TAX LAW FOR BUSINESS

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'Payable in the context of withholding'

IN many countries, one of the most commonly used structural devices to prevent noncompliance of tax obligation is through the withholding of tax at source. This device requires payors of income to withhold tax from payments, thus depriving the payee of the opportunity not to pay tax. Through withholding, the government enforces payment of the income tax not directly from the person who receives the income and is, therefore, liable for it, but indirectly, by exacting its payment, before the income reaches his hands, from the person who is to pay it to him. *(Soos, Piroska. Self-Employed Evasion and Tax Withholding. 1991)*

Historically, England introduced the principle of "taxation at source" when it reenacted the income tax in 1803 to prevent the gross frauds and evasions that had characterized the first income tax. Withholding was also an important feature of the Civil War income tax in the United States, introduced in 1862 to raise revenue for the Civil War. By the early 1940s, Canada, Australia and the United Kingdom had instituted withholding of tax on wages (*Supra*).

In the modern context, however, withholding is widely used to collect the income tax. Withholding is favored as a collection scheme because it provides a convenient payment method to taxpayers and enables the government to collect small amounts of tax efficiently. Withholding avoids the problem of inability to pay by collecting tax before taxpayers spend their income. Withholding also speeds up tax collection, insures a steady flow of funds to the treasury and increases total tax revenue because of earlier receipt of tax payments (*Supra*).

In the domestic context, the Philippines introduced the expanded withholding tax system in 1978. Under this system, withholding applies to various types of income, including business income, obtained by resident individuals, domestic corporations and foreign corporations engaged in business in the Philippines. Broad as it is, the expanded withholding tax system applies only to persons and payments specifically mentioned in the regulations.

Presently, revenue regulation (RR) 2-98 is the mother of all regulations under this system. It enumerated the scope of withholding, selection of withholding agents and the administration and enforcement. A common issue under this system pertains to time of withholding. Taxpayers and the Philippine Bureau of Internal Revenue (BIR) often argue as to when exactly the withholding of tax should be made.

The regulation is explicit that the obligation of the payor to deduct and withhold tax arises at the time an income is paid or payable, whichever comes first. The term “payable” refers to the date the obligation becomes due, demandable or legally enforceable.

The BIR insists in the latest Supreme Court (SC) Case (GR 201665) on this issue that the withholding commences at the date of execution of the contract and not from the date of the first payment. To the contrary, however, the SC rejected the BIR’s position and held that based on the loan agreement, the liability for interest payment became due and demandable on the date of the first payment.

The SC rejected also the BIR’s notion for the retroactive application of RR 12-01, which provides additional condition that the withholding of final tax commences “at the time the income payment is accrued or recorded as an expense or asset.” According to the SC, to allow a party to change his theory on appeal would be unfair to the other party and offensive to rules of fair play, justice and due process.

All told, the SC decision interpreting the term “payable” in the context of withholding clearly manifests fairness in taxation that requires equality in the treatment of taxpayers. Put differently, taxpayers should be required to pay with the same frequency and should have the same choices about complying with their tax duty.

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