REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

THE SECRETARY OF FINANCE, Petitioner,	CTA EB NO. 1776 (CTA Case No. 9145)
	Present:
- versus -	DEL ROSARIO, *P.J.*, CASTAÑEDA, JR., UY, FABON-VICTORINO, MINDARO-GRULLA, RINGPIS-LIBAN, and MANAHAN, *JJ.*
CENTURY PEAK PROPERTY DEVELOPMENT, INC. and KINGSVILLE INTERNATIONAL RESOURCES, INC., Respondents.	Promulgated: JUL 05 2019 11:48a.m.

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DECISION

Fabon-Victorino, J.:

In this *Petition for Review*[1] filed on February 15, 2018, petitioner Secretary of Finance (SOF) seeks to reverse and set aside the Decision[2] dated July 24, 2017 and Resolution[3] dated January 15, 2018 in CTA Case No. 9145. The assailed Decision in favor of respondents CENTURY PEAK PROPERTY DEVELOPMENT, INC. and KINGSVILLE INTERNATIONAL RESOURCES, INC. reversed the Certification Ruling SN. 014-2012 and Department of Finance (DOF) Resolution dated July 14, 2015 by declaring that no value-added tax (VAT) is imposable on the Deed of Assignment executed by respondents on October 13, 2010.

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[1] *En Banc* docket, pp. 9-28.
[2] *En Banc* docket, pp. 33-64.
[3] *En Banc* docket, pp. 66-71.

THE FACTS AND THE PROCEEDINGS

The pertinent facts unfurled during the trial are as follows:

Petitioner SOF is the head of the Department of Finance (DOF), a department of government, with principal office address at DOF Building, Bangko Sentral Complex, Roxas Boulevard, 1004 Manila.

Respondent Century Peak Property Development, Inc.[4] (*Century Peak*) is a domestic corporation with Tax Identification No. 007-933-304. Its principal office address is at 902 Imperial Bayfront Tower, 1642 A. Mabini Street, Malate, Manila, Philippines.

The other respondent, Kingsville International Resources, Inc. (*Kingsville*), is also a domestic corporation with Tax Identification No. 000-780-199-000. Its principal office address is at 2nd Floor Harrison Shoe Plaza, 3030 Agtarap Street corner F.B. Harrison Street, Pasay City, Metro Manila, Philippines.

Respondent *Kingsville* is the registered owner of two (2) parcels of land covered by Transfer Certificates of Title (TCT) Nos. 180739[5] and 180740[6] located at Lots 2 and 3, Block 359, corner Sta. Monica and Adriatico Streets, Zone 72, Barangay 668, Malate, Manila.

On October 13, 2010, respondent *Kingsville* executed a Deed of Assignment[7] over the said two parcels of land for and in consideration of its total subscription of 450,000 shares of stock at ₱100.00 per capital share of *Century Peak*, which was issued a Certificate of Incorporation[8] by the Securities and Exchange Commission (SEC) on December 21, 2010.

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[4] Now known as "Century Peak Hotel Management and Development, Inc."
[5] Exhibit P-12.
[6] Exhibit P-13.
[7] Exhibit P-14, docket, pp. 631-634.
[8] Exhibit P-2, docket, pp. 565-579.

On May 16, 2011, respondent *Century Peak* filed with the Commissioner of Internal Revenue (CIR) a Request for BIR Confirmation Ruling[9] on its opinion that the foregoing exchange of properties is covered by Section 40(C)(2) and (6)(c) of the National Internal Revenue Code (NIRC) of 1997, as amended, hence, not subject to tax.

On February 20, 2012, CIR issued Certification Ruling SN. 014-2012 [10] certifying that on the basis of the representations and documents submitted, *the transfer of the properties by and between Kingsville and Century Peak is not subject to income tax, capital gains tax, expanded withholding tax, and donor's tax. However, the transaction is subject to documentary stamp tax and value-added tax at twelve percent (12%)* or *in the amount of ₱5,416,164.00.*

Respondent *Century Peak* sought a reconsideration and revision of the Certification Ruling SN. 014-2012 with the CIR but was informed that the same should be filed with petitioner in accordance with Section 3 of DOF Order No. 007-02 dated May 7, 2002.

As directed, respondent *Century Peak* filed with petitioner's office a Request for Revision[11] dated May 24, 2012, which was treated as a request for review of BIR Certification Ruling SN: 014-2012.

In the Resolution dated July 14, 2015, petitioner affirmed BIR Certification Ruling SN. 014-2012.

Thus, on September 11, 2015, respondents elevated their case before the Court in Division *via* a *Petition for Review.*

In their respective *Answers*, both petitioner and the CIR argued that the transfer of the two (2) parcels of land by respondent *Kingsville* to its co-respondent *Century Peak* is considered as a '*sale, barter or exchange of goods*' subject

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[9] Exhibit P-16, docket, pp. 493-495.
[10] Exhibit P-11.
[11] Exhibit P-20.

to VAT pursuant to Section 106 of the NIRC of 1997, as amended.

During the trial, only respondents presented evidence in support of their case. On the other hand, petitioner and the CIR failed to present any, despite the opportunity granted.[12]

On July 24, 2017, the Court in Division promulgated the assailed Decision, the dispositive portion of which reads:

> **WHEREFORE**, premises considered, the instant Petition for Review is **GRANTED**. Accordingly, the Bureau of Internal Revenue Certification Ruling SN. 014-2012 and the Department of Finance Resolution dated July 14, 2015 are hereby **REVERSED** and **SET ASIDE**.
>
> **SO ORDERED**.

In holding in favor of respondents, the Court in Division ratiocinated that while respondent *Kingsville* is a corporation primarily engaged in the real estate business, there is no proof that the two parcels of land it assigned to respondent *Century Peak* in consideration of the 450,000 shares of stock were properties originally intended for sale or for use in the course of its business. Further, the Deed of Assignment that respondents executed over the two parcels of land shows that it is a pre-incorporation subscription contract pursuant to Sections 61 and 62 of the Corporation Code, hence, it cannot be deemed as sale. Additionally, Revenue Regulations (RR) No. 4-2007 is not applicable on the ground that when respondent *Kingsville* acquired the 450,000 shares of stock in the capital stock of respondent *Century Peak,* the latter was still in the process of incorporation, hence, not yet a corporation with a juridical personality.

Aggrieved, petitioner moved for the reconsideration of the adverse Decision but the same was denied in the equally assailed Resolution of January 15, 2018.

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[12] Minutes of the Hearing held on June 22, 2016, docket, p. 667.

Hence, the instant *Petition for Review* filed on February 15, 2018, raising the lone issue as follows:

> WHETHER OR NOT THE TRANSFER OF THE TWO (2) PARCELS OF LAND THROUGH A DEED OF ASSIGNMENT ENTERED INTO BY AND BETWEEN THE RESPONDENTS IS CONSIDERED A "SALE, BARTER OR EXCHANGE OF GOODS" SUBJECT TO VALUE-ADDED TAX (VAT).

Petitioner maintains that the subject Deed of Assignment over the two parcels of land is subject to VAT as it falls squarely within the ambit of the enumeration of transactions, i.e., *"sale, barter or exchange of goods or properties"* contemplated in Section 106 of the NIRC, as amended.

According to petitioner, respondent *Kingsville* is a corporation primarily engaged in the real estate business and the two (2) parcels of land were part of its stock in trade primarily for sale or lease in the course of its trade or business. That being the case, the transfer of the two (2) parcels of land through a Deed of Assignment executed by and between respondents was a "sale, barter or exchange or goods or properties" subject to VAT.

Petitioner likewise contends that respondents' argument that the subject Deed of Assignment is in the nature of a pre-incorporation subscription agreement not included in the enumeration of transactions deemed sale under Section 106 (B) betrays their case. According to petitioner, respondents overlooked the fact that **a pre-incorporation subscription agreement is not also in the enumeration of Section 109 of the NIRC or the transactions exempt from VAT**. In other words, a pre-incorporation subscription agreement is not exempt from VAT.

Finally, petitioner invokes the principle that tax statutes are strictly construed against the taxpayer who is claiming for the exception. Per petitioner, claims for tax exemption must be based on language in law too plain to be mistaken.

It cannot be made out of inference or implication. In the instant case, respondents have not shown their right to an exemption from payment of VAT on the subject Deed of Assignment.

In their *Comment*,[13] respondents submit that the use of the two (2) parcels of land as property payment for the subscription of 450,000 shares of stock of respondent *Century Peak* is perfectly legal as it is in accordance with Sections 61 and 62 of the Corporation Code. It is in the form of capital investment and not a sale transaction.

Further, petitioner and the CIR did not treat subscription agreement using cash payments for the issuance of shares of stocks under Section 62 of the Corporation Code as subject to VAT. Respondents consider ludicrous the interpretation of petitioner and the CIR to the effect that cash payment for subscribed shares is NOT subject to VAT, but property payment is.

Respondents also contend that the execution of the Deed of Assignment was not a transaction done in the course of regular business of respondent *Kingsville* which is subject to VAT. Allegedly, the Deed of assignment was actually, by **operation of law,** a pre-incorporation subscription agreement executed in accordance with Sections 61 and 62 of the Corporation Code.

Lastly, respondents contend that when the Deed of Assignment was entered into on October 13, 2010, the prevailing revenue regulation was BIR Revenue Regulations (RR) No. 4-2007, Section 4.106-8(b)(1) of which states that "*if the transferee of the transferred real property by a real estate dealer is another real estate dealer, in exchange where the transferor gains control of the transferee-corporation,* ***no output VAT is imposable on the said transfer***." Since the prevailing RR at the time of the execution of the Deed of Assignment was RR No. 4-2007, it should not be subjected to output VAT.

[13] *En Banc* docket, pp. 142-154.

The Court *En Banc's* Ruling

After a careful review of petitioner's arguments and the record of the case, the Court *En Banc* finds no reason to reverse the assailed Decision and Resolution of the Court in Division. Petitioner merely replicated his previous arguments in his *Memorandum*[14] dated July 18, 2016, *Motion for Partial Reconsideration*[15] dated August 9, 2017, and *Reply*[16] dated September 14, 2017, which the Court in Division already considered and passed upon in the assailed Decision and Resolution. In any event, petitioner's arguments shall be discussed briefly to emphasize the ruling of the Court in Division.

The transaction covered by the Deed of Assignment is not subject to VAT

Section 106 of the NIRC of 1997, as amended, pertinently provides, thus:

> SECTION 106. *Value-added Tax on Sale of Goods or Properties.* —
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> (A) *Rate and Base of Tax.* — **There shall be levied, assessed and collected on every sale, barter or exchange of goods or properties, a value-added tax equivalent to twelve percent (12%)** of the gross selling price or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferor.
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> > (1) The term 'goods or properties' shall mean all tangible and intangible objects which are capable of pecuniary estimation and shall include:
> >
> > (a) **Real properties held primarily for sale to customers**

[14] Docket, pp. 668-681.
[15] Docket, pp. 760-769.
[16] Docket, pp. 787-799.

> **or held for lease in the ordinary course of trade or business;**
>
> Xxx xxx xxx
>
> (B) *Transactions Deemed Sale.* — The following transactions shall be deemed sale:
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> (1) **Transfer, use or consumption not in the course of business of goods or properties originally intended for sale or for use in the course of business;** *xxx*

Per the foregoing provision, transfer of **goods or properties** **<u>held for sale/lease</u>** and/or **goods or properties originally <u>intended for sale</u> in the course of business** is subject to 12% VAT.

In the instant case however, petitioner merely presumed that the two (2) parcels of land owned by respondent *Kingsville* were held for sale or use in the course of its business. This is evident in the assailed Resolution of July 14, 2015 he issued, to wit:

> "Being a real estate dealer, as represented by CENTURY, KINGSVILLE is engaged in the business of buying, developing, selling, exchanging real properties as principal, and its real properties are **<u>presumably</u> held for sale or use in the course of its business**. Thus, the position that the transfer by KINGSVILLE to CENTURY of real properties is not subject to value added tax finds no basis in the law." (*Emphasis supplied*)

Note, that while respondent *Kingsville* is a corporation primarily engaged in the real estate business, there is no proof or even a hint from which it could be deduced that the two parcels of land subject of the Deed of Assignment were properties held for sale or originally intended for sale or for use in the course of respondent *Kingsville*'s business.

A scrutiny of the Deed of Assignment reveals that it is a pre-incorporation subscription contract pursuant to Sections 61 and 62 of the Corporation Code of the Philippines. Respondent *Kingsville* contributed its properties instead of cash as capital for the incorporation of respondent *Century Peak* in order for him to subscribe 450,000 shares of stock of the latter. Necessarily, respondent *Kingsville* must relinquish and transfer its ownership and formally assign all its rights over the said properties in exchange for becoming a stock holder of respondent *Century Peak*. The pertinent portion of the Deed of Assignment is quoted below for ready reference:

> **For and inconsideration of the full payment of KINGSVILLE's total subscription of Four Hundred Fifty Thousand (450,000) shares at One Hundred Pesos (P100.00) per share in capital stock of CENTURY PEAK PROPERTY DEVELOPMENT, INC., a corporation that is now in the process of incorporation under the laws of the Republic of the Philippines, KINGSVILLE hereby assigns, transfers and conveys unto CENTURY PEAK PROPERTY DEVELOPMENT, INC. all its rights, titles, and ownership over the following properties**, consisting of:
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> xxx xxx xxx
>
> With the assignment and transfer of all rights, title, and ownership of KINGSVILLE over the above-described parcels of land unto CENTURY PEAK PROPERTY DEVELOPMENT, INC., the latter shall assume all obligations over the above-described parcels of land in favor of KINGSVILLE as assignor.

Thus, considering that the subject transaction is in the nature of pre-incorporation subscription pursuant to Sections

61 and 62 of the Corporation Code of the Philippines, the same **cannot be deemed as sale**. In the case of *Delpher Trades Corporation and Delfin Pacheco vs. Intermediate Appellate Court and Hydro Pipes Philippines, Inc.*,[17] the Supreme Court relevantly ruled, thus:

> After incorporation, one becomes a stockholder of a corporation by subscription or by purchasing stock directly from the corporation or from individual owners thereof (*Salmon, Dexter & Co. v. Unson, 47 Phil. 649, citing Bole v. Fulton [1912], 233 Pa., 609*). In the case at bar, in exchange for their properties, the Pachecos acquired 2,500 original unissued no par value shares of stocks of the Delpher Trades Corporation. Consequently, the Pachecos became stockholders of the corporation by subscription. '**The essence of the stock subscription is an agreement to take and pay for original unissued shares of a corporation, formed or to be formed**. (Rohrlich 243, cited in Agbayani, Commentaries and Jurisprudence on the Commercial Laws of the Philippines, Vol. III, 1980 Edition, p. 430) It is significant that the Pachecos took no par value shares in exchange for their properties.
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> xxx xxx xxx
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> The '**Deed of Exchange**' of property between the Pachecos and Delpher Trades Corporation **cannot be considered a contract of sale**. **There was no transfer of actual ownership interests** by the Pachecos **to a third party**. **The Pacheco family merely changed their ownership from one form to another. The ownership remained in the same hands**. (*Emphases supplied*)

Clear under Section 105 of the NIRC of 1997, as amended, that VAT is imposed on any person who, in the course of trade or business, sells, exchanges or leases goods

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[17] G.R. No. L-69259, January 26, 1988.

or properties. The phrase "*in the course of trade or business*" is defined in Section 105 of the NIRC of 1997, as amended, to mean **the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto, by any person,** regardless of whether the person engaged therein is a nonstock, nonprofit private organization (irrespective of the disposition of its net income and whether it sells exclusively to members or their guests), or government entity.

In the case of *Commissioner of Internal Revenue vs. Magsaysay Lines, et al.*[18], the Supreme Court ruled that any sale, barter or exchange of goods or services not in the course of trade or business is not subject to VAT. The Supreme Court explained the basic tenet governing VAT as follows:

> A brief reiteration of the basic principles governing VAT is in order. VAT is ultimately a tax on consumption, even though it is assessed on many levels of transactions on the basis of a fixed percentage. It is the end user of consumer goods or services which ultimately shoulders the tax, as the liability therefrom is passed on to the end users by the providers of these goods or services who in turn may credit their own VAT liability (or input VAT) from the VAT payments they receive from the final consumer (or output VAT). The final purchase by the end consumer represents the final link in a production chain that itself involves several transactions and several acts of consumption. The VAT system assures fiscal adequacy through the collection of taxes on every level of consumption, yet assuages the manufacturers or providers of goods and services by enabling them to pass on their respective VAT liabilities to the next link of the chain until finally the end consumer shoulders the entire tax liability.
>
> Yet VAT is not a singular-minded tax on every transactional level. Its assessment

[18] G.R. No. 146984 dated July 28, 2006.

> bears direct relevance to the taxpayer's role or link in the production chain. Hence, as affirmed by Section 99 of the Tax Code and its subsequent incarnations, the tax is levied only on the sale, barter or exchange of goods or services by persons who engage in such activities, in the course of trade or business. These transactions outside the course of trade or business may invariably contribute to the production chain, but they do so only as a matter of accident or incident. As the sales of goods or services do not occur within the course of trade or business, the providers of such goods or services would hardly, if at all, have the opportunity to appropriately credit any VAT liability as against their own accumulated VAT collections since the accumulation of output VAT arises in the first place only through the ordinary course of trade or business.
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> xxx xxx xxx
>
> The conclusion that the sale was not in the course of trade or business, which the CIR does not dispute before this Court, should have definitively settled the matter. **Any sale, barter or exchange of goods or services not in the course of trade or business is not subject to VAT**.

Verily, the transfer of the two parcels of land pursuant to Sections 61 and 62 of the Corporation Code as pre-incorporation subscription is not a disposition or exchange of properties "*in the course of trade or business*" and is, therefore, not subject to VAT.

Anent petitioner's contention that the pre-incorporation subscription agreement is not included in the enumeration of Section 109 of the NIRC of 1997, as amended, or the transactions exempt from VAT, the Court *En Banc* is one with the Court in Division in holding that:

> Section 109 of the NIRC of 1997, as amended, enumerates the VAT exempt

transactions. **The exclusive list of transactions in this provision are transactions which <u>ordinarily in the course of trade or business</u> are liable to VAT but by provision of law are exempted.**

To reiterate, the transfer of properties for stocks under the Deed of Assignment in this case is considered a pre-incorporation subscription agreement. Pre-incorporation subscription agreement is indeed not one of the transactions enumerated in Section 109 of the NIRC of 1997, as amended.

However, Section 105 of the NIRC of 1997, as amended, is clear that the VAT is imposed only on a person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, and any person who imports goods. Moreover, Section 105 defines the phrase "in the course of trade or business" as "the regular conduct or pursuit of a commercial or economic activity, including transactions incidental thereto."

In the case of *Fort Bonifacio Development Corporation vs. Commissioner of Internal Revenue, et al.*, the Supreme Court held that if the goods or properties are not acquired from a person in the course of trade or business, the transaction would not be subject to VAT under Section 105.

In this case, petitioner Kingsville is engaged in the real estate business. Its transfer and conveyance of two parcels of land to petitioner Century Peak in consideration of the 450,000 shares of stock is a transaction that cannot be construed as being in the course of trade or business of the transferor, or even incidental to such trade or business. Thus, the Deed of Assignment executed on October 13, 2010

> is not subject to VAT. (*Emphasis supplied; citation omitted*)

WHEREFORE, the instant *Petition for Review* filed by The Secretary of Finance on February 15, 2018 is hereby **DENIED**, for lack of merit. Accordingly, the assailed Decision and Resolution dated July 24, 2017 and January 15, 2018, respectively, are **AFFIRMED.**

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

We Concur:

ROMAN G. DEL ROSARIO
Presiding Justice

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

ERLINDA P. UY
Associate Justice

Cielito N. Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

MA. BELEN RINGPIS-LIBAN
Associate Justice

Catherine T. Manahan
CATHERINE T. MANAHAN
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ROMAN G. DEL ROSARIO
Presiding Justice