

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

July 10, 2002

REVENUE REGULATIONS NO. 10-2002

SUBJECT: Implementing the Provisions of Section 34(A)(1)(a)(iv) of the Tax Code of 1997, Authorizing the Imposition of a Ceiling on “Entertainment, Amusement and Recreational Expenses”

TO: All Internal Revenue Officers and Others Concerned

Pursuant to Section 244 of the Tax Code of 1997, in relation to Section 34(A)(1)(a)(iv) of the same Code, these Regulations are hereby promulgated to provide a ceiling on the amount of entertainment, amusement and recreation expense claimed by individual taxpayers engaged in business or in the practice of their profession and of domestic or resident foreign corporations, to arrive at the taxable income subject to income tax under Sections 24(A); 25(A)(1); 26; 27(A), (B) and (C); 28(A)(1); 28(A)(6)(b) and Section 61, all of the Tax Code of 1997.

SECTION 1. COVERAGE - These regulations shall cover entertainment, amusement and recreation expenses of the following taxpayers:

- a. Individuals engaged in business, including taxable estates and trusts;
- b. Individuals engaged in the practice of profession;
- c. Domestic corporations;
- d. Resident foreign corporations;
- e. General professional partnerships, including its members.

SECTION 2. DEFINITION OF TERMS - For purposes of these Regulations, the term “**Entertainment, Amusement and Recreation Expenses**” includes representation expenses and/or depreciation or rental expense relating to entertainment facilities, as described below.

The term “**Representation Expenses**” shall refer to expenses incurred by a taxpayer in connection with the conduct of his trade, business or exercise of profession, in entertaining, providing amusement and recreation to, or meeting with, a guest or guests at a dining place, place of amusement, country club, theater, concert, play, sporting event, and similar events or places. For purposes of these Regulations, representation expenses shall not refer to fixed representation allowances that are subject to withholding tax on wages pursuant to appropriate revenue regulations.

In the case particularly of a country, golf, sports club, or any other similar club where the employee or officer of the taxpayer is the registered member and the expenses incurred in relation thereto are paid for by the taxpayer, there shall be a presumption that such expenses are fringe benefits subject to fringe benefits tax unless the taxpayer can prove that these are actually representation expenses. For purposes of proving that said expense is a representation expense and not fringe benefits, the taxpayer should maintain receipts and adequate records that indicate the (a) amount of expense (b) date and place of expense (c) purpose of expense (d) professional or business relationship of expense (e) name of person and company entertained with contact details.

The term “**Entertainment Facilities**” shall refer to (1) a yacht, vacation home or condominium; and (2) any similar item of real or personal property used by the taxpayer primarily for the entertainment, amusement, or recreation of guests or employees. To be considered an entertainment facility, such yacht, vacation home or condominium, or item of real or personal property must be owned or form part of the taxpayer’s trade, business or profession, or rented by such taxpayer, for which the taxpayer claims a depreciation or rental expense. A yacht shall be considered an entertainment facility under these Regulations if its use is in fact not restricted to specified officers or employees or positions in such a manner as to make the same a fringe benefit for purposes of imposing the fringe benefits tax.

The term “**Guests**” shall mean persons or entities with which the taxpayer has direct business relations, such as but not limited to, clients/customers or prospective clients/customers. The term shall not include employees, officers, partners, directors, stockholders, or trustees of the taxpayer.

SECTION 3. EXCLUSIONS - The following expenses are not considered entertainment, amusement and recreation expenses as defined under Section 2 hereof:

- a. Expenses which are treated as compensation or fringe benefits for services rendered under an employer-employee relationship, pursuant to Revenue Regulations 2-98, 3-98 and amendments thereto;
- b. Expenses for charitable or fund raising events;
- c. Expenses for bonafide business meeting of stockholders, partners or directors;

- d. Expenses for attending or sponsoring an employee to a business league or professional organization meeting;
- e. Expenses for events organized for promotion, marketing and advertising including concerts, conferences, seminars, workshops, conventions, and other similar events;
- f. Other expenses of a similar nature.

Notwithstanding the foregoing, such items of exclusions may, nonetheless, qualify as items of deduction under Section 34 of the Tax Code of 1997, subject to conditions for deductibility stated therein.

SECTION 4. REQUISITES OF DEDUCTIBILITY OF “ENTERTAINMENT, AMUSEMENT AND RECREATION EXPENSE” - The following are the requisites for deductibility of entertainment, amusement and recreation expense as defined above subject to the ceiling prescribed under Section 5 of these Regulations:

- a. It must be paid or incurred during the taxable year;
- b. It must be: (i) directly connected to the development, management and operation of the trade, business or profession of the taxpayer; or (ii) directly related to or in furtherance of the conduct of his or its trade, business or exercise of a profession;
- c. It must not be contrary to law, morals, good customs, public policy or public order;
- d. It must not have been paid, directly or indirectly, to an official or employee of the national government, or any local government unit, or of any government-owned or controlled corporation (GOCC), or of a foreign government, or to a private individual, or corporation, or general professional partnership (GPP), or a similar entity, if it constitutes a bribe, kickback or other similar payment;
- e. It must be duly substantiated by adequate proof. The official receipts, or invoices, or bills or statements of accounts should be in the name of the taxpayer claiming the deduction; and
- f. The appropriate amount of withholding tax, if applicable, should have been withheld therefrom and paid to the Bureau of Internal Revenue.

SECTION 5. CEILING ON ENTERTAINMENT, AMUSEMENT, AND RECREATION EXPENSE – There shall be allowed a deduction from gross income for entertainment, amusement and recreation expense, as defined in Section 2 of these Regulations, in an amount equivalent to the actual entertainment, amusement and recreation expense paid or incurred within the taxable year by the taxpayer, but in no case shall such deduction exceed **0.50 percent (%)** of net sales (i.e., gross sales less sales returns/allowances and sales discounts) for taxpayers engaged in sale of goods or properties; or **1.00 percent (%)** of net revenue (i.e., gross revenue less discounts) for

taxpayers engaged in sale of services, including exercise of profession and use or lease of properties. However, if the taxpayer is deriving income from both sale of goods/properties and services, the allowable entertainment, amusement and recreation expense shall in all cases be determined based on an apportionment formula taking into consideration the percentage of the net sales/net revenue to the total net sales/net revenue, but which in no case shall exceed the maximum percentage ceiling provided in these Regulations.

Apportionment Formula:

$$\frac{\text{Net sales/net revenue}}{\text{Total Net sales and net revenue}} \times \text{Actual Expense}$$

Illustration: ERA Corporation is engaged in the sale of goods and services with net sales/net revenue of P200,000 and P100,000 respectively. The actual entertainment, amusement and recreation expense for the taxable quarter totaled to P3,000.

	Net sales/ Net revenue (1)	Ent., Amusement & Recreation Expense (EAR) based on Apportionment Formula* (2)	Max. Percentage Ceiling of EAR Expense** (3)	Allowable Amt to be claimed as EAR Expense (whichever is lower of col. 2 and 3) (4)
Sale of Goods	P 200,000	P2,000	P 1,000	P 1,000
Sale of Services	100,000	1,000	1,000	1,000
Total	P 300,000	P 3,000	P 2,000	P 2,000

*Apportionment Formula

Sale of Goods (P200,000/P300,000) x P3,000
 Sale of Services(P100,000/P300,000) x P3,000

**Maximum Percentage Ceiling

Sale of Goods (P200,000 x 0.50%)
 Sale of Services (P100,000 x 1%)

In the above illustration, ERA Corporation can only claim a total of P2,000 as entertainment, amusement and recreation expense.

Notwithstanding the ceiling imposed on such expense, the claimed expense shall be subject to verification and audit for purposes of determining its deductibility as well as compliance with the substantiation requirements as provided in these Regulations. However, if after verification a taxpayer is found to have shifted the amount of the entertainment, amusement and recreation expense to any other expense in order to avoid being subjected to the ceiling herein prescribed, the amount shifted shall be

disallowed in its totality, without prejudice to such penalties as may be imposed by the Tax Code of 1997.

SECTION 6. REPORTING – The taxpayer is hereby required to use in its financial statements and income tax return the account title “entertainment, amusement and recreation expense”, or in the alternative, to disclose in the notes to financial statements the amount corresponding thereto when recording expenses paid or incurred of the nature as defined in Section 2 of these Regulations. However, such expense should be reported in the taxpayer’s income tax return as a separate expense item.

SECTION 7. REPEALING CLAUSE - All existing rules, regulations and other issuances or portions thereof inconsistent with the provisions of these Regulations are hereby modified, repealed or revoked accordingly.

SECTION 8. EFFECTIVITY - The ceiling provided herein shall apply only to entertainment, amusement and recreation expenses paid or incurred beginning Sept.1, 2002, regardless of the taxpayer’s accounting period (i.e., whether calendar or fiscal year).

APPROVED:

(Original Signed)
JOSE ISIDRO N. CAMACHO
Secretary of Finance

RECOMMENDING APPROVAL:

(Original Signed)
RENÉ G. BAÑEZ
Commissioner Of Internal Revenue