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TAX LAW FOR BUSINESS

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Underdeclaration of purchases not taxable income

ONE of the usual tools employed by revenue examiners in determining the correctness of the amounts reported by taxpayers is to compare it with third-party information. This is usually done through the computerized matching of data/information or simply the comparison of the reported information by transacting parties, such as buyers and sellers or purchasers of goods and services, and their suppliers.

There is no problem with this approach. However, one mistake commonly committed by the revenue officers is to conclude that the difference between a taxpayer's recorded purchases and his supplier's reported sales is a taxable income. It is usual for taxpayers to be assessed for income and value-added taxes emanating from the tax bureau's comparison between the taxpayer's reported purchases in the Summary List of Purchases (SLP) vis-à-vis a third-party data, such as the Summary List of Sales (SLS). In the event that the sales reported by the supplier in its SLS are higher than the total purchases declared by the taxpayer in its tax return

or SLP, the usual conclusion is that the difference represents an understatement of purchases. And worst, this is equated to an undeclared income, resulting in the assessment of deficiency income tax and value-added tax (VAT).

There are already a number of cases decided by the Tax Court holding that the assessment resulting from this approach is without basis. In its decision promulgated on January 4 of this year, the Tax Court, in CTA Case 8588, resolved against the position of the tax bureau and concluded that a finding of underdeclaration of purchase does not, by itself, result in the imposition of income tax and VAT. This is basically a reiteration of the court's earlier decisions in CTA Case 8345 (May 29, 2013) and CTA Case 7853 (February 16, 2012).

The court further laid down that there are three elements in the imposition of income tax, which are as follows: (1) there must be gain or profit; (2) the gain or profit is realized or received, actually or constructively; and (3) it is not exempted by law or treaty from income tax. Likewise, the court clarified that income tax is assessed on income received from any property, activity or service that produced the income. Hence, it is not when there is an underdeclared purchase, but only when there is an income, and such income was received or realized by the taxpayer, that an imposition or assessment of income tax is proper.

In these cases, the said elements were not present. Apparently, the tax bureau merely presumed that the discrepancy between the taxpayer's purchases and its supplier's sales constituted undeclared income. Clearly, the bureau's assessment was not based on undeclared income actually received by the taxpayer.

Moreover, it must be emphasized that for income-tax purposes, a taxpayer is free to deduct from its gross income a lesser amount, or not claim any deduction at all. What is prohibited by the income-tax law is to claim a deduction beyond the authorized amount.

Hence, even granting that there are undeclared purchases, which means there are unclaimed costs/deductions, the same is not prohibited by law.

Instead of treating the difference as addition to income, the bureau should do the opposite, that is, to deduct the unclaimed purchases from the income as additional costs. Commit to memory that an underdeclaration of purchases does not translate to income subject to income tax and VAT to which an assessment may be anchored.

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