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SyCipLaw TIPS

TAX ISSUES AND PRACTICAL SOLUTIONS

1. Is there an exception to the general rule that findings of fact of the Court of Tax Appeals *(CTA)* are regarded as final, binding, and conclusive upon the Supreme Court?

Yes. In *Commissioner of Customs v. Gold Mark Sea Carriers, Inc.,* (G.R. No. 208318, June 30, 2021), the Supreme Court ruled that the Court may review the factual findings of the CTA when the CTA was shown to have disregarded relevant facts and evidence, which if considered, would alter the final outcome of the case.

In this case, M/T Jacob 1 towed the barge "Cheryl Ann" from the Republic of Palau to the Port of Surigao where it temporarily stopped for emergency bunkering as it was allegedly running low on fuel and food provisions and was having a mechanical problem. "Cheryl Ann" is owned by respondent Gold Mark Sea Carriers, Inc. The Philippine Coast Guard detained M/T Jacob 1 and the barge because of a report that the barge contained used oil, without the required importation permit from the government agency concerned.

The Third Division of the CTA declared that there was no evidence to prove that the barge intended to defraud the government. The barge was not shown to have committed or attempted to commit illegal importation to justify its forfeiture. As a non-motorized vessel, the barge was only forced to enter the Port of Surigao because the tugboat navigating it needed emergency repairs.

The CTA *En Banc* affirmed the decision.

However, the Supreme Court reversed the CTA findings and ruled that the CTA *En Banc* disregarded ample evidence on record, indicating a clear intent on the part of respondent to commit illegal importation which warrants the forfeiture of the barge. The Court found that, contrary to the findings of the CTA *En Banc*, the cargo of barge "Cheryl Ann" was not bound for Malaysia, but in truth, was bound to unload its cargo in the Philippines as evidenced by the Charter Agreement between the owner of the cargo and Gold Mark. Moreover, the Maritime Industry Authority special permit issued for this specific towing arrangement showed that there was only one place where the cargo was to be discharged — Manila.

The records showed that the Philippines was the only and final destination of the illegal importation of used oil on board the barge "Cheryl Ann." It was an illegal importation because it was not covered by a corresponding importation permit in violation of existing laws and rules and regulations.

SyCipLaw Tip 1:
The parties should exert all efforts to gather, prepare and present all supporting evidence necessary to prove their factual claims while they are litigating before the CTA. In case of an adverse finding of fact by the CTA, an appellant may still have an opportunity to challenge that finding before the Supreme Court even if findings of fact of the CTA are generally regarded as final, binding and conclusive upon the Supreme Court.

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2. May the adverse party in an arbitration proceeding intervene in a separate special proceeding which is directed against a person not a party to the arbitration?

Yes, if that adverse party is an indispensable party in the separate special proceeding. In *Federal Express Corp. v. Airfreight 2100, Inc.* (G.R. No. 225050, September 14, 2021), the Supreme Court reiterated that an "indispensable party" is one whose interest will be affected by the court's action in the litigation, and without whom no final determination of the case can be had. In said party's absence, there cannot be a resolution of the dispute of the parties before the Court which is effective, complete, or equitable.

Federal Express Corp. *(FedEx)* initiated an international commercial arbitration case before the Philippine Dispute Resolution Center, Inc. *(PDRCI)* against Airfreight 2100, Inc. *(AF2100)* on various issues including "whether or not AF2100 is entitled to withhold amounts due to FedEx on the ground that AF2100 paid Value-Added Tax *(VAT)* to the Bureau of Internal Revenue *(BIR)* on behalf of FedEx." Eventually, the Arbitral Tribunal rendered a Final Award in favor of FedEx.

Afterwards, FedEx filed a Petition for Assistance in Taking Evidence *(PATE Case)* under Rule 9 of the Special Rules of Court on Alternative Dispute Resolution *(Special ADR Rules)* before the Regional Trial Court *(RTC)*. In said Petition, FedEx sought the issuance of a subpoena against respondent Commissioner of Internal Revenue *(CIR)* for the production of the copies of the monthly and quarterly VAT returns of AF2100 which are in the possession of the BIR. AF2100 filed a motion to intervene but the RTC denied the same.

The Supreme Court ruled that while it is true that the relief under Rule 9.5 of the Special ADR Rules is directed against a person not a party to the arbitration proceedings, it does not mean that the actual parties to the arbitration proceedings are to be excluded from the Petition. Since the PATE Case is merely ancillary to the main Arbitration Case in which AF2100 was a party, together with FedEx, whatever evidence FedEx might have acquired in the PATE Case could be used against and affect the rights and interests of AF2100 in the Arbitration Case.

Moreover, in the PATE Case, FedEx was requesting from the BIR documents that were filed with the BIR by AF2100 as a taxpayer. The Requested Documents contained information pertaining to AF2100 and its business. In fact, the BIR repeatedly stated in its defense that the Requested Documents involved trade secrets that were confidential in nature, and it could not open the same for inspection or reproduction without the consent or authorization of AF2100 as taxpayer. Without delving into BIR's defense of confidentiality, it is undeniable that AF2100 had legal interest in the Requested Documents subject of the PATE Case even though they were in the physical custody of the BIR.

SyCipLaw Tip 2:
Taxpayers must be proactive in defending cases where they have interests, although not impleaded by the petitioner. A party whose interest will be affected by the court's action in the litigation, and without whom no final determination of the case can be had, may file a motion to intervene in the pending action.

3. May a local government unit *(LGU)* impose local business taxes on a holding company?

No. In *City of Makati, et al. v. DMCI Holdings, Inc.* (CTA AC No. 234, February 10, 2022), the Third Division of the CTA ruled that the City of Makati "may not impose business taxes on respondent [holding company] under [the Revised Makati Revenue Code], since there is no showing that respondent is a bank or other financial institution."

Under Republic Act No. 7160, or the Local Government Code of 1991 *(LGC)*, an LGU may impose local business taxes on (i) contractors and other independent contractors under Section 143(e), and (ii) banks and other financial institutions under Section 143(f), both in relation to Section 151 of the LGC.

In this case, pursuant to the foregoing taxing power, the City of Makati adopted the Revised Makati Revenue Code *(RMRC)*, imposing local business taxes on (i) contractors and other independent contractors under Section 3A.02[g] of the RMRC, (ii) banks and other financial institutions under Section 3A.02[h] of the RMRC, and (iii) holding companies under Section 3A.02[p] of the RMRC. The City of Makati asserted that "a holding company, such as respondent, need not be a service contractor, nor an owner or operator of banks and other financial institutions" in order that local business taxes may be assessed against it under the RMRC.

SyCipLaw Tip 3:
Even as the LGC empowers each LGU to create its own sources of revenue, and to levy taxes, fees, and charges, this delegated power to tax is subject to the limitations provided under the LGC. If an LGU imposes a local business tax under its revenue code, companies should ensure that the LGC allows the LGU to impose such tax under the LGC.

CTA decisions, while persuasive, do not become the law of the land, unlike decisions of the Supreme Court.

The CTA ruled that "unlike the national government, LGUs have no inherent power to tax. They merely derived the power from Article X, Section 5 of the 1987 Constitution. Consistent with this provision, the LGC was enacted to give each LGU the power to create its own source of revenue and to levy taxes, fees, and charges subject to statutory guidelines and limitations." Thus, "the power of an LGU to impose or levy taxes cannot go beyond the limitations set forth by the provisions of the LGC of 1991."

The CTA further ruled that since the local business tax imposition on respondent holding company was made pursuant to Section 143(f), in relation to Section 151, of the LGC, for the holding company to be taxable under the RMRC, "it must fall under the purview of 'banks and other financial institutions'. Otherwise, it is not taxable under the said provisions."

In this case, the CTA found that respondent holding company does not fall under the scope of the term "banks and other financial institutions" as defined in Section 131(e) of the LGC, which provides that "'Banks and other financial institutions' include non-bank financial intermediaries, lending investors, finance and investment companies, pawnshops, money shops, insurance companies, stock markets, stockbrokers and dealers in securities and foreign exchange". Accordingly, respondent holding company cannot be assessed local business taxes under Section 3A.02[p] of the RMRC.

4. May an assessment notice which fails to indicate the due date for payment of assessed taxes be considered a valid assessment?

No. In *Commissioner of Internal Revenue v. Universal Robina Corporation* (CTA EB No. 2280 [CTA Case No. 9530], December 7, 2021), the CTA held that the failure of the CIR to state the due date for payment of assessed taxes invalidates the assessment.

In this case, the CIR issued a Formal Letter of Demand *(FLD)* to Universal Robina Corporation *(URC)* in respect of the latter's alleged tax liabilities for the taxable year ended September 30, 2010. URC protested the assessment, but the CIR ultimately issued a Final Decision on Disputed Assessment, and later, an Amended Final Decision on Disputed Assessment. On appeal, the CTA Division granted URC's petition and cancelled the tax assessment issued by the CIR on the ground that the assessment did not contain a definite due date for payment.

The CTA *En Banc* affirmed the decision of the CTA Division. While the parties did not raise the issues on the lack of definite amount of tax liabilities and due date on the subject tax assessment in the proceedings before the CTA Division, the CTA *En Banc* held that these issues are "inextricably intertwined with the validity of the assessment itself. This becomes more important in view of the doctrine that a void assessment bears no valid fruit. As such, the Court in Division was well within its authority to solve the said related matters."

Further, jurisprudence has established the rule that "a valid tax assessment must not only include a computation of tax liabilities but also a demand for payment within a period prescribed." In the present case, however, "a perusal of the FLD shows that it does not state a due date for the payment of the assessed taxes. Neither did the Court in Division find any due date in the corresponding undated Audit Result / Assessment Notice No. IAET-116-LOA-00000004-10-14-1306.64 In fact, the space in the Assessment Notice where the due date is to be indicated *'remained unaccomplished'*." Consequently, the failure of the CIR to state the due date for payment of the assessed taxes invalidates the assessment.

SyCipLaw Tip 4:
In order to be valid assessments, tax assessments issued by local tax authorities should comply with certain legal requirements, which include, among other information, that the notice of assessment should state the legal and factual bases of the assessments and the specific due date for payment of the assessed taxes. These are substantive, and not merely formal, requirements that affect the due process right of taxpayers.

A motion for reconsideration of the decision is currently pending.

CTA decisions, while persuasive, do not become the law of the land, unlike decisions of the Supreme Court.

5. Tax-free exchange in the time of CREATE

The Corporate Recovery and Tax Incentives for Enterprises *(CREATE)* Act now expressly provides that a prior BIR ruling is not required for purposes of allowing a taxpayer to avail himself of the tax exemption under Section 40(C)(2) of the National Internal Revenue Code, as amended *(Tax Code)* on tax-free exchange *(TFE)* transactions. Section 8 of Revenue Regulations *(RR)* No. 5-2021 implemented the amendments to Section 40(C)(2). Under RR No. 5-2021, the parties to the TFE transaction can proceed to request for the issuance of the Certificate Authorizing Registration *(CAR)*, as applicable, from the relevant Revenue District Office *(RDO)*, subject to a post-transaction audit by the BIR. Prior to the CREATE Act, the BIR regulations required parties to the TFE transaction to submit with their income tax returns a copy of the request for ruling filed with the BIR and the certification issued by the BIR confirming the TFE nature of the transaction.

Given that the tax payable on the exchange of properties in a TFE transaction is merely deferred, the BIR issued Revenue Memorandum Circular *(RMC)* No. 19-2022 to provide guidance to the RDOs and other revenue officers on Section 8 of RR No. 5-2021, particularly on the issuance of the CAR without a prior BIR confirmation on the TFE nature of the transaction. The revenue officers are tasked to ensure that the proper taxes on the subsequent sale of the properties exchanged in a TFE transaction are collected through the proper monitoring of the correct substituted basis on the exchanged properties. The substituted basis, as defined in the Tax Code and BIR issuances, is the basis for determining gain or loss on the subsequent sale of the properties subject of the TFE transaction.

As part of the BIR's process to monitor the substituted basis, the parties to a TFE transaction must file with, or incorporate in, their income tax returns a complete statement of all facts pertinent to the non-recognition of gain or loss on the TFE transaction.

SyCipLaw Tip 5:
Because parties to a TFE transaction are given the option to apply for a TFE ruling to confirm the tax-free exchange nature of their transaction, the parties will have to assess whether they will be able to obtain the CAR faster if they already have a BIR ruling confirming the TFE nature of the transaction. If they do proceed with filing an application for a CAR without first having obtained a favorable BIR ruling, they risk getting an assessment from the BIR if the latter finds during the post-audit that the transaction does not qualify as a TFE transaction. It is not clear under the regulations and issuances whether a post-audit by the RDO is still required if the taxpayer obtained a BIR ruling confirming the TFE nature of the transaction prior to obtaining the CAR. An ongoing audit by the RDO will also close the taxpayer's option of securing a ruling from the BIR as the LLD may refuse to issue a ruling if a transaction is already under investigation or on-going audit by the BIR at the time the request for ruling is filed.

RMC 19-2022 also provided rules on the venue for the issuance of a CAR for a TFE transaction. In case real property is exchanged, the documentary requirements for the CAR shall be submitted to the RDO where the real property is located. In case shares of stock are exchanged, the documents for the CAR shall be filed with the RDO where the issuing corporation is registered. The venue for processing the CAR in case of an exchange of shares of stocks appears to be a deviation from the previous procedure where the CAR is processed in the RDO where the seller or the transferor is registered as a taxpayer. Additionally, if the TFE transaction involves the transfer of multiple real properties and/or shares of stock located in various locations covered by different RDOs, the CAR will be processed by the RDO having jurisdiction over the place where the transferee corporation is registered. The original of the notarized BIR Form 1927 or the Application and Joint Certification which was usually filed with the BIR when a prior TFE ruling was required, must now be submitted to the RDO for purposes of processing a CAR.

The issuance of a CAR does not preclude the RDO from conducting a post-audit of the TFE transaction. If the RDO finds during the audit that the transaction is not entitled to tax deferment under Section 40(C)(2) of the Tax Code, the transaction will be subject to the applicable taxes, surcharges and interest. The result of the audit will not invalidate the CAR previously issued for the transfer of the properties.

Notwithstanding the provisions of CREATE, RMC 19-2022 gives the parties to a TFE transaction the option of requesting a ruling from the Law and Legislative Division *(LLD)* of the BIR's National Office if they wish to clarify legal issues that may affect the TFE transaction (such as the taxability of the transaction). The LLD will evaluate whether the request for ruling involves questions of law that would merit a ruling from the BIR; otherwise, the LLD will endorse the request for ruling to the relevant RDO for appropriate action.

6. Filing of Requests for Confirmation, Tax Treaty Relief Applications, and Tax Sparing Applications Made Easy

In 2021, the BIR issued Revenue Memorandum Order *(RMO)* No. 14-2021 to streamline the procedures and requirements for the availment of tax treaty benefits. A prior application with the BIR for tax treaty relief is no longer required. Instead, withholding agents or income payors may apply the applicable tax treaty rates to income payments made to non-resident payees provided that they file with the BIR after the end of their taxable year a consolidated request for confirmation *(RFC)* of the applicability of such treaty rates. If, on the other hand, the withholding agent applies the regular rates under the Tax Code to income payments made to a non-resident payee, the latter may file a tax treaty relief application *(TTRA)* to confirm the payee's entitlement to tax treaty benefits if it wants to get a refund for the excess income taxes withheld. The non-resident income payee may already file a claim for refund together with the TTRA, but the claim for refund will be processed only after non-resident income payee's entitlement to the tax treaty benefit has been confirmed.

The BIR will issue a Certificate of Entitlement to Treaty Benefit *(COE)* if the RFC or TTRA is approved. There are two types of COEs: (i) COEs for recurring transactions (applicable to income such as dividends, branch profit remittances, interest, royalties); and (ii) COEs for a particular transaction or for a period of engagement (applicable to business profits, capital gains, income from services).

In February 2022, the BIR issued RMC No. 20-2022 to clarify that taxpayers who were already issued COEs for recurring transaction no longer need to file an RFC or TTRA every time income of a similar nature is paid to the same non-resident payee. This is intended to ease the volume of applications filed with and processed by the BIR as it was observed that more than 50% of the requests filed with it are in respect of recurring transactions.

SyCipLaw Tip 6:
While, in recurring transactions, a withholding agent or income payor is no longer required to secure a COE each time it makes the same nature of payment to the same non-resident payee, the withholding agent or income payor must ensure that (i) the COE it has already obtained expressly provides that the COE applies to future payments to the same non-resident payee; (ii) the facts and circumstances under which the COE was issued are the same as those present when a payment is to be made; (iii) all the conditions and documentary requirements set out in the COE are in place when the payment is made; and (iv) all relevant documents and records are preserved and can be presented in case of a tax audit. Failure to comply with the requisites in the COE will expose the withholding agent or income payor to deficiency withholding taxes notwithstanding that it has a secured a COE for the transaction.

Notwithstanding this, the withholding agent or income payor must still comply with the requisites mentioned in the COE every time a payment is made to the non-resident. As an example, RMC No. 20-2022 provides that if the COE mentions tax residency as a requirement for the availment of the tax treaty benefit, the withholding agent or income payor must require the non-resident payee to submit a Tax Residency Certificate for the relevant year before making any payment to the non-resident payee. The same principle applies to the Certificate of Entitlement to the Reduced Dividend Rate issued for tax sparing applications.

If the requirements set out in the COE issued by the BIR are not present (for example, because there is a change in the tax residence), then the taxpayer must file a new RFC, TTRA or tax sparing application. The withholding agent or income payor should keep records of the COEs and proof of satisfaction with the requisites laid down in the COEs for purposes of tax audits.

In case of non-recurring transactions, the taxpayer must follow the procedure in RMO No. 14-2021 and RMC No. 77-2021 when filing its RFC or TTRA.

For transactions involving long-term contracts (i.e., contracts effective for more than a year), which require annual updates to be submitted to the BIR until the termination of the contract, RMC No. 20-2022 specifies the relevant documents to be submitted for purposes of the annual update.

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