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TAX CONSEQUENCES OF DOING BUSINESS IN THE PHILIPPINES

RICARDO J. ROMULO*

The impact of the Philippine system of taxation is of great importance to American investors and businessmen. According to the American Chamber of Commerce of the Philippines, the total direct United States investment in the Philippines at the end of 1963 was 415 million dollars and of this amount 110 million dollars are invested in manufacturing. Consequently, the aim of this Article, after briefly tracing the history of Philippine tax laws, is to present a thorough but concise discussion of the tax consequences of establishing and operating a business, with emphasis on American owned or controlled corporations, in the Philippines.

BRIEF HISTORY OF PHILIPPINE TAX LAWS

Prior to 1900, there existed a fairly complete system of taxation in the Philippines which had been imposed by various Spanish Royal Decrees. The principal sources of revenue under the Spanish regime were derived from customs receipts, the so-called industrial taxes, the urbana (property) tax, the stamp tax, and the personal cedula (capitation) tax. The industrial and urbana taxes in effect constituted an income tax of some five per cent of the net income of persons engaged in industrial and commercial pursuits and on the income of owners of improved city properties. The sale of stamped paper and adhesive stamps, which the law required to be used, constituted the stamp tax. The cedula or capitation tax was a graduated tax ranging from zero to P37.50.1 Evidently substantial taxes were derived from these revenue measures; it is reported that for the fiscal year 1894-1895 P6,659,-450.00 were collected in direct taxes and P4,565,000.00 in indirect taxes.2

Following the American occupation of the Philippines in 1898, this system, with few changes, was continued by the military authorities until the civil government took charge of customs and internal revenue

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1 Spanish Royal Decrees of June 14, 1878, June 19, 1890, and January 7, 1891. See Philippine Ry. v. Nolting, 34 Phil. 401 (1916); Churchill v. Rafferty, 32 Phil. 580 (1915); Compañía General de Tabacos v. City of Manila, 12 Phil. 397 (1909).
2 1 FIRST PHILIPPINE COMM'N REPORT 79-81 (1900).
A revision of the Spanish tariff schedule was promulgated in 1901 and in 1904 all previous and existing laws and ordinances regarding internal revenue taxes were repealed by the Philippine Commission and supplanted by the Internal Revenue Law of 1904. The Internal Revenue Law of 1904 was patterned after the Internal Revenue Law then in force in the United States. It laid the basic structure for a Bureau of Internal Revenue and levied primarily consumption taxes in the form of specific taxes, stamp and poll taxes, and sales taxes. The Internal Revenue Law of 1904 also created an excise tax which was generally one per cent of the gross receipts of business, manufacturing, and certain occupations as a replacement for the Spanish industrial and urbana taxes.

The Internal Revenue Law of 1914 applied the first tax on income by adopting the pertinent provisions of the United States’ Revenue Act of 1913. This was followed by the Philippine Revenue Law of 1919 which required individual taxpayers to pay a normal tax of two per cent on total net income, and an additional graduated tax or surtax ranging from one-half per cent to thirty-six per cent. The Act of 1919 further provided for a personal exemption of ₱8,000.00 for married individuals and the usual deductions for necessary expenses, interest, taxes paid, and losses sustained.

A Tax Commission was created by the President of the Philippines in August of 1938 for the purpose of revising both the national and the local tax system so as to secure a larger flow of funds into the public treasury and to distribute the tax burden among taxpayers on the principle of “ability to pay.” Consonant with these objectives, the Tax Commission recommended the adoption of a National Internal Revenue Code which codified all the existing internal revenue statutes, adopted a single progressive schedule of rates, and gave greater emphasis than theretofore given to direct taxes such as income tax and the estate and inheritance taxes. The U.S. Revenue Act of 1938, especially the chapters dealing with income tax, and Act No. 2833, as
amended, formed the basis of the Internal Revenue Code drafted by the Tax Commission.11

On June 15, 1939, the National Assembly enacted into law the recommendations of the Tax Commission as Commonwealth Act (C.A.) No. 466. This National Internal Revenue Code, with minor amendments, is the prevailing law on taxation today.

CORPORATE TAX RATES

Domestic and resident foreign corporations are subject to a tax of twenty-two per cent on the first ₱100,000 of net taxable income and thirty per cent on the excess.12 Nonresident foreign corporations, however, are subject to a flat thirty per cent tax on income from all sources within the Philippines.13 The Tax Code defines the phrases "domestic corporation," "resident foreign corporation" and "nonresident foreign corporation" in the following manner:

The term "domestic," when applied to a corporation, means created or organized in the Philippines or under its laws.14

The term "resident foreign corporation" applies to a foreign corporation engaged in trade or business within the Philippines or having an office or place of business therein.15

The term "nonresident foreign corporation" applies to a foreign corporation not engaged in trade or business within the Philippines and not having any office or place of business therein.16

Certain corporations are accorded special treatment. Building and loan associations are taxed on their net income at the rate of twelve per cent, while educational institutions are subject to an eight per cent tax.17 Domestic life insurance companies are taxed on net investment income from interest, dividends, and rents from all sources, at the rate of six and one-half per cent; however, foreign life insurance companies doing business in the Philippines, although taxed at the same rate, need report for tax purposes only their net investment income from Philip-

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14 Int. Rev. Code § 84(c), Phil. Ann. Laws tit. 72, § 84(c) (1956).
15 Int. Rev. Code § 84(g), Phil. Ann. Laws tit. 72, § 84(g) (1956).
pine sources. Foreign life insurance companies not doing business in the Philippines are taxable as other foreign corporations.

In addition to the tax provided by Section 24, the Tax Code imposes on domestic or foreign corporations which accumulate surplus beyond the reasonable needs of the business a twenty-five per cent tax on the undistributed portion of their accumulated profits or surplus. However, this tax does not apply to banks, insurance companies and personal holding companies, or where the accumulated surplus is invested directly in dollar-producing or dollar saving industries or in bonds issued by the Central Bank of the Philippines. Similarly, personal holding companies are subject to a tax of forty-five per cent on undistributed net income plus the ordinary income tax imposed by Section 24. A personal holding company, generally speaking, is any corporation which for the taxable year meets the gross income and the stock ownership requirements stipulated by Section 64 of the Internal Revenue Code.

**Basis of Tax**

Philippine income tax, whether corporate or individual, is levied on the taxpayer's net income for a fixed period. Net income is defined in Section 28 of the Internal Revenue Code as "gross income computed

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18 INT. REV. CODE § 24(c), as amended, R.A. No. 2343 (June 20, 1959), PHIL. ANN. LAWS tit. 72, § 24(c) (Supp. 4, 1963).
19 Ibid.
21 Ibid.
22 INT. REV. CODE § 63, PHIL. ANN. LAWS tit. 72, § 63 (1956).
23 Ibid.
24 INT. REV. CODE §§ 21, 24(a), as amended, R.A. No. 2343 (June 20, 1959), PHIL. ANN. LAWS tit. 72, §§ 21, 24(a) (Supp. 4, 1963); Revenue Regulations No. 2 (hereinafter cited as Rev. Regs. No. 2) §§ 4, 15.
under section 29 less the deductions allowed by section 30." Two factors are involved, therefore, in arriving at the net taxable income of a corporation: gross income and the allowable deductions.

According to Section 29(a) of the Tax Code gross income includes gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interests, rents, dividends, securities, or the transactions of any business carried on for gain or profit, or gains, profits, and income derived from any source whatever.

However, the following items are excluded from gross income: life insurance proceeds, amount received by insured as return of premium, gifts, bequests and devises, interest on government securities, compensation for injuries or sickness, income exempt under a treaty, income of foreign governments, and income accruing to the Philippine Government. The sweeping scope of Section 29(a) is readily apparent, especially in view of the catch-all provision—"gains, profits and income from any source whatever." Thus, in a recent case, the Court of Tax Appeals brushed aside without extended discussion the contention of an insurance company that reinsurance premiums are not gross income but gross receipts and therefore not subject to the payment of income tax. The narrow concept of income which required the physical separation from capital of something of exchangeable value, as evolved in the famous case of Eisner v. Macomber and adopted by the Philippine Supreme Court in Fisher v. Trinidad has given way to the development in Philippine income tax law of the accrual method, the constructive receipt doctrine and the installment method of reporting of income.

The treatment of certain gross income items pertaining to corporations, covered specifically by the Revenue Code and Regulations, is worthy of individual consideration. Dividends received by a domestic or resident foreign corporation from a domestic corporation subject to tax are taxable only to the extent of twenty-five per cent thereof; how-

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25 INT. REV. CODE § 29(b), as amended, R.A. No. 82 (Oct. 29, 1946), PHIL. ANN. LAWS tit. 72, § 29(b) (1956).
27 252 U.S. 189 (1920).
28 43 Phil. 973 (1922).
ever, dividends from a foreign corporation, whether resident or non-resident, are taxable in full. Stock dividends are taxable if they give the shareholder an interest different from that which his former stockholdings represented, or if they are cancelled or redeemed in such a manner as to make the distribution, cancellation or redemption, in whole or in part, essentially equivalent to the distribution of a taxable dividend. Dividends paid in securities or other property (other than its own stock) in which the earnings of a corporation have been invested, are income to the recipients to the amount of the full market value of such property when received by individual stockholders. When receivable by corporations, the amount of such dividends includible for tax purposes is as provided in Section 24(a) of the Tax Code. A dividend paid in the form of the stock of another corporation is not a stock dividend within the meaning of the Tax Code even though the stock was obtained by a transfer of the issuing corporation’s property. Where a corporation declares a dividend payable in stock of another corporation, setting aside the stock to be so distributed and notifying the stockholders of its action, the income arising to the recipients of such stock is the stock’s market value at the time the dividend becomes payable.

In the case of a manufacturing, merchandising or mining business, gross income means the total sales, less the cost of goods sold, plus any income from investment, incidental, or outside operations or sources. In determining gross income, subtractions are not made for depreciation, depletion, selling expenses or losses, or for items not ordinarily used in computing the cost of goods sold.

A taxpayer disposing of patents or copyrights by sale determines the profit or loss arising therefrom by computing the difference between the selling price and the cost. The taxable income in the case of patents or copyrights acquired prior to March 1, 1913 is ascertained in accordance with the provisions of Section 136 of the Revenue Regulations. The profit or loss thus ascertained is increased or decreased,

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32 Ibid.
33 Ibid.
34 Ibid.
35 Basis for determining gain or loss from sale of property.—For the purpose of ascertaining the gain or loss from the sale or exchange of property, the basis is the cost of such property, or in the case of property which should be included in the inventory, its latest inventory value. But in the case of property acquired before
as the case may be, by the amounts deducted on account of depreciation of such patent or copyrights since March 1, 1913 or since the date of acquisition if subsequent thereto. Gain or loss from a sale of goodwill results only when the business, or a part of it, to which the goodwill attaches is sold, in which case the gain or loss will be determined by comparing the sale price with the cost or other basis of the assets, including goodwill. If specific payment was not made for goodwill acquired after March 1, 1913 there can be no deductible loss with respect thereto, but gain may be realized from the sale of goodwill built up through expenditures which have been currently deducted. It is immaterial that goodwill may never have been carried on the books as an asset. The burden of proof lies with the taxpayer to establish the cost or fair market value on March 1, 1913, of the goodwill sold.

Where a corporation requires additional funds for conducting its business and obtains the funds through voluntary pro rata payments by its shareholders, the amounts so received will not be considered income, although there is no increase in the outstanding shares of stock of the corporation. The payments under these circumstances represent an additional price paid for the stocks already held by the shareholders and will be treated as additions to the operating capital of the company. Similarly, property placed in trust or certain amounts set aside in a sinking fund under the control of a trustee for the purpose of securing the payment of corporate bonds or other indebtedness are considered an asset of the corporation. However, if the trustee invests such funds under his control, the income derived is taxable.

Corporate gains on the sale or exchange of property, real or personal, are taxable in full. In other words, the capital gains of a corporation are treated as ordinary income. If a corporation deals in

March 1, 1913, when its fair market value as of that date is in excess of its cost, the gain to be included in gross income is the excess of the amount realized therefor over such fair market value. (See illustration I, section 137 of these regulations.) Also in the case of property acquired before March 1, 1913, when its fair market value as of that date is lower than its cost the deductible loss is the excess of such fair market value over the amount realized therefor. (See illustration II, Id.) No gain or loss is recognized in the case of property sold or exchanged, (a) at more than cost but less than its fair market value as of March 1, 1913 (See illustration III, Id.), or (b) at less than cost but at more than its fair market value as of March 1, 1913. (See illustration IV, Id.) . . .

38 Rev. Regs. No. 2 § 46.
37 Rev. Regs. No. 2 § 47.
36 Rev. Regs. No. 2 § 56.
39 Rev. Regs. No. 2 § 54.
its own shares the resulting gain or loss is computed in the same manner as though the corporation were dealing in the shares of another corporation. If a corporation receives its own stock as consideration for the sale of property or in satisfaction of indebtedness, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property.  

In all cases where a corporation distributes all of its property or assets in complete liquidation or dissolution, the gain realized from the transaction by the stockholders, whether corporate or individual, is taxable. The gain in such cases is usually the excess between the original cost and the fair market value of the property received in liquidation.

The gross income of a foreign corporation subject to taxation consists only of gross income from sources within the Philippines. This includes interest received on bonds, notes, or other interest bearing obligations issued by residents, corporate or otherwise, as well as income derived from dividends on the capital stock or from the net earnings of domestic or resident foreign corporation, joint stock companies, associations, or insurance companies, dividends from other foreign corporation are included to the extent provided in Section 37 of the Tax Code, as is income from rentals and royalties from all sources within the Philippines.

Finally, the determination of when income is to be deemed earned for tax purposes is subject to the so-called constructive receipt doctrine. Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which it is so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case, the income must be credited to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made.

Briefly, the allowable deductions for domestic or resident foreign corporations under Section 30 of the Tax Code are: ordinary and necessary business expenses, interest, taxes, losses, bad debts, depreciation, depletion, charitable and other contributions, and pension

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42 Int. Rev. Code § 83(a), Phil. Ann. Laws tit. 72, § 83(a) (1956); Rev. Regs. No. 2 § 256.
43 Rev. Regs. No. 2 § 60.
44 Rev. Regs. No. 2 § 52.
trusts. General principles governing the more important deductions will be reviewed separately.

Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business. Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of transportation, equipment used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business, advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. A taxpayer is entitled to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source. Philippine courts have held that before a business expense is allowed as a deduction from gross income, it must satisfy three requirements: (a) the expense must be both ordinary and necessary; (b) the expense must be paid or incurred within the taxable year; and (c) the expense must be incurred in carrying on a trade or business.

As yet the Tax Court, in distinguishing between business and personal expenses, has not construed the phrase "ordinary and necessary" in its literal sense. An expense is generally considered necessary where the expenditure is "appropriate or helpful" in the development of the taxpayer's business or if it is proper for the purpose of realizing a profit or minimizing a loss. An expense is ordinary when it involves a payment which is "normal or usual" in the taxpayer's business or trade. The question of how directly related an expense must be to the normal corporate business has been similarly answered by the courts in a liberal vein. A company engaged in the purchase and sale of school supplies deducted the fee charged by an accounting firm for the preparation of its war damage claims. The Commissioner of Internal Revenue disallowed this deduction on the theory that it was not

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connected with the regular business of the company. The Supreme Court, in overruling the Commissioner, stated:

In our opinion, this view is too narrow and technical. To carry on its business, even as specified by the petitioner, the respondent not only must have sufficient assets but must preserve the same and recover any that should be lost. The fee in question was paid by the respondent to recover its lost assets occasioned by the war and thereby to be so rehabilitated as to be able to carry on its business. The law does not say that the expense must be for or on account of transactions in one’s trade or business.  

Representation and entertainment expenses are deductible from gross income if it can be shown that they are ordinary and necessary in the promotion of the taxpayer’s business.  

It is, of course, understood that these business expenses aside from meeting the threefold test discussed above must be supported by adequate records. Partial incompleteness or a total absence of records does not necessarily mean, however, that the whole amount claimed as a business expense will be disallowed. Where there is evidence that the taxpayer actually incurred expenses, the Commissioner and the Tax Court usually allow part of the deduction based on as close an approximation as they can make. However, in such cases, they may bear “heavily, if they choose, upon the taxpayer whose inexactitude is of his own making.”  

Interest paid or accrued within the taxable year on indebtedness may be deducted from gross income. However, interest on an indebtedness incurred to purchase tax exempt government securities or bonds is not deductible. Interest paid by the taxpayer on a real estate mortgage of which he is the legal or equitable owner may be deducted as interest on his indebtedness, even though he is not directly liable upon the bond or note secured by such mortgage. Interest paid by a

51 Rev. Regs. No. 2 § 66.
53 Visayan Cebu Terminal Co. v. Collector, supra note 52.
corporation on script dividends is an allowable deduction. So-called interest on preferred stock, which is in reality a dividend, cannot be deducted in computing net income.\(^{54}\) For interest to be deductible, it must be shown that (a) there is a debt; (b) that interest is due on the debt; and (c) that the interest claimed as a deduction was paid or accrued within the year.\(^{55}\) Thus, interest payments for delinquent taxes are deductible under this section.\(^{56}\) However, interest on uncollected compensation and bonuses which could have been paid by the corporation, if the employees so desired, is not deductible because in contemplation of law no indebtedness exists.\(^{57}\)

As a general rule, taxes are deductible in the year paid or accrued. The exceptions are income taxes, estate, inheritance and gift taxes, and taxes imposed by the Philippine Government or its subdivisions for local benefits of a kind which tend to increase the value of the property assessed.\(^{58}\) Import duties paid to the proper customs officer, and business, occupation, license, privilege, excise and stamp taxes and all other taxes paid directly to the Government of the Philippines or its political subdivisions are deductible. The word “taxes” means taxes proper and no deductions are allowed for amounts representing interest, surcharge, or penalties incident to delinquency. Taxes are deductible only by the person upon whom they are imposed.\(^{59}\) Whether a particular charge is a fee or a tax depends on the purpose for which it is levied. It is said, following the common rule on this subject, that taxes are for revenue whereas license fees are exacted for regulatory and inspection purposes. Hence, automobile registration fees and “slaughter fees” charged by the city of Iloilo, which were clearly beyond the cost of regulation and inspection, were considered taxes by the Supreme Court.\(^{60}\)

\(^{54}\) Int. Rev. Code §§ 30(b)-(b) (1) PHIL. ANN. LAWS tit. 72, § 30(b)-(b) (1) (1956); Rev. Regs. No. 2 § 78.
\(^{56}\) Ibid.
\(^{58}\) Int. Rev. Code §§ 30(c)-(c) (1) (D), as amended, R.A. No. 82 (Oct. 29, 1946), PHIL. ANN. LAWS tit. 72, §§ 30(c)-(c) (1) (D) (1956); Rev. Regs. No. 2 § 80.
\(^{59}\) Rev. Regs. No. 2 § 80.
A foreign tax credit or a foreign tax deduction is available to a domestic corporation for any income, war-profit, or excess-profit taxes paid or accrued during the taxable year to any foreign country. If the taxpayer desires to claim credit for the foreign taxes paid or accrued, he must so signify on his income tax return. The allowable foreign tax credit is computed by taking the ratio between the net income from foreign sources and the total net income from all sources in relation to the total Philippine income tax due, subject, however, to two limitations. First, the amount of the credit with respect to the tax paid or accrued to any foreign country can not exceed the same proportion of the tax against which the credit is taken, which the taxpayer's net income from sources within such country taxable under Philippine law bears to his entire net income for the same taxable year. Second, the total amount of the credit can not exceed the same proportion of the tax against which the credit is taken, which the taxpayer's net income from sources outside the Philippines and taxable under Philippine law bears to his entire net income for the same taxable year.

Example (1): Taxpayer has a total taxable income of ₱50,000, of which ₱20,000 is derived from sources within a foreign country and ₱30,000 from sources within the Philippines. Assume that the foreign income tax paid is ₱6,840 and that the total Philippine income tax on all income (without regard to foreign tax credit) is ₱14,080. The maximum amount allowable as a foreign tax credit is $20,000/$50,000 x ₱14,080, or ₱5,632.

Example (2): Taxpayer has a total taxable income of ₱50,000, of which ₱20,000 is derived from U.S. sources, ₱10,000 from Hongkong sources and ₱20,000 from Philippine sources. Assume that the income taxes paid are: ₱6,840 to the U.S., ₱1,000 to Hongkong and ₱14,080 to the Philippines. The maximum amount allowable as a foreign tax credit is computed as follows:

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\begin{align*}
& \text{₱20,000/₱50,000 } \times \text{ ₱14,080 } = \text{ ₱5,632 (tentative U.S. credit)} \\
& \text{₱10,000/₱50,000 } \times \text{ ₱14,080 } = \text{ ₱2,816} \\
& \text{Reduced per Sec. 30(c) (4) (A) } = \text{ ₱1,000 (tentative Hongkong credit)} \\
& \text{Total tentative credits } = \text{ ₱6,632} \\
& \text{₱30,000/₱50,000 } \times \text{ ₱14,080 } = \text{ ₱8,448} \\
& \text{Total credit allowable per Sec. 30(c) (4) (B) } = \text{ ₱6,632}
\end{align*}
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61 Int. Rev. Code §§ 30(c) (1) (B), 30(c) (3) (A), as amended, R.A. No. 82 (Oct. 29, 1946), Phil. Ann. Laws tit. 72, §§ 30(c) (1) (B), 30(c) (3) (A) (1956); Rev. Regs. No. 2 § 82.

62 Int. Rev. Code § 30(c) (4) (A), Phil. Ann. Laws tit. 72, § 30(c) (4) (A) (1956); Rev. Regs. No. 2 § 92.

63 Int. Rev. Code § 30(c) (4) (B), Phil. Ann. Laws tit. 72, § 30(c) (4) (B) (1956); Rev. Regs. No. 2 § 92.
If the taxpayer does not signify his intention to take the benefits of a foreign tax credit, the foreign taxes paid or accrued are allowable as a foreign tax deduction. The taxpayer’s right to a foreign tax deduction was previously subject only to this condition. However, the Supreme Court in Lednicky v. Commissioner, held that a taxpayer claiming a foreign income tax payment as a deduction must establish his entitlement to take a foreign tax credit as a condition precedent to being allowed his foreign tax deduction. Thus, an American taxpayer, resident of the Philippines, whose income is derived solely from Philippine sources (consequently disqualifying him from taking a foreign tax credit), but who must nevertheless pay U.S. income taxes, cannot deduct from his Philippine income tax returns Federal income taxes paid to the American Government. The net effect of the Lednicky decision is simply to eliminate any difference or distinction between a foreign tax credit and a foreign tax deduction.

Losses actually sustained by domestic corporations, charged off within the taxable year and not compensated for by insurance or otherwise, are fully deductible. Losses must be evidenced by closed and completed transactions, and losses must be deducted in the year incurred, since the Revenue Code does not provide for net loss carry over or carry back in the case of corporations. Proper adjustment must be made in each case for expenditures or items of loss properly chargeable to capital account, and for depreciation, obsolescence, amortization, or depletion. Moreover, the amount of the loss must be reduced by the amount of any insurance or other compensation received, and by the salvage value, if any, of the property. When through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently, he may claim as a deduction the actual loss sustained. Adjustment must be made, however, for improvements, depreciation and the salvage value in determining the amount of the loss.

To warrant the deduction of a bad debt from gross income for tax
purposes, three conditions must be met. There must be: a valid subsisting debt; an ascertainment that the debt is worthless; and a charge-off of the debt within the same year when the debt was ascertained to be worthless. The taxpayer must be able to demonstrate with a reasonable degree of certainty the uncollectibility of the debt. Any amount subsequently received on account of a bad debt previously charged off, and allowed as a deduction for income tax purposes, must be included in gross income for the taxable year in which received. In determining whether a debt is worthless, the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. Legal action need not be taken by the taxpayer-creditor if the surrounding circumstances indicate that a favorable judgment cannot be satisfied.

A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business of the taxpayer is an allowable deduction from gross income. The proper allowance for depreciation of any property used in the trade or business is that amount which is set aside for the taxable year in accordance with a reasonably consistent plan whereby the aggregate of the amount so set aside, plus the salvage value, will equal the basis of the property at the end of its useful life. In the case of tangible property the depreciation allowance applies to property which is subject to wear and tear, to decay or decline from natural causes, to exhaustion and to obsolescence due to the normal progress of technology, or due to the inadequacy of the property to meet the growing needs of the business. It does not apply to inventories, to stock in trade or to land.

The capital sum to be replaced by the depreciation allowance is the cost or other basis of the property for which the allowance is made. To this amount is added the cost of improvements, additions and betterments. Deductions are allowed for the amount of any definite loss or damage sustained by the property through casualty, as distinguished

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71 Rev. Regs. No. 2 § 102. For examples of bad debts, see Rev. Regs No. 2 § 103.

72 INT. REV. CODE §§ 30(f), (f)(1), PHIL. ANN. LAWS tit. 72, §§ 30(f), (f)(1) (1956); Rev. Regs. No. 2 § 105.

73 Rev. Regs. No. 2 § 105.

from the gradual exhaustion of its utility. Apart from the depreciation allowance for "normal obsolescence," the regulations permit an additional allowance for "extraordinary obsolescence" where economic conditions so affect the tangible property that it must be abandoned prior to the end of its useful life.

Owners of or persons having an economic interest in mineral lands or oil or gas wells are entitled to a depletion allowance. The Revenue Code provides the following percentages for depletion: 27½% for oil and gas wells; 23% for mines of chromite, copper, gold, iron, manganese, etc.; and 15% for mines of ball, brick, china, sagger, tile clay and like minerals. The original cost depletion stipulated in the Internal Revenue Code was replaced by the present provisions for percentage depletion on June 18, 1960. The percentage depletion allowance is based on the gross income of the taxpayer, after deducting rents or royalties paid or incurred, but in no case can it exceed fifty per cent of the net income or net profits.

Nonresident foreign corporations are entitled to the following deductions from their gross income: (a) Only those expenses which are incurred in carrying on any business or trade conducted exclusively within the Philippines may be deducted. (b) The deductible portion of the interest payments is the proportion of such interest which the amount of gross Philippine income bears to the amount of gross world income.

Example: A nonresident foreign corporation paid during the taxable year interest of $200,000 for its business operations in the Philippines and abroad. Assume its aggregate gross global income is $5,000,000, of which $4,000,000 was from U.S. sources and $1,000,000 from sources in the Philippines. The maximum amount allowable as an interest deduction is $1,000,000/$5,000,000 x $200,000, or $40,000.

(c) In the case of a nonresident foreign corporation, the deduction for taxes is allowed only to the extent that they are connected with income
from sources within the Philippines. A nonresident foreign corporation is not entitled to take a credit for foreign taxes paid or accrued.

(d) Nonresident foreign corporations are allowed to deduct only losses: (i) incurred in business conducted within the Philippines; (ii) of property located in the Philippines due to natural calamities, accident, theft or embezzlement; or (iii) incurred in transactions entered into for profit in the Philippines, although not connected with business.

(e) The reasonable allowance for deterioration of property arising out of its use or employment in the business or trade in the case of nonresident foreign corporations is permissible only when such property is located within the Philippines. The allowance for depletion of oil and gas wells or mines is likewise limited. Consequently, in a case involving a nonresident foreign corporation "not engaged in trade or business in the Philippines," its income from Philippine sources was limited to royalty and rental payments. The Tax Court agreed with the Commissioner that the nonresident foreign corporation was not entitled to the business expense deduction or to an allowance for depreciation inasmuch as it was not doing business in the Philippines.

Sources of Taxable Income

The Revenue Code divides the income of taxpayers into three classes depending on its source: income derived in full from sources within the Philippines; income derived in full from sources without the Philippines; and income derived partly from sources within and partly from sources without the Philippines. Citizens, residents, and domestic corporations are taxable on income earned from all sources. Nonresident alien individuals and foreign corporation are taxable only on income from sources within the Philippines.

The following items are treated as gross income from sources within

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83 INT. REV. CODE § 30(c) (2) (A), PHIL. ANN. LAWS tit. 72, § 30(c) (2) (A) (1956).
84 INT. REV. CODE § 30(c) (2) (D), PHIL. ANN. LAWS tit. 72, § 30(c) (2) (D) (1956); Rev. Regs. No. 2 § 91.
85 INT. REV. CODE § 30(d) (3), PHIL. ANN. LAWS tit. 72, § 30(d) (3) (1956); Rev. Regs. No. 2 § 95.
86 INT. REV. CODE § 30(f) (2), PHIL. ANN. LAWS tit. 72, § 30(f) (2) (1956).
87 INT. REV. CODE § 30(g) (2), as amended, R.A. No. 2698 (June 18, 1960), PHIL. ANN. LAWS tit. 72, § 30(g) (2) (Supp. 4, 1963).
89 INT. REV. CODE §§ 37(a) (c) (e), PHIL. ANN. LAWS tit. 72, §§ 37(a) (c) (e) (1956); Rev. Regs. No. 2 § 152.
90 INT. REV. CODE §§ 21, 22 (a), (b), 24(b) (1), (2), as amended, R.A. No. 2343 (June 20, 1959), PHIL. ANN. LAWS tit. 72, §§ 21, 22 (a), (b), 24(b) (1), (2) (Supp. 4, 1963); Rev. Regs. No. 2 § 152.
the Philippines: (a) interest derived from sources within the Philippines, and interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise; (b) dividends received from a domestic corporation (dividends received from a foreign corporation are returnable if fifty per cent or more of the foreign corporation's gross income for the three-year period preceding the taxable year is earned in the Philippines); (c) compensation for labor or personal services performed in the Philippines; (d) rental and royalties from property located in the Philippines; and (e) gain from the sale of personal property as determined pursuant to section 37(e) of the Tax Code.  

Gross income from sources outside the Philippines includes: (a) interest, other than that specified in section 37(a)(1) of the Tax Code as being derived from sources within the Philippines; (b) dividends other than those derived from sources within the Philippines as provided in section 37(a)(2) of the Revenue Code; (c) compensation for labor or personal services performed outside the Philippines; (d) rental or royalties derived from property outside the Philippines or from any interest in such property, including rentals or royalties for the use of or the privilege of using patents, copyrights, secret processes and formulas, goodwill, trademark, trade brands, franchises, and other like property; and (e) gain derived from the sale of real property located outside the Philippines.  

Income derived from the purchase and sale of personal property is treated as derived entirely from “the country in which sold.”  

“The country in which sold” ordinarily means the place where the property is marketed.  

This is at present determined by where title to the property passes from seller to buyer.  

Since the Philippine Civil Code provisions on the sale of goods are based on the United States Uniform Sales Act, the intention of the parties is of primary importance in determining the place and time of transfer of title.  

The case of Collector v. Anglo California Nat’l Bank held:  

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93 Int. Rev. Code § 37(e), Phil. Ann. Laws tit. 72, § 37(e) (1956); Rev. Regs. No. 2 § 159.  
94 Rev. Regs. No. 2 § 159.  
96 Phil. Civil Code arts. 1458-1600 (1899); Rep. of Code Comm’n 141 (1948).  
97 Behn, Meyer & Co. v. Yangco, 38 Phil. 602 (1918).
Construing the same provision of law (which is section 119(e) of the 1934 Act, U.S. I.R.C.), United States courts are in accord in disallowing the imposition of income taxes by its government on capital gains where the sale takes place outside its territorial jurisdiction. It is likewise the prevailing view that in ascertaining the place of sale, the determination of when and where title to the goods passes from the seller to the buyer is decisive (East Coast Oil Co. vs. Comm., 31 B.T.A., 558, aff'd 85 F. (2d) 322, cert. den. 299 U.S. 608, 81 L. Ed. 449, 57 S. Ct. 234; also Disconto-Gaesellcraft vs. U.S. Steel Corporation, 267 U.S. 22; Compañía General de Tabacos de Filipinas vs. Collector, 279 U.S. 306, 73 L. Ed. 704, 49 S. Ct. 304).

In this case, it is admitted that the negotiation, perfection and consummation of the contract of sale were all done in California, U.S.A. It follows that title to the shares of stock passed from the vendor to the vendee at said place, from which time the incidents of ownership were vested on the buyer.98

However, the foregoing rule does not apply to income from the sale of personal property produced (in whole or in part) by the taxpayer within and sold outside the Philippines or produced (in whole or in part) by the taxpayer outside and sold within the Philippines.99 The income of taxpayers in this kind of a business is considered as derived partly from sources within and partly from sources without the Philippines. The determination of their net income is governed by different rules, depending upon the circumstances of each case.

Many producers or manufacturers regularly sell part of their output to wholly independent distributors or other selling concerns. Through this procedure they usually establish a fairly independent factory or production price. If the selling or distributing branch or department of the business is located in a different country than the factory where production is carried on, these producers or manufacturers may determine their net income attributable to sources within the Philippines by an accounting which treats the products as sold by the factory or production department to the distributing or selling department at the established factory prices. Of course, the price so established must not be affected by considerations of tax liability.100

In some cases no independent factory price is established. The net income is determined by deducting from the gross income derived from the sale of personal property, the expenses, losses, and other de-

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99 Int. Rev. Code § 37(e), PHIL. ANN. LAWS tit. 72, § 37(e) (1956); Rev. Regs. No. 2 § 159.
100 Rev. Regs No. 2 § 162.
ductions properly apportioned and allocated, and a ratable part of any expenses, losses, and other deductions which cannot definitely be allocated. Of the amount of net income so determined, one-half is apportioned in accordance with the value of the taxpayer’s property within the Philippines and within the foreign country. The portion attributable to sources within the Philippines is obtained by multiplying one-half of the net income by a fraction, the numerator of which is the value of the taxpayer’s property within the Philippines. The denominator is the value of the taxpayer’s property within the Philippines and within the foreign country. The remaining one-half of the net income is similarly apportioned in accordance with the gross sales of the taxpayer within the Philippines and within the foreign country. The amount attributable to sources within the Philippines is computed by multiplying the second one-half with another fraction. The numerator is the gross sales of the taxpayer within the Philippines, while the denominator is the gross sales within and without the foreign country.101

The Commissioner of Internal Revenue may consider applications from taxpayers for permission to base their returns on their books of accounts. This practice is permissible only in the cases of taxpayers who, in good faith, and unaffected by the consideration of tax liability, regularly employ in their books of accounts detailed allocations of receipts and expenditures which clearly reflect income derived from sources within the Philippines.102

OTHER POSSIBLE CORPORATE TAXES

A domestic or resident foreign corporation engaged in business in the Philippines is subject to a variety of other taxes and license fees.

Provincial taxes consist for the most part of levies on real property. Municipal taxes and licenses include levies on real and personal property, taxes on gross receipts or sales, and miscellaneous license fees. Except in the case of percentage taxes, provincial and municipal taxes and licenses are not of material consequence. Real estate taxes are usually not more than two per cent of the assessed value of the property.103 The assessed value is normally forty per cent of the market value. The improvements on the real estate as well as attached machinery used for industrial, agricultural or manufacturing purposes,

101 Ibid.
102 Ibid.
103 C.A. No. 470 (June 16, 1939).
are subject to the real estate tax, with the exception that machinery is exempt from property taxes during the first five years of its use. The City of Manila, for example, imposes taxes on wholesale and retail sales; rates in both instances are graduated and based on the type of article sold. The wholesale levy is a percentage tax of about one per cent of gross sales. The retail tax is in the form of a quarterly license fee based on gross sales in the preceding period; amounts range from P60.00 to a maximum of P1,800.00.

The National Internal Revenue Code in addition imposes specific, privilege, and percentage taxes. The specific (excise) taxes apply to certain goods manufactured or produced in the Philippines and to goods imported for domestic sale or consumption, but not to anything produced or manufactured for export from the Philippines. Those subject to specific taxes are: distilled spirits, wines, fermented liquors, tobacco products, matches, mechanical lighters, firecrackers, manufactured oils, coal, fuel oils, other fuels, cinematographic films, playing cards and saccharine. Rates range from P.15 to P75.00 based on the appropriate weight or measure.

Privilege taxes on businesses and occupations are of two types: taxes of fixed amounts (license fees), ranging from P20 to P1,000 for various types of businesses, operations and certain service occupations and secondly, percentage taxes (gross receipt and sales taxes), which are based on gross sales, receipts or earnings. Manufacturers of rope, sugar, coconut oil and desiccated coconut, millers of rice and corn, public carriers, garages and film distributors are taxed at two per cent of their gross receipts, but coconut products and rope are exempt if

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104 Manila, P.I., Ordinance Nos. 3420, 3816.
105 Ibid.
Brokers are taxed at six per cent of gross compensation received and independent contractors are taxed at three per cent.

Sales taxes are levied at various rates on the first sale, barter, or exchange of all articles based on their "gross selling price or gross value in money." The rate depends on the nature and value of the commodity sold as scheduled in four groups:

<table>
<thead>
<tr>
<th>Category</th>
<th>Rate</th>
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<tbody>
<tr>
<td>Automobiles:</td>
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<tr>
<td>P7,000 or below</td>
<td>50%</td>
</tr>
<tr>
<td>More than P7,000 to P10,000</td>
<td>75%</td>
</tr>
<tr>
<td>In excess of P10,000</td>
<td>100%</td>
</tr>
<tr>
<td>Luxury articles:</td>
<td></td>
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<tr>
<td>(Such as jewelry, perfumes, golf clubs, etc.)</td>
<td>50%</td>
</tr>
<tr>
<td>Semi-luxury articles:</td>
<td></td>
</tr>
<tr>
<td>(Such as sporting goods, appliances, luggage, etc.)</td>
<td>30%</td>
</tr>
<tr>
<td>Articles not elsewhere specified</td>
<td>7%</td>
</tr>
</tbody>
</table>

In the case of imported articles, the sales tax is collected in advance at the time of importation on the basis of landed cost plus markups of one hundred, fifty or twenty-five per cent, depending on the classification of the articles. The law provides for some relief from double taxation by allowing the cost of imported articles or materials, that are subject to tax and used in the manufacturing process, to be deducted from the gross selling price in computing the sales tax due.

"Gross selling price" or "gross value in money" has been defined by the Supreme Court as "the total amount of money or its equivalent which the purchaser pays to the vendor to receive the goods" in an arms length transaction. However, where a manufacturer sells his products through a controlled or wholly owned subsidiary the gross selling price for tax purposes is not the selling price between the manu-

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113 Inchausti & Co. v. Cromwell, 20 Phil. 345 (1911).
facturer and the "sales outlet," but is the gross selling price between
the sales outlet and the general public.114

This group of taxes, especially the sales tax, have always been con-
sidered regressive, but their true impact on manufacturers and con-
sumers is only currently being assessed. Partially completed studies of
the Joint Legislative-Executive Tax Commission show that the average
tax burden per household is estimated at ₱323 and of this ₱234 or
72.4% is attributed to production and sales taxes, and ₱89 or 27.6%
to income and property taxes. The studies further reveal that these
taxes are most regressive in the income class below ₱1,500. They are
relatively proportional for the income class ₱1,500 to ₱3,000, and re-
gressive again within the income class of ₱3,000 to ₱6,000. These
figures are most significant when it is considered that about 73% of
the total households (i.e., involved in the Tax Commission study) belong
to the income class below ₱1,500 and that the average per capita in-
come in the Philippines is ₱363.115 In other words, the main brunt of
the tax burden is carried by those who can least afford it and who, of
course, make up the overwhelming majority of the consumers in the
Philippines.

Salaries and other compensation paid to employees are subject to a
withholding tax the rate of which depends on the amount of income
and the deductions for personal and additional exemptions.116 Divi-
dends, interest, royalties, knowhow fees, rents, and other fixed and
determinable income from a domestic corporation, if paid to a non-
resident foreign corporation is subject to a thirty per cent withholding
tax; if paid to a nonresident individual, the rate is twenty per cent,
unless the income exceeds ₱23,800 in which event the withholding tax
is based on the individual tax rate schedule, but in no event can it be
less than twenty per cent.117

ACCOUNTING PRACTICE AND RESTRICTIONS

The net income of a corporation is computed on the basis of its

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114 Philippine Amusement Enterprise, Inc. v. Commissioner, Ct. Tax App. No. 718
(Jan. 25, 1964); 9 Phil. Tax J. 419 (1964); Liddell & Co. v. Collector, Gen. Reg.
No. L-9687 (June 30, 1961); Yutivo Sons Hardware Co. v. Court of Tax Appeals,
115 PHILIPPINE JOINT LEGISLATIVE-EXECUTIVE TAX COMMISSION ANN. REP. (1964);
NAT'L ECONOMIC COUNCIL, ANALYSIS OF NAT'L INCOME OF THE PHILIPPINES: 1961-
1963 (June, 1964). The per capita income figure cited is for 1963, and is in terms of
1955 constant prices.
116 Int. Rev. Code Supp. A, arts. 1, 2, 3,
117 Int. Rev. Code §§ 54, 22(b), as amended, R.A. No. 2343 (June 20, 1959), Phil.
Ann. Laws tit. 72, §§ 54, 22(b) (Supp. 4, 1963); Rev. Regs. No. 2 §§ 198, 199.
annual accounting period pursuant to the method of accounting regularly employed in keeping the corporate books and records.\textsuperscript{118} Generally, an accounting period consists of twelve months determined on a calendar or fiscal year basis. Only corporations and registered general partnerships, however, may file their returns on a fiscal year basis. The "cash basis" and the "accrual basis" are the two principal accounting methods recognized by the law and regulations.\textsuperscript{119} Application for permission to change either the period or method of accounting regularly employed by the taxpayer must be filed with the Commissioner, and in the case of accounting method changes the application must be within ninety days after the beginning of the taxable year covered by the return.\textsuperscript{120}

Although a taxpayer may adopt any approved standard method of accounting which reflects his true income, the system chosen must adhere to three essential standards: (a) In all cases in which the production, purchase, or sale of merchandise of any kind is an income-producing factor, inventories of the merchandise on hand (including finished goods, work in process, raw materials, and supplies) should be taken at the beginning and end of the year and used in computing the net income of the year in accordance with sections 144 to 151 of the Revenue Regulations. (b) Expenditures made during the year should be properly classified as between capital and income; that is to say, expenditures for items of plant, equipment, etc. which have a useful life extending substantially beyond the year should be charged to a capital account and not to an expense account. (c) In any case in which the cost of capital assets is being recovered through deductions for wear and tear, depletion, or obsolescence, any expenditure (other than ordinary repairs) made to restore the property or prolong its useful life should be added to the property account or charged against the appropriate reserve and not to current expenses.\textsuperscript{121}

If a taxpayer does not utilize an approved system of accounting or if his method does not clearly reflect his taxable income, section 38 of the Tax Code authorizes the Commissioner to make the necessary computation in such manner as in his opinion will clearly reflect the taxpayer’s income. The Philippine Commissioner of Internal Revenue

\textsuperscript{120} Rev. Regs. No. 2 §§ 168, 172.
\textsuperscript{121} Rev. Regs. No. 2 § 167.
has made use of this power in several instances by adopting the so-called "net worth-expenditure method" in his determination of a taxpayer's unreported income. Moreover, the Commissioner is further authorized by Section 44 of the Revenue Code to allocate, distribute or apportion gross income or deductions between or among two or more business entities which are controlled or owned, directly or indirectly, by the same interests, if he determines that such allocation or distribution is necessary to prevent tax evasion.

A taxpayer may adopt any reasonable and consistent method of depreciation such as the "straight-line," "fixed percentage," "declining-balance," "revaluation," or the "sinking fund" method, provided it is reasonable and takes into account operating conditions during the taxable period. The determination of "reasonableness" is made at the end of the period covered in the tax return. If it develops that the useful life of the property will be longer or shorter than the useful life as originally estimated, the portion of the cost or other basis of the property not already provided for through depreciation allowances should be spread over the remaining useful life of the property as re-estimated in light of subsequent facts, and depreciation deductions taken accordingly. Philippine tax laws do not presently allow accelerated depreciation; however, in the absence of applicable Philippine precedent or regulations, the Commissioner and the Tax Court give a great deal of weight to the depreciation tables appearing in Bulletin "F" issued by the United States Treasury Department. To quote the Tax Court on this point:

It is true that Bulletin "F" has no binding force, but it has strong persuasive force considering that the same has been the result of scientific studies and observation for a long period in the United States after whose Income Tax Law ours is patterned.

In order to reflect the net income correctly, inventories at the begin-

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125 Ibid.

ning and at the end of each year are necessary where the production, purchase, or sale of merchandise is an income producing factor. The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption, or use in productive processes together with all finished or partly finished goods. Only merchandise, title to which is vested in the taxpayer, should be included in his inventory. The law provides two tests to which each inventory must conform. It must conform as nearly as possible to the best accounting practice in the trade or business and it must clearly reflect the taxpayer's income. In this regard, greater weight is given to consistency than to any particular method of inventory or basis of valuation. The bases of valuation most commonly used by business concerns and which meet the requirements of the Code and Regulations are cost price or cost or market price, whichever is the lower.

Organizational and preoperating expenses such as incorporation fees, attorney's fees, and accountant's charges are ordinarily capital expenditures, except where such expenditures are limited to purely incidental expenses. A taxpayer may charge incidental expenses against income in the year incurred. The Bureau of Internal Revenue requires organizational and preoperating expenses to be amortized over the lifetime of the corporate taxpayer. This usually means a period of fifty years because all corporations organized under Philippine law are limited to an initial life of fifty years.

**TAX TREATIES**

On October 6, 1964, in Washington, D.C., representatives of the Philippine Republic and the United States of America signed a Tax Treaty for "the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income." This Convention, however, is still subject to ratification by the Senates of both countries.

The Tax Treaty, if and when it comes into effect, will not bring about any major changes in the income tax laws of the Philippines. The rules governing the taxable income of resident and nonresident American individuals and corporations and the provisions for foreign tax credit remain the same. The Tax Convention does introduce one

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127 INT. REV. CODE § 36, PHIL. ANN. LAWS tit. 72, § 36 (1956); Rev. Regs. No. 2 § 144.
129 Rev. Regs. No. 2 § 120.
131 Section 6(4), P.A. No. 1459 (March 1, 1906), as amended.
innovation. Article 7 states that the "industrial or commercial profits" of a corporation are subject to tax only if that corporation has a "permanent establishment" in the country seeking to impose the tax. Industrial or commercial profits are limited to those profits derived from "manufacturing, mercantile, agricultural, fishing and mining activities, and from the furnishing of personal services." Other types of income such as interest, royalties, dividends and the like continue to be taxed as discussed above. A corporation is deemed to have a permanent establishment in the taxing country if it has maintained for more than three months a "fixed place of business" such as a branch, office, factory, sales outlet, mine, quarry or construction site. Article 8 further enumerates certain conditions which will not create a permanent establishment; which will subject the corporation to taxation despite the absence of a permanent establishment; and which will not be taken into account in determining whether or not a permanent establishment exists.

Taxpayers laboring under the burdens of international double taxation may find some relief in the future from two provisions of the Tax Treaty. Each of the contracting states promises not to discriminate against a citizen of the other by subjecting him to more burdensome taxes than its own citizens bear. Article 19 creates a procedure whereby a taxpayer's claim or problem may be elevated to a government-to-government level and settled accordingly. Subject to existing laws and regulations, exchange of information and assistance in the collection of taxes between the Philippines and the United States is provided for in the Tax Treaty.

U.S. CITIZENS EMPLOYED IN THE PHILIPPINES

Under the Revenue Regulations, it appears that American citizens employed by a local business entity for a year or more are considered residents for tax purposes. Section 5 of the Regulations reads:

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122 Art. 7, para. (3), Tax Convention with the United States of America. See Appendix I for the full text of the treaty. This is the first, and so far the only, Tax Convention entered into by the Philippines.
123 Art. 8, paras. (1), (2), Tax Convention with the United States of America. See Appendix I.
124 Art. 8, paras. (3)(a)-(e), (5), Tax Convention with the United States of America. See Appendix I.
125 Art. 8, paras. (4)(a)-(c), Tax Convention with the United States of America. See Appendix I.
126 Art. 8, para. (6), Tax Convention with the United States of America. See Appendix I.
127 Art. 6, Tax Convention with the United States of America. See Appendix I.
128 Arts. 20-22, Tax Convention with the United States of America. See Appendix I.
An alien actually present in the Philippines who is not a mere transient or sojourner is a resident of the Philippines for purposes of the income tax. . . . One who comes to the Philippines for a definite purpose which in its nature may be promptly accomplished is a transient. But if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the Philippines, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned. 139

Philippine Immigration Laws allow aliens to come into the Philippines for the purpose of engaging in business under a prearranged employee relationship, or as a treaty trader or treaty investor. 140 In either category, the alien enters the Philippines “for a definite purpose” and a stay of one to three years. As a resident, the American employee must report his income from all sources and like a Filipino citizen is entitled to a personal exemption of ₱3,000 if married or head of family, ₱1,000 if single, and to an additional exemption of ₱1,000 for each dependent. 141 He may also choose to itemize his deductions pursuant to section 30 or take the optional standard deduction of ₱1,000 or ten percent of gross income whichever is lower. The individual income tax rates are graduated upwards as follows:

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<td></td>
<td>₱ 2,000</td>
<td>₱ 10,000</td>
<td>3%</td>
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<tr>
<td>Next</td>
<td>₱ 2,000</td>
<td>₱ 20,000</td>
<td>6</td>
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<tr>
<td></td>
<td>₱ 2,000</td>
<td>₱ 20,000</td>
<td>9</td>
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<td>₱ 2,000</td>
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<td>₱ 100,000</td>
<td>42</td>
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<td>₱ 10,000</td>
<td>₱ 500,000</td>
<td>44</td>
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<tr>
<td></td>
<td>₱ 10,000</td>
<td>₱ 500,000</td>
<td>46</td>
</tr>
</tbody>
</table>


140 C.A. No. 613, § 9(g) (Oct. 3, 1940); R.A. No. 1393, § 1 (Aug. 29, 1955).


He may, of course, take advantage of the foreign tax credit or deduction provisions of the Tax Code.

**General Observations**

Although the basic conditions under which the Philippine Tax Code was passed have long ceased to exist, it has not undergone any major revision since it was enacted in 1939. Under present conditions, the Tax Code has proved itself, in many respects, inadequate and a deterrent to economic growth. A recent study, for example, shows that Philippine income tax in the P20,000 to P100,000 brackets are fifty per cent to sixty per cent higher than those in the United States. Under these circumstances, savings and capital formation are virtually impossible and the desired concomittant development of a strong and large middle class is impeded. As previously mentioned, our system of indirect taxes is regressive in character and shouldered by those least able to afford it. Despite the extensive use of the corporate vehicle in conducting business and the drive for further industrialization, the present Tax Code contains no provisions which would allow net loss carry-over for five years, accelerated depreciation, or even the amortization over a five-year period of organizational and preoperating expenses.

The most serious defect of the present Philippine tax system lies in its failure to recognize the key role which taxation today plays in raising capital, distributing income, and stimulating as well as channeling investment activity.
CONVENTION BETWEEN THE REPUBLIC OF THE PHILIPPINES
AND THE UNITED STATES OF AMERICA
FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION
OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

The Government of the Republic of the Philippines and the Government of the United States of America, desiring to conclude a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, have appointed for that purpose their respective Plenipotentiaries:

The Government of the Republic of the Philippines
Mauro Mendez, Secretary of Foreign Affairs of the Republic of the Philippines, and
Rufino G. Hechanova, Secretary of Finance of the Republic of the Philippines,

The Government of the United States of America:
Dean Rusk, Secretary of State of the United States of America, who, having communicated to each other their respective full powers, found in good and due form, have agreed upon the following Articles:

ARTICLE 1
Taxes Covered

(1) The taxes which are the subject of the present Convention are:

(a) In the case of the United States, the Federal income tax, including surtax, imposed by Subtitle A of the Internal Revenue Code (but not including the tax on improperly accumulated earnings or the personal holding company tax).

(b) In the case of the Philippines, the income tax imposed by Title II of the National Internal Revenue Code (but not including the tax on improperly accumulated earnings or the personal holding company tax).

(2) The present Convention shall also apply to taxes substantially similar to those covered by paragraph (1) of this Article which are subsequently imposed in addition to, or in place of, existing taxes.

(3) For the purpose of Article 6, this Convention shall also apply to taxes of every kind, and to those imposed at the national, state, or local level.
PHILIPPINE BUSINESS TAXES

ARTICLE 2
General Definitions

(1) In the present Convention, unless the context otherwise requires:

(a) The term "United States" means the United States of America, and when used in a geographical sense means the States thereof, the District of Columbia, and Wake Island;

(b) The term "Philippines" means the Republic of the Philippines, and when used in a geographical sense means the territories compromising the Philippines;

(c) The terms "one of the Contracting States" and "the other Contracting State" mean the United States or the Philippines, as the context requires;

(d) The term "person" comprises an individual, a corporation and any other body of individuals or persons;

(e) The term "corporation" means any body corporate, association or joint stock company or other entity which is treated as a body corporate for tax purposes;

(f) The term "United States corporation" means a corporation created or organized under the laws of the United States or of any State thereof or the District of Columbia;

(g) The term "Philippine corporation" means a corporation created or organized under the laws of the Philippines;

(h) The terms "resident or corporation of one of the Contracting States" and "resident or corporation of the other Contracting State" mean a resident or corporation of the United States or a resident or corporation of the Philippines, as the context requires;

(i) The term "competent authority" means:

(1) in the United States, the Secretary of the Treasury or his delegate;

(2) in the Philippines, the Secretary of Finance or his delegate.

(2) As regards the application of the present Convention by a Contracting State, any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of the present Convention.
ARTICLE 3

General Rules of Taxation

(1) A resident or corporation of one of the Contracting States shall be taxable by the other Contracting State only on income derived from sources within that other Contracting State.

(2) A resident or corporation of one of the Contracting States shall be taxed by the other Contracting State on income taxable under paragraph (1) in accordance with the limitations set forth in the present Convention. Any income to which the provisions of the present Convention are not expressly applicable shall be taxable by each of the Contracting States in accordance with its own law. The provisions of the present Convention shall not be construed to restrict in any manner any exclusion, exemption, deduction, credit or other allowance now or hereafter accorded (a) by the laws of one of the Contracting States in the determination of the tax imposed by that State or (b) by any other agreement between the Contracting States.

(3) Except as provided in paragraph (4), a Contracting State may tax an individual who is a citizen or resident of that Contracting State (whether or not such person is also a resident of the other Contracting State) or a corporation of that Contracting State (whether or not also a corporation of the other Contracting State) as if the present Convention had not come into effect.

(4) The provisions of paragraph (3) shall not affect—

(a) the benefits conferred by a Contracting State under Articles 4 and 6;

(b) the benefits conferred by the United States under Article 18; and

(c) the benefits conferred by a Contracting State under Articles 14, 15, 16 and 17 upon individuals other than citizens of, or individuals having immigrant status in, that Contracting State.

ARTICLE 4

Relief from Double Taxation

Double taxation of income shall be avoided in the following manner:

(1) The United States shall allow as a credit against its tax specified in subparagraph (1)(a) of Article 1 the appropriate amount of taxes
paid to the Philippines. Such appropriate amount shall be based upon the full amount of tax paid to the Philippines, and such credit shall, in other respects, be allowed in accordance with the applicable revenue laws of the United States. It is agreed for this purpose that the Philippine tax specified in subparagraph (1)(b) of Article 1 shall be considered to be an income tax, and that by virtue of the provisions of paragraph (2) of this Article the Philippines satisfies the similar credit requirement prescribed by section 901 (b)(3), Internal Revenue Code of 1954, with respect to taxes paid to the Philippines.

(2) The Philippines shall allow to a resident or corporation of the Philippines as a credit against its tax specified in subparagraph (1)(b) of Article 1 the appropriate amount of taxes paid to the United States. Such appropriate amount shall be based upon the full amount of tax paid to the United States, and such credit shall, in other respects, be allowed in accordance with the revenue laws of the Philippines. It is agreed for this purpose that the United States tax specified in subparagraph (1)(a) of Article 1 shall be considered to be an income tax and that by virtue of the provisions of paragraph (1) of this Article the United States satisfies the similar credit requirement prescribed by section 30(c)(3)(b), National Internal Revenue Code, with respect to taxes paid to the United States.

**ARTICLE 5**

*Source of Income*

For the purposes of Articles 3 and 4:

(1) Income from the performance of personal services (including private pensions and annuities paid in respect of such services) or the furnishing of personal services shall be treated as income from sources within the State in which such services are performed. Compensation for personal services performed aboard ships or aircraft operated by a resident or corporation of a Contracting State and, in the case of the United States, registered in the United States (including private pensions and annuities paid in respect of such services) shall be treated as income from sources within that Contracting State, if rendered by a member of the regular complement of the ship or aircraft.

(2) The source of any item of income to which the provisions of this Article are not expressly applicable shall be determined by each of the Contracting States in accordance with its own law.
ARTICLE 6

Nondiscrimination

(1) A citizen of one of the Contracting States who is a resident of the other Contracting State shall not be subjected in that other Contracting State to more burdensome taxes than is a citizen of that other Contracting State who is resident therein.

(2) A permanent establishment which a citizen or corporation of one of the Contracting States has in the other Contracting State shall not be subject in that other Contracting State to more burdensome taxes than is a citizen or corporation of that other Contracting State carrying on the same activities. This paragraph shall not be construed as obliging either Contracting State to grant to citizens of the other Contracting State who are not residents of the former Contracting State any personal allowances or deductions which are by its law available only to residents of that former Contracting State.

(3) A corporation of one of the Contracting States, the capital of which is wholly or partly owned by one or more citizens or corporations of the other Contracting State, shall not be subjected in the former Contracting State to more burdensome taxes than is a corporation of the former Contracting State, the capital of which is wholly owned by one or more citizens or corporations of that former Contracting State.

ARTICLE 7

Business Profits

(1) A resident or corporation of one of the Contracting States shall be subject to tax in the other Contracting State with respect to its industrial or commercial profits only if that resident or corporation has a permanent establishment in that other Contracting State.

(2) In the imposition of such tax—

(a) there shall be allowed as deductions ordinary and necessary expenses, wherever incurred, which are allocable, to the reasonable satisfaction of the competent authority of that Contracting State, to income from sources within that Contracting State; and

(b) no profits shall be deemed to be derived from sources within that Contracting State merely by reason of the purchase of goods or merchandise.

(3) For purposes of paragraph (1) the term "industrial or commer-
cial profits" means income derived from the active conduct of a trade or business. It includes profits from manufacturing, mercantile, agricultural, fishing and mining activities, and from the furnishing of personal services. It does not include income from the performance of personal services, dividends, interest, royalties, income from the rental of personal property, income from real property, insurance premiums, or gains derived from the sale or exchange of capital assets.

**ARTICLE 8**

*Definition of Permanent Establishment*

(1) The term “permanent establishment” means a fixed place of business through which a resident or corporation of one of the Contracting States engages in trade or business.

(2) The term “a fixed place of business” includes, but is not limited to, a branch; an office; a store or other sales outlet; a workshop; a factory; a warehouse; a mine; quarry or other place of extraction of natural resources; a building site, or construction or installation sites, which exists for more than three months.

(3) The term “permanent establishment” shall not be deemed to include any one or more of the following:

(a) facilities used for the purpose of storage, display or delivery of goods or merchandise belonging to the resident or corporation;

(b) the maintenance of a stock of goods or merchandise belonging to the resident or corporation for the purpose of storage, display and/or delivery;

(c) the maintenance of a stock of goods or merchandise belonging to the resident or corporation for processing by another person;

(d) a fixed place of business maintained for the purpose of purchasing goods or merchandise, and/or for the collection of information, for the resident or corporation;

(e) a fixed place of business maintained for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the resident or corporation.

(4) Even if a resident or corporation of one of the Contracting States does not have a permanent establishment in the other Contracting State under paragraphs (1)-(3) of this Article, nevertheless he shall
be deemed to have a permanent establishment in the latter State if he engages in trade or business in that State through an agent who—

(a) has an authority to conclude contracts in the name of that resident or corporation and regularly exercises that authority in the latter State unless the exercise of the authority is limited to the purchase of goods or merchandise;

(b) regularly secures orders in the latter State for that resident or corporation; or

(c) maintains in the latter State a stock of goods or merchandise belonging to that resident or corporation from which he regularly makes deliveries or fills orders.

(5) Notwithstanding paragraph (4) of this Article, a resident or corporation of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it uses the services in that State of a bona fide broker, general commission agent, forwarding agent, indentor or other agent of independent status acting in the ordinary course of its business. For this purpose, an agent shall not be considered to be an agent of independent status if it acts as an agent exclusively or almost exclusively for the resident or corporation (or for that resident or corporation and any other person controlling, controlled by, or under common control with that resident or corporation) and carries on any of the activities described in paragraph (4) of this Article.

(6) The fact that a corporation of one of the Contracting States controls or is controlled by or is under common control with (a) a corporation of the other Contracting State or (b) a corporation which engages in trade or business in that other Contracting State (whether through a permanent establishment or otherwise) shall not be taken into account in determining whether the activities or fixed place of business of either corporation constitutes a permanent establishment of the other corporation.

(7) A resident or corporation of one of the Contracting States shall be deemed to have a permanent establishment in the other Contracting State if that resident or corporation provides the services in the latter State of public entertainers referred to in Article 13, paragraph (3).

(8) If a resident or corporation of one of the Contracting States has a permanent establishment in the other Contracting State at any
time during the taxable year, it shall be considered to have a permanent establishment in that other Contracting State for the entire taxable year.

**Article 9**

*Related Persons*

(1) Where a resident or corporation of a State deriving commercial and industrial profits in one of the Contracting States and any other person are related and where such related persons make arrangements or impose conditions between themselves which are different from those which would be made between independent persons, then any income which would, but for those arrangements or conditions, have accrued to such resident or corporation but, by reason of those arrangements or conditions, has not so accrued, may be included in the income of such resident or corporation for purposes of the present Convention and taxed by that Contracting State accordingly.

(2) (a) A person other than a corporation is related to a corporation if such person participates directly or indirectly in the management, control or capital of the Corporation.

(b) A corporation is related to another corporation if either participates directly or indirectly in the management, control, or capital of the other, or if any person or persons participate directly or indirectly in the management, control or capital of both corporations.

**Article 10**

*Interest*

Interest received by the Government of one of the Contracting States or any agency or instrumentality wholly owned by that Government shall be exempt from tax by the other Contracting State.

**Article 11**

*Income from Real Property*

A resident or corporation of one of the Contracting States subject to tax in the other Contracting State on income from the rental of buildings or from real property which is improved with buildings, including gains derived from the sale or exchange of such property, or on royalties in respect of the operation of mines, quarries, or other natural resources may elect for any taxable year to compute that tax on such income on a net basis.
ARTICLE 12
Gains upon Transfers to Controlled Corporations

A resident or corporation of one of the Contracting States shall be exempt from tax in the other Contracting State with respect to gain realized upon the transfer of property to a corporation in exchange for stock in such corporation—

(1) If immediately thereafter such resident or corporation, or such person together with any other persons making similar transfers as part of the same transaction, owns stock of such corporation possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation; and

(2) Where the transferee corporation is a Philippine corporation, if the property is transferred and recorded on the books of account of the corporation at a value not exceeding the value of which such property was recorded on the books of account of the transferor.

ARTICLE 13
Income from Personal Services

(1) An individual who is a resident of one of the Contracting States shall be exempt from tax by the other Contracting State with respect to income from personal services if—

(a) he is present within the latter Contracting State for a period or periods not exceeding in the aggregate 90 days during the taxable year, and

(b) such income is not deducted in computing the profits of a permanent establishment of a resident or corporation of the former Contracting State subject to tax in the latter Contracting State, and

(c) in the case of employment income, the services are performed as an employee of a resident or corporation of the former Contracting State, and

(d) the aggregate amount of such income does not exceed $3,000 (or its equivalent in Pesos)

(2) For purposes of paragraph (1) of this Article, the term “income from personal services” includes employment income and income earned by an individual from the performance of personal services in an independent capacity. The term “employment income” includes income from services performed by officers and directors of corpora-
Income from personal services performed by partners shall generally be treated as income from the performance of services in an independent capacity, but a salary or other fixed amount paid by a partnership to an active partner shall be considered income from employment by the partnership, if similar payments are not made to inactive partners.

(3) Notwithstanding paragraph (1) of this Article, the income from personal services of public entertainers, such as athletes, musicians and actors, from their activities as such, may be taxed in the Contracting State in which the services are performed if such income exceeds either $100 (or its equivalent in Pesos) for each day the individual is present in the latter Contracting State or an aggregate amount of $3,000 (or its equivalent in Pesos).

(4) Compensation received by any individual for personal services performed aboard ships or aircraft operated by a resident or corporation of a Contracting State (and, in the case of the United States, registered in the United States) shall, subject to paragraph (3) of Article 3, be exempt from tax by the other Contracting State, if the services are rendered by a member of the regular complement of the ship or aircraft.

**ARTICLE 14**

*Teachers*

An individual who is a resident of one of the Contracting States at the beginning of his visit to the other Contracting State and who, at the invitation of the Government of the other Contracting State or of a university or other accredited educational institution situated in the other Contracting State, visits the latter Contracting State for the purpose of teaching or engaging in research, or both, at a university or other accredited educational institution shall be exempt from tax by the latter Contracting State on his income from personal services for teaching or research at such educational institution, or at other such institutions, for a period not exceeding two years from the date of his arrival in the latter Contracting State.

**ARTICLE 15**

*Students and Trainees*

(1) (a) An individual who is a resident of one of the Contracting States at the beginning of his visit to the other Contracting State and
who is temporarily present in the other Contracting State for the primary purpose of—

(i) studying at a university or other accredited educational institution in that other Contracting State,

(ii) securing training required to qualify him to practice a profession or professional specialty, or

(iii) studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary or educational organization, shall be exempt from tax by that other Contracting State with respect to—

(A) gifts from abroad for the purpose of his maintenance, education, study, research or training;

(B) the grant, allowance, or award; and

(c) income from personal services performed in other Contracting State in an amount not in excess of $2,000 or its equivalent in Pesos for any taxable year; or, if such individual is securing training necessary for qualification in a medical profession or medical specialty, including any physician, medical technologist, nurse, pharmacist or other person under the Exchange Visitors Program, not in excess of $5,000 or its equivalent in Pesos for any taxable year.

(b) The benefits under this paragraph shall only extend for such period of time as may be reasonable or customarily required to effectuate the purpose of the visit, but in no event shall any individual have the benefits of this paragraph for more than five taxable years.

(2) A resident of one of the Contracting States who is present in the other Contracting State for a period not exceeding one year, as an employee of, or under contract with, a resident or corporation of the former State, for the primary purpose of—

(i) acquiring technical, professional, or business experience from a person other than that resident or corporation of the former Contracting State, or

(ii) studying at a university or other accredited educational institution in that other Contracting State, shall be exempt from tax by that other Contracting State with respect to his income from personal services performed in the other Contracting State for that period in an amount not in excess of $5,000 or its equivalent in Pesos.
(3) A resident of one of the Contracting States who is present in the other Contracting State for a period not exceeding one year, as a participant in a program sponsored by the Government of the other Contracting State, for the primary purpose of training, research, or study shall be exempt from tax by that other State with respect to his income from personal services performed in that other Contracting State and received in respect of such training, research, or study in an amount not in excess of $10,000 or its equivalent in Pesos.

**ARTICLE 16**

*Governmental Salaries*

Wages, salaries, and similar compensation, and pensions, annuities, or similar benefits paid by, or directly out of public funds of, one of the Contracting States or the political subdivisions thereof to an individual who is a national of that Contracting State for services rendered to that Contracting State or to any of its political subdivisions in the discharge of governmental functions shall be exempt from tax by the other Contracting State.

**ARTICLE 17**

*Rules Applicable to Personal Service Articles*

(1) For purposes of Articles 13, 14, 15 and 16, reimbursed travel expenses shall be considered to be income from personal services or compensation, but shall not be taken into account in computing the maximum amount of exemptions specified in Articles 13 and 15.

(2) An individual who qualifies for benefits under more than one of the provisions of Articles 13, 14 and 15 may select the application of that provision most favorable to him, but he shall not be entitled to the benefits of more than one provision in any taxable year.

**ARTICLE 18**

*Deduction for Charitable Contributions*

In the computation of taxable income under the United States income tax, a deduction shall be allowed to citizens and residents of the United States and United States corporations for contributions to any organization created or organized under the laws of the Philippines which constitutes a non-profit organization under section 27(e) of the National Internal Revenue Code of the Philippines if—
such contributions are used entirely within the Philippines and
(b) the recipient organization has qualified as a tax-exempt organization under subsection 501(c)(3) of the United States Internal Revenue Code.

Such deductions shall not, however, exceed an amount which would have been allowable under the United States Internal Revenue Code if such organization had been created or organized under the laws of the United States and if such contributions were used within the United States.

ARTICLE 19
Consultation and Taxpayer Claims

(1) The competent authorities of the Contracting States may communicate with each other directly for the purpose of giving effect to the provisions of the present Convention. Should any difficulty or doubt arise as to the interpretation or application of the present Convention, or its relationship to conventions between one of the Contracting States and any other State, the competent authorities shall endeavor to settle the question as quickly as possible by mutual agreement.

(2) The competent authorities may consult together for the purpose of considering the amendment of this Convention to add provisions dealing with such matters affecting income taxation and not covered in this Convention as may be deemed appropriate.

(3) In particular, the competent authorities of the Contracting States may consult together to endeavor to agree—

(a) to the same apportionment of industrial or commercial profits between a resident or corporation of one of the Contracting States and its permanent establishment situated in the other Contracting State; or

(b) to the same allocation of income between a resident or corporation and a related person, dealt with in Article 9, and to the appropriate procedure for effectuating such apportionment or allocation.

(4) A taxpayer shall be entitled to present his case to the Contracting State of which he is a citizen or resident, or, if the taxpayer is a corporation of one of the Contracting States, to that State, if he con-
siders that the action of the other Contracting State has resulted, or will result for him in taxation contrary to the provisions of the Convention. Should the taxpayer's claim be considered to have merit by the competent authority of the Contracting State to which the claim is made, it shall endeavor to come to an agreement with the competent authority of the other Contracting State to which the claim is made, it shall endeavor to come to an agreement with the competent authority of the other Contracting State with a view to the avoidance of taxation contrary to the provisions of the Convention.

**ARTICLE 20**

*Exchange of Information*

(1) The competent authorities of the Contracting States shall exchange such information as is necessary for the carrying out of this Convention and of the domestic laws of the Contracting States concerning taxes covered by this Convention insofar as the taxation thereunder is in accordance with this Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any persons or authorities other than those concerned with the assessment, collection or enforcement of the taxes which are the subject of this Convention (including a court or administrative body).

(2) In no case shall the provisions of paragraph (1) be construed so as to impose on one of the Contracting States the obligation:

(a) to carry out administrative measures at variance with the laws or administrative practices of that Contracting State or the other Contracting State;

(b) to supply particulars which are not obtainable under the laws of, or in the normal course of administration in, that Contracting State or the other Contracting State; or

(c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to its public policy.

**ARTICLE 21**

*Assistance in Collection*

(1) Each of the Contracting States shall endeavor to collect such taxes imposed by the other Contracting State as will ensure that any
ARTICLE 22

Exchange of Legal Information

(1) The competent authorities of the Contracting States shall notify each other of any amendments of the tax laws referred to in Article 1, paragraph (1), and of the adoption of any taxes referred to in Article 1, paragraph (2), by transmitting the texts of any amendments or new statutes at least once a year.

(2) The competent authorities of the Contracting States shall exchange the texts of all published material interpreting the present Convention under the laws of the respective States, whether in the form of regulations, rulings or judicial decisions.

ARTICLE 23

Effective Dates and Ratification

(1) The present Convention shall be ratified and the instruments of ratification exchanged at Manila as soon as possible.

(2) After the exchange of instruments of ratification, the present Convention shall have effect with respect to taxable years beginning on or after the first day of January of the year following that in which such exchange takes place.

(3) The present Convention shall continue in effect indefinitely, but it may be terminated by either of the Contracting States, on the initiative of the competent authority of that State, at any time after five years from the date specified in paragraph (2) of this Article, provided that at least six months' prior notice of termination has been given. In such event, the present Convention shall cease to be effective with respect to taxable years beginning on or after the first day of January next following the expiration of the six-month period. exemption granted under the present Convention by the other State shall not be enjoyed by persons not entitled to such benefits. The Contracting State making such collections shall be responsible to the other Contracting State for the sums thus collected.

(4) In no case shall the provisions of this Article be construed so as to impose upon either of the Contracting States the obligation to carry out administrative measures at variance with the regulations and practices of the Contracting State endeavoring to collect the tax or which would be contrary to that State's sovereignty, security or public policy.