# There's No Business Like Show Business ... Until the Taxman Comes Knocking: Analyzing Common Tax Issues in the Entertainment Industry

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## I. INTRODUCTION

In March 2005, the Department of Finance and the Bureau of Internal Revenue (BIR) introduced the Run After Tax Evaders (RATE) Program which aimed to bring to the forefront of the public's consciousness the issue

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*Cite as* 63 ATENEO L.J. 722 (2019).

on tax evasion and the eventual criminal prosecution that follows.[1] Prior to this, the prosecution of tax evaders was, more often than not, infrequent and intermittent.[2]

Under the RATE Program, the BIR is mandated to investigate criminal violations of the National Internal Revenue Code of the Philippines (1997 NIRC)[3] and assist in the prosecution of criminal cases that will "generate the maximum deterrent effect, enhance voluntary compliance, and promote public confidence in the tax system."[4]

At the RATE Program's inception, the following criteria, among others, were established for the development and filing of RATE cases:

(1) "[t]he case has a high impact on public perception;"[5] and

(2) "[t]he taxpayer is known in the sector or industry to which he or she belongs."[6]

Thus, many of the tax evasion cases filed by the BIR with the Department of Justice (DOJ) involved "actors, businesspersons, public officials, and other high-profile personalities."[7]

Applying the above criteria, it is easy to understand why entertainers and TV or media personalities[8] figured prominently in many of the tax evasion cases filed by the BIR with the DOJ. Not only do entertainers satisfy the

1. ASIAN DEVELOPMENT BANK, PROCESS MAP ON THE CRIMINAL PROSECUTION OF TAX EVASION IN THE PHILIPPINES 1 (2009).

2. *Id.*

3. An Act Amending the National Internal Revenue Code, As Amended, And For Other Purposes [NAT'L INTERNAL REVENUE CODE], Republic Act No. 8424 (1997) (as amended).

4. Bureau of Internal Revenue, Revenue Memorandum Order No. 24-2008 [BIR RMO No. 24-2008], pt. B (May 9, 2008).

5. ASIAN DEVELOPMENT BANK, *supra* note 1, at 10 (citing Interview *by* E.P. Guevara *with* BIR assistant commissioner of internal revenue (July 31, 2007) & BIR deputy commissioner of internal revenue, Presentation on the RATE Program (Apr. 20, 2006)).

6. *Id.*

7. *Id.* at 1.

8. People who work in the entertainment industry, such as film or TV actors and actresses and other famous TV and media personalities are loosely referred to in this Article as "entertainers."

BIR criteria for developing and filing RATE cases, but also singling out entertainers for tax audit and investigation is a case of "low hanging fruit."

Firstly, many of the cases filed against entertainers involved simple offenses that are not difficult to prove, such as non-filing of tax returns, substantial under-declaration of income, and overstatement of deductions.

Secondly, when an entertainer fails to report all of his income, it is fairly easy to directly verify the same. Through so-called "access letters," the BIR may request for information or certain documents from persons or entities who are publicly known to have engaged the services of the taxpayer under investigation, e.g., the home studio or network of the entertainer, the movie production company that produced the movie in which the entertainer appeared in, or companies whose products are endorsed by the said entertainers.[9] The financial information obtained from these third parties would then be compared against the income reported by the entertainer in his tax returns to verify proper reporting.[10]

While a tax audit or investigation will not necessarily lead to the filing of a criminal complaint for tax evasion, entertainers, as likely candidates for a tax audit, should be conscious of proper tax compliance to ensure that no tax regulation has been overlooked, or they should see to it that their accountants and bookkeepers faithfully file returns and pay their taxes on time.

This Article will analyze some common tax issues in the entertainment industry that affect the tax compliance of actors, actresses, and TV or media personalities. This Article, however, will not discuss the tax issues relating to the music industry (e.g., singers, songwriters, composers, and live performers) that are unique and apply specifically to that segment of the entertainment industry.

## II. INDEPENDENT CONTRACTOR VS. EMPLOYEE

The type of income received by entertainers and the manner of computing their taxable income depend on the services performed and on the

9. Under the Tax Reform Act of 1997 (also known as the National Internal Revenue Code of 1997), the Commissioner of Internal Revenue may "obtain on a regular basis from any person other than the person whose internal revenue tax liability is subject to audit or investigation ... any information such as, but not limited to, costs and volume of production, receipts or sales and gross incomes of taxpayers[.]" NAT'L INTERNAL REVENUE CODE, § 5 (B).

10. ASIAN DEVELOPMENT BANK, *supra* note 1, at 16.

contractual arrangement with the employer. On the one hand, if the taxpayer is an employee, i.e., "an individual performing services under an employer-employee relationship," [11] the taxpayer earns salaries or compensation income.[12] On the other hand, if the taxpayer is self-employed, that is, an independent contractor, he or she reports income from self-employment.[13]

Under the first paragraph of Section 34 of the 1997 NIRC,[14] on the one hand, compensation income earners are not allowed to claim any deductions in computing taxable income subject to income tax.[15] On the other hand, self-employed professionals may claim the itemized deductions under Section 34, as well as the optional standard deduction in Section 34 (L), in computing taxable income.[16]

Under their contractual arrangement with TV studios or networks, or movie production companies, actors, actresses, and TV personalities are typically independent contractors or self-employed professionals deriving professional or talent fees.[17] As an independent contractor, an entertainer

11. Bureau of Internal Revenue, Revenue Regulations No. 8-2018 [BIR RR No. 8-2018], § 2 (c) (Jan. 25, 2018).

12. *Id.* § 2 (b). If the employee's source of income is solely derived pursuant to an employer-employee relationship, he or she is referred to as a "compensation income earner." *Id.*

13. *Id.* § 2 (n). A "self-employed" taxpayer is a "sole proprietor or an independent contractor who reports income earned from self-employment. [He or she] controls [whom] [he or she] works for, how the work is done and when it is done." The term includes those "hired under a contract of service or job order, and professionals whose income is derived purely from the practice of profession and not under an employer-employee relationship." The term "professional" generally includes those who successfully complete a required governmental examination and formally certified by a professional body belonging to a specific profession, but would also include professional entertainers, artists, professional athletes, directors, producers, and other recipients of professional, promotional and talent fees. *Id.* § 2 (n).

14. All statutory references are to the National Internal Revenue Code of 1997, as amended, unless otherwise indicated.

15. NAT'L INTERNAL REVENUE CODE, § 34, para. 1.

16. *Id.* §§ 34 & 34 (L).

17. *See, e.g.*, Sonza v. ABS-CBN Broadcasting Corporation, 431 SCRA 583, 595-96 (2004).

will receive BIR Form No. 2307[18] with the creditable tax withheld from his professional or talent fees.

The discussion that follows assumes that entertainers derive self-employment income as an independent contractor, rather than as an employee earning mainly salaries pursuant to an employer-employee relationship.

## III. INCOME INCLUSION ISSUES

For income tax purposes, gross income means "all income derived from whatever source, [except when otherwise provided in the title on income tax]."[19] This definition is broadly interpreted "in recognition of the intention of Congress to tax all gains except those specifically exempted."[20] Gross income includes "[c]ompensation for services in whatever form paid, including, but not limited to[,] fees, salaries, wages, commissions, and similar items."[21]

Similarly, for value-added tax (VAT) purposes, Section 108 (A) provides that "[t]here shall be levied, assessed[,] and collected, a value-added tax equivalent to twelve percent (12%) of gross receipts derived from the ... performance of all kinds or services in the Philippines for others for a fee, remuneration[,] or consideration[.]"[22]

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18. This form is the Certificate of Creditable Tax Withheld at Source. Bureau of Internal Revenue, Certificate of Creditable Tax Withheld at Source [BIR Form No. 2307] (Sep. 2005). Under Revenue Regulations. No. 2-98, § 2.58 (B), the TV studio or network, or movie production company making an income payment to talent classified as an independent contractor is required to furnish the payee with a withholding tax statement using the prescribed form (BIR Form No. 2307) showing the income payments made and the amount of taxes withheld therefrom. Bureau of Internal Revenue, Revenue Regulations No. 2-98 [BIR RR No. 2-98], § 2.58 (B) (Apr. 17, 1998).

19. NAT'L INTERNAL REVENUE CODE, § 32 (A).

20. Commissioner of Internal Revenue v. Glenshaw Glass Company, 348 U.S. 426, 430 (1955) (citing Commissioner of Internal Revenue v. Jacobson, 336 U.S. 28, 49 (1949) & Helvering v. Stockholms Enskilda Bank, 293 U.S. 84, 87-91 (1934)).

21. NAT'L INTERNAL REVENUE CODE, § 32 (A) (1).

22. *Id.* § 108 (A). Under the new Tax Reform for Acceleration and Inclusion (TRAIN) Law, "the performance of services ... [wherein] the gross annual ... receipts do not exceed the amount of [t]hree million pesos ([₱]3,000,000)" shall be exempt from VAT. An Act Amending Sections, 5, 6, 24, 25, 27, 31, 32, 33,

Entertainers generally receive professional or talent fees for appearing in movies and TV shows and hosting shows or programs.[23] Entertainers may also "receive endorsement income from recommending products or making appearances and participating in photograph sessions for their sponsors."[24] These professional or talent fees and income from endorsement deals would obviously result in inclusion, and form part of gross income for income tax purposes and taxable gross receipts for VAT purposes.

Income inclusion is less obvious when the entertainer, in connection with his or her work as such, receives or is paid in something other than cash. The receipt of in-kind compensation often presents valuation difficulties not encountered when cash is received. Thus, these in-kind compensation or benefits may not always be declared in the entertainer's income tax or VAT returns, but they are nonetheless taxable and should form part of gross income or receipts.

*A. Fringe Benefits and Perks*

Common forms of non-cash fringe benefits are perks and other perquisites from employers of entertainers.[25] It is customary in entertainment engagements for the talent to receive so-called "wardrobe keeps" or "swag

34, 51, 52, 56, 57, 58, 74, 79, 84, 86, 90, 91, 97, 99, 100, 101, 106, 107, 108, 109, 110, 112, 114, 116, 127, 128, 129, 145, 148, 149, 151, 155, 171, 174, 175, 177, 178, 179, 180, 181, 182, 183, 186, 188, 189, 190, 191, 192, 193, 194, 195, 196, 197, 232, 236, 237, 249, 254, 264, 269, and 288; Creating New Sections 51-A, 148-A, 150-A, 150-B, 237-A, 264-A, 264-B, and 265-A; and Repealing Sections 35, 62, and 89; All Under Republic Act No. 8424, Otherwise Known as the National Internal Revenue Code of 1997, As Amended, and For Other Purposes [Tax Reform for Acceleration and Inclusion (TRAIN)], Republic Act No. 10963, § 34 (2018).

Conversely, the performance of services in the course of trade or business wherein the gross annual receipts exceed three million pesos ([₱]3,000,000) shall be subject to VAT under section 108. *See* Tax Reform for Acceleration and Inclusion (TRAIN), § 34.

23. *See Sonza*, 431 SCRA at 595-97.

24. Lights, Camera, Taxation! A Look into Tax Issues of the Entertainment Industry, *available at* https://www.andersentax.com/newsletter/2011/august/entertainment.php (last accessed Feb. 1, 2019).

25. Internal Revenue Service, Entertainment Audit Technique Guide at 13, *available at* https://www.irs.gov/pub/irs-utl/entertainmentatg.pdf (last accessed Feb. 1, 2019).

bags" and other in-kind benefits.[26] Entertainers might get to retain costumes or wardrobe after the show or filming or "get the advertiser's product after a commercial shoot."[27] In some instances, even "[a]n established spokesperson for an automobile manufacturer typically receives a new car each year"[28] and "[t]here may be merchandise deals [ ] where the compensation for a broadcast deal is in the form of a barter."[29] Frequently, talents of TV and movie studios receive "free passes to concerts, shows, and screenings."[30]

Revenue Regulations No. 2-98, § 2.78.1 (A) (1) provides that

> [c]ompensation may be paid in money or in some medium other than money, as for example, stocks, bonds[,] or other forms of property. If services are paid for in a medium other than money, the fair market value of the thing taken in payment is the amount to be included as compensation subject to withholding.[31]

While non-cash fringe benefits and perks constitute taxable income or gross receipts, their inclusion in the tax returns is often overlooked by entertainers or their accountants.

*B. Taxable Compensation Income vs. Non-Taxable Gift*

When an entertainer receives property from a third party, a question may arise as to whether the value thereof is taxable compensation income or a non-taxable gift. Additionally, under Section 32 (B) (3) of the 1997 NIRC, "[t]he value of property acquired by gift, bequest, devise, or descent[ ]" shall not be included in gross income and shall be exempt from taxation under the title on income tax.[32]

*Commissioner of Internal Revenue v. Duberstein*,[33] a case decided in the United States of America (U.S.), dealt with the exclusion of the "value of

26. Evan M. Fogelman, Common Tax Issues in Representing Entertainers & Artists, *available at* https://www.dallasbar.org/book-page/common-tax-issues-representing-entertainers-artists (last accessed Feb. 1, 2019).

27. Internal Revenue Service, *supra* note 25.

28. *Id.*

29. *Id.*

30. *Id.*

31. BIR RR No. 2-98, § 2.78.1 (A) (1).

32. NAT'L INTERNAL REVENUE CODE, § 32 (B) (3).

33. Commissioner of Internal Revenue v. Duberstein, 363 U.S. 278 (1960). Since Philippine income and gift tax laws are of U.S. origin, Philippine courts, on a number of occasions, have resorted to U.S. jurisprudence, Treasury

property acquired by gift" from the gross income of a taxpayer.[34] Mose Duberstein, an individual taxpayer, gave to a business corporation, upon request, the names of potential customers.[35] The information proved valuable, and the corporation reciprocated by giving Duberstein a Cadillac automobile, charging the cost thereof as a business expense on its own corporate income tax return.[36] The payor was not legally obligated to make the payment to Duberstein, who excluded the value of the Cadillac from his income tax return, deeming it a gift.[37]

The U.S. Supreme Court held that "mere absence of a legal or moral obligation to make such a payment does not establish that it is a gift."[38] It is also not a gift "if the payment proceeds primarily from the 'constraining force of any moral or legal duty,' or from 'the incentive of anticipated benefit' of an economic nature."[39] On the other hand, a gift, "in the statutory sense, proceeds from a 'detached and disinterested generosity,' ... 'out of affection, respect, admiration, charity[,] or like impulses.'"[40]

Thus, in determining whether the receipt of property is a non-taxable gift, the primordial consideration is the transferor's intention.[41] According to *Duberstein*, a gift results from a "detached and disinterested generosity" and is

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Regulations, and commentaries which, while not necessarily binding, have persuasive effect in Philippine jurisdiction. *See, e.g.*, Commissioner of Internal Revenue v. Court of Appeals, 301 SCRA 152, 173 (1999) & Bañas, Jr. v. Court of Appeals, 325 SCRA 259, 279 (2000) (citing Collector of Internal Revenue v. Binalbagan Estate, Inc., 13 SCRA 1, 8 (1965)).

34. *Duberstein*, 363 U.S. at 279-80.

35. *Id.* at 280.

36. *Id.* at 280-81.

37. *Id.* at 281.

38. *Id.* at 285 (citing Old Colony Trust Co. v. Commissioner of Internal Revenue, 279 U.S. 716, 730 (1929)).

39. *Duberstein*, 363 U.S. at 285 (citing Bogardus v. Commissioner of Internal Revenue, 302 U.S. 34, 41 (1937)).

40. *Duberstein*, 363 U.S. at 285 (citing Commissioner of Internal Revenue v. Lo Bue, 351 U.S. 243, 246 (1956) & Robertson v. United States, 343 U.S. 711, 714 (1952)).

41. *Duberstein*, 363 U.S. at 285 (citing *Bogardus*, 302 U.S. at 43).

freely given out of "affection, respect, admiration, charity[,] or like impulses."[42]

Several years later, the U.S. Tax Court applied the gift exclusion standard from *Duberstein* in the case of *Hornung v. Commissioner of Internal Revenue*[43] on the tax implications of the receipt of property by Paul Hornung, a professional football player.[44] The case involved two similar issues: (i) whether the value of a 1962 Chevrolet Corvette won by Hornung for his performance in the 1961 National Football League championship game should be included in his gross income for taxable year 1962;[45] and (ii) whether the value of the use of the 1962 Thunderbird automobiles furnished to Hornung by Ford Motor Co. should be included in his gross income for 1962.[46]

For the first issue, Hornung asserted that the receipt of the Corvette constituted a non-taxable gift or was a non-taxable prize and award as a result of educational, artistic, scientific, or civic achievement under Section 74 (b) of the U.S. Internal Revenue Code (IRC).[47] For the second issue, the taxpayer similarly argued that the free use of the Thunderbirds was a gift or loan to him and that he was not obligated to perform any special services for Ford Motor Co. in return for the privilege of using the cars.[48]

The U.S. Tax Court concluded that the dominant motive and purpose of the grantor (a publishing company) in awarding the Corvette to Hornung

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42. *Duberstein*, 363 U.S. at 285 (citing *Lo Bue*, 351 U.S. at 246 & *Robertson*, 343 U.S. at 714).

43. Hornung v. Commissioner of Internal Revenue, 47 T.C. 428 (1967) (U.S.).

44. *Id.* at 429-33.

45. *Id.* at 429.

46. *Id.*

47. *Id.* at 435. A provision similar to the U.S. IRC § 74 (b) is found in § 32 (B) (7) (c) of the National Internal Revenue Code which exempts from income tax

> [p]rizes and awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement but only if: (i) the recipient was selected without any action on his part to enter the contest or proceeding; and (ii) the recipient is not required to render substantial future services as a condition for receiving the prize or award.

NAT'L INTERNAL REVENUE CODE, § 32 (B) (7) (c).

48. *Hornung*, 47 T.C. at 437.

was to promote and benefit their business of publishing Sport Magazine.[49] The taxpayer also failed to carry his burden of proving that the free use of Thunderbird automobiles provided by Ford Motor Co. to Hornung was not taxable income.[50]

In addressing Hornung's "gift" argument in the receipt of the Corvette, the court determined that "the donor's motive here precludes a determination that Sport [Magazine] made a gift of the Corvette to [Hornung] in 1962."[51] According to the court, "[i]t is clear that there was no detached and disinterested generosity."[52]

Also applying *Duberstein* in the second issue, the court held that "the most critical consideration in making [a gift] determination is the transferor's intention."[53] As explained by the U.S. Tax Court, to wit —

> [The court] take[s] it that the proper criterion, established by decision here, is one that inquires what the basic reason is for his [or her] (the transferor's) conduct was in fact — the dominant reason that explains his [or her] action in making the transfer.
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> ...
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> The value of a gift may be excluded from gross income only if the gift proceeds from a 'detached and disinterested generosity' or 'out of affection, admiration, charity[,] or like impulses' and must be included if the claimed gift proceeds primarily from 'the constraining force of any moral or legal duty' or from 'the incentive of anticipated benefit or an economic nature.'
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> ...
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> The burden of proof to establish that the [Internal Revenue Service's] determination was wrong rests on [the taxpayer] ... While it is possible that Ford was motivated by detached and disinterested generosity, it seems more likely that officials of the Ford Motor Co. believed that the use of Thunderbirds by well-known and readily recognizable football stars of national renown would constitute valuable implied personal endorsements favorable to sales image of Thunderbirds ... Therefore, in the complete absence of any evidence to the contrary, it is logical to conclude that the

49. *Id.* at 433.

50. *Id.*

51. *Id.* at 435.

52. *Id.*

53. *Id.* at 438 (citing *Duberstein*, 363 U.S. at 285).

> Ford Motor Co. was motivated by commercial considerations in furnishing Thunderbirds to [the taxpayer] free of charge.[54]

A *Hornung*-type fact pattern which could prompt a gift (or compensation income) determination is quite common in the entertainment industry. In 2014, celebrity couple José Sixto Raphael "Dingdong" Dantes III and Marian Gracia Rivera, both famous showbiz personalities, celebrated their marriage in a grand and elaborate wedding ceremony attended by members of Philippine high-society.[55] But what captivated the public's imagination (and caught the attention of the international media) was the 12-foot, 120-kilogram wedding cake sponsored by Goldilocks, a local restaurant chain endorsed by Dantes.[56] The wedding cake, which was decorated with Swarovski crystals and purportedly cost ₱7 million, required 10 men to transport to the wedding venue.[57]

Whether the value of the wedding cake should be included in Dantes's taxable income or may be excluded from his gross income as an exempt gift would turn on Goldilocks's subjective intent when it furnished the cake to the celebrity couple. That the extravagant wedding cake generated publicity for Goldilocks and the fact that Dantes endorses the fastfood chain could be cited by the BIR as factual basis in concluding that Goldilocks was motivated by commercial considerations in sponsoring the lavish wedding cake, rather than by a "detached and disinterested generosity."

### *C. Taxable Barters and "Ex-Deals"*

Exchanging goods and services with an entertainer — referred to as an "ex-deal"[58] in entertainment industry parlance — is a common practice which

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54. *Hornung*, 47 T.C. at 438-39.

55. Rappler.com, IN PHOTOS: Dingdong Dantes and Marian Rivera's wedding day, *available at* https://www.rappler.com/entertainment/news/79318-photos-dingdong-dantes-marian-rivera-star-studded-wedding-day (last accessed Feb. 1, 2019).

56. ABS-CBN News, Why Marian-Dingdong Wedding Cake Made US Headlines, *available at* https://news.abs-cbn.com/lifestyle/01/01/15/why-marian-dingdong-wedding-cake-made-us-headlines (last accessed Feb. 1, 2019).

57. Karen A. Pagsolingan, Dingdong Dantes-Marian Rivera wedding cake catches attention of foreign press, *available at* https://www.pep.ph/news/46940/dingdong-dantes-marian-rivera-wedding-cake-catches-attention-of-foreign-press (last accessed Feb. 1, 2019).

58. Essentially a barter, defined as "to exchange goods for other things rather than for money." Barter, Cambridge Dictionary, *available at*

can be economically convenient for both the entertainer and the other party to the barter or exchange.

For example, Karen S., a famous TV personality, enters into an endorsement deal with the leading medical aesthetic clinic to endorse the latter's goods and services by appearing in print and billboard advertisements. In exchange for the endorsement, Karen S. will be given complimentary surgical and non-surgical cosmetic enhancement services and monthly skin rejuvenation and anti-aging treatments for one year. As typical in ex-deals, there is no exchange of cash between Karen S. and the medical aesthetic clinic.

What the fictional Karen S. (and perhaps many entertainers as well) may fail to realize is that while no money changes hands, the fair market value of property or services she receives through the ex-deal or bartering is taxable income or gross receipts.[59] The fair market value of the goods and services received by the entertainer are taxable as if they are cash.[60]

In the U.S., the Internal Revenue Service (IRS) has long taxed bartering of services. Revenue Ruling 79-24[61] is the "foundational ruling[ ] where the IRS ruled that a lawyer and a housepainter who traded services each had to include the fair market value of those services into their respective gross incomes."[62]

Professor Bryan T. Camp of the Texas Tech University School of Law explains why there is a high level of non-compliance in reporting the value of non-cash income received in bartering, as follows —

> Bartering represents as much of a realization event as a transaction conducted in cash [—] in both situations[,] a readily identifiable event (a market transaction) has occurred in which the taxpayer has actualized theretofore implicit wealth. Taxpayers consequently have a duty to report that transaction. But[,] in the absence of cash, taxpayers may not understand they have reportable income and, if they do understand, may have difficulty in setting aside cash from other transactions to pay the resulting tax. Thus, when bartering is done informally and directly between

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https://dictionary.cambridge.org/us/dictionary/english/barter (last accessed Feb. 1, 2019).

59. NAT'L INTERNAL REVENUE CODE, § 105, para. 1.

60. *Id.*

61. Rev. Rul. 79-24, 1979-1 C.B. 60.

62. Bryan T. Camp, *The Play's the Thing: A Theory of Taxing Virtual Worlds*, 59 HASTINGS L.J. 1, 41 (2007).

> taxpayers, there may be a high level on non-compliance in reporting the income received.[63]

The Author submits that the U.S. tax law on the implications of bartering services, as applied to entertainment ex-deals, has persuasive effect in the Philippines. Consequently, entertainers will have to report in their tax returns the fair market value of goods and services that they receive in a bartering transaction.

*D. Final Withholding Tax vs. Creditable Withholding Tax*

Under the BIR's Revenue Regulation No. 2-98 dated 17 April 1998, certain income payments are subject to withholding of tax at source.[64] There are two types of withholding taxes: final withholding tax (FWT) and creditable withholding tax (CWT).[65]

Under the final withholding tax system, "the amount of income tax withheld by the withholding agent is constituted as full and final settlement of the income tax due from the payee [of] the said income."[66] Since the FWT constitutes full and final settlement of the income tax due, "[t]he payee is not required to file an income tax return for the particular income."[67]

On the other hand, under the creditable withholding tax system,

> taxes withheld on certain income payments are intended to equal[,] or at least approximate[,] the tax due of the payee on the said income. The income recipient is still required to file an income tax return ... to report the income and/or pay the difference between the tax withheld and the tax due on the income.[68]

"[G]ross professional, promotional and talent fees[,] or any other form of remuneration for the services" of "[p]rofessional entertainers such as but not limited to actors and actresses, singers[,] and emcees" are subject to CWT under Revenue Regulations Section 2.57.2 (A) (2).[69]

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63. *Id.* at 32.

64. BIR RR No. 2-1998, § 2.57.

65. *Id.* § 2.57 (A) & (B).

66. *Id.* § 2.57 (A).

67. *Id.*

68. *Id.* § 2.57 (B).

69. *Id.* § 2.57.2 (A) (2).

The main difference between FWT and CWT is the need to report the underlying income received in the annual income tax return. The FWT, being full and final settlement of the income tax liability, the income received no longer needs to be reported in the income tax return.[70] On the other hand, since the CWT is merely an advance payment intended to approximate the income tax eventually due, the underlying income received must still be declared in the income tax return and the CWT credited against the income tax due.[71]

Some of the earlier tax evasion cases filed against entertainers that involved substantial underdeclaration of taxable receipts or income, perhaps arose in part from a lack of understanding of the basic difference between FWT and CWT. In some of these cases, income payments subjected to CWT were no longer reported in the income tax return. [72] The underdeclaration of income could have been brought about by the taxpayer's failure to understand the rule that income payments subjected to CWT should still be reported in the income tax return.

As entertainers have a higher likelihood of being subjected to a tax audit or investigation, care should be taken that all income payments subjected to CWT should be reported in the income tax return as it is fairly easy for the BIR to validate non-reporting. Withholding agents are required to report to the BIR on a periodic basis information about income payments subjected to withholding tax and the identity of the income recipient.[73] This would

70. BIR RR No. 2-1998, § 2.57 (A).

71. *Id.* § 2.57 (B).

72. *See, e.g.*, People v. Santos, CTA Crim. Case No. O-012, Jan. 16, 2013, *available at* http://cta.judiciary.gov.ph/home/download/52589e7fdbb6adf34405f6ab0ed2a77d (last accessed Feb. 1, 2019). In the tax evasion case filed against famous actress Judy Ann Santos, BIR alleged that Santos failed to declare income payments from various income payors that subjected the income to CWT. *Id.* at 1-2.

73. *See* Bureau of Internal Revenue, Annual Information Return of Creditable Income Taxes Withheld (Expanded)/Income Payments Exempt from Withholding Tax [BIR Form No. 1604-E] (July 1999). This is filed by every withholding agent/payor required to deduct and withhold taxes on income payments subject to CWT. *Id.* at 2. BIR Form No. 1604-E includes an Alphalist of Payees Subject to Expanded Withholding Tax which contains, among others, information on the name of the payee, his tax identification number, the amount of income received, the nature of the income, and the amount of tax withheld. *Id.*

allow the BIR to crosscheck the information provided by withholding agents with the declarations made by the taxpayer under investigation.

## IV. PERSONAL EXPENSE VS. ORDINARY AND NECESSARY BUSINESS EXPENSE

Supposed business expenses claimed by entertainers against their gross income is another contentious area that could pose compliance issues for entertainers. The IRS's observation that "taxpayers in the entertainment industry tend to be aggressive or abusive when deducting expenses that may or may not be directly related to their business activities (i.e., personal expenses)"[74] may apply to the entertainment industry in the Philippines as well.

In general, the 1997 NIRC allows as "deduction from gross income all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on[,] or which are directly attributable to, the development, management, operation and/or conduct of the trade, business[,] or exercise of a profession[.]"[75] However, in computing taxable income, "no deduction shall in any case be allowed in respect to ... [p]ersonal, living[,] or family expenses."[76]

Business expenses would normally involve whether the particular expense is "ordinary and necessary,"[77] on one hand, and whether the expense was incurred in a "trade, business[,] or exercise of a profession"[78] or for personal reasons, on the other hand. Many expenses claimed by entertainers as deductions from gross income could be assigned usually to these two questions.

The Supreme Court has often cited the "paramount rule" that "claims for deductions are a matter of legislative grace and do not turn on mere equitable considerations" and that "[t]he taxpayer in every instance has the burden of justifying the allowance of any deduction claimed."[79]

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74. Internal Revenue Service, *supra* note 25, at 6.

75. NAT'L INTERNAL REVENUE CODE, § 34 (A) (1) (a).

76. *Id.* § 36 (A) & (A) (1).

77. *Id.* § 34 (A) (1) (a).

78. *Id.*

79. Esso Std. Eastern, Inc. v. Commissioner of Internal Revenue, 175 SCRA 149, 159 (1989) (citing MERTENS, LAW OF FEDERAL INCOME TAXATION, § 25.03)

*A. Clothing, Hair Care, Make-Up, and Other Expenses to Maintain Image*

Taxpayers in the entertainment industry "sometimes incur unusually high expenses to maintain an image."[80] These expenses are "frequently related to the individual's appearance in the form of clothing, make-up, and physical fitness."[81] These are generally found to be "personal expenses" as "the inherently personal nature of the expense and the personal benefit outweigh any potential business benefit."[82] Therefore, no deduction is generally allowed for wardrobe, general make-up, or hair care or styling to "maintain an image."[83]

*Hynes v. Commissioner*[84] involved the issue of whether the taxpayer may deduct as business expenses certain expenditures for his wardrobe, laundry, dry cleaning, haircuts, and make-up.[85] The taxpayer in *Hynes* worked as a TV news anchor, news writer, and staff announcer for a TV news broadcast.[86] His contract with his employer required that he maintains "a physical appearance suitable for services as a television announcer."[87] The taxpayer wore "regular business clothing on his television appearances, but his selection of such attire was limited to colors and patterns which would televise well"[88] and "[h]e [also] often changed his shirt between the 6 P.M. and 11 P.M. broadcast, and he had his hair cut every four weeks to maintain a neat appearance."[89]

The court outlined case law relying on the objective "non-suitability for everyday wear" standard for purposes of deducting clothing expenses —

> Although a business wardrobe is a necessary condition of employment, the cost of such wardrobe has generally been considered a non[-]deductible personal expense within the meaning of section 262 ... The general rule of law is that where business clothes are suitable for general wear, a deduction for them is not allowable ... Such costs are not deductible even when it has

80. Internal Revenue Service, *supra* note 25, at 39.

81. *Id.*

82. *Id.*

83. *Id.*

84. Hynes v. Commissioner, 74 T.C. 1266 (1980) (U.S.).

85. *Id.* at 1268.

86. *Id.* at 1269.

87. *Id.*

88. *Id.*

89. *Id.*

> been shown that the particular clothes would not have been purchased but for the employment[.]
>
> ...
>
> There are recognized exceptions to the general rule, and this Court has allowed a deduction for the cost of clothes which were useful only in the business environment. For example, a deduction was allowed in *Harsaghy v. Commissioner* ... because custom and usage forbade off duty wearing of the clothing; in *Meier v. Commissioner* ... because sanitary considerations made the clothes unsuitable for general wear; in *Denny v. Commissioner* ... because the clothes were a theatrical costume; and in *Mortrud v. Commissioner* ... and *Benson v. Commissioner* ... because the clothes were a uniform not expected to be worn generally. In *Yeomans v. Commissioner* ... [the Court] established three criteria for the cost of clothing to be deductible s an ordinary and necessary business expense: (1) The clothing is required or essential in the taxpayer's employment, (2) the clothing is not suitable for general or personal wear, and (3) the clothing is not so worn. In addition, if the cost of acquiring clothing is deductible, then the cost of maintaining such clothing is likewise deductible as an ordinary and necessary business expense.[90]

In deciding against the taxpayer's deductions for the cost of his wardrobe and its maintenance, the court applied the objective standard of non-suitability of business clothes for general wear and held, in this following wise —

> In the present case, the [taxpayer] contends that he is entitled to deduct the expense of his business wardrobe because he was restricted in his selection of colors and patterns of such clothes[,] and because he did not wear the clothes when he was not at the station on camera. [The Court] cannot agree with the [taxpayer]. The restriction on the [taxpayer's] selection of his business attire is not significantly different from that applicable to other business people who must limit their selection of business clothes to conservative styles and fashions. The [taxpayer] testified that his clothes were essentially suitable for use in any professional capacity. This case is thus distinguishable from *Yeomans v. Commissioner* ... where this Court allowed a taxpayer to deduct the cost of her business attire which [the

90. *Hynes*, 74 T.C. at 1290 (citing Harsaghy v. Commissioner, 2 T.C. 484 (1943); Denny v. Commissioner, 33 B.T.A. 738 (1935); Mortrud v. Commissioner, 44 T.C. 208 (1965); Benson v. Commissioner, 146 F.2d 191 (9th Cir. 1944); & Yeomans v. Commissioner, 30 T.C. 757, 767 (1958)). Section 262 of the U.S. IRC is similar to Section 36 (A) (1) of the National Internal Revenue Code in that both provisions of law do not permit the deduction of personal, living, and family expenses. Internal Revenue Code [I.R.C.], § 262 (2006) (U.S.) & NAT'L INTERNAL REVENUE CODE, § 36 (A) (1).

> Court] found to be 'of the most advanced styles and fashions … which were not suited for her private and personal wear.' The fact that the [taxpayer] chose not to wear his business clothes when he was away from the station does not mean that such clothes were not suitable for his private and personal wear. Indeed, most people do not wear their business clothes at home. It is also irrelevant that the [taxpayer's] employment contract with the station for 1978 now provides him with a clothing allowance. Such fact does not establish that the [taxpayer's] expenses were business expenses during the years in issue.
>
> The [taxpayer] asserts that he is entitled to deduct the cost of maintaining his business wardrobe because he incurred excessive expenses in doing so, but he has failed to establish that his expenses were excessive. The [taxpayer] occasionally may have changed his shirt between the 6 and 11 p.m. news broadcasts, thus resulting in a larger laundry bill than otherwise would have been incurred, but his practice is not different from other professional people who work long hours and prefer to freshen up by changing their shirts and otherwise making themselves comfortable before facing the evening ahead.[91]

The court similarly ruled against the deductibility of the taxpayer's deductions for the cost of his haircuts and makeup —

> In *Drake v. Commissioner* ... this Court held that an enlisted man in the United States Army who was required to have his hair cut every 2 weeks could not deduct the cost of such haircuts since such expense was a non[-]deductible personal expense. [The Court] observed that expenses for one's grooming were inherently personal in nature and stated '[that the] fact that the Army may have required such grooming does not make the expenses therefor any less personal. The evidence showed that the Army's requirement was directed toward the maintenance by the [taxpayer] of a high standard of personal appearance and not toward the accomplishment of the duties of his employment.' ... [The Court] can perceive no distinction between the situation in Drake and the situation in the present case. The fact that the [taxpayer's] employment contract with the station required him to maintain a neat appearance does not put him beyond [the Court's] rationale and holding in such case, nor does it elevate his expenses for personal grooming to a business expense. Accordingly, [the Court] sustain[s] the Commissioner's disallowance of the [taxpayer's] deduction for haircuts. As far as the petitioner's makeup costs are concerned, he has presented [the Court] with no evidence to establish which portion of the total amount deducted for haircuts and makeup during the years in issue were allocable solely to makeup. Accordingly, [the Court] must also

91. *Hynes*, 74 T.C. at 1291 (citing *Yeomans*, 30 T.C. at 768).

> disallow any deduction for that item since the petitioner has failed to meet his burden of proof.[92]

*Hamper v. Commissioner of Internal Revenue*[93] involved a taxpayer in circumstances very similar to the taxpayer in *Hynes*. *Hamper* likewise considered whether deductions taken by a news anchor for the cost of conservative clothing that she was required to wear during newscasts and while appearing in public as an ambassador of the TV station were appropriate.[94] In this case, "[c]onsistent with the requirement that the taxpayer maintain a neat, professional, and conservative appearance, and as part of her community appearance, she incurred considerable expenses for clothing and for maintaining her appearance during the [tax] years at issue."[95]

The court applied the same objective standard in *Hynes* and held that the news anchor's clothing was suitable for everyday wear even if not so worn.[96] Therefore, she was not entitled to claim a deduction for costs related to clothing, shoes and accessories, "as these are inherently personal expenses."[97] The court explained its opinion, as follows —

> [The taxpayer] does not satisfy the requirement that her clothing not be suitable for everyday personal wear. Although she is required to purchase conservative business attire, it is not of a fashion that is outrageous or otherwise unsuitable for everyday personal wear. Given the nature of her expenditures, it is evident that petitioner's clothing is in fact suitable for everyday wear, even if it is not so worn. Consequently, the Court upholds respondent's determination that petitioner is not entitled to deduct expenses related to clothing, shoes, and accessory costs, as these are inherently personal expenses. Additionally, because the costs associated with the purchase of clothing are a non[-]deductible personal expense, costs for the maintenance of the clothing such as dry[-]cleaning costs are also non[-]deductible personal expenses.[98]

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92. *Id.* at 1291-92 (citing Drake v. Commissioner, 52 T.C. 842, 844 (1969)).

93. Hamper v. Commissioner of Internal Revenue, T.C. Summary Opinion 2011-17 (U.S. Tax Court 2011) (U.S.).

94. *Id.* at 1-2.

95. *Id.* at 2.

96. *Id.* at 4.

97. *Id.*

98. *Id.*

On whether expenses incurred by the taxpayer for contact lenses, makeup, and grooming may be deducted from gross income, the court similarly disallowed the deductions claimed by the taxpayer —

> [The taxpayer's] expenditures for manicures, grooming, teeth whitening, and skin care are inherently personal expenditures. Although these expenses may be related to her job, expenses that are inherently personal are non[-]deductible personal expenses. As in *Hynes* ... , the fact that [the taxpayer's] employment contract with the station required her to maintain a neat appearance does not elevate these personal expenses to a deductible business expense.[99]

*Hynes* and *Hamper* provide an important consideration for entertainers: the need to invest in clothing, hair care and styling, make-up, and related expenses to maintain a certain public image. The blurry line between personal consumption expenses and *bona fide* business expenses can be a potential area of dispute between entertainers and revenue authorities. Based on case law, however, expenses to maintain an image are generally considered to be inherently personal in nature, hence, not deductible under Section 36 (A) (1).

*B. Cosmetic Surgery and Cosmetic Dentistry*

It is quite common for entertainers to undergo aesthetic cosmetic and dental procedures to improve or enhance their personal appearance with the end view of improving their earning capacity. These cosmetic procedures, surgeries, and body enhancements are typically directed towards improving, altering, or enhancing the patient's appearance and do not meaningfully promote the proper function of the body or prevent or treat illness or disease.[100]

Similar to clothing, hair care, and make-up, expenses incurred for elective cosmetic surgery or dentistry to improve or enhance the appearance of an entertainer would be evaluated for deductibility based on the nature of these expenses as personal or as ordinary and necessary business expenses.

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99. *Hamper*, T.C. Summary Opinion 2011-17 at 5 (citing *Hynes*, 74 T.C. at 1292).

100. *See* NAT'L INTERNAL REVENUE CODE, § 150-A. Under the said provision, which was a new addition inserted by the TRAIN Law, excise tax is imposed on "invasive cosmetic procedures, surgeries, and body enhancements directed solely towards improving, altering, or enhancing the patient's appearance and do not meaningfully promote the proper function of the body or prevent or treat illness or disease[.]" *Id.*

Generally, "costs paid by a taxpayer in enhancing one's health or personal appearance, even though such costs were paid for business reasons, have been held not to be deductible as business expenses[.]"[101] An argument can be made that improving or enhancing one's physical appearance could be beneficial to an entertainer's trade or business.[102] However, this argument has been for the most part rejected by the courts as being inherently personal in nature.[103] The cost of cosmetic surgery and dentistry, therefore, is generally considered as non-deductible.

For example, *Sparkman v. Commissioner of Internal Revenue*[104] held that where the taxpayer, who was a motion picture actor and a radio performer, purchased two sets of artificial upper teeth, in order to eliminate a hiss which had developed in his speech and to restore to the taxpayer perfect enunciation which was necessary in his profession, but the taxpayer did not prove that the teeth were to be used for business purposes only, the amount paid for the dentures was not an "expense incurred in carrying on a trade or business" but was a "personal expense" and no part thereof was deductible in computing for taxation purposes the taxpayer's net income.[105]

A famous example where the taxpayer was able to successfully deduct the cost of plastic surgery procedure is the case of *Hess v. Commissioner of Internal Revenue*.[106] *Hess* involved the issue of whether the taxpayer may depreciate the cost of silicone breast implants in connection with her business as a professional exotic dancer.[107] Cynthia S. Hess underwent multiple medical procedures to replace and to substantially enlarge her implants, which finally expanded her bust size to an abnormally large size (56FF and later 56N).[108] The taxpayer's earnings almost doubled after the procedures.[109]

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101. Hess v. Commissioner of Internal Revenue, No. 11036-92S, 1994 U.S. Tax Ct. LEXIS 88, at *6 (1991).

102. *Id.* at *5.

103. *Id.* at *6.

104. Sparkman v. Commissioner of Internal Revenue, 112 F.2d 774 (Ct. App. 9th Cir. 1940) (U.S.).

105. *Id.* at 777.

106. Hess v. Commissioner of Internal Revenue, No. 11036-92S, 1994 U.S. Tax Ct. LEXIS 88 (1991).

107. *Id.* at *1-2.

108. *Id.* at *3.

109. *Id.*

The court agreed with the taxpayer's contention that the implants were a necessary "stage prop" that demonstrably increased her earnings and that she is entitled to depreciate her implants because they are assets used in the trade or business and she derived no personal benefit from them.[110]

The court rejected the application of existing case law which denied deductibility of costs incurred by a taxpayer to enhance or improve one health or personal appearance.[111] The court explained that the "reasoning in all these cases emphasizes that the benefits from the expenditure were enjoyed by the taxpayer both in personal and business activities"[112] which was not present in *Hess*.[113]

*Hess* concluded that the cosmetic procedure was detrimental to the taxpayer outside of her career and that she in fact planned to have the implants permanently removed when her career as a professional exotic dancer was over.[114] Pertinent portions of the court's ruling are as follows —

> Petitioner has shown that her implant surgery was 'incurred solely in the furtherance of the business engaged in' and 'incurred in producing revenues to the business'. The sole reason she enlarged her breasts to such a horrendous size was to increase her success (and concomitantly her income) as a professional exotic dancer. In this endeavor petitioner has succeeded, inasmuch as her fees have increased substantially since her implant surgery.
>
> Moreover, these costs were not 'incurred for the convenience, comfort, or economy of the individual in pursuing [her] business.' The implants under consideration here are not those usual breast implants that women seek to enhance their personal appearance. Rather, petitioner, in pursuit of additional income, had inserted implants that augmented her breasts to such an extent that they made her appear 'freakish'. They were so large that they ruined her personal appearance, her health, and imposed severe stress on her personal and family relationships.
>
> The cases [denying deductibility because the expense incurred benefitted the taxpayer both in personal and business activities] are distinguishable. In all of these cases, the courts found that the medical procedures[,] the general health expenditures[,] and the grooming expenditures were expenses ordinarily expended by individuals in furtherance of good health

110. *Id.* at *11.

111. *Id.* at *7-10.

112. *Hess*, 1994 U.S. Tax Ct. LEXIS 88 at *7.

113. *Id.* at *9-10.

114. *Id.* at *4.

> and maintaining an attractive appearance and, thus, were inherently personal. In contrast, petitioner's expenditures were detrimental to her health and contorted her body into a grotesque appearance, all for the purpose of making money. Thus, even though the implants were surgically made a part of her body, [the Court is] convinced that they were not inherently personal in nature.
>
> Petitioner's expenditures for implants can be analogized to clothing expenditures which, as a general rule, are not deductible as a business expense even when specific types of clothing are a necessary condition of the business or employment ... However, there is a recognized exception to this rule when: (1) The clothing is required and essential in the taxpayer's business or employment; (2) the clothing is not suitable for general or personal wear; and (3) is not so worn.
>
> ...
>
> Petitioner's line of business, that of a professional exotic dancer, was such that part of her 'costume' was her freakishly large breasts. Her implants clearly satisfy the first two criteria set forth in *Yeomans* [*v. Commissioner*]. As to the third, petitioner has proven that if she could remove her implants on a daily basis she would have done so as she preferred not to have 'worn' them in her offstage personal life. However, this was physically impossible.
>
> Because petitioner's implants were so extraordinarily large, [the Court] find[s] that they were useful only in her business. Accordingly, [the Court] hold[s] that the cost of petitioner's implant surgery is depreciable.[115]

Based on *Sparkman* and *Hess*, for an entertainer to successfully deduct the cost of aesthetic cosmetic surgery and dental surgery, he or she must be able to establish that the improvement or enhancement achieved by the procedure is required and essential in the taxpayer's trade or business and that the improvement or enhancement is unsuitable for everyday use. This would be a difficult standard to satisfy given that many of the expenses incurred by entertainers to improve or enhance their personal appearance or maintain an image are inherently personal in nature, hence, non-deductible under Section 36 (A) (1).

### *C. Traveling and Transportation Expenses*

The portion of Section 34 (A) (1) (a) (ii) of the 1997 NIRC authorizing the deduction of "travel expenses, here and abroad, while away from home in the pursuit of trade, business or profession[ ]"[116] is one of the examples in

115. *Id.* at *8-11 (citing *Yeomans v. Commissioner*, 30 T.C. 757, 767 (1958)).

116. NAT'L INTERNAL REVENUE CODE, § 34 (A) (1) (a) (ii).

that section of "ordinary and necessary expenses paid or incurred during the taxable year in carrying on[,] or which are attributable to, the development, management, operation and/or conduct of the trade, business or exercise of a profession[.]"[117]

In *Commissioner v. Flowers*,[118] the U.S. Supreme Court stated that there are three conditions that must be satisfied in order to claim a deduction for travel expenses:

(1) the expense must be generally reasonable and necessary[;][119]

(2) the expense must be incurred "while away from home"; [120] and

(3) the expense must be incurred in pursuit of business. "This means that there must be a direct connection between the expenditure and the carrying on of the trade or business of the taxpayer or his employer. Moreover, such expenditure must be necessary or appropriate to the development and pursuit of the business or trade."[121]

It is fairly easy to hurdle the first and third requirements under the *Flowers* criteria.[122] These two requirements would "come into play only if the expenses are [perceived to be] excessive or personal in nature," or if there is little or no connection between the expense and the carrying on of the trade or business.[123] The first requirement simply prohibits the taxpayer from claiming excessive or unnecessary expenses.[124] The third requirement limits "the deduction to those expenditures which are necessitated or motivated by the exigencies of the business of the taxpayer."[125]

Most of the controversy concerning the travel expense deduction involves the second *Flowers* requirement, "i.e., determining what constitutes

117. *Id.* § 34 (A) (1) (a).

118. Commissioner of Internal Revenue v. Flowers, 326 U.S. 465 (1946).

119. *Id.* at 470.

120. *Id.*

121. *Id.*

122. Edward A. Chod, *Travel, Transportation, and Commuting Expenses: Problems Involving Deductibility*, 43 MO. L. REV. 525, 526 (1978).

123. *Id.*

124. *Id.*

125. *Id.* at 526–27 (citing *Flowers*, 326 U.S. at 470).

'away from home.'"[126] The meaning of "tax home" is "important because it serves as the starting point" in evaluating the deductibility of travel expenses.[127]

The taxpayer in *Flowers* lived and practiced law in Jackson, Mississippi and was offered employment by a railroad company whose head office was 185 miles away in Mobile, Alabama.[128] The taxpayer declined to move to Mobile, but instead arranged with the railroad company to stay in Jackson on the condition that he pay his own traveling expenses between Mobile and Jackson and his own living expenses in both places.[129] The taxpayer deducted the amounts incurred to travel between Jackson and Mobile as traveling expenses under section 162 (a) (2) of the U.S. IRC.[130] The IRS disallowed the taxpayer's deduction for travel expenses, asserting that his home for tax purposes was Mobile and that he could not deduct expenses for living at a distance from work for his own convenience.[131]

Although the U.S. Supreme Court did not decide upon the meaning of "home,"[132] it sustained the disallowance on the ground that the expense in question had been incurred by the taxpayer for his own convenience rather than for business reasons.[133] The appropriate test for deductibility, therefore, is whether the travel had been motivated by "exigencies of business" or by considerations of personal preference.[134] Because the taxpayer could have chosen to live in Mobile, thereby avoiding the need for travel, the expenses were found to be self-imposed and "personal," therefore, non-deductible.[135]

126. Chod, *supra* note 122 at 527.

127. *Id.*

128. *Flowers*, 326 U.S. at 467.

129. *Id.*

130. *Id.* at 468. The provisions of § 162 (a) (2) of the U.S. IRC were substantially reproduced in § 34 (A) (1) (a) (ii) of the National Internal Revenue Code of the Philippines. I.R.C. § 162 (2006) (U.S.) & NAT'L INTERNAL REVENUE CODE, § 34 (A) (1).

131. *Flowers*, 326 U.S. at 469.

132. *Id.* at 472.

133. *Id.* at 474.

134. *Id.*

135. *Id.* at 473.

In *Hantzis v. Commissioner of Internal Revenue*,[136] the U.S. Court of Appeals for the First Circuit held that a law student who maintained a home in Boston could not deduct expenses of travelling to New York for a summer spent working at a firm in New York.[137] The court held that New York, as the place where the law student earned her income, was her tax home, and she had no business reason to maintain an abode in Boston while employed in New York.[138]

In *Ellwein v. United States*,[139] the U.S. Court of Appeals for the Eight Circuit defined "home" within the "[U.S.] IRC Section 162 (a) (2)'s 'away from home' requirement as the taxpayer's principal place of business."[140] Therefore, "[w]hen a taxpayer who maintains a residence in the vicinity of [the taxpayer's] principal place of employment is required to travel to a different location for temporary work, [the taxpayer] is considered to be 'away from home.'"[141]

In its Entertainment Audit Technique Guide, the IRS states that "a taxpayer's principal place of business encompasses the entire city, or general area, in which the taxpayer most frequently works."[142] Thus, while performing services at, or within the vicinity of, his or her place of business an individual may not deduct the cost of meals and lodging, even if the individual maintains a permanent residence elsewhere.[143]

Applying *Flowers*, *Hantzis*, *Ellwein*, and relevant administrative rulings, if the entertainer is based and frequently works, for example in Metro Manila, transportation and commuting expenses within Metro Manila would not be deductible as the said expenses are not incurred "while away from home." On the other hand, if the said entertainer is sent out of town for an assignment or for a film or TV shooting or is otherwise required to work

136. Hantzis v. Commissioner of Internal Revenue, 638 F.2d 248 (Ct. App. 1st Cir. 1981) (U.S).

137. *Id.* at 252.

138. *Id.* at 255.

139. Ellwein v. United States, 778 F.2d 506 (Ct. App. 8th Cir. 1985) (U.S.).

140. *Id.* at 509 (citing Weiberg v. Commissioner of Internal Revenue, 639 F.2d 434, 437 (Ct. App. 8th Cir. 1981) (U.S.)).

141. *Ellwein*, 778 F.2d at 509 (citing Deamer v. Commissioner of Internal Revenue, 752 F.2d 337, 339 (Ct. App. 8th Cir. 1985) (U.S.)).

142. Internal Revenue Service, *supra* note 25, at 33.

143. Rev. Rul. 73-529, 1973-2 C.B. 37 & Rev. Rul. 60-189, 1960-1 C.B. 60.

outside of Metro Manila, unreimbursed traveling expenses incurred out of town would be deductible from gross income.[144]

## V. OPTIONAL STANDARD DEDUCTION

As discussed in Part IV above, because many of the entertainer's usual expenses are non-deductible either because they are inherently personal in nature or not directly connected to the carrying on of a trade or business, the entertainer may want to consider electing the optional standard deduction (OSD) in lieu of itemized deductions under Section 34.

Under Section 34 (L), an individual engaged in a trade or business or exercising a profession "may[, in lieu of the itemized deductions under Section 34,] elect a standard deduction in an amount not exceeding forty percent (40%) of his [or her] gross sales or gross receipts."[145] Section 34 (L) requires the taxpayer to signify in his return his intention to elect the OSD, otherwise "he [or she] shall be considered as having availed himself [or herself] of the [itemized] deductions allowed in [Section 34]."[146] BIR regulations require the taxpayer to signify the election to claim OSD "by checking the appropriate box in the income tax return filed for the first quarter."[147]

There are several advantages in electing the OSD in lieu of itemized deductions under Section 34. If the individual taxpayer's level of deductions does not exceed 40% of his or her gross sales or receipts, his or her tax benefit would be greater if he or she elects the OSD as he or she would have a greater amount of deduction to reduce his taxable income. Also, electing the OSD is simpler and more straightforward, as the taxpayer just takes a straight 40% deduction. Furthermore, the substantiation requirements under Section 34 (A) (1) (b) is not applicable to OSD.[148] Moreover, the individual

144. If the entertainer is reimbursed by the principal who engaged his services, the entertainer cannot claim a deduction for travel expenses. Otherwise, the entertainer will have to report the reimbursed travel expenses as part of his gross income.

145. NAT'L INTERNAL REVENUE CODE, § 34 (L).

146. *Id.*

147. BIR RR No. 8-2018, § 8.

148. § 34 (A) (1) (b) of the National Internal Revenue Code provides that

> [n]o deduction from gross income shall be allowed under [the] Subsection [on ordinary and necessary business expenses] unless the taxpayer shall substantiate with sufficient evidence, such as official receipts or other adequate records: (i) the amount of the expense being

taxpayer electing the OSD need not submit financial statements along with the income tax return.[149] Lastly, an individual taxpayer electing the OSD is less likely to be subjected to a tax audit or investigation, or, if at all, the tax audit would be simplified since revenue authorities would no longer validate deductions claimed but, instead, would just focus on validating proper reporting of gross receipts.

## VI. CONCLUSION

As mentioned in Part II, entertainers are typically independent contractors or self-employed professionals deriving professional or talent fees. This puts entertainers in a category of taxpayers with historically low tax compliance.[150] Coupled with the fact that entertainers are high net worth individuals who are usually included in the BIR's list of top taxpayers,[151] these factors make entertainers likely candidates for a tax audit or investigation.

Entertainers, therefore, should be more conscious of tax compliance and have a higher level of taxpayer awareness. Tax awareness can be developed and tax compliance improved by making entertainers understand the common tax issues confronting the entertainment industry and equipping entertainers with a basic knowledge of tax rules and regulations.

As explained in Part III, many of the income inclusion issues arise when entertainers receive in-kind compensation and benefits that present valuation difficulties not encountered when cash is received. When entertainers receive compensation in kind, they may not understand that they have

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deducted, and (ii) the direct connection or relation of the expense being deducted to the development, management, operation and/or conduct of the trade or business or profession of the taxpayer.

NAT'L INTERNAL REVENUE CODE, § 34 (A) (1) (b).

149. *Id.* § 34 (L).

150. Aya Lowe, BIR targets self-employed tax evaders in new campaign, *available at* https://www.rappler.com/business/24092-bir-targets-self-employed-tax-evaders-in-new-campaign (last accessed Feb. 1, 2019). The report states that "[a]ccording to BIR Commissioner Kim Jacinto-Henares, there are around 1.8 million self-employed professionals working in the Philippines, but only 402,934 actually file taxes." *Id.*

151. Bianca Rose Dabu, LIST: 39 celebrities among BIR's Top 500 individual taxpayers, *available at* https://www.gmanetwork.com/news/money/personalfinance/478514/list-39-celebrities-among-bir-s-top-500-individual-taxpayers/story/?related (last accessed Feb. 1, 2019).

reportable income and, if they do understand, may have difficulty in setting aside cash from other transactions to pay the resulting tax. As observed also, some of the entertainers who ran afoul of the BIR had substantial income under-declarations, most likely from a misunderstanding of the rule that income payments subjected to CWT should still be reported in the income tax return.

Another potential problem area for entertainers is the claiming of deductions against gross income. In a tax audit or investigation, the BIR pays careful attention to deductions claimed by a taxpayer against gross income. The usual expenses that are incurred by entertainers, such as clothing, make-up, hair care and styling, and cosmetic procedures that are meant to maintain an image or improve or enhance personal appearance would likely be denied deductibility as these expenses are, according to case law, inherently personal in nature.

For an entertainer to successfully deduct these usual expenses, he or she must be able to establish that the expense is required and essential in the taxpayer's trade or business and that the item subject of the expense, e.g., make-up, clothing, etc., is unsuitable for everyday use. This would be a difficult standard to satisfy given that many of the expenses incurred by entertainers to improve or enhance their personal appearance or maintain an image are inherently personal in nature, hence, non-deductible under Section 36 (A) (1).

Thus, because many of the entertainer's usual expenses are non-deductible either because they are inherently personal in nature or not directly connected to the carrying on of a trade or business, the entertainer may want to consider electing the OSD in lieu of itemized deductions under Section 34.