QAU Memo No. 14, s2021

In this issue:

The Bureau of Internal Revenue (BIR) has issued a Revenue Regulation regarding the implementation of the New Income Tax Rates on the Regular Income of Corporations, on Certain Passive Incomes, Including Additional Allowable Deductions from Gross Income of Persons Engaged in Business or Practice of Profession Pursuant to Republic Act (RA) No.11534 or the "Corporate Recovery and Tax Incentives for Enterprises Act" (CREATE), which Further Amended the National Internal Revenue Code (NIRC) of 1997.

R.S BERNALDO & ASSOCIATES

TAKING YOU FURTHER

SALIENT FEATURES OF REPUBLIC ACT (RA) NO. 11534 OR THE "CORPORATE RECOVERY AND TAX INCENTIVES FOR ENTERPRISES ACT" (CREATE) RELATED TO NEW INCOME TAX RATES ON THE REGULAR INCOME OF CORPORATIONS, ON CERTAIN PASSIVE INCOMES, INCLUDING ADDITIONAL ALLOWABLE DEDUCTIONS FROM GROSS INCOME OF PERSONS ENGAGED IN BUSINESS OR PRACTICE OF PROFESSION

CORPORATE INCOME TAX RATES UNDER CREATE BILL

Distinction between the corporate income tax rates applicable to the regular taxable income of corporations under NIRC vs corporate income tax rates under RA No.11534

<table>
<tr><th>Type of Corporation</th><th colspan="2">F R O M
National Internal Revenue Code (NIRC) of 1997</th><th colspan="4">T O
Republic Act (RA) No.11534 or the "Corporate Recovery and Tax Incentives for Enterprises Act" (CREATE)</th></tr>
<tr><td></td><td>Regular</td><td>MCIT</td><td>Regular</td><td>Effectivity</td><td>MCIT</td><td>Effectivity</td></tr>
<tr><td colspan="7">Domestic Corporation:</td></tr>
<tr><td rowspan="2">Domestic corporations, in general</td><td rowspan="2">30%</td><td rowspan="2">2%</td><td rowspan="2">25%</td><td rowspan="2">July 1, 2020</td><td>1%</td><td>July 1, 2020 to June 30, 2023</td></tr>
<tr><td>2%</td><td>July 1, 2023</td></tr>
<tr><td rowspan="2">For corporations with net taxable income not exceeding Five Million Pesos (₱5,000,000) AND total assets not exceeding One Hundred Million (₱ 100,000,000), excluding the land on which the particular business entity's office, plant and equipment are situated</td><td rowspan="2" colspan="2">Not Applicable</td><td rowspan="2">20%</td><td rowspan="2">July 1, 2020</td><td>1%</td><td>July 1, 2020 to June 30, 2023</td></tr>
<tr><td>2%</td><td>July 1, 2023</td></tr>
</table>

Proprietary Educational Institutions and Hospitals	10%	Not Applicable	1%,	July 1, 2020 to June 30, 2023	Not Applicable	
			10%	July 1, 2023		
Foreign Corporation [on taxable income (e.g., net or gross income, as applicable) derived from all sources within the Philippines]:						
Resident Foreign Corporation	30%	2%	25%	July 1, 2020	1%	July 1, 2020 to June 30, 2023
					2%	July 1, 2023
Offshore Banking Unit (OBUs) (Note: OBUs shall now be taxed as resident foreign corporation upon effectivity of the CREATE)	Exempt	Not Applicable	25%	Upon the effectivity of the CREATE	1%	Upon the effectivity of the CREATE until June 30, 2023
					2%	July 1, 2023
Regional Operating Headquarters (ROHQ)	Exempt	Not Applicable	25%	January 1, 2022	1%	January 1, 2022 to June 30, 2023
					2%	July 1, 2023
Non-Resident Foreign Corporation	32%	Not Applicable	25%	January 1, 2022	Not Applicable	

INCOME TAX RATES ON CERTAIN PASSIVE INCOMES UNDER CREATE BILL

Distinction between the income tax rates applicable to certain passive income of individuals and corporations under NIRC vs passive income under RA No.1153:

TYPE OF CORPORATION	NATURE OF INCOME	FROM National Internal Revenue Code (NIRC) of 1997	TO Republic Act (RA) No.11534 or the "Corporate Recovery and Tax Incentives for Enterprises Act" (CREATE)	
		Rate	Rate	EFFECTIVITY
Non-Resident Alien Individual	Winnings from Philippine Charity Sweepstake Office (PCSO) games amounting to more than P10,000.00	20%	20%	Upon the effectivity of the CREATE
	Winnings from PCSO games amounting to P10,000.00 and below	Graduated Income Tax Rates	Exempt	
Domestic Corporation	Intercorporate Dividends (domestic and foreign source dividends)	From another domestic corp. - **Exempt**	From another domestic corp. - **Exempt**	For foreign source dividends, these will be exempt from income tax upon the effectivity of the CREATE, subject to the conditions discussed in Annex A.
		From nonresident foreign corp. - 30%	From nonresident foreign corp. - 25% or 20%, as the case may be	
Resident Foreign Corporation	Interest income from a depositary bank under the expanded foreign currency deposit system	7 ½ %	15%	Upon the effectivity of the CREATE
	Capital gains from sale of shares of stock not traded in the stock exchange	Not over P100, 000 - 5% On any amount in excess of P100,000 - 10%	15%	

Non-resident Foreign Corporation	Gross income received from all sources within the Phils., such as interests, dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits and income, and capital gains, except capital gains from sale of shares of stock not traded in the stock exchange	30%	25%	January 1, 2021
	Intercorporate dividend received from a domestic corporation, in general	30%	25%	January 1, 2021
	Intercorporate dividend received from a domestic corporation, if the country in which the non-resident foreign corporation is domiciled, allows a credit against the tax due from the non-resident foreign corporation's taxes deemed to have been paid in the Philippines.	The credit against the tax due is equivalent to **15%**, which is the difference between the regular income tax rate of 30% and the 15% tax on intercorporate dividends	The credit against the tax due is equivalent to **10%**, which is the difference between the regular income tax rate of 25% in Section 28(B)(1) of the Tax Code and the 15% tax on intercorporate dividends. **Or** Does not impose tax on dividends, the rate to be imposed shall be **15%**	
	Capital gains from sale of shares of stock not traded in the stock exchange	Not over P100, 000 - 5% On any amount in excess of P100,000 - 10%	15%	Upon the effectivity of the CREATE

CHANGES TO THE ALLOWABLE DEDUCTIONS FROM GROSS INCOME FOR BUSINESS PERSONS

1. Training Expenses

   Upon the effectivity of the CREATE, an additional deduction from taxable income of one-half (1/2) of the value of labor training expenses incurred for skills development of enterprise-based trainees enrolled in Public Senior High Schools, Public Higher Education Institutions, or Public Education Institution, or Public Technical and Vocational Institutions and duly covered by an apprenticeship agreement under Presidential Decree No. 442, Series of 1974, or the Labor Code of the Philippines, as amended, shall be granted to enterprises. Provided, further, that for the additional deduction for enterprise-based training of students from Public Educational Institutions, the enterprise shall secure proper "certification" from the Department of Education (DepEd), Technical Education and Skills Development Authority (TESDA), or Commission on Higher Education (CHED). Provided, finally, that such deduction shall not exceed Ten Percent (10%) of Direct Labor Wage.

2. Interest

   In the case of corporations, since the income tax rates changed effective July 1, 2020, it follows that the deduction from the interest expense of 20% shall be effective also on the said date. For other domestic corporations with net taxable income not exceeding Five Million Pesos (P5,000,000) and total assets not exceeding One Hundred Million (P 100,000,000), excluding the land on which the particular business entity's office, plant and equipment are situated, the deduction is 0% since there is no difference in the income tax rate on the taxable income (20%) with the tax rate applied on the interest income subjected to final tax (20%). However, in the case of individuals engaged in business or practice of profession, such deduction shall take effect upon the effectivity of CREATE. *See transitory provisions below for the detailed manner of computation.*

IMPROPERLY ACCUMULATED EARNINGS TAX UNDER CREATE BILL

The improperly accumulated earnings tax shall **no longer be imposed on corporations upon the effectivity of the CREATE onwards**. This shall apply to the entire taxable year for all fiscal years/taxable years ending after the effectivity of CREATE.

FROM National Internal Revenue Code (NIRC) of 1997	TO Republic Act (RA) No.11534 or the "Corporate Recovery and Tax Incentives for Enterprises Act" (CREATE)
improperly accumulated earnings tax equal to ten percent (10%) of the improperly accumulated taxable income	no longer be imposed on corporations

NON-RECOGNITION OF GAIN OR LOSS ON EXCHANGE OF PROPERTY

No gain or loss shall be recognized if:

- such corporation is a party to a reorganization and exchanges property in pursuance of a plan of reorganization solely for stock or securities in another corporation that is a party to the reorganization.
- property is transferred to a corporation by a person, alone or together with others, not exceeding four (4) persons, in exchange for stock or unit of participation in such a corporation of which as a result of such exchange, the transferor or transferors, collectively, gains or maintains control of said corporation: Provided, that stocks issued for services shall not be considered as issued in return for property.

Sale or exchanges of property used for business for shares of stocks covered under this subsection shall not be subject to value-added tax (VAT). In all of the foregoing instances of exchange of property, prior Bureau of Internal Revenue (BIR) confirmation or tax ruling shall not be required for purposes of availing of the tax exemption. The concerned parties can implement the transaction covered by this Section including, but not limited to, the issuance of the Certificate Authorizing Registration (CAR) by the Revenue District Office (RDO) where the property is located, in case of real properties, or to the RDO where the business is registered, in case of shares of stocks, subject to post-transaction audit by the Bureau.

TRANSITORY PROVISIONS

A. **Rate to be used in the deduction of a certain percentage of interest income subject to final tax.**

Illustration (lifted from the draft):

JKL Corporation secured in 2018 a bank loan for its business expansion, and incurred interest expense of ₱2,000,000 in CY 2020 on the said bank loan. In the same year, it likewise earned interest income of P300,000 subjected to final tax of 20%. For CY 2020, its gross income amounted to ₱20,000,000. Its gross assets, excluding the value of the land where its building and plant are situated, is ₱100,000,000. Its operating expenses amounted to ₱10,000,000, inclusive of the interest expense of ₱2,000,000.

Compute for the interest arbitrage using the applicable rate:

Procedure	Sample Application
i. Divide the gross interest income subjected to final tax for the year by 12 months **Interest income subjected to final tax ÷ 12**	₱300,000 ÷ 12 = P25,000

ii. Multiply the number of months applicable to old arbitrage rate by the resulting monthly gross interest income subjected to final tax; then, multiply the product by the old arbitrage rate number of months applicable x (i) x 33.33%	₱25,000 x 6 x 33.33% = ₱49,995
iii. Multiply the number of months applicable to the new arbitrage rate by the resulting monthly gross interest income subjected to final tax; then, multiply the product by the new arbitrage rate: number of months applicable x (i) x (20% or 0%, as the case may be)	₱25,000 x 6 x 20% = ₱30,000 *The taxpayer is subject to **CIT of 25%** in the second semester of 2020 even though the total assets did not exceed ₱100M, excluding the land, but the taxable income is more than ₱5M. In this case, the interest arbitrage for the 2nd semester is 20% since the difference in the CIT of 25% and the final tax rate on the interest income of 20% is 5%, which is equivalent to **20% (5% ÷ 25%)** interest arbitrage*.
iv. Add the computed interest arbitrage under items (ii) and (iii) above to get the amount to be deducted from the interest expense claimed to arrive at the allowable interest expense.	Amount to be deducted from the interest expense claimed to arrive at the allowable interest expense is P79,500. ₱49,995 + P30,000 = ₱79,500

Alternatively, we may multiply the rates reflected in the table below with the amount of gross interest income subjected to final tax to find the amount of interest deductible from the interest expense claimed. Using the same illustration, we will get the same amount of ₱79,500 (₱300,000*26.50).

Transitory rates for interest arbitrage applicable for TY 2020 for corporations under itemized corporations:

For the computation of Interest Arbitrage		
Annual Accounting Period (Transition TY 2020)	Corporations subject to Regular Rates	Other domestic corporations with net taxable income ≤5M & total assets ≤100M, exclusive of land
	30% / 25%	30% / 20%
FY 7-31-20	31.92 %	30.25 %
FY 8-31-20	30.83	27.50
FY 9-31-20	29.75	24.75
FY 10-31-20	28.67	22.00
FY 11-31-20	27.58	19.25
CY 12-31-20	26.50	16.50
FY 1-31-21	25.42	13.75
FY 2-28-21	24.33	11.00
FY 3-31-21	23.25	8.25
FY 4-30-21	22.17	5.50
FY 5-31-21	21.08	2.75
FY 6-30-21	20.00	0.00

B. Computation of Income Tax Due of The Corporations for Taxable Year 2020

Under RA 11534, corporations' income and expenses for the fiscal year shall be deemed to have been earned and spent equally for each month of the period.

Illustration (lifted from the draft):

MVAA Corporation, a domestic retailer, has gross sales of ₱1,400,000,000.00 with cost of sales of ₱560,000,000.00 and allowable deductions of ₱150,000,000.00 for calendar year 2020, its 4th year of business operations. Its total assets of P180,000,000.00 includes the land and building in which the business is situated, amounting to ₱50,000,000.00 and ₱25,000,000.00, respectively.

The corporate income tax due for taxable year 2020 shall be computed as follows:

Procedure	Sample Application
Regular Income Tax Rate	
i. Divide the taxable income for the year by 12 months	₱690,000,000.00 (840,000,000 – 150,000,000) ÷ 12 = ₱57,500,000
ii. Multiply the number of months applicable to old rate by the resulting monthly taxable income	₱57,500,000 x 6 x 30% = ₱103,500,000
iii. Multiply the number of months applicable to the new rate by the resulting monthly taxable income;	₱57,500,000 x 6 x 25% = ₱86,250,000
iv. Add the computed regular income tax under item ii and iii.	Tax due - regular would be P189,750,000. ₱103,500,000 + ₱86,250,000 = ₱189,750,000
MCIT Rate	
i. Divide the taxable income for the year by 12 months	₱690,000,000.00 (840,000,000 – 150,000,000) ÷ 12 = ₱57,500,000
ii. Multiply the number of months applicable to old MCIT rate by the resulting monthly taxable income	₱57,500,000 x 6 x 2% = ₱6,900,000.00
iii. Multiply the number of months applicable to the new MCIT rate by the resulting monthly taxable income	₱57,500,000 x 6 x 1% = ₱3,450,000.00
iv. Add the computed MCIT under item ii and iii.	Tax due – MCIT would be ₱10,350,000. ₱6,900,000 + ₱3,450,000 = ₱10,350,000
Compare the resulting figures under regular and MCIT and the higher amount shall be the income tax due/payable.	Tax due – regular is higher thus tax payable is ₱189,750,000.

Alternatively, we may multiply the rates reflected in the table below with the amount of taxable income to obtain the tax payable during the period. Using the same illustration, we will get the same amount of ₱189,750,000 which is the higher between the tax due - regular of ₱189,750,000 (₱690,000,000*27.50) and tax due – MCIT of ₱10,350,000 (₱690,000,000*1.50).

TRANSITORY RATES				
Annual Accounting Period **(Transition TY 2020)**	**Regular Corporate Income Tax Rates**	**Other domestic corporations with net taxable income ≤5M & total assets ≤100M, exclusive of land**	**MCIT**	**Proprietary Non-profit Edu/Hosp**
	30% / 25%	**30% / 20%**	**30% / 25%**	**10% / 1%**
FY 7-31-20	29.58 %	29.16 %	1.91 %	9.25 %
FY 8-31-20	29.16	28.33	1.82	8.50
FY 9-31-20	28.75	27.50	1.73	7.75
FY 10-31-20	28.33	26.66	1.64	7.00
FY 11-31-20	27.91	25.83	1.55	6.25
CY 12-31-20	27.50	25.00	1.50	5.50
FY 1-31-21	27.08	24.16	1.41	4.75
FY 2-28-21	26.66	23.33	1.32	4.00
FY 3-31-21	26.25	22.50	1.23	3.25
FY 4-30-21	25.83	21.66	1.14	2.50
FY 5-31-21	25.41	20.83	1.05	1.75
FY 6-30-21	25.00	20.00	1.00	1.00

IMPACT OF CREATE LAW TO THE INCOME TAX RETURNS AND FINANCIAL STATEMENTS TO BE FILED AFTER ITS EFFECTIVITY

PAS 12, Income Taxes, requires current and deferred taxes to be measured with reference to the tax rates and laws, as enacted or substantively enacted by the end of the reporting period. Under the Philippine legislation process, Bills turn into Law upon the President's approval or when he fails to act upon a proposed law submitted by Congress within 30 days of receipt. A bill may be vetoed by the President, but the House of Representatives may overturn a presidential veto by garnering a 2/3rds vote. Accordingly, since CREATE Bill was not yet approved by the President as of December 31, 2020, current and deferred taxes will still be measured using the existing RCIT rate of 30% in December 31, 2020 financial statements. The retroactive effect of July 2020 is ignored in the financial statements, but is considered in the preparation of the annual ITR for December 31, 2020.

See below sample computation and disclosure for reference:

Sample Computation and Disclosure

	PFRS	Tax
Profit before tax	1,000,000.00	1,000,000.00
Temporary differences:		
Unrealized foreign exchange gain	100,000.00	100,000.00
Provision for expected credit losses	50,000.00	50,000.00
Taxable profit	950,000.00	950,000.00
Tax rate	30%	27.50%
Income tax due	285,000.00	261,250.00
Income tax paid for the previous three quarters	100,000.00	100,000.00
Creditable withholding tax applied for the previous three quarters	50,000.00	50,000.00
4th quarter creditable withholding tax	10,000.00	10,000.00
Income tax payable	125,000.00	101,250.00

Note:

1. *Income tax payable under PFRS will be the amount to be presented in the Dec 31, 2020 financial statements.*
2. *Income tax payable under Tax will be the amount to be presented in the Dec 31, 2020 ITR and is subject for payment.*
3. *Any difference will be reflected as reconciliation in the Dec 31, 2021 financial statements.*

Continuing the sample computation, a disclosure under **Events After Reporting Period** section of the financial statements shall also be presented for the effect of CREATE. Sample disclosure would be:

On March 26, 2021, the Republic Act (RA) 11543, known as "The Corporate Recovery or Tax Incentives for Enterprises Act" (Create Act), was passed into law. The salient provisions of the Create Act applicable to the Company are as follow:

1. Effective July 1, 2020, the corporate income tax rate is reduced from 30% to 20% for domestic corporations with net taxable income not exceeding P5,000,000 and with total assets not exceeding P100,000,000, excluding land on which the particular business entity's office, plant, and equipment are situated during the taxable year for which the tax is imposed at 20%. All other domestic corporations and resident foreign corporations will be subject to 25% income tax;
2. Minimum corporate income tax (MCIT) rate reduced from 2% to 1% effective July 1, 2020, to June 30, 2023;
3. Percentage tax reduced from 3% to 1% effective July 1, 2020, to June 30, 2023; and
4. The imposition of improperly accumulated earnings is repealed.

As of *[approval date of financial statements],* the overall effect of the changes in tax rates if applied to the current and deferred tax balance at the reporting period would be as follows:

	Current Tax Rate as at December 31, 2020 (30%)	Subsequently Enacted Tax Rate with Retrospective Effect beginning July 1, 2020 (27.50%)	Difference
	a	*b*	*c = a - b*
Current tax	285,000.00	261,250.00	23,750.00
Deferred tax asset	15,000.00	13,750.00	1,250.00
Deferred tax liability	30,000.00	27,500.00	2,500.00
Income tax payable	125,000.00	101,250.00	23,750.00

- For those taxpayers who have already filed their income tax returns for taxable year 2020 (calendar year 2020; fiscal year ending from July 31, 2020 to fiscal year ending February 28, 2021), they may amend their income returns using the transitory rates, and any resulting excess/overpayment can be claimed for refund or carried over to the next taxable year, at taxpayers' option.
- For those taxpayers who have already issued their financial statements, no need to reissue the financial statements as the auditor's report and financial statements is reflective of the circumstances when these were issued.

QAU Memo is the official publication of R.S. Bernaldo & Associates to keep the Firm's professional staff informed of the issues affecting the practice. The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

The Firm cannot be held liable for any losses suffered as a result of reliance upon information contained in this memo.

R.S. Bernaldo & Associates is a member firm of the PKF International Limited family of legally independent firms and does not accept any responsibility or liability for the actions or inactions of any individual member or correspondent firm or firms.

Comments and suggestions are welcome.