RETROACTIVE OR NOT?

By Atty. Edward Gialogo

During BIR's audit, one of the most common reasons for disallowance of an expense is the taxpayer's failure to withhold the tax. For this lapse, the taxpayer would be assessed of deficiency Expanded Withholding Tax (EWT) and deficiency income tax (since the disallowance would result in increased taxable income).

For instance, a corporate taxpayer subject to 30% income tax claimed a rental expense amounting to P100,000.00 but failed to withhold the 5% EWT. During the audit, the BIR will disallow that rental expense and the Company will be assessed of deficiency EWT amounting to P5,000.00 and deficiency income tax amounting to P30,000.00 plus interests and other penalties.

What if, in the course of the audit investigation or at the time of reinvestigation/reconsideration, the taxpayer pays the EWT plus interests and penalties, would the BIR allow the expense?

This has been a subject of conflicting interpretations and regulations.

Revenue Regulations No. 2-98

Under the old provision of Revenue Regulations (RR) No. 2-98 (withholding tax regulations), the answer was in the affirmative-payment of EWT at the time of audit investigation or reinvestigation/reconsideration would wipe out the disallowance of expense not subjected to EWT. Thus, in the example above, the expense of P100,000.00 would be allowed and the P30,000.00 deficiency income tax plus interest and penalties would be cancelled.

Revenue Regulations No. 12-2013

Five years ago, the Department of Finance (upon recommendation of the BIR Commissioner) issued RR No. 12-2013 wherein the rule was changed 360 degrees. Under RR 12-2013, no deduction will be allowed notwithstanding the payment of the EWT at the time of audit investigation or reinvestigation/reconsideration.

In Revenue Memorandum Circular 63-2018, the BIR clarified that RR No. 12-2013, which was prejudicial to taxpayers, would be applied prospectively beginning taxable year 2013.

RR 6-2018

In January this year, the Department of Finance again turned around and issued RR No. 6-2018. Under the recent regulations, the old rule was reinstated in which the expense would be allowed even if the payment of EWT is belatedly made at the time of audit investigation or reinvestigation/reconsideration.

Retroactive or prospective?

Because of reversion to the old rule which is favorable to taxpayers, it is imperative to resolve whether RR 6-2018 should have a retroactive application particularly to taxpayers who are being audited for taxable years 2017 and/or prior years.

The answer may be found in Section 246 of the Tax Code which states that:

*"Any revocation, modification or **reversal** of any of the rules and **regulations** promulgated in accordance with the preceding Sections or any of the rulings or circulars promulgated by the Commissioner **shall not be given retroactive application** if the revocation, modification or reversal will be **prejudicial to the taxpayers…**"*

Inversely, if the revocation, modification or reversal of the rulings, circulars or regulations is **not** prejudicial to taxpayers, there is a basis to give them a retroactive application.

In ***Supreme Transliner, Inc., et al. vs. BPI Family Savings Bank, Inc.*** (February 25, 2011), the Supreme Court held that RR No. 4-1999 (regarding capital gains tax on foreclosed properties) may be given a retroactive application. Applying Section 246 of the Tax Code, the Court said that the retroactive application of the RR No. 4-1999 is more consistent with the policy of aiding the exercise of the right of redemption because it curbed the inequity of imposing capital gains tax even before the expiration of the redemption period since there is yet no transfer of title. Hence, RR No. 4-99 is not prejudicial to taxpayers and, therefore, may be given a retroactive application.

The Supreme Court also cited a commentary from Hector De Leon that "*while revenue regulations as a general rule have no retroactive effect, if the revocation is due to the fact that the regulation is erroneous or contrary to law, **such revocation shall have***

retroactive operation as to affect past transactions, *because a wrong construction of the law cannot give rise to a vested right that can be invoked by a taxpayer."*

Applying Section 246 of the Tax Code and the Supreme Court ruling in Supreme Transliner case, it can be argued that RR No. 6-2018 was issued to rectify the wrong interpretation provided in RR No. 12-2013. Thus, there is a basis to say that RR 6-2018, being the correct interpretation of the law and not prejudicial to taxpayers may be given a retroactive application.

While there may be sufficient foundation to argue for the retroactivity of RR 6-2018, some BIR examiners and officers adopt the opposite view.To put this issue to rest, it may be advisable for BIR to issue an RMC clarifying this matter.

This article is for general information only. If you have any question or comment regarding this article, you may email the author at egialogo.gdlaw@gmail.com.

***

Atty Edward G. Gialogo is the managing partner of Gialogo Dela Fuente & Associates. He is also a tax speaker in Philippine Institute of Certified Public Accountants. He was an Associate Director in the Tax Services of SyCip Gorres Velayo & Co.

Atty. Gialogo will be a Speaker for the following PICPA tax seminars:

1. UPDATES ON TRAIN LAW

Date: Aug. 29, 2018

Venue: Cavite Ecozone, EPZA, Rosario, Cavite.

Contact: 09178336695 (Elma of PICPA Cavite)

2. TARIFF AND CUSTOMS LAW

Date: Sept. 8, 2018

Venue: UE Caloocan Campus.

Contact: 09173174533 (Mira of PICPA Northern Metro Manila)