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LAW REDUCING CORPORATE INCOME TAX APPROVED

Finally, the much-awaited law that reduces the rate of corporate income tax in the Philippines was approved on 26 March 2021.

Republic Act No. 11534, otherwise known as the Corporate Recovery and Tax Incentives for Enterprises ("CREATE") Act, amends certain provisions of the National Internal Revenue Code, the most notable of which is the introduction of a two-tiered approach to income taxation of domestic corporations beginning 01 July 2020, in that **the general income tax rate of corporations shall be 25% of its taxable income (from the previous 30% rate)**. However, for domestic corporations with taxable income not exceeding Php5 million and with total assets not exceeding Php100 million (excluding the land on which the business entity's office, plant and equipment are situated), the tax rate is further reduced to only 20% of its taxable income.

Other salient provisions of the law are:

1. Including "one-person corporations" in the list of corporate taxpayers;
2. Repealing the provision giving domestic corporations the option to be taxed at 15% of gross income;
3. Reducing the rate of the minimum corporate income tax for the period 01 July 2020 to 30 June 2023 to only 1% of gross income (from the usual 2%);
4. Reducing the rate of preferential income tax of non-profit proprietary educational institutions and hospitals to only 1% of its taxable income (instead of 10%) for the period beginning 01 July 2020 until 30 June 2023;
5. Repealing the provision in the NIRC concerning the imposition of the improperly accumulated earnings tax;
6. Increasing the rate of capital gains tax on the sale of unlisted shares of a domestic corporation to 15% of the net capital gain;
7. Adjusting the deductible interest expense; i.e., the interest expense shall be reduced by twenty percent (20%) of the interest income subjected to final tax;
8. Granting businesses an additional deduction from taxable income equivalent to one-half of the value of labor training expenses incurred for skills development of enterprise-based trainees enrolled in public senior high schools, public higher education institutions, or public technical and vocational institutions duly covered by an apprenticeship agreement under the Labor Code, and for which a proper certification is secured from the DepEd, TESDA or CHED, provided that such deduction shall not exceed 10% of direct labor wage;

9. Exempting from income tax all dividends received by domestic corporations. However, for foreign-sourced dividends to be exempt, the following conditions must be fulfilled:
   (a) The dividends are actually received or remitted into the Philippines;
   (b) The funds from such dividends are reinvested in the business operations of the domestic corporation within the next taxable year from the time the dividends were received;
   (c) Such dividends were used to fund any of the following: (a) working capital requirements, (b) capital expenditures, (c) dividends payments, (d) investment in domestic subsidiaries, and (e) infrastructure projects; and
   (d) The domestic corporation holds directly at least 20% of the outstanding shares of the foreign corporation for a minimum of 2 years at the time of dividends distribution.
10. Expanding and clarifying the scope of tax-free exchanges, in that they shall no longer be limited to "a plan of merger or consolidation," rather, to a "*plan of reorganization*." Tax-free exchange pursuant to *reorganization* includes the following:
   (a) Exchange of property solely for shares pursuant to a plan of merger or consolidation;
   (b) Acquisition by a corporation of stock of another corporation which is in its (the acquiring corporation's) control, or, the acquisition by a corporation of stock of another corporation, if, immediately after the acquisition, the acquiring corporation has control of the acquired corporation;
   (c) Acquisition by a corporation in exchange solely for shares, of substantially all of the properties of another corporation;
   (d) Recapitalization, whereby the stocks and bonds of a corporation are readjusted, or an agreement of all stockholders and creditors, to make adjustments in either the capital structure, or in the debt structure, or both; and
   (e) Reincorporation, which means the formation of the same corporate business with the same assets and the same stockholders surviving under a new charter.

Additionally, the CREATE Act retained (and incorporated as well the relevant jurisprudence on the matter) the freedom from income tax and value added tax, of exchange of properties for shares whereby the <u>transferor, or transferors, collectively, gains or maintains control of said corporation</u>. The law likewise incorporates the rule that prior confirmation of, or issuance of confirmatory ruling by, the Bureau of Internal Revenue, shall not be required for purposes of availing of the tax exemption. Finally, in determining the presence of "control", the <u>collective and not the individual ownership</u> of all classes of shares entitled to vote of the transferor or transferors shall be used.

11. Reducing the corporate income tax rate of resident foreign corporations effective 01 July 2020 to 25% of their taxable income;
12. Removing the tax-exemption of offshore banking units and the preferential tax treatment of income from transactions with offshore banking units;
13. Subjecting Regional Operating Headquarters to regular corporate income tax at 25% effective 01 January 2022;

14. Reducing the corporate income tax rate of non-resident foreign corporations effective 01 January 2021 to 25% of their taxable income;
15. Reducing the rate of dividends tax on the dividends received by non-resident foreign corporations from domestic corporations effective 01 January 2021 to 25% of their taxable income. However, this rate shall be reduced further to 15% if the if the tax sparing rule is present;
16. Including the Home Development Mutual Fund (HDMF) in the list of exempt GOCCs;
17. Including in the list of VAT-exempt materials the journals and other educational reading materials covered by the UNESCO Agreement on the importation of educational, scientific and cultural materials which are not devoted principally to the publication of paid advertisements;
18. Moving the VAT-exemption of medicines for cancer, mental illness, tuberculosis, and kidney diseases to 01 January 2021 (from 01 January 2023);
19. Exempting from VAT, effective 01 January 2021 to 31 December 2023, capital equipment for the production of personal productive equipment necessary for Covid19 prevention, all drugs, vaccines and medical device, and all materials directly necessary for the production of such drugs, which are used for the treatment of Covid19;
20. Reducing the percentage tax rate to 1% from the usual 3% effective 01 July 2020 to 30 June 2023.

The law also rationalized the tax incentives granted to export as well as domestic enterprises, and provided mechanisms and conditions for the availment of those incentives.

This material is for information purposes only and does not constitute the giving of legal advice. For clarifications/queries concerning the provisions of the CREATE Act, you may contact our Tax Partners:

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