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# THE TAX DISPUTES AND LITIGATION REVIEW

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FIFTH EDITION

EDITOR  
SIMON WHITEHEAD

LAW BUSINESS RESEARCH

THE TAX  
DISPUTES AND  
LITIGATION  
REVIEW

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Fifth Edition

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# CONTENTS

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<b>Editor's Preface</b>	.....vii
	<i>Simon Whitehead</i>
<b>Chapter 1</b>	TAX APPEALS TO THE EUROPEAN COURT OF JUSTICE... 1
	<i>Paul Farmer</i>
<b>Chapter 2</b>	AUSTRIA..... 13
	<i>Franz Althuber and Stefan Holzer</i>
<b>Chapter 3</b>	BELGIUM ..... 24
	<i>Caroline P Docclo</i>
<b>Chapter 4</b>	BRAZIL ..... 39
	<i>Daniella Zagari and Maria Eugênia Doin Vieira</i>
<b>Chapter 5</b>	CANADA ..... 48
	<i>Dominic C Belley</i>
<b>Chapter 6</b>	CHILE..... 61
	<i>Patricio Silva-Riesco Ojeda and Arturo Selman Nahum</i>
<b>Chapter 7</b>	CHINA..... 72
	<i>Liu Tianyong</i>
<b>Chapter 8</b>	DENMARK ..... 86
	<i>Kaspar Bastian</i>
<b>Chapter 9</b>	DOMINICAN REPUBLIC ..... 97
	<i>Christoph Sieger and Fabio J Guzmán-Ariza</i>
<b>Chapter 10</b>	ECUADOR..... 103
	<i>Juan Gabriel Reyes-Varea and Alejandro Páez-Vallejo</i>

<b>Chapter 11</b>	FINLAND .....	114
	<i>Jouni Weckström</i>	
<b>Chapter 12</b>	FRANCE .....	125
	<i>Philippe Derouin</i>	
<b>Chapter 13</b>	GERMANY.....	135
	<i>Michael Hendricks</i>	
<b>Chapter 14</b>	GREECE.....	149
	<i>Ioannis Stavropoulos and Elina Stavropoulou</i>	
<b>Chapter 15</b>	INDIA .....	160
	<i>Aseem Chawla</i>	
<b>Chapter 16</b>	INDONESIA .....	174
	<i>David Hamzah Damian</i>	
<b>Chapter 17</b>	IRELAND.....	186
	<i>John Gulliver and Robert Henson</i>	
<b>Chapter 18</b>	ITALY .....	199
	<i>Guiglielmo Maisto</i>	
<b>Chapter 19</b>	LIECHTENSTEIN .....	213
	<i>Heinz Frommelt and Angelo Trebo</i>	
<b>Chapter 20</b>	MEXICO .....	226
	<i>Manuel Sáinz Orantes and Claudio F Cárdenas Salomon</i>	
<b>Chapter 21</b>	NETHERLANDS .....	236
	<i>Paul Halprin and Megan Ruigrok</i>	
<b>Chapter 22</b>	PHILIPPINES.....	244
	<i>Carina C Laforteza and Mark Xavier D Oyales</i>	
<b>Chapter 23</b>	POLAND.....	256
	<i>Stawomir Łuczak and Karolina Gotfryd</i>	

<b>Chapter 24</b>	PORTUGAL.....	271
	<i>Pedro Miguel Braz</i>	
<b>Chapter 25</b>	RUSSIA.....	282
	<i>Yana Proskurina and Maria Mikhaylova</i>	
<b>Chapter 26</b>	SINGAPORE.....	300
	<i>Joanna Yap</i>	
<b>Chapter 27</b>	SPAIN.....	313
	<i>Miró Ayats Vergés and Jaume Bonet León</i>	
<b>Chapter 28</b>	SWITZERLAND .....	329
	<i>Jean-Blaise Eckert</i>	
<b>Chapter 29</b>	TURKEY .....	339
	<i>Ayşe Hergüner Bilgen and Ahmet Karahan</i>	
<b>Chapter 30</b>	UNITED KINGDOM.....	352
	<i>Simon Whitehead</i>	
<b>Chapter 31</b>	UNITED STATES .....	383
	<i>Edward L Froelich</i>	
<b>Appendix 1</b>	ABOUT THE AUTHORS.....	413
<b>Appendix 2</b>	CONTRIBUTING LAW FIRMS' CONTACT DETAILS.....	429

# EDITOR'S PREFACE

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The objective of this book is to provide tax professionals involved in disputes with revenue authorities in multiple jurisdictions with an outline of the principal issues arising in those jurisdictions. In this, the fifth edition, we have continued to add to the key jurisdictions where disputes are likely to occur for multinational businesses.

Each chapter provides an overview of the procedural rules that govern tax appeals and highlights the pitfalls of which taxpayers need to be most aware. Aspects that are particularly relevant to multinationals, such as transfer pricing, are also considered. In particular, we have asked the authors to address an area where we have always found worrying and subtle variations in approach between courts in different jurisdictions, namely the differing ways in which double tax conventions can be interpreted and applied.

The idea behind this book commenced in 2013 with the general increase in litigation as tax authorities in a number of jurisdictions took a more aggressive approach to the collection of tax – in response, no doubt, to political pressure to address tax avoidance. In the UK alone we have seen the tax authority vested with broad new powers not only of disclosure but even to require tax to be paid in advance of any determination by a court that it is due. The provisions empower the revenue authority, an administrative body, to compel payment of a sum, the subject of a genuine dispute, without any form of judicial control or appeal.

Over the past year the focus on perceived cross-border abuses has continued with action by the European Commission on past tax rulings in Ireland, Luxembourg and Belgium, and the BEPS reaching a crescendo in the announcement of a 'diverted profits tax' to impose an additional tax in the UK when it is felt that a multinational is subject to too little corporation tax even in an EU context. The general targeting of cross-border tax avoidance now has European legislation in the Anti-Tax Avoidance Directive, which came into force in June 2016 with promises of more to follow. The absence of much European legislation in direct tax has always been put down to the need for unanimity and the way in which Member States closely guard their taxing rights. The relatively speedy passage of this legislation (the Parent–Subsidiary Directive before it took some 10 years to pass) and its restriction of attractive tax regimes indicates the general political disrepute with which such practices are now viewed.

These are, perhaps, extreme examples, reflective of the parliamentary cycle, yet a general toughening of stance seems to be being felt. In that light, this book provides an overview of each jurisdiction's anti-avoidance rules and any alternative mechanisms for resolving tax disputes, such as mediation, arbitration or restitution claims.

We have attempted to give readers a flavour of the tax litigation landscape in each jurisdiction. The authors have looked to the future, and have summarised the policies and approaches of the revenue authorities regarding contentious matters, addressing important questions such as how long cases take and situations in which some form of settlement might be available.

We have been lucky to obtain contributions from the leading tax litigation practitioners in their jurisdictions. Many of the authors are members of the EU Tax Group, a collection of independent law firms, of which we are a member, involved particularly in challenges to the compatibility of national tax laws with EU and EEA rights. We hope that you will find this book informative and useful.

Finally, I would like to acknowledge the hard work of my colleague Ramsey Chagoury in the editing and compilation of this book.

**Simon Whitehead**

Joseph Hage Aaronson LLP

London

February 2017

## Chapter 22

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# PHILIPPINES

*Carina C Laforteza and Mark Xavier D Oyales<sup>1</sup>*

### I INTRODUCTION

Tax litigation in the Philippines, in terms of substantive law, remains a complex law practice and requires specialised knowledge and experience. The Philippine tax system is a combination of global and schedular systems of taxation. Taxation law not only encompasses national taxes, imposed mainly under the National Internal Revenue Code (Tax Code), but also local taxes authorised under the Local Government Code (LGC) and scattered across a variety of local legislation by way of implementing local tax ordinances. Income taxation has its own intricacies. While ordinary income of corporations is taxed at a flat rate, that of individuals is taxed at a progressive rate. Certain types of income are excluded from ordinary income and are taxed separately. The law also allows various tax exemptions and deductions. One has to understand the various revenue regulations, revenue memorandum circulars and opinions regularly issued by the Philippine tax authorities to be able to view the tax system landscape clearly.

However, in terms of procedural law, tax litigation in the Philippines, whether involving national or local taxes, consists invariably of two phases: an administrative phase and a judicial phase. The challenge in procedural law is striking a balance between streamlining the assessment and increasing the tax collection while preserving the right of the taxpayers to procedural due process. This chapter focuses on the law and the recent regulations of the sometimes overzealous tax authorities to expedite assessment and collection, and their interactions with procedural due process.

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<sup>1</sup> Carina C Laforteza is a partner and Mark Xavier D Oyales is an associate at SyCip Salazar Hernandez & Gatmaitan.

## II COMMENCING DISPUTES

The Philippine tax system is mainly based on a self-assessment approach wherein the taxpayer is responsible for determining his or her tax liability, filing his or her tax return, paying the tax due and complying with reporting requirements. Internal revenue taxes are administered by the Bureau of Internal Revenue (BIR), while local taxes are administered by the local treasurer. The self-assessment approach is balanced and regulated by the authority of the BIR and the local treasurer to examine the taxpayer's returns and documents, and to assess the correct taxes due.<sup>2</sup> Tax litigation starts when the BIR or the local treasurer issues a formal assessment notice and the taxpayer disputes the same. This section provides an overview of the administrative phase of tax litigation. The judicial phase of tax litigation is discussed in detail in Section III, *infra*.

### i National taxes

After the taxpayer has filed a return, the Commissioner of the BIR (Commissioner) or his or her duly authorised representatives may authorise the examination of any taxpayer and the assessment of the correct amount of tax.<sup>3</sup> The BIR can assess internal revenue taxes within three years from the date of actual filing or the last day prescribed by law for the filing of the return – whichever is later.<sup>4</sup> However, in cases of false or fraudulent returns with intent to evade taxes, or failure to file a return, the prescriptive period is extended to 10 years after the discovery of the falsity, fraud or omission.<sup>5</sup> It should be clarified that the mere falsity of a return does not merit the application of the 10-year prescriptive period unless it can be shown that the return was made with a design to mislead or deceive on the part of the taxpayer, or at the very least show culpable negligence.<sup>6</sup>

If, prior to the expiration of the three-year period prescribed in Section 203 for the assessment of the tax, both the Commissioner and the taxpayer have agreed in writing to its assessment after such time, the tax may be assessed within the period agreed upon. To be valid, a waiver of the statute of limitations must strictly comply with the requirements prescribed by the regulations. However, in the recent *Commissioner of Internal Revenue v. Next Mobile, Inc* case,<sup>7</sup> the Supreme Court carved out an exception to this general rule. In this case, the BIR failed in five instances to verify the authority of the finance director of the taxpayer to execute the waivers. However, the Court noted that although both parties knew the infirmities of the waivers, they continued to deal with each other. Hence, the Court applied the *in pari delicto* principle, and ruled that the taxpayer cannot impugn the validity of the waivers and is deemed estopped from questioning the validity of the waivers.

Following the *Next Mobile* decision, the Commissioner issued Revenue Memorandum Order (RMO) No. 14-2016 (RMO 14-2016), which revised the guidelines for the execution of waivers from the defence of prescription by providing less stringent requirements for valid

2 National Internal Revenue Code (Tax Code), Section 6(A); LGC, Section 171.

3 Id.

4 Tax Code, Section 203.

5 Tax Code, Section 222(a).

6 *ESS Manufacturing Company, Inc v. Commissioner of Internal Revenue* (CTA Case No. 7958, 14 February 2014).

7 GR No. 212825, 7 December 2015.

waivers. RMO 14-2016 was intended to address the ‘rampant practice by the taxpayers to contest the validity of their own waivers of the statute of limitations after having availed [themselves] of the benefits thereof’.

The audit process commences with the issuance of a letter of authority (LOA) to a taxpayer who has been selected for audit. The LOA is an official document that empowers a revenue officer to examine and scrutinise a taxpayer’s books of accounts and other accounting records to determine the taxpayer’s correct internal revenue tax liabilities.

If, after review and evaluation by the Commissioner or his or her duly authorised representative, as the case may be, it is determined that there exists sufficient basis to assess the taxpayer for any tax deficiency tax or taxes, the BIR will issue a preliminary assessment notice (PAN) to inform the taxpayer of the discrepancy. Prior to their amendment in 2013, the regulations provided that the BIR would issue a PAN, and that a notice of informal conference should first be issued to the taxpayer inviting him or her to conference with the examiners to present his or her side and explanations regarding the BIR’s findings.<sup>8</sup> Under the current regulations, the BIR no longer issues notices of informal conference.<sup>9</sup> Consequently, the BIR will simply issue the PAN stating the proposed deficiency assessment, as well as the detailed facts and the law, and the relevant rules and regulations. While the Tax Code does not require informal conferences between the BIR examiners and a taxpayer prior to the issuance of a PAN, the practice of conferring with the examiners was provided in the regulations since 1999,<sup>10</sup> up until their amendment, and was recognised by jurisprudence as a guarantee of procedural due process. It was also a useful tool to enable the examiners and a taxpayer to agree on certain findings before the PAN was issued.

In some cases, however, the law provides that the issuance of the PAN may be dispensed with, and the formal letter of demand and final assessment notice (FLD/FAN) can be issued outright:

- a* when the finding for any deficiency is the result of mathematical error in the computation of the tax appearing in the tax return filed by the taxpayer;
- b* when a discrepancy has been determined between the tax withheld and the amount actually remitted by the withholding agent;
- c* when a taxpayer who opted to claim a refund or tax credit of excess creditable withholding tax for a taxable period was determined to have carried over and automatically applied the same amount claimed against the estimated tax liabilities for the taxable quarter or quarters of the succeeding taxable year;
- d* when the excise tax due on excisable articles has not been paid; or
- e* when an article locally purchased or imported by an exempt person has been sold, traded or transferred to non-exempt persons.<sup>11</sup>

If the taxpayer fails to respond to the PAN within 15 days from date of receipt of the same, he or she is considered in default, and an FLD/FAN will be issued calling for payment of the taxpayer’s deficiency tax liability, inclusive of applicable penalties.<sup>12</sup>

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8 Revenue Regulation No. 12-99, Section 3.1.1.

9 Revenue Regulation No. 18-2013, Section 3.

10 See Revenue Regulation 12-99.

11 Tax Code, Section 228.

12 Revenue Regulation No. 18-2013, Section 3.1.1.

The BIR will issue the FLD/FAN if it is not satisfied with the reply of the taxpayer to the PAN. It is noteworthy that under prevailing regulations the BIR is mandated to issue a FLD/FAN 15 days from receipt of the reply to the PAN.<sup>13</sup> While this BIR innovation may have expedited the disposition of assessments, it creates a strain on the procedural due process of taxpayers. Fifteen days is too short a time for the BIR to resolve complicated tax issues, especially now that informal conferences that could have threshed out issues have been dispensed with. The practical consequence of this regulation is that an FLD/FAN will be issued as a matter of course within 15 days from receipt of the reply without the BIR having thoroughly considered the arguments that may have been raised by the taxpayer in his or her reply to the PAN.

The FLD/FAN calling for payment of the taxpayer's deficiency tax or taxes must state the facts, the law, rules and regulations, or jurisprudence on which the assessment is based; otherwise, the assessment shall be void.<sup>14</sup> The taxpayer has 30 days from receipt of the assessment to protest the same. The two kinds of protest will be discussed in detail in Section V, *infra*. If the protest is denied in whole or in part, or is not acted upon within 180 days from the submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals (CTA) within 30 days from receipt of the said decision or from the lapse of the 180-day period. Otherwise, the decision shall become final and executory.<sup>15</sup> The reckoning point for the taxpayer to file an appeal with the CTA has been clarified in recent jurisprudence. Where the Commissioner of the BIR failed to act on the disputed assessment within the 180-day period from date of submission of documents, a taxpayer can either file a petition for review with the CTA within 30 days after the expiration of the 180-day period; or await the final decision of the Commissioner on the disputed assessments and appeal such final decision to the CTA within 30 days after receipt of a copy of such decision.

In other words, the assessment would not become final and executorial for the sole reason that petitioner failed to appeal the inaction of the Commissioner within 30 days after the 180-day regulatory period.<sup>16</sup> The above remedies, however, are exclusive, such that resort to the first remedy bars the other.

## ii Local taxes

The process for disputing local taxes is governed by separate legislation – the LGC. The dispute process does not deviate significantly from the model outlined above. It begins when the local treasurer issues a notice of assessment stating the nature of the local tax, fees, surcharges and penalties. The local treasurer has a longer period to assess local taxes than the BIR has with respect to national taxes. Local taxes may be assessed within five years from the date they became due. In the case of fraud or intent to evade the payment of taxes, the local treasurer has 10 years from discovery of the fraud to assess deficiency taxes.<sup>17</sup> The taxpayer has 60 days from receipt of the notice of assessment to file a written protest with the local treasurer. The local treasurer shall decide the protest within 60 days from the time of its filing.

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13 Revenue Regulation No. 18-2013, Section 3.1.1.

14 Tax Code, Section 228.

15 *Id.*

16 *Lascona Land Co v. Commissioner of Internal Revenue*, GR No. 171251, 5 March 2012.

17 LGC, Section 194.

The taxpayer, on the other hand, shall have 30 days from receipt of the denial or protest or from the lapse of the 60-day period prescribed within which to appeal to the regional trial court (RTC). The decision of the RTC may be appealed to the CTA, and the dispute process discussed below will be followed.

Disputing assessments for real property taxes are governed by a different set of rules in the LGC. In the case of real property taxes, the protest mechanism goes through specialised quasi-judicial bodies like the local board of assessment appeals (BAA), which has the power to summon witnesses, conduct visual inspections and issue subpoenas.<sup>18</sup> It must be noted that, unlike in the case of internal revenue taxes and other local taxes, no protest involving real property tax will be entertained unless the taxpayer first pays the tax 'under protest'.<sup>19</sup> The protest is filed within 30 days from payment of the tax to the Treasurer, who must decide the protest within 60 days from receipt.<sup>20</sup> If the protest is denied, or upon lapse of the 60-day period, the taxpayer may appeal to the BAA.<sup>21</sup> A taxpayer who is unsatisfied with the action of a local assessor may, within 60 days from the date of receipt of the written notice of assessment, appeal to the BAA of the relevant province or city.<sup>22</sup>

If the decision of the BAA is unfavourable, the taxpayer may appeal the decision to the Central Board of Assessment Appeals (CBAA) within 30 days of receipt of the decision.<sup>23</sup>

### III THE COURTS AND TRIBUNALS

The CTA is a highly specialised court that reviews cases in taxation. It has exclusive jurisdiction to review by appeal decisions and inactions of the Commissioner of the BIR in cases involving disputed assessments and refunds of internal taxes.<sup>24</sup> The CTA also reviews decisions of the RTCs on local taxes resolved by them in the exercise of their original and appellate jurisdiction and decisions of the CBAA.<sup>25</sup>

The judicial phase of tax litigation consists of several levels of review. This phase of tax litigation is crucial because, in actual practice, it seems unlikely that the BIR will reverse or cancel the assessment. Thus, there is the necessity for an objective and impartial review by the courts. At the CTA, there are two built-in tiers of review: the CTA divisions and the CTA *en banc*. The appealed decision of the Commissioner shall be decided by a division of the CTA (CTA division).<sup>26</sup> A taxpayer adversely affected by the decision of the CTA division may seek reconsideration or a new trial before the same division. The resolution of the CTA division on a motion for reconsideration or new trial may be appealed via a petition for review to the CTA *en banc*.<sup>27</sup> Ultimately, the decision of the CTA *en banc* may be appealed to the Philippine Supreme Court through a petition for review on *certiorari*.

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18 LGC, Section 229.

19 LGC, Section 252 (a).

20 Id.

21 LGC, Section 252 (d).

22 LGC, Section 226.

23 LGC, Section 229.

24 Republic Act No. 1125, as amended, Section 11.

25 Id., Section 7.

26 Id., Section 7.

27 Id., Section 18.

#### IV PENALTIES AND REMEDIES

As in the case of other jurisdictions, in the Philippines, compliance with the tax legislation is regulated through administrative, civil and criminal penalties.

Under the Tax Code, failure to file an information return, statement or list, or to keep any record, or to supply any information required by law on the date prescribed, shall be fined 1,000 Philippine pesos for each such failure.<sup>28</sup>

Moreover, non-compliance with the rules on the filing of returns and payment of taxes may subject the taxpayer to civil penalties. Civil penalties refer to surcharges, deficiency and delinquency interests. A surcharge is a penalty or exaction imposed by law in addition to the main taxes required to be paid by law. A surcharge of 25 per cent of the amount due will be imposed in the following cases:

- a failure to file a return and pay the tax due thereon;
- b filing of a return with an internal revenue other than those with whom the return is filed;
- c failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment; or
- d failure to pay the full or part of the amount of tax before the date prescribed for its payment.

Furthermore, in the case of wilful neglect to file a return or in the case of a false or fraudulent return wilfully made, the surcharge to be imposed is 50 per cent of tax or of the deficiency tax.<sup>29</sup> Under-declaration of income in an amount exceeding 30 per cent of that declared in the return is *prima facie* evidence of a false or fraudulent return.<sup>30</sup>

Deficiency interest is the interest payable at a rate of 20 per cent on any amount due or instalment thereof that is not paid on or before the date prescribed for its payment. In the case of failure to pay (1) the amount of the tax due on any return required to be filed, (2) the amount of the tax due on which no return is required, or (3) a deficiency tax, or any surcharge or interest thereon on the due date appearing in the notice and demand of the Commissioner, a delinquency interest at a rate of 20 per cent shall be assessed and collected on the unpaid amount until the amount is fully paid.<sup>31</sup> It must be noted that under regulations interpreting the Tax Code, deficiency interest and delinquency interest run simultaneously after a certain point in time.

Similarly, the LGC imposes administrative penalties for non-compliance with local taxation laws. Local legislature may impose a surcharge not exceeding 25 per cent of the amount of taxes, fees or charges not paid on time and interest at the rate not exceeding 2 per cent per month of the unpaid taxes, fees or charges including surcharges.<sup>32</sup> However, the total interest is capped at 72 per cent.<sup>33</sup>

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28 Tax Code, Section 250.

29 Tax Code, Section 248.

30 Id.

31 Tax Code, Section 249.

32 LGC, Section 168.

33 Id.

In addition, the Tax Code also imposes criminal liability on offences defined in Chapter II of the said law, and both fine and imprisonment are imposed. It is noteworthy that payment of the tax due after apprehension does not constitute a valid defence in any prosecution for violation of any provision of the Tax Code.

Section 254 of the Tax Code defines the common punishable offences. Any person required under the Tax Code or by the rules and regulations promulgated by the BIR to pay any tax, make a return, keep any record, or supply any correct and accurate information, who wilfully fails to pay such tax, make such return, keep such record, or supply such correct and accurate information, or withhold or remit taxes withheld, shall be subject to criminal prosecution.<sup>34</sup> The current administration has been very aggressive in the prosecution of cases for tax evasion through its 'Run After Tax Evaders' programme. As of October 2014, there are 269 pending cases at the Department of Justice.<sup>35</sup> The filing of a criminal action is independent from administrative proceedings. In other words, an assessment of tax deficiency is not a prerequisite to the filing of a criminal complaint.<sup>36</sup> The Tax Code not only criminalises the actual commission of the above-mentioned prohibited activities; it also penalises any person who wilfully aids or abets in its commission or who causes its commission by another.<sup>37</sup>

## V TAX CLAIMS

### i Recovering overpaid taxes

Tax refund cases are based on the civil law principle of *solutio indebiti*. Jurisprudence holds that the time-honoured doctrine that no person shall unjustly enrich himself or herself at the expense of another is enshrined in the basic legal principles. The government is not exempted from the application of this doctrine.<sup>38</sup>

If a taxpayer believes that a national internal revenue tax has been erroneously or illegally assessed or collected, or that any penalty has been excessively or in any manner wrongfully collected, he or she must file a claim for refund with the BIR. The Tax Code provides that no suit or proceeding shall be filed after the expiration of two years from the date of payment of the tax or penalty, regardless of any supervening cause that may arise after payment.<sup>39</sup> The two-year period is a prescriptive period for both the administrative and judicial claim. For instance, if a claim for a tax refund is filed with the BIR two days before the expiration of the two-year period, the judicial claim must also be filed with the CTA the next day without awaiting the decision of the Commissioner of the BIR. The prescriptive period for refund claims is especially important in this jurisdiction, because the Philippines does not adhere to the common law principle of equitable recoupment wherein tax refund claims barred by prescription may be set off against a current assessment.

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34 Tax Code, Section 255.

35 [www.bir.gov.ph/index.php/tax-evasion-cases.html](http://www.bir.gov.ph/index.php/tax-evasion-cases.html).

36 *Ungab v. Cusi*, GR No. L-41919-24, 30 May 1980.

37 Tax Code, Section 253.

38 *Commissioner v. Acesite (Phils) Hotel Corporation*, GR No. 147295, 16 February 2007.

39 Tax Code, Section 229.

For a refund of local taxes, the prescriptive period is also two years. However, the reckoning point is different; the two-year period is reckoned from payment of taxes or from the date the taxpayer is entitled to a refund.<sup>40</sup>

In the case of value added tax (VAT), the Tax Code provides for slightly different rules on the statute of limitations applicable to refund claims relating to input VAT. A VAT-registered person may claim for a refund of his or her excess input tax arising from zero-rated or effectively zero-rated transactions within two years after the close of the taxable quarter when the sales were made.<sup>41</sup> In proper cases, the Commissioner shall grant a refund within 120 days from the date of submission of complete documents in support of the application for refund.<sup>42</sup> It is the taxpayer (not the Commissioner) who determines what constitutes the relevant supporting documents for the purposes of substantiation of its entitlement to refund, although the Commissioner will not be precluded from requiring additional documents. Otherwise, the 120-day period will be rendered indeterminate or indefinite. However, whether these documents are actually complete as required by the Tax Code is for the Commissioner and the courts to determine.<sup>43</sup>

In the case of a full or partial denial of the claim for a tax refund, or the failure on the part of the Commissioner to act on an application within the period prescribed above, the taxpayer affected may, within 30 days from the receipt of the decision or from the lapse of the 120-day period, appeal the same with the CTA. The Supreme Court has clarified two important principles in the procedure for refund. First, the two-year period is a prescriptive period for the administrative claim for refund. It refers to the application for refunds with the Commissioner and not to appeals made to the CTA. Accordingly, the 30-day period, or any part of it, is not required to coincide within the two-year prescriptive period. Secondly, the 120-day waiting period is mandatory and jurisdictional. The taxpayer cannot appeal to the CTA on the basis of inaction before the expiration of the 120-day period.<sup>44</sup> Under the current regulations, failure by the Commissioner to act upon a claim for refund within the 120-day period shall already be deemed a denial of the application for refund. Moreover, it would appear from *ROHM Apollo Semiconductor Philippines v. Commissioner*<sup>45</sup> that upon the lapse of the 120-day period without any action on the part of the CIR, the taxpayer does not have the option of waiting for a decision after such period and must file an appeal within 30 days from the lapse of the waiting period.

## ii Challenging administrative decisions

As explained in Section II, *supra*, a taxpayer may file a protest against an FLD/FAN issued by the BIR. Here we focus on the different types of protest that the taxpayer may file to

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40 LGC, Section 196.

41 Tax Code, Section 112(A).

42 Tax Code, Section 112(C).

43 *Commissioner of Internal Revenue, v. Nokia (Philippines), Inc*, CTA EB No. 1241, 31 March 2016.

44 *Commissioner v. Aichi Forging Company*, GR No. 184823, 6 October 2010; *Commissioner v. San Roque Power Corporation*, GR No. 187485, 19113, 197156, 12 February 2013.

45 GR No. 168950, 14 January 2015.

challenge the FLD/FAN. The taxpayer disputing an assessment may file a written request for reconsideration or reinvestigation defined as follows:

- a* Request for reconsideration. This refers to a plea of re-evaluation of an assessment on the basis of existing records without the need of additional evidence. It may involve a question of fact or of law, or both.
- b* Request for reinvestigation. This refers to a plea of re-evaluation of an assessment on the basis of newly discovered or additional evidence that a taxpayer intends to present in the reinvestigation. It may also involve a question of fact or of law, or both.<sup>46</sup>

For requests for reinvestigation, the taxpayer shall submit all relevant supporting documents in support of his or her protest within 60 days of the date of filing of the letter of protest; otherwise, the assessment shall become final. The term ‘relevant supporting documents’ refers to those documents necessary to support the legal and factual bases in disputing a tax assessment as determined by the taxpayer. The 60-day period for the submission of all relevant supporting documents is not applicable to requests for reconsideration. A request for reinvestigation will suspend the running of the prescriptive period because it will involve a re-evaluation of the issues based on additional documentary evidence.

### **iii Claimants**

The taxpayer or his or her authorised representative or tax agent may commence any of the remedies against an assessment or a claim for refund.

## **VI COSTS**

There is no specific legislation that allows a taxpayer to recover the cost of litigation from the government, even in cases where the final decision is favourable to the taxpayer. An appeal to the CTA may take years to resolve given the current state of clogged dockets and backlog of work of most of the courts in the Philippines. The filing fee with the CTA is dependent upon the amount of the disputed tax assessment. Hence, tax litigation in this jurisdiction could be very costly.

## **VII ALTERNATIVE DISPUTE RESOLUTION**

The assessment by the BIR may be settled by compromise or abatement.<sup>47</sup> A compromise is essentially a contract whereby the parties by reciprocal concessions avoid a litigation or put an end to one already commenced.<sup>48</sup> The Commissioner is the official vested with the power and discretion to enter into a compromise. It is noteworthy that the authority of the Commissioner is not absolute and is subject to statutory limitations. For example, the compromise settlement of any tax liability is subject to minimum amounts provided by law (e.g., for cases of financial incapacity, a minimum compromise rate equivalent to 10 per

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46 Revenue Regulation No. 18-2013.

47 Tax Code, Section 204.

48 Civil Code of the Philippines, Article 2028.

cent).<sup>49</sup> Criminal violations already filed in court and those cases involving criminal tax fraud may not be compromised.<sup>50</sup> Under the Tax Code, there are two instances when the Commissioner may compromise the payment of any internal revenue tax: reasonable doubt exists as to the validity of the claim against the taxpayer; or the financial position of the taxpayer demonstrates a clear inability to pay the assessed tax.

The Commissioner may also abate or cancel the whole or any unpaid portion of a tax liability if the assessment is excessive or if the administration costs involved do not justify the collection of the amount due. To abate means to reduce in value while to cancel means to obliterate. The BIR issued RMO No. 7-2015 to adopt and implement a uniform application of the compromise penalties involving violations of the Tax Code. The recent regulation deleted from its coverage certain acts commonly resorted to by taxpayers as a means of tax evasion such as failure to make, file or submit the required summary lists of sales and Annual Alpha List of Employees.

Based on RMO No. 4-2016, the denial of applications for compromise settlement, abatement or cancellation of internal revenue tax liabilities filed by all concerned taxpayers under the respective jurisdiction of the Revenue Regions and Large Taxpayers Service (LTS) shall be considered final, and the outstanding tax liabilities or penalties, or both, shall be immediately collected from the concerned applicant taxpayer.

In practice, it is best to settle at the audit stage if the claim is indefensible, or even if it is defensible but the cost of litigation exceeds the proposed assessment.

## VIII ANTI-AVOIDANCE

In this jurisdiction, the law draws a distinction between tax avoidance (legitimate tax minimisation) and tax evasion (a scheme used outside of lawful means). Tax avoidance is a method sanctioned by law, and is used by the taxpayer in good faith and at arm's length.<sup>51</sup> Considering that the Philippine tax system is semi-schedular, meaning there are specific rates for specific taxes, an imaginative tax lawyer would typically take advantage of the tax rate differences in drawing a transaction.

Tax evasion, when availed of, would subject the taxpayer to further or additional civil or criminal liabilities. Tax evasion connotes the integration of three factors:

- a* the end to be achieved: in other words, 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;
- b* an accompanying state of mind that is described as being 'evil', in 'bad faith', 'wilful', or 'deliberate and not accidental'; and
- c* a course of action or failure of action that is unlawful.<sup>52</sup>

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49 Tax Code, Section 204.

50 Id.

51 *Commissioner v. Estate of Toda, Jr*, GR No. 147188, 14 September 2004.

52 Id.

## IX DOUBLE TAXATION TREATIES

International double taxation arises when a person is subject to tax on the same income by two or more countries for the same tax period. To ease the burden of international double taxation on international trade, the Philippines has entered into a number of bilateral tax treaties with other countries. Basically, a tax treaty seeks to reconcile the national fiscal legislation of the contracting parties and to impose a preferential tax rate on specific taxpayers. The BIR issued RMO No. 01-2000, which outlines the procedure for tax treaty relief application (TTRA). Further, RMO 72-2010, which partially superseded RMO 01-2000, provides that failure to properly file the TTRA with the International Tax Affairs Division of the BIR within the prescribed period shall have the effect of disqualifying the TTRA.

Thus, based on RMO 72-2010, it is mandatory for a taxpayer to seek a ruling of the BIR confirming its eligibility for the preferential tax rates before it can avail of the benefits of the tax treaty. This creates a legal conundrum, because the BIR is, in effect, unilaterally imposing an additional requirement beyond the text of the tax treaty in violation of the Philippines' international obligations. In the 2013 *Deutsche Bank AG Manila Branch v. Commissioner* case,<sup>53</sup> the Supreme Court held that prior application is not required before a taxpayer can avail itself of the tax treaty benefit. The Supreme Court said that a state that has contracted valid international obligations is bound to make in its legislation those modifications that may be necessary to ensure the fulfilment of the obligations undertaken. The Supreme Court further clarified that failure to strictly observe the procedure under the RMOs should not operate to divest entitlement to the relief lest we violate the international duty to comply with treaty in good faith. The *Deutsche Bank* ruling has not yet been circularised by the BIR. No clarifying administrative issuance has been issued by the BIR.

Recently, the Supreme Court has reiterated the *Deutsche Bank* ruling in *CBK Power Company Limited v. Commissioner*,<sup>54</sup> wherein the Court noted that the TTRA should merely operate to confirm the entitlement of the taxpayer to the relief. It must be noted that both rulings cover a transaction that took place prior to the issuance of RMO 72-2010. To date, the BIR has yet to issue a memorandum circular adopting the *Deutsche Bank* and *CBK Power* rulings. The *Deutsche Bank* and *CBK Power* rulings notwithstanding, it would still be prudent to comply strictly with the RMOs issued by the BIR.

In the recent *Lufthansa German Airlines – Philippine Branch v. Commissioner of Internal Revenue* case,<sup>55</sup> the CTA, invoking the *Deutsche Bank* ruling, held that the BIR's denial of an availment of the special tax rates under the relevant tax treaty for failure to file a tax treaty relief application is without basis. The CTA noted that even if the taxpayer failed to file an application for tax treaty relief, it may still avail of the provisions of the applicable tax treaty as long as it has sufficiently proved its entitlement thereto. It must be noted that in *Lufthansa*, no tax treaty relief application was filed (in contrast to the belated filing of application in *Deutsche Bank*). Hence, the CTA may have taken a pragmatic and positive approach in dealing with tax treaty entitlements.

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53 GR No. 188550, 19 August 2013.

54 GR No. 193383-84, 14 January 2015.

55 *Lufthansa German Airlines – Philippine Branch v. Commissioner of Internal Revenue*, CTA Case No. 8601, 21 March 2016.

However, compliance with the RMOs is encouraged to ensure that a taxpayer will not be subjected to deficiency assessments by the BIR arising solely from non-filing of a TTRA. It is noteworthy that in recent months, the International Tax Affairs Division has accepted applications filed even after the first taxable event.

## **X AREAS OF FOCUS**

In line with the Association of Southeast Asian Nations' integration, initiatives are underway to revise the Tax Code, specifically on income taxation, to achieve a more simplified tax system. There have been initiatives in the Philippine Congress to revisit the current schedular rate on compensation income and to increase the level of tax-exempt income. Recently, the BIR issued Revenue Regulation No. 3-2015 to implement the provisions of Republic Act No. 10653, which increased the total amount of 13 months' pay and other benefits from 30,000 to 82,000 Philippine pesos.

In the area of tax collection, Congress has been studying the enactment of a Bill of Rights of Taxpayers.<sup>56</sup> These rights are in addition to the legal rights and remedies that are provided under the current laws. The Bill also seeks to establish an Office of the Taxpayers Advocate.

## **XI OUTLOOK AND CONCLUSIONS**

Tax litigation remains a dynamic field of law in the Philippines. Generally, the current tax laws provide adequate remedies to taxpayers against erroneous assessments. However, the main challenge for tax practitioners is navigating the many administrative issuances and opinions that arise from the desire to increase tax collections and invariably conflict with the laws they seek to implement.

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<sup>56</sup> See, for instance, Senate Bill No. 718.

## Appendix 1

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# ABOUT THE AUTHORS

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Carina C Laforteza is a lawyer and a certified public accountant with extensive tax and corporate practice. Her tax work ranges from tax structuring (including how investments are to be made into the Philippines and estate tax planning) and tax compliance (including assisting clients in audits by the Philippine Bureau of Internal Revenue) to tax litigation (including petitions questioning the legality of revenue issuances) and tax-related arbitration. She was part of the team that assisted the Republic of the Philippines in defending its excise taxation on distilled spirits before the World Trade Organization.

In addition to tax work, Ms Laforteza does mergers, acquisitions and divestments. She has advised clients in the advertising, food manufacturing, mass media, telecommunications, money remittance and gaming industries. She assisted Coca-Cola FEMSA (KOF) in the acquisition of Coca-Cola Bottlers Philippines, Inc, KOF's first investment in Asia. In the past, she has been involved with infrastructure and power projects.

Ms Laforteza has been a professorial lecturer in taxation at the University of the Philippines since 2009. Before going into law, she worked as an auditor for a major accounting firm.

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