NavarroAmper&Co.

March 2015

Tax news
Interpret and integrate

Republic Act

Republic Act 10653 – An Act Increasing Tax-Exempt Ceiling on 13th Month Pay and Other Benefits

Republic Act No. (RA) 10653 increases the tax-exempt ceiling on 13th month pay and other benefits from P30,000 to P82,000. The P82,000 tax-exempt ceiling covers the 13th month pay and other benefits, such as productivity incentives and Christmas bonus received by employees.

The law mandates the President to adjust the threshold for inflation. The indexation or inflation adjustment should be done every three years using the Consumer Price Index (CPI) as published by the National Statistics Office (NSO).

The Secretary of Finance shall promulgate the rules and regulations to implement the new cap on the 13th month pay and other benefits. However, the absence of the implementing regulations shall not prevent the law from taking effect upon its effectivity.

The law shall be effective 15 days after its publication in at least two newspapers of general publication.

(Republic Act 10653 was signed by the President on 12 February 2015. The law was published on 14 February 2014 in two newspapers of general circulation, i.e., Manila Bulletin and Philippine Star, and thus, it became effective on 1 March 2015.)

BIR Issuance

Extended banking days/hours in acceptance of tax returns/payments

Authorized agent banks (AABs) will be open to accept tax returns/payments on the two Saturdays immediately prior to 15 April 2015, i.e., on 28 March 2015 and 11 April 2015. Their banking hours shall also be extended from 3:00 pm to 5:00 pm from 1 April to 15

April 2015 for purposes of accepting tax payments.

(BIR Bank Bulletin No. 2015-2, February 2, 2015)

Court Decisions

Tax treatment of treasury bonds

Under Bureau of Internal Revenue (BIR) Ruling No. 370-2011 (7 October 2011), the Commissioner of Internal Revenue (CIR) declared that all treasury bonds (including Poverty Eradication and Alleviation Certificates, or PEACe, Bonds), regardless of the number of purchasers/lenders at the time of origination/issuance, are considered deposit substitutes subject to the 20% final withholding tax (FWT).

The Supreme Court (SC) held that BIR Ruling No. 370-2011 is erroneous insofar as it stated that all treasury bonds, regardless of the number of purchasers/lenders at the time of origination/issuance, are considered deposit substitutes. Thus, the SC declared void BIR Ruling No. 370-2011 because it completely disregarded the "20 or more lender" rule under the Tax Code, and it created a distinction between debt instruments issued by the government and those issued by private corporations when there was none in the law.

With respect to the PEACe Bonds, the SC noted that while it seems that there was only one lender to whom the PEACe Bonds were issued at the time of origination, a reading of the underwriting agreement reveals that the settlement dates for the sale and distribution of the PEACe Bonds to various undisclosed investors at a purchase price fell on the same day when the PEACe Bonds were supposedly issued and, thus, the SC does not know how many investors the PEACe Bonds were sold to.

However, should there have been a simultaneous sale to 20 or more lenders/investors, the SC held that the PEACe Bonds should be deemed deposit substitutes subject to the 20% FWT on the interest or discount from the PEACe Bonds. Further, the obligation to withhold the 20% final tax on the corresponding interest from the PEACe Bonds would likewise be required of any lender/investor had the latter turned around and sold said PEACe Bonds, whether in whole or part, simultaneously to 20 or more lenders or investors.

At the same time, the SC clarified that should it be found that the PEACe Bonds were sold to 20 or more lenders/investors, the BIR may still collect the unpaid tax within 10 years after the discovery of the omission.

(Banco De Oro, Bank of Commerce, China Banking Corporation, Metropolitan Bank & Trust Company, Philippine Bank of Communications, Philippine National Bank, Philippine Veterans Bank, and Planters Development Bank v. Republic of the Philippines, Commissioner of Internal Revenue, Bureau of Internal Revenue, Secretary of Finance, Department of Finance, The National Treasurer, and Bureau of the Treasury, G.R. No. 198756, January 13, 2015)

Exceptions to the doctrine of exhaustion of administrative remedies

Under Section 4 of the Tax Code, the Secretary of Finance has the power to affirm, revise, modify or set aside rulings and issuances of the BIR pertaining to the implementation and interpretation of the Tax Code of 1997. Thus, in case a taxpayer receives an adverse ruling from the BIR, it may file a request with the Secretary of Finance to review the opinion of the BIR.

Under the doctrine of exhaustion of administrative remedies, if the superior administrative officers can grant the relief prayed for, then special civil actions are generally not entertained. The remedy within the administrative machinery must be resorted to first and pursued to its

appropriate conclusion before the court's judicial power can be sought.

However, the doctrine of exhaustion of administrative remedies may be disregarded (1) when there is a violation of due process, (2) when the issue involved is purely a legal question, (3) when the administrative action is patently illegal amounting to lack or excess of jurisdiction, (4) when there is estoppel on the part of the administrative agency concerned, (5) when there is irreparable injury, (6) when the respondent is a department secretary whose acts as an alter ego of the President bears the implied and assumed approval of the latter, (7) when to require exhaustion of administrative remedies would be unreasonable, (8) when it would amount to a nullification of a claim, (9) when the subject matter is a private land in land case proceedings, (10) when the rule does not provide a plain, speedy and adequate remedy, (11) when there are circumstances indicating the urgency of judicial intervention.

In the instant case, the subject of the Court's scrutiny is the validity of the 2011 ruling issued by the BIR in response to the request for clarification of the Secretary of Finance, which declared that all government debt instruments are deposit substitutes regardless of the 20-lender rule. Based on the foregoing, the BIR considered the PEACe Bonds as deposit substitutes, which are subject to 20% FWT upon maturity.

The SC held that the exceptions under (2) and (11) are present in the case. The question involved is purely legal, namely: (a) the interpretation of the 20-lender rule in the definition of the terms public and deposit substitutes under the Tax Code; and (b) whether the imposition of the 20% FWT on the PEACe Bonds upon maturity violates the constitutional provisions on non-impairment of contracts and due process. Judicial intervention is likewise urgent with the impending maturity of the PEACe Bonds.

The SC further held that the rule on exhaustion of administrative remedies also finds no application when the exhaustion will result in an exercise in futility. In this case, an appeal to the Secretary of Finance from the questioned BIR ruling would be a futile exercise because it was the Secretary of Finance that requested for the BIR ruling. It appears that the Secretary of Finance adopted the CIR's opinions as his own. This position was in fact confirmed in the letter of the Secretary of Finance where he ordered the Bureau of the Treasury to withhold the amount corresponding to the 20% FWT on the interest or discounts allegedly due from the bondholders on the strength of the BIR ruling.

(Banco De Oro, Bank of Commerce, China Banking Corporation, Metropolitan Bank & Trust Company, Philippine Bank of Communications, Philippine National Bank, Philippine Veterans Bank, and Planters Development Bank v. Republic of the Philippines, Commissioner of Internal Revenue, Bureau of Internal Revenue, Secretary of Finance, Department of Finance, The National Treasurer, and Bureau of the Treasury, G.R. No. 198756, January 13, 2015)

Prior ITAD ruling requirement in availment of tax treaty benefits

Due to failure to secure a BIR International Tax Affairs Division (ITAD) ruling with respect to the interest payments made to lenders on its foreign loan transactions, the taxpayer's judicial claim for refund of its erroneously paid tax was denied by the Court of Tax Appeals (CTA) on the basis of the regular tax rate under the Tax Code.

The SC held that the taxpayer's failure to comply with the requirement to apply for tax treaty relief should not deprive taxpayers of tax treaty benefits. The SC cited the case of Deutsche Bank AG Manila Branch v. CIR (GR 188550, August 19, 2013), where it held that the BIR should not impose additional

requirements that would negate the availment of the reliefs provided for under international agreements, especially since the tax treaties do not provide for any prerequisite at all for the availment of the benefits.

The SC further held that the objective in requiring the application for treaty relief with the ITAD before a party's availment of the preferential rate under a tax treaty is to avert the consequences of any erroneous interpretation and/or application of treaty provisions, such as claims for refund/credit for overpayment of taxes, or deficiency tax liabilities for underpayment. However, citing the Deutsche Bank case, it maintained that the underlying principle of prior application with the BIR becomes moot in refund cases where the very basis of the claim is erroneous or there is excessive payment arising from the non-availment of a tax treaty relief.

The SC noted that the taxpayer should not be faulted for not complying with prior ITAD filing ruling requirement since it could not have applied for a tax treaty relief precisely because it erroneously paid the tax on the basis of the regular rate as prescribed by the Tax Code. As stressed by the SC, the prior application requirement under Revenue Memorandum Order No. 1-2000 then becomes illogical.

In the Deutsche Bank case, the SC categorically held that the BIR should not impose additional requirements that would negate the availment of the reliefs provided for under international agreements, especially since said tax treaties do not provide for any prerequisite at all for the availment of the benefits under said agreements.

(CBK Power Company Limited v. Commissioner of Internal Revenue, GR 193383-84, January 14, 2014)

Filing of judicial claim for refund of erroneously paid taxes

Under Section 204(C) in relation to Section 229 of the Tax Code, both the administrative and judicial claims for refund of erroneously paid or illegally collected taxes must be filed within two years from the date of payment of the tax or penalty. In filing the judicial claim for refund, there is no need for the taxpayer to wait for the CIR to act on its application for refund before it can seek judicial recourse. What the law requires is that the administrative claim be filed prior to seeking judicial action.

In the instant case, while the taxpayer-refund claimant filed both its administrative and judicial claims for refund of excess FWT within the two-year prescriptive period under Section 204(C) of the Tax Code, it filed its judicial claim for refund only five days from filing its administrative claim for refund. The Commissioner maintained that he was deprived of the opportunity to act on the administrative claim for refund of excess FWT since the taxpayer-refund claimant hastily elevated its case before the CTA. It further argued that the failure of the taxpayer to give the Commissioner reasonable time to act on its claim violates the doctrines of exhaustion of administrative remedies and of primary jurisdiction, and thus, the taxpayer's claim for refund should be denied.

The SC held that while the taxpayer could have waited until the last day of the two-year prescriptive period if only to give the BIR at the administrative level an opportunity to act on its claim for the refund, it cannot, on that basis alone, deny a legitimate claim that was timely filed in accordance with Section 229 of the Tax Code. The SC maintained that there was no violation of Section 229 since the law, as worded, only requires that an administrative claim be priorly filed.

According to the SC, had the taxpayer awaited the action of the CIR prior to taking court action knowing full well that the two-

year prescriptive period was about to end, it would have lost not only its right to seek judicial recourse but its right to recover the FWT it erroneously paid to the government, thereby suffering irreparable damage.

(Commissioner of Internal Revenue v. CBK Power Company Limited, GR 193407-08, January 14, 2015)

Assessment based on Best Evidence Obtainable Rule

Under Section 6(B) of the Tax Code, and Section 2.3 of Revenue Memorandum Circular No. 23-00, when a taxpayer fails to submit the required report or records, or the reports submitted are false, incomplete or erroneous, the CIRis authorized to assess the taxpayer the proper tax based on the best evidence available.

However, while it is true that the Tax Code allows the CIR to resort to the Best Evidence Obtainable Rule, the assessment should be based on sufficient evidence to be considered valid. In the instant case, due to the taxpayer's failure to submit the documents, which were destroyed during Typhoon Ondoy and Pepeng, the BIR resorted to the Best Evidence Obtainable Rule through estimation of the taxpayer's deficiency taxes.

The CTA held that while a taxpayer's liability may be determined by estimation in the absence of the taxpayer's accounting records pursuant to the Best Evidence Obtainable Rule under Section 6(B) of the Tax Code, the rule does not apply where the estimation is arrived at arbitrarily and capriciously. In order to stand judicial scrutiny, the BIR should present sufficient evidence in arriving at the deficiency assessment against the taxpayer.

Applying the rule laid down by the SC in the case of CIR v. Hantex Trading, Inc. (GR 136975, March 31, 2005), the CTA held that the presumption of correctness of an assessment, being a mere presumption, cannot be made to rest on another presumption. Considering that in the deficiency assessment against the taxpayer, the BIR failed to present before the CTA any evidence that it supposedly procured by resorting to the Best Evidence Obtainable Rule, the CTA cancelled the assessment of the BIR for lack of factual basis.

(Farcon Marketing Corporation v. Bureau of Internal Revenue, CTA Case No. 8367, February 3, 2015)

FAN issued prior to the lapse of 15-day period to reply to PAN violates due process

Under Section 228 of the Tax Code, as implemented by Revenue Regulations No. (RR) 12-99, as amended, a taxpayer who receives the Preliminary Assessment Notice (PAN) is given 15 days from receipt of the PAN to file its reply to the PAN. If the 15-day period lapses without any response from the taxpayer, the taxpayer shall be considered in default. This will then trigger the BIR's issuance of the formal letter of demand (FLD) and final assessment notice (FAN).

In the instant case, the taxpayer received the PAN from the BIR assessing it for deficiency value-added tax (VAT) and withholding tax. However, even before the lapse of the 15-day period within which the taxpayer could file its reply to the PAN, the BIR issued the FLD and assessment notices.

The CTA held that the right of the taxpayer to respond to the PAN under Section 228 of the Tax Code and RR 12-99 is an important part of the due process requirement in the issuance of a deficiency tax. In wantonly disregarding the taxpayer's right to be heard with regard to its positions and arguments against the PAN, the BIR, according to the CTA, clearly violated the taxpayer's right to due process as enshrined in Section 228 of the Tax Code and RR 12-99, as amended. The CTA emphasized that procedural due process is not satisfied with the mere issuance of a PAN, without giving the taxpayer an opportunity to respond to it.

The CTA noted that while the taxpayer was given ample opportunity to contest the FLD and assessment notices, this does not cure the fatal infirmity that attended the issuance of the FLD. Hence, on the grounds of the CIR's non-observance of the 15-day period granted to the taxpayer to respond to the PAN, the CTA cancelled the deficiency tax assessments against the taxpayer.

[Polymer Products (Phil.), Inc. v. Commissioner of Internal Revenue, CTA Case No. 8299, January 30, 2015]

Proof of receipt of assessment
While an assessment sent by registered mail is deemed received by the taxpayer in the regular course of mail, if the taxpayer denies receipt of tax assessment, it is incumbent upon the BIR to prove by competent evidence that the assessment was indeed received by the taxpayer.

In the instant case, the taxpayer claims that it did not receive the FAN issued by the BIR and sent through registered mail. To prove receipt of the assessment notices, the BIR presented to the CTA the following: (a) FAN issued and sent through registered mail by the BIR; (b) judicial affidavit of the BIR personnel who placed personally the FAN in an envelope and mailed it through registered mail, and (c) certified true copy of the stamped endorsement and certification by the concerned Post Office stating that the FAN was mailed and duly-received by a certain individual who acknowledged receipt of the assessment notices.

The CTA held that while the judicial affidavit of the BIR personnel and certification from the Post Office provide proof of mailing, the same do not prove that the FAN was indeed received by the taxpayer. According to the CTA, due process requires that at the very least the notice be actually received by the taxpayer or its duly authorized representative, and not merely by a disinterested person. Thus, for failure to prove that the taxpayer or its duly authorized agent received the FAN, the assessment was cancelled.

(SVI Technologies, Inc. v. Commissioner of Internal Revenue, CTA Case No. 8488, February 2, 2015)

Contacts

For more information, please contact

Fredieric B. Landicho
Tax Partner
+63 (2) 581 9043
flandicho@deloitte.com

Richard R. Lapres
Tax Partner
+63 (2) 581 9044
rlapres@deloitte.com

Walter L. Abela, Jr.
Tax
+63 (2) 581 9034
wabela@deloitte.com

For further information, visit our website at www.deloitte.com

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries and territories, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte's more than 200,000 professionals are committed to becoming the standard of excellence.

About Deloitte Southeast Asia
Navarro Amper & Co. is a member of Deloitte Southeast Asia Ltd – a member firm of Deloitte Touche Tohmatsu Limited comprising Deloitte practices operating in Brunei, Cambodia, Guam, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam – was established to deliver measurable value to the particular demands of increasingly intra-regional and fast growing companies and enterprises.

Comprising over 270 partners and 6,300 professionals in 24 office locations, the subsidiaries and affiliates of Deloitte Southeast Asia Ltd combine their technical expertise and deep industry knowledge to deliver consistent high quality services to companies in the region.

All services are provided through the individual country practices, their subsidiaries and affiliates which are separate and independent legal entities.

About Deloitte Philippines
In the Philippines, services are exclusively and independently provided by Navarro Amper & Co., a duly registered professional partnership in the Philippines.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

© 2015 Navarro Amper & Co. All rights reserved.