Executive summary

On 21 March, 2018, the corporate tax reform bill (the Bill) was presented to the Philippine House of Representatives. The Bill seeks to reduce the Philippine corporate income tax rate while modernizing investment tax incentives and removing excessive tax exemptions and privileges.

This Alert summarizes the key proposed amendments.

Detailed discussion

Proposed reduction of corporate income tax rate and optional standard deduction percentage

The Bill reduces the current 30% corporate income tax rate by one percentage point every year beginning 1 January 2019, provided that the rate will not be lower than 20%.

The reduced corporate income tax rate will apply to domestic corporations and Philippine branches of foreign corporations.

The optional standard deduction\(^1\) rate applicable to corporations is also proposed to be reduced from the 40% to 20% of gross income.
Proposed repeal of preferential corporate income tax rate
The 10% preferential corporate income tax rate for regional operating headquarters and offshore banking units is proposed to be repealed.

Withholding tax rates on specific income of foreign corporations
A 15% withholding tax rate, an increase from the current 7.5%, is proposed on interest income of Philippine branches of foreign corporations.

A capital gains tax rate on the sale of unlisted or untraded shares is planned to be increased to 15% from the current 5% rate for gains not exceeding PhP100,000 (US$2,000), and 10% for gains exceeding PhP100,000. This applies to foreign corporations with or without branches in the Philippines.

The Bill proposes to reduce withholding tax on Philippine source income, such as dividends, royalties and service income by one percentage point every year beginning 1 January 2019, provided that the rate will not be lower than 20%.

The withholding tax rates on the following Philippine source income of foreign corporations are to be repealed:
- 25% on gross income of cinematographic film owner, lessor, or distributor
- 4.5% on gross rentals, lease, or charter fees paid to nonresident owners or lessors of vessels
- 7.5% on rentals, charters, and other fees derived by a nonresident lessor of aircraft, machineries, and other equipment

Modifications on provisions for nonrecognition transactions
No gain or loss will be recognized on an exchange of property solely for stock or securities in another corporation pursuant to a plan of reorganization. The proposed bill removes the current requirement that a maximum of five persons be in control of the corporation as a result of the reorganization.

The term “reorganization” is defined as:
- A statutory merger
- Acquisition by one corporation of stock of another corporation in exchange solely for all or a part of its voting stock, if immediately after the acquisition, the acquiring corporation is in control of the other corporation
- Acquisition by one corporation in exchange solely for all or a part of its voting stock or substantially all of the properties of another corporation
- Recapitalization
- Reincorporation

Rationalization of fiscal incentives
The following incentives may be granted to all export activities and strategic investments including those intended for the domestic market that are eligible for registration in an investment promotion agency and which will qualify for incentives upon evaluation:

Income tax incentives:
1. Income tax holiday (ITH) for a period not exceeding three years
2. 15% corporate income tax rate
3. 50% deduction for actual qualified capital expenditure incurred within three years
4. 200% deduction for research and development expenses for the year incurred
5. 200% deduction for training expenses for the year incurred
6. 50% deduction for the wages corresponding to the increment in the number of direct labor
7. Full deduction on infrastructure development expense undertaken in an area designated as necessary for country-wide development or found to be deficient in infrastructure, public utilities, or other facilities
8. Deduction for reinvestment made by a manufacturing registered enterprise, within five years from such reinvestment

Customs duty incentive - A five-year maximum exemption on customs duty on imported equipment, machinery, and spare parts exclusively used for capital equipment and machinery

In lieu of the ITH incentive under (1), the tax incentives under (2) - (8) may be granted for a period not exceeding five years, including the ITH period. Thereafter, the regular corporate income tax will be imposed.

Under no circumstances will value-added tax or local (provincial, city or municipal) taxes be used as investment tax incentives.
Sunset provisions for existing incentives
Registered activities with an existing ITH incentive will continue to be available for the ITH for the remaining period as originally granted or for a period of five years, whichever occurs first.

Registered activities that received the 5% Gross Income Tax (GIT) incentive will be allowed to continue under the following schedule:

- Two years for activities that received the GIT incentive for more than 10 years.
- Three years for activities that received the GIT incentive between 5 and 10 years.
- Five years for activities that received the ITH or the GIT incentive below five years, provided that the 5% GIT shall commence after the ITH period has lapsed and only for the remaining period within the five-year period.

Endnote
1. The Philippines allows a corporate taxpayer to choose either a standard or itemized deduction.
2. The term refers to machinery, equipment, and components that are directly and reasonably needed in the registered activity of the enterprise.
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