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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

RIZAL THEATRICAL CO., INC.,
and AYALA CORPORATION,
Petitioners,

- versus - C.T.A. CASE NO. 3463

THE HON. COMMISSIONER OF
INTERNAL REVENUE,
Respondent.
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D E C I S I O N

This is an appeal from the decision of the Commissioner of Internal Revenue assessing against and demanding from petitioners the sum of P1,580,705.66 for the year 1976 as deficiency income tax based on the theory that petitioners are in a joint venture taxable as a corporation under Section 20 of the National Internal Revenue Code, and subject to corporate tax under Section 24 of the same Code.

Petitioner Ayala Corporation is the owner and developer of a residential commercial complex located in Makati, Metro Manila. It consists, among others, of hotels, shops, and other commercial establishments.

For the purpose of having a complete and integrated residential commercial complex, petitioner Ayala Corporation constructed and maintained within the complex six (6) moviehouses namely: the Magallanes Theatre, Rizal Theatre, QUAD Cinema 1, QUAD Cinema 2, QUAD Cinema 3 and QUAD Cinema 4.

The purpose of petitioner Ayala Corporation was mainly the development of the real estate and the moviehouses in question. Accordingly the said corporation contracted the petitioner Rizal Theatrical Co., Inc., to manage and operate the said theatres under three (3) "Operating and Management Contracts".

For the year 1976, (a) the Rizal Theatre was managed and operated by the Rizal Theatrical Co., Inc., under an extension of an "Operating and Management Contract" executed on January 25, 1974 (Exh."E"); (b) the four (4) QUAD Theatres were managed and operated likewise by the Rizal

Theatrical Co., Inc., under another "Operating and Management Contract", executed on October 26, 1972 (Exh. G"), and (c) the Magallanes Theatre was managed and operated under a third "Operating and Management Contract" dated February 1, 1974 (Exh."H").

The provisions of the three (3) "Operating and Management Contract" are practically identical. They provided for the operation of the six (6) moviehouses by the Rizal Theatrical Co., Inc., whose management fees were to be computed on a certain percentage of the "net profits" from such operations. The term "net profits", on the basis of which the amount of the management fees of the manager was computed, was defined with a certain degree of definitiveness in the contracts. The term "net profits" (from which the management fees were to be quantified) was, in substance, defined as the balance from the theatre income, after deducting therefrom certain specific expenditures. The Ayala Corporation, as owner of the six (6) moviehouses concerned, borne and paid for all expenses not otherwise stipulated as operating expenses deductible from the gross operating income. It is clear from the foregoing that the term "net profits" had a restricted meaning exclusively for use and purposes of the management contracts.

The only issue involved in the above-entitled case is whether or not the relationship between Rizal Theatrical Co., Inc. and the Ayala Corporation constitutes a joint venture taxable as a corporation under Section 20 of the National Internal Revenue Code.

Petitioners during the 1976 taxable year in question had filed their separate and distinct income tax return and paid their income tax liabilities thereunder. The 1976 deficiency income tax assessment in question in the sum of P1,580,705.66 sprung from the lone issue as to whether or not the two (2) petitioners had formed themselves into joint venture.

It is the petitioners' theory that there never was a joint venture between them, that the contracts executed between them were for the management of the six (6) moviehouses and were for simple contracts of services, although the amount of the compensation to be paid to the Rizal Theatrical Co., Inc., as contractual manager, was dependent on the "net profits" as determined in accordance with the formulas laid down in the subject management contracts.

On the other hand, it is respondent's claim that these petitioners were constituted into joint venture and that contracts entered into between Ayala Corporation and Rizal Theatrical Co., Inc., although designated as "Operating and Management Contract" are in reality contract of joint venture and that the same could not be denominated as management contracts.

The term "corporations" for the purpose of the income tax law include not only private corporations organized under the Corporation Law or government owned corporations but also registered or unregistered general partnership, limited partnership, joint stock companies, insurance companies, joint ventures and similar entities.

A joint venture has generally been referred to as an association of persons with the intent, by way of a contract, express or implied, to engage in and carry out a single or joint business venture for which purpose they combine their efforts, properties, money, skills and knowledge, without creating a partnership or a corporation, pursuant to an agreement that there shall be a community of interest among themselves as to the purpose of the undertaking and that each joint venturer shall stand in relation of principal, as well as agent, as to each of the other co-venturer, with an equal right of control of the means employed to carry out the common enterprise.

To constitute a joint venture, the following factors must concur:

a) A contribution by the parties of money, property, effort, knowledge, skill or assets to a common undertaking;

b) A joint property interest in the subject matter of the venture;

c) A right of mutual control or management of the enterprise;

d) An expectation of profit, or the presence of adventure;

e) A right to participate in the profit;

f) Usually, a limitation of an objective of a single undertaking or ad hoc enterprise (Ibid; 6 Mertens 35.05); and

g) A duty to share the losses.

Based on the above-mentioned guidelines, as to what constitute a taxable joint venture, it is our opinion that the Operating and Management Agreements between Ayala Corporation and Rizal Theatrical Co., Inc., did not create a joint venture taxable as a separate corporate entity. The relationship between Ayala Corporation and Rizal Theatrical Co., Inc., was basically of an independent contract with regard to the management and operation of the six (6) moviehouses and no joint venture was ever thought of between the parties when they entered into agreement. Joint venture rests upon an express or implied agreement of two or more persons to combine their property or time or both in a specified course of business or in particular business transaction. (See Klaber v. Klaber, Fla. App. 133 So 2d 98, cited in 46 Am. Jur. 2d 32.) And, whether a joint venture exists must largely depend upon determining the intention of the parties from the facts of a particular case. (See Holtz v. United Plumbing & Heating Co., 49 Cal. 2d 501, cited in 46 Am. Jur. 2d 31.)

We will make a thorough examination of each element of joint venture.

> a) A contribution by the parties of money, property, effort, knowledge, skill or assets to a common undertaking;

As far as this requirement is concerned, petitioners do not seriously contest respondent's claim that there is, indeed some form of "pooling" of some resources to a common undertaking. Basically, the Ayala Corporation contributed the physical facilities, while the Rizal Theatrical Co., Inc., contributed the industry.

This is however, not the only element of a joint venture. Other conditions must concur, which do not exist.

> b) A joint property interest in the subject matter of the venture;

> d) An expectation of profit, or the presence of adventure;

e) A right to participate in the profit;

For this purpose, the second, fourth and fifth elements of a joint venture, will be discussed hereinbelow.

There is a bit of uncertainty as to what constitutes the "subject matter" of a venture. More particularly in this case, what the "subject matter" of the venture is somewhat unclear.

The "subject matter" of the present venture may be 1) the physical facilities of the Cinema exhibition business involved; or (2) the actual "operations for profit" of the business.

Assuming the "subject matter" of the venture to be the physical facilities, there is no question that the said facilities belong solely and exclusively to the Ayala Corporation. The Rizal Theatrical Co., Inc., did not, by virtue of its contracts for management, obtain any interest in the said properties.

On the other hand, if the term "subject matter" refers to the operation of the business for profit, the Ayala Corporation, has no voice in the said operations. Not only this, it has no real interest in common with the Rizal Theatrical Co., Inc., in the "profits" of the venture.

The manager (Rizal Theatrical Co., Inc.) has an interest in the "operating income" of the venture as its management fees were quantified from the amount of said operating income. The term "operating income", as used in the contracts (as basis of the computation of the management fees) is not synonymous, however, with "profits of the venture" (as the terms is used to denote an element of a joint venture).

Under the set-up in question, the venture may, in fact be a financial failure while still providing an "operating income" entitling the manager to ompensation. This is so because several expenses of the venture are not deducted from the gross revenues in arriving at the amount of the "operating income". Such expenses include such items as depreciation, realty taxes, structural renovations. This is understandable when the object of the Ayala Corporation in entering into the contract is reviewed. The venture was treated by the Ayala Corporation as a service inasmuch as they were developers and owners of a commercial complex in which the moviehouses were located. The idea was to furnish the complex with facilities that would draw more people in the complex and provide entertainment for people in the complex.

The same is true of the moviehouses in the complex. The interest of the Ayala Corporation was not to reap profits therefrom but to provide a service that would further "develop" the complex and makes it more marketable and valuable.

It did not matter to the Ayala Corporation (who paid the other expenses of the venture not reckoned as "deductions from gross income") that the venture would result in real losses. They would be made up in the income from "collateral benefits" for the commercial complex.

"Profits from the venture" were not the primary interests of the Ayala Corporation in the contracts of management. On the other hand, "operating income" not "profits from the venture" was the primary consideration of Rizal Theatrical Co., Inc.

From the foregoing, it would appear that the parties to the management contracts had relatively divergent or different interests in the venture and not joint interests.

c) A right of mutual control or management of the enterprise;

Under the agreements, Ayala appointed and employed Rizal Theatrical Co., Inc., as consultant and general manager to supervise, direct and control the management and operation of the Rizal Theatre. By virtue of the grant, Rizal Theatrical Co., Inc. was commissioned by Ayala to render, supervise and control the performance of all services in connection with the operation and management of the moviehouses and to do, and cause to be done, all acts reasonably necessary for the efficient and proper operation thereof. Rizal Theatrical Co., Inc. was also granted the authority to render, supervise and control the performance of related services for and in its own name and behalf. Thus Rizal Theatrical Co., Inc. had the sole prerogative in the employment of personnel; establishment of prices and price schedules; negotiations and making arrangements for hiring, leasing movie films, theatrical and other presentations; leasing of the lobby space of the theatre and the supervision and control of the activities of tenants therein; negotiation of contracts as are necessarily required in the operation of the business and allied businesses such as, but not limited to, advertising promotions and the like, and the purchase of such supplies and inventories as are required and necessary to properly operate and maintain the theatre. Evidently, the agreement between the herein taxpayers did not create a right of mutual control in the management of the enterprise. Rizal Theatrical Co., Inc. had the sole control of the operation and management of the business.

> f) Usually, a limitation of an objective to a single undertaking or ad hoc enterprise (Ibid; 6 Mertens 35.05);

A single undertaking; a random project; an isolated transaction. These are terms that will best describe a joint venture. While there had been many such single undertakings held to be partnerships or joint ventures in this jurisdiction, the best illustration, so far, has been the contribution of money to a common fund to buy lottery tickets.

In the present case, the agreements and actual practice show that the intention of the parties was not to exhibit random cinema films. Rather, the intention was to present to the commercial complex patrons a continuing service, a continuing facility. The project was to provide the entertainment facilities or cinemahouses to the commercial complex patrons on a continuing basis. It did not matter whether the exhibition of certain films and movies would draw more people to the complex than other films. The idea was to make cinema ente ainment a fixed attraction of the complex.

The contracts, therefore, envisioned the continuous exhibition of films moviehouses of the commercial complex. A permanent and continuing feature of the complex exhibiting cinema films one after another.

The project was not therefore limited to the exhibition of the random film.

g) A duty to share the losses.

Nowhere is there any indication that Rizal Theatrical Co., Inc. was intended to participate in possible losses. To the contrary, the intentions to above possible losses shouldered solely by the owner (Ayala Corporation) is implied in the contracts.

It is believed that this is one of the most important elements of joint venture.

While no loss was incurred during the existence of the contracts, as far as the intention of the parties is concerned, the intention not to have Rizal Theatrical Co., Inc. share in the losses is evident from:

1. The absence of any specific stipulation to that effect. The contracts are, on their faces, simple contracts for services. If there had been any intentions to hold Rizal Theatrical Co., Inc. liable for any loss, there would have been a clear specific provision thereof.

2. The profits or operating income (for purposes of determining management fees) were stipulated to be determined every calendar year.

The stipulations read as follows:

EXHIBIT E (for Rizal Theatre)

> "4. Management Fee... The net income shall be determined every calendar semester, that is, provisionally on June 30 and finally on December 31 of every year..."

EXHIBIT G (For QUAD Theatres)

> "4.6. The Operating Income shall be determined every calendar semester, that is provisionally on June 30, and finally on December 31, of each year. Proper accounting and payment shall be made by THEATRES to AYALA within thirty (30) days of the close of each calendar semester."

EXHIBIT H (for Magallanes Theatre)

> "4. Management Fee... The net income shall be determined every calendar semester, that is, provisionally on June 30 and finally on December 31, of every year..."

It is clear from the foregoing that should losses be incurred for any year, it would not be covered by profits in the following year. The losses of the previous year, therefore, will not diminish the profits (hence also the management fees) for the following year.

This clearly indicates the intentions of the parties to shield the manager (Rizal Theatrical Co., Inc.) from losses.

In the clear analysis, the provisions of the subject Agreements does not warrant the conclusion of the existence of a taxable joint venture.

At this juncture, it must be stated that in view of the clear and explicit intention of the parties to constitute the Rizal Theatrical Co., Inc. as a mere "Contractual Manager", the Rizal Theatrical Co., Inc. has religiously paid the necessary independent contractor's tax of 3% on its 1976 gross receipts from the management contracts.

Thus, it is worth to recall the declaration of our Supreme Court when it ruled that -

> "x x x Assessment fixes and determines the tax liability of a taxpayer and as soon as it is served an obligation arises on the part of the taxpayer concerned to pay the amount assessed and demanded. Hence, assessments should not be based on mere presumptions no matter how reasonable or logical said presumptions may be."
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> "In order to stand its test of judicial scrutiny, the assessment must be based on actual facts. The presumption of correctness of assessment being a mere presumption cannot be made to rest on another presumption." (Benipayo vs. Commissioner of Internal Revenue (CIR), G.R. No. L-3656, Jan. 31, 1962; Island Garment Mfg. Corp. vs. CIR, CTA No. 2070, June 22, 1977; Medina vs. CIR, CTA No. 1245, Dec. 27, 1971; Herrera vs. CIR, CTA

No. 2060, June 27, 1972; Samson vs. CIR, CTA No. 232, June 30, 1958; Uytengbo vs. CIR, CTA No. 363, Dec. 26, 1950.)

In a supplemental memorandum filed by petitioners on September 16, 1987, it is alleged that the Commissioner of Internal Revenue resolved, in a much similar case, that there is no taxable venture in a contractual relationship between RYR Theatrical Enterprises, Inc., with HP Development Corporation and Luz P. Martel over the moviehouses known as Harrison Plaza Cinema 1, 2 and 3.

The issue involved in the said case is the alleged existence of a taxable joint venture arising from a management contract between RYR Theatrical Enterprises, Inc., with HP Development Corporation and Luz P. Martel over the moviehouses known as Harrison Plaza Cinema 1, 2 and 3.

The tax case referred to therein has already been decided by the respondent Commissioner of Internal Revenue, based on the recommendation made by the Chief of the Appellate Division and concurred in by the Chief of Legal Service Office of the Bureau of Internal Revenue, in a memorandum dated June 15, 1987 and that the Commissioner of Internal Revenue resolved that there is no taxable joint venture in the contractual relationship of the parties to the management contract referred to above, and that the facts presented in the tax case referred to therein and in the above-entitled case now pending before this Honorable Court are esentially the same.

The said memorandum for the Commissioner of Internal Revenue dated June 15, 1987 reads as follows:

MEMORANDUM FOR:
The Commissioner

SUBJECT:

This refers to the protest of RYR THEATRICAL ENTERPRISES, INC., filed through counsel, against the assessments of P4,520,047.20 as deficiency income and fixed taxes for taxable years 1980 and 1981 in joint ventures with Luz P. Martel and HP Development Corporation under Assessment Notice Nos. FAN-1-80-87-002097, FAN-1-81-87-002098, FAN-1-80-87-002093, FAN-1-81-87-002094, FAN-4-80-87-002099, FAN-4-81-87-002000, FAN-4-80-87-002095, and FAN-4-81-87-002096, all dated March 20, 1987.

FACTS:

RYR Theatrical Enterprises, Inc. is a domestic corporation engaged in the operation not only of its own moviehouses, but also in the management and operation of theaters by third parties.

In 1979, it entered into separate contracts, entitled "Management Contract" with HP Development Corporation and Luz P. Martel, whereby it was appointed and employed as technical consultant and general manager to "supervise, direct and control the management and operation" of the moviehouses of the latter known as Harrison Plaza Cinema 1, 2 and 3, all located at the sprawling Harrison Plaza Complex, Harrison Boulevard, Manila, which was completely gutted by fire some years ago.

In the investigation of taxpayer's tax liabilities for the years 1980 and 1981, the examiner interpreted the activities embodied in the terms and provisions of the contracts which were substantially identical, not as contracts for services but as joint venture agreements, as a result of which it was assessed for deficiency income and fixed taxes.

In finding and justifying the existence of joint ventures with HP Development Corporation and Luz P. Martel, the examiner relied on the following aspects of the management contracts, vis.:

1. That the procurement of the movie films to be shown in the theaters was made by the taxpayer, which means that the latter as operator contributed capital;

2. That the compensation for the services of the taxpayer was 50% of the operating income, which is unusual in the management contracts where compensation normally is fixed and not dependent upon net profit or loss in business operations; and

3. That the taxpayer agreed to allocate and maintain sufficient capital at all times to assure the uninterrupted operation of the business.

ISSUES EVALUATION DISCUSSION:

The taxpayer, in its protest, raised the following issues:

1. There were no joint ventures with HP Development Corporation and Luz P. Martel, but only contracts for services;

2. Taxpayer's tax liabilities for the year 1981 have been condoned due to its availment of tax amnesties under Executive Order Nos. 41, 53, 64 and 95; and

3. The period within which to make an assessment for the year 1980 has already prescribed.

There is merit and basis for taxpayer's contention that the management contracts in question are contracts for services and not joint business ventures.

The features or activities cited above by the examiner as tending to show the existence of joint ventures are not strong and sufficient to overthrow the essence and substance of said contracts, which are principally for performance of services, that is, for taxpayer "to act as technical consultant and general in supervising, directing, controlling, operating and managing the operation and business of the theaters" of HP Development Corporation and Luz P. Martel.

The provisions of the contracts wherein taxpayer was under obligation, as one of the services or activities to be rendered, "to negotiate and make arrangement for hiring, leasing and showing of movie films," and "to allocate and maintain sufficient working capital at all times to assure the uninterrupted operation of the theaters, "are only phases of the whole business services and profile of the taxpayer that bolster and establish its reputation and standing as a competent, reliable and stable management firm specializing in theater operation. Likewise, there is nothing unusual regarding the payment to taxpayer of 50% of the operating income of the business as compensation or management contracts, the management fee is fixed and not dependent on the outcome of the operation of the business, the parties are free to adopt a different scheme or arrangement as regards management fee for services rendered.

Moreover, one essential element of a joint venture is the intention of the parties thereto, which may be an express or implied agreement to contribute or combine their property, skill or time in a specified course of business or common undertaking, with the intention of dividing the profits between themselves. (Klaber vs. Klaber Fla. App. 133 So 2d 98, cited in Am Jur 2d 32.)

In the instant case, was it the intention of taxpayer and HP Development Corporation or taxpayer and Luz P. Martel to engage in theater operation business? It is believed that such was not their intention when they entered into the management contracts. It is widely known in business circles, more particularly in the theater operation business that taxpayer has been in this kind of business for many years, even long before the execution of the said management contracts. It owned, operated and managed a number of first-class movie houses right in the heart of Manila. Thus, it is inconceivable for it to still engage in joint venture with third parties in the same line of business in which it was primarly engaged. It could have just put up another first-class cinema of its own somewhere else or right in the premises of the vast Harrison Plaza Commercial Complex for it had sufficient financial resources, technical services and managerial experties. But as taxpayer's counsel claims, it was his client's technical services and expertise as well as business connections that made the theater owners decide to secure its services as manager-operator. The reason is quite obvious. HP Development Corporation and Luz P. Martel were apparently business neophytes insofar as theater operation is concerned. The records show that at the time of the execution of HP Development Corporation's management contract with taxpayer on August 20, 1979, its movie theater (Harrison Plaza Cinema 3) was still under construction.

In the leading case of Eufemia <u>Evangelista, et al. vs. Collector of Internal Revenue</u>, G.R. L-9996 promulgated October 15, 1957, where three (3) sisters contributed their personal funds, including the money that they have borrowed from their father, to a common fund and bought real properties for the purpose of renting them out to several tenants, then appointed their brother to manage the properties with full power to lease, collect and receive rentals, and to take all necessary acts for the successful management and operation of the business, to the end that the properties had been handled as if the same belonged to a corporation or business undertaking operated for profit, the Supreme Court held that for tax purposes the sisters were deemed to have formed a partnership. The above case was followed by still another leading case of Collector of Internal Revenue vs. Batangas Transportation Co. and Laguna-Tayabas Batangas Co., 102 Phil. 822 (G.R. No. L-9692, Jan. 6, 1958), where two transportation companies operating separately decided to pool their resources by combining their respective fleets of buses, placed the operation of the business under one sole management called the "Joint Operation" for the purpose of economizing on expenses, to the end that they constituted a single entity, and after accounting for the gross receipts and all expenses incurred, divided the resulting net profit on a 50-50 sharing basis, the Court again ruled that the said arrangement or scheme constituted a joint venture under the National Internal Revenue Code.

It should be noted that in these two cases, the facts were clear and unequiv cal, both as to the intention of the parties and the manner by which the business enterprises were created and managed, and the participation of the parties in the net profits or losses.

On the basis of the above evaluation and discussion we find it unnecessary anymore to discuss the merits of the two remaining issues raised by the taxpayer.

RECOMMENDATION:

In view of the foregoing, and finding taxpayer's protest to be well taken, it is respectfully recommended that the questioned assessment be withdrawn and cancelled.

Respectfully submitted:

(Sgd.) EULOGIO H. NATIVIDAD
Chief, Appellate Division

I CONCUR:

(Sgd.) JAIME M. MAZA
Revenue Service, Chief Legal Office

Recommendation-APPROVED:

(Sgd.) BIENVENIDO A. TAN, JR.
Commissioner of Internal Revenue

In view of the foregoing, it is our opinion that the claim of respondent that a taxable joint venture exists among the herein petitioners does not have any merit and without any legal basis.

WHEREFORE, the appealed decision of the Commissioner of Internal Revenue against petitioners for 1976 deficiency income tax in the sum of P1,580,705.66 is hereby set aside.

No pronouncement as to costs.

SO ORDERED.

Quezon City, Metro Manila, April 24, 1989.

CONSTANTE C. ROAQUIN
Associate Judge

WE CONCUR:

AMANTE FILLER
Presiding Judge

ALEX Z. REYES
Associate Judge

C E R T I F I C A T I O N

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.

AMANTE FILLER
Presiding Judge
Court of Tax Appeals