ANATOMY OF THE PHILIPPINE TAX SYSTEM

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In any attempt to dissect the Philippine tax system and subject it to impartial and objective study, the researcher immediately discovers that he cannot escape making a pre-diagnostic impression: The Philippine tax system needs a good shot in the arm if it is to continue pumping the lifeblood of the nation.

Few will dispute the decrepit state of the country's revenue structure. Considering that the tax structure is a decisive implement in the molding of social, political and economic patterns, we have not ceased to wonder why no positive steps have as yet been taken to renovate it completely.

It would seem that nothing short of an over-all and thoroughgoing revision is necessary in order to adapt our anachronistic revenue structure to these fast-changing times.

This article will delineate some of the problem areas which have made the Philippine tax system the enfeebled instrument for the achievement of social and economic justice that it is today.

Techniques of Tax Evasion and Tax Avoidance

The twin problems of tax evasion and tax avoidance have long plagued Philippine public revenue administration. Not too many people realize it, perhaps, but the enormous extent by which tax dodgers have held back our country's social and economic progress would stagger the imagination. Some two years ago, for instance, our revenue people estimated that no less than ₱130,000,000.00 were lost to the government as a result of outright tax evasion.[1] But due to a faulty and ill-enforced system of tax administration coupled with the misdirected ingenuity of a sizable number of taxpayers themselves, it is safe to assume that a like amount, at the very least, is similarly dissipated year after year. Tax dodging, in fact, has become a science all by itself and now constitutes one of the most lucrative fields in the practice of law and accounting.

It seems rather superfluous to say that the government must no longer tolerate this sort of flagrant and contemptuous regard for our tax laws. With the annual budget running past the billion-

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[1] With ₱130 million in the public till, the Joint Legislative-Executive Tax Commission said the government could have:

(1) Built 1,270 kilometers of good asphalt road;

(2) Maintained 2,400 rural health centers; and

(3) Kept 1,077,000 pupils and students in our public schools.

peso mark, and its only trend is to soar some more if basic public services are to be supplied an exploding population, tax evasion and tax avoidance have to be reduced to a minimum.

But what is tax evasion? And how does it differ from tax avoidance?

The distinction lies in the realm of split-hair semantics. Actually, the way tax evasion and tax avoidance are practiced in this country makes it extremely difficult to determine where tax avoidance ends and tax evasion begins. What would you call a wage earner, for example, who falsely states that he is the head of family in order to minimize his income tax? Is his case any different from one who deliberately fails to file an income tax return?

At any rate, some kind of distinction between tax evasion and tax avoidance has to be drawn up, even if its uses should prove theoretical at best. As Judge Learned Hand once said, "there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands; taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant."

"Tax evasion is the elimination or reduction of one's correct and proper tax by fraudulent means. It involves the violation of the civil or criminal provisions of the Code." [2] Former Congressman Artemio M. Lobrin, one of the country's best known tax experts, says that "evasion is shrouded in an atmosphere of fraud, and usually involves falsification, deceit, subterfuge, concealment, some deliberate attempt to make things appear other than what they are." [3]

Tax avoidance, on the other hand, refers to the "exploitation by a taxpayer of legally permissible alternative tax rates or methods of assessing taxable property or income, in order to reduce tax liability. The term may be extended to include situations where a person refrains from engaging in some activity or enjoying some privilege in order to avoid the incidental taxation." [4] Sometimes, some truly smart taxpayer hits upon a brainstorm, and notwithstanding the absence of any business reason, creates a transaction that will give him benefits. This is likewise a species of tax avoidance.[5]

[2] Sydney A. Gutkin and David Beck, *Tax Avoidance v. Tax Evasion* (New York: Ronald Press, 1958), p. 21.
[3] Artemio M. Lobrin, "Tax Fraud Investigations," *The Accountant's Journal*, December, 1956. p. 265.
[4] Harold S. Sloan and Arnold J. Zurcher, *A Dictionary of Economics* (New York: Barnes & Noble, 1953), p. 316.
[5] Gutkin and Beck, *op. cit.*

A United States senator, differentiating the two terms said: "A man approaches a river which can be crossed by two bridges, one a toll bridge and the other a free bridge. If he passes on the toll bridge and fails to pay the toll, this is tax evasion. If, however, he crosses by way of the free bridge, this is tax avoidance."

We will deal presently with those of us who use the toll bridge without paying the toll.

Unscientific Tax Legislation

Our tax system's easy susceptibility to tax mitigating devices is the result of an evolutionary process characterized by piecemeal revisions, slapdash amendments, slipshod experimenting with tax concessions, and a generally unscientific method of cluttering the revenue structure with a passel of special tax laws.

Take the sumptuary tax on playing cards, for example. Seven years ago, when the specific tax on playing cards was only three pesos per deck, collections reached as high as ₱350,000 every year. But in 1956, the tax was raised *from three pesos* to ten pesos.[6] What happened? The specific tax collections from this source almost dropped to zero. Collection figures in 1960, for instance, showed the unbelievable sum of ₱190 only. Does this mean that only nineteen decks of playing cards were sold in the entire year of 1960? This is, of course, a ridiculous assumption. The crash dive in collections may be attributed to the fact that the tax was stretched to the limit, nearly ten times the actual cost of a deck of playing cards itself, that tax evasion became a profitable risk. Meantime, "blue seal" playing cards are making the rounds of gambling joints all over the country—all because of a tax law which does not work. Apparently, the levy has overshot the so-called psychological limit to taxation, the point beyond which people would rather escape the burden than pay.

The moral of this story is that tax rates can only be raised up to a point. As tax rates become higher, the incentive to evade payment is correspondingly increased. Indeed, the gain realized from outright evasion may be much greater than the profit from a strictly legal management of the business, as in the case of playing cards. A tax of one peso on a pack of American king-size cigarettes, for instance, accounts for the widespread popularity of the "blue seal" variety.

[6] See Rep. Act No. 1608.

Built-in Loopholes

In many instances, king-size loopholes have been written, intentionally or unintentionally, into our tax laws, thanks to powerful pressure groups whose dubious and, at times, corrupting influence can not be more felt than when tax and other revenue bills are being deliberated upon. Indeed, one of the great handicaps against which our Congress tries to do its job is the unceasing, often immoral pressure brought to bear by the members of its "third house"—the lobbyists.[7]

The tax on capital gains, as one particular example, is wide-open. Let us suppose that an individual purchases a capital asset in 1962 for ₱100,000. Let us assume further that this particular capital asset earns yearly an increment of ₱10,000. Say that he dies in 1982 and that his son inherits the asset. No capital gains tax will ever be paid on the ₱200,000 accretion in value because the son will now have to adopt a new base for his own subsequent tax liability. This new tax base will be the market value at the time the inheritance vests. Thus, the ₱200,000 capital gain is never subjected to the capital gains tax at all. Or, if in selling a capital asset a huge profit stands to be realized, the vendor may have the contract drawn up to be a combination of a *contract of sale* and a *contract to sell,* the acquisition of ownership over the whole *res* ostensibly spread over a number of years. Again, sales by parts may be done from year to year. This way, the income tax liability on capital gains is pushed down to much lower brackets.[8]

Sales taxes on the articles enumerated under Sections 184, 185, 185-A, and 186 of the National Internal Revenue Code,[9] on the other hand, easily lend themselves to a somewhat circuitous tax mitigating gimmick. Since the sales or percentage tax is levied only once and only on the first or "original" sale or other transaction intended to transfer ownership, giant manufacturing firms rig up sister marketing corporations, disguised as separate and independent entities, and to whom they "sell" their finished articles at outlandishly low prices. The gimmick, essentially, is that the sales tax will be levied on this first transaction where the tax base is greatly reduced. These front companies, in turn, will market them to the public—now at very high and percentage tax-free prices. Although the Supreme Court is already wise to this brother-and-sister act,[10] the theory is per-

[7] Lobbying in Congress is regulated by Rep. Act No. 1827.

[8] *The Philippine Tax System,* Report of the Senate Finance Technical Staff to the Chairman, Senate Finance Committee, p. 245. (Typewritten).

[9] All references in this article to statutory sections refer to the National Internal Revenue Code (Com. Act No. 466), unless otherwise indicated.

[10] Koppel, Inc. v. Yatco, 77 Phil. 496; Yutivo Sons Hardware Co. v. Collector of Internal Revenue, G.R. No. L-13203, Jan. 28, 1961; and Liddell & Co., Inc. v. Collector of Internal Revenue, G.R. No. L-9687, June 30, 1961. Thus, in the Liddell case, the high court upheld the respondent

fectly sound where the corporations involved can show that they are truly independent of one another.

Or take the case of automobiles. Under Section 184, automobiles are classified as luxury items, and must therefore pay a percentage tax which ranges from fifty to one hundred per cent of their selling price. Yet, it is entirely possible for an importer to mitigate his tax liability a great deal by importing unassembled automobiles. This is because our lobbyists succeeded in inserting the following "escape" proviso in Section 184(a), ". . . ; *Provided,* however, that parts and accessories of automobiles imported as replacements or as *completely knocked down parts for assembly* of automobiles shall be subject to tax under Section one hundred eighty-six. . . ." Note that the tax imposed under Section 186 is seven per cent of the selling price.

Quite unintentionally this time, the passage of Republic Act No. 3029 which added Section 185-A to the Tax Code wrote into the law a loophole as big as life for importers of refrigerators and air-conditioners. Due to the fact that Congress failed to amend Section 183(b) also in correlation with its amendment of Section 185, importers of refrigerators and air-conditioners now do not have to pay the sales tax on these articles in advance, and on their landed cost alone without the fifty per cent mark-up which originally attached to it under Section 185.

Likewise, the individual income tax can be rendered naught by a wealthy man who may create a personal holding company to which he transfers all his stocks, bonds, notes, and other similar income-producing property. Roughly, the idea is to constitute one's self into a corporation which then pays the tax on any income received, now at much lower corporate income tax rates, *i.e.,* 22 per cent on the first ₱100,000-net income and 30 per cent on the excess.[11]

Independent professional men—lawyers, doctors, dentists, architects, accountants—are notorious tax evaders. Their fees, for which they generally issue no receipts, are not subject to the withholding tax, and only God knows how much income escapes the income tax this way. In fact, the privilege tax on occupation is probably the most evaded tax of all. In 1961, for instance, only three jockeys paid their privilege tax in spite of the fact that racing forms list

Commissioner and ruled that the Liddell Motors, Inc. was but an *alter ego* of Liddell & Co., Inc., and that for sales tax purposes, the sales made by Liddell Motors, Inc. to the public should be considered as the original sales of the Liddell & Co. But see also Norton and Harrison Co. v. Collector of Internal Revenue, CTA Case No. 254, Aug. 22, 1960.

[11] See Section 24. Individual income tax rates, on the other hand starts from three per cent on the first ₱2,000 net income to 60 per cent of all net income above ₱500,000. (See Section 21, as amended by Rep. Act No. 2843.)

at least a hundred different jockeys Saturday after Saturday and Sunday after Sunday. Handsomely paid actors and actresses are no different breed; only three of them remembered to secure their professional licenses last year.[12]

The tricks of the tax evasion trade are obviously as many and varied as the number of tax evaders who employ them. But some of the more common ones are the wilful failure to keep books of accounts, non-issuance of receipts for professional services, declaration of fictitious expenses, under-declaration of income, false allocation of income, improper deductions, improper claims for exemptions, declaration of fictitious liabilities, statement of mythical business losses, false claims of exemptions as head of family, double sets of books, bank accounts under assumed names or secret bank accounts, overstatement of deductions, and so forth. It is, of course, possible that errors might result from an honest but mistaken interpretation of the law, from the honest reliance on the erroneous advice of third parties, or from the mistakes of incompetent bookkeepers and accountants.[13]

Thus, the tax structure is termite-eaten with a lot of loopholes through which tax evaders play hide-and-seek with revenue enforcers. A study of loopholes is specially important since "the significance of loopholes increases geometrically as the tax advances in rates and importance." Our congressmen should particularly guard against an unmethodical and unscientific handling of tax laws. Tax legislation in this country, or anywhere else, has not as yet attained that degree of sophistication as to eliminate altogether the incidence of loopholes. When tax laws are enacted, the chances that they have loopholes are great. Taxpayers go to great lengths in employing them. New tax laws are passed to plug these loopholes, and they in turn generate new loopholes, and so on *ad infinitum*.[14]

One area which necessitates an urgent and keen reappraisal is our toothless provisions on penalties for tax evasion. A former Commissioner of Internal Revenue cites the case of one tax evader, for example, who was fined only twenty pesos notwithstanding the fact that state prosecutors drove themselves silly in their efforts to convict him. Another tax evader who was convicted for his failure to file an income tax return covering a tax assessment of about a million pesos was fined only ₱500.00.[15] In fact, the national peni-

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[12] Bureau of Internal Revenue, "Internal Revenue Taxes and Penalties Collected and Reported to the Bureau of Internal Revenue During the Fiscal Years 1960 and 1961," p. 2. (Typewritten).

[13] A. S. Pellard and G. J. Robinson, *Legal Instruments and Federal Taxation, Procedure, Transaction, Forms; The Lawyers' Tax Manual*, 2nd ed. (New York: C. Boardman, 1960), p. 303.

[14] Gutkin and Beck, *op. cit.*, p. 10.

[15] Artemio M. Lobrin, *op. cit.*, p. 264.

tentiary at Muntinlupa has yet to be honored by the presence of a tax evader.

But though the loss of revenue from widespread tax evasion in this country should be a matter of grave concern, the greater danger springs from the well-nigh possibility that an even more widespread disrespect for law and order may be engendered. As a noted economist so aptly pointed out, "if the taxpayer feels that he is discriminated against because his neighbors are evading while he is not, any propensity to evade in order to increase his disposable income is strengthened by a propensity to evade in order to escape injustice. If this situation develops, a widespread violation of law occurs, and the spirit of disrespect may well be transferable to other legal areas." [16]

"Sitting" on Tax Cases

Two of the most disquieting provisions in the Tax Code which have actually become illegitimate, but still legal, aids to tax evasion are Sections 331 and 332. Originally intended to secure to the taxpayer some measure of protection from the harassing proclivities of corrupt revenue agents, they have in fact become the primary instruments by which the government stands defrauded of millions of pesos every year. They provide:

> "Sec. 331. *Period of limitation upon assessment and collection.*—Except as provided in the succeeding section, internal revenue taxes shall be assessed within five years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period. For the purpose of this section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day: *Provided,* That this limitation shall not apply to cases already investigated prior to the approval of this Code."

> "Sec. 332. *Exceptions as to period of limitation of assessment and collection of taxes.*—
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> (c) Where the assessment of any internal revenue tax has been made within the period of limitation above prescribed, such tax may be collected by distraint or levy or by a proceeding in court, but only if begun (1) within five years after the assessment of the tax, or (2) prior to the expiration of any period for collection agreed upon in writing by the Collector of Internal Revenue and the taxpayer before the expiration of such five-year period. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon."

[16] Philip E. Taylor, *Economics of Public Finance,* Rev. Ed. (New York: MacMillan, 1953), p. 553.

In other words, if tax liabilities are not acted upon within a certain period—a maximum of ten years in our jurisdiction—legal remedies for their collection could no longer be instituted. Thus, the government is given five years within which to assess internal revenue taxes from the time returns were filed. Upon the expiration of this five-year period, no judicial action for the collection of delinquent taxes could be maintained. Observe that even if assessments were made within that prescribed period, the government has likewise only five years from the time assessments were actually made within which to go after the recalcitrant taxpayer by distraint or levy or by a proceeding in court.[17]

Before the enactment of the National Internal Revenue Code, the government went by the rule that "the right of the State to collect taxes does not prescribe; that the right of laches does not apply to the government; that the State does not forfeit rights by the inertness of its officers in the collection of taxes; and that a debt due the State cannot be cancelled by an officer's inaction." In proposing this statute of limitations on tax cases, the Tax Commission of 1939, chairmanned by the late President Manuel Roxas who was then secretary of finance, observed that "just as the government is interested in the stability of its collections, so also are the taxpayers entitled to an assurance that they will not be subjected to further investigation, for tax purposes, after the expiration of a reasonable period of time." [18]

The Supreme Court further amplified this rule of prescription in the following wise: [19]

> "The law prescribing a limitation of actions for the collection of the (income) tax is beneficial both to the Government and to its citizens; to the Government because tax officers would be obliged to act promptly in the making of assessments, and to citizens because after the lapse of the period of prescription citizens would have a feeling of security against unscrupulous tax agents who will always find an excuse to inspect the books of the taxpayers, not to determine the latter's liability, but to take advantage of every opportunity to molest peaceful, law-abiding citizens. Without such a legal defense, taxpayers would furthermore be under obligation to keep their books and keep them open for inspection subject to the harassment by unscrupulous agents. The law on prescription being a remedial measure should be interpreted in a way conducive to bringing about the beneficent purpose of affording protection to the taxpayer within the contemplation of the commission which recommended the approval of the law."

[17] In case the taxpayer intends to evade, and files a false or fraudulent return or none at all, the tax may be assessed or judicial action for its collection (even without assessment) can be begun at any time within ten years after the discovery of the falsity, fraud or omission. See Section 332(a).

[18] *Report of the Tax Commission of the Philippines on National Internal Revenue Laws* (Manila: Bureau of Printing, 1939), Vol. II, pp. 321-322.

[19] Republic v. Ablaza, G.R. No. L-14519, July 26, 1960.

But has the law on prescription of tax actions really worked this way? Are our tax officers the more prompt, the more conscientious in their assessing and collecting tasks because of it?

Actually, Section 331 and Section 332 have only succeeded in lending themselves to the nefarious schemes of dishonest internal revenue men and would-be tax evaders to cheat the government of enormous sums in otherwise perfectly collectible revenue. For the correct under-the-table fee, one's case can always be transferred and retransferred to the bottom of an ever-mounting pile, and the Bureau of Internal Revenue will just "sit" on it until the statute of limitations runs out on the State. This is an easy thing to do considering that an average of 450,000 returns are filed every year to be assessed by a grossly inadequate revenue staff of 1,126 examiners. As of July 1, 1962, for instance, there are no fewer than 96,407 delinquent accounts which in the aggregate amount to ₱185,567,514.46.[20] These figures, please note, represent only those returns which have already been assessed. Undoubtedly, those returns which have not yet been assessed represent a much bigger figure. The odds are better than 400 to one against your return being missed at the top of the tax heap.

Dooming the Doomage Power

One piece of legislation which has only succeeded in drawing mocking circles around our revenue laws is Republic Act No. 1405—an act which cloaks bank deposits with nearly absolute secrecy.[21] Designed to discourage private hoarding so that deposits will be made more readily available by banking concerns for the economic development of the country, Republic Act No. 1405 has only succeeded in hamstringing all government efforts to ferret out the truly big tax evaders.

The sacrosanct nature of bank deposits has, in effect, doomed the Commissioner of Internal Revenue's doomage power, his one effective weapon against unscrupulous taxpayers who may have been defrauding the government over a period of years.[22] It will be noted that under Section 15 of the Tax Code, "when a report required by law as a basis for the assessment of any national internal-revenue tax shall not be forthcoming within the time fixed by law or regulation, or when there is reason to believe that any such report is false,

[20] Memorandum from Antonio P. Non, Chief of the Accounting Machines Division to the Chief of the Statistical Division, Bureau of Internal Revenue, July 24, 1962.

[21] Rep. Act No. 1405 was approved on September 9, 1955.

[22] Bank deposits may only be looked into upon the written permission of the depositor, or in cases of impeachment, or upon order of a competent court in cases of bribery or dereliction of duty of public officials or in those cases where the money deposited or invested is the subject matter of the litigation. (Sec. 2, Rep. Act No. 1405).

incomplete or erroneous, the Commissioner of Internal Revenue shall assess the proper tax on the best *evidence obtainable.*" (Italics supplied). And in cases of wholesale income tax evasion, it most oftentimes happens that the "best evidence obtainable" is the net worth method of tax investigation. Under this method, the government tries to establish an "opening net worth" or total net value of the suspected tax evader's assets at the beginning of a given year, after which the government adds the increments in the taxpayer's net worth for each succeeding year during the entire period under examination. It then estimates the difference between the adjusted net values of the taxpayer's assets at the beginning and the end of each of the various years involved. Non-deductible expenditures such as living expenses are added to these increments, and if the final figure for any one year is substantially bigger than the taxpayer's reported taxable income for the year, the government then has an almost air-tight case for income tax evasion. But Republic Act No. 1405 has practically repealed Section 15, the basis of the Commissioner's doomage power, since it renders the net worth method of tax investigation virtually obsolete.[23]

Clearly, Republic Act No. 1405 must be repealed. It has only served as a legal shield to ward off government attempts in flushing out illicitly hidden fortunes in the inviolable sanctuary of bank vaults.

The Compromise Power: Last Refuge for Tax Evaders?

In the hierarchy of powers granted the Commissioner of Internal Revenue, none could be more subject to misuse and abuse than his power to compromise civil and criminal cases arising under the Tax Code or other laws administered by the Bureau of Internal Revenue.[24] Section 309 which gives him this *carte blanche* authority to mitigate one's tax liability provides:

> "Sec. 309. *Authority of Collector to make compromises and to refund taxes.*—The Collector of Internal Revenue may compromise any civil or other case arising under this Code or other law or part of law administered by the Bureau of Internal Revenue, may credit or refund taxes erroneously or illegally received, or penalties imposed without authority, and may remit before payment any tax that appears to be unjustly assessed or excessive.
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> "* * * * * * * *"

Thus, to compromise tax controversies or not rests within the Commissioner's absolute discretion and no legal authority on earth

[23] Melecio Domingo, "Suggestions for the Improvement of Our Tax System," *Philippine Tax Journal*, February, 1959, p. 65.

[24] The power to compromise tax cases has likewise been delegated to Regional Directors of the Bureau of Internal Revenue where deficiency tax assessments do not exceed ₱10,000.00.

can compel him to act one way or the other.[25] According to its most ardent supporters, the power to compromise fills a yawning legal gap and its exercise is encouraged because of the complexities and problems of proof involved in tax laws.

There is no denying the fact, however, that like all powers, this power to compromise has often lent itself to unwholesome practices. There have been many instances where this power has been flaunted rather laxly, thus encouraging taxpayers to evade or put off as much as possible the payment of their just tax obligations. Anyway, whenever they might be discovered, they can always hope to enter into a compromise with the Bureau of Internal Revenue in which they are usually made to pay an amount very much smaller than the tax which is actually and legally due from them. Once, it was revealed by the Secretary of Finance, himself, a deficiency tax assessment running into ₱2,400,000 was compromised for the piddling sum of ₱15,000.[26] And the field is abundantly fertile for its exercise. In an eight-month period during 1960, there were no less than 9,977 deficiency tax assessment cases.[27]

Needless to say, amendment to this provision must be enacted in order to curtail the Commissioner's unlimited compromise power. Such a limitation would forestall the dubious extra-judicial settlement of huge deficiency tax assessments by the payment of nominal amounts.[28]

Even in the United States whose people's tax morality is the envy of all nations, this power to compromise tax cases has not been lightly conferred, thus rendering the possibility of collusion between taxpayers and revenue authorities virtually nil.

Thus, only the secretary of the treasury may compromise civil or criminal cases arising under Federal internal revenue laws, and only under certain specified conditions.[29]

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[25] Koppel, Inc. v. Collector of Internal Revenue, 48 O.G. 98.

[26] Cited in explanatory note to S. No. 577, authored by Sen. Rodriguez, Sr.

[27] Data culled from statistics compiled by the Joint Legislative-Executive Tax Commission.

[28] It is interesting to note that in the last session of Congress, Senate President Eulogio B. Rodriguez, Sr. introduced S. No. 577 designed to remove all authority from the Commissioner of Internal Revenue to compromise civil cases.

[29] The United States Internal Revenue Code of 1954 provides:

Sec. 7122. Compromises.

(a) *Authorization.*—The Secretary or his delegate may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.

(b) *Record.*—Whenever a compromise is made by the Secretary or his delegate in any case, there shall be placed on file in the office of the Secretary or his delegate the opinion of the General Counsel for the Department of the Treasury or his delegate, with his reasons therefore, with a statement of—

(1) the amount of tax assessed;
(2) the amount of interest, additional amount, addition to the tax or assessable penalty, imposed by law or the persons against whom the tax is assessed; and
(3) the amount actually paid in accordance with the terms of the compromise.

Notwithstanding the foregoing provisions of this subsection, no such opinion shall be required with respect to the compromise of any civil case in which the unpaid amount of tax assessed (including any interest, additional amount, additional tax or assessable penalty) is less than $500.

There can be no gainsaying the fact that the Commissioner's broad power to enter into compromise agreements with respect to civil or criminal cases arising under the Tax Code or other laws administered by the Bureau of Internal Revenue necessitates urgent re-examination in the light of our people's loose tax morality. In fraud cases and in those cases where the evidence of wilful malice to evade taxes is preponderant, the Commissioner should think twice before initiating steps toward settlement by compromise. Where the possibility of obtaining a conviction is strong, there should not even be the barest hint of compromise.

Equity in Taxation

No tax can be absolutely fair. This truism is one of the discouraging aspects of taxation. Still, this is no reason why our tax policy-makers should spare any effort to remove as much as possible elements of unfairness. It is said that a tax structure is fair enough if it helps in achieving the social and economic purposes of the nation; if it encourages desirable economic activity; whether it treats all equally-placed individuals equally; whether it readily lends itself to impartial administration.[30]

The Philippine tax system has often been criticized as being wracked with too many inequities. They question, for instance, the propriety in the manner of collecting percentage taxes on imported goods. Not only are imported articles under Sections 184, 185, and 186 given mark-ups of 100 per cent, 50 per cent, and 25 per cent, respectively, but the sales taxes imposed on them are also collected in advance. Thus, it would seem that our tax laws deny the importer the use of capital which is permitted local manufacturers of those same products. Importers make much of the fact that they can not obtain relief from the taxes they have paid until after they have sold their importations.

Again, under Section 89, judicial and funeral expenses, losses, indebtedness, and taxes are first deducted from the *common property of the decedent and the surviving spouse* before computing the estate tax. Only afterwards are their respective net shares in the conjugal partnership determined. The query has been posed: Why should judicial expenses in the testate or intestate proceedings be deducted from their common property when it is only the estate of the deceased which is open to succession?[31]

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[30] International Cooperation Administration, *Modernizing Government Revenue Administration* (Chicago: Public Administration Service, 1961), p. 11.
[31] *The Philippine Tax System, op. cit.*, p. 296.

It is also doubted whether present provisions on assessments and tax refunds can be defended on grounds of equity.[32] Section 306 gives taxpayers only two years after payment within which to make its assessment. This alleged tax inequity is proposed to be remedied by making both periods equally the same, that is, either two or five years.

The following sections of this article will discuss in some detail a number of tax discriminations which pit similarly placed groups of taxpayers against one another.

Insuring Against High Taxation

In any serious plan to eliminate all instances of tax discrimination in our revenue structure, life insurance companies will come in for the first drubbing.

Taxed at a scandalously low six-and-a-half per cent on its net investment income,[33] life insurance companies are, indeed, the sacred cow of corporate income taxation. It is not difficult to see that net investment income—the life insurance company's extremely delimited tax base—represents but a minimal portion of actual profits from its diverse operations.

This favored tax treatment becomes all the more glaring when it is considered that other forms of corporate enterprises, non-life insurance companies included, are taxed at 22 per cent on the first ₱100,000.00, and 30 per cent on the excess, of their net profits *from all sources.* In fact, life insurance companies are subject to a lower tax rate than educational institutions.

What makes this arrangement especially ridiculous is that life insurance companies used to be taxed just like other corporations, *i.e.*, 22 per cent on net income derived from all sources not exceeding ₱100,000.00 and 30 per cent on the excess. Then, the gross income of a life insurance company included net premiums, investment income, profits from sales of assets, and all such other gains, profits and income required to be reported by the Insurance Commissioner.

But due to a powerful lobby launched by one of the country's leading life insurance interests, Republic Act No. 1855—a law tailored according to its specifications— was finally squeeezed through the legislative mill in 1957. The law introduced a radical change in the method of taxing life insurance companies in that: (1) it

[32] J. S. Zulueta, "An Analysis of Our Tax Laws," *The Philippine Tax Journal*, January, 1957, Vol. 2, p. 7.
[33] This term automatically excludes premiums, capital gains, and the miscellaneous receipts of life insurance businesses which otherwise would constitute taxable income.

eliminated "premium receipts" from gross taxable income, and (2) provided for taxation only of "net investment income" from rents, interests and dividends at a flat rate of $6\frac{1}{2}$ per cent, instead of the old 22 or 30 per cent (as the case may be) on net profits derived from all sources.[34]

There seems to be little doubt that the tax situation of life insurance companies has become untenable in the light of present economic developments. In spite of its apparently risky prospects, life insurance companies are enjoying a business boom unlike any other form of corporation. By reverting to the old method of taxing life insurance companies, the government will accomplish two things with one stroke—do away with another instance of tax inequity and realize more revenues for the fast-emptying public vaults.

Can or Can't?

Another sector which has enjoyed a privileged panoply from the far-ranging sweep of the State's taxing powers comprises a small but compact group of agriculturists who put their products into tin cans before getting them to market.

The ambiguous provisions of the law, Section 188(b) of our timeworn Tax Code, has given them an undeserved tax haven at the expense of those food manufacturing concerns which purchase the agricultural products they stuff into cans. Section 188(b) states:

> "Sec. 188. *Transactions and persons not subject to percentage tax.*— In computing the tax imposed in sections one hundred eighty-four, one hundred eighty-five, and one hundred eighty-six, transactions in the following commodities shall be excluded:
>
> * * * * * * * *
>
> "(b) Agricultural products and the ordinary salt whether in their original form or not when sold, bartered, or exchanged in this country by the producer or owner of the land where produced, as well as all kinds of fish and its by-products when sold, bartered, or exchanged by the fisherman or fishing operator whether in their original state or not."

Notwithstanding this provision, however, the Commissioner of Internal Revenue slapped a ₱200,000-tax assessment against the Philippine Packing Corporation in 1954. The pineapple-packing firm contested the assessment all the way up to the Supreme Court where it was held that the exemption is not divested merely because the

[34] It is interesting to note that this method is a substantial copy of the U.S. Internal Revenue Code of 1954 on the point, before it was amended. But even the United States abandoned this net investment income theory of taxing life insurance companies in favor of the total income approach which was in force in this jurisdiction before Rep. Act No. 1855.

products themselves have undergone processing of some kind.[35] Thus, several large canning factories which raise their own crops do not pay any tax at all on the value of their production. Meanwhile other food processing factories which only buy the fruits and vegetables which they preserve in cans have to pay the seven per cent sales tax under Section 186 of the internal revenue code. The inequity in this arrangement all but announces itself.

Right after the decision in the pineapple-packing case, however, Congress enacted Republic Act No. 1612, amending Section 188(b), in order to bring within the effective mantle of the Tax Code the Philippine Packing Corporation and other food processing entities similarly situated. The law provided that only agricultural products *in their original form* were to enjoy the tax exemption. But for some curious reason, Congress scrapped this amendment and revived the exemption privilege.[36]

One does not have to draw bold lines to underscore this unjustified exemption and the inequity which it foists on other canning concerns which only buy their stuff. It is only fair that they be also taxed.

The Bench and the "Power to Destroy"

Justices and judges of our courts are the envy of all income earners in the Philippines. They pay no tax at all on their salaries. Indeed, they are "the untouchables" in our dreaded system of income taxation. It is about time they were made to pay like everybody else.

Utilizing the vagueness of the Constitution to build themselves a legislation-proof tax shelter, the Supreme Court decided that the salaries of members of the bench can not be subjected to income taxation since Article VIII, Section 9 of the Philippine Constitution prohibits the diminution of the salary of any judge during his term of office.[37] Such salaries, the high tribunal went on, must simply be excluded from the scope of the term "income" as it is taxed by the income tax law, otherwise it would be an infringement of the fundamental charter.[38]

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[35] Philippine Packing Corporation v. Collector of Internal Revenue, G.R. No. L-9040, December 26, 1956.

[36] Section 1, Rep. Act No. 1856, which took effect on June 22, 1957. It must be remembered though that for the period between August 24, 1956 and June 22, 1957, the Philippine Packing Corporation paid the 7% percentage tax on domestic sales of canned pineapple products pursuant to Rep. Act No. 1612.

[37] Perfecto v. Meer, 85 Phil. 552.

[38] Congress, in order to sidestep this decision, passed Rep. Act No. 590 in 1950, Section 13 of which provided that "no salary wherever received by any public officer of the Republic of the Philippines shall be considered as exempt from the income tax, payment of which is hereby declared not to be a diminution of his compensation fixed by the Constitution or by law." The Supreme Court, in the case of Endencia v. David, declared this particular provision as unconstitutional since Congress cannot arrogate unto itself the power to interpret constitutional provisions, this being an exclusive judicial prerogative.

It would seem that nothing less than a Constitutional amendment is needed to remedy this anomalous situation. Fortunately, it is not as complicated as all that. The Supreme Court itself has provided a clue by which future members of the judiciary, at least, may be made to pay their income tax.

In the *Perfecto v. Meer* case, the Supreme Court, in an *obiter dictum,* ventured the opinion that the legislature may validly provide by a law that salaries of judges appointed after its passage shall be subject to income tax. "No law having been enacted in the Philippines subjecting salaries of judges appointed after its passage to income tax, it could not be said that such a law would not be valid and effective as against the constitutional prohibition against diminution of judicial salaries, if adopted," the High Court said.

Thus, there remains no justifiable reason why the Congress should not now pass a law subjecting the salaries of judges to be appointed after its approval to our income tax laws since this is "merely to recognize that judges are also citizens, and that their particular function in government does not generate an immunity from sharing with their fellow citizens the material burden of the government whose Constitution they are charged with administering." [39]

Religious Schools v. the Taxing Power

Easily one of the more obvious inequities in our revenue system is the favored tax treatment of religious educational institutions.

Under our tax laws, corporations or associations devoted to purely religious and educational endeavors are exempted from the corporate income tax if no part of their net income inures to the benefit of any private stockholder or individual.[40] It has been decided by our Supreme Court that religious educational institutions come under this category since "under Section 27(e) of the Tax Code, an institution operated exclusively for educational purposes need not have, in addition, a charitable or philanthropic character to be exempt from income tax, provided no part of its net income 'inures to the benefit of any private stockholder or individual.' "[41] Non-sectarian universities and colleges, of course, are required to pay a ten per cent corporate tax on their net income since they are conducted for the private gain of a few individuals.[42]

[39] O'Malley v. Woodrough, 307 U.S. 277.

[40] See Section 27(e). The Philippine Constitution, furthermore, exempts from taxes all lands, buildings and other improvements used exclusively for religious or educational purposes.

[41] Jesus Sacred Heart College v. Collector, May 24, 1954, G.R. No. L 6807. Because of this decision, a deficiency tax assessment of P574,811.41 against the University of Sto. Tomas was summarily quashed.

[42] See Section 24.

But there is no gainsaying the fact that big religious schools are run for profit—not for the benefit of a few stockholders or individuals, perhaps, but for profit just the same. In recent years, a great many of these "exclusively" religious and educational corporations have gone beyond the stage of passive investment and engaged actively in multi-million peso commercial enterprises. Proposals to tax such income, therefore, have been loudly advocated even in the most advanced countries.[43]

In the Philippines, especially, there seems to be no justication whatever why such income should not share in government upkeep. It is widely known that religious educational institutions are practically operated on a business basis, charging their students much higher fees than their non-sectarian competitors. On the sole criterion of ability to pay alone, religions educational institutions have long lost their privileged tax position.

Franchise from Taxes

In the conglomerate of taxes found in our statute books, none probably looks more harmless in point of equity than the tax on franchises.[44] But in point of fact, our system of franchise taxation perpetrates one of the most blatant forms of inequity found anywhere in a revenue structure. Worse still, the public coffers are denied the full potential from this virtually untapped source as a consequence of the tax's limited operations.

As the law now stands,[45] industrial empires which are the lucky recipients of legislative franchises are practically untouched by the five per cent franchise tax levied under Section 259.[46] As a consequence, only municipal franchise holders are paying this five per cent tax.[47] It should be stressed at this point, too, that municipal franchise holders likewise are subject to the income tax and other business taxes.

Grantees of congressional franchises, on the other hand, are generally required to pay only a token one per cent to 2 per cent franchise tax, and this is "in lieu of all other taxes of whatever name and nature."[48]

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[43] Roy Blough, *The Federal Taxing Process* (New York: Prentice-Hall, Inc., 1952), p. 313.

[44] A tax on the franchise of a corporation, that is, on the right and privilege of carrying on business in the character of a corporation, for the purposes for which it was created, and in the conditions which surround it. *Black's Law Dictionary.*

[45] Philippine Railway Co. v. Collector, G.R. No. L-3859, March 25, 1952.

[46] It provides: "*Tax on Corporate Franchises.*—There shall be collected in respect to all existing and future franchises, upon the gross earnings or receipts from the business covered by the law granting the franchise a tax of five *per centum* or such taxes, charges, and percentages as are specified in the special charters of the grantees upon whom such franchises are conferred, whichever is higher, unless the provisions thereof preclude the imposition of a higher tax * * *"

[47] Municipalities are authorized to grant franchises for utility operations within their respective localities under Public Act No. 667.

[48] Thus, big public utility companies like the Philippine Long Distance Co., RCA Communications, Pan American World Airways, and some seventy other huge business combines whose

This situation, needless to say, cries out for immediate reform. Taxes are forced exactions, and the least the government can do is to assure those who pay them of utmost fairness in their application. Our system of franchise taxation sticks out like a sore thumb whenever equity, as a fundamental criterion in the exercise of the taxing power, is discussed. Section 259 must be made to apply even to holders of legislative franchises.[49]

Doubtless, many other tax provisions will not pass the test of equity and reasonableness. For every special tax favor, exemption, or favored rates of tax, for every peso of evaded taxes, the government must search for new sources of revenue to replace that which is lost, and this, in effect, places greater burdens of taxation on low income groups.[50]

Equity, as one of Smith's canons, is not to be taken lightly in any tax discussion. While it is true that it is next to impossible to make a tax system completely equitable, we must not falter in our constant re-examination of the National Internal Revenue Code to rid it of its more glaring inequalities.

Tax Administration and Enforcement

No tax system can conform with even the minimum standards of equity if it cannot be administered with a high degree of effectiveness. Indeed, the procedural methods for collecting money from taxpayers, for accounting for tax receipts, and for administering revenue programs constitute an area of primary concern.

In the Philippines, for instance, if all tax laws were strictly enforced and all taxes due were collected, the revenue receipts of the government would probably double or triple. But it is sad to note, however, that our revenue administration apparatus is not the well-oiled machine that it should be.

Summing Up

It is high time that the government did something to modernize and streamline our tottering tax structure. Born twenty-three

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net profits run into the millions pay only a piddling 1% to 2% franchise tax "in lieu of all other taxes." Meanwhile, penny-ante corporations which can boast only of municipal franchises pay not only the 5% franchise tax imposed under Section 259 of the Tax Code but also income and other taxes.

[49] Congress will not thereby be impairing the obligation of contracts. Section 8 of Article XIV of the Philippine Constitution provides that "no franchise or right shall be granted to any individual, firm or corporation, except under the condition that it shall be subject to amendment, alteration, or repeal by the Congress when the public interest so requires." The public interest certainly requires.

[50] AFL-CIO, "For A Fair Federal Tax Policy," *Labor's Economic Review*, June, 1956, p. 56.

years ago, the nation's Tax Code has already outlived its usefulness. Reinforced through the years with a passel of haphazardly-framed amendments, the Tax Code can no longer cope with any measure of adequacy with present-day social and economic developments. It was Adam Smith who said a century ago that a good tax system should possess the attributes of equity, certainty, convenience, and economy. The Philippine tax system has none of these.