

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 or her power to amend, alter or revoke the transfer during his or her lifetime. This is regardless of whether he or she actually exercised that 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 or her lifetime. Since this means that the transfer performed by the decedent is not absolute and transfer of all rights of ownership will only take place upon his or her death, the value of the asset transferred should still be considered part of his or her 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 or herself, to be the recipient or beneficiary. Since the decedent enjoys the right to dispose of 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 his or her 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 his or her estate, the 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 or she made during his or her 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:

- ▶ **Claims against the estate.** Third-party creditor claims such as loans obtained by the decedent, which must be evidenced by a notarized agreement.
- ▶ **Claims against insolvent persons.** Basically, bad debts or uncollectible receivables of the decedent.
- ▶ **Mortgage indebtedness, taxes and loss.** 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 the decedent by inheritance at least four years but not more than five years before his or her death may be deducted from his or her gross estate to the extent of 20% thereof. If such property was inherited by the decedent within one 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 bequests, 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 not exceeding PHP10 million. The value in excess of PHP10 million is subject to estate tax.
- ▶ **Standard deduction.** The amount of PHP5 million is deductible without question.

For a nonresident alien decedent, the estate located in the Philippines is entitled to a standard deduction of PHP500,000. His estate is also entitled to the following deductions: a) amount of claims against the estate; b) amount of claims against insolvent persons and mortgage indebtedness in proportion to the value that such amount bears to the value of his entire gross estate wherever situated; and c) the amount or value of the asset he donated for public use.



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 at a uniform rate of 6% based on the value of such net estate.

Donor's tax or gift tax

Donor's tax of 6% is imposed based on total net gifts in excess of PHP250,000 made during the calendar year, regardless of whether the gift is made to a relative or a stranger.

4. Exemptions and reliefs

The following transmissions are 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

The following donations of a Philippine resident or nonresident alien during his or her lifetime are exempt from donor's tax:

- ▶ 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

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.

An estate tax return (BIR Form 1801) is required to be filed in all cases where there are assets to be transferred subject to estate tax and 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.



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 at 6%. 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 death 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 the 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.

Sale of asset

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

A sale of unlisted shares by a parent to his or her children, for example, will only entail capital gains tax (CGT) of only 15% based on net gain. There will also be stamp duty of PHP1.50 for every PHP200, or fraction thereof, of the par value of the domestic shares sold.

On the other hand, a sale of shares listed in the Philippine Stock Exchange is subject only to stock transaction tax of 60% of 1% of the gross selling price or gross value in money of the shares of stock sold.

A sale of real estate properties that are considered capital assets is subject only to 6% CGT based on presumed gain, that is, based on the 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, the tax rate applicable to sale as a mode of transfer is the with donor's tax and estate tax except stamp duty when the transfer is by way of inheritance.

It goes without saying that a transfer by way of sale requires that there be a bona fide sale and requires the capacity of the transferee (buyer) to buy.



It should also be noted that transfer by way of sale of real estate properties that are classified as ordinary assets is not recommended since this will entail higher taxes, namely, rate of 20% to 35% income tax for individual sellers depending on the amount of taxable income realized, plus 12% value-added tax and 1.5% stamp duty. A real property is considered an ordinary asset for Philippine tax purposes when it is being used in business, or when it is 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 real properties that normally appreciate in value over time.

Philippine tax laws require that the transferor (parent) gain control, that is, 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 PHP2 for every PHP200, or fraction thereof, of the 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 15% CGT on net gain (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 PHP1.50 for every PHP200, or fraction thereof, of the 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, the increase in value of the real property will not affect the book value of the shares when the latter are subsequently sold. Therefore, an indirect transfer of real property where the incremental increase in value of the real property is not subject to tax is effectively achieved.

However, 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 in case of sale of 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 or she 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.





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.