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1. Can corporate officers be held guilty of a violation of the Tariff and Customs Code for misdeclared, misclassified, and undervalued imported goods of the company?

Yes, if there is a showing that they actively participated in or had the power to prevent the company's wrongful act but were grossly negligent. In *Fernandez, et al. v. People of the Philippines* (G.R. No. 249606, July 6, 2022), the Supreme Court held that that the President, Vice-President, Treasurer, and Corporate Secretary of Kingson Trading International Corporation (Kingson), which violated Section 3602 in relation to Section 2503 of the Tariff and Customs Code of the Philippines (TCCP), cannot hide behind the cloak of the separate corporate personality of the corporation to escape criminal liability. Citing jurisprudence, the Supreme Court said that to be held criminally liable for the acts of a corporation, there must be a showing that its officers, directors, and shareholders actively participated in or had the power to prevent the wrongful act. The Court ruled that, as responsible corporate officers of Kingston, the petitioners are criminally liable by assenting to the commission by Kingson or by being grossly negligent in directing Kingson's affairs.

In *Fernandez*, Kingson imported steel products from China and paid around Php5 million in total duties and taxes. The Bureau of Customs found that Kingson underdeclared the value of the imported goods by almost 50%. The Commissioner of Customs seized and forfeited the imported goods.

Kingson filed a Petition for Review with the Court of Tax Appeals (CTA) assailing the forfeiture while the Government filed a criminal complaint against the corporate officers of Kingson for violation of Section 3602 in relation to Section 2503 of the TCCP.

SyCipLaw TIP 1:

The officer authorized to sign certified import documents, such as the IEIRD or the Single Administrative Document (SAD), should ensure the accuracy and truthfulness of the information provided in the said documents. The statements contained therein should be supported by proper and correct documentation.

Other corporate officers who exercise direct control and supervision in the management and conduct of the company affairs, although not signatories in the documents, must also do their part to ensure that importation is made in accordance with law.

The CTA First Division, CTA *En Banc* and the Supreme Court all found that the entry of the imported goods was made by means of false or fraudulent shipping documents and that there was intent to evade the payment of taxes and duties in violation of Section 3602 in relation to Section 2503 of the TCCP. A review of the certified true copies of the export documents from China in relation to the Import Entry and Internal Revenue Declaration (IEIRD) and other supporting documents filed by Kingson showed glaring discrepancies as to the consignee's name, description of the imported shipment, and value of shipment, specifically:

a) The consignee in the export documents is not Kingson, but Solid Sea Products H.K.;

b) The description of the shipment in Kingson's documents state "2,406 bundles of steel products (SCM 440 round bar)," whereas the counterpart export documents indicate: "1,436 bundles of 10MM x 6M and 970 bundles of 12MMx6M or a total of 2,406 bundles";

c) The value of shipment as declared by Kingson is US$692,254.00, while the counterpart export documents indicate a value of US$1,281,271.86; and

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d) Kingson declared the shipment under Tariff Classification heading number No. 7228.60 at 1% rate of duty, while the actual classification of the same shipment based on the chemical analysis of the same steel product showed that it falls under heading number 7214.2000 at 7% rate of duty.

Under Section 2503 of the TCCP, undervaluation, misdeclaration in weight, measurement or quantity of more than thirty percent (30%) shall constitute *prima facie* evidence of fraud and the imported goods shall *ipso facto* be forfeited in favor of the Government. The Supreme Court ruled that both Kingson and petitioners failed to provide any plausible explanation for the glaring discrepancies (between the import documents that Kingson filed and the counterpart export documents from the Chinese government), the burden of evidence having shifted to them. Hence, it can be concluded that Kingson and the petitioners willfully and intentionally misdeclared, misclassified, and reduced the value of the shipment by more than 30% to lower the amount of taxes and duties that Kingson should have paid.

The Supreme Court also stressed that Section 1301 of the TCCP imposes a definite burden on persons authorized by law to make the import entry and held that the statements under oath contained therein constitutes *prima facie* evidence of the importer's knowledge and consent of violations of the provisions of the TCCP when the importation was found to be unlawful. In this case, the Corporate Secretary's active part in the fraud was shown by her signature in the IEIRD containing the fraudulent information as Kingson's attorney-in-fact under the declaration that she "certify[ies] that the information contained in all pages of this Declaration and the documents submitted are to the best of our knowledge and belief are true and correct."

As regards the President, Vice-President, and Treasurer of Kingson, the Supreme Court ruled that there was circumstantial evidence to prove that these corporate officers, who are also the incorporators, board members, and stockholders of Kingson, undoubtedly knew of the importation of steel from China. First, their denial of the alleged fraud, insisting that Kingson's declarations were merely based on the documents provided by the foreign shipper, is pregnant with an admission, *i.e.*, that they were personally aware of the details of the shipment and the contents of the submitted importation documents. Second, the Corporate Secretary testified that when the defect in the documents was discovered, the corporate officers of Kingson had a meeting to rectify the same and an addendum was executed to correct the error. And finally, the corporate officers failed to rebut the fact that they assented or even permitted the falsification to happen, not only of the documents appended to the IEIRD, but also of the falsified chemical analysis in a bid to secure a lower tariff classification rate.

2. Can news articles be a valid basis of a tax assessment?

No. In *Spouses Pacquiao v. Commissioner of Internal Revenue* (CTA Case No. 8683, September 29, 2022), the CTA Special Third Division cancelled the deficiency income tax assessment against the taxpayers for lack of sufficient basis because news articles are "hearsay evidence, twice removed, and are thus without any probative value."

In this case, the income of spouses Emmanuel D. Pacquiao (Pacquiao) and Jinkee J. Pacquiao were sourced from the United States of America (US) and the Philippines. Their US-sourced income was derived from Pacquiao's boxing matches and the related pay-per-view shares and closed-circuit sales. Their Philippine-sourced income consisted of talent fees for product endorsements, advertising commercials, and television appearances. The spouses were assessed deficiency income tax for taxable years 2008 and 2009 amounting to PhP2,261,217,439.92, which they assailed by filing a petition for review with the CTA.

The tax assessment was based principally on news articles discussing the boxing purse of Pacquiao or the pre-agreed amount of money he will receive for completing a fight, and the related pay per view hits for each fight. In setting aside the tax assessment, the CTA ruled that the news articles cannot provide valid support for a tax assessment because their authors have no personal knowledge on the transactions involved. Also, no other evidence corroborated the information contained in the news articles. Finally, it was not shown that the revenue officers conducted due diligence to confirm the veracity of the news articles.

While the CTA recognizes that the Commissioner of Internal Revenue (CIR) has the power to issue tax assessments based on the best evidence obtainable in the absence of accounting records or when they are false, incomplete, or erroneous pursuant to Section 6(B) of the Tax Code, as amended, the CTA held that this power cannot be exercised arbitrarily and capriciously. In addition, the CTA ruled that the taxpayers' rights to due process were violated when the Formal Letter of Demand (FLD) here only stated that the deficiency income tax assessment is based on the alleged "best possible sources," without specifying the source documents used as basis. The CTA further noted that the FLD made no reference to the news articles, and it was only during the hearing of the case that these articles were presented.

A motion for reconsideration of the decision is currently pending.

CTA decisions, while persuasive, do not become the law of the land, unlike decisions of the Supreme Court.

SyCipLaw TIP 2:

Under Section 228 of the Tax Code, an assessment is void if it does not inform the taxpayer of the law and the facts on which it is based. A tax assessment cannot be based solely on news articles because news articles are hearsay evidence and cannot be proof of facts. Therefore, a taxpayer should carefully examine a tax assessment issued against it and determine if the tax assessment has factual and legal bases.

3. For the sale of service (other than processing, manufacturing, or repacking of goods) to a foreign corporation doing business outside the Philippines to be considered a value-added tax zero-rated sale, does the relevant service agreement have to specifically state that the services are to be performed only in the Philippines?

Yes. In *Procter & Gamble International Operations SA-ROHQ v. Commissioner of Internal Revenue* (CTA Case Nos. 9768 & 9829, October 5, 2022), the CTA First Division ruled that the taxpayer, which is the Regional Operating Headquarters of a foreign corporation, is not entitled to a value-added tax (VAT) refund, or the issuance of a tax credit certificate (TCC) of its unutilized input VAT allegedly attributable to zero-rated sales of service, for its failure to establish that the services it rendered to its client-affiliates abroad were performed in the Philippines. The CTA found that the service agreements between the taxpayer and its client-affiliates do not categorically state that the services shall be performed by the taxpayer in the Philippines only.

In this case, the taxpayer filed with the Bureau of Internal Revenue – Large Taxpayers Services Regular Audit Division, an administrative claim for refund of and/or the issuance of a TCC for the first quarter of fiscal year (FY) 2016, covering the period from July 1 to September 30, 2015, in the amount of PhP37,374,865.93, and the second quarter of FY 2016, covering the period from October 1 to December 31, 2015, in the amount of PhP14,367,836.27.

SyCipLaw TIP 3:

In order to ensure that the taxpayer may successfully claim a VAT refund for its unutilized input VAT attributable to sale of services (other than processing, manufacturing or repacking of goods) to a foreign corporation doing business outside the Philippines, or to a non-resident person not engaged in business who is outside the Philippines under Section 108(B)(2) of the Tax Code, the relevant service agreement between the taxpayer and its client-affiliate should categorically provide that the contracted services will be performed only in the Philippines. If the services are rendered outside the Philippines, then the services will be exempt from VAT but no claim for refund of input VAT may be made.

The CIR neither approved nor denied the administrative claim for refund for the period covering July 1 to September 30, 2015. On the other hand, the CIR denied the administrative claim for refund for the period covering October 1 to December 31, 2015. Thus, the taxpayer filed separate petitions for review for both claims, which were eventually consolidated and heard by the CTA.

In denying both claims for refund, the CTA ruled that it is indispensable that the taxpayer is able to prove that the services it rendered to its client-affiliates were rendered in the Philippines and not abroad in order for such sales to be treated as VAT zero-rated sales. Here, all the service agreements contain a standard provision providing that the taxpayer shall not be construed to provide services to its client-affiliates outside of the taxpayer's normal place of business "other than on an occasional basis." The CTA interpreted the phrase "other than on an occasional basis" to mean that the taxpayer may render services both in the Philippines and abroad. Thus, the taxpayer failed to prove that the services here were actually performed in the Philippines only and not abroad.

A motion for reconsideration of the decision is currently pending.

CTA decisions, while persuasive, do not become the law of the land, unlike decisions of the Supreme Court.

4. Are the Filipino employees of the Asian Development Bank exempt from income tax?

No. In *Aliboso v. Commissioner of Internal Revenue* (CTA EB Case No. 2136 [CTA Case No. 9087], October 7, 2022), the CTA *En Banc* affirmed the CTA First Division's decision and ruled that the taxpayers, who are all Filipino employees of the Asian Development Bank (ADB), are not entitled to income tax refund because the relevant treaty and statutes show that the Philippine Government intended to tax their compensation.

In this case, the CIR issued Revenue Memorandum Circular (RMC) No. 31-2013, which provides that Filipinos who are employed at ADB are subject to Philippine income taxes. RMC No. 31-2013 was given retroactive effect and the taxpayers were ordered to pay income taxes for taxable years 2012 and 2013, which they paid accordingly. The taxpayers then filed a claim for refund with the CIR, who failed to act on the claim. Consequently, the taxpayers filed a petition for review with the CTA, which was denied.

On appeal, the CTA *En Banc* ruled that the Filipino employees of ADB are not exempt from income tax, under Section 45(b) of the Republic of the Philippines – ADB Agreement, because it specifically provides that the tax exemption granted therein is "subject to the power of the Government to tax its nationals." Also, Article 56(2) of the ADB Charter provides the following exception to the grant of tax exemption therein – "except where a member deposits with its instrument of ratification or acceptance a declaration that such member retains for itself and its political subdivisions the right to tax salaries and emoluments paid by the Bank to citizens or nationals of such member." Here, the CTA *En Banc* ruled that the Philippine Government reserved its right to tax the Filipino employees of ADB through Senate Resolution No. 6 dated March 16, 1966.

SyCipLaw TIP 4:

A tax exemption is never presumed. It should be clearly and expressly granted under a law or treaty. Therefore, a taxpayer currently claiming and enjoying exemption from a tax must ensure that the exemption has clear basis under the law or a treaty. Even a long-standing practice by the BIR of not collecting the tax from a taxpayer cannot give rise to a right to claim a tax exemption.

The taxpayers also argued that there was a long-standing practice by the Bureau of Internal Revenue (BIR) of not subjecting their salaries to income taxes, which should be considered a valid source of right for income tax exemption in their favor. The CTA *En Banc* denied this contention and ruled that the alleged long-standing practice cannot ripen into a tax exemption because there is no law or treaty explicitly providing for such exemption. The CTA *En Banc* ruled that "[b]asic is the rule that tax exemption represents a loss of revenue to the government and must, therefore, not rest on vague inference. Exemption from taxation is never presumed. For tax exemption to be recognized, the grant must be clear and express; it cannot be made to rest on doubtful implications."

A motion for reconsideration of the decision is currently pending.

CTA decisions, while persuasive, do not become the law of the land, unlike decisions of the Supreme Court.

5. What are the guidelines on the procedures and requirements for the payment of taxes upon the exercise of equity-based compensation granted by employers to their employees?

On November 8, 2022, the BIR issued Revenue Memorandum Circular No. 143-2022 (RMC No. 143-22) setting out the guidelines on the implementation of Revenue Regulation (RR) No. 13-2022 dated October 7, 2022 (discussed in our October 2022 TIPS). RR No. 13-2022 provides that regardless of the employee's rank, equity-based compensation shall be treated as compensation subject to income tax, and consequently, to withholding tax on compensation, upon the employee's exercise of such equity-based compensation.

Is the grant of equity-based compensation subject to Capital Gains Tax (CGT) and Documentary Stamp Tax (DST)?

No, the grant of equity-based compensation, whether with or without an option price, is not subject to CGT, since there is no realized gain on the part of the employer-grantor. The grant is likewise not subject to DST.

Is the sale, barter, or exchange by the employee-grantee of the granted equity-based compensation subject to tax?

Yes, the sale is treated as a sale, barter, or exchange of stocks not listed on the stock exchange may be subject to the 15% CGT imposed under Section 24(C) of the Tax Code, as amended, or to the 6% donor's tax.

If the equity-based compensation was granted with an option price, the difference between the sales price and the option price shall be subject to CGT.

If the equity-based compensation was granted without an option price, the cost base of the option for purposes of computing the capital gains is zero.

If the transfer was without consideration, the transfer is subject to donor's tax and the tax base shall be the fair market value (FMV) of the option at the time of the donation.

What taxes will be due on the exercise of the equity-based compensation?

When the option is exercised, the difference between the book value and FMV of the shares, whichever is higher, at the time of the exercise and the price fixed on the grant date, shall be considered additional compensation subject to income tax and to withholding tax on compensation (WTC). This rule applies to the exercise of equity-based compensation granted by employers involving its own shares or shares of stock it owns to its employees, whether rank-and-file, supervisory, or managerial employees.

Upon exercise, DST shall be imposed on the actual issuance of shares to the employee/grantee in line with Sections 174 and 175 of the Tax Code.

If the granted equity-based compensation is transferable to the employee-grantee's successor/heirs in case of death, what taxes will be due upon exercise of the same by such successors/heirs within the prescribed exercise period?

The difference between the book value and FMV of shares, whichever is higher, at the time of the exercise of the granted equity-based compensation and the price fixed on the grant date, shall be considered as a donation subject to the 6% donor's tax.

What are the tax return requirements of the employer-grantor for equity-based compensation?

For equity-based compensation exercised starting October 29, 2022, the employer-grantor shall file the following BIR Forms starting November 2022:

a) BIR Form No. 1601-C (Monthly Remittance Return of Income Taxes Withheld);

b) BIR Form No. 1604-C (Annual Information Return of Income Taxes Withheld on Compensation); and

c) BIR Form No. 2316 (Certificate of Compensation Payment/Tax Withheld).

For equity-based compensation exercised by managerial or supervisory employees prior to October 29, 2022 (which is the effectivity date of RR No. 13-2022), the employer-grantor is still required to file the following tax returns relating to the equity-based compensation:

a) BIR Form No. 1603-Q (Quarterly Remittance of Final Income Taxes Withheld on Fringe Benefits Paid to Employees Other Than Rank and File) –

    i. On or before October 31, 2022 relating to equity-based compensation exercised during the third quarter of year 2022; and/or

    ii. On or before January 31, 2023 relating to the equity-based compensation exercised any time from October 1 to 28, 2022;

b) BIR Form No. 1604-F (Annual Information Return of Income Payments Subjected to Final Withholding Taxes); and

c) BIR Form No. 2306 (Certificate of Final Tax Withheld at Source).

What other reportorial requirements should the employer-grantor comply with regarding equity-based compensation?

Within 30 days from the grant of the equity-based compensation, the employer/grantor (the issuing corporation) must submit to the Revenue District Office where it is registered a statement under oath indicating the following:

a) Terms and Conditions of the stock option;

b) Names, TINs, positions of the grantees;

c) Book value, FMV, par value of the shares subject of the option at the grant date;

d) Exercise price, exercise date/ and/or period;

e) Taxes paid on the grant, if any; and

f) Amount paid for the grant, if any.

During the exercise period, the employer/grantor must file a report on or before the 10th day of the month following the exercise stating the following:

a) Exercise Date;

b) Names, TINs, positions of those who exercised the options;

c) Book value, FMV, par value of the shares subject of the option at the exercise date/s;

d) Mode of settlement (i.e., cash, equity); and

e) Taxes withheld on the exercise, if any.

SyCipLaw TIP 5:

Employers-grantors should take note of the changes in the tax treatment of employee stock options plans especially as they relate to the taxation of stock options granted to managerial and supervisory employees. Employers-grantors should also be mindful of the reporting requirement upon granting the equity-based compensation and upon the exercise of such equity-based compensation and the appropriate tax returns to be filed upon the exercise of their employees' equity-based compensation prior to or after the effectivity of RR No. 13-2022. While neither RR No. 13-2022 nor RMC No. 143-22 expressly provides the penalties for failure to comply with the requirements, the employer-grantor may be subject to the corresponding penalties provided under the Tax Code such as fines and/or imprisonment for wrong venue or for failing to supply information as may be required under the BIR's rules and regulations.