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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.*

Effective tax interest rate is 60%

Many taxpayers are misled into thinking that their tax liabilities are limited to the basic tax due plus a straight 20-percent annual interest rate. Thus, when the court eventually finds them liable to pay a deficiency tax, they are surprised to learn that they will be paying double or triple of the basic tax due. They usually fail to take into account the deficiency interest and the delinquency interest, which, at one point, are imposed simultaneously and is effectively equivalent to an annual interest rate of 50 percent to 60 percent.

Deficiency interest is an annual 20-percent interest imposed from the time the tax is due until payment is made. For example, an annual income tax becomes due on April 15, 2005, a final assessment notice is issued on March 25, 2008, and payment is made on May 2, 2010. The 20-percent deficiency interest is imposed from April 2005 to May 2, 2010.

Delinquency interest, on the other hand, is an annual 20-percent interest imposed from the time the final assessment is issued until payment is made. In the example above, the additional 20-percent interest is imposed from March 25, 2008 to May 2, 2010.

Take note that in the example above, deficiency interest and delinquency interest are imposed simultaneously from March 25, 2008 to May 2, 2010. The taxpayer is effectively paying 40 percent during this period.

The accumulation of interest does not stop here. The Court of Tax Appeals (CTA) is now consistent in ruling that in computing delinquency interest, the base amount should include not only the basic tax due, but the deficiency interest and surcharge, as well. To illustrate:

20% DELIQUENCY INTEREST	
Basic Tax	100,000
Surcharge (25%)	25,000
20% Deficiency Interest	50,000
Base Amount	**175,000**
Multiplied by:	
Interest rate	20%

The inclusion of the deficiency interest plus the surcharge plus the basic tax in the base amount of delinquency interest effectively makes the interest rate around 60 percent annually or more. The interest is so enormous that the total tax due becomes double or triple of the amount of the basic tax.

But a closer inspection of the tax code shows that delinquency interest should not be applied to the basic deficiency tax, surcharge and interest altogether. The imposition, therefore, of the delinquency interest of 20 percent should only be applied to any one of a) basic deficiency tax; b) surcharge; and c) deficiency interest. In other words, the imposition of delinquency interest on basic deficiency tax, or surcharge, or deficiency interest, is in the alternative. The inclusion of all the three items as base amount of delinquency tax appears to have no basis in law.

But the CTA is consistent in including all three items in the base amount of delinquency interest. This has resulted in tax deficiencies that are confiscatory and insurmountable. Since we are in the advent of tax reform, the framers will hopefully clarify and simplify the imposition of interest on tax deficiencies. A straight 20-percent annual deficiency interest might be considered.

The Bureau of Internal Revenue takes years to resolve a contested assessment. The court, on the other hand, may take a decade before a final judgment is rendered. Thus, a cap on the interest that may be imposed is just fair. The Local Government Code, for example, imposes a three-year cap in the imposition of interest. This may be adapted in the new tax code. So, no matter how long a tax dispute is resolved, interest will only run up to three years.

If the effective interest rate of 60 percent will be upheld, many taxpayers will be left to hang dry when the court finally rules against them. Arguably, this is not the policy that a government wishes to undertake.

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