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# SyCipLaw TIPS

## TAX ISSUES AND PRACTICAL SOLUTIONS

**1. Can the 25% surcharge for late filing of a tax return be abated due to faulty internet connection at the taxpayer's office on the last day of filing?**

No. In *Qatar Airways with Limited Liability v. Commissioner of Internal Revenue* (G.R. No. 238914, June 8, 2020), the Supreme Court ruled that it is neither unjust nor excessive on the part of the Bureau of Internal Revenue (*BIR*) to impose a 25% surcharge even if the taxpayer was only one day late in filing its tax return (and even if the late filing is due to faulty internet connection at the taxpayer's office on the last day of filing) and in paying the tax due thereon. In this case, the taxpayer requested the abatement or cancellation of the 25% surcharge that was imposed by the BIR for the belated filing of its second quarterly income tax return. The taxpayer pleaded good faith and claimed that the late filing was due to a technical problem (*i.e.*, faulty internet connection at the taxpayer's office on the last day of filing), which was supposedly beyond the taxpayer's control. The taxpayer also argued that it had difficulty in interpreting the correct Gross Philippine Billings (*GPB*) computation for income tax under the then newly-issued BIR Revenue Regulations No. 11-2001.

The Supreme Court denied the taxpayer's request and ruled that a technical malfunction does not fall under any of the instances – when penalties imposed on the taxpayer may be abated or cancelled on the ground that the imposition thereof is unjust or excessive – enumerated in BIR Revenue Regulations No. 13-2001, as amended by BIR Revenue Regulations No. 4-2012 (*RR No. 4-12*).

In particular, according to the Supreme Court, a faulty internet connection is not a circumstance beyond the taxpayer's control, because the delay could have been easily avoided had the taxpayer filed its income tax return (*ITR*) earlier or before the deadline. On the taxpayer's argument that it had difficulty in interpreting the correct GPB computation, the Supreme Court ruled that if the taxpayer was still unsure with the figures contained in the ITR, the taxpayer could have filed a tentative quarterly ITR to avoid paying the 25% surcharge for late filing. Thereafter, the taxpayer could have modified, changed, or amended the tentative ITR already filed, if warranted.

**SyCipLaw TIP 1:**
The imposition of the 25% surcharge due to the belated filing of an ITR is strictly enforced. By itself, a faulty internet connection is not considered a meritorious circumstance in which the surcharge imposed on late payment of the tax may be abated or cancelled, even if the tax payment was only a day late. Keep in mind that, under RR No. 4-12, "one day late filing and remittance due to failure to beat the bank cut-off time" is no longer considered a meritorious circumstance in which penalties and/or interest imposed on late payment of the tax may be abated or cancelled.

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**2. What are the new requirements for availing of the 15% tax sparing rate for dividends paid by a domestic corporation to a non-resident foreign corporation?**

The BIR now requires the filing of a request for a confirmatory ruling for a taxpayer to avail itself of the 15% reduced rate (from the regular 30% final withholding tax rate) under the tax sparing provision of Section 28(B)(5)(b) of the National Internal Revenue Code, as amended (*Tax Code*). Revenue Memorandum Order No. 46-2020 (*RMO No. 46-20*) sets out the procedure and requirements for filing the request for a confirmatory ruling.

To recall, under the tax sparing rule, dividends paid by an investee domestic corporation to its shareholder that is a non-resident foreign corporation (*NRFC*) are subject to a final withholding tax of 15%, provided that the country of residence of the NRFC allows a credit against its tax due taxes deemed to have been paid in the Philippines equivalent to at least 15% (which represents the difference between the regular 30% rate and the reduced 15% rate) or provided that the country of residence of the NRFC does not impose any income tax.

**SyCipLaw Tip 2:**
If the NRFC can avail itself of both the tax sparing rate and the tax treaty rate (under a tax treaty of its country with the Philippines) for its dividend income, it would be simpler and less time-consuming for the NRFC to avail itself of the tax treaty rate. Availment of the tax treaty rate entails only the submission of a Certificate of Residence for Tax Treaty Relief (in accordance with Revenue Memorandum Order No. 8-2017), while availment of the tax sparing rate requires the filing of a request for a confirmation and a longer list of supporting documents.

Under RMO No. 46-20, a domestic corporation (the withholding agent for the dividends to the NRFC) has to submit to the BIR's International Tax Affairs Division a request for a confirmatory ruling that the NRFC is entitled to the tax sparing rate. The application must be filed at the later of: (a) 90 days from the remittance of the dividends, or (b) the determination by the foreign tax authority that the NRFC is entitled to the deemed paid tax credit or to exemption from income tax on the dividends paid by the domestic corporation. Thus, the investee domestic corporation may remit outright the dividends to the NRFC using the 15% tax sparing rate without first applying for a confirmatory ruling from the BIR.

Section 6 of RMO No. 46-20 enumerates the documentary requirements to support the application for the reduced dividend rate, and these include proof of the foreign law granting the deemed paid tax credit or income tax exemption and a document issued by or filed with the foreign tax authority on the deemed paid tax credit granted to the NRFC.

Section 5 of RMO No. 46-20 also provides that a holder of Philippine Depositary Receipts (*PDR*) may likewise be considered as a shareholder. Since a typical PDR also entitles its holder to the dividends accruing to the underlying shares, for taxation purposes, these dividends are entitled to the reduced rate provided that: (i) the PDR is coupled with a right to purchase the underlying shares; and (ii) the said right can be legally exercised.

**3. Are the EDSA MRT III real properties, which are owned by a private corporation but leased to the Republic of the Philippines through a build-lease-transfer arrangement, subject to real property tax?**

According to the Court of Tax Appeals (*CTA*) en banc, no. In *Mandaluyong City Government v. Republic of the Philippines* (CTA EB Case No. 2078, December 4, 2020), the CTA ruled that the Light Rail Transit System – LRTs Phase I (*EDSA MRT III*) real properties are not subject to real property tax (*RPT*).

Under Section 234 of Republic Act No. 7160, or the Local Government Code, real property owned by the Republic or any of its political subdivisions, are exempt from RPT, except when the beneficial use thereof has been granted, for consideration or otherwise, to a taxable person.

The CTA ruled that the Republic is not just a mere possessor of the real properties in question, but is also the beneficial owner of the same, thus the real properties are exempt from RPT. It characterized the build, lease and transfer (*BLT*) arrangement under the Revised and Restated Agreement to Build, Lease and Transfer a Light Rail System (*BLT Agreement*) between respondents Republic of the Philippines (*Republic*), through the Department of Transportation (*DOTr*), and Metro Rail Transit Corporation Limited (*MRTC*), a private corporation, as a financing mechanism -- the Republic (through the DOTr) "is obligated to amortize payments to MRTC, which in turn will be sourced from the operations of EDSA MRT III." At the end of a certain period, the MRTC shall transfer to the DOTr its title to and all of its rights and interests in the EDSA MRT III.

According to the CTA, considering that the MRT EDSA III real properties are intended for and devoted to public use, they are recognized under Philippine laws as properties of the public dominion and are therefore owned by the State or the Republic, pursuant to Article 420 of the Civil Code. Since these real properties are outside the commerce of man, they cannot be the lawful subject of an auction sale.

**SyCipLaw TIP 3:**
In a real property tax assessment involving real properties covered by the build-operate-transfer arrangements such as the BLT agreement, it is important to determine if it may be argued that the Republic is the beneficial owner of the real properties and/or whether the properties may be considered intended for and devoted to public use. If the real properties fall under these classifications, they should be exempt from RPT under Local Government Code.

**4. Is there a need for a new letter of authority if the revenue officer/s named in the letter of authority are changed?**

Yes. In *Commissioner of Internal Revenue v. Marketing Convergence, Inc.* (CTA En Banc Case No. 2109, December 3, 2020), the CTA ruled that all the revenue officers (*RO*) who conduct a tax examination or audit must be authorized by and be specifically named in a Letter of Authority (*LOA*). A mere Memorandum of Assignment is not sufficient to validly reassign an existing tax examination or audit to another RO. A new LOA naming the new RO must be issued. Unless the name of the RO is indicated in the LOA issued to the taxpayer, the RO is devoid of authority to conduct an audit and an assessment issued by such an RO is void.

**SyCipLaw TIP 4:**
Taxpayers must ensure that the ROs conducting a tax examination or audit are specifically named in and authorized under the LOAs. If they are not so authorized, the assessments they will issue can be challenged as void.

Note that petitioner Commissioner of Internal Revenue has filed a motion for reconsideration which is currently pending before the CTA.

**5. What are the requirements to establish that an entity is a non-resident foreign corporation for purposes of VAT zero-rating under Section 108(B)(2) of the Tax Code?**

In *Commissioner of Internal Revenue v. Deutsche Knowledge Services, Pte. Ltd.* (G.R. No. 234445, July 15, 2020), the Supreme Court ruled that, in order to claim refund of input VAT for sales subject to value-added tax (*VAT*) zero-rating under Section 108(B)(2) of the Tax Code, the claimant must establish the two components of a client's NRFC status, namely: (a) that the client was established under the laws of a country not the Philippines (*i.e.*, it is not a domestic corporation); and (b) that the client is not engaged in trade or business in the Philippines.

In establishing the foregoing two components of a client's NRFC status, the Supreme Court has ruled that a Securities and Exchange Commission (*SEC*) Certification of Non-Registration would show that a client is a foreign corporation. On the other hand, the articles of foreign association/certificates of incorporation, stating that a client is registered to operate in their respective home countries outside the Philippines, are prima facie evidence that the client is not engaged in trade or business in the Philippines. The absence of evidence proving either of the two components shall be fatal to a claim for credit or refund of excess input VAT attributable to zero-rated sales.

**SyCipLaw Tip 5:**
To prove entitlement to zero-rating, the claimant must present the SEC negative certification and the articles of foreign association/certificates of incorporation, and there must be no evidence that the client is doing business in the Philippines.

**6. Can the CTA rule on issues raised for the first time on appeal?**

According to the CTA en banc, yes. In *Commissioner of Internal Revenue v. Marketing Convergence, Inc.* (CTA En Banc Case No. 2109, December 3, 2020), the CTA ruled that a Division of the CTA is allowed to rule on issues raised for the first time on appeal, and is allowed to resolve issues that were not even raised by the parties. Rule 14, Section 1 of the Revised Rules of the CTA provides that the CTA is not bound by the issues specifically raised by the parties; it may also rule upon related issues necessary to achieve an orderly disposition of the case.

**SyCipLaw Tip 6:**
When a taxpayer files an appeal with the CTA, the taxpayer need not limit his appeal to the issues and arguments raised during the proceedings with the BIR. The taxpayer should study the case again and determine whether there are other arguments and issues it can raise before the CTA.

Note that petitioner Commissioner of Internal Revenue has filed a motion for reconsideration which is currently pending before the CTA.

**7. What must the Bureau of Customs prove to order the forfeiture of imported goods under Section 113 of the Customs Modernization and Tariff Act ?**

In *Garchitorena vs. Commissioner of Customs* (CTA Case No. 9972, December 9, 2020), the CTA ruled that the shipment of an importer cannot be forfeited based solely on the mere existence of an irregularity in the invoice submitted for the valuation and release of an imported vehicle, especially when the importer denied that he caused the said irregularity. In this case, the Commissioner of Customs (*Customs Commissioner*) alleged the existence of the irregularity but failed to allege that the importer caused the execution of the supposedly spurious document. On this basis, the CTA set aside the Customs Commissioner's order of forfeiture. It must also be noted that the Customs Commissioner's allegation of irregularity – the supposed undervaluation of the imported vehicle – was bereft of basis or proof as it was based solely on a previous valuation which was already abandoned.

The CTA cited the Supreme Court's ruling in *Commissioner of Customs, et al. v. New Frontier Sugar Corporation* (G.R. No. 163055, June 11, 2014), where the Supreme Court ruled that: "[t]he onus probandi [or the burden of proof] to establish the existence of fraud is lodged with the Bureau of Customs which ordered the forfeiture of the imported goods. Fraud is never presumed. It must be proved. Failure of proof of fraud is a bar to forfeiture. The reason is that forfeitures are not favored in law and equity. The fraud contemplated by law must be intentional fraud, consisting of deception willfully and deliberately done or resorted to in order to induce another to give up some right. Absent fraud, the Bureau of Customs cannot forfeit the shipment in its favor."

**SyCipLaw Tip 7:**
Mere allegation of undervaluation, or the existence of an irregularity in the document, is not sufficient to cause the forfeiture of an imported shipment. If an importer receives an order of forfeiture from the Bureau of Customs on the basis of undervaluation or a spurious invoice, the importer must check if the claim is supported by evidence of fraud. Otherwise, the importer can assail the validity of the order of forfeiture.