



## 1. Types of tax

### 1.1 Estate tax and tax on gifts during lifetime

There used to be both inheritance tax (tax on the right of heirs to inherit) and estate tax (tax on the net estate of the decedent) in the Philippines.

Now, the Philippines only imposes estate tax, which applies on the fair market value of a decedent's estate at the time of the person's death. In determining the value of the gross estate, the FMV of all properties, real or personal, tangible or intangible, is included regardless of their location. With respect to nonresident aliens, only properties located in the Philippines are subject to estate tax.

The following should be included as part of gross estate:

- ▶ **Decedent's Interest.** This refers to value of the decedent's right or expectation (short of naked title) on a property.
- ▶ **Transfers in Contemplation of Death.** This refers to the value of any disposition, whether by trust or otherwise, that is intended to take place only after the decedent's death (*donation mortis causa*).
- ▶ **Revocable Transfers.** the value of any transferred property in which the decedent retained the power to amend, alter or revoke the transfer during the decedent's lifetime. This is regardless of whether the decedent actually exercised his or her power.
- ▶ **Transfers with Retention of Rights of Ownership.** This refers to the value of any transfer where the decedent retained the power to enjoy the fruits or income of the asset during the decedent's lifetime. Since this means that the transfer done by decedent is not absolute and transfer of all rights of ownership will only take place upon the decedent's death, the value of the asset transferred should still be considered part of the decedent's gross estate.
- ▶ **Property Passing under the General Power of Appointment.** This refers to the value of any property transferred to the decedent during his or her lifetime wherein he or she was given the power to appoint any person, including himself or herself, to be the recipient or beneficiary. Since the decedent enjoys the right to dispose the property any way he or she wants to as if he or she is the owner, the value of such property should be included in the decedent's gross estate.
- ▶ **Proceeds of Life Insurance.** The value of insurance proceeds from insurance policies taken out by the decedent upon his or her own life should be included in the gross estate of the decedent when the designation of the beneficiary is revocable or when the decedent has made himself or herself or the decedent's estate, executor or administrator as the beneficiary regardless of whether the designation is irrevocable.
- ▶ **Transfers for Insufficient Consideration.** This refers to the excess of the FMV at the time of death over the value of the consideration received by the decedent for any disposition by sale that the decedent made during the decedent's lifetime that is less than a bona fide sale for an adequate and full consideration in money or money's worth.

- ▶ **Property owned in Common with Surviving Spouse.** This refers to the value of any property owned in common with the surviving spouse should be included in the decedent's gross estate. However, the value of the equal share of the surviving spouse should be deducted from the estate after all conjugal expenses have been deducted from the gross estate.

The gross estate is entitled to claim the following deductible expenses to determine the net estate:

- ▶ **Funeral Expense.** Actual funeral expenses includes cost of clothes for bereavement or 5% of the gross estate, whichever is lower but in no case to exceed PhP200,000.00
- ▶ **Judicial Expense.** Fees of executors, administrators and lawyers as well as expenses for the preservation of the estate.
- ▶ **Claims Against the Estate.** Third-party creditor claims like loans obtained by the decedent. They must be evidenced by a notarized agreement.
- ▶ **Claims Against Insolvent Persons.** Basically, bad debts/receivables of the decedent.
- ▶ **Mortgage Indebtedness, Taxes and Loss.** This refers to unpaid mortgages, unpaid taxes before the death of decedent and any losses from fire, theft or embezzlement incurred by the estate that is not covered by insurance.
- ▶ **Vanishing Deduction.** Certain percentage of the value of an asset may be deducted from the gross estate if they were acquired by inheritance or by gratuitous title by the decedent at a time proximate to the decedent's death. For example, the value of property acquired by decedent by inheritance at least 4 years but not more than 5 years before the decedent's death may be deducted from the gross estate to the extent of 20% thereof. If such property was inherited by the decedent within 1 year before his or her death, then 100% of the value of such asset is deductible from his or her gross estate.
- ▶ **Transfer for Public Use.** Any bequeath, legacies, devisees to the Philippine government or any of its political subdivisions for public use.
- ▶ **Family Home.** The actual FMV of the decedent's family home or PHP1 million, whichever is lower.
- ▶ **Standard Deduction.** The amount of PHP1 million is deductible, no questions asked.
- ▶ **Medical Expenses.** Actual medical expenses incurred within 1 year prior to the death of the decedent or PHP500,000, whichever is lower.

## 1.2 Gift tax

Donations made during the lifetime of the donor (*donation inter vivos*) is subject to donor's tax. Donor's tax is imposed on total net gifts made in any calendar year. Generally, any donation to a "stranger" is subject to donor's tax at the rate of 30% of the FMV of the property or cash donated. Otherwise, the donation is subject to graduated scale that you will see under item 4 below. A "stranger" is a person who is not a:

- ▶ Brother or sister (whether by whole or half-blood), spouse, ancestor and lineal descendant; or
- ▶ Relative by consanguinity in the collateral line within the fourth degree of relationship.

Donor's tax is also imposable on any transfer of any property (other than real property classified as capital asset) for less than adequate and full consideration in money or money's worth.

## 1.3 Real estate transfer tax

Philippines has real estate transfer tax that is imposable on all transfers of real estate property including transfer by way of inheritance. Referred to as local transfer tax (LTT), it is imposed by the local government unit having jurisdiction over the location of the property and not by the national government. In the case of cities, the maximum rate of LTT is 75% of 1% of the FMV, zonal value or consideration received, whichever is higher of the 3. On the other hand, municipalities cannot impose LTT that is higher than 50% of 1% of the FMV, zonal value or consideration received, whichever is higher.

In case of transfer by way of inheritance, the LTT should be paid within 60 days from the time of death of the decedent.



## 1.4 Endowment tax

There is no endowment tax in the Philippines.

## 1.5 Transfer duty

There is no transfer duty in case of transfer by way of inheritance. Documentary stamp tax (DST) is applicable, however, on any transfer or disposition of real property or shares of stock in a domestic company, during the lifetime of the person. DST rate on transfer of shares is PHP.75 or PHP200 of the total par value of the shares. The DST on transfers of real property is PHP15 for every PHP1,000 of the zonal value, FMV or consideration received, whichever is higher.

## 1.6 Net wealth tax

There is no net wealth tax in the Philippines.

# 2. Who is liable?

The estate tax should be paid by the executor or administrator of the estate or any person in actual or constructive possession of the property. The estate tax is a lien on the property of the decedent and must be paid before any distribution can be made to the heirs. Heirs are secondarily liable for estate tax to the extent of his distributive share in the estate.

## 2.1 Residency

The estate of any decedent, citizen or not, who, at the time of their death, is a resident of the Philippines, shall be subject to estate tax in the Philippines, regardless of the location of the property, tangible or intangible, real or personal property.

Nonresident aliens are subject to estate tax only on properties situated in the Philippines, whether they are real or personal, tangible or intangible. However, intangible personal properties of such nonresident alien will be excluded in the gross estate if the foreign country (of which the decedent is a resident at the time of his or her death) did not impose a transfer tax of any character, in respect of intangible personal property of citizens of the Philippines not residing in that foreign country (reciprocity rule).

Residence is generally determined by presence of intent to return (*animus revertendi*). It usually refers to a permanent home where one intends to return whenever away for business or pleasure.

## 2.2 Domicile

Domicile is similar to residence as far as Philippine estate tax is concerned.



### 3. Rates

#### Estate tax

The net estate of every decedent, whether resident or nonresident, shall be subject to estate tax based on the value of such net estate in accordance with the following schedule (in PHP):

Table 1

Amount (PHP)	The tax shall be	Plus	Of the excess over
< 200,000	Exempt		
200,001 - 500,000	0	5%	200,000
500,001 - 2 million	15,000	8%	500,000
> 2 million - 5 million	135,000	11%	2 million
> 5 million - 10 million	465,000	15%	5 million
> 10 million	1.22 million	20%	10 million

#### Donor's tax or gift tax

Donor's tax is imposed based on total net gifts made during the calendar year in accordance with the following schedule (in PHP):

Table 2

Amount (PHP)	The tax shall be	Plus	Of the excess over
< 100,000	Exempt		
100,000 - 200,000	0	2%	100,000
200,001 - 500,000	2,000	4%	200,000
500,001 - 1 million	14,000	6%	500,000
> 1 million - 3 million	44,000	8%	1 million
> 3 million - 5 million	204,000	10%	3 million
> 5 million - 10 million	404,000	12%	5 million
> 10 million	1,004,000	15%	10 million



## 4. Exemptions and reliefs

### Estate tax

As can be seen from Table 1, it is only when the net estate is below PHP200,000 that the estate will be exempt from estate tax.

However, the following transmissions are also not subject to estate tax:

- ▶ The merger of usufruct in the owner of the naked title;
- ▶ The transmission or delivery of the inheritance or legacy by the fiduciary heir or legatee to the commissary;
- ▶ The transmission from the first heir, legatee or donee in favor of another beneficiary, in accordance with the desire of the predecessor;
- and
- ▶ All bequests, devises, legacies or transfers to social welfare, cultural and charitable institutions, no part of the net income of which inures to the benefit of any individual, provided. However, not more than 30% of the said bequests, devises, legacies or transfers shall be used by such institutions for administration purposes.

### Donor's tax

From Table 2 above, it can be seen that it is only when the net gift is less than PHP100,000 during the calendar year that the donation is exempt from donor's tax.

However, the following donations of a Philippine resident during his or her lifetime is also exempt from donor's tax provided:

- ▶ Dowries or gifts made on account of marriage and before its celebration or within 1 year thereafter by parents to each of their legitimate, recognized natural, or adopted children to the extent of the first PHP10,000;
- ▶ Gifts made to or for the use of the national government or any entity created by any of its agencies that is not conducted for profit, or to any political subdivision of the said government; and
- ▶ Gifts in favor of an educational and/or charitable, religious, cultural or social welfare corporation, institution, accredited nongovernment organization, trust or philanthropic organization, or research institution or organization provided. However more than 30% of said gifts shall be used by such donee for administration purposes.

In the case of a nonresident alien, only first and second bullets above are exempt.

## 5. Filing procedures

### Estate tax

Before an estate tax return can be filed, the executor, administrator or heirs must apply for a new tax identification number (TIN) for the estate using Bureau of Internal Revenue (BIR) Form 1901. The decedent's TIN will be canceled.

A notice of death must be filed by the executor, administrator or any of the legal heirs within 2 months after the decedent's death with the Revenue District Office (RDO) that has jurisdiction over the place of the decedent's residence at the time of his death or if there be no legal residence in the Philippines, with the Office of the Commissioner. The notice of death is required to be filed where the gross value of the estate exceeds PHP20,000.

An estate tax return (BIR Form 1801) is required to be filed when the gross value of the estate is over PHP200,000 or when the gross value of the estate is composed of real properties, shares of stock, motor vehicles, or any property in which a BIR tax clearance is required as a condition precedent for the transfer of ownership.

Estate tax returns showing a gross value exceeding 2 million pesos (PHP2 million) shall be supported with a statement duly certified by a certified public accountant (CPA) containing the following:



- ▶ Itemized assets of the decedent with their corresponding gross value at the time of his or her death, or in the case of a nonresident, show that part of his or her gross estate situated in the Philippines;
- ▶ Itemized deductions from gross estate allowed under the law; and
- ▶ The amount of tax due whether paid or still due and outstanding.

Estate tax returns are required to be filed within 6 months from the decedent's death. The Commissioner shall have authority to grant, in meritorious cases, a reasonable extension not exceeding 30 days for filing the return.

If there is estate tax payable, the estate tax must be filed and paid with the authorized agent bank of the Revenue District Office that has jurisdiction over the place of the decedent's residence at the time of his death or if there be no legal residence in the Philippines, with the Office of the Commissioner.

The estate tax must be paid at the time the return is filed by the executor, administrator or the heirs. However, if the Commissioner finds that the payment on the due date of the estate tax or of any part thereof would impose undue hardship upon the estate or any of the heirs, he may extend the time for payment of such tax or any part thereof not to exceed 5 years, in case the estate is settled through the courts, or 2 years when the estate is settled extra-judicially. In such cases, the amount in respect of which the extension is granted shall be paid on or before the expiration date of the extension, and the running of the Statute of Limitations for assessment as provided in Section 203 of this Code shall be suspended for the period of any such extension.

A certified copy of the schedule of partition and the order of the court approving the same shall be furnished the by Commissioner within 30 days after the promulgation of such order.

If an extension is granted, the Commissioner may require the executor, administrator or beneficiary, as the case may be, to furnish a bond in such amount not exceeding double the amount of the tax and with such sureties as the Commissioner deems necessary, depending on the payment of the said tax according to the terms of the extension.

## 6. Assessments and valuations

The estate shall be appraised at its fair market value as of the time of death. However, the appraised value of real property as of the time of death shall be, whichever is the higher of the following:

- ▶ The FMV as determined by the Commissioner,
- or
- ▶ FMV as shown in the schedule of value fixed by the provincial and city assessors.

With respect to usufruct, the value of the right of usufruct, use or habitation, as well as that of annuity, there shall be taken into account the probable life of the beneficiary in accordance with the latest Basic Standard Mortality Table approved by the Secretary of Finance, upon recommendation of the Insurance Commissioner.

The book value based on the latest audited financials of the company is presumed to be the FMV of the shares of stocks of a domestic company for estate tax purposes.

For shares that are listed and traded in the stock exchange, the market price nearest to the date of death is considered the FMV of the listed shares.





## 7. Trusts, foundations and private purpose funds

As an estate planning tool, only irrevocable trusts in whatever name, shape or form can be used to reduce the estate and minimize estate tax. However, as transfers to an irrevocable trust is considered full transfer of all rights and ownership over the assets that are placed in the trust, it is a donation *inter vivos* (donation during the lifetime of the giver), hence, subject to donor's tax. If the irrevocable trust is in favor of a brother, sister (whether by whole or half-blood), spouse, ancestor and lineal descendant or first cousin, the donor's tax will be depend on the graduated scale in Table 2 above. If it is in favor of a stranger, the donor's tax is 30% of the property's FMV at the time of the transfer in reference to the irrevocable trust.

For the trust to be considered irrevocable, the trustor must not retain any right to amend, alter or revoke the trust. The trustor must not also retain the power to possess or enjoy the property or any of its fruits or income.

Also, assets that are considered part of the legitime (that portion of a parent's estate in which he or she cannot disinherit his children, without a legal cause) of compulsory or forced heirs cannot be the subject of any condition. In other words, only assets other than those pertaining to the legitime of forced heirs can be transferred to an irrevocable trust subject to certain conditions, say for example, scheduled and periodic release of the funds or upon the beneficiary reaching a certain age.

### Life insurance trust

Since the proceeds of life insurance (taken upon the life of the decedent where the irrevocable beneficiary is other than the decedent or his estate) is not considered part of the gross estate, the said proceeds may be placed in a trust and be the subject of certain conditions like gradual and periodic release of funds to see to it that an improvident child-beneficiary, for example, will not be able to squander the whole amount.

### Generation-skipping trust

As the merger of usufruct in the owner of the naked title is not subject to estate tax, therefore a trust can be formed where the naked title to the asset of the trust can be placed in the name of a grandchild but the usufruct or right to use the same can be given to the immediate child of the decedent. Hence, when the child of decedent dies, the usufruct and the title on the asset will merge in the grandchild, which is exempt from estate tax. Thus, 1 generation of estate tax is saved.

However, again, this can only be done on properties that are not part of the legitime of forced heirs as legitime cannot be the subject of any condition, burden or substitution.

### Foundations

Formation of foundations is useful in reducing the taxable estate and retaining valuable assets (e.g., expensive paintings) within family line.

Donations to foundations created for charitable purposes are exempt from the donor's tax. Such donations can become tax-deductible expenses of the donor if the foundation is an accredited donee-institution.

## 8. Grants

Grants forming part of the estate of the decedent at the time of his or her estate are considered subject to estate tax. Grants given by the decedent during his or her lifetime are subject to donor's tax unless they will qualify as one of the donations exempt from donor's tax as enumerated above.



## 9. Life insurance

Premiums paid as well as proceeds of the life insurance do not form part of the gross estate for estate tax purposes provided:

- ▶ it is taken out of the life of the decedent;
- ▶ the beneficiary is other than decedent, his or her estate, executor or administrator; and
- ▶ the designation of the beneficiary is irrevocable.

If any of these conditions are not met, then, the proceeds of the life insurance should be included in the gross estate and will become subject to estate tax.

## 10. Civil law on succession

### 10.1 Estate planning

As briefly mentioned above, there are several estate planning tools that can be used to cushion the impact of estate tax, such as:

- ▶ Donations or gifts
- ▶ Life insurance
- ▶ Trusts
- ▶ Foundations
- ▶ Straight sale
- ▶ Tax-free exchange

Donations or gifts and foundations have already been discussed above. Hence, we will focus on straight sale and tax-free exchange as planning tools.

#### **Sale of asset**

This mode of transfer during the lifetime of the decedent is the simplest way of reducing an estate, and the tax implications of a sale transaction is, in fact, lower than donor's tax.

Sale of unlisted shares in a Philippine company by a parent to his or her children, for example, will only entail capital gains tax (CGT) of 5% on the first PHP100,000 of the net gain and anything in excess of the PHP100,000 is subject to tax of only 10%. There will also be stamp duty of PHP.75/PHP200 of the total par value of the domestic shares sold.

On the other hand, sale of shares listed in the Philippine Stock Exchange is subject only to stock transaction tax of one-half of 1% of the gross selling price or gross value in money of the shares of stock sold.

Sale of real estate properties that are considered capital assets is subject only to 6% CGT based on presumed gain, that is, based on selling price, FMV or zonal value of the BIR, whichever is higher. There will also be stamp duty of 1.5% based on selling price, FMV or zonal value of the BIR, whichever is higher.

Hence, taxes applicable to sale as a mode of transfer is still generally lower compared to donor's tax and estate tax.

However, it goes without saying that a transfer by way of sale requires that there is a bona fide sale that requires the capacity to buy of the transferee (buyer).





It should also be noted that transfer by way of sale of real estate properties that are classified as ordinary asset is not recommended since this will entail higher taxes, namely, 32% income tax for individual sellers, plus 12% VAT and 1.5% stamp duty. A real property is considered as ordinary asset for Philippine tax purposes when it is being used in business, or when it being held out for sale or for lease.

### Tax-free exchange

This is more popularly known as a “property-for-shares swap” and is a very tax-efficient tool for transferring of real properties that normally appreciates in value over time.

Philippine tax laws require that the transferor (parent) gains control, i.e., has at least 51% of the transferee-corporation (NewCo) so that the property-for-shares swap will qualify as a tax-free exchange. The CGT on the exchange is deferred until the shares are sold by the parent. The transfer of the real property is also exempt from stamp duty. Stamp duty will only apply to the new issuance of shares at the rate of PHP1/PHP200 of the total par value of the shares subscribed.

The next step would be for the parent to sell his or her NewCo shares to his or her child. The sale of shares to the child is subject to 10% CGT on net gain. The book value or selling price of the shares, whichever is higher, less historical cost of the land. The sale of shares is also subject to stamp duty of PHP0.75/PHP200 of the total par value of the shares sold.

Please note that any incremental increase in value of the real property is not considered in the computation of the book value of the NewCo shares, thus, effectively, the increase in value of the real property will not affect the book value of the shares when the latter are subsequently sold. Thus, effectively, what was achieved is an indirect transfer of real property where the incremental increase in value of the real property is not being subject to tax. What is more, the CGT on the transfer of shares is only 10% compared to estate tax where the maximum statutory rate is 20%. Also, note that the CGT on sale of shares is based on net gain while estate tax is based on the FMV of the property at the time of death.

However, recently, the BIR issued a revenue regulations that requires the inclusion of the incremental increase in value of the underlying real property in the computation of the book value of the shares. Purportedly, the said revenue regulations is meant to capture the “gain” from the increase in value of the real property. This revenue regulations is being contested by various stakeholders for being unconstitutional since it seeks to tax gains that are not yet realized.

## 10.2 Succession

The Philippines has institutionalized compulsory heirs and their legitime. Regardless of the wishes and desires of a testator as provided in his or her will, the legitime of compulsory heirs must be respected. Legitime cannot be the subject of any burden, restriction, condition or substitution.

## 10.3 Forced heirship

Legitime or automatic inheritance of compulsory heirs must be respected at all times. Compulsory heirs can rescind or collate inofficious dispositions of the decedent/testator if they impair their legitime. Hence, legitime is the minimum amount of inheritance to which compulsory heirs are entitled to. Once the legitime of each compulsory heir is satisfied, everything else is considered part of “free portion” that the testator can freely dispose of, or bequeath to any person, natural or juridical, and which may be subject to conditions imposed by the testator.

If a citizen dies without a last will and testament, intestate succession rules will govern the distribution of the decedent’s entire estate and there will be no “free portion” to speak of.

Compulsory heirs are legitimate and illegitimate children, spouse and, in some instances, parents or ascendants. (See Table 3 in Annex A for the legitimes of compulsory heirs and available free portion when a person dies with a will. Table 4 shows the summary of legitimes when a person dies without a will, in which case, intestate succession takes place.)



## 10.4 Matrimonial regimes and civil partnerships

If the marriage was solemnized after February 1988 between the husband and the wife, the default property rule is considered Absolute Community of Property (ACP) where everything brought into the marriage and acquired during the marriage are presumed co-owned by the parties. Thus, should husband and wife do not execute any prenuptial agreement, their property regime will be ACP.

Marriages celebrated before February, 2008 are governed by Conjugal Partnership of Gains (CPG) unless the parties agreed by way of a prenuptial agreement that they will be governed by another property regime like complete separation of property (CSP). In CPG, everything brought in as exclusive properties of the husband or the wife, remains as his or her own, respectively. However, everything acquired during the marriage is presumed co-owned by the parties.

Common law relationships (living together without the benefit of marriage), where there is no legal impediment to marry each other, is deemed governed by the rules on co-ownership.

## 10.5 Intestacy

Intestate succession rules will govern when a citizen dies without a will.

When a citizen dies with a will, the will has to be probated in court where the extrinsic (formal) and intrinsic (substantive) validity of the will and testament will be determined.

For aliens, resident or not, the formal validity of wills is determined by the rules of the jurisdiction where they were executed. Generally, the rules of succession of the foreign country of his or her nationality will determine the hereditary rights of his or her heirs. The rules of his country of domicile or residence may also come into play. In some cases, Philippine rules on succession will apply if his country of nationality or residence, as the case may be, adheres to *renvoi doctrine* (referring back to the country of his residence at the time of death).

## 10.6 Probate

As long as a will exists, probate proceeding has to take place. The validity or invalidity of the said will becomes the subject of the probate proceeding. If the entire will is invalidated for violating formal or substantive rules in making a will, the intestate succession will be determined in the same proceeding.



## 11. Estate tax treaties

### 11.1 Unilateral rules

Foreign tax credit for estate taxes paid in foreign jurisdiction may be claimed in the Philippines with respect to assets situated or subject to estate tax in the Philippines. The foreign tax credit may be claimed with according to the following formula:

#### 1 other foreign country is involved

$$\text{Tax Credit} = \frac{\text{Net estate in foreign country}}{\text{Entire net estate}} \times \text{Philippine estate tax}$$

Or

The actual estate paid in foreign country, whichever is lower

#### 2 or more foreign countries are involved

##### Limit 1: Per foreign country

$$\frac{\text{Net estate per foreign country}}{\text{Entire net estate}} \times \text{Philippine estate tax}$$

##### Limit 2: By aggregate

$$\frac{\text{Net estate all foreign countries}}{\text{Entire net estate}} \times \text{Philippine estate tax}$$

Or

The actual amount of foreign estate tax paid, whichever is lower.

### 11.2 Double-taxation treaties

The Philippines does not have any estate tax treaties with any other country to date.



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