

PUNITIVE INTEREST

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Fairness is basic to a successful and equitable tax system. The proposed tax reform bill seeks to address many of the inequities in our Tax Code. However, there is a basic inequity that is so oppressive to taxpayers that has not yet been addressed or revised in any proposed bill – the simultaneous or overlap in the imposition of the 20% deficiency interest and 20% delinquency interest, or a total interest of 40% per annum.

The basic source of the inequity is Section 249 of our Tax Code which imposes deficiency interest on deficiency tax “from the date prescribed for its payment until the full payment thereof.” The same section also provides that delinquency interest is imposed from “the due date appearing in the notice and demand of the Commissioner” “until the amount is fully paid, which interest shall form part of the tax”.¹ Thus, while the starting points of the running of these interests are different, as discussed below, they

¹ Section 249 of the Tax Code provides:

SECTION 249. Interest. —

"(A) In General. — There shall be assessed and collected on any unpaid amount of tax, interest at the rate of twenty percent (20%) per annum, or such higher rate as may be prescribed by rules and regulations, from the date prescribed for payment until the amount is fully paid.

"(B) Deficiency Interest. — Any deficiency in the tax due, as the term is defined in this Code, shall be subject to the interest prescribed in Subsection (A) hereof, which interest shall be assessed and collected from the date prescribed for its payment until the full payment thereof.

"(C) Delinquency Interest. — In case of failure to pay:

"(1) The amount of the tax due on any return required to be filed, or

"(2) The amount of the tax due for 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**, there shall be assessed and collected on the unpaid amount, interest at the rate prescribed in Subsection (A) hereof **until the amount is fully paid, which interest shall form part of the tax.**

are both expected to run simultaneously at a certain point “until the full payment” of the tax or amount demanded.

What then is the basic difference between “deficiency” and “delinquency interest”?

Deficiency tax is the amount short of the full tax due and should be paid to the government. For instance, it is the amount still due and collectible from a taxpayer upon audit or investigation. Consequently, *deficiency interest* is imposed upon any tax that is still due and unpaid to the government. Such interest is imposed by the fact that a portion of the tax imposed or required to be paid by law, which is the "deficiency tax", is still unpaid by the taxpayer.

Delinquency, on the other hand, is defined as the failure of the taxpayer to pay the tax due on the date fixed by law or indicated in the assessment notice or letter of demand.

Section 249 of the Tax Code defines “*delinquency interest*” as the interest imposed on failure to pay (i) the amount of tax due on any return required to be filed, (ii) the amount of tax due for which no return is required, or (iii) deficiency tax, or any surcharge or interest thereon on the due date appearing in the notice and demand of the Commissioner. It is the interest upon the delay in the payment of the amount of tax due whether return is required to be filed or not, or delay in the payment of deficiency tax, surcharges and interests thereon, after notice and demand from the Commissioner. It should be noted that “delinquency interest” is imposed the “deficiency tax, plus surcharge and interest” – an interest upon interest.

Prior to 2013, our BIR does not impose both interests simultaneously – they imposed deficiency and delinquency interests one after the other. This treatment was

supported by the illustrations of Revenue Regulations (RR) No. 12-99.² Under this RR 12-99, the 20% deficiency runs from the date prescribed for payment, *i.e.*, the tax deadline, until date prescribed in a formal demand from the Commissioner.

Delinquency interest, on the other hand, runs from deadline for payment stated in formal demand until the amount is fully paid. The “date of demand” is the date when a taxpayer receives a collection letter from the Commissioner after an assessment has become final, *i.e.*, the taxpayer no longer has any remedy, such that the BIR has the right to collect and demand payment. While an assessment is pending appeal, it is not yet final, demandable and collectible.

However, RR No. 18-2013 promulgated in November 2013 amended certain sections of RR No. 12-99 and changed the illustrations to show that the deficiency interest continues to run even after formal demand. Thus, RR 18-2013 espoused the overlap or simultaneous running of both deficiency and delinquency interest. Our BIR anchored its position in Section 249 of our Tax Code which states that both interest continue to run until the tax or amount demanded is “fully paid.” Section 249 (B) and (C) (3) of the Tax Code states that the deficiency interest on any deficiency tax shall be assessed “from the date prescribed for its payment until the full payment thereof”; while the assessment of the delinquency interest that is imposed upon failure to pay a deficiency tax, or any surcharge or interest thereon, shall be reckoned from “the due date appearing in the notice and demand of the Commissioner until the amount is fully paid”.

Unfortunately, our court decisions have concurred with this overlap treatment. The first of such decisions was *Takenaka Corp. Philippine Branch v. Commissioner of Internal Revenue*, CTA EB Case No. 745 (September 4, 2012), where the Court of Tax Appeals En Banc held that because of the different nature of these interests, there is no double taxation. The CTA held that deficiency

² Then the implementing regulations governing the “Rules on Assessment of National Internal Revenue Taxes, Civil Penalties and Interest and the Extra-Judicial Settlement of a Taxpayer’s Criminal Violation of the Code Through Payment of a Suggested Compromise Penalty”.

interest is imposed for the shortage of taxes paid, while delinquency interest is imposed for the delay in payment of taxes. The same position was upheld in the more recent cases involving *Liquigaz Philippines Corporation* (CTA EB Case Nos. 1117 and 1119). In *Takenaka*, the CTA went further to state that “there is no double imposition of interests as the law clearly differentiates deficiency interest from delinquency interest.”

However, what is not considered is that interest is supposedly to be compensatory in nature; it is meant to compensate the government for the cost of money. It is not meant to be punitive. In the case of *Republic of Phil. v. Heras*,³ the Supreme Court explained the nature of interest as compensatory rather than punitive in nature, thus:

It may not be amiss to state further that, the interest collectible here is not punitive in nature, an appellee would like to impress, but compensatory, it is compensation to the state for the delay in the payment of tax. It is the charge for the use by the taxpayer of funds that rightfully should have been in the government coffers and utilized for the ends thereof.⁴

It should be noted that the BIR is already authorized to impose in addition to the deficiency tax and delinquency tax a civil penalty of 25% in certain enumerated instances and the 50% civil penalty in case of willful neglect to file the return within the period prescribed by law and regulations, or in case a false or fraudulent return is willfully made. Thus, BIR has the authority to imposed additional penalties. Thus, there is no reason why an additional 20% should be imposed to any unpaid tax.

The power of taxation is sometimes called also the power to destroy. Therefore, it should be exercised with caution to minimize injury to the proprietary rights of a taxpayer. It must be exercised fairly, equally and uniformly, lest the tax collector kill the ‘hen that lays the golden egg.’ And, in the order to maintain the general public’s trust

³ *Republic of the Phil. v. Heras*, 32 SCRA 596 (1970).

⁴ Underscoring supplied.

and confidence in the Government this power must be used justly and not treacherously.”⁵

The imposition of the exorbitance of the 40% interest definitely destroys; it is an unjust and unfair collection of an additional penalty, rather than a mere compensation to the State for delay in the payment of the tax, especially that the government pays no interest at all to taxpayers who seek refunds from the government.

In view of the foregoing, we believe that Section 249 of the Tax Code should be amended in this regard, to read as follows:

SECTION 249. Interest. —

(A) In General. — There shall be assessed and collected on any unpaid amount of tax, interest at the rate of twenty percent (20%) per annum, or such [higher] rate as may be prescribed by rules and regulations UNDER SUBSECTION (E) HEREOF, from the date prescribed for payment until the amount is fully paid; PROVIDED, THAT IN NO CASE SHALL THE DEFICIENCY AND THE DELIQUENCY INTEREST PRESCRIBED UNDER SUBSECTION (B) AND (C) HEREOF, BE IMPOSED SIMULTANEOUSLY.

(B) Deficiency Interest. — Any deficiency in the tax due, as the term is defined in this Code, shall be subject to the interest prescribed in Subsection (A) hereof, which interest shall be assessed and collected from the date prescribed for its payment until the full payment thereof.

(C) Delinquency Interest. — In case of failure to pay:

- (1) The amount of the tax due on any return required to be filed, or
- (2) The amount of the tax due for 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,

there shall be assessed and collected on the unpaid amount, interest at the rate prescribed in Subsection (A) hereof until the amount is fully paid, which interest shall form part of the tax.

⁵ *Roxas v. Court of Tax Appeals*, 23 SCRA 276 (1968).

(D) Interest on Extended Payment. — If any person required to pay the tax is qualified and elects to pay the tax on installment under the provisions of this Code, but fails to pay the tax or any installment hereof, or any part of such amount or installment on or before the date prescribed for its payment, or where the Commissioner has authorized an extension of time within which to pay a tax or a deficiency tax or any part thereof, there shall be assessed and collected interest at the rate hereinabove prescribed on the tax or deficiency tax or any part thereof unpaid from the date of notice and demand until it is paid.

(E) ADJUSTMENT OF RATE. - THE SECRETARY OF FINANCE, SHALL ADJUST THE RATE OF INTEREST PRESCRIBED UNDER SUBSECTION (A) HEREOF EFFECTIVE JANUARY 1, 2017 AND EVERY YEAR THEREAFTER IN ORDER TO FIX THE RATE OF INTEREST ANNUALLY AT NOT MORE THAN DOUBLE THE RATE OF INTEREST ON TREASURY BILLS OF ONE YEAR TENOR [OR SIMILAR MARKET BENCHMARK] AT THE TIME OF ADJUSTMENT.