

August 27, 2001

**REVENUE REGULATIONS NO. 14-2001**

**SUBJECT : Implementing Section 34(D)(3) of the National Internal Revenue Code of 1997, Relative to the Allowance of Net Operating Loss Carry-Over (NOLCO) as a Deduction from Gross Income.**

**TO : All Internal Revenue Officers and Others Concerned.**

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**SECTION 1. *Scope.*** – Pursuant to the provisions of Section 244 of the National Internal Revenue Code of 1997 (hereinafter referred to as the Code), these Regulations are hereby promulgated to govern the deduction from gross income of the Net Operating Loss Carry-Over (NOLCO) pursuant to Section 34 (D) (3) of the Code, which provides:

*“Net Operating Loss Carry-over.- The net operating loss of the business or enterprise for any taxable year immediately preceding the current taxable year, which had not been previously offset as deduction from gross income shall be carried over as a deduction from gross income for the next three (3) consecutive taxable years immediately following the year of such loss: Provided, however, That any net loss incurred in a taxable year during which the taxpayer was exempt from income tax shall not be allowed as a deduction under this Subsection: Provided, further, That a net operating loss carry-over shall be allowed only if there has been no substantial change in the ownership of the business or enterprise in that -*

*“(i) Not less than seventy-five percent (75%) in nominal value of outstanding issued shares, if the business is in the name of a corporation, is held by or on behalf of the same persons; or*

*“(ii) Not less than seventy-five percent (75%) of the paid up capital of the corporation, if the business is in the name of a corporation, is held by or on behalf of the same persons.*

*“For purposes of this Subsection, the term ‘net operating loss’ shall mean the excess of allowable deduction over gross income of the business in a taxable year:*

*“Provided, That for mines other than oil and gas wells, a net operating loss without the benefit of incentives provided for under Executive Order No. 226, as amended, otherwise known as the Omnibus Investments Code of 1987, incurred*

*in any of the first ten (10) years of operation may be carried over as a deduction from taxable income for the next five (5) years immediately following the year of such loss. The entire amount of the loss shall be carried over to the first of the five (5) taxable years following the loss, and any portion of such loss which exceeds the taxable income of such first year shall be deducted in like manner from the taxable income of the next remaining four (4) years.”*

**SEC. 2. General Principles and Policies. -**

**2.1** For purposes of these Regulations, the allowance for deduction of NOLCO shall be limited only to net operating losses accumulated beginning January 1, 1998.

**2.2** In general, NOLCO shall be allowed as a deduction from the gross income of the same taxpayer who sustained and accumulated the net operating losses regardless of the change in its ownership. This rule shall also apply in the case of a merger where the taxpayer is the surviving entity.

**2.3** Unless otherwise provided in these Regulations, NOLCO of the taxpayer shall not be transferred or assigned to another person, whether directly or indirectly, such as, but not limited to, the transfer or assignment thereof through a merger, consolidation or any form of business combination of such taxpayer with another person.

**2.4** NOLCO shall also be allowed if there has been no substantial change in the ownership of the business or enterprise in that not less than 75% in nominal value of outstanding issued shares or not less than 75% of the paid up capital of the corporation, if the business is in the name of the corporation, is held by or on behalf of the same persons.

The 75% equity, ownership or interest rule prescribed in these Regulations shall only apply to a transfer or assignment of the taxpayer's net operating losses as a result of or arising from the said taxpayer's merger or consolidation or business combination with another person. In case the transfer or assignment of the taxpayer's net operating losses arises from the said taxpayer's merger, consolidation or combination with another person, the transferee or assignee shall not be entitled to claim the same as deduction from gross income unless, as a result of the said merger, consolidation or combination, the shareholders of the transferor/assignor, or the transferor (in case of other business combinations) gains control of at least 75% or more in nominal value of the outstanding issued shares or paid up capital of the transferee/assignee (in case the transferee/assignee is a corporation) or 75% or more interest in the business of the transferee/assignee (in case the transferee/assignee is other than a corporation).

**2.5** Unless otherwise provided in these Regulations, an individual (including estate or trust) engaged in trade or business or in the exercise of profession, or a domestic or resident foreign corporation may be allowed to claim deduction of his/its corresponding NOLCO: Provided, however, that an individual who claims the 10% optional standard deduction shall not simultaneously claim deduction of the NOLCO: Provided, further, that the three-year reglementary period shall continue to run

notwithstanding the fact that the aforesaid individual availed of the 10% optional standard deduction during the said period.

2.6 The three-year reglementary period on the carry-over of NOLCO shall continue to run notwithstanding the fact that the corporation paid its income tax under the “Minimum Corporate Income Tax” computation.

2.7 NOLCO shall be availed of on a “first-in, first-out” basis.

2.8 The net operating loss incurred by a taxpayer in the year in which a substantial change in ownership in such taxpayer occurs shall not be affected by such change in ownership, notwithstanding subsections 2.3 and 2.4.

**SEC. 3. *Definition of Terms.*** - For purposes of these Regulations, the words and phrases herein provided shall mean as follows:

**3.1 *Gross Income*** - Except as otherwise provided in these Regulations, the term “Gross Income” means the pertinent items of income referred to in Section 32(A) of the Tax Code of 1997 which are required to be declared in the taxpayer’s Income Tax Return for purposes of computing his taxable income as defined in Section 31 of the same Code. All exempt income and other items of income subject to final tax shall not form part of the gross income.

**3.2 *Allowable Deductions*** – The term “Allowable Deductions” means the items of deduction enumerated under Section 34(A) to (J) and Section 34(M), including the special deductions allowed to insurance companies under Section 37 of the Code, but excluding NOLCO and any item of incentive deduction allowable under any special law that does not actually involve cash outlay: Provided, that, in the case of an individual entitled to claim the Optional Standard Deduction (OSD) under Section 34(L), in lieu of the deductions enumerated under Section 34(A) to (K), the term “allowable deductions” shall mean the aforesaid OSD plus deduction of premium payments on health and/or hospitalization insurance as provided under Section 34(M) of the Code, if applicable.

**3.3 *Net Operating Loss*** - The term “Net Operating Loss” shall mean the excess of allowable deduction over gross income of the business in a taxable year.

**3.4 *Nominal Value of Outstanding Issued Shares*** - The term “Nominal Value of Outstanding Issued Shares” shall refer to the par value (in case of par value shares of stock) or stated value (in case of no par value shares of stock) of shares of stock issued to the stockholders of the corporation.

**3.5 *Paid Up Capital of the Corporation*** - The term “Paid Up Capital of the Corporation” shall refer to the total amount paid by stockholders for their subscriptions in the shares of stock of the corporation, including any amount paid over and above the par value or stated value of the share of stock (e.g., premium on capital). For this purpose, the taxpayers shall maintain complete and accurate records of the paid-up capital of the shareholders.

**3.6 Taxable Income** – The term “Taxable Income” means the excess amount of the pertinent items of gross income over the allowable deductions and/or personal and additional exemptions, if any, authorized under the Code or under any special law.

**3.7 Taxable Year** - The term “Taxable Year” means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under Title II of the Code. Taxable year includes, in the case of a return made for a fractional part of a year, the period for which such return is made. The term “Fiscal Year” means an accounting period of twelve (12) months ending on the last day of any month other than December.

**3.8 Substantial Change in the Ownership of the Business or Enterprise** - The term “Substantial Change in the Ownership of the Business or Enterprise” shall refer to a change in the ownership of the business or enterprise as a result of or arising from its merger or consolidation or combination with another person in the manner as provided in subsection 2.4 of these Regulations. Any change in ownership as a result of or arising thereunder shall not be treated as a substantial change for as long as the stockholders of the party thereto, to whom the net operating loss is attributable, gains or retains 75% or more interest after such merger or consolidation or combination.

**3.9 Merger** - For purposes of these Regulations, the term “Merger” shall refer to the absorption of a corporation by another corporation, the latter retaining its own name and identity and acquiring the assets, liabilities, franchises and powers of the former, and the absorbed corporation ceasing to exist as a separate juridical person.

**3.10 Consolidation** - For purposes of these Regulations, the term “Consolidation” shall refer to a situation when two or more corporations are extinguished, and by the same process a new one is created, taking over the assets and assuming the liabilities of the said extinguished corporations; or the unification of two or more corporations into a single new corporation, having the combined capital, franchises and powers of all its constituents.

**3.11 Combination** - For purposes of these Regulations, the term “Combination” shall refer to a situation when an owner of a business, organized as a sole proprietorship, admits a partner in his business for the purpose of forming a co-partnership, or any such business combination which, in effect, is similar or synonymous thereto.

**3.12 By or on Behalf of the Same Persons** - The term “By or on Behalf of the Same Persons” shall refer to the maintenance of ownership despite change as when:

1. No actual change in ownership is involved in case the transfer involves change from direct ownership to indirect ownership, or vice versa.

Illustration:

Facts: P Corporation owns Q Corporation that has NOLCO. P Corporation transfers Q Corporation's shares to R Corporation in exchange for 100% of R Corporation shares.

Held: Q Corporation's NOLCO is retained because Q Corporation's shares are held "by" R Corporation "on behalf of" P Corporation, the original owner.

2. No actual change in ownership is involved as in the case of merger of the subsidiary into the parent company.

Illustration:

Facts: X Corporation owns 100% of Y Corporation. Y Corporation owns 100% of Z Corporation. Z Corporation has NOLCO. Z Corporation is merged into Y Corporation.

Held: Z Corporation's NOLCO should be retained and transferred to Y Corporation. Prior to the merger, X Corporation already indirectly owned Z Corporation, i.e., Z Corporation's shares were held "by" Y Corporation "on behalf of" X Corporation. After the merger, X now directly owns Z Corporation [absorbed corporation] which continues to exist in Y Corporation.

Any reference in these Regulations to the "75% equity, ownership, or interest rule", "75% or more in nominal value", "75% or more interest", and other similar terms shall be construed within the context of this definition.

Notwithstanding the above, in determining whether there is actual change in ownership in the above-mentioned and similar cases, each and every step of the transaction shall be considered and the whole transaction or series of transactions shall be treated as a single unit.

**SEC. 4. *Taxpayers Entitled to Deduct NOLCO from Gross Income.*** – Any individual (including estates and trusts) engaged in trade or business or in the exercise of his profession, and domestic and resident foreign corporations subject to the normal income tax (e.g., manufacturers and traders) or preferential tax rates under the Code (e.g., private educational institutions, hospitals, and regional operating headquarters) on their taxable income as defined in Section 3 of these Regulations shall be entitled to deduct from his/its gross income for the current year his/its accumulated net operating losses for the immediately preceding three (3) consecutive taxable years: Provided, however, that net operating losses incurred or sustained prior to January 1, 1998 shall not qualify for purposes of the NOLCO. Provided, further, that any provision of these Regulations notwithstanding, the following shall not be entitled to claim deduction of NOLCO:

**4.1** Offshore Banking Unit (OBU) of a foreign banking corporation, and Foreign Currency Deposit Unit (FCDU) of a domestic or foreign banking corporation, duly authorized as such by the Bangko Sentral ng Pilipinas (BSP);

**4.2** An enterprise registered with the Board of Investments (BOI) with respect to its BOI-registered activity enjoying the Income Tax Holiday incentive. Its accumulated net operating losses incurred or sustained during the period of such Income Tax Holiday shall not qualify for purposes of the NOLCO;

**4.3** An enterprise registered with the Philippine Economic Zone Authority (PEZA), pursuant to R.A. No. 7916, as amended, with respect to its PEZA-registered business activity. Its accumulated net operating losses incurred or sustained during the period of its PEZA registration shall not qualify for purposes of the NOLCO;

**4.4** An enterprise registered under R.A. No. 7227, otherwise known as the Bases Conversion and Development Act of 1992, e.g., SBMA-registered enterprises, with respect to its registered business activity. Its accumulated net operating losses incurred or sustained during the period of its said registered operation shall not qualify for purposes of the NOLCO;

**4.5** Foreign corporations engaged in international shipping or air carriage business in the Philippines; and

**4.6** In general, any person, natural or juridical, enjoying exemption from income tax, pursuant to the provisions of the Code or any special law, with respect to its operation during the period for which the aforesaid exemption is applicable. Its accumulated net operating losses incurred or sustained during the said period shall not qualify for purposes of the NOLCO.

***SEC. 5. Determination of Substantial Change in the Ownership of the Business.***

***5.1 Time of Determination of Substantial Change in the Ownership of the Business; Determined as of the End of the Taxable Year.*** - The substantial change in the ownership of the business or enterprise shall be determined as of the end of the taxable year when NOLCO is to be claimed as deduction. Whether or not substantial change in ownership occurred shall be determined on the basis of any change in the ownership of interest in the said business or enterprise arising from or incident to its merger, or consolidation, or combination with another person (e.g., in the case of merger or consolidation of two or more corporations, such change shall be determined based on the ownership of the outstanding shares of stock issued or based on paid-up capital as of the end of the taxable year, and as a result of or arising from the said merger or consolidation).

***5.2 When Change Occurs.*** - A change in the ownership of the business occurs when the person who sustained net operating losses enters into a merger, or consolidation or combination with another person, thereby resulting to the transfer or conveyance of the

said net operating losses, to another person, in the course of the said merger or consolidation or combination.

(a) **When No Substantial Change Occurs.** - No substantial change in ownership of the business occurs if, as a result of the said merger or consolidation or combination, the stockholders of the transferor, or the transferor, in case of other business combinations, gains control of at least **75% or more** in nominal value of the outstanding issued shares or paid-up capital of the transferee-assignee (in case the transferee-assignee is a corporation) or **75% or more** interest in the business of the transferee-assignee (in case the transferee-assignee is other than a corporation).

(b) **When Substantial Change Occurs.** - A substantial change in ownership of the business occurs if, as a result of the transaction referred to in subsection 5.2 (a) hereof, the stockholders of the transferor or the transferor, in case of other business combinations, gains control of the aforesaid transferee-assignee only to the extent of **less than 75%**.

**SEC. 6. Entitlement to Net Operating Loss Carry- Over. -**

**6.1 In General.** - In general, only net operating losses incurred by a qualified taxpayer for the period beginning January 1, 1998 may be carried over to the next three (3) immediately succeeding taxable years following the year of such loss for purposes of the NOLCO deduction. Provided, however, that for mines other than oil and gas wells, a net operating loss without the benefit of incentives provided for under Executive Order No. 226, otherwise known as the Omnibus Investments Code of 1987, as amended , incurred in any of the first ten (10) years of operation may be carried over as a deduction from taxable income for the next five (5) years immediately following the year of such loss. Provided, further, that the entire amount of the loss shall be carried over to the first of the five (5) taxable years following the loss, and any portion of such loss which exceeds the taxable income of such first year shall be deducted in like manner from the taxable income of the next remaining (4) four years.

**6.2 Transitory Apportionment of NOLCO, in Case of Corporation Using the Fiscal Year Accounting Period.** - In general, only net operating losses incurred beginning January 1, 1998 may be claimed as a NOLCO deduction. In the case of a corporation using a fiscal year accounting period as of the said date, whose result of operations for the fiscal year 1997-1998 shows a net operating loss, the allowable NOLCO for the succeeding fiscal years shall be determined, as follows:

NOLCO for the entire fiscal year	(1997-1998)	xxx
Multiplied by the ratio of:	<u>No. of months in 1998</u>	
	12 mos. covering FY 97-98	xxx
NOLCO to be carried over to FYs 1998-1999, 1999-2000, and/or 2000-2001		xxx

**6.3 Where Taxpayer is Exempt, or Partly Exempt from Income Tax, or Enjoying Preferential Tax Treatment Under Special Laws.** - Net operating loss or losses incurred by any person who is exempt from income tax, or enjoying preferential tax treatment pursuant to the provisions of special laws, shall not be allowed a NOLCO deduction (e.g., any BOI-registered enterprise enjoying income tax holiday pursuant to E.O. No. 226, as amended, otherwise known as the Omnibus Investments Code of 1987; or any PEZA-registered enterprise enjoying preferential tax treatment or income tax holiday pursuant to R.A. No. 7916, as amended; any person enjoying preferential tax treatment pursuant to R.A. No. 7227, otherwise known as the Bases Conversion and Development Act of 1992. See Section 4 of these Regulations for further discussion).

In case any of the aforementioned persons is engaged in both registered and unregistered business activities under any of the aforesaid laws (e.g., a corporation with a BOI-registered activity enjoying income tax holiday; and other unregistered business activities not enjoying any BOI incentive) the net operating loss or losses sustained or incurred by the said BOI-enterprise from its registered activities shall not be allowed as NOLCO deduction from its gross income derived from the unregistered business activities.

**6.4 Quarterly and Annual Availment of NOLCO.** - NOLCO shall be allowed as deduction in computing the taxpayer's income taxes per quarter and annual final adjustment income tax returns: Provided, however, that if per the taxpayer's final annual adjustment income tax return, the entire operations for the year resulted to a net operating loss, such net operating loss may be claimed as NOLCO deduction in the immediately succeeding taxable year: Provided, further, that NOLCO may be claimed as deduction only within a period of three (3) consecutive taxable years immediately following the year the net operating loss was sustained or incurred. In order that compliance with this three-year statutory requisite may be effectively monitored, the taxpayer shall, at all times, show its NOLCO deduction, in its income tax return, as a separate item of deduction. In no case may NOLCO be claimed, as a part of the taxpayer's other itemized deductions, like under deduction of "losses," in general.

**6.5 NOLCO in Relation to the Minimum Corporate Income Tax (MCIT).** - In general, domestic and resident foreign corporations subject to the normal income tax rate are liable to the 2% MCIT, if applicable, computed based on gross income, whenever the amount of the MCIT is greater than the normal income tax due (computed with the benefit of NOLCO, if any), pursuant to Sections 27 or 28 of the Code. Thus, such corporation cannot enjoy the benefit of NOLCO for as long as it is subject to MCIT in any taxable year. Provided, however, that the running of the three-year period for the expiry of NOLCO is not interrupted by the fact that such corporation is subject to MCIT in any taxable year during such three-year period.

**SEC. 7. Presentation of NOLCO in the Tax Return and Unused NOLCO in the Income Statement.** -The NOLCO shall be separately shown in the taxpayer's income tax return (also shown in the Reconciliation Section of the Tax Return) while the Unused NOLCO shall be presented in the Notes to the Financial Statements showing, in detail, the taxable year in which the net operating loss was sustained or incurred, and any



amount thereof claimed as NOLCO deduction within three (3) consecutive years immediately following the year of such loss. Failure to comply with this requirement will disqualify the taxpayer from claiming the NOLCO.

**SEC. 8. *Repealing Clause.*** - Any revenue ruling or issuance inconsistent herewith shall be considered repealed, amended or modified accordingly.

**SEC. 9. *Effectivity Clause.*** – These Regulations shall take effect beginning January 1, 1998.

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

Recommending Approval:

(Original Signed)  
**RENÉ G. BAÑEZ**  
Commissioner of Internal Revenue