

GENERAL PRINCIPLES

CONCEPT AND DEFINITION OF TAXATION

Concept and Definition

The term **taxation** defines the power by which the sovereign raises revenue to defray the necessary expenses of the government.

Taxation, in its broadest and most general sense, includes every charge or burden imposed by the sovereign power upon persons, property, or property rights for the use and support of the government and to enable it to discharge its appropriate functions, and in that broad definition there is included a proportionate levy upon persons or property and all the various other methods and devices by which revenue is exacted from persons and property for public purposes.

The power to tax is the power to destroy.

The process or means by which the sovereign, through its law-making body, raises income to defray the necessary expenses of government; a method of apportioning the cost of government among those who in some measures are privileged to enjoy its benefits and must, therefore, bear its burdens

Taxation is enforced proportional contributions from persons and properties, exacted by inherent power of the State by virtue of its sovereignty for the support of government and for all public needs (*Republic v. COCOFED*).

CLASS NOTES: Power of Taxation is different from Police Power. For example, business taxes are under Police Power, not Power of Taxation.

Taxation can also regulate (i.e. SIN Taxes).
Power of Taxation + Police Power = Power to Destroy.

There are differences between Power of Taxation and Police Power and Eminent Domain.

Characteristics

1. Enforced Contribution
2. Payable through Money.
3. Proportionate in Character.
4. Levied by Congress.
5. Territorial in Operations.
6. Levied for Public Purpose
7. Unlimited in Nature.

Purpose

1. Generation of funds for the State .
2. Implementation of police power.
3. Rehabilitation and stabilization of threatened industries which are affected by public interest.

The purpose of taxation on the part of the government is to provide funds or property with which to promote the general welfare and protection of its citizens.

Principles of a Sound Tax System

Fiscal Adequacy – sources of revenue must be adequate to meet the expenses of the government and their variations.

Administrative Feasibility – the tax system must be capable of being administered with the least inconvenience to the taxpayer.

Ability to Pay – the tax burden must be in proportion to the taxpayer's ability to pay.

INHERENT AND CONSTITUTIONAL LIMITATIONS OF TAXATION

Inherent – from the power of taxation itself:

- Public purpose
- Inherently legislative
- Territorial (Situs of taxation)
- International comity
- Exemption of government agencies

CLASS NOTES: Any violation of inherent limitations will make the tax law unconstitutional. Effect of violation: A tax law retain its validity even if its not in consonance with the principles of fiscal adequacy and administrative feasibility because the Constitution does not expressly require so. However, if a tax law runs contrary to the principle of theoretical justice, such violation will render the law unconstitutional considering that under the Constitution, the rule of taxation should be uniform and equitable.

Public Purpose

Revenues derived from taxes cannot be used for purely private purposes or for the exclusive benefit of private persons (*Gaston v. Republic Planters Bank*).

Promotion of General Welfare Test: Whether the statute is designed to promote the public interest, as opposed to the furtherance of the advantage of individuals, although each advantage to individuals might incidentally serve the public.

Duty Test: Whether the thing to be furthered by the appropriation of public revenue is something which is the duty of the State, as a government (*Pascual v. Secretary of Public Works and Communications*).

The public purpose of a tax may legally exist even if the motive which impelled the legislature to impose the tax was to favor one industry over another (*Tio v. Videogram Regulatory Board*).

The concept of public use is no longer confined to the traditional notion of use by the public, but held synonymous with public interest, public benefit, public welfare, and public convenience (*Commissioner of Internal Revenue v. Central Luzon Drug Corp.*).

CLASS NOTES: Why should taxation for public purpose? If the tax is levied not for public purpose, that will constitute a taking of property without substantive due process of law – one of the inherent limitation. Effect if not for public purpose - will become unconstitutional/ invalid (except for exemption of government entities).

Inherently Legislative

The power of taxation cannot be delegated by Congress to any other branch of government or private persons, unless its delegation is authorized by the Constitution itself (*La Suerte Cigar and Cigarette Factory v. Court of Appeals*).

The legislature has the power to determine the following: a. basis, amount, or rate of tax; b. person or property that is subject to tax; c. exemptions and exclusions from tax; and d. manner of collecting the tax.

Exceptions:

a. Delegation to Local Governments

The power to tax is purely legislative but may be delegated to local governments in respect to matters of local concern. - “Each local government unit shall have the power to create its own sources of revenues and to levy taxes, fees, and charges subject to such guidelines and limitations as the Congress may provide, consistent with the basic policy of local autonomy. Such taxes, fees, and charges shall accrue exclusively to the local governments” (*Sec. 5, Art. X, Constitution*).

b. Delegation to the President

1. **Tariff Powers by Congress under the Flexible Tariff Clause:** The Congress may, by law, authorize the President to fix within specified limits, and subject to such limitations and restrictions as it may impose, tariff rates, import and export quotas, tonnage and wharfage dues, and other duties or imposts within the framework of the national development program of the Government (*Sec. 28(2), Art VI, Constitution*).

2. **Emergency Powers:** In times of war or other national emergency, the Congress may, by law, authorize the President, for a limited period and subject to such restrictions as it may prescribe, to exercise powers necessary and proper to carry out a declared national policy. Unless sooner withdrawn by resolution of the Congress, such powers shall cease upon the next adjournment thereof (*Sec. 23(2), Art VI, Constitution*).

3. **Power to Ratify Treaties which Grant Tax Exemption:** Under our Constitution, the power to ratify is vested in the President, subject to the concurrence of the Senate. No treaty or international agreement shall be valid and effective unless concurred in by at least two-thirds of all the Members of the Senate (*Sec. 21, Art VII, Constitution*).

c. Delegation to Administrative Agencies

It is well-settled that the power to fill in the details and manner as to the enforcement and administration of a law may be delegated to various specialized administrative agencies like the Secretary of Finance.

CLASS NOTES: Exemption of Non-delegability to LGUs is redundant because it was the 1987 Constitution that granted the Power of Taxation to LGUs, not the Congress.

Territoriality / Situs of Taxation

No state may tax anything not within its jurisdiction without violating the due process clause of the constitution. The taxing power of a state does not extend beyond its territorial limits, but within such limits it may tax persons, property, income, or business.

CLASS NOTES: Re: Territoriality / **Situs** of Taxation: For example, Alex Eala competed in Brazil and won USD 1,000,000. Can her winnings be taxed in the Philippines? - Yes. Whoever is the tax authority has the power to impose tax on the tax subject. Alex Eala is a resident and citizen of the Philippines and receives benefits and protection from here.

International Comity

The Philippines “adopts the generally accepted principles of international law as part of the law of the land and adheres to the policy of peace, equality, justice, freedom, cooperation, and amity with all nations” (*Sec. 2, Art II, Constitution*).

By their inherent nature, treaties really limit or restrict the absoluteness of sovereignty. By their voluntary act, nations may surrender some aspects of their state power in exchange for greater benefits granted by or derived from a convention or pact.

The sovereignty of a state therefore cannot in fact and in reality be considered absolute. Certain restrictions enter into the picture: (1) limitations imposed by the very nature of membership in the family of nations and (2) limitations imposed by treaty stipulations.

Exemption of Government Agencies

a. If the Taxing Authority is the National Government:

Agencies and instrumentalities of the government are exempt from tax. Their exemption rests on the State's sovereign immunity from taxation. The State cannot be taxed without its consent and such consent, being in derogation of its sovereignty, is to be strictly construed.

b. If the Taxing Authority is a Local Government Unit (LGU):

RA 7160 expressly prohibits LGUs from levying tax on the National Government, its agencies and instrumentalities, and other LGUs (*Sec. 133(o), Local Government Code*).

Reason for the exemption:

The practical effect of an exemption running to the benefit of the government is merely to reduce the amount of money that has to be handled by the government in the course of its operations. Only those agencies through which the government immediately and directly exercises its sovereign powers are immune from the taxing power of the state.

As such, government-owned and controlled corporations exercising proprietary functions are generally subject to tax in the absence of tax exemption provisions in their charters or the special laws creating them.

The following GOCCs are considered tax-exempt:

- a. Government Service Insurance System (GSIS)
- b. Social Security System (SSS)
- c. Home Development Mutual Fund (HDMF)

d. Philippine Health Insurance Corporation (PHIC)

e. Local Water Districts (*Sec. 27(C), Tax Code*).

There really is no prohibition against the government taxing itself, and nothing obscene with allowing government entities exercising proprietary functions to be taxed for the purpose of raising the coffers of LGUs.

CLASS NOTES: Under Exemption of Government Agencies, taxation is the general rule while exemption is the exception. This means when there is no tax law, then the presumption is exemption.

Constitutional – from the law:

- Religious Freedom
- Equal Protection Clause
- Non-impairment of Contract Clause
- Non-imprisonment for non-payment of poll tax
- Veto Power of the President
- Origin of Revenue or Tariff Bills
- Law-Making Process
- Voting Requirement for Grant of Tax Exemption
- Tax Exemption of Properties Intended for Religious, Charitable, and Educational Purposes
- Due process
- LGU's Taxing Authority
- Tax Exemption Granted to Non-Stock, Non-Profit Educational Institutions
- Progressive system of Taxation
- Uniformity
- Private Property Taken without Just Compensation
- Presidential Power to Grant Reprieves, Commutations and Pardons and Remit Fines and Forfeitures after Conviction by Final Judgment
- Prohibition on the Use of Tax Levied for Special Purpose
- Freedom of the Press
- Prohibition on the Use of Public Money or Property for Religious Purposes
- Judicial Review Power of the Supreme Court

Due Process and Equal Protection Clause

Section 1. No person shall be deprived of life, liberty, or property without due process of law, nor shall any person be denied the equal protection of the laws. (*Article III, 1987 Constitution*)

Equality in taxation means to be called upon to pay taxes, which taxes shall be strictly proportioned to the relative value of their taxable property. Equal protection simply means that all persons or things similarly situated must be treated alike both as to the rights conferred and the liabilities imposed. (*Association of Small Landowners in the Philippines, Inc v. Secretary of Agrarian Reform*)

CLASS NOTES: Equality vs Uniformity
Equality: (concept of equal protection clause) – under like circumstances must be taxed alike [COVER ALL LAWS].

Uniformity: application of the concept of equality [SPECIFIC TO THE TAX LAWS].

Equitability: taxes shall be based on the taxpayer's ability to pay (vertical equity) = progressivity.

If there was a law passed by legislature exempting sales of newspapers and magazines – all sales of tangible property are taxable.

The SC – it is violative – why? They exempted newspaper and magazine but not the other publications (that are also in the press industry) – singling out a particular member of a class – Sec 4 and 1 of Art III was violated. Even if the tax rate is not oppressive, it could be violative of Sec 3 of Art IV – it will violate the Sec 1, Art. III – you are singling out the particular class.

Freedom of Expression

Section 4. No law shall be passed abridging the freedom of speech, of expression, or of the press, or the right of the people peaceably to assemble and petition the government for redress of grievances. (*Article III, 1987 Constitution*)

CLASS NOTES: Two Instances of Violating Freedom of Expression: 1) If the law singles out the press industry from other businesses – one class vs other classes; 2) State singles out only a member of a press.

Religious Freedom

Section 5. No law shall be made respecting an establishment of religion, or prohibiting the free exercise thereof. The free exercise and enjoyment of religious profession and worship, without discrimination or preference, shall forever be allowed. No religious test shall be required for the exercise of civil or political rights. (*Article III, 1987 Constitution*)

The constitutional guaranty of the free exercise and enjoyment of religious profession and worship carries with it the right to disseminate religious information. Any restraints of such right can only be justified like other restraints of freedom of expression on the grounds that there is a clear and present danger of any substantive evil which the State has the right to prevent." The imposition of license fees on the distribution and sale of bibles and other religious literature by a non-stock, non-profit missionary organization not for purposes of profit amounts to a condition or permit for the exercise of their right, thus violating the constitutional guarantee of the free exercise and enjoyment of religious profession and worship which carries with it the right to disseminate religious beliefs and information. (*American Bible Society v. City of Manila*)

The free exercise of religion clause does not prohibit imposing a generally applicable sales and use tax on the sale of religious materials by a religious organization. (*Tolentino v. Secretary of Finance*)

CLASS NOTES: The two clauses are freedom of religion and non-establishment clause. For selling of bibles (licensing fee), there is violation of freedom of religion (American Bible Society case). For selling of stamps with Pope figure, there is no violation of freedom of religion because State only honors Vatican State (Aglipayan case).

Private Property Taking without Just Compensation

Section 9. Private property shall not be taken for public use without just compensation. (*Article III, 1987 Constitution*)

Non-impairment of Contract Clause

Section 10. No law impairing the obligation of contracts shall be passed. (*Article III, 1987 Constitution*)

CLASS NOTES: To violate the non-impairment of contract clause, there must be a contract. The exercise of Police Power can violate the non-impairment of contract clause.

Example: Previously granted ITH for 5 years, after 2 years may law granted to revoked such ITH – Q: Was there a contract? A: There is no contract because there is no material consideration.

There should be a MATERIAL CONSIDERATION: if unilateral exemption – can be revoked.

Example: If the consideration is given by someone with a legislative franchise – gives free airline tickets to government officials – a law was passed revoking the exemption – will it be valid? (*Sec 11, Art XII*). Exemption: Not applicable to public utility (*Sec 12, Art XII*).

Non-imprisonment for non-payment of poll tax

Section 20. No person shall be imprisoned for debt or non-payment of a poll tax. (*Article III, 1987 Constitution*)

Origin of Revenue or Tariff Bills

Section 24. All appropriation, revenue or tariff bills, bills authorizing increase of the public debt, bills of local application, and private bills, shall originate exclusively in the House of Representatives, but the Senate may propose or concur with amendments. (*Article VI, 1987 Constitution*)

CLASS NOTES: Why tax laws originate from HREP: more representative of the people.

THERE SHOULD BE NO TAXATION IF NO REPRESENTATION.

Law-Making Process

Section 26. (1) Every bill passed by the Congress shall embrace only one subject which shall be expressed in the title thereof.

(2) No bill passed by either House shall become a law unless it has passed three readings on separate days, and printed copies thereof in its final form have been distributed to its Members three days before its passage, except when the President certifies to the necessity of its immediate enactment to meet a public calamity or emergency. Upon the last reading of a bill, no amendment thereto shall be allowed, and the vote thereon shall be taken immediately thereafter, and the yeas and nays entered in the Journal.

Section 27. Every bill passed by the Congress shall, before it becomes a law, be presented to the President. If he approves the same he shall sign it; otherwise, he shall veto it. (*Article VI, 1987 Constitution*)

Veto Power of the President

Section 27. (2) The President shall have the power to veto any particular item or items in an appropriation, revenue, or tariff bill, but the veto shall not affect the item or items to which he does not object. (*Article VI, 1987 Constitution*)

Progressive and Uniform System of Taxation

Section 28. (1) The rule of taxation shall be uniform and equitable. The Congress shall evolve a progressive system of taxation. (*Article VI, 1987 Constitution*)

CLASS NOTES: What does the rule of equitability require? - It requires the taxpayer's ability to pay.

How to come up with an equitable tax system? - Progressive tax rates – increase in income, increase in tax due.

"Evolve" is a gradual process; progressive is not MANDATORY in formulating tax laws.

VAT is a regressive type of tax; does it violate the progressive? - While VAT is regressive, the Constitution encourages Congress to "evolve" a progressive system; it is not a requirement per se.

Tax Exemptions of Religious, Educational, and Charitable Institutions/Organizations from Property Tax

Section 28. (3) Charitable institutions, churches and personages or convents appurtenant thereto, mosques, non-profit cemeteries, and all lands, buildings, and improvements, actually, directly, and exclusively used for religious, charitable, or educational purposes shall be exempt from taxation. (*Article VI, 1987 Constitution*)

Section 4. (3) All **revenues and assets** of non-stock, non-profit educational institutions used actually, directly, and exclusively for educational purposes shall be exempt from taxes and duties. Upon the dissolution or cessation of the corporate existence of such institutions, their assets shall be disposed of in the manner provided by law.

Proprietary educational institutions, including those cooperatively owned, may likewise be entitled to such exemptions, subject to the limitations provided by law, including restrictions on dividends and provisions for reinvestment.

(4) Subject to conditions prescribed by law, all grants, endowments, donations, or contributions used actually, directly, and exclusively for educational purposes shall be exempt from tax. (*Article XIV, 1987 Constitution*)

The Constitution exempts from taxation cemeteries, churches and parsonages or convents, appurtenant thereto, and all lands, buildings, and improvements used exclusively for religious purposes.

The exemption is only from the payment of taxes assessed on such properties enumerated, as property taxes, as contra distinguished from excise taxes. In the present case, what the Collector assessed was a donee's gift tax; the assessment was not on the properties themselves. It did not rest upon general ownership; it was an excise upon the use made of the properties, upon the exercise of the privilege of receiving the properties. (*Lladoc v. CIR*)

What is meant by actual, direct, and exclusive use of the property for charitable purposes is the direct and immediate and actual application of the property itself to the purposes for which the charitable institution is organized. It is not the use of the income from the real property that is determinative of whether the property is used for tax-exempt purposes. (*Lung Cancer of the Philippines v. QC*)

The last paragraph of Section 30 provides that if a tax-exempt charitable institution conducts "any" activity for profit, such activity is not tax exempt even as its not-for-profit activities remain tax exempt. (*St. Luke's Medical Center, Inc. v. CIR*)

The tax exemption granted by the Constitution to non-stock, non-profit educational institutions, unlike the exemption that may be availed of by proprietary educational institutions, is not subject to limitations imposed by law. The phrase "all revenues" (Sec. 4(3), Art. XIV, 1987 Constitution) is unqualified by any reference to the source of revenues. Thus, so long as the revenues and income are used actually, directly and exclusively for educational purposes, then said revenues and income shall be exempt from taxes and duties. Revenues consist of the amounts earned by a person or entity from the conduct of business operations. It may refer to the sale of goods, rendition of services, or the return of an investment. Assets, on the other hand, are the tangible and intangible properties owned by a person or entity. It may refer to real estate, cash deposit in a bank, investment in the stocks of a corporation, inventory of goods, or any property from which the person or entity may derive income or use to generate the same. The crucial point of inquiry then is on the use of the assets or on the use of the revenues. These are two things that must be viewed and treated separately. But so long as the assets or revenues are used actually, directly and exclusively for educational purposes, they are exempt from duties and taxes. (*CIR v. DLSU*)

CLASS NOTES: Requirement for exemption: 1) Used for RCE – religious, charitable, educational purposes; 2) the used must be ADE – actual, direct, and exclusive.

Primary purpose -> not the incidental; to be exempted -> What the exempt are not the institution but REAL PROPERTY.

Basis of the exemption: the USE of the property and not the ownership.

Exclusive definition has evolved: means "solely".

Example: What about a dormitory: but the proceeds are being used for the scholars – NO; Direct means immediate.

Voting Requirement for Grant of Tax Exemption

Section 28. (4) No law granting any tax exemption shall be passed without the concurrence of a majority of all the Members of the Congress. (*Article VI, 1987 Constitution*)

CLASS NOTES: Requires higher number of vote (higher than regular passage of the law). It requires an absolute majority of the entire membership of Congress because a tax exemption represents a withholding of the power to tax and a consequent loss of revenue to the government (at least 50% + 1 of all the members voting separately).

Regular Law – Attendance: Majority of the entire membership– quorum. Vote: 2/3 of all the members present.

Prohibition on the Use of Public Money or Property for Religious Purposes

Section 29. (2) No public money or property shall be appropriated, applied, paid, or employed, directly or indirectly, for the use, benefit, or support of any sect, church, denomination, sectarian institution, or system of religion, or of any priest, preacher, minister, other religious teacher, or dignitary as such, except when such priest, preacher, minister, or dignitary is assigned to the armed forces, or to any penal institution, or government orphanage or leprosarium. (*Article VI, 1987 Constitution*)

Prohibition on the Use of Tax Levied for Special Purpose

Section 29. (3) All money collected on any tax levied for a special purpose shall be treated as a special fund and paid out for such purpose only. If the purpose for which a special fund was created has been fulfilled or abandoned, the balance, if any, shall be transferred to the general funds of the Government. (*Article VI, 1987 Constitution*)

Judicial Review Power of the Supreme Court

Section 5. The Supreme Court shall have the following powers:

(2) (b) All cases involving the legality of any tax, impost, assessment, or toll, or any penalty imposed in relation thereto. (*Article VIII, 1987 Constitution*)

LGU's Taxing Authority

Section 5. Each local government unit shall have the power to create its own sources of revenues and to levy taxes, fees and charges subject to such guidelines and limitations as the Congress may provide, consistent with the basic policy of local autonomy. Such taxes, fees, and charges shall accrue exclusively to the local governments. (*Article X, 1987 Constitution*)

REQUISITES OF A VALID TAX

1. It must be for a public purpose;
2. The rule on taxation must be uniform and equitable;
3. The person or property taxed is within the jurisdiction of the taxing authority;
4. Assessment and collection are in consonance with the due process clause; AND
5. The tax must not infringe on the inherent and constitutional limitations of the power of taxation.

LIFEBLOOD DOCTRINE; MANIFESTATIONS; PROHIBITION ON COMPENSATION AND SET-OFF, IMPACT, AND EFFECT

Lifeblood Doctrine

Taxes are the lifeblood of the government and should be collected without unnecessary hindrance.

It is said that taxes are what we pay for civilized society. Without taxes, the government would be paralyzed for lack of the motive power to activate and operate it.

Since taxes are what we pay for civilized society, or are the lifeblood of the nation, the law frowns against exemptions from taxation and statutes granting tax exemptions are thus construed strictissimi juris against the taxpayer and liberally in favor of the taxing authority.

Manifestations

1. No estoppel against the government.
2. Collection of taxes cannot be enjoined (stopped) by injunction (*Sec. 218, NIRC*) -> (*Exception is Sec. 11, RA 1125*).
3. Taxes cannot be subject of compensation or set-off.
4. A valid tax may result in the destruction of the taxpayer's property.
5. Right to select the objects (subjects) of taxation.

Compulsory Nature of Taxation: Taxes are obligatory contributions imposed by law, meaning individuals and entities are required to pay taxes irrespective of personal will or consent. This compulsion is justified by the necessity of funding essential government services that serve the public interest.

Wide Scope of Taxing Power: Given the Lifeblood Doctrine, taxation is accorded wide latitude and is generally favored by courts to secure governmental functions. Any ambiguity in tax statutes is usually resolved in favor of the state, given that tax revenue is necessary for government survival and function.

Enforcement of Tax Collection: The doctrine justifies the government's strict enforcement of tax collection measures. This includes administrative remedies like distraint and levy, which allow the government to seize and sell a taxpayer's property to settle tax liabilities. The emphasis on prompt collection and enforcement is based on the idea that any delay or hindrance to tax collection could adversely impact public service and welfare.

No Compensation or Set-off in Tax Obligations: A notable manifestation of the Lifeblood Doctrine is the prohibition on compensation or set-off in taxation. This rule prohibits taxpayers from offsetting their tax obligations with claims they may have against the government. In simpler terms, a taxpayer cannot reduce their tax liability by asserting that the government owes them a separate amount. The rationale here is to protect the integrity of tax collections. Since taxes are considered paramount and essential for public welfare, they cannot be reduced or deferred due to other claims, regardless of their validity.

Prohibition on Compensation and Set-off

Compensation shall take place when two persons, in their own right, are creditors and debtors of each other. (*Civil Code, Art. 1278*)

In order that compensation may be proper, it is necessary:

1. That each one of the obligors be bound principally, and that he be at the same time a principal creditor of the other;
2. That both debts consist in a sum of money, or if the things due are consumable, they be of the same kind, and also of the same quality if the latter has been stated
3. That the two debts be due;
4. That they be liquidated and demandable;
5. That over neither of them there be any retention or controversy, commenced by third persons and communicated in due time to the debtor (*Civil Code, Art. 1279*).

General Rule:

The general rule, based on grounds of public policy, is well-settled that no set-off is admissible against demands for taxes levied for general or local governmental purposes. The reason on which the general rule is based, is that taxes are not in the nature of contracts between the party and party but grow out of a duty to, and are the positive acts of the government, to the making and enforcing of which, the personal consent of individual taxpayers is not required.

Exception:

When both claims of the government and the taxpayer have already become overdue and demandable as well as fully liquidated. Compensation, therefore, takes place by operation of law.

Impact and Effect of the Prohibition on Compensation and Set-off

Government Revenue Protection: The prohibition safeguards government revenue by ensuring taxes are collected without being compromised by other financial claims. This helps the government to meet its financial obligations and provides stable funding for public services.

Preservation of Government Funds for Essential Services: Since taxes are collected for public welfare, allowing set-off could reduce the amount available for essential services. By prohibiting set-off, the government ensures that taxes remain intact for their intended purpose of funding public services.

Limitation on Taxpayer Rights in Claims Against the Government: The prohibition reflects a limitation on taxpayer rights in situations where they may have pending claims against the government. A taxpayer must settle their tax obligations fully before pursuing claims against the government, which often must go through specific administrative or judicial processes.

Expedited Tax Collection: The prohibition on set-off contributes to the expeditious collection of taxes. Tax authorities are empowered to collect taxes without the burden of addressing other claims or counterclaims, which streamlines revenue collection efforts and minimizes legal complexities.

Legal Priority of Tax Liabilities: The prohibition reinforces the legal view that tax obligations hold a superior status compared to other types of liabilities or claims. As a consequence, this principle can influence insolvency and debt settlement proceedings, where tax claims are generally prioritized over private debts.

AUTHORITY OF CONGRESS, SECRETARY OF FINANCE, AND COMMISSIONER OF INTERNAL REVENUE (CIR)

Congress

General Rule: The power to tax is exclusively vested in the legislative body, and it may not be re-delegated. Judge Cooley enunciates the doctrine in the following oft-quoted language: "One of the settled maxims in constitutional law is that the power conferred upon the legislature to make laws cannot be delegated by that department to any other body or authority."

Exception: Taxation may be exceptionally delegated, subject to such well-settled limitations as:

1. The delegation shall not contravene any constitutional provision or the inherent limitations of taxation;
2. The delegation is effected either by:
 - a. the Constitution; or
 - b. validly enacted legislative measures or statute; and

3. The delegated levy power, except when the delegation is by an express provision of the Constitution itself, should only be in favor of the local legislative body of the local or municipal government concerned.

Legislative Power to Tax:

Section 28(1). The rule of taxation shall be uniform and equitable. The Congress shall evolve a progressive system of taxation. (*Article VI, 1987 Constitution*)

The Congress is empowered to determine:

1. Subject of taxation
2. Amount and rate of taxation
3. Purpose
4. Kind of tax
5. Apportionment
6. Situs
7. Mode of collection

Oversight Function:

Section 290, NIRC. A Congressional Oversight Committee, hereinafter referred to as the Committee, is hereby constituted in accordance with the provision of this Code. The Committee shall be composed of the Chairman of the Committee on Ways and Means of the Senate and House of Representatives and four (4) additional members from each house, to be designated by the Speaker of the House of Representatives and the Senate President, respectively.

The Committee shall, among others, in aid of legislation:

- a. Monitor and ensure the proper implementation of Republic Act No. 8240;
- b. Determine that the power of the Commissioner to compromise and abate is reasonably exercised;
- c. Review the collection performance of the Bureau of Internal Revenue (BIR);
- d. Review the implementation of the programs of the BIR; and
- e. Review the performance of the Fiscal Incentives Review Board. (*NIRC Tax Code*)

Secretary of Finance

Authority of the Secretary of Finance to promulgate rules and regulations (*Sec. 244, NIRC*) - The Secretary of Finance, upon recommendation of the CIR, shall promulgate all needful rules and regulations for the effective enforcement of the provisions of the Code.

It is an elementary rule in administrative law that administrative regulations and policies enacted by administrative bodies to interpret the law which they are entrusted to enforce have the force of law and are entitled to great respect. They have in their favor a presumption of legality.

It is of course axiomatic that a rule or regulation must bear upon, and be consistent with, the provisions of the enabling statute if such rule or regulation is to be valid. In case of conflict between a statute and an administrative order, the former must prevail.

Requisites for validity and effectivity of regulations:

1. Reasonable
2. Within the authority conferred;
3. Not contrary to law and the Constitution [Art. 7, New Civil Code]; and
4. Must be published.

Commissioner of Internal Revenue (CIR)

Administrative interpretations and opinions: The power to interpret the provisions of the Tax Code and other tax laws is under the exclusive and original jurisdiction of the Commissioner of Internal Revenue subject to review by the Secretary of Finance (*Sec. 4, par.1, NIRC*).

Revenue regulations are the formal interpretation of the provisions of the NIRC and other laws by the Secretary of Finance upon the recommendation of the Commissioner of Internal Revenue.

General Rule: The Commissioner has the sole authority to issue rulings but he also has the power to delegate said authority to his subordinates with the rank equivalent to a division chief or higher.

Exceptions: The Commissioner may not delegate the following:

1. The power to recommend the promulgation of rules and regulations by the Secretary of Finance;
2. The power to issue rulings of first impression or to reverse, revoke, or modify any existing ruling of the Bureau; and
3. The power to compromise or abate any tax liability as provided by Sec. 204 and 205 of the NIRC.

Exception to the Exception: BUT assessments issued by RDOs involving (a) Php500,000 or less, and (b) minor criminal violations as determined by the Secretary of Finance as recommended by the Commissioner, may be compromised by a Regional Evaluation Board (*Sec. 7, NIRC*).

The CIR's function and authority is lodged from Section 4 to 7 of the NIRC, summarize as follows:

1. Interpret tax laws and decide tax cases (Sec. 4);
2. Obtain information and to summon, examine, and take testimony of persons (Sec. 5);
3. To make assessments and prescribe additional requirements for tax administration and enforcement, which includes the following, among others: (Sec 6)
 - a. Examination of returns and determination of tax due;
 - b. Authority to conduct inventory-taking, surveillance and to prescribe presumptive gross sales and receipts;
 - c. Authority to terminate taxable period;
 - d. Authority to prescribe real property values;
 - e. Authority to inquire into bank deposit accounts and other related information held by financial institutions;
 - f. Authority to accredit and register tax agents;
 - g. Authority to prescribe additional procedural or documentary requirements.
4. Authority to delegate power: (Sec 7)
 - a. GENERAL RULE: The CIR may delegate the powers vested in him under the pertinent provisions of NIRC.
 - b. EXEMPTION: The following powers of the Commissioner shall not be delegated:
 - i. The power to recommend the promulgation of rules and regulations by the Secretary of Finance;
 - ii. The power to issue rulings of first impression or to reverse, revoke or modify any existing ruling of the Bureau;
 - iii. The powers to compromise or abate any tax liability. Provided, however, that assessments issued by the regional

offices involving basic deficiency taxes of Five hundred thousand pesos (P500,000) or less, and minor criminal violations, as may be determined by rules and regulations to be promulgated by the Secretary of Finance, upon recommendation of the Commissioner, discovered by regional and district officials, may be compromised by a regional evaluation board which shall be composed of the Regional Director as Chairman, the Assistant Regional Director, the heads of the Legal, Assessment and Collection Divisions and the Revenue District Officer having jurisdiction over the taxpayer, as members; and

The power to assign or assign internal revenue officers to establishments where articles subject to excise are produce or kept.

**CONSTRUCTION AND
INTERPRETATION OF TAX LAWS,
RULES, AND REGULATIONS**

General Rules on Construction of Tax Laws

1. Public purpose if always presumed.
2. Where the law is clear and unambiguous, it must be taken to mean exactly what it says, and courts have no choice but to see to it that the mandate is obeyed.
3. A statute will not be construed as imposing a tax unless it does so clearly, expressly and unambiguously. [Note: In case of doubt, it is construed most strongly against the Government and liberally in favor of the taxpayer since it is an imposition of a burden (Lifeblood Theory).]
4. Tax laws may not be extended by implication beyond the clear import of their language, nor their operation enlarged so as to embrace matters not specifically provided.
5. Tax laws operate prospectively unless the purpose of the legislature to give retroactive effect is expressly declared or may be implied from the language used.
6. Tax laws are special laws and prevail over a general law.

Construction of Tax Laws

General Rule: Tax laws are construed strictly against the government and liberally in favor of the taxpayer. No person or property is subject to taxation unless within the terms or plain import of a taxing statute. Taxes, being burdens, are not to be presumed beyond what the statute expressly and clearly declares. Tax statutes offering rewards are liberally construed in favor of informers.

Exceptions

1. The rule of strict construction as against the government is not applicable where the language of the statute is plain and there is no doubt as to the legislative intent.
2. The rule does not apply where the taxpayer claims exemption from the tax.

Construction of Tax Rules and Regulations

It is an elementary rule in administrative law that administrative regulations and policies enacted by administrative bodies to interpret the law which they are entrusted to enforce have the force of law and are entitled to great respect. They have in their favor a presumption of legality.

It is of course axiomatic that a rule or regulation must bear upon, and be consistent with, the provisions of the enabling statute if such rule or regulation is to be valid. In case of conflict between a statute and an administrative order, the former must prevail.

NOTE: Administrative rules and regulations must always be in harmony with the provisions of the law. In case of conflict with the law or the Constitution, the administrative rules and regulations are null and void. As a matter of policy, however, courts will declare a regulation or provision thereof invalid only when the conflict with the law is clear and unequivocal.

Administrative Interpretations and Opinions: The power to interpret the provisions of the Tax Code and other tax laws is under the exclusive and original jurisdiction of the Commissioner of Internal Revenue subject to review by the Secretary of Finance (*Sec. 4(1), Tax Code*).

Construction of Penal Provisions of Tax Laws

Penal provisions of tax laws must be strictly construed. It is not legitimate to stretch the language of a rule, however beneficent its intention, beyond the fair and ordinary meaning of its language. A penal statute should be construed strictly against the State and in favor of the accused. The reason for this principle is the tenderness of the law for the rights of individuals and the object is to establish a certain rule by conformity to which mankind would be safe, and the discretion of the court limited.

SUMMARY:

Tax Statutes – STRICTLY against the government; LIBERALLY in favor of the taxpayer.

Tax Exemptions / Refunds – STRICTLY against the taxpayer-claimant; LIBERALLY in favor of the taxing authority.

Administrative Issuances - STRICTLY against the government; LIBERALLY in favor of the taxpayer.

Prescriptive Period – LIBERALLY in favor of the taxpayer and taxing authority.

LGUs - same with Tax Statutes & Tax Exemptions.

Statutes limiting the LGU power to tax – STRICTLY against the national government; LIBERALLY in favor of the LGU.

Penalties for Nonpayment of Taxes – same with Tax Exemptions.

CLASS NOTES: What the question is the VALIDITY of the tax law/ measure – construe in favor of the government - ratio: LIFE BLOOD DOCTRINE

Where a law imposes a tax or not – against the Government – ration: Taxation interferes in the right of the people.

Interpretation Based on Legislative Intent (Mischief Rule) - The intention of the legislature (mischief rule) plays a significant role in the interpretation of tax laws. Courts often refer to the explanatory notes, committee reports, and deliberations to understand the intent of ambiguous tax provisions. This approach aims to prevent misapplication that would result in either an undue burden on taxpayers or a misdirection of legislative goals.

Liberal Construction for Beneficial Statutes - Tax provisions aimed at granting benefits to taxpayers, such as tax amnesties or incentives, are exceptions to strict construction. Beneficial statutes are liberally construed to promote their purpose, typically to stimulate economic activities or to aid distressed taxpayers.

Revenue Rulings – If prejudicial to taxpayer, then not retroactive (only prospective). If beneficial to taxpayer, then retroactive.

Principle of Strictissimi Juris in Tax Exemption: Laws granting tax exemption are construed in strictissimi juris against the taxpayer and liberally in favor of the taxing power.

Taxation is the rule and exemption is the exception.
The reverse of the above: GR: Never favored and never presumed – if granted must be against the taxpayer.

When is the reverse of this? The exception of the exemption:

- a. Pertaining to government properties.
- b. Traditional exemptions.
- c. Those expressly stipulated.

Purpose of tax exemption: to encourage investment.

(GR) Tax Exemptions can be generally revoked by Congress. (EXC) The exceptions to this are: 1) legislative franchise (Sec. 11, Art. XII, 1987 Constitution), 2) non-impairment clause (Sec. 10, Art. III, 1987 Constitution).

The valid grounds for revocation are: 1) based on a contract, 2) based on public policy, 3) based on a treaty.

DOUBLE TAXATION

Double Taxation

Double taxation means taxing the same property twice when it should be taxed only once; that is, “taxing the same person twice by the same jurisdiction for the same thing”.

Double taxation is not illegal and unconstitutional per se. There is no constitutional prohibition against double taxation in the Philippines. It is something not favored, but is permissible, provided some other constitutional requirement is not thereby violated, such as the requirement that taxes must be uniform.

In order to constitute double taxation in the objectionable or prohibited sense, the same property must be taxed twice when it should be taxed but once; both taxes must be imposed on the same property or subject-matter, for the same purpose, by the same State, Government, or taxing authority, within the same jurisdiction or taxing district, during the same taxing period, and they must be the same kind or character of tax.

Constitutionality of Double Taxation

There is no constitutional prohibition against double taxation in the Philippines. It is something not favored, but is permissible, provided some other constitutional requirement is not thereby violated. If the tax law follows the constitutional rule on uniformity, there can be no valid objection to taxing the same income, business or property twice.

Double taxation in its narrow sense is undoubtedly unconstitutional but in the broader sense is not necessarily so.

Where double taxation (in its narrow sense) occurs, the taxpayer may seek relief under the uniformity rule or the equal protection guarantee.

International Double Taxation

Double taxation usually takes place when a person is resident of a contracting state and derives income from, or owns capital in, the other contracting state and both states impose tax on that income or capital. To eliminate double taxation, a tax treaty resorts to several methods. The purpose of these international agreements is to reconcile the national fiscal legislations of the contracting parties in order to help the taxpayer avoid simultaneous taxation in two different jurisdictions.

More precisely, the tax conventions are drafted with a view towards the elimination of international juridical double taxation, which is defined as the imposition of comparable taxes in two or more states on the same taxpayer in respect of the same subject matter and for identical periods.

The apparent rationale for doing away with double taxation is to encourage the free flow of goods and services and the movement of capital, technology and persons between countries, conditions deemed vital in creating robust and dynamic economies.

Direct Duplicate Taxation

The same property must be taxed twice when it should be taxed once.

The **requisites** are:

1. Both taxes must be imposed on the same property or subject matter;
2. For the same purpose;
3. By the same State, Government, or taxing authority;
4. Within the same territory, jurisdiction or taxing district;
5. During the same taxing period; and
6. Of the same kind or character of tax.

Direct duplicate taxation is the objectionable kind of double taxation in its prohibited sense, since it violates the equal protection clause of the Constitution.

Indirect Duplicate Taxation

There is double taxation in the broad sense or indirect duplicate taxation if any of the elements for direct duplicate taxation is absent. It extends to all cases in which there is a burden of two or more pecuniary impositions. For example, a tax upon the same property imposed by two different states.

Double taxation, standing alone and not being forbidden by our fundamental law, is not a valid defense against the legality of a tax measure.

Indirect duplicate taxation extends to all cases in which there is a burden of two or more pecuniary impositions. It is usually allowed as long as there is no violation of the equal protection clause and uniformity clauses of the Constitution.

It is permissible, arising in the absence of one or more of the above-mentioned elements of direct double taxation. Double taxation usually takes place when a person is resident of a contracting state and derives income from, or owns capital in, the other contracting state and both states impose tax on that income or capital.

CLASS NOTES: If complete, it is Double Taxation (Direct - violative of constitution). If not complete, it is not considered Double Taxation (Indirect).

International Juridical Double Taxation (IJDT) – if same state.

Double taxation, although not favored it is still permissible, as long as other constitutional requirements are not violated.

Mitigants

Modes of Eliminating Double Taxation:

The measures that are normally adopted by sovereign taxing authorities in order to avoid the resulting inequalities of double taxation include:

1. Tax Exemption: An immunity or privilege; it is freedom from a charge or burden to which others are subjected. It is a grant of immunity, express or implied, to particular persons, or corporations of a particular class, from a tax upon property or an excise tax which persons and corporations generally within the same taxing district, are obliged to pay.
2. Tax Credit: An amount subtracted from an individual's or entity's tax liability to arrive at the total tax liability; a tax credit reduces the tax due, including whenever applicable, the income tax that is determined after applying the corresponding tax rates to taxable income. A tax credit is a direct reduction of tax liability, distinct from tax deduction, which

lowers taxable income. A tax credit refers to the amount due to a taxpayer resulting from an overpayment of a tax liability or erroneous payment of tax due. It is often issued in the form of a Tax Credit Certificate (TCC), which can be used to offset future tax obligations or be converted into a cash refund.

3. **Tax Deduction:** An amount that is allowed by law to reduce income prior to the application of the tax rate to compute the amount of tax which is due. A tax deduction is an amount that a taxpayer can subtract from their gross income to reduce their taxable income, ultimately reducing the tax liability.
4. **Tax Discount:** A tax discount is a reduction in the amount of tax that a taxpayer has to pay, often given as an incentive or benefit. An example would be early payment discounts on real property taxes through local ordinances. A tax discount is an incentive that allows taxpayers to reduce their tax liability by a certain percentage. It often encourages prompt payment.
5. **Reciprocity Principle:** Allowing reciprocal exemption either by law or by treaty. Tax treaties are agreements between two countries specifying what items of income will be taxed by the authorities of the country where the income is earned. In taxation jurisprudence, the reciprocity principle ensures that tax privileges or exemptions granted to foreign nationals or entities are based on the condition that their home country provides similar treatment to Philippine nationals or entities.

NOTE: Tax Exemption

EXEMPT PERSON	EXEMPT TRANSACTION
An individual or entity that is exempt from tax liability due to specific qualifications or status. The exemption attaches to the taxpayer, regardless of the nature of the transaction they engage in, meaning that their personal status or characteristics entitle them to exemption across various transactions.	This refers to a specific activity or type of transaction that is exempt from taxation, regardless of the status of the taxpayer. Here, the tax exemption applies to the transaction's nature or purpose, rather than the individual or entity conducting it. Any taxpayer who enters into an exempt transaction is eligible for the exemption, irrespective of whether they are typically subject to tax.
Example: Religious and charitable institutions, senior citizens and persons with disabilities, government entities.	Example: Sale of agricultural products, educational services, specific transactions by cooperatives.

NOTE: Tax Discount vs. Tax Credit

TAX DISCOUNT	TAX CREDIT
Reduce the tax base or liability at the point of assessment or payment.	Reduce the amount of tax owed by deducting it from the total tax due.
Often provided in local taxation.	Often available to mitigate double taxation on income earned abroad.
Typically apply to specific circumstances such as local taxes or early payment.	Apply more broadly to income taxes and foreign-sourced income.

CLASS NOTES: Tax deduction will be removed from gross income to derive the taxable income (30% deduction in the tax due).

Tax CREDIT IS DEDUCTIBLE FROM TAX DUE

Taxable income = Gross Income – tax deductions.

Tax Due = Taxable Income x Tax Rate.

ESCAPE FROM TAXATION

Forms of Escape from Taxation

Shifting

The act of transferring the burden of a tax from the original payer or the one on whom the tax was assessed or imposed to someone else.

Only indirect taxes may be shifted (e.g., VAT, percentage tax, excise tax). Direct taxes cannot be shifted.

Ways of shifting the tax burden:

- a. **Forward shifting** – burden of the tax is transferred from a factor of production through factor of distribution until it finally settles on the ultimate purchaser or consumer (e.g., VAT, percentage tax).
- b. **Backward shifting** – the burden of the tax is transferred from the consumer/purchaser through the factors of distribution to the factors of production (e.g., consumer/purchaser may shift tax imposed on him to the retailer by purchasing only after the price is reduced, and from the latter to the wholesaler, and finally to the manufacturer of producer).
- c. **Onward shifting** – the tax is shifted two or more times either forward or backward.

Factors in Determining Tax Shifting:

1. Elasticity of demand and supply - The more the elasticity, the lower the incidence on the sales and the higher the incidence on supply.
2. Nature of markets - In an oligopolistic market (i.e. few sellers and many buyers) tax shifting to buyers is high since few sellers can team up to determine the market price. In a situation where there are many buyers and sellers, a large portion of tax will be borne by sellers. For a monopolistic market, the entire tax burden falls on the shoulders of the buyer.
3. Government policy on pricing - In the case of government price control, the supplier cannot increase prices, hence cannot shift tax burden to buyers and vice versa.
4. Geographical location - If taxes are imposed on certain regions, it is hard to shift them to consumers because consumers will move to regions with low taxes.
5. Nature of tax (direct or indirect) - Direct tax e.g. PAYE (pay-as-you-earn) cannot be shifted whatsoever while indirect taxes can be shifted through increase in prices.
6. Rate of tax - - If the rate is too high, shifting can occur backwards or forwards; if the rate is too low, it may be absorbed by the manufacturer.
7. Time available for adjustment - The person who can adjust faster (buyer or seller) will be able to shift the tax e.g. if the buyer can shift to substitute goods, the seller will bear the tax burden.
8. The tax point.

Taxes that Can be Shifted:

1. Value-Added Tax
2. Percentage Tax
3. Excise Tax

Tax Avoidance (Tax Minimization) –legal means to escape tax. The exploitation by the taxpayer of legally permissible alternative tax rates or methods of assessing taxable property or income in order to avoid or reduce tax liability (e.g., maximize de minimis benefits – recharacterization of compensation income to de minimis allowances).

Tax Avoidance is the exploitation by the taxpayer of legally permissible alternative tax rates or methods of assessing taxable property or income in order to avoid or reduce tax liability. It is politely called “tax minimization” and is NOT punishable by law

Example: A person refrains from engaging in some activity or enjoying some privilege in

order to avoid the incidental taxation or to lower his tax bracket for a taxable year.

Tax Evasion (Tax Dodging) – illegal means to escape tax. The use by the taxpayer of illegal or fraudulent means to defeat or lessen the payment of a tax; punishable by law (e.g., deliberate failure to report a taxable income; maintenance of two books of accounts; buying of receipts to support expenses [deductions in ITR]).

Note: Mere understatement of a tax is not itself proof of fraud for the purpose of tax evasion. The burden of proof is on the prosecution to prove beyond reasonable doubt that the accused willfully failed to supply correct and accurate information

Elements:

1. The end to be achieved.
2. An accompanying state of mind described as evil, in bad faith, willful, or deliberate and not accidental.
3. A course of action (or failure of action).

Willful Blindness Doctrine: The Doctrine states that a taxpayer can no longer raise the defense that the errors on their tax returns are not their responsibility or that it is the fault of the accountants they hired. Intent to defraud need not be shown for a conviction of tax evasion. The only thing that needs to be proven is that the taxpayer was aware of his obligation to file the tax return but he nevertheless voluntarily, knowingly, and intentionally failed to file the required returns

Example: Deliberate failure to report a taxable income or property; deliberate reduction of income that has been received; overstatement of expenses.

Transformation - Whereby the manufacturer or producer upon whom the tax has been imposed pays the tax and endeavors to recoup himself by improving his process of production thereby turning out his units of products at a lower cost; transformation of the tax into a gain through the medium of production.

Capitalization - Made when the price of the property is lowered to accommodate the exclusion of the tax which is expected to be paid by the seller as a result of sale transactions.

Tax Amnesty - General pardon of the state by intentionally overlooking its authority to impose penalties on persons guilty of tax

evasion or violation of a particular revenue or tax law.

Tax Exemption vs Tax Amnesty: In Tax Exemption – NO tax will be imposed from the very beginning – may result to zero or negative tax payable (or an overpayment).

In Tax Amnesty – with tax due + penalties already imposed – but no payment will be made because it was waived – the collection of tax due.

TAX EXEMPTION

Tax Exemption - The grant of immunity to particular persons or corporations of a particular class from a tax which persons and corporations generally within the same state or taxing district are obliged to pay.

The grant of immunity to particular persons or corporations or to persons or corporations of a particular class from a tax which persons and corporations generally within the same state or taxing district are obliged to pay. It is an immunity or privilege; it is freedom from a financial charge or burden to which others are subjected. It is strictly construed against the taxpayer.

It is a waiver of the government's right to collect the amounts that would have been collectible under our tax laws.

Thus, when the law speaks of a tax exemption, it should be understood as freedom from the imposition and payment of a particular tax.

Grounds for Tax Exemption:

1. It may be based on a contract.
2. It may be based on some ground of public policy.
3. It may be created in a treaty on grounds of reciprocity or to lessen the rigors of international or multiple taxation.

But equity is NOT a ground for tax exemption. While equity cannot be used as a basis or justification for tax exemption, a law may validly authorize the condonation of taxes on equitable considerations.

Nature: Tax exemption is immunity from all civil liability only. It is an immunity or privilege, a freedom from a charge or burden of which others are subjected.

- a. Mere personal privilege.
- b. Revocable by the government, unless founded on a contract that is protected from impairment.(exp to the exp – legislative franchise, can be repealed or amended).

- c. This implies a waiver on the part of the government.
- d. Not necessarily discriminatory.

Kinds of Tax Exemption:

- a. Express or Affirmative - either entirely or in part, may be made by provisions of the Constitution, statutes, treaties, ordinances, franchises, or contracts.
- b. Implied or Exemption by Omission - when a tax is levied on certain classes without mentioning the other classes. Every tax statute, in a very real sense, makes exemptions since all those not mentioned are deemed exempted. The omission may be either accidental or intentional. Exemptions are not presumed, but when public property is involved, exemption is the rule, and taxation is the exception.

Construction of Tax Exemption:

General Rule: In the construction of tax statutes, exemptions are not favored and are construed as strictissimi juris against the taxpayer.

Exceptions:

- a. When the law itself expressly provides for a liberal construction, that is, in case of doubt, it shall be resolved in favor of exemption;
- b. When the exemption is in favor of the government itself or its agencies, or of religious, charitable, and educational institutions because the general rule is that they are exempt from tax.
- c. When the exemption is granted under special circumstances to special classes of persons.
- d. If there is an express mention or if the taxpayer falls within the purview of the exemption by clear legislative intent, the rule on strict construction does not apply.

COMPROMISE AND TAX AMNESTY

Compromise (Sec 204[A]) - A contract whereby the parties, by making reciprocal concessions, avoid litigation or put an end to one already commenced.

The Commissioner may compromise the payment of any tax, when:

- a. There is a reasonable doubt as to the claim against the taxpayer [40% of the basic assessed tax]; and
- b. The financial position of the taxpayer demonstrates a clear inability to pay the assessed tax [10% of the basic assessed tax].

Definition of Compromise:

A contract whereby the parties, by making reciprocal concessions, avoid litigation or put an end to one already commenced [Art. 2028, Civil Code]. It involves a reduction of the taxpayer's liability.

The Commissioner of Internal Revenue is allowed to compromise the payment of any internal revenue tax when (1) a reasonable doubt as to the validity of the claim against the taxpayer exists, or (2) the financial position of the taxpayer demonstrates a clear inability to pay the assessed tax [Sec. 204(A), Tax Code].

Requisites of a Tax Compromise:

1. The taxpayer must have a tax liability.
2. There must be an offer (by the taxpayer or Commissioner) of an amount to be paid by the taxpayer.
3. There must be acceptance (by the Commissioner or the taxpayer, as the case may be) of the offer in settlement of the original claim.

Tax Amnesty - General pardon of the state by intentionally overlooking its authority to impose penalties on persons guilty of tax evasion or violation of a particular revenue or tax law.

Definition of Tax Amnesty:

A tax amnesty partakes of an absolute forgiveness or waiver by the Government of its right to collect what otherwise would be due it, and in this sense, prejudicial thereto, particularly to give tax evaders, who wish to relent and are willing to reform a chance to do so and become a part of the new society with a clean slate.

Tax Exemption vs Tax Amnesty: In Tax Exemption – NO tax will be imposed from the very beginning – may result to zero or negative tax payable (or an overpayment).

In Tax Amnesty – with tax due + penalties already imposed – but no payment will be made because it was waived – the collection of tax due.

Tax Amnesty v. Tax Exemption

	Tax Amnesty	Tax Exemption
Benefit	Immunity from civil, criminal, administrative liability arising from non-payment of taxes	Immunity from civil liability (relief from paying taxes)
Coverage	Past tax liability	Future tax liability
Actual Revenue Loss	Yes	None

TAXPAYER'S SUIT: RATIONALE AND REQUISITES

Taxpayer's Suit - A special legal action where a taxpayer challenges the legality or constitutionality of a government action or expenditure that involves the use of public funds. In the context of Philippine law, a taxpayer's suit is allowed under certain conditions due to the fundamental principle that taxpayers have a vested interest in ensuring that public funds are spent legally, responsibly, and in accordance with the Constitution and applicable laws.

Requisites:

1. Legal Standing
2. Public Fund Involvement
3. Existence of a Constitutional or Statutory Violation
4. Failure of Directly Concerned Parties to Act
5. Personal Injury Not Required

Limitations:

Matters of Policy vs. Legality: Courts generally do not entertain suits that merely question the wisdom, prudence, or necessity of government policies. Taxpayer's suits are limited to questions of legality or constitutionality. Courts refrain from substituting their judgment for that of the executive or legislative branch in matters of policy-making, reserving intervention only for cases of illegal expenditure.

Requirement of Specificity: The taxpayer must allege specific facts to show the illegal or unconstitutional nature of the government expenditure. General allegations or speculative claims are insufficient grounds for initiating a taxpayer's suit.

Doctrine of Separation of Powers: The taxpayer's suit must respect the principle of separation of powers. Courts are careful not to interfere unduly with the functions of the executive and legislative branches unless there is a clear breach of the law or the Constitution.

Exclusion of Private Actions: Taxpayer's suits may not be used to address purely private wrongs. The taxpayer's suit is exclusively for the purpose of challenging public fund expenditure; it does not extend to grievances that are solely between private parties.

Classification of Taxes:

1. As to subject matter
 - a. Personal, poll or Capitation – per head
 - b. Property
 - c. Excise or privilege

2. As to who bears the burden/ incidence – direct vs indirect
 - a. Concept: impact and incidence
 - b. Impact: point in which tax is imposed; who's going to pay is already determined
 - c. Incidence: point on which the tax burden finally settles down.
 - d. Impact may be on one person but the incidence be on another.
 - e. In direct, one person has the impact and incidence.
 - f. In indirect, one person falls on one person but the incidence falls on another.
3. As to purposes
 - a. General, fiscal or revenue – to raise revenue
 - b. Special, regulatory, or sumptuary – Note: All money collected on any tax levied for a special purpose shall be treated as a special fund and paid for such purpose only. If for the purpose for which a special fund was created has been fulfilled or abandoned, the balance, if any, shall be transferred to the general funds of the Government.
4. As how amount is determined
 - a. Specific – fixed amount imposed by the head or number or by some standard of weight
 - b. Ad Valorem (Value) – based upon the value of the articles subject to tax
 - c. Mixed – specific + ad valorem
5. As to taxing authority
 - a. National
 - b. Local or Municipal
6. As to rate
 - a. Progressive
 - b. Regressive
 - c. Proportionate

Doctrine of Equitable Recoupment: This allows a taxpayer whose claim for refund has been barred by prescription to offset such claims against a current assessment.

Also allows the government to offset taxes that have not been collected from the taxpayer against a current claim for refund, although the government is time-barred from collecting the previous taxes (*Not applicable in PH).

Rationale:

1. Government Accountability – The Constitution holds that public office is a public

trust. As such, the right to hold the government accountable serves as a vital tool to ensure transparency and that the government acts in the public's best interest.

2. Citizen Oversight – Under the Constitution, government authority resides in the people. The right of citizens to directly challenge the government on proper grounds is a further recognition of the notion that government authority emanates from the people.

Requisites:

For a taxpayer's suit to prosper, two requisites must be met:

1. public funds derived from taxation are disbursed by a political subdivision or instrumentality and in doing so, a law is violated or some irregularity is committed and
2. the petitioner is directly affected by the alleged act.

Philippine Airlines, Inc. v. Edu - Motor vehicle registration fees are taxes or regulatory fees.

The legislative intent and purpose behind the law requiring owners of vehicles to pay for their registration is mainly to raise funds for the construction and maintenance of highways and to a much lesser degree, pay for the operating expenses of the administering agency. Fees may be properly regarded as taxes even though they also serve as an instrument of regulation. Indeed, taxation may be made the implement of the state's police power.

If the purpose is primarily revenue, or if revenue is, at least, one of the real and substantial purposes, then the exaction is properly called a tax. Such is the case of motor vehicle registration fees.

Thus, motor vehicle registration fees as at present exacted pursuant to the Land Transportation and Traffic Code are actually taxes intended for additional revenues of government even if one fifth or less of the amount collected is set aside for the operating expenses of the agency administering the program.

BCDA and John Hay Management Corporation v. City of Baguio - Business "taxes," thus, are a species of license fees that may be imposed by the local government unit. While incidentally revenue-earning, fees for a mayor-issued business permit are primarily

regulatory, since the local government is not precluded from imposing conditions other than the payment of business taxes before the permit is issued. Issuances of business permits are in the exercise of police power. herefore, the mayor's permit fee is not a tax that establishments within the John Hay Special Economic Zone are exempt from paying.

Taxes are "an enforced contribution of money or other property assessed in accordance with some reasonable rule of apportionment by authority of a sovereign state, on persons or property within its jurisdiction, for the purpose of defraying the public expenses" or "a rate or sum of money assessed on the person or property of a citizen by government for the use of the nation or state; burdens or charges imposed by the legislative power upon persons or property to raise money for public purposes."

Fees are "a reward or compensation allowed by law to an officer for specific services performed by him in the discharge of his official duties; a sum certain given for a particular service; the sum prescribed by law as charge for services rendered by public officers."

The term "tax" applies — generally speaking — to all kinds of exactions which become public funds. The term is often loosely used to include levies for revenue as well as levies for regulatory purposes. Thus license fees are commonly called taxes. Legally speaking, however, license fee is a legal concept quite distinct from tax; the former is imposed in the exercise of police power for purposes of regulation, while the latter is imposed under the taxing power for the purpose of raising revenues.

To be considered a license fee, the imposition questioned must relate to an occupation or activity that so engages the public interest in health, morals, safety and development as to require regulation for the protection and promotion of such public interest; the imposition must also bear a reasonable relation to the probable expenses of regulation, taking into account not only the costs of direct regulation but also its incidental consequences as well. When an activity, occupation or profession is of such a character that inspection or supervision by public officials is reasonably necessary for the safeguarding and furtherance of public health, morals and safety, or the general welfare, the legislature may provide that such inspection or supervision or other form of regulation shall be carried out at the expense of the persons engaged in such occupation or performing such activity, and that no one shall engage in the occupation or carry out the activity until a

fee or charge sufficient to cover the cost of the inspection or supervision has been paid. Accordingly, a charge of a fixed sum which bears no relation at all to the cost of inspection and regulation may be held to be a tax rather than an exercise of the police power.

The power to tax may also be exercised in the performance of a police power, if done so to raise revenue. Regulatory fees may still be considered taxes if their purpose was primarily to generate revenue.

However, taxes that accrue to a special fund, while denominated as "tax" and may incidentally earn revenue, are not necessarily taxes if the exaction was due to a primarily regulatory purpose in the exercise of police power.

For a fee to be a valid exercise of police power, therefore, the revenue incidentally generated must not exceed the cost of regulation.

Therefore, as a test to determine if an exaction is a fee or a tax one must look into the purpose of its collection. If the exaction is made to raise revenue for the government to discharge its principal functions, the exaction is a tax. If the exaction is primarily regulatory, it is a fee, even if it incidentally raises revenue, as long as the revenue generated does not exceed the cost of regulation. If the revenue exceeds the regulatory costs, it is a tax.

Republic v. Mambulao Lumber Company - The sum of P9,127.50 paid by defendant-appellant company to plaintiff-appellee as reforestation charges from 1947 to 1956 may be NOT set off or applied to the payment of the sum of P4,802.37 as forest charges due and owing from appellant to appellee.

A claim for taxes is not such a debt, demand, contract or judgment as is allowed to be set-off under the statutes of set-off, which are construed uniformly, in the light of public policy, to exclude the remedy in an action or any indebtedness of the state or municipality to one who is liable to the state or municipality for taxes.

Neither are they a proper subject of recoupment since they do not arise out of the contract or transaction sued on.

The general rule, based on grounds of public policy is well-settled that no set-off is admissible against demands for taxes levied for general or local governmental purposes. The reason on which the general rule is based, is that taxes are not in the nature of contracts between the party and party but grow out of a duty to, and are the positive acts of the government, to the making and enforcing of

which, the personal consent of individual taxpayers is not required.

If the taxpayer can properly refuse to pay his tax when called upon by the Collector, because he has a claim against the governmental body which is not included in the tax levy, it is plain that some legitimate and necessary expenditure must be curtailed. If the taxpayer's claim is disputed, the collection of the tax must await and abide the result of a lawsuit, and meanwhile the financial affairs of the government will be thrown into great confusion.

Domingo v. Garlitos - Compensation has taken place in relation to the debts of both parties. There were already law and appropriation.

ART. 1200. When all the requisites mentioned in article 1279 are present, compensation takes effect by operation of law, and extinguished both debts to the concurrent amount, even though the creditors and debtors are not aware of the compensation.

Both the claim of the Government for inheritance taxes and the claim of the intestate for services rendered have already become overdue and demandable as well as fully liquidated. Compensation, therefore, takes place by operation of law, in accordance with the provisions of Articles 1279 and 1290 of the Civil Code, and both debts are extinguished to the concurrent amount.

ABAKADA Guro v. Exec Secretary (landmark case) - The sections introduced by the Senate are germane to the subject matter and purposes of the house bills, which is to supplement our country's fiscal deficit, among others. Thus, the Senate acted within its power to propose those amendments.

RE: SENATE AMENDMENTS: To begin with, it is not the law – but the revenue bill – which is required by the Constitution to “originate exclusively” in the House of Representatives.

It is important to emphasize this, because a bill originating in the House may undergo such extensive changes in the Senate that the result may be a rewriting of the whole.

At this point, what is important to note is that, as a result of the Senate action, a distinct bill may be produced. To insist that a revenue statute – and not only the bill which initiated the legislative process culminating in the enactment of the law – must substantially be the same as the House bill would be to deny the Senate's power not only to “concur with amendments” but also to “propose

amendments.” It would be to violate the coequality of legislative power of the two houses of Congress and in fact make the House superior to the Senate.

Given, then, the power of the Senate to propose amendments, the Senate can propose its own version even with respect to bills which are required by the Constitution to originate in the House.

To reconcile or harmonize disagreeing provisions, the Bicameral Conference Committee may then (a) adopt the specific provisions of either the House bill or Senate bill, (b) decide that neither provisions in the House bill or the provisions in the Senate bill would be carried into the final form of the bill, and/or (c) try to arrive at a compromise between the disagreeing provisions.

In making his recommendation to the President on the existence of either of the two conditions, the Secretary of Finance is not acting as the alter ego of the President or even her subordinate. In such instance, he is not subject to the power of control and direction of the President. He is acting as the agent of the legislative department, to determine and declare the event upon which its expressed will is to take effect.

RE: LEGISLATIVE DELEGATION: the general rule barring delegation of legislative powers is subject to the following recognized limitations or exceptions:

- (1) Delegation of tariff powers to the President under Section 28 (2) of Article VI of the Constitution;
- (2) Delegation of emergency powers to the President under Section 23 (2) of Article VI of the Constitution;
- (3) Delegation to the people at large;
- (4) Delegation to local governments; and
- (5) Delegation to administrative bodies.

In every case of permissible delegation, there must be a showing that the delegation itself is valid.

It is valid only if the law (a) is complete in itself, setting forth therein the policy to be executed, carried out, or implemented by the delegate; and (b) fixes a standard – the limits of which are sufficiently determinate and determinable – to which the delegate must conform in the performance of his functions.

Until Congress amends the law, and absent any unequivocal basis for its unconstitutionality, the 70% limitation stays.

RE: DUE PROCESS AND EQUAL PROTECTION CLAUSES: The input tax is not a property or a property right within the

constitutional purview of the due process clause. A VAT-registered person's entitlement to the creditable input tax is a mere statutory privilege.

In this case, the tax law is uniform as it provides a standard rate of 0% or 10% (or 12%) on all goods and services.

RE: UNIFORM & EQUITABLE SYSTEM OF TAXATION: Article VI, Section 28(1) of the Constitution reads: The rule of taxation shall be uniform and equitable. The Congress shall evolve a progressive system of taxation.

Uniformity in taxation means that all taxable articles or kinds of property of the same class shall be taxed at the same rate.

Different articles may be taxed at different amounts provided that the rate is uniform on the same class everywhere with all people at all times.

Taxation is progressive when its rate goes up depending on the resources of the person affected. The VAT is an antithesis of progressive taxation. By its very nature, it is regressive.

Southern Luzon Drug Corporation v. DSWD (landmark case) - The subject laws do not violate the equal protection clause.

Equal protection requires that all persons or things similarly situated should be treated alike, both as to rights conferred and responsibilities imposed. Similar subjects, in other words, should not be treated differently, so as to give undue favor to some and unjustly discriminate against others. The guarantee means that no person or class of persons shall be denied the same protection of laws which is enjoyed by other persons or other classes in like circumstances.

For a classification to be valid, (1) it must be based upon substantial distinctions, (2) it must be germane to the purposes of the law, (3) it must not be limited to existing conditions only, and (4) it must apply equally to all members of the same class.

To recognize all senior citizens as a group, without distinction as to income, is a valid classification. The Constitution itself considered the elderly as a class of their own and deemed it a priority to address their needs. When the Constitution declared its intention to prioritize the predicament of the underprivileged sick, elderly, disabled, women, and children, it did not make any reservation as to income, race, religion or any other personal circumstances. It was a blanket privilege afforded the group of citizens in the

enumeration in view of the vulnerability of their class.

The classification is based on age and therefore qualifies all who have attained the age of 60. Senior citizens are a class of their own, who are in need and should be entitled to government support, and the fact that they may still be earning for their own sustenance should not disqualify them from the privilege.

Arkansas Writers' Project v. Ragland - Arkansas has failed to meet this heavy burden. It has advanced no compelling justification for selective, content-based taxation of certain magazines, and the tax is therefore invalid under the First Amendment. Accordingly, we reverse the judgment of the Arkansas Supreme Court and remand for proceedings not inconsistent with this opinion.

The Court stated in Minneapolis Star that "a tax that singles out the press, or that targets individual publications within the press, places a heavy burden on the State to justify its action."

A law which taxed general interest magazines but not newspapers and religious, professional, trade and sports journals was discriminatory because while the tax did not single out the press as a whole, it targeted a small group within the press. What is more, by differentiating on the basis of contents (i.e., between general interest and special interests such as religion or sports) the law became "entirely incompatible with the First Amendment's guarantee of freedom of the press."

Two Instances of Violating Freedom of Expression:

1. If the law singles out the press industry from other businesses – one class vs other classes.
2. State singles out only a MEMBER of a press.

American Bible Society vs. City of Manila (landmark case) - The license fees are not valid.

The imposition of license fees on the distribution and sale of bibles and other religious literature by a non-stock, non-profit missionary organization not for purposes of profit amounts to a condition or permit for the exercise of their right, thus violating the constitutional guarantee of the free exercise and enjoyment of religious profession and worship which carries with it the right to disseminate religious beliefs and information.

It only becomes violative if it is a pre-condition to exercise the right (religious activities). The State is not really precluded from exercise of selling bibles – a tax on the religious articles are not necessarily prohibited under this limitation.

PAGCOR vs. BIR - There is no violation of the equal protection clause.

Equal protection requires that all persons or things similarly situated should be treated alike, both as to rights conferred and responsibilities imposed. Similar subjects, in other words, should not be treated differently, so as to give undue favor to some and unjustly discriminate against others.

The guarantee means that no person or class of persons shall be denied the same protection of laws which is enjoyed by other persons or other classes in like circumstances. The "equal protection of the laws is a pledge of the protection of equal laws." It limits governmental discrimination. The equal protection clause extends to artificial persons but only insofar as their property is concerned.

There is no violation of the non-impairment clause.

The non-impairment clause is contained in Section 10, Article III of the Constitution, which provides that no law impairing the obligation of contracts shall be passed.

The non-impairment clause is limited in application to laws that derogate from prior acts or contracts by enlarging, abridging or in any manner changing the intention of the parties. There is impairment if a subsequent law changes the terms of a contract between the parties, imposes new conditions, dispenses with those agreed upon or withdraws remedies for the enforcement of the rights of the parties.

Thus, a franchise partakes the nature of a grant, which is beyond the purview of the non-impairment clause of the Constitution.

Tolentino v. Sec of Finance (landmark case) - The VAT is not regressive and does not violate the requirement that "The rule of taxation shall be uniform and equitable [and] Congress shall evolve a progressive system of taxation." There is, however, no justification for passing upon the claims that the law also violates the rule that taxation must be progressive and that it denies petitioners' right to due process and that equal protection of the laws.

Indeed, regressivity is not a negative standard for courts to enforce. What Congress is required by the Constitution to do is to "evolve a progressive system of taxation." This is a

directive to Congress, just like the directive to it to give priority to the enactment of laws for the enhancement of human dignity and the reduction of social, economic and political inequalities (Art. XIII, § 1), or for the promotion of the right to "quality education" (Art. XIV, § 1). These provisions are put in the Constitution as moral incentives to legislation, not as judicially enforceable rights.

Thus, the broad argument against the VAT is that it is regressive and that it violates the requirement that "The rule of taxation shall be uniform and equitable [and] Congress shall evolve a progressive system of taxation."

CIR v. DLSU (landmark case) - The income and revenues of DLSU proven to have been used actually, directly and exclusively for educational purposes are exempt from duties and taxes.

The income of whatever kind and character of the foregoing organizations from any of their properties, real or personal, or from any of their activities conducted for profit regardless of the disposition made of such income shall be subject to tax imposed under this Code.

The requisites for availing the tax exemption under Article XIV, Section 4 (3) are, namely: (1) the taxpayer falls under the classification non-stock, non-profit educational institution; and (2) the income it seeks to be exempted from taxation is used actually, directly and exclusively for educational purposes.

The tax exemption granted by the Constitution to non-stock, non-profit educational institutions is conditioned only on the actual, direct and exclusive use of their assets, revenues and income for educational purposes.

Further, a plain reading of the Constitution would show that Article XIV, Section 4 (3) does not require that the revenues and income must have also been sourced from educational activities or activities related to the purposes of an educational institution.

The phrase all revenues is unqualified by any reference to the source of revenues. Thus, so long as the revenues and income are used actually, directly and exclusively for educational purposes, then said revenues and income shall be exempt from taxes and duties.

Revenues consist of the amounts earned by a person or entity from the conduct of business operations. It may refer to the sale of goods, rendition of services, or the return of an investment. Revenue is a component of the tax base in income tax, VAT, and local business tax (LBT).

Assets, on the other hand, are the tangible and intangible properties owned by a person or entity. It may refer to real estate, cash deposit in a bank, investment in the stocks of a corporation, inventory of goods, or any property from which the person or entity may derive income or use to generate the same.

Thus, when a non-stock, non-profit educational institution proves that it uses its revenues actually, directly, and exclusively for educational purposes, it shall be exempted from income tax, VAT, and LBT. On the other hand, when it also shows that it uses its assets in the form of real property for educational purposes, it shall be exempted from RPT.

To be clear, proving the actual use of the taxable item will result in an exemption, but the specific tax from which the entity shall be exempted from shall depend on whether the item is an item of revenue or asset.

The crucial point of inquiry then is on the use of the assets or on the use of the revenues. These are two things that must be viewed and treated separately. But so long as the assets or revenues are used actually, directly and exclusively for educational purposes, they are exempt from duties and taxes.

La Sallian Educational Innovators Found. vs. CIR - Petitioner is exempt from paying taxes and duties.

Clearly, non-stock, non-profit educational institutions are not required to pay taxes on all their revenues and assets if they are used actually, directly and exclusively for educational purposes.

A taxpayer shall be granted with this tax exemption after proving that: (1) it falls under the classification of non-stock, non-profit educational institution; and (2) the income it seeks to be exempted from taxation is used actually, directly and exclusively for educational purposes.

Article XIV, Section 4 (3) does not require that the revenues and income must have also been earned from educational activities or activities related to the purposes of an educational institution. The phrase "all revenues" is unqualified by any reference to the source of revenues.

Thus, so long as the revenues and income are used actually, directly and exclusively for educational purposes, then said revenues and income shall be exempt from taxes and duties.

CIR v. St. Luke's Medical Center, Inc - St. Luke's is liable for deficiency income tax in 1998 under Section 27(B) of the NIRC, which imposes a preferential tax rate of 10% on the income of proprietary non-profit hospitals.

Section 27(B) of the NIRC imposes a 10% preferential tax rate on the income of (1) proprietary non-profit educational institutions and (2) proprietary non-profit hospitals. The only qualifications for hospitals are that they must be proprietary and non-profit. "Proprietary" means private, following the definition of a "proprietary educational institution" as "any private school maintained and administered by private individuals or groups" with a government permit. "Non-profit" means no net income or asset accrues to or benefits any member or specific person, with all the net income or asset devoted to the institution's purposes and all its activities conducted not for profit. "Non-profit" does not necessarily mean "charitable."

Charity is essentially a gift to an indefinite number of persons which lessens the burden of government. In other words, charitable institutions provide for free goods and services to the public which would otherwise fall on the shoulders of government. Thus, as a matter of efficiency, the government forgoes taxes which should have been spent to address public needs, because certain private entities already assume a part of the burden. This is the rationale for the tax exemption of charitable institutions. As a general principle, a charitable institution does not lose its character as such and its exemption from taxes simply because it derives income from paying patients, whether out-patient, or confined in the hospital, or receives subsidies from the government, so long as the money received is devoted or used altogether to the charitable object which it is intended to achieve; and no money inures to the private benefit of the persons managing or operating the institution.

Lung Center of the Philippines v. QC (landmark case) - The portions of the land leased to private entities as well as those parts of the hospital leased to private individuals are not exempt from such taxes. On the other hand, the portions of the land occupied by the hospital and portions of the hospital used for its patients, whether paying or non-paying, are exempt from real property taxes.

The test of a charity and a charitable organization are in law the same. The test whether an enterprise is charitable or not is whether it exists to carry out a purpose reorganized in law as charitable or whether it

is maintained for gain, profit, or private advantage.

As a general principle, a charitable institution does not lose its character as such and its exemption from taxes simply because it derives income from paying patients, whether out-patient, or confined in the hospital, or receives subsidies from the government, so long as the money received is devoted or used altogether to the charitable object which it is intended to achieve; and no money inures to the private benefit of the persons managing or operating the institution.

What is meant by actual, direct and exclusive use of the property for charitable purposes is the direct and immediate and actual application of the property itself to the purposes for which the charitable institution is organized. It is not the use of the income from the real property that is determinative of whether the property is used for tax-exempt purposes.

Chevron Philippines, Inc. vs. BCDA - The royalty fee is for regulatory purposes.

In distinguishing tax and regulation as a form of police power, the determining factor is the purpose of the implemented measure. If the purpose is primarily to raise revenue, then it will be deemed a tax even though the measure results in some form of regulation.

On the other hand, if the purpose is primarily to regulate, then it is deemed a regulation and an exercise of the police power of the state, even though incidentally, revenue is generated.

The conservative and pivotal distinction between these two (2) powers rests in the purpose for which the charge is made. If generation of revenue is the primary purpose and regulation is merely incidental, the imposition is a tax; but if regulation is the primary purpose, the fact that revenue is incidentally raised does not make the imposition a tax.

Angeles University Foundation vs. Angeles City - The petitioner is NOT exempt from the payment of building permit and related fees imposed under the National Building Code.

In distinguishing tax and regulation as a form of police power, the determining factor is the purpose of the implemented measure. If the purpose is primarily to raise revenue, then it will be deemed a tax even though the measure results in some form of regulation.

On the other hand, if the purpose is primarily to regulate, then it is deemed a regulation and

an exercise of the police power of the state, even though incidentally, revenue is generated.

The parcel of land owned by petitioner which has been assessed for real property tax is NOT exempt.

Section 28(3), Article VI of the 1987 Constitution provides: (3) Charitable institutions, churches and parsonages or convents appurtenant thereto, mosques, non-profit cemeteries, and all lands, buildings, and improvements, actually, directly and exclusively used for religious, charitable or educational purposes shall be exempt from taxation.

What is meant by actual, direct and exclusive use of the property for charitable purposes is the direct and immediate and actual application of the property itself to the purposes for which the charitable institution is organized. It is not the use of the income from the real property that is determinative of whether the property is used for tax-exempt purposes.

CIR v. Solidbank Corporation - There is no double taxation, because there is no taxing twice, by the same taxing authority, within the same jurisdiction, for the same purpose, in different taxing periods, some of the property in the territory.

Double taxation means taxing the same property twice when it should be taxed only once; that is, "taxing the same person twice by the same jurisdiction for the same thing." It is obnoxious when the taxpayer is taxed twice, when it should be but once. Otherwise described as "direct duplicate taxation," the two taxes must be imposed on the same subject matter, for the same purpose, by the same taxing authority, within the same jurisdiction, during the same taxing period; and they must be of the same kind or character.

Nursery Care Corporation et al v. Acevedo - Collection of taxes pursuant to Section 21 of the Revenue Code of Manila constituted double taxation.

There is double taxation when the same taxpayer is taxed twice when he should be taxed only once for the same purpose by the same taxing authority within the same jurisdiction during the same taxing period, and the taxes are of the same kind or character. Double taxation is obnoxious.

CIR v. Estate of Toda - The case is TAX EVASION.

Tax avoidance and tax evasion are the two most common ways used by taxpayers in escaping from taxation. Tax avoidance is the tax saving device within the means sanctioned by law. This method should be used by the taxpayer in good faith and at arms length.

Tax evasion, on the other hand, is a scheme used outside of those lawful means and when availed of it usually subjects the taxpayer to further or additional civil or criminal liabilities.

Tax evasion connotes the integration of three factors:

1. the end to be achieved, i.e., the payment of less than that known by the taxpayer to be legally due, or the non-payment of tax when it is shown that a tax is due;
2. an accompanying state of mind which is described as being "evil," in "bad faith," "willful," or "deliberate and not accidental"; and
3. a course of action or failure of action which is unlawful.

CIR v. The Hongkong Shanghai Banking Corporation Limited – Philippine Branch - What was employed to minimize taxes was a tax avoidance scheme.

A taxpayer has the legal right to decrease the amount of what otherwise would be his taxes or altogether avoid them by means which the law permits. This is called tax avoidance. It is the use of legal means to reduce tax liability. However, this method should be used by the taxpayer in good faith and at arms-length.

Tax evasion connotes the integration of three factors:

1. the end to be achieved, i.e., the payment of less than that known by the taxpayer to be legally due, or the non-payment of tax when it is shown that a tax is due;
2. an accompanying state of mind which is described as being "evil," in "bad faith," "willful," or "deliberate and not accidental"; and
3. a course of action or failure of action which is unlawful.

**NATIONAL TAXATION –
National Internal Revenue Code of
1997 [NIRC], as amended
JURISDICTION, POWERS,
AND FUNCTIONS OF THE
BUREAU OF INTERNAL REVENUE**

**Commissioner of Internal Revenue
(CIR)**

Administrative interpretations and opinions:
The power to interpret the provisions of the

Tax Code and other tax laws is under the exclusive and original jurisdiction of the Commissioner of Internal Revenue subject to review by the Secretary of Finance (Sec. 4, par.1, NIRC).

Revenue regulations are the formal interpretation of the provisions of the NIRC and other laws by the Secretary of Finance upon the recommendation of the Commissioner of Internal Revenue.

General Rule: The Commissioner has the sole authority to issue rulings but he also has the power to delegate said authority to his subordinates with the rank equivalent to a division chief or higher.

Exceptions: The Commissioner may not delegate the following:

1. The power to recommend the promulgation of rules and regulations by the Secretary of Finance;
2. The power to issue rulings of first impression or to reverse, revoke, or modify any existing ruling of the Bureau; and
3. The power to compromise or abate any tax liability as provided by Sec. 204 and 205 of the NIRC.

Exception to the Exception: BUT assessments issued by RDOs involving (a) Php500,000 or less, and (b) minor criminal violations as determined by the Secretary of Finance as recommended by the Commissioner, may be compromised by a Regional Evaluation Board (Sec. 7, NIRC).

The CIR's function and authority is lodged from Section 4 to 7 of the NIRC, summarize as follows:

1. Interpret tax laws and decide tax cases (Sec. 4);
2. Obtain information and to summon, examine, and take testimony of persons (Sec. 5);
3. To make assessments and prescribe additional requirements for tax administration and enforcement, which includes the following, among others: (Sec 6)
 - a. Examination of returns and determination of tax due;
 - b. Authority to conduct inventory-taking, surveillance and to prescribe presumptive gross sales and receipts;
 - a. Authority to terminate taxable period;
 - b. Authority to prescribe real property values;
 - c. Authority to inquire into bank deposit accounts and other related information held by financial institutions;

- d. Authority to accredit and register tax agents;
 - e. Authority to prescribe additional procedural or documentary requirements.
4. Authority to delegate power: (Sec 7)
- a. GENERAL RULE: The CIR may delegate the powers vested in him under the pertinent provisions of NIRC.
 - b. EXEMPTION: The following powers of the Commissioner shall not be delegated:
 - i. The power to recommend the promulgation of rules and regulations by the Secretary of Finance;
 - ii. The power to issue rulings of first impression or to reverse, revoke or modify any existing ruling of the Bureau;
 - iii. The powers to compromise or abate any tax liability. Provided, however, that assessments issued by the regional offices involving basic deficiency taxes of Five hundred thousand pesos (P500,000) or less, and minor criminal violations, as may be determined by rules and regulations to be promulgated by the Secretary of Finance, upon recommendation of the Commissioner, discovered by regional and district officials, may be compromised by a regional evaluation board which shall be composed of the Regional Director as Chairman, the Assistant Regional Director, the heads of the Legal, Assessment and Collection Divisions and the Revenue District Officer having jurisdiction over the taxpayer, as members; and
 - iv. The power to assign or assign internal revenue officers to

establishments where articles subject to excise are produce or kept.

INCOME TAX

Nature and General Principles

Criteria in Imposing Philippine Income Tax

- a. Citizenship – A citizen taxpayer is subject to income tax: (a) on his worldwide income if he resides in the Philippines; or (b) only on his income from sources within the Philippines, if he qualifies as a non-resident citizen.
- b. Residence – A resident alien is liable to pay income tax on his income from sources within the Philippines but exempt from tax on his income from sources outside the Philippines.
- c. Source – A non-resident alien could be subject to Philippine income tax if he derives income from sources within the Philippines such as dividend, interest, rent or royalty.

CLASS NOTES: The term 'nonresident citizen' means:

(1) A citizen of the Philippines who establishes to the satisfaction of the Commissioner the fact of his physical presence abroad with a definite intention to reside therein.

(2) A citizen of the Philippines who leaves the Philippines during the taxable year to reside abroad, either as an immigrant or for employment on a permanent basis.

(3) A citizen of the Philippines who works and derives income from abroad and whose employment thereat requires him to be physically present abroad most of the time during the taxable year.

[CLASS NOTES: "Most of the time" means 183 days because it is the majority of 365 days per year. $183 \text{ days} = 365 \text{ days} / 2$.]

(4) A citizen who has been previously considered as nonresident citizen and who arrives in the Philippines at any time during the taxable year to reside permanently in the Philippines shall likewise be treated as a nonresident citizen for the taxable year in which he arrives in the Philippines with respect to his income derived from sources abroad until the date of his arrival in the Philippines.

(5) The taxpayer shall submit proof to the Commissioner to show his intention of leaving the Philippines to reside permanently abroad or to return to and reside in the Philippines as the case may be for purpose of this Section (Section 22 (E), NIRC as amended).

Example: Based on the definition of “Non-Resident Alien”, an employee who is under secondment employment abroad is NOT considered an NRC but a RC therefore all income from within and without the Philippines are TAXABLE.

CLASS NOTES: When there is doubt as to your classification – There is a strict definition of NRC under Section 22 (E) of the NIRC.

Secondment Employment = NOT NRC – under secondment not employed outside – the PH entity still remains as its employer.

We have to prove that you are an NRC, so only those derived here in the PH will be subject to tax.

The basis is the length of stay for aliens (180 days).

Those who really are engaged in business or trade - **Different tax rate and different tax scheme.**

Engaged in trade or business – taxable like resident alien and non-resident alien ETB.

Not Engaged in trade or business - 25% FWT.

Kinds of Taxpayers

Section 23. General Principles of Income Taxation in the Philippines. - Except when otherwise provided in this Code:

(A) A citizen of the Philippines residing therein is taxable on all income derived from sources within and without the Philippines;

(B) A nonresident citizen is taxable only on income derived from sources within the Philippines;

(C) An individual citizen of the Philippines who is working and deriving income from abroad as an overseas contract worker is taxable only on income derived from sources within the Philippines: Provided, That a seaman who is a citizen of the Philippines and who receives compensation for services rendered abroad as a member of the complement of a vessel engaged exclusively in international trade shall be treated as an overseas contract worker;

(D) An alien individual, whether a resident or not of the Philippines, is taxable only on income derived from sources within the Philippines;

(E) A domestic corporation is taxable on all income derived from sources within and without the Philippines; and

(F) A foreign corporation, whether engaged or not in trade or business in the Philippines, is taxable only on income derived from sources within the Philippines. (NIRC as amended)

Individual Taxpayers

Citizens

Resident Citizens - A citizen of the Philippines residing therein is taxable on all income derived from sources within and without the Philippines.

Who are the residents? - DOMICILED here in PH.

Residence and domicile are considered the same thing for tax purposes.

Who is a citizen of the Philippines? - Not defined in the Tax Code – it only defined non-resident citizens.

Non-resident Citizens - A nonresident citizen is taxable only on income derived from sources within the Philippines.

Example: Overseas Contract Worker; Seamen.

Alien - An alien individual, whether a resident or not of the Philippines, is taxable only on income derived from sources within the Philippines.

Resident Alien - An alien individual, whether a resident or not of the Philippines, is taxable only on income derived from sources within the Philippines.

An alien actually present in the Philippines who is not a mere transient or sojourner is a resident of the Philippines income tax purposes.

The following are aliens which are considered residents:

1. If he lives in the Philippines and has no definite intention as to his stay.
2. If his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the Philippines.

Non-resident Alien - An alien individual, whether a resident or not of the Philippines, is taxable only on income derived from sources within the Philippines.

CLASS NOTES: Tax on Individuals: *Sections 24(A) and 25(A)(B), NIRC as amended.* Tax equalizer between aliens and Filipinos – same tax treatment of 15% shall apply to Filipinos employed and occupying the same position as those of aliens employed by the following companies (i.e. RAHQs, ROHQs, Offshore banking units established in the Philippines, and Petroleum Service Contractors and Subcontractors in the PH).

Corporations

NOTE: The term 'corporation' shall include partnerships, one person corporations, partnerships, no matter how created or organized, joint-stock companies, joint accounts (cuentos en participación), associations, or insurance companies, but does not include general professional partnerships and a joint venture or consortium formed for the purpose of undertaking construction projects or engaging in petroleum, coal, geothermal and other energy operations pursuant to an operating consortium agreement under a service contract with the Government. 'General professional partnerships' are partnerships formed by persons for the sole purpose of exercising their common profession, no part of the income of which is derived from engaging in any trade or business. (*Section 22, NIRC as amended*)

Domestic - A domestic corporation is taxable on all income derived from sources within and without the Philippines.

Nationality (Grandfather Rule) and Incorporation Rule.

Taxation only follows the place of incorporation test.

Foreign - A foreign corporation, whether engaged or not in trade or business in the Philippines, is taxable only on income derived from sources within the Philippines.

Resident Foreign and Non-resident Foreign.

Three ways that a foreign corporation may engage in business here in the PH.

If subsidiary, it is a domestic corporation already because it has to be registered here in the PH – remittance through dividends – 30/15%.

If branch, it is a resident foreign corporation – branch profit remittance – 15%.

CLASS NOTES: Tax on Corporations: Example: A and B agreed to buy a lotto ticket and then won. They divided the profits. Are their profits taxable? - YES. Civil Code says a partnership is an agreement whereby 2 or more parties agree to contribute money, industry, and property AND divide in profits and losses. Tax Code as amended says 'corporation' shall include partnerships etc for purposes of taxation. Therefore, their profits are taxable.

Note the difference between partnership vs. co-ownership. The key differences are 1) intention to contribute money, industry, and property, and 2) time (when) of agreement to divide in profits and losses.

CLASS NOTES: Tax on Corporations: An offline international air carrier selling passage tickets in the Philippines, through a general sales agent, is a resident foreign corporation doing business in the Philippines. As such, it is taxable under Section 28(A)(1), and not Section 28(A)(3) of the 1997 National Internal Revenue Code.

International Air Carrier. - 'Gross Philippine Billings' refers to the amount of gross revenue derived from carriage of persons, excess baggage, cargo, and mail originating from the Philippines in a continuous and uninterrupted flight, irrespective of the place of sale or issue and the place of payment of the ticket or passage document: Provided, That tickets revalidated, exchanged and/or indorsed to another international airline form part of the Gross Philippine Billings if the passenger boards a plane in a port or point in the Philippines: Provided, further, That for a flight which originates from the Philippines, but transshipment of passenger takes place at any part outside the Philippines on another airline, only the aliquot portion of the cost of the ticket corresponding to the leg flown from the Philippines to the point of transshipment shall form part of Gross Philippine Billings.

International Shipping. - 'Gross Philippine Billings' means gross revenue whether for passenger, cargo or mail originating from the

Philippines up to final destination, regardless of the place of sale or payments of the passage or freight documents. Provided, That international carriers doing business in the Philippines may avail of a preferential rate or exemption from the tax herein imposed on their gross revenue derived from the carriage of persons and their excess baggage on the basis of an applicable tax treaty or international agreement to which the Philippines is a signatory or on the basis of reciprocity such that an international carrier, whose home country grants income tax exemption to Philippine carriers, shall likewise be exempt from the tax imposed under this provision.

NOTE: IF the issue is the sale of tickets through sales agents in the Philippines, then the provisions on Gross Philippine Billings will NOT apply because the offline international air carrier is considered a resident foreign corporation.

Estates

Estates are all the property, rights and obligations of a person which are not extinguished by his death and those which have accrued thereto since the opening of the succession.

Trusts

A trust is the legal relationship between one person having an equitable ownership of property and another person owning the legal title to such property, the equitable ownership of the former entitling him to the performance of certain duties and the exercise of certain powers by the latter.

Re: Estates and Trusts: WHEN is the intention to divide profits arise? IT SHOULD BE PRESENT AT THE TIME OF CONTRIBUTION TO THE COMMON FUND.

Income

Definition

Income means all wealth which flows to the taxpayer other than a mere return of capital. Income is a gain derived from labor or capital, or both labor and capital; and includes the gain derived from the sale or exchange of capital assets (*Section 36, BIR R.R. 2-40*).

Income is all wealth that flows into the hands of the taxpayer other than as a mere return of capital. It includes gains and profits; amount of

money coming to a person within a specific time – return ON the capital.

Gains derived from capital (passive income), labor (compensation) or both combined (business income) provided it is understood to include profits gained through a sale or conversion of capital assets (dealings with capital assets).

Requisite for an income to be taxable:

1. There must be a gain.
2. The gain must be realized or received.
3. The gain must NOT be excluded by law from taxation.

Income	Capital
Denotes a flow of wealth during a definite period of time.	Fund or property existing at one distinct point in time.
Service of wealth	Wealth itself
Subject to tax	Return of capital is not subject of tax
Fruit	Tree

Realization and Recognition

Rule on Realization

Severance Test (Macomber Test; Realization Test) – There is no taxable income until there is a separation from capital of something of exchangeable value, thereby supplying the realization of transmutation which would result in the receipt of income; requires a taxable event – stock dividends – income not yet realized since it will form of capital.

Substantial Alteration of Interest Test: income is earned when there is a substantial alteration of the interest of a taxpayer (i.e., increase in the proportionate share of a stockholder in a corporation); income to be returnable for taxation must be fully and completely realized. Where there is no separation of gain or profit, or separation to increase in value from capital, there is no income subject to tax.

Flow of Wealth Test: the test of taxability is the source, i.e., the property, activity or service that produced the income determines whether any gain was derived from the transaction.

Claim of Right Doctrine (Doctrine of Ownership, Command, or Control) a taxable gain is conditioned upon the presence of a claim of right to the alleged gain and in the absence of a definite unconditional obligation to return or repay that which would otherwise constitute a gain.

CLASS NOTES: Doctrine of Involuntary Conversion: Example - Proceeds of insurance used to build another building (not a taxable event) 50M insurance claim – 10M BV of the building razed by fire; 40M usually a gain – but if the 50M proceeds was used in its entirety – not a gain subject to Income Tax.

Cash Method	Accrual Method
A method of accounting whereby all items of gross income received during the year shall be accounted for such taxable year.	A method of accounting for income in the period it is earned (i.e., rendered) regardless of whether it has been received or not.
Income is realized upon receipt of cash or its equivalent including those constructively received but not including gifts and donations. Note: Only expenses actually paid for shall be claimed as deductions during the year	Income is earned regardless of whether it has been received or not. Note: Expenses are accounted for in the period they are incurred and not in the period they are paid.
Generally used by taxpayers who do not keep regular books of accounts, such as individuals engaged in business and practice or profession.	Generally used by taxpayers whose nature of business uses inventories since this method of accounting will correctly reflect income by matching purchases and expenses against sales, such as medium and large corporations.

Test of Recognition

Whether or not a particular income be recognized as taxable income or not. Whether or not there is a law that excludes or exempts the income from being taxed.

Gross Income: all income derived from whatever source, including, but not limited, to the following items:

- a. Compensation for services in whatever form paid, including, but not limited to fees, salaries, wages, commissions, and similar items;
- b. Gross income derived from the conduct of trade or business or the exercise of a profession;
- c. Gains derived from dealings in property;
- d. Interests;
- e. Rents;
- f. Royalties;
- g. Dividends;
- h. Annuities;
- i. Prizes and winnings;
- j. Pensions;
- k. Partner's distributive share from the net income of the General Professional Partnership (GPP).

Exclusions:

- a. Life Insurance – return of human capital;

- b. Amount received by insured as return of premium;
- c. Gifts, bequests, and devises;
- d. Compensation for injuries or sickness – should be on account of the injuries/sickness;
- e. Income exempt from treaty – due to international comity;
- f. Retirement benefits, pensions, gratuities, etc.
- g. Retirement
 - a. RA 7641 – 60 years old, 5 years of service, availed once.
 - b. RA 4917 / Reasonable Private Benefit Plan – minimum req's: 50 years old, 10 years of service, availed once.
- h. Separation Pay – because of death, sickness or other physical disability for any cause beyond the control of the said official or employees;
- i. War veterans under the US Veterans Administration;
- j. SSS, GSIS retirement gratuity;
- k. Miscellaneous Items;
- l. Income derived from foreign government;
- m. Income derived by the Government of its political subdivisions;
- n. Prizes and awards, provided that:
 - a. The recipient was selected without any action on his part;
 - b. The recipient is not required to render substantial future services as a condition
- o. Prizes and awards in sports competition;
- p. 13th month pay and other benefits not exceeding the *P90,000 threshold*;
- q. GSIS, SSS, Medicare and Other Contributions;
- r. Gains from the sale of bonds, debentures, or other certificate of indebtedness;
- s. Gains from redemption of shares in mutual fund;
- t. Income derived from the sale of gold (*Section 32, NIRC as amended*).

CLASS NOTES: In relation to Test of Recognition which says whether or not a particular income be recognized as taxable income or not or whether or not there is a law that excludes or exempts the income from being taxed, the following are EXEMPTIONS from being taxed on income.

Non-stock, Non-profit Educational Institutions - All revenues and assets of non-stock, non-profit educational institutions used actually, directly, and exclusively for educational purposes shall be exempt from taxes and duties. Upon the dissolution or cessation of the corporate existence of such

institutions, their assets shall be disposed of in the manner provided by law. Proprietary educational institutions, including those cooperatively owned, may likewise be entitled to such exemptions subject to the limitations provided by law including restrictions on dividends and provisions for reinvestment (*Section 4(3), Article XIV, 1987 Constitution*).

NOTE: Section 4(3), Article XIV is different from Section 28(3), Article VI because Section 4(3) pertains to all revenues and assets while Section 28(3) pertains to real property only.

NOTE: Section 30 last paragraph says "Notwithstanding the provisions in the preceding paragraphs, the income of whatever kind and character of the foregoing organizations from any of their properties, real or personal, or from any of their activities conducted for profit regardless of the disposition made of such income, shall be subject to tax imposed under this Code." -> In relation to Section 4(3), Article XIV and Section 30 last paragraph, the Constitution will prevail!!!

General Professional Partnerships - A general professional partnership as such shall not be subject to the income tax imposed under this Chapter. Persons engaging in business as partners in a general professional partnership shall be liable for income tax only in their separate and individual capacities (*Section 26, NIRC as amended*).

GOCCs - The provisions of existing special or general laws to the contrary notwithstanding, all corporations, agencies, or instrumentalities owned or controlled by the Government, except the Government Service Insurance System (GSIS), the Social Security System (SSS), the Home Development Mutual Fund (HDMF), the Philippine Health Insurance Corporation (PHIC), and the local water districts shall pay such rate of tax upon their taxable income as are imposed by this Section upon corporations or associations engaged in a similar business, industry, or activity (*Section 27 (C), NIRC as amended*).

RAHQs - Regional or area headquarters as defined in Section 22(DD) shall not be subject to income tax (*Section 28 (A5), NIRC as amended*).

NOTE: RAHQs are not taxable because they have NO income. ROHQs are taxable because they HAVE income.

Employee Trust Funds - The tax imposed by this Title shall not apply to employee's trust which forms part of a pension, stock bonus or profit-sharing plan of an employer for the benefit of some or all of his employees (1) if contributions are made to the trust by such

employer, or employees, or both for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, and (2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees; Provided, That any amount actually distributed to any employee or distributee shall be taxable to him in the year in which so distributed to the extent that it exceeds the amount contributed by such employee or distributee (*Section 60 (B), NIRC as amended*).

CLASS NOTES: Section 32, NIRC as amended are EXCLUSIONS.

Taxability of Income

Summary of Taxability of Income

Taxpayer	Within	Without
Resident Citizen	√	√
Non-resident Citizen and OCW	√	X
Resident Alien	√	X
Non-resident Alien	√	X
Domestic Corporation	√	√
Foreign Corporation	√	X

Requisites for Income to be Taxable:

- There is INCOME, gain or profit;
- RECEIVED or REALIZED during the taxable year;
- NOT EXEMPT from income tax by law or treaty.

Sources

Compensation Income (Section 40, NIRC as amended)

Compensation is income from the rendering of services under an employer-employee relationship. All remunerations for services performed by an employee for his employer under an employer-employee (ER-EE) relationship, unless excepted under the provisions of the NIRC are considered as compensation income.

CLASS NOTES: Re: Compensation Income: Citizen and Resident Alien (Sec. 24(A), NIRC as amended)

- a. MWEs - exempt under RA 9504.
- b. Above -MWEs - exempt up to Php250k under TRAIN Law RA 10963.

Non-Resident Alien

- a. NRA-ETB (Sec. 25(A), NIRC as amended) - same as Citizen and Resident Alien.
- b. NRA-NETB (Sec. 25(B), NIRC as amended) - 25% income tax.

Fringe Benefits

Fringe Benefit means any good, service or other benefit furnished or granted in cash or in kind by an employer to an individual employee **(except rank and file employees as defined herein)** such as, but not limited to, the following: (1) Housing; (2) Expense account; (3) Vehicle of any kind; (4) Household personnel, such as maid, driver and others; (5) Interest on loan at less than market rate to the extent of the difference between the market rate and actual rate granted; (6) Membership fees, dues and other expenses borne by the employer for the employee in social and athletic clubs or other similar organizations; (7) Expenses for foreign travel; (8) Holiday and vacation expenses; (9) Educational assistance to the employee or his dependents; and (10) Life or health insurance and other non-life insurance premiums or similar amounts in excess of what the law allows.

Example: Company gives Employee A Marketing Management classes to improve her skills and gives Employee B Stress Management classes to allow her to be healthy. Here, only Employee B (fringe benefit tax paid by employer) will be subject to Fringe Benefit Tax of 35% and not Employee A (employer business expense) because it is for the benefit of the employer.

The following fringe benefits are NOT taxable: (1) Fringe benefits which are authorized and exempted from tax under special laws; (2) Contributions of the employer for the benefit of the employee to retirement, insurance and hospitalization benefit plans; (3) Benefits given to the rank and file employees, whether granted under a collective bargaining agreement or not; and (4) **De minimis benefits** as defined in the rules and regulations to be promulgated by the Secretary of Finance.

De Minimis Benefits

De Minimis Benefits are facilities or privileges that are of relatively small value and furnished by the employer as a means of promoting the health, goodwill, contentment, or efficiency of the employees which are NOT subject to tax.

What are De Minimis Benefits? - a. Monetized unused vacation leave credits of private employees up to ten (10) days; b. Monetized value of vacation and sick leave credits paid to government officials and employees; c. Medical cash allowance to dependents of employees up to Php 1,500 per semester of Php 250 per month; d. Rice subsidy up to Php 2,000 or one sack of 50kg rice per month amounting to not more than P2,000; e. Uniform and clothing allowance not exceeding Php 7,000 per annum. f. Actual medical assistance, e.g., medical allowance to cover medical and healthcare needs, annual medical/executive check-up, maternity assistance, and routine consultations, not exceeding P10,000 per annum; g. Laundry allowance up to Php 300 per month; h. Employee achievement awards, e.g., for length of service or safety achievement, in any form, whether in cash, gift certificate or any tangible personal property, with an annual monetary value not exceeding Php 10,000 received by the employee under an established written plan which does not discriminate in favor of highly paid employees; i. Gifts given during Christmas and major anniversary celebrations not exceeding Php 5,000 per employee per annum; j. Daily meal allowance for overtime work and night/graveyard shift not exceeding 25% of the basic minimum wage on a per region basis; k. Benefits under a Collective Bargaining Agreement and productivity incentive schemes provided that the total annual monetary value received from both CBA and productivity incentives schemes combined up to Php 10,000 per employee per annum.

Substituted Filing System

Conditions:

1. the employee receives purely compensation income (regardless of amount) during the taxable year.
2. the employee receives the income only from one employer in the Philippines during the taxable year,
3. the amount of tax due from the employee at the end of the year equals the amount of tax withheld by the employer.

Professional Income

Professional income are fees derived from engaging in an endeavor requiring special training as a professional as a means of livelihood, which include, but are not limited to the fees of lawyers, engineers, architects, CPAs, doctors, and the like. Professional

income refers to the fees received by a professional from the practice of his profession, provided that there is no employer-employee relationship between him and his clients.

Business Income

Business income are gains or profits derived from rendering services, selling merchandise, manufacturing products, farming, and long-term construction contracts.

Active vs. Passive Income

Active income from business activities refers to earnings generated through direct engagement in the operations and management of the business.

This includes income that requires the taxpayer's substantial involvement in the business activities that produce the revenue.

Passive Income are not generated in the active pursuit of the primary purpose of the corporation but arises from company's assets such as dividends or taxes.

Passive Income is typically derived from interests, royalties, prizes, winnings, and dividends that do not require the taxpayer's direct involvement in operational activities.

Passive Income Tax Rate (*Section 24(B), NIRC as amended*)

- a. Interests - 20%.
 - a. Time deposits -
 - i. At least 5 years - Exempt.
 - ii. If pre-invested - 5% (Four (4) years to less than five (5) years - 5%; Three (3) years to less than (4) years - 12%; Less than three (3) years - 20%).
- b. Royalties in general – 20%.
 - a. Royalties except on books, as well as other literary works and musical compositions – 10%.
- c. Prizes – 20%.
 - a. Prizes except prizes amounting to Ten thousand pesos (P10,000 - Exempt.
- d. Winnings – 20%.
 - a. Winnings except winnings amounting to Ten thousand pesos (P10,000) or less from Philippine Charity Sweepstakes and Lotto which shall be exempt – Exempt.
- e. Dividends – 10%.

Rule on Intracorporate Dividends (Section 24(D)(4), NIRC as amended)

- a. Received by Domestic Corporation -
 - a. From another corporation – Exempt.
 - b. From foreign corporation – Exempt if funds from such dividends actually received or remitted into the Philippines are reinvested in the business operations of the domestic corporation in the Philippines within the next taxable year from the time the foreign-sourced dividends were received AND shall be limited to funding the working capital requirements, capital expenditures, dividend payments, investment in domestic subsidiaries, and infrastructure project.
- b. Issued by Domestic Corporations (received from domestic corporations)
 - a. Received by a resident foreign corporation – Exempt.
 - b. Received by a non-resident corporation – subject to 15% FWT subject to the tax-sparing rule.

(The tax sparing rule allows a lower tax rate of 15% on dividends earned by foreign corporations in the Philippines, on the condition that the corporation's home country provides a tax credit for taxes deemed paid in the Philippines. This aims to reduce double taxation internationally. Certain entities like non-resident foreign corporations not engaged in trade may not avail of deductions from gross income. The document also discusses tax credits, deductions for charitable contributions, capital gains and losses, and wash sales.)

CLASS NOTES: Re: Business Income:

Individuals

- a. Gross Income is:
 - a. Sales – Cost of Sales = Gross Income. -> **Definition of GROSS INCOME under Sec. 27(E) NIRC as amended.**
- b. Taxable Income is:
 - a. Gross Income – Allowable Deductions (or OSD which is 40% of sales) = Net Income – Php 250,000 = Taxable Income x Tax Rate = Tax Due – CWT = Tax Liability.
- c. If total gross sales / gross receipts and other non-operating income:
 - a. EXCEEDS VAT threshold of Php 3 million – taxed at graduated rate of 0 to 35% of NET TAXABLE INCOME under Sec. 24(A)(2);
 - b. DOES NOT EXCEED VAT threshold – taxed at the option of the taxpayer at GRADUATED RATES or 8% of gross sales / receipts and other non-operating income in excess of Php 250,000 in lieu of graduated rates and percentage tax under Sec. 116.

Domestic Corporations

- a. Generally subject to income tax of 25% of their taxable income under Sec. 27(A).
- b. Corporations with taxable income of not more than Php 5 million AND with assets not more than Php 100 million (excluding land) - 20% tax rate.
- c. Special Domestic Corporations:
 - a. Non-stock, non-profit educational institutions – EXEMPT (Art. XIV, Sec. 4(3), 1987 Constitution; Sec. 30(H), NIRC as amended).
- d. Resident Foreign Corporations
 - a. Generally subject to 25% tax rate.
 - b. International Air Carrier or International Shipping doing business in the Philippines – subject only to 2.5% on its Gross Philippine Billings.
 - c. RAHQ – NOT subject to income tax.
 - d. ROHQ - 25% income tax.
 - e. RFCs are subject to MCIT.
 - f. Branch of a RFC is also liable to pay branch profit remittance tax rate of 15%.
- e. Non-resident Foreign Corporations

- a. Generally subject to tax rate of 25% of the GROSS INCOME during the taxable year.
- b. Rentals, charters, and other fees derived by non-resident lessors of aircraft, machinery, and equipment – 7.5% tax rate.
- c. Rentals, charters, and other fees payable to non-resident owners of vessels chartered by Philippine nationals – 4.5% tax rate.

CLASS NOTES: Re: Business Income on Minimum Corporate Income Tax (MCIT) under Sec. 27(E) NIRC as amended:

Chamber of Real Estate and Builders' Associations v. Romulo et al – MCIT is NOT oppressive.

The MCIT on domestic corporations is a new concept introduced by RA 8424 to the Philippine taxation system. It came about as a result of the perceived inadequacy of the self-assessment system in capturing the true income of corporations.

It was devised as a relatively simple and effective revenue-raising instrument compared to the normal income tax which is more difficult to control and enforce. It is a means to ensure that everyone will make some minimum contribution to the support of the public sector.

First, recognizing the birth pangs of businesses and the reality of the need to recoup initial major capital expenditures, the imposition of the MCIT commences only on the fourth taxable year immediately following the year in which the corporation commenced its operations. This grace period allows a new business to stabilize first and make its ventures viable before it is subjected to the MCIT.

Second, the law allows the carrying forward of any excess of the MCIT paid over the normal income tax which shall be credited against the normal income tax for the three immediately succeeding years.

Third, since certain businesses may be incurring genuine repeated losses, the law authorizes the Secretary of Finance to suspend the imposition of MCIT if a corporation suffers losses due to prolonged labor dispute, force majeure and legitimate business reverses.

NOTE: MCIT is taxed only AFTER the 3rd taxable year.

Summary of rules on DIVIDENDS

Dividends distributed by:	Dividends received by:	Tax Rate
Domestic Corporation	Individuals – RC/NR/RA	10%
	Individuals – NRA/ETB	20% (based in the same manner as royalties, prizes and winnings, other interest incomes)
	Individuals – NRA – NETB	25%
	Domestic Corporation	Exempt
Foreign Corporation	Resident Foreign Corporation	Exempt
	Non-resident Foreign Corporation	30% or 10% subject to the rule on tax sparing credit and/or Tax Treaty rules
Foreign Corporation, if dividend is considered income sourced within the Philippines	Individuals – RC/NR/RA	5-32% normal income tax
	Individuals – NRA – NET	25%
Foreign Corporation, if dividend is considered income sourced without the Philippines	Domestic corporation	Generally subject to 25%. Exempt subject to rules
	Resident foreign corporation, non-resident foreign corporation	25% corporate income tax
	Individuals residing in the Philippines	5-32% regular income tax
Foreign Corporation, if dividend is considered income sourced without the Philippines	Individuals non-residing in the Philippines – individuals – NRA – NETB	Exempt (based only on income WITHIN)
	Domestic corporation	Generally subject to 25%. Exempt subject to rules
	Resident foreign corporation, Non-resident foreign corporation	Exempt, no rules.

Income from Dealings in Property (Section 39, NIRC as amended)

Dealings in property such as sales or exchanges may result in gain or loss. The kind of property involved (i.e., whether the property is a capital asset or an ordinary asset) determines the tax implication and income tax treatment.

$$\text{Taxable Net Income} = \text{Ordinary Net Income} + \text{Net Capital Gains (other than those subject to final CGT)}$$

Capital vs. Ordinary Asset

Capital Assets are property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property used in the trade or business, of a character which is subject to the allowance for depreciation provided; or real property used in trade or business of the taxpayer.

Examples: Accounts Receivable, Investment in Stocks, Goodwill, RP and PP not used in trade or business.

CLASS NOTES: Please note that the Tax Code did not define ordinary assets – but by analogy – opposite of capital assets, corollary.

Ordinary Assets are those what are excluded from Capital Assets. These are:

- Stock in trade of the taxpayer or other property to be included in the inventory of the taxpayer if on hand at the close of the taxable year (e.g., supplies on hand, merchandise inventory);
- Property held by the taxpayer primarily for sale to customers in the ordinary course of business (e.g., subdivision lots by a real estate

developer) – property in general whether real or personal;

- Personal property used in trade or business is subject to depreciation (e.g., delivery truck, store, and office equipment) – depreciable assets;
- Real property used in trade or business (e.g., warehouse, factory, office building).

CLASS NOTES: There is a PRESUMED GAIN in Capital Asset disposal - that's why there is whichever is higher in the provision for the computation of CGT (real property only) - does not apply to shares of stocks.

CLASS NOTES: Re: Two-year Conversion Rule: Properties classified as ordinary assets for being used in business by a taxpayer engaged in business other than real estate business are automatically converted into capital assets upon showing of proof that the same have not been used in business for more than two (2) years prior to the consummation of the taxable transactions involving said properties.

Why important? - To determine the applicability of the following:

- Holding period;
- Loss limitation rule under Sec. 39(C); and
- Net Capital Loss Carry-over.

Types of Gains

- Ordinary gain** - if the asset involved is classified as **ordinary**, the entire amount of the gain from the transaction shall be included in the computation of gross income [Sec 32(A)], and the entire amount of the loss shall be deductible from gross income. [Sec 34(D), Tax Code]. (See Allowable Deductions from Gross Income – Losses)
- Capital gain** - If the asset involved is a **capital asset**, the rules on capital gains and losses apply in the determination of the amount to be included in gross income. [Sec. 39(A), Tax Code].

CLASS NOTES: Capital Gains from Sale of Shares of Stock not Traded in the Stock Exchange – 15% imposed upon the net capital gains (Sec. 24(C), NIRC as amended).

- Tax base is the NET CAPITAL GAIN (amount realized from the sale, barter, exchange or other disposition of shares of stock in a domestic corporation).

Capital Gains from Sale of Real Property – 6% imposed upon sale of real property (Sec. 24(D)(1), NIRC as amended).

- Tax base is the SELLING PRICE or the FMV of the property, whichever is higher.

b. The FMV is the higher amount between the zonal value of the BIR or the FMV as shown in the schedules of values in the Provincial or City Assessors (Real Property Tax Declaration).

CLASS NOTES: Computation of Gain or Loss (Sec. 40(A), NIRC as amended)

- a. Gain or Loss realized = amount realized from sale or other disposition.
- b. The adjusted basis refers to the basis at the time of acquisition plus the capital improvements less depreciation, if any. The initial refers to the following:
 - a. If the property was acquired by **PURCHASE**, the acquisition cost or purchase price plus expenses of acquisition.
 - b. If the property was inquired by **INHERITANCE**, the FMV of the property at the time of the death of the decedent ("**STEPPED-UP BASIS**").
 - c. If the property was acquired by **GIFT** or **DONATION**, the value in the hands of the last preceding owner who did not acquire the property by gift ("**CARRY-OVER BASIS**"). However, if such value is greater than the FMV of the property at the time of the gift, for the purposes of the determining loss, the FMV.
 - d. If the property was acquired in a **TRANSACTION**, where gain or loss is not required ("**SUBSTITUTED BASIS**").

Tax Free Exchanges (Sec. 40(C)(2), NIRC as amended)

Income Taxation

GAINS from sale of OTHER Capital Assets

1. They are subject to ordinary income tax.

Ordinary Gains	xxx
Add: Net Capital Gains	
Capital gains	xxx
Less: Capital losses (xxx)	xxx
Total Income	xxx
Less: Ordinary Losses	(xxx)
Net Income	xxx

2. Subject to **capital loss limitation rule**. Sec. 39(C) - Capital losses shall be allowed only to the extent of capital gains. However, banks or trust companies are not subject to this limitation and they may deduct their capital losses even if they exceed the capital gains.

Note: Ordinary losses can be deducted from the net capital gains but net capital loss cannot be used as deduction from gross income.

3. Subject to rule on **holding period**. Under Sec. 39 (B) - In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:
 100% if the capital asset has been held for not more than twelve (12) months; and
 50% if the capital asset has been held for more than twelve (12) months

5. **Net Capital Loss Carry-over**. Sec. 39(D) - If any taxpayer, other than a corporation, sustains in any taxable year a net capital loss, such loss (in an amount not in excess of the net income for such year) shall be treated in the succeeding taxable year as a loss from the sale or exchange of a capital asset held for not more than twelve (12) months.

Income Taxation

Illustration: GAINS from sale of OTHER Capital Assets

Ordinary Income				500,000.00
Add: Capital gains				
From asset held for more than 12 months	1,000,000.00	@ 50%	500,000.00	
From asset held for less than 12 months	1,000,000.00	@100%	1,000,000.00	1,500,000.00
Less: Capital losses				
Actual capital loss	(4,000,000.00)			
Capital loss limitation	1,500,000.00			(1,500,000.00)
Net Income				500,000.00
Net capital loss carry-over for next taxable year				500,000.00
Excess of actual capital loss over capital loss limitation	2,500,000.00			
Net taxable income which must not be exceeded	500,000.00			

Income Taxation

Summary of rules: Gains from sale of OTHER Capital Assets

Individuals	Corporation
1. Capital loss limitation rule.	1. Same rule Exception: Banks or trust companies are not subject to limitation.
2. Ordinary losses are deductible from capital gains but net capital loss cannot be deducted from ordinary gain or income.	2. Same rule
3. Subject to rule on holding period	3. No holding period
4. Subject to rule on net capital loss carry-over.	4. No carry over

Situs of Income Taxation

NOTE: Section 42, NIRC as amended.

Income	Situs
Interest	Residence of the debtor
Dividends	<p>From Domestic Corporation Income within</p> <p>From Foreign Corporation</p> <ol style="list-style-type: none"> Income within if 50% or more of the gross income of the FC for the preceding 3 years prior to the declaration of dividend was derived from sources within the Philippines [only the portion of the dividend corresponding to the PH gross income is earned within] Income without if less than 50% subject to the same condition
Services	Place of performance
Rentals	Location of the property
Royalties	Place or use or exercise
Sale of Real Property	Location of realty in the Philippines
Sale of Personal Property	<p>Tangible</p> <ul style="list-style-type: none"> Manufactured w/in and sold w/o Partly w/in and partly w/o the PH Manufactured w/o and sold w/in Partly w/in and partly w/o the PH Purchased w/in but sold w/o Place of Sale Purchased w/o but sold w/in Place of Sale (passage of title test) <p>Intangible</p> <p>General rule: Place of Sale Exception: Shares of stock of domestic corporations □ Place of incorporation (Philippines)</p>

CLASS NOTES: Residence principle is all income derived from sources within the Philippines by persons residing in the Philippines whether citizen or not, or domestic or foreign corporations, are subject to income tax.

Source principle is all income derived from sources within the Philippines are subject to income tax.

Gross Income v. Net Income v. Taxable Income

Gross Income
Gross income includes all income from whatever source, whether legal or illegal. It encompasses the following:

1. Compensation for services in whatever form paid, including, but not limited to, fees, salaries, wages, commissions, and similar items;
2. Gross income derived from the conduct of trade or business or the exercise of a profession;
3. Gains derived from dealings in property;
4. Interests;

- 5. Rents;
- 6. Royalties;
- 7. Dividends;
- 8. Annuities;
- 9. Prizes and winnings;
- 10. Pensions; and
- 11. A partner's distributive share from the net income of a general professional partnership.

Exception: In the case of corporations, and for the purposes of computing the Minimum Corporate Income Tax (MCIT), the term "gross income" shall mean gross sales less sales returns, discounts, and allowances, as well as the cost of goods sold.

"Cost of goods sold" shall include all business expenses directly incurred to produce the merchandise and bring it to its present location and use [Sec. 27(E)(4), Tax Code].

This simply means that when computing for the MCIT, the tax base used shall be the gross income as defined under this section and not the taxable income.

Net Income
Net Income means taxable income less applicable tax due.

Taxable Income
Section 31. Taxable Income Defined. - The term 'taxable income' means the pertinent items of gross income specified in this Code, less deductions, if any, authorized for such types of income by this Code or other special laws. (NIRC as amended)

Gross Income vs. Taxable Income vs. Net Income
<p>Gross Income</p> <p>Less: Allowable deductions</p> <p>Taxable income</p> <p>Less: Tax due (Taxable income x proper tax rate (%))</p> <p>Net Income</p>

Tax Deductions v. Tax Credits

Tax Deduction	Tax Credit
A tax deduction, on the other, reduces the income that is subject to tax in order to arrive at taxable income. A tax credit is used only after the tax has been computed; a tax deduction, before.	A tax credit reduces the tax due, including whenever applicable, the income tax that is determined after applying the corresponding tax rates to taxable income.
Tax deduction will be deducted from a gross income to derive the taxable income (30%).	Tax credit will be deducted from taxable income to derive tax due (100%).

Limitations on Tax Credit:

1. **Per Country Limit** - The amount of tax credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's taxable income from sources within such country bears to his entire taxable income for the same taxable year.

2. **Worldwide Limit** - The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's taxable income from sources without the Philippines taxable bears to his entire taxable income for the same taxable year.

Optional Standard Deduction

Section 34. Deductions from Gross Income. - Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section, in computing taxable income subject to income tax under Sections 24(A); 25(A); 26; 27(A), (B), and (C); and 28(A)(1), there shall be allowed the following deductions from gross income: (L) **Optional Standard Deduction (OSD)**. - In lieu of the deductions allowed under the preceding Subsections, an individual subject to tax under Section 24, other than a nonresident alien, may elect a standard deduction in an amount not exceeding forty percent (40%) of his gross sales or gross receipts, as the case may be. In the case of a corporation subject to tax under Sections 27(A) and 28(A)(1), it may elect a standard deduction in an amount not exceeding forty percent (40%) of its gross income as defined in Section 32 of this Code. Unless the taxpayer signifies in his return his intention to elect the optional standard deduction, he shall be considered as having availed himself of the deductions allowed in the preceding Subsections. Such election when made in the return shall be irrevocable for the taxable year for which the return is made: Provided, That an individual who is entitled to and claimed for the optional standard deduction shall not be required to submit with his tax return such financial statements otherwise required under this Code: Provided, further, That a general professional partnership and the partners comprising such partnership may avail of the optional standard deduction only once, either by the general professional partnership or the partners comprising the partnership: Provided, finally, That except when the Commissioner otherwise permits, the said individual shall keep such records pertaining to his gross sales or gross receipts, or the said corporation shall keep such records pertaining to his gross income as defined in Section 32 of this Code during the taxable year, as may be required by the rules and regulations promulgated by the Secretary of Finance, upon recommendation of the Commissioner.

Notwithstanding the provision of the preceding Subsections, The Secretary of Finance, upon recommendation of the Commissioner, after a public hearing shall have been held for this purpose, may prescribe by rules and regulations, limitations or ceilings for any of the itemized deductions under Subsections (A) to (J) of this Section: Provided, That for purposes of determining such ceilings or limitations, the Secretary of Finance shall consider the following factors:

- a. adequacy of the prescribed limits on the actual expenditure requirements of each particular industry; and
- b. effects of inflation on expenditure levels:

Provided, further, That no ceilings shall further be imposed on items of expense already subject to ceilings under present law. (NIRC as amended)

OSD for Individuals, except non-resident aliens: In lieu of the itemized deductions allowed, an individual subject to income tax other than from pure compensation income may elect a standard deduction in an amount not exceeding 40% of his gross sales or receipts, as the case may be.

Requisites:

- 1. Taxpayer is a citizen or resident alien;
- 2. Taxpayer's income is not entirely from compensation;
- 3. Taxpayer signifies in his return his intention to elect this deduction; otherwise he is considered as having availed of the itemized deductions;
- 4. Election is irrevocable for the year made; however, he can change to itemized deductions in succeeding years.

OSD for Corporations, except non-resident foreign corporations: In lieu of the itemized deductions, domestic corporations and resident foreign corporations may elect a standard deduction in an amount not exceeding 40% of gross income.

CLASS NOTES: Re: Allowable Deductions under Sec. 34, NIRC as amended:

Requirements for Allowable Deductions IN GENERAL:

- 1. They must constitute **ORDINARY** and **NECESSARY** expenses.
- 2. They must be **REASONABLE** in amount.
- 3. They must be **INCURRED** during the **TAXABLE YEAR** in carrying on the business or in the exercise of profession.
- 4. They must be sustained by **ADEQUATE PROOF**.
- 5. They must **NOT BE AGAINST** law, morals, public policy, or public order. (*CIR v. General Foods (Phils), Inc*)

Requirements for Allowable Deductions FOR INTEREST:

- 1. There must be an interest expense paid or incurred upon a debt of the taxpayer that is connected with the taxpayer's trade, business, or exercise of profession.
- 2. The interest must have been paid or incurred during the taxable year.
- 3. The interest payment arrangement must not be between related parties under Sec. 36(B), NIRC as amended.
- 4. The interest must not be incurred to finance petroleum exploration.

NOTE: In relation to Sec. 34(B), NIRC as amended – Limitations as to the amount: **TAX ARBITRAGE RULE** means the practice of taking advantage of differences in tax laws or rates in different jurisdictions to reduce one's tax liability. The tax arbitrage rule in the Philippines is a tax regulation that reduces the allowable deduction for interest expenses by 20% of the interest income subjected to final tax. This rule, based on Section 34(B)(1) of the National Internal Revenue Code (NIRC), prevents taxpayers from claiming full deductions on interest-bearing loans while earning interest income that is taxed at a lower, final rate. -> Example: Interest Expense = Php 1,000,000 Interest Income (subject to final tax) = Php 1,000,000 -> Reduction 20% x Php 1,000,000 = Php 200,000 -> Allowable Deduction Php 1,000,000 – Php 200,000 = Php 800,000.

Allowable Deductions on TAXES under Sec. 34(C), NIRC as amended.

Allowable Deductions on LOSSES (In General, NOLCO, Capital Losses, Losses from Wash Sales of Stock or Securities, Wagering Losses, Abandonment Losses) Sec. 34(D), NIRC as amended. -> **Kinds – 1) Ordinary, 2) Casualty.**

Requisites for Allowable Deductions FOR CASUALTY LOSSES:

1. The lost property is connected with trade, business, or profession.
2. The loss arises from fires, storms, shipwrecks, or other casualties, or from robbery, theft, or embezzlement.
3. They should not be compensated for by insurance.
4. They must be evidenced by closed and completed transactions.

Allowable Deductions ON NET OPERATING LOSS CARRY OVER:

- a. NOLCO – excess of allowable deductions over gross income during the year.
- b. NOLCO can be carried over for the next 3 years AFTER the year the NOLCO was sustained.
- c. There is no substantial change in the ownership of the businesses – no more than 25% change of ownership (**75% Retention Rule**).
- d. For mines with no tax incentives, losses in any of the first 10 years of operation may be carried over as a deduction for the next 5 years following the year of such loss.

Allowable Deductions on BAD DEBTS under Sec. 34(E), NIRC as amended.

Requisites for Allowable Deductions FOR BAD DEBTS:

1. The debt must be actually ascertained as worthless and charged off within the taxable year.
2. The debts must be connected with the taxpayer's profession, trade, or business.
3. The debts must not be sustained in a transaction between the parties under Sec. 36(B) of the Tax Code.
4. The debts must be actually charged off in the books of account of the taxpayer as of the end of the taxable year.
5. There must be an existing indebtedness due to the taxpayer which must be valid and legally demandable.

NOTE: In relation to Sec. 34(E), NIRC as amended - **TAX BENEFIT RULE** means that "Provided, That recovery of bad debts previously allowed as deduction in the preceding years shall be included as part of the gross income in the year of recovery to the extent of the income tax benefit of said deduction." -> This applies to BAD DEBTS under Sec. 34(E) and TAXES under Sec. 34(C).

NOTE: In relation to Sec. 34(E), NIRC as amended – SECURITIES are either stocks / bonds or debts. -> Securities becoming worthless are "ascertained to be worthless and charged off within the taxable year and are capital assets." ->

Securities are capital assets when one is NOT a dealer in securities while securities are ordinary assets when they are dealer in securities.

Allowable Deductions on DEPRECIATION under Sec. 34(F), NIRC as amended.

Allowable Deductions on DEPRECIATION:

- a. Depreciation refers to the gradual diminution in the value of an asset due to its use in trade or business resulting in ordinary wear and tear or normal obsolescence.
- b. Depreciation also means those applied to amortization of the value of intangible assets with a definite life.
- c. The law does not authorize an asset beyond its acquisition cost.

NOTE: Example: 100 million machine divided by 10 years = 10 million per year residual or depreciation expense (allowable deductions as depreciation from the gross income).

NOTE: Formula: Depreciation = (Cost – Salvage Value) / Useful Life.

Requisites for Allowable Deductions FOR DEDUCTIONS:

1. The allowance must be reasonable.
2. For the exhaustion, wear and tear of property used in trade or business.
3. Charged during the taxable year from the taxpayer's books of accounts.

Allowable Deductions on CHARITABLE AND OTHER CONTRIBUTIONS under Sec. 34(H), NIRC as amended.

Requisites for Allowable Deductions FOR CHARITABLE AND OTHER CONTRIBUTIONS:

1. The contribution or gift must be actually paid.
2. The contribution or gift must be measured based on acquisition cost.
3. It must be given to an organization specified by law.
4. The net income of the specified institution must not inure to any private stockholder or individual.
5. The person making the contribution must be engaged in trade, business, or profession.

Allowable Deductions on RESEARCH AND DEVELOPMENT under Sec. 34(I), NIRC as amended.

Allowable Deductions ON RESEARCH AND DEVELOPMENT:

- a. This may be treated:
 - i. as ordinary as ordinary and necessary expenses which may be claimed as deduction.
 - ii. as deferred expenses (ASSETS) which may be amortized for over a period of 5 years.

Allowable Deductions on PENSION TRUSTS under Sec. 34(J), NIRC as amended.

Requisites for Allowable Deductions FOR PENSION TRUSTS:

1. The employer must have established a pension or retirement plan to provide for the payment of reasonable pension to his employees.
2. The retirement plan must be registered with the BIR and declared as reasonable within the contemplation of the Tax Qualified Plan under Sec. 32(B)(6)(a).
3. The retirement plan must be actually sound.
4. The retirement plan must be funded by the employer.
5. The amount contributed must no longer be subject to his control or disposition.

NOTE: Excess retirement fund reverted to the employer shall be reported as income. If the employer does not have a Tax Qualified Plan, only the actual retirement benefits paid to the employees can be claimed as a deduction.

Withholding Taxes

Rationale

Withholding tax is a method of collecting income tax in advance from the taxable income of the recipient of income.

Withholding Taxes, provide a mechanism for the Bureau of Internal Revenue (BIR) to collect taxes at the source of income. This ensures an efficient and timely collection, reducing the risk of tax evasion and enhancing taxpayer compliance. This area of the law has been shaped by the National Internal Revenue Code (NIRC) of 1997, as amended by the Tax Reform for Acceleration and Inclusion (TRAIN) Law (R.A. No. 10963) and further enhanced by the Ease of Paying Taxes Act (R.A. No. 11976).

The purpose of the withholding tax system is three-fold:

1. To provide the taxpayer with a convenient way of paying his tax liability;
2. To ensure the collection of tax; and
3. To improve the government's cashflow.

The withholding tax system serves several objectives, primarily aimed at improving the efficiency of tax collection, reducing evasion, and ensuring compliance. Key purposes include:

1. **Efficient Revenue Collection:** By requiring certain payors to withhold tax at the source, the Bureau of Internal Revenue (BIR) can collect taxes immediately as income is earned. This reduces reliance on voluntary compliance and ensures that taxes are remitted in advance.
2. **Minimizing Evasion and Enhancing Compliance:** By involving third-party payors as withholding agents, the BIR can reduce the opportunity for underreporting and tax evasion, since withholding agents are required to remit the withheld taxes to the government on behalf of taxpayers.
3. **Steady Cash Flow for Government Operations:** Withholding tax provides the government with a steady stream of revenue, thereby supporting fiscal operations throughout the fiscal year and avoiding cash flow shortfalls.

4. Taxpayer Convenience: Withholding tax simplifies the tax compliance process for certain taxpayers, as the tax is collected incrementally as income is earned rather than in lump sums at the end of the year.

Creditable vs. Withholding Taxes

Creditable	Withholding
Under the creditable withholding tax system, taxes withheld on certain income payments are intended to equal or at least approximate the tax due of the payee on said income.	The amount of income tax withheld by the withholding agent is constituted as a full and final payment of the income tax due from the payee on the said income.
It imposed on various payments such as professional fees, rental income, commissions, interest on certain loans, and income from certain goods and services.	It applies mainly to passive income, such as interest, dividends, royalties, and other specific types of income. Foreign corporations and non-resident individuals are commonly subject to FWT on Philippine-sourced income.
The rates for CWT vary depending on the type of income and the taxpayer's classification. Examples include 1% for income from the sale of goods and 2% for income from professional services.	Rates vary depending on the type of income and the tax status of the recipient. For example, interest on bank deposits and yields from trust funds are subject to a 20% final withholding tax for residents, while non-residents have differing rates based on treaties and classifications.
The amount withheld through CWT is credited against the total tax due of the payee. If the withholding exceeds the tax due, the taxpayer may claim a refund or carry over the excess as a tax credit.	Since FWT is considered the final tax on certain income, it cannot be used as a credit against other tax liabilities. The income subject to FWT is also not included in the recipient's gross income in the annual tax return.
Withholding agents must file monthly and annual returns to report the amounts withheld.	FWT plays a key role in transactions, especially concerning treaty reliefs, where rates are sometimes reduced or exempted based on tax treaties.

Duties of a Withholding Agent

Withholding Agent refers to any person or entity with control over the payment of income, whether resident or non-resident, that is required by the NIRC or related regulations to withhold taxes on certain income payments. Withholding agents can be employers, payors of income, or any individual or corporation making payments subject to withholding.

Sec 22(K), NIRC. Any person required to deduct and withhold any tax under the provision of Section 57:

- a. Determination of Taxable Income and Proper Tax Rates: Withholding agents must determine the correct amount of taxable income and apply the appropriate withholding tax rate. The TRAIN Law amended tax rates for various income brackets, and withholding agents are responsible for adhering to these updated rates.
- b. Deduction and Withholding of Tax: Before remitting payments to payees, withholding agents must deduct the appropriate withholding tax. Withholding taxes are imposed on various payments, including salaries, wages, professional fees, rentals, and royalties. The TRAIN Law specifies reduced tax rates for certain income categories to simplify and accelerate tax compliance.
- c. Filing of Returns and Remittance of Withheld Taxes: Withholding agents are required to file withholding tax returns and remit the corresponding taxes to the BIR. This must be done within the prescribed deadlines, which may vary depending on the type of income and frequency of remittance (e.g., monthly, quarterly, or annually). Failure to meet these deadlines results in penalties and interest charges.
- d. Issuance of Certificates to Income Recipients: Withholding agents must issue certificates of withholding tax (e.g., BIR Form 2307 or 2316) to payees or employees, reflecting the income earned and tax withheld. These certificates serve as documentation for the taxpayer's income tax filings and are essential for claiming tax credits.
- e. Compliance with Record-Keeping Requirements: Withholding agents must maintain records of all transactions subject to withholding tax. These records must be retained for a period prescribed by the BIR and must be available for inspection upon request. Proper record-keeping is crucial in case of audits or discrepancies in tax filings.
- f. Reporting Obligations for Nonresident Foreign Recipients: In cases where income payments are made to nonresident foreign individuals or corporations, withholding agents must comply with specific reporting requirements, including withholding tax on interest, royalties, dividends, and other passive income earned by nonresidents in the Philippines. The agent must apply applicable tax treaties, if any, to determine the correct withholding tax rate for nonresident payees.
- g. Registration as a Withholding Agent: Entities and individuals who are designated withholding agents must register with the BIR for withholding tax purposes. This includes obtaining a Taxpayer Identification Number (TIN) specific to their role as withholding agents.

Madrigal vs. Rafferty - The Court held that the entire income is taxable to Vicente Madrigal for both normal and additional tax purposes.

Income as contrasted with capital or property is to be the test. The essential difference between capital and income is that capital is a fund; income is a flow.

A fund of property existing at an instant of time is called capital.

A flow of services rendered by that capital by the payment of money from it or any other benefit rendered by a fund of capital in relation to such fund through a period of time is called an income. Capital is wealth, while income is the service of wealth.

Association of Non-profit Clubs, Inc. vs. BIR (landmark case) - RMC No. 35-2012 erroneously foisted a sweeping interpretation that membership fees and assessment dues are sources of income of recreational clubs from which income tax liability may accrue.

"Capital" has been delineated as a "fund" or "wealth," as opposed to "income" being "the flow of services rendered by capital" or the "service of wealth".

Income as contrasted with capital or property is to be the test. The essential difference between capital and income is that capital is a fund; income is a flow. A fund of property existing at an instant of time is called capital. A flow of services rendered by that capital by the payment of money from it or any other benefit rendered by a fund of capital in relation to such fund through a period of time is called an income. Capital is wealth, while income is the service of wealth.

Thus, membership fees, assessment dues, and other fees of similar nature only constitute contributions to and/or replenishment of the funds for the maintenance and operations of the facilities offered by recreational clubs to their exclusive members. They represent funds "held in trust" by these clubs to defray their operating and general costs and hence, only constitute infusion of capital.

In fine, for as long as these membership fees, assessment dues, and the like are treated as collections by recreational clubs from their members as an inherent consequence of their membership, and are, by nature, intended for the maintenance, preservation, and upkeep of the clubs' general operations and facilities, then these fees cannot be classified as "the income of recreational clubs from whatever source" that are "subject to income tax." Instead, they only form part of capital from which no income tax may be collected or imposed.

Therefore, the State cannot impose a tax on capital as it constitutes an unconstitutional confiscation of property.

National Development Corporation v CIR (landmark case) - The NDC is liable for the tax.

The Japanese shipbuilders were liable to tax on the interest remitted to them under Section 37 of the Tax Code, thus: SEC. 37. Income from sources within the Philippines. — (a) Gross income from sources within the Philippines. — The following items of gross income shall be treated as gross income from sources within the Philippines: (1) Interest. — Interest derived from sources within the Philippines, and interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise.

CIR v. British Overseas Airways Corporation (landmark case) - The revenue derived by private respondent British Overseas Airways Corporation (BOAC) from sales of tickets in the Philippines for air transportation, while having no landing rights here, constitute income of BOAC from Philippine sources, and, accordingly, taxable.

In order that a foreign corporation may be regarded as doing business within a State, there must be continuity of conduct and intention to establish a continuous business, such as the appointment of a local agent, and not one of a temporary character.

"Gross income" includes gains, profits, and income derived from salaries, wages or compensation for personal service of whatever kind and in whatever form paid, or from profession, vocations, trades, business, commerce, sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interests, rents, dividends, securities, or the transactions of any business carried on for gain or profit, or gains, profits, and income derived from any source whatever.

Income means "cash received or its equivalent"; it is the amount of money coming to a person within a specific time; it means something distinct from principal or capital. For, while capital is a fund, income is a flow. As used in our income tax law, "income" refers to the flow of wealth.

CIR v. Japan Airlines - Proceeds from sales of Japan air lines tickets sold in the Philippines are taxable as income from sources within the Philippines.

'Gross income' includes gains, profits, and income derived from salaries, wages or compensation for personal service of whatever kind and in whatever form paid, or from profession, vocations, trades, business, commerce, sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interests, rents, dividends, securities, or the transaction of any business

carried on for gain or profit, or gains, profits and income derived from any source whatever.

The source of an income is the property, activity or service that produced the income. For the source of income to be considered as coming from the Philippines, it is sufficient that the income is derived from activity within the Philippines.

CIR v. Marubeni Corp - The respondent is liable to pay the income tax.

The situs of the two projects is in the Philippines, and the materials provided and services rendered were all done and completed within the territorial jurisdiction of the Philippines.

Saint Wealth LTD v. BIR (J. SAMUEL GAERLAN CASE) (landmark case) - Offshore-based POGO licensees are not liable to pay income tax, VAT, and other applicable taxes for income derived from their non-gaming operations. The BIR can only impose Income Tax upon Income derived from the Philippines.

The situs of the source of payments is the Philippines. The flow of wealth proceeded from, and occurred within, Philippine territory, enjoying the protection accorded by the Philippine government. It is the situs of the activity that determines whether such income is taxable in the Philippines.

Substance Test – the true test in determining whether a foreign corporation is transacting business "seems to be whether it is continuing the body or substance of the business or enterprise for which it was organized or whether it has substantially retired from it and turned it over to another."

Contract Test – transactions entered into by a foreign corporation which constitute an isolated transaction and are not a series of commercial dealings which signify an intent on the part of such corporation to do business in the Philippines, does not fall under the category of "doing business."

Intention Test – what is determinative of "doing business" is not really the number or the quantity of the transactions, but the intention of the entity to continue the body of its business in the country. The number and quantity are merely evidence of such intention. The phrase "isolated transaction" has a definite and fixed meaning, i.e., a transaction or series of transactions set apart from the common business of a foreign enterprise in the sense that no intention to engage in a progressive

pursuit of the purpose and object of the business organization.

Actual Performance Test – an essential condition to be considered as "doing business" in the Philippines is the actual performance of specific commercial acts within the territory of the Philippines.

Interpublic Group of Companies, Inc. v. CIR - A non-resident foreign corporation which collects dividends from the Philippines cannot sue here to claim tax refund.

An unlicensed foreign corporation doing business in the Philippines cannot sue before Philippine courts. On the other hand, an unlicensed foreign corporation not doing business in the Philippines can sue before Philippine courts. Thus, mere investment as a shareholder by a foreign corporation in a duly registered domestic corporation shall not be deemed "doing business" in the Philippines.

No general rule or governing principle can be laid down as to what constitutes "doing" or "engaging in" or "transacting" business. Indeed, each case must be judged in the light of its peculiar environmental circumstances.

The true test, however, seems to be whether the foreign corporation is continuing the body or substance of the business or enterprise for which it was organized or whether it has substantially retired from it and turned it over to another. The term implies a continuity of commercial dealings and arrangements, and contemplates, to that extent, the performance of acts or works or the exercise of some of the functions normally incident to, and in progressive prosecution of, the purpose and object of its organization.

IGC, being a non-resident US corporation is qualified to avail of the aforesaid 15% preferential tax rate on the dividends it earned from the Philippines.

At any rate, the application for a tax treaty relief from the BIR should merely operate to confirm the entitlement of the taxpayer to the relief. This is only applicable to taxes paid on the basis of international agreements and treaties. Once it was settled that the taxpayer is entitled to the relief under the tax treaty, then by all means it could pay its tax liabilities using the tax relief provided by the treaty.

In other words, the requirements under RMO No. 1-2000 applies only to a taxpayer who is about to pay their taxes on the basis of tax reliefs provided by international agreements and treaties and to confirm its entitlement to the said reliefs. The application for tax treaty relief is not applicable on claims for tax refund.

Bloomberg Resort v. BIR - The petitioner should have appealed to CTA first.

The "failure to ask the CIR for a reconsideration of the assailed revenue regulations and RMCs is another reason why a case directly filed before us should be dismissed. It is settled that the premature invocation of the court's intervention is fatal to one's cause of action. If a remedy within the administrative machinery can still be resorted to by giving the administrative officer every opportunity to decide on a matter that comes within his jurisdiction, then such remedy must first be exhausted before the court's power of judicial review can be sought.

The party with an administrative remedy must not only initiate the prescribed administrative procedure to obtain relief but also to pursue it to its appropriate conclusion before seeking judicial intervention in order to give the administrative agency an opportunity to decide the matter itself correctly and prevent unnecessary and premature resort to the court."

The power of the CTA includes that of determining whether or not there has been grave abuse of discretion amounting to lack or excess of jurisdiction on the part of the [regional trial court] in issuing an interlocutory order in cases falling within the exclusive appellate jurisdiction of the tax court. It, thus, follows that the CTA, by constitutional mandate, is vested with jurisdiction to issue writs of certiorari in these cases.

CIR v. St. Luke's Medical Center, Inc (supra) - St. Luke's fails to meet the requirements under Section 30(E) and (G) of the NIRC to be completely tax exempt from all its income.

Section 30(E) of the NIRC provides that a charitable institution must be:

- (1) A non-stock corporation or association;
- (2) Organized exclusively for charitable purposes;
- (3) Operated exclusively for charitable purposes; and
- (4) No part of its net income or asset shall belong to or inure to the benefit of any member, organizer, officer or any specific person.

Thus, both the organization and operations of the charitable institution must be devoted "exclusively" for charitable purposes. The organization of the institution refers to its corporate form, as shown by its articles of incorporation, by-laws and other constitutive documents.

Section 30(E) of the NIRC specifically requires that the corporation or association be non-stock, which is defined by the Corporation Code as "one where no part of its income is distributable as dividends to its members, trustees, or officers" and that any profit "obtained as an incident to its operations shall, whenever necessary or proper, be used for the furtherance of the purpose or purposes for which the corporation was organized."

To be exempt from income taxes, Section 30(E) of the NIRC requires that a charitable institution must be "organized and operated exclusively" for charitable purposes. Likewise, to be exempt from income taxes, Section 30(G) of the NIRC requires that the institution be "operated exclusively" for social welfare.

Thus, the income of whatever kind and character of the foregoing organizations from any of their properties, real or personal, or from any of their activities conducted for profit regardless of the disposition made of such income, shall be subject to tax imposed under this Code.

Air Canada V. CIR – Petitioner is a resident foreign corporation that is taxable on its income derived from sources within the Philippines. Petitioner's income from sale of airline tickets, through Aerotel, is income realized from the pursuit of its business activities in the Philippines.

An offline international air carrier selling passage tickets in the Philippines, through a general sales agent, is a resident foreign corporation doing business in the Philippines. As such, it is taxable under Section 28(A)(1), and not Section 28(A)(3) of the 1997 National Internal Revenue Code.

An offline carrier is "any foreign air carrier not certificated by the [Civil Aeronautics] Board, but who maintains office or who has designated or appointed agents or employees in the Philippines, who sells or offers for sale any air transportation in behalf of said foreign air carrier and/or others, or negotiate for, or holds itself out by solicitation, advertisement, or otherwise sells, provides, furnishes, contracts, or arranges for such transportation."

CIR v. Shinko Electric Industries Co., Ltd - Shinko is not liable for income tax and VAT for the subject taxable period.

Income is "defined as an amount of money coming to a person or corporation within a specified time, whether as payment for services, interest or profit from investment. Unless otherwise specified, it means cash or its equivalent. It can also be thought of as a flow of the fruits of one's labor."

For income to be taxable, the following requisites must exist: (1) there must be gain; (2) the gain must be realized or received; and (3) the gain must not be excluded by law or treaty from taxation.

Passive income, such as dividends or interest, are not generated in the active pursuit and performance of the corporation's primary purpose but arises from the company's assets. As such, passive income are subjected to final taxes and are not covered by regular income tax.

BIR v. First E-Bank Tower Condominium Corporation - Association dues, membership fees, and other assessments/charges are not subject to income tax.

In fine, the collection of association dues, membership fees, and other assessments/charges is purely for the benefit of the condominium owners. It is a necessary incident to the purpose to effectively oversee, maintain, or even improve the common areas of the condominium as well as its governance.

Capital is a fund or property existing at one distinct point in time while income denotes a flow of wealth during a definite period of time. Income is gain derived and severed from capital.

Gross income means income derived from whatever source, including compensation for services; the conduct of trade or business or the exercise of a profession; dealings in property; interests; rents; royalties; dividends; annuities; prizes and winnings; pensions; and a partner's distributive share in the net income of a general professional partnership.

The term "taxable income" means the pertinent items of gross income specified in this Code, less deductions if any, authorized for such types of income by this Code or other special laws.

CIR v. Jerry Ocier - He is liable. The respondent's insistence that he was not liable for the CGT and DST because he had only loaned his shares to Tan without any consideration therefrom, being unsubstantiated, must fail.

Section 24(C) of the National Internal Revenue Code (NIRC) provides: (C) Capital Gains from Sale of Shares of Stock not Traded in the Stock Exchange. - The provisions of Section 39(B) notwithstanding, a final tax at the rates prescribed below is hereby imposed upon the net capital gains realized during the taxable year from the sale, barter, exchange or other disposition of shares of stock in a domestic corporation, except shares sold, or disposed of through the stock exchange.

As the provision textually indicates, the CGT is imposed on the net capital gains realized during the taxable year from the sale, barter, exchange or other disposition of shares of stock in a domestic corporation, except shares sold, or disposed of through the stock exchange. The term disposition, being neither defined nor qualified in Section 24(C), is accorded its ordinary meaning, that is, any act of disposing, transferring to the care or possession of another, or the parting with, alienation of, or giving up of property.

Republic v. Bunsay - RTC erred in awarding consequential damages equivalent to the value of CGT and transfer taxes in favor of Spouses Bunsay.

CGT, being a tax on passive income, is imposed by the National Internal Revenue Code on the seller as a consequence of the latter's presumed income from the sale or exchange of real property.

Notably, however, the transfer of real property by way of expropriation is not an ordinary sale contemplated.

Unlike in an ordinary sale wherein the vendor sets and agrees on the selling price, the compensation paid to the affected owner in an expropriation proceeding comes in the form of just compensation determined by the court.

Supreme Transliner, Inc. v. BPI Family Savings Bank - Considering that herein petitioners-mortgagors exercised their right of redemption before the expiration of the statutory one-year period, petitioner bank is not liable to pay the capital gains tax due on the extrajudicial foreclosure sale. There was no actual transfer of title from the owners-mortgagors to the foreclosing bank.

Section 34(a) of the Tax Code shall be subject to the final capital gains tax. The term sale includes pacto de retro and other forms of conditional sale.

Further, for real property foreclosed by a bank on or after September 3, 1986, the capital gains tax and documentary stamp tax must be paid before title to the property can be consolidated in favor of the bank.

Aces Philippines Cellular Satellite Corporation v. CIR (landmark case) - The situs of the income-producing activity is within the Philippines.

Under our income tax law, this nexus is established by one's residence and source of income. The statute recognizes that the taxability of a foreign corporation's income is limited to that which is connected to Philippine territory or Philippine-sourced income. Certainly, other income the foreign corporation may derive from foreign sources is beyond the scope of the Philippines' taxing power.

CIR v. General Foods (Phils.) Inc - Even if it is necessary, it cannot be considered an ordinary expense deductible under then Section 29 (a) (1) (A) of the NIRC.

Deductions for income tax purposes partake of the nature of tax exemptions; hence, if tax exemptions are strictly construed, then deductions must also be strictly construed.

To be **deductible** from gross income, the subject advertising expense must comply with the following **requisites**: (a) the expense must be ordinary and necessary; (b) it must have been paid or incurred during the taxable year; (c) it must have been paid or incurred in carrying on the trade or business of the taxpayer; and (d) it must be supported by receipts, records or other pertinent papers.

To be deductible, an advertising expense should not only be necessary but also ordinary. These two requirements must be met.

CIR v. Isabela Cultural Corporation - The expenses for professional and security services from ICC's gross income cannot be deducted.

The requisites for the deductibility of ordinary and necessary trade, business, or professional expenses, like expenses paid for legal and auditing services, are: (a) the expense must be ordinary and necessary; (b) it must have been paid or incurred during the taxable year; (c) it must have been paid or incurred in carrying on the trade or business of the taxpayer; and (d) it must be supported by receipts, records or other pertinent papers.

The requisite that it must have been paid or incurred during the taxable year is further qualified by Section 45 of the National Internal Revenue Code (NIRC) which states that: "[t]he deduction provided for in this Title shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred', dependent upon the method of accounting upon the basis of which the net income is computed.

Under the **accrual method of accounting**, expenses not being claimed as deductions by a taxpayer in the current year when they are incurred cannot be claimed as deduction from income for the succeeding year.

Thus, a taxpayer who is authorized to deduct certain expenses and other allowable deductions for the current year but failed to do so cannot deduct the same for the next year.

The accrual method relies upon the taxpayer's right to receive amounts or its obligation to pay them, in opposition to actual receipt or payment, which characterizes the cash method of accounting. Amounts of income accrue where the right to receive them become fixed, where there is created an enforceable liability. Similarly, liabilities are accrued when fixed and determinable in amount, without regard to indeterminacy merely of time of payment.

For a taxpayer using the accrual method, the determinative question is, when do the facts present themselves in such a manner that the taxpayer must recognize income or expense? The accrual of income and expense is permitted when the **all-events test** has been met.

This test requires: (1) fixing of a right to income or liability to pay; and (2) the availability of the reasonable accurate determination of such income or liability.

The all-events test requires the right to income or liability be fixed, and the amount of such income or liability be determined with reasonable accuracy. However, the test does not demand that the amount of income or liability be known absolutely, only that a taxpayer has at his disposal the information necessary to compute the amount with reasonable accuracy.

The all-events test is satisfied where computation remains uncertain, if its basis is unchangeable; the test is satisfied where a computation may be unknown, but is not as much as unknowable, within the taxable year. The amount of liability does not have to be determined exactly; it must be determined with "reasonable accuracy."

Accordingly, the term "reasonable accuracy" implies something less than an exact or completely accurate amount.

ING Bank v. CIR - Petitioner ING Bank is liable for deficiency withholding tax on accrued bonuses for the taxable years 1996 and 1997.

The tax on compensation income is withheld at source under the creditable withholding tax system wherein the tax withheld is intended to equal or at least approximate the tax due of the payee on the said income. It was designed to enable (a) the individual taxpayer to meet his or her income tax liability on compensation earned; and (b) the government to collect at source the appropriate taxes on compensation. Taxes withheld are creditable in nature.

Thus, the employee is still required to file an income tax return to report the income and/or pay the difference between the tax withheld and the tax due on the income. For over withholding, the employee is refunded.

Therefore, absolute or exact accuracy in the determination of the amount of the compensation income is not a prerequisite for the employer's withholding obligation to arise.

Every person required to deduct and withhold the tax from the compensation of an employee is liable for the payment of such tax whether or not collected from the employee. If, for example, the employer deducts less than the correct amount of tax, or if he fails to deduct any part of the tax, he is nevertheless liable for the correct amount of the tax. However, if the employer in violation of the provisions of Chapter XI, Title II of the Tax Code fails to deduct and withhold and thereafter the employee pays the tax, it shall no longer be collected from the employer.

Such payment does not, however, operate to relieve the employer from liability for penalties or additions to the tax for failure to deduct and withhold within the time prescribed by law or regulations.

The employer will not be relieved of his liability for payment of the tax required to be withheld unless he can show that the tax has been paid by the employee.

Thus, the obligation of the payor/employer to deduct and withhold the related withholding tax arises at the time the income was paid or accrued or recorded as an expense in the payor's/employer's books, whichever comes first.