REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SPOUSES FRANCIS GO AND EDNA SAN GABRIEL GO,
Petitioners,

\- versus -

C.T.A. CASE NO. 5875

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
DEC 01 1999

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DECISION

Before Us for consideration is a Petition for Review filed by the Petitioners on April 26, 1999, seeking for a refund of capital gains tax in the amount of P1,075,056.75 and P268,770.00 as documentary stamp tax, paid by the Petitioners in a foreclosure sale involving their house and lot which were redeemed before the expiration of the statutory period of one year.

Spouses-Petitioners are taxpayers residing at No. 11-A Free Press St., West Triangle, Quezon City.

On April 27, 1995, Petitioners executed a Real Estate Mortgage covering its house and lot (Property, for brevity) in favor of Equitable Banking Corporation (Equitable Bank, for brevity) to guarantee a loan in the amount of P10,000,000.00.

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On February 16, 1996 and April 16, 1997, as the loan was increased from P10,000,000.00 to P12,000,000.00, and from P12,000,000.00 to P17,000,000.00, the real estate mortgage was accordingly amended.

By reason of Petitioners' failure to pay the loan, the Property was extra judicially foreclosed by Equitable in accordance with Act. No. 3135, as amended. Subsequently a foreclosure sale was held on January 13, 1998 and Equitable Bank ended up as the highest bidder. Consequently a Certificate of Sale dated January 13, 1998 was issued.

As a result of the said extra-judicial foreclosure sale and in the belief that the transaction is subject to capital gains tax and Documentary Stamp Tax, Equitable Bank paid the corresponding amounts of P1,075,056.75 and P268,770.00, respectively, thru Traders Royal Bank (see Annexes "E", "F" and "G").

On June 3, 1998, before the expiration of the one year period of redemption from the date of the registration of the certificate of sale as provided under Act 3135 as amended, Petitioners were able to redeem the foreclosed properties and paid to Equitable Bank the amount of P21,464,184.00 (see Annexes "H" and "I").

On January 26, 1999, Petitioners filed an administrative claim for refund with the Bureau of Internal Revenue involving the aforesaid amounts representing capital gains and documentary stamp taxes (see Annex "L").

At the time the Petitioners filed the appeal in this Court on April 26, 1999, they have not yet received any reply from respondent Commissioner. However, in a letter dated February 15, 1999 and received by the Petitioners only on May 31, 1999, respondent Commissioner of Internal Revenue denied the claim for refund with finality.

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Petitioners maintain that the payment of capital gains and documentary stamp taxes, in consequence of the extra-judicial foreclosure sale of property, is erroneous and has no factual and legal basis. Upon the other hand, in an Answer filed on June 4, 1999, Respondent opposed Petitioners' stance and advances the following Special and Affirmative Defenses, to wit:

> 9. Under section 24 D of the National Internal Revenue Code as amended by Republic Act 8424, the capital gains tax and documentary stamp tax is imposed "from the sale x x x x or other disposition of real property, x x x x classified as capital assets, including pacto de retro sales and other forms of conditional sale x x x x" and this includes the sale of petitioners' mortgaged property;
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> 10. That Revenue Regulations No. 4-99 dated March 9, 1999, affects only transaction that took place subsequent to the effectivity of said regulation which is 15 days after publication in any newspaper of general circulation, and as petitioners' transaction and payments of the required documentary stamp tax and capital gains tax took place on January 13, 1998 and February 5, 1998 respectively, such amounts cannot be refunded or tax credited;
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> 11. That said Revenue Regulations does not have retroactive effect;
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> 12. That as alleged by petitioners, the said taxes were paid by the Equitable Bank without the knowledge of the petitioners, the responsibility for the so called "unauthorized", "illegal" or "erroneous" payments, is with the said bank and therefore any dispute on the refundability to the petitioners of the said taxes is a dispute between the petitioners and the bank;
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> 13. That the herein petitioners are not entitled to the refund of the amounts prayed for in the instant Petition for Review;
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> 14. That the instant Petition for Review was prematurely filed as petitioner has not exhausted the administrative remedies required by law and jurisprudence on the action of this nature as no decision has yet been rendered by the respondent;

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> 15. Such being the case this Honorable Court had no jurisdiction over the Petition for Review.

In a Resolution promulgated on September 15, 1999, after the parties have already filed their respective memorandum, this case was thereafter considered submitted for decision.

Forming the crux of the controversy as stipulated by the contending parties is whether or not an extra-judicial foreclosure sale, which is a conditional sale, is subject to capital gains and documentary stamp taxes.

Petitioners in their Memorandum, reiterate their stance a quo and maintain the view that capital gains tax and documentary stamp tax are imposable only on sales that should lead to or result in, the transfer of ownership or title to the property. Hence, the same does not cover extra-judicial foreclosure sale.

Upon the other hand, Respondent assails Petitioners' protestations and argues that the actual transfer of title/ownership to the realty sold, in conditional sales, particularly the mortgage foreclosure sales, is not a determinative factor in the imposition of the tax. Respondent opines that it is enough that the mortgaged real property be foreclosed by the mortgage bank and a public sale thereof be held for the tax to legally accrue.

We find for the Petitioners.

Section 24 D(1) of the Tax Reform Act of 1997 provides as follows:

> "(D) Capital Gains from Sale of Real Property. -
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> "(I) *In General.* - The provisions of Section 39(B) not withstanding, a final tax of six percent (6%) based on the gross selling price or current fair

> market value as determined in accordance with Section 6(E) of this Code, whichever is higher is hereby imposed upon 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 x x x.

A cursory review of the attending circumstances reveals that the vortex of the controversy lies on the different interpretations of the parties as to the effects of the redemption of the foreclosed properties.

While it is true that under the aforequoted Section 24 D(1) of the Tax Code, conditional sale of real property includes foreclosure sale, this is subject to the condition that transfer of interest or ownership to the properties is effected. And well-settled is the rule that in a foreclosure sale, transfer of ownership ensues only upon expiration of the redemption period as provided in Section 6 of Act. No. 3135 as amended to wit:

> ***Section 6.*** – In all cases in which an extra judicial sale is made under the special power herein before 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.

Clearly from the above, the debtor/mortgagor is granted the opportunity to re-acquire ownership of his foreclosed property within one-year counted from the date of registration of the Certificate of Sale as provided under Section 33 of Rule 39 of the 1997 Rules of Civil Procedure which provides, thus:

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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 must be borne in mind that what is being subjected to 6% capital gains tax is not the transfer of ownership per se but the profit or gain that was presumed to have been realized by the seller/mortgage arising from the transfer. It bears stressing that capital gains tax is an income tax. And the concept of income implies gain, profit or flow of wealth **(Madrigal vs. Rafferty, 38 Phil. 414)**.

Prescinding from the above, it is necessary that the petitioners should have profited, materially or otherwise, from the foreclosure sale where the properties were redeemed within the specified period under Act No. 3135. It appearing that Petitioners did not earn any income from the sale of the foreclosed properties, hence, they should not be made liable to pay the capital gains tax and documentary stamp tax.

In BIR Ruling No. 006-92, the Respondent 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.

On March 9, 1999, the Secretary of Finance issued Revenue Regulations No. 4-99, in order to prevent the inequity that will arise if the capital gains tax is collected before the expiration of the redemption period, thus:

> "In case the mortgagor exercises his right of redemption within one (1) 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, Revenue Regulations 4-99)."

It is in view of the above categorical declaration of the Secretary of Finance that makes Us inclined to grant the claim for refund of the Petitioners. As no capital gains have been derived by the Petitioners in the foreclosure sale, hence the imposition of the corresponding capital gains tax is not warranted.

In a recently decided case involving an identical issue, this Court ruled in this wise:

> "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.

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> 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." (Spouses Arturo Soriano and Virginia T. Soriano vs. Hon. Liwayway Vinzons-Chato as Commissioner of Internal Revenue, CTA Case No. 5563, promulgated on June 22, 1999, with Entry of Judgment dated August 13, 1999)

Anent the issue of documentary stamp tax imposed on the foreclosure sale. We agree with Petitioners' stance that the transaction is subject only to P15.00 documentary stamp tax pursuant to Section 4 of Revenue Regulations No. 4-99 which provides, thus:

> **Section 4.** ***Documentary Stamp Tax.*** –
>
> (1) In case the mortgagor exercises his right of redemption, the transaction shall only be subject to the P15.00 documentary stamp tax imposed under Section 188 of the Tax Code of 1997 because no land or realty was sold or transferred for a consideration.

While we agree that the Government needs to raise revenues to defray expenses of the government and for it to continuously serve the people, the same should not be done at the expense of justice and equity. Thus, in **Roxas vs. Court of Appeals, 127 SCRA 276,** the Supreme Court held:

> "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 the taxpayer. It must be exercised fairly, equally and uniformly, lest the tax collector kills 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."

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 P1,075,056.75 and P268,770.00 representing capital gains tax and documentary stamp tax, respectively, paid on the foreclosure sale of the subject properties immediately.

SO ORDERED.

AMANCIO Q. SAGA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

RAMON O. DE VEYRA
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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