**DEDUCTIONS FROM GROSS INCOME**

1. **Itemized Deductions**
2. **General and administrative expenses**
3. **Interest**

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| *Requisites to be deductible*   1. There is indebtedness as evidenced by a document. 2. The indebtedness must be that of the taxpayer 3. The indebtedness must be concerned with the taxpayer’s trade, business or profession. 4. The interest must have been paid or accrued during the taxable year.   *Deductible Interest Expense Subject to Limitation*  If the taxpayer has interest income subject to 20% final tax and at the same time incurred an interest expense during the taxable year, the allowable interest expense shall be reduced by  Individual – 38% of interest income  Corporation – 33% of interest income  Rationale: Why borrow when you have money loaned to others?  *Deductible Interest Expense in Full*   1. Interest for tax delinquency - However, surcharges and compromise for late payment of income tax are non-deductible expense. 2. Interest payment on scrip dividends 3. Interest payment on deposits – Interest paid by banks and other financial institutions on the deposits of customers. 4. Interest payment on bonds.   *Nondeductible Interest Expense*   1. Interest paid in advance by a taxpayer using the cash basis method of accounting – Such interest shall be allowed as deduction in the year the indebtedness is paid. 2. Interest expense arising between related taxpayers. 3. Interest expense if the indebtedness is incurred to finance petroleum exploration. 4. Interest on preferred stocks. 5. Interest agreed on orally. 6. Interest on indebtedness that has prescribed.   *Optional Treatment of Interest Expense*   1. Outright deduction 2. Capital expenditure – interest expense will be deducted then thru means of depreciation |

1. **Taxes**

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| *Nondeductible Taxes*   1. Philippine income tax 2. Estate and donor’s taxes 3. Foreign income tax, if claimed as a tax credit 4. Percentage tax on stock transaction 5. Value-added tax 6. Taxes not related to business, trade, or profession 7. Other items related to tax such as  * Special assessment tax * Surcharges * Compromise penalty   *Foreign Income Tax Claimed as Tax Credit*   1. Who may avail?   Taxpayers taxed within and without.   1. Limit – whichever is lower of the following:   Limit 1: Tax Due \* (Taxable Income per each Foreign Country/ Taxable Income-World)  Limit 2: Tax Due \* (Taxable Income for all Foreign Country/ Taxable Income-World)  Note: If the taxpayer is individual, the taxable income figure to be used is the taxable income before personal exemptions. |

1. **Losses**

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| **Net Operating Loss Carry Over (NOLCO)**  *Requisites:*   1. Taxpayer not exempt from Income tax the year loss was sustained. 2. There has been NO substantial change in the ownership of business.   *Taxpayers Entitled to NOLCO*   1. Those not earning purely compensation income 2. Individuals engaged in business 3. Corporations 4. Taxable estates and trusts 5. Taxpayers subject to normal tax – citizens/residents   *Periods to Cover*   1. In general: Up to 3 consecutive taxable years following the year of loss 2. Exception   For mines other than oil and gas wells, loss incurred in   * First 10 years – next 5 years * Subsequently – next 3 years   **Net Capital Loss Carry Over (NCLCO)**  See notes on Dealings in Properties. The important difference is that NOLCO applies to individuals and corporations while NCLCO applies to individuals only.  **Losses from Wash Sales**  Not deductible – see Dealings in Properties lecture.  **Losses from Wagering/Gambling**   * Any gain – Normal tax * Any loss – Nondeductible. Rationale: Not related to business |

1. **Bad Debts**

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| *Amount Deductible*  Actual amount deemed worthless or uncollectible (Direct or Actual method). |

1. **Depreciation**

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| Amount deductible is based on the depreciation method and period used. In general, method used is straight line and period is the useful life.  **Petroleum Operations**   |  |  |  | | --- | --- | --- | |  | **Method** | **Depreciation Period** | | Properties directly related to production of petroleum | Straight-line or declining balance | 10 yrs or shorter as may be permitted by the commissioner | | Properties not directly related to production of petroleum | Straight-line | 5 yrs |   **Mining Operations other than Petroleum**   |  |  | | --- | --- | | **If expected life is** | **Depreciation Period** | | 10 yrs or less | Useful life | | More than 10 yrs | Any number between 5 yrs and Useful life | |

1. **Depletion**

See your book as various books on taxation provide different tax treatments for depletion.

1. **Charitable Contributions**

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| *Deductible in Full*   1. Made to foreign institutions 2. Made to accredited NGOs/Nonprofit DC provided    * Admin expense does not exceed 30% of the total expense    * For the following purpose      + Character building and youth development      + Cultural      + Health      + Education and research      + Scientific      + Social welfare    * Not later than 3 months and 15 days after close of taxable year – utilize the contribution    * Distribution of assets in event of dissolution    * No part of income of which inures to any private individual 3. Made to Government of the Philippines - exclusively for priority projects   *Deductible with Limit*   1. Made to accredited domestic corporation for the following purpose    * Cultural    * Educational    * Scientific    * Youth and sports development    * Religious    * Rehab of veterans 2. Made to NGO – no part of income of which inures to any private individual 3. Made to government of the Philippines - exclusively for public purposes 4. Limit  |  |  | | --- | --- | | **Taxpayer** | **Limit** | | Individual | 10% of Taxable Income before Contribution and Personal Exemption | | Corporate | 5% of Taxable Income before Contribution |   *Special Charitable Contributions*   1. Adopt-a-School    * Additional 50% based on actual contribution    * Exempt from donor’s tax   *Special Rules Applicable to GPPs*   1. GPPs can deduct contributions deductible in full 2. Contributions subject to limit shall be claimed & deducted by the partners in proportion to their respective interest. |

1. **Other Contributions**

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| *Contributions to Pension Trust*   1. Current Service Cost – deductible in full 2. Past Service Cost – amount contributed is deductible in equal parts over a period of 10 years beginning in the year contribution was made. |

1. **Expenses in Relation to Expanded Senior Citizens Act**

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| *Summary*   1. Discounts granted to Senior Citizens – Deduction from Gross Income 2. Private entities employing Senior Citizens – Additional 50% provided 3. Employment shall have to continue for at least 6 mos 4. Annual Taxable income of the Senior Citizen does not exceed poverty level as may be determined by NEDA thru NSCB |

1. **Optional Standard Deduction**

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| *Who are allowed to claim?*   1. Those not earning purely compensation income 2. Individuals engaged in business 3. Corporations 4. Taxable estates and trusts 5. Taxpayers subject to normal tax – citizens/residents   *Period to Cover*  Once elected, such election is irrevocable for the taxable year in which the return is made.  *Computation*   |  |  |  | | --- | --- | --- | | **Taxpayer** | **Rate** | **In Lieu of** | | Individuals engaged in business | 40% of gross sales or gross receipts  Gross sales = Sales after deducting sales discounts, returns, and allowances.  Rationale: It will provide lower amount of deduction. | Itemized deductions  For individuals claiming OSD, “allowable deductions” shall mean aforesaid OSD plus deduction on premium payments for health/and or hospitalization insurance (Sec 34(M) of Tax Code). | | Corporations | 40% of gross income  Gross income includes other income not subject to final tax. | Itemized deductions | | **Note:**  For husband and wife, each spouse may claim OSD or Itemized deductions to minimize their income tax in their individual returns. | | | |