

PHILIPPINES

B – Individual Taxation

INTRODUCTION

The significant national taxes in the Republic of the Philippines are income tax, estate tax, donor's tax, excise tax on certain goods, and documentary stamp tax. Individuals who are self-employed are also subject to a business tax in the form of value added tax or a percentage tax (see Corporate Taxation 8. and 9.6.).

Real property tax and real property transfer tax are imposed by local governments.

National internal revenue taxes, including income tax, are imposed under the National Internal Revenue Code (NIRC), as amended, and administered by the Bureau of Internal Revenue (BIR). The Bureau of Customs is responsible for the administration of taxes, tariffs and duties from imports, as well as the collection of national internal revenue taxes on imported goods as the agent of the BIR.

Local tax laws are embodied in ordinances promulgated by local governments in accordance with the Local Government Code, and are administered by the offices of the treasurer and assessor of each local government.

Social security contributions are compulsory for all employees, including self-employed persons.

The currency is the Philippine peso (PHP).

1. INCOME TAX

1.1. Taxable persons

Taxable persons are Filipino citizens, alien individuals (both resident and non-resident), estates and certain types of trusts.

All citizens are considered resident unless they fulfil the criteria for non-residents (see 6.3.). A citizen who has been previously considered as a non-resident citizen, and who arrives in the Philippines at any time during the taxable year to reside permanently in the Philippines, is a non-resident with respect to his income derived from sources abroad until the date of his arrival in the Philippines.

An alien is considered a resident based on his intentions with regard to the length and nature of his stay. While there is no stipulated period within which an alien

may be considered a resident, the BIR has ruled that an alien who has stayed in the Philippines for almost 2½ years is still a non-resident for income tax purposes, albeit engaged in trade or business (an NRAETB; see further 6.3.).

Married individuals are separately taxable (see 1.10.2.).

Partnerships are generally taxed as corporations (see Corporate Taxation 1.). An exception exists in the case of a general professional partnership that is formed by persons for the sole purpose of exercising their common profession and no part of the income of which is derived from engaging in any trade or business. Each partner is required to report as gross income his distributive share actually or constructively received, in the net income of the partnership, the net income of the partnership being computed in the same manner as that of a company.

1.2. Taxable income

1.2.1. General

A resident citizen is subject to income tax on worldwide income, while a resident alien is taxed only on income from Philippine sources. Non-resident citizens and non-resident aliens are also taxed only on income from Philippine sources (see 6.2.).

Taxable income means the pertinent items of gross income specified in the NIRC, less any deductions and/or personal and additional exemptions authorized for such types of income by the NIRC or other special laws.

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

- compensation for services including fees, salaries, wages, commissions and similar items and fringe benefits;
- gross income from the conduct of trade, business or profession;
- gains derived from dealings in property;
- interest;
- rent;
- royalties;
- dividends;
- annuities;
- prizes and winnings;
- pensions; and
- a partner's distributive share from the net income of a general professional partnership.

1.2.2. Exempt income

The following items, among others, are exempt:

- the proceeds of life insurance policies;
- gifts, bequests and devises;
- amounts received through accident or health Insurance or under Workmen's Compensation Acts, as compensation for personal injuries or sickness, plus the amounts of any damages received whether by suit or agreement, on account of such injuries or sickness;
- retirement benefits, pensions, gratuities and separation benefits, under certain conditions; and
- prizes and awards primarily in recognition of religious, charitable, scientific, educational, artistic, literary or civic achievement, under certain conditions.

1.3. Employment income

1.3.1. Salary

In general, all salary is taxable. Gross compensation income is subject to a withholding tax (see 1.9.2.).

Personal, living or family expenses are not deductible. However, an individual whose family gross income does not exceed PHP 250,000 in a taxable year may claim a maximum deduction of PHP 2,400 for health and/or hospitalization insurance. In the case of married individuals, only one spouse may claim the deduction.

Thirteenth month pay and other benefits not exceeding the total amount of PHP 30,000 are exempt.

1.3.2. Benefits in kind

Benefits in kind are taxable. However, *de minimis* benefits, i.e. those of relatively small value and offered or furnished as a means of promoting the health, goodwill, contentment and efficiency of an employee, and those furnished for the convenience of the employer, are exempt.

Fringe benefits given to non-rank and file employees are subject to a fringe benefits tax payable by the employer (see Corporate Taxation 4.3.).

1.3.3. Pension income

Retirement benefits received under the New Retirement Law (RA 7641) and those paid out of a BIR-qualified retirement plan are exempt, provided the employee has served the same employer for at least 10 years and is not less than 50 years old at the time of his retirement. The exemption may be availed of only once.

An employee's pension contributions and/or insurance premiums are not deductible. However, see 1.3.1. for the deduction for health and/or hospitalization insurance.

1.3.4. Directors' remuneration

Fees of non-executive directors are non-compensation income, and are subject to a creditable withholding tax of 10% to 15%, depending on the amount of fees earned in the current year. If the director is also an employee, the director's fees constitute compensation income subject to withholding tax (see 1.9.2.).

1.4. Business and professional income

Business and professional income of an individual is generally computed in the same manner as the taxable income of a company, i.e. gross income less allowable deductions (see Corporate Taxation 1.). Allowable deductions include:

- ordinary and necessary trade, business or professional expenses, such as salaries, wages, travel costs, rental and royalties;
- interest (however, interest incurred to acquire property used in a trade, business or profession may be treated as a capital expenditure), subject to a reduction;
- taxes, including foreign taxes not claimed as tax credit (see 6.1.3.);
- ordinary and capital losses (see 1.8.);
- bad debts;
- depreciation (see Corporate Taxation 1.3.5.);
- charitable contributions to certain domestic companies and donations to the government, its agencies or political subdivisions for public purposes, up to 10% of taxable income (under certain conditions, the donation is fully deductible);
- research and development expenses (the taxpayer may opt to treat such expenses as a deferred expense over a period of at least 60 months); and
- contributions to an employees' pension trust.

Alternatively, a self-employed person may opt for a standard deduction in an amount not exceeding 10% of his gross income. In either case, the individual is entitled to personal and additional exemptions.