NIRC – Notes on Accounting Periods and Methods of Accounting
Some excerpts from Atty. Casasola's Tax Book
NOTE: PRE-TRAIN LAW

CHAPTER VIII. ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

Sec. 43. General Rule – Taxable income is computed upon basis of taxpayer's annual accounting period (fiscal or calendar) in accordance with the method of accounting regularly employed xxx; but if no such method has been so employed, or if method does not clearly reflect the income, the computation shall be made in accordance with the method prescribed by Commissioner. If taxpayer's annual accounting period is other than fiscal year or if taxpayer has no annual accounting period or does not keep books, or if the taxpayer is individual, taxable income shall be computed on the basis of calendar year.

NOTES:

A. General Rule: Accounting period is 12 months. It can be:
    a. Calendar accounting period
    b. Fiscal accounting period
B. Exception: Taxpayer may have taxable period of less than 12 months.
    a. Short accounting period
C. Accounting Methods:
    a. Essentials (p. 473, Casasola).
        i. Inventories of merchandise on hands should be taken at the beginning and end of year.
        ii. Expenditures should be classified as between capital and income; that is to say, expenditures for items of plant, equipment, etc, which have useful life existing substantially beyond the year should be charged to capital account (and not expense account).
        iii. When cost of capital assets is being recovered through deductions for wear and tear/depletion/obsolescence, any expenditure (other than ordinary repairs) made to restore it should be added to property account or charged against appropriate reserve, and not to current expenses.
    b. Different accounting methods:
        i. Cash
        ii. Accrual

iii. Installment payment basis (when collections extend to long periods; initial payments in the year must be < 25% of gross selling price)

iv. Deferred payment basis method – for real estate dealers in sale of real properties; wherein although payment is on installment, sale shall be considered as CASH BASIS when initial payments in the year of sale is > 25% of gross selling price.

v. Percentage-of-completion-basis method (in long term contracts, whereby gross income derived from such contract may be reported upon basis of percentage of completion).

Sec. 44. Period in Which Items of Gross Income Included – Amount of all items of gross income shall be included in gross income for the taxable year in which received by taxpayer, unless xxx any such amounts are to be properly accounted for as of different period. In case of death, include all amounts accrued up to the date of death.

Sec. 45. Period for which Deductions and Credits Taken – Deductions shall be taken for the taxable year in which "paid or accrued" or "paid or incurred" xxx UNLESS in order to clearly reflect the income, deductions should be taken as of different period. In case of death xxx (see Sec. 44, last sentence).

NOTES:

A. Under accrual method, expenses not being claimed as deductions in the current year when they are incurred cannot be claimed as deduction from income for the succeeding year. Hence, a taxpayer who is authorized to deduct certain expenses and other allowable deductions for the current year but failed to do so cannot deduct the same for the next year.

B. The accrual of income/expense is permitted when all-events test has been met, which requires: 1) fixing of right to income or liability to pay; and 2) availability of reasonable accurate determination of such income or liability.

Sec. 46. Change of Accounting Period – When changing from fiscal to calendar, or calendar to fiscal, or fiscal to fiscal, net income shall be computed on basis of new accounting period, subject to provisions of Sec. 47. It must be approved by Commissioner.

NOTES:

A. Application for permission to change the accounting method and the basis shall be filed < 90 days after beginning of taxable year to be covered by return.
B. Individual taxpayer CANNOT change his accounting period from calendar to fiscal, because he is only allowed to use calendar year basis.
C. However a corporation or general co-partnership who desired to change from calendar to fiscal and vice-versa, shall submit written application to Commissioner > 60 days prior to beginning of proposed new accounting period.

Sec. 47. Final or Adjustment Returns for Period Less Than 12 Months

A. Returns for Short Period Resulting from Change of Accounting Period – For fiscal to calendar, a separate final or adjustment return shall be made for period between the close of last fiscal year for which return was made, and the following Dec. 31. For calendar to fiscal, or fiscal to fiscal, see codal.
B. Income Computed on Basis of Short Period – see codal.
   a. NOTES: When short-period return required to be filed
      i. No return can be made for period > 12 months.
      ii. A separate return for fractional part of year is required when there is change on basis of computing taxable income from one year to another year.

Sec. 48. Accounting for Long-Term Contracts. See codal.

NOTES:
A. Long-term contracts means building/installation/construction contracts covering > 1 year.
B. Use percentage-of-completion basis as accounting method.
C. There shall be deducted from gross income all expenditures on account of contract, account being taken of the material and supplies on hand at beginning and end of taxable period for use in connection with work but not yet so applied.

Sec. 49. Installment Basis

A. Sales of Dealers in Personal Property – The person may return as income in any year the proportion of installment payments actually received in that year, which the gross profit realized/to be realized when payment is completed, bears to total contract price.

    i. Thus, income of dealer in personal property on installment may be ascertained by taking as income that proportion of the total payments received in the taxable year from installment sales (such payments being allocated to the year against the sales of which they apply), which the total or gross profit realized/to be realized on the total installment sales made during each year bears to the total contract price of all such sales made during that respective year.
    ii. Deductible items are not to be allocated to the years in which the profits from the sale of particular year are to be returned as income, but must be deducted for taxable year in which the items are "paid or incurred" or "paid or accrued".

B. Sales of Realty and Casual Sales of Personalty – See codal. Income may be returned on the basis and in the manner prescribed in this Sec.

    a. Installment-basis method. Income from casual sale or disposition of personal property (other than property of a kind which should properly be included in inventory) may be reported on installment basis ONLY IF:
        i. Sales price > P1,000.
        ii. Initial payments < 25% of selling price
    b. In installment-basis, the vendor may return as income from such transactions in any taxable year that proportion of installment payments actually received in that year which the total profit realized/to be realized when property is paid for bears to the total contract price.
    c. Meaning of "deferred-payment sales of real property" – p. 490, Casasola
    d. Initial payments - contemplates at least 1 other payment in addition to initial payment.

C. Sales of Real Property Considered as Capital Asset by Individuals – individual may pay the capital gains tax in installments

D. Change from Accrual to Installment Basis – If taxpayer entitled to benefits of 49A elects to report his income on installment basis, then in computing his income for the year of change/subsequent years, amounts actually received during any such year on account of sales/disposition made in any prior year shall be excluded.

Sec. 50. Allocation of Income and Deductions – In case of two or more org/trade/businesses (whether or not incorporated/organized in PH) owned/controlled directly/indirectly by same interests, Commissioner is authorized to distribute/apportion/allocate gross income/deductions between or among such org/trade/business, if he determines that such xxx is necessary in order to prevent evasion of taxes or clearly to reflect income.

NOTES:

A. Reason: To place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining the true net income of a controlled taxpayer. Controlled taxpayer means any one of 2+ org/trade/businesses owned/controlled directly/indirectly by same interests.
B. See p. 495, Casasola, on sample application of this section.

Chapter VIII ends here.
