

TRANSFER TAXES¹

There are two things certain in this world: death and taxes.

What is a transfer tax? Transfer tax is a tax imposed upon the gratuitous disposition of private property. They are not taxes on property as such because their imposition does not rest upon general ownership but on the passing of the property.

Kinds of Transfer Taxes

1. Estate Tax
2. Donor's Tax

Presidential Decree No. 69 eliminated the inheritance tax and the donee's tax.

ESTATE TAX

Formula:

Gross estate
Less: deductions
Net estate
x tax Rate
Taxable net estate
Less: tax credit
Estate tax payable

What is an Estate Tax?

- ⊕ It is graduated tax imposed on the privilege of the decedent to transmit property at death and is based on the entire net estate, regardless of the number of heirs and relations to the decedent.
- ⊕ Estate tax is the tax on the right to transmit property at death and on certain transfer which are made by the statute the equivalent of testamentary dispositions.
- ⊕ Tax on gratuitous transfer *mortiscausa*.
- ⊕ Tax imposed on the right or privilege to transmit properties upon death of a decedent or testator.

DOCTRINES SUPPORTING THE IMPOSITION OF ESTATE TAX

1. **Benefit Receive Theory** - The tax is in return for the services rendered by the state in the distribution of the estate of the decedent and for the benefits that accrue to the estate and the heirs.

2. **State Partnership Theory** -The tax is in the nature of a share of the state as a passive and silent partner in the accumulation of property.
3. **Ability to pay Theory** - The tax is based on the fact that the receipt of inheritance creates an ability to pay and thus to contribute to governmental income.
4. **Redistribution of Wealth Theory** -The tax is imposed to help reduce undue concentration of wealth in society to which the receipt of inheritance is a contributing factor.

Bar 2004 - Estate Tax: Payment vs. Probate

Proceedings: VCC is the administrator of the estate of his father NGC, in the estate proceedings pending before the MM Regional Trial Court. Last year, he received from the Commissioner of Internal Revenue a deficiency tax assessment for the estate in the amount of P1,000,000. But he ignored the notice. Last month, the BIR effected a levy on the real properties of the estate to pay the delinquent tax. VCC filed a motion with the probate court to stop the enforcement and collection of the tax on the ground that the BIR should have secured first the approval of the probate court, which had jurisdiction over the estate, before levying on its real properties. Is VCC's contention correct? (5%)

Suggested answer: No. VCC's contention is not correct. The approval of the probate court is not necessary. Payment of estate taxes is a condition precedent for the distribution of the properties of the decedent and the collection of estate taxes is executive in nature for which the court is devoid of any jurisdiction. Hence, the approval of the court, sitting in probate, or as a settlement tribunal is not a mandatory requirement in the collection of estate taxes (**Marcos H v. Court of Appeals, 273 SCRA 47 [1997]**).

Bar 1994 - Estate Tax: Comprehensive Agrarian

Reform Law: Jose Ortiz owns 100 hectares of agricultural land planted to coconut trees. He died on May 30, 1994. Prior to his death, the government, by operation of law, acquired under the Comprehensive Agrarian Reform Law all his agricultural lands except five (5) hectares. Upon the death of Ortiz, his widow asked you how she will consider the 100 hectares of agricultural land in the preparation of the estate tax return. What advice will you give her?

Suggested answer: The 100 hectares of land that Jose Ortiz owned but which prior to his death on May 30, 1994 were acquired by the government under CARP are no longer part of his taxable gross estate, with the exception of the remaining five (5) hectares which under Sec. 78(a) of the Tax Code still forms part of "decedent's interest".

WHOSE ESTATE IS SUBJECT TO ESTATE TAX?

- I. **Resident Estate taxpayer** - Includes **citizens of the Philippines, resident alien who died in the Philippines and such alien, at the time of his death, is a resident of the Philippines.**

¹From Mamalateo's Reviewer in Taxation and AttyBarlis' Review Notes in Taxation.

Note:Real properties, personal tangible properties and personal intangible properties of resident decedent (RD) are taxed wherever situated.

II. Non- resident Estate Taxpayer - Limited to non-resident alien individual.

Real and personal tangible properties of non-resident decedent (NRD) are taxable only if they are located in the Philippines.

Real and personal tangible properties of NRD are taxable only if they acquire tax situs in the Philippines.

Bar 1994 - Estate Tax: Inclusion: Resident Alien: Cliff Robertson, an American citizen, was a permanent resident of the Philippines. He died in Miami, Florida. He left 10,000 shares of Meralco, a condominium unit at the Twin Towers Building at Pasig, Metro Manila and a house and lot in Los Angeles, California. What assets shall be included in the Estate Tax Return to be filed with the BIR?

Suggested answer: All of Mr. Robertson's assets consisting of 10,000 shares in the Meralco, a condominium unit in Pasig, and his house and lot in Los Angeles, California are taxable. The properties of a resident alien decedent like Mr. Robertson are taxable wherever situated (Sees. 77, 78 and 98, Tax Code).

Bar 2000 - Estate Tax: Situs of Taxation: Non-Resident Decedent: Discuss the rule on *situs of taxation* with respect to the imposition of the estate tax on property left behind by a non-resident decedent. (2%)

Suggested answer: The value of the gross estate of a non-resident decedent who is a Filipino citizen at the time of his death shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated to the extent of the interest therein of the decedent at the time of his death [Sec. 85 (A), NIRC of 1997]. These properties shall have a situs of taxation in the Philippines hence subject to Philippine estate taxes.

On the other hand, in the case of a non-resident decedent who at the time of his death was not a citizen of the Philippines, *only that part of the entire gross estate which is situated in the Philippines to the extent of the interest therein of the decedent at the time of his death shall be included in his taxable estate.* Provided, that, with respect to intangible personal property, we apply the rule of reciprocity. (Ibid)

PERSONAL INTANGIBLE PROPERTIES THAT ARE DEEMED TO HAVE ACQUIRED PHILIPPINE SITUS

1. Franchise which is exercised in the Philippines.
2. Shares of stock, obligation or bonds issued by Domestic Corporation or *sociedadanonima*.

3. Shares of stock, obligation or bonds issued by foreign corporation, 85% of the business of which is conducted in the Philippines.
4. Shares, obligations or bonds that acquire business situs in the Philippines.
 - Φ Such shares, obligations or bonds acquire business situs in the Philippines if they are used by foreign corporation in furtherance of its trade or business.
5. Shares or rights in any partnership, business or in any partnership, business or industry, established in the Philippines.

Note:If the personal intangible properties of a NRD do not belong to the above-mentioned enumeration, they may not form part of his gross income or we may also apply the doctrine of *mobilisequuntorpersonam*.

Mobilisequuntorpersonam, according to the Supreme Court, is a mere fiction of law. So it must yield to the provision of law which provides tax situs.

RULE ON RECIPROCIITY: Question: suppose the personal intangible properties of NRD acquired tax situs in the Philippines, can this be exempt from estate tax?

Answer: yes, by applying the Rule on Reciprocity.

Meaning of Reciprocity: There is reciprocity if the foreign country of which the decedent was a citizen or resident at the time of his death:

1. Did not impose an estate tax; or
2. Allowed a similar exemption from estate tax with respect to **intangible personal property** owned by Filipino citizens residing in the foreign country.

NOTE:Reciprocity applies only when:

1. The property is an intangible; and
2. The decedent is a non-resident alien.

It does not necessitate the existence of a tax treaty for its application. It also includes also partial exemption.

Illustration:Country of Morocco has no international personality. If it grants exemptions to the intangible personal properties to Filipino citizens who die in that country, will you apply also that rule on reciprocity?

Held:Yes, it does not matter whether the country has international personality or not. What is important is it allows or grants exemption from estate tax.

APPLICABLE LAW IN ESTATE TAXATION

1. Estate taxation is governed by the statute in force at the time of the death of the decedent (Section 3, RR 17-93)

2. 28 July 1992- amendments under RA 7499 took effect. Under said law, first P200, 000. 00 is exempt from estate taxation and the tax rate ranges from 8% to 35%.
3. 01 January 1998 amendments under the NIRC took effect. Under this law, the first P200, 000. 00 is also exempt but the tax rate only ranges from 5% to 20%.

GROSS ESTATE

What comprises gross estate? *Section 85, Gross Estate*- "the value (FMV) of the gross estate of the decedent shall be determined by including the value, **at the time of his death**, of all property, real or personal, tangible or intangible, wherever situated: provided, however, that in the case of a non-resident decedent who at the time of his death was not a citizen of the Philippines, only that part of the entire gross estate which is situated in the Philippines shall be included in his taxable estate."

INCLUSIONS IN THE GROSS ESTATE

I. Specific Items Included in the Gross Estate

1. Real and personal property, whether tangible or intangible wherever situated.
2. Franchise which must be exercised in the Philippines.
3. Shares, obligations or bonds issued by any corporation or *sociedadanonima* organized or constituted in the Philippines in accordance with its laws.
4. Shares, obligations or bonds issued by any foreign corporation 85% of the business of which is located in the Philippines.
5. Shares, obligations or bonds issued by any foreign corporation if such shares, obligations or bonds have acquired a business situs in the Philippines.
6. Share or rights in any partnership, business situs in the Philippines.
7. Proceeds a life insurance policy taken out by the decedent upon his own life.

Requisites for inclusion of Life Insurance:

1. It must be taken out by the decedent upon his own life.
2. The beneficiary is:
 - a. The estate of the deceased, his executor or administrator irrespective of whether or not the

insured retained the power of revocation; or

- b. Other than the decedent, where the insured reserved to himself the power to change or revoke the name of the beneficiary during his lifetime.

Note: If the designation of the beneficiary is irrevocable, then the proceeds of life insurance will not be included in the gross estate.

Proceeds of life insurance policy are excluded from the gross estate in the following cases:

1. Third person is irrevocably designated as beneficiary.
2. Proceeds of group insurance policy taken by the corporation for its employees.
3. Proceeds of accident insurance policy except accident insurance policy as characteristic.
4. Proceeds of GSIS life insurance policy.
5. Proceeds of life insurance payable to the heirs of deceased US and Philippine Army.

Tax tip:

- ⊕ If you are certain of your beneficiary, then make the designation of the beneficiary irrevocable since it is not included in the gross estate.
- ⊕ Kung ikawiyongtaonasangkatutakangpera at ayawmongmabawasan un dahil sa estate tax, you may take a **life insurance** and make the government as the irrevocable beneficiary- ilagay dun sa insurance policy nathe proceeds of the insurance is for the payment of estate tax only.

Consequences: [1] the premiums are allowable deductions from the gross income; [2] the proceeds of the insurance will not be included in the gross estate of the insured decedent since the designation of the beneficiary is irrevocable. Imbesnamabawasanang asset mo, may tax savings ka pa.

8. **Decedent's interest** -These are interests that had accrued prior to the death of the decedent. It includes yields, fruits and interest.

Examples:

- a. In the case of parcel of land, it may produce income in the form of harvest

which harvest may form part of the gross estate.

- b. In the case of apartment, the rental of such apartment should also be included, not only the value of the property.
- c. Dividends (date of declaration is the reference).
- d. Partnership profits
- e. Rights of usufruct.

II. **Inter Vivos Transfers Equivalent to Testamentary Dispositions**

Question: may *intervivos* transfers be subject to estate tax? Yes. The gross estate extends to gratuitous transfers made by the decedent during his lifetime which are treated by the law as substitutes for testamentary dispositions. They are transfers *inter vivos* in form but *mortis causa* in substance.

Rationale for Taxability: To reach such transfers which are really substitutes for testamentary dispositions and thus prevent the evasion of the estate tax.

THIS TRANSACTION CONTEMPLATES-

1. **Transfer in Contemplation of Death** - The term "in contemplation of death" means that the impelling or controlling motive is the thought of death, regardless of whether the transferor is near the possibility of death or not, which induces the disposition of the property for the purpose of avoiding the tax."

As long as the decedent enjoys the property despite the fact that it was transferred to a third person, said property forms part of the gross estate.

Circumstances taken into account in determining whether the transfer was made in contemplation of death:

- a. Age and state of health of decedent at the time of gift, especially where he was aware of serious illness.
- b. Length of time between the gift and the date of death.
- c. Concurrent making of a will or making a will within a short time after the transfer.

Motives which Preclude a Transfer from Being Categorized

1. To relieve the donor from the burden of management.
2. To save income or property taxes.
3. To settle family litigated and unlitigated disputes.

4. To provide independent income for dependents.
5. To see the children enjoy the property while the donor is alive.
6. To protect the family from the hazards of business
7. To reward services rendered.

Example: X has a house and lot which he transferred to Y...

- a) With the condition that X will use it while X lives.

Effect: Still part of the estate of X as he has control over the property.

- b) With the condition that X will use it only for 10 years and then X died before 10 years.

Effect: not part of the estate of X as he is not the actual owner.

Bar 2001 - Estate Tax: Donation Mortis Causa:

A, aged 90 years and suffering from incurable cancer, on August 1, 2001 wrote a will and, on the same day, made several inter-vivos gifts to his children. Ten days later, he died. In your opinion, are the inter-vivos gifts considered transfers in contemplation of death for purposes of determining properties to be included in his gross estate? Explain your answer. (5%)

Suggested answer: Yes. When the donor makes his will within a short time of, or simultaneously with, the making of gifts, the gifts are considered as having been made in contemplation of death. (**Roces v. Posadas, 58 Phil. 108**). Obviously, the intention of the donor in making the inter-vivos gifts is to avoid the imposition of the estate tax and since the donees are likewise his forced heirs who are called upon to inherit, it will create a presumption *juristantum* that said donations were made *mortis causa*, hence, the properties donated shall be included as part of A's gross estate.

2. **Transfers with retention or reservation of Rights** - It includes transfers where the decedent retains economic benefits after the transfer.

It includes:

- a. Transfer without retention of interest but intended to take effect at or after the decedent's death.
- b. Transfer with retention of interest in respect to:
 1. The possession or enjoyment of or the right to the income from the property; or
 2. The right either alone or in conjunction with any person, to designate the person who shall possess or enjoy the property or the income therefrom. And

such interest is retained by the decedent for his life for any period which does not in fact end before his death.

- c. Transfer with reversionary interest, wherein there is a possibility that the transferred property may return to the decedent or his estate or that it may become subject to a power of disposition by the decedent.

Example: X transfers his property to Y in naked ownership and to W in usufruct throughout W's lifetime subject to the condition that if W predeceases X, the property shall return to X. If X dies during W's lifetime, the value of the reversionary interest of X at death is included in his gross estate.

- 3. **Revocable Transfer** - Any transfer made by the decedent during his lifetime where the decedent has reserved the right to alter, amend, terminate, or revoke, such transfer.

Even if the control or revoking power is not exercised it is sufficient that it exists to consider it as part of the gross estate.

A transfer where:

- a. The decedent or in conjunction with any other person has reserved the right to alter, amend, revoke, or terminate; or
- b. Any such power is relinquished in contemplation of the decedent's death.

The power to alter amends or revoke shall be considered to exist on the date of the decedent's death even though:

- a. The exercise of the power is subject to a precedent giving of notice; or
- b. The alteration, amendment or revocation takes effect only upon the expiration of a stated period after the exercise of the power.

If the notice has not been given or the power has not been exercised on or before the decedent's death, such notice or the power shall be considered to have been given or exercised on the date of the decedent's death.

- 4. **Transfer of Property Under A General Power of Appointment** - This refers to a right to designate the person who shall enjoy or possess certain property from the estate of a prior decedent.

A transfer where the donor of the power of appointment authorizes the donee of such power to

designate any person he chooses to be given the right over the appointed property.

In general power of appointment, the power is exercisable in favor of the estate, executor, administrator or a creditor of the estate. If the power is exercisable other than these (estate administrator, executor, or creditor of the estate) that maybe considered as special power of appointment.

It implies that if the transfer is made under a special power of appointment it should be excluded from gross estate.

The transferee may choose freely any person who will own the property after he dies.

For purposes of taxation, the power to dispose of property at death by the exercise of appointment is the equivalent of ownership. It is a potential source of wealth to the appointee and the disposition of wealth effected by its exercise or relinquishment at death is one form of enjoyment of wealth.

Rationale for the imposition of estate tax - The will of the transferee is followed; hence the property is part of the transferee's estate.

Requisites:

- 1. The existence of general power of appointment.
- 2. An exercise of such power by the decedent (donee or appointee) by will or by deed in certain cases.
- 3. The passing of the property by virtue of the exercise of general power of appointment.

How is general power of appointment exercised by the decedent?

- i. By will
- ii. By deed in contemplation of or intended to take effect in possession or enjoyment at /or after his death.
- iii. By deed under which he has retained for his life or 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 enjoy or possess the property of the income therefrom.

- 5. **Prior Interest** - Except as otherwise specifically provided therein, subsection (B) (C) (E) of Section 85 referring to transfer in contemplation of death,

revocable transfer and proceeds of life insurance respectively shall apply to the transfers, trusts, estates, interests, rights, powers and relinquishment of powers as severally enumerated and described therein, whether made, created, arising, existing, exercised or relinquished before or after effectivity of the CTRP.

Note: In most these transfers the property remains substantially that of the transferor during his lifetime notwithstanding the transfer since he still retains either the "beneficial ownership" or "naked title" to the property.

6. Transfer for Insufficient Consideration - A transfer that is not a bona fide sale of property for an adequate and full consideration in money or money's worth.

The excess of the fair market value at the time of death shall form part of his gross estate.

However, if the purported absolute sale *inter vivos* by the decedent is shown to be fictitious then the total value of the property transferred is subject to inclusion in the taxable estate.

Example: X owns a house and lot; he wants to help Y so he sells his house worth P5M for only P1M. At the time of X's death, his house and lot is worth P10M. How much is included in the gross estate of X?

10M - 1M = 9M

9M forms part of the gross estate of X.

X bought a car worth 1.3M. X needed money so he sells his car to Y for only 1M. This is not a transfer for insufficient consideration as this is a bona fide transfer at arm's length; hence valid transfer.

Note: This is applicable only on sale of real property considered as an ordinary asset.

Why capital asset not included? Kasihindimalugi and gobyerno. Capital gains tax is computed at 6% of gross selling price or FMV whichever is higher, unlike ordinary asset which is tax at normal rate kaya pwedengmalugi ang gobyerno, kasipagmababa ang presyo than the FMV, mababa ang tax.

Bar 2000 - Estate Tax: Gross Estate: Deductions: Mr. Felix de la Cruz, a bachelor resident citizen, suffered from a heart attack while on a business trip to the USA. He died intestate on June 15, 2000 in New York City, leaving behind real properties situated in New York; his family home in Valle Verde, Pasig City; an office condominium in Makati City; shares of stocks in San

Miguel Corporation; cash in bank; and personal belongings. The decedent is heavily insured with Insular Life. He had no known debts at the time of his death. As the sole heir and appointed Administrator, how would you determine the gross estate of the decedent? What deductions may be claimed by the estate and when and where shall the return be filed and estate tax paid? (3%)

Suggested answer: The gross estate shall be determined by including the value at the time of his death **all of the properties mentioned**, to the extent of the interest he had at the time of his death *because he is a Filipino citizen*. [Sec. 85 (A), NIRC of 1997]

With respect to the **life insurance proceeds**, the amount includible in the gross estate for Philippine tax purposes would be to the extent of the amount receivable by the estate of the deceased, his executor, or administrator, under policies taken out by decedent upon his own life, irrespective of whether or not the insured retained the power of revocation, or to the extent of the amount receivable by any beneficiary designated in the policy of insurance, except when it is expressly stipulated that the designation of the beneficiary is irrevocable. [Sec. 85 (E) NIRC of 1997]

The **DEDUCTIONS** that may be claimed by the estate are:

- 1)** The actual funeral expenses or in an amount equal to five percent (5%) of the gross estate, whichever is lower, but in no case to exceed two hundred thousand pesos (P200,000.00). [Sec. 86 (A) (1) (a). NIRC of 1997]
- 2)** The judicial expenses in the testate or intestate proceedings. (Sec. 86(A)(1))
- 3)** The value of the decedent's family home located in Valle Verde, Pasig City in an amount not exceeding one million pesos (P1,000,000.00), and upon presentation of a certification of the barangay captain of the locality that the same have been the decedent's family home. [Sec. 86 (A) (4), Ibid]
- 4)** The standard deduction of P1,000,000. (Sec. 86(A)(5))
- 5)** Medical expenses incurred within one year from death in an amount not exceeding P500,000. (Sec. 86(A)(6))

The **ESTATE TAX RETURN** shall be filed within six (6) months from the decedent's death (Sec. 90 (B), NIRC of 1997), provided that the Commissioner of Internal Revenue shall have authority to grant in meritorious cases, a reasonable extension not exceeding thirty (30) days for filing the return (Sec. 90 (c), Ibid]

Except in cases where the Commissioner of Internal Revenue otherwise permits, the estate tax return shall be filed with an authorized agent bank, or Revenue District Officer, Collection Officer, or duly authorized Treasurer of Pasig City, the City in which the decedent Mr. de la Cruz was domiciled at the time of his death. [Sec. 90 (D). NIRC of 1997]

EXCLUSIONS FROM GROSS ESTATE

Rationale: The tax of the second transfer was included in the tax of the first transfer.

I. The merger of usufruct in the owner of the naked title.

Example: X has a house and lot. X gave the title to Z. X also allows Y to use the same and in case Y dies, the use goes to Z. What are the effects?

- a. **If X dies**- include the house and lot in Y's estate.
- b. **If Y dies**- exclude from the estate of Y as the will of X is being followed, there is merger of usufruct in Z (the owner of the naked title).

Why? Because the tax of the second transfer is included in the first transfer. It is by virtue of the will that the property passes from Y to Z.

II. Fideicommissary and transmissions from the first heir, legatee, or donee in favor of another beneficiary, in accordance with the desire of the predecessor.

Example: X has a house and lot. In the will of X, Y may have the title to the house and lot but in case Y dies, the property will go to Z. What are the effects?

- a. **If X dies**- include as part of X's estate as he actually owns it.
- b. **If Y dies**- exclude from the estate of Y as he has no control over its disposition.

X has a house and lot which he wants to give to Y but Y is a minor at the moment so that X institutes T to hold the property in trust for Y until Y reaches the age of majority. X died. The property passed to T. T died. Y reached the age of majority. Effect if T dies, not part of the estate of T.

III. Transfer to Social Welfare, Cultural, and Charitable Institutions

Requisites:

1. Qualified organization
2. Not more than 30% will be used for administrative purposes.

IV. Proceed of Insurance not includible in the gross estate of the decedent.

V. Separate property/ exclusive property of the Surviving Spouse - In the determination of the gross estate, the nature of the property, whether common property of the spouses, separate or

exclusive property either of the deceased or of the surviving spouse, becomes of vital importance.

What regime of property relations shall govern the spouses? - Under the Civil, the husband and wife who got married before August 3, 1988 are governed by the Conjugal Partnership of gains, while those who got married on or after August 3, 1988 are governed by the Absolute Community of Property, unless a different regime was agreed upon in the marriage settlement.

EXEMPTION FROM ESTATE TAX

1. Where the value of the net taxable estate is P200,000.00.
2. The merger of the usufruct in the owner of the naked title.
3. The transmission from the first heir, legatee, or donee in favor of another beneficiary in accordance with the desire of the predecessor.
4. All bequest, devisees, legacies, or transfers to social welfare, cultural and charitable institutions, no part of the net income of which inured to the benefit of any individual and provided that not more than 30% of the said bequest, etc shall be used by such institution for administration purposes.
5. Intangible personal property of non-resident aliens under the principle of reciprocity.
6. Retirement benefits of employees of private firms from private pension plans approved by the BIR.
7. Amount received for war damages.
8. Grants and donations to the Intramuros Administration.

ALLOWABLE DEDUCTIONS FROM THE GROSS ESTATE [SECTION 86]

These allowable deductions are-

- Φ Granted by mere legislative grace.
- Φ Construed strictly against the taxpayer.

Φ Requisites:

1. The claim for deduction must be substantiated.
2. Identify the provisions granting the deduction. The provision must be clear and definite.

ALLOWABLE DEDUCTION IF RESIDENT DECEDENT

I. Ordinary Deductions (ELIT)

- E-expenses
- L-losses
- I-indebtedness
- T- taxes

- A. Funeral Expenses** - The amount deductible is equal to 5% of the gross estate or the amount of the actual funeral expenses whichever is lower, but in no case to exceed P200, 000.00.

“Actual funeral expenses” are those which were actually incurred in connection with the internment or burial of the deceased and paid for from the estate of said deceased. Expenses incurred after the burial event though in connection to the funeral is not included [ex: 9 days & 40 days].

Requisites:

1. The expenses must be due to the internment, wake and burial; hence expenses on the death anniversary are not included.
2. The expenses must have been **shouldered by the estate** and not by other people.

Funeral expenses includes:

1. Costs of coffin, tombstone, mausoleum, and burial lot.
2. Funeral parlor fees;
3. Mourning clothing of the surviving spouse and the unmarried minor children;
4. Cost of obituary notices; and
5. Expenses during the wake.

Not included in Funeral Expense

1. Cash advances of the surviving spouse and the heirs;
2. Expenses paid by the relatives and friends; and
3. Expenses after the burial.

Bar 2001 - Estate Tax: Gross Estate:

Allowable Deduction: On the first anniversary of the death of Y, his heirs hosted a sumptuous dinner for his doctors, nurses, and others who attended to Y during his last illness. The cost of the dinner amounted to Php 50,000.00. Compared to his gross estate, the Php 50,000.00 did not exceed five percent of the estate. Is the said cost of the dinner to commemorate his one year death anniversary deductible from his gross estate? Explain your answer. (5%)

Suggested answer: No. This expense will not fall under any of the allowable deductions from gross estate. Whether viewed in the context of either funeral expenses or medical expenses, the same will not qualify as a deduction. Funeral expenses may include medical expenses of the last illness but not expenses incurred after burial nor expenses incurred to commemorate the death anniversary. **(De Guzman V. De**

Guzman, 83 SCRA 256). Medical expenses, on the other hand, are allowed only if incurred by the decedent within one year prior to his death. (Section 86(A)(6), NIRC).

B. Judicial expenses of the testamentary or intestate proceedings.

Requisite: “administration expenses” to those actually incurred in the administration of the estate.

Examples:

1. fees of the executor or administrator;
2. attorney’s fees;
3. accountant’s fees;
4. court fees;
5. salaries of employees; and
6. All other expense related to the administration of the estate.

Note: This includes “all expenses necessary to settle or preserve the estate” hence, extrajudicial expenses are included. It has no limitations as long as it is incurred in connection with the preservation, administration or settlement of the estate.

Expenses not essential to the proper settlement of the estate but incurred for the individual benefit of the heirs, legatees, or devisees are not allowed as deductions.

Example: expenses to be declared as administrator vs. an oppositor is a personal expense

C. Claims against the decedent’s estate - Debts

or obligations of the decedent that is enforceable against the estate provided that the following requisites are met:

1. They were contracted in good faith and for an adequate and full consideration in money or money’s worth.
2. They must be existing against the estate.
3. They must be legally enforceable obligations of the decedent and ought to be enforced by the claimants.
4. They must be reasonably certain in amount; and;
5. At the time the indebtedness was incurred, **the debt instrument was duly notarized and if the loan was contracted within three (3) years before the death of the decedent, the administrator or executor shall submit a statement showing the disposition of the proceeds of the loan.**

Post debts developments will not affect liability because tax liability is determined at the moment of death.

Illustration: A, decedent has an indebtedness of 10M to B. After A's death, B sued the estate of A. However, a compromise was made and B demanded only 6M. Thus the compromise triggers the assessment of deficiency tax? No, because liability for estate tax is determined at the time of death.

D. Claims against insolvent persons

Requisites for deductibility:

- a. The amount of said claims has been initially included as part of the gross estate; and
- b. The incapacity of the debtors to pay their obligations is proven and not merely alleged.

Illustration: A & B are best friends. A allowed B to use his house and lot as a security in a 3M loan that the latter obtained. B did not pay the loan. Upon knowing that B did not pay the loan, A did. Is there any possibility that the estate of A may claim the 3M loaned by B as a deduction?

Yes, per the law on credit transactions the recourse of the owner of the property which was used as a security by another is to go after the ultimate debtor. Thus, A's estate can claim it as a deduction.

E. Unpaid Mortgages Indebtedness

Requisites for deductibility:

- a. The fair market value of the property mortgaged without deducting the mortgage indebtedness has been initially included as part of his gross estate;
- b. The mortgage indebtedness was contracted in good faith and for an adequate and full consideration in money or money's worth.

Example: X obtained a 3M loan from Y and executed a Real Estate Mortgage over his house and lot worth 5M. X paid 1M. X died.

Effect: in the estate of X, include the 5M in the gross estate of X and claim as deduction the unpaid 2M.

Accommodated Loan

Example: X owns a house and lot worth 5M. Y obtained a 3M loan from Z with X's house and lot as collateral. Y paid 1M. Z died. X died.

Effect: Include in the gross estate of X the 5M as receivable from Y (reason: right of reimbursement); and claim as deduction the unpaid 2M.

F. Casualty Losses - They include all losses incurred during the settlement of the estate arising from fires, storms, shipwreck or other casualties or from robbery, theft or embezzlement.

Requisites for deductibility:

- a. Losses not compensated by an insurance or otherwise;
- b. Losses that were not claimed as a deduction for income tax purposes; and
- c. Losses incurred not later than the last day for payment of the estate tax (6 months from death).
- d. Include the worth of the property in the gross estate.
- e. File a sworn declaration of the fact of loss within 45 days from its occurrence.

G. Unpaid taxes - Unpaid income tax on income due or received before death of the decedent, and real property taxes, which have accrued prior to the death of the decedent (real property taxes accrued at the beginning of the year but may be paid before or at the end of each quarter), are deductible.

Income taxes upon income received after the death of the decedent, or property taxes not accrued before his death, or any estate tax cannot be deducted because they are chargeable to the income of the estate.

Except: estate tax because estate tax liability is determined at the time of death

II. Vanishing Deductions - An amount allowed to reduce the taxable estate of a decedent where the property was:

- a. received by him from prior decedent by gift, bequest, devise or inheritance, or
- b. Transferred to him by gift, has been the object of previous transfer deduction.

VANISHING DEDUCTION: because the rate of deduction gradually diminishes and entirely vanishes

depending upon the time interval between the two (2) successive transfers.

ALTERNATING DEDUCTION: because the present decedent's estate cannot claim it if the prior decedent's estate claimed it

Rates of vanishing deduction

Gap b/n the death of the prior decedent & death of the holder of the property	Rate of deduction
1 year	100%
More than 1 year to 2 years	80%
More than 2 years to 3 years	60%
More than 3 years to 4 years	40%
More than 4 years to 5 years	20%
More than 5 years	0%

Factors necessary in vanishing deduction, these are:

- a. There are two (2) deceased persons and the first is the donor; and
- b. The second decedent dies within five (5) years after the death of the prior decedent or in the case of gifts the decedent – donee dies within the same period after the date of the gift.

Rationale: The deduction operates to ease the harshness of successive taxation of the same property within a relatively short period of time.

Requisites for deductibility:

- 1. The present decedent must have acquired the property by inheritance or by donation.
- 2. The property must have been acquired within five (5) years prior to the death of the present decedent
- 3. The property must have formed part of the gross estate of the prior decedent if acquired by inheritance, or the taxable gift of the donor if acquired by donation.
- 4. The estate tax or the donor's tax, as the case may be, must have been paid on the previous transfer.
- 5. The property must be identified as the one received from the prior decedent or from the donor, as the case may be.
- 6. The estate of the prior decedent must not have previously availed of the vanishing deduction on the subject property

Procedure in computing vanishing deductions:

- 1. **Value taken of property previously taxed**
 Less: Mortgage paid by the present decedent on property previously mortgaged by prior decedent / donor, if any (1st deduction)
 = Initial basis

2. **Initial basis divided by the value of the gross estate of present decedent X Expenses, and transfer for public purpose**
 = 2nd deduction

3. **Initial Basis**

Less: 2nd deduction
 Final Basis
 Multiplied by rate deduction (sec.86 (A.2), NIRC)
 Vanishing Deduction

III. Transfers for Public Use

Requisites:

- 1. The disposition must be testamentary in character.
- 2. To take effect after death.
- 3. In favor of the government of the Philippines, or any political subdivision thereof.
- 4. Exclusively for public purpose.
- 5. Included in the gross estate

Query: If in a will the property was bequeathed to a city and an NGO, are the tax effects the same? No.

- a. **City** - included in the gross estate and claimed as deduction
- b. **NGO**— excluded from the gross estate and subject to the limitation that not more than 30% must be used for administrative purposes.

IV. Family Home - Refers to the dwelling house, including the land on which it is situated, where the husband and wife, or an unmarried person who is the head of the family and members of their immediate family resides as certified by the Barangay Captain of the locality.

For the purpose of availing of a family home deduction to the extent provided by law, a person may constitute only one family home.

The amount deductible is equivalent to the current fair market value of the decedent's family home if said current fair market value exceeds **P1,000,000**, the excess shall be subject to estate tax.

If the family home is commonly owned by the spouses then split the value and the amount is the one that is to be deducted in the estate of the decedent spouse.

Requisites to be deductible:

- a) The family home must be the actual residential home of the decedent and his family at the time of his death. (Decedent is married and

has dependents or is a head of family with dependents.)

- b) Such fact must be certified by the Barangay Captain of the locality where the family is situated.
- c) The total value of the family home must be included in the gross estate of the decedent.
- d) The 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 not exceeding P1, 000,000.

The return must be filed in the place where the family home is located. If there is a consequence if this was not followed? Yes, if it is filed in the wrong office then a surcharge of 25% will be imposed.

- V. **Standard deduction of 1M - On top of other deductions**, unlike the optional standard deduction which is in lieu of other deductions; hence, it does not include the P 200,000 exemption.

VI. Medical Expenses

Requisites:

- a. Must be incurred by the decedent within one (1) year prior to his death
- b. Must be duly substantiated by receipts; and
- c. Must not exceed P500, 000

Illustration: 1M total of medical expense. 500K was paid and the other 500K was not paid but a promissory note was executed. Can the taxpayer claim the 500K covered by the promissory note in the next year as a medical expense? No, because it would circumvent the ceiling.

VII. Amounts Received by Heirs under RA 4917 From the Decedent's Employer As A Consequence Of the Death of the Decedent-Employee, Provided That Such Amount Is Included in the Gross Estate of the Decedent.

- + retirement benefits
- + **Requisite:** include in gross estate

VIII. NET SHARE OF THE SURVIVING SPOUSE IN THE CONJUGAL / COMMUNITY PROPERTY

Requisite: Include the entire amount in the gross estate then deduct the share of the surviving spouse

Example: H owns a car worth 1M and a house and lot worth 5M. W owns a truck worth 2M and jewelry worth 10M. H and W own a conjugal lot worth 20M. H died.

Gross estate of H:

Exclusive	Conjugal
5 M house and lot	20 M lot
1M car	
6M	20 M

Total gross estate = 26 M

Then claim as deduction the 10M, which is the 1/2 share of the surviving spouse in the conjugal lot.

Example: H and W died simultaneously. In computing the gross estate of H and W, their shares 1/2 shares as to the conjugal lot may immediately be split as there is no surviving spouse left.

IX. Tax Credit For Estate Tax Paid To A Foreign Country - The estate tax imposed by the tax code shall be credited with the amount of any estate tax paid to a foreign country.

Concept: if a property located in the Philippines was already subjected to estate tax abroad and the same property is also subjected to estate tax in the Philippines, the foreign tax paid is allowed to reduce his Philippine estate tax.

Purpose: minimize the effect of international double taxation.

Applicable **only to residents and citizens**, not to NRA since he is taxed only on his properties within the Philippines; hence, the NRA will not be made to pay estate taxes twice for his property located abroad = no international double taxation = no tax credit. (Sec. 86 (E)(2))

Requisites:

- a. Prove that the foreign estate tax has been paid
- b. Prove reciprocity : that in the decedent's foreign country, a similar tax credit is given to Filipinos

Limitations on tax credit

- a. The tax credit limit for estate taxes paid to one foreign country is determined by the following:

TAX CREDIT LIMIT = Decedent's Net Estate situated in a foreign country x Phil. Estate tax of the Entire net estate

- b. The tax credit limit for estate taxes paid to two or more countries is determined as follows:

TAX CREDIT LIMIT = Decedent's net estate situated outside of the Phil X Phil. Estate tax of Entire net Estate

Note:

1. Under limitation A the allowable tax credit is the lower amount between the tax credit limit and the estate tax paid to the foreign country.
2. Under limitation B the allowable tax credit is the lower amount between the tax credit limit computed under (A) and that computed under (B).

ALLOWABLE DEDUCTIONS IF DECEDENT IS A NON-RESIDENT ALIEN

The deductions allowed to citizens or residents of the Philippines are also extended to a non-resident alien decedent with respect to his estates situated in the Philippines at the time of his death.

In case of deductions for expenses, losses, indebtedness and taxes, the amount of the allowable deduction is limited only to the proportion of such deductions with the value of such part of his gross estate which at the time of his death, is situated in the Philippines, bears to the value of his entire gross estate wherever situated. (Sec. 86 (B))

Formula:

Allowable deduction of non-resident estate = Philippine Gross Estate x Deductions Claimed / Entire Gross estate

As a prerequisite to the deduction, it must be included in the return required to be filed the value at the time of his death, of that part of the gross estate of the non-resident not situated in the Philippines, to determine the ratable portion of the deduction for expenses allowable.

Valuation of Property -The estate shall be appraised at its **fair market value (FMV) at the time of death** of the decedent (Sec.88, NIRC). This is regardless of any subsequent contingency affecting the estate. (*Lorenzo vs. Posadas, 64 Phil. 353*)

1. REAL PROPERTY - Higher amount of :

- a. FMV as determined by the Commissioner - This is the zonal value (of the land) as fixed by the CIR, and can be obtained from the BIR website or regional office
- b. FMV fixed by the provincial or city assessor - This is the value as shown in the tax declaration of the property

Use this amount for real properties with no zonal values (i.e. real properties other than land such as buildings and improvements).

Note: The law does not state that the prevailing market rate or the consideration as a basis for determining the FMV.

If there are no improvements in the property, get a Certificate of No-improvement, (which you can get only after obtaining a Certificate of Non-tax delinquency) and attach these to the estate tax return.

2. Personal Properties

a. **Shares of Stock** - Book or par value at the time of death, and can be obtained by writing a letter of inquiry, asking for a formal certification from the corporation which issued the shares of stock as to the value of such stock at the time of death of the decedent.

b. **Inventories** -Value as stated in the invoices (i.e.: price at purchase); or the prevailing market rate (ask for the value from those engaged in the same business); or if value cannot be definitely ascertained, state the approximate reasonable value (but this will be subject to the discretion of the BIR inspector).

c. **Motor vehicle** -These depreciate 20% per year from purchase.

Hence, motor vehicles are fully liquidated and have no estate tax liability after 5 years but include in the gross estate placing zero as the amount (to secure a tax clearance therefor).

3. Right to Usufruct, use or habitation; or annuity-

Probable life of the beneficiary shall be taken into account, in accordance with the latest basic mortality table, to be approved by the Sec. of Finance, upon recommendation of the Insurance Commissioner.

FILING OF NOTICE OF DEATH -

Where the gross value of the estate exceeds P 20,000 although exempt, the executor, administrator, or any of the legal heirs shall give, within 2 months after the decedent's death or within like period after the executor or administrator qualifies as such, a written notice thereof, to the Commissioner of Internal Revenue. (Sec. 89, NIRC)

Contents of the letter:

1. The fact that the decedent died
2. Residence of the decedent
3. Date of death

Effect of failure to file notice: subject to penalty not lower than P1, 000. 00

Note: Filing with the nearest Revenue District Office is sufficient compliance.

FILING OF RETURN AND PAYMENT OF TAX

1. File a notice of death within 60 days from date of death.
2. **By whom?** An estate tax return under oath is required by law to be filed by the executor, administrator, or any of the legal heirs:

Where the gross value of the estate exceeds P200,000 though exempt from the estate tax; or

Regardless of the gross value of the estate, where the said estate consists of registered or registrable real property, such as real property (land, bank accounts, others with definite records), motor vehicle, shares of stock or other similar property for which a clearance from the Bureau of Internal Revenue is required as a condition precedent for the transfer of ownership thereof in the name of the transferee.

3. When to file?

- Φ The return shall be filed within 6 months from the decedent's death.
- Φ The Commissioner shall have the authority to grant, in meritorious cases, a reasonable extension not exceeding 30 days for filing the return.

4. **Where to file?** Except in cases where the Commissioner otherwise permits, the return shall be filed with:

If the decedent is a resident

- a) an authorized agent bank
- b) Revenue District Officer
- c) Revenue Collection Officer
- d) Duly authorized treasurer of the city or municipality where the decedent was domiciled at the time of his death.

If the decedent is a non-resident

- a) with the Revenue District Office where his executor/administrator is registered
- b) with the Revenue District Office having jurisdiction over the residence of the executor/administrator
- c) with the Office of the Commissioner if the decedent has no executor or administrator

Copies: The return shall be filed in triplicate, two (2) for the BIR and one (1) copy for the taxpayer.

5. **When to Pay?** Pay the estate tax at the time you will file your estate tax return. (Pay as you file system)

6. **Extension for Payment:** allowed in meritorious cases 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** :

At most 2 years – if estate extrajudicially settled

At most 5 years – if estate judicially settled

NOTE: The taxpayer must not be guilty of

- a) negligence
- b) intentional disregard of the rules and regulations, or
- c) fraud

The taxpayer may also be required to pay a bond not exceeding double the amount of tax and with such sureties, as the Commissioner deems necessary

Note: The filing of the estate tax return is not sufficient to obtain a tax clearance; the administrator/executor/heir must submit additional documents to determine the correctness of the values stated by him in the estate tax return.

Such as the title of the land, tax declaration of the land and its improvements or Certificate of No-improvement, vicinity map to fix the exact location and zonal value, etc.

(Read: Revenue Memorandum Order 15-2003)

Note: To avoid the imposition of penalties while there is no extra/judicial settlement yet, any heir may file a sworn declaration to the BIR stating the fact of death, that the estate has not yet been settled and the list of the properties included in the estate, as basis for payment of estate tax.

If Gross Estate is more than 2M, additional requirement: Must submit a certificate of an independent CPA stating:

1. itemized assets of the decedent with corresponding gross value at the time of his death; or if NRA, that part of his gross estate situated in the Philippines
2. itemized deductions from the gross estate
3. amount of tax due, whether paid or still due and outstanding

LIABILITY FOR PAYMENT OF ESTATE TAX

Primarily Liable: Executor or administrator - before delivery to any beneficiary of his distributive shares. After due payment, the executor or administrator shall be discharged from *personal* liability.

Subsidiarily Liable: Beneficiary - to the extent of his distributive share, liable for the portion of the estate tax

as his distributive share bears to the value of the total net estate.

NOTE: There are two ways the government may enforce collection of estate taxes from the decedent's heirs:

1. It can collect from all the heirs the amount of the estate tax proportionate to the inheritance they received.
2. It can subject properties of the estate which are in the hands of the heirs/transferees to the payment of the tax. (CIR vs. Pineda, 21 SCRA 105).

NOTE: The heirs have a solidary obligation to settle the estate. Hence, the BIR can collect from or sue any of the heirs, but only up to the amount of that heir's share in the hereditary estate. This is without prejudice to such heir's right of reimbursement from his co-heirs of their share in the payment of the estate tax. (CIR vs. Pineda, 21 SCRA 105)

MEASURES TO INSURE PAYMENT OF ESTATE TAX

- a) No judge shall authorize the executor or judicial administrator to deliver a distributive share to any party interested in the estate unless a certification from the Commissioner that the estate tax has been paid as shown. (Sec.94)

By the court requiring the executor/administrator to submit an inventory of properties of the estate, these properties is to be distributed only after payment of estate taxes and receipt of clearance by the Commissioner or his duly authorized representative.

NOTE: The approval of the probate court is not required before estate taxes may be collected. The enforcement and collection of taxes are executive in nature. (Marcos II vs. CA, 273 SCRA 47)

- b) Registers of Deeds shall not register in the Registry of Property any document transferring real property any document transferring real property or real right therein or any chattel mortgage, by way of gift *inter vivos* or *mortis causa*, legacy or inheritance, unless certification from the commissioner that the tax has been paid and the y shall immediately notify the Commissioner, Regional Director, Revenue District Officer, or Revenue collection Officer or treasurer of the city or municipality where their offices are located, of the non-payment of the tax discovered by them. (Sec. 95)

Before the properties are transferred in the name of the heirs, a Certificate Authorizing Registration (CAR) must be shown.

- c) Any lawyer notary public, or any Government Officer who, by reason of his official duties, intervenes in the preparation or acknowledgement of documents regarding partition or disposal of donation *inter vivos* or *mortis causa*, legacy or inheritance, shall have the duty of furnishing the Commissioner, etc., with copies of such documents and any information whatsoever, which may facilitate the collection of the aforementioned tax. (Sec. 95)

Ex: deed of extrajudicial settlement, deed of donation.

- d) Neither shall a debtor of a deceased pay his debts to the heirs, legatees, executor or administrator of his creditor, unless a certification of the Commissioner that the tax fixed has been paid is shown; but he may pay the executor or judicial administrator without said certification if the credit is included in the inventory of the estate of the deceased. (Sec. 95)

Else: debtor may be personally liable for the payment of the lost tax, like a withholding agent who fails to withhold taxes

- e) Corporations, *sociedadanonima*, partnerships, business or industry organized in the Philippines shall not transfer in their books any shares obligations, bonds or rights by way of gift *inter vivos* or *mortis causa*, legacy or inheritance to the new owner unless a certification from the Commissioner that the taxes fixed and due thereon have been is shown; (Sec. 97)

Φ obligation of corporate secretary

- f) If a bank has knowledge of the death of a person who maintained a bank deposit account alone or jointly with another, it shall not allow any withdrawal from the said joint deposit account unless the Commissioner has certified that the estate taxes imposed thereon have been paid. However, the administrator of the estate or any of the heirs of the decedent may, upon authorization by the Commissioner of Internal Revenue withdraw an amount not exceeding P 20,00 without the said certification . (Sec. 97)

For this purpose, all withdrawal slips shall contain a statement to the effect that all of the joint depositors are still living at the time of withdrawal by any one of the joint depositors and such statement shall be under oath. Otherwise, the joint depositor will be liable for perjury (Sec. 267).

joint accounts covered by this rule include “and” and “and/or” accounts, but do not include an account subject to a Survivorship Agreement with a survivor-take-all feature (because there is an automatic transfer of right to the survivor; hence, not included in gross estate of the joint depositor who died – tax avoidance scheme)

- g) The estate tax together with interest, penalties, and costs that may accrue in addition thereto constitutes a lien upon all property and rights to property belonging to the taxpayer. The lien attaches when the taxpayer neglects or refuses to pay after demand. (Sec. 219)
- h) In judicial settlement of estates, the court is required to furnish the commissioner of Internal Revenue a certified copy of the schedule of participation and the court order approving the same within 30 days after its promulgation. (Sec. 91(b));
- i) The estate tax shall be paid by the executor or administrator before delivery to any beneficiary his distributive share of the estate (Sec. 91 (c)). He may be discharged from personal liability for deficiency in the estate tax only after written application to the commissioner and upon determination that no such deficiency appears. (Sec. 92)

TAX TIPS: AVOIDANCE OF ESTATE TAX LIABILITY

1. **Maximize your claims for deductions** such as the use of the transfers falling under the exclusions from gross estate.
2. **Donate properties to your relatives** as the tax rates for donor’s taxes are lower than for estate taxes.
3. **Estate Planning** (Section 40 (c), NIRC)
 - ⊕ execute a Deed of Exchange; the properties of at most 5 persons in exchange for shares of stock in order to obtain control of the corporation (more than 51% ownership)
 - ⊕ this exchange is not taxable for income tax purposes
 - ⊕ more tax savings if real properties are exchanged
 - ⊕ the properties in the deed will no longer be part of the gross estate as it is now owned by the corporation
 - ⊕ the stock shares will be included in the gross estate but the tax would be lower as the value at time of death might still be the same original value at the time of exchange; on the other hand, if there was no exchange the

estate tax for the land would be higher as the value of the land at time of death will be higher than at the time of the acquisition.

4. Set up a living trust

- ⊕ **Trust:** obligation imposed by a person regarding his property
- ⊕ Create an irrevocable trust over your properties so that they will not form part of your gross estate when you die. This is because the Irrevocable Trust is a new taxpayer created.
- ⊕ **Example:** grandfather (Grantor) during his lifetime would like to give certain properties to his grandchild. Until he reaches the age of maturity, the properties will be held in trust by X (trustee) for the grandchild (Beneficiary).

Bar 1998 - BIR: Summary Remedy: Estate Tax Deficiencies: Is the BIR authorized to collect estate tax deficiencies by the summary remedy of levy upon and sale of real properties of the decedent without first securing the authority of the court sitting in probate over the supposed will of the decedent?

Suggested answer: Yes. The BIR is authorized to collect estate tax deficiency through the summary remedy of levying upon and sale of real properties of a decedent, without the cognition and authority of the court sitting in probate over the supposed will of the deceased, because the collection of estate tax is executive in character. As such the estate tax is exempted from the application of the statute of non-claims, and this is justified by the necessity of government funding, immortalized in the maxim that taxes are the lifeblood of the government (**Marcos v. CIR, G.R. No. 120880, June 5, 1997**).

Alternative answer: Yes, if the tax assessment has already become final, executory and enforceable. The approval of the court sitting in probate over the supposed will of the deceased is not a mandatory requirement for the collection of the estate tax. The probate court is determining issues which are not against the property of the decedent, or a claim against the estate as such, but is against the interest or property right which the heir, legatee, devisee, etc. has in the property formerly held by the decedent. (**Marcos v. CIR, G.R. No. 120880, June 5, 1997**).

DONOR’S TAX/ GIFT TAX

Tax rate: 30%

Formula:

Gross gifts
Less: deductions
Net gifts
x Tax rate
Taxable gifts
Less: tax credit
Donor’s tax payable

General Principle: Before donor's tax can operate there must be a **valid donation** and **complete delivery** of the thing subject of the donation.

Nature of Donor's Tax: Donor's tax is an excise tax because what is being taxed here is the right or privilege to transmit or dispose of the property gratuitously in favor of another.

It is a tax imposed on the privilege of transmitting property by living person to another by way of donation.

It also prevents avoidance of estate tax.

Purpose of Donor's Tax

1. The primary purpose is to raise revenue.
2. To supplement income tax and estate tax.
3. To prevent the avoidance of income tax through the scheme of splitting income into various donee's who usually are members of the same family, whereby the donor, escapes the progressive rates of tax.

Definition of Donations/ Gifts: Article 725, Civil Code- a donation is an act of liberality whereby a person disposes gratuitously of a thing or right in favor of another who accepts it.

Generally therefore, a gift is a voluntary transfer of property from one person to another without any consideration or compensation therefor.

Characteristics of a Valid Donation (FACID)

1. It must be given during the lifetime of the donor.
2. It must be irrevocable.
3. It must comply with the formalities of donation
4. There must be an acceptance by the donee.

Requisites of Valid Donation

- 1) It must comply with the formalities of donation.
- 2) Acceptance by the donee of the donation.
- 3) Capacity of the donor and the donee
- 4) Intention to donate the property of the donee (Donative intent)
- 5) Delivery of the property to the donee.

It must comply with the formalities of donation.

- ⊕ If the amount of personal property is P 5, 000. 00 or less the donation may be made orally.
- ⊕ If the amount of personal property is more than P 5, 000. 00 the acceptance shall be in writing.
- ⊕ Donation of real property must be made in a public instrument irrespective of the amount.

Acceptance by the donee of the donation.

- ⊕ Acceptance must be made during the lifetime of the donor.

- ⊕ If the amount of personal property is P 5, 000. 00 or less, acceptance may be made orally.
- ⊕ If the amount of personal property is more than P 5, 000. 00, the acceptance shall be in writing.
- ⊕ In the case of donation of real property, acceptance must be made in the same deed of donation or in a separate public instrument.

Capacity of the donor and the donee

VOID DONATIONS:

1. Those made between persons who are guilty of adultery or concubinage at the time of the donation.
2. Those made between persons found guilty of the same criminal offense, in consideration thereof.
3. Those made to a public officer or his wife, descendants by reason of his office.

INCAPACITATED DONEES BY REASON OF RELATION TO DONOR

- a. The priest who heard the confession of the donor during his illness, or the minister of the gospel who extended spiritual aid to him during the same period.
- b. The relatives of such priest or minister of the gospel within the 4th degree, the church, order, chapter, community, organization or institution to which such priest or minister belongs.
- c. A guardian with respect to donation made by a ward in his favor before the final accounts of the guardianship have been approved, even if donor should die after the approval thereof; nevertheless, any donations made by ward in favor of the guardian when the latter is his ascendant, brother and sister, or spouse shall be valid.
- d. Any physician, surgeon, nurse, health officer or druggist who took care of the donor during his last illness.
- e. Individuals, associations and corporations not permitted by the law to receive donations.

INCAPACITATED DONEES BY REASON OF UNWORTHINESS

1. Parents who have abandoned their children or induced their daughters to lead a corrupt or immoral life or attempted against their virtue.
2. Any person who has been convicted of an attempt against the life of the donor, his or her spouse, descendants or ascendants.
3. Any person who has accused the donor of a crime for which the law prescribes imprisonment for 6 years or more if the accusation has been found groundless.
4. Any heir full of age who, having knowledge of the violent death of the donor, should fail to report it to an officer of the law within a month

unless the authorities have already taken action, this prohibition shall not apply to cases wherein, according to law, there is no obligation to make an accusation.

5. Any person convicted of adultery or concubinage with the spouse of the donor.
6. Any person who by fraud, violence, intimidation, or undue influence should cause the donor to make a donation or to change one already made.
7. Any person who by the same means prevents another from making a donation, or from revoking one already made, or who supplants, conceals, or alters the latter's donation.
8. Any person who falsifies or forges a supposed donation of the decedent.

Note: Under Article 87 of the Family Code- Husband and wife are prohibited from making donation to each other, except for **moderate gifts** during family rejoicing.

Intention to donate the property of the donee (Donative Intent)

Φ The must be the presence of donative intent for it to be subject to donor's tax.

Φ **Exceptions:**

1. Transfer of insufficient consideration in the case of a contract of sale.
Example: If the fair market value of the property is 100k and 50 k was the consideration given. The difference is considered a donation.
2. The amount received by a disinherited heir is subject to donor's tax because he has no right to such property and the same was gratuitously given, there is no donative intent.

By the fact that the heir was **validly disinherited** he has no right over his legitime, thus when a portion of the property is given to him then it is subject to donor's tax because the thing was given gratuitously.

Delivery of the property to the donee - For a donation to be subject to donor's tax there must be acceptance and delivery to the donee.

MODES OF DELIVERY

1. Actual
2. constructive

Note: What is the liability of the donee if there is an invalid donation? If there is no valid donation, the recipient is subject to income tax because of the provision "from whatever source derived."

What are donations subject to donor's tax?

- Φ Trust or not
- Φ Real or personal property
- Φ Tangible or intangible property

Who are liable for donor's tax?

1. Citizens, Resident Aliens and Domestic Corporation.

Subject to donor's tax regardless of where the gift was made or where the property donated is located, but they would be entitled to a tax credit equivalent to the amount of donor's taxes paid to and imposed by the authority of the foreign country where the gift was made.

2. Non-resident Aliens and Foreign Corporations-Whether or not doing business in the Philippines they are subject to tax only on their donations of property located in the Philippines.

A donation by a foreign corporation of its own shares of stock to resident employees is not subject to gift tax, but if the donation was given in consideration of the latter's services, the value of the shares can constitute taxable income.

Classification of Donor Subject to Donor's Tax:

1. **Resident Donor (RD)** - this includes citizen of the Philippines or a Resident Alien.
 - Φ Real properties, personal tangible properties, and personal intangible properties or resident donor are subject to donor's tax whatever situated.
2. **Non-resident Donor (NRD)** - he must be a non-resident alien.
 - Φ Real properties and personal tangible properties of a non-resident donor are subject to donor's tax only if they are located in the Philippines... personal intangible properties of NRD are subject to donor's tax only if they acquire tax situs in the Philippines.

Personal Intangible Properties that are Deemed Situated or Acquire Situs in the Philippines (Included in the Gross Gift)

1. Franchise which is exercised in the Philippines.
2. Shares of stock, obligation or bonds issued by Domestic Corporation *or sociedadanonima*.
3. Shares of stock, obligations or bonds issued by foreign corporation, 85% of the business of which is conducted in the Philippines.
4. Shares, obligations, bonds issued by a foreign corporation which acquires business situs in the Philippines.

- Φ Such shares, obligations or bonds acquire business situs in the Philippines if they are used by such foreign corporation in furtherance of its purpose.
- 5. Share or rights in any partnership, business or industry established in the Philippines.
- 6. Real, intangible and intangible personal property or mixed.
 - Φ Even if the personal intangible properties of the NRD acquired tax situs in the Philippines it may still be exempt from donor's tax by applying the rule on reciprocity.

Rule on Reciprocity: If the foreign country of that NRD does not impose or allows exemption on the donor's tax on properties of citizens of the Philippines who donates in that country.

CONCEPT OF CONSIDERATION UNDER GIFT TAXATION - Consideration is to be measurable in money or money's worth, mere legal consideration is not sufficient.

The consideration must flow from the donor. Mere detriment to the donee does not satisfy the purpose of the statute.

Ergo: marriage is not a consideration that can be reduced to a monetary value. If a person transfers a property to a trust in consideration of marriage, a gift is made because no monetary consideration flows to the transferor/donor.

"Consideration means money or equal value or some goods or service capable of being evaluated in money. Gratitude is not a consideration the value of which cannot be deducted from that of the property transferred as a gift. Like love and affection, it has no economic value and is not consideration in the sense of the word used in Section 103. Thus, donation given out of gratitude for services rendered constitutes taxable donation. It is not deductible from gross income of the donor for the value of said services does not constitute recoverable debt" (*Pirovano vs. Commissioner, L-19865, July 31, 1965*).

CONCEPT OF GIFTS SUBJECT TO GIFT TAXES (Section 98)

I. DIRECT GIFTS

- Φ ***There is a deed of donation.*** Thus no valid donation, no donor's tax.
- Φ ***Donative intent must be present*** in a direct gift on property. Such an intent coupled with donative act of delivery is essential to constitute gift.
- Φ Donor's tax applies to both natural juridical persons.

- Φ The law says, "a donor's tax apply whether the transfer is in trust or otherwise." So, property held in trust may be the subject of donation. But, this contemplates of a transfer where the dominion, the right over such property, use enjoyment of the same other rights must all be transferred to the donee so that it will constitute as taxable donation.

II. INDIRECT GIFTS - No donative intent; thus it may not be subject to donor's tax.

1. Cancellation of Indebtedness

- Φ Look at the intention of the transferor.
- Φ If the intention is for the recipient to render service, donor's tax is not applicable, what would apply is income tax.
- Φ If the intention of the transferor is otherwise, the indirect gift is subject to donor's tax since it constitutes a gift.

2. Transfer for Insufficient Consideration (Section 100)

- Φ Look into the classification of the property that was sold.
- Φ If it is a capital asset then the transfer is subject to capital gains tax of 6% and not to donor's tax.
- Φ **Ergo:**
 - a. Where the consideration is fictitious, the entire value of the property transferred shall be subject to donor's tax;
 - b. The amount by which the value of the property exceeds the amount of consideration shall be deemed a gift for purposes of the donor's tax.

Φ **Requisites to be subject to gift tax**

1. There was an insufficient consideration
2. The transaction was not entered into arm's length.

3. Waiver- waiver of inheritance or debts.

4. Renunciation of Inheritance

- Φ **Primordial consideration:** look if the renunciation is general or specific.
- Φ **General renunciation-** contemplates the situation that all heirs may receive the renounced property. ***It is not subject to donor's tax.***

Why? There is no donation that was made because the property was distributed to the co-heirs by operation of law and not by *animus donandi* of the renouncing heir. Upon renunciation, the renouncing heir did not become an heir.

- ⊕ **Specific renunciation-** the property was renounced in favor of a specific heir or the share of the other heirs is specified. It is subject to donor's tax.

Why? Because it is in the nature of donation since the person who will receive the property is particularly named by the renouncing heir. Such act of naming the substitute heir is constitutive of *animus donandi* on his part.

Tax tip: renounce your inheritance but the renunciation must be general.

Paul and Therese are married. They have a son Peter. Their conjugal property amounted to 4M. Paul died. Is there a remedy that Therese cannot pay estate and donor's tax?

Yes, Therese can renounce his inheritance. However, the renunciation must be general. Thus, by operation of law, the share of Therese in the net estate of Paul will go to Peter as the sole heir. This is also true even if they have more than one child, since her share will be equally divided among them.

In the end when Therese dies it is only her net estate that can be subjected to estate tax.

RULE ON DONATED CONJUGAL PROPERTY - If the property donated is conjugal, husband and wife are considered as separate donors.

The spouses are co-owners of conjugal property (Article 174, Civil Code). Thus, a gift made by the spouses of conjugal property shall be deemed separate donations by the husband and the wife in proportion to their respective interests. In other words, there will be two donations made and two separate computations of donor's taxes. **However**, unless the wife expressly joins in making the donation of conjugal property, it shall be deemed to have been made by the husband alone (*Tang Ho vs. Board of Tax Appeals, 97 Phil 829*).

Bar 1997 - Donor's Tax; Dacionen Pago; Effect: Taxation: An insolvent company had an outstanding obligation of P 100,000.00 from a creditor. Since it could not pay the debt, the creditor agreed to accept payment

through dacion en pago a property which had a market value of P30,000.00. In the dacion en pago document, the balance of the debt was condoned.

- A.** What is the tax effect on the discharge of the unpaid balance of the obligation on the debtor corporation?
B. Insofar as the creditor is concerned, how is he effected tax-wise as a consequence of the transaction?

Suggested answers:

(a) The condonation of the unpaid balance of the obligation has the effect of a donation made on the part of the creditor. It is obvious that the creditor merely desires to benefit the debtor and without any consideration therefore cancels the debt, the amount of the debt cancelled is a gift from the creditor to the debtor and need not be included in the latter's gross income (Sec. 50, RR No. 2);

(b) For the difference of P70,000 the creditor shall be subject to donor's tax at the applicable rates provided for under the National Internal Revenue Code.

Alternative answer:

(a) If the discharge was prompted by the insolvency of the debtor company, then it is a clear case of a write-off of a bad debt which has no tax consequence to the debtor.

(b) The write-off of the bad debt will entitle the creditor to claim the same as a deduction from its gross income.

Bar 1998 - Donor's Tax: Election Contributions: Are contributions to a candidate in an election subject to donor's tax? On the part of the contributor, is it allowable as a deduction from gross income? [5%]

Suggested answer:

1) No, provided the recipient candidate had complied with the requirement for filing of returns of contributions with the Commission on Elections as required under the Omnibus Election Code.

2) The contributor is not allowed to deduct the contributions because the said expense is not directly attributable to the development, management, operation and/or conduct of a trade, business or profession {Sec. 34[AJ(l)(a), NIRC}. Furthermore, if the candidate is an incumbent government official or employee, it may even be considered as a bribe or a kickback (Sec. 34[AJ(l)(c), NIRC).

Bar 2003 - Donor's Tax; Donation to Political Candidate: X is a friend of Y, the chairman of Political Party Z, who wants to run for President in the 2004 elections. Knowing that Y needs funds for posters and streamers, X is thinking of donating to Y P150,000.00 for his campaign. He asks you whether his intended donation to Y will be subject to the donor's tax. What would your answer be? Will your answer be the same if he were to donate to Political Party Z instead of to Y directly? (8%)

Suggested answer: The donation to Y, once he becomes a candidate for an elective post, is not subject to donor's tax provided that he complies with the requirement of filing returns of contributions with the

Commission on Elections as required under the Omnibus Election Code.

The answer would be the same if X had donated the amount to Political Party Z instead of to Y directly because the law places in equal footing any contribution to any candidate, political party or coalition of parties for campaign purposes. (Section 99(C) of the 1997 Tax Code).

FACTORS THAT AFFECT LIABILITY FOR GIFT TAXES (Section 99) - When the *donee or beneficiary is a stranger*, the payable gift tax by the donor shall be 30% of the net gifts. If between relatives the tax rate is 2-15%.

For the purpose of donor's tax, a stranger is a person who is not a:

1. Brother, sister (whether whole or half-blood), spouse, ancestor and lineal descendant; or
2. Relative by consanguinity in the collateral line within the fourth degree of relationship.

Illustration: A donated a property B, his son-in-law. What is the tax percentage? 30% because B is not a family member of A, as defined by the Tax Code.

Bar 2001 - Donor's Tax; Donation to a Sibling: Your bachelor client, a Filipino residing in Quezon City, wants to give his sister a gift of Php 200,000.00. He seeks your advice, for purposes of reducing if not eliminating the donor's tax on the gift, on whether it is better for him to give all of the Php 200,000.00 on Christmas 2001 or to give Php 100,000.00 on Christmas 2001 and the other Php 100,000.00 on January 1, 2002. Please explain your advice. (5%)

Suggested answer: I would advise him to split the donation. Giving the Php200,000 as a one-time donation would mean that it will be subject to a higher tax bracket under the graduated tax structure thereby necessitating the payment of donor's tax. On the other hand, splitting the donation into two equal amounts of Php 100,000 given on two different years will totally relieve the donor from the donor's tax because the first Php100,000 donation in the graduated brackets is exempt. (Section 99, NIRC). While the donor's tax is computed on the cumulative donations, the aggregation of all donations made by a donor is allowed only over one calendar year.

Bar 1999 -Donor's Tax; Sale of shares of Stock& Sale of Real Property: A, an individual, sold to B, his brother-in-law, his lot with a market value of P1,000,000 for P600,000. A's cost in the lot is P100,000. B is financially capable of buying the lot. A also owns X Co., which has a fast growing business. A sold some of his shares of stock in X Co. to his key executives in X Co. These executives are not related to A. The selling price is P3,000,000, which is the book value of the shares sold but with a market value of P5,000,000. A's cost in the shares sold is P1,000,000. The purpose of A in selling the shares is to enable his key executives to acquire a proprietary interest in the business and have a personal stake in its

business. Explain if the above transactions are subject to donor's tax. (5%)

Suggested answer: The first transaction where a lot was sold by A to his brother-in-law for a price below its fair market value will not be subject to donor's tax if the lot qualifies as a capital asset. *The transfer for less than adequate and full consideration, which gives rise to a deemed gift, does not apply to a sale of property subject to capital gains tax.* (Section 100, NIRC). However, if the lot sold is an ordinary asset, the excess of the fair market value over the consideration received shall be considered as a gift subject to the donor's tax.

The sale of shares of stock below the fair market value thereof is subject to the donor's tax pursuant to the provisions of Section 100 of the Tax Code. The excess of the fair market value over the selling price is a deemed gift.

Alternative answer: The sale of shares of stock below the fair market value will not give rise to the imposition of the donor's tax. In determining the gain from the transfer, the selling price of the shares of stocks shall be the fair market value of the shares of stocks transferred. (Section 6, RR No. 2-82). In which case, the reason for the imposition of the donor's tax on sales for inadequate consideration does not exist.

EXEMPTION FROM GIFT TAX (Section 101) - The following gifts or donation shall be exempt from donor's tax:

A. In the case of gifts made by a resident citizen

1. Donations not exceeding p100, 000. 00 for every year.
2. Dowries or gifts made on account of marriage (*applicable to resident citizens only*).
 - i. Must be made on account of marriage;
 - ii. Made before celebration of the marriage or within 1 year thereafter.
 - iii. The donation is made by the parents to their legitimate, recognized natural or adopted children.

Recognized natural Child- a recognized natural child is one born outside wedlock of parents who at the time of the conception of the former were legally free to marry each other and is recognized by one or both parents.

3. 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 government.
4. Gifts in favor of an educational and/or charitable, religious, cultural or social welfare corporation, institution, accredited non-governmental organization, provided however, that not more

than 30% of said gifts shall be used by such donee for administration purposes.

A non-profit educational and or charitable corporation, institution, accredited non-governmental organization, trust or philanthropic organization, or research institution or organization is a school, college or university and/or charitable corporations accredited non-governmental organization, trust or philanthropic organization, and/or research institution or organization:

1. Incorporated as non-stock entity;
2. Paying no dividends;
3. Governed by trustees who received no compensation;
4. Devoting all its income, whether student's free or gifts, donations subsidies or other forms of philanthropy, to the accomplishment of promotion of the purposes enumerated in its Article of Incorporation.

Bar 2000 - Donor's Tax; Donation to Non-Stock, Non-Profit Private Educational Institutions: What conditions must occur in order that all grants, donations and contributions to non-stock, non-profit private educational institutions may be exempt from the donor's tax under Section 101 (a) of the Tax Code? (3%)

Suggested answer: The following are the conditions:

1. Not more than thirty percent (30%) of said gifts shall be used by such donee for administration purposes;
2. The educational institution is incorporated as a non-stock entity,
3. paying no dividends,
4. governed by trustees who receive no compensation, and
5. 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. (Sec. 101 (A) (3), NIRC of 1997]

B. In the case of gifts made by a non-resident not a citizen of the Philippines.

1. 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 said government.
2. Gifts in favor of an educational and/or charitable, religious, cultural or social welfare corporation, institution, accredited non-governmental organization, trust or philanthropic organization, or research institution or organization, provided, however,

that not more than 30% of said gifts shall be used by such donee for administration purposes.

EXEMPTIONS UNDER SPECIAL LAWS

1. Donations to Philippine government for scientific, engineering, and technological research, invention and development (R.A. 1606)
2. Donations to social welfare, cultural and charitable organizations (P.D. 5-7; RA 1916).
3. Donations to the International Rice Research Institute (RA 2707).
4. Donations to Ramon Magsaysay award foundation (RA 3076).
5. Donations to the National Historical Institute (P.D. 373)
6. Donation to the Southern Philippines Development Administration (P.D. 690).
7. Donations to the Intramuros Administration (P.D. 1616).

OTHER DEDUCTIONS

1. Encumbrance on the property donated if assumed by the donee.

⊕ **Encumbrance** is a liability attached to the property.

2. Those specifically provided by the donee as a diminution from the property donated.

⊕ **Diminution** is imposed in the deed of donation stating that part of the donation is to be given to another third person.

3. Tax credit for donor's taxes paid to a foreign country.

⊕ **General rule:** the tax imposed upon a donor who was a citizen or a resident at the time of the donation shall be credited with the amount of any donor's tax of any character and description imposed by the authority of a foreign country.

⊕ **Limitations on credit-** the amount of credit shall be subject to each of the following limitations:

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 estate situated within such country taxable under donor's tax bears to his entire estate.
2. The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which decedent's net estate situated outside the Philippines taxable under

donor's tax bears to his entire net estate.

VALUATION OF GIFTS MADE IN PROPERTY

- ⊕ **Personal property**- fair market value at the time of the gift.
- ⊕ **Real property**- whichever is higher of
 - a. Fair market value determined by the commissioner; or
 - b. The fair market value as shown in the schedule of values fixed by the provincial or city assessor.
- ⊕ **Cash**- amount of cash.
- ⊕ **Stocks with par value**- par value
- ⊕ **Stocks without par value**- arithmetic mean?

PROCEDURE IN COMPUTING NET GIFTS - The tax for each calendar year shall be computed on the basis of the total net gifts made during the calendar year in accordance with the schedule of tax rates prescribed in the law (i.e., the first P10, 000. 00 net gifts is exempt; 2% is applied on the amount of net gift over P100, 000. 00 and 15% on the amount of net gift over 10M).

The tax is imposed on the cumulative basis during the calendar year; i.e. the rates are applied on the aggregate net gifts during the calendar year, but donor's taxes paid the calendar year are credited against the donor's tax due on the latest donation during the same calendar year, but donor's taxes paid during the calendar year are credited against the donor's tax due on the latest donation during the same calendar year. Thus all donations made in one calendar year by a donor are taxed at the same graduated tax rates as if they had been made at the time. A new computation of donor's tax is made for gifts made by the donor in another calendar year.

Bar 1995 - Donor's Tax; Basis for Determining

Gain: (1) Kenneth Yusoph owns a commercial lot which he bought many years ago for P1 Million. It is now worth P20 Million although the zonal value is only P15 Million. He donates one-half pro-indiviso interest in the land to his son Dino on 31 December 1994, and the other one-half pro-indiviso interest to the same son on 2 January 1995.

How much is the value of the gifts in 1994 and 1995 for purposes of computing the gift tax? Explain.

Suggested answer: The value of the gifts for purposes of computing the gift tax shall be P7.5million in 1994 and P7.5million in 1995. In valuing a real property for gift tax purposes the property should be appraised at the higher of two values as of the time of donation which are (a) the fair market value as determined by the Commissioner (which is the zonal value fixed pursuant to Section 16(e) of the Tax Code), or (b) the fair market value as shown in the schedule of values fixed by the Provincial and City Assessors. The fact that the property is worth P20 million as of the time of donation is immaterial unless it can be

shown that this value is one of the two values mentioned as provided under Section 81 of the Tax Code.

(2)The Revenue District Officer questions the splitting of the donations into 1994 and 1995. He says that since there were only two (2) days separating the two donations they should be treated as one, having been made within one year. Is he correct? Explain.

Suggested answer: The Revenue District Officer is not correct because the computation of the gift tax is cumulative but only insofar as gifts made within the same calendar year. Therefore, there is no legal justification for treating two gifts effected in two separate calendar years as one gift.

(3) Dino subsequently sold the land to a buyer for P 20 Million. How much did Dino gain on the sale? Explain.

Suggested answer: Dino gained an income of 19 million from the sale. Dino acquires a carry-over basis which is the basis of the property in the hands of the donor or P1 million. The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis or adjusted basis for determining gain (Sec. 34(a), NIRC). Since the property was acquired by gift, the basis for determining gain shall be the same as if it would be in the hands of the donor or the last preceding owner by whom the property was not acquired by gift. Hence, the gain is computed by deducting the basis of P1 million from the amount realized which is P20 million.

(4) Suppose, instead of receiving the lot by way of donation, Dino received it by inheritance. What would be his gain on the sale of the lot for P20 Million? Explain.

Suggested answer: If the commercial lot was received by inheritance the gain from the sale for P20 million is P5 million because the basis is the fair market value as of the date of acquisition. The stepped-up basis of P15 million which is the value for estate tax purposes is the basis for determining the gain (Sec. 34(b)(2), NIRC).

Alternative answer: If Dino held on to the property as a capital asset in that it is neither for sale in the ordinary course of business nor used in Dino's business, then upon sale thereof there is presumed to be realized an income of P20 million which is the gross selling price of the property. (Sec. 21(e), NIRC). The same would be subject to the 5% capital gains tax.

ADMINISTRATIVE PROVISIONS

1. **Filing of notice of donation (Rev. Regs. 2-2003)**
2. **Filing of donor's tax return**

Who must file donor's tax return? Any individual who makes any transfer by gift, except those which are

exempt from the tax, shall make a return under oath in duplicate.

Contents of a Donor's Tax Return

1. Each gift made during the calendar year which is to be included in computing net gifts.
2. The deductions claimed and allowable.
3. Any previous net gifts made during the same calendar year.
4. The name of the donee
5. Such further information as may be required by rules and regulations made pursuant to a law.

When to file a donor's tax return and pay donor's tax? The return of the donor shall be filed within 30 days after the date the gift is made and the tax due thereon shall be paid at the time of filing.

Where to file return and pay donor's tax? Except in cases where the commissioner otherwise permits, the return shall be filed and the tax paid to:

1. An authorized agent bank;
2. The revenue district officer;
3. Revenue collection officer;
4. Duly authorized treasurer of the city or municipality where the donor was domiciled at the time of the transfer; or
5. If there be no legal residence in the Philippines, with the office of the Commissioner.

In the case of gifts made by a non-resident, the return may be 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 TIP:

- ⊕ **If possible, make a donation not exceeding P100, 000. 00 per year.**
- ⊕ **Check the computation if donation is better than allowing estate tax (in estate taxation there is 1M automatic deduction to the gross estate).**

VALUE ADDED TAX

Formula:

Output Tax
Less: Input Tax _____
VAT Payable (Creditable)

Value Added Tax

- ♣ 12% on the value added.
- ♣ Is an indirect tax. Thus the burden of the tax [not the tax itself] can be shifted to the buyer.

- ♣ It is also a tax imposed on all level of production and distribution process.

- ♣ VAT is imposed only on the value that was added.

- ♣ **VAT is a consumption based tax-** the consumers are the one who will ultimately shoulder the burden of tax. The more you consume the more VAT you will pay. However, you will not be considered as taxpayer.

If the consumption takes place in the Philippines- there is VAT; if the consumption will happen outside the country- VAT exempt. The VAT liability of person engage in export sales is 0%.

Output Value Added Tax- Vat due on the transaction

Input Value Added Tax- VAT due from or paid by a VAT registered taxpayer who is transacting with another VAT registered taxpayer.

What is the importance of Output and Input VAT? It has something to do with the VAT crediting mechanism. However the VAT crediting mechanism can be availed of if the buyer sells the properties that he bought.

HOW DOES THE VAT OPERATE?

Santi, a VAT registered taxpayer sold 1M worth of product to Guillermo, a VAT registered taxpayer. Ayaw ni Santi magbayad ng VAT so he passed the burden of VAT to Guillermo. Guillermo then pays Santi 1.2M [P 120, 000.00-VAT]. Ayaw ni Guillermo na magpalugi so he sold the same property to Giovanni at 2,240,000 [240, 000 as the VAT.]

SITUATIONS:

- ♣ **What do you call the tax shouldered by Guillermo when he purchased the property from Santi?** Creditable input VAT [Why? Kasi nga siya ung nagbayad sa VAT, which form part of the purchase price. Creditable kasi pwedeng ikaltas sa output VAT].

- ♣ **What do you call the VAT shifted by Guillermo to Giovanni?** Creditable output VAT [Why? Kasi nga the VAT is included in the purchase price ng property na binenta ni Guillermo.]

Note: a taxpayer can utilize the benefits of creditable output and input VAT if it is a VAT registered entity and he transacts with another VAT registered entity.

- ♣ **So what can Guillermo do about these creditable input VAT and output VAT?** He can

use his input VAT to lessen his VAT liability by deducting it from his output VAT.

- **Ex:** 240, 000 [output VAT] - 120, 000 [input VAT] = 120, 000 VAT payable

- ♣ **What if Santi was a 0% rated VAT taxpayer, can Guillermo file a refund of the VAT that was shifted to him by Santi?** No, since under the law, the taxpayer is Santi and not Guillermo, since the 120, 000 formed part of the purchase price. Guillermo has no legal personality to file a claim for refund.

Remedy of Guillermo: kausapin niya si Santi para magfile g refund and 50-50 sila ng hatian ng refunded tax. ☺☺☺

- ♣ **If Santi is engaged in the business processing of sardines, what is his remedy to lessen his VAT liability [Santi has an output VAT of 120, 000]?** Santi can claim presumptive input VAT of 4% of the gross value in money of his purchases of fishes used to make sardines. Thus,
 - 800, 000 [value of fish] x .4%= 32, 000- Presumptive input VAT.
 - 120, 000 [output VAT] - 32, 000 [presumptive input VAT] = 88, 000 VAT liability.

WHO ARE LIABLE FOR VAT?

1. Any person who, in the course of trade or business, sells, barter, exchanges, leases goods or properties.
2. Any person who renders services.
3. Any person who imports goods.
4. Any person who is engaged in exportation.

TRESHHOLD AMOUNT FOR IMPOSITION OF VAT:

- ♣ Annual gross sales or receipts exceeds 1, 919, 500. 00 gross annual receipt or sales.
- ♣ For purposes of the threshold of P1, 919,500.00, the **husband and the wife** shall be considered separate taxpayers. However, the **aggregation rule** for each taxpayer shall apply. For instance, if a professional, aside from the practice of his profession, also derives revenue from other lines of business which are otherwise subject to VAT, the same shall be combined for purposes of determining whether the threshold has been exceeded. Thus, the VAT- exempt sales shall not be included in determining the threshold [RR 16-2011].
- ♣ If a **professional taxpayer selling services** is not subject to VAT, he is liable for 3% percentage tax of his gross receipts for that year.

SUBJECT TO 12% VAT

COVERED TRANSACTIONS:

- ♣ Clue: ISaBEL
 1. Importation of goods
 2. Sale of **goods** and **services** in the regular course of business or any activity that are incidental thereto.
 3. Barter
 4. Exchange
 5. Lease

VAT ON SALE OF GOODS OR PROPERTIES

- ♣ **Rate and Base** – 12% of the **gross selling price or gross value** in money shall be imposed on the following:
 1. Real properties for sale or lease.
 2. Right to use patent, copyright, design or model plan, secret formula or process, goodwill, trademark, trade brand or the like.
 3. The privilege to use in the Philippines any industrial, commercial or scientific equipment.
 4. The right to use motion picture, films, tapes and discs.
 5. Radio, TV, satellite transmission and cable TV time.
- ♣ **Formula: Gross Selling Price X 12% = Output Tax**

VAT ON IMPORTATION OF GOODS

- ♣ 12% VAT based on the total value used by the BOC shall be assessed and collected.

VAT ON SALE OF SERVICES AND USE OR LEASE OF PROPERTIES

- ♣ **Rate and Base of Tax** – 12% VAT on the gross receipts derived from the sale or exchange of services, including the use or lease of properties:
 1. Construction and service contractors.
 2. Stock, real estate, commercial, customs and immigration brokers.
 3. Lessors of property.
 4. Warehouse services.
 5. Lessors or distributors of cinematographic film.
 6. Persons engaged in milling, processing, manufacturing or repackaging goods for others.
 7. Proprietors, operators or keepers of hotels, motels, resthouses, pension houses, inns, resorts.
 8. Proprietors or restaurants, cafes and other eating places, clubs and caterers.
 9. Dealers in securities.
 10. Lending investors.
 11. Transportation contractors.
 12. Services of franchise grantees of telephone and telegraph, radio and TV broadcasting and all other franchise grantees.

RULES ON LEASE OF RESIDENTIAL UNITS [RR NO. 16-2011]

- ✦ **VAT LIABLE:** if rentals per unit exceed 12, 800 and the gross receipt per annum exceeds P1, 919, 500. 00.
- ✦ **VAT EXEMPT:**
 1. Lease of residential units with a monthly rental per unit not exceeding P12, 800.00, regardless of the amount of aggregate rentals received by the lessor during the year is exempt from VAT;
 2. Lease of residential units where the monthly rental per unit exceeds Twelve Thousand Eight Hundred Pesos (P12, 800.00) but the aggregate of such rentals of the lessor during the year do not exceed P1, 919,500.00 shall likewise be exempt from VAT, however, the same shall be subjected to three percent (3%) percentage tax.

In cases where a lessor has several residential units for lease, some are leased out for a monthly rental per unit of not exceeding P12, 800.00 while others are leased out for more than P12, 800.00 per unit, his tax liability will be as follows:

- a. The gross receipts from rentals not exceeding P12, 800.00 per month per unit shall be **exempt from VAT regardless of the aggregate annual gross receipts.**
- b. The gross receipts from rentals exceeding P12,800.00 per month per unit shall be **subject to VAT if the aggregate annual gross receipts from said units only (not including the gross receipts from units leased for not more than P12,800.00) exceeds P1,919,500.00.** Otherwise, the gross receipts will be subject to the 3% tax imposed under Section 116 of the Tax Code.
3. Sale or lease of goods or properties or the performance of services other than the transactions mentioned in the preceding paragraphs, the gross annual sales and/or receipts do not exceed the amount of P1,919,500.00.

Meaning of Residential Units: The term 'residential units' shall refer to **apartments and houses & lots used for residential purposes, and buildings or parts or units thereof used solely as dwelling places** (e.g., dormitories, rooms and bed spaces) except motels, motel rooms, hotels, hotel rooms, lodging houses, inns and pension houses.

Meaning of Unit: The term 'unit' shall mean an apartment unit in the case of apartments, house in the case of residential houses; per person in the case of

dormitories, boarding houses and bed spaces; and per room in case of rooms for rent.

Bar 1997 - VAT: Transactions "Deemed Sales": Under the Value Added tax (VAT), the tax is imposed on sales, barter, or exchange of goods and services. The VAT is also imposed on certain transactions "deemed-sales". What are these so-called transactions "deemed sales"?

Suggested answer: The following transactions shall be deemed sale:

- a) Transfer, use, or consumption not in the course of business of goods originally intended for sale or for use in the course of business;
- b) Distribution or transfer to:
 - (1) Shareholders or investors as share in the profits of VAT-registered persons; or
 - (2) Creditors in payment of debt;
- c) Consignment of goods if actual sale is not made within 60 days following the date such goods were consigned; and
- d) Retirement from or cessation of business, with respect to inventories of taxable goods existing as of such retirement or cessation.
- e) Sale of real property utilized for socialized housing under RA. No. 7279;
- f) Sale of real property utilized under the low-cost housing under BP Big. 220.

Bar Question- VAT; Covered Transactions: State whether the following transactions are a) VAT Exempt, b) subject to VAT at 12%; or c) subject to VAT at 0%:

SUGGESTED ANSWER:

1) Sale of fresh vegetables by Aling Ining at the Pamilihang Bayan ng Trece Martirez. [1%] - VAT exempt. Sale of agricultural products, such as fresh vegetables, in their original state, of a kind generally used as, or producing foods for human consumption is exempt from VAT. (Section 109(c), NIRC).

2) Services rendered by Jake's Construction Company, a contractor to the World Health Organization in the renovation of its offices in Manila. [1%] - VAT at 0%. Since Jake's Construction Company has rendered services to the World Health Organization, which is an entity exempted from taxation under international agreements to which the Philippines is a signatory, the supply of services is subject to zero percent (0%) rate. (Sec. 108[B1(3)], NIRC).

3) Sale of tractors and other agricultural implements by Bungkal Incorporated to local farmers. [1%] - VAT at 12%. Tractors and other agricultural implements fall under the definition of goods which include all tangible objects which are capable of pecuniary estimation (Sec. 106[A1(1)], NIRC, the sales of which are subject to VAT at 12%.

4) Sale of RTW by Cely's Boutique, a Filipino dress designer, in her dress shop and other outlets. [1%] -This is subject to VAT at 12%. This transaction also falls under the definition of goods which include all tangible

objects which are capable of pecuniary estimation (Sec. 106[A1(1), NIRC, the sales of which are subject to VAT at 12%.

NOT SUBJECT TO 12% VAT RATE

1. EXEMPT TRANSACTIONS –Section 109

- a. Agricultural food/ marine products sold in its original state.
 - ♣ **What about sashimi, is it subject to VAT?** Yes, not that it is a marine product in its original state but because the restaurant that serves it is selling its services. Hence the VAT is for the services rendered.
- b. Services rendered because of employer-employee relationship.
- c. Medical services except those provided by professional. It is the billing of the hospital that is not subject to VAT but it is the billing of the Doctors since it is a compensation for their services.
- d. Sale of residential units in the course of business with a gross selling price not exceeding the amount of 3, 199, 200. 00.
 - ♣ Sale of capital assets is not subject to VAT but Capital Gains Tax.

Tax Tip: plan your pricing mechanisms- What is the remedy of a condominium units valued at 6M, to avoid VAT? Split the condo units and sell it at 3M per unit.

What if there is the same buyer, is the seller still liable for tax? No, this transaction is not prohibited by the tax law.

- e. **Leasing of residential units in an amount not exceeding 12, 800. 00/month.**

EXEMPT TRANSACTIONS

The following transactions are exempt from the coverage of VAT:

1. Sale of importation or agricultural and marine products in the original state.
2. Sale of importation of fertilizers, seeds, seedlings and fingerlings, fish prawn, poultry and livestock feeds.
3. Importation of personal and household effects belonging to the residents of the

Philippines returning from abroad and NRCs coming to settle in the Philippines.

4. Importation of professional instruments and implements, apparel, domestic animals and personal household effects (except any vehicle or machinery) belonging to persons coming to settle in the Philippines, for their own self and not for sale.
5. Services subject to percentage tax under Title V of the NIRC.
6. Services by agricultural contract growers and milling for others of palay into rice, corn into grits and sugar cane into raw sugar.
7. Medical, dental, hospital and veterinary services except those rendered by professional.
8. Educational services.
9. Services rendered by individuals pursuant to an employer-employee relationship.
10. Services rendered by regional or area headquarters established by MNCs in the Philippines (do not earn income from the Philippines).
11. Transactions which are exempt under special laws and international agreements.
12. Sales by agricultural cooperatives duly registered with the CDA.
13. Gross receipts from lending activities by credit or multi-purpose cooperatives duly registered with the CDA.
14. Sales by non-agricultural, non-electric and non-credit cooperative duly registered with the CDA provided that the share capital contribution of each member does not exceed P15,000.
15. Export sales by persons who not VAT registered.
16. Sale of low-cost housing [Below P1, 919, 500. 00 Million for residential lots and P3, 199, 200. 00 for house and lot and other residential dwellings].

If two or more adjacent residential lots, house and lots or other residential dwellings are sold or disposed in favor of one buyer from the same seller, for the purpose of utilizing the lots, house and lots or other residential dwellings as one residential area, the sale shall be exempt from VAT only if the aggregate value of the said properties do not exceed P1, 919,500.00 for residential lots, and P3, 199,200.00 for residential house and

lots or other residential dwellings. Adjacent residential lots, house and lots or other residential dwellings although covered by separate titles and/or separate tax declarations, when sold or disposed to one and the same buyer, whether covered by one or separate Deed/s of Conveyance, shall be presumed as a sale of one residential lot, house and lot or residential dwelling.

This however, does not include the sale of parking lot which may or may not be included in the sale of condominium units. The sale of parking lots in a condominium is a separate and distinct transaction and is not covered by the rules on threshold amount not being a residential lot, house & lot or a residential dwelling, thus, should be subject to VAT regardless of amount of selling price. [RR no. 13-2012]

17. Lease of a residential unit with a monthly rental not exceeding P10, 000. 00
18. Sale or publication of books and newspapers, magazines which neither appear at regular interval nor devoted principally to the publication of paid advertisements.
19. Sale, importation or lease of passenger or cargo vessels.
20. Importation of fuel, goods and supplies by persons engaged in shipping or air transport.
21. Services of financial intermediaries.
22. Sale or lease of goods or performance of services other than those mentioned above and the gross receipts and/or annual sales must not exceed P1, 919, 500. 00.

Note: A VAT-registered person is given the option to be VAT-exempt or be subject to VAT.

Such election is irrevocable for a period of 3 years from the quarter the election was made.

Rationale: Such VAT-exempt person may incur a large amount of input tax in excess of his output tax, and such input tax can be credited against any tax under the NIRC.

2. ZERO RATED TRANSACTION [Section 106, A to E, 108]

Meaning of Zero Rated

- ✦ An entity that is VAT-registered is subject to 0%, meaning the gross selling price of his goods or properties shall be multiplied by 0%, hence, his output tax shall be equivalent to P0.00.

- ✦ On the other hand, since he is VAT-registered, he may claim input tax for the purchases he made from VAT-registered entities.
- ✦ The result will be a VAT creditable amount or a creditable input tax which can serve as a tax credit which can be deducted from any tax under the NIRC.
- ✦ Advantage of being subject to 0% rather than being tax-exempt is obvious – the input tax can be credited against any NIRC tax.

a. Export sales

- ✦ Actual export
- ✦ **Constructive export-** supplies a taxpayer who produces goods for exports.
- ✦ **Sale of gold or silver [not any other mineral] to the Bangko Central.**

b. Zero rated sale of service

- ✦ X Corp. operates a call center. It has a client A [NRFC] and B [DC] corporation. A Corp operates chains of hotels. B Corp operates domestic chains of hotels. The services of X Corp. are to take the bookings of A and B Corp. Are the services of X Corp. subject to VAT?

As to the services performed in favor of A Corp it is a zero rated transaction hence no liability for VAT.

As to the services performed in favor of B Corp it is subject to VAT provided that the gross receipt is more than 1, 919, 500. 00

The following are subject to 0% VAT:

a. Export Sales

- ✦ Shipment of goods from the Philippines to a foreign country.
- ✦ Sale of goods to a non-resident for delivery to the Philippines.
- ✦ Sale of raw materials or packaging materials to export-oriented enterprise whose sales exceed 70% of total annual production.
- ✦ Sale of gold to the BSP.
- ✦ Those considered export sales under the Omnibus Investment Code.
- ✦ Sale to persons engaged in international shipping or international air transport operations.

b. Foreign Currency Denominated Sale

- ✦ This is a sale to a non-resident of goods assembled or manufactured in the Philippines for delivery to a resident in the Philippines, paid in acceptable foreign currency.

3. SALES TO PERSONS EXEMPTED UNDER SPECIAL LAWS OR INTERNATIONAL AGREEMENTS.

Bar 2004 - VAT; Exemption: Constitutionality: A law was passed exempting doctors and lawyers from the operation of the value added tax. Other professionals complained and filed a suit questioning the law for being discriminatory and violative of the equal protection clause of the Constitution since complainants were not given the same exemption. Is the suit meritorious or not? Reason briefly. (5%)

Suggested answer: Yes, the suit is meritorious. The VAT is designed for economic efficiency; hence, should be neutral to those who belong to the same class. Professionals are a class of taxpayers by themselves who, in compliance with the rule of equality of taxation, must be treated alike for tax purposes. Exempting lawyers and doctors from a burden to which other professionals are subjected will make the law discriminatory and violative of the equal protection clause of the Constitution. While singling out a class for taxation purposes will not infringe upon this constitutional limitation (**Shell v. Vano, 94 Phil. 389 [1954]**), singling out a taxpayer from a class will no doubt transgress the constitutional limitation (**Ormoc Sugar Co. Inc., v. Treasurer of Ormoc City, 22 SCRA 603 [1968]**). Treating doctors and lawyers as a different class of professionals will not comply with the requirements of a reasonable, hence valid classification, because the classification is not based upon substantial distinction which makes real differences. The classification does not comply with the requirement that it should be germane to the purpose of the law either. (**Pepsi-Cola Bottling Co., Inc. v. City of Butuan, 24 SCRA 789 [1968]**).

Another answer: No. The suit is not meritorious. The equal protection clause of the Constitution merely requires that all persons subjected to legislation shall be treated alike, under like circumstances and conditions, both in the privileges conferred and in the liabilities imposed. The equality in taxation rule is not violated if classifications or distinctions are made as long as the same are based on reasonable and substantial differences. (**Pepsi-Cola Bottling Co., Inc. v. City of Butuan, 24 SCRA 789 [1968]**).

In the instant case, the professions of doctors and lawyers are not principally aimed at earning money but for the service of the people. The exemption granted to doctors and lawyers from the operation of the VAT is justified, as it is not discriminatory against the other professionals because they have reasonable and substantial differences in the conduct of their professions.

Bar Question - VAT: Exempted Transactions: Give at least three (3) real estate transactions which are not subject to the Value-Added Tax.

Suggested answer: Real estate transactions which are exempt from the value-added tax are:

- a. Sale of real property not primarily held for sale or lease in the ordinary course of trade or business;

- b. Sellers of goods and properties in the course of trade or business;
- c. Sellers of services in the course of trade or business, including lessors of goods and properties;
- d. Importers of taxable goods, whether in the course of business or not

Note: The other real estate transactions which are exempt from the value-added tax which may be cited by the bar candidates are as follows:

- a. Transfer of real property to a trustee if the property is to be held merely in trust for the trustor.
- b. Transfer of real property to a corporation in exchange for its shares of stock under Section 34(c)(2) and (6)(2) of the Tax Code.
- c. Advance payment by the lessee in a lease contract, when the same is actually a loan to the lessor from the lessee.
- d. Security deposits for lease arrangements to insure the faithful performance of certain obligations of the lessee to the lessor.
- e. Lease of residential units, boarding houses, dormitories, rooms and bed spaces offered for rent by their owners at a monthly rental not exceeding P12, 800.00 per unit.

CREDITABLE INPUT TAX

The input tax shall be creditable against the output tax incurred by a VAT-registered person. The rule is that only purchases from VAT-registered persons have input tax.

Transitional/Presumption Input Tax Credits

1. **Transitional Input Tax Credit-** A person who becomes liable to VAT or any person who elects to be VAT-registered is allowed to claim input tax on his beginning inventory of goods, materials and supplies equivalent to 2% of the value of such inventory or the actual VAT paid on such goods, materials and supplies, whichever is higher.
2. **Presumptive Tax Input Credits-** For persons or firms engaged in the processing of sardines, mackerel or milk, manufacturing refined sugar and cooking oil, and manufacturing packed noodle-based instant meals, a presumptive input tax equivalent to 4% of the gross value in money of their purchases of primary agricultural products are used as inputs to their production.

REFUNDS OR TAX CREDITS OF INPUT TAX

2 Available options

- ♣ Apply for tax credit
- ♣ Apply for a refund of the creditable input tax

Period: refund must be filed within 2 years from the close of the taxable quarter where the relevant sale was made.

Bar 2006 - VAT; Non-VAT taxpayer; Claim for Refund: Lily's Fashion, Inc. is a garment manufacturer located and registered as a Subic Bay Freeport Enterprise

under Republic Act No. 7227 and a non-VAT taxpayer. As such, it is exempt from payment of all local and national internal revenue taxes. During its operations, it purchased various supplies and materials necessary in the conduct of its manufacturing business. The suppliers of these goods shifted to Lily's Fashion, Inc. the 10% VAT on the purchased items amounting to P 500,000.00. Lily's Fashion, Inc. filed with the BIR a claim for refund for the input tax shifted to it by the suppliers. If you were the Commissioner of Internal Revenue, will you allow the refund? (5%)

Alternative answer: No, I will not allow the refund. Only VAT-Registered taxpayers are entitled to a refund of their unapplied/unused Input VAT (Tax Reform Act, Section 112[A] [1997]).

Alternative answer: No. The exemption of Lily's Fashion, Inc. is only for taxes for which it is directly liable. Hence, it cannot claim exemption for a tax shifted to it, which is not at all considered a tax to the buyer but a part of the purchase price. Lily's fashion is not the taxpayer in so far as the passed-on tax is concerned and therefore, it cannot claim for a refund of a tax merely shifted to it (Phil. Acetylene Co., Inc. v. CIR, L-1970, Aug. 17, 1987).

Bar 2006 -Taxpayer; VAT-registered; Claim for Tax Refund: Royal Mining is a VAT-registered domestic mining entity. One of its products is silver being sold to the Bangko Sentral ng Pilipinas. It filed a claim with the BIR for tax refund on the ground that under Section 106 of the Tax Code, sales of precious metals to the Bangko Sentral ng Pilipinas are considered export sales subject to zero-rated VAT. Is Royal Mining's claim meritorious? Explain. (5%)

Suggested answer: No, Royal Mining's claim is not meritorious because it is the sale to the Bangko Sentral ng Pilipinas of gold and not silver which is considered export sales at Zero-rated VAT (*Tax Reform Act, Title IV, Section 106[2][a][4]*).

INVOICING AND ACCOUNTING REQUIREMENTS

VAT-registered person must issue

- ♣ a VAT invoice for every barter, sale or exchange of goods or properties.
- ♣ a VAT Official Receipt for every lease of goods and services, and for every sale, barter of or exchange or services.

Components of VAT Invoice or VAT Official Receipt

1. Statement that the seller is a VAT-registered person followed by his TIN.
2. The total amount which the purchased is obligated to pay to the seller:
 - a. The amount of tax shall be shown as a separate item in the invoice or receipts
 - b. If the sale is exempt from VAT, the term "VAT-exempt sale" shall be written or printed prominently on the invoice or receipt.

- c. If the sale is subject to 0% VAT, the term "Zero-rated" shall be written or printed prominently on the invoice or receipt
 - d. The date of transaction, quantity, unit cost and description of the goods or properties or nature of service
3. In sales of P1000 or more, the name, business style, address and TIN of the purchaser.

RETURN AND PAYMENTS OF VAT - Every person liable to pay VAT 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. However, the payment of the VAT shall be made on a monthly basis.

Power of the Commissioner to Suspend the Business Operations of a taxpayer

- ♣ **In case of VAT-registered persons:**
 - Failure to issue invoices or receipts.
 - Failure to file a VAT return as required.
 - Understatement of taxable sales or receipts by 30% or more of his correct taxable sales.
- ♣ **For failure of any person to register as required:**
 - Temporary closure for not less than 5 days.
 - Lifted only upon compliance of the requirements.

THE BUREAU OF INTERNAL REVENUE

COMPOSITION

1. 1 Commissioner
2. 6 Deputy- Commissioners

POWERS AND DUTIES OF THE COMMISSIONER

1. POWER TO INTERPRET TAX LAWS AND DECIDE CASES

Interpretation of taxes

- ♣ The power to interpret tax laws shall be under the exclusive and original jurisdiction of the Commissioner, subject to review by the Secretary of Finance.
- ♣ **Interpretative rulings** rendered by the BIR, like other administrative bodies, do not partake of the character of legislative rules which require publication for their effectivity. Copies thereof are furnished only to the parties involved in the proceedings.
- ♣ Best guess of the CIR regarding the application of tax laws.

- ✦ Rulings and issuances of the Commissioner that pertain to the implementation and interpretation of the tax Code and other tax laws are valid, unless revoked, reversed, or suspended by the Secretary of Finance (RMC No. 40-A- 2002).

Remedy of CIR's decide Cases: The power to decide **disputed assessments, refunds** or internal revenue taxes, **fees and other charges, penalties imposed** in relation thereto, or other matters arising under the tax code or other laws or portions thereof administered by the bureau of internal revenue is vested in the Commissioner, subject to the exclusive appellate jurisdiction of the **Court of tax Appeals**.

Remedy of taxpayer: A taxpayer who receives an adverse ruling from the CIR may, within 30 days from the date of receipt of such ruling, seek its review by the Secretary of Finance. The request for review shall be in writing and under oath, and must:

- 1) Addressed to the Secretary of Finance and be filed within the legal office, DOF, DOF Building, BSP Complex, Roxas Boulevard corner, Pablo Ocampo St., City of Manila;
- 2) Contain the heading "Request for Review of BIR Ruling No.____";
- 3) Allege and show that the request was filed within the reglementary period;
- 4) Allege the material facts upon which the ruling was requested;
- 5) State that exactly the same facts were presented to BIR;
- 6) Define the issues sought to be resolved;
- 7) Contain the facts and the law relied upon to dispute the ruling of the Commissioner;
- 8) Be signed by or on behalf of the taxpayer filing the appeal, provided that only lawyers engaged by the taxpayer and/ or tax agents accredited by the BIR may sign on behalf of the taxpayer;
- 9) Indicate the tax identification number of the taxpayer;
- 10) Be accompanied by a copy of the Commissioner's challenged ruling; and
- 11) Contain a statement of the office of the CIR, indicating that a copy of the request to review the ruling was received by the Commissioner's office; and
- 12) Specifically state that the taxpayer does not have a pending assessment or case in a court of justice where the same issues are being considered.

Furthermore, the taxpayer must, at the time of filing of the request for review submit a duplicate copy of the records of the file with the BIR

pertaining to his request, which set of records must be authenticated and certified by the BIR.

These are mandatory requirements the Secretary of Finance may dismiss with prejudice a request for review that fails to comply with these requirements (*Section 3, DOF Order No. 23- 01*).

COROLLARY IS SECTION 246 OF NIRC - Section 246- "any revocation, modification or reversal of any of the rules and regulations promulgated by the Commissioner shall not be given retroactive application if the revocation, modification or reversal will be prejudicial to the Taxpayer, except in the following cases:

- a) Where the taxpayer deliberately mistakes or omits material facts from his return or any document required of him by the BIR
- b) Where the facts subsequently gathered by the BIR are materially different from the facts on which the ruling is based; or
- c) Where the taxpayer acted in bad faith."

A taxpayer cannot claim any right from a void ruling.

The nullity of a ruling must be declared by the court so that Section 246 would apply.

2. **POWER TO EXAMINE BOOK OF ACCOUNTS, etc. [Section 5]** - The exercise of this power necessitates the issuance of letters of authority to be presented to the taxpayer.

Requirement of the Issuance of Letter of Authority

Who issues the letter of authority? The CIR, Deputy Commissioner, or Regional Directors.

Nature of the Letter: It serves as an authority for the BIR to examine.

Scope of the letter: Taxpayer himself or the information desired may be obtained from private and public officers, or from any person other than the person whose tax liability is under investigation. In effect, taxpayers may be required to give information regarding customers/ clients or persons or entities they deal with if the object of the inquiry or investigation is to look into the tax liabilities of the latter. If necessary, the BIR may secure search warrants (see Section 5).

Note: A person went to your office present his ID and says that he is from the BIR and he will

inspect your books, will you show your books?

No, ask first for a letter of authority.

The question is how does a letter of authority looks like? Letters of authority are electronically generated. There are no manual entries put thereon.

The letter of authority contains:

1. Name of the taxpayer
2. Books to be inspected
3. Date and year of the books to be examined
4. Signature of the RDO
5. Serial number

If you are still in doubt of the letter of authority, then verify it to the RDO before showing your books.

Duration of the LOA: A Letter of Authority which is not served within 30 days from date of issuance is void. As a rule a LOA covers 1 taxable period. If it covers more than 1 taxable period, the other taxable periods must be specified.

[Remedy: check these requirements in the LOA, if they are not present, then the taxpayer may refuse inspection of books, since a void LOA bears no fruits].

Jurisdictional requirement on issuers of LOA.

Taxpayers listed in the National Office Audit, the issuer of LOA is the same office only. If not listed in the National Office Audit, then the issuer of LOA is the Regional Office Audit. Ergo, if the office that issued the LOA is not the proper office, then the taxpayer can refuse inspection of books.

COROLLARY IS THIRD PARTY VERIFICATION

RULE- the Commissioner can refer to the books of parties transacting with the taxpayer but there must be a LOA issued to the suppliers or customers of the taxpayer whose tax liability is being investigated.

R.A. 10021- any information obtained through the request of any foreign taxing authority maybe used by the Commissioner in the assessment of the correct tax liability of the taxpayer.

Note: even if there is a letter of authority, do not present your books if you can still avoid it so that you cannot be audited, because the BIR will do all that they can, so you can be liable for more taxes. If the authority is void, then the BIR needs to re-issue another letter. The procurement will take time since it is electronically generated and the approval of the CIR is needed. Thus if you have something to amend in your books, amend them now before an audit push through when a new letter is issued.

What if the taxpayer refused to present his books even if there is a valid letter of authority? The BIR will issue subpoena duce tecum.

What if the taxpayer refuses to obey the subpoena? The BIR will prosecute him for willful disobedience to obey subpoena. [Remember that this happened to Manny Pacquiao].

If you are prosecuted for willful disobedience to obey subpoena, will you present your books? No, since you are prosecuted for willful disobedience of a subpoena, then you can have the defense that you never received the subpoena. Your secretary had received it but she did not deliver the same to you ☺☺☺

Bar 1999 - Taxpayer: BIR Audit or

Investigation: A Co., a Philippine corporation, is a big manufacturer of consumer goods and has several suppliers of raw materials. The BIR suspects that some of the suppliers are not properly reporting their income on their sales to A Co. The CIR therefore: 1) issued an access letter to A Co. to furnish the BIR information on sales and payments to its suppliers. 2) Issued an access letter to a bank (CX Bank) to furnish the BIR on deposits of some suppliers of A Co. on the alleged ground that the suppliers are committing tax evasion. A Co., X Bank and the suppliers have not been issued by the BIR letter of authority to examine. A Co. and X Bank believe that the BIR is on a "fishing expedition" and come to you for counsel. What is your advice? (10%)

Suggested answer: I will advise A Co. and B Co. that the BIR is justified only in getting information from the former but not from the latter. The BIR is authorized to obtain information from other persons other than those whose internal revenue tax liability is subject to audit or investigation. However, this power shall not be construed as granting the Commissioner the authority to inquire into bank deposits. (*Section 5.NIRC*).

3. POWER TO INQUIRE BANK DEPOSITS -

"Notwithstanding any contrary provision of Republic Act No. 1405 and other general or special laws, the Commissioner is hereby authorized to inquire into the bank deposits of:

1. A decedent to determine his gross estate; and
2. Any taxpayer who has filed an application for compromise of his tax liability under Section 204 (A) (2) of this Code by reason of financial incapacity to pay his tax liability.

In case a taxpayer files an application to compromise the payment of his tax liabilities on his claim that his financial position demonstrates a clear inability to pay the tax assessed, **his application shall not be considered unless**

and until he waives in writing his privilege under Republic Act. 1405 or under other general or special laws, and such waiver shall constitute the authority of the Commissioner to inquire into the bank deposits of the taxpayer.”

3. Foreign taxing authority **requests** for specific information of a taxpayer pursuant to international convention or agreement and upon order of the President of the Philippines [Exchange of Tax Information act of 2009].

Note that this cannot be done by the BIR *motu proprio*, there must be a requests from the foreign country.

Bar 2000 - BIR: Bank Deposits Secrecy

Violation: A taxpayer is suspected not to have declared his correct gross income in his return filed for 1997. The examiner requested the Commissioner to authorize him to inquire into the bank deposits of the taxpayer so that he could proceed with the net worth method of investigation to establish fraud. May the examiner be allowed to look into the taxpayer's bank deposits? In what cases may the Commissioner or his duly authorized representative be allowed to inquire or look into the bank deposits of a taxpayer? (5%)

Suggested answer: No. as this would be violative of Republic Act No. 1405, the Bank Deposits Secrecy Law. The Commissioner of Internal Revenue or his duly authorized representative may be allowed to inquire or look into the bank deposits of a taxpayer in the following cases:

- a) For the purpose of determining the gross estate of a decedent;
- b) Where the taxpayer has filed an application for compromise of his tax liability by reason of financial incapacity to pay such tax liability. (Sec. 6 (F), NIRC of 1997]
- c) Where the taxpayer has signed a waiver authorizing the Commissioner or his duly authorized representatives to Inquire into the bank deposits.

Bar 2003 - BIR: Secrecy of Bank Deposit Law:

X dies in year 2000 leaving a bank deposit of P2,000,000.00 under joint account with his associates in a law office. Learning of X's death from the newspapers, the Commissioner of Internal Revenue wrote to every bank in the country asking them to disclose to him the amount of deposits that might be outstanding in his name or jointly with others at the date of his death. May the bank holding the deposit refuse to comply on the ground of the Secrecy of Bank Deposit Law? Explain. (8%)

Suggested answer: No. The Commissioner of Internal Revenue has the authority to inquire into bank deposit accounts of a decedent to determine his gross estate notwithstanding the

provisions of the Bank Secrecy Law. Hence, the banks holding the deposits in question may not refuse to disclose the amount of deposits on the ground of secrecy of bank deposits. (Section 6(F) of the 1997 Tax Code). The fact that the deposit is a joint account will not preclude the Commissioner from inquiring thereon because the law mandates that if a bank has knowledge of the death of a person, who maintained a bank deposit account alone, or jointly with another, it shall not allow any withdrawal from the said deposit account, unless the Commissioner has certified that the taxes imposed thereon have been paid. (Section 97 of the 1997 Tax Code). Hence, to be able to give the required certification, the inclusion of the deposit is imperative, which may be made possible only through the inquiry made by the Commissioner.

4. POWER TO SUMMON PERSONS AND TO TAKE TESTIMONY

How? Summons may be issued to the taxpayer or if necessary subpoena *duces tecum* or *subpoena ad testificandum* may be issued.

Fitness by Design vs. CIR [2008] - The CIR has the power to access all records to the taxpayer relevant for the assessment of correct taxes even without the consent of the taxpayer.

Right to cross examine the witness. It is not applicable because tax cases does not partake the nature of criminal prosecution. Thus, the taxpayer subject of investigation cannot invoke his right to cross examine third person summoned by the Commissioner to make testimonies regarding the former's tax liabilities.

In every case where a taxpayer is ordered to be examined and he refuses or fails to submit his records giving rise to the issuance of a subpoena *ducestecum* pursuant to RMO No. 35-90, the assessment shall only be issued after a criminal case has been instituted for failure to obey summons.

The filing of the complaint against the taxpayer for violation of the subpoena *ducestecum*, the legal division/ prosecution division shall immediately return the docket of the case to the concerned revenue officer. The revenue officer shall upon receipt of the docket, immediately proceed to determine the taxpayer's deficiency internal revenue tax liability in accordance with the "best evidence obtainable" (*Section 23 RMC No. 23- 300, Nov. 27, 2000*).

5. POWER TO EXAMINE RETURNS

When to examine returns? After a return has been filed as required under the provisions of this code, the

Commissioner or his duly authorized representative may authorized the examination of any taxpayer and the assessment of the correct amount of tax.

Does failure to file a return prevent the Commissioner from authorizing examination?

No, failure to file a return shall not prevent the Commissioner from authorizing the examination of any taxpayer for his tax liability.

When to pay deficiency taxes?The tax or any deficiency tax so assessed shall be paid upon notice and demand from the Commissioner or from his duly authorized representative.

Can a return filed in the authorized office to receive the same be withdrawn? No!

Remedy for erroneous tax return: file an amended return [not withdraw] within 3 years from the date of filing of such return. The law allows that within the 3 year period a return may be modified, changed, or amended.

Confidentiality of returns: tax returns are confidential though they are considered as public documents; it cannot be opened by any person.

When does confidentiality attach to tax returns? After the return was filed in the office of the Commissioner. The law states that "after the assessment shall have been made, the returns, together with any corrections thereof which may have been made by the Commissioner, shall be filed in the office of the Commissioner." Thus, Pursuant to Section 71 & 270 of NIRC, employees of BIR cannot divulge any information regarding a taxpayer's returns or business status that they acquired in relation their function.

When does a return be allowed to be opened? A return can be opened only upon the order of the President of the Philippines, under rules and regulations to be prescribed by the Secretary of Finance, upon the recommendation of the Commissioner.

Case: BIR vs. Ombudsman

1. Tax returns though public records are confidential
2. When it was opened, the Commissioner did not violate Section 270 because there was a lawful act (subpoena by the court).

6. POWER TO MAKE RETURN

When can the Commissioner make a return?

- (1) when a report required by law as a basis for the assessment of any national internal revenue tax shall not be forthcoming (cannot be submitted within the time fixed by laws or rules and regulation; or
- (2) When there is reason to believe that any such report is false, incomplete or erroneous.

Example: the persistent failure of the taxpayer to present his book of account for examination for the taxable years involved notwithstanding requests made, justifies the exercise of the power conferred on the Commissioner.

Basis for the return made by the commissioner:

- * **Best evidence** - An assessment based on the best evidence obtainable is justified when any of the grounds provided by law is clearly established, viz:
 1. The report or records requested from the taxpayer are not forthcoming; or
 2. The reports submitted are false, incomplete or erroneous.

Best evidence includes the corporate and accounting records of the taxpayer who is the subject of the assessment process, the accounting records of other taxpayers engaged in the same line of business, including their gross profit and net profit sales. Such evidence also includes data, records, paper, documents, or any evidence gathered by internal revenue officers from whom the subject taxpayer received any income, record, data, document and information secured from government offices or agencies such as SEC, the Bangko Sentral ng Pilipinas, Bureau of Customs, and the Tariff and Customs Commissions.

- * **Hearsay evidence**- The law allows that the Commissioner shall make or amend the return from his own knowledge and from such information as he can obtain through testimony or otherwise.

The commissioner may employ the third party verification rule.

Cir vs. Hanlex Trading- photocopy of the documents was not allowed as evidence since the BIR was in possession of the BIR but it refuses to present it. The Supreme Court said that the best evidence obtainable rule must go hand in hand with the best evidence rule. Kung

meron yung original dapatyun and ipresentna evidence.

Photocopies are inadmissible for computation of tax liabilities for it has no probative value.

- ♣ **Third party verification rule-** the BIR can ask independent individuals regarding a taxpayer's sales.

7. POWER TO CONDUCT INVENTORY TAKING, SURVEILLANCE, AND TO ISSUE PRESUMPTIVE GROSS SALES/ RECEIPTS

When to exercise the power? At any time during the taxable year.

This power of the CIR to place natural and juridical persons under observation or surveillance for the purpose of establishing a prima facie basis for assessing taxes for the months or quarters of the same or different taxable years.

The findings during the period of surveillance may be used for the purpose of assessing the taxpayer's liabilities for the months during which no surveillance was conducted.

Note that surveillance is always done in a covert manner thus notice to the taxpayer is not needed. This is used for OplanKandado by the BIR.

When to make presumptive receipts? If the taxpayer does not issue receipts such as in the case of jeepney drivers and fishermen.

8. POWER TO TERMINATE TAX PERIOD - This authorizes the Commissioner to terminate the tax period if it comes to his knowledge that: [HIRO]

- a. The taxpayer tries to hide or conceal his property;
- b. The taxpayer is intending to leave the Philippines;
- c. The taxpayer tries to remove his property from the Philippines;
- d. The taxpayer tries to perform any act tending to obstruct the proceedings for the collection of the tax for the past or current quarter or year or to render the same totally or partly ineffective unless such proceedings are begun immediately.

Consequence: The Commissioner shall declare the tax period of such taxpayer terminated at any time and shall send the taxpayer a notice of such decision, together with a request for the immediate payment of the tax for the preceding year or quarter, or such

portion thereof as may be unpaid, and said taxes shall be due and payable immediately and shall be subject to all the penalties, unless paid within the time fixed in the demand made by the Commissioner.

9. POWER TO FIX THE VALUE OF REAL PROPERTY

- This power is applicable only to lots/ lands.

The Commissioner is authorized to divide the Philippines into different zones or areas and shall, upon consultation with competent appraisers both from the private and public sectors, determine the fair market value of real properties located in each zone or area. For purposes of computing any internal revenue tax, the value of the property shall be, whichever is the higher of:

- a. The fair market value as determined by the Commissioner [zonal value]; or
- b. The fair market value as shown in the schedule of values of the provincial/ city assessors [assessed value].

10. POWER TO ACCREDIT TAX AGENTS

Who are tax agents? Those who are engaged in the regular preparation, certification, audit and filing of tax returns, information returns or other statements of reports required by the Tax Code or regulations.

Those who are engaged in the regular preparation or requests for rulings, petitions for reinvestigation, protests, requests for refund or tax credit certificates, compromise settlement and/or abatement of tax liabilities and other official papers and correspondence with the BIR, and other similar related activities;

Those who regularly appear in meetings, conferences or hearings before any office of the BIR officially on behalf of a taxpayer or client in all matters relating to a client's rights, privileges, or liabilities under laws or regulations administered by the BIR, shall be deemed to be engaged in tax practice and are required to apply for accreditation.

11. POWER TO PRESCRIBE PROCEDURE/ DOCUMENTARY REQUIREMENTS

- ♣ The Commissioner may prescribe the manner of compliance with any documentary or procedural requirement in connection with the submission or preparation of financial statements accompanying the tax returns.
- ♣ **Example:** e-filing; substituted filing
- ♣ **Net worth method-** used in tax fraud cases in order to determine whether the taxpayer earned an income or liability. If there is an increase in the Net worth then it connotes a taxable income.

12. POWER TO DELEGATE

General rule: The CIR may delegate any power vested from him by law to Division Chiefs or to officials of higher rank.

Exceptions: [RICA]

1. The power to **recommend the promulgation of rules and regulations** by the Secretary of Finance.
2. The power **to issue ruling of first impression or to reverse, revoke, or modify any existing ruling of the Bureau;**

Ruling of First Impression- these refer to the rulings, opinions and interpretations of the CIR with respect to the provisions of the NIRC and other tax laws without established precedents and which are issued in response to a specific request for ruling filed by a taxpayer with the BIR. The term includes reversal, modification or revocation of any existing ruling.

Rulings with establish precedence- cases with precedence hence can be delegated to subordinate officials.

3. The power to **compromise or abate**, under Section 204 (A) and (B) of this code, any tax liability: Provided, however, that assessments issued by the regional offices involving basic deficiency taxes of 500, 000. 00 or less, and minor criminal violations, as may be determined by rules and regulations to be promulgated by the Secretary of Finance, upon recommendation of the Commissioner discovered by regional and district officials, may be compromised by a regional evaluation board which shall be composed of the Regional Director, as Chairman, the Assistant Regional Director, the heads of the Legal, Assessment and Collection Divisions and the Revenue District Officer having jurisdiction over the taxpayer, as members; and
4. The power to assign or reassign internal revenue officers to establishments where articles subject to excise tax are produce or kept.
 - ✳ **Period of assignment-** 2 years to avoid bribery (Section 16).

13. **ENFORCEMENT OF POLICE POWERS** - The Commissioner, Deputy Commissioners, Revenue Regional Directors, Revenue District Officers and other internal revenue officers shall have authority to

make arrests and seizures for the violation of any penal law, rule or regulation administered by the Bureau of Internal Revenue. Any person so arrested shall be forthwith brought before a court there to be dealt with according to law.

Pursuant to Section 15, only the Commissioner, etc. are authorized to arrest and apprehend suspected tax evaders and, therefore, the BIR is without authority to authorize any person to help it in apprehending suspected tax evaders (*BIR Ruling No. 10; January 1, 1992*).

Plainview. The previous issuance of a warrant of arrest or seizure by a court is not required, provided such arrest and seizure is limited to violations of any penal law, or regulation administered by the BIR committed within the view of internal revenue Officers or Employees. What the constitution prohibits are arrest and seizures which are unreasonable. To require a warrant before making the arrest and seizure could enable the violator avoid apprehension.

14. POWER TO ABATE AND COMPROMISE TAX LIABILITY

COMPROMISE

General principle: A compromise agreement presupposes the correctness of assessed tax liability.

Thus, According to **CIR vs. Reyes**, an assessment that fails to inform the taxpayer of the law and the facts on which it is made is void. As a corollary, a void assessment cannot in turn be used as a basis for the perfection of a tax compromise. In the case at bar, Reyes was not informed in writing of the law and the facts on which the assessment of estate taxes had been made. She was merely notified of the findings by the CIR. Consequently the SC said, it would be premature to declare that the compromise on the estate tax liability had been perfected and consummated, considering the earlier determination that the assessment against the estate was void [CIR vs. REYES, 27 Jan 2006].

Nature of the power to compromise- "it is generally true that purely administrative and discretionary function may not be interfered with by the courts, but when the exercise of such functions by the administrative officer is tainted by a failure to abide by the command of the law, then it is incumbent on the courts to set matters right, with this court having the last say on the matter. **The discretionary authority to compromise granted to the BIR Commissioner is never meant to be absolute, uncontrolled and unrestrained. No**

such unlimited power may be validly granted to any officer of the government, except perhaps in cases of national emergency.” [PNO vs. CA, April 26, 2005].

The general rule is that compromises are to be favored and that compromises entered into in good faith cannot be set aside, this rule is not without qualification. A court may still reject a compromise or settlement when it is repugnant to law, morals, good customs, public order, or public policy.

The case of **Philippine Oil Company vs. CA** made a distinction between a self-assessed tax and a BIR assessed tax. At issue in this case was the validity of the compromise agreement executed by PNOC pursuant to EO no. 44. Under said law, the CIR was authorized to compromise delinquent accounts arising, among others, from a self-assessed tax. According to the Supreme Court, PNOC could not avail of the benefits of EO No. 44 because, for one, its tax liability was not a self-assessed tax. The SC differentiated a self-assessed tax and a BIR assessed tax in this since: **where tax liabilities are self-assessed, the compromise payment shall be based on the tax return filed by the taxpayer; on the other hand, where the BIR already issued an assessment, the compromise payment shall be computed based on the tax due on the assessment notice.** [PNO vs. CA, 26 April 2005]

Meaning of compromise- a compromise is an agreement between two or more persons who, to avoid a lawsuit, amicably settle their differences on such terms as they can agree on. A compromise by its very nature implies mutual agreement by the parties in regard to the thing or subject matter which is to be compromised. An officer of compromise does not, therefore, assume the category of a compromise until it is voluntarily accepted by the other party, and no obligation arises or is created by a simple offer or suggestion coming from one of the parties without acceptance by the other [*Ben L. Ang vs. CIR*].

Compromise penalty- a compromise penalty is a certain amount of money which the taxpayer pays to compromise a tax violation. Compromise penalties are paid in lieu of criminal prosecution, and cannot be imposed in the absence of a showing that the taxpayer consented thereto, if an offer of compromise is rejected by the taxpayer, the compromise penalty cannot be enforced through an action in court or by distraint and levy. The CIR should file a criminal action if he believes that the taxpayer is criminally liable for violation of the tax law as the only way to enforce the penalty (*CIR vs. Armando*).

Grounds for compromise:The commissioner may compromise any internal revenue tax when:

1. A reasonable doubt as to the validity of the claim against the taxpayer exists; or
Example: disputed assessments or assessments subject to administrative protest or appeal; and delinquent accounts.
2. The financial position of the taxpayer demonstrates a clear inability to pay the assessed tax.

Who may compromise taxes? The case of **Security Bank Corporation vs. CIR** dealt with the deficiency documentary stamp tax on Security Bank Corporation's 1983 sales of securities under repurchase agreements. The SC held that under Section 204 of the 1977 Tax Code [even the 1997 Tax Code], the BIR Commissioner had the sole power and authority to compromise taxes. The act of certain revenue officials in accepting the Security Bank Corporation's offer of payment, without the Commissioner's stamp of approval, was ultra vires and could not have any valid and binding legal effect upon the BIR.

Can the CIR delegate his power to compromise taxes? Yes, for as long as it is delegated to his PRO, RDO, and the fraud was discovered by them and the tax liability does not exceed 500K.

Rates for Compromise: The compromise settlement for any tax liability shall be subject to the following minimum amounts

1. For **cases of financial incapability**, a minimum compromise rate equivalent to 10% of the basic assessed tax: and
2. For other cases [such as reasonable ground], a minimum compromise rate equivalent to 40% of the basic assessed tax.

Note: It is the 10% of the basic assessed tax that is to be paid. Thus the 10% is not to be taken as a discount from the basic assessed tax.

Can the commissioner issue below the compromise rate? Yes subject to the approval of the evaluation board.

Instances where the Evaluation Board comes in:

1. Where the basic assessed tax involved exceeds 1M; or
2. Where the settlement offered is less than the prescribed minimum rates.

No compromise for financial incapability for holders of Tax credit Certificate: The CIR shall not consider any offer for compromise settlement on the ground of financial incapacity of a taxpayer with Tax Credit Certificate (TCC) on hand or in transit, or with pending claim for tax refund or tax credit, or with existing finalized agreement or prospect of future agreement with any party that resulted or could result to an increase in the equity of the taxpayer at the time of the offer for compromise or at a definite future time. Moreover, no offer of compromise shall be entertained unless and until the taxpayer waives in writing his privilege of the secrecy of bank deposits, which shall constitute as the authority of the Commissioner to inquire into the bank deposits of the taxpayer (*RR 30- 2002*).

ABATEMENT

General principle: Abatement presupposes the erroneous computation and assessment of tax liability.

Meaning-abatement refers to the cancellation of the entire tax liability. It may also mean the diminution or decrease in the amount of tax imposed; it refers to the act of eliminating or nullifying; of lessening or moderating. To abate is to nullify or reduce in value or amount, while to cancel is to obliterate, cross out or invalidate and to strike out, delete, erase; make void or invalid; annul; destroy; revoke or recall (*People vs. Tan, 16 Aug 2005*).

Grounds for abatement: The commissioner has the power to abate or cancel tax liability, when:

1. The tax or any portion thereof appears to be unjustly or excessively assessed; or
2. The administration and collection costs involved do not justify the collection of the amount due.

Are criminal violations of the Tax Code be compromised? Yes, all criminal violations may be compromised except:

1. Those already filed in court;
2. Those involving tax fraud cases.

Can the legal division of the BIR file a criminal action for tax violations? Yes.

When to compromise the civil aspect of a tax case?Compromise maybe entered into before litigation or at any stage of the litigation, even during appeal, although legal propriety demands that prior leave of court should be obtained. But a compromise can never be entered into after final judgment,

because by virtue of such final judgment, the government had already acquired a vested right.

Note: the prosecutor cannot compromise the civil aspect of the tax case. Only the CIR can do the act since such power of the CIR is undelegable.

Suppose that the civil case is already final and executory, can it still be subject to compromise?No, if this would be allowed the Doctrine of Separation of Powers will be violated for the Executive Branch will modify the Decisions of the Judiciary.

Suppose the corporation is already dissolved, can the stockholder still be compelled to pay the tax liability?No! Except in the following cases:

1. If there is evidence to prove that the assets of the corporation were taken by the stockholder.
2. If the stockholder has unpaid subscriptions.

TAX LIABILITY WHICH CAN BE COMPROMISE [RR 30-2002]

1. Delinquent accounts;
2. Cases under administrative protest after issuance of the Final Assessment Notice to the taxpayer which are still pending in the Regional Offices, Revenue District Offices, legal Service, Large Taxpayer Service, Collection Service, Enforcement Service and other Offices in the BIR National Office;
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;
6. The assessment is based on an issue which a court of competent jurisdiction made adverse decision against the Bureau, but for which the Supreme Court has not decided upon with finality (*RR 8-2004*).

TAX LIABILITY WHICH CANNOT BE COMPROMISE

1. Withholding tax cases (liability of withholding agent) unless the applicant- taxpayer invokes provisions of law that can doubt on the taxpayer's obligation to withhold;
2. Criminal tax fraud cases confirmed as such by the commissioner of Internal Revenue or his duly authorized representative;
3. Criminal violation of NIRC 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 by signing the required agreement form for the purpose. On the other hand, other protested cases shall be

handled by the Regional Evaluation Board or the National Evaluation Board on a case to case basis;

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;
7. Estate tax cases where compromise is requested on the ground of financial incapacity.

Why? It is impossible to be having an estate tax and at the same time financially incapable of paying it. Presence of Estate Tax presupposes the presence of properties where the estate tax was based.

TAX TIP: What is the remedy of a withholding agent if he did not withhold any taxes from the taxpayer? Present the Income Tax Return [ITR] of the taxpayer as evidence. If in the ITR it was reflected that the supposed to be withhold taxes were paid, then the withholding agent is absolved of liability, otherwise no. Why? To tax again the withholding agent when the taxpayer paid the same tax constitutes direct double taxation which is violative of the Constitution.

Bar 1998 - BIR: Compromise; Withholding Agent: May the Commissioner of the Internal Revenue compromise the payment of withholding tax (*tax deducted and withheld at source*) where the financial position of the taxpayer demonstrates a clear inability to pay the assessed tax? [5%]

Suggested answer: No. A taxpayer who is constituted as withholding agent who has deducted and withheld at source the tax on the income payment made by him holds the taxes as trust funds for the government (Sec. 58[D]) and is obligated to remit them to the BIR. The subsequent inability of the withholding agent to pay/remit the tax withheld is not a ground for compromise because the withholding tax is not a tax upon the withholding agent but it is only a procedure for the collection of a tax.

Bar 2004 - BIR; Compromise: After the tax assessment had become final and unappealable, the Commissioner of Internal Revenue initiated the filing of a civil action to collect the tax due from NX. After several years, a decision was rendered by the court ordering NX to pay the tax due plus penalties and surcharges. The judgment became final and executory, but attempts to execute the judgment award were futile. Subsequently, NX offered the Commissioner a compromise settlement of 50% of the judgment award, representing that this amount is all he could really afford. Does the Commissioner have the power to accept the compromise offer? Is it legal and ethical? Explain briefly. (5%)

Suggested answer: Yes. The Commissioner has the power to accept the offer of compromise if the financial position of the taxpayer clearly demonstrates a clear inability to pay the tax (Section 204, NIRC).

As represented by NX in his offer, only 50% of the judgment award is all he could really afford. This is an offer for compromise based on financial incapacity which the Commissioner shall not accept unless accompanied by a waiver of the secrecy of bank deposits (Section 6[F], NIRC). The waiver will enable the Commissioner to ascertain the financial position of the taxpayer, although the inquiry need not be limited only to the bank deposits of the taxpayer but also as to his financial position as reflected in his financial statements or other records upon which his property holdings can be ascertained.

If indeed, the financial position of NX as determined by the Commissioner demonstrates a clear inability to pay the tax, the acceptance of the offer is legal and ethical because the ground upon which the compromise was anchored is within the context of the law and the rate of compromise is well within and far exceeds the minimum prescribed by law which is only 10% of the basic tax assessed.

Bar 1998 - Taxpayer; Compromise after Criminal Action: An information was filed in court for willful non-payment of income tax the assessment of which has become final. The accused, through counsel, presented a motion that he be allowed to compromise his tax liability subject of the information. The prosecutor indicated his conformity to the motion. Is this procedure correct? [5%]

Suggested answer: No. Criminal violations, if already filed in court, may not be compromised (*Sec. 204[B], NIRC*). Furthermore, the payment of the tax due after apprehension shall not constitute a valid defense in any prosecution for violation of any provisions of the Tax Code (*Sec. 247(a), NIRC*). Finally, there is no showing that the prosecutor in the problem is a legal officer of the Bureau of Internal Revenue to whom the conducts of criminal actions are lodged by the Tax Code.

Alternative answer: No. If the compromise referred to is the civil aspect, the procedure followed is not correct. Compromise for the payment of any internal revenue tax shall be made only by the Commissioner of Internal Revenue or in a proper case the Evaluation Board of the BIR (Sec. 204, NIRC). Applying the law to the case at bar, compromise settlement can only be effected by leave of Court.

ESTOPPEL

General Rule: The government cannot be estopped from collecting taxes by the mistake, negligence, or omission of its agents.

Rationale: upon taxation depends the government's ability to serve the people for whose benefit taxes are collected. To safeguard such interest, neglect or omission of government officials entrusted with the collection of taxes should not be allowed to bring harm or detriment to the people, in the same manner as private person may be made to suffer individually on account of his own negligence, the presumption being that they take good care of their personal affairs. This should not hold true to

government officials with respect to matters not of their own personal action.

Exception: in the interest of justice and fairplay.

"Although government cannot be estopped by the negligence or omission of its agents, the obligatory provision on protesting a tax assessment cannot be rendered nugatory by a mere act of the CIR. Tax laws are civil in nature. Under our Civil Code, acts executed against the mandatory provisions of law are void, except when the law itself authorizes the validity of those acts. Failure to comply with Section 228 [assessment must contain both the facts and law where the assessment was based] does not only render the assessment void, but also finds no validation in any provision in the tax Code. We cannot condone errant or enterprising tax officials, as they are expected to be vigilant and law-abiding (*CIR vs. Reyes, 27 Jan 2006*).

ASSESSMENT OF TAX

Rule: The provisions on the statute of limitation on assessment and collection of taxes shall be construed and applied liberally in favor of the taxpayer and strictly against the government.

Meaning: An assessment is a written notice to a taxpayer to the effect that the amount stated therein is due as tax, and containing a demand for the payment thereof.

Assess means to charge with a tax, to declare a tax to be payable; to fix or settle a sum to be paid by way of tax.

General Principles Regarding Assessment

- ✦ Injunction is not available to restrain the collection of internal revenue taxes.

Exception: the Court of Appeals may issue injunctions against administrative collection, when collection could jeopardize the interest of the Government or taxpayer.

- ✦ Assessment must be directed to the proper party.
- ✦ **No mandamus-** assessment is based on the discretion of the Commissioner hence mandamus will not lie.
- ✦ **Assessment establishes a cause of action-** Assessment is merely a notice to the effect that the amount stated therein is due as a tax and a demand for the payment thereof. It is only a preliminary step but essential to warrant of distraint or levy, if that is feasible and also to establish a cause for judicial action. Without assessment, there

is no obligation on the part of the taxpayer enforceable in an action to pay.

- ✦ **Function of an Assessment-** Assessment fixes and determines the tax liability as a taxpayer as soon as it is served, and obligation arises on the part of the taxpayer concerned to pay the amount assessed and demanded. Hence, assessments should not be based on mere presumptions no matter how reasonable or logical said presumptions may be.
- ✦ **Assessment must contain a demand to pay-** An affidavit of a revenue officer merely contains a computation of tax liability, without stating a demand or a period for payment is not an assessment.
- ✦ **Control number is not necessary-** The formality of a control number in the assessment notice is not a requirement for its validity but rather the contents thereof which should inform the taxpayer of the declaration of the deficiency tax against the taxpayer. Both the formal letter and demand and the notice of assessment shall be void if the former failed to state the fact, the law, rules and regulations or jurisprudence on which the assessment is based which is a mandatory requirement in Section 228 of the NIRC (*CIR vs. Gonzales, 13 Oct. 2010*).

KINDS OF ASSESSMENTS

- 1. Self-assessment-** Taxpayers are required to file for various kinds of income earned which may be subject to tax. Examples are income tax, capital gains tax, and estate tax. When a taxpayer files a return he is actually making a self-assessment.
- 2. Deficiency assessment-** Is an assessment made by the BIR after the conduct of an investigation or audit when it finds that the tax return filed by the taxpayer contains, for example, an Underdeclaration of income, or when the taxpayer does not at all file a tax return.
- 3. Jeopardy assessment-** it is issued when the revenue officer finds itself without enough time to conduct an appropriate or thorough examination in view of the impending expiration of the prescriptive period for assessment. It is issued only to comply with the period of issuing assessment. **(Remedy of Revenue Officer)** To prevent the issuance of a jeopardy assessment the taxpayer may be required to execute a waiver of the statute of limitations.
- 4. Illegal assessment-** Conducted by an examiner who has no authority to conduct such assessment. Erroneous assessment.

What is the benefit of self-assessment over deficiency assessment of tax liability?

- ♣ It has something to do with compromise of tax liability.
- ♣ The case of Philippine Oil Company vs. CA made a distinction between a self-assessed tax and a BIR assessed tax. At issue in this case was the validity of the compromise agreement executed by PNOC pursuant to EO no. 44. Under said law, the CIR was authorized to compromise delinquent accounts arising, among others, from a self-assessed tax. According to the Supreme Court, PNOC could not avail of the benefits of EO No. 44 because, for one, its tax liability was not a self-assessed tax. The SC differentiated a self-assessed tax and a BIR assessed tax in this since: **where tax liabilities are self-assessed, the compromise payment shall be based on the tax return filed by the taxpayer; on the other hand, where the BIR already issued an assessment, the compromise payment shall be computed based on the tax due on the assessment notice.** [PNOC vs. CA, 26 April 2005]

PRELIMINARY ASSESSMENT NOTICE - It notifies the taxpayer of the findings of the examiner who recommends a deficiency assessment. The taxpayer is usually given 10 days from notice within which to explain his side.

Instances when pre-assessment are not required (Section 228) - A pre-assessment notice shall not be required in the following cases:

- ♣ When any tax deficiency is the result of mathematical error in the computation of the tax as appearing on the face of the return.
- ♣ When a discrepancy has been determined between the tax withheld and the amount actually remitted by the withholding agent.
- ♣ 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.
- ♣ When the excise tax due on excisable articles has not been paid.
- ♣ When the article locally purchased or imported by an exempt person has been sold, traded, or transferred to non-exempt persons.

Bar 2002 -BIR: Pre-Assessment Notice not Necessary: In the investigation of the withholding tax returns of AZ Medina Security Agency (AZ Medina) for the taxable years 1997 and 1998, a discrepancy between the taxes withheld from its employees and the amounts actually remitted to the government was found. Accordingly, before the period of prescription commenced to run, the BIR issued an assessment and a demand letter calling for the immediate payment of the deficiency withholding taxes in the total amount of P250,000.00. Counsel for AZ Medina protested the assessment for being null and void on the ground that no pre-assessment notice

had been issued. However, the protest was denied. Counsel then filed a petition for prohibition with the Court of Tax Appeals to restrain the collection of the tax.

A. Is the contention of the counsel tenable? Explain (2%) A. No, the contention of the counsel is untenable. Section 228 of the Tax Code expressly provides that no pre-assessment notice is required when a discrepancy has been determined between the tax withheld and the amount actually remitted by the withholding agent. Since the amount assessed relates to deficiency withholding taxes, the BIR is correct in issuing the assessment and demand letter calling for the immediate payment of the deficiency withholding taxes. (Sec. 228, NIRC).

B. Will the special civil action for prohibition brought before the CTA under Sec. 11 of R.A. No. 1125 prosper? Discuss your answer. (3%) The special civil action for prohibition will not prosper, because the CTA has no jurisdiction to entertain the same. The power to issue writ of injunction provided for under Section 11 of RA 1125 is only ancillary to its appellate jurisdiction. The CTA is not vested with original jurisdiction to issue writs of prohibition or injunction independently of and apart from an appealed case. The remedy is to appeal the decision of the BIR. (**Collector v. Yuseco, 3 SCRA 313 [1961]**).

NOTICE OF ASSESSMENT/ FORMAL/ OFFICIAL ASSESSMENT

- ♣ It is issued when the taxpayer fails to respond to the notice or proposed assessment, or his explanation is not satisfactory to the Commissioner, the BIR issues an official assessment.
 - ♣ A declaration of deficiency taxes issued to a taxpayer who fails to respond to a pre-assessment notice (PAN) within the prescribed period of time, or whose reply to the PAN was found to without merit. The notice of assessment shall inform the taxpayer of this fact, and that the report of investigation submitted by the Revenue Officer conducting the audit shall be given due course.
- ♣ **Form and Content of an Assessment-**
1. Must be in writing;
 2. Demand to pay tax liability;
 3. Must state the law and the facts on which the assessment is made, otherwise the assessment shall be void (Section 228).

COROLLARILY: Section 228 Of the NIRC- XXX“The taxpayer shall be informed on writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.”XXX

Effect of Non-compliance of Section 228- if the substance of the notice of assessment as mandated by Section 228 of the NIRC, the prescriptive period for protest will not commence, because the notice is

considered by law as void *ab initio*. A void assessment bears no valid fruit.

R.A. 8424- Effective 1997	
Before	After
Valid assessment- Inform the taxpayer of the finding of the BIR	Valid assessment- inform the taxpayer of the law and facts which the assessment is based.

Are the procedures outlined in Section 228 of the NIRC retroactive? In **CIR v. Reyes, G.R. No. 159694, January 27, 2006** - The general rule is that statutes are prospective. However, statutes that are remedial, or that do not create new or take away vested rights, do not fall under the general rule against the retroactive operation of statutes. Clearly, Section 228 provides for the procedure in case an assessment is protested. The provision does not create new or take away vested rights. In both instances, it can surely be applied retroactively. Moreover, RA 8424 does not state, either expressly or by necessary implication, that pending actions are excepted from the operation of section 228, or that applying it to pending proceedings would impair vested rights.

CIR vs. ENRON SUBIC POWER CORP- during the Notice of Informal Conference and PAN, the taxpayer was informed of the facts and law which the assessment. The taxpayer disputed the assessments. In the FAN the taxpayer was not informed of the facts and the law where the assessment was based. Is the assessment valid?

Held: No, section 229 –XXX“The taxpayer shall be informed on writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.”XXX

Moreover, the **tax advice** of tax deficiency, given by the CIR to an employee of Enron, as well as the preliminary five-day letter, were not valid substitutes for the mandatory notice in writhing of the legal and factual basis of the assessment. The steps were merely perfunctory discharges of the CIR’s duties in correctly assessing a taxpayer. The requirement for issuing a preliminary or final notice, as the case maybe, informing a taxpayer of the existence of a deficiency tax assessment is markedly different from the requirement of what notice, must contain. Just because the CIR issued an advice, a preliminary letter during the pre-assessment stage and a final notice, in the order required by law, does not necessarily mean that Enron was informed of the law and facts on which the deficiency tax assessment was made (*CIR vs. Enron, 19 Jan 2009*).

NOT DEEMED NOTICE OF ASSESSMENT - The filing of the criminal complaint with the Department of justice cannot be construed as a formal assessment.

NECESSITY OF ASSESSMENT -Taxes are generally self-assessing because they do not need a letter of demand or

assessment notice. The taxpayer is supposed to know how much he should pay as tax and when and where he should pay.

An assessment, however, is not altogether inconsequential; it is relevant in the proper pursuit of judicial and extrajudicial remedies to enforce taxpayer’s liabilities and certain matters that relate to it, such as the imposition of surcharges and interest, and in the application of statutes of limitations and in the establishment of tax liens.

WHEN IS ASSESSMENT REQUIRED?

1. In case of deficiency taxes for failure to file a return or for filing a false or fraudulent return; and
2. When the tax period (the period within which a tax must be paid) is terminated.

WHEN IS ASSESSMENT NOT REQUIRED? An assessment of tax deficiency is not necessary to a criminal prosecution for tax evasion. The crime is complete when the violator has knowingly and willfully filed a fraudulent return with intent to evade and defeat the tax.

ASSESSMENT DEEMED MADE - An assessment is deemed made only when **the collector of internal revenue personally served or mails/ sends the notice of assessment to the taxpayer.**

Thus, “an assessment must be sent to and received by the taxpayer, and must demand payment of the taxes described therein within a specific period. The revenue officer’s affidavit merely contained a computation of respondent’s tax liability. It did not sate a demand or period for payment. It was addressed to the DOJ not to the taxpayer. The joint affidavit was meant to support criminal complaint for tax evasions, it was not meant to be a notice of tax due and a demand to private respondents for the payment thereof. The fact that the complaint was sent to the DOJ, and not to private respondents, shows that commissioner intended to file a criminal complaint for tax evasion, not to issue an assessment” (*CIR vs. Pascor*).

PRESUMPTION OF CORRECTNESS OF TAX ASSESSMENT

- ♣ All presumptions are in favor of the correctness of tax assessments.
- ♣ In order to stand the test of judicial scrutiny, the assessment must be based on actual facts. The presumption of correctness of assessment being mere presumption cannot be made to rest on another presumption.
- ♣ The good faith of the assessors and the validity of their actions are presumed. They will be presumed to have taken into consideration all the facts to which their attention was called. No presumption

can be indulged that they may knowingly violate the duties imposed upon them by law.

WHO BEARS THE BURDEN OF PROOF TO SHOW ERRONEOUS ASSESSMENT? Even an assessment based on estimates is prima facie valid and lawful where it does not appear to have been arrived at arbitrarily or capriciously. Thus, it is incumbent upon the taxpayer to show clearly that the assessment is erroneous in order to relieve himself from it.

STATUTE OF LIMITATIONS ON ASSESSMENT OF TAXES

Preliminary consideration: PNOC v. Court of Appeals, G.R. No., 109976, April 26, 2005 - The defense of prescription of the period for the assessment and collection of tax liabilities shall be deemed waived when such defense was not properly pleaded and the facts alleged and evidenced submitted by the parties were not sufficient to support a finding by the supreme court on the matter – prescription, being a matter of defense, imposes the burden on the taxpayer to prove that the full period of the limitation has expired, and this requires him to positively establish the date when the period started running and when the same was fully accomplished

General rule [Sec 203]: Internal revenue taxes shall be assessed **within three years after the last day prescribed for the filing of the return**, and no proceeding in court without assessment for the collection of such taxes shall begin after the expiration of such period.

Exceptions [sec.222]:

- ♣ In the case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax collection may be filed without an assessment at any time within ten years after the discovery of the falsity, fraud or omission:
- ♣ If before the expiration of the time prescribed in the tax codes for the assessment of the tax, both the commissioner and the taxpayer have agreed in writing to its assessment after such time, the tax may be assessed within the period agreed upon.

ORDINARY ASSESSMENT- 3 Year Period

- ♣ Available to the government if there was a return filed by the taxpayer and such return is not false or fraudulent.
- ♣ The government may only make the assessment within 3 years after the last day prescribed by law for the filing of the return- not from the time of payment. However, when the return is filed beyond the period of filing prescribed by law, the 3 year

period shall be counted from the day of filing the return.

Illustration 1: Suppose the return for calendar year 2012 is filed by the taxpayer on April 10, 2013, when will the prescriptive period begin to run? Since the return was filed before the deadline, the prescriptive period will begin to run after April 15, 2013, the deadline for filing the return for 2012.

Illustration 2: Suppose the return for 2011 was filed on April 12, 2013, when will the prescriptive period begin to run? In this case, the period will commence from April 12, 2013. A careful analysis of the case would show that the return was filed beyond the period for filing the return. The return was for the calendar year 2011 but only filed in 2013. The return was filed only after the deadline. Thus, the prescription period should commence from the date the return is filed, which is April 12, 2013.

ABNORMAL OR EXTRAORDINARY ASSESSMENT—10 years

- ♣ This remedy is resorted to by the government in a case where:
 1. The taxpayer fails to file his return; or
 2. The taxpayer filed a return but the return was fraudulent; or
 3. The return filed by the taxpayer was false.

WAIVER OF STATUTE OF LIMITATIONS

RMO 20-90, Philippine Journalist Inc., v. CIR, G.R. No. 162852, 16 December 2004 - **Appellate Jurisdiction of the CTA is not limited to cases which involve decisions of the CIR on matters relating to assessments or refunds. The second part of the provision covers other cases that arise out of the NIRC or related laws and administered by the BIR.** The wording of the provision is clear and simple. It gives the CTA the Jurisdiction to determine if the warrant of distraint and levy issued by the BIR is valid and to rule if the waiver of statute of limitations was validly effected.

A **waiver of the statute of limitations** under the NIRC, to a certain extent, is a derogation of the taxpayer's right to security against prolonged and unscrupulous investigations and must therefore be carefully and strictly construed. The waiver of the statute of limitations is not a waiver of the right to invoke the defense of prescription as erroneously held by the CA. It is an agreement between the taxpayer and the BIR that the period to issue an assessment and collect the taxes due is extended to a date certain.

The waiver does not mean that the taxpayer relinquishes the right to invoke prescription unequivocally particularly where the language of the document is equivocal. For the purpose of safeguarding taxpayers from any unreasonable examination, investigation or assessment, out tax law provides a statute of limitation in collection of taxes. Thus the law on prescription, being a remedial measure should be liberally construed in order to afford such protection/

HOW SHOULD THE STATUTE OF LIMITATIONS OR PRESCRIPTIVE PERIOD BE COMPUTED?

✦ In **CIR v. Primetown Property Group, Inc.**, the taxpayer filed a claim for tax refund or credit of income tax paid in 1997. Pursuant to Section 229 of the 1997 Tax Code, it had two years from the filing of its final adjusted return to file a claim for tax refund or credit. The CIR's argument was hinged on Article 13 of the Civil Code which states that a year is understood to mean 365 days. Hence, the taxpayer had 730 days to file its claim for tax refund or credit. The CIR maintained that the taxpayer filed its claim beyond the two-year prescriptive period, i.e., 731 days, given that the year 2000 was a leap year. On the other hand, the taxpayer's contention was based on Section 31, Chapter VIII, Book I of the Administrative Code of 1987 which says that a year consists of 12 calendar months. Having filed its claim on the last day of the 24th calendar month from the filing of its final adjusted return, it maintained that its claim was filed within the prescriptive period. Clarifying the difference in treatment of legal periods by the Civil Code and the Administrative Code of 1987, the Supreme Court held that:

- (1) Under the Civil Code, a year is equivalent to 365 days, whether it be a regular year or a leap year.
- (2) There exists a manifest incompatibility in the manner of computing legal periods under the two laws. However, given that the Administrative Code of 1987 is the more recent law, its treatment of a year, i.e., 24 calendar months, governs the computation of legal periods.

Hence, the taxpayer's claim was filed within the reglementary period. [CIR v. Primetown Property Group, Inc., GR No. 162155, 28 August 2007.]

WHAT IS THE RECKONING POINT WITH RESPECT TO AMENDED RETURNS?

✦ In **CIR v. Phoenix Assurance Co., Ltd.**, the taxpayer filed its income tax return for 1952 on 1 April 1953. It amended said return on 30 August 1955. Thereafter, on 24 July 1958, the CIR assessed deficiency income tax on the basis of the amended return. The CIR contended that his right to assess had not prescribed inasmuch as the same was availed of within 5 years from the filing of the amended return. [This case was governed by the old law granting the CIR 5 years to assess and another 5 years to collect.] The Supreme Court held that where the deficiency assessment is based on the amended return, which is substantially different from the original return, the period of

limitation of the right to issue the same should be counted from the filing of the amended return. Here, the changes and alterations embodied in the amended return constituted substantial ones, i.e., exclusion of certain items from the gross income. Thus, the CIR's deficiency assessment was not barred by prescription. [CIR v. Phoenix Assurance Co., Ltd., GR No. L-19727, 20 May 1965.]

WHAT CONSTITUTES A VALID ASSESSMENT?

✦ In **Barcelon, Roxas Securities, Inc. v. CIR**, the Supreme Court had occasion to say that an assessment is deemed to have been made within the three-year prescriptive period if notice to that effect was released, mailed, or sent by the CIR to the taxpayer within said period. Receipt by the taxpayer within the prescriptive period is not necessary. However, the taxpayer should actually receive, even beyond the prescriptive period, the assessment notice which was timely released, mailed, or sent. "While a mailed letter is deemed received by the addressee in the ordinary course of mail, this is still merely a disputable presumption subject to controversion, and a direct denial of the receipt thereof shifts the burden upon the party favored by the presumption to prove that the mailed letter was indeed received by the addressee." Here, petitioner denied receiving the assessment notice and the CIR failed to present substantial evidence that such notice was indeed mailed or sent by the CIR before his right to assess had prescribed and that said notice was received by petitioner. Additionally, the Supreme Court ruled that independent evidence, such as the registry receipt of the assessment notice or a certification from the Bureau of Posts, would be acceptable. [Barcelon, Roxas Securities, Inc. v. CIR, GR No. 157064, 7 August 2006.]

✦ **Estate of the Late Juliana Diez Vda. De Gabriel v. CIR, G.R. No. 155541, January 27, 2004** - The rule that an assessment is deemed made for the purpose of giving effect to such assessment when the notice is released, mailed or sent to the taxpayer to effectuate the assessment requires that the notice must be sent to the taxpayer, and not merely to a disinterested party. Although there is no specific requirement that the taxpayer should receive that notice within the said period, due process requires at the very least that such notice actually be received.

When an estate is under administration, notice must be sent to the administrator of the estate.

Bar 1996 - BIR; False vs. Fraudulent Return: Distinguish a false return from a fraudulent return.

Suggested answer: The distinction between a false return and a fraudulent return is that the first merely implies a deviation from the truth or fact whether intentional or not, whereas the second is intentional and deceitful with the sole aim of evading the correct tax due

(Aznar vs. Commissioner, L-20569, August 23, 1974).

Alternative answer: A false return contains deviations from the truth which may be due to mistakes, carelessness or ignorance of the person preparing the return. A fraudulent return contains an intentional wrongdoing with the sole object of avoiding the tax and it may consist in the intentional underdeclaration of income, intentional overdeclaration of deductions or the recurrence of both. A false return is not necessarily tainted with fraud because the fraud contemplated by law is actual and not constructive. Any deviation from the truth on the other hands, whether intentional or not, constitutes falsity. **(Aznar vs. Commissioner, L-20569, August 23, 1974)**

Bar 1998 - BIR: Fraudulent Return; Prima Facie

Evidence: What constitutes prima facie evidence of a false or fraudulent return? [2%]

Suggested answer: There is prima facie evidence of a false or fraudulent return when the taxpayer has willfully and knowingly filed it with the intent to evade a part or all of the tax legally due from him (**Ungab v. Cusi, 97 SCRA 877**). There must appear a design to mislead or deceive on the part of the taxpayer, or at least culpable negligence. A mistake not culpable in respect of its value would not constitute a false return. (*Words and Phrases, Vol. 16, page 173*).

Bar 2002 - BIR: Fraudulent Return; Prima Facie

Evidence: What constitutes *prima facie* evidence of a false or fraudulent return to justify the imposition of a 50% surcharge on the deficiency tax due from a taxpayer? Explain. (5%)

Suggested answer: There is a prima facie evidence of false or fraudulent return when the taxpayer *SUBSTANTIALLY UNDER-DECLARED* his taxable sales, receipts or income, or *SUBSTANTIALLY OVERSTATED* his deductions, the taxpayer's failure to report sales, receipts or income in an amount exceeding 30% of that declared per return, and a claim of deduction in an amount exceeding 30% of actual deduction shall render the taxpayer liable for substantial underdeclaration and overdeclaration, respectively, and will justify the imposition of the 50% surcharge on the deficiency tax due from the taxpayer. (*Sec. 248, NIRC*).

Bar 2002 - BIR; Prescriptive Period; Assessment; Fraudulent Return:

Mr. Castro inherited from his father, who died on June 10, 1994, several pieces of real property in Metro Manila. The estate tax return was filed and the estate tax due in the amount of P250,000.00 was paid on December 06, 1994. The Tax Fraud Division of the BIR investigated the case on the basis of confidential information given by Mr. Santos on January 06, 1998 that the return filed by Mr. Castro was fraudulent and that he failed to declare all properties left by his father with intent to evade payment of the correct tax. As a result, a deficiency estate tax assessment for P1,250,000.00, inclusive of 50% surcharge for fraud, interest and penalty,

was issued against him on January 10, 2001. Mr. Castro protested the assessment on the ground of prescription.

A. Decide Mr. Castro's protest. (2%) The protest should be resolved against Mr. Castro. What was filed is a fraudulent return making the prescriptive period for assessment ten (10) years from discovery of the fraud (Section 222, NIRC). Accordingly, the assessment was issued within that prescriptive period to make an assessment based on a fraudulent return.

B. What legal requirement/s must Mr. Santos comply with so that he can claim his reward?

Explain. (3%) The legal requirements that must be complied by Mr. Santos to entitle him to reward are as follows: 1) He should voluntarily file a confidential information under oath with the Law Division of the Bureau of Internal Revenue alleging therein the specific violations constituting fraud; 2) The information must not yet be in the possession of the Bureau of Internal Revenue, or refer to a case already pending or previously investigated by the Bureau of Internal Revenue; 3) Mr. Santos should not be a government employee or a relative of a government employee within the sixth degree of consanguinity; and 4) The information must result to collections of revenues and/or fines and penalties. (Sec. 282, NIRC)

INSTANCES WHERE THE RUNNING OF THE PRESCRIPTIVE PERIOD FOR ASSESSMENT & COLLECTION IS SUSPENDED

Per Section 223 of the Tax Code, the running of the statute of limitations provided in Sections 203 and 222 on the making of assessment and the beginning of distraint or levy or a proceeding in court for collection, in respect of any deficiency, shall be suspended for the period during which the Commissioner is prohibited from making the assessment or beginning the distraint or levy or a proceeding in court and for 60 days thereafter:

1. When the taxpayer requests for a reinvestigation which is granted by the Commissioner.
2. When the taxpayer cannot be located in the address given by him in the return filed upon which a tax is being assessed or collected; provided, that if the taxpayer informs the Commissioner of any change in address, the running of the Statute of Limitations will not be suspended.
3. When the warrant of distraint or levy is duly served upon the taxpayer, his authorized representative, or a member of his household with sufficient discretion, **and** no property could be located. [note: the conjunctive is '**and**' not '**OR**']
4. The taxpayer is out of the Philippines.

Bar 2000 - Taxpayer: Prescriptive Period: Suspended: Mr. Reyes, a Filipino citizen engaged in the real estate business, filed his 1994 income tax return on March 20, 1995. On December 15, 1995, he left the Philippines as an immigrant to join his family in Canada. After the investigation of said return/the BIR issued a notice of deficiency income tax assessment on April 15, 1998. Mr. Reyes returned to the Philippines as a balik bayan on December 8, 1998. Finding his name to be in the list of delinquent taxpayers, he filed a protest against the assessment on the ground that he did not receive the notice of assessment and that the assessment had prescribed. Will the protest prosper? Explain. (5%)

Suggested answer: No. Prescription has not set in because the period of limitations for the Bureau of Internal Revenue to issue an assessment was **SUSPENDED** during the time that Mr. Reyes was out of the Philippines or from the period December 15, 1995 up to December 8, 1998. (*Sec. 223 in relation to Sec. 203, both of the NIRC of 1997*)

REPUBLIC V. HIZON, 13 December 1999 - Sec. 229 of the code mandates that a request for reconsideration must be made within thirty (30) days from the tax payer's receipt of tax deficiency assessment, otherwise the assessment becomes final, unappealable and, therefore, demandable. The notice of assessment for respondent's tax deficiency was issued by petitioner on July 18, 1986. On the other hand, respondent made her request for reconsideration thereof only on November 3, 1992, without stating when she received the notice of tax assessment. She explained that she was constrained to ask for a reconsideration in order to avoid the harassment of BIR collectors. In all likelihood, she must have been referring to the distraint and levy of her properties by petitioner's agents which took place of January 12, 1989. Even assuming that she first learned of the deficiency assessment on this date her request for reconsideration was nonetheless filed late since she made it more than 30 days thereafter. Hence, her request for reconsideration did not suspend the running for the prescriptive period provided under section 223. Although the commissioner acted on her request by eventually denying it on August 11, 1994, this is of no moment and does not distract from the fact that the assessment had become demandable

BPI v. CIR, G.R. No. 139736, 17 October 2005 - The court had consistently ruled in a number of cases that a request for reconsideration by the tax payer without a valid waiver of the prescriptive period for the assessment and collection of tax, as required by the tax code and implementing rules, will not suspend the running thereof. (Exception: section 224)

Wherein the statute of limitations on assessment and collection of taxes is considered suspended, when the tax

payer request for a reinvestigation which is granted by the commissioner.

Is assessment necessary before a taxpayer could be prosecuted for violation of the NIRC?

- ✦ **Ungab v. Cusi, May 30, 1980** - What is involved here is not collection of taxes where the assessment of the commissioner of internal revenue may be reviewed by the court of tax appeals, but a criminal prosecution for violations of the NIRC which is within the cognizance of the CFI. While there can be no civil action to enforce collection before the assessment procedures provided in the code have been followed, there is no requirement for the precise computation and assessment of the tax before there can be a criminal prosecution under the code.
- ✦ **CIR v. CA, G.R. No. 119322, 4 June 1996** - Reading Ungab carefully, the pronouncement therein that deficiency assessment is not necessary prior to prosecution is pointedly and deliberately qualified by the Court with following statement quoted from *Guzik v. U. S.*: "the crime is complete when the violator has knowingly and willfully filed a fraudulent return with intent to evade and defeat a part or all of the tax." In plain words, for criminal prosecution to proceed before assessment, there must be a prima facie showing of willful attempt to evade taxes. There was willful attempt to evade tax in Ungab because of the taxpayer's failure to declare in his income tax return "his income derived from banana saplings." In the mind of the trial court and the Court of Appeals, Fortune's situation is quite apart factually since the registered wholesale price of the goods. Approved by the BIR, is presumed to be the actual wholesale price, therefore, not fraudulent and unless and until the BIR has made a final determination of what is supposed to be the correct taxes, the taxpayer should not be placed in the crucible of criminal prosecution. Herein lies a whole of difference between Ungab and the case at bar.
- ✦ **CIR v. Pascor Realty, 29 June 1999** -The issuance of an assessment is vital in determining the period of limitation regarding its proper issuance and the period within which to protest it. Section 203 of NIRC provides that internal revenue taxes must be assessed within three years from the last day within which to file the return. Section 222, on the other hand, specifies a period of ten years in case a fraudulent return with intent to evade was submitted or in case of failure to file a return. Also, Section 228 of the same law states that said assessment may be protested only within thirty days from receipt thereof. Necessarily, the taxpayer must be certain that a specific document constitutes an assessment. Otherwise, confusion would arise regarding the period

within which to make an assessment or to protest the same, or whether interest and penalty may accrue thereon.

Bar 1999 - BIR: Prescriptive Period; Assessment & Collection: A Co., a Philippine Corporation, filed its 1995 Income Tax Return (ITR) on April 15, 1996 showing a net loss. On November 10, 1996, it amended its 1995 ITR to show more losses. After a tax investigation, the BIR disallowed certain deductions claimed by A Co., putting A Co. in a net income position. As a result, on August 5, 1999, the BIR issued a deficiency income assessment against A Co. A Co. protested the assessment on the ground that it has prescribed: Decide. (5%)

Suggested answer: The right of the BIR to assess the tax has not prescribed. *The rule is that internal revenue taxes shall be assessed within three years after the last day prescribed by law for the filing of the return. (Section 203, NIRC),* However, if the return originally filed is amended substantially, the counting of the three-year period starts from the date the amended return was filed. (**CIR v. Phoenix Assurance Co., Ltd., 14 SCRA 52**). There is a substantial amendment in this case because a new return was filed declaring more losses, which can only be done either (1) in reducing gross income or (2) in increasing the items of deductions, claimed.

Bar 2005 - BIR; Assessment; Criminal Complaint: In 1995, the BIR filed before the Department of Justice (DOJ) a criminal complaint against a corporation and its officers for alleged evasion of taxes. The complaint was supported by a sworn statement of the BIR examiners showing the computation of the tax liabilities of the erring taxpayer. The corporation filed a motion to dismiss the criminal complaint on the ground that there has been, as yet, no assessment of its tax liability; hence, the criminal complaint was premature. The DOJ denied the motion on the ground that an assessment of the tax deficiency of the corporation is not a precondition to the filing of a criminal complaint and that in any event, the joint affidavit of the BIR examiners may be considered as an assessment of the tax liability of the corporation. Is the ruling of the DOJ correct? Explain. (5%)

Suggested answer: The DOJ is correct in ruling that an assessment of the tax deficiency of the corporation is not a precondition to the filing of a criminal complaint. There is no need for an assessment so long as there is a prima facie showing of violation of the provisions of the Tax Code. After all, a criminal charge is instituted not to demand payment, but to penalize the tax payer for violation of the Tax Code. (**Commissioner of Internal Revenue v. Pascor Realty and Development Corporation, G.R. No. 128315, June 29, 1999**) Furthermore, there is nothing in the problem that shows that the BIR in filing the case is also interested in collecting the tax deficiency.

However, it is in error when it ruled that the joint affidavit of the BIR examiners may be considered as an assessment of the tax liability of the corporation. The joint affidavit showing the computation of the tax liabilities of the erring taxpayer is not a tax assessment because it was not sent to the taxpayer, and does not demand payment

of the tax within a certain period of time. An assessment is deemed made only when the BIR releases, mails or sends such notice to the taxpayer. (**Commissioner of Internal Revenue v. Pascor Realty and Development Corporation, G.R. No. 128315, June 29, 1999**)

Bar 2004 - Taxpayer: Assessment; Injunction: RR disputed a deficiency tax assessment and upon receipt of an adverse decision by the Commissioner of Internal Revenue, filed an appeal with the Court of Tax Appeals. While the appeal is pending, the BIR served a warrant of levy on the real properties of RR to enforce the collection of the disputed tax. Granting *arguendo* that the BIR can legally levy on the properties, what could RR do to stop the process? Explain briefly. (5%)

Suggested answer: RR should file a motion for injunction with the Court of Tax Appeals to stop the administrative collection process. An appeal to the CTA shall not suspend the enforcement of the tax liability, unless a motion to that effect shall have been presented in court and granted by it on the basis that such collection will jeopardize the interest of the taxpayer or the Government (**Pirovano v. CIR, 14 SCRA 832 [1965]**).

The CTA is empowered to suspend the collection of internal revenue taxes and customs duties in cases pending appeal only when: (1) in the opinion of the court the collection by the BIR will jeopardize the interest of the Government and/or the taxpayer; and (2) the taxpayer is willing to deposit the amount being collected or to file a surety bond for not more than double the amount of the tax to be fixed by the court (*Section 11, JR.A. No. 1125*).

Bar 1998- Taxpayer: Protest against Assessment: CFB Corporation, a domestic corporation engaged in food processing and other allied activities, received a letter from the BIR assessing it for delinquency income taxes. CFB filed a letter of protest. One month after, a warrant of distraint and levy was served on CFB Corporation. If you were the lawyer engaged by CFB Corporation to contest the assessment made by the BIR, what steps will you take to protect your client? (5%)

Suggested answer: I shall immediately file a motion for reconsideration of the issuance of the warrant of distraint and levy and seek from the BIR Commissioner a denial of the protest "in clear and unequivocal language." This is so because the issuance of a warrant of distraint and levy is not considered as a denial by the BIR of the protest filed by CFB Corporation (**CIR v. Union Shipping Corp., 185 SCRA 547**). Within thirty (30) days from receipt of such denial "in clear and unequivocal language," I shall then file a petition for review with the Court of Tax Appeals.

Alternative answer: Within thirty (30) days from receipt of the warrant of distraint and levy, I shall file a petition for review with the Court of Tax Appeals with an application for issuance of a writ of preliminary injunction to enjoin the Bureau of Internal Revenue from enforcing the warrant. This is the action I shall take because I shall consider the issuance of the warrant as a final decision of the Commissioner of Internal Revenue which could be the subject of appeal to the Court of Tax Appeals (**Yobes u. Flojo, 15 SCRA 278**). The CTA may, however, remand

the case to the BIR and require the Commissioner to specifically rule on the protest. The decision of the Commissioner, if adverse to my client, would then constitute an appealable decision.

Bar 1995- Taxpayer; Protest against Assessment; Donor's Tax; Mr. Rodrigo, an 80-year old retired businessman, fell in love with 20-year old Tetchie Sonora, a night club hospitality girl. Although she refused to marry him she agreed to be his "live-in" partner. In gratitude, Mr. Rodrigo transferred to her a condominium unit, where they both live, under a deed of sale for P10 Million. Mr. Rodrigo paid the capital gains tax of 5% of P10 Million. The Commissioner of Internal Revenue found that the property was transferred to Tetchie Sonora by Mr. Rodrigo because of the companionship she was providing him. Accordingly, the Commissioner made a determination that Sonora had compensation income of P10 Million in the year the condominium unit was transferred to her and issued a deficiency income tax assessment. Tetchie Sonora protests the assessment and claims that the transfer of the condominium unit was a gift and therefore excluded from income. How will you rule on the protest of Tetchie Sonora? Explain.

Suggested answer: I will grant the protest and cancel the assessment. The transfer of the property by Mr. Rodrigo to Ms. Sonora was gratuitous. The deed of sale indicating a P10 million consideration was simulated because Mr. Rodrigo did not receive anything from the sale. The problem categorically states that the transfer was made in gratitude to Ms. Sonora's companionship. The transfer being gratuitous is subject to donor's tax. Mr. Rodrigo should be assessed deficiency donor's tax and a 50% surcharge imposed for fraudulently simulating a contract of sale to evade donor's tax. (*Sec. 91(b), NIRC*).

Bar 2006 -Taxpayer; Prescriptive Period; Assessment; Deficiency Income Tax: The Commissioner of Internal Revenue issued an assessment for deficiency income tax for taxable year 2000 last July 31, 2006 in the amount of P 10 Million inclusive of surcharge and interests. If the delinquent taxpayer is your client, what steps will you take? What is your defense? (10%)

Alternative answer: As Counsel, I shall move to cancel the Assessment because of prescription. The three (3) year period of assessment for the Income Tax Returns of 2000 starts on April 15, 2001 and ends on April 16, 2004. The assessment of July 31, 2006 is beyond the three (3) year prescriptive period and can no longer have any legal, binding effect (*Tax Reform Act, Title VIII, Chapter I, Section 203 [1997]*).

Alternative answer: Since my client has lost his right to protest, I will advise him to wait for a collection action by the Commissioner. Then, I will file a petition for review with the CTA to question the collection. Since the assessment was issued beyond the prescriptive period to assess, the action to collect an invalid assessment is not warranted (**Phil. Jour-nalists, Inc. v. CIR, G.R. No. 162852, December 16, 2004**).

Bar 2006 - Taxpayer; Assessment; Deficiency Tax: On June 1, 2003, Global Bank received a final notice of assessment from the BIR for deficiency documentary stamp tax in the amount of P5 Million. On June 30, 2003, Global Bank filed a request for reconsideration with the Commissioner of Internal Revenue. The Commissioner denied the request for reconsideration only on May 30, 2006, at the same time serving on Global Bank a warrant of distraint to collect the deficiency tax. If you were its counsel, what will be your advice to the bank? Explain. (5%)

Alternative answer: The denial for the request for reconsideration is the final decision of the CIR. I would advise Global Bank to appeal the denial to the Court of Tax Appeals (CTA) within 30 days from receipt. I will further advise the bank to file a motion for injunction with the Court of Tax Appeals to enjoin the Commissioner from enforcing the assessment pending resolution of the appeal. While an appeal to the CTA will not suspend the payment, levy, distraint, and/or sale of any property of the taxpayer for the satisfaction of its tax liability, the CTA is authorized to give injunctive relief if the enforcement would jeopardize the interest of the taxpayer, as in this case, where the assessment has not become final (**Lascona Land Co. v. CIR, CTA Case No. 5777, January 4, 2000; See also Revised CTA Rules, approved by the Supreme Court on December 15, 2005**).

Alternative answer: I will advise the Bank to promptly pay the deficiency documentary stamp tax and the interest charges to avoid any further increase in the tax liability. The Bank should have appealed to the Court of Tax Appeals when the BIR failed to decide on its Request for Reconsideration within thirty (30) days after the inaction of the BIR for one hundred eighty (180) days or on December 31, 2003. The Tax Assessment has already become final, executory and unappealable at that point (**BPI v. CIR, G.R. No. 139736, October 17, 2005**).

INTERNAL REVENUE TAX REMEDIES

Importance: They exist to enhance the Government's tax collection efforts, they, too, come in as safeguards against arbitrary action. While taxes are the lifeblood of the Government and should be collected without unnecessary hindrance, such collection must nevertheless be made in accordance with law as any arbitrariness will negate the very reason or the Government itself.

CLASSIFICATION:

1. Remedies in favor of the taxpayer

A. Administrative

(1) Before Payment

- a. Filing of a petition or request for reconsideration or reinvestigation (Administrative Protest);
- b. Entering into compromise

(2) After Payment

- a. Filing of claim for tax refund; and
- b. Filing of claim for tax credit

B. Judicial

(1) Civil action

- a. Appeal to the Court of Tax Appeals
- b. Action to contest forfeiture of chattel; and
- c. Action for Damages

(2) Criminal Action - Filing of complaint against erring Bureau of Internal Revenue officials and employees

2. Remedies available to the government-
distrain and levy

Applicability of the Doctrine Exhaustion of Administrative Remedies - No civil or criminal action for the recovery of taxes shall be filed in court without the approval of the Commissioner. (Sec. 220, NIRC)

Bar 1997- Taxpayer: Exhaustion of Administrative Remedies (1997)

(a) A taxpayer received, on 15 January 1996 an assessment for an internal revenue tax deficiency. On 10 February 1996, the taxpayer forthwith filed a petition for review with the Court of Tax Appeals. Could the Tax Court entertain the petition?

(b) Under the above factual setting, the taxpayer, instead of questioning the assessment he received on 15 January 1996 paid, on 01 March 1996 the "deficiency tax" assessed. The taxpayer requested a refund from the Commissioner by submitting a written claim on 01 March 1997. It was denied. The taxpayer, on 15 March 1997, filed a petition for review with the Court of Appeals. Could the petition still be entertained?

Suggested answer:

(a) No. Before taxpayer can avail of Judicial remedy he must first exhaust administrative remedies by filing a protest within 30 days from receipt of the assessment. It is the Commissioner's decision on the protest that give the Tax Court jurisdiction over the case provided that the appeal is filed within 30 days from receipt of the Commissioner's decision. An assessment by the BIR is not the Commissioner's decision from which a petition for review may be filed with the Court of Tax Appeals. Rather, it is the action taken by the Commissioner in response to the taxpayer's protest on the assessment that would constitute the appealable decision (Section 7, RA 1125).

(b) No, the petition for review cannot be entertained by the Court of Appeals, since decisions of the Commissioner on cases involving claim for tax refunds are within the exclusive and primary jurisdiction of the Court of Tax Appeals (Section 7.RA1125).

ASSESSMENT PROCESS & REMEDIES

AUDIT

- ♣ If the BIR finds a tax liability it will issue-

INFORMAL NOTICE OF CONFERENCE

- ♣ Taxpayer will be asked to explain his tax liability.
- ♣ This is not an assessment!
- ♣ If the BIR is not satisfied then it will again issue-



PRELIMINARY ASSESSMENT NOTICE [PAN]

- ♣ This is not the assessment proper, thus cannot be a subject of protest, unless on its face it is indicated that it is the final assessment and there is no other remedy than to appeal the same.
- ♣ Upon receipt of a valid PAN, the taxpayer may respond to and seek clarification of the same within 10 days from receipt thereof.



FORMAL NOTICE OF ASSESSMENT [FAN]

- ♣ Upon receipt of a valid FAN, the taxpayer may protest against it by filing a request for reconsideration or reinvestigation. Thereafter, the taxpayer must submit all relevant supporting documents. Failure to protest and submit all relevant supporting documents shall cause the assessment to become final. At this point, the government may resort to distraint, levy, or judicial proceeding to collect.
- ♣ Must contain the facts and the law where such assessment was based.
- ♣ This is the assessment which is subject of protest.



PROTEST

- ♣ Filed before the CIR. Prerequisite before filing an appeal, unless the FAN clearly states that the remedy of the taxpayer is to appeal the assessment.
- ♣ The CIR must decide the protest within 180 days.
 - If the protest is denied then the taxpayer shall appeal the decision within 30 days from receipt of the decision.
 - If the CIR did not act on the protest within the 180 days, the taxpayer has two options:
 1. Appeal the inaction of the BIR to the CTA division within 30 days after the lapse of the 180 days OR
 2. Wait for the decision of the BIR, and appeal the same within 30 days from receipt thereof if it is adverse to the taxpayer's interest.

Note that these options are mutually exclusive; recourse to one excludes the other.

- ♣ See discussions on protest below.
- ♣ Failure to appeal shall cause the assessment to become final.



APPEAL TO CTA DIVISION

- ♣ The appeal must be made within 30 days from receipt of decision of the CIR denying the protest or

after the lapse of 180 days or upon receipt of an adverse decision upon lapse of the 180 days.

- ♣ Within 60 days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise the assessment shall become final.
- ♣ File a motion for reconsideration of the decision.

APPEAL TO CTA EN BANC

- ♣ Decisions of CTA Division must always be appeal to CTA en banc.
- ♣ Must be made within 15 days from the receipt of the decision of the CTA Division.

APPEAL TO SUPREME COURT

- ♣ By way of ordinary appeal under Rule 45 on the grounds of pure question of law.
- ♣ Must be made within 15 days from the receipt of the Decision of the CTA en Banc.

JURISDICTION OF CTA

Through the enactment of Republic Act No. 9282, the jurisdiction of the CTA has been expanded to include not only civil tax cases but also cases that are criminal in nature, as well as local tax cases, property taxes and final collection of taxes.

Pursuant to the provisions of Republic Act No. 1125 and other laws prior to R.A. 9282, the Court of Tax Appeals retains exclusive appellate jurisdiction to review by appeal, the following:

1. Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto, or other matters arising under the National Internal Revenue Code or other law or part of law administered by the Bureau of Internal Revenue;
2. Decisions of the Commissioner of Customs in cases involving liability for customs duties, fees or other money charges; seizure, detention or release of property affected; fines, forfeitures or other penalties imposed in relation thereto; or other matters arising under the Customs Law or other law or part of law administered by the Bureau of Customs [Rep. Act. No. 1125, (1954), Sec. 7];
3. In automatic review cases where such decisions of the Commission of Customs favorable to the taxpayer is elevated to the Secretary of Finance (Sec. 2315, TCC); and
4. Decisions of the Secretary of Trade and Industry, in the case of non-agricultural product, commodity or article, or the Secretary of Agriculture, in the case of agricultural product, commodity or article, in connection with the imposition of the Anti-Dumping Duty, Countervailing and Safeguard Duty [Republic Act Nos. 8751 and 8752, (1999) Sec. 301 (a) and (p), and Republic Act 8800].

Under Republic Act Number 9282, the CTA's original appellate jurisdiction was expanded to include the following:

1. Criminal cases involving violations of the National Internal Revenue Code and the Tariff and Customs Code;
2. Decisions of the Regional Trial Courts (RTC) in local tax cases;
3. Decisions of the Central Board of Assessment Appeals (CBAA) in cases involving the assessment and taxation of real property; and
4. Collection of internal revenue taxes and customs duties the assessment of which have already become final.

Bar 2006 - BIR; Jurisdiction; Review Rulings of the Commissioner: Mr. Abraham Eugenio, a pawnshop operator, after having been required by the Revenue District Officer to pay value added tax pursuant to a Revenue Memorandum Order (RMO) of the Commissioner of Internal Revenue, filed with the Regional Trial Court an action questioning the validity of the RMO. If you were the judge, will you dismiss the case? (5%)

Suggested answer: Yes. The RMO is in reality a ruling of the Commissioner in implementing the provisions of the Tax Code on the taxability of pawnshops. Jurisdiction to review rulings of the Commissioner is lodged with the Court of Tax Appeals and not with the Regional Trial Court (**CIR v. Josefina Leal, G.R. No. 113459, November 18, 2002; Tax Reform Act, RA 8424, Title I, Sec. 4 [1997]**). (**NOTA BENE:** *This concept pertains to the VAT law which is excluded from the bar coverage, Guidelines for 2006 Bar Examinations, June 15, 2006*)

Bar 2005-Taxpayer; Appeal to the Court of Tax Appeals: A taxpayer received a tax deficiency assessment of P1.2 Million from the BIR demanding payment within 10 days, otherwise, it would collect through summary remedies. The taxpayer requested for a reconsideration stating the grounds therefor. Instead of resolving the request for reconsideration, the BIR sent a Final Notice before Seizure to the taxpayer. May this action of the Commissioner of Internal Revenue be deemed a denial of the request for reconsideration of the taxpayer to entitle him to appeal to the Court of Tax Appeals? Decide with reasons. (5%)

Suggested answer: Yes, the final notice before seizure was in effect a denial of the taxpayer's request for reconsideration, not only was the notice the only response received, its nature, content and tenor supports the theory that it was the BIR's final act regarding the request for reconsideration. (**CIR v. Isabela Cultural Corporation, G.R. No. 135210, July 11, 2001**)

Bar 1999 - Taxpayer: City Board of Assessment Decision; Where to appeal: A Co., a Philippine corporation, is the owner of machinery, equipment and fixtures located at its plant in Muntinlupa City. The City Assessor characterized all these properties as real properties subject to the real property tax. A Co. appealed the matter to the Muntinlupa Board of Assessment Appeals. The Board ruled in favor of the City. In accordance with RA 1125 (An Act creating the Court of

Tax Appeals). A Co. brought a petition for review before the CTA to appeal the decision of the City Board of Assessment Appeals. Is the Petition for Review proper? Explain. (5%)

Suggested answer: No. The CTA's devoid of jurisdiction to entertain appeals from the decision of the City Board of Assessment Appeals. Said decision is instead appealable to the Central Board of Assessment Appeals, which under the Local Government Code, has appellate jurisdiction over decisions of Local Board of Assessment Appeals. (**Caltex Phils, foe. v. Central Board of Assessment Appeals, L50466, May 31, 1982**).

REMEDIES AVAILABLE TO TAXPAYERS

BEFORE PAYMENT

- ♣ Protest
- ♣ Compromise

1. PROTEST (Section 228, NIRC) - 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. It may be a:

- ♣ **Request for reconsideration**- a plea for the re-evaluation of an assessment on the basis of *existing records without need of additional evidence*. It may involve a question of fact or law or both.

Does not toll the running of the prescriptive period to assess.

- ♣ **Request for reinvestigation**- a plea for reinvestigation of an assessment on the basis of *newly-discovered or additional evidence* that a taxpayer intends to present in the reinvestigation. It may also involve question of fact or law or both.

If granted by the Commission it tolls the running period to assess.

Requirements of a valid protest

1. In writing;
2. Addressed to the CIR;
3. Must be accompanied by a waiver of the Statute of Limitations in favor of the government;
4. States the Facts, applicable law rules and regulations and jurisprudence on which his protest is based; otherwise, his protest shall be considered void and without force and effect on the event the letter of protest submitted by the taxpayer is accepted;

5. Contains the following:

- a. Name of the taxpayer and address for the immediate past three taxable years;
- b. Nature of request whether reinvestigation or reconsideration specifying newly discovered evidence that he intends to present it is a request for reinvestigation;
- c. Taxable periods covered by the assessment;
- d. Amounts and kind/s of tax involved, and Assessment Notice Number;
- e. Date of receipt of assessment notice or letter of demand;
- f. Itemized statement of the findings to which the taxpayer agrees, if any, as a basis for computing the tax due, which amount should be paid immediately upon the filing of the protest. For this purpose, the protest shall not be deemed validly filed unless payment of the agreed portion of the tax is paid first;
- g. Itemized schedule of the adjustments with which the taxpayer does not agree;
- h. Statement of facts and/or law in support of the protest; and
- i. Documentary evidence as it may deem necessary and relevant to support its protest to be submitted within sixty (60) days from the filing of the protest. If the taxpayer fails to comply with this requirement, the assessment shall become final. (*Revenue Regulation No. 12-85, dated Nov. 27, 1985.*)

Effect of a protest on the period to collect deficiency taxes: The prescriptive period is arrested [tolled] by the taxpayer's request for re-examination or reinvestigation even if he has not previously waived it (*CIR vs. Wyeth, G.R. No. 76281, Sep 30, 1991*)

Failure of the BIR to act within the 180-day period - If the Commissioner or his duly authorized representative fails to act on the taxpayer's protest within 180 days from the date of submission by the taxpayer of the required documents in support of his protest, the taxpayer may appeal to the CA within 30 days from the lapse of the 180-day period or wait for the decision and appeal the same within 30 days from receipt thereof.

Administrative actions taken during the 180-day period:

1. Grant of the Protest
2. Denial of Protest:

A. Direct Denial - The decision of the Commissioner or his duly rep shall (a) state the facts, applicable law, rules and regulations or jurisprudence on which his protest is based, otherwise the protest shall be considered void and without force and effect, 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, RR 12-99)

B. Indirect Denial

1. Commissioner did not rule on the taxpayer's MR of the assessment – it was only when respondent received summons on the civil action for the collection of deficiency income tax that the period to appeal commenced to run. (CIR vs. Union Shipping)
 2. Referral by the Commissioner of request for reinvestigation to the Solicitor General (Republic vs. LimTianTeng Sons).
- C. Reiterating the demand for immediate payment of the deficiency tax due to taxpayer's continued refusal to execute waiver (CIR vs. Ayala Securities Corp.)
- D. Preliminary collection letter may serve as assessment notice (United Int'l Pictures vs. CIR)

Acts of BIR Commissioner Considered as Denial of Protest which serves as a Basis for Appeal to CTA:

1. Filing by the **BIR of a civil suit for collection of the deficiency tax** (CIR v. Union Shipping Corp. 185 SCRA 547)
2. Indication to the taxpayer by the Commissioner in clear and unequivocal language of his final denial. (CIR v. Union Shipping Corp)
3. **BIR demand letter reiterating his previous demand to pay**, sent to taxpayer after his protest of the assessment (Surigao Electric Co. Inc. v. CTA, 57 SCRA 523)
4. **The actual issuance of a warrant of distraint and levy in certain cases cannot be considered as final decision on a disputed settlement (CIR v. Union Shipping Corp).** An implied denial cannot be inferred from the issuance of warrant of distraint and levy.
5. Isabel Cultural Center filed a protest. During the 180 days period, it received a final notice before seizure. The said final notice informed the taxpayer that if the will not pay its tax liability

then distraint and levy will be enforced. Upon receipt of the same the taxpayer appealed the implied denial of the CTA. The BIR moved to dismiss the appeal.

Held: the notice constitutes an implied denial, since the notice states that it is final.

What if the taxpayer ignored the notice of final seizure and warrants of distraint and levy is issued? It is still an implied denial.

Effect of protest filed out of time - The pendency of the taxpayer's appeal in the Court of Tax Appeals and in the Supreme Court had the effect of temporarily staying the hands of the said Commissioner. If the taxpayer's stand that the pendency of the appeal did not stop the running of the period because the Court of Tax Appeals did not have jurisdiction over the case of taxes is upheld, taxpayers would be encouraged to delay the payment of taxes in the hope of ultimately avoiding the same. Under the circumstances, the running of the prescriptive period was suspended. Deficiency Percentage Taxes must be imposed. (PROTECTOR'S SERVICES, INC., petitioner, vs. CA, G.R. No. 118176, 2000 Apr 12)

Remedies from a denial of protest

1. Motion for reconsideration
2. Appeal to the Court of Tax Appeals (RA 1125, as amended by RA 9282)

2. COMPROMISE

AFTER PAYMENT

1. **REFUND (Section 229, NIRC)** - The Legal Principle of quasi-contracts or *solution indebiti* (see Art. 2142 & 2154 of the Civil Code). The Government is within the scope of the principle of *solution indebiti*. (CIR vs. Fireman's Fund Insurance Co.)

Must be strictly construed against taxpayer -

Grounds for filing a claim for refund:

- ♣ Erroneously or illegally assessed or collected internal revenue taxes;
- ♣ Taxpayer pays under the mistake of fact, as for instance in a case where he is not aware of the existing exemption in his favor at the time payments were made.
- ♣ A tax is illegally collected if payments are made under duress.
- ♣ Penalties imposed without authority; and
- ♣ Any sum alleged to have been excessive or in any manner wrongfully collected.

The value of internal revenue stamps when they are returned in good condition by the purchaser may also be redeemed.

Bar 2005 - BIR; Authority; Refund or Credit of Taxes: State the conditions required by the Tax Code before the Commissioner of Internal Revenue could authorize the refund or credit of taxes erroneously or illegally received.

Suggested answer: Under Sec. 204(C), NIRC, the following conditions must be met:

1. There must be a written claim for refund filed by the taxpayer with the Commissioner.
2. The claim for refund must be a categorical demand for reimbursement.
3. The claim for refund must be filed within two (2) years from date of payment of the tax or penalty regardless of any supervening cause.

Bar 2002 - Taxpayer: Claim for Refund; Procedure: A. What must a taxpayer do in order to claim a refund of, or tax credit for, taxes and penalties which he alleges to have been erroneously, illegally or excessively assessed or collected? (3%)

Suggested answer: The taxpayer must comply with the following procedures in claiming a refund of, or tax credit for, taxes and penalties which he alleges to have been erroneously, illegally or excessively assessed or collected: **He should file a written claim for refund with the Commissioner within two years after the date of payment of the tax or penalty (Sec. 204, NIRC);**

1. The claim filed must state a categorical demand for reimbursement (**Bermejo v. Collector, 87 Phil. 96 [1950]**).
2. The suit or proceeding for recovery must be commenced in court within two years from date of payment of the tax or penalty regardless of any supervening event that will arise after payment (Sec. 229, NIRC).

[Note: If the answer given is only number 1, it is suggested that the same shall be given full credit considering that this is the only requirement for the Commissioner to acquire jurisdiction over the claim.]

B. Can the Commissioner grant a refund or tax credit even without a written claim for it? (2%)

Suggested answer: Yes. When the taxpayer files a return which on its face shows an overpayment of the tax and the option to refund/ claim a tax credit was chosen by the taxpayer, the Commissioner shall grant the refund or tax credit without the need for a written claim. This is so, because a return filed showing an overpayment shall be considered as a written claim for credit or refund. (*Sees. 76 and 204, NIRC*). Moreover, the law provides that 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. (*Sec. 229, NIRC*).

Period within which to file a claim for refund
General Rule is two years from the date of payment

The two-year prescriptive period provided in Section 292 (now Section 230 of the Tax Code should be computed from the time of filing the Adjustment Return or Annual Income Tax Return and final payment of income tax. (*CIR vs. TMX SALES, G.R. No. 83736, 1992 Jan 15,*)

The rationale in computing the two-year prescriptive period with respect to the petitioner corporation's claim for refund from the time it filed its final adjustment return is the fact that it was only then that ACCRAIN could ascertain whether it made profits or incurred losses in its business operations. The "date of payment", therefore, in ACCRAIN's case was when its tax liability, if any, fell due upon its filing of its final adjustment return. (*ACCRA vs CA, G.R. No. 96322, 1991 Dec 20*)

The two-year period for prescription should be counted from the date of payment of the tax, which for actions for refund of corporate income tax should be computed from the time of actual filing of the adjustment return or annual income tax return. This is so because at that point, it can already be determined whether there has been an overpayment by the taxpayer. Moreover, under Sec. 49 (a) by the NIRC (now Sec. 56(a), 1997 NIRC), payment is made at the time the return is filed. (CIR V CA, CTA, BPI, GR No. 117254. January 21, 1999)

There is some likelihood that the above rule could apply also to individuals who are self-employed (i.e., in business and professional practice) as well as estates and trusts, which are likewise required to file quarterly returns.

The prescriptive period of two years should commence to run only from the time that the refund is ascertained, which can only be determined after a final adjustment return is accomplished. (CIR V PHILAMLIFE, 244 SCRA 446. May 29, 1995)

Instances where refund is possible:

1. In case of Amended Returns
2. In case of taxpayers contemplating dissolution

Who has the personality to file a claim for refund?
The duty of the withholding agent to withhold the corresponding tax arises at the time of such accrual. The withholding agent/corporation is then obliged to remit the tax to the Government since it already and properly belongs to the Government. If a withholding agent who is personally liable for income tax withheld at source fails to

pay said withholding tax, an assessment for said deficiency withholding tax would, therefore, be legal and proper. (FILIPINAS SYNTHETIC FIBER CORP. V CA, GR No.113347. June 14, 1996)

Is setting-off of taxes against a pending claim for refund allowed?

Is automatic application of excess tax credits allowed?

Effect of existing tax liability on a pending claim for refund

Period of validity of a tax refund/credit

Returns are not actionable documents for purposes of the rules on civil procedure and evidence

Refund and Protest are mutually exclusive remedies

Is the taxpayer entitled to claim interest on the refunded tax?

- ✦ **General Rule:** The Government cannot be required to pay interest on taxes refunded to the taxpayer, unless:
 1. The Commissioner acted with patent arbitrariness. Arbitrariness presupposes inexcusable or obstinate disregard of legal provisions. (*CIR vs. Victorias Milling Corp., Inc. L-19607, Nov. 29, 1966.*)
 2. In case of Income Tax withheld on the wages of employees. Any excess of the taxes withheld over the tax due from the taxpayer shall be returned or credited within 3 months from the fifteenth (15th) day of April. Refund or credit after such time earn interest at the rate of 6% *per annum*, starting after the lapse of the 3-month period to the date the refund or credit is made (*Sec 79 (c) (2) 1997 NIRC*)

Bar 1999 - Taxpayer: Overwithholding Claim for Refund: A Co. is the wholly owned subsidiary of B Co., a non-resident German company. A Co. has a trademark licensing agreement with B Co. On Feb. 10, 1995, A Co. remitted to B Co. royalties of P 10,000,000, which A Co. subjected to a withholding tax of 25% or P2, 500,000. Upon advice of counsel, A Co. realized that the proper withholding tax rate is 10%. On March 20, 1996, A Co. filed a claim for refund of P2,500,000 with the BIR. The BIR denied the claim on Nov. 15, 1996. On Nov. 28, 1996, A Co. filed a petition for review with the CTA. The BIR attacked the capacity of A Co., as agent, to bring the refund case. Decide the issue. (5%)

Suggested answer: A Co., the withholding agent of the non-resident foreign corporation is entitled to claim the refund of excess withholding tax paid on the income of said corporation in the Philippines. Being a withholding agent, it is the one held liable for any violation of the withholding tax law should such a violation occur. In the same vein, it should be allowed to claim a refund in case

of overwithholding.(*CIR v. Wander Phils.Inc., GR No. 68378, April 15, 1988, 160 SCRA 573; CIR v. Procter & Gamble PMC, 204 SCRA 377*).

Bar 1997- Taxpayer: Prescriptive Period; Claim for Refund: A corporation files its income tax return on a calendar year basis. For the first quarter of 1993, it paid on 30 May 1993 its quarterly income tax in the amount of P3.0 million. On 20 August 1993, it paid the second quarterly income tax of P0.5 million. The third quarter resulted in a net loss, and no tax was paid. For the fourth and final return for 1993, the company reported a net loss for the year, and the taxpayer indicated in the income tax return that it opted to claim a refund of the quarterly income tax payments. On 10 January 1994, the corporation filed with the Bureau of Internal Revenue a written claim for the refund of P3.5 million. BIR failed to act on the claim for refund; hence, on 02 March 1996, the corporation filed a petition for review with the Court of Tax Appeals on its claim for refund of the overpayment of its 1993 quarterly income tax. BIR, in its answer to the petition, alleged that the claim for refund was filed beyond the reglementary period. Did the claim for refund prescribe?

Suggested answer: The claim for refund has prescribed. The counting of the two-year prescriptive period for filing a claim for refund is counted not from the date when the quarterly income taxes were paid but on the date when the final adjustment return or annual income tax return was filed (**CIR v. TMX Sales Inc., G.R. No. 83736, January 15, 1992; CIR v. Phi/Am Life Insurance Co., Inc., G.R. No. 105208, May 29, 1995**). It is obvious that the annual income tax return was filed before January 10, 1994 because the written claim for refund was filed with the BIR on January 10, 1994. Since the two-year prescriptive period is not only a limitation of action in the administrative stage but also a limitation of action for bringing the case to the judicial stage, the petition for review filed with the CTA on March 02, 1996 is beyond the reglementary period.

Bar 1996 - Taxpayer: Protest; Claim of Refund: Is protest at the time of payment of taxes and duties a requirement to preserve the taxpayers' right to claim a refund? Explain.

Suggested answer: For **TAXES** imposed under the **NIRC**, protest at the time of payment is not required to preserve the taxpayers' right to claim refund. This is clear under *Section 230 of the NIRC* which provides that a suit or proceeding maybe maintained for the recovery of national internal revenue tax or penalty alleged to have been erroneously assessed or collected, whether such tax or penalty has been paid under protest or not. For **DUTIES** imposed under the **Tariff and Customs Code**, a protest at the time of payment is required to preserve the taxpayers' claim for refund. The procedure under the TCC is to the effect that when a ruling or decision of the Collector of Customs is made whereby liability for duties is determined, the party adversely affected may protest such ruling or decision by presenting to the Collector, at the time when payment is made, or within 15 days thereafter, a written protest setting forth his objections to the ruling or decision in question (Sec. 2308. TCC).

Bar 2005 - Taxpayer; Withholding Agent; Claim of

Tax Refund: Does a withholding agent have the right to file an application for tax refund? Explain.

Suggested answer: Yes. A taxpayer is "any person subject to tax." Since, the withholding tax agent who is "required to deduct and withheld any tax" is made "personally liable for such tax" should the amount of the tax withheld be finally found to be less than that required to be withheld by law, then he is a taxpayer. Thus, he has sufficient legal interest to file an application for refund, of the amount he believes was illegally collected from him. (Commissioner of Internal Revenue v. Procter & Gamble, G.R. No. 66838, December 2, 1991)

2. OTHER REMEDIES

- a. **Action to Contest Forfeiture of Chattel (Sec. 231)** - In case of seizure of personal property under claim for forfeiture, the owner desiring to contest the validity of the forfeiture may bring an action:
- Before sale or destruction of the property to recover the property from the person seizing the property or in possession thereof upon filing of the proper bond to enjoin the sale.
 - After the sale and within 6 months to recover the net proceeds realized at the sale (*see. Sec. 231, 1997 NIRC*)

Action partakes the nature of an ordinary civil action for recovery of personal property or the net proceeds of its sale which must be brought in the ordinary courts and not the CTA

- b. **Redemption of Property Sold (Sec. 214)**

REMEDIES AVAILABLE TO THE GOVERNMENT

1. No Injunction to restrain collection of taxes (Sec. 218, NIRC)

- ♣ General rule: No Court shall have the authority to grant an injunction to restrain the collection of any national internal revenue tax, fee, or charge imposed by the NIRC.
- ♣ Exception: CTA may enjoin the collection of Internal Revenue taxes.

REQUISITES:

- there is a pending case before the CTA (ancillary remedy, not a main cause of action)
- Identify that the collection of tax is prejudicial to the interest of either the TP or government.

2. Period within which the government could collect (Secs. 203, 222, NIRC)

Assessment of Tax Liability

- ♣ Three (3) years from the following, whichever comes later:
 - The last day prescribed by law for filing the return
 - The day when the return was actually filed
- ♣ Ten (10) years after the discovery of the falsity, fraud or omission in case of:
 - False or fraudulent return with intent to evade tax, or
 - Failure to file a return
- ♣ Within the period agreed upon, when both the TP and the Commissioner have agreed in writing, before the expiration of the period in Sec. 203 for the assessment of the tax.

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- ♣ Revenue Adm. Order No. 10-95 specifically authorizes the Litigation and Prosecution section of the Legal Division of regional district offices to institute the necessary civil and criminal actions for tax collection. As the complaint filed in this case was signed by the BIR's Chief of Legal Division for Region 4 and verified by the Regional Director, there was, therefore, compliance with the law.
- ♣ Sec. 7 of NIRC, authorizes the BIR Commissioner to delegate the powers vested in him under the pertinent provision of the Code to any subordinate official with the rank equivalent to a division chief or higher.

CIR V. JAVIER, JULY 31, 1991 - There was no actual intentional fraud in filing the return. Private respondent's notation on the tax return was at most an error or mistake of fact or law not constituting fraud, an invitation for investigation and private respondent had literally "laid his cards on the table."

OVERVIEW OF REMEDIES

1. Tax Lien (Sec 219, NIRC)

- ♣ When a taxpayer neglects or refuses to pay his internal revenue tax liability after demand, the amount so demanded shall be a lien in favor of the government from the time the assessment was made by the Commissioner until paid with interest, penalties, and costs that may secure in addition thereto, upon all property and rights to property belonging to the taxpayer.
- ♣ Lien shall not be valid against any mortgagee, purchaser or judgment creditor until notice of such lien shall be filed by the Commissioner in the Register of Deeds of the province or city where the property of the taxpayer is located.
- ♣ A tax lien created in favor of the government is superior to all other claims and preferences, even

to that of a private litigant predicated on a court judgment.

Extinguishment of Tax Lien

1. Payment or remission of the tax
2. Prescription of the right of the government to assess or collect.
3. Failure to file notice of such lien in the office of register of Deeds, purchases or judgment creditor.
4. Destruction of the property subject to the lien.

NOTE:In Nos. 1 and 2, there is no more tax liability while under nos. 3 and 4, the taxpayer is still liable.

CIR V. NLRC, NOV. 09, 1994:A tax lien created in favor of the government is superior to all other claims and preferences, even to that of a private litigant predicated on a court judgment. The tax lien attaches not only from the service of the warrant of distraint of personal property but from the time the tax became due and payable.

2. Compromise

- ▲ CIR may compromise both civil and criminal liability of the taxpayer.

REQUISITES:

1. The taxpayer 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 the taxpayer as the case may be of the offer in the settlement of the original claim

Grounds for compromise

1. A reasonable doubt as to the validity of the claim against the taxpayer exists; or
2. The financial position of the taxpayer demonstrates a clear inability to pay the assessed tax

Cases that may be compromised

1. Delinquent accounts
2. Cases under administrative protest
3. Cases disputed before the courts
4. Cases for collection already filed in courts
5. Criminal violations except those already filed, and those involving fraud.

Cases that cannot be compromised

1. Withholding tax cases
2. Criminal tax fraud cases
3. Criminal cases already filed in court
4. Delinquent accounts with duly approved schedule of installment payments
5. Cases where reduction of payments had already been granted.
6. cases already decided and are final and executory

Compromise of criminal violation

- ▲ In criminal violations, the compromise must be made prior to the filing of the information in court.
- ▲ All criminal violations may be compromised except:
 1. those already filed in court; and
 2. Those involved in fraud.

Limitations:

1. Minimum compromise rate:
 - a. **10%** of the basic tax assessed – in case of financial incapacity.
 - b. **40%** of basic tax assessed – other cases.
2. Subject to approval of the Evaluation Board
 - a. When basic tax involved exceeds P1,000,000.00 **or**
 - b. Where settlement offered is less than the prescribed minimum rates.

Delegation of Power to Compromise

- ▲ **General Rule:** The power to compromise or abate shall not be delegated by the commissioner.
- ▲ **Exception:** The Regional Evaluation Board may compromise the assessment issued by the regional offices involving basic taxes of P 500,000.00 or less.

Remedy in case of failure to comply - The CIR may either:

- a. Enforce the compromise, or
- b. Regard it as rescinded and insists upon the original demand.

3. Distraint and/or Levy

4. Civil Action

5. Criminal Action

6. Forfeiture

- ▲ Implies a divestiture of property without compensation, in consequence of a default or offense.
- ▲ It includes the idea of not only losing but also having the property transferred to another without the consent of the owner and wrongdoer.

Effect: Transfer the title to the specific thing from the owner to the government.

When is forfeiture available?

- a. No bidder for the real property exposed for sale.
- b. If highest bid is for an amount insufficient to pay the taxes, penalties and costs.

Within two days thereafter, a return of the proceeding is duly made.

How enforced:

- a. In case of personal property – by seizure and sale or destruction of the specific forfeited property.
- b. In case of real property – by a judgment of condemnation and sale in a legal action or proceeding, civil or criminal, as the case may require.

When forfeited property to be destroyed or sold:

- a. To be destroyed – by order of the CIR when the sale for consumption or use of the following would be injurious to the public health or prejudicial to the enforcement of the law: (at least 20 days after seizure)
 1. distilled spirits
 2. liquors
 3. cigars
 4. cigarettes, and other manufactured products of tobacco
 5. playing cards
 6. All apparatus used in or about the illicit production of such articles.
- b. To be sold or destroyed – depends upon the discretion of CIR
 1. All other articles subject to exercise tax, (wine, automobile, mineral products, manufactured oils, miscellaneous products, non-essential items a petroleum products) manufactured or removed in violation of the Tax Code.
 2. Dies for printing or making IR stamps, labels and tags, in imitation of or purport to be lawful stamps, labels or tags.

Where to be sold:

- a. Public sale: *provided*, there is notice given not less than 20 days.
- b. Private sale: *provided*, it is with the approval of the Secretary of Finance.

Right of Redemption:

- a. Personal entitled – taxpayer or anyone for him
- b. Time to redeem – within one (1) year from forfeiture
- c. Amount to be paid – full amount of the taxes and penalties, plus interest and cost of the sale
- d. To whom paid – Commissioner or the Revenue Collection Officer
- e. Effect of failure to redeem – forfeiture shall become absolute.

NOTE: The Register of Deeds is duty bound to transfer the title of property forfeited to the government without necessity of an order from a competent court.

7. Suspension of Business Operations**8. Enforcement of Administrative Fines****ADMINISTRATIVE REMEDIES IN DETAIL**

- A. **DISTRAINT** - Seizure by the government of personal property, tangible or intangible, to enforce the payment of taxes, to be followed by its public sale, if the taxes are not voluntarily paid.

KINDS

- a. **Actual** – There is taking of possession of personal property out of the taxpayer into that of the government. In case of intangible property, taxpayer is also diverted of the power of control over the property.
- b. **Constructive** – The owner is merely prohibited from disposing of his personal property.

Difference between Actual and Constructive Distraint

Actual	Constructive
Made on the property only of a delinquent taxpayer.	May be made on the property of any taxpayer whether delinquent or not
There is actual taking or possession of the property.	Taxpayer is merely prohibited from disposing of his property.
Effected by having a list of the distraint property or by service or warrant of distraint or garnishment.	Effected by requiring the taxpayer to sign a receipt of the property or by leaving a list of same
An immediate step for collection of taxes where amount due is definite.	Such immediate step is not necessary; tax due may not be definite or it is being questioned.

Requisites:

1. Taxpayer is delinquent in the payment of tax.
2. Subsequent demand for its payment.
3. Taxpayer must fail to pay delinquent tax at time required.
4. Period within which to assess or collect has not yet prescribed.

When remedy not available: Where amount involved does not exceed P100. **Rationale:** In keeping with the provision on the abatement of the collection of tax as the cost of same might even be more than P100.

Procedure:

1. Service of warrant of distraint upon taxpayer or upon person in possession of taxpayer's personal property.

2. Posting of notice is not less than two places in the municipality or city and notice to the taxpayer specifying time and place of sale and the articles distrained.
3. Sale at public auction to highest bidder
4. Disposition of proceeds of the sale.

Who may effect distraint	Amount Involved
1. Commissioner or his duly authorized representative	In excess of P1,000,000.00
2. Revenue District Officer (RDO)	P1,000,000.00 or less but not less than P100

How Actual Distraint Effected

1. In case of Tangible Property:

- a. Copy of an account of the property distrained, signed by the officer, left either with the owner or person from whom property was taken, at the dwelling or place of business and with someone of suitable age and discretion
- b. Statement of the sum demanded.
- c. Time and place of sale.

2. In case of intangible property:

- a. Stocks and other securities - Serving a copy of the warrant upon taxpayer and upon president, manager, treasurer or other responsible officer of the issuing corporation, company or association.
- b. Debts and credits
 1. Leaving a copy of the warrant with the person owing the debts or having in his possession such credits or his agent.
 2. Warrant shall be sufficient authority for such person to pay CIR his credits or debts.
- c. Bank Accounts – garnishment
 1. Serve warrant upon taxpayer and president, manager, treasurer or responsible officer of the bank.
 2. Bank shall turn over to CIR so much of the bank accounts as may be sufficient.

How constructive Distraint Effected

1. Require taxpayer or person in possession to:
 - ▲ Sign a receipt covering property distrained
 - ▲ Obligate him to preserve the same properties.
 - ▲ Prohibit him from disposing the property from disposing the property in any manner, without the authority of the CIR.
2. Where Taxpayer or person in possession refuses to sign:
 - ▲ Officer shall prepare list of the property distrained.

- ▲ In the presence of two witnesses of sufficient age and discretion, leave a copy in the premises where property is located.

Grounds of Constructive Distraint

1. Taxpayer is retiring from any business subject to tax.
2. Taxpayer is intending to leave the Philippines; or
3. To remove his property there from.
4. Taxpayer hides or conceals his property.
5. Taxpayer acts tending to obstruct collection proceedings.

NOTE:

1. Bank accounts may be distrained without violating the confidential nature of bank accounts for no inquiry is made. BIR simply seizes so much of the deposit without having to know how much the deposits are or where the money or any part of it came from.
2. If at any time prior to the consummation of the sale, all proper charges are paid to the officer conducting the same, the goods distrained shall be restored to the owner.
3. When the amount of the bid for the property under distraint is not equal to the amount of the tax or is very much less than the actual market value of articles, the CIR or his deputy may purchase the distrained property on behalf of the national government.

Bar 2002 - BIR: Corporation: Distraint & Levy: On March 15, 2000, the BIR issued a deficiency income tax assessment for the taxable year 1997 against the Valera Group of Companies (Valera) in the amount of P10 million. Counsel for Valera protested the assessment and requested a reinvestigation of the case. During the investigation, it was shown that Valera had been transferring its properties to other persons. As no additional evidence to dispute the assessment had been presented, the BIR issued on June 16, 2000 warrants of distraint and levy on the properties and ordered the filing of an action in the Regional Trial Court for the collection of the tax. Counsel for Valera filed an injunctive suit in the Regional Trial Court to compel the BIR to hold the collection of the tax in abeyance until the decision on the protest was rendered.

A. Can the BIR file the civil action for collection, pending decision on the administrative protest? Explain. (3%) Yes, because there is no prohibition for this procedure considering that the filing of a civil action for collection during the pendency of an administrative protest constitutes the final decision of the Commissioner on the protest (**CIR v. Union Shipping Corp., 85 SCRA 548 [1990]**).

B. As counsel for Valera, what action would you take in order to protect the interest of your client? Explain your answer. (2%) I will wait for the filing of the civil action for collection and consider the same as an appealable decision. I will not file an injunctive suit

because it is not an available remedy. I would then appeal the case to the Court of Tax Appeals and move for the dismissal of the collection case with the RTC. Once the appeal to the CTA is filed on time, the CTA has exclusive jurisdiction over the case. Hence, the collection case in the RTC should be dismissed (**Tabes v. Flojo, 115 SCRA 278 [1982]**).

BAR 2002 - BIR; Distraint; Prescription of the

Action: Mr. Sebastian is a Filipino seaman employed by a Norwegian company which is engaged exclusively in international shipping. He and his wife, who manages their business, filed a joint income tax return for 1997 on March 15, 1998. After an audit of the return, the BIR issued on April 20, 2001 a deficiency income tax assessment for the sum of P250,000.00, inclusive of interest and penalty. For failure of Mr. and Mrs. Sebastian to pay the tax within the period stated in the notice of assessment, the BIR issued on August 19, 2001 warrants of distraint and levy to enforce collection of the tax.

A. What is the rule of income taxation with respect to Mr. Sebastian's income in 1997 as a seaman on board the Norwegian vessel engaged in international shipping? Explain your answer. (2%)

The income of Mr. Sebastian as a seaman is considered as income of a non-resident citizen derived from without the Philippines. The total gross income, in US dollars (or if in other foreign currency, its dollar equivalent) from without shall be declared by him for income tax purposes using a separate income tax return which will not include his income from business derived within (to be covered by another return). He is entitled to deduct from his dollar gross income a personal exemption of \$4,500 and foreign national income taxes paid to arrive at his adjusted income during the year. His adjusted income will be subject to the graduated tax rates of 1% to 3%. (*Sec. 21 (b), Tax Code of 1986[PD 1158], as amended by PD 1994*). [Note: The bar candidates are not expected to be familiar with tax history. Considering that this is already the fourth year of implementation of the Tax Code of 1997, bar candidates were taught and prepared to answer questions based on the present law. It is therefore requested that the examiner be more lenient in checking the answers to this question. Perhaps, an answer based on the present law be given full credit.]

B. If you are the lawyer of Mr. and Mrs. Sebastian, what possible defense or defenses will you raise in behalf of your clients against the action of the BIR in enforcing collection of the tax by the summary remedies of warrants of distraints and levy? Explain your answer. (3%) I will raise the defense of prescription. The right of the BIR to assess prescribes after three years counted from the last day prescribed by law for the filing of the income tax returns when the said return is filed on time. (Section 203, NIRC). The last day for filing the 1997 income tax return is April 15, 1998. Since the assessment was issued only on April 20, 2001, the BIR's right to assess has already prescribed.

E. LEVY OF REAL PROPERTY - an act of seizure of real property in order to enforce the payment of taxes. The property may be sold at public sale, if after seizure the taxes are not voluntarily paid.

NOTE: The requisites are the same as that of distraint.

Procedure:

1. International Revenue officer shall prepare a duly authenticated certificate showing
 - a. Name of taxpayer
 - b. Amount of tax and
 - c. Penalty due.
 - ♣ enforceable throughout the Philippines
2. Officer shall write upon the certificate a description of the property upon which levy is made.
3. Service of written notice to:
 - a. The taxpayer, and
 - b. RD where property is located.
4. Advertisement of the time and place of sale.
5. Sale at public auction to the highest bidder.
6. Disposition of proceeds of sale.

NOTE:The excess shall be turned over to owner.

Redemption of property sold or forfeited

- a. **Person entitled:** Taxpayer or anyone for him
- b. **Time to redeem:** one year from date of sale or forfeiture
 - ♣ Begins from registration of the deed of sale or declaration of forfeiture.
 - ♣ Cannot be extended by the courts.
- c. **Possession pending redemption:** owner not deprived of possession
- d. **Price:** Amount of taxes, penalties and interest thereon from date of delinquency to the date of sale together with interest on said purchase price at 15% per annum from date of purchase to date of redemption.

Difference between Distraint and Levy

Distraint	Levy
personal property	real property
forfeiture by government, not provided	forfeiture by government authorized where there is no bidder or the highest bid is not sufficient to pay the taxes, penalties and costs.
Taxpayer no given the right of redemption	Taxpayer can redeem properties levied upon and sold/forfeited to the government.

1. Both are summary remedies for collection of taxes.
2. Both cannot be availed of where amount involved is not more than P100.

NOTE:

1. It is the duty of the Register of Deeds concerned upon registration of the declaration of forfeiture, to transfer the title to the property with out of an order from a competent court
2. The remedy of distraint or levy may be repeated if necessary until the full amount, including all expenses, is collected.

F. GARNISHMENT

Bank Accounts – garnishment

1. Serve warrant upon taxpayer and president, manager, treasurer or responsible officer of the bank.
2. Bank shall turn over to CIR so much of the bank accounts as may be sufficient.

Bar 1998 - BIR: Garnishment: Bank Account of a Taxpayer: Is the BIR authorized to issue a warrant of garnishment against the bank account of a taxpayer despite the pendency of his protest against the assessment with the BIR or appeal with the Court of Tax Appeals? [5%]

Suggested answer: The BIR is authorized to issue a warrant of garnishment against the bank account of a taxpayer despite the pendency of protest (**Yabes v. Flojo, 15 SCRA 278**). Nowhere in the Tax Code is the Commissioner required to rule first on the protest before he can institute collection proceedings on the tax assessed. The legislative policy is to give the Commissioner much latitude in the speedy and prompt collection of taxes because it is in taxation that the Government depends to obtain the means to carry on its operations (**Republic u. Tim TianTeng Sons, Inc., 16 SCRA 584**).

Alternative answer: No, because the assessment has not yet become final, executory and demandable. The basic consideration in the collection of taxes is whether the assessment is final and unappealable or the decision of the Commissioner is final, executory and demandable, the BIR has legal basis to collect the tax liability by either administrative or judicial action.

JUDICIAL REMEDIES IN DETAIL

1. Period within which the action may be filed

Civil and Criminal Actions:

- a. Brought in the name of the Government of the Philippines.
- b. Conducted by Legal Officer of BIR
- c. Must be with the approval of the CIR, in case of action, for recovery of taxes, or enforcement of a fine, penalty or forfeiture.

CIVIL CASES (SECS 203,222,NIRC)

- * Three (3) years from the following, whichever comes later:
 - a. The last day prescribed by law for filing the return

- * b. The day when the return was actually filed
- * Ten (10) years after the discovery of the falsity, fraud or omission in case of:
 - a. False or fraudulent return with intent to evade tax, or
 - b. Failure to file a return
- * Within the period agreed upon, when both the TP and the Commissioner have agreed in writing, before the expiration of the period in Sec. 203 for the assessment of the tax.

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) RTC, Mun. TC, Metro TC- where the principal amount of taxes and fees, exclusive of charges and penalties claimed is less than P1,000,000.00 (Sec 7[c], RA 9282)

- * The approval of the CIR is essential in civil cases (Sec. 220). However under Sec. 7 of NIRC, the Commissioner may delegate such power to a Regional Director.
- * Actions instituted by the government to collect internal revenue taxes in regular courts (RTC or MTCs, depending on the amount involved). It includes filing by the government with the probate court claims against the deceased taxpayer.
- * Resorted to when the tax liability becomes final and unappealable, or when the decision of the Commissioner becomes final or executory. When:
 - * A tax is assessed and the assessment becomes final and unappealable because the taxpayer fails to file an administrative protest with the BIR within 30 days from the receipt of the assessment.
 - * When an administrative protest filed by the taxpayer against the assessment is denied, in whole and in part or is not acted upon within 180 days from submission of the documents, and
 - * The taxpayer adversely affected by the decision or inaction fails to file an appeal with the CTA within 30 days from receipt of said decision or from the lapse of the 180 day period.

CRIMINAL CASES (TITLE X, NIRC; SEC. 281, NIRC)

- * All violations of any provision of the tax code shall prescribe after five (5) years.

NOTE: When should it commence: The five (5) year prescriptive period shall begin to run from the

- a. *If known*, day of the commission of the violation.

- b. *If not known*, from the time of discovery and the institution of judicial proceeding for its investigation and punishment.

When is it interrupted:

- a. When a proceeding is instituted against the guilty person
b. When the offender is absent from the Philippines.

When should it run again: When the proceeding is dismissed for reason not constituting jeopardy.

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 P1, 000,000.00 and above.
2) RTC, Mun. TC, Metro TC- 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 P1,000,000.00 or where there is no specified amount claimed (Sec 7[b], RA 9282)

Bar 2002 - BIR: Prescriptive Period; Criminal

Action: TY Corporation filed its final adjusted income tax return for 1993 on April 12, 1994 showing a net loss from operations. After investigation, the BIR issued a pre-assessment notice on March 30, 1996. A final notice and demand letter dated April 15, 1997 was issued, personally delivered to and received by the company's chief accountant. For willful refusal and failure of TY Corporation to pay the tax, warrants of distraint and levy on its properties were issued and served upon it. On January 10, 2002, a criminal charge for violation of the Tax Code was instituted in the Regional Trial Court with the approval of the Commissioner. The company moved to dismiss the criminal complaint on the ground that an act for violation of any provision of the Tax Code prescribes after five (5) years and, in this case, the period commenced to run on March 30, 1996 when the pre-assessment was issued. How will you resolve the motion? Explain your answer. (5%)

Suggested answer: The motion to dismiss should not be granted. It is only when the assessment has become final and unappealable that the 5-year period to file a criminal action commences to run (**Tupaz v. Ulop, 316 SCRA 118 [1999]**). The pre-assessment notice issued on March 30, 1996 is not a final assessment which is enforceable by the BIR. It is the issuance of the final notice and demand letter dated April 15, 1997 and the failure of the taxpayer to protest within 30 days from receipt thereof that made the assessment final and unappealable. The earliest date that the assessment has become final is May 16, 1997 and

since the criminal charge was instituted on January 10, 2002, the same was timely filed.

Bar 2002 - BIR: Extinction; Criminal Liability of the

Taxpayer: Mr. Chan, a manufacturer of garments, was investigated for failure to file tax returns and to pay taxes for the taxable year 1997. Despite the *subpoena duce tecum* issued to him, he refused to present and submit his books of accounts and allied records. Investigators, therefore, raided his factory and seized several bundles of manufactured garments, supplies and unpaid imported textile materials. After his apprehension and based on the testimony of a former employee, deficiency income and business taxes were assessed against Mr. Chan on April 15, 2000. It was then that he paid the taxes. Criminal action was nonetheless instituted against him in the Regional Trial Court for violation of the Tax Code. Mr. Chan moved to dismiss the criminal case on the ground that he had already paid the taxes assessed against him. He also demanded the return of the garments and materials seized from his factory. How will you resolve Mr. Chan's motion? (5%)

Suggested answer: The motion to dismiss should be denied. The satisfaction of the civil liability is not one of the grounds for the extinction of criminal action (**People v. Ildefonso Tierra, 12 SCRA 666 [1964]**). Likewise, the payment of the tax due after apprehension shall not constitute a valid defense in any prosecution for violation of any provision of the Tax Code (Sec. 253[a], NIRC). However, the garments and materials seized from the factory should be ordered returned because the payment of the tax had released them from any lien that the Government has over them.

Bar 2002 - BIR: Prescriptive Period: Civil Action:

On August 5, 1997, Adamson Co., Inc. (Adamson) filed a request for reconsideration of the deficiency withholding tax assessment on July 10, 1997, covering the taxable year 1994. After administrative hearings, the original assessment of P150,000.00 was reduced to P75,000.00 and a modified assessment was thereafter issued on August 05, 1999. Despite repeated demands, Adamson failed and refused to pay the modified assessment. Consequently, the BIR brought an action for collection in the Regional Trial Court on September 15, 2000. Adamson moved to dismiss the action on the ground that the government's right to collect the tax by judicial action has prescribed. Decide the case. (5%)

Suggested answer: The right of the Government to collect by judicial action has not prescribed. The filing of the request for reconsideration suspended the running of the prescriptive period and commenced to run again when a decision on the protest was made on August 5, 1999. It must be noted that in all cases covered by an assessment, the period to collect shall be five (5) years from the date of the assessment but this period is suspended by the filing of a request for reconsideration which was acted upon by the Commissioner of Internal Revenue (**CIR v. Wyeth Suaco Laboratories, Inc., 202 SCRA 125 [1991]**).

Bar 2005 - BIR; Consequence; Taxpayer guilty of

Tax Evasion: Jose agreed to sell his condominium unit to

Jess for P2.5 Million. At the time of the sale, the property had a zonal value of P2.0 Million. Upon the advice of a tax consultant, the parties agreed to execute two deeds of sale, one indicating the zonal value of P2.0 Million as the selling price and the other showing the true selling price of P2.5 Million. The tax consultant filed the capital gains tax return using the deed of sale showing the zonal value of P2.0 Million as the selling price. Discuss the tax implications and consequences of the action. (5%)

Alternative answer: The action of the parties constitutes tax evasion and exposes Josel to:

(1) DEFICIENCY FINAL INCOME TAX on the sale of real property in the Philippines classified as a capital asset. Under Sec. 24(D) of the NIRC, the final tax of six percent (6%) shall be based on the gross selling price of P2.5 Million or zonal value of P2.0 Million, whichever is higher, i.e., P2.5 Million;

(2) FRAUD PENALTY amounting to 50% surcharge on the amount evaded (Sec. 248[B], NIRC); and

(3) DEFICIENCY INTEREST of 20% per annum on the deficiency. (Sec. 249[A][B], NIRC)

Alternative answer: There is tax evasion because of the concurrence of the following factors: 1) The payment of less than that known by the taxpayer to be legally due, or the non-payment of tax when it is shown that a tax is due. It is evident that the parties that the tax due should be computed based on the valuation of P2.5 million and not P2.0 million; 2) An accompanying state of mind which is described as being "evil" or "bad faith," "willful," or "deliberate and not accidental." Despite the above knowledge, the parties deliberately misrepresented the true basis of the sale; and 3) A course of action or failure of action which is unlawful. This is shown by the preparation of the two deeds of sale which showed different values. **(Commissioner of Internal Revenue v. The Estate of Benigno P. Tbdá, Jr., G.R. No. 147188, September 14, 2004)** The tax evasion committed should result to the imposition of a 50% fraud surcharge on the amount evaded (Sec. 248[B], NIRC) payment of the Deficiency Tax, and interest of 20% per annum on the deficiency. (Sec. 249[A][B], NIRC) The parties may likewise be subject to criminal prosecution for willfully failing to pay the tax, as well as for filing a false and fraudulent return.

(Sees. 254, 255 and 257, NIRC)

EFFECTS OF FAILURE TO PAY THE TAX ON TIME: ADDITIONS TO THE TAX (CHAPTER I, TITLE X, NIRC)

1. SURCHARGES- a civil penalty imposed by law as an addition to the main tax required to be paid. It is not a criminal penalty but a civil administrative sanction provided primarily as safeguard for the protection of the State revenue and to reimburse the government for the expenses of investigation and the loss resulting from the taxpayer's fraud. A surcharge added to the main tax is subject to interest.

- a. ORDINARY (SEC. 248A, NIRC)

Penalty: 25% of the amount due, in addition to the tax required to be paid

- a. Failure to file any return and to pay the tax due thereon as required by the NIRC or rules.
- b. Filing a return with an internal revenue officer other than those with whom the return is required to be filed. Not authorized officer.
- c. Failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment.
- d. Failure to pay the full or part of the amount of tax shown on any return, 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.

- b. FRAUD PENALTY (SEC. 248B, NIRC)

Penalty: 50% of the amount due, in addition to the tax required to be paid

- a. In case of willful neglect to file the return within the period prescribed by the NIRC or rule.
- b. In case a false or fraudulent return is willfully made.

CASE: CIR V. JAVIER, JULY 31, 1991 - There was no actual intentional fraud in filing the return. Private respondent's notation on the tax return was at most an error or mistake of fact or law not constituting fraud, an invitation for investigation and private respondent had literally "laid his cards on the table."

2. INTEREST- This is an increment on any unpaid amount of tax assessed at the rate of 20% *per annum* or such higher rate as may be prescribed by the regulations from the date prescribed for payment until the amount is fully paid.

Classes of interest

- 1. Deficiency interest
- 2. Delinquency interest
- 3. Interest on extended payment

Deficiency interest - Any deficiency in the tax due shall be subject to the interest of 20% *per annum* which shall be assessed and collected from the date prescribed for its payment until the full payment thereof.

When delinquency interest imposed? Delinquency interest is imposed in case of failure to pay:

- 1. The amount of the tax due on any return required to be filed; or
- 2. The amount of tax due for which no return is required; or

3. A deficiency tax or any surcharge or interest thereon on the issue date appearing in the notice and demand of the Commissioner.
- ♣ Rate is 20% *per annum* until the amount is fully paid which interest shall form part of the tax.

Interest on Extended Payment.

1. any person who is qualified and elects to pay the tax on installment but fails to pay the tax, or any installment, or any part on or before the date prescribed; or
2. where the Commissioner has authorized an extension of time within which to pay a tax or a deficiency tax or any part thereof,
3. From the date of notice and demand until it is paid.

Compromise Penalty

1. It is a certain amount of money which the taxpayer pays to compromise a tax violation.
2. It is pain in lieu of a criminal prosecution.
3. Since it is voluntary in character, the same may be collected only if the taxpayer is willing to pay them.

Failure to File Certain Information Returns (Sec. 250, NIRC)

- a. Penalty: **P 1,000 for each failure**
- b. The aggregate amount for all such failure shall **not exceed P 25,000** during a calendar year
- c. Upon notice and demand by the Commissioner
- d. Unless it is shown that such failure is due to reasonable cause and not to willful neglect.

Bar 1995 - BIR: Unpaid Taxes vs. Claims for Unpaid Wages: For failure of Oceanic Company, Inc. (OCEANIC), to pay deficiency taxes of P20 Million, the Commissioner of Internal Revenue issued warrants of distraint on OCEANIC's personal properties and levied on its real properties. Meanwhile, the Department of Labor through the Labor Arbiter rendered a decision ordering OCEANIC to pay unpaid wages and other benefits to its employees. Four barges belonging to OCEANIC were levied upon by the sheriff and later sold at public auction. The Commissioner of Internal Revenue filed a motion with the Labor Arbiter to annul the sale and enjoin the sheriff from disposing the proceeds thereof. The employees of OCEANIC opposed the motion contending that Art. 110 of the Labor Code gives first preference to claims for unpaid wages. Resolve the motion. Explain.

Suggested answer: The motion filed by the Commissioner should be granted because the claim of the government for unpaid taxes are generally preferred over the claims of laborers for unpaid wages. The provision of Article 110 of the Labor Code, which gives laborers' claims for preference applies only in case of bankruptcy or liquidation of the employer's business. In the instant case, Oceanic is not under bankruptcy or liquidation at the time the warrants of distraint and levy were issued hence, the

opposition of the employees is unwarranted. (**CIR vs. NLRC et al G.R. No. 74965, November 9, 1994**).

LOCAL GOVERNMENT TAXATION

Section 128 –196 of the Local Government Code of 1991 (RA 7160)

Constitutional Basis: Each local government unit shall have the power:

1. to create its own sources of revenue and
 2. to levy taxes, fees, and charges
 - a. subject to such guidelines and limitations as the Congress may provide
 - b. Consistent with the basic policy of local autonomy.
 - c. Such taxes, fees, and charges shall accrue exclusively to the local government (*Sec 5, Art X, Consti*)
- ♣ The power to tax which may be exercise by local legislative bodies is no longer merely by nature of a valid delegation as before but pursuant to direct authority conferred by Sec. 5, Art X of the Constitution (*MactanCebyIntn'l Airport vs Marcos, G.R. No. 120082, Sept 11, 1996*)
 - ♣ 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 power (*MERALCO vs Prov. of Laguna, G.R. No 131359, May 5, 1999*)

Grant of Local Taxing Authority Under Existing Law

- ♣ *Power to Create Sources of Revenue* - Each local government unit shall exercise its power to create its own sources of revenue and to levy taxes, fees, and charges subject to the provisions herein, consistent with the basic policy of local autonomy. Such taxes, fees, and charges shall accrue exclusively to the local government units (*Sec. 129, LGC*)
- ♣ Along with the power to levy taxes, local governments also have the power to:
 1. Prescribe penalties for tax violations (*Sec. 516, LGC*)
 2. Grant Local Tax Exemptions (*Sec. 192, LGC*)
 3. Adjust Local Tax Rates (*Sec. 191, LGC*)

DUAL STATUS OF LOCAL GOVERNMENTS

1. **In their public or governmental aspect**-They are agents of the state and for that purpose exercise by delegation a part of the sovereignty of the state such as in the imposition and collection of taxes,

preservation of peace and order, and the establishment of schools; and

2. **In their private or corporate aspect-** They are mere legal entities (similar to a business corporation) performing functions not strictly governmental. They act for their own purpose and not as subdivisions of the state. It is in this character that they operate; such as public utilities and public markets

TAXING POWER OF THE LOCAL GOVERNMENT:

- ♣ **Not Inherent** – Unlike a sovereign state, municipal corporations have no inherent power to tax. Being mere creatures of law, they may exercise the power only if delegated to them by the national legislature or conferred by the Constitution itself.
- ♣ **Limitations of Local Tax Power** – Sec. 5, Art X of the Constitution sought to safeguard the viability and self-sufficiency of local government units. It expressly provides the power to be subject to such limitations and guidelines as the Congress may provide.
 1. The taxpayer will not be over-burdened with unreasonable impositions
 2. Local taxation is to be fair, uniform and just.
 3. Each LGU will have its fair share of available resources

ASPECTS

1. Local Government Taxation – Levy of taxes, fees, charges and other impositions.
2. Real Property Taxation - Levy on real property imposed on a countrywide basis but authorizing to a limited extent and within certain parameters.

FUNDAMENTAL PRINCIPLES(Sec 130, LGC)

1. Taxation shall be uniform in each LGU
 2. Taxes, fees, charges and other impositions shall be:
 - a. Equitable and based on the taxpayer's ability to pay.
 - b. For public purpose.
 - c. Not unjust, excessive, oppressive or confiscatory.
 - d. Not contrary to law, public policy, national economic policy, or in restraint of trade.
 3. Not let to any private person
 4. Not inure solely to the local government levying
 5. Each LGU shall, as far as practicable, evolve a progressive system of taxation.
- ♣ **Uniformity of Taxation** – Equality and uniformity of local taxation is that all taxable articles of the same class shall be taxed at the same rate within the same territorial jurisdiction of the taxing authority.

- ♣ **Public Purpose** – Proceeds obtained are to be used to support the existence of the LGU.
- ♣ **Just Taxation** – Municipal corporations are allowed a wide range in determining tax rates of imposable taxes and license fees.

COMMON REVENUE-RAISING POWERS

Local governments are authorized to impose and collect the following charges:

1. Reasonable fees and charges for services rendered (*Sec. 153, LGC*)
2. Public Utility Charges if:
 - a. Owned, operated and maintained
 - b. Within their jurisdiction (*Sec. 154, LGC*)
3. Tools, Fees or Charges for:
 - a. Use of public road, pier or wharf, waterway bridge, ferry or telecommunication system
 - b. Funded and constructed by the local government (*Sec. 155, LGC*)

Common Limitations on the Taxing Power of LGU -

Unless otherwise provided herein, the exercise of the taxing power of provinces, cities, municipalities, and baranggays shall not extend to the levy of the following:

1. Income tax - Exception: banks and other financial institutions.
2. Documentary Stamp Tax
3. Tax on estates, inheritance, gifts, legacies and other acquisitions mortis causa. Exception: tax on transfer of real property ownership.
4. Excise taxes on articles enumerated under the NIRC, as amended, and taxes, fees or charges on petroleum products.

Taxable Articles embodied in the NIRC are:

- 1) Alcoholic products
 - 2) Tobacco products
 - 3) Petroleum products
 - 4) Miscellaneous articles
 - 5) Mineral products
- ♣ Local governments can tax the selling of these finished products or the raw materials.
 - 5. Percentage or VAT on sales, barter or exchanges or similar transactions on goods or services exchanges or similar transactions on goods or services except as otherwise provided herein.

Percentage of taxes – imposed when there is set of ratio between the amount of tax and the volume of sales.

6. Taxes on the gross receipts of transportation of contractors and persons engaged in the transportation of passengers or freight by hire and

common carriers by air, land or water except as provided by the code.

On the other hand, transportation contractors including persons who transport passengers for hire and other domestic carriers by land, air or water for transport of passengers, except owners of bancas and owners of animal drawn two-wheeled vehicle are subject to 3% percentage tax on their gross quarterly receipt (Sec 117, 1997 NIRC)

Sec 117 of NIRC, also, specifies that the gross receipt of common carriers derived from their incoming and outgoing freight shall not be subjected to local taxes imposed under LGC.

7. Taxes, fees and charges imposed under the Tariff and Customs Code and other Special Laws.
8. Customs duties, registration fees of vessels and wharfage on wharves, tonnage dues and all other kinds of customs fees, charges and due except wharfage on wharves constructed and maintained by LGU concerned.
9. Taxes, fees and charges and other Impositions which contravene Existing Government Policies or which are Violative of the Fundamental Principles of Taxation.
10. Taxes, fees, and charges and other impositions upon goods carried into or out of, or passing through, the territorial jurisdiction of LGU in the guise of charges for wharfage, tolls for bridges or otherwise, or other taxes, fees or charges in any form whatever upon such goods or merchandise.
11. Taxes, fees, or charges on agricultural and aquatic products when sold by marginal farmers or fishermen.
12. Taxes on business enterprises certified to by the Board of Investment as pioneer or non-pioneer who enjoy tax holidays for a period of 6 and 4 years, respectively from the date of registration.

Tax holidays refer to exemption from income tax only.

13. Taxes on premiums paid by way of reinsurance or retrocession.
14. Taxes, fees or other charges on Philippine products actually exported, excepted otherwise provided herein in the LGC.
15. Taxes, fees or charges on Countryside and Barangay Business Enterprises and Cooperative

duly registered under RA No. 6810 and RA 6938 otherwise known as the Cooperative Code of the Phil. Respectively.

16. Taxes, fees or charges of any kind on the National Government, its agencies and instrumentalities and LGU.
17. Taxes, fees, and charges imposed under special laws.
18. Taxes, fees or charges for registration of motor vehicles.

Exception: Tricycles

SPECIFIC TAX POWERS OF LGU'S

A. TAXING AND OTHER REVENUE – RAISING POWERS OF PROVINCES AND CITIES

Scope of Power

1. Tax on the transfer of real property ownership (Sec. 135, LGC)
2. Tax on the business of printing and publication (136, LGC)
3. Franchise tax (137, LGC)
4. Tax on sand, gravel and quarry resources (138, LGC)
5. Professional tax (139, LGC)
6. Amusement tax (140, LGC)
7. Annual fixed tax per delivery truck or van of manufacturers or producers and wholesalers of, or dealers in certain products (141, LGC)

TAX ON TRANSFER OF REAL PROPERTY OWNERSHIP

Real Property – Refers only to lands, buildings, and machineries intended by the owner of the land or building for an industry or works which may be carried on in a building or on a piece of land and which tend directly to meet the needsof the industry or works.

Transaction taxed - sale, barter, or any other mode of transferring ownership of, or title to, real property.

Rate – At not more than 50% of 1% total consideration.

Tax base –

- 1) total consideration or
- 2) fair market value, whichever is higher

Exception from tax – The sale, transfer or other disposition of real property pursuant to RA 6657

(Comprehensive Agrarian Reform Law) is exempt from tax

TAX ON BUSINESS OF PRINTING AND PUBLICATION

Transaction taxed – business of printing and publication of books, cards, posters, leaflets, handbills, certificates, receipts, pamphlets, and other similar nature

Tax Rate – Not exceeding 50% of 1% of the gross annual receipts for the preceeding calendar year, in the case of newly started business, not to exceed 1/20 of 1% of the capital investment

Exception – The receipts from the printing and/ or publishing of books or other reading materials prescribed by the DECS as school text or references are not subject to the tax imposed

FRANCHISE TAX

Franchise – Generally refers to a privilege conferred by the government on an individual or corporation, which does not belong to the citizens by common right

Purpose of Franchise Tax – to be in addition to the franchise tax imposed by the national government on business which are holders of franchise except when otherwise prohibited by law (Sec 267 (b) NIRC)

Tax Rate – not exceeding 50% of 1% , if newly started business, 1/20 of 1 %

Tax base – gross annual receipts of preceeding calendar year based on:

- a) Incoming receipts, or
- b) Realized within territorial jurisdiction.

SAND AND GRAVEL TAX

Tax Rate – not more than 10% of fair market value

Issuance of Permit – To permit to extract the sand, gravel and other quarry resources shall be issued exclusively by the provincial governor pursuant to the ordinance of the sangguniangpanlalawigan

Distribution of the Proceeds – The proceeds of the tax shall be distributed as follows

- a) Province – 30%
- b) Component city or municipality where the sand, etc are extracted – 30%
- c) Barangay where the sand, etc. are extracted – 40%

PROFESSIONAL TAX

Tax rate – in such as Sanggunian may determine in no case to exceed P300

Profession – a calling w/c requires the passing of an appropriate government board or bar examination, such as the practice of law, medicine, public accounting, engineering, etc.

Nature of Tax – Professional tax applies only to natural or physical persons and not to juridical entities. Said tax is fixed on the privilege of exercising or engaging in a profession. The tax is not based on the amount of earnings of the taxpayer

When paid – on or before Jan. 20

Where: paid on the place where you practice your profession

♣ Government employees are exempted from paying Professional's Tax.

AMUSEMENT TAX

Amusement – Pleasurable diversion and entertainment

Amusement Place – Includes theaters, cinemas, concert halls, circuses and other places of amusement where one seeks admission to entertain himself by seeing or viewing the show or performance (Sec 131c, LGC)

Tax Rate – not more than 30% of the gross receipt from admission fees

Exemption – operas, concerts, dramas, recitals, painting and art exhibitions, flower shows, musical programs, literary and oratorical presentation.

Exceptions to exemption – pop, rock, or similar concert.

TAX PER DELIVERY TRUCK OR VAN OF CERTAIN MANUFACTURERS, PRODUCERS, ETC.

Transaction taxed – use of truck, van vehicle in the delivery or distribution of distilled spirits, fermented liquors, softdrinks, cigar and cigarettes and other products, determined by the Sanggunian to sales outlets or consumers.

Tax rate – not exceeding P500 for every truck, van or any vehicle used

Exemption – exempt from tax on peddlers.

B. TAXING AND OTHER REVENUE RAISING POWERS OF MUNICIPALITIES

Municipality may levy taxes, fees and charges not otherwise levied by provinces and cities

Municipal Taxes – Municipalities may impose taxes on the following business (Sec 143, LGC)

1. Manufacturers, assemblers, repackers of liquors, distilled spirits and wines
2. Rate: At graduated annual fixed tax based on gross sales or receipts for the preceding calendar year in an amount not to exceed P6.5 M or more, a rate not exceeding 37 ½ of 1% is imposed
3. Wholesalers, distributors or dealers in any article of Commerce

Rate: Graduated annual fixed rate based on gross sales or receipts not exceeding P2M or more, the rate not exceeding 50% of 1%

4. Exporters, manufacturers, millers, producers of essential commodities

Rate: Not exceeding ½ of the rates prescribed in (a) and (b)

5. Contractors and other independent contractors

Rate: Graduated annual fixed rate when the gross receipts exceeds P2M the rate is not exceeding 50% of 1%

6. Banks and other financial institutions

Rate: Not exceeding 50% of 1% on the gross receipts of preceding calendar year

7. Peddlers

Rate: Not exceeding 50% per peddler annually

8. Any business not otherwise specified
Rate: As the Sanggunian may deem proper. When subject to excise, VAT or percentage tax, it shall not exceed 2% of gross receipts of the preceding calendar year

C. TAXING AND OTHER REVENUE RAISING POWERS OF CITIES

Cities are authorized specifically to impose taxes, fees and charges that provinces and municipalities may levy

Rate: That may be above the maximum established for provinces and municipalities but not exceeding 50% of such maximum rates except the rates of professional and amusement taxes.

D. TAXING AND OTHER REVENUE RAISING POWERS OF BARANGAYS (SEC 151 LGC)

- 1) Taxes on stores / retailers with fixed business establishment with gross sales or receipts of the preceeding calendar year of P50,000 or less in the cities & municipalities

Rate: Not exceeding 1% on such gross sales or receipts

- 2) Service Fees/ Charges – it may collect reasonable fees or charges for services rendered in connection with the regulation or the use of barangay owned property or service facilities

- 3) Barangay Clearance – no city municipality may issue any license/ permit for any business / activity is located. For such clearance, the sangguniangbrgy. May impose reasonable fee.

- 4) Other fees & charges – the brgy. May levy reasonable fees & charges:

- a) On commercials breeding of fighting cocks & cockpits;
- b) On places of recreation w/c charge admission fees; and
- c) On billboards, signs boards, neon signs and outdoor advertisement

Some Rules to Consider

- a) A revenue measure may only be imposed through an appropriate ordinances and require prior to its enactment a public hearing (Sec 132, LGC)

- b) The legislative intendment appears to limit provinces and municipalities, respectively, to the imposition of taxes that the other may levy under its specific authority

- c) Power to adjust local taxes – LGU are given authority to adjust the tax rates, but the adjustment should be made not oftener than once every 5 years but in no case shall the adjustment exceed 10% of the rates fixed under the LGC 10% of the rates fixed under the LGC (Sec 191, LGC)

- d) The interpretation of laws on the grant of tax powers to local government is to be liberally construed but doubts on the liability of a taxpayer under a valid tax ordinance is construed strictly against LGU, except as regards tax exemptions, incentives or reliefs (Sec 5, LGC)

- e) Residual Taxing Powers of Local Governments – Local governments can also impose those taxes,

fees and charges w/c do not fall within the scope of taxes w/c are enumerated under the LGC, as well as those w/c are levied on subjects or bases w/c are not taxed under the NIRC or other applicable laws (Sec 186, LGC)

- f) Peemtion or Exclusionary Rule – Instances wherein the National Government elects to tax a particular area, impliedly withholding from the local government the delegated power to tax the same field (*Victoria Milling vs Municipality of Victrorias, Negros Occidental; L-21183, Sept. 27, 1968*)

COMMUNITY TAX

Nature: The community tax, w/c replaced the residence tax, is essentially a poll or capitalization tax. It is of fixed amount imposed upon certain inhabitants of the Phil. Without regard to the property/ occupation in w/c they may be engaged.

Who are authorized to levy – cities or municipalities may levy a community tax, as well as the rates & accrual of the proceeds thereof. (Sec 156, LGC)

Persons liable to tax

- 1) Individuals – Rate: P5.00 an annual additional tax of P1.00 for every P1,000 income regardless of whether from business, exercise of profession or from property w/c in no case shall exceed P5,000
- 2) Corporations - Rate: Annual community tax of P500 and an annual additional tax w/c in no case shall exceed P10,000

Exemptions from the Tax Community

- 1) Diplomatic and consular representatives and
 - 2) Transient visitors when their stay in the Phil. Does not exceed 3 mos.
- ♣ Estates of deceased persons, being neither corporations nor individuals, are not subject to the tax, but the heirs must declare their proportionate shares of their income.
 - ♣ **Community Tax Certificate** – shall be issued to every person or corporation upon payment of the community tax. It may also be issued to any corporation / person not subject to the community tax upon payment of P1.00 (Sec 162 LGC)

COLLECTION OF TAXES

Tax Period & Manner of Payment

- 1) Unless otherwise provided in the LGC, the tax period of all local taxes, fees and charges shall be the calendar year
- 2) Such, taxes, fees and charges may be paid in quarterly installments (165, LGC)

Accrual of Taxes

- 1) Unless otherwise provided in the Code, all local taxes, fees and charges shall accrue on the 1st day of January of each year.
- 2) New taxes, fees or charges or changes in the rates thereof, shall accrue on the 1st day of the quarter next following the effectively of the ordinance imposing such new rates (Sec 166, LGC)

Time of Payment

- ♣ Unless otherwise provided in the Code, all local taxes, fees & charges shall be paid within the first 20 days of January or of each subsequent quarter.
- ♣ The sanggunian concerned may, for a justifiable reason or cause, extend the time for payment of such charges but only for a period not exceeding 6 months (Sec 167, LGC)
- ♣ Surcharges & penalties on unpaid taxes, fees or charges
- ♣ The Sanggunian may impose a surcharge not exceeding 27% of the amount of taxes, fees or charges not paid on time and an interest at the rate not exceeding 2% per month of unpaid taxes, fees or charges including surcharges, until such amount is fully paid
- ♣ In no case shall the total interest on the unpaid amount or portion thereof exceed 36 mos (Sec 168, LGC)

Civil Remedies for Collection

1) Local Government's lien

2) Administrative action

- a. Distriant of goods, chattels or effects and other personal property of whatever character
- b. Levy upon real property and interest in or rights to real property

3) Judicial Action

- ♣ Either of these remedies or all may be pursued concurrently or simultaneously at the descretion of local government unit concerned (Sec 174, LGC)

Local Government's lien

1. Superior to all items, charges or encumbrances in favor of any person, enforceable by the administrative of judicial action

2. Covers not only property or rights subject to the lien but also upon property used in business.

Distrain of Personal Property

- 1) Seizure
 - a. Upon failure to pay at the time required
 - b. Local Treasurer upon written notice
 - c. Duly authenticated certificate of delinquency serves as warrant
 - d. Subject to claim of exemption
- 2) Accounting of distraint goods
- 3) Publication of sale
 - * Not less than three public and conspicuous places in the local government's territory where distraint is made.
 - * Sale not less than 20 days after notice of publication
- 4) Procedure of sale
 - a) Public auction
 - b) Highest Bidder for cash
 - c) Within 5 days after sale, treasurer reports to the Chief Executive of the LGU the proceeding
 - d) Property not disposed within 120 days from distraint, considered sold to LGU for the amount assessed by the Committee on Appraisal which is composed of:
 - i. Chairman – Local Treasurer
 - ii. Members – COA Representative and Local Assessor

LEVY ON REAL PROPERTY

1. Levy

- a) After expiration of the period required to pay
- b) Treasurer prepare duly authenticated certificate of delinquency with force of legal execution
- c) Made by writing on the certificate the description of the property levied
 - i. Mailed to Assessor
 - ii. Mailed to Register of Deeds who annotates the levy
 - iii. Mailed to delinquent taxpayer
- d) Time of levy
 - i. Before distraint
 - ii. Simultaneous with distraint
 - iii. After distraint

2. Advertisement for Sale

- a) Within 30 days after levy
- b) Publicly effected by:
 - i. Main entrance of Municipal Hall or City hall
 - ii. Public and Conspicuous place in barangay where real property located
- * Publication once a week for 3 consecutive weeks in a newspaper of general circulation in the province, city or municipality where property is located

3. Sale Procedure

- a) Made after completion of advertisement

- b) Delinquent taxpayer fails to pay
- c) Held at the main entrance of the provincial, city or any other place as determined by the Treasurer. If no sufficient bidder, Treasurer purchase for the government.

4. Redemption of Property

- a) Within 1 year from the date of sale
- b) During redemption period, owner is entitled to possession.

Judicial Action

- 1) In any court of competent jurisdiction
- 2) Filed by local Treasurer
- 3) Within 5 years from the date taxes, fees or charges become due

PRESCRIPTION OF COLLECTION LOCAL TAXES

- 1) Prescriptive period of assessment – within five years from the date they become due.

In case of fraud of intent to evade payment – within 10 years

- 2) Prescriptive period of collection – within 5 years from the date of assessment by administrative or judicial action.
- 3) Suspension of the running of the prescriptive Period -
 - a. Treasurer legally prevented from the making of the assessment or collection
 - b. Taxpayer requests for reinvestigation and executes waiver in writing
 - c. Taxpayer out of the country
 - d. Taxpayer cannot be located

TAXPAYER'S REMEDIES

1. Remedies prior to an Assessment

- a. Administrative appeal to the Secretary of Justice; and
- b. Action for declaratory relief as and when applicable

2. Remedies after an Assessment

- a. Protest of the assessment
- b. An action for refund

Protest by Means of Appeal to the Secretary of Justice -

- a. Any question on the constitutionality or legality of tax ordinances or revenue measures may be raised on appeal within 30 days from the effectivity thereof to the Secretary of Justice.
- b. Secretary shall render decision within 60 days from the date of receipt of the appeal.

- * Such appeal shall not have the effect of suspending the effectivity of the tax

ordinance and the accrual of payment of the tax, fee or charge levied therein.

- c. Within 30 days after receipt of decision or the lapse of the 60 day period without the Secretary acting on the appeal, the aggrieved party may file appropriate proceedings with a court of competent jurisdiction
 - ♣ The appeal from the decision of the Secretary of Justice is filed with the regular court. The CTA has no jurisdiction over said appeal

Protest against Assessment

- a. Assessment made by the local Treasurer
- b. Taxpayer has 60 days from receipt to file written protest with Treasurer, otherwise it shall become final and executor
- c. Treasurer has 10 days within which to decide:
 - ♣ Treasurer cancels assessment
 - ♣ Treasurer denies protest
- d. Taxpayer appeals within 30 days after receipt of denial
- e. Treasurer does not act within 60 days, Taxpayer has 30 days from the lapse of 60 days to appeal.

Claim for Refund or Tax Credit

- ♣ A written claim for refund or credit is filed with the local Treasurer within 2 years from the date of payment of such tax, fee, or charge, or from the date the taxpayer is entitled to a refund or credit

REAL PROPERTY TAXATION

Nature and purpose of Property Taxes

- ♣ Property taxes are assessed on all property, or all property of a certain class located within a certain territory on a specified date in proportion to its value or in accordance with some other reasonable method of apportionment.
- ♣ In the Philippines, a real property tax is an annual AD VALOREM TAX imposed by LGU's on real property within their jurisdiction, determined on the basis of a fixed proportion of the value of the property.
- ♣ The function of a property tax is to raise revenue. Such tax does not impose any condition nor does it place any restriction upon the use of the property taxed.

2000 BAR QUESTION: Give two fundamental principles governing real property taxation, which are limitations on the taxing power of local governments insofar as the levying of the realty tax is concerned.

ANSWER: Fundamental Principles Governing Appraisal and Assessment of Real Property:

- a.) Real property shall be appraised at its *current and fair market value*.
- b.) Real property shall be classified for assessment purposes on the basis of *its actual use*.
- c.) Real property shall be assessed on the basis of a *uniform* standard within each local government unit.
- d.) The appraisal, assessment, and collection of real property tax shall *not be let to any private person*; and
- e.) The appraisal and assessment of real property shall *be equitable*.

APPRAISAL AND ASSESSMENT OF REAL PROPERTY:

- ♣ Steps in assessment of Real Property
 1. Listing of all properties subject to the tax; and
 2. The valuation of such properties.

Duty to declare Real Property-It shall be the responsibility of the owner, administrator or their representatives to declare, under oath, the true value of real property, taxable or exempt, within 60 days after the acquisition. The sworn declaration shall be filed once every 3 years before June 30th of the year commencing 1992. The failure or refusal to make that declaration within the prescribed period would authorize the provincial or city assessor to declare the property in the name of the defaulting owner, if known, or against an unknown owner as the case may be, and to assess the property for taxation.(Secs. 201-204 LGC). In the case of Testate Estate of Concordia Lim V. City of Manila, it was held that the unpaid tax attaches 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 who 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.

Imposition of Real Property tax - The real property tax has been considered and held to be national, despite the fact that in practice it is local in its imposition and utilization.

Justice Vitug points out that: "The real property tax has been considered and held to be a national, not a local tax in Meralco Securities Industrial Corp v. CBAA, 114 SCRA 260. The Court said that realty tax has always been imposed by the national law-making body. The real estate tax is enforced throughout the Philippines and not in a particular political subdivision, although the bulk of the tax proceeds accrue to the various local government units where the property is located. Under the Local Government Code, local government units are mandated to fix a uniform rate of basic real property tax applicable to their respective localities, the proceeds of which exclusively accrue to them. (See Secs. 233 and 271, LGC)", [Page 479, Tax Law and Jurisprudence, 2000 Edition by Justice Vitug and Judge Acosta].

Real property taxation covers the levy, assessment and collection of:

1. Annual ad valorem tax.

2. Special levies by LGUs
 - a) Additional 1% for special education fund.
 - b) Additional 5% on idle lands
 - c) Special assessments on property benefited by improvements undertaken by the government.

Real properties subject to this tax include: *Lands, buildings, machinery and other improvements, not otherwise specifically exempted under the Local Government Code. (Note that real property taxation was previously governed by the Real Property Tax Code but was amended by the Local Government Code. The changes however were only on the tax rate ceilings and assessment levels.)*

Improvements include valuable additions made to a property or an amelioration in its condition, amounting to more than a mere repair or replacement of parts involving capital expenditures and labor, which is intended to enhance its value, beauty or utility or to adopt it for new or further purposes.

Machinery embraces machines, equipment, mechanical contrivances, instruments, appliances or apparatus, which may not be attached, permanently or temporarily, to the real property.

2001 BAR QUESTION: Under Article 415 of the Civil Code, in order for machinery and equipment to be considered real property, they must be placed by the owner of the land and, in addition, must tend to directly meet the needs of the industry or works carried on by the owner. Oil companies, such as Caltex and Shell, install underground tanks in the gasoline stations located in land leased by the oil companies from others. Are those underground tanks, which were not placed there by the owner of the land but by the lessee, considered real property for purposes of real property taxation under the LGC?

SUGGESTED ANSWER FROM UP LAW CENTER: Yes. The underground tanks although installed by the lessee, Shell and Caltex, are considered as real property for purposes of the imposition of real property taxes. It is only for purposes of executing a final judgment that these machinery and equipment, installed by the lessee on a leased land, would not be considered as real property. But in the imposition of real property tax, the underground tanks are taxable as necessary fixtures of the gasoline station without which the gasoline station would not be operational. (Caltex v. CBAA, 114 SCRA 296).

EXCEPTIONS FROM REAL PROPERTY TAX:

1. 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;

2. Charitable institutions, churches, parsonages, or convents appurtenant thereto, mosques, nonprofit or religious cemeteries, and all lands, buildings, and improvements **actually, directly and exclusively** used for religious, charitable, or educational purposes.
3. All pieces of machinery and equipment that are **actually, directly, and exclusively** used by local water districts, and government – owned or controlled corporations engaged in the supply and distribution of water and/or generation and transmission of electric power.
4. All real property owned by duly registered cooperatives as provided for under RA 6938, and
5. Machinery and equipment used for pollution control and environmental protection.

Take note of the following:

1. Real properties of review schools are subject to tax (why? Considered an ordinary corporation)
2. Non-stock, nonprofit private schools are exempt.
3. Proprietary schools (stock and profit) duly accredited by DECS or CHED are exempt, if property is actually, directly and exclusively used for educational purposes.
4. The term **"exclusively"** under the Constitution does not mean **"solely" but only "primarily"** (Roman Catholic Church v. Hastings, 5 Phil 701, Province of Abra v. Hernando, 107 SCRA 104 & other cases).

2000 BAR QUESTION: Art. VI, Sec 28 (3) of the 1987 Phil. Constitution provides that charitable institutions, churches and personages or convents appurtenant thereto, mosques, non-profit cemeteries and all lands, buildings and improvements actually, directly and exclusively used for religious, charitable or educational purposes shall be exempt from taxation. A) To what kind of tax does this exemption apply? B) Is proof of actual use necessary for tax exemption purposes under the constitution?

ANSWER: A) This exemption applies only to property taxes. What is exempted is not the institution itself but the lands, buildings and improvements actually, directly and exclusively used for religious, charitable and educational purposes (CIR v. CA, GR 124043 Oct 14, 1998).

B) Yes, because tax exemptions are strictly construed against the taxpayer. There must be evidence to show that the taxpayer has complied with the requirements for exemption. Furthermore, real property taxation is based on use and not on ownership, hence the same rule must also be applied for real property tax exemptions.

Remedies against a special Levy - An owner of real property or any person having a legal interest therein, affected by a special levy may, upon receipt of the written notice of assessment thereof, avail himself of the same remedies of appeal that may be taken from assessments of the provincial, city or municipal assessor calling for the payment of the real property tax (sec 244, LGC)

Note that even the traditional exemptees (Religious, educational, charitable institutions) are required to pay special assessments and to be exempted, it must first obtain certificate of exemption.

PAYMENT OF REAL PROPERTY TAX

- ♣ The RPT for any year shall attach and become due and payable on the *1st day of January* and taxes levied under the title on real property taxation shall be from the date of accrual, and constitute as lien upon the property subject to such tax.
- ♣ Payment however, may be made on or before January 20.
- ♣ Payment by installment may be made at the discretion of the taxpayer, without penalty in four equal installments, the 1st to be due and payable on or before March 31; and the 2nd on or before September 30 and the 4th on or before December 31, except special levies which shall be governed by the local ordinance imposing the same (SEC 250.LGC).
- ♣ In case of delinquency, an interest of 2% per month on the unpaid tax shall be imposed. If the basic real property tax and the additional tax accruing to the special education fund are paid in advance, the Sanggunian may grant a *discount not exceeding 20% of the annual tax due*.

COLLECTION REMEDIES:

- ♣ The remedies for collections may be by judicial action or extrajudicial (administrative) remedy of levy. The remedy of levy can be pursued by putting up the delinquent property for public sale, subject to the owner's right to redeem after payment of the tax and penalties. But redemption by one who is not entitled thereto is ineffectual (San Juan v. Estate of Socchi, 16 SCRA 68).
- ♣ The administrative and judicial remedies, may be done alternatively or simultaneously, and the non-exercise of one remedy shall not be a bar against an availment of the other (sec 256, LGC).
- ♣ A formal demand for the payment of the delinquent tax is not required for the initiation of either remedy. It is enough that a notice of delinquency is made, to be posted and published as required under section 254 of the LGC.
- ♣ The collection of the real property tax shall be the responsibility of the treasurer of the city or municipality where the property is situated. The city or municipal treasurer may however deputize the

barangay treasurer to collect the tax on property located in the barangay provided the latter is properly bonded (Sec 247 – 269, LGC).

- ♣ The delinquent real property tax shall constitute a lawful indebtedness of the taxpayer to the province or city and collection of the tax may be enforced by *civil action in any court*. The civil action shall be filed by the local treasurer within the time prescribed by law.
- ♣ Property taxes are considered liens and together with mortgages and other encumbrances, shall be enforceable against the property by administrative or judicial actions, whether possession of the delinquent property is with the subsequent owner or possessor, and shall be removable only by payment of the delinquent taxes and the related interest and expenses (sec 246).
- ♣ Whenever the property changes ownership, the one who was owner or user, in cases where the base of tax liability is on beneficial use such as in the lease of government land to private persons, at the beginning of the year, shall be personally liable to the tax.
- ♣ The basic real property tax and any other related taxes levied shall be collected within *five (5) years from the date they become due*. No action for collection can be had beyond this period, except:
 1. If the local treasurer is legally prevented from collecting.
 2. If the owner requests for reinvestigation and signs a waiver.
 3. If the owner is out of the country or cannot be located.

PROCEDURES IN EFFECTING LEVY OF REAL PROPERTY:

- a.) Notice of delinquency
- b.) Issuance of a warrant of levy
- c.) Advertisement
- d.) Auction sale

No action for the collection of the tax, whether administrative or judicial, shall be instituted after the expiration of the 5-year period, otherwise action will not lie.

In case of fraud or intent to evade payment of the tax, such action may be instituted for the collection of the same within *10 years from the discovery of such fraud or intent to evade payment*.

TAXPAYER'S REMEDIES

A. ON ASSESSMENTS:

- ♣ Any owner or person having legal interest in the property who is not satisfied with the action of the provincial, city, or municipal assessor may, within **60 days** from the date of receipt by him of the written notice of assessment, may appeal to the local board of assessment appeals of the province or city concerned by a petition under

oath together with the supporting documents thereof.

- ♣ The Board shall decide the appeal within 20 days from receipt of the appeal, based on substantial evidence. The decision may be appealed within 30 days from receipt thereof by the taxpayer to the Central Board of Assessment Appeals.
- ♣ The decision of the Central Board of Assessment Appeals shall be final and executory.
- ♣ Note that an appeal does not suspend the collection of the tax as assessed, without prejudice to a later adjustment depending on the outcome of the appeal.

B. PAYMENT UNDER PROTEST:

- ♣ No protest shall be entertained unless the tax is first paid. When a taxpayer desires for any reason to pay his tax under protest, he shall indicate the amount or portion thereof which he is contesting and such protest shall be annotated in the tax receipts by writing thereon the word "paid" under protest, within 30 days. In the case of Manila Electric C. V. Barlis, 357 SCRA 832, the Supreme Court ruled: "**Payment of the tax assessed under protest, is a condition sine qua non before the trial court could assume jurisdiction** over the petition and for failure to do so, the RTC has no jurisdiction to entertain it." It further stated: "Under the doctrine of *primacy of administrative remedies* an error in the assessment must be administratively pursued to the exclusion of ordinary courts whose decisions would be void for lack of jurisdiction."
- ♣ The amount or portion of the tax contested shall be held in trust by the treasurer and the difference shall be treated as revenue.
- ♣ In the event that the protest is finally decided in favor of the protestant, the amount or portion of the tax protested against may either be:
 - a.) refunded to the protestant
 - b.) Applied as tax credit to any other existing or future tax liability of the said protestant.
- ♣ RPT cases are not appealable to CTA but to regular courts, as in any other local tax.
- ♣ While Mandamus is not available in IR taxes, it can be availed of in local taxes, RPT included.
- ♣ Doctrine of "exhaustion of administrative remedies" applies, so one must first go through the proper procedure before going to court, otherwise any court decision would be void for lack of jurisdiction. (Manila Electric vs. Barlis, supra).

written claim for refund or credit for taxes and interest with the provincial or city treasurer within *2 years* from the date the taxpayer is entitled thereof. If denied, or not decided in *60 days*, taxpayer can appeal to the Board of Assessment Appeals, as in protest cases.

CONDONATION/REMISSION:

- ♣ The President of the Philippines may remit or reduce the real property tax for any year in any city, municipality if he deems that public interest so requires. (Sec. 277, LGC)
- ♣ The sanggunian may also do so in case of calamities.

OTHERS: Although a tax declaration is not considered as conclusive proof of ownership, the same is admissible in evidence to show the nature of the possession of the claimant of the property for which real property taxes have been paid. (Heirs of Anastacio, Aug.9, 2001)

Unlike land registration proceedings, which are *in rem*, cases involving an auction sale of land for the collection of delinquent property taxes are in personam, thus notice by publication, though sufficient in proceedings in rem, does not as a rule satisfy the requirement of proceedings in personam (Talusán V. Tayag 356 SCRA 263, April 2001)

REFUND: Refund is available in property taxes, based on *illegal and erroneous* collections. The taxpayer may file a