REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

ALFONSO Z. SYCIP and
INTERNATIONAL CONSTRUCTION
CORPORATION,
Petitioners,

- versus - C.T.A. CASE No. 672

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.
x- - - - - - - - - - - - - - -x

D E C I S I O N

This is an appeal from a decision of respondent Commissioner of Internal Revenue dated April 7, 1959, denying the request for the withdrawal or cancellation of the donor's and donee's gift tax assessment issued against petitioners, Alfonso Z. Sycip, as donor, and International Construction Corporation, as donee, in the amounts of ₱35,899.09 and ₱325,198.87, respectively.

The assessment was issued on account of the transfer allegedly made by petitioner Alfonso Z. Sycip of ten (10) parcels of land in favor of the International Construction Corporation, pursuant to Section 111 of the Tax Code, which reads:

> SEC. 111. Transfer for less than adequate and full consideration. - Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall, for the purpose of the tax imposed by this Chapter, be deemed a gift, and shall

272

be included in computing the amount of gifts made during the calendar year.

The facts are not disputed. It appears that petitioner International Construction Corporation is a close corporation owned by the family of petitioner Alfonso Z. Sycip.

On February 21, 1954, petitioners entered into a contract entitled "Agreement of Sale," wherein Alfonso Z. Sycip agreed to sell to the International Construction Corporation, and the latter to buy from the former ten (10) parcels of land, with a total area of 15,184.95 sq. m., situated at Nagtahan street, district of San Miguel, Manila, with the improvements thereon, except a 15-door building known as the "Nagtahan Apartment," a bodega and a building known as the "Grace Christian High School," for the sum of ₱227,089.80, with interest at 5% per annum, and payable in shares of stock at par value upon the increase of its capitalization. The aforesaid ten (10) parcels of land subject matter of the agreement of sale is covered by Transfer Certificates of Title Nos. 10737, 10738, 21072, 21073, 21074, 21075, 23775, 23776 and 23777 of the Register of Deeds of Manila.

The pertinent provisions of the aforesaid agreement of sale read as follows:

NOW THEREFORE, for and in consideration of the foregoing premises, the par-

273

ties hereto have mutually covenanted and agreed and by these presents covenant and agree, as follows:

1. That the VENDOR shall sell to the VENDEE and the VENDEE shall purchase from the VENDOR the above described ten (10) parcels of land together with the improvements thereon except as hereinafter specified for the sum of TWO HUNDRED TWENTY SEVEN THOUSAND EIGHTY-NINE PESOS AND EIGHTY CENTAVOS (₱227,089.80), Philippine currency, to be paid in the manner hereinafter stipulated;

2. That the VENDEE shall execute a promissory note in favor of the VENDOR for the stipulated purchase price with interest at the rate of five per centum (5%) per annum from the date of the note until it is fully paid;

3. That the said amount of ₱227,089.80 with interest at the stipulated rate shall be paid to the VENDOR by the VENDEE with shares of stocks at par value of the VENDEE corporation upon the increase in capitalization of the said VENDEE corporation;

4. That the VENDEE shall assume and pay all taxes and other expenses levied upon or incurred in connection with the said ten (10) parcels of land and improvements thereon except as hereinafter excepted, and shall likewise enjoy the rentals or fruits thereof from March 1, 1954;

5. That this Agreement of Sale does not include the buildings in the name of Mr. John Sycip presently existing on the land, which consist of a fifteen (15) "door" building known as the "Nagtahan Apartment" and a bodega built on two (2) parcels of land owned by the herein VENDOR, and neither does this Agreement of Sale include the building thereon known as the "Grace Christian High School";

(274)

> 6. That, upon notice by the VENDEE to the VENDOR which shall not be later than October 31, 1955, that said VENDEE is ready to issue to the VENDOR the equivalent shares of stock at par value of the VENDEE corporation for the payment of the said ten (10) parcels of land with the improvements thereon except as hereinabove specified, the said VENDOR shall execute a deed of absolute sale over the real properties subject of this Agreement in favor of the VENDEE; and
>
> 7. That the VENDOR hereby agrees and binds himself and his heirs to execute and deliver in favor of the VENDEE any and all documents necessary and proper in order to validly convey the ownership and title of the said ten (10) percels of land together with the improvements thereon except as hereinabove specified to the VENDEE.

On February 21, 1954, the Vendee International Construction Corporation, thru its Treasurer Mr. Mariano V. Godinez, executed a non-negotiable promissory note in favor of Alfonso Z. Sycip in the amount of ₱227,089.80, with interest at the rate of 5% per annum which is hereby quoted as follows:

> In consideration of the transfer to this corporation of the ten (10) parcels of land, together with certain improvements thereon, situated at Nagtahan Street, San Miguel, Manila, covered by Transfer Certificates of Title Nos. 10737, 10738, 21072, 21073, 21074, 21075, 23775, 23776 and 23777 of the Registry of Deeds for the City of Manila and subject to the terms and conditions specified in that Agreement of Sale executed on even date, we hereby promise to pay to MR. ALFONSO Z. SYCIP at his office in the City of Manila, Philippines, the sum of TWO HUNDRED TWENTY SEVEN THOUSAND

275

> eighty nine pesos and 80/100 (₱227,089.80), Philippine currency, with interest thereon at the rate of five percent (5%) per annum, such payment to be made by the issuance in his favor of fully paid shares of stock at par value of this corporation upon the increase in its capitalization corresponding to the amount of the principal obligation evidenced by this promissory note with interest at the above-mentioned rate.

On the basis of the above agreement, respondent Commissioner of Internal Revenue on July 25, 1956, assessed petitioners Alfonso Z. Sycip and the International Construction Corporation for donor's and donee's gift tax in the amount of ₱35,899.09 and ₱325,198.87, respectively.

The donor's and donee's gift tax assessment was based on the findings by respondent's examiner that, per the agreement of sale, there exists a valid transfer of the ten (10) percels of land from Alfonso Z. Sycip to the International Construction Corporation for less than their adequate and full consideration; that this conclusion was arrived at by considering the prevailing market price of the ten (10) parcels of land at the time of the transaction at ₱40.00 per sq. m., and that taking into account the total area of the parcels of land to be 15,184.95 sq. m., the total fair market value thereof was ₱607,398.00. Deducting therefrom the value of consideration of ₱227,089.80, plus interest of 5% from February 21, 1954 to October 31, 1955 in the

274

sum of ₱18,924.17, or a total of ₱246,013.97 there resulted a difference of ₱361,384.03, which was considered a gift subject to donor's and donee's taxes under Section 111 of the Tax Code.

Petitioners protested the donor's and donee's gift tax assessment in a letter dated October 21, 1966, alleging that no transfer taxable as a gift under Section 111 of the National Internal Revenue Code was effected by the petitioners Alfonso Z.Sycip and the International Construction Corporation by their agreement of sale of February 21, 1954 as the ten (10) parcels of land were never transferred or conveyed to the said corporation. Petitioners further contended, in the alternative, that assuming the agreement of sale resulted in a taxable donation, the amount of taxes assessed are excessive reasoning out as follows:

> x x x. In the first place, the fair market value of the real properties as of February 21, 1954 has been grossly overstated. We have had an independent appraisal made of the properties mentioned in the instrument of February 21, 1954, and according to this appraisal, the fair market value of the property at the time was only ₱20.00 per square meter, or a total value of ₱303,699.00 x x x.
>
> Lastly, even if it should turn out that the fair market value of the properties to be transferred by Mr. Sycip exceed the fair market value of the shares issued to him, and that it was Mr. Sycip's intention to make a taxable gift, nevertheless the amount of the taxable gift is not the entire excess but only a portion

> thereof, because Mr. Sycip is a substantial stockholder of the corporation. It is settled that the gift tax should only be applied to the extent by which the taxpayer, by his contribution to the corporation, benefited the corporation, after excluding so much of the corporate interest as belongs to the taxpayer-donor.

Meantime, or on January 2, 1957, International Construction Corporation increased its capital stock from ₱500,000.00 to ₱1,500,000.00.

On October 28, 1958, petitioner Alfonso Z. Sycip sold a portion of the lands subject matter of the Agreement of Sale and covered by Certificates of Title Nos. 21072, 21073, and 21074 (now covered by TCT No. 59373) to the Government of the Republic of the Philippines.

On January 26, 1959, petitioners wrote a "Memorandum" reiterating their protest against the assessment and requesting withdrawal of the same.

On April 7, 1959, respondent denied petitioners' protest on the ground that there was a valid and completed sale as the agreement shows that the Vendee International Construction Corporation shall assume and pay the realty taxes in connection with the ten (10) parcels of land and improvements, and shall enjoy the rentals or fruits thereof from March 1, 1954; that the elements of valid sale, namely: (1) subject matter; (2) consideration, (3) parties, and (4) delivery of the subject matter, are present; that the properties in question have been placed under the vendee's possession and control as shown by the facts that it was leasing the same to various tenants from 1955 and paying the real estate tax on said properties; and that there was consideration in the form of a non-negotiable promissory note promising to pay the sum of ₱227,089.80 dated February 21, 1954 issued by the Treasurer of the Vendee Corporation. From this decision, petitioners appealed to this Court on June 15, 1959.

During the pendency of this appeal, or on October 4, 1960, petitioners Alfonso Z. Sycip and International Construction Corporation entered into an agreement annulling and rescinding their agreement of sale dated February 21, 1954.

The issues submitted for resolution before this Court are:

> (1) Whether or not the agreement of sale executed on February 21, 1954 had the effect of transferring the ten (10) parcels of land in favor of International Construction Corporation by petitioner Alfonso Z. Sycip;
>
> (2) Whether or not the said properties were transferred for less than their adequate and full consideration in money or money's worth, the amount of the values of the property in excess of the value of consideration be deemed a gift subject to donee's and donor's gift tax pursuant to

277

Section 111 of the Tax Code;

(3) Whether or not the fair market value of the real properties in question, computed at the rate of ₱40.00 per sq. m., represents the true or fair market value thereof after they have executed the contract on February 21, 1954; and

(4) Whether or not the entire excess of the fair market value of the properties over the value of the shares of stock intended as the consideration of the transfer or only a portion thereof constitutes a taxable gift, assuming that a gift tax is due.

We will pass upon the first and second issues jointly since they are interrelated.

Under Section 111 of the Tax Code, where property is transferred for less than adequate consideration, the balance between the fair market value of the property and the actual consideration is considered a gift. Petitioners urge that the contract between them is not an executed contract but an executory contract to sell, where there is no legal transfer of ownership. Respondent for his part contends that the aforesaid contract is a contract of sale that transfers ownership.

A sale is an executory contract where the seller merely promises to transfer the property at some future date, or the agreement contemplates the performance of some act or condition necessary to complete the transfer (Feliza Roman vs. J.R. Heridge, 47 Phil.

98). Under such a contract, there is no transfer of ownership; it only creates personal obligations to comply (Guerrero vs. Yñigo, 50 O.G. 5281). In the case of Leon S. Ramos vs. Filemon M. Salcedo, 48 Off. Gaz. 729,732 January 31, 1950, it was held that:

> A sale is an executory contract, "if the seller merely promises to transfer the property at some future date, or the agreement contemplates the performance of some act or condition necessary to complete the transfer. Under such a contract, until the act is performed or the condition fulfilled, which is necessary to convert the executory into an executed contract, no title passes to the buyer as against the seller or persons claiming under him" (McCullough & Co. vs. Berger, 43 Phil. 823, 831). While it is conceded that a mere recital that the seller "agree to sell" may not be conclusive that the title was not intended to pass immediately, it is however, clear from the agreement Exhibit "A" that it imports an executory contract. In it, the seller and appellee merely "agreed to sell, transfer and convey to the purchaser-appellant, the property at some future date, and it contemplates the performance of some act or condition necessary to complete the transfer, that is, payment by appellant of all the installments within the periods specified in paragraph 3 thereof; that according to paragraph 4 of the same contract, only upon the full payment of the purchase price in the manner stipulated in paragraph 3 shall the formal deed of conveyance of said property in favor of the appellant be executed by the appellee; and that, according to paragraph 6, the non-payment of such price as agreed upon, renders the contract automatically rescinded. Being an executory contract, it did not, therefore, operate to pass title to or dominion over the property (Mas vs. Lanuza, 5 Phil. 457, 458); and the appellee is not bound to deliver

> or give the material possession of said property to appellant, merely upon its execution. xx xx xx.

A perusal of the terms of the contract Exhibit A readily shows that same is merely an executory contract to sell and not an executed contract of sale. The contract states: "The VENDOR shall sell to the VENDEE and the VENDEE shall purchase from the VENDOR x x." It contemplates the performance of some acts or condition necessary to complete the transfer, to wit, that petitioner corporation increases its capitalization and thereafter gives notice "not later than October 31,1955 that said VENDEE is ready to issue to the VENDOR the equivalent shares of stock at par value of the VENDEE corporation x x x." The consideration of the sale is not the stipulated ₱227,089.80 as pretended by respondent but its equivalent in stocks. As stated in the promissory note "such payment be made by the issuance in his favor of fully paid shares of stock at par value of this corporation upon the increase in its capitalization." In the words of the contract itself, said shares of stock are "the payment of said ten (10) parcels of land." Ownership was obviously never intended to pass to International Construction Corporation by the mere execution of Exhibit A; hence, the stipulation that the "vendor shall execute a deed of absolute sale x x" when the stocks are

780

ready and notice is given "not later than October 31, 1955," which was never done. Needless to say, under the terms of Exhibit A what the parties executed was an executory contract to sell that does not pass title and not an executed contract of sale that conveys ownership.

Taxwise, for a gift to exist "there must be a conveyance, assignment, or transfer sufficient to vest legal title on the donee without power of revocation at the will of the donor." (Edson vs. Lucas, 40 F (2d) 398.) The executory contract to sell, Exhibit A, was not a transfer sufficient to vest legal title on petitioner corporation; that transfer had yet to be made by an executed contract of sale by the parties therein. To lay the gift tax at once in spite of the possibility that the sale may not be consummated, is to lay it on gift that may never become consummated in a real sense. The gift tax "is aimed at transfers of title that have the quality of a gift, and a gift is not consummated until put beyond recall." (Burnet vs. Guggenheim, 77 U.S., L. ed. 748.) Thus, it has been held that when the consummation of a gift is conditioned on the occurrence of certain events, "such conditions precedent are themselves sufficient to prevent the contract from constituting a gift". (Fred G. Gruen vs. Commissioner of Internal Revenue, 1 T.C. 130).

281

Respondent, however, calls our attention to the fact that on January 28, 1957, the capital stock of petitioner corporation was increased and thereafter Alfonso Z. Sycip demanded in writing the compliance of the terms of Exhibit A. We do not find these as of decisive consequence. It is well to recall in this connection that nothing resulted from said demand and on October 28, 1958, Alfonso Sycip sold three of the ten parcels of land in question and there is nothing to show that the purchase price thereof landed in the coffers of petitioner corporation. Moreover, on October 4, 1960, Alfonso Sycip and petitioner corporation mutually cancelled Exhibit A. Under Article 733 of the Civil Code of the Philippines, donations with an onerous cause is governed by the rules on contract and under said rules the gift becomes consummated only upon the consummation of the sale on which it is dependent. Apparently, the parties never consummated the sale and thus there is a lack of the essential requisite of a taxable gift, which is "a conveyance, assignment or transfer sufficient to vest title on the donee." (Edson v. Lucas, supra)

Respondent cites the case of William H. Board vs. Commissioner of Internal Revenue, 14 TC 322, where it was held that a completed gift is subject to the gift tax although it is later returned. Said case is not in point because there is no completed gift in the present case.

Respondent urges that after the execution of Exhibit A, petitioner corporation exercised "unfettered right of ownership" over the parcels of land in question, basing this sweeping conclusion on the fact that in the contract petitioner corporation assumed the payment of taxes but was granted the right to enjoy the rentals of the property in question from March 1, 1954. An executed contract of sale operates to pass title to, or dominion over the subject of the contract and this involves not only the obligation to pay taxes and the right to enjoy the rentals but a host of other obligations and rights. That petitioner had only this one obligation and this one right hardly supports the pretension that petitioner corporation had unfettered right of ownership. Then again the fact that the parties expressly made a stipulation that petitioner corporation should pay the taxes but enjoy the fruits rather clearly indicate that Exhibit A is indeed an executory contract to sell and not an executed contract. If the parties intended Exhibit A to be an executed contract of sale and so drafted it, there would have been no need to make an express stipulation on the payment of taxes and the enjoyment of rentals

283

because these pass onto the vendee without so stipulating.

Respondent invites our attention to the examiner's finding submitted on June 2, 1960, four years after the assessment, to the effect that the ten parcels of land in question and the related obligation in the amount of ₱227,089.80 plus interest of 5% per annum under the promissory note of petitioner corporation dated February 21, 1954 are entered in the books of petitioner corporation. In this connection, it appears that in the financial statement, Exhibit R-1, of September 30, 1959 which is not contested by respondent there is an item under "Liabilities and Stockholders' Equity" which says:

> "NOTE PAYABLE TO STOCKHOLDERS (Principal of ₱227,089.80 and Accrued Interest) (Note 3)"

Note 3 aforesaid reads as follows:

> "Note 3:
> Land costing ₱227,089.80 is the subject of an agreement of sale between the company and Mr. Alfonso Sycip. The absolute deed of sale transferring the ownership to the company will be executed upon notice from the company that it is ready to issue to the vendor the equivalent shares of the company's stock at par value in payment for the purchase price of the property plus accumulated interest."

It can be readily gleaned from this entry that they do nothing more than record the transaction involving the executory contract to sell of February 21, 1955, of the ten parcels of land involved herein. In effect, the entry does not deny that the sale was still to be consummated, the consideration thereof yet to be paid, and the title to the parcels of land still to be transferred to petitioner-corporation. This is hardly consistent with respondent's pretension that the entry aforesaid shows that the contract in question was an executed contract of sale and title passed onto the petitioner-corporation.

Having reached the conclusion that there was no gift subject to the gift tax, it is unnecessary to pass on the other issues raised in this case.

WHEREFORE, the appealed decision is hereby reversed. Without pronouncement as to costs.

SO ORDERED.

Quezon City, November 28, 1973.

RAMON L. AVANCEÑA
Associate Judge

WE CONCUR:

ROMAN M. UMALI
Presiding Judge

ESTANISLAO R. ALVAREZ
Associate Judge

285