

THE NEW INDIVIDUAL INCOME TAXATION IN THE PHILIPPINES

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Introduction

The new approach to the taxation of individual income represents a serious effort to impose a taxation system which is equally desirable and advantageous both to government and taxpayers alike. This shift from a global or unitary to a schedular approach under Batas Pambansa (BP) 135 has been met with mixed reactions by various taxpayer groups. Some protested that the new approach is a marked departure from the generally-accepted net income approach which, theoretically speaking, best reflects ability to pay and that far from being an improvement, this change is degenerative in character. Others were apprehensive about the resultant tax burden which is expected to be far heavier than what will obtain under the old approach. To a certain extent, both objections are true. Indeed the net income tax is reflective of one's ability to pay tax since theoretically what remains after deducting the cost of earning income is a good approximation or index of capability to absorb the tax. It will be discussed later that while this may hold true for a more sophisticated society, it may not be so for a developing country like the Philippines. With regard to the second objection, the elimination of certain items of deduction which have been previously enjoyed may have indeed created a heavier tax burden on some segments of society. But the reform package must concern itself with society *in toto* and not primarily with individual or group utility.

Given said framework, this paper will rationalize the adoption of the new system of individual income taxation in the Philippines. The discussion will be divided into 3 parts. Part I will discuss the former

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system of taxing incomes of individuals, including the identification of the weaknesses and difficulties inherent thereto. The second part will present the new system of taxing individual incomes and the final part of the paper synthesizes some comments and suggestions on the subject matter.

Part I

The Scenario Needing Reforms

To put the discussion in its proper context, it will be quite helpful to sketch very briefly the main features of the two approaches to income taxation as practiced in the Philippines.² The global or the unitary approach lumps together all items of individual incomes, *e.g.*, wages, salaries, business profits, dividends, etc. and applies one rate schedule on the net taxable income. The tax base which is the net taxable income is derived after deducting certain allowable items of deductions and the personal exemption from the global (aggregated) income.³ In contrast, the schedular approach allows the imposition of different rates to income from different sources.

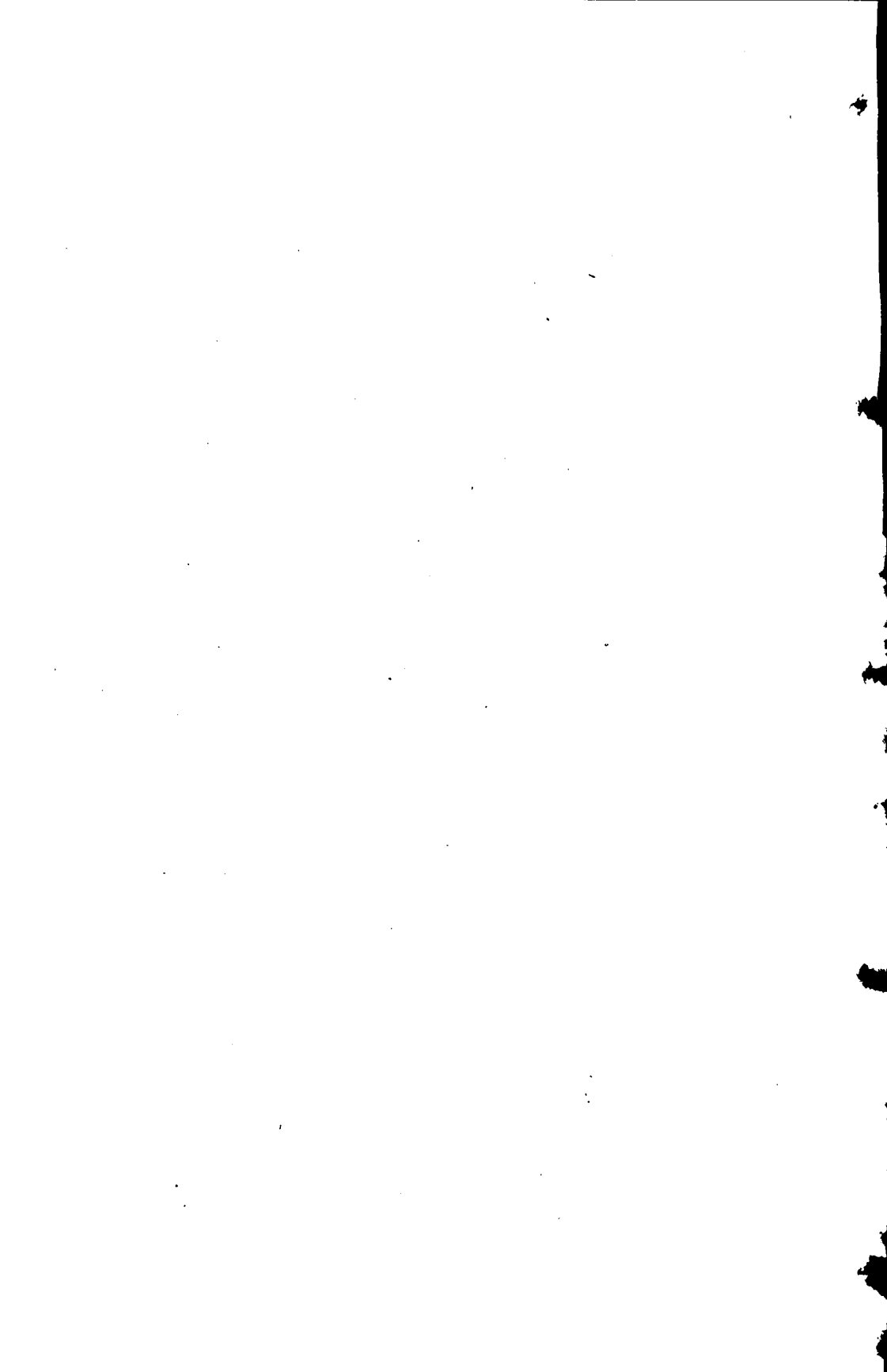
Note, however, that as practiced in the Philippines, the individual income taxation is not a "pure" unitary approach because some items of income are taxed separately. These are interest income from bank deposits, yields from deposit substitutes and dividends. The reason for this arrangement is simple: these items have not been as effectively taxed as they are under a separate rate schedule (*i. e.*, final withholding rate).

While the global approach⁴ seems to be most desirable because it meets the well-established canons of efficiency in collection,

²Please note that the changes introduced by BP 135 pertain only to resident citizens and aliens for incomes derived within and without the Philippines; and to nonresident citizens for their Philippine-sourced income.

³Tables 1 and 2 summarize the main components of the global approach.

⁴See Table 3 for listing of countries which are preponderantly global or generally schedular in their income tax system.



equity and tax progressivity, it is very difficult to administer especially in a developing economy like the Philippines. Its successful administration depends on the presence of many factors, among which are high tax ethics and a large degree of voluntary compliance among taxpayers; honest and efficient tax administration; and a reliable system of records management. The lack of any of these will affect the efficiency and productivity of income taxation. It is not imprudent to attribute the lackluster performance of the individual income tax in the Philippines to basic inadequacies. From contributing a mere 7.6 percent of total revenues in 1970, the individual income tax generated a 10.1 per cent share in 1980, an increase of only two and a half percentage points over a *decade*. This sluggish growth is attributed, among others, to the vulnerability of the income tax system to negotiation, manipulation and discretion on the part of both the taxpayer and the tax examiner. Underdeclaration and even non-declaration of incomes were major problems. The very liberal tax deductions served as significant avenues for tax avoidance and evasion. It is not an exaggeration to claim that taxpayers were able to get away with inflated deductions. The possibility that some taxpayers did not even file tax returns was not remote. Coupled with a weak tax administrative machinery and the natural propensity to shirk the tax burden, the net effect was an inadequate revenue performance and serious implications on tax progressivity.

Several studies conducted by the research staff of the National Tax Research Center (NTRC) support these observations.⁵ For instance, for the period 1963-1969 the elasticity coefficient for the personal income tax was a low 0.8680 showing the anemic response of income tax to growth in gross national product (NTRC, 1982). Another study for the period 1963 to 1970 showed still an inelastic coefficient of 0.98 (Alfiler, 1975). The main culprit for this unsatisfactory performance was the extensive claims for deductions which

⁵A more recent study was that of Llanto (1983) who estimated an elasticity of 1.29 for the personal income tax over the period 1966-81. The estimates, however, used tax data which included the effects of discretionary changes over the same period. More refined data might yield a lower estimate.

increased disproportionately with increases in income (Ramos, 1975). The net effect was a substantial erosion of the tax base. Statistics on the individual income tax revealed how the availment of deductions had affected the yield from this source. The 1970 income tax returns indicated that the deductions plus exemptions accounted for 75 per cent of the gross income of taxable individuals. Deductions comprised 50 per cent of gross income while exemptions accounted for 25 per cent. Eight years later, 1978 statistics on the individual income tax displayed a similar pattern. Deductions ate up as much as 40 per cent of the gross income of taxable individual income taxpayers. By and large, this implied that deductions were indeed too generous and/or inflated. This situation persisted because there was much ease in their availment, legal or otherwise.

A short discussion of some of the more abused items of deduction may prove interesting at this point. A notable characteristic of the Philippine individual income tax prior to BP 135 is the long list of deductions in the Tax Code which includes both income-related and personal deductions. Table 2 shows the allowable deductions under the global system. Personal deductions like medical care expenses; non-business interest expense; e.g., housing loan, were granted because of certain social considerations. On the other hand, the more problematic group of deductions were business or income-related deductions. In principle, these deductions were generally available in unlimited amounts unlike personal deductions. Despite guidelines set in the implementing revenue regulations, tax manipulations were likely owing partly to the vagueness of some provisions which can be exploited to the hilt in order to reduce the taxable base. From this set of deductions, the most commonly abused were those relating to ordinary and necessary business expenses. e.g., transportation, advertising and entertainment expenses.

With respect to salaried taxpayers, very few legitimate deductions (mostly personal deductions) were actually available. However, most of the salaried taxpayers especially those belonging to the middle class, availed themselves extensively of business-related deductions. The more enterprising ones "established" sham business enterprises which enabled them to offset "losses" therefrom against

their salaries.⁶ The 10 per cent standard deduction had become a poor choice in view of the relative financial benefit afforded by itemization of deductions. It was observed that its availment substantially decreased. In 1974, 72 per cent of individual tax filers used the standard deduction; a few years later (in 1978), only 61 per cent of individual tax filers decided to use the same. It is likely that taxpayers considered the 10 per cent standard deduction and its ceiling of ₱5,000 very inadequate in view of inflation and the relative ease in claiming fictitious deductions notwithstanding the risk of being audited and the substantiation requirements.

The other area which needed serious concern was the extent of tax evasion. A quantitative measurement of the extent of the parallel economy has not been made. Nevertheless, if the response to tax amnesty decrees⁷ is an indication, it appears that moneyed individuals have really taken good advantage of the tax loopholes to escape legitimate income taxes. Untaxed income amounted to at least ₱13.4 billion during the years covered by the amnesties. It was admitted by the Bureau of Internal Revenue (BIR) that the tax amnesty returns confirmed the suspicion of ridiculously low tax payments implying that incomes were thoroughly understated and that deductions were inflated. The limited income coverage of the global approach was also due to the low tax compliance of some income earners as shown for example by the greater proportion of collections from wages and salaries compared to non-fixed and other incomes such as profits, rents and dividends.

The tax rate structure prior to BP 135 was far from being ideal. The tax rate rose from three per cent (3%) on taxable income less than ₱2,000 through a total of 37 steps (or brackets) to a maximum of 70 percent on taxable income over ₱500,000. Compared to its neighboring countries, including the ASEAN, the top rate in the Philippines was deemed too high while the initial rate was relatively

⁶In 1979, BP 41 was enacted to disallow the offsetting of losses from one line of activity against another. This is one of the features of the original (1976) proposed modified Gross Income Tax study.

⁷Six such tax amnesties had been declared from 1973 to 1981.

low. Whereas revenue considerations dictate progressive rates, too high a set of rates on the higher income brackets may give an incentive for tax evasion. Manipulation of reported gross incomes and padding of deductions may be done since the steep marginal tax rates do really penalize incentive to work and invest.

By and large, the structural deficiencies of the individual income tax system and a weak administrative machinery together conspired to make the global approach wanting in its capability to raise adequate tax revenues from personal incomes and to be an effective tool for equity in income distribution. What is obviously needed is an approach to individual taxation which is innovative and simpler to administer given the limitations imposed by the level of development and sophistication of the economy. Such a system must necessarily curtail, if not remove, the areas of discretion and manipulation and simplify tax administration. Propelled by these needs, the Philippines turned to the schedular approach to individual taxation.

Part II

The Schedular Approach to Income Taxation, Philippine Style

In theory, the schedular approach to income taxation is relatively less superior than the global approach in approximating the taxpayer's ability to pay. However, in cases when the fiscal system is weak and is incapable of analytical assessments of actual income, the schedular approach can be relatively more effective. By varying the tax burden among different types of income (i.e., lower tax rate on labor income and a higher rate on capital income), the progressivity and equity of the tax system can be enhanced. Likewise, higher rates on capital income or unearned income may be used to offset a high degree of evasion on the said income (Musgrave, 1964). There may be a net gain in preferring a progressive schedular income tax system over a progressive global taxation which is beset with problems of tax avoidance and evasion. This is again a proof that a country should adopt a tax system which may be an antithesis of the literature developed in public finance in developed countries, but is suited to its particular stage of economic and social development.

Using a schedular system of income taxation, individual incomes are grouped under three categories: (1) compensation income, (2) business/trade/professional income and (3) passive income. A different rate schedule is imposed on each income category (Table 1), among others, because of the assumed distinctions between various income sources.⁸

The Taxation of Compensation Income

Gross compensation income includes all payments received as a result of an employer-employee relationship. Under BP 135, these are salaries, wages, compensation, emoluments, and honoraria; bonuses; allowances; nonmonetary compensation; fees (director's fees and the like); taxable pensions; amounts drawn as salaries by partners of partnerships taxable as corporations; and other incomes of a similar nature. The computation of taxable compensation has been simplified by allowing the deduction *only* of personal and additional exemptions from gross income (less the usual exclusions allowed by law).⁹ What is notable here is the *complete* disallowance of all forms of personal and business-related deductions as shown in Table 2. The word *disallowance* is used with caution, however, to avoid oversimplifications that *deductions* were just done away with. The government rationalized their use by restructuring the tax rates. By simulation, the NTRC developed a rate structure which built into it the amount of deductions equal to the level availed of by the taxpayers in 1978. This resulted in a much lower set of tax rates ranging from 0 per cent on income not over ₱2,500 to 35 per cent on incomes exceeding ₱500,000. Note that they are much lower relative to the former rates, a tax relief in fact is given to the first ₱2,500 of the income of every taxpayer by subjecting them to a 0 per cent rate.

⁸A detailed discussion of the rationale for the distinction can be obtained by reading Pigou's theory on the equal absolute theory in taxation. Harold Somers book *Public Finance and National Income* is also a valuable reference.

⁹Some of these are proceeds of life insurance policies paid to the beneficiaries upon death of the insured, compensation for injuries or sickness, social security benefits, etc. These are also excluded from the taxable gross business incomes (second category).

To determine the effect of the tax reform package on the tax burden, an estimate of the same was made. Tables 4 and 5¹⁰ illustrate that with BP 135, the absolute and the effective tax burden of taxpayers who used the optional standard deduction (OSD) will decrease while there will be an increase in the tax burden of itemizing deductions (ID). The increase in the tax burden of the latter should be viewed against the context that the deductions which were formerly available to taxpayers were built into the tax rates. It can thus be surmised that the difference in the tax burden represents the extent to which the itemizing taxpayers were able to minimize their tax liability. The new law simply compels the taxpayers to pay the tax that should rightfully be paid to the government.

The pattern in the change in the tax burden of taxpayers is noted to be the same regardless of the number of their dependents. Of course, the estimates were made using the *ceteris paribus* assumption, i.e., the changes in other variables like income did not form part of the simulation.

The added feature in the reform package which is intended to inject flexibility in the income tax system is the indexation scheme. Under this provision, an adjustment of the exemption levels may be done every three years by the President upon recommendation of the Minister of Finance after considering certain factors (e.g., inflation rate, etc.).

The new income tax system is also expected to ease administration and compliance. In contrast to the old system, where withheld taxes are only creditable, the taxes withheld from employees deriving compensation income from only one employer are deemed *final*. If a married couple derive income from one and the same employer, the taxes so withheld are also considered final, in which case the employer shall determine the withholding tax on the basis of their joint income. The requirements to file a tax return during the required

¹⁰Table 4 shows the comparative tax burden of a married taxpayer without dependent and Table 5, with four dependents. See also graphical illustrations and analyses attached to Tables 4 and 5.

period still holds. Taxpayers with mixed income shall report their business and other income (category 2) separately from compensation income but using the same form.

The Taxation of Business and Other Income

The income from business, the practice of a profession, trade, vocation or similar activities is taxed differently and separately from compensation income. The net income approach has been retained whereby allowable deductions and personal exemption can be subtracted from the gross income to determine the tax base.¹¹ Table 2 shows that the only deductions which have been disallowed are those relating to medical and educational expenses. The expenses that can be claimed as deductions are those which are related to the generation of business incomes.

The tax rates on business incomes are relatively higher than the rates for compensation income: 5 per cent of net incomes not over ₱10,000 to as much as 60 per cent of incomes exceeding ₱500,000. The difference in the range of rates is a recognition of the elbow room available to taxpayers earning business incomes in claiming deductions.

Admittedly, the problem of discretion still exists under this new scheme owing primarily to the self-assessment nature of income taxes from business and professional incomes. Declared incomes cannot be easily verified because of the non-issuance of receipts, poor record-keeping by the self-employed and the failure of the withholding system to cover adequately all types of incomes.¹² However, to the extent that the examination and audit requirements for compensation income have been greatly diminished by the new system, then it may be safely assumed that more efforts can now be devoted to assure the correct tax payments by earners of business income.

¹¹This type of taxpayers has also the option to use the optional standard deduction of 10 per cent without limit.

¹²Despite the penalties imposed by PD 1255 and the expanded withholding scheme under PD 1351, both issued in 1978.

Taxation of Passive Income

Passive income includes dividends received from a domestic corporation and the share of an individual partner in the net profits of a partnership taxable as a corporation (excluding general professional partnerships), interest on savings and time deposits, yields from deposit substitutes, trusts and similar arrangements, royalties, and prizes and winnings above ₱3,000. These are subject to a final tax on the gross amount thereof. It should be pointed out that even before BP 135, dividends and interest earnings had already been subject to a final tax.¹³ This was to assure government of tax revenues that it deserves. It was borne by experience that under the self-assessment scheme, taxpayers opted not to report passive incomes for tax purposes. Thus, the government was losing legitimate tax revenues under the global approach where passive incomes were lumped together with other incomes.

It is also worth noting that before the final taxation of passive incomes, the Bank Secrecy Act (RA 1405) effectively prevented tax authorities from investigating possible tax evasion practices with respect to interest earnings. In the case of dividends, tax evasion was also a likelihood because of the voluntary disclosure system and also because of the alleged double taxation since the same income was taxed twice: first at the corporate level and secondly at the individual shareholder level upon distribution at rates ranging from 3 per cent to 70 per cent.

The extent of tax evasion with respect to passive income is shown by the findings of a 1974 tax consciousness survey conducted by the NTRC. Survey results showed that the underdeclaration or even non-declaration of income is most common among non-salaried taxpayers, particularly passive income earners. For instance, 14.3 per cent of total tax filers did not report interest earnings while 31 per cent failed to report dividend incomes.

¹³The final tax scheme was also part of the original study to restructure the income tax.

Part III

Future Areas for Reform

It would be quite premature to give a definite evaluation of the impact of the new system on individual taxpayers and the government. What is obvious though is the tremendous simplification of tax administration that has been achieved and the possibility of better tax compliance among individual tax filers.

Some groups raise their dissenting voice with respect to the disparity (and we may add, equity implications) of the tax treatment of of business and professional income on the one hand and compensation income on the other. While the former still follows a strictly net income approach, the latter in view of the disallowance of deductions, is taxed on a modified gross income basis. The tax base for the latter, to repeat, is simply gross compensation income less personal and additional exemptions. It was mentioned earlier that the remedy seems to be indicated in a lower set of tax rates for compensation income. This point merits serious attention since it is never the intention to unduly burden one group of taxpayers or benefit some at the expense of others.

The new system can definitely stand some improvements. With respect to compensation income, a more effective withholding scheme could be devised. Present experience reveals that underwithholding of income tax from compensation incomes occur especially for family units with more than one taxpayer (i.e., where husband and wife are both employed). The withholding rate is based on one's own personal income and when this income is consolidated with the spouse's own income, a higher marginal tax rate normally materializes for the combined incomes. Thus, the final tax liability may far exceed the combined withheld taxes of the spouses. Another instance is the case of taxpayers with more than one source of compensation income. The same problem of underwithholding may occur. Each employer usually computes the required tax to be withheld starting from a zero marginal rate. These individual marginal rates would usually be lower than the applicable rate had all compensation

incomes been aggregated. What happens at the filing period is that the total taxes withheld may be very much less than the final tax liability computed on the basis of the aggregated compensation incomes. To improve the withholding system and also to save the taxpayer from the trouble of raising additional money to pay the difference, these taxpayers should be required by law (or regulations) to notify their principal or main employer of other subsidiary incomes (earned from other employers) in order that this main employer would correspondingly adjust the applicable withholding rate.

For the benefit of the lower income groups, there may be a very good reason to include under personal exemptions, all cost of living allowances mandated by law. Inspiration for this idea is President Marcos' statement to the labor sector in the annual celebration rites of the Labor Day on May 1, 1983 that the government is considering very seriously the possibility of giving tax breaks to the lower income groups (mostly wage earners) by exempting all or part of their cost of living allowances from taxation. To minimize tax losses, a certain cut-off level of income may be designated as a criterion for the enjoyment of this additional exemption.

Present law provides that where the tax withheld is final, *i.e.*, in the case of an individual with compensation income, a simplified return shall be filed with the Bureau of Internal Revenue either directly or indirectly through the employer. Note that the tax withheld may be considered final most especially if there is only a single source of compensation income. An improvement in this regard may be to dispense with the taxpayer filing the simplified return and instead to require the employer to file the return in his behalf. Although this may constitute an added administrative work to employers, it can still be worth considering, given the payoffs in terms of certain revenues and more simplification. A scheme can always be devised to lighten the administrative burden of the employers.

With respect to business and professional income, there is a need to set *effective* ceilings for deductible transportation, entertainment and advertising expenses. Because there are no such ceilings under present income tax laws, these are indeed very powerful

avenues to erode the taxable base. It will also guide business in the budgetary planning of these items.

The possible inclusion of bond interest income within the definition of passive income could further simplify tax administration and ensure tax collection from this source. This may also encourage more investors in bonds which will provide more financial capital on a longer term basis.

The new system is an attempt at a fresh approach to the old problem of taxing individual incomes in a manner which will be fair and acceptable to both government and taxpayers alike. It was never intended to be a revenue generating measure as some critics had claimed. The NTRC during the deliberations of the measure in the National Assembly estimated an additional revenue gain of only 5 per cent from compensation income which is more than offset by the revenue loss due to the proposed taxation of business incomes of individuals. It is interesting to note, however, that preliminary figures for the month of April 1983 as compared to the same month of last year showed a substantial revenue gain of 35 per cent from both compensation and business incomes of individuals. This may be due to the fact that no deductions except personal exemptions are allowed against compensation income and to increased tax compliance.

In fine, the new system seems to present an approach to the taxation of individual incomes which is innovative and equitable yet easy to administer.

Table 1. TAX TREATMENT OF INDIVIDUALS UNDER THE GLOBAL (Before BP 135)¹
AND SECULAR (After BP 135) APPROACHES, PHILIPPINES

Taxpayer	Before BP 135			After BP 135		
	Statutory Basis	Tax Base	Tax Rate/s	Statutory Basis	Tax Base	Tax Rate/s
A. Citizens		Global			Schedular	
1. Resident Citizens	Secs. 21 and 29(a) of the National Internal Revenue Code (NIRC) of 1977 as amended.	Income from all sources Taxable Net income (TNI) i.e. gross income which includes gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid or from professions, vocations, trades, businesses, commerce, sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, ¹ rents, dividends ² , securities or	3 per cent for TNI not exceeding ₱2,000 up to ₱305,240 plus 70 per cent for NIT exceeding ₱500,000	Secs. 21(a) 28(a) and 28(b), NIRC of 1977, as amended by BP 135.	Income from all sources a) Compensation Income Taxable Compensation Income (TCI) i.e. gross compensation income which refers to all income payments received as a result of an employer-employee relationship such as salaries, wages, honoraria, bonuses, pensions, allowances for transportation, representation, entertainment, fees (including director's fees) and other income of similar nature, including compensation paid in kind, less personal and additional exemptions. b) Business and/or trade income from profession	0 per cent for TCI not exceeding ₱2,500 up to ₱122,175 + 35 per cent for TCI exceeding ₱500,000

¹Beginning taxable year 1980, however, Presidential Decree 1739 issued on September 17, 1980 imposes a final (schedular) tax at 15 per cent it from savings deposit and 20 per cent if from time deposits and deposit substitutes on the gross amount of interest income if the aggregate amount of interest earned during the taxable year exceeds ₱1000 or ₱250 per quarter. (Before PD 1739, exemption was up to ₱800 per year or ₱200 per quarter).

²Presidential Decree 1800 issued on January 16, 1981 however, imposes a final (schedular) tax at 15 per cent on the gross amount of dividends received starting taxable year 1981.

Table 1 (Continued)

Taxpayer	Before BP 135			After BP 135		
	Statutory Basis	Tax Base	Tax Rate/s	Statutory Basis	Tax Base	Tax Rate/s
		the transactions of any business carried on for gain or profit, or gains, ³ profits and income derived from any source whatever less allowable deductions and personal and additional exemptions.		Secs. 21 (b), 29(a) and 29(b), NIRC as of 1977, amended by BP 135.	Taxable Net Income (TNI) i.e. gross income which includes gains, profits; and income derived from professions, vocations trades, business, commerce, sales, or from dealings in property whether real or personal, or growing out of the ownership or use of property or any interest therein; and from interest ⁴ rents, dividends, securities or the transactions of any business carried on for gain or profit or gains, profits and income of whatever kind and in whatever form derived from any source less allowable deductions and personal and additional exemptions. c) Passive Incomes c.1. Royalties, prizes exceeding ₱3,000 and other winnings except Philippine Charity Sweeps-stakes winnings –	5 per cent for TNI not exceeding ₱10,000 up to ₱197,000 plus 60 per cent for TNI not exceeding ₱500,000
				Sec. 21(c) NIRC of 1977, as amended by BP 135.		

³Capital gains from transactions involving real properties and shares of stocks were, however, made subject to final (schedular) tax by Batas Pambansa Nos. 37 issued on September 17, 1979 and 221 issued on March 25, 1982, respectively. The applicable rates are 10 per cent for net gains not exceeding ₱130,000 and 20 per cent for net gains exceeding ₱100,000 for gains arising from transactions involving real properties and shares of stocks not listed and traded through any local stock exchange. In the case of listed and traded shares of stocks, the tax is 1/4 of 1 per cent of the gross selling price.

⁴This refers to interest incomes not subject to the final withholding tax.

Table 1 (Continued)

Taxpayer	Before BP 135			After BP 135		
	Statutory Basis	Tax Base	Tax Rate/s	Statutory Basis	Tax Base	Tax Rate/s
					Total Amount	15 per cent
				Sec. 21(d), NIRC of 1977 as amended by BP 135	c.2. Interest from bank deposits if it exceeds ₱1000 per year or ₱250 per quarter – from savings deposits	
					Total Amount	15 per cent
					– from time deposits, de- posit substitutes, and trust fund and similar arrangements	
					Total Amount	20 per cent
				Sec. 21(e), NIRC of 1977 as amended by BP 135.	c.3. Dividends and shares of individual partner in the net profits of tax- able partnership. ⁵	
				Sec. 21(a),	Total Amount	15 per cent
2. Non-resident citizens	Sec. 21, NIRC of 1977, as amended	a) Income from sources within the Philippines The same tax treat- ment as resident citizens		28(a), and 28(b), NIRC of 1977, as amended by BP 135	a) Income from sources within the Philippines	
	Sec. 21. NIRC of 1977 as amended	b) Income from sources outside the Philippines		Secs 21(b), 29(a), and 29 (b)	a.1. Compensation Income The same tax treatment as resident citizens	
		Adjusted Gross Income (AGI) i.e. gross income from sources outside the	If AGI is not over \$6,000 – per cent	NIRC of 1977, as amended by BP 135.	a.2. Business and/or trade income and income from profession The same tax treatment as resident citizens	

⁵ Taxable partnership refers to partnership taxable as corporation under Section 24(a) of the NIRC of 1977, as amended. This excludes general professional partnerships the net profits of which are taxable at the hands of the partners as business incomes.

Table 1 (Continued)

Taxpayer	Before BP 135			After BP 135		
	Statutory Basis	Tax Base	Tax Rate/s	Statutory Basis	Tax Base	Tax Rate/s
		Philippines less personal exemptions (US \$2,000 if single, US \$4,000 if married or head of family) and the total amount of the national income tax actually paid the government of the foreign country of his residence.	Over \$6,000 but not over \$20,000 – 2 per cent Over \$20,000 – 3 per cent	Sec. 21 (f), NIRC of 1977 as amended by BP 135.	a.3. Passive Income The same tax treatment as resident citizens b) Income from sources outside the Philippines. The same tax treatment as before BP 135.	
B. Aliens						
1. Resident Aliens	Sec. 21, NIRC of 1977, as amended.	The same tax treatment as resident citizens		Secs. 21 (a), (b), (c), (d) and (e), NIRC of 1977, as amended by BP 135	The same tax treatment as resident citizens	
2. Non-resident aliens						
2.a. engaged in trade or business in the Philippines	Sec. 22(a) NIRC of 1977, as amended.	Income from sources within the Philippines The same tax treatment as resident citizens		Sec. 22(a) (1) NIRC of 1977, as amended by BP 135.	a) Income from sources within the Philippines. a.1. Compensation Income The same tax treatment as resident citizens a.2. Business and/or trade income The same tax treatment as resident citizens	
				Sec. 22(a) (2), NIRC of 1977, as amended by BP. 135.	a.3. Passive Income Dividends, shares in the net profits of a taxable partnership, interest, royalties in any form and	

Table 1 (Continued)

Taxpayer	Before BP 135			After BP 135		
	Statutory Basis	Tax Base	Tax Rate/s	Statutory Basis	Tax Base	Tax Rate/s
					prices exceeding ₱3,000 and other winnings except Philippine Charity Sweepstakes winnings	30 per cent
					Total Amount	
2.b. Not engaged in trade or business in the Philippines	Sec. 22(b) NIRC of 1977, as amended.	Entire income received from all sources within the Philippines as interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical or casual gains, profits, and income and capital gains (except gains realized from buying and/or selling shares of stock of Philippine corporations listed in the dollar or any acceptable foreign currency board of any stock exchange	30 per cent	Sec. 22(b), NIRC of 1977 as amended.	The same tax treatment as before BP 135.	
3. Aliens employed by regional or area head-quarters of multi-national corporations.	Sec. 22 (c) NIRC of 1977 as amended.	Gross income received in the Philippines as salaries, wages, annuities, compensations, remunerations and emoluments.	15 per cent final tax	Sec. 22(c), NIRC of 1977 as amended	The same tax treatment as before BP 135 except that the term emoluments was modified to include examples such as honoraria and allowances;	
4. Aliens employed by offshore banking units.	Sec. 22(d), NIRC of 1977, as amended.	Gross income received in the Philippines as salaries wages, annuities, compensations, remunerations and emoluments.	15 per cent final tax	Sec. 22(d), NIRC of 1977, as amended.	The same tax treatment as before BP 135 except that the term emoluments was modified to include examples such as honoraria and allowances.	

Table 1 (Continued)

<i>Taxpayer</i>	<i>Before BP 135</i>			<i>After BP 135</i>		
	<i>Statutory Basis</i>	<i>Tax Base</i>	<i>Tax Rate/s</i>	<i>Statutory Basis</i>	<i>Tax Base</i>	<i>Tax Rate/s</i>
5. Aliens employed by petroleum services contractors and subcontractors.	PD 1354	Salaries, wages, annuities, compensation, remunerations and emoluments received from contractors engaged in petroleum operations in the Philippines.	15 per cent final tax	Sec. 22(e), NIRC of 1977 as amended.	The same tax treatment as before BP 135 except that the term emoluments was modified to include examples such as honoraria and allowances.	

Table 2. ALLOWABLE DEDUCTIONS AND EXEMPTIONS

<i>Deductions</i>	<i>Before BP 135</i>	<i>After (BP) 135</i>		
		<i>Compensation Income</i>	<i>Business and or Trade Income</i>	<i>Passive Income</i>
Ordinary and necessary expenses	Allowed	Disallowed	Allowed	Even prior to BP 135, PD Nos. 1739 (issued on September 17, 1980) and 1800 (issued on January 16, 1981) levy a final tax on the gross amount <i>i.e.</i> without deductions of interest exceeding ₱1000 per year or ₱250 per quarter, and dividends, respectively.
Medical care expenses	Allowed	Disallowed	Disallowed	
Educational expenses	Allowed	Disallowed	Disallowed	
Interest	Allowed	Disallowed	Allowed	
Taxes	Allowed	Disallowed	Allowed	
Losses	Allowed	Disallowed	Allowed	
Bad Debts	Allowed	Disallowed	Allowed	
Depreciation	Allowed	Disallowed	Allowed	
Depletion of oil and gas well and mines	Allowed	Disallowed	Allowed	
Charitable and other contributions	Allowed	Disallowed	Allowed	
Pension trust	Allowed	Disallowed	Allowed	
Optional standard deduction	Allowed	Disallowed	Allowed	
Standard deduction for working wife	Allowed	Disallowed	Disallowed	
Personal exemptions for the taxpayer	Allowed	Allowed	Allowed	
Additional exemption for the taxpayer's dependents	Allowed	Allowed	Allowed	

Table 3. COUNTRIES WHICH ARE PREPONDERANTLY
GLOBAL OR GENERALLY SCHEDULAR
IN THEIR INCOME TAX SYSTEM

GLOBAL	SCHEDULAR
A. AFRICA	
1. Gabon	1. Algeria
2. Gambia	2. Benin
3. Ghana	3. Cameroon
4. Kenya	4. Congo (Kinshasa)
5. Lesotho	5. Ethiopia
6. Liberia	6. Guinea
7. Malawi	7. Ivory Coast
8. Nigeria	8. Madagascar
9. Sudan	9. Mauritania
10. Uganda	10. Morocco
11. Zambia	11. Niger
12. Zimbabwe	12. Senegal
	13. Togo
	14. Tunisia
	15. Upper Volta
B. FAR EAST	
1. Afghanistan	1. China
2. Australia	2. Hongkong
3. Bangladesh	3. Philippines
4. India	
5. Indonesia	
6. Japan	
7. Korea (Republic of)	
8. Malaysia	
9. New Zealand	
10. Pakistan	
11. Papua New Guinea	
12. Sri Lanka	
13. Singapore	

Table 3 (Continued)

GLOBAL

14. Thailand
15. Taiwan

SCHEDULAR

C. MIDDLE EAST

1. Jordan
2. Iraq
3. Israel
4. Saudi Arabia

1. Egypt
2. Iran
3. Libya
4. Lebanon
5. Syria

D. NORTH AMERICA

1. Canada
2. U.S.A.

1. Mexico

E. SOUTH AMERICA

1. Argentina
2. Colombia
3. Ecuador
4. Paraguay
5. Uruguay

1. Bolivia
2. Brazil
3. Chile
4. Peru

F. WEST INDIES

1. Bermuda
2. Haiti
3. Jamaica
4. Netherland Antilles
5. Trinidad and Tobago

1. Barbados
2. Cuba
3. Dominican Republic
4. Puerto Rico

Sources: IBFD Publications re: Taxes and Investments in the Middle East (Supplements for 1978-82), Taxes and Investment in Asia and the Pacific (Supplements for 1978-82), Taxation of Companies in Europe (Supplements for 1978-82), Taxes and Investment in African Countries (Supplements for 1978-82).

Walter H. Diamond, *Foreign Tax and Trade Briefs* Vols. I and II (New York: Matthew Bender and Company, Inc. 1977).

Table 4. COMPARATIVE TAX BURDEN OF MARRIED TAX FILERS – NO DEPENDENT

Selected Gross Income (₱000)	Old Income Tax Law (3-70)				New Income Tax Law (BP 135) (0-35)	
	OSD*		ID**		Amount	ETR(%)***
	Amount	ETR(%)	Amount	ETR (%)		
2	—	—	—	—	—	—
4	—	—	—	—	—	—
6	—	—	—	—	—	—
8	36	0.45	—	—	—	—
10	120	1.20	—	—	—	—
12	252	2.10	—	—	—	—
15	540	3.60	165	1.10	25	0.17
20	1,200	6.00	384	1.92	175	0.88
30	3,150	10.50	1,104	3.68	1,315	4.38
50	9,090	18.19	3,420	6.84	3,675	7.35
60	12,880	21.47	4,860	8.10	5,175	8.62
100	30,680	30.68	11,790	11.79	12,535	12.54
130	46,030	35.41	17,724	13.63	19,435	14.95
160	62,220	38.89	23,904	14.94	26,635	16.65
200	84,900	42.45	33,440	16.72	36,235	18.12
300	144,120	48.04	60,390	20.13	62,435	20.81
500	266,600	53.32	119,230	23.85	120,435	24.09
1,000	581,040	58.10	273,500	27.35	295,075	29.51

*OSD – Tax filers using Optional Standard Deduction.

**ID – Tax filers using Itemized Deduction.

***ETR – Effective Tax Rate (ETR equals tax due over gross income).

Source of Basic Data: National Tax Research Center.

GRAPHIC ILLUSTRATION OF TABLE 4

COMPARATIVE TAX BURDEN OF MARRIED TAX FILERS—NO DEPENDENT

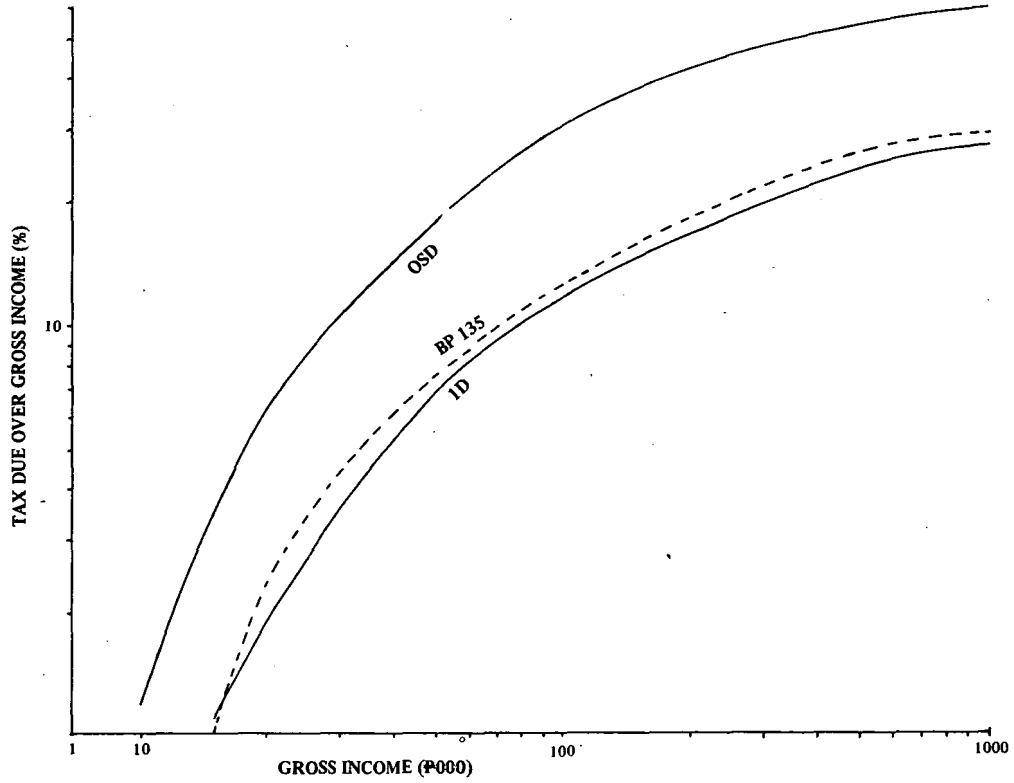


Table 5. COMPARATIVE TAX BURDEN OF MARRIED TAX FILERS – FOUR DEPENDENTS

Selected Gross Income (P000)	Old Income Tax Law (3-70)				New Income Tax Law (BP 135) (0-35)	
	OSD		ID**		Amount	ETR(%)***
	Amount	ETR(%)	Amount	ETR (%)		
2	-	-	-	-	-	-
4	-	-	-	-	-	-
6	-	-	-	-	-	-
8	-	-	-	-	-	-
10	-	-	-	-	-	-
12	-	-	-	-	-	-
15	-	-	-	-	-	-
20	180	0.90	-	-	-	-
30	1,380	4.60	144	0.48	595	1.98
50	6,150	12.30	1,560	3.12	2,635	5.27
60	9,480	15.80	2,640	4.40	3,975	6.62
100	26,400	26.40	8,503	8.51	11,015	11.02
130	41,380	31.83	14,057	10.81	17,515	13.47
160	57,380	35.86	19,896	12.44	24,715	15.45
200	79,780	39.89	29,060	14.53	34,315	17.16
300	138,760	46.25	55,450	18.51	60,115	20.04
500	261,080	52.22	113,950	22.79	118,115	23.62
1,000	575,440	57.54	267,980	26.80	292,275	29.23

*OSD – Tax filer using Optional Standard Deduction

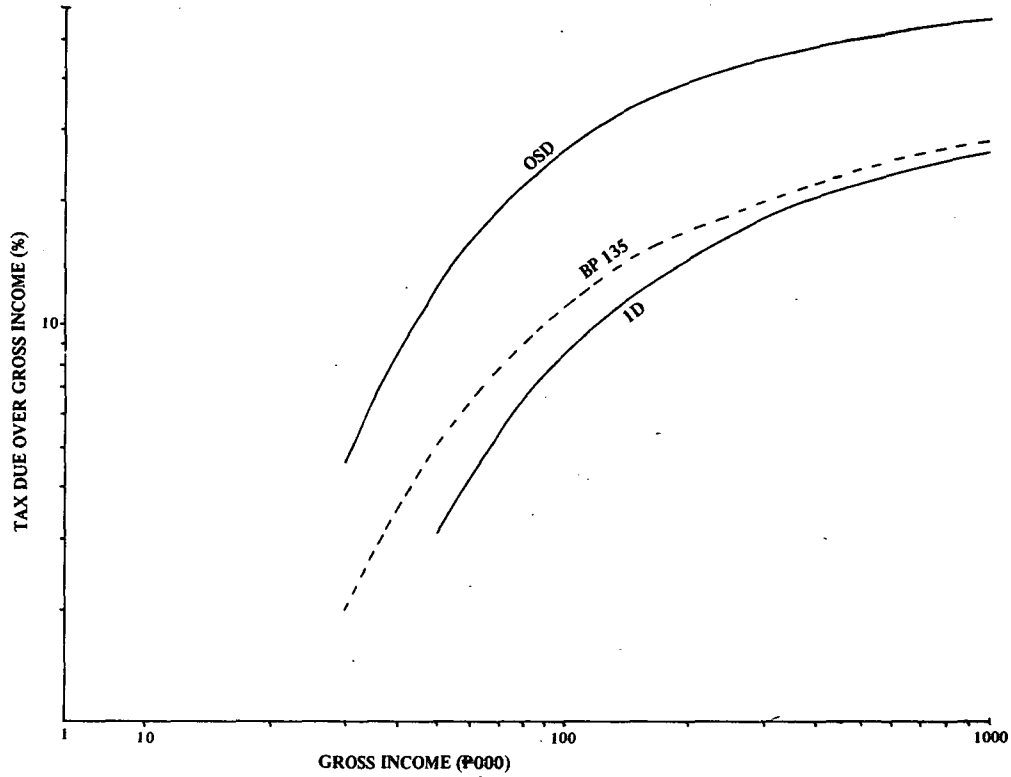
**I D – Tax filers using Itemized Deduction

***ETR – Effective Tax Rate (ETR equals tax due over gross income).

Source of Basic Data: National Tax Research Center

GRAPHIC ILLUSTRATION OF TABLE 5

COMPARATIVE TAX BURDEN OF MARRIED TAX FILERS - FOUR DEPENDENTS



COMPARATIVE TAX BURDEN OF MARRIED TAX FILERS WITH COMPENSATION INCOME

Definition of Terms

OSD refers to Optional Standard Deduction

OSD tax filer refers to one who applies the 10 per cent optional standard deduction to his gross income

ID refers to itemized deduction

ID tax filer is one who itemizes his allowable deductions

ETR means effective tax rate (tax due over gross income)

Personal exemption – ₱6,000 + ₱4,000 if gross compensation income during the year does not exceed ₱20,000.

Additional exemption – ₱2,000 per dependent but not exceeding four dependents.

*Table 4. Married Tax Filer – No Dependent

1. *With gross income of ₱10,000*

Under the old law

- OSD tax filer pays ₱120 and his ETR is 1.2%
- ID tax filer is still exempt

Under the new law

- Both OSD and ID tax filers are exempt.

Observation

- OSD tax filer is completely relieved of his tax liability.

2. *With gross income of ₱50,000*

Under the old law

- OSD tax filer pays ₱9,090; ETR of 18.19%
- ID tax filer pays ₱3,420; ETR of 6.84%

Under the new law

- Both OSD and ID tax filers pay ₱3,675; ETR of 7.35%

Observations

- OSD tax filer enjoys a reduction of ₱5,415 or 10.8 percentage points
- ID tax filer pays an additional tax of ₱225 or 0.5 percentage points

3. *With gross income of ₱100,000*

Under the old law

- OSD tax filer pays ₱30,680; ETR of 30.68%
- ID tax filer pays ₱11,790; ETR of 11.97%

Under the new law

- Both OSD and ID tax filers pay ₱12,535;
ETR of 12.54%

Observations

- OSD tax filer enjoys a reduction of ₱18,145 or in terms of ETR a reduction of 18.14 percentage points
- ID tax filer pays an additional tax of ₱745 or an increase in ETR by 0.75 percentage points

4. *With gross income of ₱500,000*

Under the old law

- OSD tax filer pays ₱266,600; ETR of 53.32%
- ID tax filer pays ₱119,230; ETR of 23.85%

Under the new law

- Both OSD and ID tax filers pay ₱120,435; ETR of 24.09%.

Observations

- OSD tax filer enjoys a reduction of ₱146,165 or 18.14 percentage points
- ID tax filer pays a additional tax of ₱1,205 or an increase of 0.24 percentage points

*Table 5. Married Tax Filer – Four Dependents

1. *With gross income of ₱20,000 and below.*

Under the old law

- Both OSD and ID tax filers are exempt.

Under the new law

- Both OSD and ID tax filers are still exempt.

2. *With gross income of ₱50,000*

Under the old law

- OSD tax filer pays ₱6,150; ETR of 12.30%

- ID tax filer pays ₱1,560; ETR of 3.12%

Under the new law

- Both OSD and ID tax filers pay ₱2,635; ETR of 2.57%

Observations

- OSD tax filer enjoys a reduction of ₱3,515 or by 7 percentage points
- ID tax filer pays an additional tax of ₱1,075 or an increase of 2.15 percentage points

3. *With gross income of ₱100,000*

Under the old law

- OSD tax filer pays ₱26,400; ETR of 26.40%
- ID tax filer pays ₱8,503; ETR of 8.51%

Under the new law

- Both OSD and ID tax filers pay ₱11,015; ETR of 11.02%

Observations

- OSD tax filer enjoys a reduction of ₱15,385 or in terms of ETR a reduction of 15.14 percentage points
- ID tax filer pays an additional tax of ₱2,512 or an increase in ETR by 2.5 percentage points.

4. *With gross income of ₱500,000*

Under the old law

- OSD tax filer pays ₱261,080; ETR of 52.22%
- ID tax filer pays ₱113,950; ETR of 22.79%

Under the new law

- Both OSD and ID tax filers pay ₱118,115; ETR of 23.62%

Observations

- OSD tax filer enjoys a reduction of ₱142,965 or 27 percentage points
- ID tax filer pays an additional tax of ₱4,165 or an increase in ETR by 0.83 percentage points

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