



REPUBLIC OF THE PHILIPPINES  
DEPARTMENT OF FINANCE  
BUREAU OF INTERNAL REVENUE



BUREAU OF INTERNAL REVENUE  
Quezon City  
RECORDS-DIVISION

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September 6, 1999

REVENUE REGULATIONS NO. 12-99

**SUBJECT :** Implementing the Provisions of the National Internal Revenue Code of 1997 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.

**TO :** All Internal Revenue Officers and Others Concerned.

**SECTION 1. Scope.** - Pursuant to the provisions of Section 244, in relation to Section 245 of the National Internal Revenue Code of 1997, these Regulations are hereby promulgated to implement the provisions of Sections 6, 7, 204, 228, 247, 248 and 249 on assessment of national internal revenue taxes, fees and charges and to provide the rules governing the extra-judicial settlement of a taxpayer's criminal violation of the said Code or any of its implementing Regulations through payment of a suggested compromise penalty.

**SECTION 2. General Principles.** -

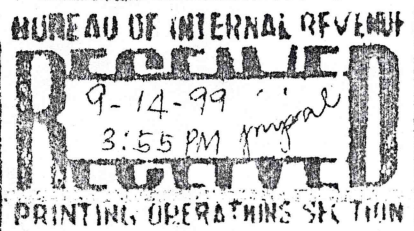
2.1 The surcharge and/or interest herein prescribed shall apply to all taxes, fees and charges imposed under the Code which shall be collected at the same time, in the same manner, and as part of the tax.

2.2 In case the tax due from the taxpayer is paid on a partial or installment basis, the interest on the deficiency tax or on the delinquency tax liability of the taxpayer shall be imposed from due date of the tax until full payment thereof. The interest shall be computed based on the diminishing balance of the tax, inclusive of interests.

**SECTION 3. Due process requirement in the issuance of a deficiency tax assessment.** -

3.1 Mode of procedures in the issuance of a deficiency tax assessment:

3.1.1 **Notice for informal conference.** - The Revenue Officer who audited the taxpayer's records shall, among others, state in his report whether or not the taxpayer agrees with his findings that the taxpayer is liable for deficiency tax or taxes. If the taxpayer is not amenable, based on the said Officer's



submitted report of investigation, the taxpayer shall be informed, in writing, by the Revenue District Office or by the Special Investigation Division, as the case may be (in the case Revenue Regional Offices) or by the Chief of Division concerned (in the case of the BIR National Office) of the discrepancy or discrepancies in the taxpayer's payment of his internal revenue taxes, for the purpose of "Informal Conference," in order to afford the taxpayer with an opportunity to present his side of the case. If the taxpayer fails to respond within fifteen (15) days from date of receipt of the notice for informal conference, he shall be considered in default, in which case, the Revenue District Officer or the Chief of the Special Investigation Division of the Revenue Regional Office, or the Chief of Division in the National Office, as the case may be, shall endorse the case with the least possible delay to the Assessment Division of the Revenue Regional Office or to the Commissioner or his duly authorized representative, as the case may be, for appropriate review and issuance of a deficiency tax assessment, if warranted.

**3.1.2 Preliminary Assessment Notice (PAN).** - If after review and evaluation by the Assessment Division or by the Commissioner or his duly authorized representative, as the case may be, it is determined that there exists sufficient basis to assess the taxpayer for any deficiency tax or taxes, the said Office shall issue to the taxpayer, at least by registered mail, a Preliminary Assessment Notice (PAN) for the proposed assessment, showing in detail, the facts and the law, rules and regulations, or jurisprudence on which the proposed assessment is based (see illustration in ANNEX A hereof). If the taxpayer fails to respond within fifteen (15) days from date of receipt of the PAN, he shall be considered in default, in which case, a formal letter of demand and assessment notice shall be caused to be issued by the said Office, calling for payment of the taxpayer's deficiency tax liability, inclusive of the applicable penalties.

**3.1.3 Exceptions to Prior Notice of the Assessment.** - The notice for informal conference and the preliminary assessment notice shall not be required in any of the following cases, in which case, issuance of the formal assessment notice for the payment of the taxpayer's deficiency tax liability shall be sufficient:

(i) When the finding for any deficiency tax is the result of mathematical error in the computation of the tax appearing on the face of the tax return filed by the taxpayer; or

(ii) When a discrepancy has been determined between the tax withheld and the amount actually remitted by the withholding agent; or

(iii) 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; or

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(iv) When the excise tax due on excisable articles has not been paid; or

(v) When an article locally purchased or imported by an exempt person, such as, but not limited to, vehicles, capital equipment, machineries and spare parts, has been sold, traded or transferred to non-exempt persons.

**3.1.4 Formal Letter of Demand and Assessment Notice.** - The formal letter of demand and assessment notice shall be issued by the Commissioner or his duly authorized representative. The letter of demand calling for payment of the taxpayer's deficiency tax or taxes shall state the facts, the law, rules and regulations, or jurisprudence on which the assessment is based, *otherwise, the formal letter of demand and assessment notice shall be void* (see illustration in ANNEX B hereof). The same shall be sent to the taxpayer only by registered mail or by personal delivery. If sent by personal delivery, the taxpayer or his duly authorized representative shall acknowledge receipt thereof in the duplicate copy of the letter of demand, showing the following: (a) His name; (b) signature; (c) designation and authority to act for and in behalf of the taxpayer, if acknowledged received by a person other than the taxpayer himself; and (d) date of receipt thereof.

**3.1.5 Disputed Assessment.** - The taxpayer or his duly authorized representative may protest administratively against the aforesaid formal letter of demand and assessment notice within thirty (30) days from date of receipt thereof. If there are several issues involved in the formal letter of demand and assessment notice but the taxpayer only disputes or protests against the validity of some of the issues raised, the taxpayer shall be required to pay the deficiency tax or taxes attributable to the undisputed issues, in which case, a collection letter shall be issued to the taxpayer calling for payment of the said deficiency tax, inclusive of the applicable surcharge and/or interest. No action shall be taken on the taxpayer's disputed issues until the taxpayer has paid the deficiency tax or taxes attributable to the said undisputed issues. The prescriptive period for assessment or collection of the tax or taxes attributable to the disputed issues shall be suspended.

The taxpayer shall state the facts, the applicable law, rules and regulations, or jurisprudence on which his protest is based, otherwise, his protest shall be considered *void and without force and effect*. If there are several issues involved in the disputed assessment and the taxpayer fails to state the facts, the applicable law, rules and regulations, or jurisprudence in support of his protest against some of the several issues on which the assessment is based, the same shall be considered undisputed issue or issues, in which case, the taxpayer shall be required to pay the corresponding deficiency tax or taxes attributable thereto.

The taxpayer shall submit the required documents in support of his protest within sixty (60) days from date of filing of his letter of protest, otherwise, the assessment shall become final, executory and demandable. The phrase "submit the required documents" includes submission or presentation of the pertinent

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documents for scrutiny and evaluation by the Revenue Officer conducting the audit. The said Revenue Officer shall state this fact in his report of investigation.

If the taxpayer fails to file a valid protest against the formal letter of demand and assessment notice within thirty (30) days from date of receipt thereof, the assessment shall become final, executory and demandable.

If the protest is denied, in whole or in part, by the Commissioner, the taxpayer may appeal to the Court of Tax Appeals within thirty (30) days from date of receipt of the said decision, otherwise, the assessment shall become final, executory and demandable.

In general, if the protest is denied, in whole or in part, by the Commissioner or his duly authorized representative, the taxpayer may appeal to the Court of Tax Appeals within thirty (30) days from date of receipt of the said decision, otherwise, the assessment shall become final, executory and demandable: Provided, however, that if the taxpayer elevates his protest to the Commissioner within thirty (30) days from date of receipt of the final decision of the Commissioner's duly authorized representative, the latter's decision shall not be considered final, executory and demandable, in which case, the protest shall be decided by the Commissioner.

If the Commissioner or his duly authorized representative fails to act on the taxpayer's protest within one hundred eighty (180) days from date of submission, by the taxpayer, of the required documents in support of his protest, the taxpayer may appeal to the Court of Tax Appeals within thirty (30) days from the lapse of the said 180-day period, otherwise, the assessment shall become final, executory and demandable.

**3.1.6 Administrative Decision on a Disputed Assessment.** - The decision of the Commissioner or his duly authorized representative shall (a) state the facts, the applicable law, rules and regulations, or jurisprudence on which such decision is based, *otherwise, the decision shall be void* (see illustration in ANNEX C hereof), in which case, the same shall not be considered a decision on a disputed assessment; and (b) that the same is his *final decision*.

**3.1.7 Constructive Service.** - If the notice to the taxpayer herein required is served by registered mail, and no response is received from the taxpayer within the prescribed period from date of the posting thereof in the mail, the same shall be considered actually or constructively received by the taxpayer. If the same is personally served on the taxpayer or his duly authorized representative who, however, refused to acknowledge receipt thereof, the same shall be constructively served on the taxpayer. Constructive service thereof shall be considered effected by leaving the same in the premises of the taxpayer and this fact of constructive service is attested to, witnessed and signed by at least two (2) revenue officers other than the revenue officer who constructively served the

BUREAU OF INTERNAL REVENUE The revenue officer who constructively served the same shall make a

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written report of this matter which shall form part of the docket of this case (see illustration in ANNEX D hereof).

#### SECTION 4. Civil Penalties:

**4.1 Twenty-Five Percent (25%) Surcharge.** - There shall be imposed, in addition to the basic tax required to be paid, a penalty equivalent to twenty-five percent (25%) thereof, in any the following cases:

**4.1.1** Failure to file any return and pay the tax due thereon as required under the provisions of this Code or rules and regulations on the date prescribed; or

**4.1.2** Unless otherwise authorized by the Commissioner, filing a return with an internal revenue officer other than those with whom the return is required to be filed; or

**4.1.3** Failure to pay the deficiency tax within the time prescribed for its payment in the notice of assessment; or

**4.1.4** Failure to pay the full or part of the amount of tax shown on any return required to be filed under the provisions of this Code or rules and regulations, or the full amount of tax due for which no return is required to be filed, on or before the date prescribed for its payment.

#### **4.2 Fifty Percent (50%) Surcharge:**

**4.2.1** In case of willful neglect to file the return within the period prescribed by the Code, or in case a false or fraudulent return is willfully made, the penalty to be imposed shall be fifty percent (50%) of the tax or of the deficiency tax, in case any payment has been made on the basis of such return before the discovery of the falsity or fraud: *Provided*, That a substantial underdeclaration of taxable sales, receipts or income, or a substantial overstatement of deductions, as determined by the Commissioner or his duly authorized representative, shall constitute *prima facie* evidence of a false or fraudulent return: *Provided, further*, That failure to report sales, receipts or income in an amount exceeding thirty percent (30%) of that declared per return, and a claim of deductions in an amount exceeding thirty percent (30%) of actual deductions, shall render the taxpayer liable for substantial underdeclaration of sales, receipts or income or for overstatement of deductions, as mentioned herein: *Provided, further*, that the term "*willful neglect to file the return within the period prescribed by the Code*" shall not apply in case the taxpayer, without notice from the Commissioner or his authorized representative, voluntarily files the said return, in which case, only 25% surcharge shall be imposed for late filing and late payment of the tax in lieu of the above 50% surcharge. Conversely, the 50% surcharge shall be imposed in case

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the taxpayer files the return only after prior notice in writing from the Commissioner or his duly authorized representative.

4.2.2 Section 6 (A) of the Code provides that any tax return filed by a taxpayer "may be modified, changed or amended" by the taxpayer "within three (3) years from date of such filing" provided, however, that "no notice for audit or investigation of such return, statement or declaration has, in the meantime, been actually served upon the taxpayer." Thus, if upon investigation, it is determined that the taxpayer's originally filed tax return is false or fraudulent, such taxpayer shall remain liable to the 50% civil penalty regardless that the taxpayer has filed his amended tax return, if the said amended tax return, however, has been filed only after issuance of the Letter of Authority for the investigation of the taxpayer's tax return or such amendment has been made in the course of the said investigation.

**SECTION 5. Mode of Procedures in Computing for the Tax and/or Applicable Surcharge.** - Shown hereunder are illustrative cases for the computation and assessment of the tax, inclusive of surcharge (if applicable) and interest:

5.1 Late filing and late payment of the tax. - **Illustration:** Income tax return for the calendar year 1998 was due for filing on April 15, 1999 but the taxpayer voluntarily filed his tax return, without notice from the BIR, only on June 30, 1999. The tax due per return amounts to P100,000. In this case, the taxpayer shall be liable for delinquency penalties consisting of 25% surcharge, plus 20% interest per annum, computed from due date of the tax until date of payment, computed as follows:

**Calendar Year 1998**

Income tax due per return		P100,000.00
Add: 25% surcharge for late filing and late payment (P100,000.00 times 25%)		P 25,000.00
20% int. p.a. from 4-15-99 to 6-30-99 (P100,000.00 times .0415524)	P 4,155.24	<u>P 29,155.24</u>
Total amount due (excluding suggested compromise for late filing and late payment of the tax)		<u><b>P129,155.24</b></u>

Only one 25% surcharge shall be imposed for late filing of the return and late payment of the tax.

5.2 The tax return is filed on time but filed through an internal revenue officer other than with whom the return is required to be filed. - **Illustration:** The taxpayer's 1998 income tax return is required to be filed through the authorized agent bank under the jurisdiction of RDO East Makati. But, without prior authorization from the BIR, the taxpayer filed his tax return and

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paid the tax through the authorized agent bank under the jurisdiction of RDO Davao City. Tax due and paid per return is P100,000.00.

**Calendar Year 1998**

Income tax due per return	P100,000.00
Add: 25% surcharge	<u>P 25,000.00</u>
Total amount due	P125,000.00
Less: Amount paid	<u>P100,000.00</u>
Amount still due	<u>P 25,000.00</u>

**5.3 Late filing and late payment due to taxpayer's willful neglect. -**

**Illustration:** The taxpayer did not file his income tax return for the calendar year 1997 which was due for filing on April 15, 1998. He was notified by the BIR of his failure to file the tax return, for which reason, he filed his tax return and paid the tax, only after the said notice, on June 30, 1999. The tax due per return is P100,000.00.

**Calendar Year 1997**

Income tax due per return	P100,000.00
Add: 50% surcharge for willful neglect to file the return and late payment of the tax (P100,000 times 50%)	P50,000.00
20% int. p.a. fr. 4-15-98 to 6-30-99 (P100,000.00 times .2415524)	<u>P24,155.24</u>
	<u>P 74,155.24</u>
Total amount due (excluding suggested compromise for late filing and late payment of the tax)	<u>P174,155.24</u>

**5.4 Penalty or penalties for deficiency tax. -** As a rule, no surcharge is imposed on deficiency tax and on the basic tax. However, if the amount due inclusive of penalties is not paid on or before the due date stated on the demand letter, the corresponding surcharge shall be imposed.

**Illustration No. 1:** Taxpayer filed on time his income tax return for calendar year 1997 and paid P100,000.00 on April 15, 1998. Upon pre-audit of his return, it was disclosed that he erroneously computed the tax due. The correct amount of tax due is P120,000.00. The taxpayer is assessed for deficiency income tax in a letter of demand and assessment notice issued on June 30, 1999.

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**Calendar Year 1997**

Tax due per pre-audit	P120,000.00
Less: Amount assessed and paid per tax return filed	<u>P100,000.00</u>
Deficiency income tax	P 20,000.00
Add: 20% int. p.a. from 4-15-98 to 6-30-99 (P20,000.00 times .2415524)	<u>P 4,831.05</u>
Amount still due	<u>P 24,831.05</u>

**Illustration No. 2:** ABC CORPORATION filed its income tax return for calendar year 1997 and paid on time its income tax shown thereunder, amounting to P100,000. Said taxpayer was investigated. Upon verification of its accounting records, it was disclosed that its deduction, from gross income, of representation expenses in the amount of P200,000.00 did not meet all the statutory requisites for deductibility. The corporation was duly notified of the said discrepancy through a Preliminary Assessment Notice. Based on the 35% income tax rate on corporations applicable in the year 1997, the income tax due after investigation amounts to P170,000.00. After deduction of income tax paid per return filed, the basic deficiency income tax amounts to P70,000, excluding penalties. Failing to protest on time against the preliminary assessment notice, a formal letter of demand and assessment notice was issued on May 31, 1999, requiring payment of the assessment not later than June 30, 1999.

**Calendar Year 1997**

Income tax due per investigation	P170,000.00
Less: Income tax paid per return	<u>P100,000.00</u>
Deficiency income tax	P 70,000.00
Add: 20% int. p.a. fr. 4-15-98 to 6-30-99 (P70,000 times .2415524)	<u>P 16,908.67</u>
Total amount still due	<u>P 86,908.67</u>

**Illustration No. 3:** XYZ CORPORATION filed its income tax return for calendar year 1997 with a net taxable income of P500,000.00. At the applicable income tax rate of 35% for the year 1997, its income tax amounted to P175,000.00. However, upon investigation, it was disclosed that its income tax return was false or fraudulent because it did not report a taxable income amounting to another P500,000.00. On its net income of P1,000,000.00, per investigation, the income tax due is P350,000.00. Deducting its payment per return filed, the deficiency, excluding penalties, amounted to P175,000.00. It was duly informed of this finding through a Preliminary Assessment Notice. Failing to protest on time against the preliminary assessment notice, a formal letter of demand and assessment notice was issued on May 31, 1999 calling for payment of the deficiency income tax on or before June 30, 1999.

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In this case, said corporation is liable for the civil penalties of 50% surcharge for having filed a false or fraudulent return, plus 20% interest per annum on the deficiency, computed as follows:

**Calendar Year 1997**

Income tax due per investigation		P350,000.00
Less: Income tax paid per return		<u>P175,000.00</u>
Deficiency income tax		P175,000.00
Add: 50% surcharge for filing a fraudulent or false return (P175,000.00 times 50%)	P 87,500.00	
20% int. p.a. fr. 4-15-98 to 6-30-99 (P175,000.00 times .2415524)	<u>P 42,271.67</u>	<u>P129,771.67</u>
 Total amount due		 <u><b>P304,771.67</b></u>

**5.5 Late payment of a deficiency tax assessed.** - In general, the deficiency tax assessed shall be paid by the taxpayer within the time prescribed in the notice and demand, otherwise, such taxpayer shall be liable for the civil penalties incident to late payment.

**Illustration:** Based on the above Illustration No. 3, Scenario 4, assuming that the calendar year 1997 deficiency income tax assessment against XYZ CORPORATION, in the amount of P304,771.67, is not paid by June 30, 1999, the deadline for payment of the assessment, and assuming further that this assessment has already become final and collectible. In this case, such corporation shall be considered late in payment of the said assessment. Assuming, further, that the corporation pays its tax assessment only by July 31, 1999, the civil penalties for late payment shall be computed as follows:

**Calendar Year 1997**

Total deficiency income tax assessed on May 31, 1999		P304,771.67
Add: 25% surcharge for late payment (P304,771.67 times 25%)	P76,192.92	
20% interest p.a. from 7-1-99 to 7-31-99 (P304,771.67 times .0166667)	<u>P 5,079.54</u>	<u>P 81,272.46</u>
 Total amount due (excluding suggested compromise penalty for late payment)		 <u><b>P386,044.13</b></u>

**5.6 Computation of 20% interest per annum in case of partial or installment payment of a tax liability.** - Illustration No. 1: In case extended payment of the tax is duly authorized. - DEF CORPORATION, due to financial incapacity, requested that it be allowed to pay its income tax liability per return for calendar year 1998, in the amount of P1,000,000.00, in four (4) monthly

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installments, starting April 15, 1999. Its request has been duly approved pursuant to Sec. 53 of the Tax Code.

In this case, no 25% surcharge shall be imposed for late payment of the tax since its deadline for payment has been duly extended. However, 20% interest per annum for the extended payment shall be imposed, computed based on the diminishing balance of the "unpaid amount", pursuant to the provisions of Section 249 (D) of the Code.

No 25% surcharge on extended payment shall be imposed provided, however, that the taxpayer's request for extension of the period within which to pay is made on or before the deadline prescribed for payment of the tax due. Conversely, if such request is made after the deadline prescribed for payment, the taxpayer shall already be treated late in payment, in which case, the 25% surcharge shall be imposed, even if payment of the delinquency be allowed in partial amortization .

**Example:**

**Calendar Year 1998**

Income tax due per return	P1,000,000.00
Less: 1 <sup>st</sup> installment of the tax on or before 4-15-99	<u>P 250,000.00</u>
Balance as of 4-15-99	P 750,000.00
Add: 20% int. p.a. from 4-15-99 to 5-15-99 (P750,000.00 times .0166667)	<u>P 12,500.03</u>
Amount due on 5-15-99	P 762,500.03
Less: 2 <sup>nd</sup> installment on 5-15-99 (P250,000.00 plus P12,500.03 interest)	<u>P 262,500.03</u>
Balance as of 5-15-99	P 500,000.00
Add: 20% int. p.a. from 5-15-99 to 6-15-99 (P500,000.00 times .0166667)	<u>P 8,333.35</u>
Amount due on 6-15-99	P 508,333.35
Less: 3 <sup>rd</sup> installment on 6-15-99 (P250,000.00 plus P8,333.35 interest)	<u>P 258,333.35</u>
Balance as of 6-15-99	P 250,000.00
Add: 20% int. p.a. from 6-15-99 to 7-15-99 (P250,000.00 times .0166667)	<u>P 4,166.68</u>
4 <sup>th</sup> and final installment on 7-15-99	<u>P 254,166.68</u>

**Illustration No. 2: Computation of tax delinquency in case of partial payment of the tax due without prior BIR authorization for extended payment. -**

**Example:** GHI CORPORATION did not file its final adjustment income tax return for the calendar year 1998 which was due on April 15, 1999. The BIR informed the corporation of its failure to file its said tax return and required that it

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file the same, inclusive of the 25% surcharge and 20% interest per annum penalties incident to the said omission. On May 15, 1999 it advised that its income tax due for the said year amounts to P1,000,000.00 but, however, due to its adverse financial condition at the moment, it will be unable to pay the entire amount, inclusive of the delinquency penalties. Hence, on May 15, 1999, it made a partial payment of P400,000.00. Assuming that the BIR demanded payment of the unpaid balance of its tax obligation payable by June 15, 1999, the unpaid balance of the corporation's delinquent income tax shall be computed as follows:

**Calendar Year 1998**

Income tax due per return		P1,000,000.00
Add: 25% surcharge for late filing and late payment	P250,000.00	
20% interest per annum from 4-15-99 to 5-15-99 (P1,000,000.00 times .0166667)	P 16,666.70	P 266,666.70
Amount due as of 5-15-99		P1,266,666.70
Less: Partial payment on 5-15-99		P 400,000.00
Balance as of 5-15-99		P 866,666.70
Add: 20% interest per annum from 5-15-99 to 6-15-99 (P866,666.70 times .0166667)		P 14,444.47
Amount still due (exclusive of the suggested compromise penalty for late filing and late payment)		<u>P 811,111.17</u>

If the said taxpayer fails to pay the amount of P811,111.17 by June 15, 1999, no further 25% surcharge for late payment of the tax shall be imposed. Instead, only the 20% interest per annum shall be imposed against the taxpayer against the taxpayer, computed from due date thereof (i.e., June 15, 1999) until paid. If said taxpayer pays the same on partial payment basis, the 20% interest per annum shall be computed on the diminishing balance thereof, pursuant to the procedures in the preceding Illustration No. 1, Section 6.6 hereof.

**SECTION 6. Suggested Compromise Penalty in Extra-judicial Settlement of a Taxpayer's Criminal Violation.** - Section 204 of the Tax Code of 1997 provides that "All criminal violations may be compromised except: (a) those already filed in court, or (b) those involving fraud." This means that, in general, the taxpayer's criminal liability arising from his violation of the pertinent provision of the Code may be settled extra-judicially instead of the BIR instituting against the taxpayer a criminal action in Court. A compromise in extra-judicial settlement of the taxpayer's criminal liability for his violation is consensual in character, hence, may not be imposed on the taxpayer without his consent. Hence, the BIR may only suggest settlement of the taxpayer's liability through a compromise.

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The extra-judicial settlement of the taxpayer's criminal liability and the amount of the suggested compromise penalty shall conform with the schedule of compromise penalties provided under Revenue Memorandum Order No. 1-90 or as hereafter revised.

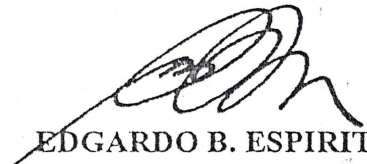
**SECTION 7. Repealing Clause.** - Any revenue issuance which is inconsistent herewith shall be considered repealed, amended, or modified accordingly.

**SECTION 8. Effectivity:**

**8.1 General Rule.** - In general, the provisions of these Regulations shall be effective beginning January 1, 1998 pursuant to the provisions of Section 8 of R.A. No. 8424, otherwise known as the National Internal Revenue Code of 1997.

**8.2 Computation of Surcharge and Interest on Deficiency Tax Assessment.** - Any deficiency tax assessment issued beginning January 1, 1998 shall be governed by the rules prescribed in these Regulations.

**8.3 Other Provisions.** - Any provision of these Regulations not otherwise specifically provided in the National Internal Revenue Code of 1997 shall take effect fifteen (15) days after publication in any newspaper of general circulation.

  
EDGARDO B. ESPIRITU  
Secretary of Finance

Recommending Approval:

  
BEETHOVEN L. RUALO  
Commissioner of Internal Revenue

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## Preliminary Assessment Notice

ABC Corporation  
 123 Makati Avenue  
 Makati City  
 TIN: 000-000-000-000

Gentlemen:

Please be informed that after investigation there has been found due from you deficiency income tax for calendar year 1997, as shown hereunder:

Assessment No. \_\_\_\_\_

Taxable income per return		P1,000,000.00
Add: Discrepancies per investigation		
1. Undeclared rental income	P200,000.00	
2. Non-deductible interest expenses	300,000.00	
3. Undocumented representation expenses	150,000.00	
4. Non-deductible bad debt expense	<u>250,000.00</u>	<u>900,000.00</u>
Taxable income per investigation		<u>P1,900,000.00</u>
Income tax due thereon (35%)		P665,000.00
Less: Income tax paid per return		<u>350,000.00</u>
Balance		P315,000.00
Add: 50% surcharge for filing of fraudulent return	P157,500.00	
20% interest per annum from 4-15-96 to 3-15-98	63,000.00	<u>220,500.00 *</u>
<b>TOTAL AMOUNT DUE</b>		<b>P535,500.00 *</b>

\*Please note that the interest and the total amount due will have to be adjusted if paid beyond 3-15-98

The complete details covering the aforementioned discrepancies established during the investigation of this case are shown in the accompanying ANNEX A-1 of this letter of demand.

The 50% surcharge has been imposed pursuant to the provisions of Section 248(B) of the National Internal Revenue Code, as amended by R.A. No. 8424, which took effect on January 1, 1998, in view of your failure to report for income tax purposes your aforementioned rental income. Such omission renders your income tax return filed for the taxable calendar year 1997 as a false or fraudulent return.

The 20% interest per annum has been imposed pursuant to the provisions of Section 249(B) of the said Code.

Pursuant to the provisions of Section 228 of the National Internal Revenue Code of 1997 and its implementing Revenue Regulations, you are hereby given the opportunity to present in writing your side of the case within fifteen (15) days from receipt hereof. If we fail to hear from you within the said period, you shall be considered in default, in which case, a formal letter of demand and assessment notice shall be issued by this Office calling for payment of your aforesaid deficiency income tax, inclusive of the aforementioned civil penalty and interest.

We hope that you will give this matter your preferential attention.

Very truly yours,

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ABC CORPORATION  
123 Makati Avenue  
Makati City  
TIN: 000-000-000-000

**DETAILS OF DISCREPANCIES**

Assessment No. \_\_\_\_\_

1. **Undeclared rental income (P200,000.00).** - Verification disclosed that you derived this rental income from the lease of your building to XYZ CORPORATION during the tax year 1997 but the same, without any legal justification, was neither recorded in your books of accounts nor declared in your income tax return, thereby resulting to the understatement of your reported taxable income for the said tax year.

2. **Non-deductible interest expense (P300,000.00).** - Verification disclosed that this interest expense, claimed as deduction from your gross income for the tax year 1997, was actually incurred in connection with your loan from Mr. JUAN CASTRO. It was, however, further disclosed that Mr. Castro owns and controls 60% of your outstanding capital stock. Hence, this interest expense is not a valid deduction from your gross income, pursuant to Section 34(B)(2), in relation to Section 36(B)(2) of the National Internal Revenue Code which provides that no deduction shall be allowed in respect of interest expense incurred between an individual and a corporation more than fifty percent (50%) in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual.

3. **Undocumented representation expenses (P50,000.00).** - Verification disclosed that this item of deduction from your gross income for the tax year 1997 is in fact unsubstantiated with any documentary evidence, hence, disallowed in audit.

4. **Non-deductible bad debt expense (P250,000.00).** - Verification disclosed that this item of deduction from your gross income for the tax year 1997 was, in fact, a mere provision for estimated uncollectible accounts from your customers as of the end of the said year. Under Section 34(E) of the said Code, a mere provision for estimated uncollectible accounts is not allowable deduction from gross income. In general, for bad debts to be deductible, the following statutory requisites must have been complied with:

4.1 That, the debts due from your debtor or debtors must have been ascertained actually worthless as of the end of the taxable year; and

4.2 That, the same have been actually charged or written-off in your books of accounts as of the end of the said taxable year.

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4.2 That, the said accounts receivable have actually been charged off or written-off the books of accounts as of the end of the taxable year.

The records of this case disclosed that you have not introduced any evidence to overthrow the validity of our said findings.

It is requested that your aforesaid deficiency income tax liability be paid immediately upon receipt hereof, inclusive of penalties incident to delinquency. This is our final decision. If you disagree, you may appeal this final decision with the Court of Tax Appeals within thirty (30) days from date of receipt hereof, otherwise our said deficiency income tax assessment shall become final, executory and demandable.

Very truly yours,



## FORMAL LETTER OF DEMAND

ABC Corporation  
 123 Makati Avenue  
 Makati City  
 TIN: 000-000-000-000

Gentlemen:

Please be informed that after investigation there has been found due from you deficiency income tax for calendar year 1997, as shown hereunder:

Assessment No. \_\_\_\_\_

Taxable income per return		P1,000,000.00
Add: Discrepancies per investigation		
1. Undeclared rental income	P200,000.00	
2. Non-deductible interest expenses	300,000.00	
3. Undocumented representation expenses	150,000.00	
4. Non-deductible bad debt expense	<u>250,000.00</u>	<u>900,000.00</u>
Taxable income per investigation		<u>P1,900,000.00</u>
Income tax due thereon (35%)		P665,000.00
Less: Income tax paid per return		<u>350,000.00</u>
Balance		P315,000.00
Add: 50% surcharge for filing of fraudulent return	P157,500.00	
20% interest per annum from 4-15-96 to 3-15-98	63,000.00	<u>220,500.00 *</u>
<b>TOTAL AMOUNT DUE</b>		<b><u>P535,500.00*</u></b>

\*Please note that the interest and the total amount due will have to be adjusted if paid beyond 3-15-98

The complete details covering the aforementioned discrepancies established during the investigation of this case are shown in the accompanying SCHEDULE 1 of this letter of demand.

The 50% surcharge has been imposed pursuant to the provisions of Section 248(B) of the National Internal Revenue Code, as amended by R.A. No. 8424, which took effect on January 1, 1998, in view of your failure to report for income tax purposes your aforementioned rental income. Such omission renders your income tax return filed for the taxable calendar year 1997 as a false or fraudulent return.

The 20% interest per annum has been imposed pursuant to the provisions of Section 249(B) of the said Code.

In view thereof, you are requested to pay your aforesaid deficiency income tax liability through the duly authorized agent bank in which you are enrolled within the time shown in the enclosed assessment notice.

Very truly yours,



## ANNEX "C"

ABC Corporation  
123 Makati Avenue  
Makati City  
TIN: 000-000-000-000

### FINAL DECISION ON DISPUTED ASSESSMENT

Gentlemen:

Referring to your letter dated May 15, 1999, please be informed that your protest against our calendar year 1997 deficiency income tax assessment in the amount of P535,500.00, the subject matter of our covering letter of demand dated March 15, 1999, is hereby denied for lack of factual and legal basis. The aforesaid assessment is premised on the following:

1. Undeclared rental income (P200,000.00). - Verification disclosed that you derived income from the lease of your building to XYZ Corporation during the year 1997 but this was not recorded in your books of accounts and also not reported in your income tax return.
2. Non-deductible interest expense deduction (P300,000.00). - Verification disclosed that this interest expenses was incurred in connection with your loan from MR. JUAN CASTRO. It was also disclosed that Mr. Castro owns 60% of the outstanding stock of ABC Corporation. Hence the said interest expense is non-deductible in computing ABC Corporation's taxable income pursuant to Section 34(B)(2)(a), in relation to Section 36(B)(2) of the NIRC, that interest paid on a loan transaction between an individual and a corporation more that fifty percent (50%) in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual shall be deductible from gross income for income tax purposes.
3. Undocumented representation expenses (P150,000.00). - Verification disclosed that the veracity of this item of deduction has not been established, hence, disallowed as a deduction from gross income.
4. Non-deductible bad debt expense (P250,000.00). - Verification disclosed that this was a mere provision for estimated collectible accounts as of the end of the year 1997. Under Section 34(E), NIRC, a mere provision for estimated uncollectible accounts is not deductible from gross income. To be deductible, two requisites must be met:

- 4.1 That, the debts due from your debtor/s (accounts receivable) have been ascertained actually worthless as of the end of the taxable year; and

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4.2 That, the said accounts receivable have actually been charged off or written-off the books of accounts as of the end of the taxable year.

The records of this case disclosed that you have not introduced any evidence to overthrow the validity of our said findings.

It is requested that your aforesaid deficiency income tax liability be paid immediately upon receipt hereof, inclusive of penalties incident to delinquency. This is our final decision. If you disagree, you may appeal this final decision with the Court of Tax Appeals within thirty (30) days from date of receipt hereof, otherwise our said deficiency income tax assessment shall become final, executory and demandable.

Very truly yours,

A handwritten signature in black ink, appearing to be a stylized letter 'C' or similar character, located to the right of the closing text.

ANNEX D

CONSTRUCTIVE SERVICE OF NOTICE/S

MEMORANDUM FOR:

The Commissioner/Regional Director  
Thru Channel

SUBJECT :

Name of Taxpayer: \_\_\_\_\_  
Address: \_\_\_\_\_  
T.I.N.: \_\_\_\_\_  
Kind of Taxes: \_\_\_\_\_  
Amount : P \_\_\_\_\_

This is to report that I/We personally served on the subject taxpayer at the above given address on \_\_\_\_\_, 1999, the formal letter of demand and assessment notice, dated \_\_\_\_\_, 1999, calling for payment of his/its above stated tax liability. However, the taxpayer refused to acknowledge receipt thereof. I/We also tried to serve the same on \_\_\_\_\_, the taxpayer's duly authorized representative, but the latter likewise refused to acknowledge receipt thereof.

Due to the foregoing, the said formal letter of demand and assessment notice were constructively delivered by leaving the same conspicuously at the taxpayer's residence/place of business at \_\_\_\_\_, on \_\_\_\_\_, 1999.

\_\_\_\_\_  
Revenue Officer

\_\_\_\_\_  
Name and Signature of Witness

\_\_\_\_\_  
Name and signature of Witness

\_\_\_\_\_  
Designation

\_\_\_\_\_  
Designation

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