

TAXATION REVIEW: INCOME TAXATION FOR INDIVIDUAL TAXPAYERS

I. Classification of Individual Taxpayers

- a. Resident citizen (RC) – a citizen of the Philippines residing therein
 - * Citizen - Those who are citizens of the Philippines at the time of the adoption of the Constitution (on February 2, 1987);
 - Those whose fathers or mothers are citizens of the Philippines;
 - Those born before January 17, 1973 of Filipino mothers who elect Philippine citizenship upon reaching the age of majority; and
 - Those who are naturalized in accordance with law.
- b. Nonresident citizen (NRC)
 1. A citizen of the Philippines who established to the satisfaction of the Commissioner the fact of his physical presence abroad with a definite intention to reside therein;
 2. A citizen of the Philippines who leaves the Philippines during the taxable year to reside abroad, either as an immigrant or for employment on a permanent basis;
 3. A citizen of the Philippines who works and derives income from abroad and whose employment thereat requires him to be physically present abroad most of the time (at least 183 days) during the taxable year; and
 4. A citizen who has been previously considered as nonresident citizen and who arrives in the Philippines at any time during the taxable year to reside permanently in the Philippines shall be treated as a nonresident citizen for the taxable year in which he arrives in the Philippines with respect to his income derived from sources abroad until the date of his arrival in the Philippines.

Note: 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.
- c. Resident aliens (RA) – an individual whose residence is within the Philippines and who is not a citizen thereof
 1. An alien who lives in the Philippines with no definite intention to his stay;
 2. One who comes to the Philippines for a definite purpose which in its nature would require an extended stay and to that end makes his home temporarily in the Philippines, although it may be his intention at all times to return to his domicile abroad; and
 3. An alien who has acquired residence in the Philippines retains his status as such until he abandons the same and actually departs from the Philippines.
- d. Nonresident aliens (NRA) – an individual whose residence is not within the Philippines and who is not a citizen thereon
 1. Engaged in trade or business in the Philippines (NRA-ETB)
 - A NRA individual who is engaged in trade or business in the Philippines; and
 - A nonresident alien individual who shall come to the Philippines and stay therein for an aggregate period of more than 180 days during any calendar year shall be deemed a NRA-ETB
 2. Not engaged in trade or business in the Philippines (NRA-NETB) – a NRA who is not a NRA-ETB.

II. Tax Rates and Tax Base

Classification	Sources of Taxable Income	Allowable Deductions	Tax Base	Tax Rate
RC	Within and without	Within and without	Taxable income	Section 24A
NRC	Within	Within	Taxable income	Section 24A
RA	Within	Within	Taxable income	Section 24A
NRA-ETB	Within	Within	Taxable income	Section 24A
NRA-NETB	Within	N / A	Gross income	25% Final Tax
Special Aliens	Within	N / A	Gross income	15% Final Tax

III. Formats of Computation

a. Pure Compensation Income Earners (BIR Form 1700)

Gross Compensation Income		XXX	
Less: Non-Taxable/Exempt Compensation		XXX	
Gross taxable compensation income			XXX
Less: Total exemptions			
Premium paid on health and/or hospitalization insurance	XXX		
Basic personal exemptions	XXX		
Additional exemption	XXX	XXX	
Taxable compensation income			XXX
Tax due [Section 24A]			XXX

b. Pure Business Income Earners or Mixed Income Earners (BIR Form 1701)

Gross Compensation Income		XXX	
Less: Non-Taxable/Exempt Compensation		XXX	
Gross taxable compensation income			XXX
Less: Total exemptions			
Premium paid on health and/or hospitalization insurance	XXX		
Basic personal exemptions	XXX		
Additional exemption	XXX	XXX	
Taxable compensation income / (excess of exemptions over gross taxable compensation income)			XXX
Taxable business income:			
Sales/receipt/revenues/fees		XXX	
Less: Cost of sales/services		XXX	
Gross income from operations		XXX	
Add: Other Non-Operating taxable income		XXX	
Gross taxable business income		XXX	
Less: Optional Standard Deduction	XXX		
<u>OR</u>			
Allowable Itemized Deductions:			
Regular Allowable Itemized Deductions	XXX		
Special Allowable Itemized Deductions	XXX		
Allowance for NOLCO	XXX	XXX	XXX
Net income			XXX
Total taxable income			XXX
Tax due [Section 24A]			XXX

Rules on centavos for all individual taxpayers:

- On taxable income – drop the fractional amount (centavos)
- On income tax due – 50 centavos or more round-up to the nearest peso, otherwise disregard centavos

IV. Premium paid on Health and/or Hospitalization Insurance

- Allowed to individual taxpayers only;
 - Amount deductible per family: P2,400 per year or P200 per month;
 - Requisites for deductibility:
 - Paid during the taxable year for health and/or hospitalization insurance taken by the taxpayer for himself, including his family; and
 - The family gross income is not more than P250,000 for the taxable year.
- * Total family income – includes primary income and other income from sources received by all members of the nuclear family (father, mother and unmarried children)

- d. In case of married taxpayers, only the spouse claiming the additional exemption for dependents shall be entitled to deduct the premium paid.

V. Personal Exemptions Allowed to Individuals

- a. Personal exemptions are arbitrary amounts allowed in the nature of a deduction from gross or net income for personal, living or family expenses of the taxpayer. These have calculated to be roughly equivalent to the minimum of subsistence.
- b. Kinds of personal exemptions:
1. Basic personal exemption (civil status); and
 2. Additional exemption (number of qualified dependent children).

VI. Basic Personal Exemption

- a. Individuals allowed:
1. Resident citizens;
 2. Non-resident citizens;
 3. Resident aliens; and
 4. NRA-ETB (subject to reciprocity).
- b. Amount of basic personal exemption:
1. Allowed to resident citizens, resident aliens and non-resident citizens:

Status of Taxpayer	Prior 01/01/ 08	Taxable Year 2008*	Effective 01/01/ 09*
Single (including married but legally separated, widow or widower)	P 20,000	P35,000	P50,000
Head of the family (single with qualified dependents)	P 25,000	P37,500	P50,000
Married (<i>for each working spouse</i>)	P32,000	P41,000	P50,000

* As provided by **Republic Act (RA) No. 9504**, effective July 6, 2008, the amount of personal exemptions shall be as follows:

- a) Basic personal exemptions - **P50,000** for single, head of family and married; and
- b) Additional exemptions – **P25,000** per qualified dependent child (maximum of 4 qualified dependent children in a taxable year)

Therefore, personal exemptions for taxable year 2008 is computed on a pro-rata basis by adding one-half of the old exemptions and one-half of the new exemptions as provided by the law.

However if the taxpayer's taxable income for taxable year 2008 covers purely compensation income received within the period of January 1 to July 5, the old personal exemptions shall apply in full without benefit of deducting the new exemption as provided by RA 9504.

2. Allowed to non-resident alien engaged in trade or business (subject to reciprocity):
 - a) Conditions for allowance of personal exemptions:
 - 1) The foreign country of which the NRA-ETB is a subject or citizen has an income tax law;
 - 2) The income tax law of the NRA-ETB's country allows personal exemptions to citizens of the Philippines not residing therein;
 - 3) The NRA-ETB files a true and accurate return of his income from all sources within the Philippines.
 - b) Amount allowed: The lower amount between what is allowed in the NRA-ETB's country and what is allowed in the Philippines.

VII. Additional Exemption (for Married or Head of the Family)

- a. Amount of additional exemption per qualified dependent child:
 - Prior January 1, 2008 - P 8,000
 - Taxable year 2008 - P16,500
 - Starting January 1, 2009 - P25,000
- b. Maximum number of dependents is 4; and
- c. The following individual taxpayers can claim additional exemption:
 1. Resident citizens;
 2. Non-resident citizens; and
 3. Resident aliens.
- d. Requisites or qualification of a dependent child for additional exemption purposes should include legitimate, illegitimate, or legally adopted child which is:
 1. Chiefly dependent upon the taxpayer;
 2. Living with the taxpayer;
 3. Not more than 21 years of age;
 4. Unmarried; and
 5. Not gainfully employed.
 - For children who are mentally or physically defective – *regardless of age*.
- e. The additional exemption for dependents shall be claimed by only one of the spouse in the case of married individuals. The proper claimant is the **husband** except in the case when:
 1. The husband waives his right to claim additional exemption; or
 2. The husband is unemployed or is a non-resident citizen deriving income from foreign sources only.
- f. In case of legally separated spouses:
 1. Additional exemption may be claimed only by the spouses who has custody of the child or children;
 2. The total amount of additional exemption that may be claimed by both shall not exceed the maximum additional exemption allowed.

A. Single – means unmarried, widowed, widower or legally separated man or woman with no qualified dependents

B. Head of Family – means a single individual with any one of the following as dependent:

1. One or both parents;
2. One or more brothers or sisters;
3. One or more legitimate, illegitimate, recognized natural or legally adopted child; and
4. Senior citizen who is a resident citizen of the Philippines, *at least 60 years of age* and has *income not more than P60,000 per annum*, subject to review by NEDA every three years.

a) Requisites for qualifications of dependents of head of family:

	Parent	Brother, Sister and Child
Living with the taxpayer	Yes	Yes
Chiefly dependent upon the support of the taxpayer	Yes	Yes
Not more than 21 years old		Yes
Unmarried		Yes
Not gainfully employed		Yes

- For brothers, sisters or child that is mentally or physically defective – regardless of age.

b) “Living with the taxpayer” does not mean actual or physical togetherness at all times and under all circumstances. As long as the other requirements of the law are met, the dependent is considered living with the taxpayer, hence qualified, even if he is not in actual physical togetherness with the taxpayer.

- c) “Chief support” means principal or main support, not just partial support. It means that the taxpayer is giving more than 50% of the dependent’s need for food, clothing and shelter.

IX. Rules of Changes of Status

- a. If the taxpayer marries or should have additional dependents during the taxable year, the taxpayer may claim the corresponding additional exemption, as the case maybe, in full for such year;
- b. If the taxpayer dies during the taxable year, his estate may still claim the personal and additional exemptions for himself and his dependents as if he died at the close of such year;
- c. If the spouse or any of the dependents dies or if any of such dependents marries, becomes 21 years old or becomes gainfully employed during the taxable year, the taxpayer may still claim the same exemptions as if the spouse or any of the dependents died, or is such dependents married, became 21 years old or become gainfully employed at the close of the year.

X. Tax Rates - Section 24 (A)

If taxable income is over	But not over	The tax shall be	Plus	Of the excess over
	P 10,000	5%		
P 10,000	30,000	P 500	10%	P 10,000
30,000	70,000	2,500	15%	30,000
70,000	140,000	8,500	20%	70,000
140,000	250,000	22,500	25%	140,000
250,000	500,000	50,000	30%	250,000
500,000		125,000	32%*	500,000

* 34% in 1998; 33% in 1999; 32% starting January 1, 2000

XI. Tax Rates – Final Tax

a. Special Aliens - Section 25 (C to E)

- 1. Alien individual employed by:
 - a) Regional or area headquarters and operating headquarters of multinational companies;
 - b) Offshore banking units; and
 - c) Foreign petroleum service contractor and subcontractor.
- 2. Tax base: Gross income received as salaries, wages, annuities, compensation, remuneration, and other emoluments, such as honoraria and allowances, except income which is subject to fringe benefit tax, from such employer.
- 3. Tax rate: 15% final withholding tax
- 4. For Filipinos occupying the same position as those special aliens employed, has the option to be taxed at either 15% final withholding tax or under Section 24 (A).

b. Final Tax Rates on Passive Income from Philippine Sources - Section 24 (B)

	Residents / Citizens	NRA-ETB	NRA-NETB
1. Prizes and winnings			
a) Prizes [except prizes amounting to P10,000 or less which shall be subject	20%	20%	25%

to tax under Section 24(A)]			
b) Other winnings (except Philippine Charity Sweepstakes and Lotto winnings shall be exempt from income tax)	20%	20%	25%
c) Informer's reward to persons (except internal revenue official or employee, or other public official or employee) instrumental in the discovery of violations of the National Internal Revenue Code and the discovery and seizure of smuggled goods	10%	10%	10%
<ul style="list-style-type: none"> • <i>Amount of reward</i> is equivalent to 10% of the: (a) revenues, surcharges or fees recovered and fine or penalty imposed and collected; or (b) fair value of smuggled goods, or P1,000,000 per case whichever is lower. 			
2. Royalties			
a) Royalties, in general	20%	20%	25%
b) Royalties on books, as well as other literary works and musical compositions	10%	10%	25%
3. Interests			
a) Interest from ANY CURRENCY bank deposits and yield or any other monetary benefit from deposit substitutes, trust funds and similar arrangements	20%	20%	25%
b) Interest income from long-term deposit or investment evidenced by certificates prescribed by BSP <ul style="list-style-type: none"> • If pre-terminated before the fifth-year, a final tax shall be imposed based on remaining maturity: <ul style="list-style-type: none"> (a) 4 years to less than 5 years (b) 3 years to less than 4 years (c) Less than 3 years 	Exempt	Exempt	25%
c) Interest income from received by resident individuals from a depository bank under expanded foreign currency deposit system (FCDS)	7 ½%	Exempt	Exempt
4. Cash and/or Property Dividends			
a. Cash and/or property dividends actually or constructively received from a domestic corporation or from joint stock company, insurance or mutual fund companies and regional operating headquarters of multi-nationals; and			
b. Sh. of an individual in the distributable net income after tax of a taxable partnership, association, joint venture or consortium On their income:			
Beginning January 1, 1998	6%	20%	25%
Beginning January 1, 1999	8%	20%	25%
Beginning January 1, 2000	10%	20%	25%
<ul style="list-style-type: none"> • Provided, however, that the tax on dividends shall apply only on income earned on or after January 1, 1998. Income forming part pf retained earnings as of December 			

31, 1997 shall (even if declared or distributed on or after January 1, 1998) be subject to this tax.

c. **Capital Gains from Sale of Shares of Stock not Traded in the Stock Exchange - Section 24 (C)**

	Residents / Citizens	NRA-ETB	NRA-NETB
Tax base: Net capital gain			
Tax rates: Not over P100,000	5%	5%	5%
Amount in excess of P100,000	10%	10%	10%
<ul style="list-style-type: none"> Shares of stocks sold through a local stock exchange, is exempt from income tax. Said transaction should be subject to business tax (stock transaction tax under other percentage tax) equivalent to ½ of 1% of gross value in money (selling price). 			

d. **Capital Gains from Sale of Real Property Located in the Philippines Classified as Capital Asset – Section 24 (D)**

Definition of Terms:

Real properties – are immovable properties such as land and building

Personal properties – are movable properties such as equipment, machineries and furniture

Ordinary assets – are assets which are intended for sale, for lease and for use in the ordinary course of trade or business. The following are considered ordinary assets:

- Stock in trade which would properly be included in the inventory of the taxpayer;
- Property primarily held for sale to customers in the ordinary course of trade or business;
- Property used in trade or business of a character which is subject to the allowance for depreciation; or
- Real property used in trade or business of the taxpayer.

Capital assets – are assets which are not intended for sale, for lease or for use in the ordinary course of trade or business.

Sale of Real Properties located in the Philippines	Residents / Citizens	NRA-ETB	NRA-NETB
1. In General Tax base: gross selling price or current fair market value whichever is higher;	6%	6%	6%
2. If real property is sold to the <u>government or any of its political subdivisions or agencies or GOCC's</u> , the tax on gains shall be either subject to the 6% capital gains tax or Section 24 (A) , at the option of the seller.			

<p>3. Exemption – the proceeds of the sale of principal residence by a natural person shall be <u>exempt</u> from the 6% capital gains tax;</p> <p>a) The proceeds is fully utilized in acquiring or constructing new principal residence within 18 calendar months from the date of disposition;</p> <p>b) The historical cost or adjusted basis of the real property sold or disposed shall be carried over to the new principal residence built or acquired;</p> <p>c) 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;</p> <p>d) The tax exemption can only be availed once for every 10 years;</p> <p>e) 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. The capital gains tax due is computed as follows:</p> $\frac{\text{Unutilized Portion}}{\text{Gross Selling Price}} \times \text{Gross selling price or current market value whichever is higher} \times 6\%$
<ul style="list-style-type: none"> • If real property sold, exchanged or disposed of is <u>classified as an ordinary asset</u>, said disposition should be <u>subject normal income tax under Section 24 (A)</u>.

Exercises:

- An individual taxpayer had the following data for the taxable year 2009:

Gross business income in the Philippines	P1,000,000
Business expenses	P 700,000
Compensation income in USA	\$ 30,000
Expenses in US	\$ 10,000

Requirements: Compute the income tax due assuming the taxpayer is a (assume an exchange rate of P40 : \$1):

 - Resident citizen;
 - An overseas contract worker with two dependent children.
 - Nonresident alien, with a qualified dependent child in his custody. His country allows basic personal exemption amounting to P60,000 and additional exemption of P20,000 per qualified dependent child to Filipinos not residing therein.
 - Nonresident alien employee (assume that his income from the Philippines and USA are compensation income from an offshore banking unit)
- Resident citizen couples have the following data for taxable year 2009:

Gross salary, husband	P130,528.49
Gross salary, wife	115,762.90
Health insurance premium paid (covering six-month period)	1,800.00

Details on their dependent children are as follow:

 - Paquito, mentally retarded born on March 15, 1986
 - Panchito, born on December 31, 1987
 - Palito, born on January 10, 1988
 - Paullita, married, born on October 13, 1990

How much is the taxable income and aggregate income tax payable of both spouses assuming the:

 - Gross salary of the husband and wife is net of P1,000 and P5,000 withholding tax, respectively;
 - Gross salary of the husband and wife is gross of P1,000 and P5,000 withholding tax, respectively.
- An individual taxpayer holds 1,000 shares of a publicly listed corporation which he acquired during the year at P100 per share. Compute the capital gains tax assuming:

 - The shares of stocks were sold directly to Anthony at P120 per share;
 - The shares of stocks were sold directly to MBM Corporation at P225 per share;
 - The shares of stocks were sold directly to Kaenneth at P80 per share;
 - The shares of stock were sold to Mark through a local stock exchange at P150 per share.
- In 2009, an individual taxpayer disposes a piece of land classified as capital asset which he acquired three years ago, costing him P2,000,000. Compute the capital gains tax due on the sale of land, assuming:

- a. The land was sold at P2,200,000 with a fair market value per assessor's office amounting to P1,800,000 and a zonal value of P2,100,000;
- b. The land was sold at P1,800,000 with a fair market value per assessor's office amounting to P1,500,000 and a zonal value of P1,600,000;
- c. The land was sold to his brother at P1,000,000 with a fair market value per assessor's office amounting to P2,100,000 and a zonal value of P1,800,000.

5. On January 1, 2009, an individual taxpayer, resident citizen, sold his residential house and lot for P3,000,000 (FMV, time of sale, P3,500,000). Said property was acquired 5 years ago from his father as a gift at a fair market value of P1,000,000, in which his father acquired it 2 years prior to the date of donation for P800,000. He intends to use the proceeds to build a new principal residence within 18 calendar months from the date of sale which will cost him P4,000,000. He notified the BIR within 30 days from the date of sale of his intention. How much is the capital gains tax due and payable? How much is the adjusted cost basis of the newly acquired residential house and lot?

6. Using the data in number 5, except that the individual taxpayer utilized only P2,000,000 of the proceeds (instead of P4,000,000) to build a new principal residence, how much is the capital gains tax due and payable? Assuming also that the taxpayer inherited the property instead of acquiring it through donation, compute the adjusted cost basis of the newly acquired property.

7. An individual taxpayer, married, with no dependents has the following passive income for taxable year 2009:

Interest from depositary bank, Philippines	8,000
Interest from depositary bank under expanded foreign currency depositary system, Philippines (in PhP)	17,000
Interest from long-term deposit, Philippines	4,000
Prize won in a contest, Philippines	10,000
Business royalty, Japan (in PhP)	26,000
Royalty from musical composition, Philippines	30,000
Raffle winnings, Philippines	5,000
Dividend from domestic corporation	13,000
Dividend from a foreign corporation, Philippines (in PhP)	3,000

Compute the total final tax due on passive income assuming:

- a. The taxpayer is a resident citizen
- b. The taxpayer is a non-resident alien who stayed in the Philippines for more than 180 days during the year
- c. The taxpayer is a non-resident alien who is not engaged in trade or business in the Philippines

8. Resident citizens, married, with 6 qualified dependent children, have the following data for the year 2009:

Gross professional income, husband, net of 10% withholding tax	P720,000
Gross business income, wife, gross of 1% withholding tax	900,000
Expenses connected with practice of profession, husband	300,000
Business expenses, wife	200,000
Gross rental from common property, gross of 5% withholding tax	300,000
Expenses on rental of common property	150,000
Interest income, bank deposit, Japan Bank of Commerce, Tokyo	60,000

Compute the taxable income and aggregate income tax payable of the spouses.