REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MICHEL J. LHUILLIER,
Petitioner,

- versus - **C.T.A. CASE NO. 6533**

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
MAY 16 2003

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DECISION

This is a judicial appeal from the decision of the respondent holding petitioner liable for deficiency value-added tax (VAT) in the amount of P1,480,371.51 for the taxable year 1999.

The antecedent facts of the case are as follows:

Petitioner is a Filipino citizen, of legal age, married and a resident of 145 Kamagong Street, Lahug, Cebu City, Philippines. He is engaged in the pawnshop business with principal place of business at M. Lhuillier Bldg., Benedicto Street, North Reclamation Area, Cebu City.

On November 15, 2001, petitioner received a Post Reporting Notice from the Revenue District Officer, Revenue District No. 81, informing the petitioner that after investigation of the latter's income, VAT and other internal revenue taxes for the taxable year 1999, it was ascertained that there is still due from him the amount of P1,678,299.59 representing deficiency income and VAT, including interest *(Annex A, Petition for Review).*

In a letter dated November 25, 2001, petitioner informed the Revenue District Officer that he is willing to seat down and talk with the latter regarding the deficiency on income tax but he is not agreeable to the findings with regard to the deficiency VAT *(Annex B, Petition for Review).*

On July 22, 2002, the Regional Director of the Bureau of Internal Revenue, Revenue Region No. 13, simultaneously issued to petitioner the subject Formal Letter of Demand and Assessment Notice bearing No. 81-VAT-13-99-2002-7-190 for deficiency VAT in the amount of P1,480,371.51, inclusive of 20% interest up to July 15, 2002, for the taxable year 1999 *(Annexes C and D, Petition for Review).* A motion for reconsideration was filed by petitioner on August 8, 2002 in accordance with Section 228 of the Tax Reform Act of 1997 (*Annex E, Petition for Review*) on the following grounds:

A. Section 102(a) of the Tax Code does not subject pawnshop businesses to value-added tax.

B. VAT on the sale of rematados should not be a tax against pawnshop but that of the pawner.

C. Penalties should not be imposed against the petitioner because no tax evasion was committed and the issue is industry wide arising from the want of any express provision in the Tax Code subjecting pawnshops to VAT.

On August 20, 2002, respondent issued his final decision denying the motion for reconsideration (*Annex F, Petition for Review*). Hence, on September 10, 2002, petitioner elevated the case to this court through a Petition for Review.

Summons was issued to respondent and on October 25, 2002, he filed his Answer alleging the following as Special and Affirmative Defenses, thus:

> 3. Investigation disclosed that petitioner earned income from his pawnshop business in the amount of P10,951,627.80 which is subject to the 10% value-added tax (VAT) on sale of services imposed under Section 108 (A) of the Tax Code.
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> 4. Investigation also disclosed that petitioner earned income from his farming business (AM Farm) in the amount of P39,058,804.19 and understated his rental income in the amount of P82,725.54 and his salaries and wages in the amount of P23,698.37, which incomes are subject to VAT.
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> 5. Investigation further disclosed that petitioner claimed credit for input VAT in the amount of P570,272.58 which was not substantiated, hence, not allowable.
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> 6. Petitioner protested the assessment only with respect to the imposition of VAT on his income from pawnshop business. Since he did not protest the imposition of deficiency VAT on his income from farming business and on his understated rental income and salaries and wages and the disallowance of creditable input VAT, the assessment has become final and executory with respect to said items.
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> 7. Interest on pledge loans and past due loans and liquidated damages form part of petitioner's gross receipts from pawnshop business subject to VAT.
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> 8. The assessment was issued in accordance with law and regulations.
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> 9. All presumptions are in favor of the correctness of tax assessments.

Since both parties already stipulated on the documentary and testimonial evidence and considering that the issues the court is tasked to resolve are purely legal, the case was submitted for decision on March 20, 2003 without further trial.

The following issues were submitted by the parties for this court's determination:

1. Whether pawnshop business is that of service or mere forbearance of money.

2. Whether pawnshop businesses are subject to VAT on sale of services under Section 108 (A) of the NIRC.

3. Whether pawnshop business is akin to a lending investor business.

4. Whether interest on pledge loans, past due loans and liquidated damages are income from service or a simple item of indemnification, and whether the same is part of petitioner's gross receipts subject to VAT.

5. Whether respondent is legally empowered to impose and charge Value Added Tax on the petitioner for the proceeds of the auction sale of pawned item.

We shall discuss and resolve the first, second and third issues jointly since they are interrelated.

Petitioner maintains that he is not liable to pay 10% VAT since pawnshop business is not engaged in the sale of services as contemplated under Section 102(a) {now Section 108(A)} of the Tax Code. According to petitioner, the business of forbearance of money is not within the generic or basic definition of service and it cannot be considered within the meaning of "*all services*" and "*all similar services*" as provided in the above-mentioned law because the inclusion mentioned in Section 102 (a) (now Section 108 (A)) should not be given more than its literal import or expanded beyond its scope. And even assuming that pawnshop is a service business, petitioner contends that imposing VAT on such business would be inequitable, absurd and unjust, taking into account that the burden will be borne by pawners who belong to the poor sector of the society.

Petitioner added that pawnshops are not lending investors that are subject to 10% value-added tax under the provisions of Section 102 (a) of the Tax Code, as amended. Unlike lending investors, pawnshops do not accept investments or placements from investors. Hence, according to petitioner, the legislative intent has always been to treat pawnshop as a separate class from that of lending investors.

On the contrary, respondent maintains that pawnshop operators, being engaged in the sale of services, are subject to value-added tax pursuant to Section 108(A) of the Tax Code. According to respondent, the phrase "sale or exchange of services" means the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration and that it includes the services enumerated therein and similar other services regardless of whether or not the performance thereof calls for the exercise or use of physical or mental faculties.

Moreover, in interpreting Section 108(A) of the Tax Code, respondent submits that the enumeration of persons performing services for others for a fee is not exclusive, but is intended to give examples of businesses subject to value-added tax on the sale or exchange of services. Respondent alleged that the legislative intent is not to limit the application of the law to those enumerated therein because the law speaks of "all kinds of services" and it would be a contradiction should the interpretation of that phrase be limited to those enumerated.

In addition, respondent made use of the definition of a pawnshop as stated in Section 3 of Presidential Decree No. 114, which refers to a person or entity engaged in the business of lending money on personal property delivered as security for loans and shall be synonymous and may be used interchangeably with, pawnbroker or pawnbrokerage. The act of lending money at interest, according to respondent, constitutes the performance of service for a fee, remuneration or consideration. Hence, pawnshops are engaged in the sale of services, therefore, subject to value-added tax.

Finally, respondent invoked Section 109 of the Tax Code, which enumerates the transactions that are exempt from the value-added tax. Respondent claimed that the enumeration is exclusive. Consequently, unless the sale or exchange is expressly mentioned in Section 109 as exempt from VAT, then such sale or exchange of services is subject to VAT under Section 108 (A) of the Tax Code.

After considering the arguments of the parties and the applicable laws, we find the contentions of petitioner unmeritorious.

Section 108(A) of the 1997 Tax Code provides for the imposition of value-added tax on the sale of services and use and lease of properties, pertinent portions of which are hereunder reproduced for easy reference:

> **Section 108**. *Value-Added Tax on Sale of Services and Use or Lease of Properties.* –
>
> (A) *Rate and Base of Tax.* – There shall be levied, assessed and collected, a value-added tax equivalent to ten percent (10%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties.
>
> The phrase *'sale or exchange of services'* means the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration, including those performed or rendered by construction and service contractors; stock, real estate, commercial, customs and immigration brokers; lessors of property, whether personal or real; warehousing services; lessors or distributors of cinematographic films; persons engaged in milling, processing, manufacturing or repacking goods for others; proprietors, operators or keepers of hotels, motels, resthouses, pension houses, inns, resorts; proprietors or operators of restaurants, refreshment parlors, cafes and other eating places, including clubs and caterers; dealers in securities; lending investors; transportation contractors

> on their transport of goods or cargoes, including persons who transport goods or cargoes for hire and other domestic common carriers by land, air and water relative to their transport of goods or cargoes; services of franchise grantees of telephone and telegraph, radio and television broadcasting and all other franchise grantees except those under Section 119 of this Code; services of banks, non-bank financial intermediaries and finance companies; and non-life insurance companies (except their crop insurances), including surety, fidelity, indemnity and bonding companies; and similar services regardless of whether or not the performance thereof calls for the exercise or use of the physical or mental faculties. xxx. (Underscoring supplied.)

From the plain language of the law, the sale or exchange of services is subject to VAT and the phrase "sale or exchange of services" encompasses the performance of all kinds of services for others for a fee, remuneration or consideration. The enumeration is not exclusive, which means that other persons performing services for a fee, remuneration or consideration, who are not expressly mentioned in the enumeration, are also subject to VAT. The enumeration of persons performing services for a fee, remuneration or consideration, such as construction and service contractors, stock, real estate, commercial, customs and immigration brokers, etc., is merely to give examples of businesses performing services for a fee, remuneration or consideration that are subject to VAT. As held in the case of ***Gomez vs. Ventura, 54 Phil. 726***:

> "xxx The maxim *expressio unius est exclusio alterius* should be applied only as a means of discovering legislative intent and should not be permitted to defeat the plain indicated purpose of the legislature. It does not apply when words are mentioned by way of example, or to remove doubts. (See Cyc., 1122 xxx." (Underscoring ours.)

Section 108(A) [formerly Section 102(a)] does not limit its application to those enumerated therein because the law speaks of "all kinds of services". To limit its application to the enumeration would contradict the very clear meaning of the phrase "all kinds of services".

In addition, the phrase "including" should be construed merely as an enlargement and not of limitation.

> "The intention of an act will prevail over the literal sense of its terms. Thus, limited words in one part of an act may be expanded by general words in another part, if the general words more nearly express the legislative intent.
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> A term whose statutory definition declares what it 'includes' is more susceptible to extension of meaning by construction than where the definition declares what a term 'means'. Thus, it has been said that 'the word 'includes' is usually a term of enlargement, and not of limitation... It, therefore, conveys the conclusion that there are other items includable, though not specifically enumerated..." Sutherland, *Statutory Construction*, 4th Ed., Vol. 2A, p. 82, Sec. 47.07 citing United States Argosy Ltd. v. Hennigan, 404 F2d 14 (CA 5th, 1968); See United States v. Gertz, 249 F2d 662 (CA 9th, 1957); Federal Land Bank of St. Paul v. Bismarck Lumber Co., 314 US 95, 86 L Ed 65, 62 S Ct1 (1941). (Emphasis supplied.)

Hence, the terms "includes" and "including" do not exclude items otherwise within the scope of the defined term.

> The terms "includes" and "including" when used in the Code are not deemed to exclude items otherwise within the meaning of the term defined. Thus, where Section 1(e) applies to the taxable income of estates "including" and thereafter lists four types of income from trusts or estates that are taxable, other types of estates may also be subject to taxation under Section 1(e). To hold differently would, in effect, substitute the term "limited to" for "including". Mertens, *Law of Federal Income Taxation*, 1995 Ed., Section 3.37, Chap. 3, pp. 55-56, citing *In re Joplin, Jr.*, 882 F2d 1507 (CA10 1989), applying IRC & 7701(c).

In the case at bar, the law is not only specific in its intent but also in its wording that "all kinds of services" should be subject to VAT. To emphasize, this court believes that the time-honored rule on statutory construction which states that the maxim "*expressio unius est exclusio alterius*" does not apply when the words are mentioned by way of example or to remove doubts is applicable in the case at bar. Thus, pawnshops, like the other businesses enumerated in the law which are engaged in the sale of services, are subject to VAT.

Furthermore, Section 105 of the Tax Code provides:

> "Any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 106 to 108 of this Code."

Inasmuch as pawnshops are engaged in the sale of services for a fee, remuneration or consideration, they are subject to VAT under Section 108(A) of the Tax Code, as amended. This conclusion finds support in recent decisions laid down by the Court of Appeals (***Commissioner of Internal Revenue vs. Agencia Exquisite of Bohol, Inc.***, *C.A. G.R. SP No.59282, March 23, 2001 and* ***Commissioner of Internal Revenue vs. Exquisite Pawnshop and Jewelry, Inc.***, *C.A. G.R. SP No. 59401, September 30, 2002)*, the latest of which is the case of ***Commissioner of Internal Revenue vs. Agencia Exquisite of Bohol, Inc.***, *C.A. G.R. SP No. 68180, promulgated on February 10, 2003,* where the Court of Appeals categorically ruled that pawnshops are subject to the 10% VAT imposed under Section 108 (A) of R.A. 8424, thus:

> "A value-added tax is a tax on transactions, imposed at every stage of the distribution process on the sale, barter, exchange of goods or property, and on the performance of services, even in the absence of profit attributable thereto.

In the case at bar, it has been the contention of respondent Agencia Exquisite of Bohol, Inc. that the business of a pawnshop is not similar to that of a lending investor. A pawnshop, according to respondent is principally engaged in the business of delivering money to another, secured by personal property, upon the condition that the latter shall pay the former, otherwise, the thing pawned shall be sold for the payment of the principal obligation. Hence, a pawnshop operator engages in a pledge transaction.

We are not convinced. The business of pawnshops are akin to that of lending investors. Respondent itself admitted that a lending investor is a person who makes a practice of lending money for themselves or others at interest. It seems that respondent forgotten that the business of a pawnshop is also to lend money for others at interest. The difference between lending investors and pawnshops lies only on the security given, that is, a lending investor may require both real and personal property as security for the loan; whereas a pawnshop can require only personal property as security for the loan. But in the end, a lending investor and a pawnshop both engage in the business of lending money for others at interest. Accordingly, a lending investor and a pawnshop are both subject to VAT, pursuant to the provision of the National Internal Revenue Code of 1997 which provides that "there shall be levied, assessed and collected, a value-added tax equivalent to ten percent (10%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties. The phrase "sale or exchange of services" means the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration, including those performed or rendered by x x x lending investors x x x."

Even assuming *arguendo* that we do not classify pawnshops as lending investors, still pawnshops are subject to the 10% VAT imposed under Section 108(A) of R.A. 8424. Pawnshops refer to persons or entities engaged in the business of lending money on personal property delivered as security for loans. As long as the entity provides service for a fee, remuneration or consideration, then the service rendered is subject to value added tax. The personal properties delivered by clients of pawnshops as security for the loans which the former obtained from the latter are in the form of remuneration or consideration, for without such personal properties, pawnshops will not extend any loan to a borrower. Furthermore, the payment of interest imposed on a borrower by a pawnshop is equivalent to a fee in exchange of the service provided by the pawnshop in lending money to such borrower. Thus, the phrase "***all kinds of services***" as stated in the second paragraph of Section 108(A) of R.A. 8424 is broad enough to cover the kind of service, that is, lending money in consideration of personal property delivered as security, which is provided by pawnshops to their borrowers. And the enumeration of sale or exchange of services under Section 108(A) of R.A. 8424 does not limit nor exclude other kinds of

> services performed for a fee, remuneration or consideration. Rather, such enumeration even expanded the meaning of the phrase "***all kinds of services***".
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> Besides, pawnshops do not merely engage in the service of lending money to pawners. Rather, pawnshops also sells, at public auction, personal properties pawned to them, in the event that the pawner fails to redeem the pawn within ninety days from the date of maturity of the obligation, the pawnbroker may ***sell or otherwise dispose*** of any article taken or received by him in pawn. Thus, by selling properties, pawnshops shall be subject to VAT."

x x x

Moreover, it bears stressing that Section 3 of Presidential Decree No. 114, otherwise known as the "Pawnshop Regulation Act", defines a pawnshop as follows:

> "Pawnshop shall refer to a person or entity engaged in the business of lending money on personal property delivered as security for loans and shall be synonymous, and may be used interchangeably with, pawnbroker or pawnbrokerage."

Judicial notice may be taken of the fact that the principal activity of pawnshops is lending money at interest on the security of personal property. The act of lending money at interest constitutes the performance of a service for a fee, remuneration or consideration for such service. In other words, the liability of pawnshop operators to pay the VAT no longer depends on the classification of their business but on the services they rendered. As a consequence thereof, any allegation that pawnshops are not lending investors has lost its bearing. For as long as pawnshops are engaged in lending money on the security of personal property, they are still within the ambit of Section 108(A). Petitioner, being engaged in the pawnshop business, is undoubtedly engaged in the sale of services like lending money. Hence, it cannot escape liability to pay the VAT under Section 108(A) of the Tax Code, as amended.

Lastly, Section 109 [formerly Section 103] of the Tax Code, as amended, enumerates the transactions that are exempt from VAT. Pawnshop transactions are not among the exempt transactions under the said section. Neither are there any express provisions of law exempting pawnshops from VAT. Since the transactions of pawnshops are not among those enumerated in Section 109 or any other express provision of law as VAT-exempt, it follows that the same are subject to VAT under Section 108(A). In this regard, tax exemptions are strictly construed against the taxpayer. In the absence of any clear provision of law exempting pawnshops from VAT, it is our conclusion that pawnshops are subject to VAT on their gross receipts considering that they are clearly engaged in the performance of services for a fee, remuneration or consideration.

In the case of ***Commissioner of Internal Revenue vs. Court of Appeals and Commonwealth Management and Services Corporation*, G.R. No. 125355, March 30, 2000,** the Supreme Court ruled that the taxpayer, not falling within the exemptions mentioned under Section 109 of the Tax Code, is subject to VAT. The High Tribunal held:

> "Section 108 of the National Internal Revenue Code of 1997 defines the phrase "sale of services" as the "performance of all kinds of services for others for a fee, remuneration or consideration." xxx
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> xxx xxx xxx
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> Hence, it is immaterial whether the primary purpose of a corporation indicates that it receives payments for services rendered to its affiliates on a reimbursement-on-cost basis only, without realizing profit, for purposes of determining liability for VAT on services rendered. <u>As long as the entity</u>

> provides service for a fee, remuneration or consideration, then the service rendered is subject to VAT.
>
> At any rate, it is a rule that because taxes are the lifeblood of the nation, statutes that allow exemptions are construed strictly against the grantee and liberally in favor of the government. Otherwise stated, any exemption from the payment of a tax must be clearly stated in the language of the law; it cannot be merely implied therefrom. In the case of VAT, Section 109, Republic Act 8424 clearly enumerates the transactions exempted from VAT." (*Emphasis ours.*)

On the fourth and fifth issues, petitioner advanced the argument that interest income cannot and should not be subjected to value-added tax, since the same is not income or receipt arising from the sale or exchange of services, rather it is a compensation for the forbearance of money.

As regards liquidated damages, petitioner claimed that since the same arise from the breach of contract committed by a clientele by means of delay in the delivery or payment of the borrowed money, it cannot be considered as income from sale or exchange of services which should be included in the imposition of the value-added tax. Neither does the sale of rematados be subject to value-added tax. According to petitioner, unlike ordinary sale of goods, auction sale is conducted as mandated by law for and in behalf of the owner of the rematados. Considering so, imposing tax on this transaction and charging the same to the pawnshop business is clearly not sanctioned by the definition of "gross receipt" in the Tax Code.

On the other hand, respondent adhered to the notion that interest on pledge loans and past due loans, liquidated damages and proceeds from the auction sale of pawned items, being incidental to the pawnshop business, are all part of the gross receipts subject to the value-added tax.

The court does not agree with the petitioner's view.

Section 108 of the Tax Code provides:

> "The term '*gross receipts*' means the total amount of money or its equivalent representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits and advanced payments actually or constructively received during the taxable quarter for the services performed or to be performed for another person, excluding value-added tax." (*Underscoring supplied*)

On the basis of the above provision in the Tax Code, we believe that interest income, liquidated damages and gains from the sale of the rematados form part of the gross receipts of pawnshop business which are subject to value-added tax. All of these are payments which are actually or constructively received incidental to the pawnshop business and, therefore, within the contemplation of the law.

In our recently decided case, we have passed upon the same issue in this wise:

> "By the very nature of the pawnshop business, money is being lent secured on personal property. The interest on pledge loans and past due loans are not compensation for forbearance of money. The same is true with liquidated damages in case the pawner fails to pay the borrowed money on time. Said loan having been secured on personal property, the pawnshop operator does not suffer any damage if ever the pawner defaults in the payment of the borrowed money. This is because in the pawnshop business, the loaned amount is always very much lower than the actual worth of the personal property pawned.
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> As regards the sale of the pawned items, what is being taxed by the respondent is the gain on auction sale and not the auction sale *per se*. xxx" *(Kwik Loan Pawnshop, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6424, promulgated on April 21, 2003)*

In sum, based on the above provisions of law and principles laid down in the cases mentioned, we hold petitioner liable for deficiency value-added tax.

WHEREFORE, Assessment Notice No. 81-VAT-13-99-2002-7-190 is hereby **UPHELD**. Accordingly, petitioner is **ORDERED to PAY** deficiency VAT in the amount of P1,480,371.51 plus 20% delinquency interest from August 22, 2002 until fully paid pursuant to Sections 248 and 249 of the Tax Code.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

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

LOVELL R. BAUTISTA
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