

Midterm Examination
Taxation 1: Income Taxation
University of San Jose – Recoletos
School of Business and Management
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35 MCQs – Theories and Short Problems

3 Open Ended Questions – Long Problems

1. Statement 1: Taxation is an inherent power of the State. True
Statement 2: The primary purpose of taxation is to generate revenue in a form of taxes to be used by the State for the benefit of the community and its subjects. True
Statement 3: The benefits received theory is based on the mutual support of the people and its government. True
Statement 4: Levying is the first aspect of taxation wherein the Congress pass tax laws to be enacted.
 - a. Only one statement is true.
 - b. Two statements are true.
 - c. Three statements are true.
 - d. All statements are true.**
2. Statement 1: All powers of the CIR can be delegated if there is a proper passing of its authority, and it is manifested through writing of a revenue memorandum order. False
Statement 2: Non-resident citizens are subject to a final tax of 25% on their gross income. False
Statement 3: In taxation, gross income and taxable income are defined differently. True (False)
Statement 4: Return on capital increases wealth and is therefore subject to tax. True
 - a. Only one statement is true.
 - b. Two statements are true.**
 - c. Three statements are true.
 - d. All statements are true.
3. Statement 1: In determining the classification of an individual taxpayer, the first thing to take note is his/her intention in coming to the country. True
Statement 2: Taxable estates, like business partnerships, are being taxed as a corporation. False
Statement 3: Recovery of lost profits is a return of capital and is therefore not taxable. False
Statement 4: Unrealized gains from holdings is subject to capital gains tax. False
 - a. Only one statement is true.**
 - b. Two statements are true.
 - c. Three statements are true.
 - d. All statements are true.
4. Statement 1: Income already subjected to final taxes are no longer part of the computation for gross income subject to basic tax. True
Statement 2: All residents and all citizens are subject to tax in their world income. False
Statement 3: Remunerations received by the employee from his/her employer are called compensation income. True
Statement 4: Ordinary and necessary expenses incurred by the employee for the benefit of his/her employer's business is not part of the employee's compensation income. True

- a. Only one statement is true.
 - b. Two statements are true.
 - c. Three statements are true.**
 - d. All statements are true.
- 5. Statement 1: Debt cancellation out of mere generosity of the creditor is subject to income tax. False
 Statement 2: Fringe benefits given to rank and file employees are subject to basic taxes. True
 Statement 3: Ordinary gains and losses are subject to basic taxes. However, only 50% of the loss shall be offsetted against the ordinary gain if the asset was held longer than 12 months. False
 Statement 4: Using the cash basis of accounting, only income received and expenses actually paid will be recognized for the year. True
 - a. Only one statement is true.
 - b. Two statements are true.**
 - c. Three statements are true.
 - d. All statements are true.
- 6. Statement 1: Employer's share of mandatory contributions is part of compensation income of the employee. False
 Statement 2: The scopes of taxation are comprehensive, unlimited, plenary and supreme. True
 Statement 3: The CIR or the Commissioner of Internal Revenue is the head chief of the Bureau of Internal Revenue. True
 Statement 4: Creditable withholding taxes are the income tax credits on the income tax model. True
 - a. Only one statement is false.**
 - b. Two statements are false.
 - c. Three statements are false.
 - d. All statements are false.
- 7. Statement 1: Capital gains tax are final taxes withheld at source. True
 Statement 2: The use of a company owned yacht is subject to fringe benefits tax. True
 Statement 3: A foreign travel with documentary evidence is exempt from fringe benefits tax in its entirety. False
 Statement 4: The situs of taxation is limited only up to the extent of the State's geological boundaries. False
 - a. Only one statement is false.
 - b. Two statements are false.**
 - c. Three statements are false.
 - d. All statements are false.
- 8. Statement 1: One of the inherent limitations of taxation is that it is required to undergo a due process of law. False
 Statement 2: Generally, the Congress is vested with the exclusive right to legislative taxing power. True
 Statement 3: Taxation is superior to the impairment clause. False
 Statement 4: Whether actually or constructively given, an income is deemed to be considered received. True
 - a. Only one statement is false.
 - b. Two statements are false.**

- c. Three statements are false.
 - d. All statements are false.
- 9. Statement 1: It is a realized benefit if it comes from an onerous transfer/transaction only. False
Statement 2: The income tax model should also be followed for income subject to final taxes. False
Statement 3: The excess amount of the 90,000 threshold of the 13th month pay and other benefits given to a supervisor is subject to basic taxes. False
Statement 4: Both percentage of completion and completed contract method are acceptable methods of recognizing income starting January 1, 1998. False
 - a. Only one statement is false.
 - b. Two statements are false.
 - c. Three statements are false.
 - d. All statements are false.**
- 10. Statement 1: Income received by minimum wage earners are not subject to taxes. True
Statement 2: If the separation is due to events beyond the control of the employee, the separation pay will not be part of gross income. True
Statement 3: Retirement pays given by the employer without a reasonable private plan will not be exempt from income tax. True
Statement 4: In taxation, fair market value is always the market value given by the CIR. False
 - a. Only one statement is false.**
 - b. Two statements are false.
 - c. Three statements are false.
 - d. All statements are false.
- 11. The following are the characteristics of the power of taxation, except:
 - a. Imposition is unlimited
 - b. Imposed even in the absence of a constitutional grant
 - c. Exercised by the government
 - d. Superior to the non-impairment clause**
- 12. Debt cancellation resulting to a capital transaction is treated as a dividends, and will be:
 - a. Treated as a compensation income
 - b. Treated as a gift
 - c. Treated as dividends**
 - d. Treated as fringe benefits
- 13. The following are supplementary income, except:
 - a. Commissions
 - b. Basic Salary**
 - c. Overtime Pay
 - d. Hazard pay
- 14. Which one of these is a similarity among the three inherent powers of the state?
 - a. All are superior to the non-impairment clause.
 - b. All are exercised exclusively by the government.
 - c. All presupposes an equivalent form of compensation received by the persons affected by the exercise of the power.**
 - d. All are unlimited in nature.
- 15. What is the tax treatment of a gain on sale of a real property?

- a. Subject to 15% CGT
 - b. Subject to 6% CGT**
 - c. Subject to Basic Taxes
 - d. Non-taxable
16. Which of the following is an ordinary asset?
- a. Jewelries held within 12 months
 - b. A condo unit bought from a friend
 - c. House and lot held by a real estate developer**
 - d. A one-month old car
17. Housing benefits given to a managerial employee is subject to:
- a. Basic taxes
 - b. Final tax of 35% or 25%**
 - c. Final tax of 35% or 15%
 - d. Not taxable
18. The following are conditions for a sale of real property to be exempt from capital gains tax, except:
- a. The seller must be a resident or citizen.
 - b. The real property being sold should be the seller's principal residence, and he/she should be able to use the proceeds of the sale to purchase a new principal residence.
 - c. Exemption can be availed once in every 10 years.
 - d. BIR is duly notified of the taxpayer's intention within 18 months from the date of sale.**
19. What is the situs of taxation for interest income?
- a. Creditor's residence
 - b. Debtor's residence**
 - c. Place where the loan was received
 - d. Presumed earned within the Philippines.
20. The pre-dominance test is to be used for dividends given by a:
- a. Non-resident foreign corporation
 - b. Domestic Corporation
 - c. Resident Foreign Corporation**
 - d. All corporation regardless of the corporation's classification
21. Royalties received every quarter for books published by KTH Publishing amounts to P500,000. The company employs a 60/40 royalty sharing to its writers – 60% to publishing house, 40% to the writer. How much is the gross income subject to final tax for the year?
- a. P200,000
 - b. P800,000**
 - c. P300,000
 - d. P1,200,000
- Solution: $500,000 \times 40\% \times 4 = 800,000$
22. Minmin was provided a car by his employer, Hyundai Motors. The ownership of the car remains to the company. The fair market value of the car at the time the benefit was given was P325,000. How much is the **fringe benefits tax** to be paid by the company?
- a. P35,000**

- b. P65,000
- c. P100,000
- d. P175,000

Solution: $325,000 / 5 = 65,000 / 65\% = 100,000 \times 35\% = 35,000$

23. Cera sold his domestic shares of stocks for P60,000. He purchased these shares in the year 2016 at a price of P45,000. How much is the capital gains tax for this transaction?

- a. **P2,250**
- b. P15,000
- c. P900
- d. None. The capital gain for this transaction is subject to basic tax.

Solution: $60,000 - 45,000 = 15,000 \times 15\% = 2,250$

24. James has a 5-year long term deposit in Philippine Bank amounting to P250,000. The deposit yields a 6% interest every year. On the 3rd year, James decided to pre-terminate his deposit. How much is the final tax withheld by the bank due to the pre-termination of the deposit?

- a. P9,000
- b. P30,000
- c. **P5,400**
- d. None. Since it is a long-term deposit.

Solution: $250,000 \times 6\% \times 3 = 45,000 \times 12\% = 5,400$

25. SM Holdings, a domestic corporation, received dividends from its affiliate company, Rustans Marketing, also a domestic corporation amounting to P90,000. How much is the final tax withheld by Rustans Marketing for the dividends to SM Holdings?

- a. **None. Since dividends between domestic corporations are tax-exempt.**
- b. None. Since dividends between domestic corporations are subject to basic taxes.
- c. P9,000
- d. P22,500

26. Keith, a resident citizen, travelled to the US for three months. Out of sheer boredom, he decided to try out playing for the US Powerball Lottery. With nothing but pure luck, he won the pot money amounting to \$1,000,000. Exchange rate during the time of winning is P52. How much is the final tax to be paid by Keith to the Philippine Government for his lottery winnings?

- a. None. The lottery winnings are tax exempt since it was won outside of the Philippines.
- b. **None. The lottery winnings will be part of his gross income subject to basic tax.**
- c. None. The lottery winnings are tax exempt since it was given by a foreign body.
- d. P10,398,000

27. Cebu Real Land Inc., a real estate developer, sold house and lot amounting to P5,000,000. Cost of acquiring and building the house and lot is P3,000,000. How much is the gain on sale for this transaction?

- a. **P2,000,000 ordinary gain**
- b. P2,000,000 capital gain
- c. P5,000,000 ordinary gain

d. P5,000,000 capital gain

28. Due to the pandemic, Capital Letters Corporation decided to do a downsizing of its company. It was initially identified that Jin is one of the employees who will be laid off. The employees who were identified to be laid off were given two options: Option 1, tender a resignation ahead of time and receive a separation package of P1,500,000. Option 2, wait for the time to be terminated and receive a separation package of P2,000,000. Jin, due to immediate financial needs, decided to choose option 1. Is his option taxable or non-taxable?

- a. Non-taxable. Since the company gave him an option.
- b. Non-taxable. All separation pays are non-taxable if the reason for termination is beyond the employee's control.
- c. **Taxable. Since he decided to tender a resignation first, and did not wait for the actual downsizing termination.**
- d. Taxable. Since he chose a lower separation compensation package.

29. A farmer has the following cropping expenses: 210,000 in the year 2019, 150,000 in the year 2020 in which 50% is attributable to the first harvest, and 120,000 in the year 2021. Proceeds of the first harvest in the year 2020 were 350,000. How much is the gross income under the crop year basis in the year 2020?

- a. None. Only farming loss of 10,000
- b. **65,000**
- c. 140,000
- d. 350,000

Solution: $350,000 - 210,000 - (150,000 \times 50\%) = 65,000$

30. Min Yoongi receives royalties from Pioneers Inc. of 50,000 monthly on his invention. How much is the final tax withheld from Min Yoongi's royalties for the current taxable year?

- a. None. His royalties are subject to basic tax.
- b. **P120,000**
- c. P10,000
- d. None. His royalties are tax-exempt

Solution: $50,000 \times 12 = 600,000 \times 20\% = 120,000$

31. These are incomes received for the use of a right or a patent.

- a. Interest income
- b. **Royalty Income**
- c. Dividend Income
- d. Tax Informant's Reward

32. Identify what constitutional limitation referred to in this example.

USJ-R, a non-stock, non-profit educational institution has a net income of P500,000 for the taxable year. However, it does not pay the related tax to this income.

- a. Exemption of religious and charitable entities, non-profit cemeteries, churches and mosque from property taxes

- b. Exemption from taxes of the revenues and assets of non-profit, non-stock educational institutions**
 - c. Free worship rule
 - d. Non-appropriation of public funds or property for the benefit of any religious organization
- 33. This is an illegal escape from taxation.
 - a. Tax dodging
 - b. Tax avoidance
 - c. Tax evasion**
 - d. Tax Shifting
- 34. The following are kinds of tax exemptions, except:
 - a. Constitutional
 - b. Inherent**
 - c. Express
 - d. Partial
- 35. The government employs the withholding tax system for easier compliance of tax payments. What principle of a sound tax system is being used as a basis in this initiative?
 - a. Fiscal Adequacy
 - b. Administrative Feasibility
 - c. Theoretical Justice**
 - d. None of the above
- 36. LONG PROBLEM 1 (5 pts)

Timothy is a rank-and-file employee of BH Corporation, and was given the following as part of his compensation package:

 - P50,000 monthly salary
 - P2,000 monthly employee share of mandatory contributions
 - Fixed monthly allowance:
 - Transportation allowance - P3,000
 - Work from Home allowance - P2,000
 - Monthly Benefits:
 - Rice Subsidy - P2,000
 - Laundry Allowance - P300
 - Yearly Benefits:
 - 13th and 14th month pay, each pay is equivalent to one-month salary
 - Clothing Allowance - P5,000
 - Medical Benefits to Employee's Dependents - P10,000
 - Medical Benefits to Employees - P15,000
 - Productivity Bonus - P20,000
 - Use of company car for the sole benefit of the employer – FMV of the car is 200,000

Compute how much is Timothy's **gross annual** compensation income.

Solution:

Taxable Basic Salary – $50,000 - 2,000 = 48,000 \times 12 = 576,000$

Transpo Allowance – $3,000 \times 12 = 36,000$

WFH Allowance – $2,000 \times 12 = 24,000$

13th month pay and other benefits: $122,000 - 90,000 = 32,000$

13th month pay – 50,000

14th month pay – 50,000

Medical benefits to dependents – $10,000 - 3,000 = 7,000$

Medical benefits to employees – $15,000 - 10,000 = 5,000$

Productivity Bonus – $20,000 - 10,000 = 10,000$

TOTAL: 668,000

37. LONG PROBLEM 2 (2 pts each = 10 pts)

Building Fairytale Construction was awarded in the bidding to construct Disney World, an amusement park to be constructed in Cebu. The contract price is 150 million. The project is expected to be completed in 5 years. The following are the costs incurred each year of construction: Year 1 – 19.5 million, Year 2 – 13 million, Year 3 – 32.5 million, Year 4 – 26 million, Year 5 – 39 million.

The company uses the percentage of completion method based on the cost incurred every year. How much is the gross income to be recognized from year 1 to year 5?

Solution:

Total contract costs: $19.5 + 13 + 32.5 + 26 + 39 = 130$ million

Total gross income of the contract = 20 million

Year 1: $19.5/130 \times 20,000,000 = \mathbf{3,000,000}$

Year 2: $32.5/130 \times 20,000,000 = 5,000,000 - 3,000,000 = \mathbf{2,000,000}$

Year 3: $65/130 \times 20,000,000 = 10,000,000 - 5,000,000 = \mathbf{5,000,000}$

Year 4: $91/130 \times 20,000,000 = 14,000,000 - 10,000,000 = \mathbf{4,000,000}$

Year 5: $20,000,000 - 14,000,000 = \mathbf{6,000,000}$

38. LONG PROBLEM 3 (5 pts each = 10 pts)

A resident citizen had the following sale transactions for the year 2020:

- Sale of his photo card collection. Originally bought at 40,000 in the year 2018. Sold at 20,000.

The following are his sale transactions for the year 2021:

- Net income from his merchandising business, P265,000
- Sale of his personal gold jewelries bought at 50,000 last 2019. Selling price is 75,000.
- Sold his 2018 Mercedes Benz to a friend for 500,000. Acquisition cost was 350,000.
- Sold his current principal residence to buy a new one. Selling price is 4,000,000. Fair market value of the property is 4,500,000. Acquisition cost was 3,000,000. After a year, he was able to buy a new house at 4,200,000.

How much is the net taxable income for the year 2021?

What is the cost of the new residence?

Solution:

Net income from merchandising – 265,000

Sale of jewelry, capital gain – $75,000 - 50,000 = 25,000 \times 50\% = 12,500$

Sale of car, capital gain – $500,000 - 350,000 = 150,000 \times 50\% = 75,000$

Net capital loss, prev year $(20,000 - 40,000 = -20,000 \times 50\%) = (10,000)$

TOTAL: 342,500

Cost of the new residence: $3,000,000 + 200,000 = \mathbf{3,200,000}$