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INSIGHTS

JULY 2018

A monthly digest of significant tax-related court decisions and regulatory issuances (includes BIR, SEC, BSP and various government agencies)

Fifth Issue, Series of 2018

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Taken during the turnover of a new 2-classroom building and the rehabilitation of a 3 classroom building in Tetep-an Elementary School, Sagada, Mt. Provice donated by BDB Law Foundation Inc., a CSR arm of BDB Law.

HIGHLIGHTS for JULY 2018

Court Decision

- **Prior year's excess credit must be substantiated in a claim for refund of excess creditable tax.** *(Commissioner of Internal Revenue v. Cebu Holdings, Inc., G.R. No. 189792, June 20, 2018).*
- **No assessment was issued unless the assessment was received by the taxpayer.** *(Commissioner of Internal Revenue v. Bank of the Philippine Islands, G.R. No. 224327, June 11, 2018).*
- **Absent any decision from the Commissioner of Customs (COC) in the seizure and forfeiture proceedings, the CTA did not acquire jurisdiction over the matter.** *(The Bureau of Customs and the Commissioner of Customs v. Jade Bros Farm and Livestock, Inc., CTA Case EB 1566, July 4, 2018).*
- **Deficiency income tax and VAT may not be assessed on the basis solely of under-declared purchases.** *(Philippine Power MC Distribution, Inc., v. Commissioner of Internal Revenue, CTA Case No. 9263, July 6, 2018).*
- **Section 228 of the Tax Code does not apply to assessment issued for violation of other provisions of the Tax Code and tax rules and regulations.** *(Frankfort, Inc. v. Commissioner of Internal Revenue, CTA Case No. 9363, July 10, 2018).*
- **In the absence of a written offer from taxpayer, imposition of penalties should be in accordance with RMO 19-2007 (now RMO 07-2015).** *(Frankfort, Inc. v. Commissioner of Internal Revenue, CTA Case No. 9363, July 10, 2018).*
- **To hold petitioner liable for percentage or amusement tax, there must be sufficient proof that it operates as a cabaret, night or day club.** *(Hard Rock Café (Makati City), Inc. v. Commissioner of Internal Revenue, CTA Case No. 9279, July 12, 2018).*

BIR Issuances

- **RMC 62-2018, July 10, 2018 –** This clarifies that withdrawal from the decedent's bank deposit account/s is allowed only (a) when made within one (1) year from date of death; (b) 6% final tax has been withheld, unless tax has been previously paid; and (c) the estate's TIN and BIR Form No. 1904 have been presented to the bank.

- **RMO 30-2018, July 10, 2018 –** This prescribes the policy that claims for refund of Capital Gains Tax (CGT) and Creditable Withholding Tax (CWT) shall be processed at the RDO having jurisdiction over the place where the subject property is located.

  RMO 33-2018, July 12, 2018 – This reiterates the existing policy that the ATCA shall be issued as proof of cancellation of assessments with issued Final Assessment Notice (FAN)/Formal Letter of Demand (FLD) of concerned delinquent taxpayers.

SEC Opinions

- **MC No. 09, S. 2018, July 18, 2018** – This memorandum circular prescribes that the name of an international governmental organization may not be used as part of a corporate or partnership name unless when duly authorized or allowed by the SEC.

Article Written

- **The Proposed Federal Tax System and the Problem of Tax Overlapping, Business Mirror: Tax Law for Business, July 19, 2018 –** The article discusses the tax system to be employed under a federal system of government if we follow the Consultative Committee's draft Constitution which was approved by the President last 10 July 2018 and endorsed to Congress.

COURT ISSUANCES

I
Significant Supreme Court Decisions

Prior year's excess credit must be substantiated in a claim for refund of excess creditable tax.

The taxpayer filed a claim for refund of excess creditable withholding tax. The taxpayer used its prior year's excess credits to pay for its current year's income tax due. The Supreme Court (SC) disallowed the same because the prior year's excess credits was unsubstantiated. Further, when the taxpayer opted to just carry-over to the succeeding year its prior year's excess credits and creditable taxes that is subject of the refund, the SC went on to explain that only the substantiated tax credits may be carried-over to the succeeding year and may be applied against the income tax due in the succeeding year. The SC ordered the BIR to issue a FAN on the taxpayer for using its unsubstantiated excess credits as payment for its income tax due for the current year. *(Commissioner of Internal Revenue vs. Cebu Holdings, Inc., G.R. No. 189792, June 20, 2018).*

Note: **How should a taxpayer substantiate its prior year's excess credits? Is it enough that the taxpayer present the income tax return or the CWT certificates of the preceding years? Or is the taxpayer required to prove, like in a claim for refund, that the said CWT certificates were declared as part of income of the corresponding taxable years. This will be a very difficult requirement for a taxpayer that is claiming for refund. In substantiating prior year's excess credits, a taxpayer needs to prove not only the immediately preceding taxable year but the many years of carry over where the immediately preceding prior year's excess credits was derived from.**

No assessment was issued unless the assessment was received by the taxpayer.

In this case, the taxpayer denied receiving the assessment notice and the BIR was unable to present evidence that such notice was, indeed, mailed or received by the taxpayer. Thus, according to the SC, the failure of the BIR to prove the receipt of the assessment by the BIR means that no assessment was issued. *(Commissioner of Internal Revenue vs. Bank of the Philippine Islands, G.R. No. 224327, June 11, 2018).*

II
Significant Court of Tax Appeals Decisions

A holding company is not subject to local business tax (LBT) on dividend income.

The Court ruled that the taxpayer is a holding company and not an investment company nor a bank and/or other financial institution as can be seen on its Articles of Incorporation (AOI). Its primary purpose does not show that any of its activities are covered by the BSP Manual akin to functions pertaining to a financial intermediary. As a holding company, it is not subject to LBT on dividend income. *(Metro Pacific Assets Holdings, Inc. v. Makati City, Case AC-184, July 2, 2018).*

Absent any decision from the Commissioner of Customs (COC) in the seizure and forfeiture proceedings, the CTA did not acquire jurisdiction over the matter.

The taxpayer allegedly imported rice without import permits from the National Food Authority. Consequently, the Bureau of Customs (BOC) refused to release the rice shipments. After their seizure, taxpayer's rice shipments

were subjected to forfeiture proceedings. The taxpayer filed a Consolidated Motion for Release Under Cash Bond. Pending resolution of the Motion, the taxpayer filed a petition for review with the CTA. The CTA ruled that it has no jurisdiction over the case absent any decision from the COC in the seizure and forfeiture proceedings over the subject rice shipments. *(The Bureau of Customs and the Commissioner of Customs v. Jade Bros Farm and Livestock, Inc., CTA Case EB 1566, July 4, 2018).*

The CTA has jurisdiction to act on disputed assessment and not when the assessment has become final, executory and demandable for taxpayer's failure to file protest.

On September 19, 2013, the taxpayer received a FAN for alleged tax deficiency of around P500 Million. Counting 30 days from receipt thereof, petitioner had until October 19, 2013 within which to file its protest. However, instead of filing a protest, petitioner wrote a letter to the BIR on November 21, 2013 stating that it made a partial payment, inclusive of the 20% interest based on the FAN. It was only on February 17, 2014 that the taxpayer filed a letter requesting for reinvestigation of tax deficiency.

The court ruled that for failure to file a protest within the reglementary period, the assessment in question became final, executory, and demandable. The fact that an assessment has become final for failure of the taxpayer to file a protest within the reglementary period means that the validity or correctness of the assessment may no longer be questioned on appeal. Consequently, the CTA had no jurisdiction to entertain such case. *(Grand Plaza Hotel Corporation v. Commissioner of Internal Revenue, CTA Case No. 8992, July 4, 2018).*

Deficiency income tax and VAT may not be assessed on the basis solely of under-declared purchases.

The sole basis of the assessment of deficiency income tax and VAT is the alleged under-declared purchases arising from the comparison of the amount of the taxpayer's purchases per Summary List of Purchases and the amount of its purchases per its VAT returns.

The court, in cancelling the assessment, ruled that income tax is assessed on income received from any property, activity or service. Such being the case, in the imposition or assessment of income tax, it must be clear that there was an income, and such income was received by the taxpayer, and not when there is an under-declaration of purchases. Moreover, it is important to note that, for income tax purposes, a taxpayer is free to deduct from its gross income a lesser amount, or not to claim any deduction at all. What is prohibited by the income tax law is to claim a deduction beyond the amount authorized therein. Thus, even when there is under-declaration of purchases, the same is not prohibited by law. Accordingly, mere reliance on the fact that there were under-declared purchases is not enough basis for the court to uphold respondent's assessment of the subject deficiency income tax.

As regards deficiency VAT, the court held that VAT can be imposed only when it is shown that the taxpayer received an amount of money or its equivalent from its sale, barter or exchange of goods or properties, or from sale or exchange of services, and not when there are under-declared purchases. In other words, the VAT is imposed when one sells, not when one purchases. *(Philippine Power MC Distribution, Inc., v. Commissioner of Internal Revenue, CTA Case No. 9263, July 6, 2018).*

Section 228 of the Tax Code does not apply to assessment for violation of other provisions of the Tax Code and tax rules and regulations.

Upon assessment, the taxpayer paid to the BIR miscellaneous penalties in the aggregate amount of ₱5,600,000.00 allegedly for the following violations: (a) no books; (b) no official receipts; (c) no back-end report; and (d) unaccounted point-of-sales machines, and subsequently claimed a refund.

A. In its claim for refund, the taxpayer argued that it was not afforded due process in accordance with the provisions of Section 228 of the Tax Code.

The court, in not upholding the taxpayer's contention, ruled that Section 228 of the Tax Code does not apply to assessment for violation of other provisions of the Tax Code and tax rules and regulations. The imposition of the said penalties was not a result of regular examination of internal revenue tax liabilities under Section 203 of the Tax Code but it was an outcome of the inspection of the taxpayer's compliance with the administrative provisions of the Tax Code, more particularly with regard to the keeping of books of accounts, official receipts and related financial records. Hence, Section 228 does not apply in the instant case.

Note: **In assessments issued by the BIR as a result of regular examination of the taxpayer's internal revenue tax liabilities and not just as an outcome of inspection of the taxpayer's compliance with the administrative provisions of the Tax Code, the BIR also would normally include findings on taxpayer's non-compliance with administrative compliance requirements, booking and invoicing requirements which would warrant the imposition of compromise penalties. In case these findings were stated in such assessments, would this decision of the CTA in *Frankfort* case still apply?**

B. The taxpayer also argued that the BIR had no basis to impose and collect said penalties in such amount in the absence of a written offer from the taxpayer.

The court held that in the absence of a written offer from the taxpayer, the amount of compromise penalties to be imposed must be those stated in RMO 19-2007 (now RMO 07-2015). Under the said RMO, taxpayer's penalties amounted to only ₱150, 000.00. Hence, the CTA partially granted taxpayer's claim of refund in the amount of ₱5, 450,000.00. *(Frankfort, Inc. v. Commissioner of Internal Revenue, CTA Case No. 9363; July 10, 2018).*

Note: **This decision of the CTA in the *Frankfort* case departs from the court's previous rulings that in the absence of any proof that the taxpayer consented to a compromise penalty, the imposition of compromise penalty should not be allowed.**

To hold the taxpayer liable for percentage or amusement tax, there must be sufficient proof that it operates as a cabaret, night or day club.

For the taxpayer to be deemed a cabaret, or night and day club, it must be established that its operations involve dancing as the main business and customers patronize the place in order to dance either with their own partners or with professional hostesses engaged by petitioner for that purpose.

The evidence, however, showed that the business activities of the taxpayer do not fall within the scope or coverage of cabarets and/or night or day clubs, since there is no indication that its customers frequent its establishment to dance, either with their own partners, or with professional hostesses provided by the taxpayer. It has no dance floor, nor does it encourage its customers to dance. The evidence presented showed that the actual business activities of the taxpayer r are those of a restaurant, with the entertainment usually by the performances of live bands, which is merely incidental to its main business to encourage or attract customers with the end in view of promoting sales of food and drinks served in the restaurant. Moreover, no tickets are sold by petitioner to its customers to view the live band as it is but a part of the service to customers as they dine. *[Hard Rock Café (Makati City), Inc. v. Commissioner of Internal Revenue, CTA Case No. 9279, July 12, 2018].*

Note: **The Court did not adopt the definition of the terms cabarets, night and day clubs under RMC 18-2010 to include other places which offer similar pleasurable diversion entertainment and function such as videoke bars, karaoke bars, karaoke televisions, karaoke boxes and music lounges, for purposes of imposing amusement tax. RMC 18-2010 unilaterally changed and expanded or widened the scope or meaning of the terms cabarets, night and day clubs as defined under the Tax Code and in existing jurisprudence. When there is a conflict between administrative issuances and jurisprudence, it is the latter which shall prevail.**

BIR Issuances

RMC 62-2018, July 10, 2018

This RMC clarifies the requirements on the withdrawal from the bank deposit account/s of a deceased depositor/joint depositor without the required electronic Certificate Authorizing Registration (eCAR), to wit:

1. Withdrawal from the bank deposit account/s shall be made within one (1) year from the date of death of the depositor/joint depositor. The amount withdrawn shall be subject to six percent (6%) final withholding tax, unless the bank deposits are already declared for estate tax purposes and is/are indicated in the eCAR presented to the bank for withdrawal of the said bank deposits.
2. For joint account, the final withholding tax shall be based on the share of the decedent in the joint bank deposits;
3. Prior to such withdrawal, the bank shall require the executor, administrator, or any of the legal heir/s withdrawing to present a copy of the Tax Identification Number (TIN) of the estate of the decedent and BIR Form No. 1904 of the estate, duly stamped received by the concerned Revenue District Office (RDO) of the Bureau of Internal Revenue in accordance with the existing guidelines on the issuance of TIN;
4. The bank shall issue the corresponding BIR Form No. 2306 (Certificate of Final Income Tax Withheld) certifying the withholding of 6% final tax, file the prescribed quarterly return on the final tax withheld and remit the same on or before the last day of the month following the close of the quarter during which the withholding was made;
5. All withdrawal slips to be used for purposes of implementing Section 27 of the TRAIN Law shall contain the following terms and conditions: (a) a sworn statement by any one of the surviving joint depositor/s to the effect that all the other joint depositor/s is/are still living at the time of withdrawal; and (b) a statement that the withdrawal is subject to 6% final withholding tax.

Note: **This circular was issued to state the requirements which must be satisfied before withdrawal of the bank deposits of a decedent, which under the Tax Code prior to TRAIN, was not allowed without prior presentation of an CAR.**

RMO 30-2018, July 10, 2018

This revenue memorandum order prescribes the policy regarding the processing of claims for refund of erroneous payment of capital gains tax (CGT) or creditable withholding tax (CWT) wherein the taxpayer's registration and the location of the property fall under the jurisdiction of different RDOs.

In such case, the processing of claims for refund and the issuance of corresponding eLA shall now be under the RDO having jurisdiction over the place where the subject property is located, regardless whether or not the claimant is its registered taxpayer.

Note: **CGT and CWT withheld on sale, exchange or transfer of real properties are payable to the RDO where the said properties are located. Corollary, any refund of erroneous payment must be applied in the same RDO where the taxes were paid.**

RMO 33-2018, July 12, 2018

This memorandum order clarifies and reiterates the existing policies and procedures in the issuance of the Authority to Cancel Assessment (ATCA).

The ATCA shall be issued as proof of cancellation of assessments with issued Final Assessment Notice (FAN)/Formal Letter of Demand (FLD) of concerned delinquent taxpayers due to any of the following instances:

1. The difference between the amounts of the original tax assessment and the reduced tax assessment after the originally issued FAN/FLD has been modified, amended or declared "null and void" covered by a final administrative decision by the Commissioner or his duly authorized revenue official as shown in the Final Decision on Disputed Assessment (FDDA), after the conduct of review/evaluation/reconsideration of the factual and/or legal bases raised in its protest/appeal/motion for reconsideration;
2. Final approval of the corresponding application for compromise settlement and abatement or cancellation of penalties pursuant to Section 204 (a) of the Tax Code and its implementing regulation;
3. Decision by the competent court/s where the assessment was either modified, amended or declared "null and void" with finality as shown in the entry of judgment;
4. Declaration that the Accounts Receivables/Delinquent Accounts (AR/DA) case is uncollectible due to insolvency by a competent court in a final and executory judgment;
5. Taxpayer's availment of tax amnesty which are included in the List of the Tax Amnesty Availers provided by the Office of the Commissioner or Deputy Commissioner, Operations Group;
6. Condonation of the assessment by virtue of law, provided the required documentations thereon have been submitted, evaluated and thereafter approved by the Commissioner or his authorized Revenue Official;
7. When the right of the government to assess/collect the corresponding deficiency/delinquent taxes has prescribed in accordance with Sections 203 and 222 of the Tax Code, as amended, and the cancellation due to the aforesaid reason has been approved by the Commissioner based on the recommendation of the National Committee on Prescribed Cases that was created for this purpose;
8. AR/DA case/s that are recommended for write-off and approved by the Commissioner of Internal Revenue or his duly authorized representative on the grounds such as but not limited to the following:
    a. Individual taxpayer is deceased and no distrainable or leviable assets could be found;
    b. Permanent cessation of business;
    c. Dissolution;
    d. Taxpayer is a general partnership and the individual partners are already deceased;
    e. AR/DA case/s with a total amount due of ₱20, 000.00 and below, provided that all collection enforcement summary remedies have been fully exhausted.
9. Such other meritorious cases which the Commissioner may deemed necessary to be covered by ATCA.

SEC Issuances

MC No. 09, S. 2018, July 18, 2018

This memorandum circular amends SEC Memorandum Circular No. 14, Series of 2017 (Consolidated Guidelines and Procedure on the Use of Corporate and Partnership Names) in order to prevent the formation of bogus organizations that could potentially misrepresent itself as an affiliate of an international governmental organization and usurp the authority pertaining to said international governmental organizations. The following paragraph has been added:

> The name of an international governmental organization such as "International Criminal Police Organization" (INTERPOL), "International Monetary Fund" (IMF), and "International Labour Organization" (ILO), may not be used as part of a corporate or partnership name unless when duly authorized or allowed by the Commission.

Articles Written

Business Mirror: Tax Law for Business,

The Proposed Federal Tax System and the Problem of Tax Overlapping

By: Pierre Martin D. Reyes

A draft Constitution was submitted to the President on July 9, 2018, by the Consultative Committee constituted to review the 1987 Constitution. The main aim of the draft Constitution is to change the country's political system, from unitary to federal. This draft was approved by the President on July 10, 2018, and has since then been endorsed to Congress. Though the said draft still needs to go through other processes before approval, it gives us a glimpse of the tax system to be employed under the proposed federal system of government.

Under our current system of government, the power of taxation is exercised by the national government through Congress. Though local government units have the power to tax, such power is merely a delegated power to be exercised within the limitations imposed by law. This system follows the principle of preemption or exclusion, which means that local governments cannot impose a tax that is already levied by the national government. On the other hand, in a federal system, the power of taxation rests in the three levels of government, i.e., the federal, the state and the local governments. This means that each level of government can impose the same tax on the same taxpayer unless otherwise limited by the Constitution.

Taxation in a federal system presents a common pool problem. As the federal, state and local governments share the same tax base, the result can be over taxation, analogous to overfishing in a shared body of water. Added to this is the problem of compliance: taxpayers will now have to go through various levels of regulations just to pay taxes. This results to overlap among the three levels of government. To illustrate, in the United States, income tax is imposed by the federal, the state and local governments, and sales tax is imposed by the state government and, if delegated, the local governments. On this point, we ask: Does the draft Constitution address this foreseeable dilemma?

Under the draft Constitution, the envisioned "Federal Republic of the Philippines" shall consist of 18 federated regions. If there is no allocation of taxing power, then the proposed Federal Government, the proposed federated regions and the several local government units under the federated regions can impose similar taxes on the same taxpayer. To resolve this, the draft Constitution clearly delineates the power to tax between the proposed federal government and the federated regions. The draft Constitution gives the federal government the power to levy and collect all taxes, duties, fees and charges, except the power to tax granted to the Federated Regions. The draft Constitution then limits the federated regions' power to tax to the following: (a) real property tax; (b) estate tax; (c) donor's tax; (d) documentary stamp tax; (e) professional tax; (f) franchise tax; (g) games and amusement tax; (h) environmental tax, pollution tax and similar taxes; (i) road users tax; (j) vehicle-registration fees; (k) transport franchise fees; and (l) local taxes and other taxes that may be granted by federal law. To emphasize that no overlap occurs, the draft Constitution expressly states, "No double taxation shall be allowed."

Thus, it can be readily seen that the allocation of the power to tax between the proposed federal government and the proposed federated regions bears a striking resemblance to the current setup between the national government and the local government units. Currently, the national government collects taxes under the National Internal Revenue Code and other national taxes, while local government units can only collect taxes delegated to it by Congress through the Local Government Code.

The change introduced by the draft Constitution is to shift certain national taxes, such as estate tax, donor's tax, documentary stamp tax, road user's tax and vehicle-registration fees to the proposed federated regions, and to give to the federated regions the power to impose local taxes, which is currently delegated to local government units.

The proposed federal government retains the sole power to impose income taxes, value-added taxes, excise taxes, customs duties and other taxes to be passed by the proposed Federal Congress.

While the tax structure under the draft Constitution will minimize, if not avoid, the excessive tax burden that can result from multiple levels of taxation under a federal system, taxpayers will inevitably be burdened by having to comply with another layer of rules set by the federated regions in addition to those set by the local governments. To resolve this, the proposed federated regions should pass uniform rules and procedures to govern taxpayer compliance.

Another inevitable outcome of the proposed tax structure is tax competition. Insofar as those taxes that they are allowed by the draft Constitution and by federal law to levy, federated regions will likely engage in a "race to the bottom" in terms of taxation and regulation to persuade taxpayers to move to their respective jurisdictions.

In a nutshell, the propriety of the shift to a federal system and the proposed tax structure is still a matter of debate. What is clear is that as the proposed draft goes through constitutional processes, it is the duty of every citizen to take part in this national debate. After all, the draft Constitution will still be presented to the people for ratification. In so doing, we, the people, will be deciding the future of our generation and generations to come. A participative and informed discussion on the draft Constitution is key in making an informed choice for the Philippines's future.

BDB Law's "Tax Law for Business" appears in the opinion section of Business Mirror every Thursday.

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