WHEN ACCOUNTING MEETS TAX: HOW THE INTERNATIONAL ACCOUNTING STANDARDS AFFECT PHILIPPINE INCOME TAXATION*

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ABSTRACT

Globalization opened new doors to investors all over the world. Cross-border trading and investments have become commonplace. Language barriers have been broken down, and not soon after were efforts to break down financial language barriers as well. The solution to the problem of non-comparability of financial statements (the main bases for prudent investment decisions) is the adoption across countries of the International Accounting Standards (IAS) and the International Financial Reporting Standards (IFRS).

To be competitive in the international market, the Philippines adopted most of the IAS and IFRS in 2005.[1]. Mr. Wilson P. Tan, Head of the Accounting Standards Group of SGV & Co. (Ernst & Young), in his presentation in the PICPA Annual National Convention (2006)[2]. noted that the IAS and IFRS has broad and deep business implications, such as on tax planning, management reporting systems, investor relations, employee and executive compensation, employee benefit plans, performance indicators, corporate finance and structured financial products, and financial accounting and reporting.

This paper will focus on the effects of the IAS on the income tax computation. As we all know, taxes are the very lifeblood of the government whose prompt and certain availability is an imperious need.[3]. In the Philippines, tax computation is intimately connected with accounting. Inherent differences between

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[1] In the Philippines, the IAS is called the Philippine Accounting Standards (PAS) and the IFRS is called the Philippine Financial Reporting Standards (PFRS).

[2] Wilson P. Tan.34 'Surviving IFRS', Available -http://www.picpa.com.ph/articles/WPT%20%20Dec%202006%20PICPA%20ANC%20Surviving%20IFRS_1.pdf- December 20, 2006 [7]

[3] Commissioner of Internal Revenue vs. Pineda, 21 SCRA 110 (1967).

tax accounting, coupled with the new differences brought about by the IAS, spell confusion in the minds of taxpayers. Considering the absence of clear cut tax guidelines, tax compliance and consequently, tax collection is in jeopardy.

To show that a tax-accounting disparity actually exists, this paper outlines the differences between accounting and tax treatment of the items of gross income and allowable deductions. It also shows the past and current solutions put forth by the government, and its efficacy and shortcomings. This paper will also show how other countries - the United States, United Kingdom, and Germany -- are responding to the changes brought about by the IAS. Finally, this paper recommends the following: a) the introduction of short term stop-gap and long term solutions ranging from a careful study of the IAS, b) the training of taxpayers and revenue examiners, c) the issuance of definitive revenue regulations to set clear guidelines on how to compute income taxes (taking the IAS into consideration), d) certain amendments to the Tax Code, and e) the issuance of a definite position on the book-tax (accounting and tax) conformity debate.

I. INTRODUCTION

With the globalization of world economy and trade liberalization, international trade barriers are being eroded. Doing business across borders is now possible and investors could invest their money anywhere in the globe. However, to convince them to part with their capital, the financial statements of prospective investments should be transparent, reliable, and comparable. Previously, an objective comparison of financial statements was almost impossible with the different accounting standards in place in different countries.

In order to set a "level playing field", countries around the world including the Philippines have adopted the new international accounting standards (IAS). It is envisioned that with the adoption of the IAS, we will be able to enhance the comparability and understandability of financial statements, which will in effect be able to develop the country's global competitiveness as well as promote greater investor protection.[4] Thus, from an investor's point of view, the shift to IAS is clearly beneficial.

However, from the point of view of tax authorities, the shift to IAS brings about many problems. In the Philippines, under Section 43 of the Tax Code, as a general rule, taxable income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books

[4] 'Primer on SEC's Initial Adoption and Implementation of International Accounting Standards (IAS) / Statement of Financial Accounting Standards (SFAS)' Available http://www.sec.gov.ph/primer/IAS%20primer.pdf.. April 3, 2002 [3-4].

of such taxpayer.[5] A literal reading of this provision implies that the income for financial accounting purposes would be the same for tax purposes. However, the latter portion of said Section 43 states that, "if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner clearly reflects the income."

Over the years, Philippine tax authorities, usually looking to US precedents, have developed certain tax principles which deviate from that of accounting. Thus, for particular transactions which have a set tax treatment, differences between the tax treatment and accounting treatment will necessarily arise,[6] and these shall be treated as reconciling items for purposes of computing taxable income. Consequently, with the shift to IAS, the number of reconciling items has more than doubled.[7]

This paper aims to analyze the effects of the new IAS on Philippine income taxation, specifically the differences between accounting and tax treatment of certain transactions before and after the adoption of certain IAS,[8] and the Bureau of Internal Revenue's stop-gap solution to the current problem. This paper will also show the view from the international plane — how the United States, United Kingdom, and Germany are responding to changes brought about by the IAS. With this background, we hope to help the country cope with this sweeping change - a change that is here to stay.

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[5] SEC. 43. General Rule. — The taxable income shall be computed upon the basis of the taxpayers annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner clearly reflects the income. If the taxpayers annual accounting period is other than a fiscal year, as defined in Section 22(Q), or if the taxpayer has no annual accounting period, or does not keep books, or if the taxpayer is an individual, the taxable income shall be computed on the basis of the calendar year.

[6] Revenue Memorandum Circular (hereinafter RMC) 22-2004, April 12, 2004, provides:

> "In case of difference between the provisions of the Tax Code and the rules and regulations issued implementing the said Tax Code, on one hand, and the generally accepted accounting principles and the generally accepted auditing standards, on the other hand, the provisions of the Tax Code and the rules and regulations issued implementing the said Tax Code shall prevail. xxx"

[7] Lina Figueroa. 'The Extra Challenge: ITR Preparation Under The New Accounting Standards' Available .http://www.punongbayan-araullo.com/pnawebsite/pnahome.nsf/section docs/KS509D 31-1-06.. January 31, 2006 [6]

[8] IAS 16 on Property, Plant, and Equipment , IAS 19 on employee benefits, IAS 23 on borrowing costs, IAS 36 on impairment losses, IAS 37 on Provisions, Contingent Liabilities and Contingent Assets, and IAS 38 on Intangible Assets, among others.

A. PHILIPPINE TAXATION, IN GENERAL

The Philippine System of Taxation was adopted from the United States. Upon the American occupation, there was already a fairly complete system of taxation in force in the country.[9] This system was continued in force by the military authorities who at the same time introduced few changes until the Civil Government assumed charge of the subject. Meanwhile, in the United States, income was selected as the norm of taxation.[10] The policy was to come up with a fair system of taxation by placing the burden of tax on those best able to pay thereby mitigating the evils arising from inequalities of wealth by a progressive scheme of taxation. Thus, the United States adopted its Income Tax Law which was later on extended to the Philippine Islands.

The first Philippine income tax law enacted by the Philippine Legislature was Act No. 2833, which took effect on January 1, 1920. Act No. 2833 substantially reproduced the United States (U.S.) Revenue Law of 1916 as amended by U.S. Revenue Law of 1917. Being a law of American origin, the authoritative decisions of the official charged with enforcing it in the U.S. had peculiar persuasive force in the Philippines.[11]

Philippine tax law developed on its own over time but American influence continues to permeate our tax system such that up to the present, American jurisprudence and writings are referred to in the interpretation of our own tax laws.

B. PHILIPPINE ACCOUNTING SYSTEM

The Accounting Standards Council (hereinafter "ASC"), established by the Philippine Institute of Certified Public Accountants (PICPA), was formally launched on November 18, 1981 to formalize the accounting standard-setting process in the Philippines.[12] Its main function is to establish and improve accounting standards that will be generally accepted in the Philippines. Such standards would generally be based on: (1) existing practices in the Philippines; (2) research or studies to be undertaken at the direction of the Chairman of the Council; (3) available literature on the topic or subject under study which were prepared locally or internationally; and (4) statements, recommendations, studies, or standards, etc., issued by other standard-setting bodies such as the International

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[9] Churchill vs. Rafferty, 32 Phil 587 (1915).

[10] Madrigal vs. Rafferty, 38 Phil 418 (1918).

[11] Commissioner of Internal Revenue vs. Juliane Baier-Nickel, 500 SCRA 93-94 (2006), citing 1 F. Dalupan, NATIONAL INTERNAL REVENUE CODE ANNOTATED, 25 (1964), and 1 J. Arañas, ANNOTATIONS AND JURISPRUDENCE ON THE NATIONAL INTERNAL REVENUE CODE, as Amended, 34 (1963).

[12] The Accounting Standards Council (hereinafter "ASC"), Available http://www.picpa.com.ph/adb/setting str.html [2]

Accounting Standards Committee (hereinafter "IASC"), and the Financial Accounting Standards Board (hereinafter "FASB").[13]

As part of its mandate, the ASC issues Statements of Financial Accounting Standards and Interpretations. These statements represent the generally accepted accounting principles in the Philippines. To be reliable and acceptable, financial reports of corporations and other business entities are prepared using these Statements as bases.

In the past, the practice of ASC is to add to or adjust an existing IAS in accordance with the accounting practice in the Philippines and adopt the same as the Philippine accounting standard in the form of Statement of Financial Accounting Standards (hereinafter "SFAS").[14] The adjustments made resulted to inconsistencies between SFAS and IAS. Towards the end of 2000, the ASC and SEC implemented a project to replace existing SFAS with their counterpart IAS.[15] Since the former are numbered according to topic, their numberings were aligned with the equivalent IAS. With the adoption of most of the IAS in 2005, the Philippine SFAS (or Philippine GAAP[16] and GAAS[17]) is one with IAS, thereby unifying the Philippine accounting system with IAS, and the world.

C. INTERNATIONAL ACCOUNTING STANDARDS (IAS)

The International Accounting Standards or IAS is a set of globally recognized accounting standards and procedures relating to the presentation of financial statements.[18] It is a set of standards that prescribes how certain transactions and other events should be reflected in the financial statements and compliance therewith is a must for a fair and credible presentation of financial statements.

The IAS is issued by the International Accounting Standards Council or IASC. Formed in 1973, the IASC was originally formed by the accountancy bodies of Australia, Canada, France, Germany, Ireland, Mexico, Netherlands, United Kingdom, and the United States.[19] Over time, more nations adopted IAS in their accounting system.

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[13] *Id* at [1].

[14] 'Primer on SEC's Initial Adoption and Implementation of International Accounting Standards (IAS) / Statement of Financial Accounting Standards (SFAS)' Available http://www.sec.gov.ph/primer/IAS%20primer.pdf. [6]

[15] *Id*

[16] Generally Accepted Accounting Principles

[17] Generally Accepted Auditing Standards

[18] See note 14, *supra*..

[19] *Id*

The IAS is one of the sources of Philippine accounting standards. Through the years, the ASC adopted some IAS suitable to the Philippine setting but in the year 2005, the Securities and Exchange Commission (hereinafter "SEC") adopted the implementation of most of the IAS to improve the quality, comparability and transparency of financial information.

D. TAX-ACCOUNTING DISPARITY

In the Philippines, the tax and accounting systems are two different systems governed by separate bodies and subject to different sets of rules, regulations and standards. Taxation is principally governed by Republic Act 8424 or the National Internal Revenue Code and the rules and regulations implementing it, while accounting is subject to Philippine Accounting Standards (PAS) and Philippine Financial Reporting Standards (PFRS). Further, taxation is the concern of the BIR while generally accepted accounting principles in the Philippines are adopted by the ASC.

With the requirement of adoption of most of the IAS in the year 2005, the differences between the accounting and tax treatments of the taxability of income and deductibility of expenses became more apparent. The government has not come up with a single legislation or regulation codifying the rules and regulations. Though there are some rulings on IAS-related matters found in jurisprudence and BIR rulings, these apply to corporations on a case-to-case basis. Hence, taxpayers are still at loss as to the proper method of determining their taxable income.

Some of the effects of the IAS on the computation of corporate income taxes have been articulated by Lina P. Figueroa in her article entitled, "The extra challenge: ITR preparation under the new accounting standards"[20]. She noted that the changes introduced by the new IAS have widened the gap between the accounting rules and the tax rules and have, as a consequence, created more complexities in tax reporting and compliance. The differences between financial reporting and tax accounting will have to be reported as reconciliation items in the income tax returns. The list of potential reconciling items under the new accounting standards has more than doubled though the extent to which these would be applicable to particular companies would differ depending largely on the nature of the business and its transactions. There would be more of the permanent and temporary differences, as well as deferred tax assets or liabilities.

We agree with her observations and add that with the complexity of the IAS and the lack of regulations from the BIR codifying the differences brought about by the IAS, the cost of compliance of corporations have increased, since they need to hire the services of accounting firms in order to arrive at the correct taxable

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20 Lina Figueroa. 'The Extra Challenge: ITR Preparation Under The New Accounting Standards' Available http://www.punongbayan-araullo.com/pnawebsite/pnahome.nsf/section_docs/KS509D_31-1-06. January 31, 2006.

income. This of course is music to accounting firms' ears as this translates to an increase in fees for advice on how to apply the IAS, fees for the correct computation of income tax, and fees for seminars on IAS. For those who don't have the resources to hire accounting firms, it is very likely that they will simply not comply with the new requirements brought about by the IAS.

Another observation of Ms. Figueroa in her article is that, in case of errors in the tax return which are later amended, any overpayment will entail opportunity costs because funds will be unnecessarily tied up as creditable taxes paid, waiting to be utilized. Furthermore, an amendment extends the period when the return will be open to BIR audit. Underestimation of the tax due, on the other hand, exposes the company to penalties.

She also predicted, quite reasonably, that tax examination would probably be the next challenge considering that audited financial statements are required to be submitted and used, in certain cases, to select tax cases for audit. These are also the basis used by tax examiners during tax investigations. In relation to this, we predict that extensive training for tax examiners on the differences between tax and accounting is definitely needed. Audit procedures to be observed by revenue officers in the conduct of audit of tax cases and in their submission of reports of investigation should be contained in Revenue Audit Memorandum Orders (RAMOs)[21], but no such RAMO on how to audit income tax returns, taking into consideration the IAS, have been released by the BIR.

Considering too that there is as yet no BIR regulation codifying the differences between IAS and tax, it appears that both taxpayers and tax examiners are in the dark as to the effects of the IAS on income tax.

II. PHILIPPINE CORPORATE TAX SYSTEM AND THE PHILIPPINE ACCOUNTING SYSTEM

A. PHILIPPINE CORPORATE TAX SYSTEM

1. The Tax Code

The Tax Code prescribes the internal revenue taxes imposed within the Philippine archipelago. In computing taxable income, Section 43 of the Code prescribes as basis the accounting method regularly employed in keeping the books of the taxpayer.[22] There is no uniform accounting method prescribed for taxpayers. Instead, the Tax Code allows the taxpayer to adopt such method and system of

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[21] BIR Revenue Adm. O. (hereinafter "RAO") No. 1-99, Section 3(g) (1999).

[22] TAX CODE, § 43

accounting which is best suited to his purpose.[23] As implied by Section 43 of the Tax Code, The Commissioner will not interfere with the taxpayer's choice of accounting method as long as it clearly reflects his income.

Even if the Tax Code recognizes the method of accounting used by the taxpayer in determining taxable income, this does not mean that the net income computed under the accounting method in place is the basis of the tax due. As explained by the Supreme Court:[24]

> "While taxable income is based on the method of accounting used by the taxpayer, it will almost always differ from accounting income. This is so because of a fundamental difference in the ends the two concepts serve. Accounting attempts to match cost against revenue. Tax law is aimed at collecting revenue. It is quick to treat an item as income, slow to recognize deductions or losses. Thus, the tax law will not recognize deductions for contingent future losses except in very limited situations. Good accounting, on the other hand, requires their recognition. Once this fundamental difference in approach is accepted, income tax accounting methods can be understood more easily. xxx"

The accounting method is employed in preparing the books of the taxpayer and the financial reports for various users such as the stockholders, management, creditors and employees. Their basic concern is the economic performance and financial standing of the corporation. On the other hand, tax returns are prepared for the State to aid it in the generation and collection of revenue. The use of accounting method in the computation of taxable income, as reflected in tax returns, may not serve this purpose.

2. BIR Issuances and Rulings

The Commissioner, subject to the review by the Secretary of Finance, has the exclusive and original jurisdiction to interpret the provisions of the Tax Code and other tax laws.[25] In this regard, the Commissioner, through the BIR, issues opinions interpreting the tax laws in the form of rulings and other issuances. These include the following:

a) *Revenue Regulations (RRs).* These are issuances signed by the Secretary of Finance, upon recommendation of the Commissioner, that specify,

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[23] BIR Revenue Reg. (hereinafter "R.R.") No. 2, § 167 (1940), provides:

> "SEC. 167. *Methods of accounting.* — It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. Any approved standard method of accounting which reflects taxpayer's income may be adopted. xxx"

[24] Consolidated Mines, Inc., vs. Court of Tax Appeals, 58 SCRA 623 (1974), citing 33 Am. Jur. 2d 688.

[25] TAX CODE, § 4

prescribe or define rules and regulations for the effective enforcement of the provisions of the Tax Code and related statutes.[26]

b) *Revenue Memorandum Orders (RMO).* These are directives or instructions outlining procedures, techniques, methods, processes, operations, activities, work flow, and the like, which are necessary to carry out programs or to achieve policy goals and objectives. These issuances may be of general or of limited scope yet in any case require definite compliance by those concerned. They are directed to the taxpayers definitely stated, or unmistakably implied thereat.[27]

c) *Revenue Memorandum Rulings (RMR).* These are rulings, opinions and interpretations of the Commissioner with respect to the provisions of the Tax Code and other tax laws, as applied to a specific set of facts, with or without established precedents, and which the Commissioner may issue from time to time for the purpose of providing taxpayers guidance on the tax consequences in specific situations.[28]

d) *Revenue Administrative Orders (RAO)* — These Orders cover subject matters which deal strictly with more or less permanent administrative set-up of the BIR. Delineations of organizational structures, statements of functions and/or responsibilities, definitions and delegations of authority, staffing and personnel requirements, standards of performance, establishment of BIR-wide programs, installation of systems, and the like, are most likely subject matter of Revenue Administrative Orders. These issuances are for general guidance, compliance and/or information.[29]

e) *Revenue Memorandum Circulars (RMC).* These issuances disseminate and embody pertinent and applicable portions as well as amplifications of the rules, precedents, laws, regulations, opinions and other orders and directives issued by or administered by the Commissioner and the BIR, for the information, guidance or compliance of revenue personnel.[30]

f) *Revenue Bulletins (RB).* These refer to periodic issuances, notices and official announcements of the Commissioner that consolidate the BIR's position on certain specific issues of law or administration in relation to the provisions of the Tax Code, relevant tax laws and other issuances for the guidance of the public.[31]

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[26] BIR 'Issuances and Rulings', Available <http://www.bir.gov.ph/iss_rul/issuances.htm>[1]

[27] BIR RAO No. 1-99, § 3, see note 21, *supra*..

[28] BIR 'Issuances and Rulings', see note 26, *supra*.

[29] BIR RAO No. 1-99, see note 27 *supra*.

[30] BIR RAO No. 1-99, see note 27, *supra*.

[31] BIR 'Issuances and Rulings', see note 26, *supra*..

g) *BIR Rulings*. These are official position of the BIR to queries raised by taxpayers and other stakeholders relative to clarification and interpretation of tax laws.[32] They apply only to a particular case or query base on the facts as recounted by the taxpayer. At the end of each ruling, there is a disclaimer which states that the ruling is being issued on the basis of the facts as represented and that if upon investigation it will be disclosed that the facts are different, then the ruling shall be considered as null and void.

Revenue regulations, being the interpretation of the Tax Code and tax laws, are signed by the Secretary of Finance, upon the recommendation of the Commissioner. With regard to the other issuances, they are signed and issued by the Commissioner or a duly authorized BIR officer. They shall be submitted to the Secretary of Finance as *mzy* be required.[33] Meanwhile, when the BIR renders an opinion by means of a circular or memorandum, no publication is necessary for its validity because it merely interprets a pre-existing law.[34] Likewise, their interpretations, while not binding upon courts, are entitled to great weight as the construction comes from the branch of the government called upon to implement the law.[35]

3. BIR Issuances on Taxpayers' Use of Accounting Methods For Internal Revenue Tax Purposes

As explained earlier, both the tax and the accounting systems serve different ends. With this in mind, some taxpayers have acquired the practice of maintaining two separate books under different methods to better serve the ends of these two concepts. The BIR issued RMC No. 44-2002 to clarify the taxpayer's use of accounting methods for internal revenue tax purposes. It specifies that the practice of some taxpayers of filing their tax returns under an accounting method that is different from the method allowed in keeping their books of accounts should be stopped immediately. RMC No. 44-2002 was supplemented by RMC No. 22-2004.

RMC No. 22-2004[36] set forth the definitive rule in case of differences between the Tax Code and such rules and regulations issued in relation thereto, and that of generally accepted accounting principles (hereinafter "GAAP") and generally accepted auditing standards (hereinafter "GAAS") as approved and adopted by the ASC. It provides that the taxability of income and the deductibility of expenses shall be determined strictly in accordance with the provisions of the Tax Code and the rules and regulations issued implementing it. It went further and held that in

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[32] *Id* at [6].

[33] *Id*, at § 4.

[34] La Suerte Cigar and Cigarette Factory, et al. vs. Court of Tax Appeals, 134 SCRA 39, (1985), citing Romualdez v. Arca, 27 SCRA 828.

[35] *Id*, citing Salaria v. Buenviaje, 81 SCRA 722.

[36] See note 6, *supra*.

case of differences between the provisions of the Tax Code and the rules and regulations issued implementing it, on one hand, and the GAAP and GAAS, on the other hand, the provisions of the Tax Code and the rules and regulations issued implementing the said Tax Code shall prevail.

This RMC seems to conflict with Sec. 43 of the Tax Code, the law it ought to implement. While Sec. 43 recognizes the accounting method used in computing taxable income, RMC 22-2004 prescribes the supremacy of the Tax Code provisions over GAAP and GAAS in case of conflict between the tax and accounting treatment of taxable income. As explained earlier, the two systems will always differ in computing taxable income because of the inherent differences of the two systems.

B. IAS AND THE ITEMS OF GROSS INCOME

The Tax Code enumerates the items of gross income in Section 32 (A). For most of these items, the IAS has a corresponding standard on how each item of gross income should be recorded and treated in the books of the corporation. The apparent similarities and/or differences in accounting and tax treatment of some of these items are outlined below.

1. Interest Income

Interest is the compensation allowed by law or fixed by the parties for the use or forbearance or detention of money.[37] Under the IAS, interest income, a financial asset, should be recorded initially at its *fair value* or the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.[38] Subsequently, loans and receivables[39] should be measured at amortized cost using the effective interest method. The Tax Code and the rules and regulations implementing it have not set a method for measuring interest income. Hence, tax follows accounting. Nonetheless, if in the opinion of the Commissioner the accounting method employed does not clearly reflect the income, he could always invoke Sec. 43 of the Tax Code, or Sec. 50[40] in cases of related party transactions.

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[37] Spouses Toring vs. Spouses Olan, CA-G.R. CV NO. 76831.

[38] Deloitte Touche Tohmatsu. 'Summaries of International Financial Reporting Standards (IFRS)' (hereafter, "Summaries of IFRS"), IAS 39 Available http://www.iasplus.com/standard/ias39.htm [36]

[39] *Id* at [27]. It provides:

> "Loans and receivables are non-derivative financial assets with fixed or determinable payments, originated or acquired, that are not quoted in an active market, not held for trading, and not designated on initial recognition as assets at fair value through profit or loss or as available-for-sale. xxx"

[40] TAX CODE, § 50 provides:

> "SEC. 50. Allocation of Income and Deductions. — In the case of two or more organizations, trades or businesses (whether or not incorporated and whether or not organized in the Philippines) owned or controlled directly or

The same standard applies to transactions between related parties, e.g. between a parent company and a subsidiary or an affiliate. A number of BIR rulings and issuances, and jurisprudence tackle the matter. Revenue Memorandum Order (hereinafter "RMO") No. 63-1999,[41] which governs the imputation of interest income on inter-company loans and advances, provides that the arm's length bargaining standard will be used as the ultimate test for determining the correct gross income and deductions between two or more enterprises under common control.[42] By arm's length interest rate, the Bureau refers to the rate which would have been charged at the time the indebtedness arose in an independent transaction between unrelated parties under similar circumstances.[43]

However, not all transactions involving the transfer of money between related parties are loans, hence, taxable. RMO 63-1999 applies to all forms of bona fide indebtedness including loans or advances of money or other consideration, whether or not evidenced by a written instrument, and indebtedness arising in the ordinary course of business out of sales, leases or the rendition of services by or between members of the group or any other similar extensions.[44] But, it does not apply to alleged indebtedness which is in fact a contribution of capital or a distribution by a corporation with respect to its shares.[45] What is contentious is the identification of the true nature of the transaction - whether it is a taxable loan or advance, or a mere distribution of capital. Jurisprudence elaborates the meaning of capital contribution.

In the case of *Filinvest Development Corporation (FDC) vs. Commissioner of Internal Revenue* (hereinafter "CIR),[46] the Court of Appeals, reversing the CTA, treated the interest-free cash advances by a taxpayer to an affiliate as capital contributions and not loans where the advances were in the nature of financial assistance to sustain an affiliate's operational and capital expenditures. The doctrine was upheld in the recent case of Belle Corporation vs. CIR,[47] where the CTA held that the advances extended by Petitioner to its affiliates/subsidiaries were financial assistance for operational and capital expenditures, hence the advances were not loans. The same principle is observed in BIR Ruling DA-536-2004 where it was ruled that the advances made by a Singapore Head Office to its Philippine branch

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indirectly by the same interests, the Commissioner is authorized to distribute, apportion or allocate gross income or deductions between or among such organization, trade or business, if he determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organization, trade or business."

[41] BIR Revenue Memorandum O. No. 63-1999, (1999).

[42] *Id.*

[43] *Id.*

[44] *Id.*

[45] *Id.*

[46] Filinvest Development Corporation vs. Commissioner of Internal Revenue CA-G.R. SP No. 72992, December 16, 2003.

[47] Belle Corporation vs. Commissioner of Internal Revenue CTA Case No. 6156, June 17, 2005.

which were used by the Branch as working capital and as payment for the acquisition costs of machinery and equipment necessary for its operation are in the nature of capital contributions.

2. Rental Income

A lease is classified as a finance lease or an operating lease at its inception (i.e. when the agreement or commitment is made).[48] Finance leases are those that transfer substantially all the risks and rewards incident to ownership to the lessee.[49] All other leases are operating leases.[50] Under the IAS, income from operating leases is recognized on a straight-line basis over the lease term.[51] Thus, if the lease is for three (3) years and the rent for each year varies, the total rental income for the entire term of the lease is summed up and allocated equally over the lease period. Stated differently, the total yearly rental income is the sum of the total rental income for the entire term divided by the lease period. Also, the rental income is allocated the same way even if the lessee pays the rent in advance.

On the other hand, the BIR treats rental income differently. As ruled in BIR Ruling 003-2000, for income arising from rentals of property, a taxpayer must report as part of the gross income advance rentals received during the taxable year, including rentals actually earned but uncollected as of the end of such period. The tax treatment of rental income is an exemption to the general rule espoused in Rule 43 that taxable income shall be computed on the basis of the method of accounting regularly employed by the taxpayer. Hence, the taxpayer may continue keeping its books following the IAS but for tax reporting purposes, rental income (including advance payments) must be recognized when actually earned, regardless of its accounting method.

The difference in accounting and tax treatment of rental income results to differences in the computation of taxable income especially if advance payments are made. In which case, advance payment has no effect on taxable income since income, under accounting practice, is recorded in the books as if they were received in the years to which the rent applies. Meanwhile, under the tax system, the entire advance payment is recognized immediately, thereby increasing taxable income on the period it was received. As a consequence, the tax due is also higher unlike under the straight-line method established by IAS.

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[48] Deloitte Touche Tohmatsu. IAS 17 Available http://www.iasplus.com/standard/ias17.htm [4].

[49] *Id.*

[50] *Id.*

[51] *Id.* at [10].

C. IAS AND THE ALLOWABLE DEDUCTIONS

The Tax Code devotes a separate chapter for allowable deductions.[52] It applies to all taxpayers except those earning compensation income arising from personal services rendered under an employer-employee relationship.

The IAS provides standards on how these deductions should be recorded and treated in the books of the corporation. Likewise, the Tax Code and other rulings and issuance provide guidelines these deductions should be treated.

1. Expenses

The Tax Code allows as deductions from gross income business expenses - all the ordinary and necessary expenses - paid or incurred during the taxable year in carrying on or which are directly attributable to, the development, management, operation and/or conduct of the trade, business or exercise of a profession.[53] Deductible expenses include: (1) salaries, wages, and other forms of compensation, (2) travel expenses, (3), rentals of properties, and (4) entertainment, amusement and recreation expenses directly related to or in furtherance of trade. To be deductible, the taxpayer must substantiate with sufficient evidence, such as official receipts or other adequate records: (i) the amount of the expense being deducted, and (ii) the direct connection or relation of the expense being deducted to the development, management, operation and/or conduct of the trade, business or profession of the taxpayer.

When recognized. Under the Tax System, business expenses are recognized when paid (under cash basis accounting) or when the obligation accrues (under accrual basis accounting).

In determining whether an expense has accrued for tax purposes, reference is made to US revenue law and jurisprudence. Under the accrual method of accounting, business expenses are deducted in the taxable year when the "all-events test"[54] has been met and when economic performance[55] has occurred. Under the "all events test", as embodied in Treasury Regulations, an accrual-basis taxpayer is

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[52] TAX CODE, § 34

[53] TAX CODE, § 34 (A) (1) (a)

[54] Internal Revenue Service (United States Department of the Treasury). Available http://www.irs.gov/publications/p538/ar02.html# d0e1880, provides that: "Under an accrual method of accounting, you generally deduct or capitalize a business expense when both the following apply.

1. The all-events test has been met. The test is met when:
   a. All events have occurred that fix the fact of liability, and
   b. The liability can be determined with reasonable accuracy.
2. Economic performance has occurred. xxx"

[55] *Id.* It provides that: "If your expense is for property or services provided to you, or for your use of property, economic performance occurs as the property or services are provided or the property is used. xxx"

entitled to deduct a business expense for the taxable year in which all events have occurred which determine the fact of the taxpayer's liability, and in which the amount of that liability can be determined with reasonable accuracy.[56] Hence, cash does not have to change hands before a business expense is deducted under the accrual method of accounting.

Salaries, wages, and other forms of compensation. Under IAS 19, salaries, bonuses, holiday pay, sick pay are considered as short-term benefits.[57] They should be recognized as an expense in the period when the employee has rendered the service. Meanwhile, profit-sharing and bonus payments should be recognized when the entity has a present legal or constructive obligation as a result of past events and when a reliable estimate of the obligation can be made.

Under the Tax System, the Tax Code adds a requirement as to when (taxable year) profit-sharing and bonuses should be allowed as deductions. They are deductible only in the taxable year when the tax required to be deducted and withheld therefrom has been paid to the BIR.[58] In the case of *ING Bank N.V. Manila Branch vs. CIR*, [59] the bonuses were accrued in 1996 and 1997, but were distributed in the respective years following their accrual. The petitioner averred that its duty to withhold the tax due falls at the time of payment, not at the time of accrual. However, the CTA held that the accrued profit sharing and bonus payments should be subjected to withholding taxes in the year these are determinable and claimed as deductions for income tax purposes. Thus, for tax purposes, profit-sharing and bonuses should not be recognized as deductions unless the withholding taxes have been paid to the BIR.

Advertising costs. The list of ordinary and necessary expenses in the Tax Code is not exclusive. Advertising expenses are another type of business expenses which are treated differently under the accounting and tax methods. IAS 38[60] states that "if an intangible item does not meet both the definition[61] of and the criteria[62]

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[56] United States vs. General Dynamics Corp., 481 U.S. 239, April 22, 1987.

[57] Deloitte Touche Tohmatsu, IAS 19. Available http://www.iasplus.com/standard/ias19.htm. [4] It defines short-term benefits as "those payable within 12 months after service is rendered, such as wages, paid vacation and sick leave, bonuses, and nonmonetary benefits such as medical care and housing xxx"

[58] TAX CODE, § 34 (K) provides:

> "(K) Additional Requirements for Deductibility of Certain Payments. — Any amount paid or payable which is otherwise deductible from, or taken into account in computing gross income or for which depreciation or amortization may be allowed under this Section, shall be allowed as a deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid to the Bureau of Internal Revenue in accordance with this Section, Sections 58 and 81 of this Code."

[59] CTA Case No. 6187, August 9,2004.

[60] Deloitte Touche Tohmatsu, IAS 38. Available <http://www.iasplus.com/standard/ias38.htm>

[61] *Id.* IAS 38 defines intangible asset as an "identifiable nonmonetary asset without physical substance. An asset is a resource that is controlled by the enterprise as a result of past events (for example, purchase or self-creation) and from which future economic benefits (inflows of cash or other assets) are expected."

for recognition as an intangible asset, the expenditure on the intangible should be recognized as an expense when it is incurred." Expenditure for advertising is among these costs which are expensed when incurred.

In the case of *CIR vs. General Foods (Phils) Inc*,[63] the Supreme Court distinguished advertising expenses which are expensed and those which are considered as capital assets, hence, amortized over a reasonable period of time. In this case, the manufacturers of Tang, Calumet and Kool-Aid spent for media advertising expenses. The issue was whether these expenses are to be considered as ordinary and necessary expenses or as capital expenditures. If considered as ordinary expenses, they are allowable as deductions in the taxable year they were incurred. As a consequence, the taxable income during the taxable will be greatly reduced resulting to a lower amount of tax payable. On the other hand, as capital expenditures, the amortization will be spread over a reasonable period of time. By spreading the advertising cost, the reduction in taxable income is gradual, and the tax payable is higher in the year the expenses are incurred, as opposed to when advertising cost is expensed outright.

The Supreme Court held in this case that the expenses are not ordinary and necessary but are the capital expenditures because they were inordinately large. For Tang alone, the expense was half of the total marketing expense. Further, the expenses were incurred in order to protect the taxpayer's branch franchise. This was considered as analogous to the maintenance of goodwill or title to one's property.

From this ruling, it could be inferred that under the tax system, advertising expenses could either be expensed or capitalized. IAS however does not make this distinction.

Provisions. Under the IAS,[64] a provision is a liability of uncertain timing or amount. Examples of provisions are: warranty obligations; legal or constructive obligations to clean up contaminated land or restore facilities; and a retailer's policy to refund customers. A provision should be recognized when: (1) an entity has a present obligation (legal or constructive) as a result of a past event; (2) it is probable that an outflow of economic benefits will be required to settle the obligation; and (3) a reliable estimate can be made of the amount of the obligation.

However, under the tax system, provisions are not deductible for income tax purposes unless they meet the all-events test for recognizing an expense.

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[62] *Id.* IAS also provides that an enterprise should recognize an intangible asset, whether purchased or self-created (at cost) if, and only if (1) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and (2) the cost of the asset can be measured reliably.

[63] Commissioner of Internal Revenue vs. General Foods (Phils) Inc., 401 SCRA 545 (2003).

[64] Deloitte Touche Tohmatsu,IAS 27. Available http://www.iasplus.com/standard/ias27.htm.

Organization expenses. Under IAS 38, start-up costs are recognized as expenses when incurred.[65]

Under the tax system, in case of corporations, expenses for organization, such as incorporation fees, attorney's fees and accountant's charges, are ordinarily capital expenditures, but where such expenditures are limited to purely incidental expenses, a taxpayer may charge such items against income in the year in which they were incurred.[66] Thus, if under the IAS, organization expenses are expensed, the same are either expensed or capitalized under the tax system.

Pre-operating expenses. Under IAS 38, pre-operating costs are recognized as expenses when incurred.[67]

Under the tax system, they are capitalized. Pre-operating expenses must be distinguished from expenses incurred while the business has already commenced. Pre-operating expenses include amounts paid or incurred before and in anticipation of the start of the business in an activity for profit or the production of income (par. 1033, page 379, US Master Tax Guide 1985).[68] In this regard, a corporation is considered to have begun business when it has commenced the activities for which it was organized.[69] Generally, this occurs after the charter or article of incorporation is issued (par. 6163-6164, p. 386, Vol. 34 Am. Jur. 2d, 1976 Ed.).[70]

By way of an example, investigatory expenses, which include costs incurred for analysis or survey of potential markets, products, labor supply, transportation facilities, and site location incurred by the taxpayer, are considered as pre-operating expenses which may be capitalized and amortized over a period of not less than sixty (60) months beginning the first month the corporation is actively in business.[71] On the contrary, expenses such as advertising, market testing and penetration, salaries and wages paid to train employees and travel expenses incurred in lining up distributors and customers are not business start-up expenditures since they were incurred when the business has already commenced. As such, these expenses are not capitalized but are allowed as deductions in the taxable year in which they were paid or incurred.[72]

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[65] Deloitte Touche Tohmatsu, IAS 38, see note 64, *supra*.

[66] BIR R.R. No. 2, § 120, (1940).

[67] Deloitte Touche Tohmatsu, IAS 38, *supra* note 63.

[68] BIR Ruling No. 102-1997, September 29, 1997.

[69] *Id.*

[70] *Id.*

[71] *Id.*

[72] *Id.*

2. Borrowing Costs

Borrowing costs are interest and other costs incurred by an entity in connection with the borrowing of funds.[73] In case the borrowing cost was incurred in relation to the acquisition, construction and production of a qualifying asset,[74] it should be treated as part of the cost of the relevant asset under the Allowed Alternative Treatment of borrowing cost.[75] Simply put, the borrowing should be capitalized.

Under the Tax Code, the equivalent provision is Section 43 (B) (3) which states that: "at the option of the taxpayer, interest incurred to acquire property used in trade, business or exercise of a profession may be allowed as a deduction or treated as a capital expenditure." Thus, while IAS impose that borrowing cost in relation to the acquisition of an asset should be capitalized, the Tax Code gives the taxpayer the option to treat the borrowing costs as a deduction or as a capital expenditure.

3. Losses

The Tax Code recognizes different type of losses.[76] These are: (1) ordinary losses which are incurred in the trade, business or profession, or of property connected therewith; (2) capital losses from the sales or exchanges of capital assets, or from securities which are capital assets becoming worthless; and (3) special kinds of losses such as losses from wash sale of stocks and securities, wagering losses and abandonment losses in petroleum operations. These losses are allowed as deductions in taxable income unless they are compensated for by insurance or other form of indemnity.[77]

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[73] Deloitte Touche Tohmatsu, IAS 23, *available at* http://www.iasplus.com/standard/ias23.htm.

[74] *Id.* IAS 23 defines qualifying asset as: "an asset that necessarily takes a substantial period of time to get ready for its intended use or sale."

[75] *Id.*

[76] TAX CODE, § 34 (D). It reads:

> (D) Losses. —
>
> > (1) *In General.* — Losses actually sustained during the taxable year and not compensated for by insurance or other forms of indemnity shall be allowed as deductions:
> >
> > > (a) If incurred in trade, profession or business;
> > >
> > > (b) Of property connected with the trade, business or profession, if the loss arises from fires, storms, shipwreck, or other casualties, or from robbery, theft or embezzlement.
> >
> > x x x"

[77] *Id.*

Impairment of assets. IAS 36 is dedicated to the impairment of assets.[78] Its objective is to ensure that assets are carried at no more than their recoverable amount.[79] IAS 36 applies to assets such as land, buildings, machinery and equipment, investment property carried at cost, intangible assets, goodwill, and, investments in subsidiaries, associates, and joint ventures.

Impairment loss, in general.

Under the IAS, when an asset is impaired, the loss is recognized immediately in profit or loss.[80] After the recognition of impairment loss, the depreciation charge for the asset is likewise adjusted in future periods to allocate the asset's revised carrying amount.[81]

Under the tax system, impairment loss is not recognized for income tax purposes because losses are not recognized unless evidenced by a closed and completed transaction.[82] As ruled in BIR Ruling DA-403-2003[83], even if impairment loss of an asset is reflected in the financial statements for financial accounting purposes, the same will not result in any tax benefit since no actual loss is sustained that may be allowed as deduction in the corporation's taxable income. Since impairment loss is not recognized in the computation of taxable income, no adjustment in future depreciation is required to be made.

An impairment loss, being in the nature of an accounting standard whose purpose is to reflect in the financial statements the true condition of the asset, would not be relevant for tax purposes, inasmuch as such impairment loss is only an estimate of what is prudently believed to be an unrecoverable value in a subsequent sale of the asset, or minimal estimated future cash flows arising from the continued use of the asset. x x x It should be noted, however, that there is as yet no actual sale or disposal to speak of.[84]

Impairment of intangible assets.

Under IAS 38, the impairment of an intangible asset, except those with indefinite useful life, is recorded as expense.[85] If such impaired asset is

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[78] Deloitte Touche Tohmatsu, IAS 36, *available at* http://www.iasplus.com/standard/ias36.htm.

[79] *Id.* According to IAS 36, an asset is *impaired* when its carrying amount exceeds its recoverable amount. *Carrying amount* refers to the amount at which an asset is recognized in the balance sheet after deducting accumulated depreciation and accumulated impairment losses. *Recoverable amount* refers to the higher of an asset's fair value less costs to sell (sometimes called net selling price) and its value in use.

[80] *Id.*

[81] *Id.*

[82] R.R. No. 2, § 96, *supra* note 23.

[83] November 10, 2003.

[84] *Id.*

[85] Deloitte Touche Tohmatsu, IAS 38, *supra* note 63.

subsequently sold, the gain or loss from the subsequent sale is computed as the difference between the selling price of the asset and its carrying amount.[86] If the impairment of loss is reversed, the resulting profit or loss is immediately recorded.

Impairment of intangible assets is also not recognized in the computation of taxable income. This is in line with the general rule on losses that only losses *actually sustained* during the taxable year and not compensated for by insurance or other forms of indemnity shall b e allowed as deductions.[87] However, BIR Ruling DA-452-2004[88], citing Section 107 of R.R. No. 2[89], held that intangible assets with definite lives may be subjected to depreciation allowance. On the other hand, intangible assets with indefinite lives are not proper subject of such allowance.

Under the Tax system, if the impaired asset is sold, the amount taxable is the excess of the selling price and the book value (acquisition cost less accumulated depreciation).[90] Book value is used as basis for determining the value of the asset and not the carrying amount because for income tax purposes, the impairment loss of the asset was not recognized. The term "carrying amount" is used when the value of the asset in the books is reduced by the impairment loss adjustments. Corollarily, if the impairment loss is reversed in the books of the taxpayer, the resulting profit or loss is not considered as income.[91]

Normal inventory losses. Under the IAS, the amount of any write-down of inventory to net realizable value[92] and all losses of inventory shall be recognized as an expense in the period the write-down or loss occurred.[93]

[86] *Id.*

[87] TAX CODE, § 34 (D), *supra* note 76.

[88] August 27, 2004.

[89] R.R. No, 2, § 107, *supra* note 23. It reads:

> "Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents, copyrights, and franchises. Intangibles, the use of which in the business or trade is not so limited, will not usually be a proper subject of such an allowance. If however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner of Internal Revenue."

[90] BIR Ruling DA-403-2003, *supra* note 86.

[91] Citytrust Investment Phils., Inc. vs. CIR, C.T.A. Case No. 4443, January 18, 1994.

[92] Deloitte Touche Tohmatsu, IAS 2, *available at* http://www.iasplus.com/standard/ias2.htm. IAS 2 defines ***Net Realizable Value*** as "NRV is the estimated selling price in the ordinary course of business, less the estimated cost of completion and the estimated costs necessary to make the sale."

[93] *Id.*

On the other hand, under the tax system, the BIR looks into the reason of the write down. In a Memorandum for the BIR Commissioner dated November 21, 1996, the Commissioner allowed the write-down since the inventory loss occurred form the normal business operation of the taxpayer and not from write-off as alleged.[94] In fact, it was due to obsolescence, losses or destruction, or shortages found in physical count. The basis for allowing the deduction is Section 34 (D) of the Tax Code which provides that the loss is deductible if it occurred in the normal operation of the taxpayer's trade, profession or business. As an additional requirement, however, the write-off of inventories must be accompanied by BIR certificate of destruction.

Obsolescence and abandonment of Property, Plant and Equipment. Under the IAS, an asset should be removed from the balance sheet when it is withdrawn from use and no future economic benefits are expected from its disposal.[95]

Under the tax system, losses due to obsolescence and abandonment losses are both deductible for tax purposes. The general rule is that losses *actually sustained* during the taxable year and not compensated for by insurance or other from of indemnity shall be allowed as deductions for tax purposes.[96]

4. Depreciation

Depreciation is the reasonable allowance for the exhaustion, wear and tear (including reasonable allowance for obsolescence) of property used in the trade or business.[97] Under the IAS,[98] the depreciable amount (cost less prior depreciation, impairment, and residual value) should be allocated on a systematic basis over the asset's useful life. Under the Tax Code,[99] the taxpayer is given enough leeway in determining the depreciable amount. The taxpayer may compute it under established accounting methods such as (1) straight-line method; (2) declining-balance method, (3) the sum-of-the-years-digit method; and (d) any other method which may be prescribed by the Secretary of Finance upon recommendation of the Commissioner.

Basis of Valuation. Under the IAS, the depreciable amount includes the impairment loss. But, under the Tax System, the prevailing doctrine is impairment losses unless covered by Section 34 (D) of the Tax Code should not be recognized. According to early jurisprudence, depreciation must be computed based on acquisition cost and not the reappraised value of the asset.[100] This is because, the

[94] November 21, 1996.

[95] Deloitte Touche Tohmatsu, IAS 16, *available at* http://www.iasplus.com/standard/ias16.htm.

[96] TAX CODE, § 34 (D), *supra* note 76.

[97] TAX CODE, § 34 (F).

[98] Deloitte Touche Tohmatsu, IAS 16, *supra* note 98.

[99] TAX CODE, § 34 (F).

[100] Basilan Estates, Inc. vs. CIR, 21 SCRA 23 (1967).

idea of profit on the investment made has never been the underlying reason for the allowance of a deduction for depreciation. Subsequently, the BIR issued Revenue Audit Memorandum Order (hereafter, "RAMO") No. 1-00[101] and ruled that no depreciation is allowable on the appraisal increase of fixed assets. This is but logical. Since the increase in the book value of the property is not recognized for tax purposes, it follows that depreciation must not be computed on the basis of the appraised value.

This notwithstanding, in a recent BIR ruling, a company was allowed to use the appraisal fair market value of its property, plant and equipment (PPE).[102] This was confirmed by BIR Ruling DA-436-2004.[103] To resolve this seeming contradiction, reference to referring to BIR Ruling No. 029-1998[104] may be instructive.

> As a general rule, in this jurisdiction, mere increase in the value of property without actual realization, either through sale or other disposition, is not taxable, ***the only exception*** being that even without sale or other disposition, if by reason of appraisal, the cost basis of property is increased and the resultant basis is used as the new tax base for purposes of computing the allowable depreciation expense, the net difference between the original cost basis and new basis due to appraisal is taxable under the economic-benefit principle. (Emphasis supplied)

With this ruling, it is clear that depreciation could be computed based on appraisal value provided that the net difference between the original cost basis and the new appraised basis is taxed. Note however that this doctrine was established only in a BIR ruling. More importantly, RAMO 1-00 which explicitly provided that no depreciation is allowable on the appraisal increase of fixed assets was issued subsequent to this BIR ruling. Still, despite this RAMO, BIR Ruling DA-413-2004 allowed the use the appraisal fair market value of its property, plant and equipment.

5. Research and Development

Under IAS 38, expenditure on research shall be recognized as an expense when incurred.[105]

Under the Tax Code, a taxpayer may treat research or development expenditures which are paid or incurred by him during the taxable year in connection with his trade, business or profession as ordinary and necessary expenses which are not chargeable to capital account.[106] Alternatively, some types

[101] March 17, 2000.

[102] BIR Ruling DA-413-2004, July 30, 2004.

[103] August 12, 2004.

[104] March 19, 1998.

[105] Deloitte Touche Tohmatsu, IAS 38, *supra* note 63.

[106] TAX CODE, § 34 (I).

of research and development expenditures may be capitalized and treated as deferred expenses.[107] These include expenses: (1) paid or incurred by the taxpayer in connection with his trade, business or profession; (2) not treated as expense, and (3) chargeable to capital account but not chargeable to property of a character which is subject to depreciation or depletion. These deferred expenses are ratably distributed over a period of not less than sixty (60) months as may be elected by the taxpayer (beginning with the month in which the taxpayer first realizes benefits from such expenditures).

III. RECONCILING THE DIFFERENCES

A. EFFORTS OF THE GOVERNMENT TO RECONCILE THE DISPARITY

In a telephone inquiry with Ms. Josephine B. Trillana, Chief of the Planning and Coordination Branch of National Tax Resource Center (hereafter "NTRC"), the researchers were informed that the NTRC has not undertaken any study on the effects of the new IAS on Philippine income tax. The NTRC is an attached agency of the Department of Finance and is the primary tax research institution of the Philippine government. One of its commitments is to recommend necessary improvements in the tax system by conducting continuing quality research on taxation and to provide responsive staff support to fiscal policy makers.[108] It has initiated a number of studies on taxation but unfortunately, no research has been made on the effect of IAS on Philippine Income Tax or on the tax-accounting disparity.

The current response of the BIR is to issue rulings on IAS-related matters on a case to case basis. Looking at the said rulings, it is evident that the BIR takes into consideration the accounting treatment of a particular transaction as well as tax principles.

In BIR Ruling No. 004-06 dated February 28, 2006 issued to V. C. Mamalateo and Associates, the issue was involved was whether the refund receivables of Meralco customers are form part of the taxable income of Meralco in the year the instruction to offset is given by the customers, either through the fixed-credit-to-bill with option to cash payment scheme or post-dated check scheme (PDC) which are modes of refund authorized by the Energy Regulatory Commission.

In this Ruling, the BIR held that Meralco follows the accounting method for reporting income and expenses in accordance with the International Financial

[107] *Id.*

[108] *Id.*

Reporting Standards (IFRS) or International Accounting Standards (IAS) so that its financial statements could be said to be prepared in accordance with generally accepted accounting principles. The BIR then cited Section 43 of the Tax Code. In addition, the BIR also discussed the realization principle (an accounting principle) and noted that the refundable amounts are Meralco's liabilities, and not part of taxable income.

In this Ruling, the BIR followed accounting treatment for tax purposes. But this is only because it just so happened that tax treatment coincides with the accounting treatment. Even if the "all-events test" (a tax principle) is applied, the result would still be the same, i.e., there is no economic performance yet as of the date of the instruction to offset, hence, it is properly not includible yet in taxable income.

The current response of the courts is the same. In the Court of Tax Appeals (CTA) Case No. 6314 dated March 17, 2006 entitled Taian (Subic) Electric, Inc. vs. Commissioner of Internal Revenue, one of the issues was whether unrealized foreign exchange gain was taxable. The Court held that, while for financial accounting purposes, foreign currency accounts (e.g., receivables, liabilities, and deposits) are periodically restated at the rate of exchange prevailing at year-end, any foreign gain/(losses) arising from this restatement shall be taxable or deductible only in the year of collection, payment, or actual conversion into pesos as the case may be. Thus, tax treatment was followed here instead of accounting treatment, with the resulting difference treated as a reconciling item.

Clearly, both the BIR and the Courts could only work within the parameters set by the current laws and regulations. The current framework is to reconcile the differences between accounting and tax treatment. In other countries, either tax treatment follows accounting treatment, tax treatment is entirely different from accounting treatment, or a variation of these two. As to whether the Philippines will continue following its current policy or follow the methods adopted by other countries, it appears that there is no study being undertaken on how to deal with IAS. The Philippines is following the safest route, i.e., maintaining the status quo.

B. EFFICACY AND SHORTCOMINGS OF THE METHODS CURRENTLY EMPLOYED

The Tax Code laid down the general rule in Section 43 that the taxable income shall be computed in accordance with the method of accounting regularly employed in keeping the books of such taxpayer. In reality, the taxable income is not really computed this way, since there are specific tax treatments for certain components of income and expenses which are different from accounting treatment. The differences that arise due to these differing treatments are treated as reconciling items. Save for the Income Tax Regulations (Revenue Regulations No. 2) issued in 1940, there is no single regulation which provides for the proper computation of taxable income, considering the components of gross income and deductible expense. And now, with the advent of the IAS and the changes in the method of accounting employed by the taxpayer, following Section 43 of the Tax Code and the maintenance of the status quo as to the tax treatment of certain items, reconciling items have, as expected, increased considerably.

Though the BIR issues rulings in response to queries of taxpayers, said rulings apply only to the particular taxpayer requesting for the ruling. Thus, at the end of each ruling is the customary paragraph, "This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation it will be disclosed that the facts are different, then this ruling shall be considered null and void." While some issues experienced by a certain taxpayer may be similar to that experienced by another, it is difficult to find a situation which is on all fours with a previous BIR ruling. The problem with this setup is that the BIR has no defined position on the effects of IAS on the income tax computation. IAS-related matters are ruled on on a case-to-case basis. In effect, only those with resources to secure a BIR ruling can be sure that their tax treatment is correct. Those who could not afford a ruling (which is majority of the taxpayers) are not sure of what they are doing.

Admittedly, even accountants are struggling to learn the new IAS, more so its effects on income tax. The different accounting and auditing firms have taken the lead by studying the IAS and by pointing out, at the same time, the differences between the IAS and tax treatment. With no revenue regulation codifying the differences between accounting and tax treatment, taxpayers, and even accountants and revenue examiners, are in the dark as to the proper treatment of the said differences. How can we expect tax compliance with this kind of setting?

Further, audit procedures to be observed by revenue officers in the conduct of audit of tax cases and in their submission of reports of investigation are supposed to be contained in RAMOs, but there is no such RAMO on how to audit income tax returns, taking into consideration the IAS. If there is anyone who should pave the way for understanding the effects of IAS on income tax computation, it should be the BIR. True, accounting firms have come up with their own analyses of the said effects[109,110], but until such time that these analyses are adopted as correct by the BIR, they remain as just that, analyses.

[109] Ruben R. Rubio, *IFRS v. Tax Accounting*, *available at* .http://www.picpa.com.ph/articles/IFRSvsTAX_7-20-06.pdf..

[110] Isla Lipana & Co. /PriceWaterhouseCoopers, *Tax Implications of New Accounting Standards*, *available at* .http://www.picpa.com.ph/articles/TAX%20IMPLICATION%20OF%20IFRS.pdf.

IV. HOW OUR COUNTERPARTS ARE RESPONDING

IAS is a world-wide phenomena and many nations are coping with the changes brought about by the IAS. The United States, the basis of Philippine revenue code, has its own accounting standards, the United States Generally Accepted Accounting Principles (US GAAP) which is different and separate from IAS, but even the US is slowly moving towards the unification of US GAAP with IAS. We cannot simply adopt what they are doing, though, because Philippine Generally Accepted Accounting Principles (Philippine GAAP) is different from US GAAP. Europe, on the other hand, the originator and proponent of IAS, is also unifying the different European nations. It has introduced a single currency to members of the European Union and is further taking steps to unify its (the continent's) accounting and tax systems. A comparison of how the United States, Germany, and the United Kingdom, are currently responding to the issue on whether to follow IAS treatment for tax purposes is discussed below as discussed by Wolfgang Schon in his article entitled, "The David R. Tillinghast Lecture - The Odd Couple: A Common Future for Financial and Tax Accounting?"[111]

A. THE UNITED STATES, THE SOURCE OF PHILIPPINE TAX RULES

Under the U.S. rule, taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books. This is exactly the same as Section 43 of the Philippine Tax Code.

The US Supreme Court in the landmark case, *Thor Power Tool Company v. Commissioner of Internal Revenue*[112], ruled that the goals of financial accounting and tax are so divergent that they should be treated differently as well. The pertinent portion of the said decision is as follows:

> "xxx the presumption petitioner postulates is insupportable in light of the vastly different objectives that financial and tax accounting have. **The primary goal of financial accounting is to provide useful information to management, shareholders, creditors, and others properly interested; the major responsibility of the accountant is to protect these parties from being misled. The primary goal of the income tax system, in contrast, is the equitable collection of revenue; the major responsibility of the Internal Revenue Service is to protect the public fisc.** Consistently with its goals and responsibilities, financial accounting has as its foundation the principle of conservatism, with its corollary that "possible errors in measurement [should] be in the direction of understatement rather than overstatement of net income and net assets." In view of the Treasury's markedly different goals and responsibilities understatement of income is not destined to be its guiding light. **Given this diversity, even contrariety, of**

[111] TAX LAW REVIEW, Winter 2005, New York University School of Law.

[112] 439 U.S. 522, 99 S.Ct. 773, 58 L.Ed.2d 785, 43 A.F.T.R.2d 79-362, 79-1 USTC P 9139, 1979-1 C.B. 167, Supreme Court of the United States, argued November 1, 1978 and decided on January 16, 1979

> **objectives, any presumptive equivalency between tax and financial accounting would be unacceptable.**
>
> xxx
>
> Financial accounting, in short, is hospitable to estimates, probabilities, and reasonable certainties; the tax law, with its mandate to preserve the revenue, can give no quarter to uncertainty. This is as it should be. Reasonable estimates may be useful, even essential, in giving shareholders and creditors an accurate picture of a firm's overall financial health; but the accountant's conservatism cannot bind the Commissioner in his efforts to collect taxes.
>
> xxx
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> Finally, a presumptive equivalency between tax and financial accounting would create insurmountable difficulties of tax administration. Accountants long have recognized that "generally accepted accounting principles" are far from being a canonical set of rules that will ensure identical accounting treatment of identical transactions. "Generally accepted accounting principles," rather, tolerate a range of "reasonable" treatments, leaving the choice among alternatives to management. Such, indeed, is precisely the case here. Variances of this sort may be tolerable in financial reporting, but they are questionable in a tax system designed to ensure as far as possible that similarly situated taxpayers pay the same tax. If management's election among "acceptable" options were dispositive for tax purposes, a firm, indeed, could decide unilaterally--within limits dictated only by its accountants--the tax it wished to pay. Such unilateral decisions would not just make the Code inequitable; they would make it unenforceable." (*Emphasis supplied*)

In spite of such pronouncement, the United States is now moving towards a closer alignment of book and tax profits. [113]. This appears to have been caused by the uproar over corporate tax shelters which climaxed in the tax issues raised by the Enron debacle. [114]

"Many employees lost both their jobs and much of their life savings in the wake of the Enron collapse. x x x **When Enron appeared to be profitable, it was paying little or no corporate income tax. Yet the spectacle of apparently profitable companies paying virtually no corporate tax has become so common that no one considers lack of taxable profit a sign of a failing company.** Enron deducted stock option spreads from taxable income, but not from profits reported to stockholders. The company also set up hundreds of

[113] Wolfgang Schön, *The David R. Tillinghast Lecture - The Odd Couple: A Common Future for Financial and Tax Accounting?*, Tax Law Review, Winter 2005, New York University School of Law.

[114] Jane G. Gravelle, *The Enron Debacle: Lessons for Tax Policy*, The Urban Institute, *available at* http://taxpolicycenter.org/UploadedPDF/310622_Enron.pdf.. Miss Gravelle is senior specialist in economic policy at the Congressional Research Service of the Library of Congress.

offshore partnerships that it classified as debt when computing corporate income taxes and equity when reporting to stockholders—exactly the outcomes most beneficial for a company attempting to conceal financial trouble." (*Emphasis supplied*)

The Enron case is an example of a system where tax and accounting are allowed to work independently but simultaneously, and without precise guidelines on how to treat taxable income. Whereas the Thor Power Tool case[115] (discussed earlier) recognized the divergent goals of financial accounting and, hence, held that tax and accounting should be treated differently, the Enron case showcased the disastrous effect of such a separate treatment of tax and accounting. Enron took advantage of the best of both worlds - tax and accounting – and made combined methods from both which are best advantageous to the company. In this manner, Enron was concealing its real financial status, making it appear, in its books and financial statements, that it was profitable. Its sudden collapse, however, proved otherwise. Thus, based on US experience, the wide gap between accounting and tax proved to be detrimental.

B. EUROPE, THE PROPONENT OF THE IAS

1. Germany

In Germany, income tax is computed on the basis of the profit and loss statement shown in the financial statements.[116]

> "The consequences resulting from this principle are twofold. First, the amount of tax to be paid is calculated on the basis of the figures published in the financial statements. Consequently, "the profit reported in the published accounts of a German company usually does not differ significantly from those in the tax accounts." **This has the result that companies are forced to evaluate their assets at the lowest amount possible, whereas their liabilities have to be valued at their highest amount possible in their commercial financial statements in order to minimize their tax liability.** Secondly, "most of the tax incentives can be claimed only if the same treatment is applied to the items in question in the commercial financial statements." The latter consequence is referred to as the so-called "umgekehrtes Ma geblichkeitsprinzip" (principle of reverse authoritativeness or principle of converse congruency). According to this principle, options prescribed by tax law may only be exercised in conformity with the commercial financial statements (financial conformity). **This means that the tax law has a direct impact on financial accounting and financial statements are dependent upon tax accounts.** The principle of converse congruency is "a logical consequence of the aim of the tax authorities to achieve a consistent and close relationship between tax and

[115] 439 U.S. 522, 99 S.Ct. 773, 58 L.Ed.2d 785, 43 A.F.T.R.2d 79-362, 79-1 USTC P 9139, 1979-1 C.B. 167, Supreme Court of the United States, argued November 1, 1978 and decided on January 16, 1979

[116] *Id.*

commercial income computation." [117] (*Internal citations omitted*) (*Emphasis supplied*)

Under financial accounting, the goal is to highlight the profitability of the taxpayer in order to attract investors and increase customer loyalty on account of the perceived financial stability of the company. On the other hand, in computing for taxable income, from the point of view of the taxpayer, the goal is to reduce tax through legal means. In the case of Germany, it has to balance these two opposing ends.

Recently, there is a move in Germany to abolish the principle of dependence of tax on accounting altogether. The German Ministry of Finance commissioned a study on the impact of IAS on German tax accounting. In this study, published in 2004, Norbert Herzig, a Cologne tax professor, pushed for autonomous rules on income measurement strictly for tax purposes. His reasons for which being:[118]

- *The private character of standard setting by the IASB.* It is hard to accept that German tax legislation should defer to the rules and principles laid down by a London-based international association.

- *The restricted field of application of IAS.* As long as these international standards are binding only for listed companies, they cannot form the basis for the corporate or personal income tax, which also addresses privately held companies, commercial partnerships, and sole entrepreneurs.

- *The information purpose of accounting standards.* These standards are primarily made to provide useful information to investors. It allows managerial discretion when it comes to the assessment of an inflow or outflow of future economic benefits. This uncertainty is not compatible with tax assessments which rely on hard numbers not subject to manipulation by the taxpayer.

The German government and business community seem to support this change. For the German Ministry of Finance, the codification of an autonomous set of tax accounting rules would imply greater independence from standard-setting bodies. For German business, the principle of dependence needs to be reassessed because IAS does not follow the conservative principles of traditional German financial accounting but takes a more symmetric view when it comes to the recognition of revenues and expenses.[119] They fear that a linkage of tax accounting to international accounting standards inevitably would lead to a higher tax payable.

[117] Sabine D. Selbach , *The Harmonization of Corporate Taxation & Accounting Standards in the European Community and their Interrelationship*, Connecticut Journal of International Law, 2003.

[118] Schön , *supra* note 16.

[119] *Id.*

This debate in Germany is also happening in many other European countries where there is a traditionally a strong linkage between financial and tax accounting. In Austria, Belgium and France the abolition of book (or accounting)-tax conformity is under scrutiny.[120] Switzerland has stopped its current financial accounting reform in order to find a consensus on the tax consequences of a broad application of IAS in the Swiss corporate sector. Even in Spain, where book-tax conformity was enacted as late as 1996, a recently published study has opted for a move away from the principle of dependence if IAS/IFRS forms the basis of this concept.

2. United Kingdom

The other extreme is England, where income measurement is done without reference to financial accounting.[121] The detailed rules and principles of British commercial accounting laid down in professional standards over time have proven to be a valuable tool in solving practical problems of income tax assessments. The courts have supported this too. In several decisions, the U.K. Courts have accepted British GAAP as a cornerstone of tax accounting.

Section 42 of the 1998 U.K. Finance Act provided explicitly that profit and loss measurement under tax law should follow the "true and fair view principle" in accordance with financial accounting standards if the tax code does not say otherwise.[122] With the advent of the IAS, the discussion as to whether U.K. legislation should continue with this position is rife. In 2002, a study commissioned by the Institute for Fiscal Studies and written by Graeme McDonald showed strong sympathy for aligning taxable income with accounting income.[123] He welcomed the positive influence of the impartial and professional judgment of financial standard setters on the confrontational relationship between the taxpayer and the government. After this, the British government in 2003 published a consultation document on "Reform of Corporation Tax," which expressly asked the public for their opinion on a closer alignment of taxable and business profits under U.K. law.[124] The same elicited mixed response. A study by Christopher Nobes on behalf of the Association of Chartered Certified Accountants, was critical of this proposal. He proposed a movement towards autonomous rules on tax accounting.[125] One of his main arguments against linkage is the fear of "pollution" of the independent, capital-market-oriented standard-setting process by tax policy issues.

In the end, the U.K. government decided to move forward on their way towards book-tax conformity. In 2004 the British Parliament enacted a provision,

[120] *Id.*

[121] *Id.*

[122] *Id.*

[123] *Id.*

[124] *Id.*

[125] *Id.*

which refers the measurement of business profits under U.K. income tax law to the IAS/IFRS.

3. The European Union

The European Union is one of the most advanced markets in the world, with a single currency and a Common Market. With the shift to IAS, resulting in uniformity in accounting, only differences in tax bases and tax rates exist.[126] The next goal, therefore, in order to have a level playing field, is to have uniformity in tax bases and tax rates as well. To further this objective, the European Commission opted for a tax regime where the Member States would be free to decide on the corporate income tax rate but where multinational enterprises would be able to rely on identical rules for the computation of the tax basis all over Europe.

Another topic for discussion is the concept of a "common consolidated tax base" applicable to multinational business activities. One practical and political argument against this concept is that it will lead to an accelerated competition for the location of parent companies and will distort the competitive situation of subsidiaries and permanent establishments in other Member States due to the tax rules of the respective parent company.

VI. RECOMMENDATIONS

In the past, there were already differences in the tax and accounting treatments of the items of gross income and allowable deductions. With the adoption of the majority of the IAS in 2005, the number of differences is expected to escalate. The accounting firms are doing their share towards the systematic adoption of IAS by studying the impact of adoption in the existing accounting and tax systems, and by re-training their staff and other accountants who attend the seminars they offer on how to cope with the changes. It is high time for the government, through the BIR, to do its part. After all, the tax-accounting disparity has an effect in the computation of taxable income and consequently, on tax compliance and collection of tax, the lifeblood of government.

A. SHORT TERM, STOP-GAP SOLUTIONS

We do not need a dramatic change in the tax system in response to the adoption of the IAS. Small but sure steps may be taken towards the reconciliation of tax and accounting principles. As shown in this paper, there are differences in the tax and accounting systems.

[126] *Id.*

For the short-term, it is best to retain the status quo, which is to reconcile the differences between accounting and tax. The identification of the differences brought about by the IAS, discussed earlier, help address this problem. The BIR should issue new regulations which embody all the changes to enlighten taxpayers who are still in the dark as to what really are the effects of the new IAS on the income tax computation. It should explain, in terms understandable to lay taxpayers, what exactly are the differences, how they came about, and how to account for them. It is best to update the Income Tax Regulations (Revenue Regulations No. 2) issued in 1940 to incorporate all the changes for the past 67 years.

Furthermore, a RAMO for audit procedures to be used by tax examiners is also necessary to ensure that examiners can ensure taxpayers' compliance. This will also be helpful to taxpayers who wish to be prepared for a BIR audit.

The BIR, in addition to training its employees, may also conduct its own study on this matter, possibly also in cooperation with the National Tax Research Center (NTRC).

The BIR could also issue a Revenue Memorandum Circular (or RMC) for the benefit of revenue officers to reiterate and amplify of the rules, precedents, laws, regulations, opinions and directives issued by or administered by the Commissioner as well as by other offices and agencies. Take the case of RMC 06-2005.[127] The Supreme Court decided the case of Philippine Journalists, Inc. vs. CIR on December 16, 2004. The said case laid down the requirements of a valid and binding waiver of the statute of limitations under the Tax Code. Then, the BIR, after less than two months, issued RMC 06-2005 for the guidance of the concerned officer. By doing the same, the revenue officers themselves who are tasked to implement the revenue code are not at a loss as to how to properly handle and settle tax-accounting disparities.

Moreover, the BIR could issue other issuances such as RAMOs[128] and Revenue Regulations. The principles in RMC 44-2002[129] and RMC 22-2004[130] are two promising circulars but unfortunately, they have not been consolidated into a more concrete rule or regulation. It is about time the BIR established precedents and regulations on how to bridge the tax-accounting disparity.

[127] February 2, 2005.

[128] RAO No. 1-99, § 3, *supra* note 27. It defines RAMOs as "the audit procedures to be observed by revenue officers in the conduct of audit of tax cases and in their submission of reports of investigation."

[129] *Supra* note 36.

[130] *Supra* note 6.

B. LONG-TERM SOLUTION

After familiarizing itself with the IAS and its impact on Philippine taxation, the government should take a bolder step. In effect, Section 43 of the Tax Code is saying that the taxpayer could adopt any accounting method it wishes provided that it clearly reflects income. But then, what is the Commissioner's basis in saying that a certain method does not clearly reflect income? Will it be on the basis of accounting or tax standards? The battle between the two systems continues.

The bolder step is to amend the Tax Code. This way, broad provisions, such as Section 43 could be expanded, supplying the details necessary for the guidance of the taxpayer. In the case of rental Income discussed earlier, BIR Ruling 003-2000 took notice of Section 43 but it still prescribed the manner by which rental income (and advance payments) should be recognized. The Ruling even emphasized that such is the rule to be followed in computing rental income notwithstanding the accounting method employed by the taxpayer. Amendments to the Tax Code could follow the same - provide a specific rule on how certain income or expenses should be treated in computing taxable income.

In the process, we should also take into consideration that any change in the tax laws will give rise to many potential problems, one of which is political pressure. Similar to what happened to Republic Act No. 9337, the E-VAT, it is to be expected that many people who do not understand what the law really is will jump to the conclusion that the law is bad- since it increases taxable income. It will take much political will on the part of the administration to push for it. As long as the proposed Tax Code addresses the right problem (the tax-accounting disparity) and as long as it provides an equitable solution, the change is very much welcome.

As for the Philippines' position on whether tax accounting should follow financial accounting, it is best that the government commission a study as to which model country to follow or to continue with the status quo, similar to that commissioner by Germany. This may be the subject of future legislation. Based on the experience of other countries as earlier discussed, it appears that the best position would be the middle ground between accounting and tax. Germany, which is on one end of the extreme, now realizes that it is not advisable for tax to follow financial accounting completely. The US and the UK, which is on the other end of the extreme, now wants its tax computation to conform more closely to financial accounting computation. As to where this middle ground is, the proposed study by Philippine tax experts will best supply the answer.

While the book-tax conformity debate is raging in other countries, we have heard of no such debate in the Philippines. It is probable that many do not see the need for the said debate since our current treatment seems to be reasonable enough. Either that, or no one is really thinking about it. It is high time that we at least scrutinize our tax laws. Looking at Philippine history, we can see that many of our laws, including that of tax, have been copied from the US simply because of our status as a former colony of the US. A thorough and objective analysis is called for, if only to ascertain the best tax model for the country independent of the influence of the US. The effects of this analysis is predictably far-reaching. Taxes, as the lifeblood of government, deserves no less than an in-depth study.

VII. CONCLUSION

The IAS is a product of many years of study and debate by policymakers from different countries. It is one of the steps taken by nations towards the ultimate goal of uniformity in business transactions all over the world. The IAS is here to stay and the country has to embrace it in order to keep up with the rest of the world. In the process, however, the government should not neglect that the accounting system is tied up with other aspects of the society, such as tax. Though tax and accounting systems are inherently different, it does not mean that they are irreconcilable.

The issue on tax-accounting disparity, at first, looks too insignificant since the taxpayer has the option to choose whatever accounting method that best suits its needs. But then, we do not want to repeat the Enron experience in the Philippines. We do not want Philippine corporations to appear profitable and fall apart without warning because of cherry picking or the practice of choosing only the best practice from both systems.

This paper was able to note a number of differences between the tax and accounting treatment of income and expense. The numbers are expected to rise as the IAS is fully integrated into our existing accounting system.

We patterned, if not copied, our Tax Code from the US Revenue Code and through the years, we still refer to US jurisprudence for the proper interpretation of our very own revenue laws. Instead of waiting at the sideline for the US or another country to take the first move, let us take a pro-active role this time and bridge the gap between tax and accounting.

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