporate income tax are as follows:

- **January 1 to October 31, 2005**: 32%
- **November 1, 2005 to December 31, 2008**: 35%
- **January 1, 2009 and onwards**: 30%

**Allowable Deductions**

A corporation has the options of choosing either the itemized or optional standard deduction. It shall indicate the choice by marking with “X” the appropriate box in the corporate income tax return, otherwise, the corporation shall be considered as having availed of the itemized deduction. The choice made in the return is irrevocable for the taxable year for which the return is made.

**Optional Standard Deduction (OSD)** – A maximum of 40% of the gross income shall be allowed as deduction in lieu of the itemized deduction. However, a corporation who availed and claimed the optional standard deduction is still required to submit its financial statements when it files its annual tax return and to keep such records pertaining to its gross income.

For purposes of the OSD, the term “gross income” derived from business shall be equivalent to gross sales less sales returns, discounts and allowances and cost of goods sold. “Cost of goods sold” shall include all business expenses directly incurred to produce the merchandise to bring them to their present location and use.

For a trading or merchandising concern, “cost of goods” sold shall include the invoice cost of the goods sold, plus import duties, freight in transporting the goods to the place where the goods are actually sold, including insurance while the goods are in transit.

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

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

**Itemized Deduction** – There shall be allowed as deduction from gross income all the ordinary and necessary trade and business expenses paid or incurred during the taxable year in carrying on or which are directly attributable to the development, management, operation and/or conduct of the trade and business. Itemized deduction includes also interest, taxes, losses, bad debts, depreciation, depletion, charitable and other contributions, research and development and pension trust.

**Minimum Corporate Income Tax**

A minimum corporate income tax (MCIT) of two percent (2%) of the gross income is imposed upon any domestic corporation and resident foreign corporation beginning the 4th taxable year (whether calendar or fiscal year, depending on the accounting period employed) immediately
following the taxable year in which such corporation commenced its business operation. The MCIT shall be imposed whenever the corporation has zero or negative taxable income or whenever the amount of minimum corporate income tax is greater than the normal income tax due from such corporation. Any excess of the MCIT over the normal income tax shall be carried forward and credited against the normal income tax for the three (3) immediate succeeding taxable years.

2. Asset Depreciation

Depreciation is the gradual diminution of the useful value of tangible property resulting from wear and tear and normal obsolescence. The term is also applied to amortization of the value of intangible assets (i.e., patents), the use of which in the trade or business is definitely limited in duration.

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. The rationale for this is that property gradually approaches a point where its usefulness is exhausted. The period of depreciation starts when the asset is placed in service and ends when the asset is disposed of, or its usefulness exhausted.

Requisites for Deductibility:

1. The allowance for depreciation must be for property arising out of its use in the trade or business.
2. The asset must have a limited useful life.
3. The allowance for depreciation must be reasonable.
4. The allowance must be charged off during the taxable year from the taxpayer’s books of accounts.
5. The total allowances must not exceed the cost of the property.

Methods and Rates of Depreciation

The determination of the reasonable allowance of deductible depreciation may be made by the use of the following methods:

1. **Straight-line method**
   The depreciation expense deductible in each of the years of the property’s estimated useful life is constant.
   Formula:
   \[
   \text{Deduction for Depreciation} = \frac{\text{Cost} - \text{Salvage Value}}{\text{Estimated Useful Life of the Property}} \times \text{Cost} - \text{Salvage Value}
   \]
   \[
   \text{NOTE: (Cost} - \text{Salvage Value) is known as the depreciable cost.}
   \]
   Alternative Method:
   \[
   \text{Depreciation Rate} = \frac{1}{\text{Estimated Useful Life of the Property}}
   \]
   \[
   \text{Deduction for Depreciation} = \text{Depreciation Rate} \times (\text{Cost} - \text{Salvage Value})
   \]

2. **Declining-balance method, using a rate not exceeding twice the rate for straight line method**
   Under this method, the depreciation allowance per year varies. Depreciation is largest in the first year and continually decreases towards the end of the useful life of the property. The depreciation rate under the straight-line method is first computed, and the result is multiplied with the rate relative to the straight-line method rate. The product (the “declining
balance rate”) is then multiplied to the yearly declining balance of the property (i.e., book value of the property at the start of the current year, which is equal to its original cost minus its accumulated depreciation) to determine the deduction for depreciation for the current year. However, in the last year of the asset’s estimated life, the depreciation is equal to the book value of the property at the start of that year (i.e., the amount of depreciation must be just enough to reduce the property’s book value to zero). Note that the salvage value is ignored in the declining balance method.

3. **Sum-of-the-years-digit method**
   Under this method, the annual depreciation is computed by applying a changing fraction to the depreciable cost of the property (original cost reduced by the salvage value). In the fraction, the numerator is the number of remaining years of the estimated useful life of the property and the denominator is the sum of the numbers representing the years of the property’s life.

4. **Any other method which may be prescribed by the Secretary of Finance upon recommendation of the Commissioner**

**Special Rules:**

- **Depreciation of Properties Used in Petroleum Operations** –
  - An allowance for depreciation in respect of all properties directly related to production of petroleum shall be allowed under the straight-line or declining-balance method of depreciation at the option of the service contractor. However, if the service contractor initially elects the declining-balance method, it *may shift* to the straight-line method. The useful life of properties used in or related to production of petroleum shall be ten (10) years or such shorter life as may be permitted by the Commissioner.
  - Properties not used directly in the production of petroleum shall be depreciated under the straight-line method on the basis of an estimated useful life of five (5) years.

- **Depreciation of Properties Used in Mining Operations** – An allowance for depreciation in respect of all properties used in mining operations other than petroleum operations, shall be computed as follows:
  - At the normal rate of depreciation *if the expected life is ten (10) years or less*; or
  - Depreciated over any number of years between five (5) years and the expected life *if the latter is more than ten (10) years*, and the depreciation thereon allowed as deduction from taxable income: Provided, that the contractor notifies the Commissioner at the beginning of the depreciation period which depreciation rate allowed will be used.

- **Depreciation Deductible by Nonresident Aliens Engaged in Trade or Business (NRAETB) or Resident Foreign Corporations (RFC)** - A reasonable allowance for the deterioration of property arising out of its use or employment or its non-use in the business, trade or profession shall be permitted only when such property is located in the Philippines.

3. **Royalties and Technical Assistance**

Under Chapter IV – Tax on Corporations of the NIRC, a final tax at the rate of 20% is imposed upon the amount of interest on currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements received by domestic corporations and resident foreign corporations, and *royalties*, derived from sources within the Philippines. However, any interest income derived by a domestic corporation from a depository
bank under the expanded foreign currency deposit system shall be subject to a final income tax at the rate of 7 1/2% of such interest income.

The Philippine Tax System, however, treats non-resident foreign corporations differently. A final tax of 35% of the gross income received by a non-resident foreign corporation 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.

Under Section 22 of the NIRC, a Domestic Corporation is one created or organized in the Philippines or under its laws, while a Foreign Corporation is one that is not domestic. A Foreign Corporation may be a resident foreign corporation or a non-resident foreign corporation. A Resident Foreign Corporation is one that is engaged in trade or business within the Philippines and a Non-resident Foreign Corporation is one not engaged in trade or business within the country.

A non-resident foreign cinematographic film owner, lessor, or distributor is liable to pay a tax of 25% of its gross income from all sources within the Philippines. A non-resident foreign owner or lessor of vessels is subject to a tax of 4 ½ % of gross rentals, lease or charter fees from leases or charters to Filipino citizens or corporations, as approved by the Maritime Industry Authority. Rentals, charters and other fees derived by a non-resident foreign lessor of aircraft, machineries and other equipment is subject to a tax of 7 ½ % of gross rentals or fees.

4. Management Assistance

Any profit remitted by a branch to its foreign head office shall be subject to a branch profit remittance tax of 15% which shall be based on the total profits applied or earmarked for remittance without any deduction for the tax component thereof (except those activities which are registered with the Philippine Economic Zone Authority). The branch profit remittance tax shall be withheld at source by the branch: provided, that interests, dividends, rents, royalties, including remuneration for technical services, salaries, wages premiums, annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits, income and capital gains received by a foreign corporation during each taxable year from all sources within the Philippines shall not be treated as branch profits unless the same are effectively connected with the conduct of its trade or business in the Philippines.

The branch profit remittance tax is 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. The branch profit remittance tax is imposed only on the profits remitted by a Philippine branch to the head office of a foreign corporation. Should the branch of a domestic corporation remit profits to its head office, the transaction is not subject to the branch profit remittance tax.

On the issue of taxability of dividends, those received by a domestic corporation or by a resident foreign corporation from a domestic corporation shall not be subject to tax. On the other hand, a final withholding tax at the rate of 15% is imposed on the amount of cash and/or property dividends received by a non-resident foreign corporation from a domestic corporation. However, such 15% tax is only applicable if the country in which the non-resident foreign corporation is domiciled allows a credit against the tax due from the non-resident foreign corporation taxes deemed to have been paid in the Philippines equivalent to 15%, which represents the difference between the regular income tax of 30% on corporations and the 15% tax on dividends.

5. Permanent Establishment
**Permanent Establishment** is defined as a fixed place of business through which the business of the enterprise is wholly or partly carried on. The concept of permanent establishment is used to determine the rights of a Contracting State to tax the business profits of enterprises of the other Contracting State. Under this concept, profits of an enterprise of a Contracting State are not taxable by the other Contracting State, unless the enterprise carries on business through a permanent establishment situated in the other Contracting State.

The business profits of a resident of a Contracting State are not be taxable in the Philippines unless an enterprise of a resident of a Contracting State carries on business in the Philippines through a permanent establishment.

A list of places, circumstances, and activities which constitute a permanent establishment is provided under the different tax treaties which the Philippines has with other countries. Any inquiries about the effective Philippine Tax Treaties may be directed to the International Tax Affairs Division of the Bureau of Internal Revenue.

6. Representative Office

A **Representative Office** is merely an extension of the corporate personality of the foreign head office in the Philippines. It does not possess a separate personality, thus the foreign head office may be held liable for the obligations that the representative office may incur. It is legally allowed to disseminate information to the customers of the head office, to promote the company’s products and to facilitate the quality control of its products. However, it cannot derive income from its operations within the Philippines.

Although fully subsidized by its head office, a Representative Office is required to have a capitalization of at least USD30,000.00 as a requisite for registration with the Securities and Exchange Commission. It is not liable for income taxes, as well as value added tax, because it cannot derive income from sale of goods or services within the Philippines.

III. Value Added Tax

1. Tax Rate

The Value-added tax (VAT) is a tax on the value added by every seller (with aggregate annual sales of articles and/or services exceeding P1.5M) to his purchase of goods and services, and a tax on the importation of goods, unless the transaction is exempt.

The taxpayer (the seller) determines his tax liability by computing the tax on the gross selling price or gross receipt (this is called the “output tax”), and subtracting or crediting the earlier VAT on the purchase or importation of goods or on the sale of service (called the “input tax”) against the tax due on his own sale.
The following shows the basic formula for the computation of the VAT Payable:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross taxable sales</td>
<td>xxx</td>
</tr>
<tr>
<td>Less: Sales returns</td>
<td>xxx</td>
</tr>
<tr>
<td>Sales allowances</td>
<td>xxx</td>
</tr>
<tr>
<td>Sales discounts</td>
<td>xxx (xxx)</td>
</tr>
<tr>
<td>Net sales</td>
<td>xxx</td>
</tr>
<tr>
<td>Output tax (12% of Net sales)</td>
<td>xxx</td>
</tr>
<tr>
<td>Input tax carried over from previous period</td>
<td>xxx</td>
</tr>
<tr>
<td>Domestic purchases</td>
<td>xxx</td>
</tr>
<tr>
<td>Importations</td>
<td>xxx</td>
</tr>
<tr>
<td>Total</td>
<td>xxx</td>
</tr>
<tr>
<td>Input tax (12% of Total)</td>
<td>xxx</td>
</tr>
<tr>
<td>Total Input tax</td>
<td>(xxx)</td>
</tr>
</tbody>
</table>

Under the Philippine Tax System, the following are the transactions subject to value added tax:

a.) Any sale, barter or exchange of goods and properties, or similar transactions in the course of trade or business;
b.) Any sale of services, or similar transactions, in the course of trade or business;
c.) Any lease of goods and properties or similar transactions, in the course of trade or business; and
d.) Any importation of goods, whether or not in the course of trade or business.

Section 105 of the NIRC clarifies that 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.

VAT RATES

A. Subject to Regular VAT of 12%

1. Every sale, barter or exchange of goods, or properties is subject to VAT equivalent to 12% of the gross selling price or gross value in money of the goods or properties sold, bartered, or exchanged;
2. Every importation of goods is subject to VAT equivalent to 12% based on the total value used by the Bureau of Customs in determining tariff and customs duties, plus customs duties, excise taxes, if any, and other charges;
3. Every sale or exchange of services, including use or lease of properties, is subject to VAT 12% of gross receipts derived from the sale or exchange of services.

The term “gross selling price” means 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 term “gross receipts”
means 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.

B. Subject to 0% VAT

A zero-rated sale by a VAT-registered person is a taxable transaction for VAT purposes, but shall not result in any output tax. However, the input tax on purchases of goods, properties or services related to such zero-rated sale shall be available as tax credit or refund.

1. Export Sales. - The term 'export sales' means:
   a.) The sale and actual shipment of goods from the Philippines to a foreign country, irrespective of any shipping arrangement that may be agreed upon which may influence or determine the transfer of ownership of the goods so exported 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 Bangko Sentral ng Pilipinas (BSP);
   b.) 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;
   c.) Sale of raw materials or packaging materials to export-oriented enterprise whose export sales exceed seventy percent (70%) of total annual production;
   d.) Sale of gold to the BSP;
   e.) Those considered export sales under Executive Order No. 226, otherwise known as the Omnibus Investment Code of 1987, and other special laws; and
   f.) The sale of goods, supplies, equipment and fuel to persons engaged in international shipping or international air transport operations.

2. Foreign Currency Denominated Sale. - The term "foreign currency denominated sale" means sale to a nonresident of goods, 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.

3. 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.

C. Subject to Final Withholding VAT

The Government or any of its political subdivisions, instrumentalities or agencies, including government-owned or -controlled corporations (GOCCs) shall, before making payment on account of each purchase of goods and services which are subject to the value-added, deduct and withhold a final value-added tax at the rate of 5% of the gross payment thereof: Provided, That the payment for lease or use of properties or property rights to non-resident owners shall be subject to ten percent (10%) withholding tax at the time of payment.

D. VAT Exempt Transactions

VAT-exempt transactions refer to the 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 transaction is not subject to VAT.

1. Sale or importation of agricultural and marine food products in their original state;
2. Sale or importation of fertilizers; seeds, seedlings and fingerlings; fish, prawn, livestock and poultry feeds, including ingredients, whether locally produced or imported, used in the manufacture of finished feeds (except specialty feeds for race horses, fighting cocks, aquarium fish, zoo animals and other animals considered as pets);
3. Importation of personal and household effects belonging to residents of the Philippines returning from abroad and non-resident citizens coming to resettle in the Philippines;
4. Importation 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, accompanying such persons, or arriving within ninety (90) days before or after their arrival;
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;
8. Educational services rendered by private educational institutions duly accredited by the Department of Education, the Commission on Higher Education, the Technical Education and Skills Development Authority, and those rendered by the government educational institutions;
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;
11. Transactions which are exempt under international agreements to which the Philippines is a signatory or under special laws;
12. Sales by agricultural cooperatives duly registered and in good standing with the Cooperative Development Authority (CDA) to their members;
13. Gross receipts from lending activities by credit or multi-purpose cooperatives duly registered and in good standing with the CDA;
14. Sales by non-agricultural, non-electric and non-credit cooperatives duly registered with and in good standing with CDA;
15. Export sales by persons who are not VAT-registered;
16. The following sales of real properties:
   a) Sale of real properties not primarily held for sale to customers or held for lease in the ordinary course of trade or business;
   b) 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;
   c) Sale of real properties utilized for specialized housing as defined under RA No. 7279, and other related laws, such as RA No. 7835 and RA No. 8763, wherein price ceiling per unit is P225,000.00;
   d) Sale of residential lot valued at P1,500,000.00 and below, or house and lot and other residential dwellings valued at P2,500,000.00 and below where the instrument of sale/transfer/disposition was executed on or after July 1, 2005.
17. Lease of residential units with a monthly rental per unit not exceeding P10,000.00, regardless of the amount of aggregate rentals received by the lessor during the year;
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; Provided, that the exemption from VAT on the importation and local purchase of passenger and/or cargo vessels shall be limited to those of one hundred fifty (150) tons and above, including engine and spare parts of said vessels;
20. Importation of life-saving equipment, safety and rescue equipment and communication and navigational safety equipment, steel plates and other metal plates including marine-grade aluminum plates, used for shipping transport operations;
21. Importation of capital equipment, machinery, spare parts, life-saving and navigational equipment, steel plates and other metal plates including marine-grade aluminum plates to be used in the construction, repair, renovation or alteration of any merchant marine vessel operated or to be operated in the domestic trade;
22. Importation of fuel, goods and supplies engaged in international shipping or air transport operations;
23. Services of banks, non-bank financial intermediaries performing quasi-banking functions, and other non-bank financial intermediaries; and
24. 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 P1,500,000.00.

2. Export of Service

The Philippine Tax System treats the following services in the same manner as export transactions subject to 0% VAT:

a. 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;
b. Services other than processing, manufacturing or repacking rendered to a person engaged in business conducted outside the Philippines or to a non-resident person 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;
c. 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 0% rate;
d. Services rendered to persons engaged in international shipping or air transport operations, including leases of property for use thereof;
e. Services performed by subcontractors and/or contractors in processing, converting, or manufacturing goods for an enterprise whose export sales exceeds 70% of total annual production;
f. Transport of passengers and cargo by domestic air or sea carriers from the Philippines to a foreign country; and
g. Sale of power or fuel generated through renewable sources of energy such as, but not limited to, biomass, solar, wind, hydropower, geothermal and steam, ocean energy, and other shipping sources using technologies such as fuel cells and hydrogen fuels.

3. Import of Service

The Philippine Tax System only recognizes importation of goods, not of services, which is subject to value added tax. The situs of VAT for sale of services is the place where the service is rendered. Therefore, if services have been rendered outside of the territorial jurisdiction of the Philippines then it cannot be subject to VAT for it is clearly outside the country’s taxing authority. For services to be subject to VAT, the NIRC explicitly shows that it must be rendered in the course of trade or business arising in the domestic market and not abroad.
IV. Customs

All articles, when imported to the Philippines, are subject to duty upon each importation, even though previously exported there except as otherwise specifically provided for in the Tariff and Customs Code, as amended, or in other laws.

Importation begins when the carrying vessel or aircraft enters the jurisdiction of the Philippines with the intention to unlade therein. Importation is deemed terminated upon payment of the 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 Customs.

Section 105 of the Tariff and Customs Code of the Philippines as amended by Executive Order No. 206 provides duty and tax free privileges to the following individuals, the extent of which depends on their particular status:

1. Returning Resident - a Filipino national who has gone abroad and is now returning.
2. Overseas Filipino Worker (OFW) - a Filipino national who worked in a foreign country under an employment contract.
3. Former Filipino - a Filipino national who has acquired foreign citizenship abroad and is now returning.

Basis of Dutiable Value

(A) Method One. – Transaction Value. - The dutiable value of an imported article subject to an ad valorem rate of duty shall be the transaction value, which shall be the price actually paid or payable for the goods when sold for export to the Philippines.

(B) Method Two. – Transaction Value of Identical Goods. – Where the dutiable value cannot be determined under method one, the dutiable value shall be the transaction value of identical goods sold for export to the Philippines and exported at or about the same time as the goods being valued.

(C) Method Three. – Transaction Value of Similar Goods. – Where the dutiable value cannot be determined under the preceding method, the dutiable value shall be the transaction value of similar goods sold for export to the Philippines and exported at or about the same time as the goods being valued.

(D) Method Four. – Deductive Value. – The dutiable value of the imported goods under this method shall be the deductive value which shall be based on the unit price at which the imported goods or identical or similar imported goods are sold in the Philippines, in the same condition as when imported, in the greatest aggregate quantity, at or about the time of the importation of the goods being valued, to persons not related to the persons from whom they buy such goods.

(E) Method Five. – Computed Value. – The dutiable value under this method shall be the computed value which shall be the sum of:

(1) The cost or the value of materials and fabrication or other processing employed in producing the imported goods;
(2) The amount for profit and general expenses equal to that usually reflected in the sale of goods of the same class or kind as the goods being valued which are made by producers in the country of exportation for export to the Philippines;
(3) The freight, insurance fees and other transportation expenses for the importation of the goods;
(4) Any assist, if its value is not included under paragraph (1); and
(5) The cost of containers and packing, if their values are not included under paragraph (1).

(F) **Method Six. – Fallback Value.** – If the dutiable value cannot be determined under the preceding methods described above, it shall be determined by using other reasonable means and on the basis of data available in the Philippines.

## V. Local Tax

Under Article X, Section 5 of the 1987 Philippine Constitution, the power to tax is no longer vested exclusively on Congress; local legislative bodies were given direct authority to levy taxes, fees and other charges, viz:

"Section 5. — Each Local Government unit shall have the power to create its own sources of revenue, to levy taxes, fees and charges subject to such guidelines and limitations as the Congress may provide, consistent with the basic policy of local autonomy. Such taxes, fees and charges shall accrue exclusively to the Local Governments."

This paradigm shift results from the realization that genuine development can be achieved only by strengthening local autonomy and promoting decentralization of governance, which resulted to the creation of the Local Government Code of 1991. Under Section 132 of the Local Government Code, the power to impose a tax, fee, or charge or to generate revenue shall be exercised by the sanggunian of the local government unit concerned through an appropriate ordinance.

The following are the local taxes imposed by the local government units:

<table>
<thead>
<tr>
<th>TYPE OF TAX</th>
<th>PROVINCE</th>
<th>MUNICIPALITY</th>
<th>CITY</th>
<th>BARANGAY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sec. 135 – Tax on Transfer of Real Property Ownership</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Sec. 136 – Tax on Business of Printing and Publication</td>
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<tr>
<td>Sec. 137 – Franchise Tax</td>
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<tr>
<td>Sec. 138 – Tax on Sand, Gravel and Other Quarry Resources</td>
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<tr>
<td>Sec. 139 – Professional Tax</td>
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<td>Sec. 140 – Amusement Tax</td>
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<tr>
<td>Sec. 141 – Annual Fixed Tax For Every Delivery Truck or Van of Manufacturers or Producers, Wholesalers of, Dealers, or Retailers in, Certain Products</td>
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<tr>
<td>Sec. 143 – Tax on Business</td>
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<tr>
<td>Sec. 147 – Fees and charges on regulation/licensing of business and occupation (except professional taxes)</td>
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<tr>
<td>Sec. 148 – Fees for Sealing and Licensing of Weights and Measures</td>
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<tr>
<td>Sec. 149 – Fishery Rentals, Fees and Charges</td>
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<td>Description</td>
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<tr>
<td>Sec. 156 – Community Tax</td>
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<td>Sec. 152(a) – Tax on Gross Sales or Receipts of Small-Scale Stores/Retailers</td>
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<td>Sec. 152(b) – Service Fees on the use of Barangay-owned properties</td>
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<td>Sec. 152(c) – Barangay Clearance</td>
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<td>Sec. 152(d) – Other Fees and Charges (on commercial breeding of fighting cocks, cockfights, cockpits; places of recreation which charge admission fees; outside ads)</td>
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<tr>
<td>Sec. 153 – Service Fees and Charges</td>
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<tr>
<td>Sec. 154 – Public Utility Charges</td>
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<tr>
<td>Sec. 155 – Toll Fees or Charges</td>
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<tr>
<td>Sec. 232 – Real Property Tax</td>
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