

**2010 – 2015**  
**TAXATION BAR EXAM QUESTIONS**  
**ON**  
**INCOME TAX**

**The Philippines adopted the semi-global tax system, which means that: (2012 Bar Question)**

- a) All taxable incomes, regardless of the nature of income, are added together to arrive at gross income, and all allowable deductions are deducted from the gross income to arrive at the taxable income;
- b) All incomes subject to final withholding taxes liable to income tax under the schedular tax system, while all ordinary income as well as income not subject to final withholding tax under the global tax system;
- c) All taxable incomes are subject to final withholding taxes under the schedular tax system;
- d) All taxable incomes from sources within and without the Philippines are liable to income tax.

**SUGGESTED ANSWER:**

**b)** All incomes subject to final withholding taxes liable to income tax under the schedular tax system, while all ordinary income as well as income not subject to final withholding tax under the global tax system

**An example of a tax where the concept of progressivity finds application is the:** (2011 Bar Question)

- (A) income tax on individuals.
- (B) excise tax on petroleum products.
- (C) value-added tax on certain articles.
- (D) amusement tax on boxing exhibitions.

**SUGGESTED ANSWER:**

**(A)** income tax on individuals.

**Alain Descartes, a French citizen permanently residing in the Philippines, received several items during the taxable year. Which among the following is NOT subject to Philippine income taxation?** (2011 Bar Question)

- (A) Consultancy fees received for designing a computer program and installing the same in the Shanghai facility of a Chinese firm.
- (B) Interests from his deposits in a local bank of foreign currency earned abroad converted to Philippine pesos.
- (C) Dividends received from an American corporation which derived 60% of its annual gross receipts from Philippine sources for the past 7 years.
- (D) Gains derived from the sale of his condominium unit located in The Fort, Taguig City to another resident alien.

**SUGGESTED ANSWER:**

**(A)** Consultancy fees received for designing a computer program and installing the same in the Shanghai facility of a Chinese firm.

**Income from the performance of services is treated as income from within the Philippines, if:** (2012 Bar Question)

- a) The payment of compensation for the service is made in the Philippines;
- b) The contract calling for the performance of services is signed in the Philippines;
- c) The service is actually performed in the Philippines;

d) The recipient of service income is a resident of the Philippines.

**SUGGESTED ANSWER:**

c) The service is actually performed in the Philippines

Section 42, NIRC.

**An individual taxpayer can adopt either the calendar or fiscal period for purposes of filing his income tax return. (2010 Bar Question)**

**SUGGESTED ANSWER:**

False. (Sec. 43, NIRC)

**Which among the following taxpayers is required to use only the calendar year for tax purposes? (2011 Bar Question)**

- (A) Partnership exclusively for the design of government infrastructure projects considered as practice of civil engineering.
- (B) Joint-stock company formed for the purpose of undertaking construction projects.
- (C) Business partnership engaged in energy operations under a service contract with the government.
- (D) Joint account (cuentas en participacion) engaged in the trading of mineral ores.

**SUGGESTED ANSWER:**

(A) Partnership exclusively for the design of government infrastructure projects considered as practice of civil engineering.

**Pierre de Savigny, a Frenchman, arrived in the Philippines on January 1, 2010 and continued to live and engage in business in the Philippines. He went on a tour of Southeast Asia from August 1 to November 5, 2010. He returned to the Philippines on November 6, 2010 and stayed until April 15, 2011 when he returned to France. He earned during his stay in the Philippines a gross income of P3 million from his investments in the country. For the year 2010, Pierre's taxable status is that of: (2011 Bar Question)**

- (A) a non-resident alien not engaged in trade or business in the Philippines.
- (B) a non-resident alien engaged in trade or business in the Philippines.
- (C) a resident alien not engaged in trade or business in the Philippines.
- (D) a resident alien engaged in trade or business in the Philippines.

**SUGGESTED ANSWER:**

(B) a non-resident alien engaged in trade or business in the Philippines.

**A resident corporation is one that is: (2012 Bar Question)**

- a) Organized under the laws of the Philippines that does business in another country;
- b) Organized under the laws of a foreign country that sets up a regional headquarter in the Philippines doing product promotion and information dissemination;
- c) Organized under the laws of the Philippines that engages business in a special economic zone;
- d) Organized under the laws of a foreign country that engages in business in Makati City, Philippines.

**SUGGESTED ANSWER:**

**d)** Organized under the laws of a foreign country that engages in business in Makati City, Philippines

Section 22 (H), NIRC.

**Aplets Corporation is registered under the laws of the Virgin Islands. It has extensive operations in Southeast Asia. In the Philippines, Its products are imported and sold at a mark-up by its exclusive distributor, Kim's Trading, Inc. The BIR compiled a record of all the imports of Kim from Aplets and imposed a tax on Aplets net income derived from its exports to Kim. Is the BIR correct? (2011 Bar Question)**

- (A) Yes. Aplets is a non-resident foreign corporation engaged in trade or business in the Philippines.
- (B) No. The tax should have been computed on the basis of gross revenues and not net income.
- (C) No. Aplets is a non-resident foreign corporation not engaged in trade or business in the Philippines.
- (D) Yes. Aplets is doing business in the Philippines through its exclusive distributor Kim's Trading, Inc.

**SUGGESTED ANSWER:**

**(C)** No. Aplets is a non-resident foreign corporation not engaged in trade or business in the Philippines.

**A general professional partnership (GPP) is one: (2012 Bar Question)**

- a) That is registered as such with the Securities and Exchange Commission and the Bureau of Internal Revenue;
- b) That is composed of individuals who exercise a common profession;
- c) That exclusively derives income from the practice of the common profession;
- d) That derives professional income and rental income from property owned by it.

**SUGGESTED ANSWER:**

**c)** That exclusively derives income from the practice of the common profession

Section 26, NIRC.

*[Note: The question is unfair because it gives an initial impression that the examiner is asking the statement which best characterizes a GPP but the real question is found after the enumeration of the choices which might not be noticed by the examinee.]*

**Income is considered realized for tax purposes when: (2011 Bar Question)**

- (A) it is recognized as revenue under accounting standards even if the law does not do so.
- (B) the taxpayer retires from the business without approval from the BIR.
- (C) the taxpayer has been paid and has received in cash or near cash the taxable income.
- (D) the earning process is complete or virtually complete and an exchange has taken place.

**SUGGESTED ANSWER:**

- (D)** the earning process is complete or virtually complete and an exchange has taken place.

**Aleta sued Boboy for breach of promise to marry. Boboy lost the case and duly paid the court's award that included, among others, P100,000 as moral damages for the mental anguish Aleta suffered.**

**Did Aleta earn a taxable income? (1%)(2013 Bar Question)**

- (A) She had a taxable income of P100,000 since income is income from whatever source.
- (B) She had no taxable income because it was a donation.
- (C) She had taxable income since she made a profit.
- (D) She had no taxable income since moral damages are compensatory.

**SUGGESTED ANSWER:**

- (D)** She had no taxable income since moral damages are compensatory.

Exemplary and moral damages awarded to a party-litigant are not considered taxable income (*America N.A.-Manila Branch vs. Commissioner of Internal Revenue*, CTA Case No. 6144, March 14, 2005).

**Hopeful Corporation obtained a loan from Generous Bank and executed a mortgage on its real property to secure the loan. When Hopeful Corporation failed to pay the loan, Generous Bank extrajudicially foreclosed the mortgage on the property and acquired the same as the highest bidder. A month after the foreclosure, Hopeful Corporation exercised its right of redemption and was able to redeem the property. Is Generous Bank liable to pay capital gains tax as a result of the foreclosure sale? Explain. (2014 Bar Question)**

**SUGGESTED ANSWER :**

No. Since *Hopeful Corporation* exercised its right to redeem the property, *Generous Bank* is not liable to pay capital gains tax on the foreclosure sale. As stated in the analogous case of Supreme Transliner, Inc., v. BPI Family Savings Bank, Inc. (G.R. No. 165617, February 25, 2011, 644 SCRA 59), Rev. Regs. No. 4-99 expressly provides that if a mortgagor exercises his right of redemption within one year from the issuance of the certificate of sale, no capital gains tax shall be imposed because no sale or transfer of real property was realized. It is only in case of non-redemption by *Hopeful Corporation* that the obligation to pay capital gains tax arises, which shall be based on the bid price of the highest bidder. The tax will be imposed only upon the expiration of the one-year period of redemption. Furthermore, the obligation to pay the capital gains tax would primarily fall on the mortgagor, *Hopeful Corporation*, and not on *Generous Bank*.

**Mr. A was preparing his income tax return and had some doubt on whether a commission he earned should be declared for the current year or for the succeeding year. He sought the opinion of his lawyer who advised him to report the commission in the succeeding year. He heeded his lawyer's advice and reported the commission in the succeeding year. The lawyer's advice turned out to be wrong; in Mr. A's petition against the BIR assessment, the court ruled against Mr. A.**

**Is Mr. A guilty of fraud? (1%)(2013 Bar Question)**

- (A) Mr. A is not guilty of fraud as he simply followed the advice of his lawyer.
- (B) Mr. A is guilty of fraud; he deliberately did not report the commission in the current year when he should have done so.
- (C) Mr. A's lawyer should pay the tax for giving the wrong advice.
- (D) Mr. A is guilty for failing to consult his accountant.

**SUGGESTED ANSWER:**

**(A)** Mr. A is not guilty of fraud as he simply followed the advice of his lawyer.

In *Santos v. People of the Philippines and BIR*, the Court of Tax Appeals (CTA) acquitted Santos from the criminal case of tax evasion and ruled that failure to supply correct and accurate information must be fully established as a positive act or state of mind; it cannot be presumed nor attributed to mere inadvertent or negligent acts. Moreover, the CTA reiterated the doctrine in *Yulivo Sons hardware v. Court of Tax Appeals* (G.R. No. L- 13203), January 28, 1961, 1 SCRA 169) that mere understatement of a tax is not itself proof of fraud for the purpose of tax evasion.

In the present case, Mr. A relied in good faith on the expertise of his lawyer in not declaring his income for that year. Therefore, he is not guilty of fraud.

**A corporation may change its taxable year to calendar or fiscal year in filing its annual income tax return, provided: (2011 Bar Question)**

- (A) it seeks prior BIR approval of its proposed change in accounting period.
- (B) it simultaneously seeks BIR approval of its new accounting period.
- (C) it should change its accounting period two years prior to changing its taxable year.
- (D) its constitution and by-laws authorizes the change.

**SUGGESTED ANSWER:**

**(A)** it seeks prior BIR approval of its proposed change in accounting period.

**The appropriate method of accounting for a contractor on his long-term construction contract (i.e., it takes more than a year to finish) is: (2012 Bar Question)**

- a) Cash method;
- b) Accrual method;
- c) Installment sale method;
- d) Percentage of completion method.

**SUGGESTED ANSWER:**

**d)** Percentage of completion method

Section 127, NIRC.

**What is the "all events test"? Explain briefly. (2010 Bar Question)**

**SUGGESTED ANSWER:**

The "all events test" is a test applied in the realization of income and expense by an accrual-basis taxpayer. The test requires (a) the fixing of a right to the income or liability to pay, and (b) the availability of reasonably accurate determination of such income or deduction during the taxable year.

**The "all events test" refers to: (2012 Bar Question)**

- a) A person who uses the cash method where all sales have been fully paid by the buyers thereof;
- b) A person who uses the installment sales method, where the full amount of consideration is paid in full by the buyer thereof within the year of sale;
- c) A person who uses the accrual method, whereby an expense is deductible for the taxable year in which all the events had occurred which determined the fact of the liability and the amount thereof could be determined with reasonable accuracy;
- d) A person who uses the completed method, whereby the construction project has been completed during the year the contract was signed.

**SUGGESTED ANSWER:**

- c) A person who uses the accrual method, whereby an expense is deductible for the taxable year in which all the events had occurred which determined the fact of the liability and the amount thereof could be determined with reasonable accuracy.

The accrual of income and expense is permitted when the all-events test has been met. This test requires: (1) fixing of a right to income or liability to pay; (2) the availability of the reasonable accurate determination of such income or liability.

The all-events test requires the right to income or liability be fixed, and the amount of such income or liability be determined with reasonable accuracy. However, the test does not demand that the amount of income or liability be known absolutely, only that a taxpayer has at his disposal the information necessary to compute the amount with reasonable accuracy. The all-events test is satisfied where computation remains uncertain, if its basis is unchangeable; the test is satisfied where a computation may be unknown, but is not as much as unknowable, within the taxable year. "The amount of liability does not have to be determined exactly; it must be determined with reasonable accuracy." (*Commissioner of Internal Revenue vs. Isabela Cultural Corporation, G.R. No. 172231, February 12, 2007*)

**There is no taxable income until such income is recognized. Taxable income is recognized when the: (2011 Bar Question)**

- (A) taxpayer fails to include the income in his income tax return.
- (B) income has been actually received in money or its equivalent.
- (C) income has been received, either actually or constructively.

(D) transaction that is the source of the income is consummated.

**SUGGESTED ANSWER:**

(C) income has been received, either actually or constructively.

**In 2010, Juliet Ulbod earned P500,000.00 as income from her beauty parlor and received P250,000.00 as Christmas gift from her spinster aunt. She had no other receipts for the year. She spent P150,000.00 for the operation of her beauty parlor. For tax purposes, her gross income for 2010 is: (2011 Bar Question)**

- (A) P750,000.00.
- (B) P500,000.00.
- (C) P350,000.00.
- (D) P600,000.00.

**SUGGESTED ANSWER:**

(B) P500,000.00.

**In 2010, Mr. Platon sent his sister Helen \$1 ,000 via a telegraphic transfer through the Bank of PI. The bank's remittance clerk made a mistake and credited Helen with \$1,000,000 which she promptly withdrew. The bank demanded the return of the mistakenly credited excess, but Helen refused. The BIR entered the picture and investigated Helen.**

**Would the BIR be correct if it determines that Helen earned taxable income under these facts? (2013 Bar Question)**

- (A) No, she had no income because she had no right to the mistakenly credited funds.
- (B) Yes, income is income regardless of the source.
- (C) No, it was not her fault that the funds in excess of \$1,000 were credited to her.
- (D) No, the funds in excess of \$1,000 were in effect donated to her.

**SUGGESTED ANSWER:**

(B) Yes, income is income regardless of the source.

Section 32 of the NIRC defines gross income as all income derived from whatever source. Consequently, the flow of wealth, without any distinction as to the lawfulness of its source, is subject to income tax. In other words, the phrase "income from whatever source" discloses a legislative policy to include all income not expressly exempted within the class of taxable income under the law.

**Mr. Gipit borrowed from Mr. Maunawain P100,000.00, payable in five (5) equal monthly installments. Before the first installment became due, Mr. Gipit rendered general cleaning services in the entire office building of Mr. Maunawain, and as compensation therefor, Mr. Maunawain cancelled the indebtedness of Mr. Gipit up to the amount of P75,000.00. Mr. Gipit claims that the cancellation of his indebtedness cannot be considered as gain on his part which must be subject to income tax, because according to him, he did not actually receive payment from Mr. Maunawain**

**for the general cleaning services. Is Mr. Gipit correct? Explain.** (2014 Bar Question)

**SUGGESTED ANSWER :**

No. Section 50 of Rev. Regs. No. 2, otherwise known as Income Tax Regulations, provides that if a debtor performs services for a creditor who cancels the debt in consideration for such services, the debtor realizes income to that amount as compensation for his services. In the given problem, the cancellation of *Mr. Gipit's* indebtedness up to the amount of Php 75,000.00 gave rise to compensation income subject to income tax, since Mr. Maunawain condoned such amount as consideration for the general cleaning services rendered by *Mr. Gipit*.

**PRT Corp. purchased a residential house and lot with a swimming pool in an upscale subdivision and required the company president to stay there without paying rent; it reasoned out that the company president must maintain a certain image and be able to entertain guests at the house to promote the company's business. The company president declared that because they are childless, he and his wife could very well live in a smaller house.**

**Was there a taxable fringe benefit? (1%)(2013 Bar Question)**

- (A) There was no taxable fringe benefit since it was for the convenience of the employer and was necessary for its business.
- (B) There was a taxable fringe benefit since the stay at the house was for free.
- (C) There was a taxable fringe benefit because the house was very luxurious.
- (D) There was no taxable fringe benefit because the company president was only required to stay there and did not demand free housing.

**SUGGESTED ANSWER:**

- (B)** There was a taxable fringe benefit since the stay at the house was for free.

First, the company president is not a rank-and-file employee. Thus, the housing benefit is subject to fringe benefits tax pursuant to Section 33 of the NIRC and Section 2.33 (A) of the RR No. 03-98. Although the housing benefit to the President may be for the convenience of the employer (PRT Corp.) or necessary to its business, still, it also inured to the benefit of the President as his stay therein is for free. RR No. 03-98 also provides for the guidelines and valuation of fringe benefits for purposes of computing the portion which shall be subject to fringe benefits tax in cases where the fringe benefits entail joint benefits to the employer and employee.

Thus, there was a taxable fringe benefit.

**Income from dealings in property (real, personal, or mixed) is the gain or loss derived:** (2011 Bar Question)

- (A) only from the cash sales of property.
- (B) from cash and gratuitous receipts of property.
- (C) from sale and lease of property.
- (D) only from the sale of property.

**SUGGESTED ANSWER:**

- (D)** only from the sale of property.

**An individual, who is a real estate dealer, sold a residential lot in Quezon City at a gain of P100,000.00 (selling price of P900,000.00 and cost is P800,00.00). The sale is subject to income tax as follows: (2012 Bar Question)**

- a) 6% capital gains tax on the gain;
- b) 6% capital gains tax on the gross selling price of fair market value, whichever is higher;
- c) Ordinary income tax at the graduated rates of 5% to 32% of net taxable income;
- d) 30% income tax on net taxable income.

**SUGGESTED ANSWER:**

- c) Ordinary income tax at the graduated rates of 5% to 32% of net taxable income

Section 24, NIRC.

**In March 2009, Tonette, who is fond of jewelries, bought a diamond ring for P750,000.00, a bracelet for P250,000.00, a necklace for P500,000.00, and a brooch for P500,000.00. Tonette derives income from the exercise of her profession as a licensed CPA. In October 2009, Tonette sold her diamond ring, bracelet, and necklace for only P1.25 million incurring a loss of P250,000.00. She used the P1.25 million to buy a solo diamond ring in November 2009 which she sold for P1.5 million in September 2010. Tonette had no other transaction in jewelry in 2010. Which among the following describes the tax implications arising from the above transactions? (2011 Bar Question)**

- (A) Tonette may deduct his 2009 loss only from her 2009 professional income.
- (B) Tonette may carry over and deduct her 2009 loss only from her 2010 gain.
- (C) Tonette may carry over and deduct her 2009 loss from her 2010 professional income as well as from her gain.
- (D) Tonette may not deduct her 2009 loss from both her 2010 professional income and her gain.

**SUGGESTED ANSWER:**

- (B) Tonette may carry over and deduct her 2009 loss only from her 2010 gain.

**Federico, a Filipino citizen, migrated to the United States some six years ago and got a permanent resident status or green card. He should pay his Philippine income taxes on: (2011 Bar Question)**

- (A) the gains derived from the sale in California, U.S.A. of jewelry he purchased in the Philippines.
- (B) the proceeds he received from a Philippine insurance company as the sole beneficiary of life insurance taken by his father who died recently.
- (C) the gains derived from the sale in the New York Stock Exchange of shares of stock in PLDT, a Philippine corporation.
- (D) dividends received from a two year old foreign corporation whose gross income was derived solely from Philippine sources.

**SUGGESTED ANSWER:**

(C) the gains derived from the sale in the New York Stock Exchange of shares of stock in PLDT, a Philippine corporation.

**Keyrand, Inc., a Philippine corporation, sold through the local stock exchange 10,000 PLDT shares that it bought 2 years ago. Keyrand sold the shares for P2 million and realized a net gain of P200,000.00. How shall it pay tax on the transaction? (2011 Bar Question)**

- (A) It shall declare a P2 million gross income in its income tax return, deducting its cost of acquisition as an expense.
- (B) It shall report the P200,000.00 in its corporate income tax return adjusted by the holding period.
- (C) It shall pay 5% tax on the first P100,000.00 of the P200,000.00 and 10% tax on the remaining P100,000.00.
- (D) It shall pay a tax of one-half of 1% of the P2 million gross sales.

**SUGGESTED ANSWER:**

- (D) It shall pay a tax of one-half of 1% of the P2 million gross sales.

**In 2006, Mr. Vicente Tagle, a retiree, bought 10,000 CDA shares that are unlisted in the local stock exchange for P10 per share. In 2010, the said shares had a book value per share of P60 per share. In view of a car accident in 2010, Mr. Vicente Tagle had to sell his CDA shares but he could sell the same only for P50 per share. The sale is subject to tax as follows: (2012 Bar Question)**

- a) 5%/10% capital gains tax on the capital gain from sale of P40 per share (P50 selling price less P10 cost);
- b) 5%/10% capital gains tax on the capital gain of P50 per share, arrived at by deducting the cost (P10 per share) from the book value (P60 per share);
- c) 5%/10% capital gains tax on the capital gain from sale of P40 per share (P50 selling price less P10 cost) plus donor's tax on the excess of the fair market value of the shares over the consideration;
- d) Graduated income tax rates of 5% to 32% on the net taxable income from the sale of the shares.

**SUGGESTED ANSWER:**

- c) 5%/10% capital gains tax on the capital gain from sale of P40 per share (P50 selling price less P10 cost) plus donor's tax on the excess of the fair market value of the shares over the consideration

Section 24(C) in relation to Section 100, NIRC; RR No. 6-2008.

**In 2000, Mr. Belen bought a residential house and lot for P1,000,000. He used the property as his and his family's principal residence. It is now year 2013 and he is thinking of selling the property to buy a new one. He seeks your advice on how much income tax he would pay if he sells the property. The total zonal value of the property is P5,000,000 and the fair market value per the tax declaration is P2,500,000. He intends to sell it for P6,000,000.**

**What material considerations will you take into account in computing the income tax? Please explain the legal relevance of each of these considerations. (2013 Bar Question)**

**SUGGESTED ANSWER:**

In computing the capital gains tax, a final tax of six percent (6%) based on the gross selling price or current fair market value, whichever is higher, shall be imposed. In this case, the basis of the tax is P6,000,000.00, the gross selling price, being higher than P2,500,00.00, the fair market value of the residential house.

Nevertheless, if within thirty (30) days from the date of sale or disposition, Mr. Belen notifies the Commissioner that he intends to utilize the whole P6,000,000.00 in acquiring a new house within eighteen (18) calendar months from the sale, the gross selling price shall be exempt from the capital gains tax.

If Mr. Belen does not utilize the whole P6,000,000.00 in acquiring a new residence under the conditions above, the portion of the gain presumed to have been realized from the sale or disposition shall be subject to capital gains tax. For this purpose, P6,000,000.00 shall be multiplied by a fraction which the unutilized amount bears to the gross selling price in order to determine the taxable portion and the 6% capital gains tax shall be imposed thereon under Section 24(D) of the NIRC.

**Mr. H decided to sell the house and lot wherein he and his family have lived for the past 10 years, hoping to buy and move to a new house and lot closer to his children's school. Concerned about the capital gains tax that will be due on the sale of their house, Mr. H approaches you as a friend for advice if it is possible for the sale of their house to be exempted from capital gains tax and the conditions they must comply with to avail themselves of said exemption. How will you respond? (2015 Bar Question)**

**SUGGESTED ANSWER:**

Mr. H may avail the exemption from capital gains tax on sale of principal residence by natural persons. Under the law, the following are the requisites: (1) proceeds of the sale of the principal residence have been fully utilized in acquiring or constructing new principal residence within eighteen (18) calendar months from the date of sale or disposition; (2) The historical cost or adjusted basis of the real property sold or disposed will be carried over to the new principal residence built or acquired; (3) The Commissioner has been duly notified, through a prescribed return, within thirty (30) days from the date of sale or disposition of the person's intention to avail of the tax exemption; and (4) Exemption was availed only once every ten (10) years.

**Interest income of a domestic commercial bank derived from a peso loan to a domestic corporation in 2010 is: (2012 Bar Question)**

- a) Subject to the 30% income tax based on its net taxable income;
- b) Subject to the 20% final withholding tax;
- c) Subject to the 7.5% final withholding tax;
- d) Subject to 10% final withholding tax.

**SUGGESTED ANSWER:**

- a) Subject to the 30% income tax based on its net taxable income

Section 27 (A).

**ABC Corp. was dissolved and liquidating dividends were declared and paid to the stockholders.**

**What tax consequence follows? (1%) (2013 Bar Question)**

- (A) ABC Corp. should deduct a final tax of 10% from the dividends.
- (B) The stockholders should declare their gain from their investment and pay income tax at the ordinary rates.
- (C) The dividends are exempt from tax.
- (D) ABC Corp. should withhold a 10% creditable tax.

**SUGGESTED ANSWER:**

- (C) The dividends are exempt from tax.

Liquidating dividends are not income and are thus not subject to income tax.

In *Wise & Co., Inc. v. Meer* (G.R. No. 48231, June 30, 1947), the Supreme Court defined liquidating dividends as the dissolving corporation's payments to the stockholders for their surrender and relinquishment of interest in the dissolving corporation. They are generally a return of capital. Liquidating dividends are unlike cash and property dividends which are *portions of corporate profits* that are set aside for distribution to the stockholders in proportion to their subscription to the capital stock of the corporation.<sup>1</sup>

**MGC Corp. secured an income tax holiday for 5 years as a pioneer industry. On the fourth year of the tax holiday, MGC Corp. declared and paid cash dividends to its stockholders, all of whom are individuals.**

**Are the dividends taxable? (1%)(2013 Bar Question)**

- (A) The dividends are taxable; the tax exemption of MGC Corp. does not extend to its stockholders.
- (B) The dividends are tax exempt because of MGC Corp.'s income tax holiday.
- (C) The dividends are taxable if they exceed 50% of MGC Corp.'s retained earnings.
- (D) The dividends are exempt if paid before the end of MGC Corp.'s fiscal year.

**SUGGESTED ANSWER:**

- (A) The dividends are taxable; the tax exemption of MGC Corp. does not extend to its stockholders.

MGC Corp. and its stockholders are separate tax entities under the NIRC. Consequently, MGC Corp.'s tax exemption does not extend to its stockholders.

Under the NIRC, stockholders who receive dividends from a domestic corporation are subject to the following scheduler income tax rates: 10% for Filipino citizens and individual resident

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<sup>1</sup>Campos, *The Corporation Code*, Volume II, p. 209.

aliens<sup>2</sup>; 20% for non-resident aliens engaged in trade or business<sup>3</sup>; and 15% for non-resident foreign corporations<sup>4</sup>. Thus, the stockholder's claim for the tax exemption is unmeritorious.

**In June 2013, DDD Corp., a domestic corporation engaged in the business of leasing real properties in the Philippines, entered into a lease agreement of a residential house and lot with EEE, Inc., a non-resident foreign corporation. The residential house and lot will be used by officials of EEE, Inc. during their visit to the Philippines. The lease agreement was signed by representatives from DDD Corp. and EEE, Inc. in Singapore. DDD Corp. did not subject the said lease to VAT believing that it was not a domestic service contract. Was DDD Corp. correct? Explain. (2015 Bar Question)**

**SUGGESTED ANSWER:**

DDD Corp. is not correct. Any person who, in the ordinary course of trade or business, leases properties, whether personal or real, shall be subject to value-added tax (VAT), except for unless the gross annual receipts of the lessor do not exceed P1,919,500.00 or that the monthly rental does not exceed P12,800, for residential units. Based on the destination principle, goods and services are taxed only in the country where they are consumed. Here, the services rendered to the officials of EEE are within the Philippines. Hence, DDD Corp. is subject to VAT.

**For income tax purposes, the source of the service income is important for the taxpayer, who is a:** (2012 Bar Question)

- a) Filipino citizen residing in Makati City;
- b) Non-resident Filipino citizen working residing in London, United Kingdom;
- c) Japanese citizen who is married to a Filipino citizen and residing in their family home located Fort Bonifacio, Taguig City;
- d) Domestic corporation.

**SUGGESTED ANSWER:**

- b) Non-resident Filipino citizen working residing in London, United Kingdom**

Section 23 in relation to Section 42, NIRC.

**During the audit conducted by the BIR official, it was found that the rental income claimed by the corporation was not subjected to expanded withholding tax. Accordingly, the claimed rental expense:** (2012 Bar Question)

- a) Is deductible from the gross income of the corporation, despite non-withholding of income tax by the corporation;
- b) Is deductible from the gross income of the corporation, provided that the 5% expanded withholding tax is paid by the corporation during the audit;
- c) Is not deductible from gross income of the corporation due to non-withholding of tax;
- d) Is deductible, if it can be shown that the lessor has correctly reported the rental income in his tax return.

**SUGGESTED ANSWER:**

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<sup>2</sup> NIRC, Section 24 (B)(2).

<sup>3</sup> NIRC, Section 25 (B).

<sup>4</sup> NIRC, Section 28 (5)(b).

c) Is not deductible from gross income of the corporation due to non-withholding of tax;

Section 34(K), NIRC.

[*Note: Percentage tax is outside of the coverage*]

**Ms. C, a resident citizen, bought ready-to-wear goods from Ms. B, a nonresident citizen.**

**a) If the goods were produced from Ms. B's factory in the Philippines, is Ms. B's income from the sale to Ms. C taxable in the Philippines? Explain.**

**b) If Ms. B is an alien individual and the goods were produced in her factory in China, is Ms. B's income from the sale of the goods to Ms. C taxable in the Philippines? Explain.**  
(2015 Bar Question)

**SUGGESTED ANSWER:**

a. Yes, the income of Ms. B from the sale of ready-to-wear goods to Ms. C is taxable. A nonresident citizen is taxable only on income derived from sources within the Philippines. In line with the source rule of income taxation, since the goods are produced and sold within the Philippines, Ms. B's Philippine-sourced income is taxable in the Philippines.

b. Yes, but only a proportionate part of the income. Gains, profits and income from the sale of personal property produced by the taxpayer without and sold within the Philippines, shall be treated as derived partly from sources within and partly without the Philippines.

**True or False.**

**Gains realized by the investor upon redemption of shares of stock in a mutual fund company are exempt from income tax.** (2010 Bar Question)

**SUGGESTED ANSWER:** TRUE.

**The proceeds received under a life insurance endowment contract is NOT considered part of gross income:** (2011 Bar Question)

- (A) if it is so stated in the life insurance endowment policy.
- (B) if the price for the endowment policy was not fully paid.
- (C) where payment is made as a result of the death of the insured.
- (D) where the beneficiary was not the one who took out the endowment contract.

**SUGGESTED ANSWER:**

(C) where payment is made as a result of the death of the insured.

**All the items below are excluded from gross income, except:** (2012 Bar Question)

- a) Gain from sale of long-term bonds, debentures and indebtedness;

- b) Value of property received by a person as donation or inheritance;
- c) Retirement benefits received from the GSIS, SSS, or accredited retirement plan;
- d) Separation pay received by a retiring employee under a voluntary retirement program of the corporate employer.

**SUGGESTED ANSWER:**

- d) Separation pay received by a retiring employee under a voluntary retirement program of the corporate employer.

Section 32(B)(6), NIRC.

**Mr. A, a citizen and resident of the Philippines, is a professional boxer. In a professional boxing match held in 2013, he won prize money in United States (US) dollars equivalent to P300,000,000.**

- a) **Is the prize money paid to and received by Mr. A in the US taxable in the Philippines? Why?**
- b) **May Mr. A's prize money qualify as an exclusion from his gross income? Why?**
- c) **The US already imposed and withheld income taxes from Mr. A's prize money. How may Mr. A use or apply the income taxes he paid on his prize money to the US when he computes his income tax liability in the Philippines for 2013? (2015 Bar Question)**

**SUGGESTED ANSWER:**

a. Yes. Under the Tax Code, the income within and without of a resident citizen is taxable. Since Mr. A is a resident Filipino citizen, his income worldwide is taxable in the Philippines.

b. No. Under the law, all prizes and awards granted to athletes in local and international sports competitions whether held in the Philippines or abroad and sanctioned by their national sports association are excluded from gross income. However, in this case, there is no showing that the boxing match was sanctioned by the Philippine National Sports Commission. Therefore, the prize money is not excluded.

c. Mr. A may avail of tax credit against his tax liability in the Philippines for taxes paid in foreign countries. He has to signify in his income tax return his desire to avail the deduction.

**Political campaign contributions are NOT deductible from gross income: (2011 Bar Question)**

- (A) if they are not reported to the Commission on Elections.
- (B) if the candidate supported wins the election because of possible corruption.
- (C) since they do not help earn the income from which they are to be deducted.
- (D) since such amounts are not considered as income of the candidate to whom given.

**SUGGESTED ANSWER:**

- (C) since they do not help earn the income from which they are to be deducted.

**The interest expense of a domestic corporation on a bank loan in connection with the purchase of a production equipment: (2012 Bar Question)**

- a) Is not deductible from gross income of the borrower-corporation;

- b) Is deductible from the gross income of the borrower-corporation during the year or it may be capitalized as part of cost of the equipment;
- c) Is deductible only for a period of five years from date of purchase;
- d) Is deductible only if the taxpayer uses the cash method of accounting.

**SUGGESTED ANSWER:**

- b) Is deductible from the gross income of the borrower-corporation during the year or it may be capitalized as part of cost of the equipment.**

Section 34(B)(3), NIRC.

**A is a travelling salesman working full time for Nu Skin Products. He receives a monthly salary plus 3% commission on his sales in a Southern province where he is based. He regularly uses his own car to maximize his visits even to far flung areas. One fine day a group of militants seized his car. He was notified the following day by the police that the marines and the militants had a bloody encounter and his car was completely destroyed after a grenade hit it.**

**A wants to file a claim for casualty loss. Explain the legal basis of your tax advice. (2010 Bar Question)**

**SUGGESTED ANSWER:**

A is not entitled to claim a casualty loss because all of his income partake the nature of compensation income. Taxpayers earning compensation income arising from personal services under an employer-employee relationship are not allowed to claim deduction except those allowed under Sec. 34(M) of the Tax Code referring only to Php 2,400 health and hospitalization insurance premiums. Therefore, the claim of casualty loss has no legal basis.

**Dr. Taimtim is an alumnus of the College of Medicine of Universal University (UU), a privately-owned center for learning which grants yearly dividends to its stockholders.**

**UU has a famous chapel located within the campus where the old folks used to say that anyone who wanted to pass the medical board examinations should offer a dozen roses on all the Sundays of October. This was what Dr. Taimtim did when he was still reviewing for the board examinations. In his case, the folk saying proved to be true because he is now a successful cardiologist. Wanting to give back to the chapel and help defray the costs of its maintenance, Dr. Taimtim donated P50,000.00 to the caretakers of the chapel which was evidenced by an acknowledgment receipt.**

**In computing his net taxable income, can Dr.Taimtim use his donation to the chapel as an allowable deduction from his gross income under the National Internal Revenue Code (NIRC)?**

**SUGGESTED ANSWER :**

No. the donation is not deductible. The chapel is owned by a privately-owned university hence, the donation for the maintenance of the chapel is a donation to the university. The donation to be deductible must comply with the requirement that the net income of the done must not inure to the benefit of any private stockholder or individual. In the instant case, the university is granting yearly dividends to

its stock holders which is a clear violation of the law appertaining to the so-called “private inurement doctrine” thereby making the donation non-deductible (*Section 34(H)(1), NIRC*).

**In 2012, Dr. K decided to return to his hometown to start his own practice. At the end of 2012, Dr. K found that he earned gross professional income in the amount of P1,000,000.00; while he incurred expenses amounting to P560,000.00 constituting mostly of his office space rent, utilities, and miscellaneous expenses related to his medical practice. However, to Dr. K's dismay, only P320,000.00 of his expenses were duly covered by receipts. What are the options available for Dr. K so he could maximize the deductions from his gross income? (2015 Bar Question)**

**SUGGESTED ANSWER:**

Dr. K may opt to use the optional standard deduction (OSD) in lieu of the itemized deduction. OSD is a maximum of forty percent (40%) of gross receipts during the taxable year. Proof of actual expenses is not required, but Dr. K shall keep such records pertaining to his gross receipts.

**True or False.**

**A corporation can claim the optional standard deduction equivalent to 40% of its gross sales or receipts, as the case may be. (2010 Bar Question)**

**SUGGESTED ANSWER:**

FALSE. The OSD should not exceed 40% of its gross income.

**Dondon and Helena were legally separated. They had six minor children, all qualified to be claimed as additional exemptions for income tax purposes. The court awarded custody of two of the children to Dondon and three to Helena, with Dondon directed to provide full financial support for them as well. The court awarded the 6th child to Dondon's father with Dondon also providing full financial support. Assuming that only Dondon is gainfully employed while Helena is not, for how many children could Dondon claim additional exemptions when he files his income tax return? (2011 Bar Question)**

- (A) Six children.
- (B) Five children.
- (C) Three children.
- (D) Two children.

**SUGGESTED ANSWER:**

**(D)** Two children.

**Premium payment for health insurance of an individual who is an employee in an amount of P2,500 per year may be deducted from gross income if his gross salary per year is not more than P250,000.(2010 Bar Question)**

**SUGGESTED ANSWER:**

False. (Sec. 34(M), NIRC)

**True or False.**

**A non-resident alien who stays in the Philippines for less than 180 days during the calendar year shall be entitled to personal exemption not to exceed the amount allowed to citizens of the Philippines by the country of which he is subject or citizen. (2010 Bar Question)**

**SUGGESTED ANSWER:**

False. [Sec. 25(A)(1) in relation to Sec. 35, NIRC]

**The head priest of the religious sect Tres Personas Solo Dios, as the corporation sole, rented out a 5,000 sq. m. lot registered in its name for use as school site of a school organized for profit. The sect used the rentals for the support and upkeep of its priests. The rented lot is: (2011 Bar Question)**

- (A) not exempt from real property taxes because the user is organized for profit.
- (B) exempt from real property taxes since it is actually, directly, and exclusively used for religious purposes.
- (C) not exempt from real property taxes since it is the rents, not the land, that is used for religious purposes.
- (D) exempt from real property taxes since it is actually, directly, and exclusively used for educational purposes.

**SUGGESTED ANSWER:**

**(D)** exempt from real property taxes since it is actually, directly, and exclusively used for educational purposes.

**Which of the following is an exclusion from gross income? (2014 Bar Question)**

- (A) Salaries and wages**
- (B) Cash dividends**
- (C) Liquidating dividends after dissolution of a corporation**
- (D) De minimis benefits**
- (E) Embezzled money**

**SUGGESTED ANSWER :**

D. *De minimis* benefits

**What are *de minimis* benefits and how are these taxed? Give three (3) examples of *de minimis* benefits. (2015 Bar Question)**

**SUGGESTED ANSWER:**

De minimis benefits are facilities, and privileges furnished or offered by an employer to his employees, which are not considered as compensation subject to income tax and consequently to withholding tax, if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as means of promoting the health, goodwill, contentment, or efficiency of his employees.

The excess over the de minimis limit prescribed shall be considered, along with the “other benefits” under Section 32(B)(7)(e)(iv), NIRC, in determining whether or not the P82,000 threshold has been exceeded. Any excess over the de minimis ceiling may be exempt if it is covered by the unused portion of the P82,000.00 non-taxable “other benefits”. Otherwise, any amount in excess of the P82,000.00 threshold becomes subject to tax.

The following shall be considered as “de minimis” benefits:

1. Monetized unused vacation leave credits of private employees not exceeding 10 days during the year;
2. Monetized unused vacation and sick leave credits paid to government officials and employees, regardless of the number of days;
3. Medical cash allowance to dependents of employees, not exceeding P750 per employee per semester or P125 per month;
4. Rice subsidy of P1,500 or one (1) sack of 50 kg. rice per month amounting to not more than P1,500;
5. Uniform and clothing allowance not exceeding P5,000 per annum;
6. Actual medical assistance not exceeding P10,000 per annum;
7. Laundry allowance not exceeding P300 per month;
8. Employees achievement awards, e.g., for length of service or safety achievement, which must be in the form of a tangible personal property other than cash or gift certificate, with an annual monetary value not exceeding P10,000 received by the employee under an established written plan which does not discriminate in favor of highly paid employees;
9. Gifts given during Christmas and major anniversary celebrations not exceeding P50,000 per employee per annum;
10. Daily meal allowance for overtime work and night/graveyard shift not exceeding 25% of the basic minimum wage on a per region basis;
11. Benefits received by an employee by virtue of a collective bargaining agreement (CBA) and productivity incentive schemes provided that the total annual monetary value received from both CBA and productivity incentive schemes combined do not exceed ten thousand pesos (P10,000.00) per employee per taxable year

**In January 2013, your friend got his first job as an office clerk. He is single and lives with his family who depends upon him for financial support. His parents have long retired from their work, and his two (2) siblings are still minors and studying in grade school. In February 2014, he consulted you as he wanted to comply with all the rules pertaining to the preparation and filing of his income tax return. He now asks you the following:**

**(A) Is he entitled to personal exemptions? If so, how much? (1%)**

**(B) Is he entitled to additional exemptions? If so, how much? (1%)**

**(C) What is the effect of the taxes withheld from his salaries on his taxable income? (2014**

Bar Question)

**SUGGESTED ANSWER :**

(A) Yes. The law allows a basic personal exemption of Php 50,000.00 for each individual taxpayer (*Section 35(A), NIRC*).

(B) No. While his parents and minor sibling are living with and dependent upon him for financial support, they are not qualified dependents for purposes of additional exemptions. The term “dependent”

for purposes of the additional personal exemption would include only legitimate, illegitimate, or legally adopted children (*Section 35(B), NIRC*).

(C) The taxes withheld from his salaries will not affect his taxable income because they are not allowed as tax deductions but as tax credits. Tax deductions reduce taxable income while tax credits reduce the tax liability (*Central Drug Corporation v. CIR*).

**Mr. E and Ms. F are both employees of AAA Corp. They got married on February 14, 2011. On December 29, 2011, the couple gave birth to triplets. On June 25, 2013, they had twins. What were the personal exemptions/deductions which Mr. E and Ms. F could claim in the following taxable years: (2015 Bar Question)**

- a) For 2010
- b) For 2011
- c) For 2013

**SUGGESTED ANSWER:**

- a. Both Mr. E and Ms. F can claim for personal exemption up to P50,000.00.
- b. Either Mr. E or Ms. F can claim for additional exemption of P25,000.00 each for their children. This is in addition to the personal exemption of P50,000.00 which they can respectively claim. According to the Tax Code, only one of the spouses can claim for additional exemption for every dependent.
- c. Mr. E and Ms. F can claim for personal exemptions, respectively. In addition, any one of them, exclusively, can claim for the additional exemptions in relation to their four dependents amounting to P25,000.00 each. Under the Tax Code, an individual may claim up to four additional exemptions in connection with his/her dependents.

**Passive income includes income derived from an activity in which the earner does not have any substantial participation. This type of income is: (2011 Bar Question)**

- (A) usually subject to a final tax.
- (B) exempt from income taxation.
- (C) taxable only if earned by a citizen.
- (D) included in the income tax return.

**SUGGESTED ANSWER:**

- (A) usually subject to a final tax.

**ABC, a domestic corporation, entered into a software license agreement with XYZ, a non-resident foreign corporation based in the U.S. Under the agreement which the parties forged in the U.S., XYZ granted ABC the right to use a computer system program and to avail of technical know-how relative to such program. In consideration for such rights, ABC agreed to pay 5% of the revenues it receives from customers who will use and apply the program in the Philippines.**

**Discuss the tax implication of the transaction. (2010 Bar Question)**

**SUGGESTED ANSWER:**

The amount payable under the agreement is in the nature of a royalty. The term royalty is broad enough to include compensation for the use of an intellectual property and supply of technical know-how as a means of enabling the application or enjoyment of any such property or right. The royalties paid to the non-resident US Corporation, equivalent to 5% of the revenues derived by ABC for the use of the program in the Philippines, is subject to a 30% final withholding tax, unless a lower tax rate is prescribed under an existing tax treaty.

**A resident Filipino citizen (not a dealer in securities) sold shares of stocks of a domestic corporation that are listed and traded in the Philippine Stock Exchange. (2012 Bar Question)**

- a) The sale is exempt from income tax but subject to the ½ of 1% stock transaction tax;
- b) The sale is subject to income tax computed at the graduated income tax rates of 5% to 32% on net taxable income;
- c) The sale is subject to the stock transaction tax and income tax;
- d) The sale is both exempt from the stock transaction tax and income tax.

**SUGGESTED ANSWER:**

- a) The sale is exempt from income tax but subject to the ½ of 1% stock transaction tax

Section 127, NIRC.

**A dealer in securities sold unlisted shares of stocks of a domestic corporation in 2010 and derived a gain of P1 Million therefrom. The gain is: (2012 Bar Question)**

- a) Taxable at 30% regular corporate income tax based on net taxable income;
- b) Taxable at 5%/10% capital gains tax based on net capital gain;
- c) Taxable at ½ of 1% stock transaction tax based on the gross selling price or fair market value, whichever is higher
- d) Exempt from income tax

**SUGGESTED ANSWER:**

- a) Taxable at 30% regular corporate income tax based on net taxable income

Section 22 (U) in relation to Section 27, NIRC.

**Which statement is correct? A non-stock, non-profit charitable association that sells its idle agricultural property is: (2012 Bar Question)**

- a) Not required to file an income tax return nor pay income tax on the transaction to the BIR, provided the sales proceeds are invested in another real estate during the year;
- b) Required to pay the 6% capital gains tax on the gross selling price of fair market value, whichever is higher;
- c) Mandated to pay the 30% regular corporate income tax on the gain from sale;
- d) Required to withhold the applicable expanded withholding tax rate on the transaction and remit the same to the BIR.

**SUGGESTED ANSWER:**

b) Required to pay the 6% capital gains tax on the gross selling price of fair market value, whichever is higher

Section 30, NIRC.

**Prior to the VAT law, sales of cars were subject to a sales tax but the tax applied only to the original or the first sale; the second and subsequent sales were not subject to tax.**

**Deltoid Motors, Inc. (Deltoid) hit on the idea of setting up a wholly-owned subsidiary, Gonmad Motors, Inc. (Gonmad), and of selling its assembled cars to Gonmad at a low price so it would pay a lower tax on the first sale. Gonmad would then sell the cars to the public at a higher price without paying any sales tax on this subsequent sale.**

**Characterize the arrangement. (1%)(2013 Bar Question)**

- (A) The plan is a legitimate exercise of tax planning and merely takes advantage of a loophole in the law.
- (B) The plan is legal because the government collects taxes anyway.
- (C) The plan is improper; the veil of corporate fiction can be pierced so that the second sale will be considered the taxable sale.
- (D) The government must respect Gonmad's separate juridical personality and Deltoid's taxable sale to it.

**SUGGESTED ANSWER:**

**(C)** The plan is improper; the veil of corporate fiction can be pierced so that the second sale will be considered the taxable sale.

The given problem is similar to the case of *Commissioner of Internal Revenue v. Norton and Harrison Company* (G.R. No. L-17618, August 31, 1964). The Supreme Court held that “a taxpayer may gain advantage of doing business thru a corporation if he pleases, but the revenue officers in proper cases, may disregard the separate corporate entity where it serves but as a shield for tax evasion and treat the person who actually may take benefits of the transactions as the person accordingly taxable.

To allow a taxpayer to deny tax liability on the ground that the sales were made through another and distinct corporation when it is proved that the latter is virtually owned by the former or that they are practically one and the same is to sanction a circumvention of our tax laws.”

**ABS Corporation is a PEZA-registered export enterprise which manufactures cameras and sells all its finished products abroad. Which statement is NOT correct? (2012 Bar Question)**

- a) ABS Corporation is subject to the 5% final tax on gross income earned, in lieu of all national and local taxes;
- b) ABS Corporation is exempt from the 30% corporate income tax on net income, provided it pays value added tax;

- c) ABS Corporation is subject to the 30% corporate income tax on net income;
- d) ABS Corporation is exempt from all national and local taxes, except real property tax.

**SUGGESTED ANSWER:**

- a) ABS Corporation is subject to the 5% final tax on gross income earned, in lieu of all national and local taxes

Sections 23 & 24, RA 7916.

**KKK Corp. secured its Certificate of Incorporation from the Securities and Exchange Commission on June 3, 2013. It commenced business operations on August 12, 2013. In April 2014, Ms. J, an employee of KKK Corp. in charge of preparing the annual income tax return of the corporation for 2013, got confused on whether she should prepare payment for the regular corporate income tax or the minimum corporate income tax.**

- a) As Ms. J's supervisor, what will be your advice?
- b) What are the distinctions between regular corporate income tax and minimum corporate income tax? (2015 Bar Question)

**SUGGESTED ANSWER:**

a. As Ms. J's supervisor, I will advise that KKK Corp. should prepare payment for the regular corporate income tax. Under the Tax Code, Minimum Corporate Income Tax (MCIT) is applicable beginning on the fourth taxable year following the commencement of operation. Thus, in this case, KKK Corp. will only apply MCIT starting taxable year 2017.

b. Distinction as to taxpayer: Regular corporate income tax applies to all corporate taxpayers; while minimum corporate income tax applies to domestic corporations and resident foreign corporations.

Distinction as to rate: Regular income tax is 30%; while minimum corporate income tax is 2%.

Distinction as to tax base: Regular corporate income tax is based on the net taxable income, except nonresident foreign corporation which is based on gross income; while minimum corporate income tax is based on gross income.

Distinction as to period of applicability: Regular corporate income tax is applicable once the corporation commenced its operation, while MCIT is applicable beginning the fourth taxable year following the commencement of operation.

**Which of the following should not be claimed as deductions from gross income? (2014 Bar Question)**

- (A) discounts given to senior citizens on certain goods and services.
- (B) advertising expense to maintain some form of goodwill for the taxpayer's business.
- (C) salaries and bonuses paid to employees.
- (D) interest payment on loans for the purchase of machinery and equipment used in business.

**SUGGESTED ANSWER :**

- B. Advertising expense to maintain some form of goodwill for the taxpayer's business.

**Freezy Corporation, a domestic corporation engaged in the manufacture and sale of ice cream, made payments to an officer of Frosty Corporation, a competitor in the ice cream business, in exchange for said officer's revelation of Frosty Corporation's trade secrets.**

**May Freezy Corporation claim the payment to the officer as deduction from its gross income? Explain. (2014 Bar Question)**

**SUGGESTED ANSWER :**

No. The payments made in exchange for the revelation of a competitors trade secrets is considered an expense which is against law, morals, good customs, or public policy, which is not deductible (*3M Philippines, Inc. v. CIR, G.R. No. 82833, September 26, 1988*). Also, the law will not allow the deduction of bribes, kickback, and other similar payments. Applying the principle of *ejusdem generis*, payment made by *Freezy Corporation* would fall under "other similar payments" which are not allowed as deduction from gross income (*Section 34(A)(1)(c), NIRC*).

**The excess of allowable deductions over gross income of the business in a taxable year is known as: (2011 Bar Question)**

- (A) net operating loss.
- (B) ordinary loss.
- (C) net deductible loss.
- (D) NOLCO.

**SUGGESTED ANSWER:**

- (A) net operating loss.

**Sale of residential house and lot by an official of a domestic corporation to another official in the same corporation for a consideration of P2.5 Million in 2011 is: (2012 Bar Question)**

- a) Exempt from VAT because the gross sales do not exceed P2.5 Million;
- b) Exempt from VAT because the property sold is a capital asset, regardless of the gross selling price;
- c) Exempt from VAT because the seller is not a person engaged in real estate business;
- d) Taxable at 12% VAT output tax on the gross selling price of P2.5 Million.

**SUGGESTED ANSWER:**

- b) Exempt from VAT because the property sold is a capital asset, regardless of the gross selling price

Section 106, NIRC.

**Lualhati Educational Foundation, Inc., a stock educational institution organized for profit, decided to lease for commercial use a 1,500 sq. m. portion of its school. The school actually, directly, and exclusively used the rents for the maintenance of its school buildings, including payment of janitorial services. Is the leased portion subject to real property tax? (2011 Bar Question)**

- (A) Yes, since Lualhati is a stock and for profit educational institution.
- (B) No, since the school actually, directly, and exclusively used the rents for educational purposes.
- (C) No, but it may be subject to income taxation on the rents it receives.
- (D) Yes, since the leased portion is not actually, directly, and exclusively used for educational purposes.

**SUGGESTED ANSWER:**

**(D)** Yes, since the leased portion is not actually, directly, and exclusively used for educational purposes.

**Zygomite Minerals, Inc., a corporation registered and holding office in Australia, not operating in the Philippines, may be subject to Philippine income taxation on: (2011 Bar Question)**

- (A) gains it derived from sale in Australia of an ore crusher it bought from the Philippines with the proceeds converted to pesos.
- (B) gains it derived from sale in Australia of shares of stock of Philex Mining Corporation, a Philippine corporation.
- (C) dividends earned from investment in a foreign corporation that derived 40% of its gross income from Philippine sources.
- (D) interests derived from its dollar deposits in a Philippine bank under the Expanded Foreign Currency Deposit System.

**SUGGESTED ANSWER:**

**(B)** gains it derived from sale in Australia of shares of stock of Philex Mining Corporation, a Philippine corporation.

**What is the "immediacy test"? Explain briefly. (2010 Bar Question)**

**SUGGESTED ANSWER:**

This test is applied to determine whether the accumulation of after tax profits by a domestic or resident foreign corporation is really for the reasonable needs of the business. Under this test, the reasonable needs of the business are construed to mean the immediate needs. The corporation should be able to prove an immediate need for the accumulation of earnings and profits, or the direct correlation of anticipated needs to such accumulation of profits to justify the said accumulation.

**True or False.**

**The capitalization rules may be resorted to by the BIR in order to compel corporate taxpayers to declare dividends to their stockholders regularly. (2010 Bar Question)**

**SUGGESTED ANSWER:**

True. [Sec. 244, NIRC; Rev. Regulation No. 2-2001 implementing Sec. 29 , NIRC)

**In 2009, Spratz, Inc.'s net profit before tax was P35 million while its operating expenses was P31 million. In 2010, its net profit before tax was P40 million and its operating expenses was P38**

**million. It did not declare dividends for 2009 and 2010. And it has no proposed capital expenditures for 2011 and the immediate future. May Spratz be subject to the improperly accumulated tax on its retained profits for 2009 and 2010?** (2011 Bar Question)

- (A) Yes, since the accumulated amounts are reasonable for operations in relation to what it usually needed annually.
- (B) Yes, since the accumulation is not reasonably necessary for the immediate needs of the business.
- (C) No, because there is no showing that the taxpayer's 2009 and 2010 net profit before tax exceeded its paid-up capital.
- (D) No, because the taxpayer is not shown to be a publicly-listed corporation, a bank, or an insurance company.

**SUGGESTED ANSWER:**

**(B)** Yes, since the accumulation is not reasonably necessary for the immediate needs of the business.

**Atty. Gambino is a partner in a general professional partnership. The partnership computes its gross revenues, claims deductions allowed under the Tax Code, and distributes the net income to the partners, including Atty. Gambino, in accordance with its articles of partnership.**

**In filing his own income tax return, Atty. Gambino claimed deductions that the partnership did not claim, such as purchase of law books, entertainment expenses, car insurance and car depreciation. The BIR disallowed the deductions.**

**Was the BIR correct?** (2013 Bar Question)

**SUGGESTED ANSWER:**

The BIR is wrong in disallowing the deductions.

Under Section 26 of the NIRC, a general professional partnership is exempt from income tax and, thus, cannot claim deductions. However, partners in a general professional partnership are liable, in their separate and individual capacities, for the payment of income tax computed on their distributive share of the general professional partnership's profits. Consequently, these partners may claim deductions under Section 34 of the NIRC from their gross income.

In the given problem, Atty. Gambino's expenses for the purchase of law books and the availing of car insurance are allowable deductions because they are ordinary and necessary expenses in the exercise of his profession. Law books are directly attributable to Atty. Gambino's development and conduct as a lawyer pursuant to Section 34(A)(1)(a) of the NIRC. Meanwhile, car insurance is an ordinary and necessary expense in the purchase of a car. It should be noted that cars are ordinarily used by lawyers who travel from one place to another for purposes of attending hearings, meeting clients, signing agreements, and the like. For these same reasons, a reasonable allowance for the car's depreciation is deductible under Section (34)(F)(1) of the NIRC. A reasonable allowance for entertainment or representation expenses can also be claimed as deduction from gross income, as these expenses are directly connected or in the furtherance of the conduct of Atty. Gambino's profession as a lawyer, applying Section (34)(A)(1)(a)(iv) of the NIRC and Revenue Regulation No. 10-2002.

**XYZ Law Offices, a law partnership in the Philippines and a VAT-registered taxpayer, received a query by e-mail from Gainsburg Corporation, a corporation organized under the laws of Delaware, but the e-mail came from California where Gainsburg has an office. Gainsburg has no office in the Philippines and does no business in the Philippines.**

**XYZ Law Offices rendered its opinion on the query and billed Gainsburg US\$1,000 for the opinion. Gainsburg remitted its payment through Citibank which converted the remitted US\$1,000 to pesos and deposited the converted amount in the XYZ Law Offices account.**

**What are the tax implications of the payment to XYZ Law Offices in terms of VAT and income taxes? (2013 Bar Question)**

**SUGGESTED ANSWER:**

Preliminarily, XYZ Law Offices is a general professional partnership which is defined under Sec. 22(B) of the NIRC as a partnership formed by persons for the sole purpose of exercising their common profession, no part of the income of which is derived from engaging in any trade or business. On the other hand, Gainsburg is considered as a nonresident foreign corporation under Sec. 22(I) of the NIRC. The tax implications are as follows:

As to VAT: XYZ Law Offices, as a general professional partnership, is subject to VAT as it rendered services to Gainsburg. Pursuant to Sec. 105 of the NIRC, any person who, in the course of business, renders services shall be subject to VAT.

In the given problem, the XYZ Law Offices rendered services to a nonresident person not engaged in business and which is outside the Philippines. The consideration for the services was paid in an acceptable foreign currency. Therefore, the transaction in the given problem is subject to zero percent (0%) rate of VAT provided under Sec. 108 (B)(2) of the NIRC.

As to income tax: XYZ Law Office is not subject thereto because it is a general professional partnership. Sec. 26 of the NIRC expressly provides that a general professional partnership shall not be subject to the income tax. Persons engaging in business as partners in a general professional partnership shall be liable for income tax only in their separate and individual capacities.

**A, B, and C, all lawyers, formed a partnership called ABC Law Firm so that they can practice their profession as lawyers. For the year 2012, ABC Law Firm received earnings and paid expenses, among which are as follows:**

**Earnings:**

- (1) Professional/legal fees from various clients**
- (2) Cash prize received from a religious society in recognition of the exemplary service of ABC Law Firm**
- (3) Gains derived from sale of excess computers and laptops**

**Payments:**

- (1) Salaries of office staff**
  - (2) Rentals for office space**
  - (3) Representation expenses incurred in meetings with clients**
- (A) What are the items in the above mentioned earnings which should be included in the computation of ABC Law Firm's gross income? Explain.**

**(B) What are the items in the above-mentioned payments which may be considered as deductions from the gross income of ABC Law Firm? Explain.**

**(C) If ABC Law Firm earns net income in 2012, what, if any, is the tax consequence on the part of ABC Law Firm insofar as the payment of income tax is concerned? What, if any, is the tax consequence on the part of A, B, and C as individual partners, insofar as the payment of income tax is concerned? (2014 Bar Question)**

**SUGGESTED ANSWER :**

(A) The three (3) items of earnings should be included in the computation of ABC *Law Firm's* gross income. The professional/legal fees from various clients is included as part of gross income being in the nature of compensation for services (*Section 32(A)(1), NIRC*). The cash prize from a religious society in recognition of its exemplary services is also included there being no law providing for its exclusion. This is not a prize in recognition of any of the achievements enumerated under the law hence, should form part of gross income (*Section 32(B)(7)(c), NIRC*). The gains from sale of excess computers and laptops should also be included as part of the firm's gross income because the term gross income specifically includes gains derived from dealings in property (*Section 32(A)(3), NIRC*).

(B) The law firm being formed as general professional partnership is entitled to the same deductions allowed to corporation (*Section 26, NIRC*). Hence, the three (3) items of deductions mentioned in the problem are all deductible, they being in the nature of ordinary and necessary expenses incurred in the practice of profession (*Section 34(A), NIRC*). However, the amount deductible for representation expenses incurred by a taxpayer engaged in sale of services, including a law firm, is subject to a ceiling of 1% of net revenue. (*RR No. 10-2002*)

(C) The net income having been earned by the law firm which is formed and qualifies as a general professional partnership, is not subject to income tax because the earner is devoid of any income tax personality. Each partner shall report as gross income his distributive shares, actuality or constructively received, in the net income of the partnership. The partnership is merely treated for income tax purposes as a pass-through entity so that its net income is not taxable at the level of the partnership but said net income should be attributed to the partners, whether or not distributed to them, and they are liable to pay the income tax based on their respective taxable income as individual taxpayers (*Section 26, NIRC*).

**BBB, Inc., a domestic corporation, enjoyed a particularly profitable year in 2014. In June 2015, its Board of Directors approved the distribution of cash dividends to its stockholders. BBB, Inc. has individual and corporate stockholders. What is the tax treatment of the cash dividends received from BBB, Inc. by the following stockholders: (2015 Bar Question)**

- a) A resident citizen
- b) Non-resident alien engaged in trade or business
- c) Non-resident alien not engaged in trade or business
- d) Domestic corporation
- e) Non-resident foreign corporation

**SUGGESTED ANSWER:**

a. A final withholding tax of ten percent (10%) shall be imposed upon the cash dividends actually or constructively received by a resident citizen from BBB, Inc.

b. A final withholding tax of twenty percent (20%) shall be imposed upon the cash dividends actually or constructively received by a nonresident alien engaged in trade or business from BBB, Inc.

c. A final withholding tax equal to twenty-five percent (25%) of the entire income received from all sources within the Philippines, including the cash dividends received from BBB, Inc.

d. Dividends received by a domestic corporation from another corporation, such as BBB, Inc., shall not be subject to tax.

e. A final withholding tax of fifteen percent (15%) is imposed on the amount of cash dividends received from BBB, Inc., subject to the tax sparing credit provision (Section 28(B)(5)(b), NIRC). The application of the tax sparing credit is that the country-domicile of the recipient corporation allows a credit against the tax due from the non-resident foreign corporation. Otherwise, the applicable tax rate is thirty percent (30%) of the gross income received during each taxable year from all sources within the Philippines.

**True or False.**

**Indicate whether each of the following individuals is required or not required to file an income tax return: (2015 Bar Question)**

- a) Filipino citizen residing outside the Philippines on his income from sources outside the Philippines.**
- b) Resident alien on income derived from sources within the Philippines.**
- c) Resident citizen earning purely compensation income from two employers within the Philippines, whose income taxes have been correctly withheld.**
- d) Resident citizen who falls under the classification of minimum wage earners.**
- e) An individual whose sole income has been subjected to final withholding tax.**

**SUGGESTED ANSWER:**

a. No, because a non-resident Filipino citizen is taxable only in income sourced within the Philippines.

b. Yes because a resident alien is taxable for income derived from sources within the Philippines.

c. Yes. A resident citizen who is earning purely compensation income from two employers should file income tax return for not being qualified for substituted filing.

d. No. Under the law, all minimum wage earners in the private and public sector shall be exempt from payment of income tax.

e. No. Under the law, an individual whose sole income has been subjected to final withholding tax pursuant to Section 57(A) of the NIRC need not file a return.

**Informer's reward is subject to a final withholding tax of 10%. (2010 Bar Question)**

**SUGGESTED ANSWER:**

True. (Sec. 282, NIRC)

**The payor of passive income subject to final tax is required to withhold the tax from the payment due the recipient. The withholding of the tax has the effect of:** (2011 Bar Question)

- (A) a final settlement of the tax liability on the income.
- (B) a credit from the recipient's income tax liability.
- (C) consummating the transaction resulting in an income.
- (D) a deduction in the recipient's income tax return.

**SUGGESTED ANSWER:**

- (A)** a final settlement of the tax liability on the income.