Republic of the Philippines
HOUSE OF REPRESENTATIVES
Quezon City, Metro Manila

Eighteenth Congress
First Regular Session

House Bill No. 4425

Introduced by Representative Jose "Jun" L. Ong, Jr.

EXPLANATORY NOTE

Optional Standard Deduction (OSD) was originally introduced in Presidential Decree No. 1158, or the "*National Internal Revenue Code of 1977,*" as an option for individual taxpayers, except those who receive purely compensation income and non-resident aliens, in lieu of availing itemized expenses or deductions from their gross income. Section 34(L) of Republic Act (RA) No. 8424, or the "*Tax Reform Act of 1997*," provided a slight modification on OSD by exempting those who avail of the OSD option from attaching the required financial statements to their income tax returns. Both laws pegged the rate for OSD at 10% of the individual's gross income.

In 2008, RA 9504 amended Section 34(L) by increasing the rate from 10% to 40% and allowing corporations to avail of the OSD. However, the amended Section 34(L) provided that the OSD for individuals shall be pegged at 40% of their gross receipts or gross sales, and for corporations at 40% of gross income. In 2017, RA 10963, or the "Tax Reform for Acceleration and Inclusion (TRAIN)," further amended Section 34(L) by allowing OSD to be availed alternatively either by general partnerships or its individual partners.

The introduction of a different basis for claiming OSD (i.e., gross receipts or gross sales for individuals vs. gross income for corporations) tended to put individuals at great disadvantage because this actually assumes that individuals or sole proprietors do not incur cost of goods sold, when in actuality, many sole proprietors do incur cost of goods sold just the same way as corporations do.

Single proprietors and corporations are similarly situated when it comes to the determination of taxable income as both of them deduct from their gross receipts or gross sales their cost of goods sold to arrive at their gross income, and thereafter their operating expenses are deducted from their gross income to arrive at their taxable income. However, the amended Section 34(L) gave an unreasonable disadvantage to sole proprietors because their income tax base is higher compared to corporations. The corresponding cost of goods sold is not allowed to be deducted from a single proprietor's gross receipts or gross sales to arrive at his gross income, hence the single proprietor may be paying income tax that includes as tax base, portion of the cost of goods sold.

It is unreasonable if not outright confiscatory to disallow cost of goods sold as deductible to gross receipts or gross sales in the case of single proprietors. There is no tax scheme in the world that does not consider cost of goods sold as being deductible to gross receipts or gross sales. The OSD replaces itemized expenses and not cost of goods sold because cost of goods sold should be based on actual cost and cannot be subject to a standardized rate that cuts across all industries.

Still, there is a need to amend Section 34(L) because the present scheme actually put into a disadvantageous position, single proprietors whose tax base is higher due to the non-deductible cost of goods sold as a precondition to its allowable rate for optional standard deduction of 40% of gross receipts or gross sales and not 40% of gross income like that of a corporation. It is noteworthy that a simple and standardized OSD rate of 40% of gross income is equitable for all types of taxpayers.

Hence, the approval of this proposed measure is earnestly urged.

JOSE "JUN" L. ONG, JR.

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AN ACT
PRESCRIBING A STANDARDIZED RATE FOR OPTIONAL STANDARD DEDUCTION AT FORTY PERCENT (40%) OF GROSS INCOME FOR ALL TAXPAYERS, AMENDING FOR THE PURPOSE SECTION 34(L) OF NATIONAL INTERNAL REVENUE CODE OF 1997, AS AMENDED

Be it enacted by the Senate and House of Representatives of the Philippines in Congress assembled:

SECTION 1. Section 34(L) of the National Internal Revenue Code of 1997, as amended, is hereby further amended to read as follows:

"SEC 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, 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*. –

"(1) *Ordinary and Necessary Trade, Business or Professional Expenses*. –

"(a) *In General – x x x*

"x x x

"(L) *Optional Standard Deduction (OSD)*. – In lieu of the deductions allowed under the preceding Subsections, an individual subject to tax under Section 24, other than a nonresident alien, may elect a standard deduction in an amount not exceeding forty percent (40%) of his gross [~~sales or gross receipts, as the case may be~~] INCOME. In the case of a corporation subject to tax under Sections 27(A) and 28(A)(1), it may elect a standard deduction in an amount not exceeding forty percent (40%) of its gross income as defined in Section 32 of this Code. x x x

"x x x."

SEC. 2. This Act shall take effect fifteen (15) days after its publication in the *Official Gazette* or in a newspaper of general circulation.

Approved,