

**[BIR REVENUE REGULATIONS NO. 16-2008,
November 26, 2008]**

**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**

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.

SECTION 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

SECTION 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.

SECTION 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) (I) 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.

SECTION 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	P1,000,000	P1,000,000
Less: Cost of Goods Sold		800, 000
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Basis of the OSD	P1,000,000	P 200,000
x OSD Rate (maximum)	.40	.40
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OSD Amount	P <u>400,000</u>	P <u>80,000</u>

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	P1,000,000	P1,000,000
Less: Cost of Sales	---	800, 000
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Basis of the OSD	P1,000,000	P 200,000
x OSD Rate (maximum)	400,000	80,000
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Net Income	P 600,000	P 120,000

SECTION 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 GP P. 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.

SECTION 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.

SECTION 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. RA 9504