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TAX LAW FOR BUSINESS

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Tax credits against deficiency tax assessment

Ours is a self-assessment system of paying taxes, where taxpayers determine their respective tax liabilities and pay them to the tax authorities. Revenue officers, however, through proper authorization, may conduct examinations after tax returns have been filed or should have been filed. The ultimate objective of the examination is to determine whether correct information and taxes had been reported and paid. If not, the tax authorities shall make a recomputation of the correct amount of taxes and require the payment of deficiency taxes.

Since the objective of a tax examination is to determine the correct tax liability, ideally, the proper approach for every examiner is to consider all items that affect the computation of taxes—whether that item increases or decreases one's tax liabilities. The tendency, however, for most revenue examiners is to include in their recomputation only the items that increase the amount of taxes and disregard the transactions that have the opposite effect, such as additional deductions and tax credits. Thus, in most assessment cases, transactions that have the effect of lowering the amount of taxes, such as unreported expenses, overpayment of taxes and utilization of available tax credits are often disregarded.

In fact, with respect to tax credits —unutilized input tax and unutilized creditable withholding taxes—carried over to the succeeding periods, it is the tendency of the revenue examiners not to allow the same in the year being examined. The usual reasoning as provided in most assessment notices is to recapture the benefit of carrying over to the subsequent period. Hence, these are usually disallowed as credits against the adjustment in taxes in the year the said credits were earned/incurred.

In a number of cases decided by the Tax Court, it had been repeatedly explained that it is improper for the tax bureau to disallow from the total input tax or creditable withholding tax credit, the amount representing excess tax credits carried over to the next accounting period. According to the Court, the disallowance is improper inasmuch as any tax benefit derived from the carry-over redounds to the succeeding year, which is not the period covered by the examination. Since the tax benefit will be in the succeeding year, at most, the taxpayer may only be assessed in the said succeeding year. With this ratiocination, in case the excess tax credit carried over to the next accounting period is higher than the adjustment or tax assessment, there should still be no deficiency tax to speak of since the taxpayer has sufficient tax credits to cover the additional taxes due.

Having said that, in another case (Court of Tax Appeals [CTA] Case 7970) decided by the Tax Court, the taxpayer was assessed for deficiency value-added tax (VAT) on alleged unreported gross receipts. The taxpayer argued that it had sufficient unutilized input VAT that may be offset against the additional output taxes. The result is that it should not be made liable since the input taxes are more than sufficient to cover the adjustment in output taxes. The Court disagreed with taxpayer's line of reasoning. First, the taxpayer was not authorized to automatically credit or offset unutilized input VAT, or any claims a taxpayer may have from the government, against a deficiency VAT assessment or any existing tax liability. Second, a record of excess and unutilized input VAT in the taxpayer's books, sufficient to cover its tax liabilities, does not bar the Bureau of Internal Revenue from issuing deficiency VAT assessment/s. The CTA further held that the existence of sufficient unutilized input VAT and the matter having the same credited against or subtracted from the subject deficiency VAT assessment, can only be viewed, at most, as a probable mode by which the subject deficiency VAT assessment can be paid/settled. But it is not a valid ground that would warrant the nullification or cancellation of the assessment.

As to the propriety of crediting the claimed input VAT against the subject deficiency VAT assessment to pay for/settle tax liability, the taxpayer needs to present and offer in evidence any VAT invoice or official receipt to support the claimed excess and unutilized input VAT.

This case is not actually adverse to the earlier cases mentioned. Excess tax credits that are carried over to the succeeding periods may still be utilized against any adjustment in taxes due in the year the tax credit was incurred. The taxpayer only needs to follow the usual requirement for substantiation, that is, proper documents should be presented to prove the existence of such tax credits. Taxpayers who are planning to bring their tax assessment cases to Court must be aware of this substantiation requirement to ensure the creditability of tax credits against tax assessments.

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