REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SPOUSES ARTURO SORIANO and VIRGINIA T. SORIANO,
Petitioners,

- versus -

HON. LIWAYWAY VINZONS-CHATO as COMMISSIONER OF BUREAU OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 5563

Promulgated:

JUN 22 1999

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DECISION

This is a case involving a claim for refund of capital gains tax in the amount of ₱946,206.13 paid by the Petitioners in a foreclosure sale involving twenty (20) parcels of land including improvements, which were redeemed before the expiration of the statutory period of one year.

Spouses-petitioners are taxpayers with residence at Tugatog, Meycauayan, Bulacan.

On March 4, 1993, Petitioners entered into a contract of loan in the sum of ₱12,000,000.00 (TSN, Feb. 3, 1998, p. 5) with Metropolitan Bank and Trust Company (Metrobank). Said loan was secured by a real estate mortgage over the said twenty pieces of real property located at Meycauayan, Bulacan covered by the following original/transfer certificate of title numbers:

TCT NO. T-153317(M)	Exhibit A
TCT NO. T-153318(M)	Exhibit A-1
TCT NO. T-153319(M)	Exhibit A-2
TCT NO. T-159694(M)	Exhibit A-3
TCT NO. T-159695(M)	Exhibit A-4
TCT NO. T-159696(M)	Exhibit A-5
TCT NO. T-159697(M)	Exhibit A-6
TCT NO. T-159698(M)	Exhibit A-7
TCT NO. T-159699(M)	Exhibit A-8
TCT NO. T--159700(M)	Exhibit A-9
TCT NO. T-159701(M)	Exhibit A-10
TCT NO. T-159702(M)	Exhibit A-11
TCT NO. T-159703(M)	Exhibit A-12
TCT NO. T-159704(M)	Exhibit A-13
TCT NO. T-87.718(M)	Exhibit A-14
TCT NO. T-87.719(M)	Exhibit A-15
TCT NO. T-160644(M)	Exhibit A-16
TCT NO. T-160645(M)	Exhibit A-17
TCT NO. T-37.203(M)	Exhibit A-18
OCT NO. O-10(M)	Exhibit A-19

The Register of Deeds of Bulacan accordingly made the corresponding annotations on the titles abovementioned (Exhs. A-20 to A-39).

Upon failure on the part of the Petitioners to pay the loan per agreement, Metrobank instituted an extra-judicial foreclosure over the said mortgaged properties on November 7, 1995. The foreclosure sale was conducted by Sheriff Carmelita S. Ipapo of the province of Bulacan on the same day. There being no other bidders, the foreclosed properties were awarded to Metrobank which tendered a bid price of ₱18,924,122.62. Consequently, the said sheriff executed a Certificate of Sale (Exh. B). The Bureau of Internal Revenue (BIR) assessed capital gains tax on said sale in the amount of ₱946,206.13 which was paid by the Petitioners (Exh. C, TSN, Feb. 3, 1998, p. 23). The following day, that is, November 8, 1995, the BIR issued a certificate (No. 887402) authorizing registration of subject properties (Exh. D). On November 9, 1995, the Certificate of Sale was registered at the Registry of Deeds (Exhs. A-41 to A-59).

On November 7, 1996, before the expiration of the redemption period of one year from the date of registration of the certificate of sale as provided under Act 3135, as amended, Petitioners were able to redeem the foreclosed properties and paid to Metrobank the amount of ₱21,927,161.90. A Deed of Redemption was then executed by Metrobank on November 7, 1996 (Exh. E).

On February 24, 1997, Petitioners filed a claim for the refund of the capital gains tax in the sum of ₱946,206.13 paid on the sale of said foreclosed properties (Exh. F). Revenue Officer Ma. Mercedes Cerezo prepared a memorandum to Revenue District Officer Alberto A. Bernales for the refund of the capital gains tax paid by the spouses (Exh. G). The same memorandum was indorsed and forwarded to the Appellate Division of the BIR on April 25, 1997 (Exh. H).

There being no action on the part of the Respondent, and mindful of the near expiry of the two-year prescriptive period, Petitioners came to Us on November 7, 1997, by way of a Petition for Review.

Petitioners maintain that they are entitled to the refund claimed. Respondent, on the other hand, by way of Special and Affirmative Defenses, avers that:

> 1) The claim for refund of capital gains tax has without any legal and factual basis and that the Memorandum of Revenue Officer Ma. Mercedes Cerezo duly indorsed by Revenue District Officer Alberto A. Bernales is only a recommendation on the matter, the same not being final and executory until the Commissioner of Internal Revenue approves it;
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> 2) Under Section 21(e) of the Tax Code, as amended, capital gains presumed to have been realized from the sale, exchange or other disposition of real property located in the Philippines classified as capital assets, including pacto de retro sales and other forms of conditional sales, by individuals including estates and trust, shall be taxed at the rate of 5% based on the gross selling price or the fair market value prevailing at the time of sale, whichever is higher. The phrase "including pacto de retro sales and other forms of conditional sales" necessarily includes a mortgage foreclosure sale under Act 3135 as amended by Act 4118. Specifically, under Revenue Memorandum Circular No. 41-86, a conditional sale transaction like a mortgage foreclosure sale is embraced under this law;
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> Based on the foregoing provision of the Tax Code, it is clear that a mortgage foreclosure sale is subject to the 5% capital gains which is not refundable or creditable for the simple reason that at the time of payment, said tax was legally due and demandable. Moreover, the subsequent redemption of the property by the mortgagor within the period of redemption does not render the collection of the tax erroneous or illegal so as to entitle the payee to a refund or credit for a tax which was legally due and collectible upon its foreclosure;

> 3) In an action for refund, the taxpayer has the burden to show that the taxes paid were erroneously or illegally collected and failure to do so is fatal to the action; and
>
> 4) Claims for tax refunds are construed strictly against the taxpayer. Taxpayer-Petitioner has no cause of action.

Respondent then submitted the case for decision without presenting any evidence.

The sole bone of contention between the parties in this case is whether or not Petitioners are liable to pay the 5% capital gains tax on the sale of foreclosed properties despite the redemption thereof within the statutory period of one year.

We find in favor of Petitioner.

Section 21 (e) of the 1995 Tax Code provides as follows:

> (e) Capital gains from sales of real property - The provisions of Section 33(b) notwithstanding, the capital gains presumed to have been realized from the sale, exchange or other disposition of real property located in the Philippines classified as capital assets, including pacto de retro sales, by individuals, including estates and trusts, shall be taxed at the rate of 5% based on the gross selling price or the fair market value prevailing at the time of sale, whichever is higher; xxx

There is no dispute between the parties that the extrajudicial foreclosure sale of the subject properties fall under the category of conditional sale mentioned in the aforequoted Section 21(e) of the Tax Code. In fact, in Revenue Memorandum Order No. 6-92 issued on January 15, 1992, mortgage foreclosure sales, whether judicial or extrajudicial, are considered conditional sales, to wit:

> "2.2. - The tax applies not only to ordinary sale transaction but also to pacto de retro sales and other forms of conditional sales, which necessarily includes mortgage foreclosure sales (judicial and extrajudicial foreclosure sales)."

The controversy stems from the different interpretations of the parties as to the effects of redemption of these foreclosed properties.

Petitioners believe that their act of redeeming their properties within the specified period entitles them to the refund of the capital gains tax paid because no transfer of ownership was effected to the winning bidder, Metrobank. Through the process of redemption, Petitioners opine, that they bought back, so to speak, their own properties, hence this fact alone erases their liability for the 5% capital gains tax earlier imposed.

Respondent, in his memorandum, argues that the 5% capital gains tax can no longer be refunded for the simple reason that at the time of payment, said tax was legally due and demandable and that the subsequent redemption does not render the collection of the tax erroneous.

The flaw in the foregoing argument of Respondent is that too much emphasis is given to legalism which already obliterates the purpose of the law in imposing the 5% capital gains tax resulting in injustice.

While it is true that under the aforequoted Section 21(e) of the Tax Code, a conditional sale of real property, including foreclosure sale, is subject to the 5% capital gains tax, this is subject to the condition that transfer of interest or ownership to the properties is effected. And in a foreclosure sale, transfer of ownership ensues only upon expiration of the redemption period as provided in Section 6 of Act 3135 as amended, to wit:

> **Section 6.** - In all cases in which an extrajudicial sale is made under the special power hereinbefore referred to, the debtor, his successors in interest or any judicial creditor or judgment creditor, or any person having a lien on the property subsequent to the deed of mortgage or trust under which the property is sold, may redeem the same within the term of one year from and after the date of the sale.

The aforequoted law gives the debtor/mortgagor the opportunity to re-acquire ownership of the foreclosed properties within one year. The period of one year is counted from the date of the registration of the Certificate of Sale as provided under Section 33 of Rule 39 of the 1997 Rules of Civil Procedure, thus:

Rule 39

> **Section 33.** - If no redemption be made within one (1) year from the date of registration of the certificate of sale, the

> purchaser is entitled to a conveyance or possession of the property x x x.

It bears stressing that it is not the transfer of ownership per se that subjects the sale to the 5% capital gains tax but the profit or gain that was presumed to have been realized by the seller/mortgagor by means of said transfer as can be clearly seen from the provisions of Section 21(e) of the Tax Code (supra). Let us not forget that the capital gains tax is an income tax defined as a tax on a person's income, wages, salary, commissions, emoluments, profits and the like (Black's Law Dictionary, 6th Edition). The concept of income implies gain, profit or flow of wealth (Madrigal vs. Rafferty 38 Phil 414). The question that should be asked at this point is: Did the Petitioners profit or gain anything from the foreclosure sale where the properties were redeemed within the specified redemption period? The answer is obvious. Petitioner did not earn any income from the sale of these foreclosed properties , hence they should not be made liable to pay the capital gains tax. Even the Respondent, in BIR Ruling No. 006-92, acknowledged the inequity of collecting the capital gains tax before the expiration of the redemption period and provided for the solution of refunding the same in case the right of redemption is exercised, to wit:

> "In foreclosure sales of mortgaged properties, the creditor-bank is the statutory

> seller, representing the owner-mortgagor of the property, so that said bank becomes liable for the capital gains tax due on such foreclosure sale based on the bid price in the auction sale. However, said bank could get reimbursement or recovery of the capital gains tax payment, if the right of redemption is exercised by the debtor-mortgagor or when the property is sold to any party whatsoever.

In order to further prevent the inequity that will arise if the capital gains tax is collected before the expiration of the period of redemption, the Secretary of Finance issued Revenue Regulations No. 4-99, dated March 9, 1999, where he categorically declared, thus:

> "In case the mortgagor exercises his right of redemption within one year from the issuance of the certificate of sale, no capital gains tax shall be imposed because no capital gains has been derived by the mortgagor and no sale or transfer of real property was realized." (Section 3 of RR 4-99)

The aforequoted RR 4-99 affirms this Court's rationale in granting the claim for refund of Petitioner. As said RR 4-99 states, no capital gains having been derived by the mortgagor (Petitioners, in the instant case), then no capital gains tax shall be imposed. It will be unjust to deprive the Petitioners their right to refund the capital gains tax which they already paid on the foreclosure sale of their properties when the facts show that they redeemed these properties within the period specified by the law.

This Court is well-aware that the Government needs to raise revenues or funds to support its various projects and services but this should not be done at the expense of justice and equity. At this point it is apt to quote the decision of the Supreme Court in the case of **Roxas vs. Court of Tax Appeals, 23 SCRA 276,** thus:

> "The power of taxation is sometimes called the power to destroy. Therefore, it should be exercised with caution to minimize injury upon the proprietary rights of a taxpayer. It must be exercised fairly, equally and uniformly, lest the tax collector kill the "hen that lays the golden egg". And in order to maintain the general public's trust and confidence in the Government, this power must be used justly and not treacherously."

The records having shown that the capital gains tax in the amount of ₱946,206.13 have been paid by the Petitioners plus the fact that Respondent did not dispute the fact of payment, then the claim for refund of Petitioners should be granted.

WHEREFORE, in view of all the foregoing, the instant Petition for Review is **GRANTED.** Respondent is hereby **ORDERED** to **REFUND** to the Petitioners the amount of ₱946,206.13 representing the capital gains tax paid on the foreclosure sale of the subject properties immediately.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

(Dissenting)
AMANCIO Q. SAGA
Associate Judge

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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DISSENTING OPINION

The majority decided in favor of the petitioner and ordered the respondent to refund the amount of ₱946,206.13 representing the capital gains tax paid on the foreclosure sale of 20 parcels of land.

The determining factor which led to the grant of the refund is the fact that petitioners redeemed the properties within the period specified by law. Thus, it was concluded that since no gain or profit was realized by petitioners, then no capital gains tax liability attaches to these transactions.

I humbly disagree with the above conclusion.

Section 21(e) of the 1995 Tax Code mandates that:

> **SEC. 21**. ***Tax on citizens or residents.*** (a) x x x
>
> (e) Capital gains from sales of real property. - The provisions of Section 33(b) notwithstanding, capital gains presumed to have been realized from the sale, exchange or other disposition of real property located in the Philippines classified as capital assets, including pacto de retro sales and other forms of conditional sales, by individuals, including estates and trusts, shall be taxed at the rate of 5% based on the gross selling price or the fair market value prevailing at the time of sale, whichever is higher; x x x. (Emphasis supplied)

The aforecited provision is unambiguous. It does not make any qualification. Section 21(e) clearly provides that all other forms of conditional sales are subject to 5% capital gains tax and this includes foreclosure sales of real property.

In short, foreclosure sale is a conditional sale which falls within the purview of Section 21(e) of the Tax Code. Further, a rereading of Section 21(e) will enlighten Us that what is taxed are "capital gains presumed" to have been realized from sale, exchange or other disposition of real property located in the Philippines, classified as capital assets, including pacto de retro sale and other forms of conditional sales. Thus, no such actual capital gains is required to be realized in the transaction or that the transaction be denominated as a sale of real property in order to justify the imposition of the capital gains tax in a mortgage foreclosure sale by banks, finance and insurance companies under Act No. 3135, as amended by Act No. 4118. Under such a situation, the mortgagee-creditor financial institution is constituted as the statutory seller thus becoming liable for the payment of the capital gains tax due on such foreclosure sale based on the bid price in the auction sale. The amount of capital gains tax paid by the financial institution is however recoverable when the right of redemption is exercised by the mortgagor-debtor or when the property is sold to any party whatsoever (BIR Ruling No. 006-92). On the other hand, whether or not the capital gains tax is paid by the mortgagor-debtor at the time of the mortgage foreclosure sale or advanced by the mortgagee-creditor, the same is not refundable because the said capital gains tax shall form part of the adjusted cost basis of the property pursuant to the provisions of Section 40(B)(1) of the Tax Code of 1997.

WHEREFORE, in view of the foregoing, I hereby register my dissent to the majority view and vote to deny the claim for refund.

AMANCIO Q. SAGA
Associate Judge