



# TAXATION LAW

## I. GENERAL PRINCIPLES

### POWER OF TAXATION

**TAXATION** - power by which the sovereign through its law-making body raises revenue to defray the necessary expenses of government from among those who in some measure are privileged to enjoy its benefits and must bear its burdens.

#### Two Fold Nature of the Power of Taxation

1. It is an inherent attribute of sovereignty
2. It is legislative in character

#### Extent of Taxing Power

Subject to constitutional and inherent restrictions, the power of taxation is regarded as comprehensive, unlimited, plenary and supreme.

#### SCOPE OF LEGISLATIVE TAXING POWER

1. Amount or rate of tax
2. Apportionment of the tax
3. Kind of tax
4. Method of collection
5. Purpose/s of its levy, *provided* it is for public purpose
6. Subject to be taxed, *provided* it is within its jurisdiction
7. Situs of taxation

**TAXES** - enforced proportional contributions from the persons and property levied by the law-making body of the State by virtue of its sovereignty in support of government and for public needs.

#### CHARACTERISTICS OF TAXES

1. forced charge;
2. pecuniary burden payable in money;
3. levied by the legislature;
4. assessed with some reasonable rule of apportionment; (see theoretical justice)
5. imposed by the State within its jurisdiction;

6. levied for a public purpose.

#### REQUISITES OF A VALID TAX

1. should be for a public purpose
2. the rule of taxation shall be uniform
3. that either the person or property taxed be within the jurisdiction of the taxing authority
4. that the assessment and collection of certain kinds of taxes guarantees against injustice to individuals, especially by way of notice and opportunity for hearing be provided
5. the tax must not impinge on the inherent and Constitutional limitations on the power of taxation

#### THEORIES AND BASES OF TAXATION

##### 1. Lifeblood Theory

Taxes are what we pay for civilized society. Without taxes, the government would be paralyzed for lack of the motive power to activate and operate it. Hence, despite the natural reluctance to surrender part of one's hard-earned income to the taxing authorities, every person who is able to must contribute his share in the running of the government. (*CIR v. Algue, Inc.*)

##### 2. Necessity Theory

The power to tax is an attribute of sovereignty emanating from necessity. It is a necessary burden to preserve the State's sovereignty and a means to give the citizenry an army to resist an aggression, a navy to defend its shores from invasion, a corps of civil servants to serve, public improvements designed for the enjoyment of the citizenry and those which come within the State's territory, and facilities and protection which a government is supposed to provide. (*Phil. Guaranty Co., Inc. v. CIR*)

##### 3. Benefits-Protection / Reciprocity Theory

Taxation is described as a *symbiotic relationship* whereby in exchange of the benefits and protection that the citizens get from the Government, taxes are paid. (*CIR v. Algue, Inc.*)





*Note:* While taxes are intended for general benefits, special benefits to taxpayers are not required. The Government renders no special or commensurate benefit to any particular person or property.

#### IS THE POWER TO TAX THE POWER TO DESTROY?

1. **“Power to tax is the power to destroy”** (*Marshall Dictum*) - refers to the unlimitedness and the degree or vigor with which the taxing power may be employed to raise revenue.  
- the financial needs of the State may outrun any human calculation, so the power to meet those needs by taxation must *not* be limited even though taxes become burdensome or confiscatory.

2. **“Power to tax is not the power to destroy while the Supreme Court sits”** (*Holmes Dictum*) - the power to tax knows no limit except those expressly stated in the Constitution.

#### *Marshall and Holmes Dictum Reconciled*

Although the power to tax is almost unlimited, it must not be exercised in an arbitrary manner. If the abuse is so great so as to destroy the natural and fundamental rights of people, it is the duty of the judiciary to hold such an act unconstitutional.

#### PURPOSES AND OBJECTIVES OF TAXATION

1. **Revenue** - basically, the purpose of taxation is to provide funds or property with which the State promotes the general welfare and protection of its citizens.
2. **Non-Revenue (Key: PR<sup>2</sup>EP)**
  - a. Promotion of general welfare
  - b. Regulation
  - c. Reduction of social inequality
  - d. Encourage economic growth
  - e. Protectionism

#### POWER OF JUDICIAL REVIEW IN TAXATION

As long as the legislature, in imposing a tax, does not violate applicable constitutional limitations or restrictions, it is not within the province of the courts to inquire into the wisdom or policy of the exaction, the motives behind it, the amount to be raised or the

persons, property or other privileges to be taxed.

The court's power in taxation is *limited* only to the application and interpretation of the law.

*Note:* The *principle of judicial non-interference* extends to the administrative realm.

#### ASPECTS OF TAXATION

1. Levy or imposition of the tax (tax legislation)
2. Enforcement or tax administration (tax administration)

#### BASIC PRINCIPLES OF A SOUND TAX SYSTEM (KEY: FAT)

1. **Fiscal Adequacy** - sufficiency to meet government expenditures and other public needs.
2. **Administrative Feasibility/ Convenience** - capability of being effectively enforced.
3. **Theoretical Justice** - based on the taxpayer's ability to pay; must be progressive. (Ability to Pay Theory)

TAXATION	POLICE POWER	EMINENT DOMAIN
<b>1. Purpose</b>		
To raise revenue	To promote public purpose through regulations	To facilitate the State's need of property for public use
<b>2. Amount of Exaction</b>		
No limit	Limited to the cost of regulation, issuance of the license or surveillance	No exaction; but private property is taken by the State for public purpose
<b>3. Benefits Received</b>		
No special or direct benefit is received by the taxpayer; merely general benefit of protection	No direct benefit is received; a healthy economic standard of society is attained	A direct benefit results in the form of just compensation to the property owner





4. Non-impairment of Contracts		
Contracts may not be impaired	Contracts may be impaired	Contracts may be impaired
5. Transfer of Property Rights		
Taxes paid become part of public funds	No transfer but only restraint in its exercise	Transfer is effected in favor of the State
6. Scope		
All persons, property and excises	All persons, property, rights and privileges	Only upon a particular property

#### SYSTEMS OF TAXATION

Global System	Schedular System
A system employed where the tax system views indifferently the tax base and generally treats in common all categories of taxable income of the individual.	A system employed where the income tax treatment varies and is made to depend on the kind or category of taxable income of the taxpayer.
A system which taxes all categories of income except certain passive incomes and capital gains. It prescribes a unitary but progressive rate for the taxable aggregate incomes and flat rates for certain passive incomes derived by individuals.	A system which itemizes the different incomes and provides for varied percentages of taxes, to be applied thereto.

#### EXAMPLES OF TAXES LEVIED WITH A REGULATORY PURPOSE, OR COMBINED EXERCISE OF POLICE POWER AND THE POWER OF TAXATION.

a. Motor vehicle registration fees are now considered revenue or tax measures. (*Pal v. Edu*, G.R No. L-41383, August 15, 1988)

This case reversed the doctrine previously held in *Republic v. Philippine Rabbit Bus Lines, Inc.*, 32 SCRA 211, to the effect that motor vehicle

registration fees are regulatory exactions and not revenue measures.

b. The tax imposed on videogram establishments is not only regulatory but a revenue measure because the earnings of such establishments have not been subject to tax depriving the government of an additional source of income. (*Tio v. Videogram Regulatory Board*, 151 SCRA 208)

c. The “coconut levy funds” were all raised under the state’s taxing and police powers.

The state’s concern to make it a strong and secure source not only in the livelihood of the significant segment of the population, but also of export earnings, the sustained growth of which is one of the imperatives of the economic growth.” *Philippine Coconut Producers Federation, Inc. Cocofed v. Presidential Commission on Good Government* (178 SCRA 236, 252)

#### CONSTRUCTION OF TAX LAWS

1. Public purpose is always presumed.
2. If the law is clear, apply the law in accordance to its plain and simple tenor.
3. A statute will **not** be construed as imposing a tax **unless** it does so clearly, expressly and unambiguously.
4. In case of doubt, it is construed most strongly against the Government, and **liberally** in favor of the taxpayer.
5. Provisions of a taxing act are **not** to be extended by implication.
6. Tax laws operate prospectively **unless** the purpose of the legislature to give retrospective effect is expressly declared or may be implied from the language used.
7. Tax laws are **special laws** and prevail over a general law.

#### NATURE OF TAX LAWS

1. Not political in character
2. Civil in nature, not subject to ex post facto law prohibitions
3. Not penal in character





**TAXES ARE PERSONAL TO THE TAXPAYER**

1. A corporation's tax delinquency *cannot* be enforced against its stockholders. (**Corporate Entity Doctrine**)

*Exception:* Stockholders may be held liable for unpaid taxes of a dissolved corporation:

- a. if it appears that the corporate assets have passed into their hands or
- b. when the stockholders have unpaid subscriptions to the capital of the corporation

2. Estate taxes are obligations that must be paid by the executor or administrator out of the net assets and *cannot* be assessed against the heirs.

*Exception:* If *prior* to the payment of the estate tax due, the properties of the deceased are distributed to the heirs, then the latter is subsidiary liable for the payment of such portion of the estate tax as his distributive share bears to the total value of the net estate. (*Sec. 9, Rev. Regs. No. 2-2003; see CIR vs. Pineda G.R. No. L-22734. September 15, 1967*)

**CLASSIFICATION OF TAXES**

1. As to subject matter:
  - a. **Personal Tax** - taxes are of fixed amount upon all persons of a certain class within the jurisdiction without regard to property, occupation or business in which they may be engaged.
  - b. **Property Tax** - assessed on property of a certain class
  - c. **Excise Tax** - imposed on the exercise of a privilege
  - d. **Customs Duties** - duties charged upon the commodities on their being imported into or exported from a country.
2. As to burden:
  - a. **Direct Tax** - both the incidence of or liability for the payment of the tax as well as the impact or burden of the tax falls on the same person.
  - b. **Indirect Tax** - The incidence of or liability for the payment of

the tax falls on one person but the burden thereof can be shifted or passed on to another.

3. As to purpose:
  - a. **General Tax** - levied for the general or ordinary purposes of the Government
  - b. **Special Tax** - levied for special purposes
4. As to manner of computation:
  - a. **Specific Tax** - the computation of the tax or the rates of the tax is already provided for by law.
  - b. **Ad Valorem Tax** - tax upon the value of the article or thing subject to taxation; the intervention of another party is needed for the computation of the tax.
5. As to taxing authority:
  - a. **National Tax** - levied by the National Government
  - b. **Local Tax** - levied by the local government
6. As to rate:
  - a. **Progressive Tax** - rate or amount of tax increases as the amount of the income or earning to be taxed increases.
  - b. **Regressive Tax** - tax rate decreases as the amount of income to be taxed increases.
  - c. **Proportionate Tax** - based on a fixed proportion of the value of the property assessed.

**IMPOSITIONS NOT STRICTLY CONSIDERED AS TAXES**

1. **Toll** - amount charged for the cost and maintenance of the property used.
2. **Penalty** - punishment for the commission of a crime.
3. **Compromise Penalty** - amount collected in lieu of criminal prosecution in cases of tax violations.
4. **Special Assessment** - levied only on land based wholly on benefit accruing thereon as a result of improvements or public works undertaken by government within the vicinity.
5. **License or Fee** - regulatory imposition in the exercise of the police power.





6. **Margin Fee** - exaction designed to stabilize the currency.
7. **Debt** - a sum of money due upon contract or one which is evidenced by judgment.
8. **Subsidy** - a legislative grant of money in aid of a private enterprise deemed to promote the public welfare.
9. **Customs duties and fees** - duties charged upon commodities on their being transported into or exported from a country.
10. **Revenue** - a broad term that includes taxes and income from other sources as well.
11. **Impost** - in its general sense, it signifies any tax, tribute or duty. In its limited sense, it means a duty on imported goods and merchandise.

Normally paid after the start of a business	Normally paid before commencement of business
Taxes, being the lifeblood of the State, cannot be surrendered except for lawful consideration	License fee may be with or without consideration
Non-payment does <i>not</i> make the business illegal but maybe a ground for criminal prosecution	Non-payment makes the business illegal

### TEST IN DETERMINING IF THE IMPOSITION IS A TAX OR A LICENSE FEE

If the purpose is primarily revenue or if revenue is, at least, one of the real and substantial purposes, then the exaction is a tax. If the purpose is regulatory in nature, it is a license. (*PAL v. Edu*)

Tax	Special Assessment
Imposed on persons, property and excises	Levied only on land
Personal liability attaches on the person assessed in case of non-payment	Cannot be made a personal liability of the person assessed
Not based on any special or direct benefit	Based wholly on benefit
Levied and paid annually	Exceptional both as to time and locality
Exemption granted is applicable ( <i>Art. VI, Sec. 28(3) 1987 Constitution</i> )	Exemption does <i>not</i> apply. N.B. If property is exempt from Real Property Tax, it is also exempt from Special Assessment.

Tax	Debt
An obligation imposed by law	Created by contract
Due to the government in its sovereign capacity	May be due to the government but in its corporate capacity
Payable in money	Payable in money, property or services
Does <i>not</i> draw interest except in case of delinquency	Draws interest if stipulated or delayed
<i>Not</i> assignable	Assignable
<i>Not</i> subject to compensation or set-off	Subject to compensation or set-off
Non-payment is punished by imprisonment <i>except</i> in poll tax	No imprisonment in case of non-payment ( <i>Art. III, Sec. 20 1987 Constitution</i> )
Imposed only by public authority	Can be imposed by private individual

Tax	License Fee
Based on the power of taxation	Emanates from police power
To generate revenue	Regulatory
Amount is unlimited	Amount is limited to the cost of (1) issuing the license, and (2) inspection and surveillance





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### COMPENSATION OR SET-OFF

**General Rule:** Taxes cannot be the subject of compensation or set-off.

#### Reasons:

1. lifeblood theory
2. taxes are not contractual obligation but arise out of duty to the government
3. the government and the taxpayer are not mutually creditors and debtors of each other. (*Francia v. IAC*)

**Exception:** When both obligations are due and demandable as well as fully liquidated and all the requisites for a valid compensation are present,

compensation takes place by operation of law. (*Domingo v. Garlitos*)

### DOCTRINE OF EQUITABLE RECOUPMENT NOT FOLLOWED IN THE PHILIPPINES

A tax presently being assessed against a taxpayer which has prescribed may not be recouped or set-off against an overpaid tax the refund of which is also barred by prescription. It is against public policy since both parties are guilty of negligence.

Tax	Toll
Enforced proportional contributions from persons and property	A sum of money for the use of something, a consideration which is paid for the use of a property which is of a public nature; e.g. road, bridge
A demand of sovereignty	A demand of proprietorship
No limit as to the amount of tax	Amount of toll depends upon the cost of construction or maintenance of the public improvement used
Imposed only by the State	May be imposed by: (1) Government (2) Private individuals or entities

Tax	Penalty
Enforced proportional contributions from persons and property	Sanction imposed as a punishment for violation of a law or acts deemed injurious; violation of tax laws may give rise to imposition of penalty
Intended to raise revenue	Designed to regulate conduct
May be imposed only by the government	May be imposed by: (1) Government (2) Private individuals or entities







Tax	Tariff
All embracing term to include various kinds of enforced contributions upon persons for the attainment of public purposes	A kind of tax imposed on articles which are traded internationally

#### TAXPAYERS' SUIT

A case where the act complained of directly involves the illegal disbursement of public funds derive from taxation (*Justice Melo, dissenting in Kilosbayan, Inc vs Guingona, Jr.*)

#### TAXPAYERS AND PUBLIC OFFICIALS HAVE LOCUS STANDI

##### REQUISITES FOR TAXPAYERS' SUIT

- The tax money is being extracted and spent in violation of specific constitutional protections against abuses of legislative power.
- That public money is being deflected to any improper purpose (*Pascual vs Secretary of Public Works*)
- That the petitioner seeks to restrain respondents from wasting public funds through the enforcement of an invalid or unconstitutional law

### LIMITATIONS ON THE TAXING POWER

#### A. INHERENT LIMITATIONS (KEY: SPINE)

- Territoriality or Situs of taxation
- Public purpose of taxes
- International comity
- Non-delegability of the taxing power
- Tax Exemption of the government

#### (1) TESTS IN DETERMINING PUBLIC PURPOSE

- Duty Test** - whether the thing to be furthered by the appropriation of public revenue is something, which is the duty of the State, as a government, to provide.
- Promotion of General Welfare Test** - whether the proceeds of the tax will directly promote the welfare of the community in equal measure.

#### (2) NON-DELEGABILITY OF THE TAXING POWER

**General Rule:** The power of taxation is peculiarly and exclusively exercised by the legislature. (See Scope of Legislative Taxing Power, *supra*)

- refers to tax legislation

#### Exceptions to Non-delegability:

- Flexible Tariff Clause: Authority of the President to fix tariff rates, import and export quotas, tonnage and wharfage dues, and other duties or imposts. (*Art. VI, Sec.28(2), 1987 Constitution*)
  - Power of local government units to levy taxes, fees, and charges. (*Art. X, Sec. 5, 1987 Constitution*)
  - Delegation to administrative agencies for implementation and collection.
- merely refers to tax administration or implementation

#### (3) SITUS OR TERRITORIALITY OF TAXATION

The power to tax is limited only to persons, property or businesses *within* the jurisdiction or territory of the taxing power.

#### FACTORS THAT DETERMINE THE SITUS:

- Kind or classification of the tax being levied
- Situs of the thing or property taxed
- Citizenship of the taxpayer
- Residence of the taxpayer
- Source of the income taxed
- Situs of the excise, privilege, business or occupation being taxed

#### APPLICATION OF SITUS OF TAXATION

Kind of Tax	Situs
Personal or Community tax	Residence or domicile of the taxpayer
Real property tax	Location of property ( <i>Lex rei sitae</i> )
Personal property tax	-tangible: where it is physically located or permanently kept ( <i>Lex rei sitae</i> ) -intangible: subject to Sec. 104 of the NIRC and the principle of <i>mobilia sequuntur personam</i>





Business tax	Place of business
Excise or Privilege tax	Where the act is performed or where occupation is pursued
Sales tax	Where the sale is consummated
Income Tax	Consider (1) citizenship, (2) residence, and (3) source of income (Sec. 42, 1997 NIRC)
Transfer tax	Residence or citizenship of the taxpayer or location of property
Franchise Tax	State which granted the franchise

#### SITUS OF TAXATION OF INTANGIBLE PERSONAL PROPERTY

**General Rule:** Domicile of the owner pursuant to the principle of the *mobilia sequuntur personam* or movables follow the person.

#### Exceptions:

1. When the property has acquired a business situs in another jurisdiction;
2. When an express provision of the statute provide for another rule.

**Illustration:** For purposes of estate and donor's taxes, the following intangible properties are deemed with a situs in the Philippines:

- (1) franchise which must be exercised in the Philippines;
- (2) shares, obligations or bonds issued by any corporation organized or constituted in the Philippines in accordance with its laws;
- (3) shares, obligations or bonds by any foreign corporation eighty-five percent (85%) of the business of which is located in the Philippines;
- (4) shares, obligations or bonds issued by any foreign corporation if such shares, obligations or bonds have acquired a business situs in the Philippines; and

- (5) shares or rights in any partnership, business or industry established in the Philippines.  
(Sec. 104, 1997 NIRC).

#### (4) EXEMPTION OF THE GOVERNMENT

As a matter of public policy, property of the State and of its municipal subdivisions devoted to government uses and purposes is deemed to be exempt from taxation although no express provision in the law is made therefor.

**General Rule:** The Government is **tax exempt**.

- However, it can also tax itself.

#### RULES:

1. Administrative Agencies
  - a. Governmental function - **tax exempt unless** when the law expressly provides for tax. (Sec. 32 B7)
  - b. Proprietary function - **taxable unless** exempted by law. (Sec. 27C)
2. GOCCs
 

**General Rule:** Income is **taxable** at the rate imposed upon corporations or associations engaged in a similar business, industry, or activity.

**Exception:** GSIS, SSS, PHIC, PCSO and PAGCOR. (Sec. 27(C), NIRC)
3. Government Educational Institutions
  - a. Property or real estate tax - property actually, directly and exclusively used for educational purposes - **exempt but** income of whatever kind and character from any of their properties, real or personal, regardless of the disposition, is **taxable**. (Sec. 30, last par., NIRC)
  - b. Income received by them *as such* are **exempt** from taxes. However, their income from any of their activities conducted for profit regardless of the disposition, is **taxable**. (Sec. 30, last par., NIRC)
4. Income derived from any public utility or from the exercise of any essential governmental function accruing to the Government of the Philippines or to any political







subdivision thereof is *not* included in gross income and **exempt** from taxation. (Sec. 32(B)(7)(b), NIRC)

5. Donations in favor of governmental institutions are considered as income on the part of the donee. However, it is *not* considered as taxable income because it is an *exclusion* from the computation of gross income. (Sec. 32 (B)(3), NIRC)
6. The amount of all bequests, legacies, devises or transfers to or for the use of the Government or any political subdivision for exclusively public purposes is *deductible* from the gross estate. (Sec. 86 (A)(3), NIRC)
7. Gifts made to or for the use of the National Government or any entity created by any of its agencies which is *not* conducted for profit, or to any political subdivision of the said Government are **exempt** from donor's tax. (Sec. 101(A)(2), NIRC)
8. Local government units are **expressly prohibited** by the LGC from levying tax upon National Government, its agencies, and instrumentalities, and local government units. [Sec. 133 (o), LGC]
9. Unless otherwise provided in the Local Government Code (LGC), tax exemptions granted to all persons, whether natural or juridical, including GOCC, except local water districts, cooperatives duly registered under RA No. 6938, non-stock and non-profit institutions, are **withdrawn** upon effectivity of the LGC. (Sec. 193, LGC)
10. Real property **owned** by the Republic of the Philippines or any of its political subdivisions except when the beneficial use thereof has been granted, for consideration or otherwise, to a taxable person shall be **exempt** from payment of real property tax. (Sec. 234, LGC)

#### (5) INTERNATIONAL COMITY

These principles limit the authority of the government to effectively impose taxes on a sovereign state and its instrumentalities, as well as on its property held and activities undertaken

in that capacity. Even where one enters the territory of another, there is an implied understanding that the former does not thereby submit itself to the authority and jurisdiction of the other.

#### B. CONSTITUTIONAL LIMITATIONS

##### A. GENERAL OR INDIRECT CONSTITUTIONAL LIMITATIONS

#### 1. Due Process Clause (Art. III, Sec. 1, 1987 Constitution)

##### Requisites:

- a. The interests of the public as distinguished from those of a particular class require the intervention of the State. (*Substantive limitation*)
- b. The means employed must be reasonably necessary to the accomplishment of the purpose and not unduly oppressive. (*Procedural limitation*)

The constitutionality of a legislative taxing act questioned on the ground of denial of due process requires the existence of an actual case or controversy.

#### 2. Equal Protection Clause (Art. III, Sec. 1, 1987 Constitution)

##### Requisites of a Valid Classification:

- a. based upon substantial distinctions
- b. germane to the purposes of the law
- c. *not* limited to existing conditions only
- d. apply equally to all members of the class

#### 3. Freedom Of Speech And Of The Press (Art. III, Sec. 4, 1987 Constitution)

There is curtailment of press freedom and freedom of thought and expression if a tax is levied in order to suppress this basic right and impose a prior restraint. (*Tolentino vs. Secretary of Finance, GR No. 115455, August 25, 1994*)

#### 4. Non-Infringement Of Religious Freedom And Worship (Art. III, Sec. 5, 1987 Constitution)





A license tax or fee constitutes a curtailment of religious freedom if imposed as a condition for its exercise. (*American Bible Society vs. City of Manila, GR No. L-9637, April 30, 1957*)

must, therefore, be given in case of failure to pay taxes		double taxation
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#### 5. Non-Impairment Of Contracts (Art. III, Sec. 10, 1987 Constitution)

No law impairing the obligation of contract shall be passed. (Sec. 10, Art. III, 1987 Constitution)

The rule, however, does not apply to public utility franchises or right since they are subject to amendment, alteration or repeal by the Congress when the public interest so requires. (*Cagayan Electric & Light Co., Inc. v. Commissioner, GR No. 60216, September 25, 1985*)

#### RULES:

- When the exemption is *bilaterally* agreed upon between the government and the taxpayer - it *cannot* be withdrawn *without* violating the non-impairment clause.
- When it is *unilaterally* granted by law, and the same is *withdrawn* by virtue of another law - no violation.
- When the exemption is granted under a franchise - it may be *withdrawn* at any time thus, not a violation of the non-impairment of contracts

#### 6. Presidential power to grant reprieves, commutations and pardons and remit fines and forfeitures after conviction (ART. VII, SEC. 19, 1987 CONSTITUTION)

Due Process	Equal Protection	Uniformity
Taxpayer may not be deprived of life, liberty or property without due process of law. Notice	Taxpayers shall be treated alike under like circumstances and conditions both in the privileges conferred and liabilities imposed.	Taxable articles, or kinds of property of the same class, shall be taxed at the same rate. There should therefore, be no direct

#### B. SPECIFIC OR DIRECT CONSTITUTIONAL LIMITATIONS

##### 1. Non-Imprisonment For Debt Or Non-Payment Of Poll Tax (Art. III, Sec. 20, 1987 Constitution)

##### 2. Rule Requiring That Appropriations, Revenue And Tariff Bills Shall Originate Exclusively From The House Of Representatives (Art. VI, Sec. 24, 1987 Constitution)

##### 3. Uniformity, Equitability And Progressivity Of Taxation (Art. VI, Sec. 28(1), 1987 Constitution)

**Uniformity** - all taxable articles or kinds of property of the same class are taxed at the same rate.

**Equitability** - the burden falls to those who are more capable to pay.

**Progressivity** - rate increases as the tax base increases.

**Q:** Is a tax law adopting a regressive system of taxation valid?

**A:** Yes. The Constitution does not really prohibit the imposition of indirect taxes which, like the VAT, are regressive. The Constitutional provision means simply that indirect taxes shall be minimized. The mandate to Congress is not to prescribe, but to evolve, a progressive tax system. (*EVAT En Banc Resolution, Tolentino, et al vs Secretary of Finance, October 30, 1995*)

##### 4. Limitations On The Congressional Power To Delegate To The President The Authority To Fix Tariff Rates, Import And Export Quotas, Etc. (Art. VI, Sec. 28(2), 1987 Constitution)

##### 5. Tax Exemption Of Properties Actually, Directly And Exclusively Used For Religious, Charitable And Educational Purposes. (Art. VI, Sec. 28(3) 7, 1987 Constitution)





The constitutional provision (above cited) which grants tax exemption applies only to property or realty taxes assessed on such properties used actually, directly exclusively for religious, charitable and educational purposes. (*Lladoc vs. Commissioner*, GR No. L-19201, June 16, 1965)

The present Constitution required that for the exemption of "lands, buildings and improvements", they should not only be "exclusively" but also "actually" and "directly" used for religious and charitable purposes. (*Province of Abra vs. Hernando*, GR No. L-49336, August 31, 1981)

The test of exemption from taxation is the use of the property for the purposes mentioned in the Constitution. (*Abra Valley College Inc. vs. Aquino*, GR No. L-39086, June 15, 1988)

#### EXCLUSIVE BUT NOT ABSOLUTE USE

The term "exclusively used" does not necessarily mean total or absolute use for religious, charitable and educational purposes. If the property is incidentally used for said purposes, the tax exemption may still subsist. (*Abra Valley College Inc. vs. Aquino*, Gr No. L-39086, June 15, 1988)

Corollarily, if a property, although actually owned by a religious, charitable and educational institution is used for a non-exempt purpose, the exemption from tax shall not attach

	ART. XIV, SEC 4(3)	ART. VI, SEC 28(3)
Grantee	Non-stock, non-profit educational institution	Religious, educational, charitable institutions
Taxes covered	Income tax Custom Duties Property tax (DECS Order No. 137-187)	Property tax

6. Voting Requirement In Connection With The Legislative Grant Of Tax Exemption (Art. VI, Sec. 28(4), 1987 Constitution)

7. Non-Impairment Of The Jurisdiction Of The Supreme Court In Tax Cases (Art. VIII, Sec. 2 And 5(2)(B), 1987 Constitution)

8. Exemption From Taxes Of The Revenues And Assets Of Educational Institutions, Including Grants, Endowments, Donations And Contributions. (Art. XIV, Sec. 4(3) And (4), 1987 Constitution)

#### OTHER SPECIFIC TAX PROVISIONS IN THE CONSTITUTION

1. Power of the President to veto any particular item or items in an appropriation, revenue, or tariff bill. (Art. VI, Sec. 27(2), 1987 Constitution)
2. Necessity of an appropriation before money may be paid out of the public treasury. (Art. VI, Sec. 29 (1), 1987 Constitution)
3. Non-appropriation of public money or property for the use, benefit, or support of any sect, church, or system of religion. (Art. VI, Sec. 29 (2), 1987 Constitution)
4. Treatment of taxes levied for a special purpose. (Art. VI, Sec. 29 (3), 1987 Constitution)
5. Internal revenue allotments to local government units. (Art. X, Sec. 6, 1987 Constitution)

#### DOUBLE TAXATION

DOUBLE TAXATION - taxing the same property twice when it should be taxed but once.

#### IS DOUBLE TAXATION PROHIBITED IN THE PHILIPPINES?

**No.** There is no constitutional prohibition against double taxation. It is not favored but permissible. (*Pepsi Cola Bottling Co. v. City of Butuan*, 1968).

#### KINDS OF DOUBLE TAXATION

- (1) Direct Duplicate Taxation / Obnoxious - double taxation in the objectionable or prohibited sense. This constitutes a violation of substantive due process.





**Elements:**

- a. the same property or subject matter is taxed twice when it should be taxed only once.
- b. both taxes are levied for the same purpose
- c. imposed by the same taxing authority
- d. within the same jurisdiction
- e. during the same taxing period
- f. covering the same kind or character of tax.

(*Villanueva vs. City of Iloilo*)

- (2) **Indirect Duplicate Taxation** - not legally objectionable. The absence of one or more of the above-mentioned elements makes the double taxation indirect.

- (3) **Domestic**- this arises when the taxes are imposed by the local or national government (within the same state)

- (4) **International**- refers to the imposition of comparable taxes in two or more states on the same taxpayer in respect of the same subject matter and for identical periods.

**REMEDIES OF DOUBLE TAXATION**

1. **Tax Sparing Rule** - same dividend earned by a NRFC within the Phil. is reduced by imposing a lower rate of 15% (in lieu of the 35%), on the condition that the country to which the NRFC is domiciled shall allow a credit against the tax due from the NRFC, taxes deemed to have been paid in the Phil. (Sec.28 B 5b) (CIR vs Procter & Gamble) (GR No. 66838, Dec. 2, 1991)

2. **Tax deductions**  
*Example:* vanishing deduction under Section 86(A)(2), NIRC

3. **Tax credits**  
*Instances under the NIRC:*
  - For VAT purposes, the tax on inputs or items that go into the manufacture of finished products (which are eventually sold) may be credited against or deducted from the output tax or tax on the finished product.
  - *Foreign income taxes* may be credited against the Phil. Income

tax, subject to certain limitations, by citizens, including members of general professional partnerships or beneficiaries of estates or trusts (*pro rata*), as well as domestic corporations.

- A tax credit is granted for *estate taxes* paid to a foreign country on the estate of citizens and resident aliens subject to certain limitations.

- The *donor's tax* imposed upon a citizen or a resident shall be credited with the amount of any donor's tax imposed by the authority of a foreign country, subject to certain limitations.

4. **Tax Exemptions**
5. **Principle of Reciprocity**
6. **Treaties with other states**

**METHODS RESORTED TO BY A TAX TREATY IN ORDER TO ELIMINATE DOUBLE TAXATION**

**FIRST METHOD:** The tax treaty sets out the respective rights to tax by the state of source or situs and by the state of residence with regard to certain classes of income or capital. In some cases, an exclusive right to tax is conferred in one of the contracting states; however, for other items of income or capital, both states are given the right to tax although the amount of tax that may be imposed by the state of source is limited.

**SECOND METHOD:** The state of source is given a full or limited right to tax together with the state of residence. In this case, the treaty makes it incumbent upon the state of residence to allow relief in order to avoid double taxation.

**TWO METHODS OF RELIEF ARE USED UNDER THE SECOND METHOD:**

1. **The exemption method**- the income or capital which is taxable in the state of source or situs is exempted in the state of residence, although in some instances it may be taken into account in determining the rate of tax applicable to the tax payer's remaining income or capital. (This may be done using the tax deduction method which allows foreign income taxes to be deducted from gross





income, in effect exempting the payment from being further taxed.)

2. **The credit method**- although the income or capital which is taxed in the state of source is still taxable in the state of residence. The tax paid in the former is credited against the tax, levied in the latter. (*Commissioner of Internal Revenue v. S.C Johnson and Son, Inc. et al.*, G.R No. 127105, June 25, 1999)

Exemption Method	Credit Method
Focus is on the income or capital itself	Focus is on the tax

**NOTE:** Computational illustration between a tax deduction and a tax credit:

#### Tax deduction method

Gross income  
Less: allowable deductions  
including  
foreign taxes paid  
 Income subject to tax  
Multiplied by rate  
 Income tax due

#### Tax credit method

Gross income  
Less: allowable deductions  
excluding  
foreign taxes paid  
 Income subject to tax  
Multiplied by rate  
 Income tax due  
Less: foreign taxes paid  
 Net income tax due

## FORMS OF ESCAPE FROM TAXATION

(1) **SHIFTING** - the process by which the tax burden is transferred from the statutory taxpayer (*impact of taxation*) to another (*incident of taxation*) without violating the law.

**IMPACT OF TAXATION** - point on which tax is originally imposed.

**INCIDENCE OF TAXATION** - point on which the tax burden finally rests or settles down.

**Illustration:** Value added tax. The seller is required by law to pay tax, but the burden is actually shifted or passed on to the buyer.

#### KINDS OF SHIFTING

- Forward shifting**- when burden of tax is transferred from a factor of production through the factors of distribution until it finally settles on the ultimate purchaser or consumer
- Backward shifting**- when burden is transferred from consumer through factors of distribution to the factors of production
- Onward shifting**- when the tax is shifted 2 or more times either forward or backward

(2) **CAPITALIZATION** - a mere increase in the value of the property is not income but merely an unrealized increase in capital. No income until after the actual sale or other disposition of the property in excess of its original cost.

**EXCEPT:** if by reason of appraisal, the cost basis of property increased and the resultant basis is used as the new tax base for purposes of computing the allowable depreciation expense, the net difference between the original cost basis and new basis is taxable under the *economic benefit principle*. (*BIR Ruling No. 029, March 19, 1998*)

(3) **TRANSFORMATION** - the manufacturer or producer upon whom the tax has been imposed, fearing the loss of his market if he should add the tax to the price, pays the tax and endeavors to recoup himself by improving his process of production, thereby turning out his units at a lower cost.

(4) **TAX AVOIDANCE** - the exploitation by the taxpayer of legally permissible alternative tax rates or methods of assessing taxable property or income, in order to avoid or reduce tax liability.

**Example:** "estate planning" (conveyance of property to a family corporation for shares) (*Delpher Trades Corp. vs. IAC, 157 SCRA 349*)







(5) **TAX EVASION** - use by the taxpayer of illegal or fraudulent means to defeat or lessen the payment of the tax.

**FACTORS IN TAX EVASION**

1. the end to be achieved, i.e. payment of less than that known by the taxpayer to be legally due, or paying no tax when it is shown that the tax is due;
2. an accompanying state of mind which is described as being evil, in bad faith, willful, or deliberate and *not* coincidental; and
3. a course of action which is unlawful.

**INDICIA OF FRAUD IN TAX EVASION**

1. Failure to declare for taxation purposes true and actual income derived from business for 2 consecutive years (*Republic vs Gonzales, L-17962*)
2. Substantial under-declaration of income tax returns of the taxpayer for 4 consecutive years coupled with intentional overstatement of deductions (*CIR vs Reyes, 104 PHIL 1061*)

	TAX AVOIDANCE	TAX EVASION
Validity	Legal and not subject to criminal penalty	Illegal and subject to criminal penalty
Effect	Minimization of taxes	Almost always results in absence of tax payments

(6) **TAX EXEMPTION** - a grant of immunity to particular persons or corporations from the obligation to pay taxes.

**LEGAL BASIS:** No law granting any tax exemption shall be passed without the concurrence of a majority of all the members of Congress (*ART VI. SEC 28(4) OF THE 1987 CONSTITUTION*)

**KINDS OF TAX EXEMPTION**

1. As to source
  - a. **Constitutional** - immunities from taxation that originate from the constitution.
  - b. **Statutory** - those which emanate from legislation

**Examples of Statutory Exemptions**

Sec. 27, NIRC

Sec. 105 Tariff and Customs Code

Sec. 234 Local Government Code

Special Laws, such as the Omnibus Investment Code of 1987 (EO 226), Philippine Overseas Shipping Act (RA 1407 as amended), Fertilizer Industry Act (RA 3050, as amended), Mineral Resources Development Decree of 1974 (PD 463 as amended), Cottage Industry Act (RA 318, as amended) and exemptions in "Housing for Low Income Group" (PD 1205, as amended)

c. **Contractual**- agreed to by the taxing authority in contracts lawfully entered into by them under enabling laws

d. **Treaty**

e. **Licensing Ordinance**

2. As to form

(1) **Express** - expressly granted by organic or statute law

(2) **Implied** - when particular persons, property or excises are deemed exempt as they fall outside the scope of the taxing provision itself.

3. As to extent

(1) **Total** - absolute immunity

(2) **Partial** - one where a collection of a part of the tax is dispensed with

4. As to object

(1) **Personal** - granted directly in favor of certain persons

(2) **Impersonal** - granted directly in favor of a certain class of property

**PRINCIPLES GOVERNING TAX EXEMPTION**

- a. Exemptions from taxation are **highly disfavored** in law and are **not presumed**.
- b. He who claims as exemption must be able to justify his claim by the **clearest grant** of organic or statute law by **words too plain** to be mistaken. If ambiguous, there is no exemption.
- c. He who claims exemption should prove by **convincing proof** that he is exempted.





- d. Taxation is the *rule*; tax exemption is the *exception*.
- e. Tax exemption must be **strictly construed** against the taxpayer and liberally in favor of the taxing authority.
- f. Tax exemptions are not presumed.
- g. Constitutional grants of tax exemption are **self-executing**.
- h. Tax exemptions are **personal**.

#### THE FOLLOWING PARTAKE THE NATURE OF TAX EXEMPTION

- 1. Deductions for income tax purposes
  - 2. Claims for refund
  - 3. Tax amnesty
  - 4. Condonation of unpaid tax liabilities
- NOTE:** must be **strictly construed** against the taxpayer

#### WHEN EXEMPTIONS ARE CONSTRUED LIBERALLY IN FAVOR OF GRANTEE

- 1. When the law so provides for such liberal construction.
- 2. Exemptions from certain taxes, granted under special circumstances to special classes of persons.
- 3. Exemptions in favor of the government, its political subdivisions or instrumentalities.
- 4. Exemptions to traditional exemptees, such as those in favor of religious and charitable institutions.
- 5. If exemptions refer to the public property

**Q:** May a tax exemption be revoked?

**A:** Yes. It is an act of liberality which could be taken back by the government unless there are restrictions. Since taxation is the rule and exemption therefrom is the exception, the exemption may be withdrawn by the taxing authority. (*Mactan Cebu International Airport Authority vs. Marcos, 261 SCRA 667*)

#### RESTRICTIONS ON REVOCATION OF TAX EXEMPTIONS

- a. **Non impairment clause.** Where the exemption was granted to private parties based on material consideration of a mutual nature, which then becomes contractual and is covered by the non-impairment clause of the Constitution.

- b. **Adherence to form-** if the tax exemption is granted by the Constitution, its revocation may be effected through Constitutional amendment only
- c. Where the tax exemption grant is in the form of a special law and not by a general law even if the terms of the general act are broad enough to include the codes in the general law unless there is manifest intent to repeal or alter the special law (*Province of Misamis Oriental vs Cagayan Electric Power and Light Co. Inc*)

#### NATURE OF TAX AMNESTY

- 1. General or intentional overlooking by the state of its authority to impose penalties on persons otherwise guilty of evasion or violation of a revenue or tax law.
- 2. Partakes of an absolute forgiveness of waiver of the government of its right to collect.
- 3. To give tax evaders, who wish to relent and are willing to reform a chance to do so.

#### RULES ON TAX AMNESTY

- 1. Tax amnesty
  - a) like tax exemption, it is never favored nor presumed
  - b) construed strictly against the taxpayer (must show complete compliance with the law)
- 2. Government not estopped from questioning the tax liability even if amnesty tax payments were already received.
 

*Reason:* Erroneous application and enforcement of the law by public officers do not block subsequent correct application of the statute. The government is never estopped by mistakes or errors of its agents.

*Basis:* Lifeblood Theory
- 3. Defense of tax amnesty, like insanity, is a personal defense.
 

*Reason:* Relates to the circumstances of a particular accused and not the character of the acts charged in the information.





Tax amnesty	Tax exemption
Immunity from all criminal, civil and administrative liabilities arising from non payment of taxes	Immunity from civil liability only
Applies only to past tax periods, hence retroactive application	Prospective application

#### DOCTRINE OF IMPRESCRIPTIBILITY

As a rule, taxes are imprescriptible as they are the lifeblood of the government. However, tax statutes may provide for statute of limitations.

The rules that have been adopted are as follows:

##### a.) *National Internal Revenue Code*

The statute of limitation for assessment of tax if a return is filed is within **three (3) years** from the last day prescribed by law for the filing of the return or if filed after the last day, within three years from date of actual filing. If no return is filed or the return filed is false or fraudulent, the period to assess is within **ten years** from discovery of the omission, fraud or falsity.

The period to collect tax is within **three years** from date of assessment. In the case, however, of omission to file or if the return filed is false or fraudulent, the period to collect is within **ten years** from discovery without need of an assessment.

##### b.) *Tariff and customs code*

It does not express any general statute of limitation; it provided, however, that “ *when articles have entered and passed free of duty or final adjustment of duties made, with subsequent delivery, such entry and passage free of duty or settlement of duties will, after the expiration of one (1) year, from the date of the final payment of duties, in the absence of fraud or protest, be final and conclusive upon all parties, unless the liquidation of import entry was merely tentative.*” (Sec 1603, TCC)

##### c.) *Local Government Code*

*Local Taxes, fees, or charges shall be assessed within five (5) years from the date they became due. In case of fraud or intent to evade the payment of taxes, fees or charges the same may be assessed within ten (10) years from discovery of the fraud or intent to evade payment. They shall also be collected either by administrative or judicial action within five (5) years from date of assessment (Sec. 194. LGC)*

## TAX ENFORCEMENT AND ADMINISTRATION

#### SOURCES OF TAX LAWS (Key: SPEC<sup>2</sup>TRA BLT)

1. Statutes
2. Presidential Decrees
3. Executive Orders
4. Constitution
5. Court Decisions
6. Tax Codes
7. Revenue Regulations
8. Administrative Issuances
9. BIR Rulings
10. Local Tax Ordinance
11. Tax Treaties and Conventions

#### REQUISITES OF TAX REGULATIONS

1. Reasonable
2. Within the authority conferred
3. *Not* contrary to law
4. Must be published

**NOTE:** Administrative regulations must always be *in harmony* with the provisions of the law. In case of discrepancy between the basic law and the implementing rule or regulation, the former prevails.

#### NON-RETROACTIVITY OF BIR RULINGS

**General Rule:** Rulings are not retroactive if they are prejudicial to the taxpayer. (Sec. 246, NIRC)

**Exceptions:**

1. Where the taxpayer deliberately misstates or omits material facts from his return or any document required of him by the BIR.
2. Where the facts subsequently gathered by the BIR is materially





different from the facts on which the ruling is based.

3. Where the taxpayer acted in bad faith.

**PRINCIPLE OF LEGISLATIVE APPROVAL OF AN ADMINISTRATIVE INTERPRETATION THROUGH REENACTMENT**

Where a statute is susceptible of the meaning placed upon it by a ruling of the government agency charged with its enforcement and the legislature thereafter reenacts the provision without substantial change, such action is to some extent confirmatory that the ruling carries out the legislative purpose.

**RULE OF NO ESTOPPEL AGAINST THE GOVERNMENT**

*General Rule:* The Government is *not* estopped by the mistakes or errors of its agents; erroneous application and enforcement of law by public officers do *not* bar the subsequent correct application of statutes. (*E. Rodriguez, Inc. vs. Collector, L-23041, July 31, 1969*)

*Exception:* In the interest of justice and fair play, as where injustice will result to the taxpayer. (*see CIR vs. CA, GR No. 117982, Feb. 6, 1997; CIR vs. CA, GR No. 107135, Feb. 3, 1999*)

**AGENCIES INVOLVED IN TAX ADMINISTRATION**

1. Bureau of Internal Revenue
  - internal revenue taxes
  - Agents of the CIR*
    - a. Commissioner of Customs with respect to taxes on imported goods
    - b. head of the appropriate government office with respect to energy tax
    - c. banks duly accredited by the CIR (*Sec. 12, 1997 NIRC*)
2. Bureau of Customs - customs law enforcement
3. Provincial, city and municipal assessors and treasurers - local and real property taxes

**ORGANIZATION AND FUNCTION OF THE BUREAU OF INTERNAL REVENUE (BIR)**

BIR shall be under the supervision and control of the Dept. of Finance (*Sec. 2, NIRC*)

**POWERS AND DUTIES OF THE BIR**

**Assessment and collection** of all national internal revenue taxes, fees, and charges

1. **Enforcement** of all forfeitures, penalties, and fines connected therewith
2. **Execution** of judgments in all cases decided in its favor by the Court of Tax Appeals (CTA) and the ordinary courts
3. Give effect to and **administer** the supervisory and police powers conferred to it by the Code or other laws

**ASSESSMENT** - a finding by the taxing authority that the taxpayer has not paid the correct taxes. It is also a written notice to a taxpayer to the effect that the amount stated therein is due as a tax and containing a demand for the payment thereof.

**General rule:** Taxes are self-assessing and thus, do not require the issuance of an assessment notice in order to establish the tax liability of a taxpayer.

**Exceptions:**

1. Tax period of a taxpayer is terminated [*Sec. 6(D), NIRC*]
2. Deficiency tax liability arising from a tax audit conducted by the BIR [*Sec. 56(B), NIRC*]
3. Tax lien [*Sec. 219, NIRC*]
4. Dissolving corporation [*Sec. 52(c), NIRC*]

**SIGNIFICANCE OF ASSESSMENT**

- a. In the proper pursuit of judicial and extrajudicial remedies to enforce taxpayer liabilities and certain matters that relate to it, such as the imposition of surcharges and interests,
- b. In the application of statute of limitations,
- c. In the establishment of tax liens, and
- d. In estimating the revenues that may be collected by government in the coming year. (*Mamalateo, Victorino. Reviewer on Taxation, 2004*)





#### KINDS

1. **SELF- ASSESSMENT-** one in which the tax is assessed by the taxpayer himself
2. **DEFICIENCY ASSESSMENT-** made by the tax assessor himself whereby the correct amount of the tax is determined after an examination or investigation is conducted. The liability is determined and assessed for the following reason:
  - a. amount ascertained exceeds that which is shown as the tax by the taxpayer in his return
  - b. no amount of tax is shown in the return
  - c. taxpayer did not file any return at all
3. **ILLEGAL AND VOID ASSESSMENT-** assessment wherein tax assessor has no power to assess at all
4. **ERRONEOUS ASSESSMENT-** assessor has power to assess but errs in the exercise thereof

#### BURDEN OF PROOF IN PRE-ASSESSMENT PROCEEDINGS

There is a *presumption* of correctness and good faith on the part of the CIR; thus, the burden lies on the taxpayer. Otherwise, the finding of the CIR will be conclusive and he will assess the taxpayer. The same is true even if the CIR is wrong, if the taxpayer does not controvert. (*Cagayan Robina Sugar Milling Co. vs. Court of Appeals, GR. No. 122451, October 12, 2000*)

*Reasons:* a. lifeblood theory

- b. presumption of regularity in performance of public functions

**NOTE:** Assessments by the BIR must have on its face the law and facts upon which the presumption is made.

#### PRINCIPLES GOVERNING TAX ASSESSMENTS

1. Assessments are *prima facie* presumed correct and made in good faith.
2. It should be based on actual facts.
3. It is discretionary on the part of the Commissioner.

4. The authority of the Commissioner to assess taxes may be delegated, except the power to make final assessments.
5. It must be directed to the right party.

**Authority of a Revenue Officer** - pursuant to a Letter of Authority issued by the Regional Director

- a. To examine taxpayers within the jurisdiction of the district in order to collect the correct amount of tax;
- b. To recommend the assessment of any deficiency tax due in the same manner that the said acts could have been performed by the Revenue Regional Director.

**General Rule:** income tax returns are confidential.

**Exception:** inquiry into income tax returns may be authorized-

1. inspection is authorized upon written order of the President of the Philippines;
2. inspection is authorized under Finance Regulations No. 33 of the Secretary of Finance;
3. production of the tax return is material evidence in a criminal case wherein the government is interested in the result; or
4. production or inspection thereof is authorized by the taxpayer himself.

**Networth Method-** inventory method of income tax verification.

- Applies the accounting principle:  
assets - liabilities = networth

Condition for its use:

1. taxpayer's books do not clearly reflect his income or the taxpayer has no books, or if he has books, he refuses to produce them;
2. there is evidence of possible source or sources of income to account for increases in networth;
3. there is a fixed starting point or opening networth; and
4. there must be proper adjustments to conform with the income tax laws.







**POWERS AND DUTIES OF THE COMMISSIONER**

**I. SECTION 4 (power to interpret tax law and decide tax cases)**

**1. Interpret provisions of this Code and other tax laws subject to review of the Secretary of Finance (Quasi-legislative)**

**2. Decide: (Quasi-judicial)**

- a) disputed assessment
- b) refunds of internal revenue taxes, fees and charges
- c) penalties imposed in relation thereto
- d) other matters arising from this Code or other laws or portions thereof administered by the BIR subject to the exclusive appellate jurisdiction of the CTA (Sec. 4)

**II. SECTION 5 (power to obtain information, summon, examine and take testimony of persons)**

**3. For the Commissioner to ascertain:**

- (a) correctness of any return or in making a return where none has been made
- (b) liability of any person for any internal revenue tax or in correcting such liability
- (c) tax compliance

The Commissioner is authorized:

1. to Examine any relevant Book, paper, record or other data
2. to Obtain any information (costs, volume of production, receipts, sales, gross income, etc), on a regular basis from:
  - i. any person other than the person under investigation or
  - ii. any office or officer of the national/local government, gov't agencies and instrumentalities (Bangko Sentral, gov't owned and controlled corporations) (e.g. LTO, Register of Deeds)
3. to Summon
  - i. the person liable for tax or required to file a return or
  - ii. any officer or employee of such person or
  - iii. any person having in his possession/custody/care
    - the books of accounts,

-- accounting records of entries relating to the business of the person liable for tax or any other person

-- to produce such books, papers, records, and other data and to give testimony

4. to take the Testimony of the person concerned, under oath as may be relevant to the inquiry
5. to cause revenue officers and employees to make a Canvass of any revenue district or region

Nothing in Section 5 shall be construed as granting the Commissioner the authority to inquire into bank deposits other than as provided for under sec. 6 (F) of the Code.

**III. SECTION 6 (power to make assessments, prescribe additional requirements for tax administration and enforcement)**

**4. Examination of returns and determination of tax due**

- A. After a return has been filed the Commissioner or his representative may authorize
  - i. the Examination of any taxpayer and
  - ii. the Assessment of the correct amount of tax;

B. Failure to file a return shall not prevent the commissioner from authorizing the examination of any taxpayer;

\* Any tax or deficiency tax so assessed shall be paid upon notice and demand from the Commissioner or his representative

\* Any return, statement or declaration filed in any authorized office shall not be withdrawn; but within three years from date of filing, the same may be modified, changed or amended; provided that no notice for audit or investigation of such return, has in the meantime, been actually served upon the taxpayer.





**5. Failure to submit required returns and other documents**

If a person

- i. fails to file a required return or report at the time prescribed or
- ii. willfully or otherwise files a false or fraudulent return,

The Commissioner shall Make or Amend the return from

- i. his own knowledge or
- ii. from such information as he can obtain through testimony or otherwise which shall be prima facie correct and sufficient for all legal purposes

**6. Inventory-taking, Surveillance, Presumptive Gross Sales**

A. Commissioner may, at any time during the taxable year

- (a) order the inventory taking of goods of any taxpayer or
- (b) may place the business operations of any person (natural/juridical) under observation or Surveillance,

if there is reason to believe that such is not declaring his correct income, sales or receipts for tax purposes.

The findings may be used as basis for assessing the taxes and shall be deemed prima facie correct.

B. Commissioner may prescribe a Minimum amount of gross receipts, sales and taxable base (taking into account the sales and income of other persons engaged in similar business):

- i. When a person has failed to issue receipts as required by sec.113 (Invoice requirements for VAT-registered persons) and Sec. 237 (Issuance of Receipts or Commercial Invoices) or
- ii. When the books of accounts or records do not correctly reflect the declarations made or required to be made in a return,  
Such minimum amount shall be considered correct.

**7. Terminate taxable period**

Commissioner shall declare the tax period of a taxpayer Terminated and send notice to the taxpayer of such decision with a request for immediate payment of the tax when it has come to the knowledge of the Commissioner:

- a) that a taxpayer is retiring from business subject to tax or
- b) is intending to leave the Phils. or
- c) to remove his property therefrom or
- d) to hide or conceal his property or
- e) is performing any act tending to obstruct the proceedings for the collection of tax

**8. Prescribe Real Property Values**

The Commissioner is authorized to:

- a. Divide the Phils. into different zones or areas and
- b. Determine the fair market value of real properties located in each zone or area

*For tax purposes, the value of the property shall be whichever is higher of:*

- a) *Fair market value as determined by the Commissioner; or*
- b) *Fair market value as shown in the schedule of values of the provincial and city assessors.*

**9. Authority to Inquire into Bank Deposit**

Notwithstanding R.A. 1405 (Bank Secrecy Law) the Commissioner is authorized to inquire into the Bank deposits of:

- (a) a decedent to determine his gross estate
- (b) a taxpayer who has filed an application to compromise payment of tax liability by reason of financial incapacity

*The taxpayer's application for compromise shall not be considered unless he waives in writing his privilege under RA 1405 and other general or special laws. Such waiver shall authorize the Commissioner to inquire into his bank deposits.*





**10. Authority to Register tax agents**

- (a) The Commissioner shall accredit and Register, individuals and general professional partnerships and their rep. who prepare and file tax returns and other papers or who appear before the BIR
- (b) The Commissioner shall create national and regional accreditation boards.

*Those who are denied accreditation may appeal the same to the Sec. Of Finance who shall rule on the appeal within 60 days from receipt of such appeal. Failure to do so within the prescribed period shall be deemed as approval for accreditation.*

**11. Authority to Prescribe Additional Requirements**

The Commissioner may prescribe the manner of compliance with any documentary or procedural Requirement for the submission or preparation of financial statements accompanying tax returns.

**IV. SECTION 7 (Authority to Delegate Power )**

**12. The Commissioner may delegate the powers vested in him to**

- subordinate officials with rank equivalent to Division Chief or higher, subject to limitations/restrictions imposed under the rules and regulations

EXCEPT, (the following powers shall NOT be delegated)

- a) power to Recommend the promulgation of rules and regulations by the Sec. of Finance
- b) power to Issue rulings of first impression or to Reverse, revoke modify any existing rule of the BIR
- c) power to Compromise or Abate any tax liability

*provided however that the regional evaluation board may compromise:*

1. assessments issued by regional offices involving deficiency taxes of P500,000 or less and
2. minor criminal violations as may be determined by the rules and regulations
3. discovered by regional and district officials

*Regional Evaluation Board is composed of:*

- i. Regional Director as Chairman
- ii. Asst. Regional Director
- iii. Heads of the Legal, Assessment and Collection Div.
- iv. Revenue District Officer having jurisdiction over the taxpayer

- d) power to Assign or reassign internal revenue officers to establishments where articles subject to excise tax are kept.

**V. SECTIONS 8, 14, 15, 16, 17 (Other Powers)**

**13. Duty to ensure the provision and distribution of forms, receipts, certificates, and appliances, and the acknowledgment of payment of taxes (Sec. 8)**

**14. Authority to administer oaths and to take testimony (Sec. 14)**

**15. Authority to make arrests and seizures (Sec. 15)**

**16. Authority to employ, assign or reassign internal revenue officers involved in excise tax functions to establishments where articles subject to excise tax are produced or kept (Sec. 16)**

**17. Authority to assign or reassign internal revenue officers and employees of the BIR to other or special duties connected with the enforcement or administration of the revenue laws (Sec. 17)**





ARE LEGAL OFFICERS OF THE BIR AUTHORIZED TO INSTITUTE APPEAL PROCEEDINGS WITHOUT THE PARTICIPATION OF THE SOLICITOR GENERAL?

NO. The *institution* or *commencement* before a proper court of civil and criminal actions and proceedings arising under the Tax Reform Act which shall be conducted by legal officers of the BIR is not in dispute. An *appeal* from such court, however, is not a matter of right. It is still the Solicitor General who has the primary responsibility to appear for the government in appellate proceedings. (*Commissioner vs. La Suerte Cigar and Cigarette Factory, GR No. 144942, July 4, 2002*)

#### SOURCES OF REVENUE

The following taxes, fees and charges are deemed to be national internal revenue taxes. (Sec. 21, NIRC)

1. Income tax
2. Estate and donor's taxes
3. Value-added tax
4. Other percentage taxes
5. Excise taxes
6. Documentary stamp taxes
7. Such other taxes as are or hereafter may be imposed and collected by the Bureau of Internal Revenue.

## II. NATIONAL TAXATION

### A. INCOME TAXATION

#### DEFINITIONS

**INCOME TAX** - tax on all yearly profits arising from property, possessions, trade or business, or as a tax on a person's income, emoluments, profits and the like (61 CJS 1559)  
- tax on income, whether gross or net. (27 Am. Jur. 308)

**INCOME** - all wealth, which flows into the taxpayer other than as a mere return of capital.

**CAPITAL** - resource of person, which can be used in producing goods and services.

Income	Capital
All wealth, which flows into the taxpayer other than as a mere return of capital.	Fund or property which can be used in producing goods or services
Flow of Wealth	Fund or property
Source of wealth	Wealth

#### REQUISITES FOR INCOME TO BE TAXABLE

1. There must be a gain or profit.
2. The gain must be realized or received.
3. The gain must not be excluded by law or treaty from taxation.

#### TESTS ON TAXABILITY OF INCOME

1. **Flow of Wealth Test** - The determining factor for the imposition of income tax is whether any gain was derived from the transaction.
2. **Realization Test** - unless the income is deemed "realized," there is no taxable income.
3. **Economic-Benefit Principle Test** - flow of wealth realized is taxable only to the extent that the taxpayer is economically benefited.

#### CRITERIA IN IMPOSING INCOME TAX

1. **Citizenship Principle** - A citizen of the Philippines is subject to Philippine income tax (a.) on his worldwide income, if he resides in the Philippines, or (b.) only on his income from sources within the Philippines, if he qualifies as nonresident citizen.
2. **Residence Principle** - resident alien is liable to pay income tax on his income from sources within the Philippines but exempt from tax on his income from sources outside the Philippines.
3. **Source Principle** - An alien is subject to Philippine income tax because he derives income from sources within the Philippines. Thus, a nonresident alien is liable to pay Philippine income tax on his income from sources within the Philippines such as dividend, interest, rent, or royalty, despite the fact that he has not set foot in the Philippines.





## CLASSIFICATION OF TAXPAYERS

### Individuals

- a. citizens
  - (1) resident citizens (RC)
  - (2) non-resident citizens (NRC)
- b. aliens
  - (1) resident aliens (RA)
  - (2) non-resident aliens (NRA)
    - (a) engaged in trade or business within the Phils. (NRAETB)
    - (b) not engaged in trade or business within the Philippines (NRANETB)

### Corporations

- a. Domestic (DC)
- b. Foreign
  - (1) resident foreign corporation (RFC)
  - (2) non-resident foreign corporation (NRFC)

### Estates

### Trusts

### Partnerships

## A. INDIVIDUALS

### WHO ARE TAXABLE?

1. Resident Citizen
2. Non-resident Citizen

A **non-resident citizen** means, a Filipino citizen:

- a. who establishes to the satisfaction of the Commissioner the fact of his physical presence abroad with a definite intention to reside therein;
- b. who leaves the Philippines during the taxable year to reside abroad, either as an immigrant or for employment on a permanent basis;
- c. who works and derives income from abroad and whose employment thereat requires him to be physically present abroad most of the time during the taxable year;
- d. who is previously considered as a non-resident and who arrives in the Philippines at anytime during the taxable year to reside thereat permanently shall be

considered non-resident for the taxable year in which he arrives in the Philippines with respect to his income derived from sources abroad until the date of his arrival [Sec.22 (E), NIRC]

**NOTE:** An **overseas contract worker (OCW)** is taxable only on income derived from sources within the Philippines. [Sec. 23 (B)(C)]

A **seaman** is considered as an OCW provided the following requirements are met:

1. receives compensation for services rendered abroad as a member of the complement of a vessel; and
2. such vessel is engaged exclusively in international trade.

Based on the above provisions, there are three (3) types of nonresident citizens, namely: (1) immigrants; (2) employees of a foreign entity on a permanent basis; and (3) overseas contract workers. Immigrants and employees of a foreign entity on a permanent basis are treated as nonresident citizens from the time they depart from the Philippines. However, overseas contract workers must be physically present abroad most of the time during the calendar year to qualify as nonresident citizens.

3. **Resident alien** - means an individual whose residence is within the Philippines and who is not a citizen thereof. [Sec.22 (F), NIRC]
4. **Non-resident alien engaged in trade or business within the Philippines. (NRAETB)**

A **non-resident alien** means an individual whose residence is not within the Philippines and who is not a citizen thereof. [Sec.22 (G)]

The term **trade or business** includes the performance of the functions of a public office. [Sec. 22 (S)]

The term **trade, business or profession** shall not include performance of services by the taxpayer as an employee. [Sec. 22 (CC)]







A non-resident alien individual who shall come to the Philippines and stay therein for an aggregate period of more than 180 days during any calendar year shall be deemed a *non-resident alien doing business in the Philippines* Section 22(G) notwithstanding [Sec. 25(A)(1)]

5. **Non-resident alien not engaged in trade or business within the Philippines.** (NRANETB)

**ONLY RESIDENT CITIZENS** are taxable for income derived from sources *within and without the Philippines*. All other individual income taxpayers are taxable only for income derived from sources *within the Philippines*.

❖ **Tax Rates:** Please refer to Annex A.

## **B. CORPORATIONS**

### **WHO ARE TAXABLE?**

1. **Domestic Corporation** - created or organized in the Phils. or under its law [Sec. 22(C), NIRC]
2. **Resident Foreign Corporation** - engaged in trade or business within the Philippines [Sec. 22(H), NIRC]
3. **Non-resident Foreign Corporation** - not engaged in trade or business within the Philippines [Sec. 22(I), NIRC]

### **A Corporation Includes:**

1. Partnerships, no matter how created or organized;
2. Joint-stock companies;
3. Joint accounts (cuentas en participacion)
4. Associations; or
5. Insurance companies [Sec. 22(B), NIRC].

### **Excludes:**

1. General professional partnerships;
2. Joint venture or consortium formed for the purpose of undertaking construction projects or engaging in petroleum, coal, geothermal and other energy operations pursuant to an operating or consortium agreement under a service contract with the Government.

### **CORPORATIONS EXEMPT FROM INCOME TAXATION (FOR INCOME REALIZED AS SUCH) UNDER NIRC**

#### **1. Those enumerated under Sec. 30.**

Exempt corporations are subject to income tax on their income from any of their properties, real or personal, or from any other activities conducted for profit, *regardless of the disposition made of such income*.

2. **With respect to GOCCs**, the general rule is that these corporations are taxable as any other corporation except:

- a. GSIS
- b. SSS
- c. PHIC
- d. PCSO
- e. PAGCOR [Sec. 27 (C)]

3. **Regional or Area Headquarters under Sec. 22 (DD)** - not subject to income tax

Regional *operating* headquarters under Sec. 22(EE) shall pay a tax of 10% of their taxable income.

**ONLY DOMESTIC CORPORATIONS** are taxable for income derived from sources *within and without the Philippines*. All other corporate income taxpayers are taxable only for income derived from sources *within the Philippines*.

❖ **Tax Rates:** Please refer to Annex B.

## **C. ESTATES AND TRUSTS**

**ESTATE** - refers to the mass of properties left by a deceased person.

### **RULES ON TAXABILITY OF ESTATE**

When a person who owns property dies, the following taxes are payable under the provisions of the *income tax law*:

1. Income tax for individual under Sec. 24 and 25 (to cover the period beginning January to the time of death);
2. Estate income tax under Sec. 60 if the estate is under administration or judicial settlement.





#### ESTATES UNDER JUDICIAL SETTLEMENT

##### A. During the Pendency of the Settlement

**General Rule:** An estate under judicial settlement is subject to income tax in the same manner as individuals. Its status is the same as the status of the decedent prior to his death.

##### Exceptions:

1. The entitlement to personal exemption is limited only to ₱20,000.
2. No additional exemption is allowed.
3. The distribution to the heirs during the taxable year of estate income is deductible from the taxable income of the estate. Such distributed income shall form part of the respective heirs' taxable income.

Where no such distribution to the heirs is made during the taxable year that the income is earned, and such income is subjected to income tax payment by the estate, the subsequent distribution thereof is no longer taxable on the part of the recipient.

##### B. TERMINATION OF THE JUDICIAL SETTLEMENT (WHERE THE HEIRS STILL DO NOT DIVIDE THE PROPERTY)

1. If the heirs contribute to the estate money, property, or industry with intention to divide the profits between/among themselves, an unregistered partnership is created and the estate becomes liable for the payment of corporate income tax. (*Evangelista vs. Collector*, GR No. L-9996, October 15, 1957; *Oña vs. Commissioner*, GR No. L-19342, May 25, 1972)
2. If the heirs, without contributing money, property or industry to improve the estate, simply divide the fruits thereof between/among themselves, a co-ownership is created, and individual income tax is imposed on the income received by each of the heirs, payable in their

separate and individual capacity. (*Pascual vs. Commissioner*, GR No. L-78133, October 18, 1988; *Obillos vs. Commissioner*, GR No. L-68118, October 29, 1985)

#### ESTATES NOT UNDER JUDICIAL SETTLEMENT

Pending the extrajudicial settlement, either of the following situations may arise:

1. If the heirs contribute money, property, or industry to the estate with the intention of dividing the profits between/among themselves, an unregistered partnership is created and the estate becomes liable for the payment of corporate income tax; or
2. If the heirs, without contributing money, property or industry to the estate, simply divide the fruits thereof between/among themselves, a co-ownership is created and income tax is imposed on the income received by each of the heirs, payable in their separate and individual capacity.

**TRUST** - A right to the property, whether real or personal, held by one person for the benefit of another.

#### WHEN TRUSTS ARE TAXABLE ENTITIES

1. A trust, the income of which is to be accumulated
2. A trust in which the fiduciary may, at his discretion, either distribute or accumulate the income.

#### RULES ON TAXABILITY OF THE INCOME OF A TRUST

1. The income of the trust for the taxable year which is to be distributed to the beneficiaries - *filing and payment of tax lie on the beneficiaries.*
2. The income of the trust which is to be accumulated or held for future distribution whether consisting of ordinary income or gain from the sale of assets included in the "corpus" of the estate - *filing of return and payment of tax become*





*the burden of the trustee or fiduciary.*

*Exceptions:*

- a. In the case of a revocable trust, the income of the trust will be returned by the grantor.
- b. In a trust where the income is held for the benefit of the grantor, the income of the trust becomes income to the grantor.
- c. In the case of trust administered in a foreign country, the income of the trust; undiminished by any amount distributed to the beneficiaries shall be taxed to the trustee.

**IRREVOCABLE TRUSTS** (irrevocable both as to corpus and as to income) -

Trust itself, through the trustee or fiduciary, is liable for the payment of income tax. Taxed exactly in the same way as estates under judicial settlement and its status as an individual is that of the trustor. It is entitled to the minimum personal exemption (₱20,000) and distribution of trust income during the taxable year to the beneficiaries is deductible from the trust's taxable income.

**REVOCABLE TRUSTS** - the trustor, not the trust itself, is subject to the payment of income tax on the trust income.

#### **EXEMPTION OF EMPLOYEES' TRUST**

Provided:

1. the employee's trust must be part of a pension, stock bonus or profit sharing plan of the employer for the benefit of some or all of his employees;
2. contributions are made to the trust by such employer, or such employees, or both;
3. such contributions are made for the purpose of distributing to such employees both the earnings and principal of the fund accumulated by the trust, and
4. that the trust instrument makes it impossible for any part of the trust corpus or income to be used for, or diverted to, purposes other than the

exclusive benefit of such employees.  
(Sec. 60B, NIRC)

Tax exemption is likewise to be enjoyed by the **income of the pension trust**; otherwise, taxation of those earnings would result in a diminution of accumulated income and reduce whatever the trust beneficiaries would receive out of the trust fund. (*Commissioner vs. Court of Appeals, Court of Tax Appeals and GCL Retirement Plans, GR No. 95022, March 23, 1992*)

## **D. PARTNERSHIPS**

### **KINDS OF PARTNERSHIP FOR TAX PURPOSES UNDER THE NIRC**

#### **1. General Professional Partnerships (GPP) -** formed by persons for:

- a. the sole purpose of exercising a common profession and
- b. no part of the income of which is derived from engaging in any trade or business. [Sec. 22(B), NIRC].

#### **2. Taxable or Business Partnership -**

All other partnerships except general professional partnerships no matter, how created or organized. It includes unregistered joint ventures and business partnerships.

However, joint ventures are not taxables as corporations when it is; (a) undertaking construction projects (b) engaged in petroleum, coal and other energy operation under a service contract with the government

**General co-partnerships (GCP)** are partnerships, which are by law assimilated to be within the context of, and so legally contemplated as, corporations. The partnership itself is subject to corporate taxation. The individual partners are considered stockholders and, therefore, profits distributed to them by the partnership are taxable as dividends.

The taxable income for a taxable year, after deducting the corporate income tax imposed therein, shall be deemed to have been *actually or constructively received* by the partners in the same taxable year





and shall be taxed to them in their individual capacity *whether actually distributed or not*. [Sec. 73(D), NIRC]

#### LIABILITY OF A PARTNERSHIP

1. **General Professional Partnership** - They are *not subject to income tax*, but are required to file returns of their income for the purpose of furnishing information as to the share of each partner in the net gain or profit, which each partner shall include in his individual return. The partnership shall act as the withholding agent.

The net income (income for distribution) shall be computed in the same manner as a corporation. Date of filing of the return is April 15 of each year.

2. **Taxable or Business Partnership** - The income tax of this type of Partnership is *computed and taxed like that of a corporation*. This kind of partnership, like a regular corporation, is also required to file a quarterly corporate income tax return. Filing and payment of quarterly return is within 60 days after the end of each quarter while the annual return is on or before April 15 of the following year.

#### LIABILITY OF A PARTNER

##### Rules:

1. **Share of a partner in general professional Partnership**
  - a. Each partner shall report as *gross income* (business income) his distributed share actually or constructively received in the net income of the partnership. (Sec. 26, NIRC) [The same share shall be subject to creditable withholding tax of 10%.] They are liable *in their separate and individual capacity*.
  - b. Share of a partner in the loss of a general professional partnership may be taken by the individual partner in his return of income.

- c. Each partner in a general professional partnership shall, report as gross income his distributed share in the net income of the GPP, based on his agreed ratio, whether he avails of itemized or optional standard deduction.

- d. Payments made to a partner of a GPP for services rendered shall be considered as *ordinary business income* subject to Sec. 24A (Effective January 1, 1982)

#### 2. Share of a partner in Taxable or Business partnership

- a. Share of a partner in the net income of a taxable or business partnership (dividend) shall be subject to a final tax as follows.
  - Resident Citizen, Non-resident Citizen and Resident Alien (2000 and onward) - 10% (Sec. 24B2)
  - Non-resident Alien engaged in trade or business - 20% (Sec. 25 A2)
  - Non-resident alien not engaged in trade or business - 25% (Sec. 25B)
- b. Share of a partner in the loss of a taxable or business partnership may be taken by the individual partner in his return of income.
- c. Payments made to a partner of a business or taxable partnership for services rendered shall be considered as compensation income subject to sec. 24A.

#### KINDS OF INCOME TAXES UNDER THE NIRC

1. Net Income Tax
2. Optional Corporate Income tax
3. Minimum Corporate Income Tax
4. Improperly Accumulated Earnings Tax
5. Preferential Rates or Special Rates of Income Tax
6. Gross Income Tax
7. Final Income Tax
8. Fringe Benefits Tax
9. Capital Gains Tax





## (1) NET INCOME TAX

**DEFINITION:** Means gross income less deductions and/or personal and additional exemptions (Sec. 31, NIRC)

### NET INCOME TAX FORMULA

Entire Income

Less: Exclusions and Income subject to Final Tax (e.g. Passive Income)

Gross Income

Less: Deductions (and/or additional exemptions, if applicable)

Net Taxable Income

Multiply by: Tax Rate (%)

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Net Income Tax Due

Less: Tax Credit, if any

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Tax Still due, if any

## GROSS INCOME

**DEFINITION:** Means all income derived from whatever source, including but not limited to the following (Sec. 32)

- Compensation;
- Gross income from profession, trade or business;
- Gains from dealings in property;
- Interests;
- Rents;
- Royalties;
- Dividends;
- Annuities;
- Prizes and winnings;
- Pensions;
- Partner's share in the net income of the general professional partnership

❖ See Annex D for detailed discussion of items.

### KINDS OF DIVIDENDS

#### 1. Cash and Property Dividends

##### Individual Taxpayer

- From Domestic Corporations
  - RC, NRC, RA - 10% (Sec. 24A)
  - NRAETB - 20% (Sec. 25A2)
  - NRANETB - 25% on gross income (Sec. 25B)
- From Foreign Corporations
  - RC, NRC, RA, NRAETB - 5-32% (Sec. 24, 25A1)

- NRANETB - 25% on gross income (Sec. 25B)

### Corporate Taxpayer

- Foreign to Domestic Corp. - 32% (Sec. 32A)
- Domestic to Domestic Corp. - **Exempt**; intercorporate dividends (Sec. 27D)
- Domestic to Foreign Corp. -
  - Resident Foreign Corp. - **Exempt** (Sec. 28 [A] 7d)
  - Nonresident Foreign Corp. - 15% subject to the condition stated in Sec. 28 [B] 5. Otherwise, it shall be taxed at 32%. (See *Commissioner vs. Procter and Gamble*, GR No. 66838, December 2, 1991)

## 2. Stock Dividends

**General rule:** *Not* subject to tax because it does *not constitute income*; it represents transfer of surplus to capital account. (Sec. 73B, 1997 NIRC)

### Exceptions:

- Sec. 73B, 1997 NIRC
  - there is redemption or cancellation
  - the transaction involves stock dividends, and
  - the "time and manner" of the transaction makes it "essentially equivalent to a distribution of taxable dividends". (see *Commissioner vs. Court of Appeals, Court of Tax Appeals & ANSCOR*, GR No. 108576, Jan. 30, 1999)
- the recipient is other than the shareholder (*Bachrach vs. Seifert*, GR No. L-2659, October 12, 1950)
- change in the stockholder's equity results by virtue of the stock dividend issuance.

## 3. Liquidating Dividends - When a corporation distributes all of its assets in *complete* liquidation or dissolution, the gain realized or loss sustained by the stockholder, whether individual







or corporation, is taxable income or deductible loss, as the case may be. (Sec. 73A)

A liquidating dividend is *not* a dividend income. The transaction is considered a sale or exchange of property between the corporation and the stockholder.

#### EXCLUSIONS FROM GROSS INCOME

**NOTE:** Under the 1997 Tax Code, the term “exclusions” refers to items that are not included in the determination of gross income either because:

- (a) they represent return of capital or are not income, gain or profit; or
- (b) they are subject to another kind of internal revenue tax; or
- (c) they are income, gain or profit that are expressly exempt from income tax under the constitution, tax treaty, Tax Code, or a general or special law.

1. **Proceeds of life insurance** paid by reason of the death of the insured to his estate or to any beneficiary (individual, partnership, or corporation, but not a transferee for a valuable consideration), directly or in trust.

**NOTE:** if the proceeds are retained by the insurer, the interest thereon is taxable;

2. **Return of insurance premium;**

**NOTE:** if such amounts (when added to amounts already received before the taxable year under such contracts) exceed the aggregate premiums or considerations paid (whether or not paid during the taxable year), then the excess shall be included in the gross income. However, in the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee are exempt from taxation. No loss is realized on surrender of a life

insurance policy for its surrender value.

3. **Gift, bequest or devise**

Gifts, bequests, and devises (which are subject to estate or gift taxes) are excluded, but not the income from such property. If the amount received is on account of services rendered, whether constituting a demandable debt or not, or the use of the opportunity to use of capital, the receipt is income (*Pirovano vs. Commissioner, 14 SCRA 832*)

4. **Compensation for personal injuries or sickness, whether by suit or agreement**

**NOTE:** The phrase “personal injuries” should be given a restrictive meaning to refer only to physical injuries. The theory for this is that recoupment on account of such losses is not income, since it is not derived from capital, from labor or from both combined. And the fact that the payment of compensation for such loss was voluntary does not change its exempt status. It was in fact compensation for a loss, which impaired petitioner’s capital.

5. **Income exempt under Treaty;**

6. **Retirement benefits, pension, gratuities, etc.**

- a. those derived under R.A. 7641 (pertains to private firms without retirement trust fund);
- b. those received by officials and employees of private employers in accordance with a reasonable private benefit plan;

**Requisites:**

- (1) in the service of the same employer for at least 10 years;
- (2) at least 50 years old;
- (3) must be availed of only once
- (4) plan approved by the BIR (R.R.2-98);

- c. separation pay because of death, sickness, or other physical disability or for any





cause beyond the control of the official or employee (e.g. retrenchment, redundancy or cessation of business);

*“for any cause beyond the control of said official or employee”* - connotes involuntariness on the part of the official or employee; separation must not be asked or initiated by the official or employee.

- d. social security benefits, retirement gratuities, pensions and other similar benefits received by citizens and aliens who come to reside permanently here from foreign sources private or public;
- e. benefits due to residents under the laws of the U.S. administered by the U.S. Veterans Administration
- f. SSS benefits; and
- g. GSIS benefits.

#### 7. Miscellaneous items

- a. Passive income derived in the Philippines by:
  - (1) Foreign governments;
  - (2) Financing institutions owned, controlled or enjoying refinancing from foreign governments
  - (3) International or regional financial institutions established by foreign governments
- b. Income derived from any public utility or from the exercise of any governmental function;
- c. Prizes and awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement  
*Requisites:*
  - (1) recipient was selected without any action on his part; and
  - (2) recipient is not required to render substantial future services.
- d. Prizes and awards granted to athletes in sports competitions

and sanctioned by their national sports association ;

- e. 13<sup>th</sup> month pay and other benefits up to P30,000.00;
- f. GSIS,SSS, Medicare and union dues of individuals;
- g. Gains derived from debt securities with a maturity of more than 5 years;
- h. Gains from redemption of shares in Mutual Fund.

#### EXCLUSIONS VS. DEDUCTIONS

Exclusions [Sec. 32(B)]	Deductions [Sec. 34]
Refer to flow of wealth which are not treated as part of gross income because: (1) exempted by the fundamental law; (2) exempted by statute; (3) do not come within the definition of income	Refer to the amounts which the law allows to be subtracted from gross income in order to arrive at net income
Pertain to the computation of gross income	Pertain to the computation of the net income
Something earned or received by the taxpayer which do not form part of gross income	Something spent or paid in earning of gross income

#### DEDUCTIONS

**DEFINITION:** Items or amounts which the law allows to be deducted from gross income in order to arrive at the taxable income.

#### BASIC PRINCIPLES GOVERNING DEDUCTIONS

- a. The taxpayer seeking a deduction must point to some specific provisions of the statute authorizing the deduction; and
- b. He must be able to prove that he is entitled to the deduction authorized or allowed. (*Atlas Consolidated Mining & Dev. Corp. vs.*





Commissioner, GR No. L-26911, January 21, 1981)

- c. Any amount paid or payable which is otherwise deductible from, or taken into account in computing gross income or for which depreciation or amortization may be allowed, shall be allowed as deduction only if it is shown that the tax required to be deducted and withheld therefrom has been paid to the BIR. [Sec. 34(K), NIRC]

**NOTE:** Deductions for income tax purposes partake of the nature of tax exemptions; hence, if tax exemptions are to be strictly construed, then it follows that deductions must also be strictly construed.

#### TAXPAYERS WHO CANNOT AVAIL OF DEDUCTIONS FROM GROSS INCOME

1. Citizens and resident aliens whose income is purely compensation income (except for premium payments on health and/or hospitalization insurance);
2. Non-resident aliens not engaged in trade or business in the Philippines; and
3. Non-resident foreign corporation

#### CLASSES OF DEDUCTIONS

##### 1. Individuals

- a. with gross compensation income from employer-employee relationship only
  - (1) premium payments on health and/or hospitalization insurance
  - (2) personal additional exemptions
- b. gross income from business or practice of profession
  - (1) Optional Standard Deduction (OSD)
  - (2) Itemized deductions
  - (3) premium payments on health and/or hospitalization insurance
  - (4) personal additional exemptions

##### 2. Corporations

- Itemized Deductions

#### KINDS OF DEDUCTIONS

- a. **Optional standard deductions (OSD)**  
-10% of the gross income.

The OSD may be availed of only by individuals (except nonresident alien) who are *not* purely compensation income earners.

- b. **Personal and additional exemptions**  
Available only to individuals (business income and compensation income earners).

NRAETB may be entitled to personal exemptions (only) subject to reciprocity, i.e.,

- a. the country of which he is a subject or citizen has an income tax law; and
- b. the income tax law of his country allows personal exemption to citizens of the Philippines not residing therein, but deriving income therefrom and not to exceed the amount allowed in NIRC.

The personal exemption shall be equal to that allowed by the income tax law of his country to a citizen of the Philippines not residing therein, or the amount provided in the NIRC, whichever is lower.

#### Individuals *not* entitled to these exemptions:

- a. Non-resident Alien not engaged in trade or business
- b. Alien individual employed by Regional or Area Headquarters of Multinational Companies
- c. Alien individual employed by Offshore Banking Units
- d. Alien individual employed by Petroleum Service Contractor and Subcontractor

##### c. **Itemized deductions**

- a. ordinary *and* necessary expenses
- b. interests
- c. taxes
- d. losses
- e. bad debts
- f. depreciation of property;





- g. depletion of oil and gas wells and mines;
  - h. charitable and other contributions;
  - i. research and development;
  - j. pension trust contributions of employees; and
  - k. premium payments on health and/or hospitalization insurance. (This is the only deduction which a compensation income earner may claim as a deduction.)
- d. **Special deductions**
- a. private proprietary educational institutions and hospitals that are non-profit (Sec. 34 A, 2)
  - b. insurance companies (Sec. 37)
  - c. estates and trusts (Sec. 61)

### PERSONAL EXEMPTIONS

#### A. Amounts of Personal Exemptions [Sec. 35, NIRC]

1. **P 20,000** - Single individual or married individual judicially decreed legally separated without qualified dependent children.
2. **P 25,000** - Head of the family or married individual judicially decreed legally separated with qualified dependent children.
3. **P 32,000** - For *each* legally married individual.

#### Head of the Family

1. Unmarried or legally separated person with one or both parents, or one or more brothers or sisters, or one or more legitimate, recognized natural or legally adopted children living with and dependent upon the taxpayer for their chief support; and  
"Chief support" means more than one-half of the requirements for support.
2. Where such brother / sister or children are not more than 21 years of age, unmarried and not gainfully employed, or where such dependents regardless of age, are incapable of self -

support because of mental or physical defect.

Parents, brothers, sisters and senior citizen with the tax payer, whether relative or not, may qualify the taxpayer, to the personal exemption of P25,000 as head of the family *but not to the additional exemption of P8,000.*

#### B. Additional Exemption for Dependents [Sec. 35, NIRC]

P 8,000 - For each of the qualified dependent children not exceeding four (4) in number.

The additional exemption refers only to qualified dependent children such as legitimate, recognized natural, illegitimate and legally adopted.

The proper claimant of the additional exemption is the husband being the head of the family except under the following cases:

1. Husband is unemployed
2. Husband is working abroad like an OFW or a seaman
3. Husband explicitly waived his right of the exemption in favor of his wife in the withholding exemption certificate.

#### A Senior Citizen is:

1. any resident citizen of the Philippines
2. at least sixty 60 years old, including those who have retired from both government offices and private enterprises, and
3. has an income of not more than Sixty thousand pesos (60,000) per annum subject to the review of the National Economic Development Authority (NEDA) every three years.

Parents and dependents qualify the taxpayer, to the personal exemption of P25,000 as head of the family *but not to the additional exemption of P8,000.*

**NOTE:** NRAETB may deduct personal exemption (not additional exemption), but only to the extent allowed by his country to Filipinos





not residing therein, and shall not exceed the aforementioned amounts. NRANETB cannot claim any personal or additional exemptions.

### C. Change of Status [Sec. 35, NIRC]

1. If the taxpayer should marry or should have additional dependents during the taxable year, he may claim the corresponding exemptions in full for such year.
2. If the taxpayer should die during the taxable year, his estate may claim the corresponding exemptions as if he died at the close of such year.
3. If the spouse or any dependent should die or any dependent should marry or become twenty-one years old during the year, or should become gainfully employed, the taxpayer may claim the exemptions as if the spouse or dependent died or as if such dependent married, became twenty one years old or became gainfully employed at the close of such year.
4. For any other event and for which there are no specific rules applicable from the above-mentioned, the status of the taxpayer at the end of the year shall determine his exemptions. *(strictly construed against the taxpayer)*

Examples:

- became legally separated - can only claim P 20,000
- 25 years old child became incapacitated - cannot claim additional exemption

## ITEMIZED DEDUCTIONS

### A. ORDINARY AND NECESSARY EXPENSES

**NECESSARY EXPENSE** - appropriate and helpful in the development of taxpayer's business and are intended to minimize losses or to increase profits. These are the day-to-day expenses.

**ORDINARY EXPENSE** - normal or usual in relation to the taxpayer's business and the surrounding circumstance.

### REQUISITES OF BUSINESS EXPENSE TO BE DEDUCTIBLE

1. ordinary and necessary;
2. paid or incurred w/in the taxable year;
3. paid or incurred in carrying on a trade or business;
4. substantiated with official receipts or other adequate records.
5. if subject to withholding taxes proof of payment to the Bureau of Internal Revenue must be shown.
6. must be reasonable (when the expense is not lavish, extravagant or excessive under the circumstances)
7. must not be contrary to law, public policy or morals.

**NOTE:** While illegal income will form part of income of the taxpayer, expenses which constitute bribe, kickback and other similar payment, being against law and public policy are not deductible from gross income. *(Subsec. A, 1, c)*

**CAPITAL EXPENDITURE** - An expenditure that benefits not only the current period but also future periods. It is not deductible but depreciable, *except*, if the taxpayer is a non-profit proprietary educational institution which may elect either to deduct the capital expense or depreciate it.

❖ See Annex E - Business Expenses

❖ See Annex F - Ceiling on "Entertainment, Amusement and Recreational Expenses"

### B. INTEREST

**INTEREST** - shall refer to the payment for the use or forbearance or detention of money, regardless of the name it is called or denominated. It includes the amount paid for the borrower's use of, money during the term of the loan, as well as for his detention of money after the due date for its repayment.







**REQUISITES FOR DEDUCTIBILITY (REV. REG. No. 13-2000)**

1. There must be an indebtedness;
2. There should be an interest expense paid or incurred upon such indebtedness;
3. The indebtedness must be that of the taxpayer;
4. The indebtedness must be connected with the taxpayer's trade, business or exercise of profession;
5. The interest expense must have been paid or incurred during the taxable year;
6. The interest must have been stipulated in writing;
7. The interest must be legally due;
8. The interest arrangement must not be between related taxpayers;
9. The interest must not be incurred to finance petroleum operations; and
10. In case of interest incurred to acquire property used in trade, business or exercise of profession, the same, was not treated as a capital expenditure.
11. The interest is not expressly disallowed by law to be deducted from gross income of the taxpayer.

**RULES ON DEDUCTIBILITY OF INTEREST EXPENSE**

**General Rule** - In general, the amount of interest expense paid or incurred within a taxable year of indebtedness in connection with the taxpayer's trade business or exercise of profession, shall be allowed as a deduction from the taxpayer's gross income.

**Limitation** - The amount of interest expense paid incurred by a taxpayer in connection with his trade, business or exercise of a profession from an existing indebtedness shall be reduced by an amount equal the following percentages of interest income earned which had been subjected to final withholding depending on the year when the interest income earned, viz:

38% - beginning January 1, 2000 and thereafter

**Aim of Limitation:** To discourage so-called "back-to-back" loans where a taxpayer secures a loan from a bank,

turns around and invests the loan proceeds in money market placements. By imposing a limit as to the amount of interest expense that can be deducted from gross income, the previous practice of tax arbitrage was absolutely nullified.

**Tax Arbitrage** - is a method of borrowing without entering into a debtor/creditor relationship, often to resolve financing and exchange control problems. In tax cases, back-to-back loan is used to take advantage of the lower of tax on interest income and a higher rate of tax on interest expense deduction.

**Illustration:**

On June 1, 2000 Company X has:

1. Obtained a loan from ABC Financing Corporation in connection with the operation of its business and its interest expense on the loan amounted to P 120,000.
2. Deposit account in DEF Bank and derived interest income thereof amounting to P200,000 on which the final tax of P40,000 has been withheld.

Assume that Company X's net income before the deduction of interest expense is P500,000.

The deductible expense shall be computed as follows:

**Year 2000**

Net Income before	
interest expense	P500,000
Less: Interest Expense	P120,000
Less: 38% of interest	
income from deposit	
(38% x P200,000)	76,000
<b>Deductible Interest</b>	
<b>Expense</b>	<b>44,000</b>
Taxable Income	<u>P456,000</u>

**Deductible Interest Expense**

1. Interest on taxes, such as those paid for deficiency or delinquency, since taxes are considered indebtedness (provided that the tax is a deductible tax, except in the case of income tax). However, fines,





penalties, and surcharges on account of taxes are not deductible. *The interest on unpaid business tax shall not be subjected to the limitation on deduction.*

2. Interest paid by a corporation on scrip dividends
3. Interest on deposits paid by authorized banks of the *Bangko Sentral ng Pilipinas* to depositors, if it is shown that the tax on such interest was withheld.
4. Interest paid by a corporate taxpayer who is liable on a mortgage upon real property of which the said corporation is the legal or equitable owner, even though it is not directly liable for the indebtedness.

#### NON-DEDUCTIBLE INTEREST EXPENSE

1. An individual taxpayer reporting income on the cash basis incurs an indebtedness on which an interest is paid in advance through discount or otherwise:
  - allowed as a deduction in the year the indebtedness is paid
  - if the indebtedness is payable *periodic amortization* on, the amount of interest which corresponds to the amount of the principal amortized or paid during the year shall be allowed as deduction in such taxable year.
2. Interest paid on indebtedness between related taxpayer
3. If the indebtedness is incurred to finance petroleum exploration
4. Interest on preferred stock, which in reality is dividend
5. Interest on unpaid salaries and bonuses
6. Interest calculated for cost keeping on account of capital or surplus invested in business which does not represent charges arising under interest-bearing obligation.
7. Interest paid when there is no stipulation for the payment thereof.

#### OPTIONAL TREATMENT OF INTEREST EXPENSE

At the option of the taxpayer, interest *incurred to acquire property used in trade or business* may be allowed as a deduction or treated as

*capital expenditure.* [Sec 34 (B)(3), NIRC]

### C. TAXES

Taxes mean **TAXES PROPER**, and therefore no deductions are allowed for:

1. interest
2. surcharges
3. penalties or fines incident to delinquency (Sec. 80, Rev. Reg. 2)

#### REQUISITES FOR DEDUCTIBILITY

1. must be in connection with taxpayer's business;
2. tax must be imposed by law on, and payable by taxpayer (direct tax); and
3. paid or incurred during the taxable year.

#### TAXES NOT DEDUCTIBLE

1. income tax;
2. estate and donor's tax;
3. special assessments;
4. excess electric consumption tax;
5. foreign income tax, war profits and excess profits tax, if the taxpayer makes use of tax credit; and
6. final taxes, being in the nature of income tax.

**NOTE:** Taxes allowed as deductions, when refunded or credited, shall be included as part of gross income in the year of receipt to the extent of the income tax benefit of said deduction. (*Tax Benefit Rule*)

For NRAETB and RFC, taxes paid or incurred are allowed as deductions only if and to the extent that they are connected from income within the Philippines.

**EXCEPTIONS** to requirement that only such persons on whom the tax is imposed by law can claim deduction thereof:

1. Taxes of shareholder upon his interest as such and paid by the corporation without reimbursement from him, can be claimed by the corporation as deduction.
2. A corporation paying the tax for the holder its bonds or other obligation containing a tax-free covenant





clause cannot claim deduction for such taxes paid by it pursuant to such covenant.

### TAX CREDIT

**DEFINITION:** right of an income taxpayer to deduct from income tax payable the foreign income tax he has paid to his foreign country subject to limitation.

#### WHO CAN CLAIM TAX CREDIT

1. resident citizens of the Philippines
2. resident aliens under the principle of reciprocity
3. domestic corporations which include partnerships except general professional partnership
4. beneficiaries of estates and trusts
5. members of beneficiaries of local partnerships

#### WHO ARE NOT ENTITLED TO TAX CREDIT

1. non-resident citizens
2. resident aliens, if without reciprocity
3. resident aliens whose income is derived solely from sources within the Philippines
4. foreign corporations (resident and non-resident)

#### FORMULA FOR COMPUTING LIMITATION

##### 1. Per country limitation

$$\frac{\text{Taxable income from foreign country}}{\text{Taxable income from all sources}} \times \text{Phil. income tax Limit} = \text{Tax Credit}$$

##### 2. Over-all limitation

$$\frac{\text{Taxable income from outside sources}}{\text{Taxable income from all sources}} \times \text{Phil. income tax Limit} = \text{Tax Credit}$$

*The allowable tax credit is the "lower amount" between the tax credit computed under No. 1 and No. 2.*

#### WHEN CREDIT FOR TAXES MAY BE TAKEN

The credit for taxes provided by Section 30(C)(3) to (9) may ordinarily be taken either in the return for the year in which the taxes accrued or on which the taxes were paid, dependent upon

whether the accounts of the taxpayer are kept and his returns filed upon the accrual basis or upon cash receipts and disbursements basis.

#### LIMITATIONS ON CREDIT FOR FOREIGN TAXES

- 1) The amount of credit in respect to the taxes paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within such country taxable under Title II (income Tax) bears to his entire net income for the same taxable year; and
- 2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources without the Philippines taxable under Title II (Income Tax) bears to his entire net income for the same taxable year.

### D. LOSSES

**LOSSES** - refer to such losses which do not come under the category of bad debts, inventory losses, depreciation, etc., and which arise in taxpayer's profession, trade or business.

#### REQUISITES FOR DEDUCTIBILITY

1. Actually sustained during the taxable year
2. Connected with the trade, business or profession
3. Evidenced by a close and completed transaction
4. Not compensated for by insurance or other form of indemnity
5. Not claimed as a deduction for estate tax purposes
6. Notice of loss must be filed with the Bureau of Internal Revenue *within 45 days from the date of discovery* of the casualty or robbery, theft or embezzlement.

**NOTE:** The taxpayer's failure to record in his books the alleged loss proves that the loss had not been suffered, hence, not deductible. (*City Lumber vs. Domingo and Court of Tax Appeals, GR No. L-18611, January 30, 1964*)





## CATEGORY AND TYPES OF LOSSES

### 1. ORDINARY LOSSES

- a. Incurred in trade or business, or practice of profession
- **Net operating loss carry-over (NOLCO)**
  - Refers to the excess of allowable deductions over gross income of the business for any taxable year, which had not been previously offset as deduction from gross income.
  - Can be carried over as a deduction from gross income for the next 3 consecutive years immediately following the year of such loss.
  - For mines, other than oil and gas well, net operating loss incurred in any of the first ten years of operation may be carried over for the next 5 years.
- **Requirements:**
  - (1) The taxpayer was not exempt from income tax in the year of such net operating loss;
  - (2) The loss was not incurred in a taxable year during the taxpayer was exempt from income tax; and
  - (3) There has been *no* substantial change in the ownership of the business or enterprise. There is no substantial change in the ownership of the business when:
    - (a) not less than 75% in nominal value of the outstanding issued shares is held by or on behalf of the same persons; or
    - (b) not less than 75% of the paid up capital is held by or on behalf of the same person.

**NOTE:** The 3 year period shall continue to run notwithstanding that the corporation paid its taxes under MCIT, or that the individual availed the 10% OSD.

❖ See Annex S for illustration.

- b. Of property connected, with the trade, business or profession, if the loss arises from fires, storms, shipwreck or other casualties, or from robbery, theft, or embezzlement.

#### (1) Total destruction

The replacement cost to restore the property to its normal operating condition, but in no case shall the deductible loss be more than the net book value of the property as a whole, immediately before casualty.

#### (2) Partial Destruction

The excess over the net book value immediately before the casualty should be capitalized, subject to depreciation over the remaining useful life of the property.

### 2. CAPITAL LOSSES (LOSSES ARE DEDUCTIBLE ONLY TO THE EXTENT OF CAPITAL GAINS)

- a. Losses from sale or exchange of capital assets
- b. Losses resulting from securities becoming worthless and which are capital assets.
- c. Losses from short sales of property.
- d. Losses due to failure to exercise privilege or option to buy or sell property.

### 3. SPECIAL KINDS OF LOSSES

- a. **Wagering losses** - deductible only to the extent of gain or winnings. [Sec. 34 (D)(6)]; deemed to apply only to individuals
- b. **Losses on wash sales of stocks** - not deductible because these are considered to be artificial loss.

**Wash sales** - a sale or other disposition of stock or securities where substantially identical securities are acquired or purchased within 61-day period, beginning 30 days before the sale and ending 30 days after the sale. [Sec. 38]





**General rule:** Losses from wash sales are not deductible.

**Exception:** When the sale is made by a *dealer* in stock or securities and with respect to a transaction made in the ordinary course of the business of such dealer, losses from such sale is deductible.

**Elements of Wash Sales:**

- (1) The sale or other disposition of stock resulted to a loss;
- (2) There was an acquisition or contract or option for acquisition of stock or securities within 30 days before the sale or 30 days after the sale; and
- (3) The stock or securities sold were substantially the same as those acquired within the 61-day period.

c. **Abandonment losses** in petroleum operation and producing well.

- (1) In case a contract area where petroleum operations are undertaken is partially or wholly abandoned, all accumulated exploration and development expenditures pertaining thereto shall be allowed as a deduction.
- (2) In case a producing well is abandoned, the unamortized cost thereof, as well as the undepreciated cost of equipment directly used therein, shall be allowed as deduction in the year the well, equipment or facility is abandoned.

d. **Losses due to voluntary removal of building** incident to renewal or replacements - deductible expense from gross income.

e. **Loss of useful value of capital assets** due to charges in business conditions - deductible expense only to the extent of actual loss sustained (after adjustment for improvement, depreciation and salvage value)

f. **Losses from sales or exchanges of property between related taxpayers** - losses of this nature is not deductible but gains are taxable.

g. **Losses of farmers** - if incurred in the operation of farm business, it is deductible.

h. **Loss in shrinkage in value of stock** - if the stock of the corporation becomes worthless, the cost or other basis may be deducted by the owner in the taxable year in which the stock of its worthlessness is made. Any amount claimed as a loss on account of shrinkage in value of the stock through fluctuation in the market or otherwise cannot be deducted from gross income.

## E. BAD DEBTS

**BAD DEBTS** - shall refer to those debts resulting from the worthlessness or uncollectibility, in whole or in part, of amounts due the taxpayer by others, arising from money lent or from uncollectible amounts of income from goods sold or services rendered.

### REQUISITES FOR DEDUCTIBILITY

1. Existing indebtedness due to the taxpayer which must be valid and legally demandable;
2. Connected with the taxpayer's trade, business or practice of profession;
3. Must not be sustained in a transaction entered into between related parties;
4. Actually ascertained to be worthless and uncollectible as of the end of the taxable year.; and
5. Actually charged off in the books of accounts of the taxpayer as of the end of the taxable year.

### EQUITABLE DOCTRINE OF TAX BENEFIT

A recovery of bad debts previously deducted from gross income constitutes taxable income if in the year the account was written off, the deduction resulted in a tax benefit. (*Tax Benefit Rule*)







**Illustration:**

	Case A	Case B	Case C
Net income (loss) before write off for bad debts	P10,000	(P 9,000)	P 5,000
Less: Accounts written off as bad debts	<u>3,000</u>	<u>2,000</u>	<u>6,000</u>
Final Net Income (Loss)	P 7,000	(P11,000)	(P1,000)
Bad debts recovery in a subsequent year	3,000	2,000	6,000
<b>TAXABLE INCOME upon the bad debt recovery</b>	<b>P3,000</b>	<b>P - 0 -</b>	<b>P5,000</b>

**ASCERTAINMENT OF WORTHLESSNESS**

- Proof of Two Facts:
  1. taxpayer did in fact ascertain the debt to be worthless, in the year for which deduction is sought,
  2. that in so doing, he acted in good faith. (*Collector vs. Goodrich International Rubber, GR No. L-22265, Dec. 22, 1967*)
- Depends upon the particular facts and the circumstances of the case.
- Good faith does not require that the taxpayer be an "incorrigible optimist" but on the other hand, he may not be unduly pessimistic.

**F. DEPRECIATION**

**DEPRECIATION** - the gradual diminution in the service or useful value of tangible property due from exhaustion, wear and tear and normal obsolescence.

The term also applies to amortization of intangible assets, the use of which in trade or business is of limited duration.

**REQUISITES FOR DEDUCTIBILITY**

1. The allowance for depreciation must be reasonable.
2. It must be for property use or employment in trade or business or

out of its not being used temporarily during the year.

3. The allowance must be charged off within the taxable, year.
4. Schedule on the allowance must be attached to the return.

**PROPERTY HELD BY ONE PERSON FOR LIFE WITH THE REMAINDER TO ANOTHER PERSON**

The deduction shall be computed as if the life tenant was the absolute owner of the property and, as such the expense shall accrue to him.

**PROPERTY HELD IN TRUST**

Allowable deduction shall be apportioned between the income beneficiaries, and the trustees in accordance with the pertinent provisions of the instrument creating or in the absence of such provisions, on the basis of the trust income allowable to each.

**METHODS OF DEPRECIATION**

The term "reasonable allowance" shall include (but not limited to) an allowance computed in accordance, with the regulations prescribed by the Department of Finance, under any of the following methods.

1. Straight-line method
2. Declining-balance method
3. Sum of the years-digit method
4. Any other method which may be prescribed by the Department of Finance upon recommendation of the Commissioner of Internal Revenue.

**METHODS OF DEPRECIATION**

Kind	Formula
1)Straight-line	$\frac{\text{cost} - \text{salvage value}}{\text{estimated life}}$
2)Declining balance	$\text{cost} - \text{depreciation} \times \text{Rate}$ $\text{estimated life}$
3)Sum of the years digits (SYD)	$\frac{\text{nth period}}{\text{SYD}} \times \text{cost} - \text{salvage}$

**Illustration:** A machine is used in the manufacturing department of Corporation A, compute the depreciation per annum with the following facts:

Cost = P15,000      Salvage Value= P5,000





1. *Straight Line Method* with estimated life = 5 years  

$$\frac{15,000 - 5,000}{5 \text{ years}} = \underline{\underline{P2,000}}$$
2. *Declining balance* with rate of 200%  
 Year 1:  $\frac{15,000 - 0}{5} \times 200\% = \underline{\underline{P6,000}}$   
 Year 2:  $\frac{15,000 - 6,000}{5} \times 200\% = \underline{\underline{P3,600}}$
3. *Sum of the years digits*  
 SYD for 5 years = 5+4+3+2+1 or 15  
 Year 1:  $\frac{5}{15} \times (15,000 - 5,000) = \underline{\underline{P3,333.33}}$   
 Year 2:  $\frac{4}{15} \times (15,000 - 5,000) = \underline{\underline{P2,666.67}}$

#### AGREEMENT AS TO USEFUL LIFE ON WHICH DEPRECIATION RATE IS BASED

The Bureau of Internal Revenue and the taxpayer may agree in writing on the useful life of the property to be depreciated. The agreed rate may be modified if justified by facts or circumstances. The change shall not be effective before the taxable year on which notice in writing by certified mail or registered mail is served by the party initiating.

#### SPECIAL TYPES OF DEPRECIATION

1. **Petroleum Operations**
  - Depreciation of all properties directly related to production of petroleum shall be allowed under straight-line (SL) or declining balance (DB) method
  - May shift from DB to SL method
  - Useful life: 10 years or shorter life as allowed by the Commissioner
  - Useful life of property not directly related to production: 5 years under straight line method
2. **Mining Operations**
  - Depreciation on all properties in mining operations other than petroleum operations at the normal rate if expected life is less than 10 years.
  - If expected life is more than 10 years, depreciation shall be any number of years between 5 years and the expected life.

3. Depreciation deductible by non-resident aliens engaged in trade/business or non-resident corporation
  - a. Only when such property is located in the Philippines.

#### G. DEPLETION OF OIL AND GAS WELLS AND MINES

**DEPLETION** - exhaustion of natural resources as in mines, oil, and gas wells. The natural resources are called "wasting assets". As the physical units representing such resources are extracted and sold, such assets move towards exhaustion.

Known as cost of depletion allowance for mines, oil gas wells and other natural deposits starting calendar year 1976 and fiscal year beginning July 1, 1975

#### TO WHOM ALLOWED

Only mining entities owning economic interest in mineral deposits.

*Economic interest* means interest in minerals in place investment therein or secured by operating or contract agreement for which income is derived, and return of capital expected, from the extraction of mineral.

Mere economic or pecuniary advantage to be derived by production by one who has no capital investment in the mineral deposit does not amount to economic interest.

#### FEATURES

1. Intangible Exploration and development drilling cost in petroleum exploration shall be treated either as:
  - a. revenue expenditures; or
  - b. capital expenditures
2. The total amount deductible for exploration and development expenditures shall not exceed 50% of net income from mining operation. The excess shall be carried forward to the succeeding year until fully deducted.





## H. CHARITABLE AND OTHER CONTRIBUTIONS

### TAX TREATMENT

A. Deductible In Full	B. Deductible Subject To Limitation
<p>1) Recipient is:</p> <p>(a) Government of the Philippines;</p> <p>(b) Any of its agencies or political subdivisions;</p> <p>or</p> <p>(c) Any fully-owned government corporation</p> <p><b>For priority activity in:</b></p> <ol style="list-style-type: none"> <li>Science;</li> <li>Education</li> <li>Culture</li> <li>Health</li> <li>Economic Development</li> <li>Human Settlement</li> <li>Youth and Sports Development</li> </ol> <p>2) Recipient is a foreign or international organization with an agreement with the Philippine Government on deductibility, or in accordance with special law.</p> <p>3) Recipient is an accredited non-government organization, organized/ operated for (purposes):</p>	<p>1) Recipient is:</p> <p>(a) Government of the Philippines;</p> <p>(b) Any of its agencies or political subdivisions</p> <p>For a non-priority activity in any of the areas mentioned in A, and exclusively for a public purpose.</p> <p>2) Non-government organizations</p> <p>3) Recipient is an accredited domestic corporation or association organized/operated for (purposes):</p>

<p>(a) Scientific;</p> <p>(b) Educational;</p> <p>(c) Cultural;</p> <p>(d) Character building/youth and sports development</p> <p>(e) Charitable</p> <p>(f) Social welfare</p> <p>(g) Health</p> <p>(h) Research</p> <p><b>And satisfying the following conditions:</b></p> <ol style="list-style-type: none"> <li>The donation must be utilized not later than the 15<sup>th</sup> day of the 3<sup>rd</sup> month following the close of its taxable year.</li> <li>The administrative expense must not exceed 30% of total expenses.</li> <li>Upon dissolution, assets must be distributed to another non-profit domestic corporation or to the state.</li> </ol>	<p>(a) Scientific</p> <p>(b) Educational;</p> <p>(c) Cultural;</p> <p>(d) Youth and sports development</p> <p>(e) Charitable</p> <p>(f) Social welfare</p> <p>(g) <i>Religious</i></p> <p>(h) <i>Rehabilitation of Veterans</i></p> <p>If the conditions in Table A is not complied with:</p> <p><b>Subject to limitation:</b></p> <p>(a) Individual - 10% taxable income from trade business or profession before contribution</p> <p>(b) Corporation - 5% taxable income from trade business or profession before contribution</p>
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### REQUISITES FOR DEDUCTIBILITY

- The contribution or gift must be actually paid.
- It must be given to the organizations specified in the code.
- The net income of the institution must not inure to the benefit of any private stockholder or individual.

### VALUATION

Charitable contribution of *property* other than money shall be based on the acquisition cost of said property.

## I. RESEARCH AND DEVELOPMENT (R&D)





## TAX TREATMENT

*Either as:*

### 1. Revenue Expenditures

Requisites:

- Paid or incurred during the taxable year
- Ordinary and necessary expenses in connection with trade business or profession
- Not chargeable to capital account

### 2. Deferred Expenses

Requisites:

- Paid or incurred in connection with trade, business, or profession
- Not treated as expense
- Chargeable to capital account but not chargeable to property subject to depreciation or depletion.

Amount deductible:

Amount ratably distributed over a period of 60 months beginning with the month taxpayer realized benefits from such expenditures.

## EXCLUSION FROM RESEARCH AND DEVELOPMENT EXPENDITURES

- Any expenditure for the acquisition or improvement of land or for the improvement of property to be used in connection with research and development subject to depreciation and depletion.
- Any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent or quality of any deposit of ore or other mineral including oil or gas.

## J. PENSION TRUST CONTRIBUTIONS

**PENSION TRUST CONTRIBUTIONS** - a deduction applicable only to the employer on account of its contribution to a private pension plan for the benefit of its employee. This deduction is purely business in character.

### REQUISITES FOR DEDUCTIBILITY

- The employer must have established a pension or retirement plan to

provide for the payment of reasonable pensions to his employees;

- The pension plan is reasonable and actuarially sound;
- It must be funded by the employer;
- The amount contributed must be no longer subject to the control and disposition of the employer;
- The payment has not yet been allowed as a deduction; and
- The deduction is apportioned in equal parts over a period of 10 consecutive years beginning with the year in which the transfer or payment is made.

## SUMMARY OF RULES ON RETIREMENT BENEFITS PLAN / PENSION TRUST

- Exempt from Income Tax** - employees' trust under *Sec. 60(B)*
- Exclusion from Gross Income** - amount received by the employee from the fund upon compliance of certain conditions under *Sec. 32(B)(6)*
- Deduction from Gross Income** -
  - Amounts contributed by the employer during the taxable year into the pension plan to cover the pension liability accruing during the year - considered as ordinary and necessary expenses under *Sec. 34(A)(1)*
  - 1/10 of the reasonable amount paid by the employer to cover pension liability applicable to the years prior to the taxable year, or so paid to place the trust in a sound financial basis - deductible under *Sec. 34(J)*

## K. PREMIUM PAYMENTS ON HEALTH AND/OR HOSPITALIZATION INSURANCE

**DEFINITION:** It is an amount of premium on health and/or hospitalization paid by an individual taxpayer (head of family or married), for himself and members of his family during the taxable year.

### REQUISITES FOR DEDUCTIBILITY

- Insurance must have actually been taken





2. The amount of premium deductible does not exceed P2,400 per family or P200 per month during the taxable year.
3. That said family has a gross income of not more than P250,000 for the taxable year.
4. In case of married individual, only the spouse claiming additional exemption shall be entitled to this deduction.

#### WHO MAY AVAIL OF THE DEDUCTION

1. Individual taxpayers earning purely compensation income during the year.
2. Individual taxpayer earning business income or in practice of his profession whether availing of itemized or optional standard deductions during the year.
3. Individual taxpayer earning both compensation, and business or practice of profession during the year.

### NON-DEDUCTIBLE EXPENSES

#### REASONS FOR NON-DEDUCTIBILITY

1. Personal expenses
2. Capital expenditures
3. Items not normally subject to income tax and therefore are not deductible.
4. Items taken advantage of by the taxpayer to avoid payment of income tax.

#### SPECIFIC ITEMS (SECTION 36)

1. Personal, living or family expenses;
2. Amount paid out for new buildings or for permanent improvements, or betterment made to increase the value of any property or estate,  
*Except* that intangible drilling and development cost incurred in petroleum operations are deductible;
3. Amount expended in restoring property or in making good the exhaustion thereof for which an allowance has been made;
4. Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or

business carried on by the taxpayer, individual or corporate, when the taxpayer is directly or indirectly a beneficiary under such policy. [Sec. 36]

5. Losses from sales or exchanges of property *between related taxpayers*. [Sec. 36]

#### TRANSACTIONS BETWEEN RELATED PARTIES

1. Between members of the family;  
“Family” includes only the brothers, sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants of the taxpayer.
2. Except in the case of distributions in liquidation:
  - a. between an individual and a corporation more than 50% in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;
  - b. between two corporations more than 50% in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale of exchange was a personal holding company or a foreign personal holding company; or
3. Between the grantor and a fiduciary of any trust;
4. Between the fiduciary of a trust and the fiduciary of another trust if the same person is a grantor with respect to each trust;
5. Between a fiduciary of a trust and a beneficiary of such trust.

#### TAX CONSEQUENCES

The following are *not deductible*:

1. Interest expense [Sec. 34 (B)(2)]
2. Bad debts [Sec. 34 (E)(1)]
3. Losses from sales or exchanges of property [Sec 36 (B)]

### (2) OPTIONAL CORPORATE INCOME TAX SECTION 27 (A)







**APPLIES TO:**

1. Domestic corporations (DC)
2. Resident foreign corporations (RFC)

**RATE OF TAX AND DATE OF EFFECTIVITY**

**15% of the Gross Income** effective January 1, 2000

**CONDITIONS OR REQUIREMENTS**

1. A tax effort ratio of 20% of Gross National Product
2. A ratio of 40% income tax collection to total tax revenues
3. A VAT tax effort of 4% of GNP
4. A 0.9% ratio of Consolidated Public Sector Financial Position (CPSFP) to GNP

**OTHER FEATURES**

1. Available only to firms whose ratio of:

Cost of sales

$\leq 55\%$

Gross sales or receipts from all sources

2. The election shall be *irrevocable* for three (3) consecutive years

**MEANING OF GROSS INCOME**

**General concept -**

Gross sales

Less:

- (1) Sales Return;
- (2) Discount and allowances
- (3) Cost of goods sold - means all business expenses directly incurred to produce the merchandise to bring them to their present location and use.

**(3) MINIMUM CORPORATE INCOME TAX (MCIT)**  
**SECTION 27 (E)**

**WHO ARE COVERED?**

MCIT is imposed on domestic and resident foreign corporations

1. Whenever such corporation has zero or negative taxable income; or
2. Whenever the amount of MCIT is greater than the normal income tax due from such corporation determined under Section 27[A].

**LIMITATIONS**

1. The MCIT shall apply only to domestic and resident foreign corporations subject to the normal corporate income tax (income tax rates under Sec 27[A] of the CTRP).
2. In the case of a domestic corporation whose operations or activities are partly covered by the regular income tax system and partly covered under a special income tax system, the MCIT *shall apply on operations covered by the regular corporate income tax system*.
3. In computing for the MCIT due from a resident foreign corporation, only the gross income from sources within the Philippines shall be considered for such purpose.

**WHEN DOES A CORPORATION BECOME LIABLE UNDER THE MCIT?**

MCIT is imposed beginning on the fourth taxable year immediately following the year in which such corporation commenced its business. The taxable year in which the business operations commenced shall be the year when the corporation registers with the BIR.

**CARRY FORWARD OF THE EXCESS MINIMUM TAX**

- Any excess of MCIT over the normal income tax can be carried forward on an annual basis.
- The excess can be credited against the normal income tax due in the next 3 immediately succeeding taxable years.
- Any amount of the excess MCIT which cannot be credited against the normal income tax due in the next 3-year period shall be forfeited.

**RELIEF FROM MCIT**

The Secretary of Finance is authorized to suspend the imposition of the MCIT on any corporation which suffers losses because of:





- a. prolonged labor dispute;
- b. force majeure; or
- c. legitimate business reverses.

"Substantial losses from a prolonged labor dispute" means losses arising from a strike staged by the employees which lasted for more than six (6) months within a taxable period and which has caused the temporary shutdown of business operations.

"Force majeure" means a cause due to an irresistible force as by "Act of God" like lightning, earthquake, storm, flood and the like. This term shall also include armed conflicts like war and insurgency.

"Legitimate business reverses" shall include substantial losses sustained due to fire, robbery, theft, or embezzlement, or for other economic reason as determined by the Secretary of Finance.

**TAX RATE:** 2% of gross income or taxable base pertinent to a trading/merchandising concern or a service entity

**TAX BASE:** Gross Income  
**MEANING OF GROSS INCOME**

**General concept - gross income means:**

Gross sales

Less:

- (1) Sales Return;
- (2) Discount and allowances
- (3) Cost of goods sold - means all business expenses directly incurred to produce the merchandise to bring them to their present location and use.

#### KINDS OF BUSINESS

A. Trading or Merchandising Concern	
<b>Gross Income =</b> gross sales/ receipts less sales returns, discounts and allowances and <i>cost of goods sold</i>	<b>Cost of Sales =</b> 1. <u>Invoice cost</u> of the goods sold; 2. <u>import duties</u> ; 3. <u>freight</u> in transporting the goods to the place where the goods are actually sold;

	4. <u>insurance</u> while the goods are in transit.
<b>B. Manufacturing Gross Income (Same)</b>	<b>Cost of Sales =</b> All cost of production of finished goods, such as 1. raw materials used; 2. direct labor; 3. manufacturing overhead; 4. freight cost; 5. insurance premiums; 6. other costs incurred to bring the raw materials to the factory or warehouse.
<b>C. Services Gross Income =</b> Gross receipts less sales returns, allowances, discounts and <i>costs</i> <i>of services</i>	<b>Cost of Services =</b> All direct costs and expenses necessarily incurred to provide the services required by the customers and clients including: a. Salaries and employee benefits of personnel, consultants and specialists <u>directly</u> <u>rendering the</u> <u>service</u> ; b. Cost of facilities directly utilized in providing the service. It shall not include interest expense <i>except for</i> <i>banks and other</i> <i>financial</i> <i>institutions.</i>

- Gross income *excludes* passive income subject to final tax.
- Other income and Extraordinary Income are *included* since RR 9-98 provides that gross sales include sales contributory to income taxable under the regular corporate tax.
- ❖ See Annex T for interplay of normal tax, optional corporate income tax and MCIT.





#### (4) IMPROPERLY ACCUMULATED EARNINGS (IAE) TAX SECTION 29

##### (REVENUE REGULATIONS NO. 2 - 2001)

**DEFINITION:** “Improperly accumulated earnings (IAE)” are the profits of a corporation that are permitted to accumulate instead of being distributed by a corporation to its shareholders for the purpose of *avoiding the income tax* with respect to its shareholders or the shareholders of another corporation.

**TAX RATE:** 10% of the Improperly Accumulated Taxable Income (in addition to other taxes).

##### **Rationale behind IAET**

If the earnings and profits were distributed, the shareholders would then be liable to income tax thereon, whereas if the distribution were not made to them, they would incur no tax in respect to the undistributed earnings and profits of the corporation. Thus, a tax is being imposed;

- a. in the nature of a penalty to the corporation for the improper accumulation of its earnings, and
- b. as a form of deterrent to the avoidance of tax upon shareholders who are supposed to pay dividends tax on the earnings distributed to them by the corporation.

##### **“IMPROPERLY ACCUMULATED TAXABLE INCOME”**

Taxable income for the year

Add:

Income exempt from tax;

Income excluded from gross income;

Income subject to final tax;

Net operating loss carry-over (NOLCO)

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**Total**

Less:

Income tax paid/payable for the taxable year

Dividends actually or constructively paid/issued from the applicable year's taxable income

Amount reserved for the reasonable needs of the business as defined in the Regulations

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Tax base of improperly accumulated earnings tax

##### **EXCLUSIONS**

- For corporations using the calendar basis the accumulated earnings tax shall not apply on IAE as of Dec. 31, 1997.
- For fiscal year basis, the tax shall not apply to the 12-month period of fiscal year 1997-1998.

IAE as of the end of a calendar or fiscal year period on or after Dec. 31, 1998 shall be subject to the 10% tax.

##### **WHO ARE COVERED?**

**General Rule:** The IAE tax shall apply to every corporation formed or availed for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of being divided or distributed. These are:

1. *Domestic corporations* as defined under the Tax Code;
2. Corporations which are classified as *closely-held corporations*.
  - those corporations at least fifty percent (50%) in value of the outstanding capital stock or at least fifty percent (50%) of the total combined voting power of all classes of stock entitled to vote is owned directly or indirectly by or for not more than twenty (20) individuals.
  - Domestic corporations not falling under the aforesaid definition are, therefore, publicly-held corporations.

**Exception:** The said tax shall not apply to:

1. Publicly held corporations (Sec. 29)





2. Banks and other non-banks Financial intermediaries (*Sec. 29*)
3. Insurance companies (*Sec. 29*)
4. Taxable partnerships (*deemed to have actually or constructively received the taxable income under Sec. 73D*)
5. General professional partnerships (*exempt; taxable against the partners*)
6. Non- taxable joint ventures and
7. Enterprises duly registered with the Philippine Economic Zone Authority (PEZA) under R.A. 7916, and enterprises registered pursuant to the Bases Conversion and Development Act of 1992 under R.A. 7227, as well as other enterprises duly registered under special economic zones declared by law which enjoy payment of special tax rate on their registered operations or activities in lieu of other taxes, national or local.
8. Foreign corporations [*RR No. 02-2001*]

#### EVIDENCE OF PURPOSE TO AVOID INCOME TAX

1. The fact that any corporation is a mere holding company or investment company shall be *prima facie* evidence of a purpose to avoid the tax upon its shareholders or members.

#### Instances indicative of purpose to avoid income tax upon shareholders:

- a. Investment of substantial earnings and profits of the corporation in *unrelated* business or in stock or securities of unrelated business;
- b. Investment in bonds and other long-term securities;
- c. Accumulation of earnings in excess of 100% of paid-up capital, not otherwise intended for the reasonable needs of the business as defined in these Regulations.

2. The fact that the earnings or profits of a corporation are permitted to accumulate beyond the *reasonable needs of the business* shall be determinative of the purpose to avoid the tax upon its shareholders or members unless the corporation, by the clear preponderance of evidence, shall prove the contrary.

**“Reasonable needs of the business”** includes the reasonably anticipated needs of the business such as:

- a. Allowance for the increase in the accumulation of earnings up to 100% of the paid-up capital of the corporation as of Balance Sheet date, inclusive of accumulations taken from other years;
- b. Earnings reserved for definite corporate expansion projects or programs as approved by the Board of Directors or equivalent body;
- c. Reserved for building, plants or equipment acquisition as approved by the Board of Directors or equivalent body;
- d. Reserved for compliance with any loan covenant or pre-existing obligation established under a legitimate business agreement;
- e. Earnings required by law or applicable regulations to be retained by the corporation or in respect of which there is legal prohibition against its distribution;
- f. In the case of subsidiaries of foreign corporations in the Philippines, all undistributed earnings intended or reserved for investments within the Philippines as can be proven by corporate records and/or relevant documentary evidence.

The *controlling intention of the taxpayer* is that which is manifested *at the time of accumulation*, not subsequently declared intentions, which are merely the product of afterthought.





A speculative and indefinite purpose will not suffice.

Definiteness of plan/s coupled with action/s taken towards its consummation is essential.

#### PERIOD FOR PAYMENT OF DIVIDEND/ PAYMENT OF IAET

Dividends must be declared and paid or issued not later than one year following the close of the taxable year, otherwise, the IAET, if any, should be paid within fifteen (15) days thereafter.

### (5) INCOME SUBJECT TO PREFERENTIAL OR SPECIAL RATES

Pertains to income derived by a particular individual or corporation belonging to a class of income taxpayer that is subject to either a preferential or special rate.

❖ **Tax Rates:** Please refer to Annex C.

### (6) GROSS INCOME TAX (GIT)

#### GROSS INCOME TAX (GIT) FORMULA

Entire Income
Less: Exclusions and Income subject to Final Tax (e.g. Passive Income)
Gross Income
Multiply by: Tax Rates (%)
Net Income Tax Due

#### GIT APPLIES TO

1. Non-resident alien not engaged in trade or business (25%); and
2. Non-resident foreign corporation. (32%)

❖ **Tax Rates:** Please refer to Annex A and B.

### (7) FINAL INCOME TAX

#### GENERAL PRINCIPLES

1. It is constituted as a full and final payment of the income tax due from the payee on a particular type of income subject to final withholding tax (FWT).

The finality of the withholding tax is limited only to the payee's income tax liability and does not extend to other taxes that may be imposed on said income.

2. The income subjected to final income tax is no longer subject to the net income tax; otherwise, there would be a violation of prohibited double taxation.
3. The liability for the payment of the tax rests primarily on the payor as withholding agent.
4. The payee is not required to file an income tax return for the particular income subjected to FWT. It is the withholding agent who files the return.
5. The rate of the final tax is multiplied to the gross income. Thus, deductions and/or personal and additional exemptions are not allowed.

### (8) FRINGE BENEFIT TAX (FBT)

**FRINGE BENEFIT TAX** is a *final income tax* on the employee which shall be withheld and paid by the employer on a quarterly basis.

**FRINGE BENEFIT** means any good, service, or other benefit furnished or granted by an employer, in cash or in kind, in addition to basic salaries, to an individual employee (except rank and file employees) such as, but not limited to the following:

1. Housing
2. Expense Account
3. Vehicle of any kind
4. Household personnel, such as maid, driver and others
5. Interest on loan at less than market rate to the extent of the difference between the market rate and actual rate granted.
6. Membership fees, dues and other expenses borne by the employer for the employee in social and athletic clubs and similar organizations







7. Expenses for foreign travel
8. Holiday and vacation expenses
9. Educational assistance to the employee or his dependents; and
10. Life or health insurance and other non-life insurance premiums or similar amounts on excess of what the law allows.

#### PERSONS LIABLE

The **EMPLOYER** (as a withholding agent), whether individual, professional partnership or a corporation, regardless of whether the corporation is taxable or not, or the government and its instrumentalities

**TAX RATE: 32%** (from January 1, 2000 onwards) of the *Grossed up Monetary Value (GMV)* of fringe benefits.

In the case of aliens, the tax rates to be applied on fringe benefit shall be as follows:

1. NRANEBT 25%
2. Aliens employed by regional HO 15 %
3. Aliens employed by OBU 15%
4. Aliens employed by Petroleum Service Contractors and Subcontractors 15%

#### “GMV” OF THE FRINGE BENEFIT REPRESENTS

1. The whole amount of income realized by the employee which includes the net amount of money or net monetary value of property which has been received; plus
2. The amount of fringe benefit tax thereon otherwise due from the employee but paid by the employer for and in behalf of the employee.

“GMV” of the fringe benefit shall be determined by dividing the monetary value of the fringe benefit by the **Grossed up divisor**. The Grossed up divisor is the difference between 100% and the applicable rates.

YEAR	GROSSED UP DIVISOR	RATE
1998	66%	34% FWT
1999	67%	33% FWT

2000 onwards	68%	32% FWT
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#### FRINGE BENEFITS NOT SUBJECT TO FBT

1. Fringe benefits *not* considered as *gross income* -
  - a. if it is required or necessary to the business of employer
  - b. if it is for the convenience or advantage of employer
2. Fringe Benefit that is not taxable under Sec. 32 (B) - Exclusions from Gross Income
3. Fringe benefits not taxable under Sec. 33 Fringe Benefit Tax:
  - a. Fringe Benefits which are authorized and exempted under special laws, such as the 13th month Pay and Other Benefits with the ceiling of P30,000.
  - b. Contributions of the employer for the benefit of the employee to retirement, insurance and hospitalization benefit plans;
  - c. Benefits given to the Rank and File Employees, whether granted under a collective bargaining agreement or not; and
  - d. The *De minimis* benefits - benefits which are relatively small in value offered by the employer as a means of promoting goodwill, contentment, efficiency of Employees

The term “**Rank and File Employees**” shall mean all employees who are holding neither managerial nor supervisory position as defined in the Labor Code

In the case of rank and file employees, fringe benefits other than those excluded from gross income under the Tax Code and other special laws, are taxable under the individual normal tax rate.

#### DEDUCTIBILITY TO THE TAXABLE INCOME OF THE EMPLOYER

**General Rule:** The amount of taxable fringe benefit and the fringe benefits tax shall constitute allowable deductions from gross income of the employer.





**Exception:**

If the basis for computation of the fringe benefits tax is the depreciation value, the zonal value or the fair market value, only the actual fringe benefits tax paid shall constitute a deductible expense for the employer. The value of the fringe benefit shall not be deductible and shall be presumed to have been tacked on or actually claimed as depreciation expense by the employer. Provided, however, that if the aforesaid zonal value or fair market value of the said property is greater than its cost subject to depreciation, the excess amount shall be allowed as a deduction from the employer's gross income as fringe benefit expense. (Sec. 2.33[D], Rev. Reg. No. 3-98)

**EXAMPLE OF DE MINIMIS BENEFITS NOT SUBJECT TO FBT (RR NO. 8-2000 AND 10-2000)**

1. Monetized unused vacation leave credits of PRIVATE employees not exceeding (10) days during the year and the monetized value of leave credits paid to government officials and employees
2. Medical cash allowance to dependents of employees not exceeding P750.00 per employee per semester or P125 per month;
3. Rice subsidy of P1,000.00 or one (1) sack of 50kg. rice per month amounting to not more than P1,000:00,
4. Uniform and clothing allowance not exceeding P3,000 per annum;
5. Actual yearly medical benefits not exceeding P10,000 per annum;
6. Laundry allowance not exceeding P300 per month;
7. Employees achievement awards e. g. for length of service or safety achievement, which must be in the form of a tangible personal property other than cash or gift certificate, with an annual monetary value of not exceeding P10,000 received by the employee under an established written plan which does not discriminate in favor paid employees;

8. Gifts given during Christmas and major anniversary celebrations not exceeding P3, 000 per employee per annum;
9. Flowers, fruits, books or similar items given to employees under special circumstances
10. Daily meal allowance for overtime work not exceeding 25% of the basic minimum wage.

**Time for filing of quarterly remittance return of final income taxes withheld**

The tax imposed under Sec. 33 shall be treated as a final income tax on the employee that shall be withheld and paid by the employer, whether a large taxpayer or non-large taxpayer, *on or before the 10<sup>th</sup> day of the month* following the calendar quarter in which the fringe benefits were granted (RR 04-2002).

- ❖ For Additional Rules on Fringe Benefits, refer to **Annex H**.

**(9) CAPITAL GAINS TAX**

**SUMMARY OF TAX RATES**

**1. Individuals**

- a. On sale of shares of stock of a domestic corporation not listed and traded thru a local stock exchange, held as capital asset  
*On the Net Capital Gain*  
 Not over P100,000 - FT of 5%  
 Amount in excess of P100,000 - FT of 10%
- b. On sale of real property in the Philippines held as capital asset  
*On the gross selling price, or the current fair market value at the time of sale, whichever is higher* - FT of 6%

**2. Corporations**

- a. On sale of shares of stock of a domestic corporation not listed and traded thru a local stock exchange, held as capital asset  
*On the Net Capital Gain* -  
 Not over P100,000 - FT of 5%  
 Amount in excess of P100,000 - FT of 10%





- b. On sale of land/building held as capital asset

On the *gross selling price, or the current fair market value* at the time of sale, whichever is higher  
- FT of 6%

(Reyes, Virgilio. *Income Tax Law and Accounting - A New Approach*, 2002)

## CAPITAL GAINS AND LOSSES - IN GENERAL

### CONCEPT OF CAPITAL ASSETS

Under the tax code, there is no definition for the term "capital assets". What it gives is the meaning of ordinary assets:

- a. **Ordinary assets (Sec. 39, NIRC)**
  - a. Stock in trade of the taxpayer or other properties of a kind which would properly be included in the inventory of the taxpayer;
  - b. Property held by the taxpayer primarily for sale to customers in the ordinary course of business;
  - c. Property used in trade or business and subject to depreciation; and
  - d. Real property used in trade or business.
- b. **Capital Assets** include all property held by the taxpayer whether or not connected in trade or business but not including those enumerated above (#1) as ordinary assets.

CAPITAL GAIN	CAPITAL LOSS
The gain derived from the sale or exchange of capital assets.	The loss incurred from the sale or exchange of capital assets.

NET CAPITAL GAIN	NET CAPITAL LOSS
------------------	------------------

The excess of the gains from sales/exchanges of capital assets over the gains from such sales/exchanges.	The excess of the losses from sales/exchanges of capital assets over the gains from such sales/exchanges.
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### TRANSACTION RESULTING IN TAXABLE GAINS BUT NON-RECOGNITION OF LOSSES

- a. Sale or exchange between related parties;
- b. Wash sales by non-dealers of securities and when not subject to the stock transfer tax;
- c. Exchanges not solely in kind in merger and consolidation; and
- d. Sales or exchanges that are not at arms length.

### REQUISITES FOR RECOGNITION OF CAPITAL GAIN/LOSS

1. The transaction must involve property classified as capital asset; and
2. The transaction must be a sale or exchange or one considered as equivalent to a sale or exchange.

### RULES ON THE RECOGNITION OF CAPITAL GAINS OR LOSSES

INDIVIDUAL	CORPORATION
<p>➤ <b>Holding Period</b></p> <p>The percentages of gain or loss to be taken into account shall be the following:</p> <ol style="list-style-type: none"><li>a. 100% - if the capital assets has been held for 12 mos. or less; and</li><li>b. 50% - if the capital asset has been held for more than 12 mos.</li></ol>	Capital gains and losses are recognized to the extent of 100%. (There is no holding period)
➤ <b>Non-deductibility of</b>	• Capital losses are allowed only





<p><b>Net Capital losses</b></p> <ul style="list-style-type: none"> <li>Capital losses are allowed only to extent of the capital gains; hence, the net capital loss is not deductible.</li> </ul>	<p>to extent of the capital gains; hence, the net capital loss is not deductible.</p> <p><b>Exception:</b> If any domestic bank or trust company, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision)</p>
<p>➤ <b>Net Capital Loss Carry -Over</b></p> <ul style="list-style-type: none"> <li>Allowed</li> </ul> <p>The net capital loss (in an amount not in excess of the taxable income before personal exemption for such year) shall be treated in the succeeding year (but not beyond 12 months) as a deduction as short-term capital loss (at 100%) from the net capital gains.</p>	<ul style="list-style-type: none"> <li>Not allowed</li> </ul>

❖ See Annex U for illustration.

#### SALE OR EXCHANGE OF CAPITAL ASSETS

The following are considered as sale or exchange of capital assets:

1. Retirement of bonds
2. Short sales of property
3. Failure to exercise privilege or option to buy or sell property
4. Securities becoming worthless
5. Distribution in liquidation of corporations
6. Readjustment of interest in a general professional partnership.

#### TAX FREE EXCHANGES

Sales or exchanges resulting in non-recognition of gains or losses:

1. Exchange *solely in kind* in legitimate **mergers and consolidation**; includes:

- a. Between the corporations which are parties to the merger or consolidation (property for stocks);
- b. Between a stockholder of a corporation party to a merger or consolidation and the other party corporation (stock for stock);
- c. Between a security holder of a corporation party to a merger or consolidation and the other party corporation (securities for securities)

2. Transfer to a **controlled corporation** - exchange of property for stocks resulting in acquisition of corporate control by a person, alone or together with others not exceeding four.

“Control” means ownership of stocks in a corporation amounting to at least 51% of the total voting power of all classes of stocks entitled to vote.

#### SALE OR EXCHANGE OF ORDINARY ASSETS

General rules of income taxation apply to both gain and loss.

❖ See Annex D (Gross Income - Gains from dealings in property)

#### SUMMARY OF TAX TREATMENT OF GAINS/LOSSES IN THE EXCHANGE OF PROPERTIES

**General Rule:** Upon the sale or exchange of property, the entire gain or loss, as the case may be, shall be recognized. [Sec. 40 (C, 1)]

#### Exceptions:

1. Transactions where gains and losses are not recognized -
  - a. Exchange solely in kind in legitimate mergers and consolidation
  - b. Transfer to a controlled corporation [Sec. 40(C, 2)]





2. Transactions where gain is recognized but not the loss -
  - a. Transactions between related taxpayers [Sec. 36]
  - b. Illegal transactions [Sec. 96, Rev. Reg. 2]
  - c. Exchanges of property, not solely in kind, in pursuance of corporate mergers and consolidations [Sec. 40, (C, 3)]

#### IMPORTANT DISTINCTION

If it is an **ordinary asset**, the ordinary gains and losses are considered in determining income or loss from trade, business or profession. (See Secs. 32A, 34D)

If it is a **capital asset**, determine further whether or not it is a real property located in the Philippines. If it is, then it is subject to capital gains tax. (See Secs. 24D, 27D5) (See also Secs. 24C, 27D2) If not, the capital gains and losses are considered in determining the taxable income. (Sec. 39)

#### CAPITAL GAINS AND LOSSES - SHARES OF STOCK

The taxation of shares of stock whether or not listed and traded in the stock exchange is subject to *final tax*.

#### WHO ARE LIABLE TO THE TAX

1. Individual taxpayer, citizen or alien
2. Corporate taxpayer, domestic or foreign
3. Other taxpayers such as estate, trust, trust funds and pension among others.

#### RATES OF TAX

1. **Shares of stock not traded through a local stock exchange** - Net capital gains derived during the taxable year from sale, exchange, or transfer shall be taxed as follows (on a per transaction basis):
 

Not over P 100,000	- 5%
Over P 100,000	- 10%
2. **Shares of stock listed through a local stock exchange** -  $\frac{1}{2}$  of 1% of the gross selling price of the stock.

#### EXCEPTIONS TO THE TAX

1. Gains derived by dealers in securities.
2. All other gains which are specifically exempt from income tax under existing investment incentives and other special laws.

#### BASIS FOR COMPUTING GAIN OR LOSS (BIR RULING 146-98)

- The fair market value (FMV) of the sale of shares not traded but listed in the stock exchange is the highest closing price on the day the shares were sold, transferred or exchanged.
- When no sale is made in the stock exchange, the FMV shall be the highest selling price on the day nearest to the day of sale, transfer or exchange.
- For shares not listed in the exchange, the FMV shall be the book value nearest the valuation date

The above rules shall be used in computing for the net capital gain/loss for disposition of shares.

#### IMPORTANT FEATURES

1. Sale of shares of stock of a domestic corporation listed and traded in a local stock exchange and that of initial public offering shall be subject to Percentage tax (Business Tax)
2. Capital losses sustained during the year (not listed and traded in a local stock exchange) shall be allowed as a capital loss deductible on the same taxable year only (no carry-over)
3. The entire amount of capital gain and capital loss (not listed and traded in a local stock exchange) shall be considered without taking into account holding period irrespective of who is the taxpayer (all 100%)
4. Non-deductibility of losses on wash sales.

#### FILING AND PAYMENT OF TAX

1. **Listed and Traded in the Stock Exchange** - The stockbroker shall turn over the tax collected to the







B.I.R. within *five (5)* banking days from the date of collection.

2. **Not traded through the stock exchange**  
- It shall be paid by the seller on a per transaction basis upon filing of the required return within *30 days* following each sale or other disposition of shares of stock.

## **CAPITAL GAINS AND LOSSES (REAL PROPERTY)**

### **PERSONS LIABLE AND TRANSACTIONS AFFECTED**

1. **Individual taxpayers, estates and trusts**

Sale or exchange or other disposition of real property considered as capital assets.

The said sale shall include "*pacto de retro sale*" and other conditional sale.

2. **Domestic Corporation**

Sale or exchange or disposition of lands and/or building which are not actually used in business and are treated as capital asset.

### **EXCEPTIONS TO THE TAX**

1. Gains derived by dealers in real estate

### **RATE AND BASIS OF TAX**

A final tax of 6% is based on the *gross selling price* or *fair market value* or *zonal value* whichever is *higher*.

*Note:* Gain or loss is immaterial, there being a conclusive presumption of gain.

- ❖ See **Annex G** - Guidelines in Determining Whether a Real Property is a Capital or an Ordinary Asset.

### **EXEMPTION OF CERTAIN INDIVIDUALS FROM THE CAPITAL GAINS TAX ON THE SALE OR DISPOSITION OF A PRINCIPAL RESIDENCE**

#### **Conditions:**

- a. Sale or disposition of the old principal residence;
- b. By natural persons - citizens or aliens *provided* that they are residents

taxable under Sec. 24 of the Code (does not include an estate or a trust);

- c. The proceeds of which is fully utilized in (a) acquiring or (b) constructing a new principal residence within eighteen (18) calendar months from date of sale or disposition;
- d. Notify the Commissioner within thirty (30) days from the date of sale or disposition through a prescribed return of his intention to avail the tax exemption;
- e. Can only be availed of only once every ten (10) years;
- f. The historical cost or adjusted basis of his old principal residence sold, exchanged or disposed shall be carried over to the cost basis of his new principal residence
- g. If there is no full utilization, the portion of the gains presumed to have been realized shall be subject to capital gains tax.

### **GROSS INCOME FROM DIFFERENT SOURCES (SEC. 42)**

- ❖ Please refer to Annex I.

### **ACCOUNTING PERIODS AND METHODS OF ACCOUNTING**

#### **I. ACCOUNTING PERIODS**

##### **A. General rule (Sec. 43)**

Taxable income is computed upon the basis of taxpayer's annual accounting period (fiscal or calendar year) in accordance with the method of accounting employed.

- If no method of accounting employed or method does not clearly reflect the income, computation shall be made in accordance w/ such method as the opinion of the Commissioner clearly reflects the income.
- Taxable income is computed *based on calendar year* if:
  1. accounting period is other than a fiscal year
  2. taxpayer has no accounting period
  3. taxpayer does not keep books





4. taxpayer is an individual
  - **Fiscal year:** accounting period of 12 months ending on the last day of any month other than December
  - **Calendar year:** accounting period from January 1 to December 31
- B. Periods in which items of gross income included (Sec. 44)**
- Amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, any such amounts are to be properly accounted for in a different period under methods of accounting permitted
  - In case of death of taxpayer: include for the taxable year in which falls the date of his death, all amounts which accrued up to the date of his death; if not otherwise properly includible in respect of such period or a prior period
- C. Period for which deduction and credits taken (Sec. 45)**
- Deductions provided in this Title shall be taken for the taxable year in which 'paid or incurred, dependent upon the method of accounting upon the basis of which the net income is computed, unless, in order to reflect the income, deductions should be taken as of a different period.
  - In case of death of taxpayer: deductions allowed for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly allowable in respect of such period or a prior period.
- D. Change of accounting period (Sec.46)**
- Kinds of changes:
    - from fiscal year to calendar year
    - from calendar year to fiscal year
    - from one fiscal year to another
  - Effect of change: Net income, shall, with the approval of the Commissioner, be computed on the basis of the new accounting period, subject to Sec. 47.
- E. Final or adjustment returns for a period of less than 12 months**
- (1) Returns for short period resulting from change of accounting period
- taxpayer is other than an individual
  - with the approval of the Commissioner
  - If change is from fiscal year to calendar year:
    - separate final or adjustment return be made for the period between the close of the last fiscal year for which return was made and the following December 31
  - If change is from calendar year to fiscal year:
    - separate final or adjustment return be made for the period between the close of the last calendar for which return was made and the date designated as the close of the fiscal year
  - If change is from one fiscal year to another:
    - separate final or adjustment return be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year
- (2) Income computed on basis of short period
- In what cases?
    - a. Where a separate final or adjustment return is made on account of a change in accounting period
    - b. In all other cases where a separate final or adjustment return is require or permitted by





R&R prescribed by Sec. of Finance. upon recommendation of Commissioner

- Both shall be made for a fractional part of a year.
- Then income is computed on the basis of the short period for which separate final or adjustment return is made.

## II. METHODS OF ACCOUNTING

### A. Cash method

Recognition of income and expense dependent on inflow or outflow of cash.

### B. Accrual method

Method under which income, gains and profits are included in gross income when earned whether received or not, and expenses are allowed as deductions when incurred: although not yet paid. It is the right to receive and not the actual receipt that determines the inclusion of the amount in gross income

- Examples:
  1. interest or rent income earned but not yet received
  2. rent expense accrued but not yet paid
  3. wages due to workers but remaining unpaid

### C. Accounting for long-term contracts

- *Long-term contracts:* building, installation or construction contracts covering a period in excess of 1 yr
- Persons whose gross income is derived in whole or in part from such contracts shall report such income upon the basis of *percentage of completion*
- The return is accompanied by a return certificate of architects or engineers

showing the percentage of completion during the taxable year of the entire work performed under the contract

- Deductions from gross income: all expenditures made during the taxable year on account of the contract: account being taken of the material and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied.
- Amended return may be permitted /required by the Commissioner: if upon completion of contract, taxable income has not been clearly reflected for any year(s).

### D. Installment basis

#### (1) Sales of dealers in personal property

Under rules and regulations prescribed by the Sec. of Finance, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income there from in any taxable year that proportion of the installment payments actually received in that year, which the gross profit realized or to be realized when payment is completed, bears to the contract price.

*Example: Sale in 2000*

Contract price (CP)	
(installments receivable)	P200, 000
Cost	150,000
Gross profit (GP)	50,000

Installments payable in 2 equal annual installments

GP/CP ratio  
=  $50,000/200,000 = 25\%$

Collections in 2000=P100,000





Income for 2000  
= P100,000 x 25% = P25,000

(2) Sales of realty and casual sales of Personalty

- *In cases of:*
  - a. casual sale or other casual disposition of personal property (other than inventory on hand of the taxpayer at the close of the taxable year) for a price > P1,000, or
  - b. sale or other disposition of real property, if in either case the initial payments do not exceed 25% of the selling price
- *How may income be returned:* same as in sales of dealer in personal property above
- *Initial payments:* payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(3) Sales of real property considered as capital asset by individuals

- Individual who sells or disposes of real property, considered as capital asset and is otherwise qualified to report the gain under (2) above may pay the capital gains tax in installments under rules and regulations to be promulgated by the Sec. of Finance.

(4) Change from accrual to installment basis

- taxpayer must be entitled to benefits under (1) hereof sales of dealers in personal property
- in computing income for the year of change or any subsequent year: amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

**E. Allocation of income and deductions**

- Applicable to: cases of 2 or more organizations, trades or businesses (incorporated and organized within the Philippines) owned or controlled directly /indirectly by the same interest
- Commissioner is authorized to distribute, apportion or allocate gross income or deductions between or among such organization, trade or business, if he determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or to clearly reflect the income of any such organization, trade or business.

**FILING OF TAX RETURN AND PAYMENT OF TAX**

**TAX RETURN** - This is a report made by the taxpayer to the BIR of all gross income received during the taxable year, the allowable deductions including exemptions, the net taxable income, the income tax rate, the income tax due, the income tax withheld, if any, and the income tax still to be paid or refundable.





**PERSONS REQUIRED TO FILE INCOME TAX RETURN**

**a. Individual**

1. Resident citizen;
2. Non-resident citizen on income from within the Phil.;
3. Resident alien on income from within the Phil.;
4. NRAETB on income from within the Phil.
5. An individual (citizens / aliens) engaged in business or practice of a profession within the Phil. regardless of the amount of gross income;
6. Individual deriving compensation income concurrently from two or more employers at any time during the taxable year;
7. Individual whose pure compensation income derived from sources within the Phil. exceeds P60,000.

**b. Taxable Estate and Trust**

**c. General Professional Partnership**

**d. Corporation**

1. Not exempt from income tax;
2. Exempt from income tax under Sec. 30 of NIRC but has not shown proof of exemption.

**INDIVIDUALS EXEMPT FROM FILING INCOME TAX RETURN**

1. Individual whose gross income does not exceed total personal and additional exemptions;
2. Individual with respect to pure compensation income derived from sources within the Philippines, the income tax on which has been correctly withheld;
3. Individual whose sole income has been subjected to final withholding income tax;
4. Individual who is exempt from income tax.

**SUBSTITUTED FILING** - is when the employer's annual return may be considered as the "substitute" Income Tax Return (ITR) of employee inasmuch as the information provided in his income tax return would exactly be the

same information contained in the employer's annual return.

**HOW IS "SUBSTITUTED FILING" DIFFERENT FROM "NON-FILING"?**

- **Substituted Filing** - an individual taxpayer although required under the law to file his income tax return, will no longer have to personally file his own income tax return.  
- but instead the *employer's annual information return* filed is the considered "substitute" income tax return of the employee inasmuch as the information in the employer's return is *exactly the same information* contained in the employee's return.
- **Non-filing** - applicable to certain types of individual taxpayers who are not required under the law to file an income tax return.  
Example: employee whose pure compensation income does not exceed P60,000 and has only one employer for the taxable year and whose tax withheld is equivalent to his tax due.

**SUBSTITUTED FILING OF INCOME TAX RETURNS BY EMPLOYEES RECEIVING PURELY COMPENSATION INCOME. [SECTION 4, RR 3-2002; RMC 01-03]**

**Requisites:**

1. The employee receives *purely compensation income* (regardless of amount) during the taxable year.
2. The employee receives the income only from *one employer* during the taxable year.
3. The *amount of tax due* from the employee at the end of the year *equals* the amount of tax withheld by the *employer*.
4. The employee's spouse also complies with all three (3) conditions stated above.
5. The employer files the annual information return (BIR Form No. 1604-CF)







6. The employer issues BIR Form 2316 (Oct 2002 ENCS) version to each employee

**INDIVIDUALS NOT QUALIFIED FOR SUBSTITUTED FILING (STILL REQUIRED TO FILE)**

1. Individuals deriving compensation from two or more employers concurrently or successively during the taxable year.
2. Employees deriving compensation income, regardless of the amount, whether from a single or several employers during the calendar year, the income tax of which has not been withheld correctly (i.e. tax due is not equal to the tax withheld) resulting to collectible or refundable return.
3. Employees whose monthly gross compensation income does not exceed P5,000 or the statutory minimum wage, whichever is higher, and opted for non-withholding of tax on said income.
4. Individuals deriving other non-business, non-profession-related income in addition to compensation income not otherwise subject to final tax.
5. Individuals receiving purely compensation income from a single employer although the income tax of which has been correctly withheld, but whose spouse falls under 1 to 4 above.
6. Non-resident aliens engaged in trade or business in the Philippines deriving purely compensation income, or compensation income and other non-business, non-profession-related income.

**NOTE:** Non-filing of ITR, for employees who are qualified for the substituted filing shall be *OPTIONAL* for the taxable year 2001, the returns for which shall be filed on or before April 15, 2002. Thereafter, substituted filing where applicable shall be *MANDATORY*. [Sec 5 RR 3-2002]

**REQUIREMENT OF BANKS FOR SUBMISSION OF AN ITR FOR LOAN OR CREDIT CARD APPLICATIONS**

Banks may require the submission of BIR Form No. 1700 (for employees not entitled to substituted filing of ITR). However, for employees entitled to substituted filing of ITR, the submission of the Joint Certification will suffice.

**JOINT CERTIFICATION** - It is a sworn statement made by the employer and employee, which serve the following purposes:

1. It contains the employee's consent that BIR Form No. 1604CF may be considered his substituted return, in lieu of BIR Form No. 1700, which the employee no longer filed.
2. It contains the employer's certification that he has reported the employee's income to the BIR and that he has remitted the taxes on the employee's income, as indicated in BIR Form No. 1604-CF.
3. It serves as proof of financial capacity in case the employee decides to apply for a bank loan or a credit-card, or for any other purpose, as if he had in fact filed a BIR Form No. 1700.

**INDIVIDUALS REQUIRED TO FILE AN INFORMATION RETURN**

Individuals not required to file an income tax return may nevertheless be required to file an information return pursuant to rules and, regulations prescribed by the Secretary of Finance upon recommendation of the Commissioner.

**PLACE OF FILING**

1. Legal residence - authorized agent bank; Revenue District Officer; Collection agent or duly authorized treasurer
2. Principal place of business
3. With the Office of the Commissioner





#### TIME FOR FILING (PAY AS YOU FILE SYSTEM)

**April 15** - for those earning sole compensation income or solely business, practice of profession or combination of business and compensation.

#### RETURN AND PAYMENT OF ESTIMATED INCOME TAX BY INDIVIDUAL (SELF-EMPLOYED OR PRACTICE OF PROFESSION)

1. First quarter - April 15 of current year
2. Second quarter - August 15 of current year
3. Third quarter - November 15 of current year
4. Final quarter - April 15 of the following year.

**Note:** When the tax due is in excess of P2,000 - the taxpayer may elect to pay in two (2) equal installments:  
 1<sup>st</sup> installment - April 15  
 2<sup>nd</sup> installment - on or before July 15

#### EXTENSION OF TIME TO FILE RETURN

The Commissioner may on meritorious cases grant a reasonable extension of time for filing income tax return and may subject the imposition of twenty (20) percent interest per annum from the original due date.

#### RETURN OF HUSBAND AND WIFE

- **File one (1) return** for the taxpayer year if following requisites complied;
  - a. Married individuals (citizens, resident or nonresident aliens)
  - b. Do not derived income purely from compensation.
- **If impracticable to file one return:** each spouse file a separate return of income but the return so filed shall be consolidated by the Bureau for the purposes of verification for the year.

#### UNMARRIED MINOR

- Income of unmarried minors derived from property received by the living

parent shall be included in the return of the parent, except:

- a. when donor's tax has been paid on such property, or
- b. when transfer of such property is exempt from donor's tax

#### PERSONS UNDER DISABILITY

If a taxpayer is unable to make his own return, it may be made by his

1. duly authorized agents;
  2. representative;
  3. by guardian;
  4. other person charged with the care of his person or property;
- who will assume the responsibility of making the return and incurring penalties provided for erroneous, false or fraudulent return.

#### RETURN OF ESTATE, TRUST AND PARTNESHIP

Estate and Trust with gross income of P20,000 or more and partnership (whether professional or business) shall file their income tax return on or before April 15.

#### TAX RETURNS OF GENERAL PROFESSIONAL PARTNERSHIPS (GPP)

- Each GPP shall file in duplicate, a return of its income (except those income exempt)
- Shall set forth:
  - a. items of gross income and deductions allowed
  - b. names of partners
  - c. TIN
  - d. address and share of each partner

#### TAX RETURN OF A CORPORATION

Those required to file:

1. Corporation subject to tax having existed during the taxable year, whether with income or not.
2. Corporation in the process of liquidation or receivership.
3. Insurance company doing business in the Philippines or deriving income therein
4. Foreign corporation having income from within the Philippines





#### FILING OF RETURN (PAY AS YOU FILE SYSTEM)

Quarterly returns for the first three (3) quarters on a strictly sixty (60) day basis and the final or adjusted return on the 15th day of the fourth (4th) month following the close of either a fiscal or calendar year.

❖ See Annex V for Illustration.

#### WHO SHALL FILE?

The return shall be filed by the president, vice-president, or other principal officer, and shall be sworn to by such officer and by the treasurer or assistant treasurer.

### WITHHOLDING TAXES

#### WITHHOLDING TAXES

##### Kinds:

1. Withholding Tax at Source:
  - a. Final Withholding Tax
  - b. Creditable Withholding Tax (Expanded withholding tax)
2. Withholding Tax on Compensation (Wages)
3. Withholding Tax on Creditable Value-Added Tax
4. Withholding of Percentage Tax

FINAL WITHHOLDING TAX SYSTEM	CREDITABLE WITHHOLDING TAX SYSTEM
The amount of income tax withheld by the withholding agent is constituted as a full and final payment of the income due from the payee on the said income. [Sec. 2.57 (a), Rev. Reg. 2-98]	Taxes withheld on certain income payments are intended to equal or at least approximate the tax due from the payee on the said income.
The liability for payment of the tax rests primarily on the payor or the withholding agent. The payee is not required to file an income tax return for the particular income.	The income recipient is still required to file an income tax return and/or pay the difference between the tax withheld and the tax due on the income. [Sec. 2.57(B), Rev. Regs. 2-98]

#### TIME TO WITHHOLD TAX AT SOURCE

- arises at the time an income is paid or payable, whichever comes first. The term "payable" refers to the date the obligation becomes due, demandable or legally enforceable. (Sec. 2.54.4 Rev. Regs. 2.98)

#### NATURE OF WITHHOLDING AGENT'S LIABILITY

The withholding agent is directly and independently liable for the correct amount of the tax that should be withheld from the dividend remittance. (*Commissioner vs. Procter and Gamble*, GR No. 66838, December 2, 1991)

#### CONSEQUENCES FOR FAILURE TO WITHHOLD:

1. liable for surcharges and penalties;
2. liable upon conviction to a penalty equal to the total amount of the tax not withheld, or not accounted for and remitted. (Sec. 251, 1997 NIRC)
3. any income payment which is otherwise deductible from the payor's gross income will not be allowed as a deduction if it is shown that the income tax required to be withheld is not paid to the BIR. (Sec. 2.58.5, Rev. Reg. 2-98)

#### WITHHOLDING TAX ON COMPENSATION

Every employer must withhold from compensation paid, an amount computed in accordance with the regulations.

##### Exception:

Where such compensation income of an individual:

1. Does not exceed the statutory minimum wages; or
2. Five thousand (P5,000) monthly (P60,000 a year)
  - **whichever is higher.**

#### ELEMENTS OF WITHHOLDING ON COMPENSATION

1. There must be an employer-employee relationship
2. There must be payment of compensation or wages for services rendered
3. There must be a payroll period.





#### COMPENSATION EXEMPTED

1. Remunerations received as an incident of employment
2. Remunerations paid for agriculture labor
3. Remunerations paid for domestic services
4. Remunerations for casual not in the course of an employer's trade or business.
5. Compensation for services of a citizen, resident of the Philippines, for a foreign government or an international organization
6. Damages
7. Life insurance
8. Amount received by the insured as return of premium
9. Compensation for injuries and sickness
10. Income exempt under treaty
11. Thirteenth (13th) month pay and other benefits
12. GSIS; SSS; Philhealth and other contributions,

#### TAX-FREE COVENANT BOND [SEC. 57(C)]

**COVENANT BONDS** - bonds, mortgages, deeds of trust and other similar obligations of domestic/resident foreign corporation, which contain a contract/provision by which the obligor agrees;

1. to pay any portion of the tax imposed upon the obligee;
  2. to reimburse the obligee for any portion of the tax; or
  3. to pay the interest without deduction for any tax which the obligor may be required/permitted to pay or to retain therefrom.
- Obligor shall deduct and withhold a tax = 30% of the interest and other payments whether interest or other payments are payable annually or at a shorter period; whether bonds, securities, obligations had been/will be issued/ marketed and the interest and other payments paid within and without the Philippines if the interest or other payment is payable to a non-resident alien or a citizen or resident of the Philippines

#### INCOME OF RECIPIENT [SEC. 58 (D)]

- Income which any creditable tax is required to be withheld at source shall be included in the return of its recipient.
- The excess of the amount of tax withheld over the tax due on his return shall be refunded to him, subject to Section 204 (abatement, refund/credit taxes).
- If amount withheld at source is *less than* the tax due on his return, the difference is paid in accordance with Section 56 (payment and assessment of income tax).
- All taxes withheld shall be considered as trust funds and maintained in a separate account and not commingled with any other funds of the withholding agent.

### B. TRANSFER TAXES

TRANSFER TAX	INCOME TAX
Tax on transfer of property.	Tax on income
Rates are lower --5% to 20% - estate tax -- 2% to 15 % or 30% - donor's tax	Rates are higher -- 5% to 32%
Lesser exemptions	More exemptions

#### (1) ESTATE TAXES

**DEFINITION:** an excise tax on the right of transmitting property at the time of death and on the privilege that a person is given in controlling to a certain extent the disposition of his property to take effect upon death.

#### ESTATE TAX FORMULA

Gross Estate (Sec. 85)  
 Less: (1) Deductions (Sec. 86)  
       (2) Net share of the SS in the CPP  
 -----  
 Net Taxable Estate





*Multiply by: Tax rate (Sec. 84)*

Estate Tax due

Less: Tax Credit [if any] (Sec. 86[E] or 110[B])

Estate Tax Due, if any

## GROSS ESTATE

A DECEDENT'S GROSS ESTATE INCLUDES (SEC. 85)

RESIDENT & NON-RESIDENT CITIZEN, RESIDENT ALIEN DECEDENT	NON-RESIDENT ALIEN DECEDENT
1. Real property <i>wherever</i> situated	1. Real property situated in the <i>Philippines</i> .
2. Personal property <i>wherever</i> situated a) Tangible, and b) Intangible	2. Personal property a) Tangible property situated in the <i>Philippines</i> b) Intangible personal property with a situs in the <i>Philippines</i> unless exempted on the basis of reciprocity.

THE LAW THAT GOVERNS THE IMPOSITION OF ESTATE TAX

The statute in force *at the time of death of the decedent* shall govern estate taxation.

INTANGIBLE PERSONAL PROPERTIES WITH A SITUS IN THE PHIL. (SEC. 104, 1997 NIRC)

1. Franchise which must be exercised in the Philippines;
2. Shares, obligations or bonds issued by any corporation or *sociedad anonima* organized or constituted in the Philippines in accordance with its laws;

3. Shares, obligations or bonds issued by any foreign corporation eighty-five per centum (85%) of the business of which is located in the Philippines;
4. Shares, obligations or bonds issued by any foreign corporation, if such shares, obligations or bonds have acquired a business situs in the Philippines;
5. Shares or rights in any partnership, business or industry established in the Philippines.

INTANGIBLE PERSONAL PROPERTY, WITH A SITUS IN THE PHILIPPINES, OF A DECEDENT WHO IS A NON-RESIDENT ALIEN SHALL NOT FORM PART OF THE GROSS ESTATE IF (RECIPROCITY CLAUSE) (SEC. 104)

1. the decedent at the time of his death was a citizen and resident of a foreign country which at the time of his death
  - a. did not impose a transfer tax or death tax of any character
  - b. in respect of intangible personal property of citizens of the Philippines not residing in that foreign country; or
2. the laws of the foreign country of which the decedent was a citizen and resident at the time of his death
  - a. allow a similar exemption from transfer taxes or death taxes of every character
  - b. in respect of intangible personal property owned by citizens of the Philippines not residing in that foreign country (Reciprocity).

## VALUATION OF THE GROSS ESTATE

The properties comprising the gross estate shall be valued based on their fair market value as of the time of death.

PROPERTY	VALUATION
1) Real Property	- fair market value a) as determined by the Commissioner or b) as shown in the schedule of values







	fixed by the provincial and city assessors WHICHEVER IS HIGHER
2) Shares of Stock <u>Unlisted</u> Common Shares Preferred Shares  <u>Listed</u>	-book value -par value -arithmetic mean between the highest and lowest quotation at a date nearest the date of death, if none is available on the date of death itself.
3) Right to usufruct, use or habitation, as well as that of annuity	- shall be taken into account the probable life of the beneficiary in accordance with the latest basic standard mortality table, to be approved by the Secretary of Finance, upon recommendation of the Insurance Commissioner.
4) Personal property	- whether tangible or intangible, appraised at FMV. "Sentimental value" is practically disregarded.

possess or enjoy the property or the income therefrom.

**Exception:** bona fide sale for an adequate and full consideration in money or money's worth.

### 3. REVOCABLE TRANSFER

A transfer whereby the terms of enjoyment of the property *may be altered, amended, revoked or terminated* by the decedent alone or in conjunction with any other person, or where any such power is relinquished in contemplation of the decedent's death. It is enough that the decedent had the power to alter, amend or revoke though he did not exercise such power.

**Exception:** bona fide sale for an adequate and full consideration in money or money's worth.

### 4. TRANSFER UNDER GENERAL POWER OF APPOINTMENT

A power of appointment is the right to designate the person or persons who will succeed to the property of the prior decedent.

The general power of appointment may be exercised by the decedent:

1. by will; or
2. by deed executed in contemplation of his death; or
3. by deed under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death:
  - a. the possession or enjoyment of, or the right to the income from the property; or
  - b. the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

**Exception:** bona fide sale for an adequate and full consideration in money or money's worth.

### 5. PROCEEDS OF LIFE INSURANCE

Proceeds of life insurance taken by the decedent on his own life shall be

## INCLUSIONS IN THE GROSS ESTATE (SEC. 85)

### 1. DECEDENT'S INTEREST

To the extent of the interest in property of the decedent at the time of his death.

### 2. TRANSFER IN CONTEMPLATION OF DEATH

1. A transfer motivated by the thought of impending death although death may not be imminent; or
2. A transfer by which the decedent retained for his life or for any period which does not in fact end before his death:
  - a. the possession or enjoyment of, or the right to the income from the property, or
  - b. the right, either alone or in conjunction with any person, to designate the person who shall





included in the gross estate if the beneficiary is:

- a. the *estate* of the decedent, his *executor* or *administrator* (regardless whether the designation is revocable or irrevocable); or
- b. a third person other than the estate, executor or administrator where the designation of the beneficiary is *revocable*.

## 6. TRANSFERS FOR INSUFFICIENT CONSIDERATION

The value to be included in the gross estate is the *excess* of the fair market value of the property at the time of the decedent's death over the consideration received. This is applicable in cases of transfer in contemplation of death, revocable transfer and transfer under general power of appointment made for a consideration but is not a bona fide sale for an adequate and full consideration in money or money's worth.

## 7. PRIOR INTERESTS

All transfers, trusts, estates, interests, rights, powers and relinquishment of powers made, created, arising, existing, exercised or relinquished before or after the effectivity of the NIRC.

## PROPERTY RELATIONS BETWEEN HUSBAND AND WIFE

The property relations between the spouses shall be governed by contract (marriage settlement) executed before the marriage.

In the absence of such contract, or if the contract is void:

On marriages contracted before August 3, 1988, the system of conjugal partnership of gains shall govern;

On marriages contracted on or after August 3, 1988 (effectivity of the Family Code of the Philippines), the system of absolute community of property shall govern.

## EXEMPT TRANSMISSIONS (SEC. 87)

1. The merger of usufruct in the owner of the naked title;
2. Fideicommissary substitution;

3. The transmission from the first heir, legatee or donee in favor of another beneficiary, in accordance with the will of the predecessor; and

All bequests, devices, legacies or transfers to social welfare, cultural and charitable institutions no part of the net income of which inures to the benefit of any individual; Provided, that not more than 30% of the said bequests, legacies or transfers shall be used by such institutions for administration purposes.

## DEDUCTIONS ON GROSS ESTATE APPLICABLE TO RESIDENT ALIENS AND CITIZENS (REVENUE REGULATIONS 2-2003)

The following are deductible from the gross estate of citizens and resident aliens:

1. Expenses, losses, indebtedness, taxes, etc. (*ordinary deductions*)
2. Transfer for public use
3. Vanishing deduction
4. Family home
5. Standard deduction equivalent to one million pesos (P1,000,000)
6. Medical expenses
7. Amounts received by heirs under RA 4917 (Retirement Benefits)
8. Net share of the surviving spouse in the conjugal or community property

## 1. ORDINARY DEDUCTIONS

### A. FUNERAL EXPENSES

The amount deductible is the lowest among the following:

1. actual funeral expenses
2. 5% of the gross estate
3. P200,000.

It includes the following:

1. Mourning apparel of the surviving spouse and unmarried minor children of the deceased, bought and used in the occasion of the burial.
2. Expenses of the wake preceding the burial including food and drinks.
3. Publication charges for death notices.
4. Telecommunication expenses in informing relatives of the deceased.





5. Cost of burial plot. Tombstone monument or mausoleum but not their upkeep. In case deceased owns a family estate or several burial lots, only the value corresponding to the plot where he is buried is deductible.
6. Interment fees and charges.
7. All other expenses incurred for the performance of the ritual and ceremonies incident to the interment.

Expenses incurred *after* the interment, such as for prayers, masses, entertainment, or the like are *not deductible*.

Any portion of the funeral and burial expenses *borne or defrayed by relatives and friends* of the deceased are *not deductible*.

#### B. JUDICIAL EXPENSES OF THE TESTAMENTARY OR INTESTATE PROCEEDINGS

Expenses allowed as deduction under this category are those:

1. incurred in the inventory-taking of assets comprising the gross estate,
2. administration,
3. payment of debts of the estate, as well as the distribution of the estate among the heirs.

In short, these deductible items are expenses incurred during the settlement of the estate but not beyond the last day prescribed by law, or the extension thereof, for the filing of the estate tax return.

#### C. CLAIMS AGAINST THE ESTATE

The word "claims" is generally construed to mean debts or demands of a *pecuniary nature* which could have been enforced against the deceased in his lifetime and could have been reduced to simple money judgments.

Claims against the estate or indebtedness in respect of property may arise out of:

1. Contract;
2. Tort; or
3. Operation of Law.

#### Requisites:

1. The liability represents a personal obligation of the deceased existing at the time of his death except unpaid obligations incurred incident to his death such as unpaid funeral expenses (i.e., expenses incurred up to the time of interment) and unpaid medical expenses which are classified under a different category of deductions;
2. The liability was contracted in good faith and for adequate and full consideration in money or money's worth;
3. The claim must be a debt or claim which is valid in law and enforceable in court;
4. The indebtedness must not have been condoned by the creditor or the action to collect from the decedent must not have prescribed.

#### D. CLAIMS AGAINST INSOLVENT PERSONS

##### Requisites:

1. The amount thereof has been initially included as part of his gross estate (for otherwise they would constitute double deductions if they were to be deducted)
2. The incapacity of the debtors to pay their obligation is proven.

#### C. UNPAID MORTGAGE

- In case unpaid mortgage payable is being claimed by the estate, verification must be made as to who was the beneficiary of the loan proceeds.
- If the loan is found to be merely an accommodation loan where the loan proceeds went to another person, the value of the unpaid loan must be included as a receivable of the estate.
- If there is a legal impediment to recognize the same as receivable of the estate, said unpaid obligation/mortgage payable shall not be allowed as a deduction from the gross estate.





- In all instances, the mortgaged property, *to the extent of the decedent's interest therein, should* always form part of the gross taxable estate.

#### F. TAXES

Taxes which have accrued as of the death of the decedent which were unpaid as of the time of death.

**The following are not deductible:**

1. income tax on income received after death
2. property taxes not accrued before death
3. estate tax

#### G. LOSSES

**Requisites:**

1. It should arise from fire, storm, shipwreck, or other casualty, robbery, theft or embezzlement;
2. Not compensated by insurance or otherwise;
3. Not claimed as deduction in an income tax return of the taxable estate;
4. Occurring during the settlement of the estate; and
5. Occurring before the last day for the payment of the estate tax (last day to pay: six months after the decedent's death).

### 2. TRANSFER FOR PUBLIC USE

**Requisites:**

1. The disposition is in a last will and testament
2. To take effect after death
3. In favor of the government of the Phil., or any political subdivision thereof
4. For exclusive public purposes.

*Note:* This should also include bequests, devices, or transfers to social welfare, cultural and charitable institutions.

### 3. VANISHING DEDUCTION

**DEFINITION:** The deduction allowed from the gross estate for properties that were subject to donor's or estate taxes. It is called vanishing deduction because the

deduction allowed diminishes over a period of five years. The rate of deduction depends on the period from the date of transfer to the death of the decedent, as follows:

PERIOD	DEDUCTION
• 1 year or less	100%
• 1 year - 2 years	80%
• 2 years - 3 years	60%
• 3 years - 4 years	40%
• 4 years - 5 years	20%

**Requisites:**

1. the present decedent died within 5 years from transfer of the property from a prior decedent or donor.
2. The property must be located in the Phils.
3. The property formed part of the taxable estate of the prior decedent, or of the taxable gift of the donor.
4. The estate tax or donor's tax on the gift must have been finally determined and paid.
5. The property must be identified as the one received from the prior decedent, or something acquired in exchange therefor.
6. No vanishing deduction on the property was allowable to the estate of the prior decedent.

### 4. FAMILY HOME

**Conditions:**

1. The family home must be the *actual* residential home of the decedent and his family at the time of his death, *as certified by the Barangay Captain* of the locality where the family home is situated;
2. The total value of the family home must be included as part of the gross estate of the decedent; and
3. Allowable deduction must be in an amount equivalent to
  - the current fair market value of the family home as declared or included in the gross estate, or
  - the extent of the decedent's interest (whether conjugal/community or exclusive property), **whichever is lower**, but not exceeding P1,000,000





## 5. STANDARD DEDUCTION

A deduction in the amount of One Million Pesos (P1,000,000) shall be allowed as an additional deduction *without need of substantiation*.

The full amount of P1,000,000 shall be allowed as deduction for the benefit of the decedent.

## 6. MEDICAL EXPENSES

- Any amount of medical expenses incurred within one year from death in excess of Five Hundred Thousand Pesos (P500,000) *shall no longer be allowed* as a deduction under this subsection.
- Neither can any unpaid amount thereof in excess of the P500,000 threshold nor any unpaid amount for medical expenses incurred prior to the one-year period from date of death be allowed to be deducted from the gross estate as claim against the estate.

## 7. AMOUNT RECEIVED BY HEIRS UNDER REPUBLIC ACT NO. 4917

Any amount received by the heirs from the decedent's employer *as a consequence of the death of the decedent-employee* in accordance with Republic Act No. 4917 is allowed as a deduction provided that the amount of the separation benefit is included as part of the gross estate of the decedent.

## 8. NET SHARE OF THE SURVIVING SPOUSE IN THE CONJUGAL PARTNERSHIP OR COMMUNITY PROPERTY

After deducting the allowable deductions (*only the ordinary deductions*) appertaining to the conjugal or community properties included in the gross estate, the share of the surviving spouse must be removed to ensure that only the decedent's interest in the estate is taxed.

## DEDUCTIONS ON GROSS ESTATE APPLICABLE TO NON-RESIDENT ALIENS

The following are deductible from the gross estate of non-resident aliens:

- Expenses, losses, indebtedness and taxes (ELIT) (*ordinary deductions*)

Formula:

$$\text{Tax Credit Limit} = \frac{\text{Phil. Gross Estate}}{\text{World Gross Estate}} \times \text{World ELIT}$$

- Transfer for public use
- Vanishing deduction on property in the Philippines.
- Conjugal share of the surviving spouse

## ESTATE TAX CREDIT

A tax credit is granted for estate taxes paid to a foreign country on the estate of citizens and resident aliens subject to the following limitations

### 1. One foreign country only

The tax credit is whichever is lower between:

- Estate tax paid to the foreign country
- Tax Credit Limit = 
$$\frac{\text{NTE, foreign country}}{\text{NTE, world}} \times \text{Phil. estate Tax}$$

(NTE - Net Taxable Estate)

### 2. More than one foreign country

The credit shall be that which is the lower amount between Limit A and Limit B.

**Limit A.** Whichever is lower between:

- Estate tax paid to a foreign country
- Tax Credit Limit = 
$$\frac{\text{NTE, foreign country}}{\text{NTE, world}} \times \text{Phil. estate Tax}$$







Limit B. Whichever is lower between:

- Total of estate taxes paid to all foreign countries
- Tax Credit Limit =  $\frac{\text{NTE outside Phil.} \times \text{Phil. estate Tax}}{\text{NTE, world}}$

## SETTLEMENT OF THE ESTATE TAX

### A. FILING

#### NOTICE OF DEATH TO BE FILED

In all cases of transfers subject to tax, or where, though exempt from tax, *the gross value of the estate exceeds P20,000*, the executor, administrator or any of the legal heirs, *within two months* after the decedent's death, or within a like period after qualifying as such executor or administrator, shall give a written notice thereof to the Commissioner. (Sec. 89)

#### AN ESTATE TAX RETURN IS REQUIRED TO BE FILED

1. when the estate is subject to estate tax; or
2. when the estate is not subject to estate tax but the gross estate exceeds P 200,000; or
3. regardless of the amount of the gross estate, where the gross estate consists of registered or registrable property such as motor vehicle or shares of stock or other similar property for which clearance from the BIR is required as a condition precedent for the transfer of ownership thereof in the name of the transferee.

#### TIME FOR FILING OF THE ESTATE TAX RETURN

The estate tax return shall be filed *within six (6) months after the death* of the decedent.

**Extension:** The BIR may, in meritorious cases, grant an extension of *not exceeding thirty (30) days* for the filing of the estate tax return.

WHEN THE GROSS ESTATE EXCEEDS P2,000,000, THE ESTATE TAX RETURN SHALL BE ACCOMPANIED BY A STATEMENT WHICH IS CERTIFIED BY AN INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT STATING

1. the itemized assets of the decedent with its corresponding gross value at the time of his death, or in the case of a non-resident, not citizen of the Philippines, that part of his gross estate situated in the Philippines;
2. the itemized deductions from the gross estate;
3. the amount of tax due, whether paid or still due and outstanding.

#### PLACE WHERE TO FILE THE ESTATE TAX RETURN

##### 1. Resident Citizen

- with the Accredited Agent Bank (AAB), Revenue District Officer, Collection Officer or duly authorized Treasurer of the city or municipality where the decedent was domiciled at the time of his death.

##### 2. Non-resident (citizen or alien)

- a. has registered executor or administrator
  - with the Revenue District Office where such executor or administrator is registered
- b. executor or administrator is not registered
  - with the Revenue District Office having jurisdiction over the executor' or administrator's residence
- c. no executor or administrator
  - with the Office of the Commissioner (Sec. 9C, Rev. Reg. 2-2003)

### B. PAYMENT

#### PAYMENT OF THE ESTATE TAX DUE

The estate tax due shall paid at the time when the estate tax return is filed.

When the Commissioner finds that the payment of the estate tax on the due date would impose undue hardships upon the estate or any heir:

- a. the payment of the estate tax may be extended for a period not to exceed five (5) years if





there is a judicial settlement of the estate; or

- b. the payment of the estate tax may be extended for a period not to exceed two (2) years if there is an extra-judicial settlement of the estate.

**NOTE:** In case the available cash is not sufficient to pay its total estate tax liability, the estate may be allowed to *pay tax by installment*. (Sec. 9F, Rev. Reg. 2-2003)

#### LIABILITY FOR PAYMENT

The estate tax shall be paid by the executor or administrator before delivery to any beneficiary of his distributive share of the estate.

Such beneficiary to the extent of his distributive share of the estate shall be subsidiarily liable for the payment of such portion of the estate tax as his distributive share bears to the value of the total net estate. (Sec. 9G, Rev. Reg. 2-2003)

No judge shall authorize the distribution of the estate unless a certification from the Commissioner that tax has been paid is shown. (Sec. 94)

No shares or other forms of securities shall be transferred in the books of any corporation, partnership, business or industry organized in the Philippines, unless a similar certification by the Commissioner is shown. (Sec. 97)

When a bank has knowledge of the death of a person who maintained a joint account, it shall not allow any withdrawal by the surviving depositor without the above certification. (Sec. 97)

**Provided:** that the administrator of the estate or any one (1) of the heirs of the decedent may, upon authorization by the Commissioner, withdraw an amount not exceeding twenty thousand pesos (**P20,000**) without the said certification.

There is nothing in the Tax Code and in the pertinent remedial law that implies the necessity of the probate court or estate settlement of court's approval of the State's claim for estate taxes before the same can be enforced and collected by the BIR. On the contrary, under Section 94, it is the probate or settlement court which is bidden not to authorize the delivery of the distributive share to any interested party without a certification from the CIR showing the payment of the estate tax. (*Marcos II vs. Court of Appeals*, GR No. 120880, June 5, 1997)

#### COLLECTION OF TAX FROM THE HEIRS

An estate or inheritance tax, whether assessed before or after the death of the deceased, can be collected from the heirs even after the distribution of the properties of the decedent. (*Palanca vs. Commissioner of Internal Revenue*, GR No. 16661, January 31, 1962)

The Government has two ways of collecting taxes due from the estate.

- a. By going after all the heirs and collecting from each one of them the amount of the tax proportionate to the inheritance received, or
- b. Pursuant to the lien created by Section 219 of the Tax Code upon all property and rights to property belonging to the taxpayer for unpaid income tax, is by subjecting said property of the estate which is in the hands of an heir or transferee to the payment of the tax due the estate. (*Commissioner of Internal Revenue vs. Pineda*, GR No. L -22734, September 15, 1967)





## (2) DONOR'S TAXES

**DEFINITION:** A tax on the privilege of transmitting one's property or property rights to another or others without adequate and full valuable consideration.

### COVERAGE OF THE TAX (SEC. 104)

RESIDENT & NON-RESIDENT CITIZEN, RESIDENT ALIEN DONOR	NON-RESIDENT ALIEN DONOR
1. Real property <i>wherever</i> situated	1. Real property situated in the <i>Philippines</i> .
2. Personal property <i>wherever</i> situated a. Tangible, and Intangible	2. Personal property a. Tangible property situated in the <i>Philippines</i> b. Intangible personal property with a situs in the Philippines unless exempted on the basis of reciprocity.

### REQUISITES

1. Capacity of the donor
2. Donative Intent
3. Delivery, whether actual or constructive, of the subject gift
4. Acceptance by the donee

### LAW THAT GOVERNS THE IMPOSITION OF DONOR'S TAX

The donor's tax shall not apply unless and until there is a completed gift. The transfer is *perfected* from the moment the donor knows of the acceptance by the donee; it is *completed* by the deliver, either actually or constructively, of the donated property to the donee. Thus, the law in force *at the time of the perfection/completion of the donation* shall govern the imposition of the donor's tax.

A gift that is *incomplete* because of reserved powers, becomes complete when either:

1. the donor renounces the power; or
  2. his right to exercise the reserved power ceases because of the happening of some event or contingency or the fulfillment of some condition, other than because of the donor's death.
- Renunciation by the surviving spouse of his/her share in the conjugal partnership or absolute community *after the dissolution of the marriage* in favor of the heirs of the deceased spouse or any other person/s is subject to donor's tax.
  - Whereas *general renunciation* by an heir, including the surviving spouse, of his/her share in the hereditary estate left by the decedent is not subject to donor's tax, unless specifically and categorically done in favor of identified heir/s to the exclusion or disadvantage of the other co-heirs in the hereditary estate. (Sec. 11, Rev. Reg. 2-2003)

**STRANGER** - a person who is not a brother, sister, spouse, ancestor and lineal descendant, or of a relative by consanguinity in the collateral within the 4<sup>th</sup> civil degree.

- A legally adopted child is *entitled to all the rights and obligations provided by law to legitimate children*, and therefore, donation to him shall *not* be considered as donation made to stranger.
- Donation made between business organizations and those made between an individual and a business organization shall be considered as donation made to a stranger.

### VALUATION OF GIFTS OF PROPERTY

The fair market value of the property given at the time of the gift shall be the value of the gift.





INTANGIBLE PERSONAL PROPERTIES WITH A SITUS IN THE PHIL. (SAME AS IN ESTATE TAX SUBJECT TO THE RECIPROCITY RULE) (SEC. 104)

*Formula: (On a cumulative basis over a period of one calendar year)*

1. On the 1<sup>st</sup> donation of a year

Gross gifts	xxx
Less: Deductions from gross gifts	xxx
Net gifts	xxx
Multiply by: Tax Rate	xxx
Donor's tax on the net gifts	xxx

2. On donation of a subsequent date during the year

Gross gifts made on this date	XX
Less: Deductions from gross gifts	XX
Net gifts	XX
Add: All prior net gifts within the year	XX
Aggregate net gifts	XX
Multiply by: Tax Rate	XX
Donor's tax on aggregate net gifts	XX
Less: Donor's tax on all prior net gifts	XX
Donor's tax on the net gifts on this date	XX

EXEMPTION OF CERTAIN GIFTS

1. Gifts made by a resident
  - a. Dowries or gifts made on account of marriage and before its celebration or within one year thereafter by parents to each of their legitimate, illegitimate or adopted children to the extent of the first P10,000.
  - b. Gifts made to or for the use of the National Government or any entity created by any of its agencies which is not conducted for profit, or to any political subdivision of the said government.
  - c. Gifts in favor of educational, charitable, religious, cultural or social welfare corporation, institutions, foundations, trust

or philanthropic organization, research institution or organization, accredited non-government organization (NGO). Provided, that no more than 30% of said gifts shall be used by such donee for administration purposes.

2. Gifts made by a non-resident not a citizen of the Phil.
  - a. same as (b)
  - b. same as (c) except accredited non-government organization (NGO)

A NON-PROFIT EDUCATIONAL AND/OR CHARITABLE CORPORATION, INSTITUTION, ACCREDITED NON-GOVERNMENT ORGANIZATION, TRUST OR PHILANTHROPIC ORGANIZATION, RESEARCH INSTITUTION OR ORGANIZATION IS

1. one incorporated as a non-stock entity
2. paying no dividends
3. governed by trustees who receive no compensation, and
4. devoting all its income whether students' fees or gifts, donations, subsidies or other forms of philanthropy to the accomplishment and promotion of the purposes enumerated in its Articles of Incorporation.

TAX CREDIT FOR DONOR'S TAXES PAID TO A FOREIGN COUNTRY

1. Donor was a Filipino citizen or resident alien
2. At time of foreign donation
3. Donor's taxes of any character and description
4. Are imposed and paid by the authority of a foreign country.

LIMITATIONS ON TAX CREDIT

1. The amount of the credit in respect to the tax paid to any country shall not exceed the same proportion of the tax against which such credit is taken, which the decedent's net gifts situated within such country taxable under the NIRC bears to his entire net gift; and





- The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the decedent's net gift situated outside the Philippines taxable under the NIRC bears to his entire net gift.

#### FORMULA OF TAX CREDIT LIMIT

- For donor's taxes paid to one foreign country

$$\frac{\text{NG situated in a foreign country}}{\text{Entire net gift}} \times \text{PDT} = \text{Credit Limit}$$

(NG - Net Gifts; PDT - Phil. Donor's Tax)

- For donor's taxes paid to two or more foreign country

$$\frac{\text{NG outside the Phil.}}{\text{Entire net gifts}} \times \text{PDT} = \text{Tax Credit Limit}$$

The allowable tax credit is the lower amount between the tax credit limit under (a) and (b).

### SETTLEMENT OF THE DONOR'S TAX

#### TIME FOR FILING OF RETURN AND PAYMENT OF THE DONOR'S TAX

The donor's tax return is filed and the donor's tax due is paid *within thirty (30) days* after the date the gift is made.

The return shall be under oath in duplicate setting forth:

- Each gift made during the calendar year which is to be included in computing net gifts;
- The deductions claimed and allowable;
- Any previous net gifts made during the same calendar year;
- The name of the donee;
- Relationship of the donor to the donee; and
- Such further information as may be required by rules and regulations made pursuant to law.

**NOTE:** The filing of a notice of donation is *not required*, unlike in estate tax where notice of death is required.

#### PLACE FOR FILING OF RETURN AND PAYMENT OF THE DONOR'S TAX

##### 1. Resident

- With an authorized agent bank, the Revenue District Officer, Revenue Collection Officer or duly authorized Treasurer of the city or municipality where the donor was *domiciled* at the time of the transfer, or if there be no legal residence in the Philippines, with the *Office of the Commissioner*.

##### 2. Non-resident

- Filed with the *Philippine Embassy or Consulate* in the country where he is domiciled at the time of the transfer, or directly with the *Office of the Commissioner*.

#### TAX RATE

If the donee is a **stranger**, the rate of tax shall be 30% of the net gifts.

If the donee is **not a stranger**, the rate shall be from 2% to 15% of the net gifts.

❖ See Annex W - Donor's Tax

### C. TAX REMEDIES UNDER THE NIRC

#### I. TAX REMEDIES OF THE GOVERNMENT

##### IMPORTANCE

- They enhance and support the government's tax collection.
- They are safeguards of taxpayer's rights against arbitrary action.

TAX COLLECTION CANNOT BE RESTRAINED BY COURT INJUNCTION (**SEC. 218, 1997 NIRC**)

**Justification:** Lifeblood Theory







**Exception:** Injunction may be issued by the CTA in aid of its appellate jurisdiction under RA 1125 (as amended by RA 9282).

#### Conditions for the Issuance of an Injunction by the Court of Tax Appeals

The CTA may enjoin collection of taxes:

- a. If in its opinion the same may jeopardize the interest of the government and/or the taxpayer.
- b. In this instance, the court may require the taxpayer either to deposit the amount claimed or file a surety bond for not more than double the amount with the court.

\* Before enforcement of remedies, assessment is necessary to trigger the process. If no return is filed, the Commissioner is empowered to obtain information, and to summon/examine, and take testimony of persons to determine the amount of tax due. (Sec. 5, 1997 NIRC)

#### TAX REMEDIES UNDER THE 1997 TAX CODE:

1. Summary - remedies at the administrative level or regulation that are executed without ceremony or delay; short or concise
2. Substantive - remedies provided for by law or regulation; an essential part or constituent or relating to what is essential
3. Procedural - remedies involving law of pleading, evidence, jurisdiction, etc.
4. Administrative - remedies available at the administration (BIR) level
5. Judicial - remedies that are enforced through judicial action, which may be civil or criminal

#### TAX REMEDIES OF THE GOVERNMENT TO EFFECT COLLECTION OF TAXES

1. Compromise (Sec. 204)
2. Distraint (Actual and Constructive) (Secs. 205-208)
3. Levy (Sec. 207B)
4. Tax Lien (Sec. 219)
5. Civil Action (Sec. 221)
6. Criminal Action (Secs. 221, and 222)

7. Forfeiture of Property (Sec. 224-225)
8. Suspension of business operations in violation of VAT (Sec. 115)
9. Enforcement of Administrative Fine

The remedies of distraint and levy as well as collection by civil and criminal actions may, in the discretion of the Commissioner, be pursued singly or independently of each other, or all of them simultaneously.

#### (1) COMPROMISE

**DEFINITION:** A contract whereby the parties, by reciprocal concessions, avoid litigation or put an end to one already commenced (Art. 2028, New Civil Code).

##### REQUISITES

1. The taxpayer must have a tax liability.
2. There must be an offer (by the taxpayer of an amount to be paid by the taxpayer)
3. There must be an acceptance (by the Commissioner or taxpayer as the case may be) of the offer in the settlement of the original claim.

##### OFFICERS AUTHORIZED TO COMPROMISE

1. The Commissioner of Internal Revenue (CIR) with respect to criminal and civil cases arising from violations of the Tax Code [Secs. 7(C) and 204, 1997 NIRC]. This power of the CIR is discretionary and once exercised by him cannot be reviewed or interfered with by the Courts. (*Koppel, Philippines vs. Commissioner, GR No. L-1977, September 21, 1950*)
2. By the Regional Evaluation Board composed of:
  - a. the Regional Director as Chairman,
  - b. Assistant Regional Director, the heads of the Legal, Assessment and Collection Divisions, and





- c. the Revenue District Officer having jurisdiction over the taxpayer, as members;
- on assessments issued by the regional offices involving basic taxes of P500,000 or less, and minor criminal violations.

#### CASES WHICH MAY BE COMPROMISED

1. Delinquent accounts
2. Cases under administrative protests
3. Civil tax cases being disputed before the courts
4. Collection cases filed in courts
5. Criminal violations, other than those already filed in court or those involving criminal tax fraud; and,
6. Cases covered by pre-assessment notices but taxpayer is not agreeable to the findings of the audit office as confirmed by the review office. (Sec.2, Rev. Reg. 7-2001)

#### EXCEPTIONS

1. Withholding tax cases;
2. Criminal tax fraud cases;
3. Criminal violations already filed in court;
4. Delinquent accounts with duly approved schedule of installment payments;
5. Cases where final reports of reinvestigation or reconsideration have been issued resulting to reduction in the original assessment and the taxpayer is agreeable to such decision.
6. Cases which become final and executory after final judgment of a court, where compromise is requested on the ground of doubtful validity of the assessment (RR. 30-2002);
7. Estate tax cases where compromise is requested on the ground of financial incapacity of the taxpayer. (RR. 30-2002)

#### COMMISSIONER MAY COMPROMISE THE PAYMENT OF ANY INTERNAL REVENUE TAX WHEN

1. A reasonable doubt as to the validity of the claim against the taxpayer exists; or

- a. The delinquent account or disputed assessment is one resulting from a jeopardy assessment.
- b. The assessment seems to be arbitrary in nature, appearing to be based on presumptions, and there is reason to believe that its is lacking in legal and/or factual basis; or
- c. The taxpayer failed to file an administrative protest on account of the alleged failure to receive notice of assessment or preliminary assessment and there is reason to believe that its is lacking in legal and/or factual basis; or
- d. The taxpayer failed to file a request for reinvestigation/reconsideration within 30 days from receipt of final assessment notice and there is reason to believe that its is lacking in legal and/or factual basis; or
- e. The taxpayer failed to elevate to the CTA an adverse decision of the Commissioner, or his authorized representative, in some cases, within 30 days from receipt thereof and there is reason to believe that its is lacking in legal and/or factual basis; or
- f. The assessment were issued on or after Jan. 1, 1998, where the demand notice allegedly failed to comply with the formalities prescribed under Sec. 228 of the 1997 NIRC; or
- g. Assessments made based on the "Best Evidence Obtainable Rule" and there is reason to believe that the same can be disputed by sufficient and competent evidence.
- h. The assessment was issued within the prescriptive period for assessment as extended by the taxpayer's execution of Waiver of the Statute of Limitations the validity or authenticity of which is being questioned or at issue and there is strong reason to believe and





- evidence to prove that it is not authentic. (RR. 30- 2002)
- i. The assessment is based on an issue where a court of competent jurisdiction made an adverse decision against the Bureau, but for which the Supreme Court has not decided upon with finality. (RR. 08-2004).
2. The financial position of the taxpayer demonstrates a **clear inability to pay** the assessed tax [Sec. 204(A), 1997 NIRC]. In such case, the taxpayer should waive the confidentiality privilege on bank deposits under RA No. 1405 [Sec. 6(F)(2), NIRC].
 

Financial Incapacity. – The offer to compromise based on financial incapacity may be accepted upon showing that:

    - a. The corporation ceased operation or is already dissolved. Provided, that tax liabilities corresponding to the Subscription Receivable or Assets distributed/distributable to the stockholders representing return of capital at the time of cessation of operation or dissolution of business shall not be considered for compromise; or
    - b. The taxpayer, as reflected in its latest Balance Sheet supposed to be filed with the Bureau of Internal Revenue, is suffering from surplus or earnings deficit resulting to impairment in the original capital by at least 50%, provided that amounts payable or due to stockholders other than business-related transactions which are properly includible in the regular "accounts payable" are by fiction of law considered as part of capital and not liability, and provided further that the taxpayer has no sufficient liquid asset to satisfy the tax liability; or
    - c. The taxpayer is suffering from a networth deficit (total liabilities exceed total assets) computed by deducting total liabilities (net of deferred credits and amounts payable to stockholders/owners reflected as liabilities, except business-related transactions) from total assets (net of prepaid expenses, deferred charges, pre-operating expenses, as well as appraisal increases in fixed assets), taken from the latest audited financial statements, provided that in the case of an individual taxpayer, he has no other leviable properties under the law other than his family home; (Sec. 3, RR. 30-2002).
    - c. The taxpayer is a compensation earner with no other source of income and the family's gross monthly compensation does not exceed (P10,500/month if single; P21,000/month if married), and that it appears that the taxpayer possesses no other leviable/distrainable assets, other than his family home; or
    - d. The taxpayer has been granted by the SEC or by any competent tribunal a moratorium or suspension of payments to creditors, or otherwise declared bankrupt or insolvent. (Sec. 3, RR. 07-2001)
- The Congressional Oversight Committee, under Section 290 of the 1997 NIRC is empowered to require the BIR:
1. The submission of all pertinent information, including but not limited to industry audits, collection performance data, status reports on criminal actions initiated against persons; and
  2. The submission of taxpayer returns.





#### MINIMUM COMPROMISE RATES (MCR) OF ANY TAX LIABILITY

- a. In case of financial incapacity:  
MCR = 10% of the basic assessed tax
- b. Other cases:  
MCR = 40% of the basic assessed tax  
[Sec. 204(A), 1997 NIRC]

#### APPROVAL OF THE COMPROMISE BY THE EVALUATION BOARD IS REQUIRED WHEN

- a. the basic tax involved exceeds P1,000,000.00, or
- b. the settlement offered is less than the MCR.

**NOTE:** The MCR may be less than the prescribed rates of 10% or 40%, as the case may be, provided it is approved by the Evaluation Board (composed of the BIR Commissioner and the four BIR Deputy Commissioners).

#### COMPROMISE OF CRIMINAL VIOLATIONS

**General Rule:** All criminal violations under the CTRP may be compromised.

#### Exceptions:

1. Those already filed in court
2. Those involving fraud [Sec. 204(B), 1997 NIRC].

#### EXTENT OF THE COMMISSIONER'S DISCRETION TO COMPROMISE CRIMINAL VIOLATIONS

1. **Before the complaint is filed with the Prosecutor's Office:** The CIR has full discretion to compromise except those involving fraud.
2. **After the complaint is filed with the Prosecutor's Office but before the information is filed with the court:** The CIR can still compromise provided the prosecutor must give consent.
3. **After information is filed with the court:** The CIR is no longer permitted to compromise with or without the consent of the Prosecutor. (*People vs. Magdaluyo*, GR No. L-16235, April 20, 1961)

This is more so, when the court has rendered a **final judgment**. As a mere agent of the Government, the Commissioner is not authorized to

accept anything less than what is adjudicated in favor of the Government. By virtue of such final judgment, the Government has already acquired a **vested right**.

#### NATURE OF A COMPROMISE IN EXTRAJUDICIAL SETTLEMENT OF THE TAXPAYER'S CRIMINAL LIABILITY FOR HIS VIOLATION

It is consensual in character, hence, may not be imposed on the taxpayer without his consent. The BIR may only suggest settlement of his tax liability through a compromise. The extrajudicial settlement and the amount of the suggested compromise penalty should conform with the schedule of compromise penalties provided under the relevant BIR regulations or orders.

#### REMEDY IN CASE THE TAXPAYER REFUSES OR FAILS TO ABIDE THE TAX COMPROMISE

1. Enforce the compromise
  - a. If it is a judicial compromise, it can be enforced by mere execution. A judicial compromise is one where a decision based on the compromise agreement is rendered by the court on request of the parties.
  - b. Any other compromise is extrajudicial and like any other contract can only be enforced by court action.
2. Regard it as rescinded and insist upon original demand (*Art. 2041, Civil Code*).

#### COMPROMISE PENALTY

It is an amount of money that the taxpayer pays to compromise a tax violation. This is paid in lieu of criminal prosecution. A taxpayer cannot be compelled to pay a compromise penalty. If he does not want to pay, the CIR must institute a criminal action.

#### COMPROMISE VS. ABATEMENT

*Compromise* involves a reduction of the taxpayer's liability, while *abatement* means that the entire tax liability of the taxpayer is cancelled.





## ABATEMENT

### THE COMMISSIONER MAY ABATE OR CANCEL A TAX LIABILITY WHEN

1. The tax or any portion thereof appears to be **unjustly or excessively assessed**; [Sec. 204(B), 1997 NIRC].
  - a. When the filing of the return/payment is made at the wrong venue;
  - b. When the taxpayer's mistake in payment of his tax is due to erroneous written official advice of a revenue officer;
  - c. When the taxpayer fails to file the return and pay the tax on time due to substantial losses from prolonged labor dispute, force majeure, legitimate business reverses, provided, however, the abatement shall only cover the surcharge and the compromise penalty and not the interest imposed under Sec. 249 of the Code;
  - d. When the assessment is brought about or the result of taxpayer's non-compliance with the law due to a difficult interpretation of said law.
  - e. When the taxpayer fails to file the return and pay the correct tax on time due to circumstances beyond his control, provided, however, the abatement shall only cover the surcharge and the compromise penalty and not the interest imposed under Sec. 249 of the Code;
  - f. Late payment of the tax under meritorious circumstances (ex. Failure to beat bank cut-off time, surcharge erroneously imposed, etc.) (Sec. 2, Rev. Reg. 13-2001)
2. The **administration and collection costs involved do not justify the collection** of the amount due [Sec. 204(B), 1997 NIRC].
  - a. Abatement of penalties on assessment confirmed by the lower court but appealed by the taxpayer to a higher court
    - b. Abatement of penalties on withholding tax assessment under meritorious circumstances
    - c. Abatement of penalties on delayed installment payment under meritorious circumstances
    - d. Abatement of penalties on assessment reduced after reinvestigation but taxpayer is still contesting reduced assessment; and
    - e. Such other circumstances which the Commissioner may deem analogous to the enumeration above. (Sec. 3, Rev. Reg. 13-2001)
3. The *Commissioner* may also, even **without a claim** therefor, refund or credit any tax where on the face of the return upon which payment was made such **payment appears clearly to have been erroneously paid** (Sec. 229, 1997 NIRC)).

## (2) DISTRAINT

**DEFINITION:** It is the seizure by the government of personal property, tangible or intangible, to enforce the payment of taxes. The property may be offered in a public sale, if taxes are not voluntarily paid. It is a summary remedy.

### NATURE OF THE WARRANT OF DISTRAINT OR LEVY

The warrant is a summary procedure "forcing" the taxpayer to pay. The receipt of a warrant may or may not partake the character of a final decision. If it is an indication of a final decision, the taxpayer may appeal to the CTA within 30 days from service of the warrant.

☛ Duties of the officer serving the warrant of distraint:

1. Make an account of the personal properties distrained;
2. Sign the list of personal properties distrained to which shall be added, a statement of the sum demanded and note of the time and place of sale;





3. Leave either with the owner or person from whose possession such personal properties were taken, or at the dwelling or place of business of such person with someone of suitable age and discretion (Sec. 208, CTRP)

### TWO TYPES OF DISTRRAINT

1. **Actual:** there is taking of possession of the personal property from the taxpayer by the government. Physical transfer of possession is not always required. This is true in the case of intangible property such as stocks and credits.
2. **Constructive:** the owner is merely prohibited from disposing of his property.

### ACTUAL VS. CONSTRUCTIVE DISTRRAINT

ACTUAL DISTRRAINT	CONSTRUCTIVE DISTRRAINT
Made only on the property of a delinquent taxpayer	Made on the property of any taxpayer, whether delinquent or not
There is taking of possession	The taxpayer is merely prohibited from disposing of his property
Effected by leaving a list of distrained property or by service of a warrant of distrainment or garnishment	Effected by requiring the taxpayer to sign a receipt of the property or by the revenue officer preparing and leaving a list of such property
An immediate step for collection of taxes	Not necessarily so

ACTUAL DISTRRAINT	CONSTRUCTIVE DISTRRAINT
<b>Both</b> Are summary remedies for the collection of taxes; <i>NOTE:</i> Refer only to personal property; and cannot be availed of where the amount of the tax involved is not more than P100	

### REQUISITES FOR THE EXERCISE OF THE REMEDY OF DISTRRAINT

1. The taxpayer must be delinquent (except in constructive distrainment) in the payment of tax;
2. There must be a subsequent demand for its payment (assessment);
3. The taxpayer must fail to pay the tax at the time required; and
4. The period within which to assess or collect the tax has not yet prescribed.

### PERSONS WHO SHALL SEIZE AND DISTRRAINT PERSONAL PROPERTY (ACTUAL DISTRRAINT)

1. Amount of delinquent tax is more than P1,000,000 - Commissioner or his duly authorized representatives.
2. Amount of delinquent tax is P1,000,000 or less - Revenue District Officer. (Sec. 207(A), 1997 NIRC)

### AUTHORITY OF THE COMMISSIONER TO INQUIRE INTO BANK DEPOSIT ACCOUNTS

Distrainment includes garnishment of money even in bank deposits because RA 1405 (Bank Secrecy Law) covers only divulging of information of deposits. No inquiry is made on garnishment for it only earmarks a portion of the deposits.

Notwithstanding any contrary provision of RA 1405, the Commissioner is authorized to inquire into the bank deposits of:

1. a decedent to determine his gross estate
2. a taxpayer who waives his right by reason of financial incapacity to pay his tax liability (Sec.5, NIRC)







PROCEDURES FOR THE ACTUAL DISTRAINT OR GARNISHMENT

I  
Commencement of distraint proceedings

Either by the CIR or his duly authorized representative; or by the Revenue District Officer

II  
Service of Warrant of Distraint (Sec. 208)

With respect to:

1. Personal property -
  - (a) upon the owner of the goods, chattels, or other personal property; or
  - (b) upon the person from whose possession such properties are taken.
2. Stocks and other securities
  - (a) upon the taxpayer; and
  - (b) upon the president, manager, treasurer or other responsible officer of the corporation, company or association which issued the said stock and securities.
3. Bank accounts shall be garnished by serving a warrant of distraint -
  - (a) upon the taxpayer; and
  - (b) upon the president, manager, treasurer, or other responsible officer of the bank.

*Note:* Upon receipt of the warrant of distraint, the bank shall turn over to the Commissioner so much of the bank accounts as may be sufficient to satisfy the claim of the government.

4. Debts and credits -
  - (a) persons owing or having in his possession the debts;
  - (b) or under his control such credits; or
  - (c) upon his agent.

*Note:* The warrant of distraint shall be sufficient authority to the person owing the debts or having in his possession or under his control any credits belonging to the taxpayer to pay to the Commissioner the amount of such debts or credits.

Taxpayer must sign receipt

III  
Posting of Notice (Sec. 209, NIRC)

Notice specifying the time and place of sale and the articles distrained. The posting shall be made in not less than two (2) public places in the city or municipality where the distraint is made. One place for posting of such notice is at the Office of the Mayor of such city or municipality.

IV  
Sale of Property Distrained

THE TAXPAYER'S PROPERTY MAY BE PLACED UNDER CONSTRUCTIVE DISTRAINT WHEN HE

1. is retiring from any business subject to tax;
2. is intending to -
  - a. leave the Philippines,
  - b. remove his property therefrom,
  - c. hide or conceal his property,
3. is performing any act tending to obstruct the proceeding for collecting the tax due or which may be due from him (Sec. 223, 1997 NIRC).





**PROCEDURE FOR THE CONSTRUCTIVE DISTRRAINT OF PERSONAL PROPERTY**

**Taxpayer's obligation to preserve**

CIR shall require the taxpayer or any person having possession or control of such property to

- (a) sign a receipt covering the property distrained and
- (b) obligate himself to
  1. preserve the same intact and unaltered and
  2. not to dispose of the same in any manner whatsoever without the express authority of the Commissioner of Internal Revenue.



**Remedy when taxpayer didn't sign receipt**

If the taxpayer or person in possession of the property refuses or fails to sign the receipt referred to, the revenue officer effecting the constructive distraint shall

- (a) proceed to prepare a list of such property and
- (b) in the presence of two (2) witnesses leave a copy thereof in the premises where the property distrained is located, after which the said property shall be deemed to have been placed under constructive distraint.

**(3) LEVY**

**DEFINITION:** It refers to the act of seizure of real property in order to enforce the payment of taxes. The property may be offered in a public sale, if after seizure, the taxes are not voluntarily paid.

**REQUISITES FOR THE EXERCISE OF THE REMEDY OF LEVY**

Same as in the remedy of distraint.

**WHEN MAY LEVY BE EFFECTED?**

Real property may be levied upon before, simultaneously, or after the distraint of personal property belonging to the delinquent [Sec. 207(B), 1997 NIRC]; and the remedy by distraint and levy may be repeated if necessary until the full amount, including all expenses, is collected (Sec. 217, 1997 NIRC).

**PROCEDURE OF LEVY ON REAL PROPERTY**

**I  
Prepare Certificate of Levy**

I  
Preparation of a duly authenticated certificate containing:

- (a) description of the property levied;
- (b) name of the taxpayer, and
- (c) the amounts of tax and penalty due from him. This certificate shall operate with the force of a legal execution throughout the Philippines (Sec. 207B, 1997 NIRC).



**II  
Service of Notice**

Service of written notice to:

- (a) the delinquent taxpayer; or
- (b) if he is absent from the Philippines, to his agent or manager of the business in respect to which the liability arose; or
- c. to the occupant of the property.
- d. the proper Register of Deeds shall also be notified of the levy (Sec. 207B, 1997 NIRC).



**III  
Advertisement of the Time and Place of Sale**

The advertisement shall contain:

1. the amount of tax and penalties due;
2. name of the taxpayer against whom taxes are levied;





3. short description the property to be sold.

The advertisement shall be made within 20 days after the levy, and the same shall be for a period of at least 30 days. It shall be effectuated by:

- posting a notice at the main entrance of the municipal building or city hall and in a public and conspicuous place in the barrio or district in which the real property lies; and
- by publication once a week for 3 weeks in a newspaper of general circulation in the municipality or city where the property is located (Sec. 213, CTRP).



#### DISTRAINT VS. LEVY

DISTRAINT	LEVY
Refers to personal property	Refers to real property
Forfeiture by the government is not provided	Forfeiture is authorized
The taxpayer is not given the right of redemption with respect to distrained personal property.	The right of redemption is granted in case of real property levied upon and sold, or forfeited to the government.
<b>Both</b> <ul style="list-style-type: none"> <li>Are summary remedies for the collection of taxes; and</li> <li>Cannot be availed of where the amount of the tax involved is not more than P100</li> </ul>	

#### REDEMPTION OF PROPERTY SOLD

Within 1 year from the date of sale, the property may be redeemed by the delinquent taxpayer or anyone from him, upon payment of the taxes, penalties

and interest thereon from the date of delinquency to the date of sale, together with interest on purchase price at 15% per annum from the date of sale to the date of redemption. (Sec. 214, NIRC).

#### FORFEITURE TO THE GOVERNMENT

If there is no bidder in the public sale or if the amount of the highest bid is insufficient to pay the taxes, penalties and costs, the real property shall be forfeited to the Government.

#### FURTHER DISTRAINT AND LEVY

The remedy of distraint and levy *may be repeated* if necessary until the full amount of the tax delinquency due including all expenses is collected from the taxpayer. Otherwise, a clever taxpayer who is able to conceal most of the valuable part of his property would escape payment of his tax liability by sacrificing an insignificant portion of his holdings.

#### (4) TAX LIEN

**DEFINITION:** It is a legal claim or charge on property, either real or personal, established by law as a security in default of the payment of taxes (51 AmJur 881). Generally, it attaches to the property irrespective of ownership or transfer thereof.

#### EXTENT AND NATURE

The tax, together with interests, penalties, and costs that may accrue in addition thereto is a *lien upon all property and rights to property belonging to the taxpayer*.

The lien shall not be valid against any mortgagee, purchaser, or judgment creditor until notice of such lien shall be filed by the Commissioner of Internal Revenue in the Office of the Register of Deeds of the province or city where the property of the taxpayer is situated or located (Sec. 219, 1997 NIRC).





#### WHEN DOES IT ATTACH?

Not only from the service of the warrant of distraint but from the time tax became due and payable.

#### LIEN VS. DISTRAINT

LIEN	DISTRAINT
Directed against the property subject to the tax	Need not be directed against the property subject to tax
Regardless of the owner of the property	Property seized must be owned by the taxpayer

#### (5) CIVIL ACTIONS

**DEFINITION:** For tax remedy purposes, these are actions instituted by the government to collect internal revenue taxes. It includes filing by the government with the probate court claims against the deceased taxpayer.

#### WHEN RESORTED TO?

1. When a tax is assessed but the assessment becomes final and unappealable because the **taxpayer fails to file an administrative protest with the CIR within 30 days from receipt**; or
2. When a protest against assessment is filed and a decision of the CIR was rendered but the said decision becomes final, executory, and demandable for **failure of the taxpayer to appeal the decision to the CTA within 30 days from receipt of the decision**.

**NOTE:** Judicial action may be resorted to even *before assessment* although impractical, as stated in *Sec. 203, 1997 NIRC*, "... and no proceeding in court without assessment for the collection of such taxes shall be begun *after* the expiration of such (3year) period."

It should be noted that no civil or criminal action for the recovery of

taxes shall be filed in court without the approval of the Commissioner.

#### WHERE TO FILE

1. **Court of Tax Appeals** - where the principal amount of taxes and fees, exclusive of charges and penalties claimed is *One million pesos and above*.
2. **Regional Trial Court, Municipal Trial Court, Metropolitan Trial Court** - where the principal amount of taxes and fees, exclusive of charges and penalties claimed is *less than One million pesos*. (*Sec. 7, RA No. 9282*)

**THE APPROVAL OF THE CIR IS ESSENTIAL IN CIVIL CASES.** However, under *Sec. 7, 1997 NIRC*, the Commissioner may delegate such power to a Regional Director.

#### DEFENSES WHICH ARE PRECLUDED BY FINAL AND EXECUTORY ASSESSMENTS

1. Invalidity or illegality of the assessment; and
2. Prescription of the government's right to assess.

#### (6) CRIMINAL ACTIONS

The judgment in the criminal case shall not only impose the penalty but shall also order the payment of taxes subject of the criminal case as finally decided by the Commissioner (*Sec. 205, NIRC*).

#### WHERE TO FILE

1. **Court of Tax Appeals** - on criminal offenses arising from violations of the NIRC or TCC and other laws administered by the BIR and the BOC, where the principal amount of taxes and fees, exclusive of charges and penalties claimed is *One million pesos and above*.
2. **Regional Trial Court, Municipal Trial Court, Metropolitan Trial Court** - on criminal offenses arising from violations of the NIRC or TCC and other laws administered by the BIR and the BOC, where the principal





amount of taxes and fees, exclusive of charges and penalties claimed is *less than One million pesos or where there is no specified amount claimed.* (Sec. 7, RA No. 9282)

#### IMPORTANT CONSIDERATIONS

11. No criminal action shall be begun without the approval of the Commissioner. (Sec. 220, 1997 NIRC)
12. It shall be brought in the name of the Government and shall be conducted by the legal officers of the BIR.

#### EFFECT OF ACQUITTAL OF THE TAXPAYER IN A CRIMINAL ACTION

It does not necessarily result in the exoneration of said taxpayer from his civil liability to pay taxes.

**Rationale:** The duty to pay tax is imposed by statute prior to and independent of any attempt on the part of the taxpayer to evade payment. It is not a mere consequence of the felonious acts charged, nor is it a mere civil liability derived from a crime. (*Republic vs. Patanao*, GR No. L-14142, May 30, 1961)

#### EFFECT OF SUBSEQUENT SATISFACTION OF CIVIL LIABILITY

The subsequent satisfaction of civil liability by payment or prescription *does not extinguish* the taxpayer's criminal liability.

#### NO SUBSIDIARY IMPRISONMENT

In case of *insolvency* on the part of the taxpayer, subsidiary imprisonment cannot be imposed as regards the *tax which he is sentenced to pay*.

However, it may be imposed in cases of failure to pay the fine imposed. (Sec. 280, 1997 NIRC)

#### CRIMINAL ACTION MAY BE FILED DURING THE PENDENCY OF AN ADMINISTRATIVE PROTEST IN THE BIR

It is not a requirement for the filing thereof that there be a precise computation and assessment of the tax, since what is involved in the criminal action is not the collection of tax but a **criminal prosecution for the violation of the NIRC**. *Provided, however*, that there is a **prima facie** showing of a **willful attempt** to evade taxes. (*See Ungab vs. Cusi*, GR Nos. L-41919-24, May 30, 1980 in relation to *Commissioner vs. Court of Appeals*, GR No. 119322, June 4, 1996)

#### (7) FORFEITURE

**DEFINITION:** divestiture of property without compensation, in consequence of a default or offense.

#### ENFORCEMENT OF THE REMEDY OF FORFEITURE

- a. **In case of personal property** - The forfeiture of chattels and removable fixtures of any sort is enforced by **seizure and sale or destruction** of the specific forfeited property.
- b. **In case of real property** - The forfeiture of real property is enforced by a **judgment of condemnation and sale** in a legal action or proceeding, civil or criminal, as the case may require.
- c. **In case of distilled spirits, liquors, cigars, cigarettes manufactured, products of tobacco and apparatus used for their production** - Upon forfeiture, may be destroyed by order of the Commissioner where the sale may be injurious to public health or prejudicial to law enforcement.





- d. Other articles subject to excise tax which have been manufactured or removed in violation of the Code, dies for printing or making fake revenue stamps and labels - Upon forfeiture may be sold or destroyed at the discretion of the Commissioner. Forfeited property shall not be destroyed until at least 20 days from seizure.

P 1 M per case, whichever is lower, shall be given to persons instrumental in the discovery and seizure of such smuggled goods.

\* This does not apply to all public officials whether incumbent or retired, who acquired the information in the course of performance of their duties during their incumbency.

#### EFFECT OF THE FORFEITURE OF PROPERTY

The effect is to transfer the title to the specific thing from the owner to the government. All the proceeds in case of a sale go to the coffers of the government (*U.S. vs. Surla, GR No. 6536, September 2, 1911*). In seizure for the enforcement of a tax lien, the residue, after deducting the tax liability and expenses will go to the taxpayer (*Bank of the Phil. Island vs. Trinidad, GR No. 16014, October 4, 1941*).

#### INFORMER'S REWARD (Sec 282)

A. For violations of the NIRC, a reward of 10% of the revenues, surcharges, or fees **recovered** and/or fine or penalty imposed and **collected** or P 1 M per case, whichever is lower shall be given to:

1. any person who voluntarily gives definite and sworn information not yet in the possession of the BIR leading to the discovery of fraud upon the Internal Revenue Laws and/or any violations thereof
2. an informer where the offender has offered to compromise the violation of law committed by him and his offer has been accepted and **collected** by the CIR. This excludes an Internal Revenue Officer/employee or other public official/employee, or his relative within the sixth degree

\* This shall not refer to a case already pending or examined by the CIR

B. For the discovery and seizure of smuggled goods

- a reward of 10% of the FMV of the smuggled and confiscated goods or

### PREScriptive PERIODS FOR THE ASSESSMENT AND COLLECTION OF TAXES

#### RATIONALE OF PRESCRIPTIVE PERIODS

Such periods are designated to secure the taxpayers against unreasonable investigation after the lapse of the period prescribed. They are also beneficial to the government because tax officers will be obliged to act promptly.

#### RULES ON PRESCRIPTION

1. When the tax law itself is silent on prescription, the tax is **imprescriptible**;
2. When no return is required, tax is **imprescriptible**;  
*Note: Remedy of taxpayer is to file a return.*
3. Defense of prescription is **waivable**;

#### WHAT CONSTITUTES ASSESSMENT?

An assessment contains not only a computation of tax liabilities but also a demand for payment within a prescribed period.

### PREScriptive PERIOD FOR THE ASSESSMENT OF TAXES

#### General Rule:

*Three (3) years* after the date the return is due or filed, whichever is later (*Sec. 203, 1997 NIRC*).







**Exceptions:**

1. **Failure to file a return:** ten (10) years from the date of the discovery of the omission to file the return (*Sec.222[A]*);
2. **False or fraudulent return with intention to evade the tax:** ten (10) years from the date of the discovery of the falsity or fraud (*Sec.222 [A]*);

*Note:* Nothing in Section 222(A) shall be construed to authorize the examination and investigation or inquiry into any tax return filed in accordance with the provisions of any tax amnesty law or decree.

- Fraud must be *alleged and proved as a fact*. It must be the product of a deliberate intent to evade taxes. It may be established by the:
  - a. Intentional and substantial understatement of tax liability by the taxpayer;
  - b. Intentional and substantial overstatement of deductions of exemptions; and/or
  - c. Recurrence of the above circumstances
- Falsity constitutes a deviation from the truth due to *mistake, carelessness or ignorance*.

**There is fraud in the following decided cases:**

1. Fraud must be the product of a deliberate intent to evade taxes (*Jalandoni vs. Republic*)
2. Simple statement that return filed was not fraudulent does not disprove existence of fraud (*Tayengco vs. Collector*)
3. Substantial under-declarations of income for six consecutive five years demonstrate fraudulence of return (*Perez vs. CTA*)
4. Presence of fictitious expenses, with no evidence presented, proves existence of fraud (*Tan Guan vs. Commissioner*)

However, the courts did not consider the tax returns filed as false or fraudulent with intent to evade payment of tax in the following cases:

- a. Mere understatement in the tax return will not necessarily imply fraud (*Jalandoni vs. Republic*)
  - b. Sale of a real property for a price less than its fair market value is not necessarily a false return (*Commissioner vs. Ayala Securities*)
  - c. Fraud is a question of fact and the circumstances constituting fraud must be alleged and proved in the trial court (*Commissioner vs. Ayala Securities*)
  - d. Fraud is never imputed and the courts never sustain findings of fraud upon circumstances that only create suspicion (*Commissioner vs. Javier*)
  - e. Mistakes of revenue officers on three different occasions remove element of fraud (*Aznar vs. CTA and Collector*)
3. **Agreement in writing** to the extension of the period to assess between the CIR and the taxpayer before the expiration of the 3-year period. NB: The extended period agreed upon can further be extended by a subsequent written agreement made before the expiration of the extended period previously agreed upon (*Sec. 222[b]*).
  4. **Written waiver of renunciation** of the original three (3) year limitation, signed by the taxpayer (*Sambrano vs. Court of Tax Appeals, GR No. L-8652, March 30, 1957*).

*Note:* Notice of the assessment is released, mailed or sent to the taxpayer also within the 3 year period. It is *not required that the notice be received by the taxpayer within the prescribed period*. But the sending of the notice must clearly be proven. (*Basilan Estate, Inc. vs. Commissioner, GR No. L-22492, September 5, 1967*)

**AMENDMENT OF RETURN**

If the amended return is *substantially different* from the original return, the prescriptive period shall be





counted from the filing of the amended return. But the said period shall run from the filing of the original return if the same is sufficiently complete to enable the Commissioner to make a proper assessment. (*Commissioner vs. Phoenix Assurance Co., GR No. L-19727, May 20, 1965*)

**When Substantive:**

- a. substantial under declaration (exceeding 30% of that declared) of taxable sales, receipts or income,
- b. or a substantial overstatement (exceeding 30% of deductions) (Sec. 248)

**PRESCRIPTIVE PERIOD FOR THE COLLECTION OF TAXES**

**General Periods:**

*Five (5) years* - from assessment or within period for collection agreed upon in writing before expiration of the 5-year period (Sec. 222, 1997 NIRC).

*Ten (10) years* - without assessment in case of false or fraudulent return with intent to evade or failure to file return (Sec. 222, 1997 NIRC).

**WHAT IS THE PRESCRIPTIVE PERIOD WHERE THE GOVERNMENT'S ACTION IS ON A BOND WHICH THE TAXPAYER EXECUTES IN ORDER TO SECURE THE PAYMENT OF HIS TAX OBLIGATION?**

*Ten (10) years* under Art. 1144(1) of the Civil Code and not three (3) years under the NIRC. In this case, the Government proceeds by court action to forfeit a bond. The action is for the enforcement of a contractual obligation. (*Republic vs. Araneta, GR No. L-14142, May 30, 1961*)

**GROUND FORS FOR SUSPENSION OF THE RUNNING OF THE STATUTE OF LIMITATIONS**

- a. When the CIR is prohibited from making the assessment or beginning the distraint or levy or a proceeding in court, and for sixty (60) days thereafter;

- b. When the taxpayer requests for a reconsideration which is granted by the CIR;
- c. When the taxpayer cannot be located in the address given by him in the return, unless he informs the CIR of any change in his address.
- d. When the warrant of distraint or levy is duly served, and no property is located; and
- e. When the taxpayer is out of the Philippines (Sec. 223, 1997 NIRC).

**A TAX RETURN IS CONSIDERED FILED FOR PURPOSES OF STARTING THE RUNNING OF THE PERIOD OF LIMITATIONS IF**

- a. The return is valid - it has complied substantially with the requirements of the law; and
- b. The return is appropriate - it is a return for the particular tax required by law.

*Note:* A defective tax return is the same as if no return was filed at all.

**PRESCRIPTIVE PERIOD FOR THE VIOLATION OF ANY PROVISION OF THE TAX CODE (SEC. 281, 1997 NIRC)**

1. Should be filed within *five (5) years* from the (a) day of the *commission of the violation* of the law, and if the same be not known, from the (b) *discovery thereof and the institution of the judicial proceedings* for its investigation and punishment.
2. Illustrative case: (*Lim vs. Court of Appeals GR Nos. 48134-37, October 18, 1990*)
  - a. charge is **failure or refusal to pay** deficiency income tax - committed *only* after the finality of the assessment coupled with the taxpayer's willful refusal to pay the taxes within the allotted period. (i.e. cannot be committed upon filing the return)





- b. charge is filing of false or fraudulent return with intent to evade the assessment - in addition to the fact of discovery, there must be a judicial proceeding for the investigation and punishment of the tax offense before the 5 year prescriptive period begins to run.

## II. TAX REMEDIES OF THE TAXPAYER

### GENERAL REMEDIES

#### A. ADMINISTRATIVE

##### Before Payment

- a. Protest - filing a petition for reconsideration or reinvestigation within 30 days from receipt of assessment. Within 60 days from filing of protest, all relevant supporting documents should have been submitted, otherwise, the assessment shall become final - cannot be appealed (Sec. 228, 1997 NIRC).

*Note:* Submission of documents within the 60 day period is optional to the taxpayer.

"That the relevant supporting documents mentioned in the law refers to such documents which the taxpayer feels would be necessary to support his protest and not what the Commissioner feels should be submitted, otherwise, taxpayer would always be at the mercy of the BIR which may require production of such documents which taxpayer could not produce." (Standard Chartered Bank vs. CIR, CTA Case No. 5696, August 16, 2001)

A protest is a vital document which is a formal declaration of resistance of the taxpayer. It is a repository of all arguments. It can be used in court in case administrative remedies have been exhausted. It is also the formal act of the taxpayer questioning the official actuation of the CIR. This is equivalent to a pleading.

- b. Entering into a compromise (Sec. 204, 1997 NIRC).

##### After Payment

Filing of claim for refund or tax credit within 2 years from date of payment regardless of any supervening cause (Sec. 229, 1997 NIRC).

#### B. JUDICIAL

##### Civil Action

- a. Appeal to the Court of Tax Appeals - within 30 days from receipt of decision on the protest or from the lapse of 180 days due to inaction of the Commissioner (Sec. 228, 1997 NIRC).

- b. Action to contest forfeiture of chattel, at any time before the sale or destruction thereof, to recover the same, and upon giving proper bond, enjoin the sale; or after the sale and within 6 months, an action to recover the net proceeds realized at the sale (Sec. 231, 1997 NIRC); and

- c. Action for damages against a revenue officer by reason of any act done in the performance of official duty (Sec. 227, 1997 NIRC).

##### Criminal Action

- a. Filing of criminal complaint against erring BIR officials and employees.
- b. Injunction - when the CTA in its opinion, the collection by the BIR may jeopardize taxpayer.

*Note:* With the enactment of the new CTA law (RA No. 9282) amending RA No. 1125, CTA now has jurisdiction over





criminal cases. (See Chapter VI - Court of Tax Appeals.)

### Substantive Remedies

1. Questioning the constitutionality or validity of tax statutes or regulations
2. Non-retroactivity of rulings (Sec. 246, NIRC)
3. Failure to inform the taxpayer in writing of the legal and factual bases of assessment makes it void (Sec. 228, NIRC)
4. Preservation of books of accounts and once a year examination (Sec. 235, NIRC)

### ASSESSMENT AND PROTEST

#### ➤ Assessment

**General rule:** Taxes are self assessing and thus, do not require the issuance of an assessment notice in order to establish the tax liability of a taxpayer.

**Exceptions:**

1. Tax period of a taxpayer is terminated (Sec. 6(D), NIRC)
2. Deficiency tax liability arising from a tax audit conducted by the BIR (Sec. 56(B), NIRC)
3. Tax lien (Sec. 219, NIRC)
4. Dissolving Corporation (Sec. 52(c), NIRC)

#### ➤ Protest

##### 1. Direct denial of protest

**Administrative decision on a disputed assessment** - The decision of the Commissioner or his duly authorized representative shall (a) state the facts, the applicable law, rules and regulation or jurisprudence on which such decision is based otherwise, the decision shall be void, in which case the same shall not be considered a decision a disputed assessment and (b) that the same is his final decision (Sec. 3.1.5, Rev. Regs. No. 12-99)

##### 2. Indirect denial of protest

- a. Commissioner did not rule on the taxpayer's motion for reconsideration of the assessment - it was only when respondent received the summons on

the civil action for the collection of deficiency income tax that the period to appeal commenced to run (*Commissioner vs. Union Shipping Corp.*)

- b. Referral by the Commissioner of request for reinvestigation to the Solicitor General (*Republic vs Lim Tian Teng Sons*)
- c. Reiterating the demand for immediate payment of the deficiency tax due to taxpayer's continued refusal to execute waiver (*Commissioner vs. Ayala Securities Corp.*)
- d. Preliminary collection letter may serve as assessment notice (*United International Pictures vs. Commissioner*)

### ACTS OF BIR COMMISSIONER CONSIDERED AS DENIAL OF PROTEST WHICH SERVE AS A BASIS FOR APPEAL TO THE COURT OF TAX APPEALS

1. filing by the BIR of a civil suit for collection of the deficiency tax (*Commissioner vs. Union Shipping Corporation, GR No. 66160, May 21, 1990*)
2. indication to the taxpayer by the Commissioner "in clear and unequivocal language" of his final denial. (*Commissioner vs. Union Shipping Corporation, GR No. 66160, May 21, 1990*)
3. BIR demand letter reiterating his previous demand to pay, sent to the taxpayer after his protest of the assessment. (*Surigao Electric Co., Inc. vs. CTA, GR No. L-25289, June 28, 1974; Commissioner vs. Ayala Securities Corporation, GR No. L-29485, March 31, 1976*)
4. The actual issuance of a warrant of distraint and levy in certain cases cannot be considered a final decision on a disputed settlement. (*Commissioner vs. Union Shipping Corporation, GR No. 66160, May 21, 1990*)





## FILING OF CLAIM FOR TAX REFUND OR TAX CREDIT

### GROUND FOR FILING A CLAIM FOR TAX REFUND OR TAX CREDIT

1. Tax is collected erroneously or illegally.
2. Penalty is collected without authority.
3. Sum collected is excessive.

### TAX REFUND VS. TAX CREDIT

TAX REFUND	TAX CREDIT
The taxpayer asks for restitution of the money paid as tax	The taxpayer asks that the money so paid be applied to his existing tax liability
Two-year period to file claim with the CIR starts after the payment of the tax or penalty	Two-year period starts from the date such credit was allowed (in case credit is wrongly made).

### REQUISITES OF TAX REFUND OR TAX CREDIT

1. Claim must be in writing;
2. It must be filed with the Commissioner within two (2) years after the payment of the tax or penalty.  
*Note:* No suit or proceeding shall be begun after the expiration of the said two (2) years regardless of any supervening cause that may arise after payment.
3. Show proof of payment.

### COMMENCEMENT OF THE TWO (2) YEAR PERIOD (JURISPRUDENCE)

1. Tax sought to be refunded is illegally or erroneously collected
  - from the date the tax was paid. (*Commissioner vs. Victorias Milling, GR No. L-24108, January 31, 1968*)
2. Tax is paid only in installments or only in part
  - from the date the last or final installment or payment because for

tax purposes, there is no payment until the whole or entire tax liability is fully paid. (*Collector vs. Prieto, GR No. L-11976, August 29, 1961*)

3. Taxpayer merely made a deposit
  - counted from the conversion of the deposit to payment (*Union Garment vs. Collector, CTA Case No. 416, November 17, 1958*)
  - Merely making a deposit is not equivalent to payment until the amount is actually applied to the specific purpose for which it was deposited.
4. Tax has been withheld from source (through the withholding tax system)
  - counted from the date it falls due at the end of the taxable year
  - A taxpayer who contributes to the withholding tax system does not really deposit an amount to the government, but in truth, performs and extinguishes his tax obligation for the year concerned. (*Gibbs vs. Commissioner, GR No. L-17406, November 29, 1965*)
5. End of taxable year vs. date of the filing of the final adjusted return
  - from the date when the final adjusted return was filed.
  - the rationale in computing this period is the fact that it is only then the corporation can ascertain whether it made profits or incurred losses in its business operations. (*ACCRA Investments vs. Court of Appeals, GR No. 96322, December 20, 1991*)
6. Date when quarterly income tax was paid vs. date when final adjusted return was filed
  - from the date when final adjusted return was filed
  - The filing of the quarterly income tax return (Sec. 68) and payment of quarterly income tax should only be considered mere installments of the annual tax due. (*Commissioner vs. TMX Sales, GR No. 83736, January 15, 1992*)
7. Date when the final adjustment return was actually filed (ex. Apr. 2) vs. Last day when the adjustment return could still be filed (ex. Apr. 15)







- from the date the final adjustment return was actually filed. (*Commissioner vs. Court of Appeals, GR No. 117254, January 21, 1999*)
- 8. Tax was not erroneously or illegally paid but the taxpayer became entitled to refund because of supervening circumstances
  - from the date the taxpayer becomes entitled to refund and not from the date of payment. (*Commissioner vs. Don Pedro Central Azucarera, GR No. L-28467, Feb. 28, 1973*)

**PAYMENT UNDER PROTEST IS NOT NECESSARY UNDER NIRC**

A suit or proceeding for tax refund may be maintained "whether or not such tax, penalty or sum has been paid under protest or duress" (Sec. 229, NIRC).

*Note:* Similarly, payment under protest is *not necessary* in refund for local taxes. (See Sec. 196, LGC).

However, payment under protest is necessary in claim for refund for real property taxes (Sec. 252, LGC) and for customs duties (Sec. 2308, TCC).

**SUSPENSION OF THE TWO-YEAR PRESCRIPTIVE PERIOD**

1. There is a pending litigation between the Government and the taxpayer; and
2. CIR in that litigated case agreed to abide by the decision of the SC as to the collection of taxes relative thereto (*Panay Electric Co. vs. Collector, GR No. L-10574, May 28, 1958*).

**INTEREST ON TAX REFUNDS**

**General Rule:**

Government *cannot be required to pay interest* on taxes refunded to the taxpayer in the absence of a statutory provision clearly or expressly directing or authorizing such payment. (*Commissioner vs. Sweeney, GR No. L-12178, August 29, 1959*)

**Exceptions:**

1. When the CIR acted with patent arbitrariness. Arbitrariness presupposes inexcusable or obstinate disregard of legal provisions. (*Commissioner vs. Victorias Milling, GR No. L-19667, Nov. 29, 1966*)
2. Under Sec. 79(C)(2) with respect to income taxes withheld on the wages of the employees.

**TAX CREDIT CERTIFICATE**

1. May be applied against any internal revenue tax *except* withholding taxes,
2. Original copy is surrendered to the revenue office,
3. No tax refund will be given resulting from availment of incentives granted by law where no actual payment was made (Sec. 204C, 1997 NIRC).

**FORFEITURE OF CASH REFUND/TAX CREDIT**

1. Forfeiture of refund in favor of the government when a refund check or warrant remains unclaimed or uncashed within five (5) years from date of mailing or delivery.
2. Forfeiture of Tax Credit - a tax credit certificate which remains unutilized after five (5) years from date of issue, shall be invalid, unless revalidated (Sec. 230, 1997 NIRC).

**REGLEMENTARY PERIODS  
IN INCOME TAX IMPOSED  
BY LAW UPON THE TAXPAYER  
(PURSUANT TO REV. REG. NO. 12-99,  
SEC. 228 OF THE 1997 NIRC, AND RA  
NO. 1125 AS AMENDED BY RA NO.  
9282)**

BIR makes a **tax assessment**



If taxpayer is not satisfied with the assessment **file a protest within 30 days** from receipt thereof







Submit supporting documents within 60 days from date of the filing of the protest



If protest is denied, **elevate the matter** to the Commissioner of Internal Revenue (CIR) **within 30 days** from receipt of the decision of the CIR's duly authorized representative officer



**Appeal to the Division of the Court of Tax Appeals (CTA) within 30 days** from receipt of final decision of CIR or his duly authorized representative (the taxpayer has the option to appeal straight to the CTA upon receipt of the decision of the CIR's duly authorized representative)



If the CIR or his duly authorized representative **fails to act on the protest within 180 days** from date of submission by taxpayer, the latter may **appeal within 30 days** from lapse of the 180-day period with the CTA Division



The Party adversely affected by the CTA Division's decision may file one motion for reconsideration/new trial **within 15 days** from receipt of decision. If the MR is denied file a petition for review with the CTA en banc



**Appeal to the Supreme Court within 15 days** from receipt of the CTA en banc decision under Rule 45 of the Rules of Court

#### PRE-ASSESSMENT NOTICE, WHEN NOT REQUIRED (SEC. 228, NIRC)

1. When the finding for any deficiency tax is the result of mathematical error in the computation of the tax as appearing on the face of the return; or
2. When a discrepancy has been determined between the tax withheld and the amount actually remitted by the withholding agent; or
3. When a taxpayer who opted to claim a refund or tax credit of

excess creditable withholding tax for a taxable period was determined to have carried over and automatically applied the same amount claimed against the estimated tax liabilities for the taxable quarter or quarters of the succeeding taxable year; or

4. When the excise tax due on excisable articles has not been paid;
5. When an article locally purchased or imported by an exempt person, such as, but not limited to, vehicles, capital equipment, machineries and spare parts, has been sold, traded or transferred to non-exempt persons.

#### Notes:

- As a general rule, payment under protest is not required under the NIRC, except when partial payment of uncontroverted taxes is required under RR 12-99. The Commissioner may, even without a written claim therefor, refund or credit any tax, where on the face of the return upon which payment was made, such payment appears clearly to have been erroneously paid.
- In case of the CIR's final denial of the claim for refund, the 30-day period to appeal with the CTA must be within the 2-year peremptory period for instituting judicial action.

- ❖ See Annex N - Assessment Process and Appeal

### ADDITIONS TO THE TAX (SECS. 247-252 NIRC)

**DEFINITION:** increments to the basic tax incident due to the taxpayer's non-compliance with certain legal requirements.





## 1. CIVIL PENALTY / SURCHARGE

### 1. 25% surcharge

- a. Failure to file any return and pay the tax due thereon as required under the provisions of this Code or rules and regulations on the date prescribed; or
- b. Unless otherwise authorized by the Commissioner, filing a return with an internal revenue officer other than those with whom the return is required to be filed; or
- c. Failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment; or
- d. Failure to pay the full or part of the amount of tax shown on any return required to be filed under the provisions of this Code or rules and regulations, or the full amount of tax due for which no return is required to be filed, on or before the date prescribed for its payment. (Sec. 248)

### 2. 50% surcharge

- a. in case of willful neglect to file the return within the period prescribed by the Code, or
  - will not apply in case a taxpayer, without notice from the Commissioner, or his duly authorized representative, voluntarily files the said return (only 25% shall be imposed)
  - 50% surcharge shall be imposed in case the taxpayer files the return only after prior notice in writing from the Commissioner or his duly authorized representative (Sec. 4.2, Rev. Reg. 12-99)

- b. in case a false or fraudulent return is willfully made

#### Prima Facie evidence

- substantial underdeclaration (*exceeding 30% of that declared*) of taxable sales, receipts or income,
- or a substantial overstatement (*exceeding 30% of actual deductions*) of deductions (Sec. 248)

## 2. INTEREST

- 20% per annum or such higher rate as may be prescribed by the rules and regulations

- a. Deficiency interest (Sec. 249B)
- b. Delinquency interest (Sec. 249C)
- c. Interest on Extended Payment (Sec. 249D)

## 3. OTHER CIVIL PENALTIES OR ADMINISTRATIVE FINES

- a. Failure to file certain information returns (Sec. 250)
- b. Failure of a withholding agent to collect and remit tax (Sec. 251)
- c. Failure of a withholding agent of refund excess withholding tax (Sec. 252)

## III. LOCAL TAXATION

### POWERS AND LIMITATIONS

#### NATURE AND SOURCE OF LOCAL TAXING POWER (SEE. SEC 5, ART. X, 1987 CONSTITUTION AND SEC. 129, LGC)

The Local Government Unit has the power:

- a. to create its own sources of revenue and
- b. to levy taxes, fees and charges.





Congress cannot enact laws depriving LGU from exercising such power to tax but it may set guidelines and limitations for the exercise.

***Such taxes, fees, and charges shall accrue exclusively to the local government units.***

#### NATURE OF THE TAXING POWER

- a. Not inherent;
- b. Exercised only if delegated to them by law or Constitution;
- c. Not absolute; subject to limitations provided for by law.

Under the present constitutional rule, "where there is neither a grant nor a prohibition by statute, the tax power must be deemed to exist although Congress may provide statutory limitations and guidelines. The basic rationale for the current rule is to safeguard the viability and self-sufficiency of local government units by directly granting them general and broad tax powers." (*Manila Electric Co. vs. Province of Laguna*, G.R. No. 131359)

#### ASPECTS OF LOCAL TAXING POWER

- a. local taxation
- b. real property taxation

#### FUNDAMENTAL PRINCIPLES GOVERNING LOCAL TAXATION (SEC. 130, LGC)

- a. Shall be uniform in each local sub-unit
- b. Shall be equitable and based as much as possible on the taxpayer's ability to pay
- c. Levied for public purposes
- d. Shall not be unjust, excessive, oppressive, or confiscatory
- e. Shall not be contrary to law, public policy, national economic policy, or in restraint of trade
- f. Collection of local taxes and other impositions shall not be let to any person
- g. The revenues collected under the Code shall inure solely to the benefit of, and subject to disposition by, the LGU levying the tax or other imposition unless otherwise specifically provided therein

- h. Each LGU shall, as far as practicable, evolve a progressive system of taxation.

#### LOCAL TAXING AUTHORITY (SEC. 132, LGC)

Shall be exercised by the Sanggunian of the LGU concerned through an appropriate ordinance.

#### POWER TO PRESCRIBE PENALTIES FOR TAX VIOLATIONS AND LIMITATIONS THEREON (SEC. 516, LGC)

1. The Sanggunian is authorized to prescribe fines or other penalties for violations of tax ordinances.
  - a. in no case shall fines be less than P1,000 nor more than P5,000
  - b. nor shall the imprisonment be less than one (1) month nor more than six (6) month.
2. Such fine or other penalty shall be imposed at the discretion of the court.
3. The Sangguniang Barangay may prescribe a fine of not less than P100 nor more than P1,000.

#### POWER TO ADJUST LOCAL TAX RATE (SEC. 191, LGC)

Adjustment of the tax rates as prescribed herein should not be oftener than once every five (5) years, and in no case shall such adjustment exceed ten percent (10%) of the rates fixed under the LGC.

#### POWER TO GRANT LOCAL TAX EXEMPTIONS (SEC. 192, LGC)

Local government units may, through ordinances duly approved, grant tax exemptions, incentives or reliefs under such terms and conditions, as they may deem necessary.

#### TAX EXEMPTIONS EXISTING BEFORE THE EFFECTIVITY OF THE LGC HAS BEEN ABOLISHED (SEC. 193, LGC)

Unless otherwise provided in this Code, tax exemptions or incentives granted to, or presently enjoyed by all persons, whether natural or juridical, including government-owned or controlled corporations are hereby withdrawn upon the effectivity of the





LGC

**except** the following:

8. local water districts,
9. cooperatives duly registered under R.A. No. 6938, non-stock and non-profit hospitals and
10. educational institutions.

The power to grant tax exemptions, tax incentives and tax reliefs shall *not apply to regulatory fees* which are levied under the police power of the LGU.

Tax exemptions shall be conferred through the issuance of a non-transferable tax exemption certificate.

**GUIDELINES FOR THE GRANTING OF TAX EXEMPTIONS, TAX INCENTIVES AND TAX RELIEFS (ART. 282[B], RULES AND REGULATIONS IMPLEMENTING THE LGC)**

**1. On the grant of tax exemptions or tax reliefs:**

- a. the same may be granted in cases of natural calamities, civil disturbance, general failure of crops, or adverse economic conditions such as substantial decrease in prices of agricultural or agri-based products.
- b. The grant shall be through an ordinance.
- c. Any exemption or relief granted to a type or kind of business shall apply to all business similarly situated.
- d. The same shall take effect only during the next calendar year for a period not exceeding 12 months as may be provided in the ordinance.
- e. In the case of shared revenues, the exemption or relief shall only extend to the LGU granting such exemption or relief.

**2. On the grant of tax incentives:**

- a. The same shall be granted only to new investments in the locality and the ordinance shall prescribe the terms and conditions therefore.
- b. The grant shall be for a definite period of not exceeding 1 calendar year.

- c. The grant shall be by ordinance passed prior to the 1<sup>st</sup> day of January of any year.
- d. Any grant to a type or kind of business shall apply to all businesses similarly situated.

**LEVYING OF LOCAL TAXES (LOCAL TAX ORDINANCE)**

**Requisites:**

1. The procedure applicable to local government ordinances in general should be observed (*Sec. 187, LGC*)
2. Procedural details (*Secs. 54, 55, and 59, LGC*):
  - a. necessity of a quorum
  - b. submission for approval by the local chief executive
  - c. the matter of veto and overriding the same
  - d. the publication and affectivity
3. Public hearings are required before any local tax ordinance is enacted (*Sec. 187, LGC*)
4. Within 10 days after their approval, publication in full for 3 consecutive days in a newspaper of general circulation. In absence of such newspaper in the province, city or municipality, then the ordinances may be posted in at least 2 conspicuous and publicly accessible places (*Sec. 189, LGC*)

**RESIDUAL TAXING POWERS OF THE LOCAL GOVERNMENT UNITS (SEC. 186, LGC)**

To levy taxes, fees or charges on any base or subject NOT:

1. Specifically enumerated in LGC
2. Taxed under the provisions of the NIRC, as amended, and
3. Other applicable laws

**Conditions:**

1. That the taxes, fees, or charges shall not be unjust, excessive, oppressive, confiscatory or contrary to declared national policy
2. The ordinance levying such taxes, fees or charges shall not be enacted without any prior public hearing conducted for the purpose.





#### LIMITATIONS OF THE RESIDUAL POWER

1. Constitutional limitations on taxing power
2. Common limitations prescribed in Sec. 133 of the LGC
3. Fundamental principles governing the exercise of the taxing power of the LGUs prescribed under Sec. 130 of the LGC
4. The ordinance levying such residual taxes shall not be enacted without any prior public hearing conducted for the purpose and
5. The principle of preemption.

#### PRINCIPLE OF PREEMPTION OR EXCLUSIONARY DOCTRINE

Where the National Government elects to tax a particular area, it impliedly withholds from the local government the delegated power to tax the same field. This doctrine principally rests on the *intention* of the Congress.

#### Excluded impositions (pursuant to the doctrine of preemption):

- a. Taxes which are levied under the NIRC, unless otherwise provided by LGC of 1991;
- b. Taxes, fees, etc. which are imposed under the Tariffs and Customs Code;
- c. Taxes, fees, etc., the imposition of which contravenes existing governmental policies or which violates the fundamental principles of taxation;
- d. Taxes, fees and other charges imposed under special law.

#### COMMON LIMITATIONS ON LOCAL TAXING POWER (SEC. 133, LGC)

Local government units cannot levy:

1. Income tax, except on banks and other financial institutions;
2. Documentary stamp tax;
3. Estate tax, inheritance, gifts, legacies and other acquisitions *mortis causa* except as otherwise provided
4. Customs duties, registration fees of vessels and wharfage on wharves, tonnage dues and all other kinds of customs fees,

charges and dues except wharfage on wharves constructed and maintained by the local government unit concerned;

5. Taxes, fees, charges and other impositions upon goods carried into or out of, or passing through, the territorial jurisdictions of local government units in the guise of charges for wharfage, tolls for bridges or otherwise.
6. Taxes, fees or charges on agricultural and aquatic products when sold by marginal farmers or fishermen;
7. Taxes on business enterprises certified by the Board of Investments as pioneer or non-pioneer for a period of 6 and 4 years, respectively, from the date of registration;
8. Excise taxes on articles enumerated under the NIRC, as amended, and taxes, fees or charges on petroleum products;
9. Percentage or value-added tax (VAT) on sales, barter or exchanges or similar transactions on goods or services except as otherwise provided herein;
10. Taxes on the gross receipts of transportation contractors and persons engaged in the transportation of passengers or freight by hire and common carriers by air, land or water, except as provided in the Code;
11. Taxes on premiums paid by way of Reinsurance or retrocession;
12. Taxes, fees or charges for the registration of motor vehicles and for the issuance of all kinds of licenses or permits for the driving thereof, except tricycle;
13. Taxes, fees or other charges on Philippine products actually exported, except as otherwise provided in the Code;
14. Taxes, fees or charges on Countryside and barangay business enterprises and *cooperatives* duly registered under R.A. 6810 and R.A. 6938,





(Cooperatives Code of the Philippines) ; and

15. Taxes, fees or charges of any kind on the National Government, its agencies and instrumentalities, and local government units.

#### CLASSIFICATION OF COMMON LIMITATIONS

1. Taxes which are levied under the NIRC unless otherwise provided by the LGC
  - *Numbers 1, 2, 3, 8, 9, 10*
2. Taxes, fees, etc. which are imposed under the Tariffs and Customs Code
  - *Number 4*
3. Taxes, fees and charges where the imposition of which contravenes existing governmental policies or which are violative of the fundamental principles of taxation
  - *Numbers 5, 6, 7, 11, 13, 14, 15*
4. Taxes, fees, and charges imposed under special laws.
  - *Number 12*

#### TAXES AND OTHER IMPOSITIONS THAT THE LOCAL GOVERNMENT MAY LEVY

##### (A) PROVINCES (SECS. 134-141, LGC)

1. Tax on Transfer of Real Property
2. Tax on Business of Printing and Publication
3. Franchise Tax
4. Tax on Sand, Gravel and other Quarry Resources extracted from Public Land
5. Professional Tax
6. Amusement Tax
7. Annual Fixed Tax for every Delivery Truck or Van of Manufacturers or Producers, Wholesalers of, Dealers, or Retailers in, certain products

- ❖ See Annex J for the rates and details.

##### (B) MUNICIPALITIES (SEC. 143, LGC)

#### 1. Municipal Taxes- taxes on the businesses of the following:

- a. On manufacturers, assemblers, repackers, processors, brewers, distillers, rectifiers, and compounders of liquors, distilled spirits, and wines or manufacturers of any article of commerce of whatever kind or
- b. On wholesalers, distributors, or dealers in any article of commerce of whatever kind or
- c. On exporters, and on manufacturers, millers, producers, wholesalers, distributors, dealers or retailers of essential commodities
- d. On retailers
- e. On contractors and other independent
- f. On banks and other financial
- g. On peddlers engaged in the sale of any merchandise or article of commerce
- h. On any business, not otherwise specified in the preceding paragraphs, which the sanggunian concerned may deem proper to tax.

#### 2. Municipal non-revenue fees and charges

The municipality may impose and collect such reasonable fees and charges on business and occupation except professional taxes reserved for provinces. (Sec. 147. LGC)

#### RATES OF TAX WITHIN THE METROPOLITAN MANILA AREA (SEC. 144, LGC)

- Not to exceed by 50% the maximum rates prescribed in the preceding Section.







**PAYMENT OF BUSINESS TAXES**

- a. It shall be payable for every separate or distinct establishment or place where business subject to the tax is conducted and one line of business does not become exempt by being conducted with some other business for which such tax has been paid.
- b. The tax on a business must be paid by the person conducting the same.
- c. In cases where a person conducts or operates 2 or more of the businesses mentioned in Section 143 of LGC
  - which are subject to the *same rate of tax*, the tax shall be computed on the combined total gross sales or receipts of the said 2 or more related businesses.
  - which are subject to *different rates of tax*, the gross sales or receipts of each business shall be separately reported for the purpose of computing the tax due from each business.

❖ See Annex K for the rates and details.

**(C) CITIES  
(SEC. 151, LGC)**

- The city may levy the taxes, fees, and charges which the province or municipality may impose.
- The tax rates that the city may levy *may exceed* the maximum rates allowed for the province or municipality by not more than 50% except the rates of professional and amusement taxes.

**(D) BARANGAYS  
(SEC. 152, LGC)**

Barangays may levy the following taxes, fees, and charges which shall accrue exclusively to them:

- a. **Taxes** - On stores or retailers with fixed business establishments with the gross

- sales or receipts for the preceding calendar year of P50,000 or less (for barangays in the cities) and P30,000 or less (for barangays in municipalities)
- b. **Rate** = not exceeding 1% of such gross sales or receipts.
- c. **Service Fees or Charges** - For services rendered in connection with the regulation or the use of barangay-owned properties or service facilities such as palay, copra or tobacco dryers
- d. **Barangay Clearance** - No city or municipality may issue any license or permit fee for any business or activity unless a clearance is first obtained from the barangay where such business or activity is located or conducted.
- e. **Other Fees and Charges** - The barangay may levy reasonable fees and charges:
  1. On Commercial breeding of fighting cocks, cockfights and cockpits;
  2. On places of Recreation which charge admission fees; and
  3. On Billboards, signboards, neon signs and outdoor advertisements.

**SITUS OF LOCAL TAXATION**

**A. Situs According to the Cases**

With respect to excise tax, the tax is upon the performance of an act, enjoyment of a privilege or the engaging in an occupation. The power to levy such tax is not dependent on the domicile of the taxpayer, but on the place in which the act is performed or the occupation is engaged in; not upon the location of the office, but the place where the sale is perfected. (*Allied Thread Co., Inc. v. City Mayor of Manila, L-40296*)

With respect to sale, it is the place of the consummation of the sale, associated with the delivery of the things which are the subject matter of the contract that determines the situs of the contract for purposes of taxation, and not merely the place of the





perfection of the contract. (*Shell Co., Inc. v. Municipality of Sipocot, Camarines Sur 105 Phil 1263*)

#### B. Situs According to Sec. 150, LGC

**Branch or sales office** - a fixed place in the locality which conducts the operation of the business as an extension of the principal office

**Principal office**- the head or the main office of the business; the city or the municipality specifically mentioned in the Articles of Incorporation or official registration papers as being the official address of said principal office shall be considered the situs thereof.

1. Place of sale (with branch or sales outlet therein):
  - Municipality or city where the branch or outlet is located.
2. Place of sale (no branch or sales outlet):
  - Municipality or city of principal office (not in the place of sale)
3. If manufacturer, assembler, contractor, producer, or exporter (MACPE) with factory, project office, plant or plantation (FPPP)
4. 30% of recorded sales in the principal office: city or municipality where the principal office is located
5. 70% of recorded sales in the principal office: city or municipality where the FPPP is located
  - pro rata if FPPP are located in different municipalities or cities in proportion to their respective volumes of production.
6. If plantation is located in some other place than where the factory is located, the foregoing 70% shall be subdivided as follows:
  - 60% to the city or municipality where the factory is located
  - 40% to the city or municipality where the plantation is located.

#### COMMON REVENUE-RAISING POWERS OF LGUs (SEC. 153 TO 155)

1. Service fees and charges for services rendered
2. Public Utility Charges for the operation of public utilities owned,

operated and maintained by LGUs within their jurisdiction.

3. Toll fees or charges for the use of any public road, pier or wharf, waterway, bridge, ferry or telecommunication system funded and constructed by the local government unit concerned

#### Exceptions:

- a. Officers and enlisted men of the AFP and PNP;
- b. Post office personnel delivering mail; and
- c. Physically handicapped and disabled citizens who are sixty-five (65) years or older.(Sec. 152, LGC)

When public safety and welfare so requires, the sanggunian concerned may discontinue the collection of the tolls, and thereafter the said facility shall be free and open for public use.

#### COMMUNITY TAX

Cities or municipalities may levy a community tax.

#### A. Individuals Liable (Sec. 157)

- a. every inhabitant of the Philippines;
- b. eighteen (18) years of age or over;
- c. under any of the following instances:
- d. who has been regularly employed on a wage or salary basis for at *least thirty (30) consecutive working days* during any calendar year; or
- e. who is engaged in business or occupation; or
- f. who owns real property with an aggregate assessed value of P1,000 or more; or
- g. who is required by law to file an income tax return

**Tax Rate** = P5.00 and an annual additional tax of P1.00 for every P1,000 of income regardless of whether from business, exercise of profession or from property which in no case shall exceed P5,000.

In case of husband and wife, the additional tax herein imposed





shall be based upon the total property owned by them and the total gross receipts or earnings derived by them.

**B. Juridical Persons (Sec. 158)**

Every corporation no matter how created or organized, whether domestic or resident foreign, engaged in or doing business in the Philippines shall pay an annual community tax.

**Tax Rate** = P500 and an annual additional tax which in no case shall exceed P10,000 in accordance with the following schedule:

1. For every P5,000 worth of real property owned by it during the preceding year based on the valuation used for the payment of the real property tax - P2.00; and
2. For every P5,000 of gross receipts or earnings derived by it from its business in the Philippines during the preceding year - P2.00.

The dividends received by a corporation shall, for the purpose of the additional tax, be considered as part of the gross receipts or earnings of said corporation.

**THE FOLLOWING ARE EXEMPT FROM THE COMMUNITY TAX (SEC. 159)**

1. Diplomatic and consular representatives; and
2. Transient visitors when their stay in the Philippines does not exceed three (3) months.

**PLACE OF PAYMENT:** place of residence of the individual, or in the place where the principal office of the juridical entity is located.

**TIME OF PAYMENT:** accrues on the 1<sup>st</sup> day of January of each year which shall be paid not later than the last day of February of each year.

**PENALTIES FOR DELINQUENCY:** an interest of 24% per annum from the due

date until it is paid shall be added to the amount due.

A community tax certificate may also be issued to any person or corporation not subject to the community tax upon payment of P1.00 (Sec. 162, LGC).

**PRESENTATION OF COMMUNITY TAX CERTIFICATE ON CERTAIN OCCASIONS - (SEC. 163)**

**A. Individual**

1. When an individual subject to the community tax acknowledges any document before a notary public;
2. takes the oath of office upon election or appointment to any position in the government service;
3. receives any license, certificate or permit from any public authority; pays any tax or fee;
4. receives any money from any public fund;
5. transacts other official business; or
6. receives any salary or wage from any person or corporation.

The presentation of the community tax certificate shall not be required in connection with the registration of a voter.

**B. Corporation**

1. receives any license, certificate or permit from any public authority;
2. pays any tax or fee;
3. receives money from public funds; or
4. transacts other official business.

The city or municipal treasurer deputizes the barangay treasurer to collect the community tax in their respective jurisdictions. (Sec. 164, LCG)

The proceeds of the community tax actually and directly collected by the city or municipal treasurer shall accrue entirely to the general fund of the city or municipality concerned.





Proceeds of the community tax collected through the barangay treasurers shall be apportioned as follows:

- 50% accrues to the general fund of the city or municipality concerned; and
- 50% accrues to the barangay where the tax is collected.

#### COLLECTION OF LOCAL TAXES

##### Tax Period and Manner of Payment - (Sec. 165, LGC)

Unless otherwise provided, the tax period shall be the *calendar year*.

Such taxes, fees, and charges may be paid in quarterly installments.

##### Accrual of Tax - (Sec. 166, LGC)

Unless otherwise provided, shall accrue on the first day of January of each year.

However, new taxes, fees or charges, or changes in the rates thereof, shall accrue on the *first day of the quarter next following* the effectivity of the ordinance imposing such new levies or rates.

##### Time of Payment - (Sec. 167, LGC)

Unless otherwise provided shall be paid *within the first twenty (20) days of January* or of each subsequent quarter as the case may be.

May, for a justifiable reason or cause, be extended without surcharges or penalties, but only for a period *not exceeding six (6) months*.

##### Surcharges and Penalties on Unpaid Taxes, Fees or Charges - (Sec. 168, LGC)

Surcharge not exceeding 25% of the amount of taxes, fees or charges including surcharges, until such amount is fully paid.

But in no case shall the total interest on the unpaid amount or portion thereof exceed thirty-six (36) months.

##### Interests on Other Unpaid Revenues - (Sec. 169, LGC)

An interest thereon at the rate not exceeding 2% per month from the date it is due until it is paid, but in no case shall the total interest on the unpaid amount or portion thereof exceed thirty-six (36) months.

#### COLLECTION OF LOCAL REVENUES BY THE TREASURER - (SEC. 170 LGC)

All local taxes, fees and charges shall be collected by the provincial, city, municipal or barangay treasurer, or their duly authorized deputies.

The provincial, city or municipal treasurer may designate the barangay treasurer or his deputy to collect local taxes, fees or charges.

In case a bond is required for the purpose, the provincial, city or municipal government shall pay the premiums thereon in addition to the premiums of the bond that may be required under the Code.

## LOCAL TAX REMEDIES UNDER THE LGC

### 1. TAX REMEDIES OF THE LOCAL GOVERNMENT UNITS (LGUs)

#### CIVIL REMEDIES OF THE LOCAL GOVERNMENT UNITS (LGU) TO EFFECT COLLECTION OF TAXES

(1) **Local Government's Lien** - Local taxes, fees, charges and other revenues constitute a lien, superior to all liens, charges or encumbrances in favor of any person, enforceable by any appropriate administrative or judicial action.

#### (2) Civil Remedies

(a) by administrative action through distraint of personal property and by levy upon real property

(b) by judicial action





Either of these remedies or all may be pursued concurrently or simultaneously at the discretion of the LGU concerned.

#### JURISDICTION OF COURTS OVER LOCAL TAXATION CASES

- a. With the amendment brought by RA No. 9282, the Court of Tax Appeals now has appellate jurisdiction over local taxation cases decided by the Regional Trial Court in the exercise of its appellate or original jurisdiction.
- b. Regular judicial courts are not prohibited from enjoining the collection of local taxes, subject to Rule 58 (Preliminary Injunction) of the Rules of Court.

*Note:* Unlike the NIRC, the Local Tax Code does not contain any specific provision prohibiting courts from enjoining the collection of local taxes. Such statutory lapse or intent may have allowed preliminary injunction where local taxes are involved. But it cannot negate the procedural rules and requirements under Rule 58 of the Rules of Courts. (*Valley Trading Co. vs. CFI of Isabela, GR No. 49529, March 31, 1989*)

#### PREScriptive PERIODS FOR THE ASSESSMENT AND COLLECTION OF LOCAL TAXES

##### PREScriptive PERIODS OF ASSESSMENT

1. **Local taxes, fees, or charges** - five (5) years from the date they became due. (*Sec. 194, LGC*).
2. **When there is fraud or intent to evade the payment of taxes, fees or charges** - ten (10) years from discovery of the fraud or intent to evade the payment (*Sec. 194, LGC*).

##### PREScriptive PERIOD OF COLLECTION

Local taxes, fees, or charges may be collected within five (5) years from the date of assessment by administrative or judicial action. No such action shall be instituted after the expiration of such period (*Sec. 194, LGC*).

#### GROUND S FOR THE SUSPENSION OF THE RUNNING OF THE PRESCRIPTIVE PERIODS

- a. The treasurer is legally prevented from the assessment or collection of the tax;
- b. The taxpayer requests for a reinvestigation and executes a waiver in writing before the expiration of the period within which to assess or collect; and
- c. The taxpayer is out of the country or otherwise cannot be located (*Sec. 194, LGC*).

## 2. TAX REMEDIES OF THE TAXPAYER

#### REMEDIES OF THE TAXPAYER IN LOCAL TAXATION

##### A. ADMINISTRATIVE

##### *Before assessment*

- a. **Appeal** - any question on constitutionality or legality of tax ordinance within 30 days from effectivity thereof to Secretary of Justice (*Sec. 187 LGC*)
- b. **Declaratory relief** whenever applicable.

##### *After assessment*

- a. **Protest** - within 60 days from receipt of assessment (*Sec. 195 LGC*). Payment under protest is not necessary.
- b. **Payment & subsequent refund or tax credit** - within 2 years from payment of tax to local treasurer (*Sec. 196 LGC*). It is to be noted that, unlike in internal revenue taxes, the supervening cause applies in local taxation because the period for the filing of claims for refund or credit of local taxes is counted not necessarily from the date of payment but from the date the taxpayer is entitled to a refund or credit.
- c. **Right of redemption** - 1 year from the date of sale or from the date of forfeiture (*Sec. 179, LGC*).





## B. JUDICIAL

### 1. Court action

- within 30 days after receipt of decision or lapse of 60 days of Secretary of Justice's inaction (*Sec. 187 LGC*)
- within 30 days from receipt when protest of assessment is denied (*Sec. 195 LGC*)
- if no action is taken by the treasurer in refund cases and the two year period is about to lapse (*Sec. 195 LGC*)
- if remedies available does not provide plain, speedy and adequate remedy.

### 2. Action for declaratory relief

### 3. Injunction - if irreparable damage would be caused to the taxpayer and no adequate remedy is available.

## IV. REAL PROPERTY TAXATION

### DEFINITIONS:

**REAL PROPERTY TAXATION** - A direct tax on ownership of lands and buildings or other improvements thereon payable regardless of whether the property is used or not, although the value may vary in accordance with such factor.

Under the LGC, it covers the administration, appraisal, assessment, levy and collection of Real Property Tax, i.e. tax on land and building and other structures and improvements on it, including machineries.

**REAL PROPERTY** - subject to the definition given by *Art. 415 of the Civil Code*.

**IMPROVEMENT** - valuable addition made to a property or amelioration in its condition amounting to more than a mere replacement of parts involving capital expenditures and labor.

## NATURE AND CLASSES

### CHARACTERISTICS OF REAL PROPERTY TAX

1. Direct tax on the Ownership of real property
2. *Ad valorem* tax. The value is based on the tax base.
3. Proportionate - the tax is calculated on the basis of a certain percentage of the value assessed.
4. Indivisible single obligation
5. Local tax

### TAXING AUTHORITIES (*SEC. 233, LGC*)

LGU	Rate of Basic Real Property Tax
1. Province	<i>not exceeding</i> 1% of assessed value
2. City	<i>not exceeding</i> 2%
3. Municipality within Metro Manila	<i>not exceeding</i> 2%.

### FUNDAMENTAL PRINCIPLES GOVERNING REAL PROPERTY TAXATION (*SEC. 198, LGC*)

1. Real property shall be appraised at its current and Fair market value;
2. Real property shall be classified for assessment purposes on the basis of actual Use.
3. Real property shall be assessed on the basis of Uniform classification within each LGU
4. The appraisal, assessment, levy and collection of RP Tax shall not be let to any Private person
5. The appraisal and assessment of real property shall be Equitable.

### EXTENT OF THE POWER TO LEVY

- Basic real property tax;
- 1% additional real estate tax to finance the Special Education Fund; (*Sec. 236*)
- 5% additional ad valorem tax on Idle lands; (*Sec. 236, LGC*) and
- Special levy or special assessments (may be imposed







even by municipalities outside Metro Manila) on lands comprised within its territorial jurisdiction specially benefited by public works, projects or improvements funded by the local government unit concerned.

*Provided:*

- Special levy shall not exceed 60% of the actual cost of such projects and improvements, including the costs of acquiring land and such other real property in connection therewith
- not apply to lands exempt from basic real property tax and the remainder of the land have been donated to the local government unit concerned for the construction of said projects. (Sec. 240, LGC).

**FOR PURPOSES OF REAL PROPERTY TAXATION IDLE LANDS SHALL INCLUDE: (SEC. 237, LGC)**

1. Agricultural lands more than one hectare in area one-half of which remain uncultivated or unimproved by the owner of the property or person having legal interest therein.  
Agricultural lands planted to permanent or perennial crops with at least 50 trees to a hectare shall not be considered idle lands.  
Lands actually used for grazing purposes shall likewise not be considered idle lands; and
2. Lands *other than agricultural* located in a city or municipality more than one thousand square meters in area one-half of which remain unutilized or unimproved by the owner of the property or person having legal interest therein.

**IDLE LANDS EXEMPT FROM TAX (SEC. 238, LGC)**

By reason of:

1. *force majeure*
2. civil disturbance
3. natural calamity
4. or any cause which physically or legally prevents the owner of

the property or person having legal interest therein from improving, utilizing or cultivating the same.

**CLASSIFICATION OF LANDS FOR PURPOSES OF ASSESSMENT SEC. 218 (A)**

- a. Commercial
- b. Agricultural
- c. Residential
- d. Mineral
- e. Industrial
- f. Timberland
- g. Special

**SPECIAL CLASSES OF REAL PROPERTY (SEC. 216, LGC)**

1. Hospitals
2. Cultural and Scientific purposes
3. owned and used by Local water districts
4. GOCCs rendering essential public services in the supply and distribution of water and/or generation or transmission of electric power.

**PROPERTIES EXEMPT FROM REAL PROPERTY TAX (SEC. 234, LGC)**

Exemption is limited only to the following:

1. Real property **owned** by the government *except* when the **beneficial use** thereof has been granted to a taxable person;
2. Charitable institutions, churches, personages or convents appurtenant thereto, mosques, non-profit or religious cemeteries and all lands, buildings and improvements **actually, directly and exclusively** used for religious, charitable or educational purposes (Art. VI, Sec. 28, Constitution);
3. Machineries and equipment that are **actually, directly and exclusively** used by local water utilities and GOCC's engaged in the supply and distribution of water and/or electric power;





4. Real property owned by duly registered cooperatives as provided for in RA 6938; and
5. Machinery and equipment used for pollution control and environmental protection.

#### ACTUAL USE OF PROPERTY AS BASIS FOR ASSESSMENT (SEC. 217 LGC)

Real property shall be classified, valued and assessed on the basis of **actual use regardless of where located, whoever owns it, and whoever uses it.**

Unpaid realty taxes attach to the property and is chargeable against the person who had actual or beneficial use and possession of it regardless of whether or not he is the owner. To impose the real property tax on the subsequent owner which was neither the owner nor the beneficial user of the property during the designated periods would not only be contrary to law but also unjust. (*Estate of Lim vs. City of Manila, GR No. 90639, February 21, 1990*)

### PROCEDURE

#### STEP 1: DECLARATION OF REAL PROPERTY

##### DECLARATION BY OWNER OR ADMINISTRATOR (SEC. 202-203)

- File a sworn declaration with the assessor
  - once every 3 years during the period from January 1 to June 30.

##### • For newly acquired property -

**WHEN:** Must file with the assessor within 60 days from date of transfer

**WHAT:** Sworn statement containing the fair market value and description of the property.

##### • For improvement on property

**WHEN:** Must file within 60 days upon completion or occupation (whichever comes earlier)

**WHAT:** Sworn statement containing the fair market value and description of the property.

##### DECLARATION BY PROVINCIAL / CITY / MUNICIPAL ASSESSOR (SEC. 204)

**WHEN:** Only when the person under Sec. 202 *refuses or fails* to make a declaration within the prescribed time.

No oath by the assessor is required.

**Notes:** Proof of Exemption of Real Property from Taxation - (Sec. 206)

**WHO:** By any person or for whom real property is declared.

- Claim for exemption must be filed with the assessor together with sufficient documentary evidence to support claim

**WHEN:** within 30 days from the date of declaration of property.

##### IF PROPERTY IS DECLARED FOR THE FIRST TIME - (SEC. 222)

If Declared for the first time, real property shall be assessed for back taxes:

For not more than 10 years prior to date of initial assessment

Taxes shall be computed on the basis of applicable schedule of values in force during the corresponding period.

#### STEP 2: LISTING OF REAL PROPERTY IN THE ASSESSMENT ROLLS (SECS. 205, 207)

- All declarations shall be kept and filed under a uniform classification system to be established by the provincial, city or municipal assessor.

#### STEP 3: APPRAISAL AND VALUATION OF REAL PROPERTY (SECS. 212-214, 224-225)

##### DETERMINATION OF FAIR MARKET VALUE (FMV) For land

- Assessor of the province/city or municipality *may summon* the owners of the properties to be affected and *may take depositions* concerning the property, its





ownership, amount, nature and value (Sec. 213, LGC)

- Assessor prepares a schedule of FMV for different classes of properties.
- Sanggunian enacts an ordinance
- The schedule of FMV is published in a newspaper of general circulation in the province, city or municipality concerned or in the absence thereof, shall be posted in the provincial capitol, city or municipal hall and in two other conspicuous public places therein (Sec. 212, LGC)

#### For machinery

1. For Brand new machinery: FMV is the acquisition cost
2. In all other cases: FMV  

$$= \frac{\text{Remaining eco. life}}{\text{Estimated Eco. Life}} \times \text{Replacement Cost}$$

### STEP 4: DETERMINE ASSESSED VALUE (SEC. 218)

#### Determine Assessed Value

##### Procedure

1. Take the schedule of FMV
2. Assessed Value = FMV x Assessment level
3. Tax = Assessed value x Tax rate

### STEP 5: PAYMENT AND COLLECTION OF TAX

(a) **Accrual of Tax:** January of every year and such will constitute as a superior lien. (Sec. 246)

(b) **Time and Manner of Payment:** (Sec. 250)

1. basic real property tax in 4 equal installments (March 31, June 30, September 30, December 30)
2. special levy - governed by ordinance

(c) **Interest for Late Payment** (Sec. 255)

1. two percent (2%) for each month on unpaid amount until the delinquent amount is paid

2. provided in no case shall the total interest exceed thirty-six (36) months.

#### (d) **For Advance and Prompt Payment**

1. Advance payment - discount not exceeding 20% of annual tax (Sec. 251, LCG)
2. Prompt payment - discount not exceeding 10% of annual tax due (Art 342 IRR)

#### **COLLECTION OF TAX (SEC. 247)**

It shall be the responsibility of the city or municipal treasurer concerned.

The city or municipal treasurer may deputize the barangay treasurer to collect all taxes on real property located in the barangay; provided, the barangay treasurer is properly bonded.

#### **PERIOD TO COLLECT (SEC. 270)**

1. within five (5) years from the date they become due
2. within ten (10) years from discovery of fraud, in case there is fraud or intent to evade

#### **SUSPENSION OF PRESCRIPTIVE PERIOD (SEC. 270)**

1. local treasurer is **legally prevented** to collect tax.
2. the owner or property requests for **reinvestigation** and **writes a waiver** before expiration of period to collect.
3. the owner of property is out of the country or cannot be located.

## **REAL PROPERTY TAX REMEDIES UNDER THE LGC**

### **1. TAX REMEDIES OF THE LOCAL GOVERNMENT TO EFFECT COLLECTION OF TAXES**

#### **A. ADMINISTRATIVE**

1. Real Property tax lien (Secs. 257, LGC) - superior to all liens, charges or encumbrances;
2. Distraint (Sec. 254[B], LGC);
3. Levy (Sec. 254[A], 258 LGC);
4. Purchase of property by local treasurer for want of bidder (Sec. 263, LGC).





## B. JUDICIAL

Civil Action (Sec. 266, 270 LGC)

### PRESCRIPTIVE PERIODS FOR THE COLLECTION OF REAL PROPERTY TAXES

1. Basic real property tax and any other tax levied under the title on Real Property Taxation- five (5) years from the date they became due. (Sec. 270, LGC).
2. When there is fraud or intent to evade the payment of taxes - ten (10) years from discovery of the fraud or intent to evade the payment (Sec. 270, LGC).

### GROUND FOR THE SUSPENSION OF THE RUNNING OF THE PRESCRIPTIVE PERIODS

1. The treasurer is legally prevented from the assessment or collection of the tax;
2. The taxpayer requests for a reinvestigation and executes a waiver in writing before the expiration of the period within which to assess or collect; and
3. The taxpayer is out of the country or otherwise cannot be located (Sec. 270, LGC).

## 2. TAX REMEDIES OF THE TAXPAYER

### A. ADMINISTRATIVE

**Protest** - payment under protest is required within 30 days to provincial, city, or municipal treasurer. No protest shall be entertained unless the tax is first paid. (Sec. 252 LGC)

**Claim for Tax Refund or Credit** (Sec. 253)

- a) the taxpayer may file a written claim for refund or credit with the provincial or city treasurer within two years from the date the taxpayer is entitled to such reduction or adjustment.

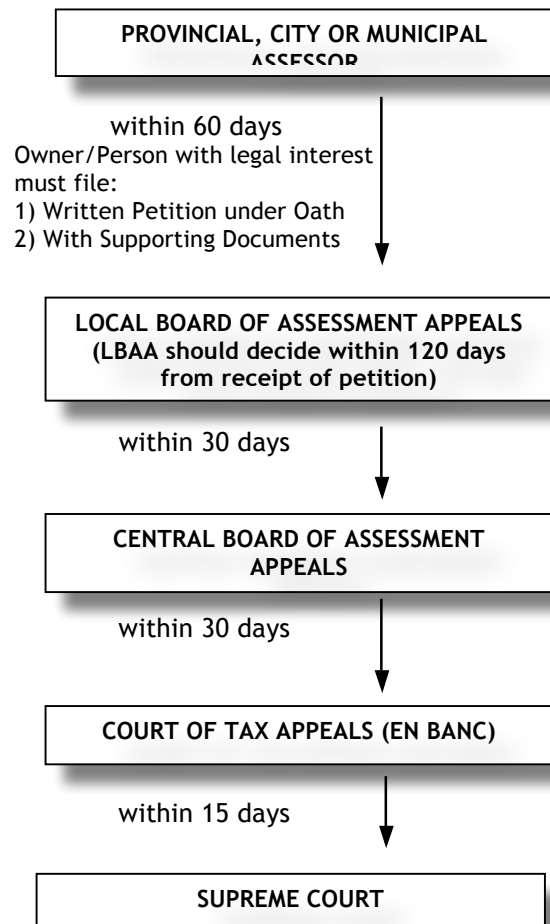
- b) in case of denial of refund or credit, appeal to LBAA as in protest case.

**Redemption of real property** (Sec. 261 LGC)

**Remedy against the Assessment/Appeal**

- 1<sup>st</sup>: within 60 days from notice of assessment of provincial, city or municipal assessor to LBAA (Sec. 226 LGC)
- 2<sup>nd</sup>: within 30 days from receipt of decision of LBAA to CBAA (Sec. 230 LGC)
- 3<sup>rd</sup>: within 30 days from receipt of decision of CBAA to Court of Tax Appeals en banc
- 4<sup>th</sup>: within 15 days from receipt of decision of Court of Tax Appeals en banc to the Supreme Court

### APPEALS IN REAL PROPERTY TAXATION





### B. JUDICIAL

1. Court Action - appeal of CBAA's decision to Court of Tax Appeals en banc.
2. Suit assailing validity of tax; recovery of refund of taxes paid (Sec. 64 PD 464).
3. Suit to declare invalidity of tax due to irregularity in assessment and collection (Sec. 64 PD 464)
4. Suit assailing the validity of tax sale (Sec. 83 PD 464) (Sec. 267 LGC)

### CONDONATION OF REAL PROPERTY TAXES

1. By the Sanggunian
 

Real property taxes may be condoned wholly or partially in a given local government unit when:

  - a. There is general failure of crops;
  - b. There is substantial decrease in the price of agricultural or agri-based products; or
  - c. There is calamity.
2. By the President of the Philippines
  - when public interest so requires.

## V. TARIFF AND CUSTOMS CODE

### DEFINITIONS

**TARIFF:** Customs duties, toll or tribute payable upon merchandise to the Government.

**CUSTOM DUTIES:** Tax assessed upon merchandise from or exported to, a foreign country. (*Garcia v. Executive Sec.*, GR No. 101273, July 3, 1992))

*Note: Customs and tariffs are synonymous with one another. They both refer to the taxes imposed on imported or exported wares, articles, or merchandise.*

### OTHER TYPES OF FEES CHARGED BY THE BUREAU OF CUSTOMS

- Arrastre charge
- Wharfage due - counterpart of license, charged not for the use of any wharf but for a special fund known as the Port Works Fund.

- Berthing fee
- Harbor fee
- Tonnage due

### MEANING AND SCOPE OF THE TARIFF AND CUSTOMS LAWS

Include not only the provisions of the Tariff and Customs Code (TCC) and regulations pursuant thereto, but all other laws and regulations that are subject to the Bureau of Customs (BOC) or otherwise within its jurisdiction.

As to its scope, therefore, tariff and customs laws extend not only to the provisions of the TCC but to all other laws as well, the enforcement of which is entrusted to the BOC.

## THE BUREAU OF CUSTOMS

### FUNCTIONS OF THE BUREAU OF CUSTOMS

1. Assessment and collection of revenues from imported articles and all other impositions under the tariff and customs laws;
2. Control smuggling and related frauds;
3. Supervision and control over the entrance and clearance of vessels and aircraft engaged in foreign commerce;
4. Enforcement of TCC and related laws;
5. Supervision and control over the handling of foreign mails arriving in the Philippines;
6. Supervise and control all import and export cargoes for the protection of government revenue;
7. Exclusive original jurisdiction over seizure and forfeiture cases under the tariff and customs laws.

### JURISDICTION OF COLLECTOR OF CUSTOMS OVER IMPORTATION OF ARTICLES

1. Cause all articles for importation to be entered in the customhouse,
2. Cause all such articles to be appraised and classified,
3. Assess and collect the duties, taxes and other charges thereon, and





4. Hold possession of all imported articles until the duties, taxes and other charges are paid thereon. (Sec. 1206, TCC)

#### TERRITORIAL JURISDICTION OF THE BOC

1. All seas within the jurisdiction of the Philippines
2. All coasts, ports, airports, harbors, bays, rivers and inland waters whether navigable or not from the sea. (1<sup>st</sup> par, Sec. 603, TCC)

### CUSTOMS DUTIES

#### WHEN TARIFF AND CUSTOMS APPLIED

Only after importation has begun but before importation is terminated.

*Importation begins:*

- 1) when the conveying vessel or aircraft
- 2) enters the jurisdiction of the Phil.
- 3) with intention to unload therein

*Importation is deemed terminated:*

(a) upon payment of the duties, taxes and other charges due upon the articles.

(b) and legal permit for withdrawal shall have been granted.

- In case the articles are free of duties, taxes and other charges, until they have legally left the jurisdiction of the customs (Sec. 1202, TCC)

#### INTENTION TO UNLOAD

Even if not yet unloaded, and there is unmanifested cargo, forfeiture may take place because importation has already begun.

#### ARTICLES UNDER TCC

*May either be:*

1. **Subject to duty -**
  - a. Live animals and animal products;
  - b. Vegetable products;
  - c. Animal or vegetable fats; oils and their cleavage products;

- prepared edible fats; animal or vegetable waxes;
- d. Prepared foodstuffs; beverages, spirits and vinegar; tobacco and manufactured tobacco substitutes;
- e. Mineral products;
- f. Products of chemical or allied industries;
- g. Plastics and articles thereof; rubber and articles thereof;
- h. Raw hides and skins; leather, etc.;
- i. Wood and articles of wood, etc.;
- j. Pulp of wood, etc.;
- k. Textiles and textile articles;
- l. Articles of stone; plaster, cement, etc.;
- m. Footwear, headgear, etc.;
- n. Natural or cultured pearls precious/semi-precious stones;
- o. Base metals and articles of base metals;
- p. Machinery and mechanical appliances; electric equipment; sound recorders, etc;
- q. Vehicles, aircraft, vessels and associated transport equipment;
- r. Optical, photographic, medical, surgical instruments, etc.;
- s. Arms, ammunition, parts and accessories;
- t. Miscellaneous manufactured articles; and
- u. Works of art, collector's pieces and antiques (Sec. 104, Title 1, TCC).

#### 2. Prohibited from being imported (Prohibited importation)

- a. *Absolutely prohibited* such as: weapons of war; gambling devices; narcotics or prohibited drugs; immoral, obscene or insidious articles; and those prohibited under special laws (Sec. 102, TCC).

#### b. *Qualifiedly prohibited*

Where such conditions as to warrant a lawful importation do not exist, the legal effects of the importation of qualifiedly prohibited articles are the same as those of absolutely prohibited articles. (*Auyong Hian vs. CTA*,







GR No. L-28782, September 12, 1974)

**3. Conditionally-free from tariff and customs duties** (conditionally-free importation)

- Those provided in Sec. 105, TCC;
- Those granted to government agencies, GOCCs with agreements with foreign countries;
- Those given to international institutions entitled to exemption by agreement or special laws; and
- Those that may be granted by the President upon NEDA's recommendation.

**4. Free from TC duties (duty-free)**

Imported goods must be entered in a customhouse at their port of entry otherwise they shall be considered as contraband and the importer is liable for smuggling (See Sec. 101, TCC).

All articles when imported from any country into the Philippines shall be subject to duty upon each importation, even though previously exported from the Philippines, except as otherwise specifically provided for in the TCC or other laws.

**LIABILITY FOR CUSTOMS DUTIES**

**General Rule:** All importations / exportations of goods are subject to customs duties (Sec. 105, TCC).

**Exceptions:**

- (1) Exemptions under the TCC;
- (2) Exemptions granted to government agencies, instrumentalities or GOCCs with existing contracts, commitments, agreements, or obligations with foreign countries;
- (3) Exemptions of international organizations pursuant to agreements or special laws; and
- (4) Exemptions granted by the Pres. of the Phil. upon recommendation of NEDA (Sec. 105, TCC).

**LIABILITY OF IMPORTER FOR CUSTOM DUTIES**

- A *personal debt* which can be discharged only by payment in full thereof;
- A *lien* upon the imported articles while they are in custody or subject to the control of the government. (Sec. 1204, TCC).

**EXTENT OF IMPORTER'S LIABILITY**

The liability of an importer is limited to the value of the imported merchandise. In case of forfeiture of the seized material, the maximum civil penalty is the forfeiture itself. (*Mendoza vs. David*, GR No. L-9452, March 27, 1961)

**DRAWBACK**

A device resorted to for enabling a commodity affected by taxes to be exported and sold in foreign markets upon the same terms as if it had not been taxed at all. (*Uy Chaco Sons vs. Collector of Customs*, GR No. 7618, March 27, 1913)

**IMPORT ENTRY**

It is a declaration to the BOC showing particulars of the imported article that will enable the customs authorities to determine the correct duties. An importer is required to file an import entry. It must be accomplished from disembarking of last cargo from vessel.

**TRANSACTION VALUE UNDER RA NO. 8181**

It is the invoice value of the goods plus freight, insurance, costs, expenses and other necessary expenses. This replaces the Home Consumption Value as basis of valuation of goods.

**CLASSIFICATION OF CUSTOM DUTIES**

**A. Regular Duties** - those which are imposed and collected merely as a source of revenue.

1. **Ad valorem duty:** This is a duty based on the value of the imported article.
2. **Specific duty:** This is a duty based on the dutiable weight of goods (either the gross weight, legal weight, or net weight).





3. **Alternating duties:** This is a duty which alternates ad valorem and specific.
4. **Compound Duty:** This is a duty consisting of ad valorem and specific duties.

**B. Special duties** - those which are imposed and collected in addition to the ordinary customs duties usually to protect local industries against foreign competition.

1. **Dumping duty**
2. **Countervailing duty**

3. **Marking duty**
4. **Discriminatory duty**

#### NATURE OF SPECIAL CUSTOMS DUTIES

Special customs duties are additional import duties imposed on specific kinds of imported articles under certain conditions.

#### PURPOSE OF SPECIAL CUSTOMS DUTIES

The special customs duties are imposed for the protection of consumers and manufacturers, as well as Phil. products from undue competition posed by foreign-made products.

#### SPECIAL DUTIES COMPARED

DUMPING DUTY	COUNTERVAILING DUTY	MARKING DUTY	DISCRIMINATORY DUTY
1. <b>Nature</b> Imposed upon foreign products with value lower than their fair market value to the detriment of local products.	Imposed upon foreign goods enjoying subsidy thus allowing them to sell at lower prices to the detriment of local products similarly situated.	Imposed upon those not properly marked as to place of origin of the goods.	Imposed upon goods coming from countries that discriminate against Philippine products.
2. <b>Amount/Rate</b> Difference between the actual price and the normal value of the article.	Equivalent to the bounty, subsidy, or subvention.	5% ad valorem of articles	Any amount not exceeding 100% ad valorem of the subject articles
3. <b>Imposing Authority</b> Special committee on Anti-Dumping (composed of the Secretary of Finance as Chairman; Members: the Secretary of DTI, and either the Secretary of Agriculture if article in question is agricultural product or the Secretary of labor if non-agricultural product)	Secretary of Finance	Commissioner of Customs	President of the Philippines





### FLEXIBLE TARIFF CLAUSE

The President may fix tariff rates, import and export quotas, etc. under TCC (See Sec. 28, Art. VI, Constitution and Sec. 401, TCC)

1. to increase, reduce or remove existing protective rates of import duty (including any necessary change in classification).

The existing rates may be increased or decreased to any level, on one or several stages but in no case shall the increased rate of import duty be higher than a maximum of one hundred (100%) per cent ad valorem

2. to establish import quota or to ban imports of any commodity, as may be necessary; and
3. to impose an additional duty on all imports not exceeding ten (10%) per cent ad valorem whenever necessary:

### LIMITATIONS IMPOSED REGARDING THE FLEXIBLE TARIFF CLAUSE

- a. Conduct by the Tariff Commission of an investigation in a *public hearing*.

The Commission shall also hear the views and recommendations of any government office, agency or instrumentality concerned.

The Commission shall submit their findings and recommendations to the NEDA within thirty (30) days after the termination of the public hearings.

The NEDA thereafter submits its recommendation to the President.

- b. The power of the President to increase or decrease the rates of import duty within the abovementioned limits fixed in the Code shall include the modification in the form of duty.

In such a case the corresponding ad valorem or specific equivalents of the duty with respect to the imports from the principal competing foreign country for the most recent representative period shall be used as bases (Sec. 401, TCC).

### THE TARIFF COMMISSION (TC)

#### FUNCTIONS OF THE TARIFF COMMISSION

##### 1. Investigative Powers (Sec. 505, TCC)

- a. the administration of and the fiscal and industrial effects of the tariff and customs laws of this country now in force or which may hereafter be enacted;
- b. the relations between the rates of duty on raw materials and the finished or partly finished products;
- c. the effects of ad valorem and specific duties and of compound specific and ad valorem duties;
- d. all questions relative to the arrangement of schedules and classification of articles in the several schedules of the tariff law;
- e. the tariff relations between the Philippines and foreign countries, commercial treaties, preferential provisions, economic alliances, the effect of export bounties and preferential transportation rates;
- f. the volume of importations, compared with domestic production and consumption;
- g. conditions, causes, and effects relating to competition of foreign industries with those of the Philippines, including dumping and cost of production; and
- h. in general, to investigate the operation of customs and tariff laws, including their relation to the national revenues, their effect upon the industries and labor of the country and to submit reports of its investigation as provided.

##### 2. Administrative Assistance to the President and Congress (Sec. 506, TCC)





## TAX REMEDIES UNDER THE TARIFF AND CUSTOMS CODE (TCC)

### TAX REMEDIES OF THE GOVERNMENT

#### A. ADMINISTRATIVE

##### 1. Tax Lien (Sec. 1204 TCC)

- attaches on the goods, regardless of ownership, while still in the custody or control of the Government
- availed of when the importation is neither prohibited nor improperly made

##### 2. Administrative Fines and Forfeitures

- applied when the importation is unlawful,
- and it may be exercised even where the articles are not or no longer in Custom's custody
  - *unless* the importation is merely attempted in which case it may be effected only while the goods are still within the Customs jurisdiction or in the hands of a person who is aware thereof (Sec. 2531 & 2530, TCC)
- under Sec. 2530(a) of the TCC, in order to warrant forfeiture, it is not necessary that the vessel or aircraft must itself carry the contraband. The complementary if collateral use of the Cessna plane for smuggling operation is sufficient for it to be deemed to have been used in smuggling. (*Llamado vs. Commissioner of Customs*, GR No. L-28809, May 16, 1983)

##### 3. Reduction of customs duties / compromise

- subject to approval of Sec. of Finance (Sec. 709, 2316 TCC)

#### 4. Seizure, Search, Arrest (Sec. 2205, 2210, 2211 TCC)

#### B. JUDICIAL

1. this remedy is normally availed of when the tax lien is lost by the release of the goods
  - Civil Action (Sec. 1204, TCC)
  - Criminal Action

### TAX REMEDIES OF THE TAXPAYER

#### A. ADMINISTRATIVE

##### 1. Protest

- a. Any importer or interested party if dissatisfied with published value within 15 days from date of publication, or within 5 days from the date the importer is entitled to refund if payment is rendered erroneous or illegal by events occurring after the payment.
- b. Taxpayer - within 15 days from assessment. Payment under protest is necessary. (Sec. 2308, 2210 TCC)

##### 2. Refund

- a. A written claim for refund may be submitted by the importer in abatement cases on missing packages, deficiencies in the contents of packages or shortages before arrival of the goods in the Philippines, articles lost or destroyed after such arrival, dead or injured animals, and for manifest clerical errors; and
- b. Drawback cases where the goods are re-exported (Sec. 1701-1708 TCC).

##### 3. Settlement of any seizure by payment of fine or redemption

- But this shall not be allowed in any case where importation is absolutely prohibited, or the release would be contrary to law, or when there is an actual and





intentional fraud (Sec. 2307 TCC).

#### 4. Appeal

- Within 15 days to the Commissioner after notification by Collector of his decision (Sec. 2313 TCC).

### B. JUDICIAL

#### 1. Appeal

- Within 30 days from receipt of decision of the Commissioner or Secretary of Finance to the division of the CTA (Sec. 2403 TCC, Sec. 7 RA 1125, as amended by Sec. 9 RA 9282)
- Since Sec.11 of RA 1125 as amended by RA 9282 empowers the Tax Court to issue injunctions, it would appear that an importer may appeal without first paying the duties, such as in seizure, but not in protest cases.

#### 2. Action to question the legality of seizure

#### 3. Abandonment (Sec. 1801 TCC)

- expressly (Sec. 1801 TCC)
- impliedly -
  - failure to file an import entry within 30 days from the discharge of goods or
  - having filed an entry fails to claim within 15 days but it shall not be so effective until so declared by the collector. (Sec. 1801, as amended by RA 7651)

### TWO KINDS OF PROCEEDINGS IN THE BUREAU OF CUSTOMS (BOC)

#### A. CUSTOMS PROTEST CASES

**DEFINITION:** These are cases which deal solely with liability for customs duties, fees, and other charges.

**Note:** Before filing a protest, there must first be a payment under protest.

#### WHEN CUSTOMS PROTEST APPLICABLE

The customs protest is required to be filed only in case the liability of the taxpayer for duties, taxes, fees and other charges is determined and the taxpayer disputes said liability.

#### WHEN CUSTOMS PROTEST **NOT** REQUIRED

Where there is no dispute, but the claim for refund arises by reason of the happening of supervening events such as when the raw material imported is utilized in the production of finished products subsequently exported and a duty drawback is claimed.

#### REQUIREMENTS FOR MAKING A PROTEST

1. Must be in writing
2. Must point out the particular decision or ruling of the Collector of Customs to which exception is taken or objection made;
3. Must state the grounds relied upon for relief;
4. Must be limited to the subject matter of a single adjustment;
5. Must be filed when the amount claimed is paid or within 15 days after the payment;
6. Protestant must furnish samples of goods under protest when required.

#### PROCEDURE IN CUSTOMS PROTEST CASES

The Collector acting within his jurisdiction shall cause the imported goods to be entered at the customhouse



The Collector shall assess, liquidate, and collect the duties thereon, or detain the said goods if the party liable does not pay the same



The party adversely affected (the protestant) may file a written protest on his foregoing liability with the Collector within 15 days after paying the





liquidated amount (the payment under protest rule applies)



Hearing within 15 days from receipt of the duly presented protest. Upon termination of the hearing, the Collector shall decide on the same within 30 days



If decision is adverse to the protestant



Appeal with the Commissioner within 15 days from notice



Appeal with the Court of Tax Appeals Division within 30 days from notice



Appeal with the CTA en banc



Appeal by certiorari with the Supreme Court within 15 days from notice



If decision is adverse to the government



Automatic Review by the Commissioner



Automatic review by the Secretary of Finance



If decision of Commissioner or Secretary of Finance is adverse to the protestant, he may appeal to the CTA and SC under the same procedure on the left.

#### REASONS FOR THE AUTOMATIC REVIEW OF DECISIONS ADVERSE TO THE GOVERNMENT

1. To protect the interest of the Government
2. A favorable decision will not be appealed by the taxpayer and certainly a Collector will not appeal his own decision.
3. Lifeblood Theory

#### B. SEIZURE AND FORFEITURE CASES

**DEFINITION:** These refer to matters involving *smuggling*. It is administrative and civil in nature and is *directed against the res* or imported articles and entails a determination of the legality of their importation. These are actions in *rem*.

Thus, It is of no defense that the owner of the vessel sought to be forfeited had no actual knowledge that his property was used illegally. The absence or lack of actual knowledge of such use is a defense personal to the owner himself, which cannot in any way absolve the vessel from the liability of forfeiture. (*Commissioner of Customs vs. Manila Star Ferry, Inc.*, GR Nos. 31776-78, October 21, 1993)

#### SMUGGLING

1. An act of any person who shall:
  - a. Fraudulently import any article contrary to law, or
  - b. Assist in so doing, or
  - c. Receive, conceal, buy, sell, facilitate, transport, conceal or sell such article knowing its illegal importation (Sec. 3601, TCC)
  - d. Export contrary to law. (Sec. 3514, TCC)
2. The Philippines is divided into various ports of entry - entry other than port of entry, will be SMUGGLING.

#### PORT OF ENTRY

A domestic port open to both foreign and coastwise trade including "airport of entry". (Sec. 3514, TCC)

ALL articles imported into the Philippines whether subject to duty or not shall be entered through a customhouse at a port of entry.

**ENTRY:** in Customs law means-

1. the documents filed at the Customs house
2. the submission and acceptance of the documents
3. the procedure of passing goods through the customs house (*Rodriguez vs. Court of Appeals*, GR No. 115218, September 18, 1995)

**CONTRABAND:** Articles of prohibited importations or exportations. (Sec. 3514, TCC)







### EVIDENCE FOR CONVICTION IN SMUGGLING CASES

Mere possession of the article in question - *unless* defendant could explain that his possession is lawful to the satisfaction of the court (Sec. 3601, TCC). Payment of the tax due after apprehension is not a valid defense (*Rodriguez vs. Court of Appeals*, GR No. 115218, September 18, 1995)

### THINGS SUBJECT TO CONFISCATION IN SMUGGLING CASES

Anything that was used for smuggling is subject to confiscation, like the vessel, plane, etc. (*Llamado vs. Commissioner of Customs*, GR No. L-28809, May 16, 1983).

**Exception:** Common carriers that are not privately chartered cannot be confiscated.

### RIGHT OF CUSTOMS OFFICERS TO EFFECT SEIZURE & ARREST (SEC. 2205)

1. May seize any vessel, aircraft, cargo, article, animal or other movable property when the same is subject to forfeiture or liable for any time as imposed under tariff and customs laws, rules & regulations
2. May exercise such powers only in conformity with the laws and provisions of the TCC

### COMMON CARRIERS; FORFEITURE

1. Common carriers are generally not subject to forfeiture although if the owner has knowledge of its use in smuggling and was a consenting party, it may also be forfeited.
2. If a motor vehicle is hired to carry smuggled goods but it has no Certificate of Public Convenience (CPC), it is not a common carrier. It is thus subject to forfeiture, and lack of personal knowledge of the owner or the carrier is not a defense to forfeiture.

### PROPERTIES NOT SUBJECT TO FORFEITURE IN THE ABSENCE OF PRIMA FACIE EVIDENCE

The forfeiture of the vehicle, vessel or aircraft shall not be effected if it is established that the owner thereof or his

agent in charge of the means of conveyance used as aforesaid has ***no knowledge of or participation in the unlawful act:***

*Provided*, however, that a prima facie presumption shall exist against the vessel, vehicle or aircraft under any of the following circumstances:

1. If the conveyance has been used for smuggling at least twice before;
2. If the owner is not in the business for which the conveyance is generally used; and
3. If the owner is financially not in a position to own such conveyance.

### DOCTRINE OF HOT PURSUIT

#### Requisites:

1. **Over Vessels**
  - a. An act is done in Phil. Waters which constitutes a violation of the tariff and customs laws
  - b. a pursuit of such vessel began within the jurisdictional waters which
    - (i) may continue beyond the maritime zone, and
    - (ii) the vessel may be seized on the high seas.
2. **Over Imported Articles**
  - a. There is a violation of the tariff and customs laws
  - b. As a consequence they may be pursued in the Phil.
  - c. With jurisdiction over them at any place therein for the enforcement of the law. (2<sup>nd</sup> par. Sec. 603, TCC)

### REGIONAL TRIAL COURTS (RTC)

VS.

### BUREAU OF CUSTOMS (BOC)

- The RTCs do not have jurisdiction over seizure and forfeiture proceedings conducted by the BOC and to interfere with these proceedings. The Collector of Customs has exclusive jurisdiction over all questions touching on the





seizure and forfeiture of dutiable goods.

- No petitions for certiorari, prohibition or mandamus filed with the RTC will lie because these are in reality attempts to review the Commissioner's actuations. Neither replevin filed with the RTC will issue. **Rationale: Doctrine of Primary Jurisdiction.**
- Even if a Customs seizure is illegal, exclusive jurisdiction (to the exclusion of regular courts) still belongs to the Bureau of Customs (*Jao v. Court of Appeals*, GR No. 104604, October 6, 1995).

#### GOODS IN CUSTOM'S CUSTODY BEYOND REACH OF ATTACHMENT

Goods in the custom's custody pending payment of customs duties are beyond the reach of attachment. As long as the importation has not been terminated, the imported goods remain under the jurisdiction of the Bureau of Customs. (*Viduya vs. Berdiago*, GR No. L-29218, October 29, 1976)

#### ADMINISTRATIVE AND JUDICIAL PROCEDURES RELATIVE TO CUSTOMS SEIZURES AND FORFEITURES

Determination of probable cause and issuance of warrant



Actual seizure of the articles



Listing of description, appraisal and classification of seized property



Report of seizure to the Comm. of Customs and the Chairman, Comm. on Audit



Issuance by the Collector of a warrant of detention



Notification to owner or importer



Formal hearing



District collector renders his decisions

✍  
If decision is not favorable to the aggrieved owner or importer



Appeal by the aggrieved owner or importer

✍  
If decision is not favorable to the government



Automatic Review by the Commissioner

#### PERSONS HAVING POLICE AUTHORITY TO ENFORCE THE TARIFF & CUSTOMS LAWS AND EFFECT SEARCHES, SEIZURES AND ARRESTS (SEC. 2203, TCC)

- 1) officials of the BOC, district collectors, police officers, agents, inspectors, and guests of the BOC;
- 2) officers of the Phil. Navy and other members of the AFP and national law enforcement agencies when authorized by the Commissioner of Customs
- 3) officials of the BIR on all cases falling within the regular performances of their duties, when the payment of internal taxes are involved;
- 4) officers generally empowered by law to effect arrests and execute processes of courts, when acting under the direction of the Collector.

#### REQUIREMENTS FOR CUSTOMS FORFEITURE

1. The wrongful making by the owner, importer, exporter or consignee of any declaration or affidavit, or the wrongful making or delivery by the same persons of any invoice, letter or paper - all touching on the importation or exportation of merchandise.; and
2. That such declaration, affidavit, invoice, letter or paper is false. (*Farolan, Jr. vs. Court of Tax Appeals*, GR No. 42204, January 21, 1993)

#### PLACES WHERE SEARCHES & SEIZURES MAY BE CONDUCTED

- (a) enclosures
- (b) dwelling house (there must be search warrant issued by a judge)





- (c) vessels or aircrafts and persons or articles conveyed therein
- (d) vehicles, beasts and persons
- (e) persons arriving from foreign countries.

**Note:** Burden of proof in seizure or forfeiture is on the claimant. (Sec. 2535, TCC)

#### REQUIREMENTS FOR MANIFEST

A manifest in coastwise trade for cargo and passengers transported from one place or port in the Philippines to another is required when one or both of such places is a port of entry (Sec. 906, TCC). Manifests are also required of vessel from a foreign port (Sec. 1005, TCC).

#### IS MANIFEST REQUIRED ONLY FOR IMPORTED GOODS?

NO. Articles subject to seizure do not have to be imported goods. Manifests are also required for articles found on vessels or aircraft engaged in coastwise trade. (*Rigor vs. Rosales*, GR No. L-33756, October 23, 1982)

**UNMANIFESTED CARGO IS SUBJECT TO FORFEITURE** whether the act of smuggling is established or not under the principle of *res ipsa loquitur*. It is enough that the cargo was unmanifested and that there was no showing that payment of duties thereon had been made for it to be subject to forfeiture.

#### SETTLEMENT OF FORFEITURE CASES

**General Rule:** Settlement of cases by payment of fine or redemption of forfeited property is *allowed*.

#### Exceptions:

1. the importation is absolutely prohibited or
2. the surrender of the property to the person offering to redeem would be contrary to law, or
3. when there is fraud. (Sec. 2307, TCC)

#### ACQUITTAL IN CRIMINAL CHARGE NOT RES JUDICATA IN SEIZURE OR FORFEITURE PROCEEDINGS

##### Reasons:

- 1) Criminal proceedings are actions in *personam* while seizure or forfeiture proceedings are actions in *rem*.
- 2) Customs compromise does not extinguish criminal liability. (*People vs. Desiderio*, GR No. L-208005, November 26, 1965)

**Note:** At any time prior to the sale, the delinquent importer **may settle his obligations** with the Bureau of Customs, in which case the aforesaid articles may be delivered upon payment of the corresponding duties and taxes and compliance with all other legal requirements (Sec. 1508, TCC)

#### ABATEMENT

The reduction or non-imposition of customs duties on certain imported materials as a result of:

- 1) Damage incurred during voyage;
- 2) Deficiency in contents packages
- 3) Loss or destruction of articles after arrival
- 4) Death or injury of animals

#### FRAUDULENT PRACTICES CONSIDERED AS CRIMINAL OFFENSES AGAINST CUSTOMS REVENUE LAWS

- 1) Unlawful importation;
- 2) Entry of imported or exported article by means of any false or fraudulent practices, invoice, declaration, affidavit, or other documents;
- 3) Entry of goods at less than their true weights or measures or upon a classification as to quality or value;
- 4) Payment of less than the amount due;
- 5) Filing any false or fraudulent claim for the payment of drawback or refund of duties upon the exportation of merchandise; or
- 6) Filing any affidavit, certificate or other document to secure to himself or others the payment of any drawback, allowance or refund of duties on the exportation of mdse. greater than that legally due thereon. (Sec. 3602, TCC)





## VI. COURT OF TAX APPEALS (RA 1125 as amended by RA 9282)

- ❖ See ANNEX O for comparison of CTA as created by RA No. 1125 and the amendments made by RA No. 9282.

### NATURE AND POWERS

#### ELEVATION OF RANK

shall be of the same level as the Court of Appeals, possessing all the inherent powers of a Court of Justice

#### COMPOSITION

- Consists of a Presiding Justice and five (5) Associate Justices
- May sit en banc or in two (2) Divisions, each Division consisting of three (3) Justices. The Presiding Justice and the most Senior Associate Justice shall serve as chairmen of the two divisions

#### QUORUM

- Four (4) Justices shall constitute a quorum for sessions *EN BANC*.
- Two (2) Justices for sessions of a *DIVISION*.

*PROVIDED: in case the required quorum cannot be had due to any vacancy, disqualification, inhibition, disability, or any other lawful cause, the Presiding Justice shall designate any Justice of other Divisions of the Court to sit temporarily therein.*

#### POWERS

1. to administer oaths;
2. to receive evidence;
3. to summon witnesses by subpoena;
4. to require production of papers or documents *by subpoena duces tecum*;
5. to punish contempt;
6. to promulgate rules and regulations for the conduct of its business;

7. to assess damage against appellant if appeal to CTA is found to be frivolous or dilatory;
8. to suspend the collection of the tax pending appeal; and
9. to render decisions on cases brought before it
10. to issue order authorizing distraint of personal property and levy of real property

### DISTRAINT OF PERSONAL PROPERTY AND LEVY OF REAL PROPERTY

Upon the issuance of any ruling, order or decision by the CTA favorable to the national government, the CTA shall issue an order authorizing the BIR, through the Commissioner:

1. to seize and distraint any goods, chattels, or effects and the personal property, including stocks and other securities, debts, credits, bank accounts, and interests in and rights to personal property and/or
2. levy the real property of such persons in sufficient quantity to satisfy the tax or charge together with any increment thereto incident to delinquency.

This remedy shall not be exclusive and shall not preclude the Court from availing of other means under the Rules of Court.

### JURISDICTION

#### I. EXCLUSIVE APPELLATE JURISDICTION TO REVIEW BY APPEAL

##### (a) Decisions of the *Commissioner of Internal Revenue*

1. in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto,
2. or other matters arising under the NIRC or other laws administered by the BIR;

##### (b) Inaction by the *Commissioner of Internal Revenue*

1. in cases involving disputed assessments, refunds of internal revenue taxes, fees





- or other charges, penalties in relation thereto,
- 2. or other matters arising under the NIRC or other laws administered by the BIR, where the NIRC provides a specific period for action, in which case the inaction shall be deemed a denial;
- (c) Decisions, orders or resolutions of the **RTC**
  - in local tax cases originally decided or resolved by them in the exercise of their original or appellate jurisdiction;
- (d) Decisions of the **Commissioner of Customs**
  - 1. in cases involving liability for customs duties, fees or other money charges, seizure, detention or release of property affected, fines, forfeitures or other penalties in relation thereto,
  - 2. or other matters arising under the Customs Law or other laws administered by the Bureau of Customs;
- (e) Decisions of the **Central Board of Assessment Appeals**
  - in the exercise of its appellate jurisdiction over cases involving the assessment and taxation of real property originally decided by the provincial or city board of assessment appeals;
- (f) Decisions of the **Secretary of Finance**
  - on customs cases elevated to him automatically for review from decisions of the Commissioner of Customs which are adverse to the Government under Section 2315 of the Tariff and Customs Code;
- (g) Decisions of the **Secretary of Trade and Industry** in the case of nonagricultural product, commodity or article, and the **Secretary of Agriculture** in the case of agricultural product, commodity or article,
  - involving dumping and countervailing duties under Secs. 301 and 302, respectively, of the

Tariff and Customs Code, and safeguard measures under RA No. 8800, where either party may appeal the decision to impose or not to impose said duties.

## II. JURISDICTION OVER CASES INVOLVING CRIMINAL CASES

- (a) **Exclusive original jurisdiction** over all criminal cases arising from violations of the NIRC or Tariff and Customs Code and other laws administered by the BIR or the Bureau of Customs
  - *Provided however*, where the principal amount of taxes and fees, exclusive of charges and penalties claimed is less than one million pesos (P1, 000, 000.00) or where there is no specified amount claimed - the offenses or penalties shall be tried by the *regular courts* and the jurisdiction of the CTA shall be appellate.
  - Any provision of law or the Rules of Court to the contrary notwithstanding, the criminal action and the corresponding civil action for the recovery of civil liability for taxes and penalties shall at all times be simultaneously instituted with, and jointly determined in the same proceeding by the CTA, the filing of the criminal action being deemed to necessarily carry with it the filing of the civil action, and no right to reserve the filing of such civil action separately from the criminal action will be recognized.
- (b) **Exclusive appellate jurisdiction** in criminal offenses
  - Over appeals from the judgments, resolutions or orders of the RTC in tax cases originally decided by them, in their respective territorial jurisdiction.
  - Over petitions for review of the judgments, resolutions, or







orders of the RTC in the exercise of their appellate jurisdiction over tax cases originally decided by the Metropolitan Trial Courts, Municipal Trial Courts, and Municipal Circuit Trial Courts in their respective jurisdiction.

### III. JURISDICTION OVER TAX COLLECTION CASES

(a) **Exclusive original jurisdiction** in tax collection cases involving final and executory assessments for taxes, fees, charges and penalties.

- In collection cases where the principal amount of taxes and fees, exclusive of charges and penalties, claimed is less than one million pesos (P 1, 000, 000.00) - shall be tried by the proper *Municipal Trial Court, Metropolitan Trial Court, and Regional Trial Court.*

(b) **Exclusive appellate jurisdiction** in tax collection cases

- Over appeals from the judgments, resolutions or orders of RTC in tax collection cases originally decided by them, in their respective territorial jurisdiction.
- Over petitions for review of the judgements, resolutions or orders of the RTC in the exercise of their appellate jurisdiction over tax collection cases originally decided by the Metropolitan Trial Courts, Municipal Trial Courts and Municipal Circuit Trial Courts, in their respective jurisdiction.

☞ In criminal and collection cases, the Government may directly file the said cases with the CTA covering amounts within its exclusive and original jurisdiction.

❖ See **ANNEX P** - Comparative Diagrams on CTA jurisdiction.

### “OTHER MATTERS”

Those controversies which can be considered within the scope of the function of the BIR / BOC under ejusdem generis rule (e.g. action for the nullity of distraint and levy; questioning the propriety of the assessment; collection of compromise penalties).

### APPEAL

#### WHEN

Within 30 days after the receipt of such decision or ruling or after the expiration of the period fixed by law for action.

#### MODES OF APPEAL

- (1) By filing a petition for review under a procedure analogous to that provided for under Rule 42 of 1997 Rules on Civil Procedure
  - decision, ruling, or inaction of the *Commissioner of Internal Revenue, Commissioner of Customs, the Secretary of Finance, the Secretary of Trade and Industry or the Secretary of Agriculture or the Regional Trial Courts*
  - this appeal shall be heard by a Division of the CTA
- (2) By filing a petition for review under a procedure analogous to that provided for under Rule 43 of 1997 Rules on Civil Procedure
  - decisions or rulings of the *Central Board of Assessments Appeals* and the *Regional Trial Courts* in the exercise of its *appellate* jurisdiction
  - this appeal shall be heard by the CTA en banc.

#### PROCEDURE

- A. Any party adversely affected by a ruling, order or decision of a Division of the CTA may file a motion for reconsideration or new trial before the same Division within 15 days from notice







- B. Any party adversely affected by a resolution of a Division of the CTA on a motion for reconsideration or new trial may file a petition for review with the CTA en banc.
- C. Any party adversely affected by a decision or ruling of the CTA en banc may file with the Supreme Court a verified petition for review on certiorari pursuant to Rule 45 of the 1997 Rules on Civil Procedure.

### THIRTY (30) DAY PRESCRIPTIVE PERIOD FOR APPEAL

Starts to run from the *date the taxpayer receives the appealable decision*. If the taxpayer's request for reconsideration (i.e., the protest is denied or the original assessment is maintained, the appealable decision is the decision denying the request for reconsideration.

The said period is *jurisdictional and non-extendible*. Requests or motions for reconsideration, however, operate to suspend the running of the period to appeal. A pro forma request for reconsideration or one which is directed to the Secretary of Finance does not suspend the running of the 30-day reglementary period.

### ONLY A FINAL DECISION IS APPEALABLE TO THE COURT OF TAX APPEALS

- Preliminary collection letters, post reporting notices and pre-assessment notices are not appealable, because they are not the final decision of the Commissioner.
- An assessment can be appealed if taxpayer does not seek a reconsideration.
- At times there is an exchange of communications between taxpayer and Commissioner states that his action is final, then, period for appeal begins to run.
- Commissioner must state that his decision is final, for period of appeal to run.
- Final decision cannot be implied from issuance of warrant of distraint and levy, unless it is issued after a request for reconsideration.

**GENERAL RULE:** New issues cannot be raised for the first time on appeal.

### EXCEPTIONS:

- Defense of prescription  
Reason: This is a statutory right. (*Visayan Land Transportation vs. Collector*)
- Errors of administrative officials  
Reason: State can never be in estoppel and lifeblood theory. (*Commissioner vs. Procter and Gamble Phils. Mfg. Corp, GR No. 66838, April 15, 1988*)

**NOTE:** However, this was reversed in Supreme Court's subsequent resolution wherein it was held that "in the absence of explicit statutory provisions to the contrary, the Government must follow the same rules of procedure which bind private parties." (*Commissioner vs. Procter and Gamble, GR No. 66838, December 2, 1991, Resolution*)

### TAX COLLECTION NOT SUSPENDED DURING APPEAL

**General Rule:** No appeal taken to the CTA shall suspend the payment, levy or distraint, and/or sale of any property of the taxpayer.

**Exception:** The CTA is empowered to suspend the collection of internal revenue taxes and custom duties only when there was a -

- showing that collection of the tax may jeopardize the interest of the government and / or the taxpayer;
- deposit of the amount claimed or file a surety bond for not more than double the amount of tax with the Court when required; and
- showing by taxpayer that appeal is not frivolous nor dilatory.

### CAN THE CTA ENJOIN COLLECTION OF TAXES?

- Sec. 11 of RA No. 1125 as amended by Sec. 9 of RA No. 9282 grants CTA power to suspend collection of tax if such collection works to serious prejudice of either taxpayer or government.





- However, Sec. 218 of the Tax Code provides no court may grant injunction to restrain collection of any tax, fee or charge imposed by Tax Code.
- The provision in Tax Code refers to courts other than the CTA. (*Blaquera vs. Rodriguez*, GR No. L-11295, March 29, 1958)
- Appeal to the CTA does not automatically suspend collection unless CTA issues suspension order at any stage of proceedings.

#### SIMULTANEOUS FILING OF AN APPLICATION FOR REFUND OR CREDIT AND INSTITUTION OF A CASE BEFORE THE CTA ALLOWED

The law fixes the same period of two (2) years for filing a claim for refund with the Commissioner and for filing a case with the CTA. The two-year period for both starts from the date after the payment of the tax or penalty, or from the approval of the application for credit.

**Observation:** If we are not going to allow the taxpayer to file a refund before the CTA and let him wait for the CIR's decision, and the latter failed to render a decision within the 2-year period, the said taxpayer can no longer file a refund before the CTA because his right to appeal has prescribed.

#### WEIGHT OF DECISION OF CTA

- Decisions of Tax Court have persuasive effect and may serve as judicial guides. They have more persuasive value than BIR Rulings.
- CTA's findings of fact are entitled to the highest respect. (*Raymundo vs. de Joya*, GR No. L-27733, December 3, 1980)
- The Supreme Court will not set aside conclusions reached by Tax Court which by the very nature of its function, is dedicated exclusively to the consideration of tax problems and has developed an expertise on the subject, unless there has been an abuse or an improvident exercise of authority on its part. (*Commissioner vs. Court of Appeals*)

& *Atlas Consolidated*, GR No. 86785, November 21, 1991)

## VII. VALUE-ADDED TAX (VAT)

### TITLE IV OF NIRC

**DEFINITION:** The value-added tax is an indirect tax and the amount of tax may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services. This rule shall likewise apply to existing contracts of sale or lease of goods, properties or services at the time of the effectivity of Republic Act No. 7716.

VAT replaced Sales Tax as imposed by previous Tax Laws.

#### HISTORY:

- Executive Order No. 273
- Republic Act No. 7716
- Republic Act No. 8241
- Republic Act No. 8424 (took effect on 1 January 1998)

#### TRANSACTIONS COVERED BY VAT:

1. Sale of Commodities or Goods (in the course of trade or business only)
2. Sale of Services (in the course of trade or business only)
3. Exportation (in the course of trade or business only)
4. Importation (**whether or not** in the course of trade or business)

#### PERSONS LIABLE FOR VAT

Any person who, in the course of trade or business, sells, barter, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 106 to 108 of the National Internal Revenue Code.

#### "IN THE COURSE OF TRADE OR BUSINESS"

The regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto, by any person regardless of





whether or not the person engaged therein is a non-stock, nonprofit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests), or government entity.

Therefore if the disposition of goods or services is **NOT** in the course of trade or business then it is not subject to VAT; with the exception of importation of course.

The rule of regularity, to the contrary notwithstanding, services as defined in this Code rendered in the Philippines by non-resident foreign persons shall be considered as being course of trade or business.

**Importation is subject to VAT regardless of whether or not it is in the course of trade or business**

The reason for the rule is to protect our local or domestic goods or articles and to regulate the entry or introduction of foreign articles to our local market. Regulation is one of the purposes of Taxation.

#### **Tax Rates:**

1. 10% - the rate used in sale of commodities and goods, sale of services, and importation.
2. Zero-rated (0%) - the rate used in exportation.

#### **MANNER OF COMPUTING THE VAT:**

##### **A. 10% rate of Tax**

1. In sale of commodities and goods, 10% is multiplied with the Gross Selling Price.
2. In sale of services, 10% is multiplied with the Gross Receipts.
3. In importation, 10% is multiplied with the rates used by the Bureau of Customs in imposing tariff and customs duties plus customs duties, excise taxes, if any, and other charges, such tax to be paid by the importer prior to the release of such goods from customs custody: Provided, That where the customs duties are determined on the basis

of the quantity or volume of the goods, the value-added tax shall be based on the landed cost plus excise taxes, if any. customs duties.

##### **B. Zero-rated (0%) rate of tax**

1. Export Sales as provided in Section 106(A)(2)(a)
2. Foreign Currency Denominated Sale as provided in Section 106 (A)(2)(b)
3. Sale to persons or entities which is VAT exempt under special laws or international agreements to which the Philippines is a signatory as provided in Section 106 (A)(2)(c)
4. Transactions subject to zero-rated (0%) as provided in Section 108(B)

#### **REGISTRATION UNDER THE VAT SYSTEM (SECTION 236 OF THE NIRC)**

**General Rule:** Failure to register is subject to temporary closure of the establishment for 5 days as provided in Section 115(b).

**Exception:** It does not apply to an exporter who fails to register. The effect is, instead of treating the transaction as zero-rated (0%), it is treated as an exempt transaction.

**What is the difference? In zero-rated (0%) transactions, tax credit is available. However, in exempt transactions, tax credit is not available.**

#### **EXEMPT TRANSACTIONS (SECTION 109):**

1. In Section 109(a) and (c), food and non-food products are VAT-exempt as long as these products are in its original state. The simple process of preparation or preservation for the market such as freezing, drying, salting, broiling, roasting, smoking, or stripping **does not** remove the product from its category of being in its original state.
- However, even if the products were no longer in its original state, it can still be VAT-exempt under Section 109(r), if sold by agricultural cooperatives duly registered by Cooperative Development Authority.





2. Under Section 109(m), private educational institutions are exempt from VAT if duly accredited by the DECS or by the CHED. In case of government educational institution, no accreditation is required.
  3. Transactions in the field of Arts are VAT-exempt only, as provided in Section 109(n), if the seller is the artist himself or the artist's services performed for the production of such works.
  4. Section 109(p) makes Regional or Area Headquarters exempt from VAT.
  5. Under Section 109(w) in order for the sale or lease of real property to be exempted from VAT, the transaction must NOT be conducted in the ordinary course of trade or business. It complements Section 106(A)(1)(a) where it states that in order for the sale or lease of real property to be covered by VAT, it must be made in the ordinary course of trade or business.
  6. Revenue Regulations No. 6-97 adds a requirement in order for the lease of residential units with a monthly rental of not more than P8,000.00, as provided in Section 109(x), to be VAT exempt, that the annual gross receipts must not exceed P550,000.00.
  7. Section 109(z) provides that the sale or lease of goods or performances of services other than those mentioned in the preceding paragraphs are VAT exempt if the Gross Annual Receipts do not exceed P550,000.00. However, the limitation of P550,000.00 does apply for those transactions from Section 109(a) to (y), except (x) because Revenue Regulations No. 6-97 imposes a P550,000.00 limitation.
- In cases of tax-free importation of goods into the Philippines by persons, entities or agencies exempt from tax where such goods are

subsequently sold, transferred or exchanged in the Philippines to non-exempt persons or entities, the purchasers, transferees or recipients shall be considered the importers thereof, who shall be liable for any internal revenue tax on such importation. The tax due on such importation shall constitute a lien on the goods superior to all charges or liens on the goods, irrespective of the possessor thereof.

#### TRANSACTIONS DEEMED SALE:

The following transactions shall be deemed sale therefore making them covered by VAT:

- (1) Transfer, use or consumption not in the course of business of goods or properties originally intended for sale or for use in the course of business;
- (2) Distribution or transfer to:
  - (a) Shareholders or investors as share in the profits of the VAT-registered persons; or
  - (b) Creditors in payment of debt;
- (3) Consignment of goods if actual sale is not made within sixty (60) days following the date such goods were consigned; and
- (4) Retirement from or cessation of business, with respect to inventories of taxable goods existing as of such retirement or cessation.

**How to determine the VAT:** The tax shall be computed by multiplying the total amount indicated in the invoice by one-eleventh (1/11).

**Example:** the total amount indicated in the invoice is P110.  $P110/11 = P10$ . P10 is the amount of VAT.

#### TAX CREDIT AND REFUND

##### Formula for Tax Credit:

Output  
Less: Input  
VAT due.

- If Input is greater than Output, Tax Credit is available.





**"INPUT TAX"** means the value-added tax due from or paid by a VAT-registered person in the course of his trade or business on importation of goods or local purchase of goods or services, including lease or use of property, from a VAT-registered person. It shall also include the transitional input tax determined in accordance with Section 111 of the NIRC.

**"OUTPUT TAX"** means the value-added tax due on the sale or lease of taxable goods or properties or services by any person registered or required to register under Section 236 of the NIRC.

- If at the end of any taxable quarter the output tax exceeds the input tax, the excess shall be paid by the VAT-registered person. If the input tax exceeds the output tax, the excess shall be carried over to the succeeding quarter or quarters. Any input tax attributable to the purchase of capital goods or to zero-rated sales by a VAT-registered person may at his option be refunded or credited against other internal revenue taxes, subject to the provisions of Section 112.

#### **OPTIONS OF A TAXPAYER AS PROVIDED IN SECTION 112:**

1. to claim for tax credit; or
2. to claim for refund

The claim, which must be in writing, for both cases, must be filed within 2 years after the close of the taxable quarter when the sales were made for: a) the issuance of a tax credit certificate; b) refund of creditable input tax due or paid attributable to such sales.

#### **HOW TO DETERMINE CREDITABLE INPUT TAX**

The sum of the excess input tax carried over from the preceding month or quarter and the input tax creditable to a VAT-registered person during the taxable month or quarter shall be

reduced by the amount of claim for refund or tax credit for value-added tax and other adjustments, such as purchase returns or allowances and input tax attributable to exempt sale.

The claim for tax credit referred to in the foregoing paragraph shall include not only those filed with the Bureau of Internal Revenue but also those filed with other government agencies, such as the Board of Investments or the Bureau of Customs.

The Commissioner within 120 days, in proper cases, from the date of submission of complete documents in support of the application shall grant a refund or issue the tax credit certificate for creditable input taxes.

Remedy in case of full, or partial denial, or failure on the part of the Commissioner to act upon the application for tax credit or refund: the taxpayer affected may, within thirty (30) days from the receipt of the decision denying the claim or after the expiration of the one hundred twenty day-period, appeal the decision or the unacted claim with the Court of Tax Appeals.

#### **RETURN AND PAYMENT OF VAT**

Every person liable to pay the value-added tax shall file a quarterly return of the amount of his gross sales or receipts within 25 days following the close of each taxable quarter prescribed for each taxpayer: *Provided, however,* That VAT-registered persons shall pay the value-added tax on a monthly basis.

Any person, whose registration has been cancelled in accordance with Section 236, shall file a return and pay the tax due thereon *within 25 days* from the date of cancellation of registration: *Provided,* That only one consolidated return shall be filed by the taxpayer for his principal place of business or head office and all branches.



