[BIR REVENUE REGULATIONS NO. 2-2001, February 12, 2001]

IMPLEMENTING THE PROVISION ON IMPROPERLY ACCUMULATED EARNINGS TAX UNDER SECTION 29 OF THE TAX CODE OF 1997

SECTION 1. *Scope* -Pursuant to Section 244 of the Tax Code of 1997, in relation to Section 29 of the same Code, these Regulations are being issued to prescribe the rules governing the imposition of Improperly Accumulated Earnings Tax.

SEC. 2. *Concept of Improperly Accumulated Earnings Tax (IAET)* - Pursuant to Section 29 of the Code, there is imposed for each taxable year, in addition to other taxes imposed under Title II of the Tax Code of 1997. a tax equal to 10%of the improperly accumulated taxable income of corporations formed or availed of for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting the earnings and profits of the corporation to accumulate instead of dividing them among or distributing them to the shareholders. The rationale is that if the earnings and profits were distributed, the shareholders would then be liable to income tax thereon, whereas, if the distribution were not made to them, they would incur no tax in respect to the undistributed earnings and profits of the corporation. Thus, a tax is being imposed of its earnings, and as a form of deterrent to the avoidance of tax upon shareholders who are supposed to pay dividends tax on the earnings distributed to them by the corporation.

The touchstone of the liability is the purpose behind the accumulation of the income and not the consequences of the accumulation. Thus, if the failure to pay dividends is due to some other causes, such as the use of undistributed earnings and profits for the reasonable needs of the business, such purpose would not generally make the accumulated or undistributed earnings subject to the tax. However, if there is a determination that a corporation has accumulated income beyond the reasonable needs of the business, the 10% improperly accumulated earnings tax shall be imposed.

SEC. 3. *Determination of Reasonable Needs of the Business* - An accumulation of earnings or profits (including undistributed earnings or profits of prior years) is unreasonable if it is not necessary for the purpose of the business, considering all the circumstances of the case. To determine the "reasonable needs" of the business in order to justify an accumulation of earnings, these Regulations hereby adhere to the so-called "Immediately Test" under American jurisprudence as adopted in this jurisdiction. Accordingly, the term "reasonable needs of the business" are hereby construed to mean the immediate needs of the business, including reasonably anticipated needs. In either case, the corporation should be able to prove an immediate need for the accumulation of the earnings and profits, or the direct correlation of anticipated needs to such accumulation of profits. Otherwise, such accumulation would be deemed to be not for the reasonable needs of the business, and the penalty tax would apply.

For purposes of these Regulations, the following constitute accumulation of earnings for the reasonable needs of the business:

a) Allowance for the increase in the accumulation of earnings up to 100% of the paid-up capital of the corporation as of Balance Sheet date, inclusive of accumulations taken from other years;

b) Earnings reserved for definite corporate expansion projects or programs requiring considerable capital expenditure as approved by the Board of Directors or equivalent body;

c) Earnings reserved for definite corporate expansion projects or programs requiring considerable capital expenditure as approved by the Board of Directors or equivalent body;

d) Earnings reserved for compliance with any loan covenant or pre-existing obligation established under a legitimate business agreement;

e) Earnings required by law or applicable regulations to be retained by the corporation or in respect of which there is legal prohibition against its distribution;

f) In the case of subsidiaries of foreign corporations in the Philippines, all undistributed earnings intended or reserved for investments within the Philippines as can be proven by corporate records and/or relevant documentary evidence.

SEC. 4. *Coverage.* The 10% Improperly Accumulated Earnings Tax (IAET) is imposed on improperly accumulated taxable income earned starting January 1, 1998 by domestic corporation as defined under the Tax Code and which are classified as closely-held corporations. Provided, however, that Improperly Accumulated Earnings Tax shall not apply to the following corporations:

a) Banks and other non-bank financial intermediaries;

b) Insurance companies;

c) Publicly-held corporations;

d) Taxable partnerships;

e) General professional partnerships;

f) Non-taxable joint ventures; and

g) Enterprises duly registered with the Philippine Economic Zone Authority (PEZA) under R.A. 7916, and enterprises registered pursuant to the Bases Conversion and Development Act of 1992 under R.A. 7227, as well as other enterprises duly registered under special economic zones