

CPA REVIEW SCHOOL OF THE PHILIPPINES
Manila

DEDUCTIONS AND EXEMPTIONS

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1. Which of the following statements is true?
 - a. Payments which constitute bribes, kickbacks and others of similar nature which are necessary to realize profits are allowed as deductions from gross income
 - b. The taxes which are deductible from gross income include the taxes, interest and penalties incident to tax delinquency.
 - c. Deductions are amounts allowed by the Tax Code to be deducted from gross income to arrive at the income tax liability of a taxpayer.
 - d. Losses from wagering transactions shall be allowed only up the extent of the gains from such transactions.

2. This is not deductible from gross income
 - a. Transportation expenses from the main office to the branch.
 - b. Transportation expenses from home to the office and from the office back to home.
 - c. Travel expenses on business trips.
 - d. Travel expenses while away from home in the pursuit of trade, business or profession.

3. A revenue expenditure is
 - a. Usually incurred in the acquisition, betterment or permanent improvement of the asset
 - b. Capitalized and the cost is recovered through annual depreciation
 - c. Ordinarily to benefit more than one accounting period
 - d. To benefit one accounting period and is a deduction from gross income in the year paid or incurred.

4. No deductions shall be allowed where the transaction is between "related taxpayers" under Sec. 36(B) of the Tax Code for
 - A) Losses from sales or exchanges of property
 - B) Interest expense
 - C) Bad debts
 - a. A and B
 - b. B and C
 - c. A and C
 - d. A, B and C

5. The phrase "related taxpayers" under Sec. 36(B) of the Tax Code will apply to the following, except:
 - a. Between members of a family
 - b. Between the grantor and a fiduciary of any trust
 - c. Between a fiduciary of a trust and a beneficiary of such trust
 - d. Between an individual and a corporation more than 50% in value of the outstanding stock of which is owned, directly or indirectly by or for such individual, in case of distributions in liquidation

6. The optional standard deduction for corporations is
 - a. 10% of the gross income
 - b. 10% of the gross sales/receipts
 - c. 40% of the gross income
 - d. 40% of the gross sales/receipts

7. The optional standard deduction for individuals is
 - a. 10% of the gross income
 - b. 10% of the gross sales receipts
 - c. 40% of the gross income
 - d. 40% of the gross sales/receipts

8. Interest expense incurred to acquire property used in trade or business or exercise of a profession is

- a. Not allowed as a deduction against gross income
 b. Required to be treated as a capital expenditure to form part of the cost of the asset
 c. Allowed as a deduction or treated as a capital expenditure at the option of the taxpayer
 d. Allowed as a deduction or treated as a capital expenditure at the option of the government
9. A Corp. had net sales of P1M. The actual entertainment, amusement and recreation expense amounted to P20,000. The deductible "EAR" expense is
 a. P20,000 b. P6,000 c. P10,000 d. P5,000
10. C Corp. had net revenues of P1M. The actual entertainment, amusement and recreation expense amounted to P20,000. The deductible "EAR" expense is
 a. P20,000 b. P6,000 c. P5,000 d. P10,000
11. C Corp. is engaged in the sale of goods and services with net sales and net revenue of P2M and P1M, respectively. The actual entertainment, amusement and recreation expense amounted to P18,000. The deductible "EAR" expense is
 a. P18,000 b. P16,000 c. P12,000 d. P6,000
12. If an individual is on the cash basis of accounting, will interest paid in advance be allowed as a deduction?
First answer -- No, it is a deduction in the year that the indebtedness is paid and not in the year that the interest is paid.
Second answer -- Yes, if the indebtedness is payable in periodic amortizations, the amount of the interest which corresponds to the amount of the principal amortized or paid during the year shall be allowed as a deduction in such taxable year.
- a. True, true b. True, false c. False, false d. False, true

13. One of the following losses cannot be deducted from gross income:
 a. To construct a bigger warehouse, a corporation demolished an old warehouse which had a construction cost of P2 M and a book value of P300,000.
 b. Demolition of a building existing on land purchased, where the corporation had no use for the building at the time of purchase and it was its intention to remove the building in order to build its factory.
 c. A corporation retired its machinery from the business because of the increase in the cost of production and the failure of the machinery to meet the desired number of units of production.
 d. A Corp. ascertained that its B Corp. stocks are worthless because of the total insolvency of B Corp.

14. A domestic corporation organized in 2006 provided the following information:

	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Net Sales	P4,000,000	P5,000,000	P6,000,000	P7,000,000	P9,000,000
Cost of Sales	2,000,000	3,500,000	4,200,000	5,000,000	5,200,000
Business Expenses	1,900,000	1,550,000	1,820,000	2,100,000	2,300,000

The income tax still due for 2014 is

- a. P35,000
 b. P30,000
 c. P40,000
 d. P32,000

15. The income tax still due for 2018 is

- a. P293,000
- b. P399,000
- c. P344,000
- d. P450,000

16. Examples of taxes that are deductible except

- a. Occupation tax
- b. Privilege tax
- c. Documentary stamp tax
- d. Philippine income tax

17. Non-deductible taxes, except

- a. Special assessment
- b. Donor's tax
- c. Estate tax
- d. Business tax

18. A, not happy with her present job, resigned and started her own business. The business requires her to travel so she used her car for the purpose. Assume that A started her business on April 1 and that she uses the car for business 70% of the time. Assuming total expenses for the year for the use of the car is P300,000, the deductible expense is

- a. P210,000
- b. P300,000
- c. P225,000
- d. P157,500

19. A acquired a machine at a cost of P500,000. Scrap value is P40,000 and the estimated useful life was 25 years. After depreciating the asset for 20 years using the straight-line method, it was determined that the remaining life is not five ears. The annual depreciation from the 21st year assuming a remaining life of 10 years without scrap is

- a. P17,600
- b. P20,000
- c. P35,200
- d. P13,200

20. I. An expense which is necessary but not ordinary, or ordinary but not necessary is deductible from gross income.

II. The taxpayer must signify his intention to elect the itemized deduction, otherwise, he is deemed to have chosen the optional standard deduction.

- a. True, true
- b. True, false
- c. False, true
- d. False, false

21. I. Interest paid on preferred stock is deductible from gross income of the paying corporation.

II. A capital expenditure usually benefits more than one accounting period and is deductible from gross income in the year it is paid or incurred.

- a. True, true
- b. True, false
- c. False, true
- d. False, false

22. A) The cost of leasehold improvements shall be deductible by the lessee by spreading the cost of the

- improvements over the life of the improvements or the remaining term of the lease whichever period is shorter.
- B) Contributions by the employer to a pension trust for past service cost is deductible in full in the year that the employer made the contributions.
- True, true
 - True, false
 - False, true
 - False, false
23. Beginning 1/1/2018, for individuals with purely gross compensation income, the following may not be deducted:
- Personal exemptions
 - Additional exemptions
 - Optional standard deduction
 - Premium payments on health and/or hospitalization insurance
 - All of the above.
24. Beginning 1/1/2018, for individuals with gross income from business or practice of profession, which of the following may be deducted:
- Optional standard deduction
 - Itemized Deduction
 - Personal basic exemptions
 - Additional exemptions
 - Premium payments on health and/or hospitalization insurance
- A,B,C and D
 - B, C and D
 - C, D and E and Either A or B
 - Either A or B
25. Any amount subsequently received on account of a bad debt previously charged off and allowed as a deduction from gross income in prior years must be included in gross income in the taxable year in which received. This is
- Severance test
 - Life-blood theory
 - Destination of income test
 - Equitable doctrine of tax benefit
26. A took out a life insurance policy of P1,000,000 naming his wife as beneficiary. The policy provides that the insurance company will pay A and his beneficiary the amount of P1,000,000 after the 25th year of the policy, should he die before this date. The premiums paid on the policy is P700,000. If A outlived the policy and received the proceeds of P1,000,000, such proceeds will be:
- Taxable in full
 - Exempt from income tax
 - Partly taxable, partly exempt
 - Subject to final tax
27. Using the preceding number, if A dies and his beneficiary received the proceeds of P1,000,000, such proceeds will be
- Taxable in full
 - Partly taxable, partly exempt
 - Exempt from income tax
 - Subject to final tax

28. May consider capital expenditures as revenue expenditures
- Resident citizen
 - Domestic corporation
 - Private educational institutions
 - Resident alien
29. A building was partially destroyed by fire in 2017. The building had a book value of P5M. The insurance company was willing to pay P4M, which was refused by the owner. Finally, the claim was settled in 2018 for P4.6M. The proceeds will be
- Exempt from income tax
 - Part of taxable income
 - Subject to final tax
 - Partly exempt, partly taxable
30. One of the following is not correct for deductibility of losses from gross income
- Must arise from fire, storm or other casualty, robbery, theft or embezzlement.
 - Must not be compensated by insurance or other form of indemnity.
 - A declaration of loss by casualty should be filed with the Bureau of Internal Revenue.
 - Must have been claimed as deduction in the estate return of the taxpayer.
31. Which of the following statements is not correct?
- The Optional Standard Deduction is an amount equal to forty (40%) of the gross income from business or practice of profession of the taxpayer.
 - The Optional Standard Deduction is not available against compensation income arising out of an employer-employee relationship.
 - The election of Optional Standard Deduction is irrevocable for the taxable year for which the choice is made.
 - Unless the taxpayer signifies in his return his intention he shall be considered as having availed of the itemized deduction.
32. The net operating loss, which had not been previously offset as deduction from gross income shall be carried over as deduction from gross income for the next
- 2 consecutive taxable years immediately following such loss.
 - 3 consecutive taxable years immediately following such loss.
 - 4 consecutive taxable years immediately following such loss.
 - Taxable year immediately following such loss.

Items 33 and 34 pertain to the following:

A taxpayer engaged in business incurred a partial loss of property as follows:

	<u>Asset 1</u>	<u>Asset 2</u>
Book value of the asset at the time of loss	P 200,000	P 200,000
Cost to restore the property back to its normal operating condition	120,000	300,000
Insurance recovery	50,000	None
Salvage	None	40,000

33. The deductible loss for asset 1 is
- P 120,000
 - P 70,000
 - P 30,000
 - P 80,000
34. The deductible loss for asset 2 is
- P 300,000
 - P 300,000
 - P 160,000
 - P 240,000

Items 35 to 37 pertain to the following:

ABC put up a qualified retirement plan approved by the BIR. It appointed B Corp. to administer the plan, which called for the payment of P200,000 to cover the retirement of employees for past services rendered and a yearly contribution of P50,000. The following amounts were paid for the first three years of the plan's operation.

	<u>Contribution for Services</u>	
	<u>Past Years</u>	<u>Current Years</u>
First year.....	P 100,000	P 50,000
Second year.....	60,000	50,000
Third year.....	40,000	50,000

35. The pension expense for the first year is
 a. P 150,000 b. P 15,000 c. P 60,000 d. P 105,000
36. The pension expense for the second year is
 a. P 110,000 b. P 11,000 c. P 56,000 d. P 66,000
37. The pension expense for the third year is
 a. P 90,000 b. P 9,000 c. P 54,000 d. P 70,000
38. Mr. Santos, a retailer of goods, uses the accrual method in reporting his income and expenses. His transactions show:

	Jan. 1 to June 30	July 1 to Sept. 30	Oct. 1 to Dec. 31
Gross Sales	P 1,000,000	P 700,000	P 900,000
Cost of Sales	600,000	200,000	300,000
Business expenses	100,000	50,000	70,000
Non-operating income			
In the ITR	50,000	40,000	10,000

If the calendar year is 2018, and he avails of the OSD, his taxable net income under the graduated rates is:

- a. P 1,660,000
 b. P 1,040,000
 c. P 900,000
 d. None of the above
39. Using the preceding number, but using JD, his taxable net income is:
 a. P 1,380,000
 b. P 1,500,000
 c. P 1,230,000
 d. None of the above

40. ABC Corporation, a retailer of goods, uses the accrual method in reporting his income and expenses under the calendar year basis. Its transactions show:

	Jan. 1 to June 30	July 1 to Sept. 30	Oct. 1 to Dec. 31
Gross Sales	P 1,000,000	P 700,000	P 900,000
Cost of Sales	600,000	300,000	600,000
Itemized deduction	100,000	50,000	150,000
Other income in the ITR	70,000	20,000	10,000

If the calendar year is 2015, the net taxable income using the OSD is

- P 1,560,000
- P 1,040,000
- P 720,000
- None of the above

41. The records of a domestic corporation organized in 2000 show:

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Gross Income	P 2,000,000	P 2,200,000	P 2,500,000	P 2,800,000
Deductions (where 5% represents bad debts written off)	<u>1,900,000</u>	<u>2,000,000</u>	<u>2,520,000</u>	<u>2,400,000</u>
Net Income (Loss)	P 100,000	P 200,000	(P 20,000)	P 400,000

Subsequent recovery of bad debts written off:

In 2015

P 60,000

In 2016

P 10,000

- a) The income tax payable for 2015 is

- P 30,000
- P 40,000
- P 58,500
- P 40,500

- b) The income tax payable for 2016 is

- P 78,000
- P 68,000
- P 60,000
- P 50,000

- c) The income tax payable in 2017 is

- P - 0 -
- P 50,000
- P 18,000
- P 24,000

- d) The income tax payable for 2018 is

- P 73,000
- P 70,000
- P 67,000
- P 64,000

42. A Corporation is engaged in the trading business. The reported income and expenses for taxable year 2018 show:

Sales	P 10,000,000
Cost of Sales	6,000,000
General business expenses	1,000,000
Interest on time deposit (gross)	100,000
Interest expense on loans payable	180,000

The net taxable income is

- P 2,820,000
- P 2,853,000
- P 2,862,000
- P 2,858,000

43. The records of Manila Bus Corp. show salaries and wages paid for its rank and file employees:

To non-senior citizens	P 1,800,000
To senior citizen	200,000

The deductible salaries and wages expense is

- P 2,000,000
 - P 1,960,000
 - P 2,400,000
 - P 2,030,000
44. The term "net operating loss" shall mean
- The excess of allowable deductions over gross income of the business in a taxable year
 - The excess of the ordinary itemized deductions over gross income of the business in a taxable year
 - The excess of optional standard deduction over gross income of the business in a taxable year
 - Loss incurred which shall be carried over as a deduction from gross income to be spread for the next three years
45. For mines other than oil and gas wells, a net operating loss without the benefit of incentives under Executive Order 226, as amended, otherwise known as Omnibus Investment Code of 1987, may be carried over as a deduction from taxable income, if incurred in any of the
- First 10 years of operation
 - First 4 years of operation
 - First 3 years of operation
 - First 5 years of operation
46. Using the preceding number, such net operating loss can be carried as a deduction from taxable income, within how many years immediately following the year of such loss?
- 5 years
 - 3 years
 - 10 years
 - 4 years

47. Atty. A rendered the following services during the year:

Gross receipts from legal fees	P 3,000,000
Value of 60 hours assistance to indigent client	200,000
Value of other pro-bono services	150,000
Direct cost of services	1,200,000
Other deductible expenses	900,000

The taxable net income of Atty. A is

- P550,000
 - P720,000
 - P750,000
 - P900,000
48. ABC Corporation employs regular people, persons with disabilities (PWDs) and senior citizens as employees, and pays the following compensation:

Regular employees	P 800,000
PWD employee	300,000
Senior citizen employee with salary grade:	
a. Above poverty level	200,000
b. Below poverty level	100,000

The deductible compensation expense is

- P 1,400,000
- P 1,490,000
- P 1,115,000
- P 1,500,000

49. Healthy Drugs Corporation had the following data during the year:

Transactions	Customer		Totals
	Regular	Senior Citizen	
Sales (net)	Php 8,000,000	Php 3,200,000	Php 11,200,000
Cost of Sales	5,000,000	2,000,000	7,000,000
Other Deductible expenses			2,000,000

Healthy adopts a policy of giving senior citizen a 20% discount. As a result, it granted Php 800,000 total senior citizen's discount during the year. The taxable net income is

- a. P 2,000,000 b. P 1,400,000 c. P 2,200,000 d. P 1,250,000

50. Delicious Eatery Corporations provides 20% discount to senior citizens. It recorded the following during the year:

Transactions	Customer		Totals
	Regular	Senior Citizen	
Receipts (net)	Php 8,000,000	Php 2,000,000	Php 10,000,000
Cost of Services			6,000,000
Other Deductible expenses			2,000,000

The regular and special itemized deductions from gross income total:

- a. P 2,500,000 b. P 2,400,000 c. P 2,000,000 d. P 1,600,000

51. Using the above data, the taxable net income is

- b. P 1,600,000 b. P 2,000,000 c. P 1,500,000 d. P 1,000,000

52. To improve productivity, ABC Corporation negotiated a productivity incentive program wherein the employees will receive productivity bonuses equivalent to 40% of production cost savings measured by an independent expert. ABC requires employees to undergo studies through an "employee advancement study program" with TESDA. All employees who finished their special studies are required to remain at ABC for a period of at least 2 years. The following were determined during the year:

Cost of special studies:	
Managerial employees	Php 2,000,000
Rank & file employees	4,000,000
Total distributable productivity bonus	2,000,000
Total	Php 8,000,000

The allowable deduction for the benefits given is

- a. Php 8,000,000 b. Php 9,000,000 c. Php 10,000,000 d. Php 11,000,000

53. Dick Tracy Corporation paid the following expenses during the year:

Interest for late payment (delinquent) income tax	P 5,000
Surcharge and compromise for late payment of income tax	30,000
Interest on bonds issued	40,000
Interest on money borrowed by the Company from a stockholder who owns 80% of the outstanding stock of the Company	20,000

What is Dick Tracy Corporation's deductible expense?

- a) P45,000 b) P75,000 c) P95,000 d) P60,000

54. Mr. Allan Bautista is engaged in the business of buying and selling of used cars. In the taxable year, he sold a used car to his first cousin thereby incurring a loss of P50,000. Allan's acquisition cost of the car was P100,000. Can Allan deduct the loss in his ITR in computing his income tax payable?

- a) No. The loss is a personal, and not connected with his business.
- b) No. The loss is connected with his business, but the loss is between related parties under Section 36 (B) of the Tax Code.
- c) Yes. The loss is a capital loss which can be offset against capital gains that are includible in the ITR.
- d) Yes. The loss is connected with his business, and is not between related parties.

55. ABC, is a domestic corporation engaged in the merchandising business. For the calendar year 2018, it had a net income per books of P500,000, after considering, among others, the following:

a) Dividend received from a domestic corporation	P30,000
b) Provision for doubtful accounts	10,000
c) Dividend received from a foreign corporation	20,000
d) Portion of P150,000 advance rental already earned	100,000
e) Recovery of receivables previously written off:	
i) Previously allowed by the BIR as deduction	10,000
ii) Previously disallowed by the BIR as deduction	30,000
f) Refund of deductible taxes	
i) Previously allowed by the BIR as deduction	25,000
ii) Previously disallowed by the BIR as deduction	15,000
g) Bank interest income:	
i) Philippine Bank	80,000
ii) USA Bank	100,000

The taxable net income is

- a. P485,000 b. P365,000 c. P375,000 d. None of the above

56. In the preceding problem, if the amounts in items (e) and (f) are included as part of book net income, the taxable net income is:

- a. P485,000 b. P375,000 c. P365,000 d. P405,000

57. The net operating loss incurred in a taxable year during which the taxpayer was exempt from income tax shall

- a. Be carried over as a deduction from gross income for the next taxable year
- b. Be carried over as a deduction from gross income for the next 3 consecutive taxable years
- c. Be carried over as a deduction from gross income for the next 5 consecutive taxable years
- d. Not be allowed as a deduction for the next taxable year.

58. **Statement 1:** Under Sec. 34(L) of the Tax Code, as amended by R.A. No. 10963 (TRAIN), a general professional partnership and the partners comprising such partnership may avail of the OSD only once, either the by GPP or the partners comprising the partnership.

Statement 2: The partners of a GPP can may avail either the Itemized Deductions or the OSD against their distributive shares IF the basis of such distributive share is the GPP's gross income, and not its net income. This means that the GPP does not avail either of the Itemized Deductions nor of the OSD in computing the basis of the distributive shares of the partners.

- a. Both are true.
- b. Only Statement 1 is true.
- c. Only Statement 2 is true.
- d. Both are false.

59. Lorna de Jesus borrowed ₱100,000 from Chris de Diablo. As collateral, she mortgaged her house in favor of Chris. She was not able to pay, and Chris immediately foreclosed the property in 2015. In the public auction held in 2015, Chris was the highest bidder with a bid of ₱40,000. In 2017, Chris eventually sold the house for ₱75,000. Chris is not in the real estate business nor did he previously use the house for business.

How much loss can Chris deduct in 2015 and in 2017?

- a) ₱60,000 in 2015, None in 2017.
 - b) ₱60,000 in 2015, ₱25,000 in 2017.
 - c) ₱60,000 in 2015, ₱40,000 in 2017.
 - d) None in both years.
60. For individuals before 2018, premiums paid during the taxable year for health and/or hospitalization insurance taken out by him on himself, including his family shall be allowed as deductions from gross income, provided that the family has a gross income of
- a. More than P250,000
 - b. More than P500,000
 - c. Not more than P250,000
 - d. Not more than P2,400
61. **First statement** – Before 2018, in case of a married taxpayer, only the spouse claiming the additional exemptions for dependents shall be entitled to the deduction on premium payments on health and/or hospitalization insurance.

Second Statement – Before 2018, the deduction for premium payments on health and or hospitalization insurance shall not exceed P2,400 per year for the family or P200 per month.

- a. True, true
- b. True, false
- c. False, true
- d. False, false

END