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Discussion on the Feasibility of Allowing the Tax Deductibility of Charitable Contributions and Donations from the Income of Compensation Income Earners*

I. INTRODUCTION

A cursory reading of Section 34 of the National Internal Revenue Code (NIRC) of 1997 reveals that among the allowable deductions, only the charitable contributions and donations and the premium on the hospitalization or health insurance may be considered non-business related. Presently, self-employed individuals and professionals are allowed to claim these deductions against their gross income while individuals earning compensation income, that is income arising from an employer-employee relationship, only the premium on health or hospitalization insurance not exceeding ₱200 per month or ₱2,400 per year is allowed as deductible expenses, subject also to the condition that the aggregate family income does not exceed ₱250,000 per year. Compensation income earners are not allowed to deduct from their gross income any charitable contributions or gifts made by them during the taxable year. This, therefore, raises the question of equity of the tax treatment between the said groups of individual taxpayers.

This paper discusses the feasibility of extending charitable contributions and donations as allowable expense to compensation income earners with the end in view of improving the equity feature of the individual income tax system.

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II. COMMENTS AND OBSERVATIONS

1. The deductibility of charitable and other contributions from the gross income of individual income earners, without regard to the source of income was originally allowed under Section 30 of Commonwealth Act No. 466 (CA 466)[1]. In the beginning therefore, the deduction was available to both individuals earning compensation income and business/profession income. However, the said provision on the deductibility of charitable and other donations underwent a number of amendments and revisions, as follows:

a. Republic Act (RA) No. 82[2]- provides for the partial deductibility of charitable contributions or gifts made to corporations or associations organized and operated exclusively for the rehabilitation of veterans.

b. RA 6110[3] - notwithstanding the maximum deductions provided by law, Sec. 30 (h) (1) to (14) enumerated donee institutions for which the full deductibility of donations made thereto is to be allowed.

c. Presidential Decree (P.D.) Nos. 1158 and 1158-A[4]- removed the Philippine Amateur Athletic Association from among the donee institutions to which donations are fully deductible from gross income. It also expanded the list of donee organizations from the original fourteen (14) donee institutions under RA No. 6110 to twenty-one (21). However, the law provides that to be fully deductible not more than 30% of the donations should be used for administrative purposes of the donee institution.

d. Batas Pambansa (B.P.) No. 45[5]- removed the specific enumeration of donee institutions and introduced general

[1] Otherwise Known as "The National Internal Revenue Code (NIRC)", approved on June 15, 1939 and effective July 1, 1939.

[2] Entitled "An Act to Amend Sections Twenty-One, Twenty-Two, Twenty-Three, Twenty-Four, Twenty-Seven, Twenty-Nine, Thirty, Thirty-Four, Fifty-Three, Fifty-Four, and to Repeal Subsection (U) of Section Eighty-Four of Commonwealth Act Numbered Four Hundred And Sixty-Six (CA 466), as Amended" approved October 29, 1946 and effective January 1, 1946.

[3] Entitled "An Act Amending Certain Provisions of the NIRC, as Amended", approved August 4, 1969 and effective September 1, 1969.

[4] Entitled "Amending Certain Sections of the NIRC of 1939 for Incorporation in the Consolidation and Codification of All Existing Revenue Laws Under a Presidential Decree (PD) No. 1158", issued June 3, 1977.

[5] An Act Amending Paragraph (h) of Section 30 of the NIRC of 1977, as Amended, and For Other Purposes, approved on December 18, 1979.

criteria in terms of objective and character of the donee institutions to determine whether donations made thereto are partially (subject to a ceiling) or fully deductible (not subject to a ceiling) from the gross income of the donor.

e. RA 8424[6]- increased the amount of charitable and other contributions allowed to be deducted from gross income but subject to a ceiling, from 6% to 10% in the case of individuals, and from 3% to 5% in the case of corporations.

2. At present, the deductibility of donations and other charitable contributions is governed by the provision of Section 34 of RA 8424 which states as follows:

> Section 34. Deductions from Gross Income. – Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section other than under Subsection (M) hereof, in computing taxable income subject to income tax under Section 24(A); 25 (A); 26; 27 (A)(B) and (C); and 28 (A)(1), there shall be allowed the following deductions from gross income:
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> xxx.
> (H) Charitable and Other Contributions.-
> 1) In General.- Contributions or gifts actually paid or made within the taxable year to, or for the use of the Government of the Philippines or any of its agencies or any political subdivision thereof exclusively for public purposes, or to accredited domestic corporations or associations organized and operated exclusively for public purposes, or to accredited domestic corporations or associations organized and operated exclusively for religious, charitable, scientific, youth and sports development, cultural or educational purposes or for the rehabilitation of veterans, or to social welfare institutions, or to non-government organizations, in accordance with rules and regulations promulgated by the Secretary of Finance, upon the recommendation of the Commissioner, no part of the net income of which inures to the benefit of any private stockholder or individual in an amount not in excess of ten percent (10%) in the case of an individual, and five percent (5%) in the case of a corporation, of the taxpayer's taxable income derived from trade, business or profession, computed without the benefit of this deduction.

[6] Otherwise known as "The National Internal Revenue Code (NIRC) of 1997, As Amended".

3. As a general rule, the deduction is subject to a ceiling of 5% (corporations) and 10% (individuals), of the taxpayer's gross income. It is not clear anymore why there is a ceiling on deductible contributions. In the main, it may be presumed that the ceiling is not intended to discourage charity or generosity but to prevent/minimize abuses in the claim of deductible donations. The same proviso also allows full deductibility and exemption from the 5% or 10% ceiling if the donations are made in favor of the government, foreign institutions or international organizations and accredited nongovernment organizations (NGOs).[7]

4. Based on the foregoing provision, self-employed individuals and professionals are allowed to deduct from their gross income items enumerated under Section 34 of the NIRC of 1997,[8] as amended, which are also allowed as deductions to corporations' gross income when determining the latter's liability to income tax. The allowable deductions extended to self-employed individuals and professionals include charitable contributions or donations which are either deductible in full or up to 10% of their taxable income. Meanwhile, compensation or fixed income earners are not allowed to claim deductions from their gross income except payments on health and/or hospitalization premiums/insurance under certain conditions as provided under Section 34 (M) of the NIRC, as amended.

5. Compensation income earners and professionals, as individual taxpayers, are comparable in the sense that both of them earn income through the provision of services, talents or skills. Strictly speaking, both of them appear to be engaged in the same activity, that of providing services. Their difference, if any, is in the manner by which remuneration for their services is received. As may be noted, for compensation income earners, the receipt is generally on a regular (daily, weekly, bi-monthly) interval while for professionals their income is received depending on the contract they have with and on the number of clients/persons who avail of their services. In addition, the income of a compensation income

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[7] As amended by BIR-NEDA Regulations No. 01-81 (April 30, 1981), BIR Revenue Regulations (RR) No. 10-82 (December 9,1982) and RR No. 13-98 (December 8, 1998).

[8] Section 34. Deductions from Gross Income.- Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section other than under Subsection (M) hereof, in computing taxable income subject to income tax under Sections 24(A);25(A);26;27(A),(B) and (C); and 28 (A)(1), there shall be allowed the following deductions from gross income:

(A) Expenses
(B) Interest
(C) Taxes
(D) Losses
(E) Bad Debts
(F) Depreciation
(G) Depletion of Oil and Gas Wells and Mines
(H) Charitable other Contributions
(I) Research and Development
(J) Pension Trusts
(K) Additional Requirements for Deductibility of Certain Payments
(L) Optional Standard Deductions
(M) Premium Payments on Health and/or Hospitalization Insurance of an Individual Taxpayer.

earners is usually fixed in nature, while that of a professional is variable as the same is based on number of clients/persons availing of the professional services. In providing services, however, both the compensation income earners and self-employed/professionals incur expenses such as transportation, representation, etc. Just like their self-employed counterparts, compensation income earners may also be asked/requested by certain institutions to give donations which the latter may use to pursue their activities. However, wage earners are precluded from deducting such expenses from their gross income while self-employed/business professionals as mentioned under Sec. 34 of the NIRC of 1997 as amended, are allowed to claim the same as necessary expenses in the pursuit of their business/profession. The disparity leads to an inequity in the tax treatment among the various types of individual taxpayers. It must be noted, that the 1987 Philippine Constitution enunciates that taxation must be uniform and equitable[9]. Of course, in the beginning this was not the case as all types of individual taxpayers were allowed to claim deductions from their gross income. It was only in 1982 when the Modified Gross Income Tax (MGIT) was adopted for compensation income earners that deductions ceased to be allowed for this type of taxpayers.[10] As may be noted, the MGIT was adopted in order to make the individual income tax more revenue productive and less prone to tax manipulation or abuse.

6. Thus and as based on the data[11] provided by the BIR, the income tax collection from compensation income earners for 2009 was Php 111.813 billion while that from business and professionals was only Php 18.769 billion, giving a ratio of 85.63% to 14.37% in favor of wage earners. It may also be emphasized that over the years, compensation income earners have been making more revenue contributions to the individual income tax collection as against their self-employed counterparts.

7. Considering the observation that self-employed and professionals contribute significantly less than what compensation income earners share in the individual income tax collection, one of the options that may be looked into and explored in order to somehow equalize the taxation disparity among the individual taxpayers is to review the items of deductions allowed to business/profession income earners with the end view of making their income tax payments more revenue productive and less prone to tax manipulation/abuse. Along this line, it may be mentioned that a proposal in this regard, referred to as the Simplified Net Income Tax System (SNITS) has been filed in Congress. The SNITS has, however, raised a number of issues the discussion of which is deemed beyond the scope of this paper.

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[9] Section 28 (1) Article VI of the 1987 Philippine Constitution provides that "The rule of taxation shall be uniform and equitable."

[10] Pursuant to Batas Pambansa Blg. 135 (BP 135) also known as "An Act Amending Certain Provisions of the NIRC of 1977, As Amended, and for Other Purposes". Approved December 18, 1981. Effective January 1, 1982.

[11] 2009 BIR Annual Report.

8. From another angle, allowing compensation income earners to deduct their donations may also be an option to correct the disparity in the tax treatment of individual income taxpayers.

9. Allowing compensation income earners to deduct donations and contributions from their gross income has another beneficial effect which is to encourage philanthropy such that donations are expected to increase and thereby generate more funds and resources to donee institution/s that will consequently redound to the benefit and welfare of the less fortunate citizens of the country. In a way, the amount of donations deducted from the gross income of wage earner may be viewed as a form of government subsidy or revenue directly appropriated from its coffers to help the less fortunate citizens. In a way therefore, the government is only assisting, together with individual donors or contributors, welfare-oriented institutions which are in turn helping the less fortunate segment of our society.

10. Also, extending the privilege of deducting charitable contribution from gross income on the part of compensation income earners will further strengthen the provision of the Constitution that "the State shall encourage non-governmental, community based, or sectoral organizations that promote the welfare of the nation"[12].

11. The government recognizes the important role of non-government organizations in the promotion of national welfare. Donations or contributions to nonprofit sector is of critical importance in poor countries like the Philippines as it provides urgently needed basic services to the poor as a complement to government programs. In a report[13] released by the National Disaster Coordinating Council (NDCC) on the after effects of "Typhoon Ondoy" which devastated several provinces in the Philippines on September of 2009, the total cost of damage both to infrastructure and agriculture was Php 11 billion. The total cost of assistance in cash or in kind provided by the government during the relief operation was Php 161.266 million including that of NGOs. The assistance given by NGOs' and International Nongovernment Organizations' amounted to Php 17.740 million or 11% of the total cost. It is however important to note, that the government through the NDRRMC account, Department of Social Welfare and Development (DSWD), Department of Health (DOH) and other government agencies also received significant amount of donations from international and local donors, as follows:

[12] Section 23 Article II of the 1987 Philippine Constitution.

[13] National Disaster Coordinating Council's (NDCCs) Final Report on Tropical Storm "Ondoy" (Ketsana). www.ndcc.gov.ph/attachments/092_NDCC Update Final Report re TS Ondoy and Pepeng.pdf. (viewed June 21, 2011). The NDCC was later renamed as the National Disaster Risk Reduction and Management Council (NDRRMC).

Table 1. SUMMARY OF DONATIONS RECEIVED FROM INTERNATIONAL AND LOCAL DONORS FOR TYPHOON ONDOY AND TYPHOON PEPENG[14]

Government Agency	*Amount*	*Donor and Type of Donation*
NDRRMC Account	Php 20,852,633.87 Php 17,180,560.26	International (Cash and Check) Local (Cash and Check)
DSWD	Php 256.84 million Php 120.67 million	Worth of Relief supplies Local and International (Cash)
DOH	Php 8.16 million	In kind
	Php 0.36 million	Cash

12. In the Asia Pacific Region it was found out in a study entitled, "Philanthropy and Law in Asia: A Comparative Study of the Nonprofit Legal Systems in Ten Asia Pacific Societies"[15] that charitable contributions are generally deductible from taxable income. However, most nations in the region limit the percentage that individual and corporate contributors may deduct. For individuals, tax deductible contribution limits expressed as a percentage of income range from 5% (Korea) to 10% (Thailand) to 25% (Japan). Also, the applicable percentage for corporations usually differs from that available to individuals: 2% rather than 10 % in Thailand, and 7 % rather than 5% in Korea. Australia and Singapore on the other hand, allow unlimited deductions for charitable contributions to non-profit organizations (NPOs).[16]

13. Hong Kong's tax system lists allowances including charitable contributions as deductible from assessable income for salaries tax purposes which is up to 35% of an individual's income after allowable expenses and depreciation allowances or assessable profits. [17] India, on the other end, provides a 50%-100% tax deduction for charitable donations. Donations to certain funds, approved educational institutions of national importance, and charitable institutions are deductible by 50% of the donated amount. While

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[14] NDCCs Final Report on Tropical Storm Ondoy and Peping. page 17. www.ndcc.gov.ph/attachments/092_NDCC Update Final Report re TS Ondoy and Pepeng.pdf. (viewed June 21, 2011).

[15] Source:http://www.asiapacificphilanthropy.org/files/philanthropy%20and%20law%20in%20asia.pdf (June 27, 2011).

[16] Ibid, p. 55.

[17] www.lowtax.net/lowtax/html/hongkong/jhkpetx.html (June 27, 2011).

donations to the Prime Minister Relief Funds, National Foundation for Communal Harmony, Blood Transfusion Council, The Africa Fund, and Earthquake Relief Fund are deductible up to 100% of the donated amount[18].

14. Also, several countries in the Central and East European region provide incentives for donations by individuals to charity in the form of tax deductions or tax credits. (See Annex A for a list of such countries).

15. Moreover, a study[19] observes that there are two benefits of fundamental importance from public policy standpoint of tax deductions on charitable contributions. The first is the concept of treasury efficiency. Charitable deductions can be more efficient than direct subsidies when deductions serve to unlock private funds that would not have been otherwise available to benefit the public. Private funds would not have been available if the government had acted on its own, providing a direct subsidy to the NGO. The second concept is the notion of a joint venture between the government and the donor claiming a deduction. In this situation the donor, not the government, selects the charities that will receive the donor's contributions without obligation to repay the money given on the part of the recipient organization. This in turn ensures that the money donated will go to a cause that the donor supports. The joint venture is completed when the government recognizes the contribution made as an item of deduction/credit for income tax purposes of the donor.

16. Based on the foregoing, there are sufficient arguments to allow compensation income earners to deduct donations and contributions from their gross income.

17. On the other hand, there are also arguments to disallow the deduction. The primary reason is that, allowing the deductibility of donations to compensation income earners will lead to a lower tax base/ net taxable income ultimately resulting to revenue loss on the part of the government. Moreover, taking into consideration that in the Philippines, the bulk of income tax collected by the government comes from compensation income earners, a claim of deduction for their donations by such taxpayers may result into a considerable amount of revenue loss which the government cannot afford as of this time in the light of the fiscal crisis which it is experiencing.

18. Also, allowing the deductibility of donations whether in part or in full from compensation income earners will distort or weaken the MGIT presently applied on these earners. What may be done instead is to press for the passage of the SNITS for self-employed individuals so that some sort of parity may be established for all individual income earners. Allowing compensation income earners to claim deduction for their contributions can also entail additional workload on the part of the BIR which is tasked to verify every

[18] www.causeindia.com/taxdeductions.php (June 27, 2011)

[19] Thomas Silk (Editor) "*Philanthropy and Law in Asia: A Comparative Study of the Non-Profit Legal Systems in Ten Asia Pacific Societies*," at http://www.asiapacificphilanthropy.org/files/philanthropy%20and%20law%20in%20asia.pdf (June 27, 2011).

item of deduction claimed by a taxpayer as said claim can be a source of tax abuse and leakage which the taxpayers may take advantage of. Given the increasing number of taxpayers and those claiming itemized deductions, it may be better that the verification efforts of the BIR be concentrated or focused on self-employed individuals for greater and optimum revenue results.

19. The fact also that most compensation income earners (especially if they have only one employer) are subject to a withholding tax scheme renders the deduction of contributions impractical or difficult to implement. As the tax is withheld even before the contribution is made (or even after the contribution is made), there will be problems in setting the applicable withholding tax. If the withholding tax is less/more, tax payment/refund is going to be a consequence. The employee must likewise inform his/her employer about the donation and the latter should also check the correctness of deduction claimed before making any adjustment in the withholding tax system.

20. Based on the foregoing, the retention of the present MGIT on compensation income earners is recommended. Thus, the deduction of contributions from the taxable income of compensation income earners is not endorsed.

III. CONCLUSION

1. There appears to be a disparity in the tax treatment of compensation income earners and self-employed/ business professionals. An option that may be explored to promote equity among individual taxpayers which is also practiced in other countries is to allow the deductibility of donations and other charitable contributions from the gross income of all individual income earners. This was the practice before in the Philippines. However, in view of the need to make the income tax more revenue productive and less prone to the manipulation/abuse, compensation income earners were subjected to the MGIT under which no claim for deduction is allowed. The MGIT has proven to be a revenue-productive scheme. Wage earners constitute the bulk of the income tax revenue contributions.

2. Allowing them, therefore, to claim a deduction for their contributions may be counterproductive as it may lead to a substantial government revenue loss which the latter can ill afford at this time. In addition, there are administrative/implementation problems likely to arise from the proposal.

3. To correct the tax disparity among individual taxpayers, the government should instead put a limit on the deductions claimed by self-employed individuals.

Annex A

Table 1. RATES OF TAX DEDUCTIONS OR CREDITS FOR DONATIONS AND CHARITABLE CONTRIBUTIONS OF INDIVIDUALS

Country	Rate of Charitable Contribution as Tax Deduction/Credit
1) Federation Of Bosnia and Herzegovina	100% deductible
2) Bulgaria	5 % of income
3) Republic Of Srpstka	10% of income
3) Croatia	2% of income
4) Czech Republic	10% of income. However, to qualify for such deduction, the donation must at least be 2% of the donor's income.
5) Estonia	5% of taxable income
6) Hungary	30% of the donation (Tax Credit)
7) Slovakia	Can deduct contribution in excess of 2% of their tax liability but not more than 10%.
8) Poland	10% of the donor's taxable basis if donations were made to organizations whose activities include charity, religion, public security, national defense, environmental protection, fire protection and housing investment by local government; 15% -donations to organizations whose activities include, science, education, culture, sport and physical exercise, rehabilitation of the disable, health care and social care and support for infrastructure investment in rural areas.

Source:
http://www.icnl.org/knowledge/pubs/Analysis_Tax_Benefits_Charitable_Donations_Individuals.pdf (June 28, 2011).