

Philippines

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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 (FMV) 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 the gross estate:

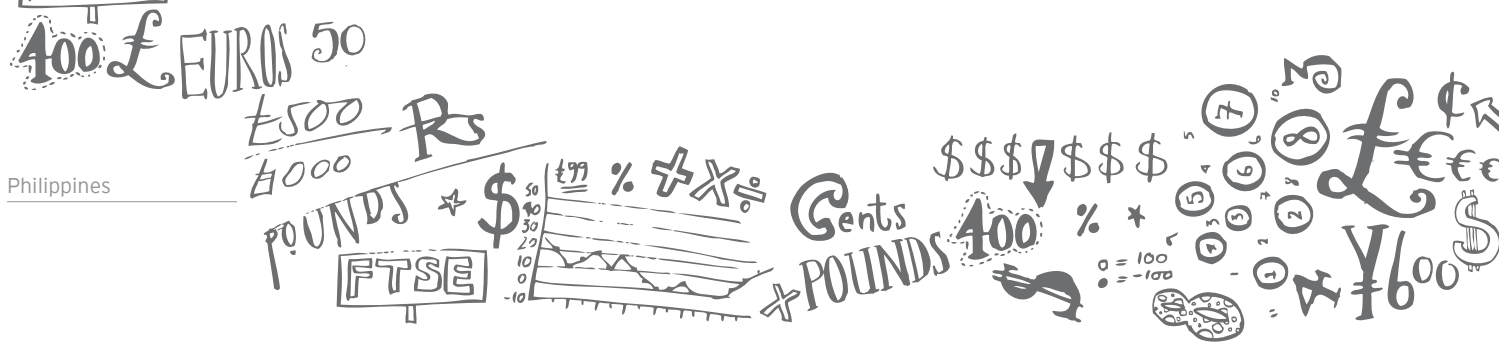
- ▶ **Decedent's interest.** This refers to value of the decedent's right or expectation (short of naked title) on a property.
- ▶ **Transfers in contemplation of death.** The value of any disposition, whether by trust or otherwise, that is intended to take place only after the decedent's death (*donation mortis causa*).
- ▶ **Revocable transfers.** The value of any transferred property where the decedent retained his power to amend, alter or revoke the transfer during his lifetime. This is regardless of whether he actually exercised his power or not.
- ▶ **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 his 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 his death, the value of the asset transferred should still be considered part of his gross estate.



- ▶ **Property passing under the general power of appointment.** This refers to the value of any property for which the decedent was given the power to appoint any person, including himself, to be the recipient or beneficiary. Since the decedent enjoys the right to dispose the property any way he wants to as if he is the owner, the value of such property should be included in his gross estate.
- ▶ **Proceeds of life insurance.** The value of insurance proceeds from insurance policies taken out by the decedent upon his 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 his estate his executor or administrator as the beneficiary regardless of whether the designation is irrevocable or not.
- ▶ **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 he made during his 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.** 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.
- ▶ **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.** A certain percentage of the value of an asset may be deducted from the gross estate if it was 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 four years but not more than five years before his/her death his death may be deducted from his gross estate to the extent of 20% thereof. If such property was inherited by the decedent within one year before his death, then 100% of the value of such asset is deductible from his gross estate.
- ▶ **Transfer for public use.** Any bequeath, legacies or 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 one (1) year prior to the death of the decedent or PHP500,000, whichever is lower.





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 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

Over	But not over	The tax shall be	Plus	Of the excess over
	200,000	Exempt		
200,000	500,000	0	5%	200,000
500,000	2,000,000	15,000	8%	500,000
2,000,000	5,000,000	135,000	11%	2,000,000
5,000,000	10,000,000	465,000	15%	5,000,000
10,000,000	And over	1,215,000	20%	10,000,000

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):



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Table 2

Over	But not over	The tax shall be	Plus	Of the excess over
	100,000	Exempt		
100,000	200,000	0	2%	100,000
200,000	500,000	2,000	4%	200,000
500,000	1,000,000	14,000	6%	500,000
1,000,000	3,000,000	44,000	8%	1,000,000
3,000,000	5,000,000	204,000	10%	3,000,000
5,000,000	10,000,000	404,000	12%	5,000,000
10,000,000		1,004,000	15%	10,000,000

4. Exemptions and reliefs

Estate tax

As can be seen from Table 1 above, 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 fideicommissary
- ▶ The transmission from the first heir, legatee or donee in favor of another beneficiary, in accordance with the desire of the predecessor
- ▶ 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, that no 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/her lifetime are also exempt from donor's tax:

- ▶ Dowries or gifts made on account of marriage and before its celebration or within one 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
- ▶ 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, that no more than 30% of said gifts shall be used by such donee for administration purposes

In the case of a nonresident alien, only the 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 TIN of the decedent will be cancelled.

A notice of death must be filed by the executor, administrator or any of the legal heirs within two 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 is 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, regardless of the gross value of the estate, when the estate is composed of real properties, shares of stock or motor vehicles, or any property where a BIR tax clearance is required as a condition precedent for the transfer of ownership.

Estate tax returns showing a gross value exceeding PHP2,000,000 shall be supported with a statement duly certified by a certified public accountant containing the following:

- ▶ Itemized assets of the decedent with their corresponding gross value at the time of his death, or, in the case of a nonresident and not a citizen of the Philippines, of that part of his gross estate situated in the Philippines
- ▶ Itemized deductions from gross estate allowed under the law
- ▶ The amount of tax due whether paid or still due and outstanding

Estate tax returns are required to be filed within six 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 is 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 five years, in case the estate is settled through the courts, or two years in case the estate is settled extra-judicially. In such case, the amount in respect of which the extension is granted shall be paid on or before the date of the expiration of the period of the extension, and the running of the statute of limitations for assessment as provided in Section 203 of the National Internal Revenue 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 to the 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, conditioned upon the payment of the said tax in accordance with the terms of the extension.



6. Assessments and valuations

The estate shall be appraised at its FMV 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 FMV as determined by the Commissioner
- or
- ▶ The FMV as shown in the schedule of values 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 financial of the company is presumed to be the FMV of the shares of stock 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, thus, minimize estate tax. However, as transfers to an irrevocable trust are considered full transfer of all rights and ownership over the assets that are placed in the trust, they are considered as a donation *inter vivos* (donation during the lifetime of the giver) and hence are 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 in accordance with the graduated scale in Table 2 above. If it is in favor of a stranger, the donor's tax is 30% of the FMV of the property at the time of the transfer 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 or her children without a legal cause) of compulsory or forced heirs cannot be the subject of any condition. Hence, they cannot be transferred to an irrevocable trust that is subject to certain conditions. In other words, only assets other than those pertaining to the legitime of forced heirs may be transferred to an irrevocable trust, subject to certain conditions, such as a 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 when the irrevocable beneficiary is other than the decedent or his estate) are not considered part of the gross estate, such proceeds may be placed in a trust and be the subject of certain conditions, such as a gradual and periodic release of funds, in order to ensure that an improvident child-beneficiary, for example, will not be able to squander the entire amount.

Generation-skipping trust

Because the merger of usufruct in the owner of the naked title is not subject to estate tax (as noted in Section 4), a trust may be formed whereby 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 the decedent dies, the usufruct and the title on the asset will merge in the grandchild, which is exempt from estate tax. Thus, one 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 terms of reducing the taxable estate and retaining valuable assets (e.g., expensive paintings) within the family line.

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

8. Grants

From an estate tax perspective, grants forming part of the estate of the decedent at the time of his estate are considered subject to estate tax. Grants given by the decedent during his 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 estate, executor or administrator
- ▶ 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

The first four bullets have already been discussed above. Hence, we will focus on straight sale and tax-free exchange as planning tools.





However, recently the BIR issued a revenue regulation that requires the incremental increase in value of the underlying real property to be included in the computation of the book value of the shares. The revenue regulation purportedly is meant to capture the “gain” from the increase in value of the real property.

The transferor in a tax-free exchange has, of course, the option of retaining ownership of the shares until he dies, in which case the incremental increase in value of the underlying real property will not be included in the computation of the estate tax.

10.2 Succession

The Philippines has, by law, institutionalized the concept of compulsory heirs and their legitime. Thus, 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 that compulsory heirs are entitled to. Once the legitime of each compulsory heir is satisfied, everything else is considered part of the “free portion” which 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.

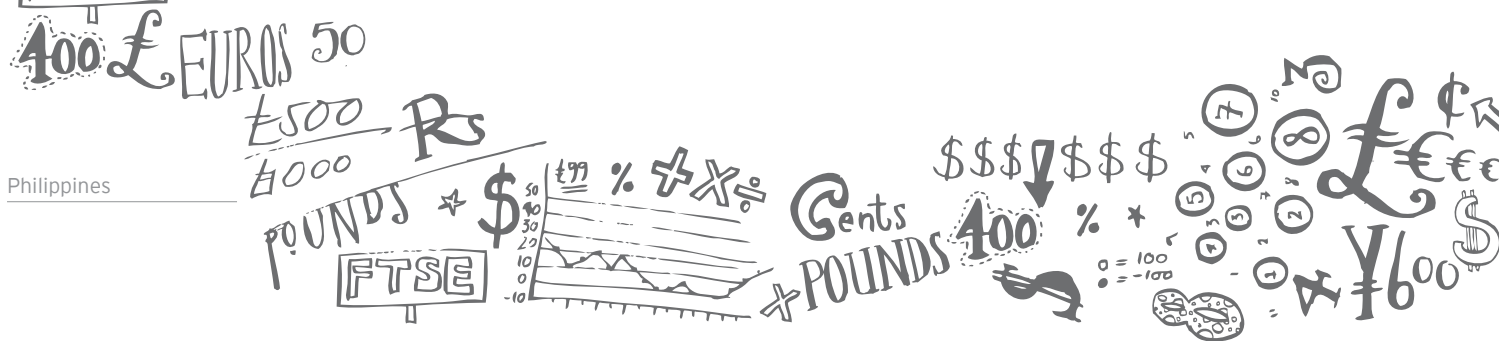
Compulsory heirs are legitimate and illegitimate children, a spouse and, in some instances, parents or ascendants. (Please see Table 3 in Annex A for the legitimes of compulsory heirs and available free portion when a person dies with a will. Table 4 shows the summary of legitimes when a person dies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

10.4 Matrimonial regimes and civil partnerships

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

Marriages solemnized before August 1988 are governed by the Conjugal Partnership of Gains (CPG) regime, unless the parties agreed by way of a prenuptial agreement that they will be governed by another property regime, such as complete separation of property. Under the CPG regime, everything brought in as the 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), when 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; for example, were the legitimes respected?) 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 in which the will was 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 the *renvoi* doctrine (referring back to the decedent's country of residence at the time of death).

10.6 Probate

As long as a will exists, a probate proceeding has to take place during which the validity or invalidity of the will is determined. 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

A foreign tax credit for estate taxes paid in a 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 in accordance with the following formula:

One 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

**Two 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.