REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE
Quezon City

Sections 27 and 45 of the National Internal Revenue Code of 1997, as amended		CT-336-2022

Date: JUN 2022

Person to Contact: Chief, Law Division
Tel. Nos. 926-55-36 / 927-09-63

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Attention: **ATTY. CARLOS T. CARADO II**
Partner, Tax

Gentlemen:

This refers to your letter dated February 08, 2018, requesting on behalf of your client, NGK Spark Plugs (Philippines), Inc. ("NGK"), for confirmation on the proper timing of recognition of deductibility of sales rebates granted by NGK to its customers/distributors for income tax purposes.

It is represented that NGK was incorporated in the Philippines and registered with the Securities and Exchange Commission (SEC) on February 21, 2008; that its primary purpose is to import/export, promote, market, sell (at wholesale), and/or distribute spark plugs and/or similar parts or accessories for various kinds or types of motors; that it offers sales rebates to certain customers at graduated rates for meeting certain levels of sales volume executed under an agreement; and that its practice is to consider sales rebates as deduction from gross sales for income tax purposes upon accrual, (i.e. same period when the corresponding inventory is sold to customers/distributors) which are supported by BIR-registered credit memos.

In reply, please be informed that Section 27 (A) of the National Internal Revenue Code (Tax Code) of 1997, as amended, partly provides that:

> *"SEC. 27. Rates of Income tax on Domestic Corporations. –*
>
> *xxx xxx xxx*
>
> *(A) In General. - Except as otherwise provided in this Code, an income tax of thirty-five percent (35%) is hereby imposed upon the taxable income derived during each taxable year from all sources within and without the Philippines by every corporation, as defined in Section 22(B) of this Code and taxable under this Title as a corporation, organized in, or existing under the laws of the Philippines: Provided, That effective January 1, 2009, the rate of income tax shall be thirty percent (30%).*
>
> *xxx xxx xxx*
>
> *For purposes of this Section, the term* ***'gross income'*** *derived from business shall be equivalent to* ***gross sales less sales returns, discounts and allowances and cost of goods sold.*** *'Cost of goods sold' shall include all business expenses directly incurred to produce the merchandise to bring them to their present location and use."* (Emphasis and underscoring supplied)

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In the case of *Commissioner of Internal Revenue, vs. Central Luzon Drug Corporation,*[1] the Supreme Court states that:

> *"By ordinary acceptation, a* ***discount*** *is an "abatement or reduction made from the gross amount or value of anything." To be more precise, it is in business parlance "a deduction or lowering of an amount of money;" or "a reduction from the full amount or value of something, especially a price." In business there are many kinds of discount, the most common of which is that affecting the income statement or financial report upon which the income tax is based.*
>
> *xxx xxx xxx*
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> *..... Applying generally accepted accounting principles (GAAP) in the country, this type of discount is reflected in the income statement as a line item deducted -- along with returns, allowances,* ***rebates*** *and other similar expenses* ***-- from gross sales to arrive at net sales****. This type of presentation is resorted to, because the accounts receivable and sales figures that arise from sales discounts, -- as well as from quantity, volume or bulk discounts -- are recorded in the manual and computerized books of accounts and reflected in the financial statements at the gross amounts of the invoices. This manner of recording credit sales -- known as the gross method -- is most widely used, because it is simple, more convenient to apply than the net method, and produces no material errors over time.*
>
> *xxx xxx xxx*
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> *The term sales discounts is not expressly defined in the Tax Code, but one provision adverts to amounts whose sum -- along with sales returns, allowances and cost of goods sold -- is deducted from gross sales to come up with the gross income, profit or margin derived from business. In another provision therein, sales discounts that are granted and indicated in the invoices at the time of sale -- and that do not depend upon the happening of any future event -- may be excluded from the gross sales within the same quarter they were given. While determinative only of the VAT, the latter provision also appears as a suitable reference point for income tax purposes already embraced in the former. After all, these two provisions affirm that sales discounts are amounts that are always deductible from gross sales."* (Emphasis and underscoring supplied)

Applying the above quoted provision of the National Internal Revenue Code of 1997, as amended, and the above quoted decision of the Supreme Court, the sales rebates being offered by NGK to certain customers at graduated rates for meeting certain levels of sales volume executed under an agreement are considered as deductions from gross sales to arrive at net sales.

As to when the sales rebates shall be reported for tax purposes, Section 45 of the Tax Code of 1997, as amended, states that:

> *"SEC. 45. Period for which Deductions and Credits Taken. - The deductions provided for in this Title shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred', dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income, the deductions should be taken as of a different period. . . . ."*

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[1] G.R. No. 159647 April 15, 2005

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Revenue Audit Memorandum Order (RAMO) No. 1-2000, provides that under the accrual method of accounting, expenses not being claimed as deductions by a taxpayer in the current year when they are incurred cannot be claimed as deduction from income for the succeeding year. Thus, a taxpayer who is authorized to deduct certain expenses and other allowable deduction for the current year but failed to do so cannot deduct the same for the next year.

The accrual method relies upon the taxpayer's right to receive amounts or its obligation to pay them, in opposition to actual receipt or payment, which characterizes the cash method of accounting. Amounts of income accrue where the right to receive them become fixed, where there is created an enforceable liability. Similarly, liabilities are accrued when fixed and determinable in amount, without regard to indeterminacy merely of time of payment.

The U.S. Rules which have persuasive effect on Philippine Law, as specifically provided under paragraph 3 of Section 12A:51 of MERTENS' Law of Federal Income Taxation states as follows:

> *"For a taxpayer on the accrual method, the question becomes when do the facts present themselves in such a manner that the taxpayer must recognize income or expenses. The accrual of income or expenses is permitted when the all-events test has been met. The all-events test requires:*
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> *(1) fixing of a right to income or liability to pay; and*
> *(2) the availability of the reasonably accurate determination of such income or liability."*

The first element requires that a taxpayer's right to receive amounts in income be fixed by looking initially to the nature of the taxpayer's right to income. Generally, the taxpayer's right to receive amounts of income cannot be fixed before the time another becomes obligated to pay the income. It further requires that income accrues to the taxpayer when there arises a fixed and unconditional right to the receipt of a sum certain, even though actual payment is to be deferred.

On the second element, it requires that the amount of the income or liability be determined with reasonable accuracy. However, the all-events test does not demand that the amount of income or liability be known absolutely, only that a taxpayer has at his disposal, the information necessary to compute the amount with reasonable accuracy. It would also suffice where the computation remains uncertain, if its basis is unchangeable; the test is satisfied where a computation may be unknown within the taxable year.

In the case of *Commissioner of Internal Revenue, vs. Isabela Cultural Corporation*[2], the Supreme Court states that:

> ***"…. The amount of liability does not have to be determined exactly; it must be determined with "reasonable accuracy." Accordingly, the term "reasonable accuracy" implies something less than an exact or completely accurate amount.***
>
> ***The propriety of an accrual must be judged by the facts that a taxpayer knew, or could reasonably be expected to have known, at the closing of its books for the taxable year.*** *Accrual method of accounting presents largely a question of fact; such that the taxpayer bears the burden of proof of establishing the accrual of an item of income or deduction.*
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> *Corollarily, it is a governing principle in taxation that tax exemptions must be construed in strictissimi juris against the taxpayer and liberally in favor of the taxing authority; and one who claims an exemption must be able to*

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[2] G.R. No. 172231, February 12, 2007

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justify the sa ne by the clearest grant of organic or statute law. An exemption from the com non burden cannot be permitted to exist upon vague implications. And since a deduction for income tax purposes partakes of the nature of a tax exemption, then it must also be strictly construed."

In view thereof, the sales rebates shall be reported only as deduction by NGK for tax purposes when the all-events test has been met. Otherwise, NGK cannot claim the sales rebates as deduction in the same period they were incurred. Also, as previously stated, the accrual method presents largely a question of fact. Thus, in this case, NGK bears the burden of establishing the accrual of such expense.

This ruling is being issued on the basis on 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.

Very truly yours,

CAESAR R. DULAY
Commissioner of Internal Revenue

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