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SyCipLaw TIPS

TAX ISSUES AND PRACTICAL SOLUTIONS

1. If a taxpayer believes that a national internal revenue tax assessment issued against it is based on an unconstitutional law, may the taxpayer question the assessment by filing a petition for declaratory relief with prayer for injunction before the Regional Trial Court?

No. In *Commissioner of Internal Revenue v. Standard Insurance Co., Inc.* (G.R. No. 219340, April 28, 2021), the Supreme Court ruled that courts have no jurisdiction over petitions for declaratory relief against the imposition of tax liability or validity of tax assessments. Further, no court has the authority to grant an injunction to restrain the collection of any national internal revenue tax, except only when in the opinion of the Court of Tax Appeals (*CTA*), the collection thereof may jeopardize the interest of the government and/or the taxpayer.

SyCipLaw Tip 1:
SyCipLaw Tip: Once an assessment for national internal revenue tax is issued, the proper remedy would be to timely protest or appeal the assessment in accordance with the revenue regulations, not to file a petition for declaratory relief even if there is a constitutional argument against the legal basis of the assessment.

2. Is a new or amended Letter of Authority (*LOA)* required when the revenue officer/s named in the original LOA were re-assigned and substituted?

Yes. In *Commissioner of Internal Revenue v. McDonald's Philippines Realty Corp.* (G.R. No. 242670, May 10, 2021), the Supreme Court ruled that the practice of re-assigning or transferring revenue officers originally named in the LOA and substituting or replacing them without a separate or amended LOA (i) violates the taxpayer's right to due process in tax audit or investigation, (ii) usurps the statutory power of the Commissioner of Internal Revenue (*CIR)* or his duly authorized representative to grant the power to examine the books of account of a taxpayer, and (iii) does not comply with existing revenue rules and regulations on the requirement of an LOA in the grant of authority by the CIR or his duly authorized representative to examine the taxpayer's books of accounts. On this basis, the Supreme Court upheld the invalidation of the assessment on the ground that the revenue officer who continued the audit of the taxpayer's books was not authorized by way of an LOA to investigate the taxpayers' books of accounts.

The Supreme Court said that "there must be a grant of authority, in the form of a LOA, before any revenue officer can conduct an examination or assessment. The revenue officer so authorized must not go beyond the authority given. In the absence of such authority, the assessment or examination is a nullity."

SyCipLaw Tip 2:
A taxpayer must always be mindful to check if the revenue officers conducting an audit of its books are the ones duly authorized to do so pursuant to an LOA. In case of re-assignment or substitution, a new or amended LOA must be issued to the new revenue officer/s who will continue the audit. Failure of the Bureau of Internal Revenue (*BIR*) to issue a new or amended LOA may be raised to assail the validity of the assessment.

The Supreme Court said that a notice of reassignment is not sufficient and further explained that "the service of a copy of a memorandum of assignment, referral memorandum, or such other equivalent internal BIR document may notify the taxpayer of the fact of reassignment and transfer of revenue officers. However, notice of the fact of reassignment and transfer of cases is one thing; proof of the existence of authority to conduct an examination and assessment is another thing. The memorandum of assignment, referral memorandum, or any equivalent document is not proof of the existence of authority of the substitute or replacement revenue officer. The memorandum of assignment, referral memorandum, or any equivalent document is not issued by the CIR or his duly authorized representative for the purpose of vesting upon the revenue officer authority to examine a taxpayer's books of accounts. It is issued by the revenue district officer or other subordinate official for the purpose of reassignment and transfer of cases of revenue officers."

3. Are all tax refunds to be construed strictly against the claimant-taxpayer?

No. In *Petron Corporation v. Commissioner of Internal Revenue (*CTA Case No. 8544, July 19, 2021), the CTA Second Division declared that the rule that tax exemptions should be construed strictly against the taxpayer presupposes that the taxpayer is clearly subject to the tax being levied against the taxpayer. Unless a statute imposes a tax clearly, expressly, and unambiguously, the equally well-settled rule that the imposition of a tax cannot be presumed will apply. There must be a clear delineation between a claim for refund premised on a tax exemption under a statute and a claim for refund based on erroneous payment when the taxpayer or article, as the case may be, is not subject to tax. The former should be construed against the claimant-taxpayer, whereas the latter should be construed against the Government.

SyCipLaw Tip 3:
In a claim for tax refund, the taxpayer must determine whether the refund is premised on a tax exemption under a statute or on an erroneous payment (*i.e.*, whether the taxpayer or article, as the case may be, is not subject to tax). In the case of the former, the taxpayer has the burden of proving entitlement to refund and the rule that tax exemptions are strictly construed against the taxpayer will apply. In the case of the latter, the applicable rule is that imposition of taxes is strictly construed against the Government, and so the burden is on the Government to prove that the taxpayer or the article is indeed subject to tax.

CTA decisions, while persuasive, do not become the law of the land, unlike decisions of the Supreme Court.

In this case, the CTA Second Division amended their previous decision denying the claim for refund based on an erroneous payment of excise taxes. In the previous decision, the CTA Second Division subjected alkylate, a substance not included in the enumeration under Section 148(e) of the National Internal Revenue Code, as amended (*Tax Code*), to excise tax and ruled that "as long as the process of distillation was employed, the resulting product *may* fall within the ambit of 'other similar products of distillation', subject to tax."

In its Amended Decision, the CTA Second Division noted that two conditions must concur before excise taxes are imposed: (a) the articles subject to tax belong to any of the categories of goods enumerated in Title IV of the Tax Code; and (b) said articles are for domestic sale or consumption, excluding those that are actually exported. Thus, insofar as excise taxes are concerned, non-taxability is the rule, while taxability is the exception.

The CTA Second Division applied the rule of strict statutory construction against the government in determining whether the claimant-taxpayer was entitled to the refund of erroneously paid excise taxes. According to the CTA Second Division, the absence of a distinction between primary and secondary, or direct and indirect, products of distillation should work in the taxpayer's favor. It ruled that "since the Congress did not clearly, expressly, and unambiguously impose an excise tax on alkylate (or those which are not directly produced by distillation) under Section 148(e), [the taxpayer] is thus correct that its claim for refund should have been resolved in its favor."

SyCipLaw Tip 4:
The taxpayer should make sure that its suppliers furnish it with CWTs in a timely manner and which are in form and substance compliant with law and regulations. In a situation where the taxpayer will ask for a refund of CWT, the burden is on the taxpayer to ensure that the claim is properly substantiated by a Certificate of Creditable Tax Withheld at Source, which is complete in relevant details. The taxpayer must also prove that the income earned or received was declared in the same period with the related tax credit.

CTA decisions, while persuasive, do not become the law of the land, unlike decisions of the Supreme Court.

4. What are the requirements for refund of excess and unutilized creditable withholding taxes?

In *Proctor & Gamble Distributing (Philippines), Inc. v. Commissioner on Internal Revenue* (CTA Case No. 9946, July 22, 2021), the CTA Second Division enumerated the requisites for a corporate taxpayer to be entitled to refund of excess withholding taxes as follows: (a) the claim for refund was filed within the two-year reglementary period; (b) the fact of withholding is established by a copy of the withholding tax statement, duly issued by the payor to the payee, showing the amount paid and income tax withheld from that amount; and (c) it is shown on the income tax return that the income payment received is being declared as part of the taxpayer's gross income.

Regarding the second requisite, a certificate of creditable tax withheld at source is competent proof to establish the fact that taxes have been withheld. Proof of actual remittance is not a condition to claim a refund of unutilized tax credits. Upon presentation of a withholding tax certificate, complete in its relevant details and with a written statement that it was made under the penalties of perjury, the burden of evidence then shifts to the CIR to prove that: (a) the certificate is not complete; (b) it is false; or (c) it was not issued regularly.

As regards the third requisite, the taxpayer must prove that the income payment pertaining to the substantiated creditable withholding taxes (*CWTs)* were declared as part of its gross income subject to income tax for the same taxable year. "It is not enough that the related income earned or received be declared as part of the gross income. What is essential is that in claiming the tax credits, there must be proof that the declaration of income earned or received is made in the same period with the claiming of the related tax credit."

In this case, out of the PhP105.3 million claim for refund, only PhP84.3 million (or reduced by PhP21 million) was granted by the CTA Second Division. The court disallowed the CWTs that were not properly substantiated or untraceable or pertain to income earned outside the period subject of the refund. The CTA Second Division also disallowed the Certificates of Creditable Tax Withheld at Source that were merely stamped or electronically signed by the payor, unsigned by the payor, merely photocopied, or contains the incorrect taxpayer identification number of the taxpayer.

5. Are all transactions intended to combat COVID-19 value-added tax (*VAT*)-exempt?

No, the law grants tax exemptions only to specific transactions relating to the COVID pandemic.

BIR Ruling No. VAT-063-21 issued on March 3, 2021 involves the request of a service provider for VAT exemption on the Information Communications Technology (*ICT)* services procured by the Quezon City Government to track COVID positive, contacts, and walk-in symptomatic patients without contact with healthcare workers. In response, the BIR reiterated the rule that when a taxpayer claims an exemption, it must point to the specific provision of law authorizing the exemption. The taxpayer must also be able to prove that it is entitled to the exemption under the law. The BIR noted that there is nothing in Republic Act No. 11469, otherwise known as "Bayanihan to Heal as One Act", that grants VAT exemption to local government units or domestic corporations relative to transactions involving ICT services during the pandemic. Likewise, the nature of the transaction does not warrant the operation of Section 109 of the Tax Code that would justify VAT exemption. Further, the BIR found that the agreement between the Quezon City Government and the service provider is within the purview of Section 108 (A) of the Tax Code. Thus, the BIR denied the service provider's request for VAT exemption.

SyCipLaw Tip 5:
Tax exemptions are strictly construed against the taxpayer. Thus, a taxpayer claiming an exemption must be able to point to a specific provision of the statute authorizing the exemption and prove entitlement to the exemption provided under the law. Only specific transactions relating to the COVID pandemic are provided VAT exemption privileges under the law. Accordingly, while the sale of a product or service may help mitigate the risks of COVID-19, the transaction may not necessarily be subject to VAT exemption.

Please see also our TIP number [3] on Tax Refunds.

SyCipLaw Tip 6:
Taxpayers should ensure that they pay their taxes on time to avoid penalties. Good faith or economic difficulties during a pandemic do not provide sufficient grounds for the BIR to abate tax liabilities in case a taxpayer is not able to pay taxes on time.

6. Can the BIR waive penalties, interest, and/or surcharges on delayed payment of tax due to the COVID-19 pandemic?

No. In BIR Ruling No. OT-193-21 issued May 25, 2021, the BIR stated that the imposition of the surcharge for failure to file a return and pay the tax due thereon, and of the interest on delinquency, is mandatory. In this request for ruling, the taxpayer invoked humanitarian considerations and the difficulties brought about by the COVID-19 pandemic as reasons for requesting the BIR to waive the penalties, interest, and/or surcharges arising from the taxpayer's late payment of documentary stamp tax one day after the deadline. The BIR denied the request, emphasizing that it should not act merely out of compassion or charity, but should consider the pecuniary interest of the government, justice and equity, and public policy.

The BIR explained that the intention of the law is to hasten the payment of taxes because the maintenance of the government as well as its activities depend on tax collections. It added that the surcharge and interest imposed are not penal but compensatory in nature as they are compensation for the delay in payment and for the concomitant use by the taxpayer of the funds that rightfully should be in the government's hands.

Additionally, under Section 204 (B) of the Tax Code, the Commissioner may abate or cancel tax liability only in two cases: (a) the tax or any portion thereof appears to be unjustly or excessively assessed; or (b) the administration and collection costs involved do not justify the collection of the amount due. Good faith alone is not sufficient to avoid the surcharge which is designated to ensure timely compliance with the law.

7. Are non-stock non-profit organizations automatically exempted from income taxation?

No. A non-stock non-profit organization (*NSNP*) must comply with certain requirements before it can avail itself of income tax exemption.

First, the NSNP must be among those organizations enumerated in Section 30 of the Tax Code. These include nonstock corporations or associations organized and operated exclusively for religious, charitable, scientific, athletic, or cultural purposes, business league chambers of commerce, civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, and non-stock and non-profit educational institutions, among others.

Second, the NSNP must apply for a Certificate of Tax Exemption (*CTE*) from the BIR. Before granting a CTE, the BIR requires the applicant to pass two tests. The first one is the *Organizational Test* which requires the NSNP to show that its primary purpose of incorporation is among those specified in Section 30 of the Tax Code. The second one is the *Operational Test* which requires the NSNP to show that its regular activities are devoted exclusively to the accomplishment of the purposes specified in Section 30 of the Tax Code.

SyCipLaw Tip 7:
As a general rule, non-stock non-profit organizations are subject to income tax. Section 30 of the Tax Code provides for an exemption. However, before availing themselves of such exemption, NSNPs must ensure that they are compliant with all the requirements by laws and regulations. A taxpayer must always remember that exemptions from taxation are construed in *strictissimi juris* against the taxpayer and liberally in favor of the taxing authority.

Please see also our TIP number [3] on Tax Refunds.

Third, the income of the NSNP that is sought to be exempted from income taxation must not come from properties or activities that are conducted for profit, regardless of the disposition of such income. Thus, interest income from bank deposits, gains from investments, and rental income from real or personal properties are subject to income taxation.

Lastly, the NSNP must ensure that its earnings or assets do not inure to the benefit of any of its trustees, organizers, officers, members, or any specific person. More popularly known as the Non-Inurement Rule, the rule was crafted to ensure that NSNPs are not used as tax shelters because of tax exemptions they may be entitled to. Some examples of what is considered as inurements are: compensation or honorarium to its trustees or organizers, exorbitant or unreasonable compensation to its employees, welfare aid and financial assistance to its members, and other similar disbursements.

SyCipLaw Tip 8:
Foreign embassies and their diplomatic personnel may avail themselves of VAT exemption on their purchase of local goods or services based on reciprocity. However, the method by which the VAT exemption may be claimed will depend on the VAT privilege granted to PSFPs under the laws of the country of the concerned foreign embassy. Accordingly, some diplomatic missions and diplomatic personnel will not be entitled to point-of-sale VAT exemption but will instead need to file a claim for refund/reimbursement of the VAT paid on their local purchases with the DFA-OP, which will then endorse the claim to the BIR.

8. May diplomatic personnel claim exemption from VAT on their local purchases of goods and services?

Yes, but only if the sending State also accords VAT exemption privileges on local purchases of goods and services to Philippine diplomatic personnel in that sending State. While the Vienna Convention on Diplomatic Relations exempts diplomatic missions and diplomatic agents from dues and taxes, they are generally subject to indirect taxes which are normally incorporated in the price of goods or services. Nevertheless, on the basis of reciprocity, the BIR may grant VAT privileges to a foreign mission and its qualified personnel on their local purchase of goods and/or services, subject to a categorical confirmation from the Office of Protocol of the Department of Foreign Affairs (*DFA-OP*) that the foreign government accords the same VAT privileges to the Philippine Foreign Service Posts (*PFSPs*) and its personnel on their purchase of goods and services in the concerned foreign country.

Pursuant to Revenue Memorandum Order (*RMO*) No. 10-2019, as amended by RMO No. 41-2020, a resident foreign mission, its qualified personnel, and the latter's dependent/s may be accorded VAT exemption on their purchase of goods and/or services either on a point-of-sale or on a refund/reimbursement basis. The method of granting VAT exemption depends on the VAT privilege being accorded to our PFSPs by foreign governments, which is regularly monitored by the DFA-OP.

In ITAD BIR Ruling No. 30-21 issued on June 8, 2021 to the Embassy of India, the BIR found that based on the endorsement of the DFA-OP and DFA Matrix on VAT privileges enjoyed by PFSPs, the Government of the Republic of India accords VAT exemption on local purchase of goods and services, by way of refund/reimbursement, to the Philippine Embassy and its diplomatic personnel in New Delhi, India. Thus, the BIR ruled that the Embassy of India and its diplomatic personnel in the Philippines are entitled to the same VAT exemption through reimbursement/refund, and not through point-of-sale basis. The diplomatic personnel of the Embassy of India may secure the VAT reimbursement/refund on purchases of local goods and services in the Philippines following the guidelines in RMO No. 10-2019, as amended by RMO No. 41-2020.