

# ***Finding your way*** Doing business and investing in the Philippines

*An investor's  
guide*

*2013 edition*



### ***Disclaimer***

The contents of the Doing Business and Investing in the Philippines book are summaries and compilations in general terms of selected issuances from various government agencies available as of the date of writing. They do not cover exhaustively the subjects it treats but is intended to answer some of the important, broad questions that may arise. They do not necessarily reflect the official positions of Isla Lipana & Co., the Philippine member firm of the PwC global network. Isla Lipana & Co. is not liable on any ground whatsoever for any review, retransmission, dissemination or other use of, or in respect of decisions or actions in reliance upon the contents of this Doing Business and Investing in the Philippines book which are intended for guidance only and as such should not be regarded as a substitute for professional advice.

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# Doing Business and Investing in the Philippines (2013)

This Guide has been prepared for the assistance of those interested in doing business in the Philippines. It does not cover exhaustively the subjects it treats but is intended to answer some of the important, broad questions that may arise. When specific problems occur in practice, it will often be necessary to refer to the laws, regulations, and decisions of the country and to obtain appropriate accounting, tax, and legal advice.

The material contained in chapters 1 to 12 of this Guide was initially assembled on 31 December 2012. The taxation material (chapters 13 to 24) has been revised to reflect changes introduced by tax laws and regulations which took effect as of the first quarter (Q1) of 2013. Moreover, whenever available, some data in this Guide were also updated to reflect 2013 Q1 figures. Thus, unless otherwise indicated, it is generally based on information available at 31 December 2012.

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## Message from the Chairman and Senior Partner



We thank you for your interest in investing in the Philippines, one of the most resilient and fastest-growing economies in Asia today. This is the best time to explore in a profitable venture by riding the growth of an exciting and dynamic market currently enjoying an all-time high investor confidence.

The Philippines offers a wide range of investment opportunities and it has become a popular destination of foreign firms looking to expand their business. Among the sectors that welcome foreign investments are BPO, mining, infrastructure, agriculture, bio-fuels and renewable energy, and tourism development.

We have prepared this book on *Doing Business and Investing in the Philippines* with you in mind as you prepare to make that all-important strategic business move. We have included a chapter entitled “Introduction to PricewaterhouseCoopers (PwC)” which sets out the services we offer to our clients, including advice on how to start up a business in the Philippines.

This guide and two of our other publications, *How to Invest in the Philippines* and *Investment Incentives in the Philippines*, are our way of bringing credible information to private sector, and supporting the government bring in the much needed investments to boost the country’s economy. You can download these materials free of charge from our website [www.pwc.com/ph](http://www.pwc.com/ph).

Please feel free to contact us for any questions on this guide, and on how we can further assist you in growing your business on Philippine soil.

A handwritten signature in black ink, appearing to read 'Alexander B. Cabrera', written over a light blue horizontal line.

**Alexander B. Cabrera**  
Chairman and Senior Partner



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# **Chapter 1**

## **The Philippines – A profile**

### ***Investor considerations***

- The Philippines occupies a strategic geographical location, acting as a potential gateway for investors to the Asian market.
- The large workforce is skilled and well educated. English is the official business language, and is widely spoken even in most remote areas of the country.
- Natural resources are abundant.
- The Philippine government has established a liberal program of fiscal and non-fiscal incentives aimed at attracting foreign capital and technology to supplement local resources.
- The government has embarked on concerted efforts to remedy weaknesses in the country's administrative systems and infrastructure.
- Qualitative and quantitative information about exposure to risks arising from financial instruments including credit risk, liquidity risk, and market risk must be disclosed.

## ***Geography and climate***

The Philippine archipelago lies in Southeast Asia in a position that has led to its becoming a cultural crossroads, a place where Malays, Hindus, Arabs, Chinese, Spaniards, Americans, and others have interacted to forge a unique cultural and racial blend. The archipelago numbers some 7,107 islands and islets. The Philippines is strategically within 4.5 hours flying time of all Southeast Asian capital cities. Its coastline is bordered to the west and north by the South China Sea, to the east by the Pacific Ocean, and to the south by the Celebes Sea and the coastal waters of Borneo.

Eleven islands make up 95% of the Philippine landmass, and two of these — Luzon and Mindanao — measure 105,000 and 95,000 square kilometers, respectively. They, together with the cluster of the Visayan Islands that separate them, represent the three principal regions of the archipelago that are identified by the three stars on the Philippine flag. Topographically, the Philippines is broken up by the sea, which gives it one of the longest coastlines of any nation in the world.

The Philippines has a land area of approximately 300,000 square kilometers (115,000 square miles), which makes it about the same size as Italy or the state of Arizona in the United States. Its topography is varied, and includes vast arable lands, mountainous regions, a coastline extending to more than 18,000 kilometers and around 60 natural harbors.

The country's climate is tropical, with average temperature varying from 75°F to 87°F (24°C to 31°C). The northern half of the country has a pleasant, cool weather from November to February; a hot, dry season from March through May or June; and rainy weather from July to October when storms visit the area. The southern half of the country has a less changeable climate and is seldom affected by tropical storms. Humidity is high, ranging from 71% in March to 85% in September. Average rainfall is 305 centimeters (120 inches).

The largest urban area in the country is Metro Manila, located in Luzon. Metro Manila is a contiguous area consisting of 16 cities and one municipality and has a population of around 12 million people. The cities composing Metro Manila include Manila, the capital city and the country's major commercial port, Makati, Pasig, Quezon City, and Taguig, the country's foremost business and commercial centers and the office locations for most of the big national and multinational banks and corporations operating in the Philippines.

The Philippines has a number of international commercial port cities outside Manila, including Batangas and Subic in Luzon, Cebu and Iloilo in the Visayas, and Davao and Zamboanga in Mindanao.

## ***History***

The Philippines became known to the Western world when the Portuguese explorer, Ferdinand Magellan, discovered

it in 1521. However, its relations with neighboring countries, particularly China, date back to the ninth century. The Chinese influence on the Philippines was mainly economic, and even today, Chinese businessmen continue to have a prominent role in Philippine business.

Spain colonized the Philippines in the late 16th century and ruled the country for more than 300 years. Its influence over the Philippines was mainly political and religious. The Spanish influence is most visible today with 83% of the country's population remaining Catholic.

The United States acquired the Philippines from Spain in 1898 through the Treaty of Paris and ruled for 48 years. The Americans contributed to the development of potential Filipino leaders capable of running an independent government. They also introduced a system of free education, which emphasized democratic traditions and the practical application of laws and principles. The Americans have left a strong legacy in the Philippines. A large part of the Philippine legal and political system remains patterned after that of the United States. Perhaps more significantly, English has become established as the language of government, commerce, and education.

The Philippines gained its independence from the United States on 4 July 1946. Since then, the country's form of government has been the presidential system, except for the years 1972 to 1981 when the country was under martial law, and 1981 to 1986 when a combination of

the presidential and parliamentary systems were in place. In 1987, almost a year after the people took to the streets to depose President Ferdinand E. Marcos in the bloodless revolution of EDSA, a new Philippine Constitution was proclaimed, providing for a democratic republican state and a presidential form of government.

In June 2010, former President Gloria Macapagal-Arroyo ended her term of office; and this marked the beginning of President Benigno Simeon C. Aquino III's administration. Under the existing constitution the president has a term limit of six years.

### ***Political system***

Under the 1987 Constitution, the Philippines is a democratic republican state with a presidential form of government. The Philippine government consists of the executive, legislative, and judicial branches.

The executive branch consists of a number of executive departments, such as the Department of Finance and the Department of Trade and Industry, as well as some independent agencies of a largely regulatory character, including the Securities and Exchange Commission and the Bangko Sentral ng Pilipinas (the central bank). The President heads the executive branch, and is responsible for appointing the cabinet members that head the executive departments.

The legislative branch consists of the Congress, which is made up of two chambers. The House of Representatives,

which is the lower chamber, has a maximum of 287 representatives, while the Senate consists of 24 senators. The president, vice president, and members of the executive cabinet are not members of Congress.

The judiciary branch consists of a system of courts. It is headed by the Supreme Court, which is composed of a chief justice and 14 associate justices.

At the local government level, the country is divided into provinces, cities, and municipalities. A governor heads each province, while mayors head the cities and municipalities. Cities and municipalities are further divided into barangays, which are headed by barangay captains. Local government units are given autonomy, and are responsible for providing some social services. To fund their operations, they are empowered to impose limited local taxes and fees.

To aid administration, the country is also divided into 17 regions, each of which has some commonality in terms of location, dialects, attitudes, food, and culture. Each province, city, and municipality will be a member of one of these regions, which

allows for planning to be effected with regional interests in mind, rather than merely those of a province or city.

As of 30 September 2012, the number of regions and local government units within each of the three main island groupings are shown in Table I.

### **Legal system**

Philippine law is a combination of Anglo-American law, Roman law, Spanish law, and the indigenous customs and traditions of the Filipino people. Many of the existing laws are based on Spanish and American statutes. The 1987 Constitution is the fundamental law of the land. Other sources of legal jurisprudence are the Civil Code, the Revised Penal Code, the National Internal Revenue Code, the Labor Code, and the Code of Commerce. Letters of Instruction, judicial decisions and pronouncements, administrative orders, and rules and regulations issued by the three branches of the government are also part of the law of the land.

The United States introduced and developed the educational system, together with the English language, into the

**Table I: Regions and government units**

	<b>Luzon</b>	<b>Visayas</b>	<b>Mindanao</b>	<b>Total</b>
Regions	8	3	6	17
Provinces	38	16	26	80
Cities	71	39	33	143
Municipalities	700	369	422	1,491
Barangays	20,500	11,444	10,084	42,028

Source: National Statistics Office, [www.nscb.gov.ph](http://www.nscb.gov.ph)

Philippines. Perhaps because of this, a number of local statutory rules have been patterned after the law of the United States. Consequently, decisions in the United States Supreme Court can be persuasive when Philippine courts consider similar legal issues.

Government agencies are generally empowered to issue implementing regulations for the various laws passed by Congress.

## ***Population and social patterns***

### **Population**

Philippine population growth slowed down by 18.8% from a national annual rate of 2.34% from 1990-2000 to 1.90% from 2000 to 2010. As of May 2010, the population is 92.34 million which is approximately higher by 15.83 million compared to the 2000 population of 76.51 million. This is projected to reach approximately 103 million by 2015 based on the latest average annual exponential growth rate released by the National Statistical Coordination Board (NSCB) of 1.82%. The Philippine population is a mixture of Indo-Malay, Chinese, and Spanish descent. About 63% of the population is of working age (15 to 65 years old). There are slightly more females than males.

By region, Calabarzon (Region IV-A) has the largest population with 12.61 million residents, followed by the National Capital Region (NCR) with 11.86 million, and Central Luzon (Region III) with 10.14 million. The combined population of these

three regions comprised more than one-third of the Philippine population.

Based on the 2012 census figure (latest available data), of the thirty-three (33) highly urbanized cities (HUCs), four have their population in millions. Three of such HUCs are in the NCR: Quezon City (2.76 million), City of Manila (1.65 million), and Caloocan City (1.49 million). The other HUC is Davao City at 1.45 million

Among the provinces, Cavite has the largest population with 3.09 million. Bulacan is second with 2.92 million and Pangasinan is third with 2.78 million.

### **Language**

There are 87 native dialects spoken throughout the Philippines, the three main ones being Tagalog, Cebuano, and Ilocano. The official national language is Filipino, which is spoken mainly in the Metro Manila area and is widely used in mass media. Filipino is also used as a medium of instruction in schools, alongside English. Spanish and Chinese are also spoken.

Most Filipinos are bilingual, speaking English fluently as their second language. English is the main language used in business, government, and schools, and is also common in everyday communication. Local laws are also written in English.

### **Religion**

The Philippines is the only predominantly Christian country in Asia. Approximately 83% of the population belong to the Roman Catholic Church, and a further 12% belong to other denominations. There are two

prominent local independent churches, the Aglipay (Philippine Independent Church) and the Iglesia ni Cristo (Church of Christ).

Muslim Filipinos constitute around 5% of the population, and are concentrated mainly in the southern part of the country, in Mindanao and in the Sulu archipelago.

**Education**

The educational system is largely patterned after the American system. Public education is free at the elementary and secondary levels. College education is financed mainly by the private sector, although there are a large number of colleges and universities established by the Government, foremost of which is the University of the Philippines with regional campuses throughout the country, which offer subsidized tuition rates to students.

Beginning school year June 2012, the Department of Education has implemented the new K to 12 Program which covers kindergarten and 12 years of basic education (six years of primary education, four years of Junior High School, and two years of Senior High School) to provide sufficient time for mastery of concepts and

skills, develop lifelong learners, and prepare graduates for tertiary education, middle-level skills development, employment, and entrepreneurship.

The school year starts in June and ends in March. Filipinos value education highly and consider it a vehicle for improved social status. In the 2009-2010 school year (latest available data), about 20.7 million Filipinos were enrolled in schools. The participation rate was 85.01% for elementary schools. Primary schooling is completed by 70.96% of those who enrol in grade one, while 74.23% of students that enrol in first year high school go on to complete their secondary education.

**Living standards**

On the basis of data in the 2009 survey of family income and expenditures (latest available estimates) by the National Statistics Office, the average annual Filipino family income and expenditures are PHP206,000 and PHP176,000, respectively.

As of 2009, the poverty threshold in the Philippines was estimated at PHP16,841,

**Table II: Unemployed rates**

	2010	2011	2012
Population aged 15 years and over	60.7 million	61.8 million	62.9 million
Unemployment rate	7.4%	7.0%	7.0%
Underemployment rate	18.8%	19.3%	20.0%

Source: Bureau of Labor and Employment Statistics (BLES)

**Table III: Economic performance indicators**

	<b>2011 % (at constant 2000 prices)</b>	<b>2012 % (at constant 2000 prices)</b>	<b>2013 Q1 % (at constant 2000 prices)</b>
Growth of GDP	3.6	6.8	7.8
Growth of GNP	2.8	6.5	7.1
Key components			
Agriculture, hunting, fishery, and forestry	2.6	2.8	3.3
Industry	1.8	6.8	10.9
Services	4.9	7.6	7.0
Net Factor Income from Abroad (NFIA)	-1.6	4.8	3.2

Source: [www.nscb.gov.ph](http://www.nscb.gov.ph)

with 20.9% of families having income below this threshold.

Unemployment rates are shown in Table II.

### **Cultural and social life**

Filipino culture has assimilated Asian, Spanish, and American influences as it evolved. Filipinos are fond of taking the latest recreational trends from around the world (particularly the United States) and then adapting them to the local market.

Filipinos are a versatile and talented people, as evidenced by their music and other arts. Contemporary Filipino music has been influenced by Western music, while still retaining much of the flavor of typically melancholic traditional Filipino folk music. The resulting blend is popularized through the Original Pilipino Music (OPM) brand that sells well in the local market. This includes several local rock bands who became very popular and

have dominated the airwaves and entertainment scenes over the years.

Various venues for performances of both Filipino artists and foreign groups can be found throughout the country. Cultural centers, theaters, nightclubs, discotheques, pubs, karaoke, videoke, and concert/comedy bars are located in major cities. Museums and galleries are available for art enthusiasts. Filipinos are also sports-loving people. Basketball is the national sport, and at least one court can be found in almost every barangay in the Philippines.

### **The economy**

#### **General description**

The Philippine economic system is essentially market-oriented, although pricing mechanisms remain regulated in a few sectors to protect consumers. The Philippines has undergone significant structural reforms in the past decade. On the domestic front, the competitiveness of

the market has been enhanced through the dismantling of protection for “infant industries” and the breakdown of industries with monopolistic or cartel tendencies. On the international front, the economy has been opened up to global competition, through a tariff reduction program and the loosening of restrictions on inward foreign investment. The result is a diverse economy, featuring a sound mix between the agricultural, industrial, and service industries. The overall economic picture is shown in Table III.

The figures above show that in 2012, the Philippine economy was able to bounce back and achieve a 6.8% growth, exceeding expectations and making it the best performer in Southeast Asia. The country’s economic growth was the strongest in Asia during the period after China’s. Most analysts took special note of the country’s resiliency amidst global economic downturn. With the upbeat business and consumer sentiments, coupled by sustained government expenditure, the Philippine economy posted a 7.8% GDP in the first quarter of 2013. Robust domestic consumption and higher government spending have helped cushion the economy from the worst of the global slowdown, while manageable inflation has allowed authorities to keep interest rates conducive to growth. The growth momentum is expected to continue as government works to ease the cost of doing business and as more infrastructure projects under the private-public partnership scheme get underway.

A strong BPO sector, booming construction, increased consumer and government spending, and external trade contributed to the highest quarterly growth since 2010.

The Philippines adheres to the principles of a democratic republican state with a presidential form of government. Under the leadership of Benigno Simeon “Noy” C. Aquino III, its 15th President, the country has identified six priority investment areas in the fields of tourism, information technology and business process outsourcing, electronics, mining, housing, and agriculture. One hundred percent foreign ownership remains permissible in many areas of investment, although certain industries are subject to foreign ownership limitation. He has also started his fight against corruption by compiling the names of the country’s most notorious smugglers and the evidence against them as anti-corruption drive is the centerpiece of his platform.

### **Mineral and energy resources**

The Philippines is rich in minerals and certain energy resources. It ranks among the top ten world producers of gold, copper, and chromite. Its mineral reserves also include silver, nickel, cobalt, and zinc. The Mining Act of 1995 created a framework for increased foreign investment in the mining sector, but was challenged on constitutional grounds. In December 2004, however, the Supreme Court upheld the constitutionality of the law in an *en banc* decision. The industry has continuously worked closely with relevant government



agencies to address other impediments to mining, such as implementation issues at the local government level and perceptions about potential adverse environmental effects, so that an effective mining sector may be established in the Philippines.

Foreign investors are encouraged to participate actively in the development and discovery of new resources, particularly in the exploration for oil and natural gas deposits and the development of non-conventional sources of energy.

### **Agriculture, fishery, and forestry**

Agriculture and forestry are listed as preferred areas of activity in the

government's Investment Priorities Plan. This means that enterprises engaged in these activities will be entitled to Board of Investment (BOI) incentives (see Chapter 4), and generally may be 100% owned by foreign investors if the activities are "pioneer" or conducted in less-developed areas. The government's aim is to develop more effective linkages between the agricultural and industrial sectors, so that both sectors can improve their international competitiveness and expand their capacity to service both local and export markets.

**Table IV – Gross value added in manufacturing by industry group at constant prices (In million pesos)**

	2010	2011	2012
Food manufactures	479,445	494,349	531,704
Beverage Industries	50,133	58,743	60,303
Tobacco Manufactures	5,968	4,844	4,675
Textile Manufactures	31,472	30,763	30,102
Wearing Apparel	26,465	27,976	39,554
Basic Metal Industries	26,024	25,869	20,983
Furniture and Fixtures	20,185	39,326	53,346
Miscellaneous manufactures	43,186	48,599	45,176
Gross value added in manufacturing	1,264,523	1,324,330	1,395,711

Source: [www.nscb.gov.ph](http://www.nscb.gov.ph)

## **Manufacturing**

Food processing has remained the primary manufacturing industry in the Philippines. Other major industries, based on contribution to total output, were electrical machinery, petroleum and coal products, chemical products, apparel, and beverages, a breakdown of which is shown in Table IV.

## **High-tech industries**

Industrialization is one of the country's major long-term economic objectives. A major priority in the country's development plans is to facilitate the development of information and communication technology (ICT) with a view to establishing the Philippines as a knowledge and software development center, an e-service and call center hub for Asia. Thus, the government has been earnestly implementing its commitment to build the physical infrastructure needed to support this vision, as well as pursuing the legal, judicial, and educational reforms needed to provide effective support to the industry.

The development of labor-intensive and export-oriented industries is also highly encouraged to meet the twin objectives of providing wider employment opportunities to the Filipino people and making Philippine products competitive in the world market. One of the primary export-oriented industries is the assembly of electronic products, such as semiconductor devices and components, integrated circuits, transistors, watch modules, and intermediate frequency transformers. American and Japanese investors are at the

forefront of the semiconductor industry in the Philippines.

## **Service industries**

The country's Gross Domestic Product (GDP) grew by 7.1% in the fourth quarter of 2012, paving the way for the full-year GDP estimate to post a broad-based growth of 6.8%. The increase was fuelled by the robust performance of the services sector led by trade and real estate, renting and business activities, as well as the substantial improvements of manufacturing and construction.

## **Transport and communications**

Being an archipelago of more than 7,000 islands, overland transport in the Philippines is somewhat restricted. However, there is a road network covering the entire archipelago. National carriers service airports in more than 25 cities. There are also more than a dozen major shipping ports throughout the country, and a roll-on, roll-off (RORO) system has been implemented to connect the road systems of different islands. Former President Gloria Macapagal-Arroyo, during her eighth State of the Nation Address (SONA), highlighted the economic benefits of the RORO where said boats carried 33 metric tons of cargo and 31 million passengers. Thirty-nine RORO ports have been built as of 2009 and twelve more ports are slated to start.

Infrastructure is underdeveloped in many parts of the country, and a number of projects are ongoing to address this,

including the construction or upgrading of local and international airports at strategic points and the construction of new highways, ports, and mass transportation facilities. Part of this project are the recently upgraded Diosdado Macapagal International Airport in Clarkfield, Pampanga; the recent completion of the world-class superhighway which interconnects the two premier Philippine freeport zones, i.e., Subic and Clark; new highways connecting provinces surrounding Metro Manila; and the Metro Rail Transit system that passes through Metro Manila. The government has also established the “Build-Operate-Transfer” (BOT) scheme for infrastructure development projects, which can provide promising investment opportunities for foreign investors (see Chapter 3).

In line with the Aquino administration’s goal of tapping the private sector to boost public infrastructure activities and economic growth, the government released 4.6 billion Philippine pesos for the implementation of projects under the Administration’s Public-Private Partnership (PPP) Program. Such projects primarily involve the rehabilitation of various airports in the country, foremost are Terminal 1 of the Ninoy Aquino International Airport (NAIA), the New Legazpi Airport in Bicol, and the Central Mindanao Airport.

The telecommunications sector has been liberalized, and a number of foreign investors have established partnerships with local companies. Firms operating in the telecommunication sector are privately owned and most cellular mobile telephone system operators provide nationwide

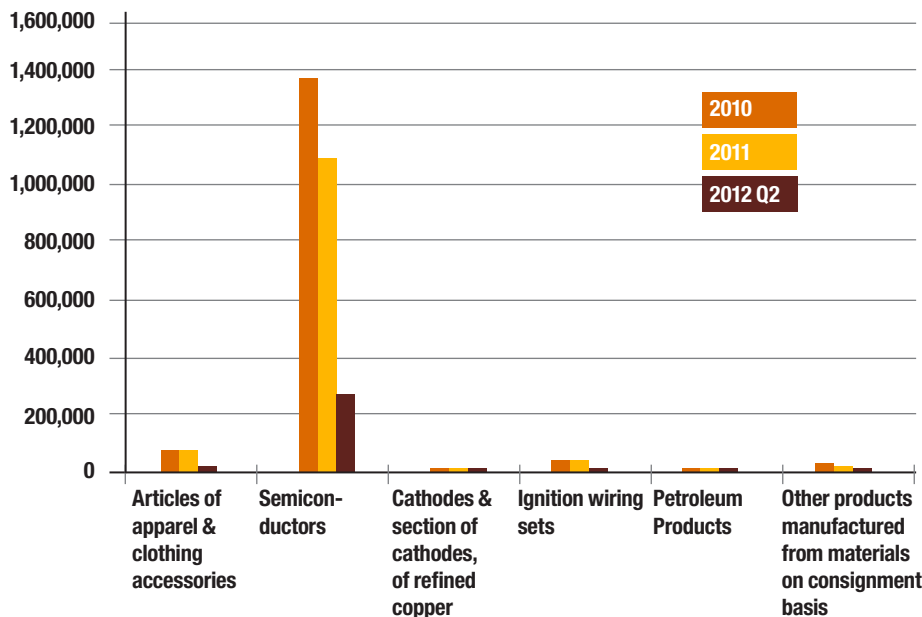
**Table V: External performance indicators**

	2009	2010	2011
GDP growth (% change per year)	1.1	7.6	3.7
CPI (% change per year)	4.2	3.8	4.8
Unemployment rate (%)	7.5	7.4	7.0
Fiscal balance (% of GDP)	3.7	3.5	2.0
Export growth (% change per year)	22.1	34.9	6.9
Import growth (% change per year)	24.0	32.9	1.6
Current account balance (% of GDP)	5.6	4.5	3.1
External debt (% of GNI)	32.0	31.2	...

... = data not available, CPI = consumer price index, GDP = gross domestic product, GNI = gross national income

Sources: ADB, 2012, Asian Development Outlook, Manila; ADB staff estimates; World Bank 2012, World Development Indicators Online

Diagram I — Principal Merchandise Exports – At Constant Prices PHP (Millions)



Source: [www.nscb.gov.ph](http://www.nscb.gov.ph)

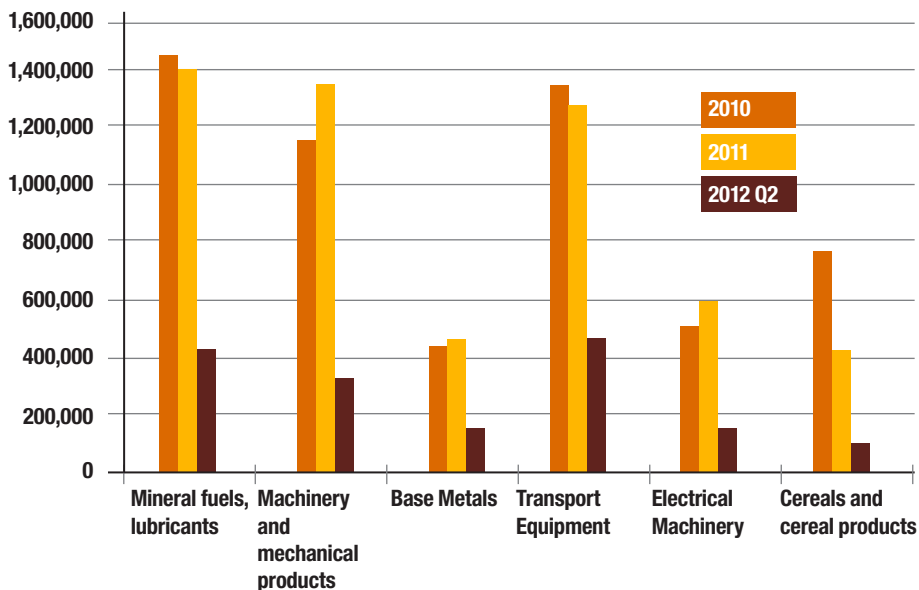
coverage. Growth in this sector slowed down for the past several years. There was no increase in the number of applicants for license to operate an exchange carrier service since 2006. In 2011, there are 70 local exchange carriers, 13 inter-exchange carrier services, 11 international gateway facility operators, 9 cellular mobile telephone system operators, and 19 broadband services.

The mobile segment of the telecommunications market in the Philippines has slowed significantly after years of solid growth. The slowing

reflected, among other things, a general downturn in the Philippine economy. Although the economy certainly picked up in 2010/2011, growth in mobile subscribers has continued at a generally slower pace, with mobile revenue growth also down in what has been a highly competitive market. In 2012, the Philippines had almost 95 million mobile subscribers. The government has also initiated efforts to build alternative backbone networks.

Several major daily newspapers and weekly magazines are available in English, and vernacular editions of the dailies are also produced. Certain international

**Diagram II — Principal Merchandise Imports – At Constant (2000) Prices PHP (Millions)**



Source: [www.nscb.gov.ph](http://www.nscb.gov.ph)

dailies, such as the Asian Wall Street Journal and other United States newspapers, are also available.

### Foreign trade and balance of payments

Foreign trade plays a significant role in steering the economic development of the country (see Table V). Export-oriented enterprises are seen to have a large capacity to generate jobs and provide foreign exchange for the country, and there are a number of incentives aimed at promoting the export sector (see Chapter 4).

Philippine exports are dominated by electronic components (semiconductors and electronic microcircuits) comprising 68.08% of the total exports. Electronic products had the biggest share among the major export categories with export earnings worth 2.43 billion US dollars in 2012.

No export category other than those shown accounted for more than 1% of the total merchandise exports.

Overseas Filipino workers (OFWs) also contribute significant foreign capital to the economy. Personal remittances from OFWs

in December 2012 expanded by 9.7 % year-on-year, the highest monthly growth registered in 2012. This positive development brought the full-year personal remittances to 23.8 billion US dollars, higher by 6.4% compared to the level recorded in the same period of 2011.

Japan, the United States, the European Union, and China are the Philippines’ major trading partners.

The country’s outstanding external debt approved/registered with the BSP stood at 62.9 billion US dollars as of end of March 2012, reflecting an increase of 1.2 billion US dollars (or 1.9%) compared to the level at the close of 2011. The increase is due largely to 2.3 billion US dollars net availments as investment and business activities by both public and private sector entities escalated due to the upbeat business sentiment.

**Hints for the business visitor**

**Visitors’ visas**

To enter the Philippines, a foreign national is required to present a passport that is valid for at least six months from the date of entry, along with a ticket for onward travel from the Philippines. A visitor who is a national of a country with which the Philippines has a reciprocity agreement may enter the Philippines visa-free for an initial period of 21 days. Other visitors will need to obtain a visa before travelling to the Philippines. Visitors may file an application to extend a visa while they are in the Philippines.

Visitors that intend to work in the Philippines are required to obtain special visas and work permits (see Chapter 10).

**Currency**

The monetary unit in the Philippines is the peso (PHP), which is divided into centavos (¢). The currency consists of paper notes and coins. The paper notes are in the denominations of PHP1,000, PHP500, PHP200, PHP100, PHP50, and PHP20; the coins are PHP10, PHP5, PHP1, and PHP0.25. Coins are also in circulation in PHP0.10 and PHP0.05 denominations, but these are rarely used because of their nominal value.

The peso floats in relation to foreign currencies. The average exchange rate for some major currencies against the Philippine pesos as of February 2013 are shown below.

US\$1	PHP 40.74
¥1	0.44
£1	61.74
euro	53.52
A\$1	41.57
HK\$1	5.25
CAD\$1	39.81

**International time**

Philippine time is eight hours ahead of Greenwich Mean Time (GMT) and 13 hours ahead of US Eastern Standard Time (EST). The Philippines does not normally practice daylight saving time.

### Business hours

A working day consists of eight hours. Banking institutions may fix their own business hours, which should not be fewer than six hours a day, any time between 8am and 5pm. Ordinarily, commercial banks transact business from 9am to 3pm and savings banks from 9am to 5pm. Automated teller machines operate 24 hours. Certain banks offer extended banking service hours and Saturday and Sunday banking in selected branches.

Government and private offices are open from 8am to 5pm, Monday through Friday, with a lunch break from 12pm to 1pm. Some private offices are open on Saturdays.

### Statutory holidays

The following are designated as regular holidays and nationwide special days, unless otherwise modified by law, order, or proclamation.

Regular holidays	Date
New Year's Day	1 January
Maundy Thursday	Movable date
Good Friday	Movable date
Eidul Fitr	Movable date
Araw ng Kagitingan (Bataan and Corregidor Day)	9 April
Labor Day	1 May
Independence Day	12 June
Ninoy Aquino Day	21 August
National Heroes Day	Last Monday of August
Eid'l Adha	Movable date

Regular holidays	Date
All Saints Day	1 November
Bonifacio Day	30 November
Christmas Day	25 December
Rizal Day	30 December
Last day of the year	31 December

The President may also declare additional days to be non-working days. For example, the President for the past few years has declared 25 February, the anniversary of the 1986 EDSA People Power Revolution, as a holiday. Republic Act 9492 makes majority of the holidays “movable” to Mondays. In the event the holiday falls on a Wednesday, the holiday will be observed on the Monday of the week. If the holiday falls on a Sunday, the holiday will be observed on the Monday that follows. For movable holidays, the President shall issue a proclamation, at least six months prior to the holiday concerned, indicating the specific date that shall be declared as a nonworking day.

### Weights and measures

The Philippines is on the metric system and uses the International System of Units (SI) as the sole standard of weights and measures.

### Dates and numbers

Dates are usually written in the order of month, day, and year, e.g., March 31, 2012 or 3/31/12. Commas denote thousands, and decimal points denote fractions, e.g., 1,500.05.

## **Business information services**

See Appendix XIX for a list of agencies that offer information that might be useful to foreign businessmen.



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# Chapter 2

## Business environment

### ***Investor considerations***

- Inbound foreign investment into the Philippines is actively encouraged, and a wide range of incentives is available for investment activities.
- The Philippines has established a number of special economic zones and freeports. Goods that are imported into these zones are subject to duties and taxes only if they are withdrawn for use in the domestic market.
- The Philippines has a ready and steady supply of highly skilled and trainable labor, including professional, technical, managerial, and skilled workers. Workers can comprehend and generally communicate in English.
- The Philippines is a member of the Association of Southeast Asian Nations (ASEAN), which gives it preferential tariff access to the markets of the other nine member countries. The Philippines is also a member of Asia-Pacific Economic Cooperation (APEC), whose member countries account for more than 48% of world trade.
- Provinces in the Southern Philippines are members of the Brunei Darussalam, Indonesia, Malaysia, Philippines-East ASEAN Growth Area (BIMP-EAGA).

## ***Industrial climate***

The Philippine government promotes the principles of transparency and free enterprise, and believes that economic development is best led by the private sector. Inbound foreign investment is actively encouraged, and incentives are available for investment activities that will facilitate the country's development or export capacity. Foreign access to the more critical sectors of the economy, such as banking and finance, insurance, telecommunications, and transportation, is being increasingly liberalized. The Philippines also has an abundance of highly skilled and technology-based manpower, which provides strong support for both processing and high-technology industries.

## ***Framework of industry***

Most businesses in the Philippines are owned by families, or by a small group of individuals, either directly or through private corporations. The government recognizes, however, the importance of broad public ownership of the nation's industries and has established policies to encourage more dispersed public ownership for large corporations. The government is also taking steps to promote competition through the privatization of government-owned-and-controlled corporations and the deregulation of certain industries.

## ***Aims of government policy***

### **Economic development plans**

The main thrust of the government's economic plans is to achieve prosperity for the greater number of Filipino people as a means to fight poverty and create massive employment opportunities. The principal objectives are embodied in the 2011-2016 Philippine Development Plan, and include the promotion of livelihood, strengthening of education, attainment of fiscal stability, decentralized development, and achieving sustained national harmony. Infrastructure development is another priority area for the government. Free enterprise is promoted as a means toward enhancing the country's global competitiveness.

Another cornerstone in the government's development policy traces back from the Comprehensive Agrarian Reform Law passed in 1988. On 7 August 2009, Republic Act (RA) 9700 was signed into law, extending the Comprehensive Agrarian Reform Program (CARP) for another five years. A large part of the Philippine population remains dependent on agriculture for its livelihood. The agrarian reform involves the redistribution of lands to landless farmers and regular farm workers, while seeking to provide farmer-beneficiaries with the support services necessary to improve their economic status and increase land productivity. The government continues to make efforts to facilitate the disposition of agrarian cases to bolster land acquisition and distribution activities. For 2012, the

Department of Agrarian Reform set a land distribution target of 180,000 hectares.

### **Trends toward nationalization/ privatization**

A major feature of the general economic policy of the government is to generate more jobs for the Filipino people. Means to achieve this are through vigorous support for micro, small, and medium enterprises and agribusiness; developing two million hectares of new lands for agribusiness; and creating three million micro enterprises which are provided with credit, technology, and marketing support. The privatization program is also being pursued aggressively by the government through Public-Private Partnership (PPP) schemes under RA 7718, otherwise known as the Build-Operate-Transfer (BOT) Law and its implementing rules and regulations. The PPP procurement model aims to attract private sector finance and expertise to develop infrastructure assets and services in a holistic manner by partnering with the government to achieve a common set of objectives through efficient allocation of project risks. A key feature of the PPP model is the ability to achieve optimal risk transfer while harnessing private sector innovation through synergies between the design, construction, and facilities management working together. This will enable the development of an outcome of higher quality and greater value than either party could achieve individually. Under the BOT Law, a project shall generally be eligible for procurement if it has a cost recovery component which

covers at least 50% of the project cost. Some of the PPP projects rolled-out include the rehabilitation of the Mactan-Cebu International Airport Passenger Terminal Building, School Infrastructure Project, modernization of the Philippine Orthopedic Center, and the NLEX-SLEX Connector Road project.

### **Regional/special industry development**

The aim of the government is to provide equal development opportunities to all sectors of the economy and all regions of the country. The government pursues a national policy of fostering economic growth and development, particularly in the rural areas where increased employment opportunities and income are most needed. This policy of regional dispersal has spurred the rise of industrial estates and parks, special economic zones, and special development programs in areas outside Metro Manila.

The Philippines is divided into 17 regions, with each region having its own development plan. Foreign investments supporting these plans are generally entitled to various incentives depending on the nature of the activities (see Chapter 4).

Incentive opportunities in Metro Manila are quite limited, reflecting the government's desire that rural areas become more developed to discourage further urban migration.

### **Special economic zones**

The Philippines has established a number of special economic zones. Goods that are

imported into these zones are not subject to duty or tax while they remain inside these zones, but do become subject to duties and taxes if they are withdrawn from the zones for use in the domestic market.

Enterprises operating in these zones are entitled to a preferential tax treatment of 5% tax on gross income in lieu of all other Philippine taxes. In addition, new ecozone export or free trade enterprises may be granted income tax holidays for up to eight years from the start of commercial operations (see Chapter 4 for further information).

### **Financial services**

More than 150 of the top 7,000 Philippine corporations are involved in various forms of financial intermediation. The market for consumer finance and loan syndication is relatively mature, although the market for other specialized financing services, such as leasing and factoring, remains fairly immature (see Chapter 7 for further discussion on the local finance industry).

Special incentives are offered for foreign banks that operate offshore banking units in the Philippines (see Chapter 4), including an exemption from tax on foreign-sourced income. Beyond that, however, there are no significant incentives in the financial services sector.

### **Public/private sector cooperation**

The government considers the participation of non-government sectors in

making economic decisions to be essential to the country's economic recovery. Transparency in the public sector is encouraged, and the government has taken initiatives to give the private business sector a larger role in the economic decision-making process through public consultations.

There are numerous international and local non-governmental organizations (NGOs) in the Philippines, operating in various fields of socio-economic activities. The NGOs work closely with relevant government agencies to coordinate their respective goals. The views of NGOs are also represented in the formulation and implementation of economic development policies, either through direct representation in consultative meetings or through the government agencies they work with.

### **Labor/management relations**

The Philippines has a ready and steady supply of highly skilled and trainable labor, including professional, technical, managerial, and skilled workers. Most Filipinos speak fluent English, as it is the official business language and the main language of instruction in schools. Wage rates in the Philippines are also competitive with the rest of the Asian region.

The Philippine Constitution guarantees workers the right to organize and bargain collectively, although only around two million Philippine workers are union members. The strategies adopted by the National Conciliation and Mediation Board

of the Department of Labor and Employment (DOLE) for preventing and resolving labor disputes have proven fairly effective in preserving industrial peace. In 2012, only 3 labor strikes, occurred of the 207 strike notices filed for the year. (see Chapter 10 for further discussion on the local labor market.)

## **Overseas trade relations**

### **Membership in trade blocs**

The Philippines is a member of the Association of Southeast Asian Nations or ASEAN. Under the ASEAN Free Trade Agreement (AFTA), the six original members (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand) have reduced their tariffs to less than 5% on tariff lines representing 90% of intra-ASEAN trade. Ultimately, the aim is to eliminate all import duties among the six original members by 2010, and by 2015 for any new members (the other current members are Cambodia, Laos, Myanmar, and Vietnam). Products originating in the Philippines will benefit from the preferential tariff rates when exported to ASEAN member countries.

Through its membership with ASEAN, the Philippines firmed up trade agreements with China, Korea, Japan, Australia, New Zealand, and India. All of these agreements provide for scheduled reductions of up to 0% duty rates for selected goods by 2015. The Philippines has also firmed up trade agreements with Australia, New Zealand, and Japan through its membership with ASEAN.

The Philippines is also a member of Asia Pacific Economic Cooperation (APEC), which aims to achieve free trade and investment liberalization among the Pacific Rim countries representing more than 40% of the total world population and more than 48% of world trade. Membership in APEC is expected to provide the Philippines with greater market access for goods, services, and technology through the reduction of trade barriers among member countries, while market integration should result in greater technical cooperation and more mobile human and capital resources.

The Philippines is also a founding member of the World Trade Organisation (WTO), when it succeeded the General Agreement on Tariffs and Trade in January 1995.

Various provinces in the country are autonomously establishing separate arrangements with their nearest neighbors. The provinces in northwestern Luzon are gearing for ties with Taiwan and the People's Republic of China. In the south, the formation of a growth area known as the Brunei Darussalam, Indonesia, Malaysia, Philippines-East ASEAN Growth Area (BIMP-EAGA) links the economies of Brunei Darussalam; East and West Kalimantan and North Sulawesi of Indonesia; Sabah, Sarawak and Labuan of Malaysia; and Mindanao of the Philippines. Mindanao and Sulawesi are pursuing commercial ties with northern Australia.

## **Exports**

Several incentives are available to enterprises engaged in predominantly export activities. These include simplified import-export procedures, exemption from payment of taxes and duties on imported goods that are subsequently exported, and tax holidays (see Chapter 4 for further information).

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# Chapter 3

## Foreign investment and trade opportunities

### *Investor considerations*

- The Philippines, with its strategic location, is a gateway to the huge Asian market and a favorable base for Asia-Pacific expansion programs. Its affiliation with the ASEAN affords it preferential access into the large ASEAN Free Trade Area (AFTA), which constitutes a large potential consumer market for a host of manufactured products.
- A pool of English-speaking labor is highly trainable. Their capabilities and merits as blue-collar workers, technicians, professionals, and managers have been confirmed in postings with resident foreign firms and in overseas assignments.
- The country's vast and youthful population provides a strong market for consumer products.
- Capital investment opportunities are available for export-related businesses, as well as in the deregulated telecommunications, transportation (airline, shipping, automotive), and post-extractive petroleum processing and distribution ("downstream oil") industries. More investment areas have been opened to foreign investors, such as banking, retail trade, and the energy sector.

- Special economic zones and freeports are available and accessible in various parts of the country. Sound infrastructure support is provided, and enterprises locating there are granted fiscal and non-fiscal incentives.
- The Philippines has a competitive edge in information and communications technology (ICT)-based activities. Certain economic zones and buildings are ideal sites for information technology-oriented enterprises, and are eligible for tax and non-tax incentives. International call centres have been flourishing in these locations particularly in Makati, Quezon City, Taguig, Pasig, Pasay, Cebu, and Davao.
- The Philippines has a well-developed legal system, patterned broadly after that of the United States, although the speed and quality of judicial decisions continue to cause concern to investors.

## ***Investment climate***

### **Government attitude toward foreign investment**

The Philippine government believes that economic development is best led by the private sector, and is committed to developing simple, fair, transparent, and predictable administrative rules, rationalizing investment incentives, and reducing the cost of doing business by eliminating graft and corruption.

Inbound foreign investment is actively encouraged, and wide incentives are available for investment activities that will facilitate the country's development or export capacity as well as inflow of foreign currencies (see Chapter 4). The general theme of the incentive program is to

encourage inflow of foreign capital and transfer of technology that supplements local resources.

Balanced against this is the government's desire to limit foreign ownership and participation in certain activities for constitutional or national interest reasons. In broad terms, foreign ownership is restricted to 40% in entities undertaking activities listed in the Foreign Investment Negative List (FINL) (the list can be found at the end of Chapter 5). For activities not listed in the FINL, 100% foreign ownership is generally permitted.

Foreign equity investments are preferred to foreign debt. Consistent with this theme, the government is continuing to dismantle investment restrictions to allow foreign investors to participate in an increasing



number of sectors of the economy with 100% equity ownership.

### **Trade policy**

The government's policy on trade is based on the principle of free enterprise. A comprehensive tariff reform program has significantly reduced tariff rates from an average nominal tariff of 27.84% in 1990, 6.49% in 2004, to 7.01% in 2010. The overall average applied Most-Favored-Nation (MFN) tariff in 2011-2013 declined by about 4.42% from the 2010 level. This resulted from the reduction/elimination of rates of duty under Executive Order 61 on certain not locally produced manufacturing inputs and on certain tariff lines that were merged/unified.

Nevertheless, the Philippines does retain higher tariff rates (20% to 65%) on sensitive agricultural products such as grains, livestock and meat products, sugar, certain vegetables, coffee, and other commodities generally produced domestically. A few agricultural commodities are subject to minimum access volumes, but these represent less than 1% of all tariff lines. The Philippines also imposes dumping and countervailing duties on imports if necessary to counteract unfair trade practices, including safeguard measures against increased imports that may cause serious injury to domestic industries and producers.

The Philippines is an active member of the Association of Southeast Asian Nations (ASEAN) and the Asia Pacific Economic Cooperation (APEC), both of which aim to

achieve free trade between member countries. Through ASEAN, the Philippines recently concluded trade agreements with China, Korea, Japan, Australia, New Zealand, and India aimed towards eliminating tariff rates for selected tradable goods.

The Philippines is also a member of the World Trade Organization (WTO). (Refer to Chapter 2 for further information on these memberships.)

Former President Gloria Macapagal-Arroyo and former Prime Minister Junichiro Koizumi signed the Japan-Philippines Economic Partnership Agreement (JPEPA) in 2006, which was further ratified in 2008. JPEPA is a comprehensive bilateral trade and investment agreement between Japan and the Philippines aimed at increasing trade and investment opportunities between the two economies.

### **Taxation policy**

Income tax holidays of three to eight years are available to enterprises registered with the Board of Investments (BOI) to undertake activities identified in the government's Investment Priorities Plan. They are also available to export-oriented enterprises that locate within a special economic zone (ecozone) administered by the Philippine Economic Zone Authority (PEZA) or similar agency.

PEZA-registered enterprises are also entitled to a special 5% tax on gross income (sales less direct costs) in lieu of all national and local taxes, once their income tax holiday expires. However, enterprises

located in freeports are also subject to the special 5% tax, but are not entitled to income tax holidays (see Chapter 4 for further information).

### **Local competitor attitude toward foreign investment**

Filipinos recognize that foreign business interest can bring in new and proven technology that the Philippines has not yet developed. Most major companies in the country started as foreign investments or joint ventures of foreigners and Filipino businessmen. There are pockets of isolated resistance and protests from adversely affected local firms that do not yet have the capability to survive global competition. However, the government is proactively addressing their concerns through the adoption of safety nets and provision of support to enable small and medium enterprises to prepare and be eventually competitive in the global market.

### **Labor attitude toward foreign investment**

Foreign investment and management are welcomed by Philippine labor, as foreign companies play a significant role in generating employment and training the national workforce.

A small segment of the labor sector, because of its political orientation, maintains a strong stance against restrictive and authoritative management. However, even this sector welcomes foreign investments that will truly improve the lot of the poor and will respect the

environment and the community. They also welcome participative management that encourages dialogue with, and respects the rights of employees.

### ***Special investment opportunities***

There are many reasons why foreign business enterprises invest in the Philippines. The most obvious is that the country has a large pool of skilled and trainable labor that is productive, competitively priced, and fluent in speaking English. Their capabilities and merits as blue-collar workers, technicians, professionals, and managers have been confirmed in postings with resident foreign firms and in overseas assignments. This labor, combined with the Philippines' strategic location in Southeast Asia, ready transportation access to the Northeast Asian market, preferential access to the lucrative ASEAN market, and generous fiscal concessions granted by the government, makes the Philippines a logical place to locate Asia-Pacific expansion programs and production facilities.

At the same time, the Philippines is one of the most populous nations in the East Asia-Pacific region, approximately 92.34 million as of May 2010 and projected to increase to 103 million by 2015, making it a potential market for many manufactured products and consumer goods, particularly food and other basic items.

The previously restricted telecommunications, transportation (airline, shipping, automotive), banking,

retail trade, energy, and post-extractive petroleum processing and distribution (“downstream oil”) industries have been opened to participation by foreign investors.

The Philippines also offers opportunities for foreign investors with experience in industrial, infrastructure, and socio-economic development. Incentives are available through the BOI for enterprises pursuing these activities. The Build-Operate-Transfer (BOT) scheme for infrastructure development also offers a unique opportunity for construction enterprises. Investors finance the construction of the infrastructure, operate the facility for a fixed term during which they collect user fees to recover their investment plus a reasonable rate of return, and then transfer the facility to the government at the end of the fixed term. The local finance industry has successfully syndicated a number of loans for BOT contracts.

The Philippines has a competitive edge on information and communications technology (ICT), which surveys suggest to be matched in the Asia-Pacific region only by Singapore. Special economic zones and facilities have been established, and should make ideal sites for information technology-oriented enterprises. Generous tax and non-tax incentives are available to entities registered with PEZA.

The Philippine government actively encourages inbound foreign investment and is committed to developing an investor-friendly climate. There is a clear trend

toward greater liberalization of inward investment, and increasing sectors of the economy are being opened to 100% foreign ownership.

### ***Planning guide for the foreign investor***

#### **National and local government policy considerations**

Inbound foreign investment into the Philippines is actively encouraged, and wide incentives are available for investment activities.

#### **Investment possibilities/restrictions**

- Foreign ownership of 100% is permitted in many areas of investment.
- Enterprises engaged in activities included in the Foreign Investment Negative List are subject to foreign ownership limitations (see the list at the end of Chapter 5).

#### **Registration requirements**

- Before commencing activities, businesses operated through corporations or partnerships must register with the Securities and Exchange Commission, while businesses owned by individuals must register with the Department of Trade and Industry.
- Businesses must also register with a number of other government agencies (see Chapter 6), including the Bureau of Internal Revenue and the local

government unit of the place where activities will be conducted.

### **Possible business structure**

- The main vehicles used by foreign investors are domestically incorporated entities and registered branch offices. Joint ventures tend to be feasible investment vehicles only for construction projects and certain energy operations (see Chapter 19).
- The regulatory environment in the Philippines tends to favor the establishment of a subsidiary over a branch, as foreign ownership restrictions preclude operation of a branch in certain industries. However, branches generally receive the most favorable tax treatment for foreign investors.

### **Investment incentives**

- Wide incentives are available to foreign investment that significantly contribute to national industrialization and socio-economic development, and in export-oriented activities.
- Income tax holidays of three to eight years are a central feature in most incentive packages.
- Enterprises locating in special economic zones may be entitled to a special 5% rate of tax on their gross income (sales less direct costs) in lieu of all other national and local taxes.

### **Location/industries**

- Foreign and local contractors may undertake infrastructure development projects under the BOT arrangement and other schemes (see Chapter 2).
- Enterprises locating in special economic zones and less-developed regions are entitled to incentives.
- Subic Bay Freeport, Clark Freeport Zone and other former United States naval facilities, offer first class commercial and industrial facilities that are available for immediate use.

### **Finance**

- Foreign-owned enterprises licensed to do business with the Securities and Exchange Commission face no significant legal impediments when they seek to obtain local finance.
- There are some regulatory procedures on the purchase of foreign exchange through the banking system when addressing foreign currency loan repayment, profit remittance, and capital repatriation.

### **Repatriation of capital and profits**

Capital and profits may be freely repatriated through the banking system, but prior registration of the foreign investment with the Bangko Sentral ng Pilipinas is required if foreign currency to service the repatriation will be sourced from the banking system.

## **Tax planning considerations**

- Branches are slightly more advantageous from a Philippine tax perspective than corporations.
- Income from services rendered by an alien outside the Philippines is exempt from Philippine income tax.
- The provision of many fringe benefits is subject to more favorable tax treatment than equivalent cash compensation payments.

See also “Corporate tax planning strategies” in Chapter 15, and “Tax planning for expatriates” in Chapter 20.

## **Labor and labor costs**

- The Philippines has a ready and steady supply of highly skilled and trainable labor, including professional, technical, managerial, and skilled workers.
- Labor costs are in the moderate range for Southeast Asia, but are compensated by worker productivity and fluency in English.

## **Market studies**

- Some regulatory agencies may require submission of a feasibility study before permitting enterprises to register.
- Many foreign companies establish a representative office to undertake research on the market (see Chapter 9 for establishment requirements).

## **International financial center**

Incentives are offered to multinationals that establish regional headquarters in the Philippines, and to foreign banks that establish offshore banking units.

## **Information and assistance**

A list of agencies and business organizations is provided in Appendix XIX.

## **Trends**

There is an ongoing trend toward greater liberalization of inward investment, with increasing sectors of the economy being opened to foreign participation and 100% foreign ownership.

# Chapter 4

## Investment incentives

### *Investor considerations*

- The Philippine government has established a liberal program of fiscal and non-fiscal incentives aimed at attracting foreign capital and technology to supplement local resources.
- Incentives are available through the Board of Investments (BOI) for a broad range of activities that promote the general economic development of the Philippines. These include activities that the government has identified as investment priorities, and those involving the export of more than 50% of production if Filipino-owned or 70% if the enterprise is more than 40% owned by foreign investors.
- Income tax holidays for three to eight years are a central feature in the incentive package for investments registered with the BOI.
- Enterprises registered with the Philippine Economic Zone Authority (PEZA) are entitled to a holiday from income tax and local taxes for three to eight years. After that, they are subject to a 5% tax on gross income (sales less direct costs) in lieu of all local and national taxes.

- PEZA-registered enterprises may generally import capital equipment and production supplies free of taxes and duties, either directly as a specific incentive or indirectly through the bonded warehouse system.
- Enterprises that are 100% foreign-owned and engaged in preferred areas of investment are entitled to BOI or PEZA incentives. However, foreign ownership is restricted in enterprises that are undertaking activities listed in the Foreign Investment Negative List (FINL).
- Incentives are offered to multinationals that establish regional headquarters in the Philippines, and to foreign banks that establish offshore banking units.
- Congress is expected to conduct a continuing review of fiscal incentives. At a minimum, this should result in the incentive laws being consolidated into a single code. The broader incentives framework may also be revised.

### ***Investment policy***

The Philippine government's policy on inward foreign investment is set out in the Foreign Investments Act of 1991. Inward foreign investment is encouraged in activities that significantly contribute to national industrialization and socio-economic development, and in export-oriented undertakings. There is also a clear trend toward greater liberalization of inward investment, with increasing sectors of the economy being opened to 100% foreign ownership.

The government has established a liberal program of fiscal and non-fiscal incentives in its aim to attract foreign capital and technology that supplements local resources. In broad terms, the incentives can be divided into the following.

1. Incentives offered through the BOI, which support projects in the interests of the country's general economic development;

2. The broader incentives offered through the PEZA and similar authorities, which in practice are offered to export-oriented enterprises locating within identified economic zones;
3. The incentives offered to firms locating in the industrial and commercial freeport zones in Subic and Clark, the former United States military bases administered by the Subic Bay Metropolitan Authority and Clark Development Corporation, respectively; and
4. Concessionary tax and regulatory treatment offered to multinationals establishing regional headquarter operations in the country.

There are constraints on foreign ownership and participation in certain activities for constitutional or national interest reasons. See the FINL at the end of Chapter 5 for further details.

### ***Tax concessions***

Income tax holidays for three to eight years are a central feature in the incentive package for investments registered with the BOI. Additional tax incentives can include special tax deductions and the tax and duty-free importation of some items through customs bonded warehouses.

PEZA-registered enterprises are entitled to the same tax incentives as BOI-registered enterprises. In addition, however, they are entitled to tax and duty-free importation of capital equipment, raw materials, and supplies. After the income tax holiday, they

are also entitled to a special tax rate of 5% on gross income (measured as sales less direct costs) in lieu of all Philippine national and local taxes. Profits remitted offshore by a PEZA-registered branch of a foreign corporation are also not subject to branch profits remittance tax.

Enterprises locating in the former United States military bases that were converted into industrial and commercial freeports are not entitled to income tax holidays. However, they are granted the 5% preferential tax on gross income in lieu of all Philippine national and local taxes, and the tax and duty-free importation of raw materials and capital equipment.

### ***Regional incentives***

The aim of the government is to provide equal development opportunities to all sectors of the economy and to all regions of the country. Because of this, the incentive framework for the country is not directed at any specific region. For BOI incentives, the test is whether an activity is in line with the country's development priorities as listed in the Investment Priorities Plan (IPP). For PEZA incentives, the activities must be undertaken within a prescribed zone. This policy of regional dispersal has spurred the rise of industrial estates and parks, special economic zones, and special development programs throughout the country.

There is an exception to the regional dispersal policy for information technology parks and buildings. This is in connection with PEZA-issued guidelines allowing an



information technology park or building to be declared as an economic zone, even if it is located in the Metro Manila area.

## ***Board of Investment incentives***

### **Investments covered**

The BOI is responsible for preparing the IPP, which is a list of promoted investment areas eligible for government incentives. The IPP identifies specific activities and categories of economic activity for which the government wants to encourage investment, and is revised annually in consultation with the private sector.

The IPP contains a long and diverse list of activities that are potentially entitled to BOI incentives. The 2012 IPP has identified the following preferred sectors under the Regular List: agriculture/agribusiness and fishery; creative industries/knowledge-based services; shipbuilding; mass housing; energy; infrastructure; research and development (R&D); iron and steel; strategic projects; motor vehicles; hospital/medical services; green projects; and disaster prevention, mitigation and recovery projects.

Other listings contained in the IPP include the Mandatory List which enumerates other activities that require inclusion in the IPP under existing laws; Export Activities which cover the manufacture of export products, service exports and activities in support of exporters; and ARMM List which covers priority activities locating in the Autonomous Region of Muslim Mindanao as identified by the Regional BOI

of the ARMM in accordance with Executive Order 458.

BOI incentives are granted under the Omnibus Investments Code of 1987. The Code differentiates among “pioneer” projects (i.e., essentially those that introduce new products or processes into the Philippines, or conduct certain approved activities), non-pioneer projects, projects involving the export of more than 50% of total production, and projects undertaken in less-developed areas. The characterization of a project determines the extent of the incentives that are available.

### **Eligibility**

Only Philippine citizens and enterprises organized under Philippine law are entitled to apply for BOI incentives. Thus, foreign investors seeking to obtain incentives need to do so through an equity investment into a Philippine corporation.

Enterprises owned 100% by foreign investors are generally entitled to BOI incentives if they engage in pioneer projects, export at least 70% of their total production (or some lower percentage that the BOI determines), or undertake projects in areas identified by the BOI as less-developed areas of the country. However, the enterprises are obliged to attain 60% Filipino ownership within 30 years from registration (or such longer period as the BOI allows), unless they will be exporting 100% of their production. The maximum foreign ownership for certain activities is constrained for constitutional or national

interest reasons (see the FINL at the end of Chapter 5 for further details).

For enterprises engaged in non-pioneer projects, BOI incentives are available only if foreign ownership is limited to 40%, unless the enterprise will export more than 70% of its annual production.

The BOI approves registration and the entitlement to incentives on a case by case basis, based on documents submitted during the application process. The following documents, among others, will need to be submitted:

- A feasibility report, containing the applicant's five-year projected financial statements; and
- A notarized application form, indicating the type of project, how the activity relates to those listed in the IPP, the production capacity geared for export, the capital structure of the enterprise, and the nationality of its investors.

## **Tax incentives**

Pioneer enterprises and enterprises registered in less developed areas are entitled to an income tax holiday for their first six years of operations, extendible by up to two years if certain conditions are met. Non-pioneer enterprises are entitled to an income tax holiday for their first four years of operations, extendible by up to three years if certain conditions are met. Registered expanding export-oriented firms are granted a three-year income tax holiday. To encourage the regional

dispersal of industry, however, projects located in the Metro Manila area are generally not granted an income tax holiday benefit.

The initial years of entitlement to an income tax holiday are guaranteed in the Specific Terms and Conditions attached to the enterprise's certificate of registration with the BOI. Any annual extension of the income tax holiday will, however, depend on the company's compliance with specified conditions.

Other tax incentives are listed below.

- Subject to certain conditions being met, the importation of spare parts by export producers operating a customs bonded warehouse and exporting at least 70% of their production will be exempt from taxes and duties.
- Subject to certain conditions being met, the importation of breeding stocks and genetic materials will be exempt from taxes and duties for the first ten years of operation. If breeding stocks and genetic materials are locally sourced, there may be an entitlement to a tax credit for the amount of taxes and duties that would have been waived had they been imported.
- Enterprises registered in less-developed areas may deduct from their taxable income the cost of constructing necessary and major infrastructure and public facilities. Any amount that cannot be deducted fully in the year incurred may be carried forward and offset in a future year up to the tenth

year of operations. Title to the infrastructure works will, however, be transferred to the Philippine government upon completion.

- For the first five years from registration, a registered enterprise is allowed an additional deduction from taxable income equivalent to 50% of the wages of additional skilled and unskilled workers in the direct labor force, subject to meeting a prescribed capital to labor ratio. This incentive cannot be used by enterprises enjoying an income tax holiday, but can be useful in the fourth and fifth years of operations for expanding export-oriented firms, and in the fifth year for non-pioneer enterprises.
- Under the Local Government Code, pioneer enterprises registered with the BOI are exempt from the payment of local business tax for a period of six years, while registered non-pioneer enterprises are exempt for four years.

### **Non-tax incentives**

The following non-tax incentives are granted to all BOI-registered enterprises:

- Access to the bonded manufacturing/trading warehouse system of registered export-oriented enterprises, which can result in the deferral or elimination of taxes and customs duties (see Chapter 8);
- Simplified customs procedures for imports and exports;

- The generally unrestricted use of consigned equipment; and
- Employment in general of foreign nationals in supervisory, technical, or advisory positions for five years from registration.

### **Earnings**

Repatriated earnings are subject to normal tax, either as a tax on dividends if repatriated by a subsidiary or as a branch profit remittance tax if repatriated by a branch (see the discussion on “Branch versus subsidiary” in Chapter 15 for further information).

### **Special economic zones (“ecozones”)**

#### **Investments covered**

The Special Economic Zone Act of 1995 established the PEZA as successor of EPZA (Export Processing Zone Authority). The Act also laid the framework for specific areas in the Philippines to be identified as special economic zones or “ecozones.”

Enterprises locating in an ecozone, as well as the developers and operators of the zone, are entitled to all incentives available to BOI-registered enterprises, as well as to additional incentives available under the Act.

Currently, ecozones are essentially export-oriented, with enterprises located inside the zones generally required to export 100% of their production. The PEZA has shown itself to be fairly flexible on this requirement, however, approving in some

cases the sale of up to 30% of production in the domestic market.

Based on a policy of encouraging regional dispersal, the general rule is that ecozones cannot be established in the Metro Manila area. However, the PEZA has recently issued guidelines making an exception for information technology parks and buildings. Unlike other ecozones, the developers and operators of information technology zones in Metro Manila will not be entitled to incentives. However, enterprises that locate their operations within the zones will be entitled to full incentives.

As of January 2013, there are 277 operating ecozones. In addition, special economic zones in Cagayan and Zamboanga City were established under separate legislation in 1995 and in Aurora province in 2007. The latter was expanded and developed to become the Aurora Pacific Economic and Freeport Zone in 2010. In 2009, Congress passed a law converting the previously established ecozone in Bataan into the Freeport Area of Bataan. These zones are administered by separate authorities but are otherwise equivalent to PEZA ecozones in their operation and incentives. References throughout this chapter to PEZA should be read to include the Cagayan Economic Zone Authority, the Zamboanga City Special Economic Zone Authority, the Aurora Pacific Economic Zone and Freeport Authority, and the Authority of the Freeport Area of Bataan, as appropriate. (Source: Philippine Economic Zone Authority, [www.peza.gov.ph](http://www.peza.gov.ph))

## **Eligibility**

To be entitled to benefits, an enterprise must register with the PEZA. Subsidiaries and branches of foreign companies are eligible to locate their operations in the zones. Full foreign ownership is allowed provided they are not engaged in activities that appear on the FINL (see the list at the end of Chapter 5 for further details).

The PEZA approves registration and the entitlement to incentives on a case by case basis. In broad terms, applicants for PEZA incentives must provide similar information for BOI incentives, including a feasibility report and a duly notarized application form. There are, however, minor differences in the details of the materials that need to be submitted.

## **Tax incentives**

PEZA-registered enterprises are entitled to all of the fiscal incentives available to BOI-registered enterprises, as well as the following additional fiscal incentives.

- During the income tax holiday period, PEZA-registered enterprises are also exempt from local taxes and licenses, except for certain real property taxes.
- At the end of the income tax holiday period, PEZA-registered enterprises pay a 5% tax on their gross income (sales less direct costs) in lieu of all national and local taxes.
- Profits remitted offshore by a PEZA-registered branch of a foreign corporation are not subject to branch profits remittance tax.

- Capital equipment and spare parts and all production materials and supplies may be imported free of taxes and duties.
- Additional deduction equivalent to 50% of training expenses, chargeable against the 3% share of the national government in the special 5% tax on gross income.
- Sales to a PEZA-registered enterprise by a VAT-registered person are subject to a 0% rate of VAT.
- An amount equivalent to one half of the value of training expenses incurred in developing skilled and unskilled labor or for managerial or other managerial development programs incurred by a PEZA firm may be deducted from the national government's share of the 3% (out of 5%) final tax.
- If foreign investors own a majority of the capital stock of the registered enterprise, foreign nationals may retain top managerial positions indefinitely. The employment of foreign nationals generally is less restricted, and visa processing is simplified.

### **Earnings**

Profits remitted offshore by a PEZA-registered branch of a foreign corporation are not subject to branch profits remittance tax upon repatriation. Profits remitted by a corporation by way of dividend, however, are subject to normal dividend taxation.

### ***Bases conversion incentives***

Under the Bases Conversion and Development Act of 1992 (BCDA), the former United States military bases were converted into industrial and commercial areas. The most significant of these is the Subic Special Economic Zone, administered by the Subic Bay Metropolitan Authority (SBMA). On 20 March 2007, the BCDA was amended by RA 9400, which granted tax and duty incentives to the registered enterprises within the special ecozones of John Hay, the Poro Point, Morong, and Clark.

The following tax and non-tax incentives are granted to business enterprises operating in a Freeport Zone:

- Raw materials and capital equipment may be imported free of tax and duty;

### **Non-tax incentives**

PEZA-registered enterprises are entitled to all of the non-fiscal incentives available to BOI-registered enterprises, as well as the following additional non-tax incentives:

- Any foreign investor in the ecozones with an initial investment of US\$100,000 or more is entitled to permanent resident status. For investments of US\$150,000 or more, the permanent resident status also extends to the investor's spouse and dependent children under 21 years of age.

- A 5% tax is imposed on gross income (sales less costs of sales) in lieu of all national and local taxes;
- Foreign currency depository units established within the zone are subject to liberalized banking and finance regulation; and
- Any foreign investor investing more than US\$250,000 is entitled to permanent residence in the zone, as well as the investor's spouse and dependent children under 21 years of age.

## Industry incentives

### Mining industry

Enterprises engaged in mining activities are entitled to register for BOI incentives. In addition, the following incentives are available under the Mining Act of 1995:

- Exemption from real property tax and other taxes or assessments of pollution control devices on land or buildings;
- Net operating loss carry-forward for the first ten years of operation against taxable income for the five years immediately following the year of such loss;
- Accelerated depreciation; and
- Option to deduct from taxable income the accumulated exploration and development costs or those incurred or paid during the taxable year, subject to certain limitations.

In December 2004, the Supreme Court upheld the constitutionality of the law in an *en banc* decision. The industry is working closely with relevant government agencies to address other impediments to mining, such as implementation issues at the local government level and perceptions about potential adverse environmental effects, so that an effective mining sector may be established in the Philippines.

### Mini-hydroelectric power developers

Mini-hydroelectric power developers are entitled to register for BOI incentives. In addition, developers are entitled to the following incentives under the Mini-hydroelectric Power Incentives Act:

- Special real property tax rate of 2.5% on the original cost of equipment and machinery;
- Exemption from VAT on sale of electric power; and
- Income tax holiday for seven years.

### Shipping industry

Under the Philippine Overseas Shipping Development Act of 1992 and the Domestic Shipping Development Act of 2004, tax incentives are available to qualified Philippine domestic shipping enterprises engaged in overseas shipping. The incentives include exemption from import duties and taxes on the acquisition of vessels and spare parts. Foreign ownership in Philippine domestic shipping enterprises is limited to 40%.

## **Tourism**

Projects that have been endorsed by the Department of Tourism involving the establishment of tourist accommodation facilities, tourism estates, historic-cultural heritage projects, and tourist bus operations are entitled to register for BOI incentives. Parallel rules are currently being drafted by PEZA to qualify tourism-based enterprises for registration.

RA 9593 also known as “The Tourism Act of 2009”, declaring a national policy for tourism as an engine of investment, employment, growth, and national development took effect on 12 August 2009. This law equips the Department of Tourism with the necessary tools to make the tourism industry of the country more globally competitive. It also provided for the creation of the Tourism Infrastructure and Enterprise Zone Authority (TIEZA) which is tasked to identify specific geographical areas as Tourism Enterprise Zones (TEZ) and responsible for the regulation, supervision, and management of the cultural, economic, and environmental sustainable development of TEZs and other tourism infrastructure projects in the country, including the grant of incentives. TIEZA registered enterprises are entitled to fiscal and non-fiscal incentives. Fiscal incentives include among others, income tax holiday of six years from commencement of operations, up to a maximum of another six years subject to certain conditions; 5% tax on gross income in lieu of all other national and local taxes after the income tax holiday period; net loss carry forward of up to six years;

reduction in applicable real estate taxes; and waivers of local fees and charges.

## **Special visas for investors and retirees**

A special investor visa may be issued to an individual who invests US\$75,000 or more in the Philippines, provided the individual has not been convicted of a crime involving moral turpitude, is not afflicted with a dangerous or contagious disease, and has not been institutionalized for any mental disorder or disability. The special investor visa allows the investor to reside in the Philippines as long as the investment is maintained.

A retiree’s visa (i.e., Special Resident Retiree’s Visa) is also available to persons coming to retire in the Philippines, subject to a prescribed amount being invested in the Philippines.

## **International financial center operations**

### **Holding companies and investment vehicles**

There are no tax incentives available to foreign investors to encourage the use of holding companies or investment companies in the Philippines. Foreign investors using a holding company to manage their investments run the risk of having a 10% improperly accumulated earnings tax imposed if the company does not distribute its income by way of dividends (see Chapter 15). The Corporation Code also imposes limits on the amount of retained earnings that may be accumulated (see Chapter 9).



## Regional headquarters

The Philippines offers concessions to multinationals that establish either a regional or area headquarters (RHQ) or a regional operating headquarters (ROHQ).

- **Regional or area headquarters (RHQ)**

An RHQ is a branch office that principally serves as a supervision, communications, and coordination center for the subsidiaries, branches, or affiliates of a multinational company operating in the Asia-Pacific Region and other foreign markets. It is allowed to operate only as a cost center, and may not participate in any manner in the management of any subsidiary or other branch office the multinational has in the Philippines, or to solicit or market any goods or services.

- **Regional Operating Headquarters (ROHQ)**

An ROHQ has the attributes of a branch office that is allowed to derive income in the Philippines by performing qualifying services to affiliates, subsidiaries, or branches of its head office in the Asia-Pacific Region (including the Philippines) and other foreign markets. The qualifying services, however, are limited to general administration and planning, business planning and coordination, sourcing and procurement of raw materials and components, corporate finance advisory services, marketing control and sales promotion, training and personnel management, logistics

services, research and development services and product development, technical support and maintenance, data processing and communication, and business development. An ROHQ is not also allowed to offer services to entities other than those affiliates, branches, or subsidiaries identified in its registration with the Securities and Exchange Commission, or to engage directly or indirectly in the sale and distribution of goods and services.

- **Capitalization requirements**

The head office of an RHQ is required to remit annually into the Philippines at least US\$50,000 or the equivalent in other acceptable foreign currencies to finance the RHQ's operations.

An ROHQ is required to have an assigned capital equivalent of at least US\$200,000, but is not subject to annual remittance requirements.

- **Incentives**

Both RHQs and ROHQs are entitled to the following incentives.

1. Exemption from all taxes, fees, or charges imposed by a local government unit except real property tax on land improvements and equipment.
2. Tax and duty-free importation of training materials and equipment.
3. Direct importation of new motor vehicles subject to the payment of the corresponding taxes and duties.



There is some variation, however, in the income tax and VAT treatment for RHQs and ROHQs. Because an RHQ operates as a cost center, and so will not earn any income, it is not subject to Philippine income tax. RHQs are also VAT-exempt taxpayers, and sales of goods and services and the lease of property to an RHQ are entitled to VAT zero-rating. By contrast, ROHQs are subject to a preferential 10% income tax rate on their income. They are also subject to VAT in the same manner as ordinary Philippine taxpayers.

Aliens employed by RHQs and ROHQs and occupying managerial and technical positions enjoy the following incentives.

1. Gross compensation income is subject to a 15% final withholding tax. This concession is also extended to Filipino employees occupying positions equivalent to alien employees in an RHQ or ROHQ subject to certain conditions.
2. Personal and household effects may be imported free of tax and duty.
3. Exemption from travel tax.
4. Multiple-entry visas valid for one year, for themselves as well as their spouses and unmarried children below age 21.

A multinational establishing an RHQ or an ROHQ may also establish a regional warehouse in an ecozone. A regional

warehouse may be used to store spare parts, components, semi-finished products, and raw materials; undertake limited activities of a packing and labelling nature; make alterations to meet customer specifications; and fill orders made by its head office. Materials stored in a regional warehouse will not be subject to import taxes and duties, unless they are withdrawn for use in the local market.

### ***Tax haven activities and offshore operations***

#### **Offshore banking**

The Philippines allows foreign banks to establish offshore banking units (OBUs), aimed at facilitating the flow of international capital into the Philippines. OBUs are subject to virtually no exchange control by local authorities on their offshore operations and are not subject to tax on income they source from outside the Philippines. Income derived by OBUs from foreign currency transactions with nonresidents, other OBUs, local commercial banks, including branches of foreign banks that may be authorized by the Bangko Sentral ng Pilipinas (BSP) to transact business with OBUs, shall be exempt from all taxes except net income from such transactions as may be specified by the Secretary of Finance, upon recommendation of the Monetary Board, which shall be subject to the regular income tax payable by banks. However, any interest income derived from currency loans granted to residents other than OBUs

or local commercial banks, including local branches of foreign banks that may be authorized by the BSP to transact business with OBUs, shall be subject only to a final tax rate of 10%.

### ***Nonresidents are exempt from income tax on income derived from transactions with OBUs.***

Foreign personnel of OBUs, their spouses and their dependents, are allowed multiple-entry special visas renewable annually, and are exempt from immigration fees and customs duties on personal effects. Foreign personnel are also subject to a flat 15% tax on their employment income from OBUs, rather than the normal progressive income tax rates. Filipino employees occupying the same positions as aliens employed by OBUs may elect to be subject to the 15% tax rate or to the normal progressive tax rates.

As an alternative to OBUs, local branches of foreign banks may instead establish a foreign currency deposit unit (FCDU). Banks that are designated FCDUs may accept foreign currency funds from both resident and nonresident sources. Residents deriving income from an FCDU are subject to a final tax of 7.5%. A local branch of a foreign bank may opt to operate as an OBU or an FCDU, but not both.

FCDU profits repatriated by a branch of a foreign bank are subject to branch profits remittance tax. Following the rationale of the court, branch profits remittance tax should apply also to profits repatriated by an OBU.

### ***Export incentives***

The promotion of exports is a key feature in the government's incentives program. Foreign-owned enterprises that export more than 70% of their production are entitled to BOI incentives. Those enterprises that export 100% of their production (or some lower percentage agreed with the PEZA) and located within an ecozone are entitled to the more substantial PEZA incentives.

The earning of foreign exchange is also encouraged. For example, under the VAT rules, export sales and the provision of services to nonresidents may be zero-rated only if paid for in acceptable foreign currency (essentially one of the more widely traded international currencies). In practice, remittance into the Philippine banking system is also expected.

### ***Incentives to invest in other countries***

The Philippine government does not offer incentives for investments to be made outside Philippine territory.

### ***Incentives and foreign investment strategy***

The government has established a liberal program of fiscal and non-fiscal incentives in its aim to attract foreign capital and technology to supplement local resources, and these are considered comparable to many incentives offered elsewhere in Asia. At the same time, there is a clear trend toward greater liberalization of inward investment, with increasing sectors of the

economy being opened to 100% foreign ownership.

The Philippines is strategically located for ready transportation access to both the ASEAN and North Asian markets.

Supported by a large potential local consumer base, a ready and steady supply of skilled English-speaking labor, the generous incentives offered through the PEZA in particular, the country has the potential to create lucrative opportunities for investors. There remain some negative factors, including the restrictions on foreign ownership in enterprises undertaking activities included in the FINL and the number of regulatory agencies with which investors may have to deal with. However, the government is responsive to the needs and concerns of investors, and has shown itself willing to discuss and seek to resolve issues at the highest levels of government.

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# Chapter 5

## Restrictions on foreign investment and investors

### *Investor considerations*

- Foreign exchange controls have been liberalized. However, registration of inward investments with the Bangko Sentral ng Pilipinas (BSP) is recommended to facilitate the future repatriation of capital and profits through the Philippine banking system. There are also some restrictions on the purchase of foreign currency from the banking system to meet the obligations on foreign currency denominated loans.
- Foreign ownership of up to 100% is permitted in many areas of investment, although certain industries are subject to foreign ownership limitations. (See the “Ninth Foreign Investment Negative List” at the end of this chapter for details.)
- The Board of Investments (BOI) offers investments for a broad range of activities that promote the general economic development of the Philippines.
- Incentives are also available through the Philippine Economic Zone Authority (PEZA) and related agencies for investors that undertake export-oriented activities within one of a number of designated special economic zones/facilities.
- Ownership of private land is restricted to Filipino citizens and to companies that are at least 60% owned by Philippine nationals. However, foreign investors may obtain 50-year leases, renewable for another 25 years, on private land.

## **Regulatory climate**

### **Regulatory authorities**

The main government agencies with which business structures must be registered are the Department of Trade and Industry (DTI) and the Securities and Exchange Commission (SEC). Businesses owned by individuals register with the DTI, while businesses operated through corporations or partnerships must register with the SEC. Businesses operating in the Philippines must also register with the following government agencies:

- Bureau of Internal Revenue (BIR);
- Local government unit (LGU) in the place where they will be operating;
- Home Development Mutual Fund (HDMF);
- Social Security System (SSS); and
- Philippine Health Insurance Corporation (PhilHealth)

If investors wish to obtain fiscal and non-fiscal incentives, projects must be registered with the appropriate regulatory authority. The BOI deals with projects involving activities listed in the government's Investment Priorities Plan (see Chapter 4). Other significant agencies that deal with enterprises locating within the economic zones they administer are:

- PEZA;
- Cagayan Economic Zone Authority;
- Zamboanga City Special Economic Zone Authority;

- Subic Bay Metropolitan Authority (SBMA);
- Clark Development Corporation (CDC);
- Aurora Pacific Economic Zone and Freeport Authority; and
- Authority of the Freeport Area of Bataan

Investors undertaking projects that are not entitled to incentives do not need to register with these agencies.

The BSP is the central monetary authority and is responsible for the administration and control of foreign exchange operations. Although not a formal requirement, it is generally recommended that investors register their investments with the BSP, as this facilitates access to foreign exchange through the banking system when profits and capital are repatriated offshore.

### **Regulatory legislation**

The central law applying to foreign investments is the Foreign Investments Act of 1991, which established the framework for the government's policy on inward investment. Foreign investments are encouraged in enterprises that contribute significantly to national industrialization and socio-economic development. Foreign ownership of 100% is permitted, except for certain activities for which foreign ownership is limited for constitutional or national interest reasons. These activities are set out in the Foreign Investment Negative List (FINL), a copy of which can be found at the end of this chapter.

Other important laws for foreign investments are listed below.

- The Corporation Code of the Philippines is the law under which domestic corporations are established, and under which both domestic and foreign corporations are granted licences to do business in the Philippines. The Corporation Code is discussed in more detail in the sections on “Corporations” and “Branches” in Chapter 9.
- The Omnibus Investments Code of 1987 embodies and harmonizes the basic incentive laws. Incentives are open to Philippine enterprises owned by both foreign and local investors. The Omnibus Investments Code is discussed in more detail in the section on “Board of Investment Incentives” in Chapter 4.
- The Special Economic Zone Act of 1995 sets out the framework and mechanisms for the creation, administration, and coordination of special economic zones (ecozones), and created the PEZA. Other laws with similar effect are the Cagayan Special Economic Zone Act of 1995, the Zamboanga City Special Economic Zone Act of 1995, the Bases Conversion and Development Act of 1992, the Aurora Special Economic Zone Act of 2007 (amended to add a freeport in 2010), and the Freeport Area of Bataan Act in 2009. The incentives available under the various pieces of legislation are discussed in the sections on

“Special economic zones (ecozones)” and “Bases conversion incentives” in Chapter 4.

- The New Central Bank Act of 1993, the Banking Liberalization Act of 1994, and the General Banking Law of 2000 are the laws under which the BSP operates. These laws, together with relevant BSP circulars, govern the foreign exchange rules and regulations of the country. The role of the BSP is discussed in more detail in Chapter 7.

While most provisions in these laws are clear, some are broad and open to interpretation. Generally, however, doubts concerning benefits and incentives granted under incentive laws are resolved in favor of investors and registered enterprises.

## **Exchange controls**

### **Inward investment**

Foreign exchange controls in the Philippines have been liberalized.

There are no remittance restrictions if a person already holds foreign currency (e.g. a foreign currency denominated account in the Philippines) or obtains foreign currency from outside the banking system (e.g. purchase from a non-banking entity). There are some restrictions, however, on the purchase of foreign exchange through the banking system (when Philippine pesos are used to purchase foreign currency through a local bank or branch of a foreign bank) to make payments for capital repatriation, dividends, and obligations on foreign currency loans.

## Registration of foreign capital and technology

- **Capital**

Although not a formal requirement, it is generally recommended that foreign equity investment, whether cash or in kind, be registered with the BSP. Foreign investments registered with the BSP will be issued with a Bangko Sentral Registration Document (BSRD). This serves as the authority to purchase foreign exchange from the Philippine banking system for repatriation of divestment proceeds or remittance of profits and cash dividends.

One of the registration requirements is that the inward investment be converted into Philippine pesos. Because of this, some investors may prefer not to register their investment and to obtain foreign currency from outside the banking system to repatriate profits.

- **Loans**

The BSP regulates foreign currency loans to ensure that interest and principal owed to creditors can be serviced in an orderly manner and with due regard to the economy's overall debt servicing capacity.

All public and publicly-guaranteed private sector obligations from foreign creditors require prior BSP approval.

Other private sector loans from foreign creditors and other financing schemes

or arrangements also require prior approval and registration with the BSP if they are to be serviced using foreign exchange purchased from the Philippine banking system. In practice, approval is likely to be given only to enterprises registered with the BOI, export-oriented projects, projects listed in the Investment Priorities Plan, projects listed in the Medium-Term Public Investment Program, and other projects declared priority by the Philippine government.

The proceeds of the loan must also, with limited exceptions, be converted into Philippine peso through an authorized bank.

If the payments of principal and interest on foreign-denominated loans are to be made with foreign currency obtained from outside the banking system, there is no requirement to register the loan with the BSP.

- **Technology agreements**

It may be necessary to register certain technology agreements with the Intellectual Property Office to ensure that they remain enforceable under Philippine law (see the section "Patents, trademarks and copyrights" in Chapter 6). However, there is no requirement for an agreement to be registered with the BSP before foreign currency may be purchased through the banking system to make payments under the agreement.

## **Currency accounts**

Both residents and nonresidents (subject to internal rules of the bank concerned/ AMLA requirements) may deposit with authorized banks, on a demand, savings or time basis, foreign currencies that are acceptable as part of the international reserves of the Philippines (essentially the major internationally traded currencies, the currencies of the original ASEAN members, and certain Middle Eastern currencies).

## **Repatriation of capital, dividends, interest**

Except for investments made before 15 March 1973, capital may be repatriated or dividends paid using foreign currency purchased from the banking system only if the investment has been registered with the BSP. Similarly, interest and principal repayments on foreign currency denominated loans may be paid using foreign currency purchased from the banking system only if the loan has been approved and registered with the BSP. In other cases, the foreign currency must be obtained from sources outside the banking system.

## **Royalties, service fees, and imported goods**

There are no difficulties in purchasing foreign currency from within the banking system to meet payment obligations to suppliers, or payments for royalties or service fees. However, documentation to support the reason for purchasing the

foreign currency may need to be provided to the bank, particularly for payments in excess of US\$120,000. The bank is also likely to require evidence that any necessary withholding taxes have been deducted and remitted to the Bureau of Internal Revenue.

## **Guarantees against inconvertibility**

All investors and registered enterprises are entitled to the basic rights and guarantees provided in the Constitution. In addition to constitutional rights, the Philippine government also recognizes the right to the repatriation of investments, the remittance of earnings, and the freedom from expropriation of investments. Protection is also afforded to foreign investments by the World Bank's Multilateral Investment Guarantee Agreement, which the Philippines acceded to in 1993.

## ***Restrictions on foreign investment***

### **Industries closed to private enterprise**

There are no industries closed to private enterprise. The Philippine Constitution encourages private enterprises to broaden the base of their ownership. However, the exploration, development, and utilization of natural resources are under the full control and supervision of the government. Foreign participation is allowed under a financial and technical assistance agreement with the government. For this purpose, the government may enter into co-production, joint venture, or production-sharing agreements with private



enterprises that are at least 60% owned by Filipino citizens or Philippine nationals.

### **Restrictions on foreign ownership**

Investment laws permit 100% foreign ownership in a Philippine enterprise, unless the enterprise will be undertaking activities listed in the FINL. The FINL is issued under the Foreign Investments Act of 1991, and prescribes the maximum level of foreign equity for covered activities (see the “Ninth Regular Foreign Investment Negative List” at the end of this chapter).

The banking industry is not included in the FINL but is subject to ownership restrictions under specific legislation. Currently, foreign ownership in Philippine banks is limited to 60% (see Chapter 7). BSP Circular 775-2012 also requires local banks with foreign equity to list with the Philippine Stock Exchange at least 10% of their shares (see Chapter 7). There are no foreign ownership restrictions for insurance companies but there are minimum capitalization requirements.

An existing life and non-life insurance company is required to have a Paid-Up Capital (PUC) of one billion Philippine pesos by 2020. The increase shall be done gradually every two years starting with two hundred fifty million Philippine pesos by end of 2012, four hundred million Philippine pesos by end of 2014, six hundred million Philippine pesos by end of 2016, eight hundred million Philippine pesos by end of 2018, and one billion Philippine pesos by end of 2020. The same PUC requirement shall apply to the life and

non-life units of new or existing or licensed composite insurance companies. The required minimum capital for a new insurance company shall be one billion, two billion, or five hundred million Philippine pesos, depending on its function.

An existing or licensed professional reinsurance company is required to increase its PUC gradually beginning end of 2012 at one billion Philippine pesos, one billion two hundred million Philippine pesos by end of 2014, one billion four hundred million Philippine pesos by end of 2016, one billion seven hundred million Philippine pesos by end of 2018, and two billion Philippine pesos by end of 2020. Compliance with the prescribed PUC requirement may be deferred for existing insurance and professional reinsurance companies that meet the Risk-Based Capital (RBC) Hurdle Rate of 150% and insurance companies which are in the process of merger or consolidation.

An existing or licensed branch office of a foreign insurance company shall have total security deposits at least equal to the minimum PUC required for domestic insurance companies. An existing or licensed mutual insurance company shall have available cash assets of the same amount as the PUC of an insurance company, exclusive of all liabilities. An existing or licensed insurance company engaged in microinsurance business as defined in the law, shall have a PUC of not less than half of the required PUC of an existing or licensed insurance company.

Reinsurance companies are required to have a PUC of two billion Philippine pesos by 2020.

(Source: Department Order 15-2012 dated 01 June 2012, Department of Finance)

## **Other types of restrictions**

Private ownership of land is reserved for Philippine citizens and corporations owned at least 60% by Filipinos. Foreigners may own buildings on leased land. A private corporation that is 60% Filipino-owned may hold alienable public lands only through lease.

Under the Investors' Lease Act of 1993, foreign investors may lease land for certain industrial and agricultural projects for a straight period of 50 years, renewable for another 25 years.

## **Bilateral investment treaties**

The Philippines has entered into bilateral investment agreements with Argentina, Australia, Austria, Bangladesh, Belgium, Cambodia, Canada, Chile, China, Czech Republic, Denmark, Finland, France, Germany, India, Indonesia, Iran, Italy, Korea, Kuwait, Luxembourg, Mongolia, Myanmar, the Netherlands, Pakistan, Portugal, Romania, Russian Federation, Saudi Arabia, Spain, Sweden, Switzerland, Taiwan Province of China, Thailand, Turkey, the United Kingdom, and Vietnam.

These treaties essentially provide for the mutual promotion and protection of investments in the territories of the

contracting countries. They ensure fair and equitable treatment of investments by investors in the other contracting countries, provide for unrestricted transfer of investments and investment returns, and establish procedures for settling disputes between investors in the contracting countries.

## ***Policy trends***

### **Effect on foreign investment**

The Philippine government welcomes foreign investment. It has established liberal incentives aimed at attracting foreign capital and technology to supplement local resources, and there are many opportunities for foreign investors (see Chapter 4). However, there are a few issues that investors will need to plan around.

Foreign investors coming to the Philippines will need to deal with a number of government regulatory and administrative agencies. For the most part, dealings with these agencies will be largely of a reporting nature, and are unlikely to have any real impact on the investor's day-to-day operations. Investors should be conscious, however, that failure to comply properly with registration procedures could have unfavorable consequences. Engaging the services of a local professional firm to assist in the registration process can ease the process (registration with all relevant agencies can typically be completed within four to six weeks from filing of the necessary documentation) and will also

ensure that registration requirements are not overlooked.

Accessing foreign currency to repatriate capital and pay dividends and interest may also require some planning. Registering an investment with the BSP will ensure that foreign currency can be obtained through the banking system to repatriate capital and remit profits or dividends. However, obtaining foreign currency to service principal and interest payments on foreign loans requires that the loan must first be approved by the BSP, which in practice is only likely to be granted for enterprises registered for certain incentives. For most firms, the inability to purchase foreign exchange through the banking system means that sourcing debt capital from offshore to fund local operations (including loans from affiliates) may not be advisable unless the investor has a natural source of foreign denominated receipts, such as export earnings.

Two other issues in particular that investors need to be aware of concern their ability to enforce legal rights in the Philippines. First, under the Corporation Code, a foreign corporation that is doing business in the Philippines but has not secured a license from the SEC may be sued in a Philippine court but cannot bring suit itself. Second, under the Intellectual Property Code, contracts involving the transfer or use of intellectual property or know-how may be unenforceable if certain contractual requirements are not met (see the section “Patents, trademarks and copyrights” in Chapter 6).

## **Ninth Regular Foreign Investment Negative List**

The Ninth Regular Foreign Investment Negative List took effect on 29 October 2012. This list does not include banking and other financial institutions, which are governed and regulated by the General Banking Law of 2000 and other laws administered by the BSP, or insurers (see “Restrictions on foreign ownership” above).

### **Abbreviations used**

- CA – Commonwealth Act
- LOI – Letter of Instruction
- PD – Presidential Decree
- RA – Republic Act
- SEC – Securities and Exchange Commission
- BOT – Build-Operate-Transfer

### **List A: Foreign ownership is limited by mandate of the constitution and specific laws**

#### *No Foreign Equity*

1. Mass media except recording (Art. XVI, Sec. 11 of the Constitution; Presidential Memorandum dated 4 May 1994)
2. Practice of all professions<sup>1</sup> (Art. XII, Sec. 14 of the Constitution; Sec. 1 of RA 5181)
  - a. Engineering
    - i. Aeronautical engineering

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<sup>1</sup> This is limited to Filipino citizens save in cases prescribed by law.

- ii. Agricultural engineering
- iii. Chemical engineering
- iv. Civil engineering
- v. Electrical engineering
- vi. Electronics and communication engineering
- vii. Geodetic engineering
- viii. Mechanical engineering
- ix. Metallurgical engineering
- x. Mining engineering
- xi. Naval architecture and marine engineering
- xii. Sanitary engineering
- b. Medicine and allied professions
  - i. Medicine
  - ii. Medical technology
  - iii. Dentistry
  - iv. Midwifery
  - v. Nursing
  - vi. Nutrition and dietetics
  - vii. Optometry
  - viii. Pharmacy
  - ix. Physical and occupational therapy
  - x. Radiologic and x-ray technology
  - xi. Veterinary medicine
- c. Accountancy
- d. Architecture
- e. Criminology
- f. Chemistry
- g. Customs brokerage
- h. Environmental planning
- i. Forestry
- j. Geology
- k. Interior design
- l. Landscape architecture
- m. Law
- n. Librarianship
- o. Marine deck officers
- p. Marine engine officers
- q. Master plumbing
- r. Sugar technology
- s. Social work
- t. Teaching
- u. Agriculture
- v. Fisheries
- w. Guidance counselling
- x. Real estate service
- y. Respiratory therapy
- z. Psychology
- 3. Retail trade enterprises with paid-up capital of less than US\$2,500,000 (Sec. 5 of RA 8762) <sup>2</sup>

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<sup>2</sup> Full foreign participation is allowed for retail trade enterprises: (a) with paid-up capital of US\$2,500,000 or more provided that investments for establishing a store is not less than US\$830,000; or (b) specializing in high end or luxury products, provided that the paid-up capital per store is not less than US\$250,000 (Sec. 5 of RA 8762)

4. Cooperatives (Ch. III, Art. 26 of RA 6938)
  5. Private security agencies (Sec. 4 of RA 5487)
  6. Small-scale mining (Sec. 3 of RA 7076)
  7. Utilization of marine resources in archipelagic waters, territorial sea, and exclusive economic zone as well as small-scale utilization of natural resources in rivers, lakes, bays, and lagoons (Art. XII, Sec. 2 of the Constitution)
  8. Ownership, operation, and management of cockpits (Sec. 5 of PD 449)
  9. Manufacture, repair, and stockpiling and/or distribution of nuclear weapons (Art. II, Sec. 8 of the Constitution)<sup>3</sup>
  10. Manufacture, repair, and stockpiling and/or distribution of biological, chemical and radiological weapons and anti-personnel mines (various treaties to which the Philippines is a signatory and conventions supported by the Philippines)<sup>3</sup>
  11. Manufacture of firecrackers and other pyrotechnic devices (Sec. 5 of RA 7183)
- Up to Twenty-Percent (20%) Foreign Equity*
12. Private radio communications network (RA 3846)
  13. Private recruitment, whether for local or overseas employment (Art. 27 of PD 442)
  14. Contracts for the construction and repair of locally-funded public works (Sec. 1 of CA 541; LOI 630) except:
    - a. Infrastructure/development projects covered in RA 7718; and
    - b. Projects which are foreign funded or assisted and required to undergo international competitive bidding [Sec. 2(a) of RA 7718]
  15. Contracts for the construction of defense-related structures (Sec. 1 of CA 541)
- Up to Thirty Percent (30%) Foreign Equity*
16. Advertising (Art. XVI, Sec. 11 of the Constitution)
- Up to Forty Percent (40%) Foreign Equity*
17. Exploration, development, and utilization of natural resources (Art. XII, Sec. 2 of the Constitution)<sup>4</sup>
  18. Ownership of private lands (Art. XII, Sec. 7 of the Constitution; Ch. 5, Sec. 22 of CA 141; Sec. 4 of RA 9182)
  19. Operation and management of public utilities (Art. XII, Sec. 11 of the Constitution; Sec. 16 of CA 146)
  20. Ownership/establishment and administration of educational

<sup>3</sup> Domestic investments are also prohibited (Art. II, Sec. 8 of the Constitution; Conventions/Treaties to which the Philippines is a signatory)

<sup>4</sup> Full foreign participation is allowed through financial or technical assistance agreement with the President (Art. XII, Sec. 2 of the Constitution)

institutions (Art. XIV, Sec. 4 of the Constitution)

21. Culture, production, milling, processing, trading (except retailing) of rice and corn; and acquiring by barter, purchase or otherwise, rice and corn and the by-products thereof (Sec. 5 of PD 194; Sec. 15 of RA 8762)<sup>5</sup>
22. Contracts for the supply of materials, goods, and commodities to government-owned or controlled corporation, company, agency or municipal corporation (Sec. 1 of RA 5183)
23. Project proponent and facility operator of a BOT Project requiring a public utilities franchise (Art. XII, Sec. 11 of the Constitution; Sec. 2(a) of RA 7718)
24. Operation of deep sea commercial fishing vessels (Sec. 27 of RA 8550)
25. Adjustment companies (Sec. 323 of PD 612 as amended by PD 1814)
26. Ownership of condominium units where the common areas in the condominium project are co-owned by the owners of the separate units or owned by a corporation (Sec. 5 of RA 4726)

#### *Up to Forty-Nine Percent (49%) Foreign Equity*

27. Lending companies

<sup>5</sup> Full foreign participation is allowed provided that within the 30-year period from start of operation, the foreign investor shall divest a minimum of 60 percent of their equity to Filipino citizens (Sec. 5 of PD 194; National Food Authority (NFA) Council Resolution No. 193 s. 1998)

#### *Up to Sixty Percent (60%) Foreign Equity*

28. Financing companies regulated by the Securities and Exchange Commission (SEC) (Sec. 6 of RA 5980 as amended by RA 8556)<sup>6</sup>
29. Investment houses regulated by the SEC (Sec. 5 of PD 129 as amended by RA 8366)<sup>6</sup>

#### **List B: Foreign ownership is limited for reasons of security, defense, risk to health and morals, and protection of small- and medium-scale enterprises**

#### *Up to Forty Percent (40%) Foreign Equity*

1. Manufacture, repair, storage, and/or distribution of products and/or ingredients requiring Philippine National Police (PNP) clearance
  - a. Firearms (handguns to shotguns), parts of firearms and ammunition therefor, instruments or implements used or intended to be used in the manufacture of firearms
  - b. Gunpowder
  - c. Dynamite
  - d. Blasting supplies
  - e. Ingredients used in making explosives:
    - i. Chlorates of potassium and sodium

<sup>6</sup> No foreign national may be allowed to own stock in financing companies or investment houses unless the country of which he is a national accords the same reciprocal rights to Filipinos (Sec. 6 of RA 5980 as amended by RA 8556; PD 129 as amended by RA 8366)

- ii. Nitrates of ammonium, potassium, sodium barium, copper (11), lead (11), calcium, and cuprite
  - iii. Nitric acid
  - iv. Nitrocellulose
  - v. Perchlorates of ammonium, potassium, and sodium
  - vi. Dinitrocellulose
  - vii. Glycerol
  - viii. Amorphous phosphorus
  - ix. Hydrogen peroxide
  - x. Strontium nitrate powder
  - xi. Toluene
- f. Telescopic sights, sniper scope, and other similar devices
- However, the manufacture or repair of these items may be authorized to non-Philippine nationals by the Chief of the PNP; provided that a substantial percentage of output as determined by the PNP, is exported and the extent of foreign equity ownership allowed is specified in the said authority/clearance (RA 7042 as amended by RA 8179)
2. Manufacture, repair, storage and/or distribution of products requiring Department of National Defense (DND) clearance;
- a. Guns and ammunition for warfare
- b. Military ordinance and parts thereof (e.g., torpedoes, depth charges, bombs, grenades, missiles)
- c. Gunnery, bombing, and fire control systems and components
- d. Guided missiles/missile systems and components
- e. Tactical aircraft (fixed and rotary-winged), parts and components thereof
- f. Space vehicles and component systems
- g. Combat vessels (air, land, and naval) and auxiliaries
- h. Weapons repair and maintenance equipment
- i. Military communications equipment
- j. Night vision equipment
- k. Stimulated coherent radiation devices, components, and accessories
- l. Armament training devices
- m. Others as may be determined by the Secretary of the DND
- However, the manufacture or repair of these items may be authorized to non-Philippine nationals by the Secretary of National Defense; provided that a substantial percentage of output as determined by the Secretary, is exported and the extent of foreign equity ownership allowed is specified in the said authority/clearance. (RA 7042 as amended by RA 8179).

3. Manufacture and distribution of dangerous drugs (RA 7042 as amended by RA 8179)
4. Sauna and steam bathhouses, massage clinics, and other like activities regulated by law because of risks posed to public health and morals (RA 7042 as amended by RA 8179)
5. All forms of gambling, except those covered by investment agreements with the Philippine Amusement and Gaming Corporation (PAGCOR) pursuant to RA 9487, otherwise known as the PAGCOR Charter
6. Domestic market enterprises with paid-in equity capital of less than the equivalent of US\$200,000 (RA 7042 as amended by RA 8179)
7. Domestic market enterprises which involve advanced technology or employ at least fifty (50) direct employees with paid-in-equity capital of less than the equivalent of US\$100,000 (RA 7042 as amended by RA 8179)



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# Chapter 6

## Regulatory environment

### *Investor considerations*

- Business enterprises are required to register with a number of government agencies.
- A number of government agencies are responsible for specific sectors of the Philippine economy. However, their regulatory role tends largely to be one of monitoring, with limited impact on the day-to-day operations of businesses.
- Many Philippine laws are patterned after laws that have proven effective in other countries, with the result that the legal framework for business and consumer protection is generally sound and well developed.
- The general theme underpinning the various Philippine laws touching on competition policy is to encourage free market enterprise.
- Monopolies may be regulated or prohibited by the Philippine government if that is in the public interest. The central issue, however, is not that a monopoly exists, but whether the monopolist uses its power to alter the price of a product or to restrain free competition in the market.
- There are no restrictions on acquisitions, mergers or consolidation, unless they will result in unfair competition, will restrain trade to artificially prevent free competition in the market, or will result in foreign ownership that violates the Foreign Investment Negative List (FINL).

## **Regulation of business**

The Philippine government, in line with its aim to improve the country's investment climate and promote the global competitiveness of local industries, is conscious of the need to reduce the extent to which businesses need to interact with government agencies. Developments at the Philippine Economic Zone Authority (PEZA), for example, include the establishment of a "one-stop shop" within special economic zones where registered enterprises may go to deal with all of their registration and reporting requirements. For most businesses, however, the reality for now is that they still need to deal with a number of government agencies when conducting various aspects of their business.

The two main agencies for business registrations are the Department of Trade and Industry (DTI) and the Securities and Exchange Commission (SEC). Businesses owned by individuals must register with the DTI, while businesses operated through corporations or partnerships must register with the SEC.

At a minimum, however, a business enterprise must also register with the Bureau of Internal Revenue (BIR), the Home Development Mutual Fund (HDMF), the Social Security System (SSS), and the Philippine Health Insurance Corporation. The enterprise must also register with the local government unit of the place where its business will be conducted, unless it is registered with one of the agencies responsible for administering Philippine

incentive laws (other than the Board of Investments).

In addition, it is recommended that foreign investors register their investment with the Bangko Sentral ng Pilipinas (BSP) to facilitate the repatriation of their investment and profits through the Philippine banking system. Firms seeking to benefit from incentives offered by the government will need to register with the relevant agency. The most significant agencies are the Board of Investments, the PEZA, the Cagayan Economic Zone Authority, the Zamboanga City Special Economic Zone Authority, the Subic Bay Metropolitan Authority, the Clark Development Corporation, the Aurora Pacific Economic Zone and Freeport Authority, and the Authority of the Freeport Area of Bataan. Importers need to be accredited with the Bureau of Customs (BOC).

The Philippines also has numerous agencies responsible for overseeing specialized sectors of the economy. These include the National Telecommunications Commission, the Philippine Contractors Accreditation Board (construction industry), the Professional Regulations Commission (exercise of licensed professions), the Supreme Court (practice of law), the BSP (banking), and the Insurance Commission (insurance).

Despite the large number of government agencies businesses may need to deal with, the regulatory system tends to have limited impact on the day-to-day operations of most businesses. In many cases, the

regulatory agency performs largely a monitoring role, confining itself to collecting information from enterprises under its jurisdiction. One consequence is that businesses may find that they need to provide copies of their financial statements to a number of agencies.

Many Philippine laws are patterned after laws that have proven effective in other countries, resulting to a legal framework for business and consumer protection that is generally sound and well developed. However, a recognized challenge facing the Philippine government is the need for institutional strengthening of its agencies, as the implementation of the laws is often not of the same standard as the law itself. While businesses are required to comply with various statutory requirements, relevant government agencies need to increase their capacity to enforce the rights which the former are entitled to under the law.

Government agencies are typically also empowered to issue implementing regulations for the various laws passed by Congress.

### **Competition policy**

The general theme underpinning the various Philippine laws touching on competition policy is to encourage free market enterprise.

### **Price controls**

As a general rule, prices in the Philippines are determined on the basis of supply and demand and the interplay of market forces.

The government has some discretion to impose price controls if it considers them appropriate in certain situations. Under RA 7581 or the Price Act of 1992, the government may impose controls on the price of basic necessities and prime commodities to ensure that they remain available to consumers at reasonable prices, provided this does not deny legitimate business a fair return on its investment.

The government also monitors domestic petroleum prices through the Department of Energy and electric power prices through the Energy Regulatory Commission. If participants in those markets are found to be abusing their market strength or engaging in anti-competitive or discriminatory behavior, the relevant agencies may impose penalties and corrective pricing measures.

### **Monopolies and anti-trust**

The Philippine Constitution requires the government to regulate or prohibit monopolies if that is in the public interest. Based on the Revised Penal Code of 1930, the central issue here is not whether a monopoly exists, but whether the monopolist uses its power to alter the price of a product or to restrain free competition in the market.

The Philippines has no formal Anti-Trust Law. The Constitution, however, supported by the Revised Penal Code, prohibits any combination of businesses that would result in unfair competition or restrain trade to artificially prevent free

competition in the market. In a similar vein, the Civil Code gives a right of action to persons who suffer damage from acts constituting unfair competition in agricultural, commercial or industrial enterprises, or in labor.

A proposed anti-trust legislation has recently been filed in Congress. The bill is more liberal in approach and has factored business considerations. While it does not totally prohibit monopolies, it contains provisions on anti-competitive agreements (e.g., price fixing market allocation), abuse of dominant position (e.g., predatory pricing), and anti-competitive mergers, coupled with more detailed enforcement mechanism.

### **Acquisitions and mergers**

There are no restrictions on acquisitions, mergers or consolidations, unless they will result in unfair competition, will restrain trade to artificially prevent free competition in the market, or will result in foreign ownership that violates the FINL (see Chapter 5).

Mergers involving two corporations must be approved by a majority vote of the board of directors or trustees, by the stockholders owning or representing at least two-thirds of the outstanding capital of the constituent corporations, and by the SEC. Those involving specialized industries commonly also require approval from the appropriate government agency. The Filipino ownership requirements for certain business activities and industries also apply

to foreign acquisitions of existing companies.

### **Securities markets**

The Philippine Stock Exchange (PSE), which resulted from the merger in 1992 of the Manila Stock Exchange and the Makati Stock Exchange, has unified trading floors in Pasig City and Makati City.

The more important documentary requirements required to be submitted for the public offering or listing of shares in the PSE are as follows:

- Copies of the latest amended articles of incorporation, amended by-laws, and any certificate of increase in capital stock, certified as true copies by the SEC;
- A report on the dividend declaration history of the corporation, along with a history of issuances and subscriptions of shares from the time of incorporation;
- List of stockholders before the initial public offering, including details on the number of shares issued and outstanding, the percentage of ownership of Filipino citizens and alien stockholders, and background information on the twenty largest stockholders;
- Audited financial statements for the last three fiscal years for the applicant and its subsidiaries, along with interim financial statements; and
- Details of the basis and computation of the offer price range, the appraisal

report used in the valuation of the assets, the company's prospectus and work program for the application of the proceeds of offerings, and the company's financial projections, supported by a letter prepared by an accredited auditing firm.

The minimum number of stockholders a company must have after an initial public offering depends upon the board on which it will be listed. Listing in the First Board requires 1,000 stockholders and capitalization exceeding four hundred million Philippine pesos. Listing in the Second Board requires 500 stockholders and capitalization exceeding one hundred million Philippine pesos, while listing in the Small and Medium Enterprises Board requires 50 stockholders and capitalization exceeding twenty million Philippine pesos.

If an initial public offering involves a corporation that previously was 50% owned or controlled directly or indirectly by 20 or fewer individuals, a percentage tax of between 1% and 4% of the issue price is payable. The actual rate depends on the percentage of the stock of the corporation that is on offer.

Listed Companies are required to observe the Minimum Public Offering (MPO) of at least ten percent (10%) of the company's issued and outstanding shares exclusive of any treasury shares or such percentage as may be prescribed by the SEC or PSE, whichever is higher. Non-compliance with the MPO requirement will subject the company to the payment of the 5% and 10% capital gains tax based on the net

gains from the shares sold and DST of PHP0.75 for every PHP200 of the par value of the stock or portion thereof. However, the CGT shall not apply to the following companies:

- Dealers in securities subjecting their gross receipts to VAT and sale or exchange of securities to income tax;
- Investors in shares of stock in a mutual fund company in connection with their realized gains upon redemption in a mutual fund company; and
- Natural or juridical persons specifically exempt from taxes under existing investment incentives and other special laws

The PSE and listed companies are required to comply with certain reporting requirements of the BIR for purposes of monitoring compliance with the MPO requirement.

### **Imports and exports**

As a general rule, the Philippines permits the importation of all kinds of merchandise. The importation of certain commodities is, however, regulated or prohibited for reasons of public health and safety, national security, international commitments, or to facilitate the development or rationalization of local industry. (See Chapter 8 for a discussion of import restrictions.)

In line with principles adopted internationally, safeguard measures may be imposed against increased imports that cause, or threaten to cause, serious injury

to domestic industries and producers. Anti-dumping duties can also be imposed to protect domestic enterprises against unfair foreign competition and trade practices.

On the export side, the Trade and Industry Development Council has a mandate to define the overall trade development strategy for the country based on the development of a strong domestic industrial base and directed towards global competitiveness. Exports that generate foreign exchange earnings for the country are generally freely encouraged.

The export of some commodities is regulated or prohibited for reasons of national interest. Regulated commodities require clearances or permits from government agencies such as the Department of Agriculture or the Department of Environment and Natural Resources, and include such commodities as cement, oil and petroleum products, firearms, and some raw materials coming from plants. Prohibited exports include ramie seeds and seedlings, certain wildlife species, and certain live fish stock.

### **Consumer protection**

The Consumer Act of the Philippines of 1992 establishes standards of conduct for business and industry and provides protection of the interests and general welfare of consumers. It protects consumers against hazards to health and safety; and against deceptive, unfair and unconscionable sales acts and practices. It also sets out consumer rights and provides

for means of redress against noncompliant businesses.

The Consumer Act is enforced by three agencies. The Department of Agriculture enforces the rules relating to agricultural products. The Department of Health, through the Food and Drug Administration, enforces the rules for food, drugs, cosmetics, and pharmaceutical devices and substances. The Department of Trade and Industry enforces the rules for other consumer products.

### **Pollution control**

The government acknowledges that the need to attain sustainable economic development must be balanced with the need to promote and protect the country's environment. The government encourages cooperation and self-regulation among citizens and industries through the application of market-based instruments. The primary focus is on pollution prevention rather than on pollution control.

The Philippine Clean Air Act of 1999 (RA 8749), primarily administered by the Department of Environment and Natural Resources, establishes the maximum permitted emission levels for hazardous air pollutants. The penalties for violating the pollution standards include fines and the suspension of operations until proper environmental safeguards are put in place. A third offense can result in the permanent closure of operations. Criminal charges may also be filed against repeat offenders,

and can upon conviction result in imprisonment for six to ten years.

Other key environmental laws include: RA 9003, which provides for an ecological solid waste management program; RA 6969, which provides for a program to control toxic substances and hazardous nuclear wastes; RA 9275 or the Philippine Clean Water Act, which provides for a program on comprehensive water quality management; and RA 9729, mainstreaming climate change into government policy formulations and establishing the framework strategy and program on climate change.

### **Special industries**

Industry-specific laws govern most specialized industries, and are implemented by a relevant government agency. Specialized laws include the General Banking Law of 2000, the Financing Company Act of 1998, the Insurance Code of the Philippines of 1974, the Telecommunications Policy Act of 1995, the Retail Trade Liberalization Act of 2000, the Downstream Oil Industry Deregulation Act of 1996, the Oil Exploration and Development Act of 1972, the Philippine Biofuels Act of 2006, the Renewable Energy Act of 2008, and the Real Estate Investment Trust Act of 2009.

In general terms, the laws tend to give the relevant government agency some powers to monitor the behavior of participants in the industry and to issue regulations if necessary. In practice, however, firms that conduct their affairs in a principled manner

should not expect the agencies to have much impact on their operations, beyond the need to provide relevant information.

### **Patents, trademarks, and copyrights**

The Philippines is a member of the Paris Union for the Protection of Industrial Property and a signatory of the International Copyright Law.

The Intellectual Property Code of the Philippines, enacted in 1997, sets out the role of the Intellectual Property Office, and contains the law on patents, trademarks, service marks, trade names, and copyright. The Code is consistent with intellectual property law used internationally, and affords traditional rights and protection to the owners of intellectual property.

The Code provides legal protection against video and audio piracy. In addition to the Intellectual Property Office, there are other administrative agencies such as the Optical Media Board responsible for combating the widespread sale of pirated video and audio products in the Philippines. The government is considering other potent measures to help curb the problem. The Bureau of Customs has also become more vigilant in dealing with products as they come across the border.

### **Technology transfer arrangements**

From a foreign investor perspective, the rules on voluntary licensing of technology transfer arrangements are an important feature of the Code. In broad terms, a technology transfer arrangement is a

contract or agreement involving the transfer of systematic knowledge for the manufacture of a product or the application of a process. It also includes the transfer, assignment, or licensing of all intellectual property rights and the licensing of computer software other than that developed for the mass market. Service contracts are also potentially subject to the rules.

The Intellectual Property Code protects the legal rights of owners of intellectual property. The *quid pro quo* of the voluntary licensing rules is that they aim to ensure that Philippine licensees are not subject to abusive practices by the licensors of intellectual property that have an adverse effect on competition and trade. If a technology transfer arrangement does not include certain mandatory provisions to protect the licensee, or includes certain prohibited provisions, the arrangement is unenforceable in Philippine courts unless an exemption has been obtained from the Documentation, Information and Technology Transfer Bureau of the Intellectual Property Office.

The requirements under the voluntary licensing rules are reasonable. They require that Philippine law should govern the interpretation of the contract, and that the licensee should have access to improvements in techniques and processes related to the technology during the period of the arrangement. They also prevent undue restrictions or obligations being placed on the licensee, such as obliging the licensee to acquire inputs from a particular source or obligating the licensee to transfer

for free to the licensor the inventions or improvements that may be obtained through the use of the licensed technology.

The list of requirements under the Code is, however, quite extensive and it is important that foreign owners of intellectual property seek independent advice on their contractual arrangements when entering into contracts with Philippine licensees. The contracts are generally subject to Philippine taxes, even though the foreign owner might not be doing business within the Philippines. Having the proposed contract reviewed prior to implementation can also ensure that unexpected tax consequences do not arise subsequently.



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# Chapter 7

## Banking and finance

### *Investor considerations*

- The Philippine banking system remains in transition from one whose lending priorities are influenced heavily by the government's development program into one where banking priorities are driven more directly by market forces.
- Despite the external challenges of the world market, the Philippines currently enjoys a strong domestic economy, increased public spending, stable inflation, low interest rates, and a solid external position which boost market confidence in the financial sector.
- The Bangko Sentral ng Pilipinas or BSP (formerly the Central Bank of the Philippines) is taking continuing initiatives to improve its prudential regulation and supervision of the operations and activities of banks and non-bank financial intermediaries, which can be expected to further strengthen the Philippine banking system and achieve economic stability for the country.
- A wide range of banking services is available. The market for specialized banking services is relatively new, but is maturing.
- Foreign banks play an important role in the banking system, particularly in facilitating inbound foreign capital. A number of major international banks have branch operations in the Philippines offering full banking services.

- The Philippine Stock Exchange lists a variety of equity securities. There are generally no constraints on transactions by foreigners.
- Foreign investors currently may acquire up to 60% equity in a Philippine bank.

### ***Banking system***

The Philippine banking system has been undergoing a sustained period of transition, as it seeks to move from the type of system normally associated with developing countries, when lending priorities are influenced heavily by the government's development program into one where banking priorities are driven more directly by market forces. The capital markets have been liberalized, although the supervisory and regulatory framework for banks is not yet as strong as it might be. The BSP is, however, taking continuing initiatives to improve its prudential regulation and supervision, which can be expected to further strengthen the banking system over time.

The banking system's asset base has been expanding steadily, supported by sustained growth in deposits. As of July 2012, the total resources of the banking system stood at 7.72 trillion Philippine pesos. Liquid assets-to-deposit ratio remained strong at 54.7% from last year's 57.1%. The big banks' total loan portfolio is 3.371 trillion

Philippine pesos. Banks have been offloading their non-performing assets and problem loans. Philippine non-performing loans (NPL) ratio has been declining since 2000 while banks provisioning against potential losses has been steadily expanding. As a result, the NPL ratio is now at the pre-Asian crisis level of around 4.0% (as of July 2012, the average NPL ratio of universal banks and commercial banks is 2.18%). Furthermore, the profitability of the banking system has remained resilient, although with some moderation of late. Banks have remained adequately capitalized at levels above both the BSP-regulatory requirement of 10% and the Bank for International Settlements' (BIS) standard of 8.0%. Banks have likewise remained solvent as capital adequacy ratio (CAR) was above regulatory and international standards at 17.6% on a consolidated basis and 16.7% on a solo basis.

A wide range of banking services is available, including such specialized services as investment and trust services, finance leasing, and derivative contracts.

Electronic banking is considered a regular service product. The market for specialized banking services is relatively new, but is maturing. New financial products typically require BSP approval before they may be offered. However, the BSP has shown a willingness to lift restrictions on the use of specialized banking products as the system shows itself to have adequate controls in place to deal with the financial risks associated with new products.

The Philippines also has an offshore banking system, consisting of offshore banking units (OBUs) and foreign currency deposit units (FCDUs), which aims to attract offshore funds. There is a virtual absence of exchange control by local authorities insofar as purely offshore operations of these units are concerned, and they provide tax advantages to would-be investors (see Chapter 4 for further details on the incentives available).

Starting 01 January 2014, the BSP will require universal banks and commercial banks to adopt the capital adequacy standards under Basel III. However, the implementation will be on a staggered basis stretching through end of 2018 to allow internationally active banks to raise capital organically.

In late 2001, the Philippines passed the Anti-Money Laundering Act. To address concerns of the Financial Action Task-Force (FATF) that the Philippines might still be used for money laundering, the Act was amended in May 2003 to reduce the covered transactions to PHP500,000 per banking day. The Act was again recently

amended by RA 10365 dated 13 February 2013 which expanded the coverage of persons, natural or juridical, who are required to comply with the law; and activities considered unlawful. The Philippines is now employing anti-money laundering policies and procedures in line with international banking standards.

In 2010, the Philippines passed the Exchange of Information on Tax Matters Act of 2009 which amended RA 1405 and RA 6426. The law expanded the authority of the Commissioner of Internal Revenue to require banks to disclose bank account information upon the request of a foreign tax authority. Following the passage and administrative implementation of the law, the Philippines joined other 80 jurisdictions on the Organization for Economic Cooperation and Development's white list of jurisdictions that have complied with the internationally agreed standards on transparency and exchange of tax information.

### **Central Bank**

The BSP is an independent central monetary authority, established in its current form under the New Central Bank Act of 1993. Its powers and functions are exercised through the Monetary Board, chaired by the BSP Governor. The Monetary Board has five full-time members from the private sector and one member from the Cabinet appointed by the President of the Philippines. The Governor is the chief executive officer of the BSP and is required to direct and supervise the operations and internal administration of

the BSP. Each of BSP's operating sectors — the banking services sector, the supervision and examination sector, and the resource management sector — is headed by a deputy governor.

The primary objective of the BSP is to maintain price stability conducive to a balanced and sustainable growth of the Philippine economy. It is also charged with promoting and maintaining monetary stability and the convertibility of the Philippine peso. The BSP has the sole authority to issue Philippine currency.

The BSP is also responsible for the supervision of the banking system. Its authority includes the ability to issue rules of conduct or establish standards of operation for financial institutions. It is also authorized to conduct examinations to determine whether financial institutions are complying with banking laws and regulations, whether they are conducting their business on a safe or sound basis, and to inquire into their solvency and liquidity. If financial institutions are non-compliant, the BSP has the power to impose sanctions and to force corrective action to be undertaken.

### **Banking market**

- **Universal and commercial banks**

Universal banks and commercial banks are the largest single group of financial institutions in the country, accounting for almost 97% of the combined assets of the banking system. As of the 2nd quarter of 2012, there are 20 universal banks and 17 commercial banks

serving the Philippines. (Source: Bangko Sentral ng Pilipinas, [www.bsp.gov.ph](http://www.bsp.gov.ph))

Aside from functioning as depositories of funds and sources of credit, they also engage in: accepting drafts; issuing letters of credit; discounting and negotiating promissory notes, drafts and bills of exchange, and other evidences of debt; accepting and/or creating demand deposits; receiving other types of deposits and deposit substitutes; buying and selling foreign exchange; accepting deposits and trust accounts from residents and nonresidents; maintaining deposits with foreign banks abroad, OBUs and FCDUs; investing in debt instruments denominated in foreign currency; and other activities that may be necessary or incidental to carry on the business of commercial banking.

Certain commercial banks, referred to as “universal banks,” are also empowered to engage in the activities of an investment house (underwriting, securities dealership, and equity investment) and to invest in other industries other than those allied to the banking industry.

- **Other banks**

The remainder of the banking market is divided between thrift banks, rural banks, and a few specialized government institutions. As of December 2012, there are 70 thrift banks and 589 rural/cooperative banks serving the Philippines. (Source:

Bangko Sentral ng Pilipinas, [www.bsp.gov.ph](http://www.bsp.gov.ph))

Thrift banks include savings and mortgage banks, private development banks, and stock savings and loan associations. Savings banks serve primarily as thrift institutions, drawing funds from household and individual savers. Like other thrift banks, stock savings and loan associations conduct deposit and lending business with the general public. Private development banks supply medium and long-term funds for the creation or expansion of industrial enterprises.

Rural banks specialize in small loans for agricultural purposes as well as to retail traders. Their main sources of funds are savings and time deposits. In line with the government's regional dispersal program, a rehabilitation program has been initiated that seeks to strengthen rural banks through a capital buildup and conversion scheme. This program aims at enabling these rural banks to make countryside loans and lend start-up funds for small-scale projects.

The following are government banks created for specialized purposes.

- The Development Bank of the Philippines, established to finance development projects in such areas as agriculture, industry, and low-cost housing. It also undertakes investment banking functions.
- The Land Bank of the Philippines, established to assist the government in the acquisition of landed estates under the agrarian reform program. Under its charter, the Land Bank functions as an expanded commercial bank.
- The Philippine Amanah Bank, established to provide financial assistance to the Muslim communities of Mindanao.
- The Opportunity Micro-Finance Bank, established to fund, monitor, service, and screen Grameen-banking type developmental loans to specified marginalized sectors of Philippine society.

### **Role of foreign banks**

A number of foreign banks operate in the Philippines through branches, OBUs, representative offices, and equity investments in financial and non-financial enterprises. They play an important role in servicing the country's foreign currency needs and ensure a larger and more effective access to international capital. They also play an important role in introducing innovative financial products into the Philippines.

Foreign banks may acquire up to 60% equity in a Philippine bank. Foreign-controlled banks are likewise required to list at least 10% of their shareholdings with the Philippine Stock Exchange within three years from BSP approval of the foreign investment.

Establishing a local branch with full banking functions is not currently an option for foreign banks. Those banks that are operating such branches in the Philippines are doing so because of special dispensations offered before 1998. Foreign banks may establish a branch to operate as an offshore banking unit. However, as an OBU, they will not be able to offer traditional banking services to Philippine customers.

### ***Specialized financial institutions***

Finance companies are well established and the market for consumer finance and loan syndication is relatively mature. Some notable loan syndications have been concluded for build-operate-transfer contracts for infrastructure development.

The market for other specialized financing services such as leasing and factoring, remains fairly immature. Only a handful of leasing companies currently exist, with activities concentrated on a few lease items, such as transportation, construction, and office equipment. The market is in a development phase and it seems reasonable to expect the sector to develop in the medium term.

### ***Investment institutions***

Collective investment vehicles in the Philippines include investment companies which are engaged in investing, reinvesting, and trading in securities, private insurance companies, privately administered pension plans, and mutual funds. The local market is, however, not a large one.

Among the more significant institutional investors in the Philippines are the Government Service Insurance System (GSIS) and the Social Security System (SSS), which are administered by the government. The GSIS and SSS draw their funds from compulsory contributions by members and invest their funds in local financial assets such as: government securities; housing, salary, commercial and industrial loans; corporate bonds; and money market instruments. The GSIS and SSS also invest heavily in listed Philippine shares; thus, they can have a reasonable influence on market indices.

### ***Financial markets***

#### **Securities markets**

The Philippine Stock Exchange has unified trading floors in Pasig City and Makati City. Trading is normally effected through securities dealers and brokers. Listed companies come from a variety of sectors including banking and financial services, commercial and industrial, property, mining, and oil exploration. (For a description of public offering and listing requirements for shares, see “Securities markets” in Chapter 6.)

A feature of many listed companies is strong family ownership, and in some cases family control. The government recognizes, however, that wide public ownership of the nation’s industry is good for the economy, and some laws exist encouraging private corporations to distribute their stocks more widely.

There are no restrictions on the ability of foreign investors to acquire shares in listed companies, other than the general foreign ownership restrictions identified in Chapter 5.

The Philippines also has unlisted stocks that are traded over-the-counter. There is the Alternative Trading System (ATS) that is regulated by the Securities and Exchange Commission (SEC) rules. The ATS refers to any organization, association, person or group of persons, or system that constitutes, operates, maintains, or provides an electronic market place or facility that brings together primary market issuers of securities and secondary market sellers and buyers of securities.

The Philippine debt securities market is relatively not liquid. Government bonds constitute around 90% of traded debt instruments and are typically held to maturity by banks. Secondary trading of bonds generally is limited. Apart from Certificate of Deposits, large companies tend to tap offshore markets for debt securities rather than issue debt in the domestic market.

### **Specialized financial markets**

The financial futures market in the Philippines has been discontinued, though the BSP has declared its policy to support the development of the Philippine financial market by providing banks and their clients with expanded opportunities for financial risk management and investment diversification through the prudent use of derivatives. By following BSP's most

recently issued guidelines, a bank may engage in financial derivatives activity whether as an end-user, broker, or dealer of derivative instruments. In the Triennial Bank Survey of December 2007 conducted by the Bank for International Settlements or BIS, the Philippines was featured as one of the active players, though contributing only 0.1% to the overall geographical distribution of reported over-the-counter derivatives market activity in foreign exchange.

In the April 2010 survey, the Philippines maintained its contribution of 0.1% to the overall geographical distribution.

### ***International financial market***

The Philippines is not an international financial center, although it has created incentives for branches of foreign banks to establish OBUs and FCDUs to facilitate the flow of foreign capital into the Philippines (see Chapter 4 for details on the incentives available). Notably, OBUs and FCDUs are not subject to tax on income from sources outside the Philippines.

Foreign exchange is traded off the floor through the Philippine Dealing System (PDS), a 24-hour electronic, screen-based interbank trading system. The Philippines also has a bullion market for gold and silver, but this is largely to serve the needs of local suppliers and users.

## **Sources of funds**

### **Local financing**

Short-term capital is generally readily available through the money market and the banking system. Interest rates on loans from the banking system are based on market forces.

Medium-term capital is also available. Long-term capital tends to be limited to priorities attuned to the government's development program and supported by some form of government guarantee, although banks may be prepared to provide such capital for other projects or investments that meet conventional tests of viability, development, and ability of the borrower to pay.

Some venture capital may be obtained through Venture Capital Corporations (VCCs). However, these were established primarily to assist small- and medium-scale enterprises, and any amounts available are likely to be quite limited.

A public offering of shares is another option for raising capital in the Philippines. The Philippines has a number of investment houses (or investment banks) that are engaged in underwriting activities and providing placements for equity, stocks, and securities of private corporations. (For a description of public offering and listing requirements for shares, see "Securities markets" in Chapter 6.) Initial public offerings are, however, subject to a percentage tax of between 1% and 4% of the issue price of the shares, if 50% or more of the outstanding capital stock or

combined voting power in the corporation at the time is owned directly or indirectly by or for not more than 20 individuals.

Finally, companies may issue debt securities. There are currently very few corporate bonds traded in the Philippines. However, a fixed income exchange infrastructure was established in early 2005 to trade both government and private securities, including trade acceptances, banker acceptances, commercial papers, bank-issued notes, qualified loans, certificates of deposits, and asset-backed securities. Provision for facilities for private debt auction, securities lending and borrowing, and repurchase agreements are also under consideration.

### **Availability to foreign investors**

Foreign-owned domestic corporations and foreign investors licensed to do business with the Securities and Exchange Commission face no significant legal impediments when they seek to obtain local finance.

Foreign investors are also able to invest freely in government securities. They can also invest in listed shares that are not classified as being restricted purely to local residents; provided that the foreign ownership limit of the equity security has not yet been reached.

There are no restrictions on the use of un-repatriated funds, other than those identified in Chapter 5.



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# Chapter 8

## Exporting to the Philippines

### *Tips for exporters*

- Exporters to the Philippines should ensure that their nominated importer is accredited with the Bureau of Customs (BOC).
- Before exporting products, it is important to check whether any additional permits from agencies such as the Food and Drug Administration, National Telecommunications Commission, or the Department of Environment and Natural Resources are required before importation will be allowed.
- Before engaging a customs broker, exporters should review his or her reputation and qualifications. They should also check the methods the broker will adopt when resolving customs issues.
- Caution should be exercised when considering the use of a common bonded trading warehouse to store imported goods temporarily as this involves commingling of your products with those of other importers.
- If there is any uncertainty about the correct classification of a product, a tariff classification ruling should be obtained from the Philippine Tariff Commission before the product is imported.

- Should issues arise with the BOC, importers should elect to clear the goods under tentative release.
- PwC's practice of customs and international trade consultants can assist exporters in various aspects of exporting to the Philippines. (Chapter 25 outlines the services we can provide.)

## Import restrictions

As a general rule, the Philippines permits the importation of all kinds of merchandise. The importation of certain commodities is, however, regulated or prohibited for reasons of public health and safety, national security, international commitments, or to facilitate the development or rationalization of local industry.

Imports may be classified into three types.

1. Freely Importable Commodities — Commodities that are neither regulated nor prohibited. The importation of these commodities does not require the prior approval of, or clearance from any government agency.
2. Regulated Commodities — Commodities that require clearances or permits from appropriate government agencies. They are as follows:

Commodities	Government agencies
Live Animals and Meat	Bureau of Animal Industry (BAI)

Commodities	Government agencies
Plants	Bureau of Plant Industry (BPI)
Marine and Aquatic Products	Bureau of Fisheries and Aquatic Resources (BFAR)
Medicines and the like	Food and Drug Administration (FDA)
Firearms, Parts, Ammunition, etc.	Philippine National Police (PNP)
VHS, Tapes, CDs, DVDs, etc.	Optical Media Board (OMB)
TV, Movie, Film Print and Negatives, etc.	Movie and Television Review and Classification Board (MTRCB)
Transceivers, Communication Equipment, etc.	National Telecommunications Commission (NTC)
Endangered Species	Dept. of Environment and Natural Resources (DENR)
Fertilizers and Pesticides	Fertilizer and Pesticide Authority (FPA)

If the proper clearance or permit is not on hand, the commodities will not be cleared by Customs.

3. Prohibited Commodities — Commodities that may not be imported under existing laws. These include

right-hand drive vehicles under Republic Act (RA) 8506 (with exceptions), used clothing and rags, toy guns, and any adulterated or misbranded drug or article of food.

## **Import duties**

### **Customs duties**

Applicable customs duties are determined based on the tariff classification of the imported product. As with the rest of the ASEAN (Association of South East Asian Nations) countries, tariff classification in the Philippines is based on the ASEAN Harmonised Tariff Nomenclature (AHTN), which has been patterned after the Harmonised Commodity Classification and Coding System (HS) Convention and its 2002 revisions. The latest edition, HS 2012, was implemented on 01 January 2012. Under HS 2012, the overall AHTN tariff lines were reduced by 247, or an approximately 4% cut in the number of AHTN tariff lines in 2010. The AHTN is slightly more detailed and complex, but it is something that can be managed and should not be a barrier to market access. So far, the Philippine Tariff Commission, which is a government agency independent of the BOC, has issued 267 classification rulings to address commonly raised valuation and tariff classification issues. However, if there is any uncertainty about the correct classification of a product, securing a tariff classification ruling prior to importation of the product is advisable to allay potential clearance difficulties. A tax classification ruling carries persuasive

support and is generally followed by the BOC.

- **Customs valuation**

On 01 January 2000, the Philippines adopted the World Trade Organization (WTO) Valuation Agreement, where the declared invoice price is used as the basis for determining customs duties. This marked a major shift in the Philippines, which had previously used a pre-shipment inspection regime and export value approach to customs valuation. This change has proved particularly challenging for the BOC, which needed to adapt from a system in which it established customs values, into one where customs values are essentially determined by the importer. However, if importers can properly explain their valuations and provide appropriate supporting documentation, they can achieve a compliant result.

- **Post Entry-Audit**

On 04 June 2001, the Philippine legislature ratified RA 9135 which, among others, established the use of the Transaction Value System in valuing imported goods. The same law, however, gave the BOC the authority to conduct audits of importing companies (including those in special economic zones) to verify the accuracy of the information declared to the BOC. Audits may cover transactions as far as three years back.

Companies are thus required to maintain records for import activities for as long as three years from the date of the import transaction, and ensure at all times that their procedures are consistent with all pertinent Customs rules and regulations.

- **Voluntary Disclosure Program**

The Voluntary Disclosure Program (VDP) is a non-punitive facility for importers to voluntarily disclose or report erroneous, inaccurate, or insufficient information stated in import entry declarations. It is part of the BOC's continuing effort to promote consistency with customs rules and regulations as well as encourage best customs practices.

Importers that avail of the Program shall be exempt from paying any fines or penalties and shall also be accorded "least priority status" in Customs audit selection for subsequent importations; provided, however, that the importer submits a Customs Compliance Improvement Program that addresses the cause/s that led to the inadvertent errors in the import entry declaration and the measures that the importer will implement in order to henceforth comply with customs laws, rules and regulations.

- **Tariff rates**

The Philippine Government's comprehensive tariff reform program has reduced tariff rates significantly in recent years, with the average nominal

tariff rate falling from 27.84% in 1990 to approximately 6.49% in 2004, 7.01% in 2010, and 4.42% in 2012.

As a protective measure, the Philippines retains higher tariff rates (20% to 65%) on sensitive agricultural products such as grains, livestock and meat products, sugar, certain vegetables, and coffee. A few agricultural commodities are subject to minimum access volumes, but these represent less than 1% of all tariff lines.

In view of recent free trade agreements such as the ASEAN Free Trade Area (AFTA), ASEAN-China Free Trade Area (ACFTA), ASEAN-Korea Free Trade Area (AKFTA), ASEAN-Australia-New Zealand Free Trade Area (AANZFTA), ASEAN-Japan Comprehensive Economic Partnership Agreement (AJCEPA), and the recently implemented ASEAN-India Free Trade Area (AIFTA), the Philippines has taken steps to progressively eliminate tariffs. Tariff reductions for the Philippines range from 10% to 35% for most products included in the Normal Track list.

- **ASEAN Free Trade Area**

Under the ASEAN Common Effective Preferential Tariff (CEPT) scheme, ASEAN-member countries extend to each other reduced tariff rates and other trade preferences. A company manufacturing in the ASEAN with the necessary qualifying content that uses the CEPT rate for example, can obtain a commercial advantage over

competitors whose products may be subject to the higher most favored nation (MFN) tariff rate. The degree of commercial advantage from duty rates will depend on the tariff classification of the product (whether it is in the Inclusion List) and the relative margin of preference compared to the MFN tariff rate.

As of January 2003, tariff ranges in the Philippines for the CEPT fell within the 0% to 5% band. In 2008, with the signing of Executive Order (EO) 703, the Philippines eliminated duty rates on 80% of tariff lines in the CEPT Inclusion List.

In 2010, the Philippines implemented the commitment to eliminate the tariff rates on the remaining products in the CEPT Inclusion List for year 2010 through EO 850.

- **ASEAN-China Free Trade Area**

Under the ASEAN-China Free Trade Area (ACFTA), MFN rates between ASEAN-member countries and China are reduced. Similar to the AFTA, companies can obtain a commercial advantage from imported products from China provided the necessary qualifying content is met.

In 2007, under EOs 613 and 618, the Philippines was able to reduce MFN rates in the Philippines from the 0% to 20% range to within the 0% to 12% range.

Further in 2009, the Philippines under EO 814, was able to reduce the tariff

rates within the 0% to 5% range on certain products in accordance with the schedule of tariff reduction for said year.

- **ASEAN-Korea Free Trade Area**

Similar to the ACFTA, the ASEAN-Korea Free Trade Area (AKFTA) effectively reduces MFN rates for products traded between ASEAN-member countries and Korea. Companies can obtain a commercial advantage from imported products from Korea provided the necessary qualifying content is met.

Under EO 812, the Philippines reduced the tariff rates on the articles granted tariff concession under the Normal Track of the AKFTA to within the 0% to 5% range beginning 2009, and 0% in 2012.

- **ASEAN-Australia-New Zealand Free Trade Area**

The ASEAN-Australia-New Zealand Free Trade Area (AANZFTA) effectively reduces custom duties for products traded between ASEAN-member countries and Australia and New Zealand. EO 851 provides the schedule of tariff reduction on articles granted concession under the AANZFTA.

- **ASEAN and Japan Comprehensive Economic Partnership**

The Agreement on Comprehensive Economic Partnership among Members of the Association of

Southeast Asian Nations and Japan (AJCEPA) was signed on 14 April 2008. Under the AJCEPA, the ASEAN-member countries and Japan shall eliminate or reduce their tariff rates in accordance with an agreed upon schedule.

In 2010, EO 852 modified the rates of duty on certain articles to implement the commitments under the AJCEPA.

- **ASEAN - India Free Trade Area**

Acknowledging the growing trade and recognizing the economic potentials of closer linkages, the ASEAN- India Free Trade Area (AIFTA) was implemented in the Philippines through the enactment of EO 25 on 17 May 2011. AIFTA effectively aims to reduce the tariff rates within the 0%-5% rate on certain products granted tariff concession by 2022.

## **Other taxes**

In addition to customs duties, imported merchandise is subject to value-added tax (VAT) at the rate of 12%. VAT is based on the total value used by the BOC in determining tariff and customs duties, plus import duties, excise taxes, and other charges on imports (including arrastre, wharfage, and brokerage fees) before their release from customs custody.

Automobiles, fuel, tobacco and cigarettes, alcohol and liquor, and other non-essential goods are subject to excise taxes imposed under the Tax Code. The system is complex, with tax imposed either as a

percentage of the value of the goods or as a specified amount per unit of quantity (see Appendix XIII for an outline of some of the rates of excise tax that apply).

## **Documentation procedures**

The following import documents are required for all shipments to the Philippines:

- Commercial invoice;
- Bill of lading or international air way bill;
- Certificate of origin (as applicable);
- Packing list; and
- Various special certificates required depending on the nature of the goods being shipped, such as the required permits from government agencies for regulated goods.

A Pro Forma Invoice will not be accepted by Customs where there is a buyer transaction. Such an invoice may be used for importation of samples, articles for processing or reconditioning, returned articles previously exported, articles sent, and other similar cases.

The importer is also required to complete an Import Entry Declaration and an accompanying Supplemental Declaration on Valuation. These may be submitted to the BOC electronically via Electronic Data Interchange or by regular manual processing procedures.

Import entries can be filed manually with the Entry Encoding Center (EEC), or electronically via a Value Added Service

Provider (VASP) through the VASP-BOC gateway. The VASP-BOC gateway allows importers to process, submit, and monitor import documents electronically through the Internet. Paper declarations, on the other hand, are digitized by the EEC into computer-readable messages, which are then fed into the BOC computer for processing under the Automated Customs Processing Operating System (ACOS). Through a selectivity scheme built into the ACOS, incoming cargo is classified into four “lanes.”

Clearance time for each lane varies, from typically one to two days for “Super Green Lane” to up to a week for “Red Lane.”

Approximately 70% of all imports receive Green Lane treatment, meaning that they are not subjected to customs examination (physical or documentary). Duties and taxes are paid directly through authorized agent banks, which are also electronically linked with the BOC.

Customs brokers are typically engaged to process and clear imported goods. Brokers prepare declarations and compute duty liabilities, and can also handle clearance of the goods and physical delivery to the importer’s premises.

All PEZA-registered ecozone export enterprises and IT/IT-enabled enterprises are already using the Electronic Import Permit System (eIPS) for the filing and processing of their import permit applications.

## **Customs and storage**

In the vast majority of cases, there are adequate and secure airport and port storage facilities for goods that remain under the control of Customs before they are cleared. At a practical level, pilferage can be expected from time to time depending on the nature of the products being imported, but the extent of the problem is not significant.

### **Bonded warehouses**

There are typically four types of customs bonded warehouses (CBWs), each governed by special rules.

1. Customs manufacturing bonded warehouse (CMBW). These are further divided into garments, miscellaneous, and common bonded manufacturing warehouse.
2. Private/public bonded warehouse (PPBW)
3. Industry-Specific Customs bonded warehouse (ICBW)
4. Multinational regional bonded warehouse (MRBW)

An alternative to using a PPBW or an ICBW is to establish a customs manufacturing bonded warehouse or multinational regional bonded warehouse, where the importer will retain full control over the imported goods and operation of the warehouse. Manufacturers that export more than 70% of their production might consider establishing their manufacturing operations as a CMBW to benefit from

suspended duty payments on imports used in the manufacturing process.

The BOC tightly monitors the activities of existing CBWs. The Presidential Anti-Smuggling Group (PASG) initiative to prevent illegal activities occurring in CBWs resulted in more audits, closure of several bonded warehouses, and the creation and promotion of the use of ICBWs. The BOC also established stricter rules on what types of goods may be stored in a bonded warehouse.

### **Special economic zones**

Goods that are brought into special economic zones established under the Special Economic Zone Act of 1995 are not subject to duty or tax while they remain inside these zones. Similar treatment is also given to goods that are brought into the Zamboanga City or Cagayan Special Economic Zones, Aurora Pacific Economic Zone and Freeport, Freeport Area of Bataan or the industrial and commercial areas located inside the former United States military bases. Duties and taxes become payable, however, to the extent that goods are withdrawn (i.e., imported) for use in the domestic market.

### **Port of entry and inland transport**

Being an archipelago of over 7,000 islands, overland transport in the Philippines is somewhat restricted. The principal ports of entry to the Philippines are Manila, Cebu, Iloilo, Davao, Batangas, Legaspi, Tacloban, Surigao, Cagayan de Oro, Zamboanga, and Subic. The Philippines also has 13

international airports in various locations nationwide, namely: Manila; Angeles; Bacolod; Iloilo; Cebu; Davao; General Santos; Kalibo; Misamis Oriental; Laoag; Subic; Puerto Princessa; and Zamboanga.

Most imports enter through one of the main ports. Goods bound for destinations outside the port of entry are usually transshipped or delivered by inter-island ferry or by truck. Generally, the network of roads and expressway facilitates the transportation of goods ensuring speedy distribution from the port to the importer's premises. However, importers whose goods are shipped through the ports for delivery within Metro Manila have to contend with the truck ban imposed during weekdays, unless their cargo is exempted.

### **Re-exports**

In general, companies that export at least 70% of their total production output may qualify to operate a customs bonded manufacturing warehouse. This allows them to store imported goods (raw materials) temporarily in the bonded warehouse without paying the usual duties and taxes. Duties and taxes will be charged only on goods that are subsequently withdrawn for access to the domestic market. Rules for bonded warehouses are enforced by way of an onsite customs warehouseman and guard.

If manufacturing is undertaken outside of a bonded environment (perhaps because less than 70% of production is exported), the Tariff and Customs Code of the Philippines provides for duty drawbacks on exports.



Certain conditions must be met, including the submission of relevant import and export documentation and inventory records, and manufacture and exportation occurring within a specified period of time.

### **Local representation**

#### **Market surveys**

It would be prudent to survey existing and potential markets for imported products or services before initiating export sales to the Philippines. This will also help to identify the port that will facilitate the most efficient distribution of the imported product. Many foreign companies establish representative offices to undertake research on the market (see Chapter 9 for information on the requirements for establishing a representative office).

PwC Financial Advisors, Inc. in Manila can assist importers to undertake market surveys.

#### **Local agent**

It is common business practice to employ local customs brokers to complete customs requirements and clear imported goods. It would be advisable, however, to screen customs brokers, to specifically assess their knowledge of customs laws and regulations, as well as their compliance record and reputation. It is also prudent to formulate a detailed agreement on the functions and responsibilities of the customs broker, as this will reduce the likelihood of problems arising that might otherwise compromise transactions with the BOC.

#### **Employee/salesperson**

It is a straightforward exercise to retain the services of a Filipino employee or salesperson in the Philippines. Employing an expatriate employee or salesperson, however, is subject to regulations imposed by the Bureau of Immigration. Among other things, the expatriate must secure an employment permit from the Department of Labor and Employment before commencing employment.

Retaining the services of an employee or salesperson in the Philippines by the foreign employer has legal and tax consequences. In this case, the employer may be required to register with the Philippine Securities and Exchange Commission and contribute the requisite capital to its Philippine operations (see Chapter 9 “Business entities” for a discussion on capitalization requirements). Philippine tax consequences for the foreign employer would also need to be considered (see “Imports” in Chapter 16).

#### **Sales agent or subsidiary**

Employment of a sales agent or establishment of a sales subsidiary is permitted under Philippine laws, and should not present any significant practical difficulties (see “Imports” in Chapter 16 for the tax consequences of trading through a sales subsidiary).

### **Sources of information**

Further information and assistance may be obtained from the commercial department of the Philippine embassy in any foreign

country. Similar information may be obtained in the Philippines from the Department of Trade and Industry particularly the Bureau on Import Services, the Bangko Sentral ng Pilipinas, the Department of Finance (Bureau of Customs), and the Philippine Chamber of Commerce and Industry. Alternatively, information might be sought through one of a number of Foreign Chambers operating in the Philippines or from PwC network.

Contact details for various agencies and organizations that may be able to assist prospective investors are provided in Appendix XIX.

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# Chapter 9

## Business entities

### *Guide to “doing business” entities*

#### Choice of entity

- The main vehicles used by foreign investors are corporations and branches. Joint ventures tend to be feasible investment vehicles only for construction projects and certain energy operations (see Chapter 19).
- The regulatory environment tends to favor the establishment of a subsidiary over a branch, as foreign ownership restrictions preclude operation of a branch in certain industries.
- There are no significant impediments to investment repatriation. However, to facilitate the remittance of profits, inward foreign investments should be preferably registered with the Bangko Sentral ng Pilipinas.
- Branch profits remittances are subject to 15% tax under the Tax Code, although this may be reduced under some tax treaties. The statutory tax rate on profits remitted by way of dividend is 30%, although tax treaties and other factors are likely to reduce the rate to 10% or 15% in practice.

## Corporation

- Forming a corporation requires between five and 15 individual incorporators, each of whom must subscribe to at least one share of stock of the corporation to be formed. A majority of the incorporators must be residents of the Philippines.
- Stock corporations must have between five and 15 individual directors (or trustees of not less than five to even more than 15 if a non-stock corporation), each of whom must hold in its name at least one share of stock. A majority of the directors (or trustees) must be residents of the Philippines.
- Financial institutions, retail trade enterprises, and foreign-owned corporations are subject to minimum capitalization requirements. The minimum paid-up capital for foreign-owned corporations is US\$200,000, unless they are export-oriented, will utilize advanced technology in their domestic operations, or will employ at least 50 employees.

## Branch

Foreign corporations are required to obtain a license from the Securities and Exchange Commission (SEC) before they may do business in the Philippines, which typically involves remitting capital of at least US\$200,000 to the Philippines. Failure to obtain a license will result in the corporation losing its ability to sue in local courts.

## Foreign ownership restrictions

- Foreign ownership is restricted in corporations undertaking activities listed in the Foreign Investments Negative List (FINL) (see the list at the end of Chapter 5). Branches cannot engage in activities listed in the FINL because they do not have the requisite Filipino ownership.
- Foreign ownership participation in management is limited.
- To set up a domestic corporation, a majority of the incorporators/directors must be individual Philippine residents.
- The ratio of foreign directors to the total number of directors should generally not exceed the ratio of foreign equity to the total equity in the corporation.
- No employee representation is necessary in the board of directors.

## Liquidating an investment

There are no impediments to shareholders liquidating their investments by selling or assigning their shares, other than restrictions that may be contained in the by-laws of the corporation, such as minimum holding periods for initial public offerings.

## Tax considerations

Branches receive the most favorable tax treatment for foreign investors. Application of a relevant tax treaty may overcome some domestic limitations on deductibility, while

the treaty source rules potentially allow allocated interest and royalties expense to avoid Philippine withholding taxes (see “Branch versus subsidiary” in Chapter 15). Foreign branches registered with the Philippine Economic Zone Authority (PEZA) are also exempt from the 15% branch profit remittance tax.

### **Professional advice**

- Philippine registration requirements are quite extensive, and the consequences of failing to comply with all obligations can extend to being prevented from undertaking further business activities in the Philippines or being precluded from pursuing legal actions in court. Using local professional firms to coordinate and submit documents can help to ensure that the various registration requirements are met.
- The Intellectual Property Code requires the inclusion of mandatory clauses and the exclusion of prohibited clauses in technology transfer agreements which, if not complied with, may result in the contract being unenforceable. Careful drafting may also be required to ensure there are no unexpected tax consequences. Local professional firms can review draft contracts and identify provisions that might have unexpected consequences for the investor.

### **Company law**

Philippine law governing commercial activities is derived from a mixture of

Spanish civil law and US common law. The Philippine Corporation Code, Tax Code, Revised Securities Code, and Insurance Code are generally based on their US counterparts. The laws on sales, partnership, agency, contracts, and credit transactions contained in the Philippine Civil Code of 1949, are based on the Spanish Civil Code.

The Foreign Investments Act (FIA) of 1991 is also relevant to foreign investors because it places constraints on the extent to which they may own enterprises that engage in certain activities. There are also special laws that regulate certain industries.

United States precedents are not binding on Philippine courts. However, when the law concerned is based on its United States counterpart, the precedents can have persuasive effect.

### **Forms of business enterprise**

The following forms of business entity may be established.

#### **1. Corporation**

Corporations are juridical persons established under the Corporation Code and regulated by the SEC, with a personality separate and distinct from that of its stockholders. The liability of the shareholders of a corporation is limited to the amount of their share in the capital.

#### **2. Close (private) corporation**

A close corporation is a particular type of corporation subject to less rigid formal requirements than other

corporations. In this form of entity, management and ownership are merged because of direct stockholder management of the corporation. To be a close corporation, a corporation must have 20 or fewer shareholders, must have certain restrictions on share transfer, and cannot have two-thirds or more of its voting stock owned by a corporation that is not a close corporation. A close corporation is not allowed to engage in mining, oil, banking, insurance, public utilities, education, or other activities considered to be in the public interest.

### 3. Branch

Foreign corporations may establish a branch in the Philippines if the laws of their home country similarly allow Filipino citizens and corporations to do business there. Branches are required to register with the SEC and secure a license to do business in the Philippines. However, a branch cannot be used to conduct activities that are included in the FINL because it does not have the requisite Filipino ownership.

### 4. Partnership

Under the Civil Code of the Philippines, a partnership is treated as a juridical person, having a separate legal personality from that of its members. Partnerships may be either general partnerships, where the partners have unlimited liability for the debts and obligations of the partnership; or limited partnerships, where one or

more general partners have unlimited liability and the limited partners have liability only up to the amount of their capital contributions. A general professional partnership is the business structure commonly used by professionals such as accountants and lawyers, to practice their profession.

### 5. Joint venture

Corporations may enter into a consortium among themselves to finance a specific venture. Joint ventures, while not expressly recognized as such under the Civil Code, are afforded the same legal status as a partnership.

### 6. Sole proprietorship

An individual may operate a business as the sole beneficial owner of the business. This “one-man” form of business organization is most common in small retail trade operations.

## Foreign enterprise entities

The most common form of corporate vehicle used by foreign investors is the corporation. One reason is that a branch cannot be used if the activities to be undertaken are included in the FINL. By contrast, a corporation readily accommodates the requisite Filipino ownership.

Branches are, however, still commonly used as corporate vehicles, since they tend to receive more favorable tax treatment (see “Branch versus subsidiary” in Chapter 15). They are also the only vehicle that can

be used if an investor wants to establish a regional headquarters in the Philippines (see Chapter 4). Finally, the absence of tax on profit remittances should make them the vehicle of choice for investors locating in a special economic zone (see Chapter 4).

Joint ventures tend to be feasible investment vehicles only for construction projects and certain energy operations. Joint ventures in other activities are subject to unfavorable tax treatment as partnerships (see Chapter 19).

## **Corporation**

### **Formation procedures**

The formation of corporations is governed by the Corporation Code. However, if foreign investors are to own shares in a corporation, the FIA of 1991 will also be relevant as it places constraints on foreign ownership in enterprises engaged in certain activities (see Chapter 5).

- **Registration requirements**

Corporate existence and juridical personality commences from the date the SEC issues a certificate of incorporation. However, before a corporation may commence operations in the Philippines, it must also register with the Bureau of Internal Revenue (BIR), the Social Security System (SSS), the Home Development Mutual Fund (HDMF), the Philippine Health Insurance Corporation (PhilHealth), and the local government unit where its principal office will be located. Registration with the SEC and other

government agencies usually takes six to eight weeks to complete.

To establish a corporation, between five and 15 individuals must act as incorporators. They must each subscribe to at least one share, and a majority of them must be residents of the Philippines. At least 25% of the authorized capital stock must be subscribed at the time of incorporation, and at least 25% of that subscribed stock must be paid. However, when the capital stock consists of no-par value shares, the subscriptions must be paid in full.

Once incorporation formalities are completed, the incorporators may sell their shares. The corporation will still need to retain at least five individual shareholders, as it must have at least five directors, each of whom must hold at least one share.

Among the more important documents required to be filed with the SEC in applying for incorporation are the articles of incorporation, by-laws, and the treasurer's affidavit indicating that the necessary capital has been subscribed and received for the benefit of the corporation to be formed.

- **Formation costs**

The cost of registering a corporation will depend on its capital structure. Filing fees with the SEC is calculated at the rate of 0.2% of the authorized capital stock of the corporation, plus nominal filing fees. The original issue

of shares of stock is also subject to a documentary stamp tax equivalent to PHP1 on each PHP200 or fractional part thereof of the par value of the shares issued. There are also charges imposed by the other government agencies, such as the local government and the tax office.

### **Public disclosure of information requirements**

The SEC requires the submission of audited financial statements (AFS) by stock corporations with paid-up capital of at least PHP50,000. The AFS must also be accompanied by a statement of management that it takes responsibility for the information and representations in the financial statements.

In addition, corporations are required to file an annual general information sheet with the SEC which provides information on the corporation's general profile such as: the names of directors, officers, and stockholders; capital composition; investments; treasury shares; retained earnings; and dividends.

All information filed by corporations with the SEC are available for public inspection.

### **Capital structure**

- **Minimum authorized, issued, and paid-in capital**

Corporations are required to have a minimum paid-up capital of PHP5,000. For corporations trading in certain industries or undertaking specific

activity, however, the minimum capitalization is higher.

At least 25% of the capital stock of a corporation must be subscribed, and 25% of the subscribed capital must be paid up.

If foreign investors will hold more than 40% of the shares in a Philippine corporation that produces goods for sale or renders services or otherwise engages in business in the Philippines, the general requirement under the FIA is a minimum capitalization of US\$200,000. This is reduced to US\$100,000 if the corporation will undertake activities utilizing advanced technology or employ directly at least 50 employees. Export-oriented enterprises are not subject to the minimum capitalization requirement.

Under the FIA, ownership requirements are based on the "capital stock outstanding and entitled to vote." In determining outstanding capital stock, the Act does not differentiate between ordinary shares and shares carrying only partial voting rights or paying preferential dividends.

However, in a recent decision of the Supreme Court, it was clarified that in case of economic activities which are reserved to Philippine nationals (i.e., a citizen of the Philippines or a domestic partnership or association wholly owned by citizens of the Philippines; or a corporation organized under the laws of the Philippines of which at least 60% of the capital stock outstanding and



entitled to vote is owned and held by citizens of the Philippines) full beneficial ownership of 60% of the outstanding capital stock, coupled with 60% of voting rights, is required. A subsequent Memorandum Circular of the SEC further laid down the rule that the required percentage of Filipino ownership shall be applied to both (a) the total number of outstanding shares of stock entitled to vote in the election of directors; and (b) to the total number of outstanding shares of stock, whether or not entitled to vote in the election of directors.

For certain specialized activities, such as banking and retail trade, the minimum capitalization is substantially higher if foreign investors are to hold more than 40% of the shares of a corporation.

Share capital may be contributed in cash (in any acceptable currency) or property.

- **Par value or no-par value**

Shares of stock may have par value or no-par value, as provided in the articles of incorporation. In both cases, the shares should be paid in cash or in kind at a fair valuation equal to the par or issued value of the stocks. No-par value shares may not be issued for a consideration less than PHP5 per share.

- **Minimum and maximum number of shareholders**

Because of the requirement that the directors of a corporation each hold at least one share, all corporations require a minimum of five shareholders.

Except for close corporations, there is no limit on the maximum number of shareholders in a corporation.

- **Types of share ownership**

Philippine corporations may issue only registered shares. Details of share ownership and changes thereto must be recorded in the corporation's Stock and Transfer Book.

- **Classes of shares**

Corporations are permitted to classify shares, and each class of shares may have such rights, privileges, and restrictions as are stated in the articles of incorporation. At least one class of share, however, must carry full voting rights.

Major classes of shares of stock may be grouped into the categories of common and preferred stock, and voting and non-voting stock. However, the Corporation Code still entitles holders of non-voting shares to vote on a number of specified matters relating generally to fundamental changes in the corporation's business or in the relationships between stockholders.

Founders' shares classified as such in the articles of incorporation, can be issued granting certain rights and

privileges not enjoyed by the owners of other stocks. However, an exclusive right to vote and be voted for in the election of directors must be for a limited period of not more than five years.

- **Loans and debentures**

Corporations may incur bonded indebtedness by issuing bonds to the public or to a specific group of lenders. The bonds may be issued either in bearer form or for registration in the owner's name. The issuance of bonds or debentures requires approval by stockholders representing at least two-thirds of the outstanding capital stock of the corporation. If the bonds or debentures will be issued to 20 or more holders, approval is also required from the SEC.

- **Increase and decrease in capital**

Subject to SEC approval, a corporation may increase or decrease its capital stock by a majority vote of the board of directors and a two-thirds vote of the shareholders. Whether a corporation is allowed to decrease its capital stock will depend on the purpose and how it will carry out the decrease. In any case, capital cannot be reduced if creditors will be prejudiced.

Increase in capital may be funded by cash or property infusion, or by converting existing retained earnings into capital by way of stock dividends.

- **Capital contributions**

Amounts received in excess of the par value of shares are treated as additional paid-in capital. There are no restrictions on how a corporation may apply its additional paid-in capital, except that it generally may not be distributed as dividends.

- **Transferability of shares**

The transfer of shares is not unreasonably restricted but may be regulated under certain conditions, especially if the transfer impairs the rights of creditors or other shareholders or violates the nationality requirement in certain activities. No transfer is valid, except between the parties, until it is recorded in the books of the corporation and the relevant taxes have been paid. Shares of stock against which the corporation holds an unpaid claim are not transferable in the corporate books.

- **Liability of shareholders**

A shareholder may be personally liable for corporate debts only to the extent of the shareholder's unpaid subscribed capital. However, the shareholder is liable for damages arising from a breach of fiduciary duties, fraud, gross negligence, and other unauthorized acts such as the unlawful disposition of corporate assets.

## Relationship of shareholders, directors, and officers

- **Directors' responsibility**

The board of directors collectively exercises corporate powers, and is responsible for the conduct of the business of a corporation. However, certain activities, such as the reconstruction of capital and the creation of bonded indebtedness, require the direct participation of shareholders in the form of a vote.

The directors of a corporation are elected by the shareholders. At least one share of the capital stock must be registered in the director's name in the books of the corporation. The board of directors formally organize by electing from among themselves the statutory corporate officers. The board of directors also elect a treasurer who may or may not be a director; a secretary who must be a resident and a citizen of the Philippines, and other officers as may be provided for in the by-laws. Any two or more positions, except those of president and secretary and of president and treasurer, may be held concurrently by the same person.

- **Directors' liability**

The official position of a director is one of trust. To the corporation and its shareholders, they act as trustees. To third parties, they act as agents.

Directors are liable for losses and damages resulting from gross negligence, assenting to patently

unlawful acts, bad faith in directing the affairs of the corporation, and acquiring personal or pecuniary interest in conflict with their duties as directors.

- **Meetings and voting rights**

Regular meetings of shareholders are held annually on a date fixed in the by-laws. Special meetings of shareholders can be held whenever they are considered necessary, or as provided in the by-laws. Proxy voting is permitted, but notarization is necessary to make the proxy valid against third parties. Documentary stamp tax is also payable.

- **Dividends**

The board of directors may declare cash dividends out of unrestricted retained earnings. Distributions from additional paid-in capital or premium on capital may be declared only as stock dividends.

Stock corporations are prohibited from retaining surplus profits in excess of 100% of their paid-in capital stock, except under any one of the following circumstances.

- It is justified by definite corporate expansion projects or programs approved by the board of directors.
- The corporation is prohibited under a loan agreement with any local or foreign financial institution or creditor from

declaring dividends without the lender's consent, and the consent has not been secured.

- It can be clearly shown that retention is necessary because of special circumstances, such as the need to maintain a special reserve for probable contingencies.

Stock dividends may be issued to convert surplus profits into authorized capital, and are not subject to income tax. They are, however, subject to a documentary stamp tax based on the par value represented by each share. The issuance of stock dividends requires the approval of stockholders representing at least two-thirds of the outstanding capital stock of the corporation.

### **Liquidation, receivership**

Corporations may be dissolved for any of the following causes.

- Expiration of the period provided for in the articles of incorporation.
- Enactment of a special law requiring dissolution.
- A judicial decree of forfeiture.
- Failure to organize and commence business within two years from the date of incorporation.
- Inoperative for five years after it has commenced operations.
- Voluntary dissolution, judicial or extrajudicial.

Corporate assets may be liquidated by the corporation itself through the board of directors and creditors, by receivership or by trusteeship. Liquidation through the board of directors takes three years from corporate dissolution. Liquidation by receivership and trusteeship may extend beyond three years.

Under the trust-fund doctrine, impairment of capital is prohibited, principally to protect the corporation's creditors.

Upon dissolution, the right of shareholders to the distribution of corporate assets is subordinated to the rights of the creditors. The interests of the shareholders in the remaining assets are in proportion to their shareholdings, in the absence of any contrary provision in the articles of incorporation and in the certificates of stock. Holders of stocks preferred as to assets must be paid before holders of common stock and holders of stocks preferred as to dividends.

As an alternative to dissolution, financially distressed enterprises and individuals may resort to rehabilitation or liquidation. RA 10142<sup>1</sup>, otherwise known as the "Financial Rehabilitation and Insolvency Act of 2010 (FRIA)," repealed the 1956 Insolvency Law. The salient points of the FRIA are as follows:

- Proceedings under RA 10142 shall be *in rem* and shall be conducted in a summary and non-adversarial manner.

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1 Lapsed into law on 18 July 2010

- There are three modes of rehabilitation: (1) court-supervised rehabilitation which may be voluntary (i.e., initiated by the debtor) or involuntary (i.e., initiated by the creditors); (2) pre-negotiated rehabilitation where the petition is filed by the debtor himself or jointly with any of the creditors, for the approval of a pre-negotiated rehabilitation plan; and (3) out of court or informal restructuring agreements or rehabilitation plans where the debtor and a specific number of creditors work out among themselves a rehabilitation plan that would bind the rest of the creditors.
- Liquidation of insolvent juridical persons and individuals, which may also be voluntarily or involuntarily.
- Rehabilitation proceedings may, upon motion of the debtor or the concerned creditors, be converted into a liquidation proceeding.
- Cross-border insolvency proceedings are allowed.

The Philippines does not have a specialized court system for insolvency proceedings, which hampers development of the requisite expertise on the intricacies of corporate issues and the quick response mechanism necessary for the courts to handle corporate rehabilitation issues efficiently. Thus, court proceedings can be tedious and lengthy, and do not guarantee recovery. Because of these shortcomings, most secured creditors would prefer to ensure timely recovery by enforcing their

rights over the collateral through the foreclosure of mortgages. Unsecured creditors, by contrast, tend to pursue informal “workout agreements” with the company. Recent legislations have also been passed adopting alternative modes of dispute resolution so as to reduce extreme reliance in the courts to resolve conflicts.

### **Books and records**

All corporations must maintain books of account, consisting of a journal and a ledger or their equivalents. Subsidiary books may also be kept as required by the particular business. It is an administrative requirement that all books be registered with the BIR before they may be used (see “Statutory requirements” in Chapter 11 for further information.)

Corporations are also required to keep records of all business transactions, minutes of meetings of directors and shareholders, a stock and transfer book, and annual financial statements at its principal place of office. These books and records shall be open to the inspection of any director or stockholder upon written request.

### **Statutory audit**

A statutory audit is required for all corporations with authorized capital stock or paid-up capital exceeding PHP50,000 including branches of foreign corporations. It is also required for any corporation whose gross sales or earnings exceed PHP150,000 in any quarter.

## ***Branch of a foreign corporation***

Because it does not have the requisite Filipino ownership, a branch may only undertake business activities that are not included in the FINL. Unlike a corporation, which requires a set of officers, a branch office may operate with only one resident agent, who may also serve as the general manager.

### **Types of branch operation**

Branches can, subject to constraints imposed by the FINL, be used to conduct the business operations of a multinational in the Philippines. A general requirement is that US\$200,000 be inwardly remitted to the Philippines as assigned capital. However, branches engaged in activities utilizing advanced technology for its domestic operations, or that employ at least 50 direct employees, are required to inwardly remit the reduced amount of US\$100,000 as assigned capital. Export-oriented branches are not subject to minimum assigned capitalization requirements.

Special rules exist, however, for certain types of branch operations, as follows:

- A representative or liaison office can be established to undertake activities such as promoting and disseminating information about a multinational's products, including dealing directly with the clients of the head office. Establishing a representative office requires an initial inward remittance of US\$30,000, and the subsequent

expenses of the office to be met by the head office.

- A regional or area headquarters (RHQ) can be established to serve principally as a supervision, communications, and coordination center for the subsidiaries, branches, or affiliates of a multinational company operating in the Asia-Pacific region and other foreign markets. It is allowed to operate only as a cost center, and may not participate in any manner in the management of any subsidiary or other branch office the multinational has in the Philippines, or to solicit or market any goods or services. Establishing an RHQ requires a minimum annual inward remittance of US\$50,000 to cover the operational costs of the headquarters.

The Philippines also has special rules for regional operating headquarters (ROHQ), which are established to perform various qualifying support services to its affiliates, subsidiaries, or branches in the Philippines, in the Asia-Pacific region and in other foreign markets. Inward remittance of US\$200,000 as assigned capital is still required, as for normal branch operations. However, ROHQs are entitled among other benefits, to a preferential tax rate of 10% on their income.

The incentives available to RHQs and ROHQs are discussed in Chapter 4.

### **Formation procedures**

In the same manner as a corporation, a branch is required to register with the SEC

and the other government agencies before it may commence actual operations. Corporate documents of the head office are required to be submitted, among others. Proof that the head office is financially solvent is also required.

Within 60 days from the issuance of the license to transact business, a branch office is required to submit to the SEC securities with an actual market value of PHP100,000. Further, within six months after the end of each fiscal year, additional securities are required to be deposited equivalent in market value to 2% of the amount by which its income for that fiscal year exceeds five million Philippine pesos. The SEC also requires deposit of additional securities if the actual market value of the deposit securities decreased by at least 10% of their actual market value at the time of deposit. There are allowable deductions from the gross income such as sales returns, allowances, discounts, and direct costs and expenses incurred with foreign entities and related parties.

- **Formation costs**

The cost of registering a branch will depend on the amount of its assigned capital. Filing fees with the SEC are 1% of the assigned capital for the branch, while nominal filing fees will also be payable to the relevant local government unit.

- **Public disclosure of information requirements**

The public disclosure of information requirements for branches is the same as for corporations.

## **Conduct of the entity**

Because the directors of a foreign corporation are beyond the jurisdiction of the Philippine authorities, the Philippines does not have any rules governing the way the affairs of a branch should be conducted by its responsible officers. The security deposit requirements for branch operations were established to provide some cover against such eventualities. Further, the branch shall designate a resident agent in the Philippines who shall receive summons and legal processes for the branch. This will allow the SEC and other government agencies to acquire jurisdiction over the foreign corporation.

## **Liquidation, receivership**

To liquidate a branch office and repatriate its capital, a branch must file a petition with the SEC for withdrawal of its license to operate in the Philippines. The following conditions must be met:

- All claims that have accrued in the Philippines must have been paid, compromised, or settled.
- All taxes, imposts, assessments, and penalties, if any, lawfully due to the Philippine government or any of its agencies must have been paid.
- The petition must have been published once a week for three consecutive weeks in a newspaper of general circulation.

## **Books and records**

The books and record keeping requirements for branches are the same as for corporations.

## **Statutory audit**

The statutory audit requirements for branches are the same as for corporations.

## **Partnership**

A partnership has a separate legal personality from that of each of the partners. A partnership will be either general or limited, depending on the liability of the partners. A partnership is general when all the partners are personally liable for the contracts of the partnership once its assets are exhausted. In a limited partnership, at least one partner has unlimited personal liability, but the liability of other partners is limited to the amount of their capital contributions.

A partnership is the legal entity commonly used by professionals seeking to exercise their common profession, such as accountants and lawyers. For tax purposes, they are referred to as “general professional partnerships,” and are taxed as conduit vehicles, rather than as corporations as in the case for other partnerships (see Chapter 19). Under the Civil Code, however, they are treated as any other partnership.

In general, any person who can enter into contractual relations may become a partner. A partnership can also become a partner in another partnership, either with natural persons or with other partnerships.

Generally, a corporation is not qualified to be a partner in a partnership. However, the SEC may allow a corporation to become a partner in a partnership where the contract of partnership provides that it is to be managed jointly by all the partners and that the partners are to be collectively liable to partnership creditors. The corporation must also be permitted to enter into a partnership under its articles of incorporation.

A partnership with more than PHP3,000 in capital must register with the SEC. Registration follows the pattern outlined above for corporations. The filing fee for the articles of partnership is the greater of PHP1,000 or 0.2% of the partnership capital.

Partnerships are subject to the same record keeping and statutory audit requirements as corporations (see Chapter 11).

## **Joint venture**

Corporations may enter into a consortium among themselves to finance a specific venture and divide the profits according to the terms of the agreement. Joint ventures, while not expressly recognized as such under the Civil Code of the Philippines, are afforded the same legal status as a partnership.

Joint ventures are popular for investments in construction projects, or in energy operations pursuant to an operating or consortium agreement under a service contract with the Philippine government. In these cases, the joint venture will be treated as a conduit vehicle for tax



purposes, which overcomes the punitive nature of the tax rules applying to partnerships (see Chapter 19 for further discussion on this issue).

### ***Sole proprietorship***

Sole proprietors must register with the Department of Trade and Industry, as well as the appropriate local government unit. They are not usually subject to the regulations and requirements governing corporations and partnerships in the operation of their business. However, if the activity involves the practice of a profession included in the FINL, registration of an alien individual will not be allowed (see the list at the end of Chapter 5).

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# **Chapter 10**

## Labor relations and social security

### ***Investor considerations***

- The Philippines has a ready and steady supply of highly skilled and trainable labor, including professional, technical, managerial, and skilled workers. Workers have high productivity, and typically are fluent in English.
- Minimum wages vary by region and whether the employee is an agricultural or non-agricultural worker.
- Minimum wages are set by the Regional Wage Boards, and tend to be determined by what is considered a minimum liveable wage, rather than by measures of labor productivity.
- Employer and employee social security contributions are fairly nominal.
- Foreigners working in the Philippines are required to have employment permits and work visas or permits before they may commence their duties. Processing of applications normally takes one to two months.

## **Labor relations**

### **Availability of labor**

Philippine labor consists of English-speaking, highly qualified professional, technical, and managerial talent as well as skilled and semi-skilled manpower. Though many Filipinos have sought overseas employment, the country still has a surplus of manpower. Of the total workforce of 40.431 million, 2.763 million were unemployed and a further 7.158 million were underemployed. (Source: Bureau of Labor and Employment Statistics, [www.bles.dole.gov.ph](http://www.bles.dole.gov.ph))

### **Employer/employee relations**

Employer/employee relations are principally governed by the Labor Code of the Philippines. The Labor Code provides protection to labor and prescribes rules on such issues as wages, labor standards, health and safety, post-employment benefits, notice periods, and conciliation and arbitration procedures for the solution of labor/management problems. The Labor Code also makes unfair labor practice a criminal offense and provides that the rights of workers and trade unions are not to be repressed.

The Code was enacted in 1974 and has not been significantly revised since. The Code also tends to favor employees over employers, and practices that are commonplace in other jurisdictions – particularly for hiring and firing – may not be acceptable under Philippine law. Labor issues can be managed, but employers that

do not come to terms with local laws and practices can get into significant difficulties.

### **Unions**

The Constitution and the Labor Code generally grant workers and employees the right to form or join a labor organization or union of their own choice for the purpose of collective bargaining. However, supervisory employees and rank-and-file employees cannot be members of the same labor organization, and managerial employees are not eligible to join, assist, or form any labor organization.

The Philippine trade union movement is composed of several unions and federations with different ideological leanings. Unionized workers make up about 5.2% of the workforce. Unions are scattered in various places of work throughout the country and are either independent or affiliated with federations or trade union centers.

The strategies adopted by the National Conciliation and Mediation Board of the Department of Labor and Employment (DOLE) for preventing and resolving labor disputes have proven fairly effective in preserving industrial peace. In 2012, only 3 strikes occurred of the 207 strike notices filed for the year.

### **Employee training programs**

Employers, especially those in manufacturing and service industries, provide employee training programs. The government does not generally subsidize

training programs. The exception is for PEZA-registered firms and firms registered with other investment promotion agencies (e.g., Zamboanga Economic Zone Authority, Cagayan Economic Zone Authority), which are entitled to a special deduction for certain training expenses (see Chapter 4).

### **Employee participation in management**

While the Philippine Constitution recognizes the right of workers to participate in policy and decision-making processes affecting their rights and benefits, the intention is to refer to participation in grievance procedures and voluntary modes of settling disputes and not to formulation of corporate programs and policies. Thus, there is no law requiring labor representation in an enterprise's management. The Labor Code, however, promotes the creation of labor-management councils. In establishments with a union, the workers' representatives to the council shall be nominated by the exclusive bargaining representative. In organized establishments, the representative shall be elected directly by the employees at large.

### **Profit sharing**

There is no law requiring employers to adopt profit-sharing plans with their employees. However, profit-sharing plans can be adopted on a voluntary basis as an additional incentive for employees.

Some companies use stock options and bonuses based on performance and profit

contribution. A stock-option plan generally needs to be ratified by the vote of shareholders representing two-thirds of the outstanding capital stock of the employer.

## **Working conditions**

### **Wages and salaries**

Skilled and semi-skilled workers may be paid on an hourly, daily, or weekly basis. Employees must be paid at least the statutory minimum wage. Minimum wage levels vary by region, and whether the employee is an agricultural or non-agricultural worker. They tend to be established to a fair extent by what is considered a minimum liveable wage, rather than any measure of labor productivity. In international terms, however, minimum wages remain relatively low, and range from PHP419 per day for agricultural workers up to PHP456 per day for non-agricultural workers in Metro Manila as of December 2012.

Salaries of managerial and professional employees vary widely according to the employee's type of work, function, and position; and the employer's status, industry classification, union status, and location.

Please refer to Figure 1.

A presidential decree made compulsory the annual payment by way of bonuses of a "13th month" pay to "rank and file" employees not later than 31 December each year. The 13th month pay is 1/12 of the annual salary received from the same employer. A general practice has developed

**Figure 1 — Range of average daily wage rates of time-rate workers on full-time basis by major occupation groups, Philippines (In Pesos)**

CATEGORY	2007	2008	2009	2010	2011
	Ave	Ave	Ave	Ave	Ave
ALL WAGES AND SALARY WORKERS	266.65	278.93	290.73	306.53	317.44
Employed in:					
Private Households	123.35	123.30	125.85	133.20	138.99
Private Establishments	256.31	269.47	280.23	294.19	299.11
Government/ Government Corporations	435.32	448.10	473.58	502.75	557.91
Family-Operated Activities	226.90	209.40	250.79	223.08	245.28

Source: Bureau of Labor and Employment Statistics, [www.bles.dole.gov.ph](http://www.bles.dole.gov.ph)

that the 13th month salary is paid in two installments to be timed with school enrolment (May) and Christmas time in addition to any bonuses or profit-sharing privileges granted during the year. It is also common for the 13th month pay to be paid to managerial and supervisory staff.

Financially distressed companies may obtain an exemption from payment of the 13th month pay.

Basic employment contracts typically stipulate the amount of wages or salary, the basis for any bonuses and profit shares to be paid, entitlements to vacation and sick leave, and retirement pay and any other benefits that will be provided.

### Fringe benefits

Many large establishments voluntarily provide paid sick, vacation and holiday leaves, private pension plans, subsidized

meals, rice and transportation allowances, and group hospitalization and group life insurance benefits.

Once an employer has granted benefits to employees, they may not generally be eliminated or diminished under labor law.

In some establishments, executives and other high-ranking employees are provided with housing and car plans. This can be a useful tax planning tool, as preferential fringe benefit tax treatment applies to accommodation and motor vehicles (see Chapter 20). Expatriate executives usually enjoy greater fringe benefits than their local counterparts.

### Hours worked

An employee may be required to work for a maximum period of eight hours a day or 48 hours a week at the regular rate of pay. Legislated minimum differential rates exist

for overtime work, night shift work, rest day and holiday work. Employees are entitled to a minimum of one rest day per week.

The employer may compress the work days from six days (from Monday to Saturday) to five days (from Monday to Friday) and even to four days (from Monday to Thursday). DOLE allows Compressed Work Week Schemes, wherein work beyond eight hours will not be compensable by overtime premium provided the total number of hours worked per day shall not exceed 12 hours and 48 hours in a week. In any case, any work performed beyond 12 hours a day or 48 hours a week shall be subject to overtime premium.

These requirements do not apply, however, to government personnel, managerial employees, field personnel, dependent members of the family of an employer, domestic helpers and persons in the personal service of another, and employees who are paid by results as determined in appropriate regulations by the DOLE. Female employees are discouraged from being employed between 10pm and 6am, although companies can apply for an exemption from this restriction.

The Labor Code regulates the employment of women and minors except in circumstances prescribed under the Labor Code or in regulations issued by the Secretary of Labor. The employment of children below age 15 is not allowed unless their parents or guardians assume responsibility.

## **Paid holidays and vacations**

Statutory holidays granted with full pay to monthly paid employees are listed in Chapter 1. An employee with at least one year of service is entitled to an annual paid service incentive leave of at least five days. However, the prevailing practice is to provide two weeks paid vacation leave and two weeks paid sick leave per year. Most labor agreements contain provisions for the accumulation of paid vacation and their commutation (i.e., exchange of comparable pay for vacations not taken), normally within two years from the date of employment.

## **Equal opportunities**

Under the Labor Code and other statutory laws, equal work opportunities exist regardless of sex, race, and religion. However, the employment of nonresident aliens is subject to the issuance of relevant visas and work permits.

## **Health and safety**

The DOLE is responsible for the administration and enforcement of occupational safety and health standards set for all establishments. Local government units are also allowed to conduct industrial safety inspections of establishments within their jurisdictions.

An employer must keep a supply of such first-aid medicines and equipment as the nature and conditions of work would require. Some level of free medical and dental care facilities must also be provided to employees, with the minimum provision

based on the number of employees and whether working conditions are hazardous.

### **Termination of employment**

An employer may terminate the services of an employee for just cause, such as serious misconduct or gross and habitual neglect of duties. Applying the two notices and hearing rule, the dismissed employee should be notified initially of the ground for termination, specifying the particular act or omission constituting the ground. The employee is then entitled to be heard and present his defense. Thereafter, if there is still a valid ground for the dismissal, the notice of termination must be given to the employee. Employees dismissed for just cause are not entitled to any severance pay.

If an employee is illegally dismissed, suspended, or laid off, the DOLE may, after due process, order the reinstatement with back wages of the employee, or require the payment of termination pay, other benefits and remedies that it considers equitable under the circumstances.

Employees may also be terminated for other causes authorized under the Labor Code, such as the installation of labor-saving devices or redundancy. The employee must be given one month's notice of termination, and the DOLE must also be advised. The employee will be entitled to separation pay equal to the greater of one month's pay or one-half month's pay for every year of service depending on the reason for termination.

Employees may also be separated in certain circumstances for ill health. The employee will be entitled to separation pay equal to one month's pay or one-half month's pay for every year of service, whichever is higher.

## **Social security**

### **Social security system**

The Philippine social security system consists of the following bodies.

#### **1. Social Security System (SSS)**

The SSS was created to provide private employees and their families with protection against disability, sickness, old age, and death. The Government Service Insurance System (GSIS) is an equivalent system for government employees.

#### **2. Home Development Mutual Fund (HDMF)**

The HDMF is a provident savings system providing housing loans to private and government employees, and to self-employed persons who elect to join the Fund.

#### **3. Philippine Health Insurance Corporation (PhilHealth)**

The National Health Insurance Program is administered by PhilHealth, which is designed to provide employees with a practical means of paying for adequate medical care.

#### 4. Employees' Compensation Program

All employees must be covered by the Employees' Compensation Program of the Labor Code, administered through the SSS. The Program grants medical and rehabilitation services and disability and death benefits to employees. Premiums are collected from employers and paid to a State Insurance Fund administered by the Employees' Compensation Commission.

##### Coverage

All persons under the age of 60 who earn income from employment of more than PHP1,000 per month are required to contribute to the SSS. Government employees are required to contribute to the equivalent GSIS.

Employees are also required to contribute to the HDMF and PhilHealth. Membership is optional, however, for self-employed persons.

Foreign personnel are also required to make contributions. Opting out is not possible, except in limited circumstances under some of the Philippines' international social security agreements. In practice, however, the potential savings involved are generally insufficient to justify the efforts required to effect the exemption.

##### Contributions

Employee contributions for social security are deducted from the employee's salary payments. For 2012, the maximum monthly deductions are PHP500 for SSS,

PHP100 for HDMF, and PHP437.50 for PhilHealth.

Employers are also required to make contributions. SSS contributions are roughly 200% of the employee contributions, with a maximum employer contribution of PHP1,090 per month. Employer contributions for HDMF and PhilHealth are generally of the same amount as the employee contributions.

##### Benefits

Employee social security benefits include access to sickness and maternity leave benefits, retirement and disability benefits, and death benefits. By international standards, the benefits are not large. The maximum pension payable on retirement, for example, is PHP15,000 per month. Details of the employee benefits are set out in Appendix XI.

Employee benefits also include access to salary, education, and housing loans. A salary loan is an amount equivalent to a month's salary (up to a maximum of PHP30,000) granted by the SSS to a qualified employee at a stated rate of interest. The loan is generally payable within a two-year period through monthly salary deductions, which are remitted quarterly by the employer to the SSS.

Outbound expatriates are entitled to some social security benefits upon departing the Philippines. However, because the benefits are not large by international standards, the amounts involved are generally not worth pursuing.



## **Social security agreements**

The Philippines has concluded bilateral Social Security Agreements (SSAs) with Austria, Belgium, Canada, France, Netherlands, Quebec (a distinct and separate treaty from that concluded with Canada), Spain, Switzerland, the United Kingdom, and Northern Ireland. These agreements tend to be beneficial mainly for outbound Filipino workers, as they can potentially be exempted from the social security requirements of the country in which they work. For inbound expatriates, the agreements potentially allow them to opt out of Philippine social security requirements. However, because local social security contributions are very small by international standards, the potential savings are generally insufficient to justify the effort required to secure the exemption.

The first round of negotiations on draft agreement on social security with Sweden was held in September 1996 but has not progressed subsequently. Agreements with Indonesia, Italy, Micronesia, and Palau are pending ratification by their respective legislatures. Bilateral SSAs with Greece, Israel, South Korea, and Portugal are under negotiation. Recently, the Philippine government has also formed working groups tasked to draw up a bilateral SSA with Japan to facilitate convenient pension premium and benefit payments by and for both expatriate employers and employees, and further promote closer relations between the two countries.

## **Personal Equity and Retirement Account (PERA)**

In 2008, a law on the establishment of Personal Equity and Retirement Account (PERA) was enacted. PERA refers to voluntary retirement account established by and for the exclusive use and benefit of a “Contributor” for the purpose of being invested solely in PERA investment products in the Philippines. There are certain privileges/incentives available in the establishment of a PERA. The Contributor shall be given an income tax credit equivalent to 5% of the total PERA contribution. Income earned from investments of the maximum amount allowed is tax exempt. The same tax exemption applies to the distribution of the PERA upon retirement or death of the Contributor.

If a private employer decides to contribute to its employee’s PERA, the amount shall be allowed as a deduction from the employer’s gross income.

The Bangko Sentral ng Pilipinas passed the implementing rules of PERA on 21 October 2009, which took effect on 18 November 2009. The Bureau of Internal Revenue has likewise issued the Revenue Regulations implementing all aspects of tax administration related to this law, which took effect on 01 January 2012.

## ***Payroll costs***

### **Labor cost containment**

There are no wage control statutes in the Philippines, although the Labor Code generally prohibits employers from diminishing existing employee benefits. Minimum wage levels are reviewed and adjusted by Regional Wage Boards as the need arises, taking into consideration the prevailing economic conditions affecting the cost of living of wage earners, the viability of business and industry, and the interests of labor and management.

Employees may be terminated for justifiable reasons, including the installation of labor-saving devices and redundancy.

### ***Contracting and Sub-Contracting***

The Labor Code prescribes the conditions for regulating contracting and subcontracting, and the rights and obligations of parties to this arrangement.

Contracting and sub-contracting arrangements are allowed under a regulated environment to ensure the promotion of employment and the observance of the rights of workers. Labor-only contracting remains prohibited. Job contracting is permissible.

Job contracting allows companies to forecast manpower requirements and rationalize the right-sizing of their regular workforce.

## ***Foreign personnel***

### **Work permits**

To enter the Philippines, a foreign national is required to present a passport valid for at least six months from the date of entry. A visitor who is a national of a country with which the Philippines has a reciprocity agreement may enter the Philippines visa-free for an initial period of 21 days provided he/she has a valid plane ticket for onward travel from the Philippines. Other visitors will need to obtain an entry visa (such as business or tourist visa) before travelling to the Philippines. Visitors may file an application to extend their 21 days visa-free entry status or entry visa while they are in the Philippines.

Generally, foreign personnel who intend to work in the Philippines for more than six months are required to secure an Alien Employment Permit (AEP) from the DOLE and working visa from the Bureau of Immigration (BI) before they can legally start working. The working visa is issued only after the AEP has been secured.

AEP and working visa are valid for the term of employment/work in the Philippines. Renewals should be sought before the end of the period.

The processing of AEP applications by the DOLE is from three to four weeks, while the processing of the working visa by the BI is from four to six weeks.

Foreign personnel who will work in the Philippines for six months or less will only be required to secure a Special Work

Permit (SWP) from the BI before they can legally start working. The SWP is initially valid for three months and renewable for another three months. The processing of SWP applications by the BI is from two to four working days.

As part of its incentives program, the government has adopted a more liberal approach to work permit and working visa requirements of personnel employed by enterprises registered with the BOI, the PEZA, and similar agencies, and for foreign personnel employed by regional or area headquarters of multinational companies (see Chapter 4 for further details).

The BI has automated the entire process of registration. Foreign nationals who are issued immigrant and non-immigrant visa and other foreign nationals who are required to register under the Alien Registration Act are now required to register and apply for an Alien Certificate of Registration (ACR) I-Card. The ACR I-Card is a microchip-based credit card-sized identification card issued to registered foreign nationals replacing the paper-based ACR.

### **Special arrangements or concessions**

Employers are required to deduct social security contributions from the income of foreign personnel. However, the maximum deduction for 2012 is only PHP1,037.50 per month.

Foreign personnel are also entitled to benefits under the social security system. However, because the benefits are based on a maximum salary of PHP15,000 per

month, and are therefore not large by international standards, the amounts involved are generally not worth pursuing for foreign personnel.

### **Restrictions on employment**

Foreign nationals employed in supervisory, technical, or advisory positions in enterprises registered with the BOI or the PEZA should not exceed 5% of the total number of staff employed in each category. The duration of employment is limited to five years from registration, although this can be extended at the discretion of the BOI or the PEZA. Working visas issued to these foreign nationals are generally valid for one year, subject to renewal.

### **Living conditions**

Foreign personnel enjoy good living conditions, as the general cost of living in the Philippines is relatively low and their employment contracts normally provide for very generous compensation packages. English-speaking household help is available at reasonable salary rates. Dining places offering international and Filipino cuisine abound throughout the country, and are inexpensive by international standards. This is offset to some extent though by the cost of accommodation, utilities, and education.

Within the Makati area, which is the country's foremost business and commercial center and is an office location for most of the big national and multinational banks and corporations operating in the Philippines, apartment

rentals start at around PHP45,000 per month for a furnished one-bedroom apartment, and at PHP30,000 per month for studio-type bedroom in a condominium. The rentals for houses in the prime subdivisions in Makati starts at around PHP50,000 per month. At the top end of the market, rentals at around PHP140,000 to PHP160,000 (or more) per month are common.

Spouses and unmarried children under 21 years of age may accompany foreign personnel employed in the Philippines. The Philippines has a number of foreign schools accredited by the Western Association of Schools and Colleges that offer high quality instruction. There are also many private schools offering reasonable standards of education.

The visas issued to foreign personnel do not afford any inherent employment rights to other members of their family, and spouses who wish to work while in the Philippines must obtain an alien employment permit and a working visa in their own right.

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# **Chapter 11**

## **Audit requirements and practices**

### ***Investor considerations***

- All persons subject to internal revenue taxes are required to keep books of account, including proper records of all business transactions.
- The tax authorities require every person with gross sales or receipts exceeding PHP150,000 in any quarter to submit audited financial statements with their tax returns. Various other government agencies require persons under their supervisory powers to submit audited financial statements.
- The Securities and Exchange Commission (SEC) requires stock corporations with paid-up capital of at least PHP50,000 including branches of foreign corporations, to file the report of an independent certified public accountant (CPA) on their financial statements.
- Auditors must be independent of the entity that they are auditing.
- For local statutory audits, full-scope audit is required.

- The SEC requires external auditors to be changed or, in case of a firm, the signing partner to be rotated for public companies and secondary licensees every five years. The Bangko Sentral ng Pilipinas (BSP) requires the external auditor or the lead and concurring partner engaged by banks, quasi-banks, trust entities or non-stock savings and loan associations for regular audit or special engagements to be changed or rotated every five years. The Insurance Commission (IC) requires all insurance/reinsurance companies, professional reinsurers, insurance/reinsurance brokers, general agents, pre-need companies, and mutual benefit associations and trusts to change their external auditor/signing partner every five years. Such individual rotating after the pre-defined period should not participate in the audit engagement until a further period of time, normally two years, has elapsed.
- Isla Lipana & Co., a member firm of PwC, has highly trained staff and licensed professionals available to provide advice and assistance in the establishment and operation of a business enterprise and in meeting statutory audit and tax requirements and general regulatory compliance services.

## ***Statutory requirements***

### **Books and records**

All persons, natural or juridical, who are subject to tax must maintain books of account, consisting of a journal and a ledger or their equivalents. The books must be prepared in a native Philippine language, English, or Spanish. Persons whose gross quarterly sales, earnings, receipts, or output do not exceed PHP50,000 may keep and use a simplified

set of bookkeeping records, in a form authorized by the Secretary of Finance. Subsidiary books may also be kept as required by the particular business.

It is an administrative requirement that all books be registered with the Bureau of Internal Revenue (BIR) before they may be used. If computerized accounting systems, computerized books of account, or loose-leaf records will be used, permission must first be obtained from the BIR. For computerized books, microfilm of the

computer printouts and the bound volume of the original printouts will also need to be kept on file.

Companies incorporated under the Corporation Code are also required to keep records of all business transactions, minutes of meetings of directors and shareholders, and a stock and transfer book.

The Tax Code generally requires that books and records be retained for three years following the day on which the tax return for the year is filed (or is due to be filed if the return is filed early). However, local governments generally require records to be retained for five years, and the Philippine Stock Exchange (PSE) generally requires brokers and dealers in securities to retain their records for six years. In some circumstances, it may be prudent to retain books and records beyond these periods.

### **Audited financial statements**

In practice, all but the smallest of entities in the Philippines will be required to obtain the report of an independent CPA on their financial statements. This is because it is a statutory requirement that any corporation, partnership, or person whose gross sales, earnings, receipts, or output exceed PHP150,000 (approximately US\$3,660) in any quarter must file audited financial statements with their annual tax return. This annual tax return must be accompanied by a statement that management takes responsibility for the information and representation in the annual income tax return.

The SEC also requires the submission of audited financial statements by stock corporations with paid-up capital of at least PHP50,000 (approximately US\$1,220), including branches of foreign corporations. The financial statements must also be accompanied by a statement that management takes responsibility for the information and representations in the financial statements.

For corporations referred to under the implementing regulations of the Securities Regulation Code as “public companies,” the SEC also requires submission of periodic SEC reports and forms. Public companies are defined to be corporations having any of the following:

- A class of equity securities that has been registered for sale to the public without going through a formal listing;
- A class of equity securities that has been listed with registered exchanges; or
- Assets in excess of fifty million Philippine pesos and having 200 or more holders, at least 200 of whom are holding at least 100 shares of a class of its equity securities.

The SEC imposes monetary and/or non-monetary penalties and/or requires written explanations if corporations fail to file audited financial statements on time, or if the audited financial statements filed are deficient. The PSE, the BSP, the IC, the National Telecommunications Commission, the Board of Transportation, the Board of Investments, and other

government agencies also typically require audited accounts to be submitted by entities under their regulatory supervision.

In addition, the BSP, the National Electrification Administration, the SEC, and the IC require those who audit companies under their regulatory supervision to be accredited, with renewal of accreditation every three years. The Professional Regulatory Board of Accountancy (PRBOA) also requires auditors to be accredited, subject to periodic renewal.

The BIR does not require the submission of consolidated financial statements. On the other hand, the SEC rules and Philippine Financial Reporting Standards require that consolidated financial statements be prepared by the ultimate parent of a group of companies unless there are circumstances that preclude such consolidation.

An independent auditor is usually appointed by the board of directors of a corporation, by the audit committee (if there is one), or by the shareholders themselves, depending on the provisions of the corporation's by-laws. The SEC requires external auditors to be changed or, in the case of firm, the signing partner to be rotated for public companies and secondary licensees every 5 years. The BSP requires the external auditor or the lead and concurring partner engaged by banks, quasi-banks, trust entities, or non-stock savings and loan associations for regular audit or special engagements to be changed or rotated every five 5 years. The IC

requires all insurance/reinsurance companies, professional reinsurers, insurance/reinsurance brokers, general agents, pre-need companies, mutual benefit associations, and trusts to change their external auditor/signing partner every five years. Such individual rotating after the pre-defined period should not participate in the audit engagement until a further period of time, normally two years, has elapsed.

### **Accounting profession**

Formally, the Professional Regulation Commission (PRC) is the government agency responsible for regulating the accounting profession in the Philippines. Practical responsibility, however, lies more with the PRBOA, which is responsible for the licensure examination as well as for the promulgation and observance of professional ethics, rules to implement the Philippine Accountancy Law of 2004, and Continuing Professional Education, among other powers and functions. The PRBOA is currently made up of representatives from the profession in public practice, commerce and industry, government, and education and reports to the PRC.

To practice the accounting profession, a person needs to pass the licensure examination given by the PRBOA. Candidates for the examination must possess a bachelor degree in accountancy granted by a school, college, academy, or institute duly recognized and/or accredited by the Commission on Higher Education or other authorized government offices. The CPA title is conferred on the candidates



who pass the licensure examination. Foreign CPAs or their equivalent cannot practice accountancy in the Philippines; except when allowed under the foreign reciprocity provisions in the international treaty with their respective countries, and only upon submission of the necessary documents and obtaining the necessary clearance from the PRBOA. They are further subject to the observance of the accreditation rules of regulatory agencies.

The Philippine Institute of Certified Public Accountants (PICPA) is the national accredited professional organization of all CPAs in the country. It holds annual conventions, seminars, and monthly membership meetings to which speakers in accounting and allied fields are invited. Through PICPA, the country is actively represented in the world's major accounting bodies. Foremost among these international organizations is the International Federation of Accountants (IFAC), the broad objective of which is the development and enhancement of a well coordinated worldwide accountancy profession functioning under harmonized standards. Another organization is the Confederation of Asian and Pacific Accountants (CAPA), which seeks the development of a coordinated regional accounting profession with harmonized standards. Finally, there is the ASEAN Federation of Accountants (AFA), which strives to work together in a spirit of cooperation with the ASEAN region's varied groups whose economic efforts may be complemented by the accountancy profession. PICPA had assumed the overall

leadership of these organizations in a number of times and has been taking active roles in the pursuit of their respective goals. PICPA also had a significant part in the formative years of these organizations. PICPA, as the accredited professional organization, has been provided with expanded roles through the implementing rules and regulations of the Philippine Accountancy Law of 2004.

Two standard-setting bodies constituted under that Law are the Financial Reporting Standards Council (FRSC) and the Auditing and Assurance Standards Council (AASC). Both bodies issue accounting and auditing pronouncements to guide professional accounting and auditing practice in the Philippines, respectively; and are guided in their pronouncements by developments in international financial reporting standards and auditing standards.

As required by the auditing standards, the external auditor appointed by the company should be independent, that is, the auditor must be free from any obligation to or interest in the particular client under audit, its management or its owners. The auditor must avoid situations that may lead outsiders to doubt that independence. The Revised Code of Ethics for Professional Accountants in the Philippines, which is parallel to that issued by the IFAC, was approved on 12 October 2008. The Revised Code of Ethics provides a principles-based framework for identifying, evaluating, and responding to threats to independence, outlines the threats to independence, and prescribes safeguards capable of

eliminating such threats or reducing them to an acceptable level. The local accounting profession may provide certain permitted non-audit services as long as these services do not compromise the independence and objectivity of the external audit. The SEC, through a Circular Memorandum, prohibits an accredited external auditor from rendering certain non-audit services to clients that are public companies, secondary licensees of the SEC, and all other companies covered by the said Circular.

### **Auditing standards**

The statements on auditing standards issued by the AASC are embodied through the Philippine Standards on Auditing (PSA) and Philippine Auditing Practice Statements (PAPS).

The typical unqualified auditor's report is worded as follows.

We have audited the accompanying financial statements of ABC Company, which comprise the statements of financial position as of December 31 (Year A) and (Year B) and the statements of total comprehensive income, statements of changes in equity, and statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

#### **Management's Responsibility for the Financial Statements**

The management is responsible for the preparation and fair presentation of these financial statements in accordance with Philippine Financial Reporting Standards, and such internal control as management

determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Philippine Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### **Opinion**

In our opinion, the accompanying financial

statements present fairly, in all material respects, the financial position of ABC Company as of December 31 (Year A) and (Year B), and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards.

These have been renamed locally as Philippine Standards on Auditing (PSAs) and Philippine Auditing Practice Notes (PAPNs).

The deviations from this form are required if the auditor cannot be satisfied as to the validity or reasonableness of any of management's assertions on the financial statements. The statements of total comprehensive income, changes in equity, and cash flows for public companies are required to be prepared for three years. The other documents which are required to be filed with the audited financial statements for particular groups of entities are provided in Rule 68 of the Securities Regulation Code, as amended, issued by the SEC.

The Chairman of the Board, Chief Executive Officer, and Chief Finance Officer shall all sign the Statement of Management's Responsibility. Failure of any of the prescribed signatories to sign constitutes a material deficiency in the financial statements.

### ***Trends in the development of auditing***

In line with its aim of achieving uniformity of the local generally accepted auditing standards with international standards on auditing, the AASC has adopted all International Standards on Auditing (ISA) and International Auditing Practice Notes issued by the International Auditing and Assurance Standards Board (IAASB).

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# Chapter 12

## Accounting principles and practices

### *Investor considerations*

- Philippine Financial Reporting Standards (PFRS) is the primary financial reporting framework in the Philippines.
- Qualified Small and Medium-sized Enterprises (SMEs) should use PFRS for SMEs as their financial reporting framework, with certain exceptions.
- The Securities Regulation Code (SRC) Rule 68 sets out the general financial reporting requirements for the following entities:
  - Stock corporations with paid-up capital stock of PHP50,000 or more;
  - Non-stock corporations with total assets of PHP500,000 or more, or with gross annual receipts of PHP100,000 or more;
  - Branch offices of stock foreign corporations with assigned capital in the equivalent amount of one million Philippine pesos or more;
  - Branch offices of non-stock corporations with total assets in the equivalent amount of one million Philippine pesos or more; and

- Regional operating headquarters of foreign corporations with total revenues in the equivalent amount of one million Philippine pesos or more.
- There are various government regulatory bodies in the Philippines, such as the Securities and Exchange Commission (SEC), the Professional Regulatory Board of Accountancy (PRBOA), the Professional Regulation Commission (PRC), the Bangko Sentral ng Pilipinas (BSP), and the Insurance Commission (IC), which may establish additional reporting requirements for entities over which they have jurisdiction. Close attention must be given to the issuances of the SEC because of the extent of its monitoring responsibilities and the powers accorded to it under the SRC. The SRC governs the registration and issuance of securities and allows the SEC to prescribe the form and content of financial statements and other periodic information to be filed by corporations covered by the SRC.
- Existing revenue issuances also require certain disclosures to be made in the notes to the financial statements that will be attached to the income tax returns to be filed with the Bureau of Internal Revenue (BIR).
- Listed and public companies are subject to more stringent reportorial requirements and more extensive financial statement disclosures as required by Part II of the SRC Rule 68.
- In addition to the annual audited financial statements, the SEC requires submission of the General Information Sheet (GIS) 30 days after the date of the annual stockholders' meeting. If no such meeting was held during the year, the GIS shall be filed not later than January of the following year.
- SEC Memorandum Circular No. 8, series of 2009, provides the scale of fines for non-compliance with the financial reporting requirements of the SEC.

## Accounting principles

The most authoritative sources of generally accepted accounting principles (GAAP) in the Philippines are the accounting standards issued by the Financial Reporting Standards Council (FRSC), as endorsed and approved by the PRBOA, the PRC, and the SEC. The accounting standards issued by the FRSC are embodied in PFRS and Philippine Accounting Standards (PAS), collectively referred to as PFRS. The Philippine Interpretations Committee (PIC) issues implementation guidance on PFRS and PAS. Such implementation guidance is approved for issuance by the FRSC. If the FRSC has not published a standard, the published standards of other authoritative professional bodies, such as the International Accounting Standards Board (IASB) will have persuasive effect in determining GAAP. In the absence of such standards, reference may be made to accounting principles and practices with long history of acceptance and usage.

SRC Rule 68 sets out the acceptable financial reporting framework in the Philippines, depending on the type of entity, as follows:

1. For large and/or publicly-accountable entities – PFRS
2. For qualified SMEs – PFRS for SMEs
3. For micro-entities – income tax basis, accounting standards in effect as of 31 December 2004 or PFRS for SMEs

Large and/or publicly-accountable entities are those that meet any of the following criteria:

1. Total assets of more than three hundred fifty million Philippine pesos or total liabilities of more than two hundred fifty million Philippine pesos;
2. Are required to file financial statements under Part II of SRC Rule 68;
3. Are in the process of filing their financial statements for the purpose of issuing any class of instruments in a public market; or
4. Are holders of secondary licenses issued by regulatory agencies.

SMEs are those that meet all of the following criteria:

1. Total assets of between three million Philippine pesos to three hundred fifty million Philippine pesos or total liabilities of between three million Philippine pesos to two hundred fifty million Philippine pesos. If the entity is a parent company, the said amounts shall be based on the consolidated figures;
2. Are not required to file financial statements under Part II of SRC Rule 68;
3. Are not in the process of filing their financial statements for the purpose of issuing any class of instruments in a public market; and
4. Are not holders of secondary licenses issued by regulatory agencies.

For qualified SMEs, the application of PFRS for SMEs is mandatory except when the entity meets any of the following criteria:

- a. It is a subsidiary of a parent company reporting under full PFRS;
- b. It is a subsidiary of a foreign parent company that will be moving towards International Financial Reporting Standards (IFRS) pursuant to the foreign country's published convergence plan;
- c. It is a subsidiary of a foreign parent company that has been applying the standards for a non-publicly accountable entity for local reporting purposes, and is considering moving to full PFRS instead of the PFRS for SMEs in order to align its policies with the expected move to full IFRS by its foreign parent company pursuant to its country's published convergence plan;
- d. It has short-term projections that show that it will breach the quantitative thresholds set in the criteria for an SME, and the breach is expected to be significant and continuing due to its long-term effect on the company's asset or liability size;
- e. It is part of a group, either as a significant joint venture or an associate, that is reporting under full PFRS;
- f. It is a branch office or regional operating headquarters of a foreign company reporting under the full IFRS;
- g. It has a concrete plan to conduct an initial public offering within the next two years;
- h. It has a subsidiary that is mandated to report under full PFRS; or
- i. It has been preparing financial statements using full PFRS and has decided to liquidate.

Micro-entities are those that meet all of the following criteria:

1. Total assets and total liabilities are below three million Philippine pesos;
2. Are not required to file financial statements under Part II of SRC Rule 68;
3. Are not in the process of filing their financial statements for the purpose of issuing any class of instruments in a public market; and
4. Are not holders of secondary licenses issued by regulatory agencies.

### ***Differences between PFRS and IFRS***

PFRS is substantially consistent with IFRS except for the following:

1. For pre-need companies, the financial reporting framework is set forth in Pre-Need Rule 31, as amended: Accounting Standards for Pre-Need Plans and Pre-Need Uniform Chart of Accounts (PNUCA). PFRS apply to the extent that they are not superseded by the provisions of the Amended Pre-Need Rule 31.

2. For banks, certain exchange offers of the Bureau of Treasury of eligible government securities to new government bonds were exempted from the tainting provision of PAS 39, *Financial Instruments: Recognition and Measurement*, subject to conditions specified in the SEC Notice dated 19 January 2006.
3. For mining companies, pre-2005 hedging contracts were exempted from the fair value requirements of PAS 39 subject to conditions specified in the SEC Notice dated 30 November 2006.
4. For Philippine financial reporting purposes, the mandatory application of International Financial Reporting Interpretations Committee 15 (IFRIC 15), *Agreements for the Construction of Real Estate*, has been deferred indefinitely by the SEC. Until the effectivity of IFRIC 15, entities are allowed to apply the percentage-of-completion method from the sales of property under pre-completion contracts in accordance with PIC Q&A No. 2006-01.
5. PAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, is consistent with IAS 20 in all material respects, except for the accounting of government loans with low interest rates received prior to 1 January 2009. PIC Q&A 2007-02 presents three alternative accounting methods.
6. In availing of the exemption from preparing consolidated financial statements under PAS 27, Consolidated and Separate Financial Statements, PIC Q&A 2006-02 states that other financial reporting standards that are converged or virtually converged with IFRS, or are conceptually similar to IFRS, are deemed acceptable in applying the provisions of PAS 27 paragraph 10(d).
7. SEC Financial Reporting Bulletin (FRB) No. 006 provides guidance on the proper classification of deposits for future stock subscription (i.e., equity vs. liability). According to this bulletin, an entity shall classify a contract to deliver its own equity instruments under equity as a separate account from “Outstanding Capital Stock” if and only if, all of the following elements are present as of end of the reporting period:
  - a. The unissued authorized capital stock of the entity is insufficient to cover the amount of shares indicated in the contract;
  - b. Board of Directors approval of the proposed increase in authorized capital stock (for which a deposit was received by the corporation);
  - c. Stockholders approval of said proposed increase; and
  - d. The application for the approval of the proposed increase has been filed with the SEC.



## **Local regulations affecting financial reporting**

SRC Rule 68 provides most of the reportorial and disclosure requirements of covered entities on top of what is required under PFRS, including, but not limited to, the following:

- An entity that has unrestricted retained earnings in excess of 100% of its paid-in capital stock is required to prepare a Reconciliation of Retained Earnings (Annex 68-C) in accordance with SEC FRB No. 014, and to disclose in its financial statements its concrete plan to comply with Section 43 of the Corporation Code, which states that “stock corporations are prohibited from retaining surplus profits in excess of one hundred (100%) percent of their paid-in capital stock, except [in certain conditions].”
- An entity that has incurred a capital deficiency (i.e., negative equity) is required to disclose in the notes to its financial statements a concrete plan to address the capital deficiency.
- Part I Section 4 of SRC Rule 68 provides the list of other documents to be filed together with the financial statements, which are applicable to non-stock and non-profit organizations, foundations, issuers of securities to the public, secondary licensees, public companies, financing companies, mutual funds, investment houses, listed companies, and large and/or publicly-accountable entities.
- Part II of SRC Rule 68 sets forth the additional reportorial requirements for

listed and public companies. It includes, among other things, the presentation of three-year statements of comprehensive income, changes in equity and cash flows, submission of interim financial statements, as well as quarterly and annual reports, inclusion of additional disclosure requirements in the notes to the financial statements (Annex 68-D), and submission of supplementary schedules (Annex 68-E).

SEC Memorandum Circular No. 16, series of 2009, provides that the management of the company is responsible for the preparation and presentation of financial statements in accordance with the applicable financial reporting framework, including all disclosures and their supporting documentation. It states that the company should neither allow nor require its external auditor to prepare its financial statements and/or any of its supporting documents.

The BIR likewise mandates additional disclosure requirements in the notes to the financial statements, as follows:

- Disclosure of information on taxes, duties, and license fees paid or accrued during the year in addition to what is mandated by PFRS (Revenue Regulations 15-2010).
- Disclosure of schedules of sales/receipts/fees, cost of sales/services, non-operating and taxable other income, itemized deductions (if the taxpayer did not avail of the Optional Standard Deduction or OSD), and taxes

and licenses (Revenue Regulations 19-2011).

### **Functional currency reporting**

The SEC and BIR allow companies to adopt functional currency reporting in their financial statements. Under this method, a company may present its financial statements in a currency other than the Philippine Peso (e.g., U.S. Dollar, Japanese Yen, Euro), if such currency is the company's functional currency. In determining the functional currency, the company's operating, investing, and financing activities are considered.

Before adopting the functional currency reporting (other than the Philippine Peso), the company should notify the SEC within 45 days after the end of the year in which the company intends to initially present a functional currency financial statement. The company should also notify the BIR, using the duly received SEC notification, within 30 days from filing of the SEC notification. In the case of a change in functional currency, the company should notify the SEC within 30 days after the end of the year in which the change occurred. The notification to the SEC should be accompanied by the company's external auditor's evaluation that the company is qualified to adopt functional currency reporting (other than the Philippine Peso).

For tax reporting purposes, companies can use their functional currency books as basis in determining their tax liabilities. However, the tax returns to be filed with the BIR shall still be presented in Philippine

Peso. For the income tax filing, the company's income and expenses may be translated to Philippine Peso using the monthly average exchange rate. For the other tax filings, the exchange rate at transaction date shall be used in computing the tax liability.

The exchange rates provided by the BSP are normally used in translating the functional currency transactions to Philippine Peso.

Companies adopting functional currency reporting (other than Philippine Peso) can maintain their general ledger in functional currency and are not required to maintain a separate general ledger in Philippine Peso. They should, however, maintain subsidiary ledgers for the translation of other tax liabilities from functional currency to Philippine Peso.

### **Trends in the development of accounting**

#### **Harmonization with international accounting and auditing standards**

There is global trend toward the harmonization of accounting and auditing standards, particularly the convergence project to align IFRS with US GAAP, so that financial statements and preparation procedures will become more comparable across international borders. The Philippine accounting profession has been responsive to this development, and local accounting and auditing standards setters are continuing to adopt international developments in IFRSs and ISAs.

# Chapter 13

## Tax system

### *Investor considerations*

- Domestic corporations and resident citizens are subject to Philippine tax on worldwide income; foreign corporations, nonresident citizens, and aliens are subject to Philippine tax on Philippine-sourced income.
- Corporate profits are subject to classical taxation; income is taxed when earned by a corporation, and again in the hands of the shareholders upon distribution.
- Active income is generally aggregated and subjected to ordinary income tax. Passive income is generally subject to flat tax, with the rate depending on the type of income realized.
- The taxation of foreign entities engaged in business activities in the Philippines will be influenced by whether they are licensed to do business by the Philippine Securities and Exchange Commission (SEC). Unlicensed foreign entities are generally taxed on gross income, whereas licensed foreign entities are taxed on net income.

## Principal taxes

The principal taxes are as follows:

1. Income tax, applying to both income and gains
2. Taxes on transactions:
  - a. Estate and donor's (gift) taxes;
  - b. Value-added tax;
  - c. Excise taxes;
  - d. Tariff and customs duties;
  - e. Percentage taxes;
  - f. Documentary stamp tax; and
  - g. Local business taxes.

3. Taxes on property:

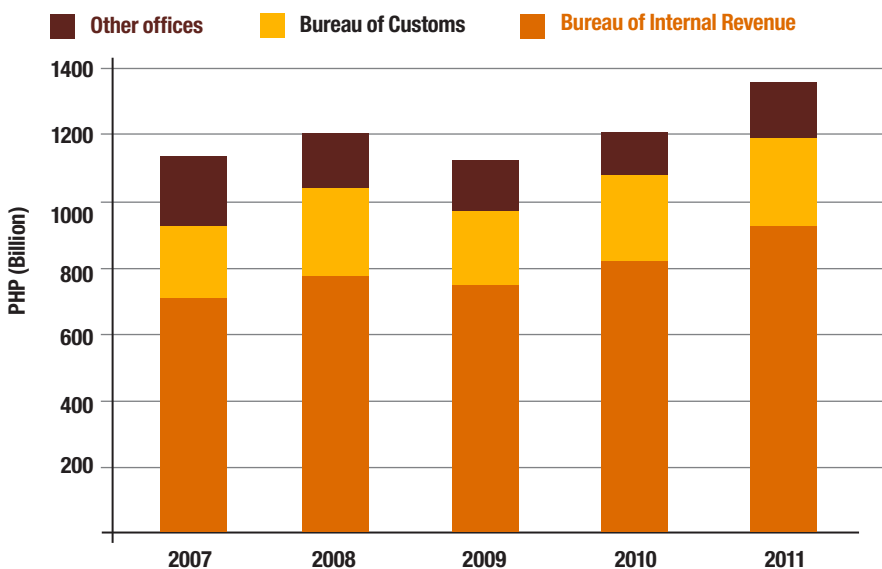
- a. Real property tax; and
- b. Idle land tax.

## Direct and indirect tax burden

The Philippine Government collects the bulk of its revenue through the Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC).

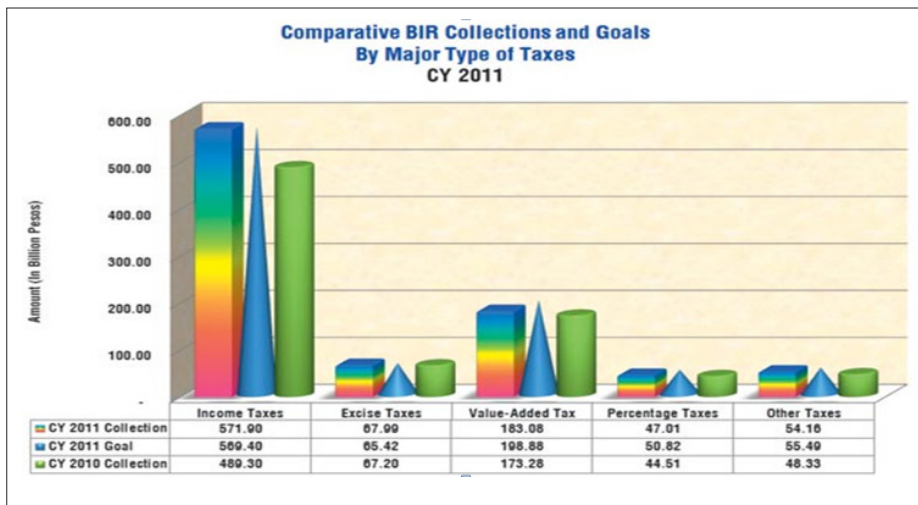
As illustrated in Diagram III, there had been a steady increase in government revenue during the past five years, from 1,136.6 billion Philippine pesos in 2007 to 1,359.9 billion Philippine pesos in 2011 but with slight decline in 2009 at 1,123.2

**Diagram III — Collection of Government Revenue by Agency (in PHP billion)**



Source: Department of Finance

**Diagram IV — BIR collection, by type (in PHP billion)**



Source: Bureau of Internal Revenue

billion Philippine pesos. The contribution of the BOC started to increase by 18% in 2003 to as high as 24.2% in 2008, but declined by 15.3% in 2009. It then constantly increased at 18.6% in 2010 and 2.3% for 2011. The contribution of the BIR is at 67.95% as of tax year 2011. Non-tax revenues marked its highest contribution in 2007 at 18.8% but gradually declined before settling at 12.6% in 2011.

The BIR collects revenues from a variety of tax sources. The mix of taxes collected for the years 2010 and 2011 is shown in Diagram IV.

All types of taxes collected for the CY 2011 are higher than CY 2010 collections, with income tax and excise taxes exceeding their collection targets for 2011. Excise taxes posted the largest surplus of 3.94%,

while income tax collection surpassed both target and CY 2010 collection by 0.44% and 16.88%, respectively. VAT collections for 2011 are 5.65% higher than CY2010 collections.

### **Legislative framework**

#### **Statute law**

Under the Philippine Constitution, all laws, including tax statutes, must be passed by Congress and approved by the President. Laws generally take effect 15 days following their publication in the Official Gazette or in a newspaper of general circulation, unless otherwise provided in the statute.

The general taxation framework for the Philippines is set out in the National

Internal Revenue Code of 1997, commonly referred to as the NIRC or the Philippine Tax Code. However, laws relating to tax incentives are generally contained in Executive Order (EO) 226 or the Omnibus Investments Code or in the statute governing the relevant investment incentives.

Legislative amendment by Congress is infrequent. However, the Tax Code affords the BIR a broad regulatory authority. Although this authority must be exercised in accordance with principles established in the Tax Code, the courts generally afford the BIR a degree of latitude on how it interprets the statute. Thus, close monitoring of the frequent regulations and rulings issued by the BIR needs to be made.

As a general rule, amendments to the law and regulations and rulings issued by the BIR do not have retroactive effect.

### **Case Law**

Judicial interpretations can generally be used as precedents in interpreting tax law, although their value will depend on the issues involved and the authority of the court rendering the decision. The BIR, in administering the law, will follow decisions issued by the Supreme Court, and less persuaded by decisions of the lower courts.

The National Internal Revenue Code or Commonwealth Act 466, issued in 1939, on which the current Tax Code is based, was largely adapted from the United States Tax Code of that time. Before 1939, the United States income tax laws applied directly to the Philippines. Because of this, decisions

on tax laws issued by the United States Supreme Court and other United States courts continue to be persuasive in interpreting Philippine tax laws.

### **Anti-avoidance**

The Philippine Tax Code does not contain any significant anti-avoidance rules. The courts have also recognized the doctrine from the United States Supreme Court that a “taxpayer has the legal right to decrease the amount of what otherwise would be his taxes or altogether avoid them through means which the law permits.”

### **Form versus substance**

Provided the form of an arrangement is consistent with the intention and actions of the parties, the BIR can be expected to honor the form of the arrangement, unless the arrangement is contrary to law. If the intention or action of the parties to an arrangement differs from its form, or the arrangement is a sham, the BIR can be expected to look beyond the form in making an assessment.

### **Securing a tax ruling**

Officers of the BIR are generally willing to discuss or comment on the tax consequences of contemplated transactions. The officer’s opinion is not binding, however, unless issued in the form of a ruling. A BIR ruling is issued only when requested by a specific taxpayer and cannot be issued on a no-name basis and if based only on hypothetical facts.

Although a ruling is strictly valid only for the person to whom it is issued, it will have persuasive effect for other taxpayers with similar transactions. A BIR ruling is binding until revoked.

The BIR requires taxpayers to obtain advance approval for the following:

1. Changes in accounting periods or accounting methods;
2. Use of Computerized Accounting Systems, computerized books of accounts, or loose-leaf records; and
3. Application of tax treaty provisions and benefits.

It may also be prudent for taxpayers to seek advance rulings in other situations, particularly when application of the law is unclear. Because such a ruling will bind the BIR, it ensures that problems will be avoided in a subsequent audit provided the facts as represented in the ruling remain to be the same.

## **Income tax**

### **Concepts of income taxation**

In general terms, the Philippine tax system distinguishes between the taxation of active and passive income.

Active income earned by a taxpayer from various sources is generally aggregated and subjected to tax as a whole. Individuals are subject to tax at progressive rates between 5% and 32% on taxable income, while corporations are subject to a flat rate of 30%. For domestic corporations and branches of foreign corporations, there is a

minimum income tax equal to 2% of their gross income (sales less cost of sales) beginning on the fourth taxable year immediately following the year in which they register and commence business operations (see Chapter 15).

Passive income is generally subject to flat rates of tax ranging from 5% to 30%, depending on the character of the income and the taxpayer concerned.

For corporations, the Philippines has adopted the classical system of taxation. Profits are taxed once at the corporate level, and then again in the hands of the shareholder (unless it is a domestic corporation or a branch of a foreign corporation) once they are distributed. No credit is given to shareholders to recognize tax paid by the corporation.

### **Classes of taxpayer**

Persons are classified for tax purposes either as individuals or corporations. Trusts are generally subject to tax as if they are individuals. Partnerships, joint ventures, and other corporate bodies, whether incorporated or not, are generally taxed as corporations; except for general professional partnerships and certain joint ventures or consortium formed for undertaking construction projects or engaging in petroleum exploration, which are taxed as conduit entities (see Chapter 19).

Taxable persons are further segregated based on their citizenship, and whether they are resident or nonresident. Resident

citizens and domestic corporations are subject to tax on their worldwide income. Nonresident citizens, resident and nonresident aliens, and foreign corporations are subject to tax only on their Philippine-sourced income.

In practice, an important determinant for how the business activities of foreign entities will be taxed is whether they are licensed by the Philippine SEC to do business in the Philippines. A licensed corporation will be treated as a “resident foreign corporation,” subject to 30% tax on its net Philippine-sourced income.

An unlicensed foreign corporation is treated as a “nonresident foreign corporation,” subject to 30% final withholding tax on its gross Philippine-sourced income. Under the Tax Code, no deduction is given for expenses incurred by such nonresident corporation even if the income arises from the sale of goods. This treatment can be overcome, however, if the corporation is a resident of a country with which the Philippines has a tax treaty. Please note that similar to the nonresident foreign corporation, a nonresident alien not engaged in business and trade in the Philippines is taxed based on his gross Philippine-sourced income, subject to 25% tax (see Chapter 16 for further discussion on these issues).

### **Taxable income**

The components of gross income include traditional items of income, such as compensation for services, gross income from the conduct of trade or business or the

exercise of a profession, gains from dealings in property, interests, dividends, rents, royalties, and pensions and annuities.

Prizes and winnings in general are also included in gross income, along with the distributive share of a partner from the net income of the general professional partnership to which he belongs.

Capital gains arising from the sale of shares of stock of domestic corporations and from the sale of real property are subject to special tax rates (see “Capital gains” in Chapter 15). Other gains are taxed as ordinary income.

### **Tax year**

The standard fiscal year aligns with the calendar year (31 December). However, corporations may adopt an alternative fiscal year for reporting income (see “Accounting period” in Chapter 15).

### **Tax-free zones**

Qualified enterprises located in special economic zones are entitled to income tax holiday (ITH) in their initial period of operations. Once the ITH period expires, they are subject to a 5% tax on their gross income (sales less direct costs) in lieu of all other local and national taxes (see Chapter 4).

### **Tax holidays**

Enterprises registered with the Board of Investments (BOI) and Philippine Economic Zone Authority (PEZA) are generally entitled to ITH for the first three



to eight years of operations, depending on the nature of the activities being undertaken (see Chapter 4).

### **Capital taxation**

The Philippines does not generally impose any taxes based on wealth or capital. There are some exceptions, as follows:

- The issue of new shares in a company is subject to documentary stamp tax equivalent to PHP1 on each PHP200 or a fractional part thereof, of their par value.
- Initial public offerings of closely held corporations give rise to a tax of up to 4% of the issue price of the shares.
- The gifting of property is subject to donor's tax (see Chapter 20). The Philippines also imposes an estate tax (see Chapter 21).

### **International aspects**

#### **Foreign operations**

Domestic corporations and resident citizens are subject to tax on their worldwide income. Under the Tax Code, relief for double taxation is provided by way of either a deduction or a non-refundable credit for foreign taxes (see Chapter 18). Philippine tax treaties also provide for a credit to be given for foreign taxes (see Chapter 24).

#### **International financial center operations**

The Philippines offers tax concessions to encourage the establishment of offshore banking units and of regional or area headquarters or regional operating headquarters of multinational companies (see Chapter 4).

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# Chapter 14

## Tax administration

### *Investor considerations*

- Taxpayers are generally required to file several tax returns on a monthly, quarterly, and annual basis.
- Tax deficiencies are subject to a 25% surcharge, as well as interest at a rate of 20% per annum. For fraud, falsehood or wilful neglect, the surcharge is 50%.
- Failing to file a return either on time or at the prescribed location may attract a 25% surcharge.
- Failure to account properly for withholding tax may result in the underlying payment becoming non-deductible for income tax purposes.

## ***Administration of the tax system***

Taxes are imposed both at the national and local government levels. The Bureau of Internal Revenue (BIR) administers national taxes imposed under the National Internal Revenue Code. The treasurer and assessor offices of the different local government units administer local taxes imposed under the Local Government Code. The Bureau of Customs collects taxes and duties on imports.

Although the taxes are commonly levied on the same income base, each agency is separately responsible for collecting the revenues under its jurisdiction.

## ***Corporate taxpayers***

### **Income tax returns**

A domestic or a resident foreign corporation is required to file income tax returns on a quarterly basis. Within 60 days from the close of each of the first three quarters in its taxable year, the corporation must file in duplicate a return summarizing its gross income and deductions for the year to date. A final annual income tax return must be filed on or before the 15th day of the fourth month following the close of the tax year.

The place where a return must be filed is also prescribed. Filing a return in the wrong location may attract a penalty of 25% of the tax due, even though the return might have been filed and the tax paid on the due date.

Nonresident corporations generally do not file income tax returns because income

payments to them are subject to final withholding tax. If tax has been overdeducted from an income payment, a refund is sought by filing a formal claim for refund, rather than by filing a tax return.

The Commissioner of Internal Revenue (CIR) has authority to grant in meritorious cases extensions of time for filing income tax returns. In practice, however, extensions are rarely granted.

Audited financial statements must accompany the annual income tax returns of corporations, if their gross revenues exceed PHP150,000 in any quarter (see “Audited financial statements” in Chapter 11).

### **Self-assessment**

All returns are filed by taxpayers on a self-assessment basis, with the amount of tax calculated required to be paid at the same time that the return is filed.

After a return is filed, the CIR, through a duly authorized representative, is entitled to examine it (see “Tax audits” below). If the CIR does not consider the amount determined by the taxpayer to be correct, the taxpayer will be notified of the findings through a preliminary assessment notice. The preliminary assessment notice will also prescribe a time within which the taxpayer may respond to the notice. If the taxpayer fails to respond, the CIR will issue an assessment based on the findings.

### **Appeals**

Assessments issued by the CIR may be protested administratively by filing a

request for reconsideration or reinvestigation within 30 days from receipt of the final assessment notice. Otherwise, the assessment becomes final and may not be appealed. Upon filing of either request, the taxpayer must submit supporting documents within 60 days thereon, otherwise, the assessment shall also become final. If the protest is denied in whole or in part, the taxpayer may, within 30 days from receipt of the denial, appeal to the Court of Tax Appeals (CTA). Otherwise the decision becomes final, executory, and demandable. A CTA decision may be appealed to the CTA en banc within 15 days from receipt of notice thereof. The CTA en banc decision may in turn be appealed to the Supreme Court. The same period applies.

If the CIR fails to act on a protest within 180 days from receipt of the supporting documents, the taxpayer may file within the next 30 days after expiration of the 180-day period an appeal with the CTA in accordance with the procedures mentioned above. Alternatively, the taxpayer may wait for the CIR to make a decision and if the protest is denied, appeal the decision to the CTA within the normal 30-day appeal period from receipt.

Although the BIR is not precluded by the Tax Code from pursuing taxes that are in dispute, legal remedies are available to the taxpayer to prevent the collection of taxes while an appeal is pending.

## **Payment and collection**

Income tax payments must be made at the same time the corresponding return is filed.

## **Withholding taxes**

The following payments, among others, shall be subject to withholding of tax:

1. Salaries, wages, and other remuneration paid to employees;
2. Passive income, such as interest, dividends, royalties, prizes, and deemed capital gains on traded securities;
3. Income payments to certain residents, such as professionals and contractors; and
4. Fixed and determinable income payments to nonresidents.

To ensure withholding tax remittances for employees are correct, employers are required to compute the correct amount of tax for each employee for the entire year before paying their final payroll for the year. Any discrepancies between the correct tax for the year and the amounts actually deducted should be corrected in that payroll.

Except for the month of December, returns must be filed and payments remitted for withholding taxes within ten days at the end of each month. Returns and payments for December are due on 15 January. Taxpayers who are subject to the BIR's electronic filing and payment system (EFPS) are given a grace period ranging

from one to five days for filing their returns.

Failure to withhold and remit taxes may result in a combination of the non-deductibility of an otherwise deductible expense, an assessment for the deficiency withholding tax, and the imposition of corresponding surcharge and interest charges.

### **Tax audits**

The BIR conducts tax audits by examining the tax returns, books of account, and other supporting documents. An audit is usually conducted at the taxpayer's place of business. In the case of non-business tax returns of an individual, however, the audit is done at the BIR office, with the result communicated by mail.

After a tax audit, the taxpayer is usually called for a conference to discuss the findings of the BIR. If the taxpayer and the BIR cannot agree on the findings, a preliminary assessment notice is issued. The taxpayer can then submit his written objections, together with any supporting documents, or propose a basis for paying the deficiency tax and any corresponding penalties.

If the findings are not resolved, or the tax deficiency is not paid, a formal assessment is issued to the taxpayer. The taxpayer must then either pay the tax due as assessed or file a formal protest against the assessment (see the section on "Appeals" above).

### **Penalties**

Civil and criminal penalties are imposed for failure to comply with the provisions of the Tax Code. Civil penalties include a surcharge equivalent to 25% of the amount due, or 50% in the case of fraud, falsehood, or wilful neglect. The deficiency tax (but not the surcharge) is subject to annual interest of 20% from the date prescribed for payment until the amount is fully paid.

Criminal penalties consist of fine or imprisonment or both, depending on the gravity of the offense or violation upon conviction. An alien offender will be deported immediately after serving the sentence without further proceedings for deportation. In the case of corporations, the penalty is imposed on the officers and employees responsible for the violation. In addition, a fine is imposed on the corporation.

### **Statute of limitations**

There is no statutory obligation on the part of the CIR to make an assessment for internal revenue taxes, and most taxes are collected based on the taxpayer's self-calculation. If an assessment is to be issued, however, it must be done within three years from the deadline or the date of actual filing of the return, whichever comes later. The taxpayer and the CIR can, however, agree in writing to extend this period.

In the case of a false or fraudulent return or of failure to file a return, the tax may be assessed or a proceeding in court for collection may be commenced without

assessment at any time within ten years from the discovery of the falsity, fraud, or omission.

Any internal revenue tax that has been assessed within the period of limitation may be collected by distraint or levy or by a proceeding in court within five years following the assessment of the tax.

The prescription periods are suspended in certain circumstances, such as when the offender is absent from the Philippines, or the CIR grants a taxpayer's request for a reinvestigation, or the taxpayer and the BIR agree to a waiver of the prescriptive period for assessment.

In the case of overpayment of tax, a claim for refund or credit may be filed with the BIR within two years from the date of erroneous payment of the tax. If the claim is denied or no decision is received from the BIR, a petition for review may be filed with the CTA. This must be filed before the two-year period expires, and in the case of a denied claim, within 30 days from the receipt of the denial.

A claim for refund or issuance of tax credit certificate of input value-added tax (VAT) arising from zero-rated sales may be filed by a taxpayer within two years after the close of the taxable quarter when the sales were made. Further, a claim for refund or issuance of tax credit certificate for unutilized input VAT credits may be filed by the taxpayer within two years from closure or retirement of business (see Chapter 22).

## **Transfer pricing regulations**

Philippine law on transfer pricing is found in Section 50 of the Tax Code, authorizing the CIR to distribute, apportion or allocate gross income or deductions between or among related parties (whether or not organized in the Philippines) in order to arrive at the correct taxable income. Just recently, implementing regulations (Revenue Regulations No. 2-2013, otherwise known as the "Transfer Pricing Guidelines") were issued. These new regulations, which take effect from 09 February 2013, provide guidance in applying the arm's length principle to cross-border and domestic transactions between associated enterprises. It also mandates the maintenance of transfer pricing documentation without providing any threshold amount.

The new guidelines are largely based on the arm's length methodologies under the OECD Transfer Pricing Guidelines namely, Comparable Uncontrolled Price method, Resale Price method, Cost Plus method, Profit Split method, and Transactional Net Margin method. There is no hierarchy or preference for any one method. Instead, the pricing method that produces the most reliable measure of an arm's length result should be used.

The new guidelines also contain a provision on Advance Pricing Agreement or APA. An APA is an agreement entered into between the taxpayer and the BIR to determine in advance an appropriate set of criteria (e.g., method, comparable, and appropriate adjustments thereto) to

ascertain the transfer prices of controlled transactions over a fixed period of time. While securing an APA is optional, doing so reduces the risk of transfer pricing examination and double taxation. In the absence of an APA, the taxpayer may still invoke the provisions of the Mutual Agreement Procedure (MAP) under Philippine tax treaties to resolve double taxation issues. The MAP is a mechanism where two governments can mutually arrive at a satisfactory solution to eliminate double taxation issues arising from transfer pricing adjustments. The BIR will be issuing separate guidelines on APA applications and the MAP process.

There are no special provisions for a transfer pricing tax audit. Thus, the three-year regular statute of limitations applies.

The new guidelines do not indicate whether transfer pricing audits will be performed by a special task force or as part of the BIR's regular tax audit. What is clear though is that companies should expect BIR activities to intensify as a result of the new guidelines. Now, more than ever, documentation of arm's length dealings is key (see Chapter 16).

### **Local government taxes**

Local government business taxes are payable by 20 January of each year, based on the preceding year's gross sales or receipts declared to the local government unit where the business is conducted. The taxpayer has the option to make payments in four equal instalments by the 20th day of

the first month of each quarter. However, regulatory fees, e.g., mayor's permit, garbage fees, are payable in full on 20 January of each year.

Real estate taxes are payable each year to the city or municipality where the property is located. The owner has the option to pay the tax in four equal instalments on or before the last day of each calendar quarter.

## **Individual**

### **Tax returns**

An individual taxpayer other than a nonresident alien not engaged in business in the Philippines is required to file, on or before the 15th day of April, an income tax return for the preceding year. However, for taxpayers whose sole income arises from employment by a single employer and has been subjected to the correct withholding tax, the BIR has waived the filing requirement and allowed substituted filing instead.

### **Payment**

As a rule, any tax due must be paid upon filing of the return. However, if the tax due exceeds PHP2,000, the taxpayer may elect to pay one-half of the tax upon filing of the return and the balance on or before 15 July following the close of the calendar year.

Because of the requirement that employers adjust their withholding from the last payroll to ensure that correct deductions are made for the year, individuals whose income consists only of compensation

income derived from a single employer should not have any income tax payable when they complete their return.

### **Community property**

The property relations between husband and wife may be agreed upon before marriage. In the absence of such agreement, an absolute community of property governs. Under this arrangement, generally all the property owned by the spouses at the time of marriage or acquired thereafter belongs to both of them. Inherited or donated property remains the exclusive property of the recipient spouse.

### **Spouse**

For tax purposes, a husband and wife must file a joint income tax return, although their tax liabilities will be computed separately.

### **Foreign personnel**

Alien employees of regional or area headquarters and regional operating headquarters of multinational corporations, offshore banking units, and service contractors and subcontractors engaged in petroleum exploration in the Philippines are not required to file an income tax return with respect to income arising from their employment, since such income is subject to final withholding tax.

### **Exit permits**

There is no tax clearance requirement for an exit permit. A travel tax, however, is imposed on foreign travel of all citizens,

permanent resident aliens, and non-immigrant aliens who have stayed in the Philippines for at least one year.

### **Donor's tax**

Any individual who makes any transfer by gift (except those exempt by law) is required to file a donor's tax return within 30 days after the gift is made and pay the tax due thereon at the same time (see Appendix X for the rates of tax).

### ***Trusts, partnerships, joint ventures***

#### **Estates and trusts**

Estates and trusts are covered by the same filing and payment requirements that apply to individuals (see Chapter 21).

#### **Estate tax**

Where the gross value of an estate exceeds PHP200,000 or the estate consists of registrable property for which BIR clearance is required to transfer ownership, the executor, the administrator, or any of the legal heirs is required to file an estate tax return under oath within six months from the decedent's death. The filing period is extendible by 30 days, subject to the CIR's approval. The estate tax due must be paid upon filing of the return. However, if payment would place undue hardship on the estate, the payment period may also be extended to two years if the estate is settled extrajudicially, or five years if the estate is settled judicially.



## **Partnerships and joint ventures**

As a general rule, partnerships and joint ventures are subject to the filing and payment requirements that apply to corporations (see Chapter 19).

Joint ventures formed for the purpose of undertaking construction projects or engaging in energy operations pursuant to an operating or consortium agreement under a service contract with the government are not treated as corporations, so they do not need to file a return. The joint venturers would include their share of the income in their own tax returns.

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# Chapter 15

## Taxation of corporations

### *Investor considerations*

- Domestic corporations are taxed on worldwide income. Foreign corporations are taxed only on Philippine-sourced income.
- Corporate profits are subject to classical taxation; income is taxed when earned by a corporation, and again in the hands of the shareholders on distribution.
- The corporate tax rate is 30%.
- Domestic and resident foreign corporations may elect a standard deduction in an amount not exceeding 40% of their gross income.
- Active business income is subject to corporate tax of 30%. Passive income is subject to varying fixed rates of tax, collected generally through withholding at source.
- Dividends paid by a domestic corporation are exempt if derived by another domestic corporation or a resident foreign corporation (a foreign corporation engaged in business in the Philippines).

- Capital gains from the sale of shares of stock of domestic corporations not traded in the Philippine Stock Exchange are subject to tax at 5% or 10%, depending on the extent of the gain. Sales of stocks traded in the Philippine Stock Exchange are subject to a 0.5% tax based on the gross selling price or gross value in money of the shares of stock sold, bartered, exchanged, or otherwise disposed, subject to the Minimum Public Ownership condition.
- Net capital gains from the disposition of assets that are not employed in the business operations of a corporation are taxed as ordinary income. Net capital losses from the disposition of such assets may be deducted only to the extent of the gains in the same year.
- Branches are subject to corporate tax rates; branch profits remittances are subject to a 15% tax. The rate of branch profits remittance tax is reduced under some tax treaties.
- Domestic corporations may be subject to a 10% tax on improperly accumulated earnings.
- A 2% minimum corporate income tax (MCIT) applies to the gross profit of a domestic corporation and resident foreign corporation (for its Philippine-sourced income) beginning on the fourth taxable year immediately following the one in which it starts its business operation, if it exceeds the normal corporate income tax.
- The Bureau of Internal Revenue (BIR) may challenge the prices adopted for transactions between related parties if they are not consistent with the arm's length principle
- Operating losses may generally be carried forward and offset against income in the three succeeding years.
- Group taxation is not available.

## **Corporate tax system**

### **Corporations and shareholders**

The Philippines has adopted the classical system of taxation. Income is taxed in the hands of the company when it is earned. The income is then taxed again in the hands of the shareholders once it is distributed by way of dividends.

### **Taxable entities**

For tax purposes, the term “corporation” includes partnerships (other than general professional partnerships), associations, insurance companies, and joint ventures (other than those formed for undertaking construction projects or for undertaking energy-related operations pursuant to an operating or consortium agreement under a service contract with the government).

### **Territoriality**

The place of incorporation plays an important role in the taxation of corporations in the Philippines. A corporation incorporated in the Philippines, ordinarily referred to as a domestic corporation, is subject to tax on its worldwide income. On the other hand, a corporation organized outside the Philippines, commonly called a foreign corporation, is taxed only on its Philippine-sourced income.

## **Gross income**

### **Accounting period**

The accounting period used by a corporation for tax purposes is the annual accounting period used in keeping its books. An accounting period consists normally of 12 months and may be either a calendar or a fiscal year. The accounting period of a corporation is defined in its by-laws. A change in accounting period requires the prior approval of the Commissioner of Internal Revenue (CIR).

### **Accounting methods**

There is no uniform method of accounting prescribed for taxpayers. Any approved standard accounting method that clearly reflects the taxpayer’s income and conforms to the best accounting practice of the industry may be adopted.

An accounting method will not be regarded as clearly reflecting the income unless all items of gross income and deductions are treated with reasonable consistency. Acceptable methods of accounting include the accrual basis, cash basis, crop-year basis, and the percentage-of-completion basis for long term contracts.

A change in accounting method shall require the prior approval of the CIR.

### **Business profits**

The business profits of a corporation for tax purposes are computed based on the financial statements after adjustments to reflect any specific tax treatment required by the Tax Code and other special laws.

## **Intercompany transactions**

The Tax Code contains a transfer pricing rule patterned after the United States Tax Code. The CIR has the authority to adjust the prices used between related parties if they do not comply with the arm's length standard. New Transfer Pricing Regulations were recently issued by the BIR which took effect on 09 February 2013 (see Chapter 16).

The BIR is now more active in looking at transfer pricing issues in tax examinations. It would be prudent for investors to give some consideration to their pricing policies when investing in the Philippines.

## **Inventory valuation**

Inventory valuation will typically follow the basis used in the financial accounts of a corporation (see Chapter 12). The CIR has the discretion to change the valuation approach if it is not a realistic approach for determining the true income of a taxpayer.

## **Capital gains**

Gains or losses from the sale of inventories, depreciable assets, and real property used in the trade or business of a taxpayer are treated as ordinary income or expenditure.

Special tax rates apply for certain capital gains. The first PHP100,000 of gains from sale of shares of stock of domestic corporations not traded in the Stock Exchange are subject to 5% tax, with 10% applying to any excess. Capital losses are deductible only to the extent of capital gains derived in the same year. Losses that cannot be so offset are forfeited. A gain is

presumed to have been made from the sale, exchange, or disposition of any land or building not used in the business of a corporation, with a tax of 6% being imposed on the selling price or the fair market value of the land or building, whichever is higher.

Sale of shares in traded companies and facilitated through the local stock exchange, other than by a dealer in securities, are subject only to a tax of 0.5% on the gross selling price or gross value in money of the shares sold provided the listed corporation observes the Minimum Public Ownership (MPO) of at least 10% based on the company's issued and outstanding shares exclusive of any treasury shares or such percentage as may be prescribed by the SEC or PSE, whichever is higher.

## **Interest**

Interest income earned by a domestic or resident foreign corporation from a local bank or branch of a foreign bank is subject to final withholding tax at the rate of 20%. Interest earned by a domestic or resident foreign corporation from a foreign currency deposit unit (FCDU) is taxed at a lower rate of 7.5%.

The interest income of corporations which derive interest income as part of their active business operations, i.e., financial institutions, and interest income not subject to final tax are subject to ordinary income tax.

Interest income earned by a nonresident foreign corporation from a foreign

currency loan is subject to a final withholding tax at the rate of 20%. However, no tax is payable if the interest is derived from an offshore banking unit (OBU) or a FCDU. Other interest income earned from the Philippines by a nonresident foreign corporation is subject to 30% tax.

## **Dividends**

Under the Corporation Code, a domestic corporation may pay dividends only from unrestricted retained earnings (see Chapter 9).

In line with the dividend restriction imposed by the Corporation Code, the Tax Code defines the term “dividend” narrowly to refer to the distribution of the earnings or profits of a corporation. Thus, any distribution from a corporation that has negative earnings may generally be treated as a return of capital for tax purposes, rather than as a dividend.

Dividends, whether cash or property, received from a domestic corporation by either another domestic corporation or a resident foreign corporation, are exempt from tax. Dividends received by a domestic corporation from foreign sources are included in gross income. Stock dividends are not taxed provided there are no changes in the proportionate interest of the stockholders, but are subject to a documentary stamp tax of 0.5% of the par value represented by each share.

## **Royalties**

As a general rule, royalty income derived locally by a domestic corporation or a resident foreign corporation is subject to a final tax of 20%. In its rulings, the BIR have made a distinction between passive royalties (subject to 20% final tax) and those derived from the active pursuit of business (subject to 30% tax with deduction for expenses).

Royalties derived by a foreign corporation are generally subject to a final withholding tax of 30%. The domestic definition of royalties is quite broad, encompassing some technical services.

To reduce the potential Philippine tax impost, it is advisable for foreign corporations licensing technology or providing high-value services to be resident in a country with which the Philippines has a tax treaty. The treaty definition of royalties is typically much narrower than the domestic definition, potentially offering an exemption from Philippine tax if the income can be characterized as business profits and the foreign corporation does not have a permanent establishment in the Philippines. For those items of income that fall within the treaty definition of royalties, the treaty will at least provide for a rate lower than the 30% domestic tax rate (see Appendix IV for details of the maximum rates of tax on royalties under Philippine tax treaties).

## **Service fees**

Based on the broad definition of the term “royalties” in the Tax Code, the BIR may treat technical service fees as royalties. If the fees are being paid to a nonresident, it may be prudent to route services through a provider residing in a country with which the Philippines has a tax treaty. Provided the service provider does not establish a permanent establishment in the Philippines, any income should be exempt from Philippine tax as business profits (see Chapter 24).

## **Exchange gains and losses**

As a general rule, foreign exchange gains or losses are treated as taxable income or allowable deductions in the tax year in which they are realized.

## **Non-taxable income**

Non-taxable income items that may be received by a corporation include dividends received from another domestic corporation, proceeds of life insurance policies, returns of policy premiums, income exempt under treaty, and gifts, bequests and devises. Passive income items already subject to final withholding tax (such as interest on bank deposits and royalties) are also excluded from taxable income.

## **Deductions**

For tax purposes, the generally accepted method of accounting for expenses for financial reporting purposes is applied, with certain exceptions.

## **Business expenses**

In general, all ordinary and necessary expenses paid or incurred during the taxable year in the development, management, operation, or conduct of any trade or business and supported by records and pertinent papers are deductible.

An additional requirement for deductibility of certain payments is that relevant withholding tax obligations have been complied with. If relevant tax has not been withheld, the BIR may seek deficiency tax on both the withholding and deductibility fronts. Recent BIR issuances impose stricter rules on withholding, such that even subsequent payment of the tax before a formal assessment will not justify deductibility of the expense.

There are limited express statutory rules on the boundary between revenue and capital expenditure. In practice, taxpayers may adopt any distinction that conforms with Philippine Financial Reporting Standards (PFRS).

## **Depreciation**

A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property (except land) used in the trade or business is allowed as a deduction. The Tax Code cites explicitly the straightline method, the double-declining-balance method, and the sum-of-the-years-digits method as acceptable methods for computing depreciation. In practice, the depreciation and amortization methods and rates used for financial reporting are also generally allowed.

In the case of a resident foreign corporation, depreciation is allowed only when the property is located within the Philippines. Depreciation rates are not prescribed, but they are generally based on the estimated economic or useful lives of the assets.

Intangibles with limited life, such as patents, copyrights, and franchises, may be amortized. Those with unlimited life, such as goodwill, trade names, and formulas, are not ordinarily subject to amortization. Gains and losses on sale of depreciated assets are considered taxable income and deductible items, respectively.

### **Leasing agreements**

A lease agreement may either be an operating lease or a finance lease.

In an operating lease, the asset is not wholly amortized during the primary period of the lease. The lessor does not rely solely on the rentals during the primary period for profits but looks for the recovery of the balance of costs and for the remainder of profits from the sale or release of the returned asset at the end of the primary lease period. In this type of lease, the lessor gets the deduction for depreciation, while the lessee gets the deduction for rentals.

A finance or “full payout lease” involves payment over an obligatory period (also called the primary or basic period) of specified rental amounts for the use of the lessor’s property, sufficient in total to amortize the capital outlay of the lessor and to provide for the lessor’s borrowing costs

and profits. The obligatory period is the primary or basic non-cancellable period, which must be at least 730 days. This type of lease is treated as a sale on an installment basis. Special rules, however, apply to finance lease of certain tangible personal property.

### **Investment credit or allowance**

Although the Philippines offers a variety of tax incentives (see Chapter 4), it no longer has any special tax deductions for amounts invested.

### **Depletion of oil and gas wells and mines**

A reasonable allowance for depletion or amortization computed in accordance with the cost-depletion method is deductible. After production in commercial quantities has commenced, intangible exploration and development drilling costs incurred for non-producing wells or mines may be deducted from taxable income in the year incurred. If such expenditures are incurred for producing wells in the same contract area, they are deductible in full in the year paid or incurred, subject to a limit of 25% of the net income from mining operations. Alternatively, the taxpayer may elect to capitalize and amortize the expenditures.

### **Interest**

Interest paid or accrued within a taxable year on indebtedness incurred in connection with the taxpayer’s trade or business is generally deductible. However, the following restrictions apply:



- A deduction will not be allowed if the indebtedness is incurred to finance petroleum operations, or the interest is paid to certain related parties;
- Interest payments are deductible only if any necessary withholding taxes have been deducted and remitted to the BIR; and
- The amount of the deduction is reduced by 33% of the amount of any interest income derived by the taxpayer that has been subject to final tax.

The Philippines does not have any formal thin capitalization rules.

Taxpayers may elect to treat interest expenses incurred in acquiring property used in their business as capital expenditure. Given that operating losses may only be carried forward for three years, this can be a useful rule for companies in a loss situation.

### **Royalties and service fees**

Royalties and technical service fees are generally allowed as deductions, provided the appropriate withholding tax has been deducted. In practice, the BIR has been known to test whether the amount paid is reasonable, although the statutory basis for this is somewhat tenuous except for payments to related parties. An additional regulatory requirement is that agreements involving nonresidents should comply with the provisions of the Intellectual Property Code.

### **Employee remuneration**

Remuneration for employee services is deductible, provided the amount is reasonable. Excessive compensation paid to an employee shareholder may be disallowed as a deduction and treated as an indirect dividend.

The Corporation Code limits compensation of directors who are not officers to 10% of the corporation's pre-tax income during the preceding year except when services are rendered outside of a director's usual duties. In such cases, the director would be entitled to be paid the reasonable value of these services.

### **Insurance premiums**

Insurance premiums are generally deductible. However, premiums on life insurance of officers and employees with the corporation as beneficiary are not allowed as deduction. Self-insurance reserves are also not deductible.

For insurance premiums paid to affiliates, the issue to watch for is the taxability of the affiliate on the income. Under the Tax Code, the premiums are subject to 30% withholding tax, unless the affiliate is doing business in the Philippines. Use of an appropriate tax treaty should be able to eliminate this liability, although it should be noted that most Philippine tax treaties contain a rule deeming a foreign insurer to have a permanent establishment in some circumstances. In most instances, the deemed permanent establishment should either not apply or will have no practical

consequences. However, some care is required.

### **Intercompany charges**

Payments to foreign affiliates for management fees, research and development, and general and administrative expenses are deductible. However, if the amounts paid are not consistent with the arm's length principle, the BIR is authorized to make an adjustment for tax purposes. To minimize the risk that the BIR will question the legitimacy of payments made, taxpayers should be prepared to present the written agreement and justify that the amounts paid are reasonable. In general, some explanation of the nature of the services provided and the benefits accruing to the local affiliate, a reasonable allocation to determine the share of the overall costs that relate to the services rendered to the Philippines, plus a reasonable profit element, tends to be acceptable to the authorities (see Chapter 16 for the write-up on transfer pricing).

### **Other deductions**

- **Travel and entertainment**

Travel and entertainment expenses are allowed as deductions provided they are reasonable in amount, incurred in the pursuit or furtherance of the company's business, and adequately substantiated. Administratively, the BIR restricts deductions for entertainment expenditure to 0.5% of net sales for taxpayers selling goods,

and 1% of net revenue for taxpayers selling services.

- **Bad debts**

Debts actually ascertained to be worthless and charged off within the taxable year are deductible, except for those sustained in transactions entered into between certain related parties. Bad debts subsequently recovered are taxable in the year of recovery if they have been allowed as a deduction in an earlier year, but only to the extent of the income tax benefit from the deduction.

- **Taxes**

Taxes paid or accrued within the taxable year are deductible, except for Philippine income tax, estate and donor's taxes, and special assessment taxes. Foreign income taxes paid are also deductible if the corporation does not claim a credit for foreign taxes.

- **Charitable contributions**

Contributions actually paid within the taxable year to the Philippine Government or any of its political subdivisions and to accredited religious, charitable, educational, scientific, athletic, or cultural organizations are deductible. In general, the deduction is limited to 5% of the taxable income from a corporation's trade or business. However, donations made to certain institutions are deductible in full.

- **Pension trusts**

Contributions to pension trusts maintained for employees are deductible. Contributions covering the cost of pension payments during a taxable year are deductible in full in that year. The deduction for contributions in excess of that amount must be apportioned in equal parts over a period of ten consecutive years beginning with the year in which the transfer or payment is made.

- **Research and development**

Research and development expenses are generally deductible in the year in which they are incurred. However, a taxpayer may elect to treat the expenditure as capital expenditure, which can be amortized for a period of not less than 60 months from the month in which the taxpayer starts to benefit from the expenditure.

## **Losses**

Provided there is no substantial change in ownership, net operating losses incurred by a business or enterprise may be carried forward and offset against gross income for the following three years. In broad terms, a substantial change in ownership is one in which more than 25% of the ownership is transferred.

Loss offsets between profitable and losing subsidiaries are not permitted. However, if a subsidiary in loss position is merged into or consolidated with a new entity or a profitable affiliate, the losses may be

utilized by the post-merger or new entity, depending on the ownership structure.

Losses incurred by a corporation when it is exempt from tax (such as a corporation benefiting from an income tax holiday) cannot be carried forward.

For mining operations, net operating losses (calculated without the benefit of Board of Investments incentives such as the special deduction for labor) incurred in the first ten years of operation may be offset within five years from the year in which the operating loss is incurred.

## **Optional standard deduction**

Domestic corporations and resident foreign corporations (branches of foreign corporations) may elect an optional standard deduction (OSD) in an amount not exceeding 40% of their gross income, provided the intention to avail of the OSD is signified in the returns (quarterly and final tax returns). If no such election is made in the return, the corporation shall be considered as having availed of the itemized deductions generally allowed under the Tax Code. Once the election has been made in the return, the same shall be irrevocable for the taxable year for which the return is made.

For purposes of the OSD, gross income refers to the gross sales less sales returns, discounts and allowances, and cost of goods sold. In the case of sellers of services, gross income means the gross receipts less sales returns, allowances, discounts, and cost of services. The “cost of goods sold” and “cost of services” are specifically

defined for each type of business activity under appropriate regulations.

### ***Tax computation***

#### **Net income**

Taxable income is determined by starting with the profit reflected in the financial accounts of a corporation. Any expenses that are nondeductible for tax purposes are added back to that profit. The resulting amount is then reduced by any income subject to final tax (such as interest, dividends, and royalties) and tax-exempt income (see Appendix III for a sample calculation).

#### **Tax rates**

The corporate tax rate on taxable income is 30%. A number of specific items of income are, however, subject to final tax at lower rates. The various tax rates are set out in Appendix I.

#### **Tax credits**

Domestic corporations are entitled to claim a credit for any income taxes paid to a foreign country, provided the taxes are not claimed as deductions.

The amount of tax credit that may be claimed is subject to certain limitations (see Chapter 18 for further detail). Foreign corporations are not entitled to credits for foreign taxes, as they are not subject to tax on their foreign-sourced income.

#### **Consolidation**

Group taxation is not allowed. Thus, filing of income tax returns on a consolidated basis is not permitted.

### ***Minimum corporate income tax (MCIT)***

Beginning on their fourth taxable year following the year in which they have registered or commenced business operations, corporations are subject to a minimum corporate income tax equal to 2% of their gross income (essentially sales less costs of sales), computed and paid on a quarterly basis, and consolidated annually. The tax applies to both domestic corporations and resident foreign corporations.

The MCIT is payable if it exceeds normal income tax (excluding final taxes) for the taxable year. The MCIT paid in excess of the normal income tax may be carried forward and credited against normal income tax payable in the following three years.

### ***Improperly accumulated earnings tax (IAET)***

A 10% tax is imposed on the improperly accumulated earnings of a corporation. The tax is aimed at corporations that accumulate income beyond the reasonable needs of their business, rather than distributing that income by way of dividends subject to tax in the hands of the shareholders. The BIR has taken a narrow view on what constitutes the reasonable needs of a business, basing it generally on

the limitations on retained earnings in the Corporation Code (see Chapter 9). Thus, the ordinary needs have essentially been defined to be accumulations of up to 100% of the paid-up capital of a corporation, along with any amounts required for documented and approved business expansion projects and for earnings that cannot be distributed because of loan covenants or regulatory constraints.

Based on administrative practice, the improperly accumulated earnings tax only applies to companies where more than 50% of their shares are owned directly or indirectly through corporate shareholdings, by a group of 20 or fewer individuals.

No relief is available when earnings subject to IAET are subsequently distributed. The subsequent dividend will be subject to normal dividend taxation. The government retains the IAET previously paid.

### **Other taxes**

Corporations are subject to local business tax on their revenues. The actual amount varies depending on where the business is operated. The business tax is due and payable on every separate and distinct establishment or place where business is conducted, and on each line of business. Local business tax is deductible in determining a corporation's taxable income.

As indicated under "Special industries," certain types of enterprises are taxed on gross receipts from business at various rates, and public utilities are subject to a

franchise tax in addition to regular corporate income tax.

Corporations may also be subject to VAT and other indirect taxes (see Chapters 22 and 23 for details).

### **Branch versus subsidiary**

In broad terms, the regulatory environment in the Philippines tends to favor the establishment of a subsidiary, while the tax rules tend to favor a branch, provided the corporation concerned is a resident of a country with which the Philippines has a tax treaty.

On the regulatory side, there are a number of industries in the Philippines that do not permit 100% foreign ownership (see Chapter 5). Operation within these industries will require the establishment of a separate corporation with the requisite ownership by Philippine nationals. Establishment of a subsidiary also limits the parent company's liabilities to the extent of its equity in the subsidiary, whereas the exposure may be somewhat higher when a foreign corporation operates using a Philippine branch.

From a tax perspective, a branch is subject to income tax only on Philippine-sourced income, while a subsidiary is subject to income tax on worldwide income. The statutory rate of income tax on dividends remitted by a subsidiary is 30%, although the rate may be reduced to 15% under the tax sparing rule or "deemed paid" tax credit provision of the Tax Code. It may be further reduced to 10% under some treaties. Profits remitted by a branch are

generally subject to 15% branch profits remittance tax (again, reduced to 10% or even exempt under some treaties).

## **Special industries**

### **Banks and finance companies**

Income derived by OBUs from foreign currency transactions with nonresidents, other OBUs, local commercial banks, including branches of foreign banks that may be authorized by the Bangko Sentral ng Pilipinas (BSP) to transact business with OBUs shall be exempt from all taxes except net income from such transactions as may be specified by the Secretary of Finance, upon recommendation of the Monetary Board, which shall be subject to the regular income tax payable by banks. However, any interest income derived from foreign currency loans granted to residents other than OBUs or local commercial banks, including local branches of foreign banks that may be authorized by the BSP to transact business with OBUs, shall be subject to a final tax at the rate of 10%. Any income of nonresidents, whether individuals or corporations, from transactions with said OBUs shall be exempt from income tax.

Banks and finance companies are treated for income tax purposes as any other corporation, except that income derived from residents under the expanded foreign currency deposit system is subject to a final tax of 10% and income derived under the system from nonresidents is tax exempt. In addition to income tax, however, banks are also subject to gross receipts tax between

0% and 7%. The rate of gross receipts tax depends on the maturity of the instrument on which the income arises.

### **Public utility companies**

Gas and water utility companies are subject to the regular corporate income tax. In addition, they are subject to a percentage tax of 2% of their gross receipts. They are, however, exempt from VAT.

### **Transport**

International carriers doing business in the Philippines are subject to 2.5% tax on their gross billings for the carriage of persons, excess baggage, cargo, and mail originating from the Philippines, in lieu of the 30% corporate income tax rate. The rate is typically reduced to 1.5% for carriers who are resident in a country with which the Philippines has a tax treaty. Exemption from this tax is also available under international agreements to which the Philippines is a signatory or on the basis of reciprocity in cases where the home country of the international carrier grants income tax exemption to Philippine carriers (Republic Act No. 10378). In addition, they are subject to a 3% percentage tax in lieu of the VAT, based on their gross quarterly receipts.

Domestic carriers, however, are subject to the regular corporate income tax. They are also subject to the 12% VAT.

### **Insurance**

Insurance companies are subject to income tax in the same manner as any other

corporation. However, they are allowed to claim a deduction for any net additions to reserve funds they are required to make by law and for any sums other than dividends paid on policy and annuity contracts. When the reserves are released, they are treated as taxable income.

In addition, life insurance premiums are subject to a 2% gross receipts tax, while non-life insurance premiums are subject to 12% VAT.

### **Real Estate Investment Trusts**

Real Estate Investment Trusts (REITs) which refer to domestic corporations established principally for the purpose of owning income-generating real estate are subject to income tax in the same manner as any other corporation. However, they are allowed to claim as deduction the dividends distributed to shareholders, subject to certain conditions. REITs are also exempt from the MCIT.

REITs shall be subject to 12% VAT on gross sales from any disposal of real property and gross receipts from rental of real property but shall not be subject to VAT on their sale, exchange, or transfer of securities forming part of their real estate-related assets.

### **Natural resources**

Natural resource companies are subject to the regular corporate income tax. However, special deductions, such as the use of accelerated depreciation rates for fixed assets for mining companies may be available, depending on the nature of the

activities conducted (see “Industry incentives” in Chapter 4).

Excise tax is imposed at various rates on the sale or transfer of petroleum and mineral products. VAT is typically also chargeable on such transactions, although exemptions are available for certain natural resources (see Chapter 22 and Appendix XII for further information).

Subcontractors entering into a contract with a service contractor engaged in petroleum operations are subject to 8% final tax on their gross receipts in lieu of all other taxes.

### ***Holding companies***

There are no tax advantages or incentives for holding companies established to hold shares in domestic corporations. Holding companies are taxed in the same manner as any other corporation. Dividends from Philippine companies will be exempt from income tax. However, the ability to use a holding company to defer the repatriation of earnings is complicated by the IAET, and the restrictions on retained earnings under the Corporation Code (see Chapter 9).

### ***Corporate tax planning strategies***

#### **Type of entity**

- ***Subsidiary versus branch***

The regulatory environment in the Philippines tends to favor the establishment of a subsidiary as foreign ownership restrictions preclude the operation of a branch in certain industries.



Branches are slightly more advantageous from a tax perspective, mainly because application of a relevant tax treaty may overcome some domestic limitations on deductibility, while the treaty source rules potentially allow some interest and royalties expense to escape Philippine withholding taxes. Branches are also not subject to IAET.

- **Joint venture**

In practice, joint ventures exist in the traditional sense only for certain investments in the construction and energy sectors, in which case they are treated as conduit vehicles for tax purposes with the income taxed in the hands of the joint venture partners.

Other joint ventures are taxed as corporations for income tax purposes. At the same time, the joint venturers will be separately taxed on their share of the after-tax profits of the joint venture, whether distributed or not.

### **Holding company**

- Domestic holding companies are not subject to tax on their dividend income from Philippine corporations.
- Holding companies are potentially subject to 10% IAET on their improperly accumulated taxable income.

### **Special industries/Special-use companies/Locality incentives**

- Tax holidays and other fiscal incentives are granted to enterprises registered with the Board of Investments and the Philippine Economic Zone Authority.
- Qualified firms located in special economic zones and freeports are subject to a 5% tax in lieu of all local and national taxes upon the expiry of any income tax holiday period to which they may be entitled.

### **Reorganizations**

Most corporate reorganizations can be effected tax-free if appropriate steps are followed (see Chapter 17).

### **Liquidations**

The gain realized by the shareholder from the distribution of property or assets in complete liquidation or dissolution of a corporation is treated as a taxable capital gain. Any loss incurred is treated as a capital loss and is deductible only to the extent of capital gain in the same year (see Chapter 17).

### **Acquisitions**

- When buying an asset, the tax basis will have consequences for the future measurement of taxable income. Future charges for inventory in cost of goods sold, depreciation expense, and gain or loss on sale of assets will be based on the purchase price of the relevant asset.



- Because goodwill is not generally depreciable for tax purposes, the buyer in an asset purchase should attempt to minimize the allocation of purchase cost to goodwill to the extent legally permissible.
- If the seller will be making a gain, the preference would usually be the sale of shares over the sale of assets. Gains from the sale of shares are subject to a lower tax rate (maximum of 10%).
- have a permanent establishment in the Philippines.
- For branches, application of a relevant tax treaty may overcome some domestic limitations on deductibility, while the treaty source rules potentially allow some interest and royalties expense to avoid Philippine withholding taxes.

### **International center/No tax/Low tax**

- Regional or area headquarters are not subject to Philippine tax.
- Regional operating headquarters are subject to 10% tax on their taxable income.
- OBUs are subject to a 10% final tax on income from foreign currency transactions with Philippine residents other than OBUs or local commercial banks, including local branches of foreign banks authorized to transact business in the Philippines with OBUs.

### **Tax treaties**

- The application of some domestic laws, particularly with regard to source and income attribution, is not that clear. The rules under tax treaties are clearer, and the BIR and the courts can generally be expected to apply them in accordance with international practice.
- Tax treaties will exempt the business profits of a foreign corporation from Philippine income tax if it does not

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# Chapter 16

## Taxation of foreign corporations

### *Investor considerations*

- Foreign corporations are taxed only on Philippine-sourced income.
- The corporate tax rate is 30%.
- An important determinant of how the business activities of foreign entities will be taxed is whether they are licensed by the Philippine Securities and Exchange Commission (SEC) to do business in the Philippines. A licensed corporation will be treated as a “resident foreign corporation,” subject to tax on its net Philippine-sourced income. An unlicensed corporation will generally be treated as a “nonresident foreign corporation,” subject to tax on its gross Philippine-sourced income.
- For branch operations, it is advisable that the corporation concerned is a resident in a country with which the Philippines has a tax treaty.
- A foreign corporation utilizing a selling agent or distributor in the Philippines may be considered to be doing business in the Philippines, creating a potential exposure to both licensing and tax requirements.
- Dividends received by a resident foreign corporation from a domestic corporation are tax exempt.

- Under the Tax Code, interest on foreign loans is subject to final withholding tax of 20%, while royalties are taxed at 30%. However, both rates may be reduced under a relevant tax treaty.
- The Bureau of Internal Revenue (BIR) has recently issued Transfer Pricing Regulations which provide guidance in applying the arm's length principle to cross-border and domestic transactions between associated enterprises, and mandates the maintenance of contemporaneous documentation on transfer pricing.

### ***Tax concepts***

Foreign corporations are subject to income tax only on Philippine-sourced income. Resident foreign corporations are subject to tax on their net income from the Philippines, while nonresident foreign corporations are subject to tax on their gross Philippine-sourced income.

In practice, an important determinant of how the business activities of foreign entities will be taxed is whether they are licensed by the SEC to do business in the Philippines. A licensed corporation will be treated as a “resident foreign corporation,” subject to tax on its net Philippine-sourced income.

An unlicensed foreign corporation is generally treated as a “nonresident foreign corporation,” subject to tax on its gross Philippine-sourced income. The concept of source is defined in the Tax Code with regard to the situs of sale; so any sale

consummated in the Philippines is treated as Philippine-sourced income.

Favorable tax treatment may apply if the nonresident foreign corporation considered “not doing business” in the Philippines is a resident in a treaty country. The Philippines has a comprehensive network of double tax agreements which operate to (a) reduce withholding tax on certain payments (such as interest, royalties, and dividends), (b) exempt business profits derived by a company residing in a treaty country which does not have a permanent establishment in the Philippines, and (c) provide exemption from capital gains tax and stock transaction tax of gains derived from any subsequent disposal of an investment in the Philippines.

If the foreign corporation is conducting some business activities in the Philippines, either directly or using an agent, it is possible that the corporation will be considered to be “doing business” under the Foreign Investments Act. Under the

Corporation Code, an unlicensed foreign corporation doing business in the Philippines is not able to pursue an action in Philippine courts. Potentially, this could make it difficult to challenge a position by the BIR that the corporation is subject to tax on gross income.

## **Imports**

### **Imports without agent**

Generally, no tax is levied on sales covered by a contract consummated abroad between a foreign corporation and a Philippine customer. If, however, the sale is consummated in the Philippines, it will be treated as Philippine-sourced income. For corporations who are not residents in a country with which the Philippines has a tax treaty, this can lead to a potential income tax exposure.

### **Unrelated agent**

Appointing a sales representative or distributor who is domiciled in the Philippines and acts in the name of a foreign corporation may constitute engaging in trade or business in the Philippines. Consequently, the corporation should consider registering with the SEC.

For an agent not to constitute the foreign principal as engaging in trade or business in the Philippines, the agent would need to transact business in its own name and for its own account. Typically, this would involve the agent acting as a distributor that buys and sells the products of the principal. Generally, commissionaire type arrangements might not be viable

alternatives as they are likely to create permanent establishment issues based on recent rulings of the BIR.

### **Employee/salesperson**

A dependent employee/salesperson of a foreign employer will constitute engaging in trade or business in the Philippines for such employer/principal.

### **Sales subsidiary**

A sales subsidiary is the method least likely to cause practical difficulties from a tax and customs perspective, provided the subsidiary is acting as a principal of the sales it makes in the Philippines rather than as agent for its parent company. Both the Tax Code and Philippine tax treaties recognize the separate legal existence of parent and subsidiary companies. The subsidiary will be taxed on income it derives in its own capacity. The parent company will not be considered engaged in trade or business in the Philippines, and so will not be taxed in the Philippines on business profits.

### **Branch operations**

A foreign corporation with a branch in the Philippines, whether engaged in selling, manufacturing, or providing services, is taxed in the same manner as a domestic corporation on its net income from Philippine sources.

Under the Tax Code, it is the place where the actual sale is consummated, rather than where the business activities of an entity are conducted, that determines the

extent to which income from the sale of personal property should be subject to tax as Philippine-sourced income. Corollary to this, Case Law has provided another perspective on source-based income taxation when it was ruled that income derived from airline ticket sales sold in the Philippines is taxable here even if the flights originated outside of the Philippines (Commissioner of Internal Revenue vs. BOAC).

It is advisable, therefore, that corporations that can benefit from treaty protection under a relevant treaty establish branches in the Philippines. The rules in Philippine treaties for attributing income to a permanent establishment typically follow closely the standard formulation of the United Nations Model Convention. The BIR has not stated any formal position on how branch profits should be determined under a treaty, but investors should not anticipate any real difficulties if they adopt attribution principles as they are applied internationally.

### **Transfer of branch profits**

Under the Tax Code, remittances of branch profit are generally subject to 15% tax, except those remitted by firms registered with the Philippine Export Zone Authority (PEZA) and freeport zones which are tax exempt.

The Dividends Article in most Philippine treaties preserves the right to impose this tax, although the rate is limited to 10% under some treaties. A few Philippine treaties, most notably those with Singapore

and the United Kingdom, do not contain provisions permitting the Philippines to impose branch profits remittance tax. These treaties may be interpreted to permit the branch profits to be remitted free of Philippine tax.

Interest, dividends, rents, royalties, technical service fees, capital gains, premiums, annuities, emoluments, and other fixed or determinable income are treated as branch profits only if they are effectively connected with the conduct of a foreign corporation's business in the Philippines.

### **Tax rates**

Resident foreign corporations are essentially subject to the same tax treatment as domestic corporations. Most Philippine treaties also contain a Non-Discrimination Article, reinforcing the principle of equivalent taxation for branches and domestic corporations.

### ***Income from subsidiaries***

#### **Dividends**

Dividends received by a resident foreign corporation from a domestic corporation are tax exempt.

Dividends received by a nonresident foreign corporation are subject to withholding tax of 15% or 30%. If the home country exempts the dividend from tax, or allows a 15% or greater credit for the underlying taxes paid by the Philippine corporation, the rate will be 15%. Otherwise, 30% tax will be imposed.

The rate of tax on dividends paid to a nonresident foreign corporation can be reduced under a relevant tax treaty (See Appendix IV for a schedule of Philippine treaty rates on dividends.)

### **Interest**

Interest on foreign loans is generally subject to 20% final withholding tax, although this rate may be reduced under a relevant tax treaty.

Interest income earned by a domestic or resident foreign corporation from currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds or similar arrangements is subject to final withholding tax at a rate of 20%. Interest earned by a domestic or resident foreign corporation from a foreign currency deposit unit (FCDU) is taxed at a lower rate of 7.5%.

The interest income of corporations such as financial institutions, which derive interest income as part of their active business operations, and interest income not subject to final tax is subject to ordinary income tax.

Interest income earned by a nonresident foreign corporation from a foreign currency loan is subject to final withholding tax at a rate of 20%. However, no tax will be payable if the interest is derived from an offshore banking unit (OBU) or an FCDU. Other interest income earned from the Philippines by a nonresident foreign corporation is subject to 30%.

### **Royalties**

Under the Tax Code, royalties paid to a nonresident foreign corporation are subject to 30% withholding tax. The rate of tax can be reduced under a relevant tax treaty, at 10% to 25% depending on the treaty. Royalties are also subject to 12% VAT.

### **Capital gains**

A capital gain realized by a Philippine subsidiary and distributed to the foreign parent is treated in the same way as any other dividend. If the foreign parent sells, transfers, or exchanges its shares of stock in a subsidiary, it is liable to capital gains tax unless exempt under a relevant tax treaty (see Appendix I for tax rates).

### **Service/management fees**

Fees for services rendered in the Philippines by nonresident foreign corporations are generally subject to 30% income tax and 12% VAT. If treaty protection applies, no income tax will be due.

### **Rentals**

Rentals from property used in the Philippines are treated as Philippine-sourced income. Philippine treaties also preserve the right of the Philippines to tax the income even if the owner of the property does not have a permanent establishment in the Philippines.

Nonresident owners or lessors of vessels are subject to 4.5% tax on their gross receipts from leases or charters to Filipino citizens or corporations approved by the

Maritime Industry Authority. On aircraft, machineries, and other equipment used in the Philippines, the rate of tax is 7.5%. On any other property, the rate of tax is 30% of gross receipts. However, this rate can be reduced to the rate of tax applying to royalties under a relevant tax treaty.

### **Portfolio investments**

There is no special tax treatment for dividends and capital gains received by a foreign corporation from portfolio investments.

### **International financial center**

Income derived by OBUs from foreign currency transactions with nonresidents, other OBUs, local commercial banks, including branches of foreign banks that may be authorized by the Bangko Sentral ng Pilipinas (BSP) to transact business with OBUs shall be exempt from all taxes except net income from such transactions as may be specified by the Secretary of Finance, upon recommendation of the Monetary Board which shall be subject to the regular income tax payable by banks. However, any interest income derived from foreign currency loans granted to residents other than OBUs or local commercial banks, including local branches of foreign banks that may be authorized by the BSP to transact business with OBUs, shall be subject only to a final tax at the rate of 10%. Any income of nonresidents, whether individuals or corporations, from transactions with said OBUs shall be exempt from income tax.

Regional or area headquarters and representative or liaison offices are exempt from income tax, because constraints on their operations preclude them from earning income from business activities in the Philippines. A regional operating headquarters is subject to tax at a rate of 10%. (See Chapters 4 and 9 for a discussion on the permitted activities and establishment requirements for these types of branch operation, respectively.)

### **Transfer pricing**

#### **General considerations**

Philippine law on transfer pricing is found in Section 50 of the Tax Code, authorizing the Commissioner of Internal Revenue to distribute, apportion, or allocate gross income or deductions between or among related parties (whether or not organized in the Philippines) in order to arrive at the correct taxable income. Just recently, implementing regulations (Revenue Regulations 2-2013, otherwise known as the “Transfer Pricing Guidelines”) were issued. These new regulations, which took effect on 09 February 2013, provide guidance in applying the arm’s length principle to cross-border and domestic transactions between associated enterprises. It also mandates the maintenance of transfer pricing documentation without providing any threshold amount.

#### **Pricing methodologies**

Consistent with the Interim Transfer Pricing Guidelines issued in 2008

(Revenue Memorandum Circular 26-2008), the new guidelines are largely based on the arm's length methodologies under the OECD Transfer Pricing Guidelines. The OECD Methods of determining compliance of taxpayers' transactions with the arm's length rule are as follows:

- The Comparable Uncontrolled Price method;
- The Resale Price method;
- The Cost Plus method;
- Profit Split method; and
- Transactional Net Margin Method.

There is no hierarchy or preference for any one method. Instead, the pricing method that produces the most reliable measure of an arm's length result should be used.

### **Documentation requirements**

The Transfer Pricing Guidelines require contemporaneous documentation on transfer pricing (i.e., they must exist or be brought into existence at the time the related party transactions or arrangements are developed or implemented). Although they need not be submitted when the tax returns are filed, transfer pricing documentation should be retained and submitted to the BIR upon request. The mandatory retention period is three years from the filing of the return (or longer if under examination).

Drawing from OECD Guidelines, the Transfer Pricing Guidelines provide that transfer pricing documentation generally include details such as: the organizational

structure; nature of the business/industry and market conditions; the specific transaction under analysis, any assumptions, strategies, or policies; a functional analysis; and the selection and application of the most appropriate transfer pricing method, among others. The main purpose of keeping adequate transfer pricing documentation is for taxpayers to be able to (i) defend their transfer pricing analysis, (ii) prevent transfer pricing adjustments arising from tax examinations, and (iii) support their applications for Mutual Agreement Procedures (MAP) under a relevant tax treaty.

In any case, companies should determine the risks and rewards of putting up detailed documentation. This will depend largely on the nature and significance of the related party transaction and tax risks involved. If the risks are minimal, simple documentation may suffice.

### **Advanced Pricing Arrangement (APA) and Mutual Agreement Procedure (MAP)**

An APA is an agreement entered into between the taxpayer and the BIR to determine in advance an appropriate set of criteria (e.g., method, comparable and appropriate adjustments thereto) to ascertain the transfer prices of controlled transactions over a fixed period of time. While securing an APA is optional, doing so reduces the risk of transfer pricing examination and double taxation. In the absence of an APA, the taxpayer may still invoke the provisions of the MAP under Philippine tax treaties to resolve double



taxation issues. The MAP is a mechanism where two governments can mutually arrive at a satisfactory solution to eliminate double taxation issues arising from transfer pricing adjustments.

The BIR will be issuing separate guidelines on APA applications and the MAP process.

### **Enforcement of Transfer Pricing Rules**

There are no special provisions for a transfer pricing tax audit. Thus, the three-year regular statute of limitations applies.

The new guidelines do not indicate whether transfer pricing audits will be performed by a special task force or as part of the BIR's regular tax audit. What is clear, however, is that companies should expect BIR activities to intensify as a result of the new guidelines. Now, more than ever, documentation of arm's length dealings is key.

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# **Chapter 17**

## Taxation of shareholders

### ***Investor considerations***

- Dividends received by domestic and resident foreign corporations from domestic corporations are not taxable.
- Gains from sale of stocks of domestic corporations not traded in the Stock Exchange are subject to tax at a maximum rate of 10%. Sales of traded stocks are subject to a 0.5% transaction tax on their gross selling price.
- Most corporate reorganizations can be effected tax-free if appropriate steps are followed.

## **Domestic shareholders**

### **Dividends**

Dividends received by resident individuals (including resident aliens) from domestic corporations are subject to a final income tax of 10%. Dividends received by a domestic corporation or a resident foreign corporation from a domestic corporation are exempt from income tax.

Dividends received from foreign corporations are subject to normal income tax at the progressive rates of 5% to 32% for an individual, and 30% for a corporation.

### **Capital gains**

The first PHP100,000 of net capital gains from the sale of shares of stock in domestic corporations not traded through the facilities of the Philippine Stock Exchange (PSE) are subject to tax at a rate of 5%. Any gains in excess of PHP100,000 are subject to tax at 10%. The same rates apply to both individual and corporate shareholders.

Capital gains from the sale of shares of stock in domestic listed corporations traded through the facilities of the PSE are not generally subject to income tax. Instead, a final percentage tax is imposed on said sale equal to 0.5% of the gross selling price of the shares. However, the Bureau of Internal Revenue recently issued Revenue Regulations (RR) 16-2012 which subjects to the capital gains tax of 5% and 10%, capital gains of listed corporations who fail to observe the Minimum Public Ownership (MPO) of at least ten percent (10%) of the

company's issued and outstanding shares exclusive of any treasury shares, or such percentage as may be prescribed by the Securities and Exchange Commission (SEC) or PSE, whichever is higher.

Capital gains from the sale or transfer of shares in a foreign corporation by a resident citizen or a domestic corporation are included in ordinary income. However, if the shareholder is an individual and has held the shares for more than 12 months, only 50% of the gain will be taxable.

### **Documentary stamp tax**

The issuance and transfer of shares are generally subject to documentary stamp tax (DST) based on the par value of the shares issued or transferred, or the issue value in case the shares have no par value. Under Republic Act 9648, shares listed and traded through the local stock exchange are exempt from DST. However, DST shall apply if the listed corporation fails to observe the required level of MPO as prescribed in RR 16-2012. (See Chapter 23 and Appendix XIII).

## **Foreign shareholders**

### **Dividends**

Dividends received by a nonresident alien from a domestic corporation are generally subject to 25% tax. However, if the individual is present in the Philippines for more than 180 days in a calendar year, or is engaged in trade or business within the Philippines, the rate is reduced to 20%.

Dividends received by a nonresident foreign corporation from a domestic corporation are subject to withholding tax of 15% or 30%. If the home country exempts the dividends from tax, or allows a 15% or greater credit for the underlying taxes in the Philippines, the rate will be 15%. Otherwise, 30% tax will be imposed.

The rate of tax on dividends received by a nonresident foreign corporation or an alien may be reduced under a relevant tax treaty. (See Appendix IV for a schedule of Philippine treaty rates on dividends.)

### **Capital gains**

Foreign shareholders, individual or corporate, are taxed on net capital gains on the transfer of their shareholdings in domestic corporations in the same manner as domestic shareholders. Relief may, however, be available under a relevant tax treaty.

## **Reorganizations**

### **Incorporation**

No gain or loss is recognized on the transfer of property (services not included) to a corporation if the property transferred is exchanged for stock in the corporation and the transferor, alone or with not more than four other transferors, gains control (51% or more of the voting stocks) of the corporation. Thus, a transfer of a business from a single proprietorship or partnership to a corporation in exchange for the latter's shares of stock will not give rise to a taxable gain provided this condition is met.

If, in addition to shares of stock, money and/or other property is received, any gain (but not any loss) shall be recognized. However, the taxable amount cannot exceed the sum of the money and the fair market value of the other property received.

### **Merger or consolidation**

A merger (absorption of one corporation by another) or consolidation (two or more corporations creating a new corporate entity) can be effected under the Corporation Code. Provided the merger or consolidation is undertaken for a bona fide business purpose and not for the purpose of escaping taxation, neither the corporation nor any shareholder will recognize a gain or loss under any of the following situations:

- A corporation exchanges property solely for stock in another corporation; or
- A shareholder exchanges stock in a corporation solely for stock in another corporation; or
- A holder of a corporation's securities exchanges them solely for stock or securities in another corporation.

### **Reorganization**

With effective planning, split-ups, split-offs, and spin-offs can generally be arranged so that no gain shall be recognized on the transaction, and thus will not be taxable.

## **Liquidation**

The gain realized by the shareholder, whether individual or corporate, from the distribution of property or assets in complete liquidation or dissolution of a corporation is treated as a taxable capital gain. Any loss incurred is treated as a capital loss and is deductible only to the extent of capital gain in the same year.

## **Acquisitions**

### **Asset acquisition**

In an asset acquisition, the basis for depreciation of the purchased assets on the part of the buyer is the total purchase price of the assets. Since the total purchase price must be allocated to the various assets purchased in proportion to their fair market values, it is often desirable to specify in the contract of sale the value assigned to each asset or group of assets. This is important because the buyer and the seller often have conflicting interests as to the relative value of the assets. A realistic agreement between unrelated and adverse parties in arm's-length negotiations is usually allowed as evidence of value for tax purposes.

The amount of purchase price allocated to goodwill may not be deducted or amortized for tax purposes unless the business or the asset related to the said goodwill is subsequently sold.

The seller will recognize gain or loss on the sale of its assets and will be taxed according to the nature of the assets (whether capital or ordinary) sold.

If a corporation is acquired through the purchase of its assets rather than its shares of stock, its tax attributes (e.g., tax credits and other incentives) will not be retained by the buyer. However, in general, interest incurred on borrowings to finance the purchase of assets may be deducted for income tax purposes.

### **Share acquisition**

If a foreign investor purchases shares of a domestic corporation for cash or other consideration, any gain on the transaction is taxable to the selling shareholder as a capital gain. If the payment is received in installments over a period exceeding one year, the seller can partly defer the reporting of taxable income, provided the initial payments during the year of sale do not exceed 25% of the selling price.

Subject to certain conditions, the tax attributes of the acquired corporation such as its entitlement to tax credits or other incentives will be retained, because its corporate existence has not been affected. Similarly, the original cost of the assets will continue to be the basis of depreciation for tax purposes.

Interest expense on funds borrowed to acquire the shares cannot be claimed as a deduction by the foreign investor, either from any dividend income or capital gain that may be derived from the shares, or from the earnings of the acquired domestic corporation.

## Buyer and seller

- **Buyer**

When buying an asset, the tax basis will have consequences for the future measurement of taxable income. Future charges for inventory in cost of goods sold, depreciation expense, and gain or loss on sale of assets will be based on the purchase price for the relevant asset.

- **Seller**

If the seller will be making a gain, it would usually prefer the sale of shares to the sale of assets. Gains from the sale of shares are subject to a lower tax rate (maximum of 10%).

(See Appendix XVII for other points that should be considered by investors, their legal counsel, and their accountants before acquiring a business enterprise in the Philippines.)

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# **Chapter 18**

## Taxation of foreign operations

### ***Investor considerations***

- Income earned through a foreign subsidiary is taxed only when it is paid to a Philippine resident shareholder as a dividend. Income earned through a foreign branch is taxed as it accrues.
- Losses incurred by a foreign branch are deductible against other income earned by a Philippine corporation.
- Double taxation is generally relieved by way of a credit for foreign taxes. However, a taxpayer may take a deduction for foreign taxes instead, if that leads to a more favorable outcome.

## ***Taxation of foreign income***

### **Branch income**

Domestic corporations are taxed on their worldwide income, regardless of whether the income is remitted to the Philippines. Income and expenses of foreign branches of a domestic corporation are treated in much the same way as income earned and expenses incurred locally. The gross income of the foreign branch is included in the gross income of the parent domestic corporation, and the expenses of the branch are allowed as deductions in arriving at the taxable income of the domestic corporation. Losses incurred by a branch are not ring-fenced. The net income or net loss from each branch operation is considered separate only for the purpose of computing a corporation's entitlement to foreign tax credits. Subject to certain limitations, relief from double taxation by way of credit for foreign taxes paid is provided for in the Philippine Tax Code and in tax treaties entered into by the Philippines.

### **Foreign subsidiary income**

The Philippine Tax Code allows for the taxation of earnings from a foreign subsidiary only when they are declared or distributed as dividends. Dividends from foreign subsidiaries form part of the gross income of the domestic corporation and are subject to the normal corporate income tax rate of 30%.

If a domestic corporation is in a loss position for income tax purposes, it may be

appropriate to have its foreign subsidiaries declare or pay dividends to absorb the loss, if there is a risk that losses carried forward will not be utilized.

### **Liquidation proceeds**

If a foreign subsidiary distributes all of its assets in complete liquidation or dissolution, the capital gain or loss derived therefrom shall be subject to the regular income tax rates imposed under the Tax Code, as amended. It shall be imposed on the individual taxpayer or to the corporation on its income or treated as deductible loss, as the case may be.

### **Capital gains**

Gains realized from the sale of shares in foreign subsidiaries are treated as capital gains, and form part of the gross income of the Philippine shareholder subject to normal income tax. If, however, the shares are sold at a loss, the loss will be deductible only to the extent that the shareholder has also derived capital gains in that same year. Losses that cannot be offset are forfeited.

### **Dividends**

Dividends are taxed when they are received by a shareholder. It should be noted, however, that under the Tax Code a dividend arises only if a payment is made out of the earnings or profits of a company.

### **Interest**

Interest earned from foreign sources is included in a taxpayer's gross income in the year in which it accrues, unless the



recipient is an individual using the cash basis of accounting. If a financial instrument is disposed of or matures, any gain or loss is treated as a capital gain or loss. Any such capital gain will be subject to ordinary income tax, while any loss will be deductible only to the extent of the capital gain derived by the taxpayer in the same year.

### **Royalties**

Royalties earned from foreign sources are included in a taxpayer's gross income in the year in which they accrue, unless the recipient is an individual using the cash basis of accounting.

### **Foreign exchange gains and losses**

In general, foreign exchange gains or losses will be taxable or deductible only when they are realized. Branch profits and dividends earned from foreign subsidiaries are translated into Philippine pesos at the prevailing exchange rate on each transaction date.

### **Double taxation relief**

Double taxation relief for various types of investor is specifically addressed by pertinent provisions of existing tax treaties with foreign countries which the Philippines has entered into. At present, the Philippines has tax treaty agreements enforced with 37 countries. (Refer to Chapter 24 for more detailed discussions.) Under the Tax Code, the relief is limited and comes in the form of either a deduction or foreign tax credit for taxes paid or

incurred in any foreign country by a citizen and domestic corporation.

### **Limitation on foreign tax credits**

Credits for foreign taxes are determined on a country by country basis. The maximum credit available will be limited to the amount of Philippine tax payable on income earned from each country. For example, if a Philippine company has taxable income of ten million Philippine pesos, of which one million Philippine pesos are interest earned from a Hong Kong company while three million Philippine pesos are profits earned by its Hong Kong branch, the credit for any tax paid in Hong Kong will be limited to 40% of the Philippine tax payable on ten million Philippine pesos.

There is, however, a further limitation, based on the total amount of foreign-sourced income that the taxpayer earns. If, for example, the company had incurred a loss in its Malaysian branch of one and a half million Philippine pesos so that its net foreign income was only two and a half million Philippine pesos the credit for any tax paid in Hong Kong would be limited to 25% of the Philippine tax payable on ten million Philippine pesos.

If a deduction is taken for foreign taxes, the amount of deduction will be determined solely by the amount of foreign taxes paid or incurred.

### **Branches**

Subject to the limitations discussed in the previous section, any foreign taxes paid on

the income of a branch of a domestic corporation will be creditable against income tax or deductible from gross income in determining the Philippine tax payable on the income.

If the activities of a branch result in a loss, the loss is deductible against other income of the corporation. If the branch subsequently becomes profitable, those profits will be taxed in the year derived.

### **Subsidiaries**

Subject to the limitations discussed above, any tax payable to a foreign country on a dividend paid to a shareholder resident in the Philippines will be creditable against, or deductible from tax due in determining, the Philippine tax payable on the income. A credit is available, however, only to the extent that tax is paid by or for the shareholder. A credit will not arise for underlying taxes paid by the foreign subsidiary on its income.

The profits of the foreign subsidiary shall be subject to Philippine tax only when distributed by way of dividends to shareholders residing in the Philippines.

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# **Chapter 19**

## Partnerships and joint ventures

### ***Investor considerations***

- Partnerships are not tax effective vehicles for conducting business. Most partnerships are taxed as corporations for income tax purposes. At the same time, the partners are separately taxed on their share in the after-tax profits of the partnership, whether distributed or not.
- The exception is for general professional partnerships, which are treated as conduit vehicles with the income taxed only in the hands of the partners.
- In practice, joint ventures exist in the traditional sense only for certain investments in the construction and energy sectors, in which case; they are treated as conduit vehicles for tax purposes with the income taxed in the hands of the joint venture partners. Other joint ventures are taxed in the same manner as partnerships.

## **Partnerships**

### **Entity or conduit**

For tax purposes, it is necessary to differentiate between ordinary partnerships and general professional partnerships. Partnerships have a juridical personality separate and distinct from those of the partners and ordinarily are taxed as separate entities. General professional partnerships, however, are taxed as conduit vehicles, with income being taxed only in the hands of the partners.

In general, any person who can enter into contractual relations may become a partner. A partnership can also become a partner in another partnership, either with natural persons or with other partnerships.

A corporation may not be a partner in a partnership as a matter of public policy. The Securities and Exchange Commission may, however, allow a corporation to become a partner in a partnership where the contract of partnership provides that it is to be managed jointly by all the partners and that the partners are to be collectively liable to partnership creditors. The corporation must also be permitted to enter into a partnership by its Articles of Incorporation.

### **Taxable income**

Partnerships ordinarily are taxed on the same basis as corporations. At the same time, however, the partners' shares in the after-tax profits of the partnership are subject to tax in the hands of the partners,

whether the income is distributed or not. Resident individual partners are subject to tax on such profit shares at the rate of 10%. On the other hand, nonresident individual partners are subject to tax at the rate of 25%, although this rate may be reduced under a relevant tax treaty. No relief is provided to recognize tax paid at the partnership level.

General professional partnerships, however, are not subject to income tax. Instead, the partners in a general professional partnership are taxed in their individual capacities on the basis of their shares in the net profits of the partnership. If a general professional partnership incurs an operating loss, the partners may carry their share of the loss forward and offset it against income earned in the succeeding three years.

### **Taxation of foreign partners**

Ordinary partnerships are treated under Philippine law as having a separate legal existence from their partners. Foreign partners will be subject to tax on their share in the after-tax profits of the partnership, whether or not that income is distributed.

From a tax treaty standpoint, partnerships are entitled to benefit from treaty provisions in their own right. The separate legal existence of partnerships also means that a nonresident partner could not be considered to have a permanent establishment in the Philippines merely because the partnership is engaged in business activities in the Philippines.

## ***Joint ventures***

A joint venture established in the traditional sense would be treated as a partnership. To overcome the punitive nature of the tax and other rules applying to partnerships, the common approach for joint ventures in the Philippines is to establish a new corporation, with the joint venture partners becoming shareholders in that corporation. Normal corporate taxation principles would then apply (see Chapters 15 and 17).

The exception concerns investments in construction projects and energy operations pursuant to an operating or consortium agreement under a service contract with the Philippine government. In these cases, the joint venture would be treated as a conduit vehicle, with the joint venture partners taxed directly on their own share of the income from the joint venture.

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# **Chapter 20**

## **Taxation of individuals**

### ***Tax planning for expatriates***

#### **Resident/Nonresident status**

Alien expatriates will generally qualify for nonresident status if their assignment is for a fixed period of time. In most cases, nonresident status will offer slight tax advantages provided that a certain threshold period is not exceeded during any calendar year.

It also reduces the extent to which Philippine donor's and estate taxes might become payable.

#### **Pre and post-assignment periods, bonuses**

Under the Tax Code and Philippine tax treaties, the taxability of compensation payments in whatever form is determined by the place where the services to which the compensation relates are performed, rather than the time or place where the compensation is paid.

#### **Job-related activities partially outside the Philippines**

Aliens are taxed only on Philippine-sourced income. Income from services rendered outside the Philippines is exempt from Philippine income tax.

#### **Special foreign assignment allowances**

Actual expenses associated with relocating an expatriate to the Philippines are deductible to the employer, but are not taxable to the employee.

### **Structuring employment packages**

The provision of fringe benefits such as housing accommodation, the use of motor vehicles, retirement, group insurance, and group hospitalization benefit plans are subject to more favorable tax treatment than equivalent cash compensation payments. The appropriate structuring of a package as a mixture of compensation and benefits can reduce the amount of Philippine tax payable.

### **Social security contributions**

Employers are required to deduct various social security contributions from compensation paid to expatriates. As of 2013, the maximum deduction is PHP1,037.50 per month for employees (inclusive of SSS, HDMF, and PhilHealth contributions).

### **Special tax concessions**

Income received by alien executives of a Regional or Area Headquarters or Regional Operating Headquarters of a multinational company, an offshore banking unit, or a foreign service contractor or subcontractor engaged in petroleum operations is taxed at a flat rate of 15% based on gross income. It might be possible for an employer to establish a regional headquarters to benefit from this concession (see Chapter 4).

### **Timing of arrival/departure**

Nonresident aliens have some potential for reducing their Philippine tax through appropriate timing of their arrival and departure from the Philippines. If they are present in the Philippines for an aggregate of 180 days or less during any calendar year, they will be subject to a flat 25% rate of tax for the year, instead of the progressive tax rates of up to 32%.

## ***Territoriality and residence***

Individuals are classified into the following categories for income taxation purposes:

- Resident citizens are liable for tax on their worldwide income;
- Nonresident citizens are liable for tax only on their Philippine-sourced income;
- Aliens are liable for tax only on their Philippine-sourced income.

There is also a distinction between resident and nonresident aliens, and this can have some bearing on the rate of tax payable in the Philippines. A resident alien is an individual who is stateless or is a national of another country and who lives in the Philippines with no definite intention as to length of stay, but who is not a mere transient or sojourner. An expatriate working in the Philippines on a contract for an indefinite period potentially falls into this category. Progressive tax rates of between 5% and 32% will apply for the entire period of a resident alien's stay in the Philippines. Because the 32% rate applies to annual taxable income exceeding PHP500,000, which approximates US\$12,500 using an indicative exchange rate of PHP40 to US\$1, it is likely that the majority of an expatriate's income will be subject to this rate of tax.

Most expatriates will be classified as nonresident aliens, because their contracts will be for a specified period of engagement. A nonresident alien who is not engaged in trade or business in the Philippines and is present in the Philippines

for 180 days or less during any calendar year will be subject to tax at a flat rate of 25% of gross taxable income for that year. In most cases, this will be less than the amount of tax that would be calculated using progressive rates, so there is some potential for tax savings through the appropriate timing of entry to and exit from the Philippines.

Nonresident aliens engaged in trade or business are subject to the ordinary progressive tax rates between 5% and 32%.

Consideration should also be given to the provisions in Philippine tax treaties which often exempt from tax income earned by individuals from short-term visits to the Philippines. The Philippine tax authority requires securing a tax treaty relief ruling to confirm a tax exemption under an existing treaty.

## ***Special provisions***

Alien executives employed by certain entities are entitled to preferential tax rates under the Tax Code. A flat 15% tax applies to income received by an alien employed by a regional or area headquarters (RHQ) or regional operating headquarters (ROHQ) of a multinational company, an offshore banking unit, or a foreign service contractor or subcontractor engaged in petroleum operations. Filipinos employed and occupying the same position as those of aliens, i.e., managerial or highly technical positions, in these companies are entitled to the same concessionary rate.

Qualified Filipino employees of duly registered RHQs and ROHQs have the



option to be taxed at either 15% of gross income or at the regular progressive tax rates on their net taxable income, subject to the following tests or conditions:

1. **Position and Function Test** – The employee must be occupying a managerial or technical position and actually exercising managerial or technical functions pertaining to said position;
2. **Compensation Threshold Test** – The employee must have received or is due to receive a gross annual compensation of at least PHP975,000; and
3. **Exclusivity Test** – The employee must be exclusively working for the RHQ or ROHQ as regular employee (not just a consultant or contractual personnel).

## Gross income

### Employee services

Taxable compensation income includes all remuneration for services performed by an employee for an employer, such as salaries, wages, bonuses, honoraria, taxable pensions, tax reimbursements, allowances (e.g., living, education, transportation, entertainment, and the like), fees (including directors' fees), and other income of similar nature, whether monetary or non-monetary.

There is some scope to reduce the amount of Philippine tax payable through the provision of fringe benefits to managerial or supervisory level employees. Benefits subject to fringe benefits tax are excluded from taxable compensation. Fully taxable

fringe benefits will not offer any tax savings, as they are subject to 32% tax on their grossed-up monetary value (reduced to 25% if the beneficiary is a nonresident alien subject to the 25% flat tax and 15% for employees subject to the 15% flat tax rate). However, certain benefits are entitled to a lower rate of tax or are entirely exempt.

- Only 50% of the benefit provided to an employee by way of company-owned or leased housing accommodation or motor vehicle is treated as a taxable fringe benefit.
- Benefits for the convenience or advantage of the employer, or that are required by the nature of the trade, business, or profession of the employer, are treated as non-taxable fringe benefits.
- Contributions for the benefit of the employee to retirement, group insurance, and group hospitalization benefit plans are not subject to fringe benefits tax.
- Fringe benefits that are of relatively small value ("*de minimis*" benefits) are exempt from both fringe benefits tax and income tax.

### Capital gains

Special rules apply to sales of shares of stock and sales of real property.

- The first PHP100,000 of net capital gains from sale of shares of stock of domestic corporations not traded in the Philippine Stock Exchange are subject

to 5% tax, with 10% applying to any excess.

- Sale of shares in traded companies, other than by a dealer in securities and facilitated through the local stock exchange, is subject only to a tax of 0.5% on the gross selling price or gross value in money of the shares sold, subject to the Minimum Public Ownership (MPO) condition.
- A 6% tax is imposed on presumed gain from the sale, exchange, or disposition of any land or building not used in the business of a taxpayer. The tax is imposed on the selling price or the fair market value of the land or building, whichever is higher.

Capital gain from other property located in the Philippines is subject to Philippine tax, regardless of the nationality or residence of the person deriving the gain. Capital loss is deductible, but only to the extent of capital gain derived in the same year. If an asset has been held for more than 12 months, only 50% of the gain or loss will be taxable or deductible. Individuals may carry-over excess net capital loss subject to certain limitations, and apply them against capital gain in the subsequent tax year.

### **Other income**

- **Passive income**

Passive income derived by individuals from Philippine sources is usually subject to a fixed rate of tax, with taxation withheld at source when the payor is a resident in the Philippines.

The rates of tax range up to 20% for citizens and resident aliens and 25% for nonresident aliens, depending on the type of income being earned (see Appendix VI).

- **Foreign income**

Foreign income derived by a resident Philippine citizen, including passive income, is subject to tax at ordinary tax rates.

Aliens are subject to Philippine tax only on their Philippine-sourced income. This means that rental income from personal homes abroad will not be taxable in the Philippines, nor will losses be deductible. Compensation paid by a Philippine employer for services performed outside the Philippines should also be treated as foreign-sourced income not subject to Philippine tax. In this regard, the following tax principles adopted internationally should be noted, i.e., source is defined with respect to the place where services are rendered, not the place where compensation is paid. Thus, bonuses relating to services performed before an alien employee came to the Philippines but paid while the employee is in the Philippines are not subject to Philippine tax.

Conversely, remuneration paid to an employee relating to services rendered while in the Philippines has a Philippine source and is taxable unless exempted under a relevant treaty, even

if the employee has left the Philippines before the remuneration is paid.

- **Pensions and annuities**

Returns of premiums are excluded from gross income.

Annuities are generally taxed as ordinary income. However, aliens will not be subject to tax on annuities accruing from foreign sources.

### **Closely-held companies**

There are no special tax consequences for the individual shareholders of closely-held corporations. Dividends paid by such corporations will be taxed in the same way as dividends from any other corporation.

### **Deductions**

#### **Business**

Self-employed individuals are entitled to deductions from their gross income on the same basis as corporations (see Chapter 15). Alternatively, self-employed individuals may elect to take a standard deduction equal to 40% of their gross sales or receipts.

#### **Non-business**

The only deductions available for non-business expenses are for social security contributions, and for medical insurance up to a maximum of PHP2,400 per family per year provided that the family has a combined gross income of not more than PHP250,000 for the taxable year.

### **Personal allowances**

A basic personal exemption amounting to PHP50,000 is granted for each individual taxpayer per year. An additional exemption of PHP25,000 per qualified dependent child (QDC) is available for each QDC but not to exceed four.

The personal exemptions of a nonresident alien individual engaged in trade or business in the Philippines are limited to the amount of exemptions his home country would allow to a Philippine citizen that is not residing there but not to exceed the amount of personal exemptions allowed in the Philippines.

### **Double taxation relief**

Under the Tax Code, relief from double taxation of foreign income is generally provided to resident Filipino citizens by way of a credit for foreign taxes paid. The amount of foreign tax credit is essentially limited to the amount of Philippine income tax payable on the foreign income (see “Double taxation relief” in Chapter 18).

If the foreign tax is paid in connection with the taxpayer’s profession, trade or business, the taxpayer can opt to take a deduction, rather than a credit, for the foreign tax.

### **Tax computation**

#### **Taxable income**

The taxable income of individuals deriving compensation income (from an employer-employee relationship) is determined by deducting their personal and additional exemptions from their gross compensation

income. (See Appendix VIII for a sample tax calculation.)

Individuals deriving income other than compensation income may deduct certain allowable deductions in addition to the personal and additional exemptions, social security contributions, and medical insurance up to PHP2,400.

### **Social security and other contributions**

Social security contributions are withheld from the salaries of employees, both citizens and aliens, at graduated amounts based on compensation. The self-employed remit contributions directly. The monthly contribution from an employee is limited to PHP500. Employer contributions are limited to PHP1,090 per month, inclusive of PHP30 employees compensation (EC) contributions.

Both employees and employers must also make monthly contributions to the Philippine Health Insurance Corporation (PhilHealth, formerly known as “Medicare”) up to a maximum of PHP437.50. Employers must also make monthly contributions to the Employees’ Compensation Program amounting to up to a maximum of PHP30 per employee.

Home Development Mutual Fund (HDMF) contributions are also withheld from the salaries of employees, both citizens and aliens. The maximum mandatory deduction is PHP100 per month. The employer is generally required to contribute an equivalent amount.

The prescribed mandatory amounts of social security, PhilHealth, and HDMF contributions are excluded from the taxable compensation of employees.

Details of the mandatory contributions for social security are set out in Appendix XI.

### **Tax rates**

Tax is imposed on a progressive basis, with rates ranging from 5% to 32%. The 32% rate applies to any taxable income in excess of PHP500,000 per year (see Appendix VI for a schedule of the tax rates).

### **Tax credits**

Subject to certain limitations, relief from double taxation of foreign income is generally provided to resident Filipino citizens by way of a credit for foreign taxes paid (see “Double taxation relief” in Chapter 18). However, if the foreign tax is paid in connection with the taxpayer’s profession, trade, or business, the taxpayer can opt to take a deduction instead for the foreign tax.

### **Other taxes**

#### **Local taxes on income**

Local governments do not impose any tax on the compensation income of individuals.

#### **Community taxes**

Community taxes of up to PHP5,005 are imposed on every inhabitant of the Philippines aged 18 years or over, based on real property owned in the Philippines, gross receipts or earnings from business and salaries, or earnings derived from the

exercise of a profession (see Chapter 23). The details of an individual's community tax certificate are required to be indicated in his annual income tax return.

### **Wealth tax**

The Philippines does not impose any taxes on wealth owned by individuals.

### **Donor's tax**

The donor's tax applies to all transfers by a person, resident or nonresident, of property by gift. The tax is levied at progressive rates between 2% and 15% (see Appendix X) on the fair market value of gifts made during any calendar year. Gifts other than those made to close relatives are subject to a flat rate of 30%.

Donor's tax does not apply to a gift by a nonresident of real or personal property situated outside the Philippines.

Donor's tax is payable by the donor. If the donor fails to pay the proper tax, the Tax Code does not empower the BIR to recover the deficient tax from the donee. However, non-payment of the donor's tax may affect the formal transfer of ownership to the donee for certain gifts, i.e., real property and shares of stock.

### **Estate tax**

Estate tax applies to the estate of a nonresident alien only to the extent that his estate consists of property situated in the Philippines. However, tax is imposed on the worldwide estate of a resident alien (see Chapter 21 for further information.)

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# **Chapter 21**

## Taxation of trusts and estates

### ***Investor considerations***

- Trust law in the Philippines is patterned after the trust laws of the United States, but the statutory rules are not extensive.
- Income accruing to beneficiaries is taxed in their hands as ordinary income.
- Income retained by the trustee is generally taxed as if the trust was a separate entity, using the tax rates applied to individuals. However, if the trust property is able to revest in the grantor, income retained by the trust is taxed in the hands of the grantor.

## Trusts

The concept of a trust is fundamentally the same as in other countries — it involves the transfer of certain properties to a trust, with those properties held by trustees for the benefit of the grantor or one or more other beneficiaries.

### Types of trusts

Trusts may either be testamentary, express or implied. A testamentary trust is created by will. An express trust is created by the intention of a trustor or by the intention between affected parties. An implied trust comes into being by operation of law.

### Taxation of trusts

Trusts are characterized either as irrevocable or revocable trusts for tax purposes.

1. Irrevocable trust — An irrevocable trust is one where the grantor abandons ownership of and control over the principal and income of the trust property under terms and conditions that cannot be changed or revoked by the grantor or any other person. An irrevocable trust is treated as a distinct taxable entity. The income of the trust will essentially be calculated in the same manner as an individual. Any of the income that does not accrue to the beneficiaries will be taxed in the hands of the trustee at the rates applicable for individuals.
2. Revocable trust — A revocable trust is one where the grantor retains the right to change the terms and conditions of

the trust. It also includes a trust where the grantor, or a person who does not have a substantial interest in the disposition of the corpus or income of the trust, has the power to revest in the grantor the title to any part of the trust corpus. In a revocable trust, any income other than that accruing to the beneficiaries is taxable in the hands of the grantor.

The first PHP20,000 income earned each year by a trust is exempt from tax.

If two or more trusts have the same creator and beneficiary, tax is computed on their consolidated income and the PHP20,000 exemption will be permitted only once. The tax on the consolidated income will be collected from the trustees in proportion to the net income of the respective trusts.

Employee pension trusts established under conditions laid down by law are exempt from income tax.

### Taxation of beneficiaries

The beneficiaries' distributive share in the net income of a trust or estate is included in their tax returns as ordinary income and taxed accordingly. The trustee is required to deduct a 15% creditable withholding tax from the income.

### Tax treatment of trustor/grantor

The tax treatment of the trustor/grantor will depend on whether any power or interest in the trust or in its income has been retained. For a revocable trust, when the trustor/grantor retains certain powers or interests, the trustor/grantor is required

to include the income of the trust in his income tax return. For an irrevocable trust, however, the trustor/grantor does not retain any powers or interests, so there is no need to report any income.

estate consists of property situated in the Philippines. Nonresident citizens of the Philippines remain subject to estate tax on their worldwide estate.

### **Use of trusts**

There appears to be little potential for trusts to be used for tax planning purposes in the Philippines.

The statutory laws on trusts generally are not extensive. However, the Philippines follows the principle that when a statute is adopted from a foreign jurisdiction, it is presumed also to have adopted the construction of that statute. Because the Philippine tax rules for trusts are traced from the United States, an express trust established to operate a business is likely to be classified as an association, subject to normal corporate taxation.

Donor's tax of up to 30% is imposed on contributions made to an irrevocable trust.

### ***Estates***

Estate tax is imposed on the net estate (gross estate less allowable deductions) of a decedent, based on the rates in Appendix X. The gross estate consists of all property, real or personal, tangible or intangible, regardless of where it is situated. Various deductions are permitted in determining the amount of the net estate, including a standard deduction of one million Philippine pesos, as well as one million Philippine pesos for family home.

Estate tax applies to the estate of a nonresident alien only to the extent that his



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# Chapter 22

## Value-added tax

### *Investor considerations*

- VAT rate is either 12% or zero-rated.
- Export sales may be zero-rated, subject to certain requirements being met. Sales to firms located in special economic zones are also zero-rated.
- The Bureau of Internal Revenue (BIR) will generally not allow foreign suppliers to register for VAT unless they are licensed with the Securities and Exchange Commission (SEC) to do business in the Philippines.
- Refunds may be obtained only for excess input credits that arise from zero-rated sales or when a person ceases business.
- A tax credit certificate (used to pay other internal revenue taxes) can be sought instead of a refund. Tax credit certificates may be obtained for unused input tax within two years after the close of the taxable quarter when the sales were made or within two years from retirement of one's business, as the case may be.
- Obtaining a refund or tax credit certificate can be a drawn-out process, so if feasible, taxpayers should structure their arrangements to reduce the likelihood that excess input credits will arise.
- Taxpayers that are exempt from VAT by virtue of having gross receipts of less than PHP1,919,500 are subject instead to a 3% percentage tax on their gross receipts (see Chapter 23).

## **Background/General description**

The VAT was introduced in the Philippines in 1988. VAT is collected on the value added at each stage of the supply chain. Registered persons account for VAT on their sales, less a credit for VAT incurred on their inputs.

The VAT, being an indirect tax, may be passed on to the buyer/customer. The VAT-registered buyer/customer may use the passed on VAT as input VAT against its VAT liability (output VAT).

The BIR and the courts can be quite strict about compliance with various documentation requirements. Imprecise documentation can result in the loss of input credits. It is important, therefore, to ensure that documentation is prepared correctly.

## **Taxpayers**

In general, any person importing goods or engaged in the sale of goods or services in the Philippines is subject to VAT. Taxpayers whose annual sales or gross receipts from VATable transactions exceed PHP1,919,500 are required to register for VAT. On the other hand, taxpayers whose turnovers are below the exemption threshold may voluntarily register for VAT or are otherwise generally subject to percentage tax.

## **Basis of VAT**

### **Taxable transactions/activities**

As a general rule, sales, exchanges, leases, and services made, entered into or

rendered in the regular conduct or pursuit of a commercial or economic activity are subject to VAT. Services performed in the Philippines by nonresidents, and royalties or rentals paid to nonresident foreign licensors or lessors, are subject to VAT but to be withheld by the Philippine payor.

The VAT system contains numerous exempt transactions (see Appendix XII for the list of exempt transactions).

Zero-rating is also available for certain transactions, including exported goods and services rendered to nonresidents. However, for the supply of services to nonresidents to be considered zero-rated, payment must be made in an acceptable foreign currency (essentially one of the more widely traded international currencies) in accordance with Bangko Sentral rules. In practice, remittance into the Philippine banking system is also expected. If the payment is not made in this manner, the 12% VAT rate will remain applicable. Sales to entities that are effectively exempt from tax, such as those registered and located in the special economic zones, are also zero-rated.

### **Rates**

Transactions will be either subject to the standard 12% VAT rate, zero-rated, or exempt from VAT. However, sales of goods and services to government agencies/entities are subject to 5% final withholding VAT. Gross payments by government and private entities to nonresidents for services rendered in the Philippines are also subject to 12% final withholding VAT.

## **Invoicing**

A VAT-registered person is required to issue VAT invoice (for sale of goods) and VAT official receipt (for sale of services). Input tax to be allowed as tax credit should be evidenced by proper VAT invoice or official receipt, as the case may be.

## **Computation**

VAT-registered taxpayers are required to file VAT returns on a quarterly basis. However, they are also required to file VAT declarations and pay VAT on a monthly basis.

The amount of VAT payable for a period is calculated by deducting any input VAT paid on purchases and importations from the amount of output tax charged on sales in that period. VAT on goods is generally accounted for on the basis of sales that are consummated during a period, even if the payment is made in another period. On the other hand, VAT on services, are accounted for on the basis of actual or constructive receipts during the period.

## **Excess input credits**

As a general rule, excess input credits are carried forward and offset against output tax payable in the following quarters. However, when the input VAT credits arise from zero-rated sales, the taxpayer may file a claim for refund or the issuance of a tax credit certificate within two years after the close of the taxable quarter when the export sales were made.

A tax credit certificate may be used to pay internal revenue taxes, except withholding

taxes, and is not transferable. Similarly, a taxpayer with excess input credits when ceasing to be VAT-registered may also apply for a claim for refund or tax credit certificate within two years from the cancellation of its VAT registration.

An administrative claim for refund or tax credit for excess input tax credits shall be acted upon by the BIR within 120 days from filing of the claim and complete supporting documents. If denied or not acted upon within the 120-day period, appeal can be made to the Court of Tax Appeals (CTA) within 30 days from denial or the end of 120 days even if this is already beyond the two-year period. Any appeal made before the lapse of the 120-day period in case of inaction may be a ground for dismissal of the claim.

## **Registration**

Application for registration is made with the Revenue District Office (RDO) where the taxpayer's principal place of business is located.

Foreign suppliers are generally ineligible to register for VAT unless they are licensed by the SEC to do business in the Philippines. Some care is required so that imports are routed through appropriate channels to ensure that VAT collected by the Bureau of Customs does not become an additional cost of transacting with Philippine customers. Strict compliance with import documentation requirements is also important to ensure that claims for input VAT credits are not invalidated.

The effect of registration is not retroactive. This means that any input VAT paid on purchases of goods and services before registration will be lost. It is important, therefore, to register for VAT before purchasing goods and services subject to VAT. Non-VAT taxpayers that subsequently register for VAT are entitled to an input VAT credit for inventories on hand at the time of becoming registered. However, they are not allowed an input credit for any other VAT paid while they were unregistered.

### **Administration**

The BIR administers the VAT. VAT returns without payments are filed directly with the RDO where the taxpayer's principal office is registered. Returns with payments must be filed with an accredited bank, or through the BIR's Electronic Filing and Payment System (EFPS).

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# Chapter 23

## Other indirect taxes

### **Documentary stamp tax**

Documentary stamp tax (DST) is imposed on legal and commercial documents, instruments, and papers specified in the Tax Code. The tax is generally based on the face value of the document, and the rate varies, depending on the nature of the instrument (see Appendix XIII for the list of principal stamp taxes).

If one of the parties to a taxable document is exempt from paying the stamp tax, the party who is not exempt will become liable for the tax instead.

Failure to pay the corresponding DST means that the document cannot be admitted or used as evidence in court, until the requisite stamp tax has been paid. In some cases, it will also mean that legal transfer of an asset cannot be recorded.

Returns and payments for DST must be filed within five days after the close of the month in which the document was made, signed, issued, accepted, or transferred.

Failure to do so will result in the imposition of a surcharge equivalent to 25% of the amount due, or 50% in the case of fraud, falsity, or willful violation. The deficiency tax (but not the surcharge) is subject to annual interest of 20% from the date prescribed for payment until the amount is fully paid.

### **Excise tax**

Excise taxes apply to certain articles manufactured or produced in the Philippines for domestic sale or consumption or for any other disposition and to certain imported items. For imports, excise taxes are in addition to any applicable customs duties and value-added tax.

The Philippines has both specific taxes (excise tax is based on weight, volume, or some other physical unit of measurement) and ad valorem taxes (excise tax is based on the selling price or other specified value of an article). Among the articles covered

by excise taxes are alcohol products, tobacco products, petroleum products, mineral products, jewellery, perfumes, and automobiles (see Appendix XIII for further information on the various rates of excise tax).

Excise taxes on domestic products must be paid by the manufacturer or person having possession of the items, and generally must be paid immediately before removal from the place of production or, if imported, from customs custody.

### **Percentage taxes**

Certain transactions exempt from VAT are subject instead to percentage taxes based on gross sales, receipts or earnings. The rates that apply to more significant business activities are shown in Appendix XIII.

Winnings from horse races are subject to a 10% tax, reduced to 4% if the winnings arise from a double, forecast/quinella or trifecta bet.

Sale of shares listed and traded in the stock exchange, other than those made by a dealer in securities, are subject to a tax of 0.5% of the gross selling price or gross value in money of the shares sold. However, the capital gain tax of 5% (on the first PHP100,000) and 10% (on the excess of the PHP100,000 gain) shall apply if the listed company fails to observe the required Minimum Public Ownership condition prescribed under Revenue Regulations 16-2012 (see note 2 in Appendix I).

For initial public offerings made by closely held corporations (corporations 50% or

more of stocks are owned by a group of 20 or fewer individuals), a tax of between 1% and 4% is payable, depending on the percentage of the shares in the company being offered.

### **Returns and payments**

Generally, percentage taxes are payable within 20 days from the end of the month. Other percentage taxes such as: overseas communication tax, amusement tax, tax on winnings, and tax on sale of shares sold through the Philippine Stock Exchange or through initial public offering, are payable within their specific applicable periods as stated in the Tax Code.

Taxpayers making payment through the Bureau of Internal Revenue's Electronic Filing and Payment System (EFPS) are given a grace period of five days within which to file their returns and pay the tax.

### **Real property tax**

An annual ad valorem tax is imposed on real property such as land, buildings, machinery, and other improvements attached to real property, as well as other facilities not permanently attached but used in business. The tax is based on assessed value, which is arrived at by applying an assessment level percentage to the current market value of the property. (See Appendix XIII for the tax rates and assessment levels.)

### ***Local taxes***

Cities and municipalities levy license fees and taxes on almost all types of businesses. The fees are generally nominal. Local business taxes on most business establishments are based on gross sales or gross receipts; others are fixed in amount. The rates vary depending on the city or municipal ordinance, but maximum amounts are set by the Local Government Code. The maximum rate under the law is 3.63% of gross revenues, but in practice, a maximum rate of 0.91% is likely to apply for most businesses.

### ***Community tax***

The annual basic community tax is PHP5 for individuals and PHP500 for corporations. The annual additional community tax is graduated on the basis of gross earnings or receipts (exclusive of dividends) and real property owned. The maximum community tax is PHP5,005 for individuals and PHP10,500 for corporations.

### ***Deductibility***

All the above taxes may be deducted as business expenses.

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# Chapter 24

## Tax treaties

### *Investor considerations*

- The Philippines currently has a network of 37 tax treaties. Several others are at various stages of negotiation.
- As an emerging economy, the Philippines tends to pattern its tax treaties more on the United Nations Model than on the Organization for Economic Co-operation and Development (OECD) Model.
- The rules in the tax treaties for taxing inward investment into the Philippines are clearly more favorable than their domestic counterparts. The effective use of treaties will offer significant opportunities to facilitate tax planning for Philippine operations.
- Withholding tax rates under Philippine treaties remain relatively high by global standards, but are significantly lower than the rates applicable under domestic law.
- The Bureau of Internal Revenue (BIR) requires taxpayers to apply formally for treaty relief, even if the transactions involved are straightforward.



## **Tax treaty policy**

The Philippine government has not formally stated its policies and objectives regarding tax treaties. There have been, however, a number of new treaties negotiated in recent years, and several others are known to be in the pipeline, suggesting that the government is keen to expand its network.

Tax treaties are seen to be a means of encouraging inward investment into the Philippines. They can offer significant tax savings on passive income earned from the Philippines, such as interest and royalties, as well as a more stable basis for determining the extent to which Philippine tax will be imposed on local business operations.

As an emerging economy, the Philippines tends to pattern its tax treaties more on the United Nations Model than the OECD Model. The Commentary to the OECD Model Tax Convention, however, is the authority usually referred to by the local authorities in support of their interpretation of Philippine treaties.

Philippine tax treaties always take precedence over the provisions of the Tax Code, except when the Tax Code provides for more favorable tax treatment.

## **Withholding taxes**

Under domestic law, the general rule is that Philippine-sourced income paid to nonresident corporations is subject to 30% withholding tax. The exceptions include the following.

1. Cinematographic film rentals – 25%.
2. Leasing of vessels – 4.5%.
3. Leasing of equipment – 7.5%.
4. Interest on foreign loans – 20%.
5. Dividends – 15% or 30%, depending on circumstances.
6. Capital gains from sales of shares not traded in the stock exchange – 5% or 10%, depending on the amount of gains.

The withholding tax rates on interest, dividends, and royalties are generally reduced under Philippine tax treaties. It is difficult to describe Philippine treaties in general terms, as the positions adopted are not always consistent, and can vary quite widely from treaty to treaty.

Details of the rates under the various Philippine tax treaties are set out in Appendix IV.

## **Dividends and branch profit remittances**

Most Philippine treaties adopt split rates for dividends, based on whether they are paid on portfolio investment or substantial holdings. In most treaties, the threshold for substantial holdings is 25% ownership, although some treaties adopt a 10% threshold.

In more recent treaties, the Philippines has tended to adopt a 15% rate for portfolio dividends and 10% for substantial holdings. For earlier treaties, however, the rates tend to be 25% for portfolio dividends and 15% for more substantial holdings.

Most Philippine treaties also contain a rule preserving the Philippines' right to impose tax on branch profit remittances. Under domestic law, the branch profits remittance tax rate is 15%. Most treaties preserve this rate, although a few reduce it to 10%. The most notable treaties that do not contain a provision on branch profit remittances are those with the United Kingdom and Singapore. These treaties may be interpreted to permit the profits of branch operations to be remitted free of Philippine tax.

## **Interest**

In general terms, the rate of tax on interest under Philippine treaties is 15%. Some of the more recent treaties, however, have adopted a lower rate of 10%, and the indication seems to be that this is the rate that might be expected to be adopted in future treaties.

Many Philippine treaties also provide for a lower 10% rate to apply to interest paid on publicly issued bonds, and to interest paid by entities registered under Philippine investment incentive laws. It is also common for a treaty to exempt from Philippine tax interest paid by the Philippine government or received by a foreign government.

## **Royalties**

In more recent treaties, the Philippines has adopted a 15% rate for royalties across the board. In older treaties, however, the rate tends to be 25%, reduced to 15% in limited circumstances. In a few isolated cases, a

10% rate is available for royalties paid by an entity registered under Philippine investment incentive laws.

A number of Philippine treaties contain most favored nation (MFN) provisions, limiting the Philippine rate to the lowest applying to similar royalties paid to a resident of a third State. The recent tax treaties with Bahrain and the Czech Republic have the effect of reducing the Philippine tax rate on non-cinematographic film royalties to 10% across the board for countries with MFN provisions.

## ***Permanent establishment***

Philippine tax treaties tend to follow the United Nations Model Convention in the Permanent Establishment article. The main implication is that most Philippine treaties contain a rule deeming a permanent establishment to arise when services are performed in the Philippines for a specified period of time. The maintenance of a warehouse for delivery can also result in a deemed permanent establishment.

The Business Profits article in most Philippine treaties permits the Philippines to tax only those profits attributable to a permanent establishment. There are, however, a few exceptions that allow the Philippines to tax other profits using the force-of-attraction principle, meaning that the Philippines can potentially also tax local profits that do not relate to the activities of the permanent establishment.

The rules in Philippine treaties for attributing income to a permanent establishment typically follow closely the

standard formulation of the United Nations Model Convention. The BIR has not stated any formal position on how branch profits should be determined under a treaty, but investors should not anticipate any real difficulties in adopting attribution principles applied internationally.

Attribution of income under the provisions of the tax treaties is in marked contrast to that under domestic law. Under the Tax Code, it is the place where the actual sale is consummated, rather than where the business activities of an entity are conducted, that determines the extent to which income from the sale of personal property should be subject to tax as Philippine-sourced income. Case Law has provided a similar perspective on source-based income taxation when it was ruled that income derived from airline ticket sales sold in the Philippines is taxable here even if the flights originated outside of the Philippines (Commissioner of Internal Revenue vs. BOAC).

### ***Personal services***

Under domestic law, an employee is subject to tax on any income earned from the exercise of employment in the Philippines. No exemption is available even if the employee is only in the country for a short period and employed by a foreign company that does not have any business operations in the Philippines.

All Philippine treaties contain a rule that exempts employees from Philippine tax on their employment income if they are in the Philippines for less than a prescribed

period and meet certain other conditions. The actual requirements vary by treaty. In most cases, the time test is 183 days in either a calendar year or a 12-month period, although the period is shorter in a couple of treaties. The employer cannot be a Philippine resident, although the test in some treaties is the narrower one that the employer must be resident in the same state as the employee. Finally, the cost of the employee's salary cannot be borne by a Philippine permanent establishment.

### ***Other articles***

The other articles contained in Philippine treaties tend to follow those adopted internationally. For example, the Philippines can generally tax income from the alienation of real property located in the Philippines.

The main exception concerns income from international transportation. Philippine tax treaties typically allow the Philippines to impose 1.5% tax on the gross revenues that nonresidents earn in the Philippines from the operation of ships or aircraft in international traffic.

### ***Elimination of double taxation***

For Philippine residents investing in other countries, Philippine treaties relieve double taxation by providing for a credit to be given for foreign tax. This reinforces the Tax Code provision having similar effect.

For investors into the Philippines, the treaties provide for double taxation to be relieved by way of credit or exemption,

depending on the treaty policy of the investor's home country.

A number of Philippine treaties provide for inward investors to be entitled to an additional tax sparing credit in their home State.

### ***Anti-abuse of treaties***

With the exception of the treaties concluded with Israel and Switzerland, Philippine tax treaties do not contain limitation of benefits provisions.

The BIR requires taxpayers to apply formally for treaty relief, even if the transactions involved are straightforward. The existing rules strictly require that treaty relief applications in the prescribed form, must be filed with the International Tax Affairs Division of the BIR before the transaction or the occurrence of the first taxable event, i.e., the first or the only time when the income payor is required to withhold the applicable tax. Failure to comply within the filing deadline shall result to entitlement to the treaty benefits only starting from the date of filing of the application.

### ***Exchange of information***

With the exception of a recent agreement with Bahrain, all Philippine tax treaties contain an Exchange of Information article. The BIR does not, however, release details on the extent to which it initiates information exchanges under this article, so the extent to which it is used in practice is uncertain.

In 2010, the Philippine government passed a law giving authority to the Commissioner of Internal Revenue to inquire into bank deposit accounts and other related information held by financial institutions of a taxpayer upon request for supply of tax information from a foreign tax authority pursuant to an international convention or agreement on tax matters to which the Philippines is a party. Foreign tax authorities may also request to inspect returns filed by a taxpayer under this law.

### ***Competent authority/mutual agreement***

Philippine tax treaties generally follow the Mutual Agreement Article contained in the OECD and United Nations Model Tax Conventions, so that there is potential for inward investors to seek assistance from the Competent Authority in their home State if issues arise with the way in which the Philippines imposes tax. The procedure has not, however, been widely tested to date.

# Chapter 25

## Introduction to PwC

### ***PwC helps clients create the value they're looking for***

We recognize that value means different things to different people. That's why we build relationships with our clients and our people — to understand their goals and ambitions, and the things they value.

Isla Lipana & Co., a Philippine member firm of PwC, helps organizations and individuals create the value they're looking for. We're a network of firms in 158 countries with more than 180,000 people who are committed to delivering quality in assurance, tax, and advisory services. Tell us what matters to you and find out more by visiting us at [www.pwc.com/ph](http://www.pwc.com/ph).

"PwC" is the brand under which member firms of PricewaterhouseCoopers International Limited (PwCIL) operate and provide services. Together, these firms form the PwC network. Each firm in the network is a separate legal entity and does not act as agent of PwCIL or any other member firm. PwCIL does not provide any services to clients. PwCIL is not responsible or liable for the acts or omissions of any of its member firms nor can it control the exercise of their professional judgment or bind them in any way.

## ***Isla Lipana & Co. is PwC in the Philippines***

PwC refers to the Philippine member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see [www.pwc.com/](http://www.pwc.com/) structure for further details.

We at Isla Lipana & Co. have provided professional services in the Philippines for more than 90 years. We stick to the highest quality standards in delivering audit and assurance, tax, and advisory services within and outside the Philippines.

Our clients include government agencies and leading corporations, both local and foreign, across different industries. We mainly serve these industries:

- Consumer and industrial products and services.
- Financial services.
- Technology, information communications, and entertainment.
- Other services and emerging enterprises.

Our diverse team of experienced professionals includes accountants, tax advisers, systems analysts, economists, human resources professionals, project development managers, industrial engineers, and investment advisors.

Our people are active in various professional, public and private sector organizations and participate in public forums involving taxation, investment incentives, and advocacy issues. We make sure we keep up with the latest

developments so that we can give clients informed advice on different issues that might affect their businesses.

## ***Isla Lipana & Co. performs audit, taxation, advisory, and Japanese business services***

We deliver quality services to our clients through our main office in Makati City and our branch office in Cebu. Currently, we have 21 partners and principals and over 700 professional staff.

### **Assurance**

The financial statement audit has never been more important. There is stronger clamour for good corporate governance and greater reliability of financial reports. This has influenced reforms in the regulatory landscape and significant changes in financial reporting standards.

The impact of the changes is embedded in our audit methodology; and we make sure our clients fully understand its effects.

We apply the full rigour of our global audit methodology (called **PwC Audit**) to our clients, and tailor it to the size and nature of their business. This methodology provides a robust assurance process that upholds a superior and distinctive audit that is of global standards.

We adhere to the PwC independence rules which are generally more stringent than local independence rules.

Some of our main Assurance services are:

- Financial statement audit

- Regulatory compliance and reporting
- Assistance on capital market transactions
- Financial accounting
- Independent controls and systems process assurance
- Internal audit.

## Advisory

Clients engage us to help solve their strategic and day-to-day problems. We do this by creating unique, value-added solutions based on the combination of industry knowledge, subject matter expertise in Consulting and Deals, and our collective experience from all areas of PwC.

We help clients implement their business strategies by working with them to:

- build effective organizations
- innovate and grow
- reduce costs
- manage crisis, risk, and regulation
- leverage talent
- execute better deals
- restructure troubled businesses.

## Consulting

We help organizations to work smarter and grow faster. We consult with our clients to build effective organizations, innovate and grow, reduce costs, manage risk and regulation, and make the most out of their talent.

Our aim is to support you in designing, managing, and executing lasting beneficial change.

## Deals

We help clients do better deals and create value through mergers, acquisitions, disposals, and restructuring. We work together with them to help develop the right strategy before the deal, execute their deals seamlessly, identify issues and points of negotiation and value, and implement changes to deliver synergies and improvements after the deal.

## Our competencies

- Business recovery services
- Finance function reviews
- Operations reviews
- Change management
- Process streamlining and documentation
- Risk management
- Corporate finance
- Due diligence
- Business forensics
- Business and market strategy
- Information technology consulting
- HR consulting
- Transaction services
- Valuations.

## Tax Services

Tax is a significant cost in business. As such, properly managing and controlling inherent tax risks are a must. And to keep up with tax developments and have a clearer understanding, top businessmen seek professional tax advice to help them manage tax risk, control costs, and seize tax planning opportunities.

To develop a comprehensive tax strategy for your business, we cover various considerations relevant to our clients' particular businesses, i.e., industry, markets, finance, economics, and government regulations. We take a consultative approach rather than focus on compliance to identify all risks.

Increasingly, companies require a variety of accounting, tax, and business services to manage risks and gain competitive advantage. Our tax professionals can provide these diverse disciplines to help you minimize tax liabilities and meet compliance obligations.

We can be your advocates with tax authorities to support a tax position that will work to our clients' advantage. And we give clients tailored, implementable, and defensible tax planning structures.

The range of tax services includes:

- Planning
- Opinions and rulings
- Assessments
- Audits
- Availment of incentives
- Claims for refund
- Business services
- Global compliance and accounting
- International assignment solutions
- Customs and international trade.

### *Start-up issues for foreign investors*

Our Tax Services team also assists foreign investors and organizations in tackling main issues in their operations related to their investment in the Philippines. Our team also helps them on how best to take advantage of the wide range of investment incentives available (see Chapter 4). We have ample experience in advising clients on all aspects of setting up a Philippine operation, and in dealing with issues such as:

- Determining an appropriate fiscal and capital structure for the organization.
- Forming the company and branch, including registering with relevant government agencies.
- Identifying incentives that may be available, and preparing applications to proper government agencies.
- Doing feasibility and location studies.

### *Legal services*

For engagements that call for legal services, we can refer our clients to our correspondent law firm Cabrera Lavadia & Associates, a connected firm to PwC global legal services network that specializes in tax consultation. This firm handles corporate services work, such as business



registrations, government compliance, mergers, acquisitions, insolvency, corporate restructuring, and corporate secretarial services. It also assists in immigration applications and labor issues, legal due diligence reviews, and court cases.

### *Japanese business development*

Our Japanese Business Development group assists Japanese firms operating or preparing to operate in the Philippines. They make sure that we serve our Japanese clients despite the differences in cultures, languages, and business practices.

### *Customs and international trade*

The Worldtrade Management Services (WMS) is a regional customs and international trade consulting practice of PwC.

The WMS practice in Asia has a team based in the region including Japan, China, Hong Kong, Indonesia, Malaysia, Philippines, Singapore, and Thailand. They come from different sectors—including ex-senior government officials, customs officials, tax lawyers, financial accountants as well as people from the private sector who have experience in logistics and trade.

The Philippines accesses WMS technical services in providing customs and international trade services in the following areas.

- Customs planning, risk management and tariff advice, including assistance with valuation and tariff preference issues, ruling applications to the Tariff Commission and Bureau of Customs,

Super Green Lane accreditation, and customs bonded warehouse application and implementation.

- Dispute resolution, such as Value and Classification Review Committee (VCRC) and tentative release.
- General customs management support, such as customs broker selection and engagement, and performance review.
- Anti-dumping protests and safeguard measures.
- Refund and duty drawback application.
- Post-entry audit related matters.

For more information on PwC in the Philippines, visit our website at [www.pwc.com/ph](http://www.pwc.com/ph).

# Appendix I

## Corporate income tax rates

### 2012 rates

	Domestic/ resident Rates (%)	Nonresident foreign corporation Rates (%)
Taxable income not subject to special tax rates	30 <sup>1</sup>	30 <sup>1</sup>
Interest from deposits and yield from deposit substitutes/trust funds and royalties	20	30 <sup>1</sup>
Interest on foreign loans	N/A	20
Interest income from a depository bank under the expanded foreign currency deposit system	7.5	N/A
Dividends from domestic corporations	0	15/30 <sup>1</sup>
Gains on sales of shares of stock not traded in the Stock Exchange	5/10 <sup>2</sup>	5/10 <sup>2</sup>

Entity	Rates (%)	Tax base
Proprietary educational institutions and non-profit hospitals	10 <sup>3</sup>	Taxable income
Certain enterprises registered with the Philippine Economic Zone Authority	5 <sup>4</sup>	Gross income
Nonresident lessors of aircraft, machinery and other equipment	7.5	Gross Philippine rentals, lease, charter fees
Nonresident owners or lessors of vessels chartered by Philippine nationals and approved by the Maritime Industry Authority	4.5	Gross Philippine rentals, lease, charter fees
Nonresident cinematographic film owners, lessors or distributors	25	Gross Philippine-sourced income
Foreign international carriers (air and sea)	2.5	Gross Philippine billings
Offshore banking units (OBUs) and foreign currency deposit units (FCDUs) authorised by the Bangko Sentral ng Pilipinas	10	Interest income from foreign currency loans granted to residents
Regional operating headquarters	10	Taxable income

### Notes

1. The rate of 15% applies if the country where the nonresident is domiciled exempts the dividend from tax or permits a 15% or greater credit for taxes deemed paid in the Philippines.
2. The 5% rate applies to the first PH₱100,000 gain, with the 10% rate applying to the excess. Shares of stock in listed companies are generally subject to a 0.5% tax on the sale proceeds. However, under existing revenue issuances, the 5% and 10% rates shall apply if the sale of listed shares is pre-arranged or where the buyer is predetermined or in any case where the public cannot take part in trading, or if the listed company fails to observe the Minimum Public Ownership (MPO) of at least 10% of the company's issued and outstanding shares exclusive of treasury shares or such percentage as may be prescribed by the Securities and Exchange Commission or Philippine Stock Exchange, whichever is higher.
3. If the gross income from unrelated trade, business, or other activity of proprietary educational institutions and non-profit hospitals exceed fifty percent (50%) of their total gross income derived from all sources, the 30% corporate tax rate shall be imposed on the entire taxable income.

The term "unrelated trade, business, or other activity" means any trade, business, or other activity, the conduct of which is not substantially related to the exercise or performance by such educational institution or hospital of its primary purpose or function.

4. The 5% preferential tax rate shall be deemed applicable only to those income derived from the entity's registered activity/ies.

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# ***Appendix II***

## **Tax depreciation rates**

The Philippines does not have prescribed depreciation rates. Deductions are based on a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property (except land) used in the trade or business of a taxpayer.

The Tax Code cites explicitly the straightline method, the double-declining-balance method, and the sum-of-the-years-digits method as acceptable methods for computing depreciation. In practice, the depreciation and amortization methods and rates used for financial reporting are generally also allowed (see also “Valuation of Assets” in Chapter 12).

In the case of a resident foreign corporation, depreciation is allowed only when the property is located within the Philippines.

Depreciation rates are not prescribed, but they are generally based on the estimated economic or useful lives of the assets.

Intangibles with limited life, such as patents, copyrights, and franchises, can be amortized. Those with unlimited life, such as goodwill, trade names, and formulas, are not ordinarily subject to amortization.

Gains and losses on sale of depreciated assets are considered taxable income and deductible items, respectively.

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# Appendix III

## Corporate tax calculations

### **Example 1**

Fiscal year, 31 December 2012<sup>1</sup>

#### Assumptions

1. A domestic corporation received a cash dividend of PHP80,000 from a foreign corporation and opted to claim the PHP20,000 foreign tax deducted from the dividend as a credit.
2. The corporation incurred a capital loss of PHP50,000 from the sale of non-depreciable capital assets.
3. The corporation incurred interest expense of PHP750,000.

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#### **Tax computation**

Net income per financial statement		P8,000,000
Add back non-deductible items of expenditure:		
Premium paid for life insurance policy on corporation president with the corporation as beneficiary	P30,000	
Foreign tax withheld on dividend	20,000	
Income tax paid for the first three quarters	850,000	
Capital loss on non-depreciable assets <sup>2</sup>	50,000	
Adjustment on interest expense for interest income subject to final withholding tax <sup>3</sup>	49,500	
Provision for doubtful accounts <sup>4</sup>	40,000	
Provision for inventory obsolescence <sup>5</sup>	25,000	
Unrealized foreign exchange loss <sup>5</sup>	10,000	P1,074,500

### Tax computation

Deduct income already subjected to final withholding tax, tax-exempt income and other tax deductible expenses

Interest income on Philippine currency deposits <sup>6</sup>	P150,000	
Dividends received from a domestic corporation	60,000	
Bad debts written off	80,000	
Realized foreign exchange loss	20,000	P310,000
Taxable net income		P8,764,350
Tax payable – 30% of taxable income <sup>7</sup>		2,629,350
Less-Deductions for taxes paid:		
Income tax paid for the first three quarters	850,000	
Foreign tax withheld on dividend	20,000	P(870,000)
Net tax payable with return		<b>P1,759,350</b>

### Example 2

Fiscal year, 31 December 2012

Assumptions

1. A domestic corporation received a cash dividend of PHP180,000 from a foreign corporation and opted to claim the PHP40,000 foreign tax deducted from the dividend as a deduction.
2. The corporation incurred interest expense of PHP100,000.

### Tax computation

Net income per financial statement		P1,000,000
Add back non-deductible items of expenditure:		
Income tax paid for the first three quarters	P100,000	
Adjustment on interest expense for interest income subject to final withholding <sup>3</sup>	49,500	149,500
Deduct income already subjected to final withholding tax, tax-exempt income, and other tax deductible expenses:		
Interest income on Philippine currency deposits <sup>6</sup>	150,000	
Dividends received from a domestic corporation	1,160,000	1,310,000
Net Loss for tax purposes <sup>7</sup>		<b>P(160,500)</b>

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**Tax computation**

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Tax payable – 30% of taxable income	0
Less-Income tax paid for the first three quarters	(100,000)
Tax overpayment	<u>P100,000</u>

**Notes**

1. The year-end is based on the taxpayer's annual accounting period.
2. Certain capital losses are deductible only to the extent of capital gains derived in the same year.
3. Interest paid or incurred within a taxable year on indebtedness in connection with the taxpayer's profession, trade, or business shall be allowed as deduction from gross income provided that the allowable deduction be reduced by 33% of the amount of any interest income derived by the taxpayer that has been subject to final tax.
4. A deduction is permitted only when debts become uncollectible and are written off as bad debts.
5. Deductions are permitted only when the losses are realized or sustained.
6. Final tax would have been withheld at source.
7. Subject to there not being a substantial change in ownership (see "Losses" in Chapter 15) the loss can be carried forward for up to three years.

# Appendix IV

## Withholding taxes

	Dividends		Interest <sup>1</sup>	Royalties
	Portfolio	Substantial holdings <sup>2</sup>		
Domestic rates:				
Resident individuals	10	10	7.5/20 <sup>3</sup>	10/20 <sup>4</sup>
Nonresident individuals engaged in business or present in the Philippines for more than 180 days in a year	20	20	20/Exempt <sup>3</sup>	10/20 <sup>4</sup>
Other nonresident individuals	25	25	25/Exempt <sup>3</sup>	25
Domestic corporations and foreign corporations doing business in the Philippines	Nil	Nil	7.5/20 <sup>3</sup>	20
Nonresident foreign corporations	15/30 <sup>5</sup>	15/30 <sup>5</sup>	20/30/Exempt <sup>6</sup>	30
Treaty tax rates:				
Australia	25	15/25 <sup>7</sup>	10/15 <sup>8</sup>	15/25 <sup>9</sup>
Austria	25	10 <sup>10</sup>	10/15 <sup>8,11</sup>	10/15 <sup>9,12</sup>
Bahrain	15	10 <sup>10</sup>	10	10/15 <sup>13</sup>
Bangladesh	15	10 <sup>17</sup>	15	15
Belgium	15	10 <sup>10</sup>	10	15
Brazil	15/25 <sup>27</sup>	15	10/15 <sup>8</sup>	15/25 <sup>14</sup>
Canada	25	15 <sup>10</sup>	10/15 <sup>8</sup>	10/25 <sup>12</sup>
China, P.R.	15	10 <sup>10</sup>	10	10/15 <sup>15</sup>
Czech Republic	15	10 <sup>10</sup>	10	10/15 <sup>16</sup>
Denmark	15	10 <sup>17</sup>	10	15
Finland	15/30 <sup>5</sup>	15 <sup>10</sup>	10/15 <sup>8</sup>	15/25 <sup>18</sup>
France	15	10 <sup>10</sup>	10/15 <sup>8</sup>	15



	Dividends		Interest <sup>1</sup>	Royalties
	Portfolio	Substantial holdings <sup>2</sup>		
Germany	15	10 <sup>17</sup>	10/15 <sup>8,20,19</sup>	10/15 <sup>15</sup>
Hungary	20	15 <sup>17</sup>	15	15 <sup>12</sup>
India	20	15 <sup>10</sup>	10/15 <sup>8,20</sup>	15/30 <sup>9</sup>
Indonesia	20	15 <sup>17</sup>	10/15 <sup>8</sup>	15/25 <sup>9</sup>
Israel	15	10 <sup>10</sup>	10	15 <sup>12</sup>
Italy	15	15	10/15 <sup>8</sup>	15/25 <sup>9,21</sup>
Japan	15	10 <sup>10</sup>	10	10/15 <sup>23</sup>
Korea, Republic of	25	10 <sup>17</sup>	10/15 <sup>8</sup>	10/15 <sup>9</sup>
Malaysia	15/25 <sup>7</sup>	15	15	15/25 <sup>18</sup>
Netherlands	15	10 <sup>10</sup>	10/15 <sup>8,19,20</sup>	10/15 <sup>9</sup>
New Zealand	15	15	10	15
Norway	25	15 <sup>10</sup>	15	7.5/10/25 <sup>12,24</sup>
Pakistan	25	15 <sup>17</sup>	10/15 <sup>8</sup>	15/25 <sup>9</sup>
Poland	15	10 <sup>17</sup>	10	15
Romania	15	10 <sup>17</sup>	10/15 <sup>8,19,20</sup>	10/15/25 <sup>25</sup>
Russia	15	15	15	15
Singapore	25	15 <sup>26</sup>	10/15 <sup>8</sup>	0/15/25 <sup>18</sup>
Spain	15	10 <sup>10</sup>	10/15 <sup>8,19</sup>	10/15/20 <sup>22</sup>
Sweden	15	10 <sup>17</sup>	10	15
Switzerland	15	10 <sup>10</sup>	10	15
Thailand	15/20/30 <sup>5</sup>	15 <sup>26</sup>	10 <sup>8</sup> /15	15/25 <sup>9,21</sup>
United Arab Emirates	15	10 <sup>10</sup>	10	10
United Kingdom	25	15 <sup>10</sup>	10/15 <sup>8</sup>	15/25 <sup>9,21</sup>
United States	25	20 <sup>10</sup>	10/15 <sup>8</sup>	15/25 <sup>9,12</sup>
Vietnam	15	10 <sup>17</sup>	15	15

## **Notes**

1. Interest derived by a foreign government or its agencies is typically exempt from Philippine tax. Many treaties also contain special rules for both Philippine and home country taxation of interest paid on instruments secured by a government agency of one of the countries. Such provisions have been excluded from the analysis.
2. Under the treaties, these rates apply only to intercorporate dividends.
3. Interest derived from a foreign currency deposit unit is subject to 7.5% tax. Interest from deposits and yields or other monetary benefits from deposit substitutes and from trusts and similar arrangements is subject to 20% tax. Interest from transactions with depositary banks under the expanded foreign currency deposit system shall be exempt from income tax. Other interest earned is subject to normal income tax rates of 5%-32% for individuals and 30% for corporations.
4. Royalties on books, other literary works, and musical compositions are subject to 10% tax. Other royalties are subject to 20% tax.
5. The rate of 15% applies if the country in which the nonresident foreign corporation is domiciled exempts the dividend from tax or permits a 15% or greater credit for taxes deemed to have been paid in the Philippines.
6. The 20% rate applies in case of interest on foreign loans. Exemption applies in respect to interest from transactions with depositary banks under the expanded foreign currency deposit system.
7. Entitlement to the lower rate depends on how the dividend will be taxed in the concerned Contracting State.
8. The 10% rate applies to interest paid in respect of the public issues of bonds, debentures, or similar obligations.
9. The lower rate applies to royalties paid by an enterprise registered with the Board of Investments and engaged in preferred areas of activity.
10. The threshold for substantial ownership is 10%. In the case of Japan, the protocol amending the treaty reduced the threshold for substantial ownership and the dividend tax rate effective 1 January 2009.
11. The 10% rate also applies to interest paid by a company registered with the Board of Investments and engaged in preferred pioneer areas of investment in the Philippines.
12. The treaty also contains a most-favored-nation rule, limiting the Philippine tax on royalties to the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid in similar circumstances to a resident of a third state.
13. The 15% rate applies to royalties arising from the use of, or the right to use, any copyright of literary, artistic, or scientific work, including cinematographic films or tapes for television or broadcasting.
14. The 25% rate applies to royalties arising from the use of, or the right to use trademarks and cinematographic films, films or tapes for television or radio broadcasting.
15. The 10% rate applies to the use of, or the right to use, any patent, trade mark, design or model, plan, secret formula or process, or from the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial or scientific

experience. Strictly, application of the rate is at the discretion of the Philippine Competent Authorities.

16. The 10% rate applies to royalties arising from the use of, or the right to use, any copyright of literary, artistic, or scientific work (other than copyright of cinematographic films), any patent, trade mark, design or model, plan, secret formula or process, or from the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial, or scientific experience.
17. The threshold for substantial ownership is 25%.
18. The 15% rate applies to royalties paid by an enterprise registered and engaged in preferred areas of activities, and to royalties in respect of cinematographic films or tapes for television or broadcasting, and for the use of, or the right to use, any copyright. The 25% rate applies to other royalties.
19. The 10% rate also applies to interest paid in connection with the sale on credit of any industrial, commercial, or scientific equipment.
20. The 10% rate also applies to interest paid on any loans granted by a bank. In the case of the RP-India Tax Treaty, the 10% rate also applies to insurance companies.
21. The 15% rate also applies to royalties in respect of cinematographic films or tapes for television or broadcasting.
22. The 10% rate applies to royalties paid by an enterprise registered with the Board of Investments and engaged in preferred pioneer areas of activity. The 20% rate applies to rentals from cinematographic films and tapes for television or broadcasting. The 15% rate applies to all other royalties.
23. The 15% rate applies to royalties paid for the use of or the right to use cinematographic films and films or tapes for radio or television broadcasting. The change in royalty tax rate became effective on 1 January 2009.
24. The 7.5% rate applies to the lease of containers. The 10% rate applies to royalties paid by an enterprise registered with the Board of Investments. The 25% rate applies to other royalties.
25. The 10% rate applies to royalties paid by an enterprise registered with the Board of Investments and engaged in preferred pioneer areas of activity. The 15% rate applies to rentals from cinematographic films and tapes for television or broadcasting. The 25% rate applies to all other royalties.
26. The threshold for substantial ownership is 15%.
27. The 15% rate applies if the recipient is a company including a partnership, and the 25% rate applies in other cases.

# Appendix V

## Tax treaties

### Income tax treaties in force

Australia	Hungary	Romania
Austria	India	Russia
Bahrain	Indonesia	Singapore
Bangladesh	Israel	Spain
Belgium	Italy	Sweden
Brazil	Japan	Switzerland
Canada	Korea, Rep. of	Thailand
China, P.R.	Malaysia	United Arab Emirates
Czech Republic	Netherlands	United Kingdom
Denmark	New Zealand	United States
Finland	Norway	Vietnam
France	Pakistan	
Germany	Poland	

Source: Bureau of Internal Revenue

# Appendix VI

## Individual tax rate

Nature of income	Resident (citizen or alien)	Nonresident engaged in business <sup>1</sup>	Other non residents
	%	%	%
Passive income:			
Interest and royalties	20 <sup>2,3</sup>	20 <sup>3</sup>	25 <sup>2</sup>
Prizes and winnings	20 <sup>4</sup>	20 <sup>4</sup>	25
Dividends from domestic corporations	10	20	25
Capital gains from shares of stock in domestic corporations not traded in the Philippine Stock Exchange <sup>5</sup>	5/10	5/10	5/10
Presumptive gain from sale of real property	6	6	6
Employment income from a regional or area headquarters (RHQ) or regional operating headquarters (ROHQ) of multinational companies, or from an offshore banking unit, or from a petroleum service contractor or subcontractor <sup>7</sup>	15	15	15
Ordinary compensation, business and other income <sup>8,9</sup>	5-32	5-32	25

## Notes:

1. The term, “nonresident engaged in business” also includes nonresident aliens who are not actually engaged in business in the Philippines, but who are present in the Philippines for more than 180 days in a calendar year.
2. Interest derived by a resident individual from a depository bank under the expanded foreign currency deposit system is subject to 7.5% tax. Interest derived by non-resident alien individuals from a depository bank under the expanded foreign currency deposit system is exempt.
3. Royalties on books, other literary works and musical compositions derived by a resident individual or a nonresident engaged in business in the Philippines are subject to 10% tax.
4. Prizes amounting to PHP10,000 or less are subject to normal income tax rates. Philippine Charity Sweepstakes and Lotto winnings are exempt.
5. The first PHP100,000 of gains are subject to 5% tax, with 10% applying to any gain exceeding that amount. Sales of shares of stock in domestic corporations traded in the Philippine Stock Exchange are subject to a tax of 0.5% of the gross selling price.
6. A 6% tax based on the gross selling price or fair market value, whichever is higher, is imposed on capital gains presumed to have been realized from the sale, exchange, or other disposition of real property located in the Philippines. However, the presumed gain from the sale or disposition of an individual's principal residence is exempt if the proceeds are fully utilized in acquiring or constructing a new principal residence within 18 months from the date of sale or disposal.
7. The concessionary rate applies to aliens, and to Filipino employees occupying the same positions as those alien employees. Filipino employees of RHQs and ROHQs registered under Book III of the Omnibus Investments Act and who meet the conditions under Revenue Regulations 11-2010 have the option to be taxed at either 15% of gross income or at the regular graduated tax rates (see below) on their taxable income.
8. Individual tax rates on compensation, business, and other income are not subject to final taxes.
9. Minimum wage earners are exempt from payment of income tax on their taxable income, including holiday pay, night shift differential pay, and hazard pay.

## Individual tax rates on compensation, business, and other income not subject to final taxes

Taxable income			
Over (Column 1)	Not over	Tax on Column <sup>1</sup>	Percentage on excess
0	P 10,000		5
P 10,000	P 30,000	P 500	10
P 30,000	P 70,000	2,500	15
P 70,000	P 140,000	8,500	20
P 140,000	P 250,000	22,500	25
P 250,000	P 500,000	50,000	30
P 500,000		125,000	32

# Appendix VII

## Personal allowances

### Personal allowances for resident citizens and resident aliens – Deductions

	Pesos
Individual taxpayer (Single, Head of family, Married <sup>1</sup> )	50,000
Each dependent <sup>2</sup> - up to a maximum of four	25,000

### ***Personal allowances for nonresident aliens-Deductions***

A nonresident alien engaged in trade or business in the Philippines, or a nonresident alien present in the Philippines for 180 days or more in a calendar year may claim personal exemptions. However, the amount claimed cannot exceed the amount of exemption his home country would allow to a Philippine citizen that is not residing there. Other nonresident aliens are not entitled to personal exemptions.

### ***Notes:***

1. Married spouses file a single return, but compute their income taxes separately and are each entitled to a personal exemption of PHP50,000. If additional exemptions are to be claimed for dependents, they are to be claimed by the husband unless he explicitly waives his right in favor of his wife.
2. Dependents include legitimate, illegitimate, or legally adopted children chiefly dependent upon and living with the taxpayer if such dependent is not more than 21 years of age, unmarried, and not gainfully employed or if such dependent, regardless of age, is incapable of self-support because of mental or physical disability.

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# Appendix VIII

## Individual tax calculations

### **Example I – Resident citizen**

#### *Assumptions*

1. A resident citizen husband and wife, who is not working, and two children.
2. Income consists of a monthly salary of PHP100,000, 13th month pay of PHP100,000, and bonuses of PHP60,000.
3. Dividends received from domestic corporations amount to PHP9,000, net of PHP1,000 withholding tax.
4. Dividends received from a foreign corporation amount to PHP56,000 net of PHP24,000 foreign withholding tax. A tax credit is claimed for foreign taxes.
5. Actual taxes withheld by the employer during the year amounted to PHP358,600.

#### **Tax computation**

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##### **Income subject to progressive taxation<sup>1</sup>**

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Salary	P1,200,000	
13th month pay	100,000	
Bonuses	60,000	
Foreign source dividend	80,000	
Total gross income subject to progressive taxation		P 1,440,000
Less – Exemptions		
Personal exemption as married individual	50,000	
Additional exemption for dependents (P25,000 x 2)	50,000	
Exemption for 13th month pay and bonuses	30,000	
Taxable income		<u>1,310,000</u>
Tax on taxable income of 1,310,000:		



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**Income subject to progressive taxation<sup>1</sup>**

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On first 500,000	P125,000	
On remainder—810,000 at 32%	259,200	P 384,200
Less – Foreign tax credit <sup>2</sup>		P (21,799)
Total tax		P 362,401
Less – Tax withheld at source <sup>3</sup>		(358,600)
Tax due		<u><u>P3,801</u></u>

**Notes:**

1. The dividends from domestic corporations are subject to final withholding tax of 10%, thus are not included in the tax calculation.
2. The foreign tax credit is limited to the lesser of:
  - a. The amount of foreign tax paid (PHP24,000); or
  - b. The proportion of Philippine tax payable on the taxpayer's taxable foreign-sourced income over his entire taxable income (PHP80,000/PHP1,410,000 × PHP384,200 = PHP21,799).
3. If there is any discrepancy between the amount that should have been withheld throughout the year based on compensation income earned and the amount actually withheld, the employer will make the adjustments before paying the final salary in December. The tax withheld on salary should, therefore, reconcile with the correct tax payable on compensation income. As withholding agent, the employer is responsible for withholding the correct amount of tax from the taxable salary of the employee, and failure to do so may result to the imposition of penalties and surcharges. It is expedient, therefore, for employers to calculate the correct taxes in December each year.

**Example II – Nonresident Alien engaged in business**

1. A single alien is employed in the Philippines on an eighteen month fixed contract that commenced on 1 November 2012. He intends to return to his home country at the end of the period so he will be considered as a nonresident alien. However, as he will be staying in the Philippines for more than 180 days in 2013, he is classified as a nonresident alien engaged in business for that taxable year.
2. The total compensation package is worth PHP200,000 monthly, consisting of cash compensation before tax of PHP150,000 and accommodation that costs the employer PHP50,000 to provide. No bonuses are paid, but PHP150,000 is paid as 13th month pay.
3. During the taxable year 2013, the employee is required to render services for his Philippine employer for three weeks on a contract in China.

4. Actual taxes withheld by the Philippine employer during the year amounted to PHP537,000.

## Tax computation

### Income subject to progressive taxation

Salary (P150,000 x 12) <sup>1</sup>		P1,800,000
13th month pay		150,000
Total gross income subject to progressive taxation		P1,950,000
Less—Exemptions		
Personal exemption <sup>2</sup>	P50,000	
Exemption for bonuses/13th month pay	30,000	80,000
		P1,870,000
Less – Non-taxable foreign-source income <sup>3</sup>		112,500
Taxable income		P1,757,500
Tax on taxable income of 1,787,500 <sup>4</sup>		
On first 500,000	125,000	
On remainder-1,257,500 at 32%	402,400	P527,400
Less—Tax withheld at source <sup>5</sup>		(537,000)
Excess <sup>6</sup>		<b>(P 9,600)</b>

## Notes

The employee is not subject to tax on the accommodation benefit. Instead, the benefit will be subject to fringe benefits tax payable by the employer. The value of the benefit is calculated by grossing up the amount paid for accommodation ( $\text{PHP}50,000 / (1 - 32\%) = \text{PHP}73,529$ ). Fifty percent of this will be treated as a taxable fringe benefit, subject to 32% fringe benefit tax. Thus the monthly fringe benefit tax payable by the employer will be  $\text{PHP}11,765$  ( $\text{PHP}73,529 \times 50\% \times 32\%$  tax).

5. Because the employee is considered a nonresident alien engaged in business in the Philippines, any personal exemption is limited to exemptions to which a Philippine citizen not residing in the employee's home country would be entitled to there. For illustrative purposes, it is assumed that the exemptions that would be allowed to such a Philippine-citizen are higher than the maximum Philippine exemptions, and that the employee therefore qualifies for the maximum Philippine exemption.

Compensation for services rendered outside the Philippines is treated as foreign-sourced income. Because aliens are taxable only on Philippine-sourced income, compensation relating to the employment exercised in China should not be subject to Philippine tax. The exempt compensation income is calculated as  $\text{PHP}1,950,000 \times 3/52 = \text{PHP}112,500$ . The 13th month pay

is included in the calculations, as its payment relates to the employment services that have been provided throughout the year.

6. Because the alien is assigned in the Philippines for a definite period of more than 180 days, the progressive tax rates apply.
7. If there is any discrepancy between the amount that should have been withheld throughout the year based on income earned and the amount actually withheld, the employer will make the adjustments before paying the final salary in December. The tax withheld on salary should, therefore, reconcile with the correct tax payable on compensation income. As withholding agent, the employer is responsible for withholding the correct amount of tax from the taxable salary of the employee, and failure to do so may result to the imposition of penalties and surcharges. It is expedient, therefore, for employers to calculate the correct taxes in December each year.
8. Any excess tax (when the amount of cumulative tax already deducted and withheld is greater than the tax computed) shall be credited or refunded to the employee not later than 25 January of the following year.

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# **Appendix IX**

## **Tax on foreign nationals working in the Philippines**

### **Year 2013**

#### *Assumptions*

1. The employee is a single foreign national.
2. The employee is on a fixed-period contract and intends to return to his home country at the end of his assignment. The employee will therefore be characterized as a nonresident alien.
3. The employee's home country would allow a Philippine citizen that is not residing there exemptions exceeding those offered by the Philippines to nonresident aliens, so the employee will be entitled to full personal exemptions in the Philippines.
4. For each year of his contract, the employee will be present in the Philippines for more than 180 days and would therefore be considered as being engaged in business in the Philippines (otherwise, a flat rate of 25% tax applies).
5. Employment services are performed entirely in the Philippines (compensation for services performed outside the Philippines are exempt as foreign-sourced income – see Example 2 in Appendix VIII).
6. Only income from employment is covered in the table and includes cash allowances.
7. The table includes only national income tax. Community tax is collected separately.
8. Social security payments of employees are excluded from the tables but will need to be deducted. See Appendix XI for details of other deductions required. The maximum amount required to be withheld is US\$24.29 per month.
9. The exchange rate used is US\$1 = PHP42.70, which is the average exchange rate as of June 2013.

### Tax amounts

Total remuneration (Monthly)	Monthly income tax payable (In US dollars)
2,500	700
3,000	860
3,500	1,020
4,000	1,180
4,500	1,340
5,000	1,500

### ***Additional commentary***

1. The top marginal tax rate of 32% applies to any taxable income in excess of US\$11,710 per year (US\$976 per month).
2. If the aggregate of the monthly tax withheld exceeds the amount properly payable based on actual compensation for the year, the employer should make an adjustment in making the compensation payments in December.
3. Any additional compensation payments during the year, such as 13th month pay and other bonuses or incentive payment, will be taxable at 32%, subject to the first US\$703 being exempt.

# Appendix X

## Estate and donor's tax rates

### Estate tax

Net gifts over (Column 1)	Not over	Tax on Column 1	Percentage on excess
P0	P200,000	Exempt	
200,000	500,000	0	5
500,000	2,000,000	15,000	8
2,000,000	5,000,000	135,000	11
5,000,000	10,000,000	465,000	15
10,000,000	And Over	1,215,000	20

### Donor's tax

Net gifts over (Column 1)	Not over	Tax on Column 1	Percentage on excess
P0	P100,000	Exempt	
100,000	200,000	0	2
200,000	500,000	2,000	4
500,000	1,000,000	14,000	6
1,000,000	3,000,000	44,000	8
3,000,000	5,000,000	204,000	10
5,000,000	10,000,000	404,000	12
10,000,000		1,004,000	15

### Note:

If the donee is a person other than a brother, sister (whether by whole or half blood), spouse, ancestor, lineal descendant, or a relative by consanguinity in the collateral line within the fourth degree of relationship; the tax payable by the donor is 30% of the net gifts.

# Appendix XI

## Social security contributions and benefits

### Social Security System contributions

Range of compensation	Monthly salary credit <sup>1</sup>	Employer-Employee							SE/VM/OFW
		Social Security			EC	Total contribution			Total contribution
		ER	EE	Total	ER	ER	EE	Total	
1,000 - 1,249.99	1,000	70.70	33.30	104	10	80.70	33.30	114	104
1,250 - 1,749.99	1,500	106.00	50.00	156	10	116.00	50.00	166	156
1,750 - 2,249.99	2,000	141.30	66.70	208	10	151.30	66.70	218	208
2,250 - 2,749.99	2,500	176.70	83.30	260	10	186.70	83.30	270	260
2,750 - 3,249.99	3,000	212.00	100.00	312	10	222.00	100.00	322	312
3,250 - 3,749.99	3,500	247.30	116.70	364	10	257.30	116.70	374	364
3,750 - 4,249.99	4,000	282.70	133.30	416	10	292.70	133.30	426	416
4,250 - 4,749.99	4,500	318.00	150.00	468	10	328.00	150.00	478	468
4,750 - 5,249.99	5,000	353.30	166.70	520	10	363.30	166.70	530	520
5,250 - 5,749.99	5,500	388.70	183.30	572	10	398.70	183.30	582	572
5,750 - 6,249.99	6,000	424.00	200.00	624	10	434.00	200.00	634	624
6,250 - 6,749.99	6,500	459.30	216.70	676	10	469.30	216.70	686	676
6,750 - 7,249.99	7,000	494.70	233.30	728	10	504.70	233.30	738	728
7,250 - 7,749.99	7,500	530.00	250.00	780	10	540.00	250.00	790	780
7,750 - 8,249.99	8,000	565.30	266.70	832	10	575.30	266.70	842	832
8,250 - 8,749.99	8,500	600.70	283.30	884	10	610.70	283.30	894	884
8,750 - 9,249.99	9,000	636.00	300.00	936	10	646.00	300.00	946	936

<sup>1</sup> The minimum monthly salary credit for OFW members is PHP5,000

Range of compensation	Monthly salary credit <sup>1</sup>	Employer-Employee							SE/VM/OFW
		Social Security			EC	Total contribution			Total contribution
		ER	EE	Total	ER	ER	EE	Total	
9,250 - 9,749.99	9,500	671.30	316.70	988	10	681.30	316.70	998	988
9,750 - 10,249.99	10,000	706.70	333.30	1,040	10	716.70	333.30	1,050	1,040
10,250 - 10,749.99	10,500	742.00	350.00	1,092	10	752.00	350.00	1,102	1,092
10,750 - 11,249.99	11,000	777.30	366.70	1,144	10	787.30	366.70	1,154	1,144
11,250 - 11,749.99	11,500	812.70	383.30	1,196	10	822.70	383.30	1,206	1,196
11,750 - 12,249.99	12,000	848.00	400.00	1,248	10	858.00	400.00	1,258	1,248
12,250 - 12,749.99	12,500	883.30	416.70	1,300	10	893.30	416.70	1,310	1,300
12,750 - 13,249.99	13,000	918.70	433.30	1,352	10	928.70	433.30	1,362	1,352
13,250 - 13,749.99	13,500	954.00	450.00	1,404	10	964.00	450.00	1,414	1,404
13,750 - 14,249.99	14,000	989.30	466.70	1,456	10	999.30	466.70	1,466	1,456
14,250 - 14,749.99	14,500	1,024.70	483.30	1,508	10	1,034.70	483.30	1,518	1,508
14,750 – over	15,000	1,060.00	500.00	1,560	30	1,090.00	500.00	1,590	1,560

### ***PhilHealth contributions***

Monthly salary bracket	Monthly salary range	Salary Base (SB)	Total monthly contribution	Employee Share (EeS) (EeS = 0.5 x TMC)	Employer Share (ErS) (ErS = 0.5 x TMC)
1	7,999.99 and below	7,000	175.00	87.50	87.50
2	8,000.00 to 8,999.99	8,000	200.00	100.00	100.00
3	9,000.00 to 9,999.99	9,000	225.00	112.50	112.50
4	10,000.00 to 10,999.99	10,000	250.00	125.00	125.00
5	11,000.00 to 11,999.99	11,000	275.00	137.50	137.50
6	12,000.00 to 12,999.99	12,000	300.00	150.00	150.00
7	13,000.00 to 13,999.99	13,000	325.00	162.50	162.50
8	14,000.00 to 14,999.99	14,000	350.00	175.00	175.00
9	15,000.00 to 15,999.99	15,000	375.00	187.50	187.50
10	16,000.00 to 16,999.99	16,000	400.00	200.00	200.00
11	17,000.00 to 17,999.99	17,000	425.00	212.50	212.50



Monthly salary bracket	Monthly salary range	Salary Base (SB)	Total monthly contribution	Employee Share (EeS) (EeS = 0.5 x TMC)	Employer Share (ErS) (ErS = 0.5 x TMC)
12	18,000.00 to 18,999.99	18,000	450.00	225.00	225.00
13	19,000.00 to 19,999.99	19,000	475.00	237.50	237.50
14	20,000.00 to 20,999.99	20,000	500.00	250.00	250.00
15	21,000.00 to 21,999.99	21,000	525.00	262.50	262.50
16	22,000.00 to 22,999.99	22,000	550.00	275.00	275.00
17	23,000.00 to 23,999.99	23,000	575.00	287.50	287.50
18	24,000.00 to 24,999.99	24,000	600.00	300.00	300.00
19	25,000.00 to 25,999.99	25,000	625.00	312.50	312.50
20	26,000.00 to 26,999.99	26,000	650.00	325.00	325.00
21	27,000.00 to 27,999.99	27,000	675.00	337.50	337.50
22	28,000.00 to 28,999.99	28,000	700.00	350.00	350.00
23	29,000.00 to 29,999.99	29,000	725.00	362.50	362.50
24	30,000.00 to 30,999.99	30,000	750.00	375.00	375.00
25	31,000.00 to 31,999.99	31,000	775.00	387.50	387.50
26	32,000.00 to 32,999.99	32,000	800.00	400.00	400.00
27	33,000.00 to 33,999.99	33,000	825.00	412.50	412.50
28	34,000.00 to 34,999.99	34,000	850.00	425.00	425.00
29	35,000.00 and up	35,000	875.00	437.50	437.50

#### Notes

1. Philhealth contributions shall be paid within the first ten calendar days following the applicable month.
2. SSS contributions shall be paid on the scheduled date following the applicable month based on the 10th digit of the Company's SSS Number.
3. HDMF contributions shall be paid on the scheduled date following the applicable month based on the first Letter of Employer/Business name.
4. SSS and PhilHealth contributions of employers are tax deductible while employees' contributions are exclusions from gross compensation income.

5. SSS and PhilHealth coverage shall be compulsory for all employees not over 60 years of age and their employers.
6. Currently, the Philippines has social security agreements with Austria, Belgium, Canada, France, Netherlands, Quebec (a distinct and separate treaty from that concluded with Canada), Spain, Switzerland, United Kingdom, and Northern Ireland. As such, foreign nationals of these countries who are working in the Philippines may be exempted from the Philippine social security coverage for a certain period and subject to certain limitations.

**Home Development Mutual Fund contributions**

The Home Development Mutual Fund contribution rates applicable in 2012 are as follows.

Employee contributions		Employer contributions
Voluntary	Non-voluntary	
2% of monthly gross earnings for self-employed; PHP100 for unemployed	1%-2% of monthly compensation	2% of employee's monthly compensation

*Notes*

- Monthly compensation is basic salary plus cost-of-living allowance, provided the maximum monthly compensation to be used in computing employee and employer contributions is not more than PHP5,000.
7. A member who requires to do so may be allowed to contribute more than what is required. The employer, however, shall only be mandated to contribute only 2% of the monthly compensation, unless the employer agrees to match the employee's increased contribution.
8. Membership in the fund is voluntary for employees receiving less than PHP4,000 monthly compensation and mandatory for employees receiving PHP4,000 and above, effective 1 January 1995.

## ***Social Security System benefits***

An employee who is registered with the Social Security System may claim the following benefits.

1. Monthly pension:

A pension of at least PHP1,200 per month is granted to members with at least 10 years of service depending on the salary credit level.

2. Dependent's pension:

In the case of an employee's death, permanent disability, or retirement, the dependent's pension will be the higher of 10% of the employee's monthly pension entitlement or PHP250 per month.

3. Retirement benefits:

A member who has reached the age of 60 and already separated from employment (age 65 in the case of self-employed persons), and who has paid at least 120 monthly contributions before retiring, is entitled to either a monthly pension or a lump sum payment equivalent to the total contributions paid by the employee plus interest.

4. Death benefits:

The primary beneficiaries of a member who has paid at least 36 monthly contributions prior to the semester of death, shall be entitled to either a monthly pension or a lump sum benefit equivalent to 36 times the monthly pension.

5. Permanent disability benefits:

A member who has paid at least 36 monthly contributions prior to disability shall be entitled to the monthly pension. If the contributions are less, the benefit will be the equivalent to the higher of the monthly pension

6. Funeral benefit:

A funeral grant equivalent to PHP20,000 in cash or kind is paid upon the death of a member.

7. Sickness benefit:

Subject to certain conditions, a member who has paid at least three monthly contributions in the 12-month period preceding the semester of sickness shall be paid the equivalent of at least 90% of the average daily salary credit.

8. Maternity leave benefits:

Subject to certain conditions, a female member who has paid at least three monthly contributions immediately preceding the birth or miscarriage shall be paid a daily maternity benefit equivalent to 100% of her average daily salary credit for 60 days for normal delivery or a miscarriage and 78 days for a caesarean delivery.

### ***PhilHealth benefits***

The health insurance program provides medical care to sick member-employees who may find themselves in sudden need of financial assistance when hospitalized (includes room and board, medical expenses such as drugs and medicines, and doctor's fees).

### ***Home Development Mutual Fund benefits***

The benefits available to Home Development Mutual Fund members are as follows.

1. Home ownership by way of a housing credit system
2. Small and short-term loans
3. Provident benefits
4. Return of contributions equivalent to total accumulated value upon termination of membership
5. Optional withdrawal of contributions after the tenth or fifteenth year of continued membership
6. Dividend benefits —The board of trustees shall set aside annually an amount less than 70% of the annual net income of the fund and shall be paid in the form of dividends, credited proportionately to their total accumulated value
7. Death benefits

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## ***Appendix XII***

# Transactions exempt from value-added tax

The following transactions are exempt from the value-added tax.

1. Sale or importation of agricultural and marine food products in their original state. Products are considered to be in their original state even if they have undergone the simple processes of preparation or preservation for the market. Polished and/or husked rice, corn grits, raw cane sugar and molasses, ordinary salt, and copra shall be considered in their original state.
2. Sale or importation of livestock and poultry of a kind generally used as, or yielding or producing foods for human consumption; and breeding stock and genetic materials therefor.
3. Sale or importation of fertilizers; seeds, seedlings and fingerlings; fish, prawn, livestock and poultry feeds, including ingredients, whether locally produced or imported, used in the manufacture of finished feeds (except specialty feeds for race horses, fighting cocks, aquarium fish, zoo animals and other animals generally considered as pets).
4. Importation of personal and household effects belonging to the residents of the Philippines returning from abroad and nonresident citizens coming to resettle in the Philippines, provided the goods are exempt from customs duties under the Tariff and Customs Code of the Philippines.
5. Importation of professional instruments and implements, wearing apparel, domestic animals, and personal household effects belonging to persons coming to settle in the Philippines. The effects (except any vehicle, vessel, aircraft, machinery, other goods for use in the manufacture and merchandise of any kind in commercial quantity) must be for their own use and not for sale, barter or exchange, and must accompany the persons or reach the country within 90 days before or after their arrival, upon the production of evidence satisfactory to the Commissioner of Internal Revenue (CIR),

that such persons are actually coming to settle in the Philippines and that the change of residence is bona fide.

6. Services subject to percentage tax which include the following: a) cars for rent or hire, transportation contractors, including persons who transport passengers for hire, and other domestic carriers by land for the transport of passengers, and keepers of garages; b) franchise grantees of radio and/or television broadcasting whose annual sales of the preceding year do not exceed P10,000,000, and gas and water utilities; c) international air/shipping carriers; d) banks and non-bank financial intermediaries; e) agents of foreign insurance companies; f) persons/entities subject to amusement tax; g) overseas dispatch, messages or communications originating from the Philippines; h) and life insurance business (see Chapter 23).
7. Services by agricultural contract growers and milling for others of palay into rice, corn into grits, and sugar cane into raw sugar.
8. Medical, dental, hospital, and veterinary services except those rendered by professionals.
9. Educational services rendered by private educational institutions, duly accredited by the Department of Education (DepEd), the Commission on Higher Education (CHED), the Technical Education and Skills Development Authority (TESDA), and those rendered by government educational institutions.
10. Services rendered by individuals pursuant to an employer-employee relationship.
11. Services rendered by regional or area headquarters established in the Philippines by multinational corporations which act as supervisory, communications, and coordinating centers for their affiliates, subsidiaries, or branches in the Asia-Pacific Region and do not earn or derive income from the Philippines.
12. Transactions exempt under international agreements to which the Philippines is a signatory.
13. Transactions exempt under special laws other than Presidential Decree No. 529 (Petroleum Exploration Concessionaires under the Petroleum Act of 1949).
14. Sales by agricultural cooperatives duly registered with the Cooperative Development Authority to their members as well as sale of their produce, whether in its original state or processed form, to non-members; their importation of direct farm inputs, machineries, and equipment, including spare parts thereof, to be used directly and exclusively in the production and/or processing of their produce.
15. Gross receipts from lending activities by credit or multi-purpose cooperatives duly registered with the Cooperative Development Authority.

16. Sales by non-agricultural, non-electric, and non-credit cooperatives duly registered with the Cooperative Development Authority, provided that the share capital contribution of each member does not exceed PHP15,000 and regardless of the aggregate capital and net surplus ratably distributed among the members.

Note: Please refer to Republic Act 9520 (Philippine Cooperative Code of 2008) for further refinements and qualifications on these exemptions.

17. Export sales by persons who are not VAT-registered.
18. Sale of real properties not primarily held for sale to customers or held for lease in the ordinary course of trade or business.
19. Sale of real properties utilized for approved low-cost and socialized housing as defined under Republic Act 7279, and other related laws; residential lots valued at PHP1,919,500 and below; house and lot and other residential dwellings valued at PHP3,199,200 and below. These thresholds were in effect since 01 January 2012, and shall be adjusted every three years thereafter to their present values using the Consumer Price Index, as published by the National Statistics Office (NSO).
20. Sale or disposal of two or more adjacent residential lots, house and lots or other residential dwellings in favor of one buyer from the same seller, for the purpose of utilizing the lots, house and lots or other residential dwellings as one residential area, where the aggregate value of the said properties do not exceed PHP1,919,500 for residential lots, and PHP3,199,200 for residential house and lots or other residential dwellings. Adjacent residential lots, house and lots or other residential dwellings although covered by separate titles and/or separate tax declarations, when sold or disposed to one and the same buyer, whether covered by one or separate Deed/s of Conveyance, shall be presumed as a sale of one residential lot, house and lot or residential dwelling.

The VAT exemption does not apply to the sale of parking lot which may or may not be included in the sale of condominium units, the same being a separate and distinct transaction and not considered a residential lot, house and lot or a residential dwelling.

21. Lease of residential unit with a monthly rental not exceeding PHP12,800. This threshold amount was in effect since 01 January 2012, and shall be adjusted every three years thereafter to its present value using Consumer Price Index, as published by the NSO.

22. Sale, importation, printing or publication of books and any newspaper, magazine, review or bulletin which appears at regular intervals with fixed prices for subscription and sale and which is not devoted principally to the publication of paid advertisements.
23. Transport of passengers by international carriers (RA 10374).
24. Sale, importation, or lease of passenger or cargo vessels and aircraft, including engine, equipment, and spare parts thereof for domestic or international transport operations.
25. Importation of fuel, goods, and supplies by persons engaged in international shipping or air transport operations.
26. Services of banks, non-bank financial intermediaries performing quasi-banking functions, and other non-bank financial intermediaries.
27. Sale or lease of goods or properties or the performance of services other than the transactions mentioned in the preceding paragraphs, the gross annual sales and/or receipts do not exceed the amount of PHP1,919,500. This threshold amount was in effect since 01 January 2012, and shall be adjusted every three years thereafter to its present value using the Consumer Price Index, as published by the NSO.



# Appendix XIII

## Other indirect taxes

### A. Percentage taxes

#### 1. On international carriers

International air carriers	3% of quarterly gross receipts
International shipping carriers	3% of quarterly gross receipts

#### 2. On domestic carriers and keepers of garage

Cars for rent or hire driven by the lessee, transportation contractors, including persons who transport passengers for hire and other domestic carriers by land for the transport of passengers (except owners of bancas and animal-drawn two-wheeled vehicle) and keepers of garage.	3% of quarterly gross receipts
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In computing the percentage tax, the following shall be considered the minimum quarterly gross receipts (in Philippine pesos) in each particular case:

#### Jeepney for hire

a. Manila and other cities	2,400
b. Provincial	1,200

#### Public utility bus

a. Not exceeding 30 passengers	3,600
b. Exceeding 30 but not 50	6,000
c. Exceeding 50	7,200

#### Taxis

a. Manila and other cities	3,600
b. Provincial	2,400
Car for hire (with chauffeur)	3,000
Car for hire (without chauffeur)	1,800

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### 3. On franchise

Gas/ water utilities	2% based on gross receipts
Radio/TV broadcast companies	3% of gross receipts if receipts for the preceding year do not exceed PHP10 million

Radio and TV broadcast companies may elect instead to register for VAT. Radio and TV broadcast companies whose annual gross receipts for the preceding year exceed P10 million is required to register as VAT taxpayer.

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### 4. On overseas dispatch

On overseas dispatch, message or conversation transmitted from the Philippines by telephone, telegraph, telewriter exchange, wireless, and other communication equipment services	10% of amount paid originating from the Philippines
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### 5. On banks and non-bank financial intermediaries performing quasi-banking functions

a. Interests, commissions, and discounts from lending activities and financial leasing based on remaining maturities of instruments from which the receipts are derived:

i. short-term maturity (less than five years)	5% of gross receipts
ii. long-term maturity (more than five years)	1 % of gross receipts

If the maturity period is shortened thru pretermination, the maturity period shall be reckoned to end as of the date of pretermination for purposes of classifying the transaction; and the correct rate shall be applied accordingly.

b. Dividends and equity shares and net income of subsidiaries	0% of gross receipts
c. Royalties, rentals of property, profits from exchange, and all other items treated as gross income under the Tax Code	7% of gross receipts
d. Net trading gains within the taxable year on foreign currency, debt securities, derivatives, and other similar financial instruments	7% of gross receipts

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### 6. On other non-bank financial intermediaries

a. Interest, commissions, and discounts from lending activities and financial leasing based on the remaining maturities of the instrument from which the receipts are derived:

i. short-term maturity (5 years or less)	5% of gross receipts
ii. long-term maturity (more than 5 years)	1% of gross receipts
b. Other items of gross income	5% of gross receipts

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## 7. Life insurance companies doing business in the Philippines

Total premiums collected	2%
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## 8. Agents of foreign insurance companies

Every fire, marine, or miscellaneous insurance agent authorized under the Insurance Code to transact on risks located in the Philippines	Twice the tax imposed on life insurance companies
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In all cases where owners of property obtain insurance directly from foreign insurance companies, it shall be the duty of said owners to report to the Insurance Commissioner and Commissioner of Internal Revenue and pay the tax of 5% on premiums paid.

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## 9. Amusement taxes

Cockpits	18% of gross receipts
Cabarets, night or day clubs	18% of gross receipts
Boxing exhibitions, except when the World or Oriental Championships in any division is at stake and one of the contenders is a citizen of the Philippines and the exhibition is promoted by a citizen/s of the Philippines or by corporations of Philippine nationality	10% of gross receipts
Professional basketball games	15% of gross receipts
Jai-alai and race tracks	30% of gross receipts

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## 10. Winnings

Winnings from double forecast/quinella and trifecta bets	4% of winnings
Other winning tickets from horse races	10% of winnings
Owner of running race horses	10% of prizes

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## 11. Stock transaction tax

On sale, barter, or exchange of shares listed and traded through the local stock exchange provided the Minimum Public Ownership condition is met	0.5% of gross selling price or gross value in money
Shares sold or exchanged through initial public offering in closely held corporations (50% in value of the outstanding capital stock is owned directly or indirectly by or for not more than 20 individuals)	4%, 2%, or 1% of gross selling price or gross value in money of the shares sold in proportion to total outstanding shares

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## B. Excise tax

### 1. Alcohol products

Distilled spirits <sup>1</sup>	15% ad valorem tax based on net retail price (excluding excise tax and VAT), plus PHP20 per proof liter
Wines <sup>2</sup>	
a. Sparkling wines/champagnes with net retail price per bottle of 750 ml. volume capacity	Rates are PHP250 or PHP700 based on net retail price
b. Still and carbonated wines	Rates are PHP30 or PHP60 depending on alcohol content
Fermented liquor <sup>3</sup>	Rates are PHP15 or PHP20 depending on the net retail price per liter of volume capacity

### 2. Tobacco products

Tobacco <sup>4</sup>	PHP1.75 per kilogram
Chewing tobacco <sup>4</sup>	PHP1.50 per kilogram
Cigars <sup>5</sup>	20% of the net retail price per cigar (excluding the excise and VAT) plus PHP5 per cigar
Cigarettes packed by hand	PHP12 per pack <sup>6</sup>
Cigarettes packed by machine	PHP12 per pack if net retail price is PHP11.50 and below, and PHP25 if more than PHP11.50 <sup>7</sup>

<sup>1</sup> Effective 1 January 2015, excise tax on distilled spirits shall be 20% of net retail price (excluding excise tax and VAT) per proof liter, plus additional PHP20 per proof liter, the latter to be increased by 4% every year thereafter effective 1 January 2016, through appropriate revenue regulations.

<sup>2</sup> Effective 1 January 2014, excise tax rates on wines shall be increased by 4% every year thereafter, through appropriate revenue regulations.

<sup>3</sup> Excise tax rates on fermented liquor shall be increased to PHP17 and PHP21 effective 1 January 2014, PHP19 and PHP22 effective 1 January 2015, PHP21 and PHP23 effective 1 January 2016, and PHP23.50 on all fermented liquors effective 1 January 2017. The rates will be increased by 4% every year thereafter effective 1 January 2018, through appropriate revenue regulations.

<sup>4</sup> The excise tax rates on tobacco (including chewing tobacco) shall be increased by 4% every year thereafter effective on 1 January 2014, through appropriate revenue regulations.

<sup>5</sup> The additional tax of PHP5 per cigar shall be increased by 4% effective on 1 January 2014, through appropriate revenue regulations.

<sup>6</sup> Excise tax on cigarettes packed by hand per pack shall be increased to PHP15 effective 1 January 2014, PHP18 effective 1 January 2015, PHP21 effective 1 January 2016, PHP30 effective 1 January 2017, and by 4% every year thereafter effective on 1 January 2018, through appropriate revenue regulations.

<sup>7</sup> Excise tax on cigarettes packed by machine per pack shall be increased to PHP17 and PHP27 effective 1 January 2014, PHP21 and PHP28 effective 1 January 2015, PHP25 and PHP29 effective 1 January 2016, PHP30 on all cigarettes packed by machine effective 1 January 2017, and by 4% every year thereafter effective 1 January 2018, through appropriate revenue regulations.

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### 3. Petroleum products

Manufactured oils and other fuels, including lubricating oils and greases, processed gas, waxes and petrolatum, denatured alcohol, naphtha, regular gasoline and similar products, leaded premium gasoline, aviation turbo jet fuel, kerosene, diesel fuel oil, LPG, asphalts, and bunker fuel oil	Rates vary from PHP0.00 to PHP5.35 per liter or kilogram of volume capacity
Petroleum sold to international carriers and exempt entities or agencies	Exempt

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### 4. Mineral products

Coal and coke	PHP10 per metric ton
Non-metallic minerals and quarry resources	2% of actual market value of gross output at the time of removal
Metallic minerals (copper and other metallic minerals, gold, and chromite)	2% of actual market value of the gross output at the time of removal
Indigenous petroleum (except locally extracted natural gas and liquefied natural gas)	3% of fair international market price

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### 5. Automobiles

Tax rates depend on manufacturer's or importer's selling price, net of excise and VAT in accordance with the following schedule:

Net manufacturer's price/Importer's selling price	Tax Rate
Up to PHP600,000	2%
Over PHP600,000 to PHP1.1Million	PHP12,000 + 20% of value in excess of PHP600,000
Over PHP1.1Million to PHP2.1Million	PHP112,000 + 40% of value in excess of PHP1.1Million
Over PHP2.1Million	PHP512,000 + 60% of value in excess of PHP2.1Million

For imported automobiles not for sale, tax is based on the total value used by the Bureau of Customs in determining tariff and customs duties, including customs duty and all other charges.

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### 6. Non-essential goods

On all goods commonly or commercially known as jewelry, whether real or imitation, perfumes and toilet waters, and yachts and other vessels intended for pleasure or sport	20% of the wholesale price or value of the importation used by the Bureau of Customs in determining tariff and custom duties, net of excise tax and VAT.
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## C. Stamp tax rates

Taxable document/transaction (tax base)	Rate
Original issue of shares	PHP1 for every PHP200 or fractional part of par value <sup>8</sup>
Other sales agreement, agreement to sell, memoranda of sales, delivery or transfer of shares or certificates of stock	PHP0.75 for every PHP200 or fractional part of par value <sup>9</sup>
Sale, barter, or exchange of shares of stock listed and traded through the local stock exchange	Exempt
Certificate of profits, interest in property or accumulations	PHP0.50 for every PHP200 or fractional part of face value
Non-exempt debt instruments (refer to instruments representing borrowing and lending transactions including but not limited to debentures, certificates of indebtedness, due bills, bonds, loan agreements (including those signed abroad wherein the object of the contract is located or used in the Philippines), instruments and securities issued by the government or any of its instrumentalities, deposit substitute debt instruments, certificates or other evidences of deposits that are either drawing interest significantly higher than the regular savings deposit or drawing interest and have a specific maturity date, orders for payment of any sum of money otherwise than at sight or on demand, promissory notes (whether negotiable or non-negotiable), except bank notes issued for circulation	PHP1 for every PHP200 or fractional value of the issue price <sup>10</sup>
Bank check, draft, certificate of deposit not bearing interest, other instruments	PHP1.50 for each instrument

<sup>8</sup> For stock dividends, stamp tax is based on the actual value represented by each share. For no-par value shares, the stamp tax shall be based on the actual consideration for the issuance of the shares.

<sup>9</sup> For no par value shares, the stamp tax is 25% of that paid on the original issue of the shares.

<sup>10</sup> If the maturity of the debt instrument is less than one year, the stamp tax shall be of a proportional amount in accordance with the ratio of its term in number of days to 365 days. Moreover, only one stamp tax shall be imposed on either loan agreement, or promissory note issued to secure a loan

<b>Taxable document/transaction (tax base)</b>	<b>Rate</b>
Bills of exchange between points in the Philippines or drafts, acceptance or payment of bill of exchange or order for the payment of money purporting to be drawn in a foreign country but payable in the Philippines, foreign bills of exchange and letters of credit drawn in but payable out of the Philippines	PHP0.30 for every PHP200 or fractional part of the face value of the instrument
Life insurance policies	One-time stamp tax at graduated rates from PHP0.00 to ₱100 based on the amount of insurance <sup>11</sup>
Property insurance (including renewals), other than reinsurance contracts or any instrument by which cession or acceptance of insurance risks under any reinsurance agreement is effected or recorded	PHP0.50 for every PHP4 or fractional part of the premium charged
Fidelity bond, other insurance policy	PHP0.50 for every PHP4 or fractional part of the premium charged
Policy of annuity	PHP0.50 for every PHP200 or fractional part of premium or installment payment or contract price collected
Pre-need plan	PHP0.20 for every PHP200 or fractional part of premium or contribution collected
Indemnity bonds	PHP0.30 for every PHP4 or fractional part of the premium charged
Certificate of damage or otherwise, and on every other document or certificate issued by any customs officer, marine surveyor, notary public, and on each certificate required by law or by rules or regulations of a public office	PHP15
Warehouse receipt, except when the warehouse receipt issued to any person within one calendar month covers property valued at PHP200 or less	PHP15
Jai-alai, horse race ticket, lotto, other authorized number games	PHP0.10 for every PHP1 or fractional part thereof
Bill of lading and receipts (except charter party) for any goods, merchandise, or effects shipped from one port or place in the Philippines to another port or place in the Philippines or foreign port	PHP1 if value of goods exceeds PHP100 and does not exceed PHP1,000, and PHP10 if value exceeds PHP1,000, other than freight tickets

<sup>11</sup> The same graduated rates shall be applied by non-life insurance companies in the computation of stamp tax due on accident and health insurance policies pursuant to Revenue Memorandum Circular No. 24-2011.

<b>Taxable document/transaction (tax base)</b>	<b>Rate</b>
Goods, merchandise, or effects carried as accompanied baggage of passengers on land and water carriers primarily engaged in the transportation of passengers	Exempt
Proxy	PHP15
Power of attorney	PHP15
Lease agreement/contract for hire, use, or rent of lands or tenement (except personal service)	PHP3 for the first PHP2,000 or fractional part of amount stipulated in the contract, plus an additional PHP1 for every PHP1,000 or fractional part in excess of the first PHP2,000 for each year of the term of said contract
Mortgage, pledge, deed of trust <sup>12</sup>	PHP20 for the first PHP5,000 of amount secured, and PHP10 for every PHP5,000 or fractional part in excess of PHP5,000
Deed of sale or conveyance of real property	PHP15 for each PHP1,000 or fractional part of the consideration or fair market value, whichever is higher
Charter party, similar instruments	<p>PHP500 if registered gross tonnage of vessel does not exceed 1,000 tons and duration of charter/ contract does not exceed six months, and PHP50 for each month or fraction in excess of six months</p> <p>PHP1,000 if registered gross tonnage is between 1,000 and 10,000 tons and duration of the charter/contract does not exceed six months, and PHP100 for each month or fraction in excess of six months</p> <p>PHP1,500 if registered tonnage exceeds 10,000 tons and the duration of charter/ contract does not exceed six months, and PHP150 for each month or fraction in excess of six months</p>

<sup>12</sup> If the amount secured is fluctuating, stamp tax is based on amount actually loaned.



<b>Taxable document/transaction (tax base)</b>	<b>Rate</b>
Assignment or transfer of any mortgage, lease, or policy of insurance; or the renewal or continuance of agreement, contract, charter, evidence of obligation or indebtedness by altering or otherwise	Exempt if there is no change in the maturity date or remaining period of coverage from that of the original instruments; otherwise, stamp tax shall be the same amount paid on the original document

### ***D. Real property taxes***

Real property taxes are based on the taxable value of real property. The basic tax rates are fixed by the provincial, city, or municipal board or council and are applied uniformly in the localities covered in accordance with the rates provided for by law, as follows:

<b>Location</b>	<b>Rate</b>
Province	Not more than 1% of assessed value
City (including municipality in Metro Manila)	Not more than 2% of assessed value

### **Special levies on real properties**

In addition to the basic tax, an additional levy on real property may be imposed as follows:

<b>Nature or levy</b>	<b>Tax rate</b>
Additional levy for Special Education Fund	Not more than 1% of assessed value
Additional levy on idle lands	Not more than 5% of assessed value
Special levy on lands specially benefitted by public works projects or improvements funded by the local government unit concerned	Not more than 60% of actual cost of the projects and improvements, including the costs of acquiring land and such other real property in connection therewith

### **Assessed value**

Real property is classified, valued, and assessed based on its actual use. The different types of real property are as follows: A - residential; B - agricultural; C - commercial/industrial/mineral; and D - timberland.

Real property tax is based on the assessed value of the property, which is determined by multiplying the current market value of the real property by its assessment level. The assessment levels for the different classes of real property are fixed by ordinances of the different local government units at rates not exceeding those provided in the Local Government Code.

### Assessment level

Land and machinery	A	B	C	D
	%	%	%	%
Land	20	40	50	20
Machinery	50	40	80	0

### Buildings and other improvements market value

	Assessment level			
	A	B	C	D
(in PHP)	%	%	%	%
175,000 and under	0	25	30	45
From 175,001 to 300,000	10	25	30	45
From 300,001 to 500,000	20	30	35	50
From 500,001 to 750,000	25	35	40	55
From 750,001 to 1,000,000	30	40	50	60
From 1,000,001 to 2,000,000	35	45	60	65
From 2,000,001 to 5,000,000	40	50	70	70
From 5,000,001 to 10,000,000	50	50	75	70
10,000,001 and over	60	50	80	70

The maximum assessment levels for all lands, buildings, machineries, and other improvements used for cultural, scientific, and hospital purposes is 15%; and 10% for those used by local water districts and government owned or controlled corporations engaged in the supply and distribution of water and/or generation and transmission of electric power.

# Appendix XIV

## Financial statements

### *Financial statements in accordance with PFRS – applicable from 1 January 2012*

#### **ABC Company**

Consolidated Statements of Financial Position

31 December 20X2 and 20X1

(All amounts in thousand PHP)

<b>ASSETS</b>	<b>Notes</b>	<b>20X2</b>	<b>20X1</b>
<b>CURRENT ASSETS</b>			
Cash and cash equivalents	5	312,400	322,900
Trade receivables	6	91,600	110,800
Inventories	7	135,230	132,500
Other current assets	8	25,650	12,540
<b>Total current assets</b>		<b>564,880</b>	<b>578,740</b>
<b>NON-CURRENT ASSETS</b>			
Available-for-sale financial assets	9	142,500	156,000
Property, plant and equipment	10	350,700	360,020
Investments in associates	11	100,150	110,770
Goodwill	12	80,800	91,200
Other intangible assets	13	227,470	227,470
<b>Total non-current assets</b>		<b>901,620</b>	<b>945,460</b>
<b>Total assets</b>		<b>1,466,500</b>	<b>1,524,200</b>

(forward)

(The notes on pages XX to XX are an integral part of these consolidated financial statements.) – Notes not presented in this illustration.

(Note to reader: This set of financial statements assumes that the preparer is not a first-time adopter of Philippine Financial Reporting Standards.)

## Financial statements (Cont.)

Consolidated Statements of Financial Position (cont.)

LIABILITIES AND EQUITY	Notes	20X2	20X1
CURRENT LIABILITIES			
Trade and other payables	14	115,100	187,620
Short-term borrowings	15	150,000	200,000
Current portion of long-term borrowings	15	10,000	20,000
Current tax payable		35,000	42,000
Short-term provisions	16	5,000	4,800
Total current liabilities		315,100	454,420
NON-CURRENT LIABILITIES			
Long-term borrowings	15	120,000	160,000
Deferred tax	20	28,800	26,040
Long-term provisions	16	28,850	52,240
Total non-current liabilities		177,650	238,280
EQUITY			
Capital and reserves attributable to the company's equity holders			
Share capital	17	650,000	600,000
Retained earnings	17	243,500	161,700
Other reserves	17	10,200	21,200
		903,700	782,900
Non-controlling interests		70,050	48,600
Total equity		973,750	831,500
Total liabilities and equity		1,466,500	1,524,200

(The notes on pages XX to XX are an integral part of these consolidated financial statements) – Notes not presented in this illustration.

**ABC Company**

## Consolidated Statements of Total Comprehensive Income

31 December 20X2 and 20X1

(All amounts in thousand PHP)

	Notes	20X2	20X1
Revenue	18	390,000	355,000
Cost of sales	19	(245,000)	(230,000)
<b>Gross profit</b>		145,000	125,000
Other income		20,667	11,300
Distribution costs	20	(9,000)	(8,700)
Administrative expenses	20	(20,000)	(21,000)
Other expenses		(2,100)	(1,200)
<b>Operating profit</b>		134,567	104,400
Finance costs	15	(8,000)	(7,500)
Share in profit of associates	11	35,100	30,100
<b>Profit before tax</b>		161,667	128,000
Income tax expense	21	(40,417)	(32,000)
<b>Profit for the year from continuing operations</b>		121,250	96,000
Loss for the year from discontinued operations		—	(30,500)
<b>PROFIT FOR THE YEAR</b>		121,250	65,500
<b>Other comprehensive income:</b>			
Changes in fair value of available-for-sale financial assets	9	(24,000)	26,667
Actuarial (losses) gains on defined benefit pension plans	22	5,053	11,367
Share in other comprehensive income (loss) of associates	11	280	(760)
Income tax relating to components of other comprehensive income	17	4,667	(9,334)
<b>Other comprehensive income for the year, net of tax</b>		(14,000)	28,000
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		107,250	93,500

(forward)

## **Financial statements (Cont.)**

### Consolidated Statements of Total Comprehensive Income (cont.)

	Note	20X2	20X1
Profit attributable to:			
Equity holders of the Parent Company		97,000	52,400
Non-controlling interests		24,250	13,100
		121,250	65,500
Total comprehensive income attributable to:			
Equity holders of the Parent Company		85,800	74,800
Non-controlling interests		21,450	18,700
		107,250	93,500
Earnings per share (in PHP):			
Basic and diluted	22	0.46	0.30

(The notes on pages XX to XX are an integral part of these consolidated financial statements.) – Notes not presented in this illustration.

## ABC Company

### Consolidated Statements of Changes in Equity

31 December 20X2 and 20X1

(All amounts in thousand PHP)

	Attributable to equity holders of the Parent					
	Share capital (Note 17)	Other reserves (Note 17)	Retained earnings (Note 17)	Total	Non-controlling interests	Total equity
<b>Balance at January 1, 20X1</b>	600,000	(400)	118,500	718,100	29,900	748,000
<b>Comprehensive income</b>						
Profit for the year	-	-	53,200	53,200	12,300	65,500
Other comprehensive income for the year						
Changes in fair value of available-for-sale financial assets	-	17,567	-	17,567	9,100	26,667
Share in other comprehensive income (loss) of associates	-	10,667	-	10,667	-	10,667
Income tax relating to components of other comprehensive income	-	(6,634)	-	(6,634)	(2,700)	(9,334)
<b>Total comprehensive income</b>	-	21,600	53,200	74,800	18,700	93,500
<b>Transactions with owners</b>						
Dividends declared	-	-	(10,000)	(10,000)	-	(10,000)
<b>Balance at December 31, 20X1</b>	600,000	21,200	161,700	782,900	48,600	831,500
<b>Comprehensive income</b>						
Profit for the year	-	-	97,000	97,000	24,250	121,250
Other comprehensive income for the year						
Changes in fair value of available-for-sale financial assets	-	(20,000)	-	(20,000)	(4,000)	(24,000)
Share in other comprehensive income (loss) of associates	-	5,333	-	5,333	-	5,333
Income tax relating to components of other comprehensive income	-	3,467	-	3,467	1,200	4,667
<b>Total comprehensive income</b>	-	(11,200)	97,000	85,800	21,450	107,250
<b>Transactions with owners</b>						
Issuance of share capital	50,000	-	-	50,000	-	50,000
Dividends declared	-	-	(15,000)	(15,000)	-	(15,000)
<b>Total transactions with owners</b>	50,000	-	(15,000)	35,000	-	35,000
<b>Balance at December 31, 20X2</b>	650,000	10,000	243,700	903,700	70,050	973,750

(The notes on pages XX to XX are an integral part of these consolidated financial statements.) – Notes not presented in this illustration.

**ABC Company**

## Consolidated Statements of Cash Flows

31 December 20X2 and 20X1

(All amounts in thousand PHP)

	Notes	20X2	20X1
<b>Cash flows from operating activities</b>			
Profit before income tax including discontinued operations		161,667	51,750
Adjustments for:			
Depreciation and amortization	10	70,140	72,100
Goodwill impairment charge	12	10,400	-
Inventory write-down	7	12,500	-
Finance costs	15	8,000	7,500
Interest income		(2,500)	(2,500)
Dividend income	9	(7,500)	(7,500)
Share in profit of associates	11	(35,100)	(30,100)
Operating income before working capital changes		217,607	91,250
Changes in working capital			
Trade receivables		19,200	(20,500)
Inventories		(15,230)	(35,000)
Other current assets		(13,610)	(50,000)
Trade and other payables		(157,347)	60,000
Cash generated from operations		50,620	45,750
Interest paid		8,200	7,800
Income tax paid		45,000	40,000
Net cash generated from operating activities		103,820	93,550
<b>Cash flows from investing activities</b>			
Purchases of property, plant and equipment	10	(60,820)	(40,000)
Interest received		3,000	3,000



	Notes	20X2	20X1
Dividends received	9	7,500	7,500
Net cash used in investing activities		(50,320)	(29,500)
<b>Cash flows from financing activities</b>			
Proceeds from issuance of ordinary shares	17	50,000	-
Proceeds from borrowings	15	-	50,000
Repayments of borrowings	15	(100,000)	-
Dividends paid	17	(15,000)	(15,000)
Net cash generated from financing activities		(65,000)	35,000
Effect of exchange rate changes on cash and cash equivalents		1,000	1,500
<b>Net (decrease) increase in cash and cash equivalents</b>		(10,500)	100,550
Cash and cash equivalents at beginning of year		322,900	222,350
<b>Cash and cash equivalents at end of year</b>		312,400	322,900

(The notes on pages XX to XX are an integral part of these consolidated financial statements.) – Notes not presented in this illustration.

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# Appendix XV

## Setting up in the Philippines – A checklist

### **I. Investor's considerations**

#### *A. Market*

- ☐ Existing and potential market for products/services
- ☐ Demand for the products/services
- ☐ Demographic research
- ☐ Degree of competition
- ☐ Market surveys
- ☐ Franchising
- ☐ Patents, trademarks, and copyrights
- ☐ Restrictions on foreign participation

#### *B. Preparation of a business plan*

- ☐ Description of the business (project)
- ☐ Nature or kind of product/service/ and industry
- ☐ Financial projections
- ☐ Overall strategy
- ☐ Assistance from professional advisers, such as PwC

#### *C. Form of entity*

- ☐ Corporation (subsidiary operation)
- ☐ Joint venture
- ☐ Branch
- ☐ Partnership
- ☐ Sole proprietorship (for individuals only)
- ☐ Regional headquarters
- ☐ Regional operating headquarters
- ☐ Representative office

#### *D. Initial capital requirements*

- ☐ Sources of starting capital (local and foreign)
- ☐ Minimum capitalization requirements
- ☐ Rules and regulations on domestic borrowings
- ☐ Regulations on repatriation of capital and earnings

*E. Capital structure*

- ☐ Debt-equity ratio requirements
- ☐ Considerations on thin capitalization
- ☐ Foreign equity limitation
- ☐ Lease/purchase of assets
- ☐ Capital/cash contribution from parent/holding company
- ☐ Tax implications
- ☐ Assistance from bankers, attorneys, accountants, underwriters, and others
- ☐ Repatriation of interest and principal of foreign-source loans

*F. Location*

- ☐ Where to set up operations
- ☐ Accessibility of transportation, power and utility facilities, as well as human resources
- ☐ Eligibility for incentives in export processing zones/less developed areas
- ☐ Where to set up operations

*G. Premises*

- ☐ Restriction on foreign ownership of real estate
- ☐ Lease of real estate
- ☐ Insurance requirements
- ☐ Health and safety regulations
- ☐ Possibility for expansion
- ☐ Permits required
- ☐ Storage/warehousing

*H. Management*

- ☐ Organizational chart/structure
- ☐ Requirements and availability (local and foreign)
- ☐ Qualifications of officers
- ☐ Compensation surveys
- ☐ Restrictions on expatriate personnel (permits, number, duration of employment)

*I. Labor*

- ☐ Number and skills of employees/workers needed
- ☐ Salary range and fringe benefits
- ☐ Projected costs
- ☐ Recruitment
- ☐ Salary withholdings and social security costs
- ☐ Unions
- ☐ Training programs

*J. Selling the product*

- ☐ Advertising
- ☐ Marketing strategy and methods
- ☐ Pricing policy
- ☐ Channel of distribution
- ☐ Sales force
- ☐ Exports
- ☐ VAT requirements
- ☐ Projected costs

## *K. Formation procedures*

- ☐ Appointment of professional advisers (auditors, attorneys, bankers, etc.)
- ☐ Company secretarial services
- ☐ Registration of corporate name/business name/trade name
- ☐ Legal formalities
- ☐ Ordering of stationery/design of logo
- ☐ Opening of bank accounts

## **II. Business adviser's considerations**

### *A. Documentation requirements*

- ☐ Certificate to do business
- ☐ Articles of incorporation and by-laws

### *B. Registration*

- ☐ Regulatory authority
- ☐ Registration fee
- ☐ Extent of foreign equity

### *C. Permits and licenses*

- ☐ National and local authorities
- ☐ Place of business
- ☐ Form of entity
- ☐ Nature of business

### *D. Governing statutes*

- ☐ Foreign Investments Act of 1991
- ☐ Omnibus Investments Code of 1987
- ☐ Corporation Code
- ☐ Anti-Money Laundering Law

- ☐ Securities Regulation Code
- ☐ Special Economic Zone Acts
- ☐ Banking and other allied special laws
- ☐ Insurance Code
- ☐ Local Government Code
- ☐ Others

### *E. Conduct of entity*

- ☐ Composition of the board of directors/trustees and officers
- ☐ Powers of directors and other officers

### *F. Contracts and agreements*

- ☐ Management contracts/licensing agreements
- ☐ Voting trust agreements
- ☐ Tax implications of entering into management contracts

### *G. Property evaluation and documentation*

- ☐ Evaluation by recognized professionals
- ☐ Accounting treatment
- ☐ Tax implications

### *H. "Doing business" qualifications*

- ☐ Acts considered as "doing business" under the Foreign Investments Act of 1991

## **III. Accountant's considerations**

### *A. Evaluation of industry*

- ☐ Historical background of industry
- ☐ Demand/competition
- ☐ Resource assessment

☐ Technological appraisal

☐ Support structures

*B. Tax planning*

☐ Government fees, licenses, permits, municipal tax

☐ Income tax (varying as to form of business organization)

☐ Business taxes

☐ Transfer pricing

☐ Tax exemption

☐ Business design and strategies to minimize tax liabilities

*C. Requirements for tax purposes*

☐ Registration with the Bureau of Internal Revenue

☐ Types of tax covered

☐ Books of account

*D. Management control systems*

☐ Computerization

☐ Approval from the Bureau of Internal Revenue

*E. Financing requirements*

☐ Preparation of request for financing

☐ Local or international financial institutions

*F. Management consulting*

☐ Operational reviews

☐ Marketing and feasibility analysis

☐ Strategic planning

*G. Projections*

☐ Cash flow

☐ Debt repayment

☐ Sales forecast

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# Appendix XVI

## Structuring an investment – A Checklist

### **I. Investor's considerations**

#### *A. Investor's considerations*

- ☐ Limitations on foreign ownership, depending on activities
- ☐ Number of founder shareholders required, including local shareholders
- ☐ Advantages/disadvantages of incorporating
- ☐ Availability of local funding, including equity issues
- ☐ Degree to which capital must be imported
- ☐ Incorporation and maintenance costs
- ☐ Applicable incentives
- ☐ Taxed as entity; shareholders taxed on dividends received
- ☐ Minimum capital requirements
- ☐ Statutory audit may be required
- ☐ Repatriation of capital and profits

#### *B. Business adviser's considerations*

- ☐ At least five incorporators, the majority of whom must be Philippine residents
- ☐ Articles of incorporation
- ☐ By-laws
- ☐ Stock and transfer book
- ☐ Registration requirements (Securities and Exchange Commission, local government units, Bureau of Internal Revenue, other government agencies)
- ☐ Annual shareholders' meeting
- ☐ Board of directors' meeting

#### *C. Accountant's considerations*

- ☐ Tax advantages/disadvantages of incorporating
- ☐ Tax planning opportunities to minimize tax
- ☐ Financial statements filing requirements

## **II. Branch**

### *A. Investor's considerations*

- ☐ Type of entity
- ☐ Limitations on foreign participation depending on their activities
- ☐ Advantages/disadvantages of operating as a branch
- ☐ Head office's liability
- ☐ Reasonable pro-rata head office's expenses deductible
- ☐ Registration and maintenance costs
- ☐ Minimum capital requirements
- ☐ Tax on profit remittance to head office
- ☐ Security deposit with Securities and Exchange Commission

### *B. Business adviser's considerations*

- ☐ Requirements to establish branch
- ☐ Registration requirements (Securities and Exchange Commission, local government units, Bureau of Internal Revenue, other government agencies)
- ☐ Board resolution for the establishment of branch office
- ☐ Resident agent
- ☐ Head office's financial statements
- ☐ Head office's articles of incorporation

### *C. Accountant's considerations*

- ☐ Taxation of a branch
- ☐ Taxation of profits when repatriated

- ☐ Tax planning opportunities to minimize tax
- ☐ Financial statements filing requirements

## **III. Partnership**

### *A. Investor's considerations*

- ☐ Limitations on foreign investment participation depending on their activities
  - ☐ Requirement for local partners
  - ☐ Advantages/disadvantages of operating as a partnership
- ### *B. Business adviser's considerations*
- ☐ Organization requirements
  - ☐ Registration requirements (Securities and Exchange Commission, local government units, Bureau of Internal Revenue, other government agencies)
  - ☐ Documentation

### *C. Accountant's considerations*

- ☐ Taxed as conduit or entity
- ☐ Tax planning opportunities to minimize tax
- ☐ Financial statements filing requirements
- ☐ BIR assessments
- ☐ Reports from special regulatory bodies

#### **IV. Joint venture**

##### *A. Investor's considerations*

- ☐ Only an agreement, not a juridical entity
- ☐ Administration of joint venture
- ☐ Advantages/disadvantages of participating in a joint venture
- ☐ Obligations of a joint venture (between parties, vis à vis third parties)
- ☐ Term of joint venture

##### *B. Business adviser's considerations*

- ☐ Requirements
- ☐ Drafting of agreement

##### *C. Accountant's considerations*

- ☐ Taxed as conduit or entity
- ☐ Tax planning opportunities to minimize tax
- ☐ Financial statements filing requirements

#### **V. Sole proprietorship**

##### *A. Investor's considerations*

- ☐ Foreign individual investor may operate as sole proprietor if activities not included in Foreign Investment Negative List
- ☐ Advantages/disadvantages of operating as a sole proprietor
- ☐ Minimum capital requirements
- ☐ Unlimited liability

##### *B. Business adviser's considerations*

- ☐ Formation and registration requirements

##### *C. Accountant's considerations*

- ☐ Individual tax planning opportunities to minimize tax



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# **Appendix XVII**

## **Acquiring a business enterprise – A Checklist**

### **I. Investor's considerations**

#### **A. History and current status of the enterprise**

- ☐ When, where, and by whom established; changes of ownership since inception
- ☐ Major shareholders
- ☐ History of development, including introduction of new products
- ☐ Trade reputation
- ☐ Reasons of owners for selling
- ☐ Viability of the business
- ☐ Registered for incentives

#### **B. Market and competitors**

- ☐ Overview of industry in which the company operates
- ☐ Markets served, potential new markets, and involvement in any declining markets
- ☐ Principal competitors
- ☐ Seasonality

#### **C. Capital requirements**

- ☐ Limitation on foreign ownership
- ☐ Minimum capitalization requirements
- ☐ Debt-to-equity requirements

#### **D. Location and premises**

- ☐ Main premises: owned or leased
  - ☐ Space available for expansion, any planning restrictions or approvals required for developing the current sites
  - ☐ Availability of customs bonded warehouse
  - ☐ Accessibility by road, rail, or other transport facilities
  - ☐ Whether premises are in a less-developed area or export processing zone and eligible for investment incentives
- #### **E. Management evaluation**
- ☐ Management organization chart
  - ☐ Key officers-name, age, years of service, and qualifications

- ☐ Details of current salaries, other remuneration, service agreements, and pension scheme

*F. Production evaluation*

- ☐ Estimated production capacity, scope for utilization of space capacity, quality of plant and equipment
- ☐ Details of patents, tools, and dies
- ☐ Nature and amount of work subcontracted to outside firms
- ☐ Relationship between fixed and variable costs
- ☐ Raw materials used and principal suppliers
- ☐ Impact of purchases in foreign currencies
- ☐ Terms of purchases
- ☐ Existence of government controls over raw-material purchases
- ☐ Supply position of raw materials and existence of alternative suppliers

*G. Workforce evaluation*

- ☐ Number of employees at each main factory and office
- ☐ Labor relations with management and unions
- ☐ Existence of collective bargaining agreements
- ☐ Approximate current salaries or pay rates
- ☐ Pension scheme arrangements
- ☐ Other employee benefits

*H. Sales and marketing-analysis of current and potential*

- ☐ Sales promotion methods, export methods and distribution
- ☐ Nature of relationship between the company and its selling agents
- ☐ Sales by product, by major customers, and by geographical market
- ☐ Existence of controls on selling prices by the government

**II. Business adviser's considerations**

*A. Corporate, statutory and regulatory documents*

- ☐ Articles of incorporation
  - ☐ By-laws
  - ☐ Stock and transfer book
  - ☐ Minutes of meeting of the board of directors and stockholders
  - ☐ Shareholders' agreement
- ☐ Regulatory documents
  - ☐ Annual reports
  - ☐ SEC reports
  - ☐ BIR assessments
  - ☐ Reports from special regulatory bodies

*B. Contractual obligations, other than with management or labor*

- ☐ Loan agreements
- ☐ Insurance policies

☐ Mortgages

☐ Leases

☐ Licenses

☐ Franchises

☐ Guarantees

*C. Management/labor obligations*

☐ Pension, profit-sharing, stock-option, and other employee benefit plans

☐ Effect of acquisition on labor union

☐ History

☐ Effect on buyer of

☐ Termination of employees

☐ Retention of employees

*D. Property titles and liens*

☐ Real property

☐ List and description

☐ Title documents

☐ Surveys

☐ Insurance policies

☐ Tangible personal property

☐ List by category

☐ Valuation

☐ Intangible personal property

☐ List by category

☐ Existing liens

☐ Verification with the Register of Deeds

☐ Pending legislation

*E. Others*

☐ Requirements/qualifications for doing business in the country

☐ Public disclosure requirements

**III. Accountant's considerations**

*A. Past trading results*

☐ Accounting policies, compliance with standards and the law, and consistency of application

☐ Sales: trends, long-term contracts

☐ Other income: details of royalties; management and technical fees; service fees; rents; income from other investments

☐ Cost of sales: material; labor and overhead cost; accuracy of costing procedures

☐ Gross profits: by product; division; brand; and percentage margin on sales

☐ Overheads by main categories

☐ Confirming client accounts and bad debts

☐ Interest and other costs of borrowing

☐ Taxation

☐ Analysis of extraordinary items

☐ Purchase commitments, including capital commitments

*B. Financial statements*

☐ Balance sheet

☐ Income statement and statement of retained earnings

☐ Statement of cash flows

☐ Auditor's report

*C. Current tax status*

☐ Tax position of parties involved

☐ Outstanding tax assessment

☐ Change of ownership rules

☐ Status of examinations by tax authorities

*D. Future prospects*

☐ Profit and cash-flow forecasts, and assumptions on which based

☐ Accuracy of past forecasting

☐ Long-term prospects and discussion of any known significant changes since last audited accounts

☐ Adequacy of working capital, relationships with bankers

*E. Method of acquisition*

☐ Tax implications of method of purchase - share versus assets

☐ Implications for future operations

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# Appendix XVIII

## Major events/changes in the last two years

### **Year 2012**

#### *Local bourse remains bullish*

The Philippine Stock Exchange (PSE) recorded 38 incidences of all-time closing highs in 2012, with the bellwether PSEi posting its last record-close for the year on 26 December at 5,832.30 index points. On its last trading day, 28 December, the PSEi ended at 5,812.73, 33% higher than last year's close.

Meanwhile, the World Federation of Exchanges recognised the PSE as the world's third best performing stock market in 2012 as its domestic market capitalisation expanded by 38.9% year-on-year as of end-2012.

#### *Supreme Court issues TRO against Cybercrime Prevention Act*

In response to legal issues concerning online interactions in the Philippines, the Cybercrime Prevention Act of 2012 or Republic Act (RA) 10175 was created and signed into law on 12 September 2012. The law, which is divided into 31 sections split across eight chapters, criminalizes offenses

such as: hacking, data interference, device misuse, cybersquatting, cybersex, child pornography, and libel.

The law, however, did not gain support from the public. Specifically, the provision penalizing libel was bombarded with criticisms as it was perceived to limit freedom of speech. The Supreme Court unanimously issued a 120-day temporary restraining order (TRO) against the implementation of RA 10175 on 9 October 2012. This was extended indefinitely on 5 February 2013, a day before the TRO expires.

The DOJ plans to introduce an enhanced version of the law, where the contentious online libel provision will be dropped, during the 16th Congress.

#### *President Benigno Aquino III signs the Reproductive Health Bill into law*

After being stalled for more than a decade due to strong opposition from the Roman Catholic Church and conservative legislators from the Congress and Senate, President Benigno Aquino III signed into

law RA 10354, otherwise known as the Responsible Parenthood and Reproductive Health Act of 2012 or RH Law on 21 December 2012.

The controversial law, which was greatly criticized by advocates of abstinence and natural planning method, makes birth control options easily accessible to the poor, including those in far-flung areas, and allows local government health centers to provide subsidized “medically-safe” and “non-abortifacient” birth control options. The law also requires sex education in public schools and family planning training conducted by community health officers.

The RH law was deemed as a solution to the pressing problem on overpopulation and poverty in the Philippines. However, backers of the legislation, including the Aquino Administration, reiterated that its purpose is not to limit population growth but to offer poor families the same reproductive health options the financially-capable ones can afford.

#### *Release of the new mining policy guidelines (October 2012)*

President Benigno Aquino III approved the amendments to the implementing rules and regulations (IRR) of Executive Order (EO) 79 revised by the Mining Industry Coordinating Council (MICC) in response to issues raised by stakeholders on some sections of the original regulations.

The original IRR was supposed to take effect on 29 September 2012 but it was suspended a day before its implementation. The new mining rule, which included the

revised Sections 3, 7, and 9, took effect on 25 October 2012.

The definition of “expired mining tenements” or lapsed mining contract of 25-50 years was included in the revised Section 3.

Taking into consideration the supply and price concerns of cement companies, the IRR’s Section 7 was reworded by the MICC to allow the expansion of quarrying areas where failure to expand would cause economic disruption.

In Section 9, changes were made to remove the provision on renegotiating mining contract after a mining firm’s first 25 years of operation. The new rule states that contracts shall be renewed “subject to existing laws, rules, and regulations at the time of renewal.”

#### *Philippines lends IMF US\$1bn (June 2012)*

The Philippines became a creditor nation as it extended one billion US dollars loan to the International Monetary Fund (IMF). The loan will be part of the four hundred fifty six billion US dollars committed fund that will be lent to debt-stricken European countries like Greece and Spain.

The Bangko Sentral ng Pilipinas (BSP) said that the fund will be used to help stabilize the global economy amid the euro zone crisis. Association of Southeast Asian Nations (ASEAN) members Malaysia and Thailand have also pledged one billion US dollars.

After four decades of being a debtor, the Philippines prepaid all its outstanding debt with the IMF in 2006.

### *Domestic economy expands 6.6% in 2012*

The gross domestic product or GDP growth of 6.8% in the fourth quarter of last year allowed the Philippine domestic economy to expand by 6.6% for the full year 2012.

The 6.6% domestic expansion went beyond the 5%-6% growth target of the government for the year and almost doubled the 3.9% posted in 2011.

The growth, according to the National Statistical Coordination Board (NSCB), was bolstered by the robust performance of the services sector, particularly trade and real estate, renting, and business activities. Significant improvements in manufacturing and construction were also noted by the NSCB.

In May 2013, full-year 2012 GDP was revised upward to 6.8% while GDP in the last three months of the year was raised to 7.1%. Revisions were brought about by the changes in the estimates for public administration and defense, mining and quarrying, other services, and construction. For 2013, the government targets a GDP growth of 6% to 7%.

### *Foreign currency remittances hit a record of US\$21.39bn in 2012*

The BSP reported that remittances hit a record high of twenty-one billion three hundred ninety million US dollars in 2012, which was up 6.3% from twenty billion one hundred twenty million US dollars in 2011.

This was amid increasing global demand for skilled Filipino workers abroad, particularly in the Middle East. The 6.3% growth in remittances exceeded the BSP's 5% forecast.

The US with a share of 42.6% remained as the primary source of remittances last year. It was followed by Canada at 9.2%, Saudi Arabia at 8.1%, United Kingdom at 5%, Japan at 4.7%, United Arab Emirates at 4.5%, and Singapore at 4.1%.

### **Year 2011**

### *Foreign currency remittances grew 7.2% in 2011*

The BSP reported that overseas remittances grew by an annual 7.2% to twenty billion one hundred twenty million US dollars in 2011, slightly higher than the 7% projection of the BSP.

Land-based workers accounted for 78.4% of the total, while sea-based Filipino workers accounted for the remaining.

The United States, Canada, Saudi Arabia, United Kingdom, Japan, United Arab Emirates, Singapore, Italy, Germany, and Norway were the top sources of remittances during the period.

### *NTC approves PLDT-Digitel merger (October 2011)*

The National Telecommunications Commission (NTC) gave the Philippine Long Distance Telephone Co. (PLDT) and Digital Telecommunications Philippines Inc. (Digitel) merger a go signal but the approval came with steep set of

requirements that would set a level playing field among telecommunications firms.

Following the NTC's approval, PLDT announced that it had completed its acquisition of 51.55% or majority interest in Digitel from JG Summit Holdings, Inc. and other shareholders in a landmark share swap transaction worth sixty-nine billion two hundred million Philippine pesos. JG Summit currently holds approximately 12.9% of PLDT's expanded outstanding common stock as a result of the share swap transaction.

### *Philippine IT-BPO industry hits US\$11bn revenue target in 2011*

The Business Processing Association of the Philippines (BPAP), through its President and Chief Executive Benedict Hernandez, reported that information technology and business process outsourcing (IT-BPO) industry in the Philippines generated revenues of eleven billion US dollars in 2011, up 24% from a year ago, and employed 638,000 workers, 22% higher than a year ago.

The contact center sector, which comprised more than half or 65% of the IT-BPO industry, grew by 21% in 2011. It provided seven billion four hundred million US dollars worth of services and employed 416,000 employees.

The industry targets to grow by an average of 20% every year.

### *Philippine Team for the 26th Southeast Asian games brought home 36 gold medals (November 2011)*

The Philippine Team bagged 36 gold medals, 56 silvers, and 77 bronzes in the 26th Southeast Asian Games (SEA Games), the region's biggest multi-sport event. It was held in Jakarta and Palembang, Indonesia from 11 to 22 November 2011. The country ranked sixth among 11 competing countries.

### *CoA welcomes two new officials (April 2011)*

President Benigno Aquino III appointed Ma. Gracia Pulido-Tan and Heidi Mendoza as chairperson and commissioner of the Commission on Audit (CoA), respectively.

Tan, who is a lawyer and the former undersecretary of the Department of Finance, replaced former CoA Chairman Reynaldo Villar. Heidi Mendoza, a former state auditor who leaked the fund scam in the Armed Forces of the Philippines, replaced former Commissioner Evelyn San Buenaventura.

### *Philippine Airline workers continue to protest*

The battle between the Philippine Airlines (PAL) and its employees' association (known as PALEA) intensified as the retrenched workers sought legal actions against the imposed spin-off/outsourcing program.

The Office of the President, in a decision dated 11 August 2011, denied PALEA's motion for reconsideration and upheld PAL's right to outsource its non-core operations.



This eventually prompted PAL workers to retaliate through work stoppage, which led to the cancelation of 172 PAL flight in September 2011. PAL went on with its move to outsource non-core operations, effective 1 October 2011, which left around 2,600 employees jobless. It was said to be the airline's survival plan for the stiff competition in the airline industry and to prevent the firm's continued heavy and substantial losses.

The PALEA continues to file series of petitions before the Court of Appeals until 2013 in a bid to reverse the ruling in favor of PAL's imposed spin-off/outsourcing program.

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# Appendix XIX

## Business information services

### **Government institutions**

The official Web site of the Philippine government is [www.gov.ph](http://www.gov.ph)

#### *Bangko Sentral ng Pilipinas*

BSP Building  
A. Mabini St. corner P. Ocampo St., Malate,  
Metro Manila  
Telephone: +63 (2) 708 7701  
Web site: [www.bsp.gov.ph](http://www.bsp.gov.ph)

#### *Board of Investments*

Industry and Investments Building  
385 Senator Gil J. Puyat Avenue, Makati  
City  
Telephone: +63 (2) 895 8322  
Web site: [www.boi.gov.ph](http://www.boi.gov.ph)

#### *Bureau of Export Trade Promotion*

1F and 2F DTI International Building  
375 Senator Gil J. Puyat Avenue, Makati  
City  
Telephone: +63 (2) 465 3300  
Fax: +63 (2) 899 0111  
Web site: [www.betp.dti.gov.ph](http://www.betp.dti.gov.ph)

#### *Bureau of Immigration and Deportation*

Magallanes Drive, Intramuros, Manila  
Telephone: +63 (2) 527 3248  
Web site: [www.immigration.gov.ph](http://www.immigration.gov.ph)

#### *Bureau of Internal Revenue*

BIR National Office Building  
BIR Road, Diliman, Quezon City  
Telephone: +63 (2) 981 7000  
Web site: [www.bir.gov.ph](http://www.bir.gov.ph)

#### *Center for International Trade Expositions and Missions*

Golden Shell Pavilion  
ITC Complex, Roxas Boulevard corner Sen.  
Gil J. Puyat Avenue, Pasay City  
Telephone: +63 (2) 831 2201 to 09  
Fax: +63 (2) 832 3965/ 834 0177  
Web site: [www.citem.gov.ph](http://www.citem.gov.ph)

#### *Department of Finance*

DOF Building  
BSP Complex, Roxas Boulevard 1004  
Metro Manila  
Telephone: +63 (2) 523 6051  
Web site: [www.dof.gov.ph/](http://www.dof.gov.ph/)

### *Department of Foreign Affairs*

DFA Building

2330 Roxas Boulevard, Pasay City

Telephone: +63 (2) 834 4000 (trunk line)

Consular Office: +63 (2) 834 4800/ 4212

Web site <http://dfa.gov.ph/>

### *Department of Labor and Employment*

DOLE Building

Muralla Wing corner General Luna St.,

Intramuros, Manila

Telephone: +63 (2) 527 3000/ 527 8000

Fax: +63 (2) 336 8182 (Labor Secretary's fax number)

Web site: [www.dole.gov.ph](http://www.dole.gov.ph)

### *Department of Tourism*

DOT Building

T.F. Valencia Circle

T.M. Kalaw St., Rizal Park, Manila

Telephone: +63 (2) 523 8411

Web site: <http://www.tourism.gov.ph>

### *Department of Trade and Industry*

361 Trade and Industry Building

Senator Gil Puyat Avenue, Makati City

Telephone: +63 (2) 751 0384

Fax: +63 (2) 895 6487

Web site: [www.dti.gov.ph](http://www.dti.gov.ph)

### *National Economic Development Authority*

NEDA Building

12 Saint Josemaria Escriva Drive, Ortigas Center, Pasig City

Telephone: +63 (2) 631 0945 to 56

Web site: [www.neda.gov.ph/](http://www.neda.gov.ph/)

### *Securities and Exchange Commission*

SEC Building

EDSA, Greenhills, Mandaluyong City

Telephone: +63 (2) 584 0923/584 5343

Fax: +63 (2) 584 5498/ 584 6434

Web site: [www.sec.gov.ph/](http://www.sec.gov.ph/)

### **Government offices dealing with special economic zones**

#### *Cagayan Economic Zone Authority*

7F, Westar Building

611 Shaw Boulevard, Pasig City

Telephone: +63 (2) 636 2392/ 636 5774/ 747 3058

Fax: +63 (2) 631 3997

Web site: [ceza.gov.ph](http://ceza.gov.ph)

#### *Philippine Economic Zone Authority*

PEZA Building

Roxas Boulevard corner San Luis St., Pasay City

Telephone: +63 (2) 551 3436 / 551 3438

Fax: +63 (2) 891 6380

Web site: [www.peza.gov.ph](http://www.peza.gov.ph)

#### *Zamboanga City Special Economic Zone Authority & Freeport*

San Ramon, Zamboanga City

Telephone: +63 (62) 992 2012/ 926 1026

Fax: +63 (62) 992 2012

Web site: [zambofreeport.com.ph](http://zambofreeport.com.ph)

#### *Aurora Pacific Economic Zone and Freeport Authority*

Room 303 and 304 Languages

Internationale Building

926 A. Arnaiz Avenue (formerly Pasay

Road), Barangay San Lorenzo, Makati City

Telephone: +63 (2) 813 4381/ 813 4384

Fax: 813 3674

Web site: [www.aurorapacific.com.ph](http://www.aurorapacific.com.ph)

#### *Authority of the Freeport Area of Bataan*

2F, AFAB Administration Building

Freeport Area of Bataan, Mariveles, Bataan

Telephone: +63 (47) 935 7551/935 4009/ 935 4004

Fax: +63 (47) 935 6046

Web site: [www.freeportareaofbataan.com/fab](http://www.freeportareaofbataan.com/fab)

### *Clark Development Corporation*

Building 2122  
C.P. Garcia St., Clark Freeport Zone,  
Pampanga  
Telephone: +63 (45) 599 2092/ 599 4902  
Fax: +63 (45) 599-2507  
Web site: [www.clark.com.ph](http://www.clark.com.ph)

### *Subic Bay Metropolitan Authority*

SBMA Center Building  
229 Waterfront Road, Subic Bay Freeport  
Zone  
Telephone: +63 (47) 252 3737  
Fax: +63 (47) 252 5278  
Web site: [www.sbma.com](http://www.sbma.com)

## **Selected Chambers of Commerce**

### *American Chamber of Commerce of the Philippines, Inc.*

2F, Corinthian Plaza, Paseo de Roxas CPO  
Box 2562, Makati City  
Telephone: +63 (2) 818 7911 to 13  
Fax: +63 (2) 811 3081  
Web site: [www.amchamphilippines.com](http://www.amchamphilippines.com)

### *European Chamber of Commerce of the Philippines*

19F, Philippine AXA Life Centre  
Senator Gil J. Puyat Avenue corner Tindalo  
St., Makati City  
Telephone: +63 (2) 845 1324/ 759 6680  
Fax: +63 (2) 845 1395/ 759 6690  
Web site: [www.eccp.com](http://www.eccp.com)

### *Australian-New Zealand Chamber of Commerce (Phils.), Inc.*

Unit C, 3F, Glass Tower  
115 Carlos Palanca St., Legaspi Village,  
Makati City  
Telephone: +63 (2) 954 1254  
Fax: +63 (2) 954 1566  
Web site: [www.anzcham.com](http://www.anzcham.com)

### *Japanese Chamber of Commerce and Industry of the Philippines, Inc. (JCCPI)*

22F, Trident Tower  
312 Senator Gil J. Puyat Avenue, Salcedo  
Village, Makati City  
Telephone: +63 (2) 816 6877/ 892 3233  
Fax: +63 (2) 815 0317  
Web site: [www.jccipi.com.ph](http://www.jccipi.com.ph)

### *Philippine Chamber of Commerce and Industry*

3F, Commerce and Industry Plaza  
1030 Campus Avenue corner Park Avenue  
McKinley Town Center, Fort Bonifacio,  
Taguig City  
Telephone: +63 (2) 846 8196  
Fax: +63 (2) 846 8619  
Web site: [www.philippinechamber.com](http://www.philippinechamber.com)

## **Other organizations/institutions**

### *Asian Development Bank*

6 ADB Avenue, Mandaluyong City  
Telephone: +63 (2) 632 4444  
Fax: +63 (2) 636 2444  
Web site: <http://www.adb.org>

### *University of Asia and the Pacific*

Pearl Drive, Ortigas Center, Pasig City  
Telephone: +63 (2) 637 0912 to 26  
Web site: [www.uap.asia](http://www.uap.asia)

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# Appendix XX

## Reading list

The following publications are likely to be of interest to foreign business persons who are considering the Philippines as a place in which to invest or set up operations.

### **PwC Philippines publications**

#### *Doing Business and Investing in the Philippines. 2013*

This publication provides answers to the most common concerns and practical questions related to the investment climate in the Philippines.

#### *How to Invest in the Philippines—A Business Guide. 2013*

This book has been prepared for would-be investors and captures what they need to know about the country, government policies on foreign investments, accounting and auditing requirements, significant laws and regulations, and other matters of interest to business people.

#### *Investment Incentives in the Philippines. 2013*

This guide gives local and foreign investors information on the various fiscal and

non-fiscal incentives being made available by the Philippine government.

#### *Client Advisory Letter*

A newsletter that features developments in Philippine taxation and the regulatory environment.

#### *National Internal Revenue Code of 1997 (2009 edition)*

This book provides a comprehensive and updated reference material to tax practitioners and tax administrators to assist them in their tax planning and compliance.

#### *Consolidated Withholding Tax (CWT) and Fringe Benefits Tax (FBT) Regulations Handbook: Philippines 2006*

This book provides taxpayers, potential investors, accountants, or practitioners an easy reference on the various withholding tax and FBT requirements that have to be complied by taxpayers.

### *Philippine Resiliency: A Gem Uncovered (2009)*

This is a compilation of partners' thought leadership in various subjects relevant to the practice today.

These publications are available online at [www.pwc.com/ph](http://www.pwc.com/ph).

### **Non-PwC publications**

#### *Foreign Trade Statistics of the Philippines*

This annual publication of NSO presents information on the quantity and value of Philippine trade with other countries and contains comparative data for previous years.

#### *Philippine Development Plan 2011-2016*

This NEDA-released publication contains the socio-economic blueprint of the Aquino Administration. It presents the vision and mission of the current Administration as well as the policies and strategies it intends to undertake to solve pressing problems in the country.

#### *Philippine Statistical Yearbook*

The Philippine Statistical Yearbook is published annually by the NSCB, and presents time series statistics about the country's economic environment.

#### *Philippine Yearbook*

The Philippine Yearbook, which is published annually by the NSO, is a comprehensive publication that features the latest statistical tables from various government agencies and discusses topics relevant to the government, industry and economy.

### *Philippine Alert*

This monthly journal produced by Wallace Business Forum provides an update on the country's key statistical indicators and discusses important events or developments that affect Philippine business climate.

### *BusinessWorld's Top 1000 Corporations in the Philippines*

This magazine, which ranks top corporations based on gross revenues, is published annually by BusinessWorld Publishing Corp. Also included in this publication is an industry ranking and competitors' performance of the country's biggest corporations.

### *Philippines' Top 15000 Corporations*

This publication is released annually by Philippine Business Profiles and Perspectives, Inc., and contains financial information of the top 15000 corporations in the Philippines.

### *Philippines 25000 Corporations*

The Philippines 25000 Corporations, released annually by CIBI Information, Inc., is the official ranking of the SEC on the country's top 25000 corporations. It provides information on the financial performance of top companies in various industries.

### **Other publications**

Most of the Chambers of Commerce in the Philippines publish newsletters, typically on a monthly basis. The Asian Development Bank (ADB) also issues numerous publications dealing with

various aspects of the Philippines. See Appendix XIX for contact details of the ADB and some of the local Chambers of Commerce.





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Avenue Cebu Business Park, 6000 Cebu  
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