Benchmarking of Tax Liabilities

by Atty. Rainer P. Dela Fuente, CPA / September 2014

Q: Is there a way by which the Bureau of Internal Revenue (BIR) can assess the correctness of an entity's tax liabilities if the said taxpayer fails or refuses to submit complete and accurate financial records?

A: Yes. In the absence of accounting records or other documents necessary for the proper documentation of a taxpayer's Internal Revenue Tax Liability, Section 6(B) of the National Internal Revenue Code (NIRC) requires that the assessment of the tax be determined based on the "Best Evidence Obtainable" as follows:

"[w]hen a report required by laws as a basis for the assessment of any national internal revenue tax shall not be forthcoming within the time fixed by laws or any such report is false, incomplete, or erroneous, the Commissioner shall assess the proper tax on the best evidence obtainable."

In situations where an entity fails or refuses to make certain records available despite the issuance by the BIR of audit notices, or in some cases a subpoena duces tecum, the BIR shall make an assessment based on the "Best Evidence Obtainable" rule cited above.

Since there are no means by which the correctness and accuracy of the returns or receipts (submitted by the taxpayer) can be ascertained, the BIR resort to "benchmarking." Benchmarking is an effective tool to gauge company performance vis-à-vis those of the key players within its sector. Under this method, the tax compliance levels of various companies within the industry are identified based on certain metrics. If a company (taxpayer) falls below the benchmarks, a notice shall be sent to them requiring an explanation as to why the reported amounts is below the industry level. BIR RMO No. 05-2012 prescribes the policies and procedures in the use of the benchmarking method.

As a matter of due process, the taxpayer is given an opportunity to explain why they fall below the benchmarks. It is worthy to note that even if companies belong to the same industry, it is inevitable that there will be differences in terms of gross profit for several reasons. Within the same industry, companies may be doing various functions, serving different markets or are employing different business strategies, which affect their gross profit level.

From the above, it is clear that the taxpayers should be given the leeway to explain why they fall below the established benchmarks, by considering business realities in order to have a fair and efficient assessment system.

This article is for general information only and not intended as a substitute for a professional advice on a specific tax issue. For questions or comments, the author may be reached via rdelafuente@gdlaw.ph.

GIALOGO, DELA FUENTE
& ASSOCIATES