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LET'S TALK TAX

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Coming soon: tax relief for individual income taxpayers

When newspapers report about the efforts of Congress to pass a law intending to lower the taxes that are being paid by individuals, I must admit that I was skeptical on the possibility of this happening in the next couple of months. After all, bills seeking to reduce the tax burden on these taxpayers have long been filed, deliberated and studied in previous sessions of Congress, left unapproved when the last sessions ended, and then refiled when the next Congress opens its first regular session.

When I heard that the House of Representatives had already approved its version and transmitted the same to Congress, my hopes were raised, but I was still not that enthusiastic. I was expecting that it would take a few more months before the Senate, too, can approve its own version. Hence, it was a pleasant surprise to read a few days later that the Senate had approved its version. What was doubly astonishing to read, immediately thereafter, that the House, in what I believe is an unprecedented move, recalled the version it earlier approved and adopted instead the Senate version.

This genius stroke of legislative craftsmanship eliminated the need for the House and Senate to convene a bicameral committee to reconcile differences in the versions approved by the two bodies. The Senate version, thus, became the enrolled bill, which after it is signed by the representatives of both houses will be forwarded to the President for her approval. This display of cooperative efforts shows that the House and Senate can, if they truly wish, work together for the immediate approval of much-needed legislations. As one foreign host exclaimed in her show when she talked about the story of the new Filipino phenomenal singer Arnel Pineda "dreams still so happen. Don't stop dreaming."

So, what is in store for individual taxpayers under this forthcoming law? Will this reduce the tax being deducted from their salaries and leave them with bigger take-home pay, which they badly need to address the rising cost of gasoline, electricity, tuition fees, food, and almost all of their basic needs?

The forthcoming law provides for the following relief:

1. Minimum wage earners shall be exempt from income tax.

Currently, those receiving the minimum wage or monthly salary not exceeding P5,000 may be exempted from withholding tax, but they are still liable to pay income tax at the end of the year. This time, if this law is passed, the exemption granted to minimum wage earners will be absolute! No withholding tax, no requirement to pay income tax at the end of the year.

The term "minimum wage earner," as defined, refers to a worker in the private sector paid the statutory minimum wage. For an employee in the public sector, the minimum wage shall be equivalent to the statutory minimum wage for non-agricultural employees set in the place where he has been assigned to work.

In addition to their basic salaries, holiday pay, overtime pay, night shift differential pay, and hazard pay received by minimum wage earners shall likewise be exempt from income tax.

2. The basic personal exemption that can be availed by individuals will be increased to P50,000, regardless of their civil status.

At the moment, the personal exemption levels varies depending on the civil status — married, P32,000; head of the family, P25,000; and single, P20,000. Due to the current higher rates of personal exemption, almost all single taxpayers declare their parents as dependents to qualify as head of the family, even if their parents had already passed away.

With the amendment, there is thus less reason to lie about one's status. Also, employers will be relieved of the current burden of obtaining from employees the currently required numerous documentary requirements just to establish their civil status for tax purposes.

3. The additional exemption for dependents is increased to P25,000 per dependent, from the current P8,000.
4. The optional deduction which an individual engaging in trade or business or pursuit of profession may claim, in lieu of the itemized deduction of business expenses, is increased from 10% of gross income to 40% of gross sales or receipts.
5. Corporations shall also be given the option to avail of the optional deduction, in lieu of the itemized deductions, equivalent to 40% of gross income.

The first three changes are intended to alleviate the current tax burden of individuals, particularly the salaried individuals. In the long term, however, some had been hoping for more.

For one, it has often been asked if it will be possible to provide in the law for the personal and additional exemption levels to be re-evaluated by a government agency on a regular basis, say three or four years, in relation to certain economic indicators, for the purpose of adjusting the same without further need of legislation. It is noted that the current levels were set in 1997 and it had taken Congress 10 years before finally passing a law to adjust the same. If such provision is in place, legislation will no longer be necessary.

There is likewise a clamor for the current income brackets to be adjusted. The significant burden imposed on individuals primarily comes from the fact that the income thresholds set under the current graduated tax rates are very low.

In 1997, those earning P500,000 or roughly P45,000 per month were probably holding managerial or executive positions. Today, this rate will be the average salary of a supervisor. Considering that the rate of personal exemption had, on the average, been doubled, shouldn't the minimum salary level subjected to the top tax rate be adjusted to P1,000,000?

Other countries have high income tax rates for individuals, but the amount of income subjected to such high rates are indeed significant amounts.

Be that as it may, the forthcoming law provides a much-needed break.

The adjustment of the rate of the standard optional deduction for individuals and introduction of the optional standard deduction for corporation, based on my understanding, is expected to generate additional revenues for government. The thinking is that with the simplification of the computation of taxes and elimination of the need to keep complex records and other documents to substantiate their deductible expenses, individuals engaging in business or practice of profession will be enticed to report their income and pay their true taxes. The same assumption is made for corporations.

Whether this objective can be accomplished depends on how BIR will implement this legislation.

Reviewing the Senate version which was adopted by the House, it is noted that while the rate is the same, i.e. 40%, the basis set is different: for individuals, the 40% optional deduction is based on gross sales, while for corporations, it shall be based on gross income. For accountants and tax practitioners, gross sales are different from gross income. Gross sales is the total amount at which your goods or services are sold. Gross income is gross sales minus cost of goods sold or cost of services.

Is this just a play of words or did Congress deliberately provide for a different deduction for corporations and individuals?

One interpretation that has been espoused is that a corporation opting to avail of the standard deduction will be allowed to claim as deduction from its gross sales, cost of goods sold or cost of service, as applicable, plus a standard deduction equal to 40% of its gross income. On the other hand, an individual engaged in business or practice of profession shall

be allowed to deduct its cost of goods/service plus a standard deduction equal to 40% of its gross sales.

Hence, assuming they are engaging in the same business and earning the same level of profits, an individual will be subjected to a less amount of income tax than a corporation since it is allowed to claim a higher amount of standard deduction.

An alternative interpretation, on the other hand, is that an individual availing of the standard deduction will be allowed to claim a deduction equal to 40% only of gross sales — period, no deduction for cost of goods sold/service. This interpretation, compared to the first one, places individuals at a disadvantaged position, tax-wise, compared to a corporation.

It will be interesting to see how BIR interprets these provisions.

As a policy, tax should be equitable, which means that entities receiving the same level of income should have the same tax burden, regardless of the legal form that the business is undertaken. The different basis prescribed for the optional deduction of individuals and corporations do not seem to support this policy.

However, it is likewise recognized that tax policies may be adopted to address certain realities, which in this case is the general difficulty faced by BIR in monitoring the tax compliance of individuals engaging in business or practice of profession. The implementation of this forthcoming law will be an interesting show to watch.

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