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SENATE RECEIVED BY:       

S. BILL No. 2210

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*Introduced by Senator Ralph G. Recto*

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### Explanatory Note

The last major overhaul of the income taxation of corporations and self-employed was via Republic Act No. 8424, otherwise known as the "Tax Reform Act of 1997," which became effective on January 1, 1998. RA 8424 was the third component of the Comprehensive Tax Reform Package (CTRP) of the government. Among others, RA 8424 lowered the income tax rates, instituted a minimum corporate income tax, introduced controls on certain business deductions, universalized the net operating loss carry-over and accelerated depreciation incentives. The law was meant to be "pro-poor and pro-progress" by aiming to create a robust business environment that will eventually result in higher tax collections to finance domestic social and infrastructure needs.

After six years of implementing the income tax reform component of the CTRP, problems beset the income tax system. Corporate income tax revenues grew by merely 8.84% in post-CTRP years versus 16.54% in pre-CTRP years. Income tax collections from the self-employed grew by only 6.77% versus 19.86% prior to the CTRP. Buoyancy estimates for the corporate income tax declined from 1.3 to 0.82.

The individual and corporate income tax effort, or the ratio of revenues to GDP, has been almost constant from 1996 to 1999. The Philippine corporate income tax has been under-performing compared to other Asian countries. The Philippines' corporate income tax effort of 2.59 percent in 2000 lags behind Thailand's which is at 8.58 percent, Malaysia's at 5.99 percent, Indonesia at 8.39 percent and Singapore's at 6.88 percent.

There are structural weaknesses in the taxation of business income. One of these problems is the narrow tax base. Many business expenses are being overstated. Even non-business related expenditures or expenditures which have a personal element to them are being claimed as deductible expenses for income tax purposes. In 2003, the BIR data on large taxpayers show that the total deductions (both direct and indirect costs) across all industries reduced gross revenues by 98%, hence, leaving merely 2% as taxable income. There was no improvement from the pre-CTRP years. Hence, despite limitations on certain business deductions, the income tax base remains constricted. This gives rise to the issue of inequity between compensation and business income earners. The compensation income earner pays the full income tax because of the final withholding tax system while the business income earner can harness the allowance for business expenses and deductions to reduce his income tax liability.

The net income tax system for business also gives rise to inherent difficulties in tax administration. The BIR needs to ascertain not only the correctness of gross revenues declared by taxpayers but the validity of each and

every item of expense claimed as a deduction. This has given a wide latitude of discretion to the tax examiners, which result in under-the-table deals and taxpayer harassment. This has also undermined tax collection efforts and contributed, to a large extent, to the low quality of tax ethics among our taxpayers.

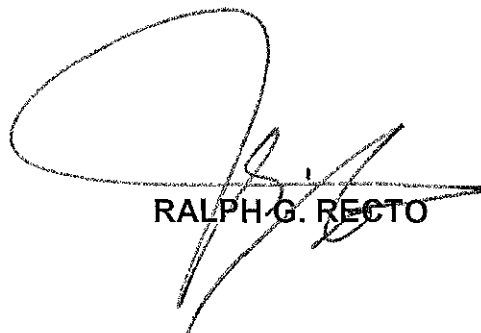
There are also so-called hard-to-tax groups that do not report items of income, do not issue receipts or do not file income returns at all. The non-filing of income tax returns is common to small and medium-sized businesses which find it burdensome to keep formal accounting and business records.

Recent research also reveals that the Philippines, compared with other countries in the region, has the second highest rate of corporate tax at 32%. It is next to Laos which imposes a 35% corporate tax. Developed countries in the ASEAN region are at the lower end of the scale, e.g., Singapore has 22% and Malaysia imposes a 28% tax. Indonesia's top rate is 30% while Thailand, Brunei and Myanmar levy a 30% tax. Yet, the Philippines tax effort has been the lowest.

To address these weaknesses, this bill seeks to introduce the concept of simplified net income taxation of business income. The tax treatment of corporations and the self-employed individuals shall be aligned, and both shall be subject to the simplified net income tax structure. Only direct costs incurred in the production of goods and services shall be allowed as deductions from gross revenues in order to arrive at the tax base which is simplified net income. Certain items of expense that are currently allowed as business deductions under the net income tax system shall be disallowed. These expenses are the commonly abused expenses.

The simplified net income tax system will expand the income tax base and enhance tax revenues of government.

In view of the foregoing, early approval of this bill is earnestly requested.




**RALPH G. RECTO**

THIRTEENTH CONGRESS OF THE )  
REPUBLIC OF THE PHILIPPINES )  
Second Regular Session )

6 FEB 20 04:16

SENATE  
S. B. No. 2210

RECEIVED BY: 

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*Introduced by Senator Ralph G. Recto*

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**AN ACT**  
**ADOPTING THE SIMPLIFIED NET INCOME TAXATION SCHEME FOR AN**  
**INDIVIDUAL ENGAGED IN TRADE/BUSINESS AND/OR PRACTICE OF**  
**PROFESSION, CREATING A NEW SECTION SEC. 34-A, REPEALING SUBSECTION**  
**(L) OF SECTION 34, AND AMENDING SECTIONS 22 AND 24, ALL UNDER THE**  
**NATIONAL INTERNAL REVENUE CODE OF 1997, AS AMENDED**

*Be it enacted by the Senate and House of Representatives of the Philippines in Congress assembled:*

1 SECTION 1. *Short Title.* – This Act shall be known as the “Simplified Net Income  
2 Tax Reform Act of 2006.”

3 SEC. 2. Section 22 of the National Internal Revenue Code (NIRC) of 1997, as  
4 amended, is hereby further amended by adding the following definitions after subsection  
5 (FF), to read as follows:

6 “Sec. 22. *Definitions.* – When used in this Title:

7 “(FF) The term ‘long-term deposit or investment certificates’ shall refer to  
8 certificate of time deposit or investment in the form of savings, common or  
9 individual trust funds, deposit substitutes, investment management accounts  
10 and other investments with a maturity period of not less than (5) years, the  
11 form of which shall be prescribed by the Bangko Sentral ng Pilipinas (BSP)  
12 and issued by banks only (not by non-bank financial intermediaries and  
13 finance companies) to individuals in denominations of Ten thousand pesos  
14 (P10,000) and other denominations as may be prescribed by the BSP.

15 “(GG) “SELF-EMPLOYED” MEANS PERSONS ENGAGED IN TRADE OR  
16 BUSINESS AND WHO DERIVE THEIR PERSONAL INCOME FROM SUCH  
17 TRADE OR BUSINESS. THIS INCLUDES SINGLE PROPRIETORSHIPS,

1 SUCH AS BUT NOT LIMITED TO MANUFACTURERS, TRADERS, MARKET  
2 VENDORS, OWNERS OF EATERIES, FARMERS AND SERVICE SHOPS;  
3 AND

4 “(HH) “PROFESIONALS” MEANS PERSONS WHO DERIVE THEIR  
5 INCOME FROM THE PRACTICE OF THEIR PROFESSION. THIS  
6 INCLUDES LAWYERS AND OTHER PERSONS WHO ARE REGISTERED  
7 WITH THE PROFESSIONAL REGULATION COMMISSION SUCH AS  
8 DOCTORS, DENTISTS, CERTIFIED PUBLIC ACCOUNTANTS,  
9 ARCHITECTS AND OTHERS SIMILARLY SITUATED. THE TERM  
10 “PROFESSIONAL” ALSO REFERS TO ONE WHO PURSUES AN ART OR  
11 SPORTS AND MAKES HIS LIVING THEREFROM SUCH AS ARTISTS,  
12 ATHLETES AND OTHERS SIMILARLY SITUATED.”

13 SEC. 3. Subsection (A) of Section 24 of the National Internal Revenue Code of  
14 1997 as amended, on income tax on individuals, is hereby amended, to read as follows:

15 “Sec. 24. *Income Tax Rates.* –

16 “(A) *Rates of Income Tax on Individual Citizen and Individual Resident*  
17 *Alien of the Philippines.* –

18 “(1) An income tax is hereby imposed:

19 “(a) On the taxable income defined in Section 31 of this Code, other than  
20 income subject to tax under Subsections (B), (C) and (D) of this Section,  
21 derived for each taxable year from all sources within and without the  
22 Philippines by every individual citizen of the Philippines residing therein;

23 “(b) On the taxable income defined in Section 31 of this Code, other than  
24 income subject to tax under Subsections (B), (C) and (D) of this Section,  
25 derived for each taxable year from all sources within the Philippines by an  
26 individual citizen of the Philippines who is residing outside of the Philippines  
27 including overseas contract workers referred to in Subsection (C) of Section  
28 23 hereof; and

1           “(c) On the taxable income defined in Section 31 of this Code, other than  
2 income subject to tax under Subsections (B), (C) and (D) of this Section,  
3 derived for each taxable year from all sources within the Philippines by an  
4 individual alien who is a resident of the Philippines.

5           “(2) *RATES OF TAX ON TAXABLE INCOME OF INDIVIDUALS.* – The  
6 tax shall be computed in accordance with and at the rates established in the  
7 following schedule:

8	Not over P10,000 . . . . .	5%
9	Over P10,000 but not over . . . . .	P500+10% of the excess over
10	P30,000	P10,000
11	Over P30,000 but not over. . . . .	P2,500+15% of the excess over
12	P70,000	P30,000
13	Over P70,000 but not over. . . . .	P8,500+20% of the excess over
14	P140,000	P70,000
15	Over P140,000 but not over. . . . .	P22,500+25% of the excess over
16	P250,000	P140,000
17	Over P250,000 but not over. . . . .	P50,000+30% of the excess over
18	P500,000	P250,000
19	Over P500,000 . . . . .	P125,000+[34%] 32% of the
20		excess over P500,000 [in 1998].

21           [*Provided,* That effective January 1, 1999, the top marginal rate shall be  
22 thirty-three percent (33%) and effective January 1, 2000, the said rate shall  
23 be thirty-two percent (32%).]

24           “For married individuals, the husband and wife, subject to the provision of  
25 Section 51(D) hereof, shall compute separately their individual income tax  
26 based on their respective total taxable income: *Provided,* That if any income  
27 cannot be definitely attributed to or identified as income exclusively earned or  
28 realized by either of the spouses, the same shall be divided equally between  
29 the spouses for the purpose of determining their respective taxable income.

1           “(3) *SIMPLIFIED NET INCOME TAX FOR THE SELF-EMPLOYED*  
2           *ENGAGED IN TRADE/BUSINESS AND FOR PROFESSIONALS ENGAGED*  
3           *IN THE PRACTICE OF PROFESSION.* – AN INCOME TAX FOLLOWING  
4           THE PRESCRIBED RATE FOR INDIVIDUALS UNDER THE PRECEDING  
5           PARAGRAPH IS HEREBY IMPOSED UPON THE TAXABLE INCOME  
6           DERIVED DURING EACH TAXABLE YEAR FROM ALL SOURCES WITHIN  
7           AND WITHOUT THE PHILIPPINES BY AN INDIVIDUAL CITIZEN AND  
8           INDIVIDUAL RESIDENT ALIEN OF THE PHILIPPINES ENGAGED IN  
9           TRADE, BUSINESS AND/OR PRACTICE OF PROFESSION.”

10           SEC. 4. Chapter VII, Title II of the National Internal Revenue Code of 1997, as  
11           amended, is hereby further amended by adding a new section to be known as Section  
12           34-A, to read as follows:

13           “Sec. 34-A. *DEDUCTIONS FROM THE GROSS REVENUES OF SELF-*  
14           *EMPLOYED AND/OR PROFESSIONALS.* ; IN COMPUTING THE TAXABLE  
15           INCOME SUBJECT TO TAX UNDER SUBSECTION 24(A)(3) IN THE CASE  
16           OF INDIVIDUALS ENGAGED IN TRADE/BUSINESS AND/OR PRACTICE  
17           OF PROFESSION, ONLY THE FOLLOWING EXPENSES/DEDUCTIONS  
18           INCURRED IN DOING BUSINESS SHALL BE ALLOWED TO BE  
19           SUBTRACTED FROM THE GROSS REVENUES OF SUCH INDIVIDUALS:

20           “(A) SALES DISCOUNTS;

21           “(B) SALES RETURNS AND ALLOWANCES;

22           “(C) RAW MATERIALS, SUPPLIES, AND DIRECT LABOR;

23           “(D) SALARIES OF EMPLOYEES DIRECTLY ENGAGED IN  
24           ACTIVITIES IN THE COURSE OF OR PURSUANT TO THE BUSINESS,  
25           TRADE OR PRACTICE OF THEIR PROFESSION;

26           “(E) TELECOMMUNICATIONS, ELECTRICITY, FUEL AND WATER:  
27           *PROVIDED, THAT THE TOTAL AMOUNT OF THESE EXPENSES SHOULD*  
28           NOT EXCEED TEN PERCENT (10%) OF GROSS INCOME OF SUCH  
29           INDIVIDUAL;

1           “(F) BUSINESS RENTALS;

2           “(G) DEPRECIATION IN ACCORDANCE WITH SUBSECTION 34 (F)  
3       HEREOF;

4           “(H) CONTRIBUTIONS MADE TO THE GOVERNMENT OR ANY OF  
5       ITS AGENCIES OR ANY POLITICAL SUBDIVISION THEREOF  
6       EXCLUSIVELY FOR PUBLIC PURPOSES, OR TO ACCREDITED  
7       DOMESTIC CORPORATIONS OR ASSOCIATIONS ORGANIZED AND  
8       OPERATED EXCLUSIVELY FOR RELIGIOUS, CHARITABLE, SCIENTIFIC,  
9       YOUTH AND SPORTS DEVELOPMENT, CULTURAL OR EDUCATIONAL  
10      PURPOSES OR FOR THE REHABILITATION OF VETERANS, OR TO  
11      SOCIAL WELFARE INSTITUTIONS, OR TO NON-GOVERNMENT  
12      ORGANIZATIONS, IN ACCORDANCE WITH SUBSECTION 34(H) HEREOF;

13          “(I) INTEREST PAID OR ACCRUED WITHIN A TAXABLE YEAR ON  
14      LOANS CONTRACTED FROM ACCREDITED FINANCIAL INSTITUTIONS  
15      WHICH MUST BE PROVEN TO HAVE BEEN INCURRED IN CONNECTION  
16      WITH THE CONDUCT OF A TAXPAYER'S PROFESSION, TRADE OR  
17      BUSINESS IN ACCORDANCE WITH SUBSECTION 34(B) HEREOF;

18          “(J) FREIGHT, HANDLING AND TRUCKING;

19          “(K) INSURANCE EXPENSE;

20          “(L) PROFESSIONAL FEES;

21          “(M)     SSS,    GSIS,   PHILHEALTH,   AND   HDMF   (PAG-IBIG)  
22      CONTRIBUTIONS; AND

23          “(N) TAXES AND LICENSES IN ACCORDANCE WITH SUBSECTION  
24      34(C) HEREOF.

25          “FOR INDIVIDUALS ENGAGED IN TRADE/BUSINESS AND/OR  
26      PRACTICE OF THEIR PROFESSION WHOSE EXPENSES/DEDUCTIONS  
27      ENUMERATED IN THE PRECEDING PARAGRAPH ARE DIFFICULT TO  
28      DETERMINE, SAID INDIVIDUAL SHALL BE ALLOWED AN OPTIONAL  
29      STANDARD DEDUCTION EQUIVALENT TO FORTY PERCENT (40%) OF

1 HIS GROSS REVENUES IN LIEU OF THE SAID EXPENSES/DEDUCTIONS  
2 PROVIDED HEREIN. UNLESS THE TAXPAYER SIGNIFIES IN HIS  
3 RETURN HIS INTENTION TO ELECT THE OPTIONAL STANDARD  
4 DEDUCTION, HE SHALL BE CONSIDERED AS HAVING AVAILED  
5 HIMSELF OF THE EXPENSES/DEDUCTIONS PRESCRIBED UNDER THIS  
6 SECTION. SUCH ELECTION WHEN MADE IN THE RETURN SHALL BE  
7 IRREVOCABLE FOR THE TAXABLE YEAR FOR WHICH THE RETURN IS  
8 MADE: *PROVIDED*, THAT AN INDIVIDUAL WHO IS ENTITLED TO AND  
9 CLAIMED FOR THE OPTIONAL STANDARD DEDUCTION SHALL NOT BE  
10 REQUIRED TO SUBMIT WITH HIS TAX RETURN SUCH FINANCIAL  
11 STATEMENTS OTHERWISE REQUIRED UNDER THIS CODE; *PROVIDED*  
12 *FURTHER*, THAT EXCEPT WHEN THE COMMISSIONER OTHERWISE  
13 PERMITS, THE SAID INDIVIDUAL SHALL KEEP SUCH RECORDS  
14 PERTAINING TO HIS GROSS REVENUES DURING THE TAXABLE YEAR,  
15 AS MAY BE REQUIRED BY THE RULES AND REGULATIONS  
16 PROMULGATED BY THE SECRETARY OF FINANCE, UPON  
17 RECOMMENDATION OF THE COMMISSIONER.”

18 SEC. 5. Subsection (L) of Section 34 of the NIRC of 1997, as amended, is  
19 hereby repealed.

20 SEC. 6. *Implementing Rules and Regulations.* – The Secretary of Finance shall,  
21 upon recommendation of the Commissioner of Internal Revenue, promulgate the rules  
22 and regulations necessary for the effective implementation of this Act.

23 SEC. 7. *Repealing Clause.* – All laws, executive orders, decrees, rules and  
24 regulations, and other issuances or parts thereof inconsistent with the provisions of this  
25 Act, are hereby repealed or modified accordingly.

26 SEC. 8. *Effectivity.* – This Act shall take effect after fifteen (15) days from its  
27 publication in the Official Gazette or in at least two (2) national newspapers of general  
28 circulation.

29 *Approved.*