REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

DAO HENG SECURITIES (PHILS.) INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 4841

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated :
APR 21 1995

x - x

DECISION

This is an appeal from the decision of respondent Commissioner of Internal Revenue denying the protest filed by the petitioner against the tax assessments issued for alleged deficiency percentage and value-added taxes for the first semester of 1988.

Petitioner is a domestic corporation organized and existing under the laws of the Philippines with principal office located at Paseo de Roxas, Makati. On April 23, 1991, petitioner received a letter from respondent dated April 10, 1991 assessing them for the total amount of P312,808.81 as unpaid taxes for the first semester of 1988, broken down as follows:

Deficiency value-added tax (VAT)	P 96,655.45
Deficiency Percentage Tax (as lending investor)	P216,153.36
Total Tax Due	P312,808.81

Petitioner, through its external auditor, filed a protest and maintained that the assessments for the 6% percentage tax and value-added tax for the first semester of 1988 have no factual nor legal basis.

Respondent, in a letter dated March 31, 1992, denied the protest and stood firmly behind the findings of the BIR examiners. Petitioner then elevated its case to this Court and prayed for the cancellation of the assessments issued against them for the first semester of 1988.

The assessment for percentage taxes in the amount of P216,153.36 stemmed from the belief of the BIR examiners that petitioner is a lending investor thus subject to the 6% percentage tax provided in Section 116 of the 1988 Tax Code. The investigation conducted by the examiners allegedly uncovered petitioner's business practice of lending money to its clients by advancing the purchase price of the securities bought by its customers and subsequently imposing interest on the monetary advances made by them. It is their theory that the habituality by which this practice is done classifies the petitioner as a lending investor.

Petitioner disagrees with this conclusion and denies ever having been a lending investor. It insists that it is a stock broker and in the course of engaging in this kind of business, it enters into agreements with some of its clients whereby petitioner advances the payments on the securities bought by these clients which will eventually be paid on a date agreed upon with additional charges as interest. To prove its point, petitioner presented as one of its witnesses, Ms. Evelyn Dipasupil, their management accountant in 1988 who testified that the advances made by the corporation as a stock broker are privileges extended to its margin clients and this is a common practice in the business of stock brokerage. Quoted hereunder are portions of her testimony, thus:

> A. In a stockbrokerage business we have two kinds of clients. One we call a cash client and the other a margin client. As contrasted with a cash client a margin client is allowed to pay for any of the purchases, of course with the mutual agreement with the stockbroker, for at least certain period of time. A cash client is one who is requested to pay on exactly four days from the date of the transaction to pay off whatever securities was bought by him. On the other hand, we as a broker are also obliged to pay on the fourth day from the transaction date any proceeds due to a cash client. With regard to a margin client, the sales proceeds of a margin client are credited to their account on the fourth day upon the transaction day.

Q. Mrs. Witness, I would like you to clarify what the term margin exactly means?

A. The term margin refers to these clients whom we have margin agreement with. Which means to say that we at a certain point in time advanced for them the cost of the securities that they bought and per also our agreement with them they are supposed to deposit to us a certain amount to cover for a margin line that we give them. They are allowed to buy and sell for their account securities as listed in the stock exchanges so that any given time when their account is already due which as I've said all accounts whether cash or margin on the fourth day from the transaction date. If they are not able to give us the purchase price we advance for them this purchase price because we are liable to a clearing house to pay off the results of our transaction for any particular day.

In its memorandum, petitioner argues that it merely "accommodated its customers in the purchase of securities, in effect lending the securities on account on which it charges its customers interest". It further contends that such act can never be classified as lending money to its customers.

The other aspect of the assessment concerns the value-added tax that petitioner allegedly failed to pay for the first semester of 1988 in the amount of P96,655.45. The investigation conducted by the examiners led to the conclusion that petitioner allegedly underdeclared its gross receipts thus resulting in the payment of a lesser amount in value-added tax than what was actually due from them for the aforementioned period. This underdeclaration was noted by the examiners when it was discovered that the gross receipts declared in petitioner's day book is more than that reported by the petitioner in its VAT returns. The total amount of P96,655.45 as value added tax was computed as follows:

	Per Daybook	Per Return
1st Quarter Sales	P1,230,919.98	P1,037,786.92
2nd Quarter	809,016.80	561,268.31
Total	P2,039,936.78	P1,599,055.23
Difference	P 440,881.55	
Basic Tax	P 44,088.25	
25% Surcharge	11,022.06	
20% Interest	31,545.14	
Compromise	10,000.00	
Total VAT Due	P 96,655.45	

Petitioner provided an explanation for this discrepancy by stating that its day book entries contained all its transactions including the commissions whereas its VAT returns reflected the amounts which already excluded the commissions/rebates which petitioner gave to its clients. The commissions are evidenced by the credit memos offered by the petitioner as exhibits (Exhibits "B" to "JJ-2"). Petitioner contends that the commissions which it refunded to its clients should not form part of its gross receipts for the purpose of computing its value-added tax. Respondent disagrees and reiterates her original reason for denying the protest which is clearly enunciated in her answer to the petition, thus:

> 4. Petitioner as a VAT registered business entity granted sales discounts/rebates to its clients which it deducted from its gross sales but subsequently disallowed by respondent's investigating revenue enforcers for failure to comply with the following requirements, to wit:
>
> > a) That the discount must be granted at the time of the sale;
> >
> > b) That the amount thereof must be indicated as a separate item on the face of the invoice; and
> >
> > c) That the same must form part of the gross sales duly recorded in the books of accounts, thereby resulting in the herein deficiency VAT assessment.

The two basic issues presented to Us for resolution are as follows:

> 1. Whether or not petitioner falls under the category of a lending investor subject to the 6% percentage tax provided in Section 116 of the Tax Code:
>
> 2. Whether or not petitioner can exclude the amounts given to its clients as commissions from its gross receipts for the purpose of computing the value-added tax.

Petitioner submitted its memorandum and both parties offered their respective evidence.

<u>First Issue</u>

The fact that petitioner received interest income during the first semester of 1988 served as the signpost which led the examiners to delve into its source. It was discovered that a major portion of its interest income was derived from the amounts which the petitioner received as payments for the advances made by them in buying securities for some of their clients. Petitioner admits this fact but argues that their receipt of interest income in this manner does not make it a lending investor because this practice does not involve the lending of money but the lending of chattels (securities) on account. Furthermore, this is not done in a regular or habitual manner to make it fall within the purview of the definition of a lending investor.

A careful analysis of the business practice of the petitioner has led this Court to believe that the petitioner should not be taxed as a lending investor under Section 116 of the 1988 Tax Code. Section 157(u) of the 1987 Tax Code defines a lending investor as "one who makes a practice of lending money for themselves or others at interest". At a glance, we can easily conclude that the petitioner falls squarely within the category of a lending investor because admittedly it advances money to purchase stocks in favor of some of its clients with the agreement that these be paid at a future date with interest. However we are led to conclude otherwise if seen in the context of the nature of the stockbrokerage industry. The act of advancing money to buy stocks in the name of some of its clients is necessary and essential in the business of the petitioner because without such arrangements the petitioner would lose a big bulk of its clients. The testimony of their Management Accountant elucidates this point clearly, thus:

> Q. Since these margin transactions appeared to be somewhat burdensome to your company, can you cite any particular reason why you do engage in this kind of margin transaction?
>
> A. Well, most people who strike margin agreement with us are what you call bigger local investors. These are people who have assets but at the moment not that liquid in cash. So for us not to forgo of the commission that we can get from these people, we have a margin agreement with them. We agree to give them a margin line of say for example 30 or 60 days depending on the viability of the client. So we allow them to purchase on a margin line securities for their accounts and they get to pay us as per our agreement. So that is given 30 or 60 days but then again their account is also affected by their sale proceeds. If they sell anytime within our agreed number of days then their account is credited for the exact amount of the sale proceeds. If they sell after the due date of

> their purchase, then they also get credited for the full amount of the sale proceeds. If they sell before the due date then the same is also true.

In the cases of **Insular Life Assurance Company vs. Commissioner of Internal Revenue**, CTA Case No. 2336 and **Filipinas Life Assurance Company vs. Commissioner of Internal Revenue**, CTA Case No. 2337, this Court is resolving the issue of whether or not insurance companies should be taxed as a lending investor made the following declaration, thus:

> We have had occasion to express the same view. It has been held that "when a person or company is already taxed on its main business, it may not be further taxed for doing something or engaging in an activity or work which is merely a part of, incidental to and is necessary to its main business". (**Asturias Sugar Central, Inc. vs. Commissioner of Internal Revenue**, C.T.A. Case No. 983, February 14, 1963, citing **Standard Vacuum Oil Co. vs. Antigua**, 96 Phil. 909.) This doctrine was cited and relied upon by this Court in the Asturias case in connection with the issue of whether or not the taxpayer therein was liable for the fixed tax as a lending investor. The doctrine is but the result of the correct application of the rule of interpretation to determine the legislative intent behind revenue laws. Where the law taxes a business, it is presumed to be the legislative intent not to separately tax every activity which is merely incidental or necessary to the conduct of said business. (Underscoring supplied)
>
> There can be no question that lending money at interest by life insurance companies is not only incidental to their business but is essential to their very existence. No

> insurance company can survive without investing its funds in loans.

In the instant case, it is indeed necessary to enter into such liberal arrangements whereby petitioner advances money to buy securities in order to maintain a big bulk of their clients thereby protecting their commissions which comprise their main source of income. In the stockbrokerage industry, this may be considered a "business-saving" device and because such practice is essential and incidental to their main activity then this should not be taxed separately. The interest income derived by the petitioner on the monetary advances it made during the first semester of 1988 was properly declared in its final income tax return (see page 39, BIR Records) and we find that the same interest income should not be taxed again on percentage tax imposed by Section 116 of the 1988 Tax Code. However, considering that this interest income was earned by reason of its stockbrokerage operation said income should form part of "gross receipt" for VAT purposes.

In conclusion, we find the assessment for percentage taxes for the first semester of 1988 improper as we do not find any sufficient legal and factual basis to sustain the same.

Second Issue

Petitioner admitted that there was a discrepancy in the figures in its day book with those that were indicated in the VAT returns in the amount of P440,881.55 for the first semester of 1988 and this is because it already excluded the commissions/rebates it had granted to its clients resulting in a decreased amount of gross receipts. Respondent claims that the exclusion of these commissions cannot be allowed because it does not conform to the requirements provided in Section 100(d)(3) of the Tax Code. On the other hand, petitioner insists that Section 100(d)(3) of the Tax Code applies only to the sale of goods and as a stockbroker it is engaged not in the sale of goods but in the sale of services.

We agree with the petitioner that the aforementioned Section 100(d)(3) refers to sale of goods hence cannot be applied to the business of the petitioner which involves the sale of services. Nevertheless petitioner is still subject to the provision found in Section 102(a) of the Tax Code, thus:

> **SEC 102** - *Value-added tax on sale of services (a) Rate and base of Tax.* - There shall be levied, assessed and collected, a value-added tax equivalent to 10% of gross receipts derived by any person engaged in the sale of services. The phrase "sale of services" means the performance of all kinds of services for others for a fee, remuneration or consideration, including those performed or rendered by construction and services

> contractors; stock, real estate, commercial, customs and immigration brokers; lessors of personal property; lessors or distributors of cinematographic films; persons engaged in milling, processing, manufacturing or repacking goods for others, and similar services, regardless of whether or not the performance thereof calls for the exercise or use of the physical or mental facilities. xxxxx

The aforementioned law speaks of "gross receipts" and this term has been defined by VAT Implementing Regulations as:

> "The total amount of money or its equivalent representing the contract price, compensation or service fee, including the amount charged for materials supplied with the services and deposits or advance payments actually or constructively received during the taxable quarter for the services performed or to be performed for another person, excluding value-added tax."

The term "gross receipts" has been interpreted to mean the whole amount received by the contractor without any deduction (p. 378, Hector S. de Leon, 1994 National Internal Revenue Code Annotated). Therefore it was erroneous on the part of the petitioner to exclude the commissions/rebates it granted to its clients because this had the effect of diminishing the total amount it received from engaging in the business of stock brokerage and it is for this reason that the assessment issued by the respondent for the value-added tax for the first semester of 1988 cannot be set aside.

It is important to note that respondent failed to include the interest income received by the petitioner for the above-mentioned period as part of the "gross receipts" subject to value-added tax. As quoted earlier, gross receipts refers to the "total amount of money xxxxx received during the taxable quarter for the services performed or to be performed for another person excluding value-added tax". (supra) This definition itself is broad enough to embrace all kinds of income received by the taxpayer in connection with its brokerage services which as discussed earlier includes the interest income being taxed separately by the respondent. Unfortunately, respondent did not assess deficiency value-added tax from the interest income of the petitioner. Inasmuch as we are not in the position to issue assessment notices because such is the sole prerogative of the Commissioner of Internal Revenue, this Court is confined to recommend that in the future all interest income received by the petitioner from its stockbrokerage business must form part of the gross receipts subject to the 10% value-added tax.

In view of all the foregoing, the deficiency percentage tax assessment issued against petitioner for the first semester of 1988 in the amount of P216,153.36

is hereby cancelled and set aside and respondent is ordered to desist from collecting said amount. With respect to the deficiency value-added tax assessment, we hold the petitioner corporation liable in the amount of P86,655.45 inclusive of the 25% surcharge plus 20% interest from April 10, 1991, the date it was demanded for payment, until fully paid pursuant to Sections 248 and 249(c)(3) of the Tax Code. The tax due from the petitioner is less than that assessed by the respondent in the amount of P96,655.45 as we excluded the compromise penalty of P10,000.00 because there was no compromise agreement entered into between the petitioner and respondent with respect to its value-added tax deficiency.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

(On leave)
MANUEL K. GRUBA
Associate Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals