REPUBLIKA NG PILIPINAS
KAGAWARAN NG PANANALAPI
KAWANIHAN NG RENTAS INTERNAS

Quezon City

November 26, 2008

REVENUE REGULATIONS NO. 16 - 2008

SUBJECT : IMPLEMENTING THE PROVISIONS OF SECTION 34(L) OF THE TAX CODE OF 1997, AS AMENDED BY SECTION 3 OF REPUBLIC ACT NO. 9504, DEALING ON THE OPTIONAL STANDARD DEDUCTION (OSD) ALLOWED TO INDIVIDUALS AND CORPORATIONS IN COMPUTING THEIR TAXABLE INCOME

TO : ALL REVENUE OFFICERS AND OTHERS CONCERNED

SECTION 1. SCOPE. - Pursuant to Sec. 244, in relation to Sec. 3 of Republic Act No. 9504 (RA 9504) amending Sec. 34(L) of the Tax Code of 1997 (Code), as amended, these Regulations are hereby promulgated in order to implement the provisions on Optional Standard Deduction (OSD) for individuals and corporations.

SEC. 2. PERSONS COVERED. - The following may be allowed to claim OSD in lieu of the itemized deductions (i.e. items of ordinary and necessary expenses allowed under Sections 34 (A) to (J) and (M), Section 37, other special laws, if applicable):

1. Individuals:
    i. Resident Citizen
    ii. Non-resident citizen
    iii. Resident Alien
    iv. Taxable estates and trusts

2. Corporations:
    i. Domestic corporation
    ii. Resident foreign corporation

SEC. 3. DETERMINATION OF THE AMOUNT OF OPTIONAL STANDARD DEDUCTION FOR INDIVIDUALS. - The OSD allowed to individual taxpayers shall be a maximum of forty percent (40%) of gross sales or gross receipts during the taxable year. If the individual is on the accrual basis of accounting for his income and deductions, the OSD shall be based on the gross sales during the taxable year. On the other hand, if the individual employs the cash basis of accounting for his income and deductions, the OSD shall be based on his gross receipts during the taxable year.

It should be emphasized that the "*cost of sales*" in case of individual seller of goods, or the "*cost of services*" in the case of individual seller of services, are not allowed to be deducted for purposes of determining the basis of the OSD pursuant to this Section inasmuch as the law (RA 9504) is specific as to the basis thereof which states

that for individuals, the basis of the 40% OSD shall be the "gross sales" or "gross receipts" and not the "gross income".

For other individual taxpayers allowed by law to report their income and deductions under a different method of accounting (e.g. percentage of completion basis, etc.) other than cash and accrual method of accounting, the "gross sales" or "gross receipts" pursuant to this Section shall be determined in accordance with said acceptable method of accounting.

SEC. 4. DETERMINATION OF THE AMOUNT OF OPTIONAL STANDARD DEDUCTION FOR CORPORATIONS. - In the case of corporate taxpayers subject to tax under Sections 27(A) and 28(A)(1) of the Code, as amended, the OSD allowed shall be in an amount not exceeding forty percent (40 %) of their gross income.

For purposes of these Regulations, **"Gross Income"** shall mean the gross sales less sales returns, discounts and allowances and cost of goods sold. "*Gross sales*" shall include only sales contributory to income taxable under Sec. 27(A) of the Code. "*Cost of goods sold*" shall include the purchase price or cost to produce the merchandise and all expenses directly incurred in bringing them to their present location and use.

For trading or merchandising concern, "*cost of goods sold*" means the invoice cost of goods sold, plus import duties, freight in transporting the goods to the place where the goods are actually sold, including insurance while the goods are in transit.

For manufacturing concern, "*cost of goods sold*" means all costs incurred in the production of the finished goods such as raw materials used, direct labor and manufacturing overhead, freight cost, insurance premiums and other costs incurred to bring the raw materials to the factory or warehouse. The term may be used interchangeably with *"cost of goods manufactured and sold"*.

In the case of sellers of services, the term "*gross income*" means the "gross receipts" less sales returns, allowances, discounts and cost of services. "*Cost of services*" means all direct costs and expenses necessarily incurred to provide the services required by the customers and clients including (a) salaries and employee benefits of personnel, consultants and specialists directly rendering the service, and (b) cost of facilities directly utilized in providing the service such as depreciation or rental of equipment used and cost of supplies: *Provided, however,* that "*cost of services*" shall not include interest expense except in the case of banks and other financial institutions. The term "gross receipts" as used herein means amounts actually or constructively received during the taxable year. However, for taxpayers engaged as sellers of services but employing the accrual basis of accounting for their income, the term "*gross receipts*" shall mean amounts earned as gross revenue during the taxable year.

The items of gross income under Section 32(A) of the Code, as amended, which are required to be declared in the income tax return of the taxpayer for the taxable year are part of the gross income against which the OSD may be deducted in arriving at taxable income. Passive incomes which have been subjected to a final tax at source shall not form part of the gross income for purposes of computing the forty percent (40%) optional standard deduction.

For other taxpayers allowed by law to report their income and deductions under a different method of accounting (e.g. percentage of completion basis, etc.)

other than cash and accrual method of accounting , the "gross income" pursuant to this Section shall be determined in accordance with said acceptable method of accounting.

SEC. 5. ILLUSTRATIVE EXAMPLES IN DETERMINING THE BASIS OF THE 40% OSD FOR INDIVIDUALS AND CORPORATIONS. – Suppose a retailer of goods, whose accounting method is under the accrual basis, has a gross sales of P1,000,000.00 with a cost of sales amounting to P800,000. The computation of the OSD for individuals and corporations shall be determined as follows:

	If Individual	If Corporation
Gross Sales	P 1,000,000	P 1,000,000
Less: Cost of Goods Sold		800,000
Basis of the OSD	P1,000,000	P 200,000
X OSD Rate (maximum)	.40	.40
OSD Amount	P 400,000	P 80,000

If the taxpayer opts to use the OSD in lieu of the itemized deduction allowed under Section 34 of the Code, as amended, his/ its net taxable income shall be as follows :

	If Individual	If Corporation
Gross Sales	P 1,000,000	P 1,000,000
Less : Cost of Sales	-	800,000
Gross Sales/Gross Income	P 1,000,000	P 200,000
Less : OSD (maximum)	400,000	80,000
Net Income	**P 600,000**	**P 120,000**

SEC. 6. DETERMINATION OF THE OPTIONAL STANDARD DEDUCTION FOR GENERAL PROFESSIONAL PARTNERSHIPS (GPPs) AND PARTNERS OF GPPs. – Pursuant to Sec. 26 of the Code, a GPP is not subject to income tax imposed under Title II thereof. However, the partners shall be liable to pay income tax on their separate and individual capacities for their respective distributive share in the net income of the GPP.

Sec. 26 of the Code likewise provides that- *"For purposes of computing the distributive share of the partners, the net income of the GPP shall be computed in the same manner as a corporation."* As such, a GPP may claim either the itemized deductions allowed under Section 34 of the Code or in lieu thereof, it can opt to avail of the OSD allowed to corporations in claiming the deductions in an amount not exceeding forty percent (40 %) of its gross income. The net income determined by either claiming the itemized deduction or OSD from the GPP's gross income is the distributable net income from which the share of each partner is to be determined. Each partner shall report as gross income his distributive share, actually or constructively received, in the net income of the partnership.

The GPP is not a taxable entity for income tax purposes since it is only acting as a *"pass-through"* entity where its income is ultimately taxed to the partners comprising it. In computing taxable income defined under Section 31 of the Code, the individual partner can still claim either itemized deductions or optional standard deduction from his share in the net income of the GPP because said share is considered as gross income in the hands of the partner *(Section 32(A)(11) and Section 26, NIRC).* If the GPP availed of the itemized deduction in computing its net income, the partners may still either claim itemized deduction or OSD from said share, *provided, that,* in claiming itemized deductions, the partner is precluded from claiming expenses already claimed by the GPP. In fine, if the GPP claimed itemized deductions and a partner is also claiming itemized deductions, the deductions allowed to the partner must be the ordinary and necessary expenses for the practice of profession which were not yet claimed by the GPP in computing its net income. The GPP and each of the partners are entitled to their own election of deductions to claim during the taxable year thereby resulting to four possibilities, namely: (1) the GPP may claim itemized deductions in computing net income and a partner may also claim itemized deductions in computing his taxable income; or (2) the GPP may claim OSD in computing net income while a partner may claim itemized deductions in computing his taxable income; or (3) the GPP may claim itemized deductions in computing net income while a partner may claim OSD in computing his taxable income; or (4) the GPP may claim OSD in computing net income and a partner may also claim OSD in computing his taxable income.

SEC.7. OTHER IMPLICATIONS OF THE OPTIONAL STANDARD DEDUCTION. – A taxpayer who elected to avail of the OSD not exceeding forty percent (40%) of gross sales or gross receipts, in case of an individual taxable under Secs. 24(A) and 25(A)(1) of the Tax Code, or forty percent (40%) of gross income, in case of a corporation subject to tax under Sec. 27(A) or 28(A)(1) of the same Code shall signify in his/its return such intention, otherwise he/it shall be considered as having availed himself of the itemized deductions allowed under Sec. 34 of the Code. Once the election to avail the OSD is signified in the return, it shall be irrevocable for the taxable year for which the return is made. This means that a taxpayer who initially filed a return availing

OSD is precluded from amending said return in order to shift to the itemized deductions. An individual taxpayer who is entitled to and claimed the OSD shall not be required to submit with his tax return such financial statements otherwise required under the Code. Provided, that, except when the Commissioner otherwise permits, the said individual shall keep such records pertaining to his gross sales or gross receipts. In the case of a corporation, however, said corporation is still required to submit its financial statements when it files its annual income tax return and to keep such records pertaining to its gross income as herein defined.

In the filing of the quarterly income tax returns, the taxpayer may opt to use either the itemized deduction or OSD. However, in filing the final adjustment income tax return, the taxpayer must make a choice as to what method of deduction it or he shall employ for the purpose of determining its/his taxable net income for the entire year. The taxpayer is, thus, not allowed to use a hybrid method of claiming its/his deduction for one taxable year.

SEC. 8. TRANSITORY PROVISIONS. - For taxable period 2008 which is the initial year of the implementation of the 40% OSD under RA 9504 which modified the OSD for individuals from 10% of gross income to 40% of gross sales/ gross receipts and introduced the OSD as an alternative deduction for corporations, the 40% maximum deduction shall only cover the period beginning the effectivity of RA 9504. RA9504 became effective July 06, 2008. However, in order to simplify and provide ease of administration during the transition period, July 1, 2008 shall be considered as the start of the period when the 40% OSD may be allowed.

In the case of an individual taxpayer, he is given the option to either use the itemized method of deduction or the 40% OSD in the filing of his quarterly income tax return covering the third quarter ending September 30, 2008. However, if in the filing of his annual income tax return and he chooses OSD to be his method of deduction, the rate of OSD to be applied for the period covering January 2008 to June 30, 2008 shall only be 10% of gross income (i.e., where gross income is determined by deducting cost of sales from the gross sales or gross receipts) while the rate of OSD for the period covering July 01, 2008 to December 31, 2008 shall be 40% of gross sales/gross receipts.

Example. - Mr. ERA, a retailer of goods, uses the accrual method of accounting in reporting his income and expenses. For the period January to June 30, 2008, he reported his net income using the itemized method of deduction where his gross sales for the period amounted to P1,000,000 and his cost of sales for same period amounted to P600,000. With the effectivity of RA 9504, he decided to use the 40% OSD in claiming his business expenses for the third quarter covering July 01 to September 30, 2008. His gross sales for said period amounted to P700,000 where he claimed a 40% OSD (P700,000 x 40%) or P280,000 in lieu of his actual business expenses of P250,000 consisting of cost of sales of P200,000 and P50,000 operating expenses. For the last quarter of Year 2008, his gross sales amounted to P900,000 while his cost of sales for the same last quarter amounted to P500,000. If Mr. ERA decides to use the OSD method of deduction when he files his annual income tax return, his net income under the OSD method of determining deduction shall be as follows:

(a) To compute for OSD allowed for the various periods covering the Year 2008 -

	Jan. to June 30	July 01 to Sept.	Oct . to December
Gross Sales	P 1,000,000	P 700,000	P 900,000
Less : Cost of Sales	600,000	-	-
Gross Sales / Gross Income	P 400,000	P 700,000	P 900,000
X OSD rate (maximum)	.10	.40	.40
OSD	**P 40,000**	**P 280,000**	**P 360,000**

(b) To compute for the net income of Mr. ERA under OSD the same shall be determined as follows :

Gross Sales (January to December 2008) (P1,000,000 plus P700,000 plus P900,000)	P2,600,000
Less : Cost of Sales (from January to June 30, 2008)	600,000
Less : OSD (P 40,000 plus P280,00 plus P 360,000)	680,000
Net Income for Year 2008	**P 1,320,000**

As can be gleaned from the above illustration, an individual taxpayer is not allowed to compute his net income for Year 2008 partly by claiming itemized deduction and partly by using OSD. The choice of deduction to be used shall only be for one method of deduction (i.e., either itemized or OSD) to be applied for the entire year of Year 2008.

The provisions of Sec. 6 above preventing the use of the hybrid method of deduction for the entire taxable year, notwithstanding, a corporate taxpayer who opts

to use the OSD method in claiming its deductions when filing its annual income tax return for Year 2008 shall be allowed to use the 40% OSD only in respect to the period beginning July 01, 2008 while the method of deduction to be used prior thereof shall remain to be under the itemized deduction method.

Example. - GSV Corporation, a retailer of goods, uses the accrual method of accounting in declaring its income and expenses under calendar year basis. For the period January to June 30, 2008, it reported its net income using the itemized method of deduction where its gross sales for the period amounted to P1,000,000 and its cost of sales for same period amounted to P600,000 as well as operating expenses of P100,000. With the effectivity of RA 9504, it decided to use the 40% OSD in claiming its business expenses for the third quarter covering July 01 to September 30, 2008. Its gross sales for said period amounted to P700,000 where it claimed a 40% OSD of gross income with cost of sales amounting to P 300,000 or P160,000 (i.e, P700,000 less P300,000 = P400,000 x 40%) in lieu of its actual operating expenses of P50,000. For the last quarter of Year 2008, its gross sales amounted to P900,000 while its cost of sales for the same last quarter amounted to P600,000 and operating expenses of P150,000. If GSV Corporation decides to use the OSD method of deduction when it files its annual income tax return, its net income for the year shall be computed as follows:

(a) To compute for OSD allowed for the period from July 06 to December 31, 2008

	July 01 to Sept.	Oct. to December
Gross Sales	P 700,000	P 900,000
Less : Cost of Sales	300,000	600,000
Gross Sales / Gross Income	P 400,000	P 300,000
X OSD rate (maximum)	.40	.40
OSD	**P 160,000**	**P 120,000**

(b) To compute for the net income of GSV Corporation , the net income for the period from January 1 to July 05, 2008 shall be computed using the itemized method of deduction while the 40% OSD shall be applied for the period covering July 06, 2008 to December 31, 2008.

Gross Sales (January to December 2008)		P2,600,000
(P1,000,000 plus P700,000 plus P900,000)		
Less : Cost of Sales		
January to June 30	P 600,000	

July 01 to September 30	300,000		
October 1 to December 31	600,000		1,500,000
Gross Income			P 1,100,000
Less : Deductions			
Itemized Deductions			
(Operating expenses			
from January to June 30)		100,000	
Optional Standard Deduction (OSD)			
(July 01 to September 30) P160,000			
(October 1 to December 31)	120,000	280,000	380,000
Net Income of GSV Corporation			**P 720,000**

SEC. 8. REPEALING CLAUSE. - All regulations, rules, orders or portions thereof which are inconsistent with the provisions of these Regulations are hereby amended, modified or repealed accordingly.

SEC. 9. EFFECTIVITY CLAUSE. - These Regulations shall take effect on July 6, 2008, the effectivity date of R.A. No. 9504.

(Original Signed)
MARGARITO B. TEVES
Secretary of Finance

Recommending Approval:

(Original Signed)
SIXTO S. ESQUIVIAS IV
Commissioner of Internal Revenue