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Supreme Court: Straight to the FAN!

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Going through the process of a tax assessment is not something to be scared of.

Every taxpayer's responsibility is to be compliant with the requirements set by the Philippine taxing authority to avoid getting imposed with unwanted penalties. However, this is not only the reason why taxpayers choose to follow the tax rules. Nowadays, taxpayers prefer to be compliant rather than to take the risk of catching the attention of the Bureau of Internal Revenue and increase the possibility of going through the process of a tax assessment.

Going through the process of a tax assessment is not something to be scared of. In fact, our Philippine tax laws ensure all taxpayers their right to due process by giving them a chance to prove their compliance with the requirements.

It is explicitly mentioned in Section 228 of the Philippine Tax Code that when the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings. In practice, the said notification is served through a preliminary assessment notice which normally contains the initial findings of the Philippine taxing authority's examination.

As a general rule, the failure of the Philippine taxing authority to notify through a preliminary assessment notice will render the said assessment void. However, this rule is not without exception. According to the tax rules, there are cases that the Bureau of Internal Revenue may issue a final assessment notice without serving a preliminary assessment notice.

Take for instance, the case of Commissioner of Internal Revenue v. Cebu Holdings, Inc., G.R. No. 189792 dated 20 June 2018. In the said case, the Commissioner of Internal Revenue filed a petition for review to the Supreme Court with regard to the ruling made by the Court of Tax Appeals in relation to the application of Cebu Holdings, Inc. for a tax credit certificate.
In the said case, the taxpayer, in its annual income tax return for the taxable year 2002, reported a total prior year excess credits of P30.150 million and a total current year creditable withholding taxes of P18.992 million.

In computing the income tax liability for the said year, the taxpayer applied first the prior year excess credits against its P13.956 million income tax due. Since the total amount of prior year excess credits is more than enough to cover the income tax due, the taxpayer still had unapplied portion amounting to P16.194 million which was carried over by the latter as tax credits in its income tax return for the succeeding year.

The taxpayer then applied for a tax credit certificate in the amount equivalent to its current year creditable withholding taxes of P18.992 million. The said application for an issuance of a tax credit certificate was the subject of this case.

After the review of the documents presented for this case, the Supreme Court agreed to the findings of the Court of Tax Appeals that out of the P30.150 million amount of prior year excess credits, only P0.288 million was substantiated and out of the P18.992 million amount of current year creditable withholding taxes, only P15.752 million complied with the requisites for claiming a tax refund or tax credit certificate which are enumerated in the case decision as follows:

(1) A claim of refund filed within the two-year prescriptive period;
(2) The fact of withholding is established by a copy of a statement duly issued by the payor (withholding agent) to the payee, showing the amount of tax withheld therefrom; and
(3) The income upon which the taxes were withheld was included in the income tax return of the recipient as part of the gross income.

As such, the Supreme Court held that instead of P18.992 million, the taxpayer was only entitled to a tax credit certificate of P2.084 million which was the total overpayment after applying the P0.288 million amount of substantiated prior year excess credits and P15.752 million amount of substantiated current year creditable withholding taxes against the taxpayer's income tax due of P13.956 million.

The Supreme Court further ruled that the taxpayer's carry over of the P16.194 million prior year excess credits was erroneous since it was no longer entitled to claim any tax credit from 2002 in its income tax return for 2003. The Supreme Court explained that out of the P30.150 million prior year excess credits, only P0.288 million thousand was substantiated and the same had already been fully applied by the taxpayer against its income tax due in 2002. In this regard, the Supreme Court ruled that the taxpayer should be assessed deficiency tax for 2003 equivalent to the P16.194 million prior year excess credits that was erroneously carried over.

The taxpayer argued that the alleged deficiency income tax of P16.194 million for 2003 had no bearing on the case which merely involved a claim for a tax credit certificate for the taxable year 2002. However, the Court ignored the former's argument and ordered the Commissioner of Internal Revenue to issue a final assessment notice and a demand letter for payment of the said deficiency tax for 2003. The Supreme Court cited that one of the cases when preliminary assessment notice is not required to be issued is when a taxpayer who opted to claim a refund or tax credit of excess creditable withholding tax for a taxable period was determined to have carried over and automatically applied the same amount claimed against the estimated tax liabilities for the taxable quarter or quarters of the succeeding taxable year pursuant to Section 228(c) of the Tax Code, as amended.

In the said case, the Supreme Court ordered the issuance of the tax credit certificate in the amount of P2.084 million and a final assessment notice for the taxpayer's deficiency tax of P16.194 million. It was stressed that the taxpayer cannot offset the amount of tax credit certificate granted to it against the amount of deficiency tax assessed for 2003.

Some taxpayers who plan to file for claim of tax refund or tax credit certificate may think that denial of the application is the worst case scenario. However, this decision says otherwise. The ruling reminds all the taxpayers to be more vigilant in its dealings with the tax authorities and to ensure that the latter's requirements in relation to the claim for tax refund or tax credit certificate are faithfully met. As illustrated in the case, not only is it possible that a refund or a tax credit certificate claimed be denied but that a final assessment, even without an issuance of a preliminary assessment notice, may stem from the Court's findings on the case.

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