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TAX LAW FOR BUSINESS

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Part One

Antibusiness Tax Code provisions (Penalty charges)

Every first week of the month in 2016, I have committed to write about and discuss the antibusiness provisions in the Tax Code that need to be changed, removed, overhauled or clarified.

I do this with the hope to provide a common understanding, to both the private business and the government, of the difficulties encountered in doing business under a tax system that is unjust, complicated, unclear and unreasonable. I do this with the end-objective that changes to these laws be considered in proposals for tax reform for the new administration, six months from now.

Thus, today, I discuss the civil penalties imposable on assessed deficiency taxes, such as the surcharges and penalty interests which, many believe, are too burdensome, confiscatory and its application confusing.

Too heavy penalty charges encourage more tax evasion

Under current tax laws, any unpaid tax, whether intentional or not, shall be imposed with the following penalty charges:

1. A 20 percent per annum “deficiency interest” computed from the date the tax is required to be paid until its full payment. As the term connotes, it is imposed on a deficiency tax—that is, the amount of tax not reported and paid in the tax return such as those arising from tax investigations. (Section 249, Tax Code)
2. A 20 percent per annum delinquency interest for failure to pay the amount of tax due indicated in the return, or amount of tax due for which no return is required, and on deficiency taxes, including surcharges and interests, as appearing in the notice of demand or final assessment notice. The interest is computed from the due date indicated in the letter of demand, or from filing of the return or in the case where return is not required, from the due date of payment until fully paid. (Section 249, Tax Code)
3. A surcharge of 25 percent for failure to file a return and pay the tax on time, or filing a tax return with the wrong venue, or failure to pay the deficiency tax within the time prescribed in the notice of assessment. (Section 248, Tax Code)
4. A surcharge of 50 percent in case of willful neglect to file a return, or in the case of false or fraudulent return. (Section 248, Tax Code)
5. A penalty ranging from P1,000 to P25,000 for each failure to file the required information. (Section 250, Tax Code)

These penalty charges can be imposed singly, or a combination of two or more, or all of the above simultaneously for as long as the circumstances warrant, without regard as to whether the nonpayment arose from simple mistake, inadvertence or intentional.

In a recent decision of the Court of Tax Appeals (CTA) involving an assessment case (Fort Bonifacio Development Corp. v. Commissioner of Internal Revenue, December 21, 2015, CTA

Case 7696 and 7728), the following civil penalties were applied and added to the basic tax assessment:

1. A 25-percent surcharge for failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment;
2. A 20 percent per annum deficiency interest from the time it is required to be paid until its full payment;
3. A 20 percent per annum delinquency interest on the basic tax assessment from the time the demand to pay was made as indicated in the assessment notice until full payment;
4. A 20 percent per annum delinquency interest on the 25-percent surcharge until full payment; and
5. A 20 percent per annum delinquency interest on the deficiency interest accrued until full payment.

For a clearer picture of its application, let us take an example of a taxpayer with an income-tax liability of P1 million (basic tax) in 2011, as indicated in the Assessment Notice and Letter of Demand of the Bureau of Internal Revenue (BIR). The letter demands that payment be made on or before April 15, 2014. The tax has not been paid and it will be paid only on April 15, 2016. Applying the above decision, the total tax liability will be computed as follows:

A tax liability of P1 million, which remains unpaid for four years despite a BIR demand letter on the second year, will amount to P2.87 million at the end of the fourth year. It will increase by 187 percent, or equivalent to an annual simple interest of 46.75 percent on the average. This is due largely to the overlapping application of the deficiency interest and the delinquency interest, thus resulting to a 40-percent interest per annum, which will apply once a Letter of Demand or Assessment Notice is issued. The 40-percent interest is computed from the time the demand for payment is made until full payment of the tax.

In adopting this position of overlapping application, the CTA relied on the provisions of the Tax Code which require the imposition of both the deficiency and delinquency interest until full payment of the tax is made—which means, therefore, that a tax liability that remains unpaid on the due date indicated in the Assessment Notice or final Letter of Demand shall be slapped with

both deficiency interest and delinquency interest at the rate of 20 percent per annum each, or a total of 40 percent per annum or more when compounded. But the CTA has not been consistent of its position on this. One case decided by the CTA En Banc, (in the case of Liquigaz Phils. Corp. v. CIR, CTA En Banc 1117, September 21, 2015), the court adopted a more liberal interpretation, saying that when the assessment becomes delinquent, the deficiency interest stops to run and delinquency interest begins. In short, there is no overlapping in its application.

The BIR, on the other hand, supported the overlapping application of deficiency and delinquency interests through its issuance of Revenue Regulations (RR) 18-2013 (November 28, 2013). However, it clarified that if the assessment is timely protested, the delinquency interest does not begin to run until the assessment becomes final, due and collectible. Such that, if after the protest is considered and the tax assessment is upheld, then it is only from this time that the delinquency interest applies until full payment is made. It abandoned its old position under RR 12-99 that delinquency interest and deficiency interest are not imposed simultaneously.

Basic Tax Due	1,000,000
Add: 25% Surcharge	250,000
Add: 20% deficiency interest on the basic tax from 4-15-12 to 12-31-15 (4 years)	800,000
Add: 20% delinquency interest on basic tax from 4-15-2014 to 12-31-15 (2 years)	400,000
Add: 20% delinquency interest on the 25% surcharge from 4-15-2014 to 12-31-15 (2 years)	100,000
Add: 20% delinquency interest on accrued interest from 4-15-2014 to 12-31-15 (2 years)	320,000
Total tax liability	2,870,000

Interest rate of 20% per annum is too high

ON the rate of penalty interest at 20 percent per annum, this is complained of as too high considering the prevailing interest rates in the market. The rate of interest, which is pegged at 20 percent per annum regardless of the nature and amount of infraction, whether intentional or through deceit or fraud, and regardless of the prevailing market rate, is too restrictive. At present, bank deposits earn from 1-percent to 2-percent interest, while other investment products yield as high as 7 percent to 8 percent only.

The 20-percent interest penalty charge was incorporated in the Tax Code during that time when prevailing interest rates are high. While there is justification in imposing a higher than market rate (to discourage nonpayment of taxes), a 20-percent rate compared to the 1-percent to 2-percent prevailing interest rates is too high as a penalty and is no longer commensurate to the infraction being punished.

Penalties that are too restrictive, especially when imposed on acts of simple mistake or inadvertence, not intentional, not through deceit or fraud, will encourage more tax evasion rather than to encourage more compliance. I say this because, with our complicated tax laws as complicated further by complicated tax regulations and compliance requirements, it is almost certain that taxpayers, no matter how careful they are, will not make a 100-percent compliance. Thus, for taxpayers who cannot afford professional assistance such as the small and medium enterprises, they would rather take the risk of not joining the tax net and do business underground rather than to register and comply but face a bigger chance of being caught and penalized heavily.

Of course, tax, by its very nature, is confiscatory and burdensome. But, I have always believed that, if put in proper structure, it can even be a booster to business, removing inequalities in the playing field, and promotes efficiency.

Recommendations for tax reform

Changes in the civil penalties imposed for deficiency and delinquency taxes should form part of the tax-reform package and it should have the following features:

Penalty interest, both deficiency and delinquency interest, should be benchmarked to prevailing market rates or at least, near market rates to cover for the cost of money lost by the government due to nonpayment of the tax. Then, a certain percentage increase shall be added, say 3 percent to 5 percent for example, as a form of penalty for nonpayment. In the case of nonpayment with intent to evade or in case of fraudulent returns, the increase shall be a higher rate than those committed through mistake or inadvertence, or in cases involving highly technical and difficult questions of law.

There should be no overlapping application of deficiency interest and delinquency interest to avoid compounding the penalty. Deficiency interest shall only be imposed from the time the tax is required to be paid until the date stated in the Letter of Demand and Assessment Notice, or if protested, from the time the assessment becomes final, due and demandable. The delinquency interest, on the other hand, shall be imposed from the date indicated in the Assessment Notice and Letter of Demand or from the finality of the assessment up to full payment of the tax.

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