REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

VJ PROPERTIES, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 5970

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

OCT 0 1 2002

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DECISION

This case involves an appeal for the cancellation and withdrawal of the assessment notices issued by the respondent against petitioner covering deficiency income tax and deficiency increments on creditable withholding tax for taxable years 1995 and 1996 in the aggregate amount of P2,884,842.71.

The material antecedents are as follows:

Petitioner is a corporation duly registered with the Securities and Exchange Commission, and was issued SEC Certificate of Registration No. 170382 and is primarily engaged in the business of acquiring by purchase, lease, or otherwise, and to own, develop, subdivide, sell, hold for investment or otherwise, real estate of all kinds, as stated in its Articles of Incorporation. It is a registered VAT taxpayer and was issued a Certificate of Registration with RDO Control No. 94-470-003757 and Taxpayer Identification No. 047-000-839-232V issued on January 15, 1992 by Revenue District Office No. 47 in Makati City (*pars. 1 & 2, Joint Stipulation of Facts*).

In 1995, petitioner constructed 14 townhouse units, which were referred to as "VJ Townhomes". In the same year, petitioner sold 7 units to various individuals for an aggregate selling price of P12,299,880.00 from which creditable taxes of P1,143,328.90 were withheld (*BIR records, pp. 58-94).* In its 1995 amended income tax return petitioner reflected a taxable income of P1,538,835.31 with the corresponding income tax due of P538,592.00 (*Exhibit E*).

In the following year 1996, petitioner sold 4 townhouse units also to individual buyers for a total contract price of P9,613,800.00 from which creditable taxes of P480,690.00 were withheld (*BIR records, pp. 215-249*). Petitioner's income tax return for the said year showed a net loss of P3,428,386.08 (*Exhibit F*).

On April 20, 1999, petitioner received from respondent two demand letters (*Exhibits G & I*) along with three assessment notices (*Exhibits H, J & K*) all dated April 13, 1999 holding petitioner liable for deficiency income tax of P1,765,733.90 and deficiency increments on creditable withholding tax of P453,034.60 for taxable year 1995 and deficiency income tax of P666,074.21 for taxable year 1996, or a total amount of P2,884,842.71, broken down as follows:

	1995	**1996**	**Total**
Deficiency Income Tax			
Basic tax due	P 870,366.95	P 366,328.12	
25% Surcharge	217,591.74	91,582.03	
20% Interest	652,775.21	183,164.06	
Compromise Penalty	25,000.00	25,000.00	
	P1,765,733.90	**P 666,074.21**	
Deficiency Increments on Creditable Withholding Tax			
25% Surcharge	P 100,714.02		
20% Interest	327,320.58		
Compromise Penalty	25,000.00		
	P 453,034.60		

P2,218,768.50	**P 666,074.21**	**P2,884,842.71**

Attached to the demand letters/assessment notices received by petitioner from respondent were the "Details of Discrepancies" (*Exhibit L*) showing the detailed computations of the aforesaid deficiency tax assessments.

As can be gathered from the "Details of Discrepancies," the alleged deficiency income taxes P1,765,733.90 for taxable year 1995 and P666,074.21 for taxable year 1996 resulted from:

a) the alleged erroneous recording made by petitioner in 1996 of the amount of P873,981.82 as Value-Added Tax (VAT) instead of sales;

b) the alleged overstatement of petitioner's cost of sales for 1995 and 1996;

Cost of Sales	1995	1996
As reported by petitioner in its ITR	P 7,906,364.40	P 6,868,553.65
As computed by respondent's examiner	5,199,975.50	2,436,732.89
Overstatement	P 2,706,388.90	P 4,431,820.76

c) the respondent's disallowance of petitioner's 1995 operating expenses amounting to P1,626,297.20 and

d) the respondent's disallowance of petitioner's 1996 interest expense of P612,245.60.

As to the alleged deficiency increments on creditable withholding tax for taxable year 1995 of P453,034.60, the same were computed by the examiner based on the alleged underwithholding of the creditable tax due on petitioner's sale of seven (7) townhouse units in 1995.

On May 10, 1999, petitioner, through its external auditor, Mr. Arturo R. Dimaano, filed two letters dated May 5, 1999 with the Assessment Division of the Bureau of Internal Revenue protesting the deficiency tax assessments (*Exhibits M & N; par. 6, Joint Stipulation of Facts*).

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Respondent failed to act on petitioner's protest letters within (180) days from May 10, 1999 or until November 6, 1999. Hence, petitioner filed the instant Petition for Review on December 6, 1999 or within thirty (30) days from the lapse of the aforesaid 180-day period in compliance with Section 228 of the Tax Code, as implemented by Section 3.1.5 of Revenue Regulations No. 12-99 (*pars. 7 & 8, Joint Stipulation of Facts*).

Respondent, in his Answer filed through registered mail on January 26, 2000, prayed for the dismissal of the case and interposed by way of Special and Affirmative Defenses that:

> "6. The Assessments in question were issued in accordance with laws and regulations; and
>
> 7. All presumptions are in favor of the correctness of the tax assessments (***Interprovincial Autobus, Inc. vs. CIR, 98 Phil. 290***)."

In their Joint Stipulation of Facts and Simplification of Issues filed on June 19, 2000 and approved by this court on June 23, 2000 (*CTA records, pp. 67-71 & 72*), the parties submitted the following issues for this court's resolution:

1. Whether the respondent's use of the inventory method in computing the alleged deficiency income taxes for the calendar years ending 1995 and 1996 is accurate and with legal basis;

2. Whether respondent's disallowance of operating expenses in the amount of P1,626,297.00 is valid, considering that respondent did not furnish petitioner any information which particular operating expenses claimed as deductions were disallowed and the reason for such disallowance;

3. Whether respondent's disallowance of interest expenses in the amount of P612,245.60 for the calendar year 1996, is valid, considering that respondent did not explain how such amount was determined nor stating the law, rules and regulations, or jurisprudence on which such disallowance was based;

4. Whether petitioner is liable for deficiency increments in creditable withholding tax in the amount of P453,034.69, considering that it is not the withholding agent with regard to such income payment; and

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5. Whether petitioner is liable for deficiency income tax and deficiency increments on creditable withholding tax for the taxable years 1995 and 1996 in the total amount of P2,884,842.71, and if not, the same be declared null and void and be cancelled accordingly.

The first three stipulated issues pertain to the adjustments made by the respondent's examiner that resulted to the alleged deficiency income tax assessments for taxable years 1995 and 1996. However, before going to the said issues, we deem it appropriate to discuss first the adjustment made by the examiner on petitioner's 1996 gross sales from real properties (i.e., the inclusion of the amount of P873,981.82 as part of petitioner's 1996 gross sales from real properties) as this is the first of the adjustments made by the examiner as appearing in the "Details of Discrepancies" but which was not raised as an issue by the parties.

It is the respondent's opinion that the total contract price of P9,613,800.00 received by petitioner from its sale of four (4) units of townhouses in 1996 should have been fully declared as gross income in the latter's 1996 income tax return and not merely the amount of P8,739,818.18. Hence, in computing for the alleged 1996 deficiency income tax of P666,074.21, respondent included the amount of P873,981.82 (the difference between P9,613,800.00 and P8,739,818.18) as part of petitioner's gross sales from real properties (*Exhibit L-9*). Respondent alleged that the total contract price of P9,613,800.00 received by petitioner in 1996 from its buyers of real properties was not inclusive of VAT since it was indicated in the Deeds of Absolute Sale that the VAT shall be shouldered by petitioner (seller) and not the buyers. Thus, it is respondent's view that the total contract price of P9,613,800.00 should not have been broken down by petitioner into the amounts of P873,981.82 as representing 10% VAT (computed by multiplying

P9,613.800.00 by 1/11) and P8,739,818.18 as representing its gross sales from real properties.

Petitioner, on the other hand, argued that since its real property sales transactions became subject to VAT effective January 1, 1996, it follows that the contract payments it received therefrom amounting to P9,613,800.00 necessarily included 10% VAT in the amount of P873,981.82 and only the amount of P8,739,818.18 represents its actual gross sales from real properties.

The said issue had already been resolved by this court in favor of petitioner in a separate case filed by the latter involving its claim for refund of excess creditable withholding taxes for 1995 and 1996 (***VJ Properties, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 5810, dated March 7, 2002)*** wherein it was held, thus:

> "As can be seen in the 1996 Deeds of Absolute Sale (Exhibits JJ, NN, QQ & UU), the amount of P9,613,800.00 represents the aggregate gross selling price received by Petitioner from its sale of real properties in 1996. There is no specific provision in the 1996 Deeds of Absolute Sale that the said amount of P9,613,800.00 is exclusive of the 10% VAT due on the said sale of real properties. While it was specifically stated in the Deeds of Absolute Sale that "The seller shall pay the capital gains tax as well as the Value Added Tax and realty taxes for 1996", this does not mean that the 10% VAT was never passed on by Petitioner to its buyers of real properties or that the amount of P9,613,800.00 was not inclusive of VAT.
>
> In Revenue Memorandum Circular No. 3-96, the BIR clarified thus:
>
> Q-19 What is the basis of the VAT on taxable sales of real property?
> A-19 For cash basis/deferred payment plan — The computation of the VAT by persons/entities engaged in the sale of real property in the course of trade or business shall be based on the gross selling price which is either selling price stated in the sales document or the zonal values of the real properties sold, whichever is higher. In the absence of zonal values the gross selling price shall refer to the market value as shown in the latest tax declaration or the consideration, whichever is higher.

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Corollary thereto, Section 4.100-6 of Revenue Regulations No. 7-95, provides:

> SECTION 4.100-6. Computation of output tax. — The output tax on the sale of goods or properties during the month or quarter shall be computed by multiplying the total amount indicated in the invoice by 1/11. In taxable sales of real property where the zonal value/market value applies, output tax shall be computed by multiplying the zonal value or market value, as the case may be, by 1/11.

> Based on the above, the tax base for computing the VAT on the sale of real properties is the selling price indicated in the sales document or the zonal value whichever is higher. As per the BIR examiner's report in CTA Case No. 5970 (CTA records, page 13) the zonal value of the real properties sold in 1996 equals the selling price. Since the 10% VAT is computed by multiplying the selling price by 1/11, then out of the total selling price of P9,613,800.00, the amount of P873,918.82 represents VAT while the remaining amount of P8,739,818.18 pertains to Petitioner's gross income."

In other words, respondent erred in including the amount of P873,981.82 as part of petitioner's 1996 gross income. The amount of P873,918.82 pertained to petitioner's 10% output VAT liability on its 1996 sales of real properties which was properly recorded in its books (*Exhibit BB-4-a*) and reported in its quarterly VAT returns for the third and fourth quarters of 1996 (*Exhibits EE & GG*). VAT does not form part of gross income. In this regard, it is interesting to note also that while the examiner included the amount of P873,981.82 as part of petitioner's 1996 gross sales, the examiner did not find petitioner deficient of any VAT liability for the said year. Hence, the inclusion of the amount of P873,981.82 as part of petitioner's 1996 gross sales from real properties is devoid of merit.

We now proceed to the first stipulated issue of whether the respondent's use of the inventory method in computing the alleged deficiency income taxes for the calendar

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years ending 1995 and 1996 is accurate and with legal basis. As admitted by petitioner in its memorandum (*CTA records, page 247*), the said issue is more factual than legal.

The respondent's examiner computed the cost of the eleven (11) units of townhouses sold by petitioner in 1995 and 1996 by determining the difference between the balances of the Townhouses inventories as of December 31, 1995 and December 31, 1996 as follows:

Townhouses, balance as of 12/31/95	(*Exhibits L-4, B-6*)	P 12,059,546.57
Townhouses, balance as of 12/31/96	(*Exhibit C-6*)	4,422,838.18
Cost of Townhouses Sold for 1995 & 1996	(*Exhibit L-5*)	P 7,636,708.39

The above amount of P7,636,708.39 was then allocated between the 11 units of townhouses sold in 1995 and 1996 (7 units in 1995 and 4 units in 1996) based on the proportionate land area sold for each year as shown below:

Area Sold		Cost of 11 units	Allocated Cost
1995 - 1,025.79 sq.m. = 1,025.79/1,506.48	X	P 7,636,708.39	P 5,199,975.50
1996 - 480.69 sq.m. = 480.69/1,506.58	X	7,636,708.39	2,436,732.89
1,506.48 sq.m.			
Total Cost of 11 units sold			P 7,636,708.39

The court finds the above computations inaccurate.

As correctly pointed out by petitioner, the respondent's examiner failed to take into account that the townhouse inventory balance as of December 31, 1995 of P12,059,546.57 (*Exhibit B-6*) represents the balance after deducting the amount of P7,906,364.40 (*Exhibits B-2 & Section C of Exhibit E*) pertaining to the cost of the 7 townhouse units sold in 1995. The examiner should have based its computations on the actual total cost incurred by petitioner amounting to P19,700,150.33 which consisted of the cost of the land of P1,819,000.00 (*Exhibit Z-2*) and the accumulated cost of constructing all of the 14 townhouse units in the amount of P17,881,150.33 (*Exhibit Z-3*).

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As correctly illustrated by petitioner's external auditor, Mr. Arturo R. Dimaano, in the protest letters he filed on behalf of petitioner (*Exhibits M & N*), if we are to adopt the examiner's method of computation but using the actual total cost figure of P17,881,150.33, the cost of sales for 1995 and 1996 would have been P10,402,603.44 and P4,874,708.11, respectively, as shown below:

Total Cost of 14 units	P 19,700,150.33
Less: Townhouses inventory, Dec.31,1996 (3 units)	4,422,838.18
Total Cost of 11 units sold	P 15,277,312.15

Allocated as follows:

	Area Sold		Cost of 11 units	Allocated Cost
1995 -	1,025.79 sq.m. = 1,025.79/1,506.48	X	P 15,277,312.15	P 10,402,603.44
1996 -	480.69 sq.m. = 480.69/1,506.58	X	15,277,312.15	4,874,708.71
	1,506.48 sq.m.			
			Total Cost of 11 units sold	P 15,277,312.15

It is to be noted that the above computed cost of sales for 1995 of P10,402,603.44 is even a lot higher than the amount of P7,906,364.40 reported by petitioner in its 1995 income tax return. While the above computed cost of sales for 1996 of P4,874,708.71 is lower by P1,993,844.94 than the reported amount of P6,868,553.65, nevertheless, petitioner would still be in a net loss position after deducting the lower computed cost of sales of P4,874,708.71 from the correct gross sales from real properties of P8,739,818.18, as earlier stated, and assuming that the disallowance of the interest expense of P612,245.60 was correct, as shown below:

Sales		P 8,739,818.18
Less: Cost of Sales		4,874,708.71
Gross Profit from Sales		P 3,865,109.47
Add: Service Income		2,690,909.05
Total Taxable Income		P 6,556,018.52
Less: Operating Expenses	P 7,990,559.66	
Less: Disallowed Interest Expense	612,245.60	7,378,314.06
Net Loss		P (822,295.54)

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Evidently, the cost of sales computations made by the respondent for 1995 and 1996 were erroneous and not reflective of the actual cost incurred by petitioner in the said years. Therefore, the alleged undeclared gross income of petitioner for 1995 and 1996 was only brought about by the respondent's erroneous cost of sales computations for 1995 and 1996.

With reference to the second issue of whether or not the disallowance of the 1995 operating expenses of P1,626,297.00 is valid or not, petitioner alleged that despite its request in its protest letter dated May 5, 1999 (*Exhibit M*), respondent failed to provide any information as to which particular item of the operating expenses it claimed as deduction for taxable year 1995 was disallowed and the reason for the disallowance contrary to existing law, rules and regulations.

We agree with the petitioner.

Section 228 of the Tax Code, provides among others, that "the taxpayer shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void." This is in consonance with the due process requirement of the 1997 Philippine Constitution, which provides that "No person shall be deprived of his property without due process of law." The taxpayer needs to know the nature of the examiner's findings in order to be able to properly contest the same and submit supporting documents.

The memorandum-report of the respondent's examiner dated October 12, 1998 shows that the expenses of P1,626,297.00 were disallowed based on the finding that the said expenses represent payments to individual professional contractors (i.e., electrician, architect and engineers) for which petitioner failed to withhold the corresponding tax.

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The respondent's examiner cited as legal basis for the disallowance Section 29 of the then Tax Code (*BIR records, page 427*). Unfortunately, however, respondent failed to convey in writing such information to petitioner. In the demand letter and assessment notices for taxable year 1995 sent by respondent to petitioner (*Exhibits I, J & K*) and particularly in the attached "Details of Discrepancies" (*Exhibit L*), there was no indication whatsoever as to how the respondent's examiner arrived at the disallowed amount of P1,626,927.00 and the reason for the disallowance. Petitioner cannot be expected to be able to determine and thereafter refute the examiner's findings without the disclosure of the details of the assessment. Accordingly, the court finds the disallowance of P1,626,927.00 invalid and illegal for respondent's failure to inform petitioner in writing of the facts and the law on which the said disallowance is based.

As to the issue of whether or not the disallowance of the interest expense of P612,245.60 for taxable year 1996 is valid or not, the answer is in the affirmative.

Petitioner, in its memorandum (*CTA records, page 264*) admitted that the amount of P612,245.60 was erroneously recorded twice in its 1996 books of accounts. Hence, petitioner conceded to the disallowance of the amount of P612,245.60 from its claimed operating expenses of P7,990,559.66. However, as correctly stressed by petitioner, even if there was valid disallowance of the interest expense of P612,245.60 still petitioner incurred a net loss and had no tax due for taxable year 1996. As earlier stated, the adjustments made by the examiner to petitioner's 1996 gross income were erroneous and considering that petitioner's net loss amounted to P3,428,386.08 (*Exhibit F*), the disallowance of the interest expense of P612,245.60 would not result to any deficiency income tax.

Concerning the issue of whether or not petitioner is liable for deficiency increments on creditable withholding taxes for taxable year 1995 of P453,034.60, the answer is negative.

Pursuant to the following provisions of Sections 50(b) and 51(a) of the 1995 Tax Code, the withholding of the creditable income taxes and the remittance thereof to the Bureau of Internal Revenue is the responsibility of the payor-corporation/persons(withholding agent) and not the payee(income recipient):

> "**SECTION 50.** ***Withholding of Tax at Source.*** — xxx xxx xxx
>
> (b) Withholding of creditable tax at source. — The Secretary of Finance may upon the recommendation of the Commissioner of Internal Revenue, require also the withholding of a tax on the items of income payable to persons (natural or juridical) residing in the Philippines by payor-corporation/persons as provided for by law at the rate of not less than 2 1/2% but not more than 35% thereof which shall be credited against the income tax liability of the taxpayer for the taxable year.
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> **SECTION 51.** ***Returns and Payment of Taxes Withheld at Source.*** — (a) Quarterly returns and payment of taxes withheld. — Taxes deducted and withheld under Section 50 shall be covered by a return and paid to the Revenue District Officer, Collection Agent, or duly authorized Treasurer of the city, or municipality where the withholding agent has his legal residence or principal place of business or where the withholding agent is a corporation, where the principal office is located. The taxes deducted and withheld by the withholding agent shall be held as a special fund in trust for the Government until paid to the collecting officers. The Commissioner of Internal Revenue may, with the approval of the Secretary of Finance, require these withholding agents to pay or deposit the taxes deducted or withheld at more frequent intervals when necessary to protect the interest of the Government. x x x"

Further, Section 2 in relation to Section 1 of Revenue Regulations No. 12-94 (amending Revenue Regulations No. 6-85) enumerates the persons who are required to deduct and withhold the creditable income taxes due on real property sales transactions as follows:

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"**Sec. 1.** ***Income payments subject to creditable withholding tax and rates prescribed thereon***. — Except as herein otherwise provided, there shall be withheld a creditable income tax at the rates herein specified for each class of payee from the following items of income payments to persons residing in the Philippines.
xxx xxx

(j) Gross selling price or total amount of consideration or its equivalent paid to the seller/owner for the sale, exchange or transfer of —
xxx xxx

3. Real property, other than capital asset, by an individual, estate, trust, trust fund or pension fund or real property, whether held as capital or ordinary asset, by a corporation (a) not registered with the HLURB as engaged in Socialized Housing projects under RA 7279; (b) the selling price thereof is over P2,000,000.00, and (c) the seller/transferor is habitually engaged in the real estate business — five percent (5%)

4. Real property, other than capital asset, by an individual, estate, trust, trust fund or pension fund or real property whether held as capital or ordinary asset, by a corporation not habitually engaged in the real estate business — seven and one-half percent (7.5%).

For this purpose, the seller shall automatically be considered habitually engaged in the real estate business upon submission of a certificate of accreditation issued by the Chamber of Real Estate Builders Association, Inc. (CREBA); the National Real Estate Association (NREA); or the Subdivision and Housing Developers Association, Inc. (SHDA). Otherwise, the seller shall submit evidence showing that he is in fact habitually engaged in the real estate business."

"**Sec. 2.** ***Persons required to deduct and withhold***. — The following persons are hereby constituted as withholding agents for purposes of the tax required to be withheld on income payments enumerated in the preceding section:

(a) An individual, with respect to payments made in connection with his trade or business. However, insofar as taxable sale, exchange or transfer of real property specified in Section 1(j) is concerned, individual buyers not engaged in trade or business are also constituted as withholding agents, but they need not register as such;

(b) In general, any juridical person, whether or not engaged in trade or business; and

(c) All government offices, including government-owned or controlled corporations, as well as provincial, city or municipal governments."

Clearly, the payment of the creditable taxes withheld to the BIR is the duty of the payor/withholding agent such that the failure to withhold and remit payment of amounts withheld will make the payor/withholding agent liable and not the payee/income recipient. In the case at bar, the individual buyers of the real properties sold by petitioner, being the payors, are the duly constituted withholding agents and are to be held liable, and not the petitioner, which is the income recipient, for failure to withhold the correct tax on their income payments to the latter.

WHEREFORE, in the light of all the foregoing, the court finds the instant petition meritorious and in accordance with law. Accordingly, the assessments issued by the respondent against petitioner for deficiency income tax of P1,765,733.90 and deficiency increments on creditable withholding tax of P453,034.60 for taxable year 1995 and deficiency income tax of P666,074.21 for taxable year 1996, in the total amount of P2,884,842.71, are hereby ordered **CANCELLED and WITHDRAWN**.

SO ORDERED.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Judge

I CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

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CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge

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