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**TAX LAW FOR BUSINESS**

***BDB Law's "Tax Law for Business"*** *appears in the opinion section of* ***Business Mirror*** *every Thursday*.

*Part Two*

# Antibusiness Tax Code provisions

## (Cruelty of the withholding tax system)

Let me begin by saying that under the withholding-tax system (WTS), the tax required to be paid or remitted by a taxpayer is not actually a tax imposed on his own income. It is not his own tax liability. Rather, it is a tax due from another taxpayer of which he is obliged to collect and remit to the government. When one files a withholding-tax return, he is not paying his own tax liability. He is only remitting the tax collected by him for the account of another taxpayer.

The WTS is actually a business-process outsourcing (BPO) arrangement whereby the Bureau of Internal Revenue (BIR) outsources its collection function to taxpayers. Payors of income are constituted as agents of the government in the collection of taxes. The only difference is that, these withholding agents are not paid for doing the outsourced work. On the contrary, on the strength of the state's taxing and police powers combined, nonperformance is severely punished with penalties far greater than nonpayment of one's tax liability.

Under the Tax Code, failure to properly comply with the withholding- tax rules is slapped with the following penalties:

1. The amount paid or payable cannot be allowed as a deductible expense from the taxable income of the withholding agent. This includes depreciation or amortization on assets purchased on which a withholding is required. (Section 34K, Tax Code)
2. The withholding agent is liable for the amount of tax not withheld and/or remitted, including surcharges, deficiency interest and delinquency interest. (Section 251, Tax Code)
3. In case of failure to supply the required information, such as the alpha list, withholding agent is liable for penalty ranging from P1,000 to P25,000 (Section 250, Tax Code). If such failure is willful or deliberate, it shall also be punished with imprisonment from one year to three years (Section 255, Tax Code).

A single violation of nonwithholding makes one liable not only for penalties, but also for the amount not withheld and remitted. But more alarming is the disallowance of the expense as a deduction from the gross income of the withholding agent exposing him to an outright additional tax payment equivalent to 30 percent of the amount not subjected to withholding tax.

These penalties provide a good source of income for the government, generating far bigger revenue than the tax that would have been collected if there was compliance with the WTS regulations. Additional revenue will come from three sources, to wit:

1. Payment of the amount not withheld, including penalties;
2. Payment of additional income tax equal to 30 percent of the disallowed expense due to nonwithholding;
3. Payment of the corresponding income tax by the income recipient upon filing his annual income-tax return.

If there was proper withholding, the government’s income would only be to the extent of the amount required to be withheld. In the above enumeration, it is only that in 1.

Note that except in final taxes, failure to withhold the required tax does not deprive the government of that tax. This same amount will be recovered later on when the income recipient pays his income-tax return at year-end. At most, the government only loses the chance to use that money in advance. Also, it may lose the audit trail in tracking income recipients.

The Tax Code requires that income tax shall be determined on a yearly basis, and payment thereof is required not later than April 15 of the following year. But through the WTS, the government is able to collect in advance, as early as February 15 of the current year, the tax that is supposed to be due at a much later time, April 15 of the following year, or a period of 14 months. The taxpayer, on the other hand, is denied the use of that money for the same period and this may even continue longer if the total tax withheld exceeds the year-end tax liability because then, that amount is locked up with the government until the amount is offset against future taxes or is refunded.

In Revenue Regulations 2-98, the BIR saw the unfairness of these rules and tried to soften its implementation by allowing the claiming of deductions despite failure to withhold provided that taxpayer pays the amount not withheld, including penalties, upon investigation. However, the current tax administration reversed this position and clarified that no deduction will be allowed for an expense not subjected to withholding despite payment of the deficiency withholding taxes. In addition, stricter penalties for noncompliance with withholding rules were introduced such as the non-deductibility of the expense for failure to supply all the required information in the alpha list.

The penalties imposed under the Tax Code for noncompliance with withholding-tax laws and regulations cover the following infractions: (a) failure to remit; (b) failure to withhold; (c) incorrect rate of withholding; and (d) failure to supply information.

In the imposition of these penalties, the law does not make a distinction as to the nature and gravity of the infraction. For example, a taxpayer who withholds the tax but does not remit the amount collected is slapped with the same penalty as the one who simply fails to withhold. Surely, one who collects the tax and use it like his own is committing a much graver offense than the one who simply fails to comply with an obligation to withhold.

Since time immemorial, deficiency withholding taxes has not been the subject of tax compromises or amnesties on the premise that these are government funds in the hands of private persons. But this is not true if the offense is only for failure to withhold. That is why, in penalizing the offense, a distinction has to be made based on the nature and gravity of the offense.

Statistics would show that most investigations conducted by the BIR have resulted in deficiency withholding taxes such as the creditable withholding tax, final tax and even withholding tax on compensation. In most cases, taxpayers just offered to pay the amount not withheld (plus penalties) so that the related expense will be allowed as deduction from taxable income. With the recent change introduced by the current commissioner, taxpayers will no longer be given this concession beginning 2013.

The state of our current withholding-tax rules is something that deserves a serious study and consideration for adjustment. Many taxpayers are perennially assessed for failure to withhold or for applying the incorrect rate, which, to me, is an indication of the complexity of our WTS and the difficulties complying with it.

Everyday complaints against the withholding-tax structure include:

1. Rates being too high resulting in excess tax payments for many taxpayers. Businesses operating on thin spread, such as those in trading, ends up in excess taxes every year that adds up to significant amount.
2. Guidance for the characterization or classification of the income payment is inadequate, resulting in improper rate being used.
3. The required default rate of 1 percent or 2 percent on purchases of goods and services not covered by specific WTS imposed on top 20,000 corporations (TTC) is an impossible task and chaotic for many businesses. Would salesmen, employees or even officers claiming reimbursable business expenses carry withholding-tax certificates ready to be issued every time they pay for meals, transportation or lodging? Because of the impossibility of complying with this rule, a practice has developed among businesses to just shoulder (or gross up) the

tax required to be withheld and remit it to the BIR. But this practice may distort reporting, especially if such reports (like alpha lists) are used to track down income recipients.

4. The cost of complying with withholding-tax requirements has become too expensive.

The Philippines used to be one of the countries with best practices in withholding tax. With the changes introduced over time, that may not be the case anymore. Thus, this request to consider changes in the withholding-tax structure as part of a tax reform giving due consideration to the concerns raised in this article.

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