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1. Are informal settlement agreements between the Commissioner of Internal Revenue and the taxpayer valid and binding?

Yes. In *Commissioner of Internal Revenue ("CIR") v. Toledo Power Company* (G.R. No. 259309, dated February 13, 2023), the Supreme Court held that the informal settlement agreement entered into between the taxpayer and the CIR was valid and binding.

On July 30, 2015, Toledo received a Preliminary Assessment Notice (*"PAN"*) from the Bureau of Internal Revenue (*"BIR"*) assessing deficiency taxes in the amount of PHP 92,769,216.84 including deficiency value-added tax (*"VAT"*) in the amount of PHP 4,025,642.60 on its sale of power to Carmen Copper Corporation (*"CCC"*). On September 4, 2015, Toledo paid the assessed VAT deficiency based on the PAN with interest, in the total amount of PHP 6,971,071.10. Such payment was pursuant to an informal settlement agreement between the CIR and Toledo, where the parties agreed to the payment of a lower amount instead of the original assessed tax deficiency. On March 26, 2015, in a complete turnaround, Toledo filed an administrative claim for a refund of the assessed VAT deficiency that it had paid, on the ground that it was erroneously or illegally collected under Section 229 of the National Internal Revenue Code, as amended (*"Tax Code"*). On March 21, 2016, Toledo filed a Petition for Review with the Court of Tax Appeals (*"CTA"*) to meet the 2-year prescriptive period under Sections 204 (C) and 229 of the Tax Code. The CTA En Banc granted the claim for refund of PHP 6,971,071.10.

The Supreme Court reversed the CTA's ruling. It held that while the Tax Code provides the procedure for settlement and compromise of tax disputes including limitations on the BIR's authority, the Legislature has never prevented the BIR to use other less formal methods of resolving tax controversy, without going through the tedious process of litigation. As such, the CIR may enter into informal settlements to write *finis* to any of these cases within the parameters prescribed by law.

The Supreme Court further held that the informal settlement contained all the essential elements of a contract under Article 1318 of the Civil Code. Here, both parties entered into an informal settlement agreement to terminate the tax investigation and the BIR's right to pursue deficiency taxes in the total amount of PHP 92,769,216.84 in exchange for the taxpayer's payment of PHP 6,971,071.10 VAT deficiency. Toledo paid the amount as consideration and the CIR stopped its tax investigation constituting the object or subject matter of the informal agreement, thus, allowing his cause of action against Toledo to prescribe. When all the elements are present, the informal settlement between the parties is generally binding and cannot be undone except in case of falsity or fraud under Section 248 (b) of the Tax Code. Hence, Toledo was estopped from seeking a refund of the settlement amount especially after it had already benefitted therefrom in terms of being made exempt from an otherwise tedious litigation and the payment of the huge amount of PHP 92,769,216.84.

By way of *obiter dictum*,[1] the Supreme Court said that, even assuming there was no informal settlement, Toledo's claim for refund must still fail following the doctrine of estoppel under Article 1431 of the Civil Code. By paying the VAT deficiency, Toledo impliedly admitted the validity of the findings under the PAN. Had it truly believed that its sale of power to CCC was zero-rated, it should have contested the findings by filing a reply to the PAN or questioning the validity of the CIR findings after the issuance of a Final Letter of Demand/Final Assessment Notice ("*FLD/FAN*"); but instead, it chose to pay the amount without any reservation or protest. Toledo's misrepresentation hinged not only on its deafening silence on the real reason it paid the amount in the first place, but also on its inexplicable failure to categorically state or make of record that the payment made by the company was conditional or under protest. ■

SyCipLaw Tip No. 1

The taxpayer and the CIR may enter into informal settlements to agree on the payment of a lower tax deficiency assessment. As a general rule, such agreements constitute valid and binding contracts that cannot be undone by the taxpayer or the CIR. Once the lower tax deficiency has been paid pursuant to an informal settlement, the taxpayer is estopped from filing an administrative or judicial claim for refund of the amount paid on the ground that such tax had been erroneously or illegally collected unless the taxpayer has explicitly reserved its right to protest the assessment or seek a refund of what it paid.

2. While a tax case is pending in court, may the CIR and the taxpayer enter into a compromise agreement and request for judicial approval thereof?

Yes. In *CIR v. CTA-Third Division and Citysuper, Inc.* (G.R. No. 239464, dated October 10, 2022), the Supreme Court approved a compromise agreement between the CIR and Citysuper, even while the Supreme Court had already rendered a decision on the case, but the decision was pending a motion for reconsideration. The Supreme Court's decision dated May 10, 2021 upheld the tax assessment against Citysuper in the amount of PHP 2,083,016,072.43. On December 13, 2021, Citysuper wrote to the BIR, stating that it had been suffering from business losses exacerbated by the COVID-19 pandemic and offering to amicably settle its deficiency tax assessment, by paying PHP 600,000,000.00. Meanwhile, on December 21, 2021, Citysuper filed a motion for reconsideration of the Supreme Court's decision dated May 10, 2021.

On January 20, 2022, the CIR and Citysuper entered into a judicial compromise agreement where the taxpayer paid, and the BIR accepted, the amount of PHP 600,000,000.00 as full settlement of the taxpayer's tax liability for the taxable year 2011. The CIR and Citysuper jointly asked the Supreme Court to approve the judicial compromise agreement and to declare the case closed and terminated. After reviewing its terms, the Supreme Court, in a minute resolution, approved the compromise agreement upon finding that it was not contrary to law, morals, good customs, and public policy and that it appeared to be freely executed by the parties. ■

SyCipLaw Tip No. 2

The taxpayer may still enter into a compromise agreement with the CIR while a tax assessment is pending in court, even at the appeal stages. Under Section 204(A) of the Tax Code, the CIR is authorized to compromise the payment of any internal revenue tax at a minimum compromise rate of 10% in cases of financial incapacity or 40% in cases of doubtful validity. A compromise agreement is subject to the approval of the National Evaluation Board where: (1) the basic tax involved exceeds PHP 1 million; or (2) the settlement offered is less than the prescribed minimum rates. Notably, the minute resolution of the Supreme Court did not discuss compliance with the requirements of Section 204(A) of the Tax Code. However, please note that Revenue Regulations No. 30-02 implementing Section 204(A) of the Tax Code purports to apply to, among others, civil tax cases being disputed before the courts.

[1] *Obiter dictum* is an opinion expressed by a court upon some question of law that is not necessary to the decision of the case before it. It is a remark made, or opinion expressed, by a judge "by the way," that is, incidentally or collaterally, and not directly upon the question before him, and is not binding as precedent. *Delta Motors Corporation v. Court of Appeals*, (G.R. No. 121075, July 24, 1997).

3. May a corporation file a claim for a tax refund if it paid final withholding taxes on dividends, which were erroneously declared and paid?

Yes. In *Matex International, Inc. v. Commissioner of Internal Revenue* (CTA EB No. 2627, January 30, 2024), the CTA En Banc ruled that taxes paid on the excessive payment of dividends are considered erroneously paid taxes, which fall within the context of Section 229 of the Tax Code.

In this case, the taxpayer declared and paid cash dividends to its stockholders, and withheld and paid final withholding taxes ("*FWT*") at the rate of 10%, pursuant to the Philippines-Japan Tax Treaty ("*RP-Japan Treaty*"). Subsequently, the taxpayer discovered that the dividends declared exceeded its unrestricted retained earnings, and so it reversed and recalled the excessive dividends paid, which were returned by the stockholders, net of the 10% FWT. The taxpayer claimed that there was erroneously paid FWT arising from the excess dividend distribution.

The BIR argued that the taxpayer failed to prove that the FWT was erroneously paid. The BIR emphasized that the taxpayer failed to show that the dividends declared were returned and that the taxpayer failed to show it had insufficient unrestricted retained earnings at the time of declaration.

The CTA En Banc ruled that the term "erroneous" in Section 229 of the Tax Code must be construed in its ordinary meaning – that there has been a mistake or incorrect payment of tax. It cited *SMI-ED Phil. Technology, Inc. v. Commissioner of Internal Revenue* (G.R. No. 175410, November 12, 2014), where the Supreme Court held that "[t]axes are generally self-assessed. They are initially computed and voluntarily paid by the taxpayer. xxx The self-assessing and voluntarily paying taxpayer, however, may later find that he or she has erroneously paid taxes. Erroneously paid taxes may come in the form of amounts that should not have been paid. Thus, a taxpayer may find that he or she has paid more than the amount that should have been paid under the law."

Here, the CTA En Banc ruled that the FWT paid on the overpaid dividends is considered as an erroneously paid tax, which may be the subject of a claim for refund or credit. It further ruled that the taxpayer was able to prove that it had erroneously declared and paid dividends based on the amount of unrestricted retained earnings in its audited financial statements. Accordingly, the CTA En Banc considered the taxes paid on the excessive payment of dividends as an "erroneously paid tax" within the context of Section 229 of the Tax Code. ■

SyCipLaw Tip No. 3

Taxpayers who made excessive payments of taxes to the BIR, regardless of whether the mistake was due to an erroneous calculation of the tax or an erroneous calculation of the tax base, may file an administrative claim for tax refund or credit within two years from the erroneous payment of the tax to the BIR, pursuant to Section 204 of the Tax Code.

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

4. Does the Court of Tax Appeals have jurisdiction over a petition for review questioning a Final Notice Before Seizure issued by the Bureau of Internal Revenue?

Yes. In *Bureau of Internal Revenue v. Megaconstruct Group, Inc.* (CTA EB Case No. 2633, February 1, 2024), the CTA En Banc ruled that the CTA has jurisdiction over a petition for review questioning a Final Notice Before Seizure ("*FNBS*") issued by the BIR.

In this case, the taxpayer was initially registered with Revenue District Office ("*RDO*") No. 36 in Palawan. On August 3, 2011, the taxpayer notified the BIR of the change of its business address and the transfer of its

registration to RDO No. 25 in Bulacan.

The BIR issued a Letter of Authority ("*LOA*") dated November 3, 2015, authorizing the examination of the taxpayer's books of accounts and other accounting records for taxable year 2014. On March 27, 2018, the BIR issued a PAN against the taxpayer for deficiency income tax for the year 2014. Thereafter, the BIR issued a Final Letter of Demand, with the attached Final Assessment Notices ("*FAN*") dated April 13, 2018. The LOA, PAN, FLD, and FAN were all delivered to the taxpayer's former address in Palawan.

Subsequently, the taxpayer received a Preliminary Collection Letter dated October 23, 2018 ("*PCL*") from the BIR. The taxpayer also received an FNBS dated November 14, 2018. Notably, the PCL and the FNBS were delivered to the taxpayer's current address in Bulacan. On December 19, 2018, the taxpayer filed a letter with the BIR, protesting the PCL and FNBS. Subsequently, on December 21, 2018, the taxpayer filed a petition for review with the CTA.

The BIR argued that the CTA had no jurisdiction over the petition for review considering that the subject assessment has allegedly become final, executory, and demandable. The BIR pointed out that the reckoning period in determining whether the assessment has become final and executory should have been the date of the taxpayer's receipt of the PCL dated October 23, 2018, and not the taxpayer's receipt of the FNBS dated November 14, 2018.

On the other hand, the taxpayer argued that the petition for review was filed on time since the reckoning period to determine whether the assessment has become final and executory should be based on its receipt of the FNBS dated November 14, 2018.

The CTA En Banc ruled that Section 7(a)(1) of Republic Act No. 1125, as amended by Republic Act No. 9282, not only confers jurisdiction on the CTA to decide cases relating to decisions of the Commissioner on Internal Revenue on disputed assessments and refunds of internal revenue taxes, but also on "other matters" arising under the Tax Code. Thus, the appellate jurisdiction of the CTA also covers other cases that arise out of the Tax Code and related laws administered by the BIR.

Here, the CTA En Banc ruled that an FNBS is also a mode of collection by the BIR of the alleged deficiency tax assessments against the taxpayer, prior to the seizure of its property. As such, questioning the FNBS is covered under the phrase "other matters" under Section 7(a)(1) of Republic Act No. 1125, as amended, and the CTA properly acquired jurisdiction over the case. ■

SyCipLaw Tip No. 4

Taxpayers are not limited to filing a petition for review with the CTA to question decisions or inactions of the CIR on disputed assessments and tax refunds. They may also file a petition for review for other matters decided by the CIR arising from the Tax Code or related laws administered by the BIR, including the issuance of an FNBS by the BIR. However, taxpayers should be aware that the reckoning period for the 30-day period to file a petition for review before the CTA may be from receipt of the PCL, as held by the Supreme Court in *CIR v Avon Products Manufacturing, Inc.* (G.R. No. 201398-99 and 201418-19, October 3, 2018). The CTA acknowledged in *Yap v. BIR* (CTA Case No. 10019, March 9, 2023, discussed in the April 2023 issue of TIPS) that the Supreme Court is the final arbiter on the issue of whether the 30 days should be counted from the taxpayers' receipt of the PCL or the Warrant of Distraint and Levy ("*WDL*"), or as in this case, the FNBS. Until the Supreme Court finally settles the issue, it would be prudent for a taxpayer to consider receipt of the PCL as the reckoning point for filing the petition with the CTA.

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

5. Are all international service provisions or cross-border service agreements rendered by non-resident foreign corporations ("*NRFCs*") automatically subject to income tax and VAT pursuant to Revenue Memorandum Circular ("*RMC*") No. 5-2024?

No. The BIR issued RMC No. 38-2024 on March 15, 2024, to clarify and address the concerns identified in RMC No. 5-2024 (discussed in the February 2024 issue of TIPS). In RMC No. 38-2024, the BIR clarified that international service provisions or cross-border service agreements analogous to the services in *Aces Philippines Cellular Satellite Corp. v. Commissioner of Internal Revenue, G.R. No. 226680 dated August 30, 2022* ("*Aces*") (see discussion in the February 2023 issue of TIPS) and enumerated in Question No. 2 of RMC No. 5-2024, are not automatically subject to income tax and VAT.

The BIR expounded that the enumeration of activities within the scope of "international service provision" was merely intended to underscore that, akin to the scenario in Aces, these services are similarly performed, rendered, delivered, or supplied by NRFCs to a domestic or resident entity within the Philippines. The criterion for determining whether the source of income from the listed cross-border services resides within the Philippines hinges on whether the property, activity, or service generating the income is situated in the Philippines.

Furthermore, the BIR has emphasized that in ascertaining the source of income, it is imperative to consider all components of the activity, rather than isolating or segmenting any particular activity as the sole income-generating activity. This approach is consistent with the principle outlined in Article 1233 of the Civil Code, which states that there is performance when the thing or service in which the obligation consists has been completely delivered or rendered. The factors that are crucial in the determination of the source of income include: whether the cross-border services are dependent on the successful use, consumption, or utilization by the Philippine purchaser of the service for income to be accrued; whether the performance of the service depends on the facilities located in the Philippines; or whether the particular stages occurring in the Philippines are so integral to the overall transaction that the business activity would not have been accomplished without it.

Should the income-generating activities occurring within the Philippines be regarded as indispensable or essential, the income emanating from these activities will be classified as sourced within the Philippines for taxation purposes, regardless of the location of the receipt of payment.

The BIR asserts that the principles laid down in RMC No. 5-2024 are in alignment with, and do not contradict, the provisions concerning the sources of income as outlined in Section 42 of the Tax Code. According to this section, the source of income for services rendered is determined by the location where the service is performed. Nevertheless, the BIR has highlighted that the Supreme Court, in the case of Aces, established that merely identifying any property, activity, or service is insufficient for determining the source of income. It is necessary to specifically look into the property, activity, or service that generated the income or the origin of the wealth inflow. Consequently, the criterion outlined in Section 42 of the Tax Code is considered insufficient by itself and must be coupled with the determination of the location of the service that produces the income or where the inflow of wealth originates.

The BIR has further emphasized that should it be determined that the source of income from cross-border services resides within the Philippines, such transactions will consequently be subjected to VAT, under Sections 105 and 108 of the Tax Code. These sections state that services rendered or performed in the Philippines by NRFCs are subject to VAT.

a. On the applicability of tax treaties on international service provision

The BIR explained that RMC No. 5-2024 simply delineates guidelines to ascertain the source of taxation for cross-border services. Upon determining that the source resides within the Philippines, the affected taxpayer is

then entitled to invoke the application of a particular tax treaty. A taxpayer may assert that the income, which is derived from or sourced within the Philippines, is exempt from income tax or eligible for a preferential tax rate by filing a request for confirmation of treaty benefit.

b. Reimbursable or allocable expenses for cross-border services within the scope of "international service provision"

The BIR reaffirmed that RMC No. 5-2024 also encompasses reimbursable or allocable expenses pertaining to cross-border services between or among affiliated entities. To ascertain the source of income for charges levied by the parent company or its affiliates to a related domestic entity for the services rendered by the former to the latter, we must look into the property, activity, or service that produced the income, or where the inflow of wealth originated. ■

SyCipLaw Tip No. 5

Notwithstanding the RMC No. 38-2024 clarification that the services listed in RMC No. 5-2024 are not automatically subject to income tax and VAT, the principles laid down in RMC No. 5-2024 remain the same.

Philippine entities engaged in service agreements with NRFCs should evaluate whether their existing contracts may expose them to a risk of deficiency final withholding tax and VAT. Given the BIR's clarification that the services detailed in RMC No. 5-2024 are not automatically subject to income tax and VAT, the taxability of services provided by NRFCs to domestic entities will be assessed on a case-by-case basis.

Parties may want to obtain a tax ruling from the BIR to confirm the tax implications of their specific arrangements and clarify the requirement to withhold taxes on payments made to NRFCs. They may also want to file a request for confirmation of eligibility under an applicable tax treaty. However, filing such a request would mean an admission that the situs of income is in the Philippines.

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