REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION
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SPOUSES EDUARDO X. GENATO AND LYDIA M. GENATO AND CONDOMINIUM PUSHERS, INC.
Petitioners,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA Case No. 8919

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SPOUSES EDUARDO X. GENATO AND LYDIA M. GENATO AND LANDMART PHILIPPINES, INC.
Petitioners,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA Case No. 8920

Members:

DEL ROSARIO, P.J.,
UY, and
MINDARO-GRULLA, JJ.

Promulgated:
MAR 30 2017 ; 1130pm

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DECISION

UY, J.:

The instant case is a consolidation of two Petitions for Review, both filed on November 6, 2014 as follows: by petitioners, Spouses Eduardo X. Genato and Lydia M. Genato, and Condominium Pushers, Inc. (CPI), in ***CTA Case No. 8919***; and by petitioners, Spouses Eduardo X. Genato and Lydia M. Genato and Landmart Philippines, Inc. (LPI), in ***CTA Case No. 8920***, commonly against respondent Commissioner of Internal Revenue, seeking the refund or issuance of tax credit certificate (TCC) in the aggregate amount of

₱3,316,146.00, allegedly representing capital gains taxes paid on November 9, 2012 and on December 7, 2012.

THE FACTS

Petitioners, Spouses Eduardo X. Genato and Lydia M. Genato (hereinafter referred to as "Spouses Genato"), are registered taxpayers with Taxpayer Identification Number (TIN) 106-173-019-000 and TIN 106-974-204-000, respectively, and with residence address at 230 Amapola Street, Palm Village, Makati City. They are the owners of (a) real properties subject of Deeds of Conveyance in favor of CPI and LPI on which capital gains taxes were paid, and (b) majority of the capital stock of CPI and LPI.[1]

Petitioners CPI and LPI are two (2) distinct domestic corporations duly organized and existing under Philippine laws, both with principal addresses at 230 Amapola Street, Palm Village, Makati City; and whose stockholders are the Spouses Eduardo X. Genato and Lydia M. Genato, Paul M. Genato, Alberto M. Genato, and Margarita L. Genato.[2]

Petitioners CPI and LPI are authorized by the Securities and Exchange Commission (SEC) to transact business in the Philippines under SEC Registration Nos. 57481 and 61730, respectively. Both CPI and LPI are registered with the Bureau of Internal Revenue (BIR), Revenue District Office (RDO) No. 49 with TIN 000-157-841-000 and TIN 000-163-562-000, respectively.[3]

On the other hand, respondent is the duly appointed Commissioner of Internal Revenue vested under appropriate laws with the authority to carry out the functions, duties, and responsibilities of his office, including, *inter alia*, the authority to compromise, abate and refund or credit taxes under Section 204 of the National Internal Revenue Code (NIRC) of 1997, and other tax laws, rules and regulations.[4]

On August 17, 2011 and August 22, 2011, the SEC approved the separate applications of CPI and LPI for the increase in their respective capital stock from ₱5,000,000.00 to ₱25,000,000.00.[5]

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[1] Par. 1, Joint Stipulation of Facts (JSF), Docket (CTA Case No. 8919), p. 292.
[2] Par. 2, JSF, Docket (CTA Case No. 8919), p. 292.
[3] Pars. 3 and 4, JSF, Docket (CTA Case No. 8919), p. 292.
[4] Par. 5, JSF, Docket (CTA Case No. 8919), p. 292.

On November 8, 2012, Spouses Genato executed a Deed of Conveyance[6] and a Supplemental Deed of Conveyance[7] **in favor of CPI**, transferring the following real properties:

(1) Transfer Certificate of Title (TCT) No. 006-2010000229 located at 255 Amapola Street, Palm Village, Makati City;
(2) TCT No. 112800 located at 468 Adalla Street, Palm Village, Makati City; and
(3) TCT No. 112914 located at 470 Adalla Street, Palm Village, Makati City.

The foregoing real properties were conveyed in exchange for 199,925 shares of stock of CPI with an aggregate par value of ₱19,992,500 to be issued to Spouses Genato. The conveyance made by Spouses Genato was intended as partial payment of ₱17,000,000 of their subscription to the increase in capital stock of CPI which was approved by the SEC.[8]

On the same date, Spouses Genato executed a similar Deed of Conveyance[9] and Supplemental Deed of Conveyance[10] **in favor of LPI**, transferring the following real properties:

(1) TCT No. 157117 located at 231 Amapola Street, Palm Village, Makati City; and
(2) TCT No. 157116 located at 233 Amapola Street, Palm Village, Makati City.

The foregoing real properties were also conveyed in exchange for 199,948 shares of LPI with an aggregate par value of ₱19,994,800 to be issued to Spouses Genato. The conveyance made by Spouses Genato was intended as partial payment of ₱12,000,000 of their subscription to the increase in capital stock of LPI which was approved by the SEC.[11]

On November 9, 2012, Spouses Genato filed their Capital Gains Tax Return[12] and paid the amount of ₱1,020,000.00[13] by

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[5] Par. 6, JSF, Docket (CTA Case No. 8919), Docket, p. 292.
[6] Exhibits "P-5", "5-a", and "5-b", Docket (CTA Case No. 8919), pp. 227 to 229.
[7] Exhibits "P-6", "6-a", and "6-b", Docket (CTA Case No. 8919), pp. 230 to 232.
[8] Refer to Par. 7, JSF, Docket (CTA Case No. 8919), Docket, p. 293.
[9] Exhibits "P-7", "7-a", and "7-b", Docket (CTA Case No. 8919), pp. 233 to 235.
[10] Exhibits "P-8", "8-a", and "8-b", Docket (CTA Case No. 8919), pp. 236 to 238.
[11] Refer to Par. 8, JSF, Docket (CTA Case No. 8919), p. 293.

reason of their conveyance of real properties in favor of CPI. On December 7, 2012, petitioner Eduardo X. Genato paid deficiency capital gains tax in the amount of ₱969,062.00.[14]

Similarly, on November 9, 2012, Spouses Genato filed their Capital Gains Tax Return[15] and paid the amount of ₱720,000.00[16] by reason of their conveyance of real properties in favor of LPI. On December 7, 2012, petitioner Eduardo X. Genato likewise paid deficiency capital gains tax in the amount of ₱607,084.00.[17]

Spouses Genato executed Affidavits of Rescission dated July 15, 2013,[18] rescinding both the Deeds of Conveyance and the Supplemental Deeds of Conveyance made by Spouses Genato in favor of CPI and LPI. They notified the BIR (RDO 49) of the rescission of the conveyance of the real properties through Notices of Rescission dated September 27, 2013.[19]

On November 12, 2013, CPI and LPI filed with the SEC, Petitions for Cancellation[20] of the increase in capital stock. The SEC granted the cancellation in the Orders[21] both dated April 4, 2014. Consequently, the authorized capital stocks of CPI and LPI were reverted to the original amount of ₱5,000,000.00.

On November 3, 2014, the following written claims for the issuance of TCC in the total amount of ₱ 3,316,146.00 were filed with the BIR, to wit:

(1) On behalf of Spouses Genato and CPI, in the amounts of ₱1,020,000.00 and ₱969,062.00, representing the payments of capital gains tax on November 9, 2012 and December 7, 2012, respectively;[22] and

(2) On behalf of Spouses Genato and LPI, in the amounts of ₱720,000.00 and ₱607,084.00, representing the payments of

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[12] Exhibit "P-9", Docket (CTA Case No. 8919), p. 239.
[13] Exhibit "P-10", Docket (CTA Case No. 8919), p. 240.
[14] Exhibit "P-13" and "P-14", Docket (CTA Case No. 8919), pp. 243 to 244.
[15] Exhibit "P-11", Docket (CTA Case No. 8919), p. 241.
[16] Exhibit "P-12", Docket (CTA Case No. 8919), p. 242.
[17] Exhibits "P-15" and "P-16", Docket (CTA Case No. 8919), pp. 245 to 246.
[18] Exhibits "P-17" and "P-18", Docket (CTA Case No. 8919), pp. 247 to 248.
[19] Exhibits "P-19" and "P-20", Docket (CTA Case No. 8919), pp. 249 to 250.
[20] Exhibits "P-21" and "P-22", Docket (CTA Case No. 8919), pp. 251 to 264.
[21] Exhibits "P-23" and "P-24", Docket (CTA Case No. 8919), pp. 265 to 270.
[22] Exhibit "P-25", Docket (CTA Case No. 8919), pp. 271 to 276.

capital gains tax on November 9, 2012 and December 7, 2012, respectively.[23]

Due to respondent's inaction and considering that the two-year period to file a judicial claim for refund or tax credit is about to expire, petitioners separately filed the present consolidated *Petitions for Review* on November 6, 2014, namely CTA Case Nos. 8919 and 8920.[24]

Respondent separately filed, his *Answers* to the said *Petitions for Review* through registered mail on December 24, 2014, both of which were received by this Court on January 7, 2015. The said *Answers* interpose the same Special and Affirmative Defenses, to wit:

"1. Article 1191 of the New Civil Code provides as follows:

> '**Art. 1191**. The power to rescind obligations is implied in reciprocal ones, ***in case one of the obligors should not comply with what is incumbent upon him.***'

2. In the case of petitioners, none of the parties cannot comply with their respective obligations. As a matter of fact, petitioners Condominium Pushers, Inc. (in CTA Case No. 8919) and petitioners Landmart Philippines, Inc. (in CTA Case No. 8920) complied with their obligation and delivered the shares of stocks subscribed by Spouses Genato. On the other hand, Spouses Eduardo X. Genato and Lydia M. Genato as payment for the shares subscribed delivered the real properties subject of the Deed of Conveyance of Real Property and Supplemental Deed of Conveyance. Thus, both parties can comply and already complied with their respective obligations. Hence, petitioners cannot validly resort to rescission under Article 1191 of the New Civil Code.

3. Moreover, Article 1381 of the New Civil Code provides as follows:

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[23] Exhibit "P-26", Docket (CTA Case No. 8919), pp. 277 to 282.
[24] Docket (CTA Case No. 8919), pp. 7 to 18; Docket (CTA Case No. 8920), pp. 7 to 18.

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'**Art. 1381**. The following contracts are rescissible:

1. Those which are entered into by guardians whenever the wards whom they represent suffer lesion by more than one-fourth of the value of the things which are the object thereof;

2. Those agreed upon in representation of absentees, if the latter suffer the lesion stated in the preceding number;

3. Those undertaken in fraud of creditors when the latter cannot in any other manner collect the claims due them;

4. Those which refer to things under litigation if they have been entered into by the defendant without the knowledge and approval of the litigants or of competent judicial authority;

5. All other contracts specially declared by law to be subject to rescission.'

4. In the case at bench, it is quite unequivocal that none of the above-mentioned grounds exists.

5. It is worthy to note that petitioners resorted to rescission only upon notification to them imposing donor's tax on the excess of the book value of the shares of stock over the value of the real properties transferred. The execution of the Affidavit of Rescission is a mere afterthought to escape and avoid payment of donor's tax. In relation to Article 1381 of the New Civil Code, this ground relied upon by petitioner in rescinding the contract does not fall among those specified therein.

6. Stated differently, the rescission of contracts resorted to by petitioner was made with the intention of avoiding the payment of donor's tax. This was made in bad faith which not be given a premium for their actions.

7. Section 6 of the Tax Code provides:

> '***SEC. 6. Power of the Commissioner to make Assessment and Prescribe Additional Requirements for Tax Administration and Enforcement***. -
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> (A) Examination of Returns and Determination of Tax Due. – **After a return has been filed as required under the provisions of this Code, the Commissioner or his duly authorized representative may authorize the examination of any taxpayer and the assessment of the correct amount of tax**. Provided, however, That failure to file a return shall not prevent the Commissioner from authorizing the examination of any taxpayer.
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> The tax or any deficiency tax so assessed shall be paid upon notice and demand from the Commissioner or from his duly authorized representative.
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> ***Any return, statement or declaration filed in any office authorized to receive the same shall not be withdrawn***: Provided, That within three (3) years from the date of such filing the same may be modified, changed, or amended: Provided, further, That no notice for audit or investigation of such return, statement or declaration has, in the meantime, been actually served upon the taxpayer.'

8. In the present case, from the petitioners' filing of the appropriate Capital Gains Tax Return together with the supporting documents of the subject transaction, the BIR discovered that the book value of the subject shares of stocks is much higher than the value of the real properties involved. Thus, pursuant to Section 100 of the NIRC of the 1997, as amended, the BIR assessed the petitioners for the corresponding donor's tax.

9. Upon receipt by the petitioners of the notice of the proposed deficiency donor's tax assessment, petitioners mutually rescinded the contracts. The act of petitioners in rescinding the contract is in effect withdrawing the capital gains tax returns filed with the BIR. However, it must be noted that the act of withdrawing any returns filed with the BIR cannot validly be made when there was already a notice for audit or assessment as provided for under Section 6 of the NIRC.

10. Hence, the Capital Gains Tax Returns filed by petitioner: on November 9, 2012 in the amount of One Million Twenty Thousand Pesos (Php1,020,000.00) and on December 7, 2012 in the amount of Nine Hundred Sixty Nine Thousand and Sixty Two Pesos (Php969,062.00) in CTA Case No, 8919; and on November 9, 2012 in the amount of Seven Hundred Twenty Thousand Pesos (Php720,000.00) and on December 7, 2012 in the amount of Six Hundred Seven Thousand and Eighty Four Pesos (Php607,084.00) in CTA Case No. 8920, cannot be considered as erroneously or illegally collected tax because at the time the same were paid, the contract is very much legal and valid.

11. Assessment are *prima facie* presumed correct and made in good faith. The taxpayer has the duty of proving otherwise. In the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. (*Aban, Law of Basic Taxation in the Philippines, 1st Edition, p. 109*);

12. In an action for tax credit or refund, the burden is upon the taxpayer to prove that he is entitled thereto, and failure to discharge the said burden is fatal to the claim (*Emmanuel & Zenaida Aguilar v. Commissioner, CA-GR No. Sp. 16432, March 30, 1990 cited in Aban, Law of Basic Taxation in the Philippines, 1st Edition, p. 206*);

13. Claims for refund are construed strictly against the claimant, the same partake the nature of exemption from taxation (*Commissioner of Internal Revenue vs. Ledesma, 31 SCRA 95*) and as such, they are looked

> upon with disfavor. (*Western Minolco Corp. vs. Commissioner of Internal Revenue, 124 SCRA 121*).
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> 14. Finally, Petitioner should be reminded that taxes are important because it is the lifeblood of the government and so should be calculated without unnecessary hindrance (*Commissioner vs. Algue, Inc. L-28896, 17 February 1988*). Taxes are enforced proportional contribution from persons and property levied by the state, thus, no one is considered entitled to recover that which he must give up to another- *Non videtur quisquam id capere quod ei necesse est alii restitutere.*"

On February 11, 2015, petitioners filed a *Reply (Re: Answer dated December 23, 2014)*[25] in CTA Case No. 8919; and *Reply (Re: Answer dated December 22, 2014)*[26] in CTA Case No. 8920, similarly alleging, among others, that both the Supreme Court and this Court expressly recognize the right of contracting parties to mutually rescind an agreement. Respondent allegedly fails to appreciate that the remedy of "rescission" is not confined to the rescissible contracts enumerated under Articles 1191 and 1381 of the Civil Code as "rescission" is used in four (4) distinct contexts in civil law, namely, (i) the right of rescission under the law on obligations as granted in Article 1191 of the Civil Code; (ii) "rescissible contracts" enumerated under Article 1381 of the Civil Code; (iii) rescission under Article 1659 of the Civil Code; and (iv) <u>rescission by mutual agreement</u>, expressly recognized in jurisprudence. Relative thereto, petitioners invoke the doctrine laid down in *Pryce Corporation (Formerly Pryce Properties Corporation v. Philippine Amusement and Gaming Corporation)* [27] wherein it was held that parties have the right to effect the rescission of a contract by mutual agreement. Thus, petitioners pray to grant their refund claims in the instant case.

The Court set CTA Case No. 8919[28] and CTA Case No. 8920[29] for Pre-Trial Conference on March 26, 2015 and on February 19, 2015, respectively. However, the Pre-Trial Conference for CTA Case No. 8920 originally scheduled on February 19, 2015 was reset to March 19, 2015.[30]

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[25] Docket (CTA Case No. 8919), pp. 122 to 128.
[26] Docket (CTA Case No. 8920), pp. 132 to 138.
[27] G.R. No. 157480, May 6, 2005
[28] Notice of Pre-Trial Conference, Docket (CTA Case No. 8919), p. 102.
[29] Notice of Pre-Trial Conference, Docket (CTA Case No. 8920), p. 111.
[30] Notice of hearing dated February 13, 2015, Docket (CTA Case No. 8920), p. 189.

On February 13, 2015, petitioners filed a *Motion for Consolidation (With Motion Defer Pre-Trial Conference)*[31], praying that CTA Case No. 8919 be consolidated with CTA Case No. 8920 and that the scheduled Pre-Trial Conference be deferred pending the resolution of the *Motion for Consolidation*. After the filing of respondent's *Comment (to the Motion for Consolidation dated February 13, 2015)*[32] through registered mail on February 25, 2015 and received by the Court on March 5, 2015, the Court granted petitioners' *Motion for Consolidation* in the Resolutions dated March 10, 2015[33] and May 5, 2015[34].

Hence, CTA Case No. 8920 was consolidated with CTA Case No. 8919 and the Pre-Trial Conference was reset to July 2, 2015. Respondent's Pre-Trial Brief[35] and petitioners' Pre-Trial Brief[36] were both filed on June 26, 2015. By agreement of the parties, they filed their *Joint Stipulation of Facts*[37] and *Supplemental Joint Stipulation of Facts*[38] on July 16, 2015 and on August 20, 2015, respectively. Both were approved by the Court in the Resolution dated September 15, 2015.[39] The Court later issued the Pre-Trial Order on October 13, 2015.[40]

During trial, petitioners presented their lone witness, Lydia M. Genato. On the other hand, respondent's counsel, Atty. Catherine Herrera, manifested during the hearing held on March 1, 2016 for the presentation of respondent's evidence,[41] that she will not be presenting any evidence and would be submitting the case for decision as there was no investigation report submitted. Thus, both parties were given thirty (30) days within which to file their respective memorandum.

Petitioners filed their *Memorandum* on March 31, 2016;[42] while respondent filed a *Manifestation (In Lieu of Submission of*

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[31] Docket (CTA Case No. 8919), pp. 129 to 137; Docket (CTA Case No. 8920), pp. 139 to 147.
[32] Docket (CTA Case No. 8920), pp. 192 to 193.
[33] Docket (CTA Case No. 8920), pp. 196 to 197; Docket (CTA Case No. 8919), pp. 166 to 167.
[34] Docket (CTA Case No. 8919), pp. 172 to 173.
[35] Docket (CTA Case No. 8919), pp. 174 to 177.
[36] Docket (CTA Case No. 8919), pp. 178 to 192.
[37] Docket (CTA Case No. 8919), pp. 291 to 295.
[38] Docket (CTA Case No. 8919), pp. 300 to 305.
[39] Docket (CTA Case No. 8919), pp. 327 to 328.
[40] Docket (CTA Case No. 8919), pp. 337 to 347.
[41] Minutes of the hearing on March 1, 2016, Docket (CTA Case No. 8919), pp. 468 to 469.
[42] Docket (CTA Case No. 8919), pp. 474 to 490.

Memorandum)[43] through registered mail on March 31, 2016 and received by the Court on April 13, 2016, stating that respondent would be adopting all his pleadings filed in relation to this case as his *Memorandum*. Thereafter, the instant case was submitted for decision in the Resolution dated April 19, 2016.[44]

Hence, this Decision.

THE ISSUE

As stipulated by the parties, the lone issue for the Court's resolution is as follows:

> "Whether or not Petitioners are entitled to the claim for refund or tax credit of the capital gains taxes paid by Petitioners on November 9, 2014 and on December 7, 2014."[45]

Parenthetically, the dates referred in the foregoing lone issue statement must be modified. As borne out by the facts of these consolidated cases, the correct year is 2012, not "2014". Thus, in resolving the said issue, the respective payment of the subject capital gains taxes is recognized as done on November 9, 2012 and on December 7, 2012, respectively.

Petitioners' arguments:

Petitioners argue that the mutual rescission of the Deed of Conveyance had the necessary effect of totally abrogating the obligations of the subject contracts. The effect of rescission, in other words, allegedly renders the capital gains taxes as having been erroneously paid within the coverage of Section 204(C) in relation to Section 229, both of the Tax Code.

Allegedly, this view was upheld by this Court in *Benito Legarda, Inc. vs. The Commissioner of Internal Revenue*[46]. In said case, petitioner-corporation Benito Legarda, Inc. entered into a Contract to Sell with the Spouses Vergara, and thereafter, received a down

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[43] Docket (CTA Case No. 8919), pp. 491 to 493.
[44] Docket (CTA Case No. 8919), p. 497.
[45] JSF, Docket (CTA Case No. 8919), p. 294.
[46] CTA Case No. 6617, April 29, 2004.

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payment plus value-added tax ("VAT") therefor. The aforesaid VAT was duly remitted and paid to the BIR. However, since the occupants of the lots subject of the Contract to Sell refused to surrender possession of the said properties to the Spouses Vergara, the parties agreed to mutually rescind the Contract to Sell. Petitioner-corporation refunded to the Spouses Vergara the down payment it had received. However, it could no longer refund the VAT already paid to the BIR. Thus, Petitioner-corporation sought a refund/credit of the VAT. The CTA held that in order to fulfill the obligation to restore the parties to their original status before the Contract to Sell, the CIR is mandated to refund or grant tax credit to the petitioner-corporation for the VAT paid on the rescinded transaction. The CTA held:

> "[I]t can be said that with the rescission of the Contract to Sell, petitioner and Spouses Vergara were returned to their previous positions prior to the transaction, as if they never entered into the said agreement. Thus, petitioner has no obligation to remit the value-added tax of P38,232.00 to the BIR, and if payment has been made, the same must be returned."

Petitioners claim that on the basis of Article 2154 of the New Civil Code of the Philippines, the CTA characterized the remittance of VAT to the BIR as "erroneous payment", and categorically said that the BIR had "the obligation to return the same to" petitioner-corporation. Thus, petitioners submit that they are entitled to their refund claims in these consolidated cases.

Respondent's counter-arguments:

Respondent points out that the parties to the subject contracts (petitioners herein) can comply and already complied with their respective obligations. According to respondent, said petitioners cannot validly resort to rescission under Article 1191 of the Civil Code.

Moreover, respondent stresses that it is quite unequivocal that none of the grounds stated under Article 1381 of the Civil Code exists. In this connection, respondent is of the view that the rescission of contracts resorted to by petitioners was made with the intention of avoiding the payment of donor's tax; and that this was made in bad faith which should not be given a premium for their actions.

The act of petitioners in rescinding the contract is allegedly in effect, withdrawing the capital gains tax returns filed with the BIR, contrary to the provisions of Section 6 of the NIRC.

Respondent likewise contends that the Capital Gains Tax Returns filed by petitioners cannot be considered as an erroneously or illegally collected tax because at the time the same were paid, the contract is very much legal and valid.

Lastly, respondent avers that claims for refund are construed strictly against the claimant; that the same partake the nature of exemption from taxation and as such, they are looked upon with disfavor.

THE COURT'S RULING

The consolidated Petitions for Review are meritorious, but only insofar as the Spouses Eduardo X. Genato and Lydia M. Genato are concerned, as they were the ones who paid the capital gains tax sought to be refunded in these consolidated cases.

The rescission of subject contracts is valid.

Respondent primarily argues that the rescission of the subject contracts/agreements is not valid because it is allegedly not in accordance with Articles 1191 and 1381 of the Civil Code.

We disagree.

Said Articles 1191 and 1381 provide as follows:

> "Art. 1191. The power to rescind obligations is implied in reciprocal ones, in case one of the obligors should not comply with what is incumbent upon him.
>
> The injured party may choose between the fulfillment and the rescission of the obligation, with the payment of damages in either case. He may also seek rescission, even after he has chosen fulfillment, if the latter should become impossible.

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xxx xxx xxx."

"Art. 1381. The following contracts are rescissible:

(1) Those which are entered into by guardians whenever the wards whom they represent suffer lesion by more than one-fourth of the value of the things which are the object thereof;

(2) Those agreed upon in representation of absentees, if the latter suffer the lesion stated in the preceding number;

(3) Those undertaken in fraud of creditors when the latter cannot in any other manner collect the claims due them;

(4) Those which refer to things under litigation if they have been entered into by the defendants without the knowledge and approval of the litigants or of competent judicial authority.

(5) All other contracts specially declared by law to be subject to rescission."

Without a doubt, the right of rescission of a party to an obligation under Article 1191 of the Civil Code is predicated on a breach of faith by the other party who violates the reciprocity between them.[47] Furthermore, the above-quoted Article 1381 is explicit as to which contracts are rescissible.

In these consolidated cases, there is no showing that the subject rescission is "predicated on a breach by the other party"; neither is it shown that the subject contracts/agreements fall under any of the enumerated contracts that are rescissible under the said Article 1381. Nevertheless, the absence of such indicators does not deprive petitioners of their rights to pursue the instant refund claims.

In *Pryce Corporation (formerly Pryce Properties Corporation) vs. Philippine Amusement and Gaming Corporation*,[48] the Supreme Court said:

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[47] *Spouses Mariano Z. Velarde and Avelina D. Velarde vs. Court of Appeals, et al.*, G.R. No. 108346, July 11, 2001.
[48] G.R. No. 157480, May 6, 2005.

> "**Rescission has likewise been defined as the unmaking of a contract, or its *undoing from the beginning, and not merely its termination.* <u>*Rescission* may be effected by both parties by mutual agreement</u>;** or unilaterally by one of them declaring a rescission of contract without the consent of the other, if a legally sufficient ground exists, or if a decree of rescission is applied for before the courts. xxx xxx xxx
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> **Thus, mutual restitution is required in a rescission (or resolution), in order to bring back the parties to their original situation prior to the inception of the contract.** xxx xxx xxx." *(Emphases and underscoring supplied)*

Based on the foregoing jurisprudential pronouncements, it is clear that rescission of contracts may be effected by mutual agreement of both parties. Correspondingly, even when the subject rescission does not fall under Articles 1191 and 1381 of the Civil Code, the rescission of the subject Deeds of Conveyance and Supplemental Deeds of Conveyance, effected by mutual agreement of the contracting parties in the instant cases (between Spouses Genato and CPI in CTA Case No. 8919; and Spouses Genato and LPI in CTA Case No. 8920), are still considered as valid.

Moreover, We find no merit in respondent's contention that the subject rescission was made in bad faith.

Bad faith imports a dishonest purpose. Bad faith means breach of a known duty through some ill motive or interest. Bad faith partakes of the nature of fraud.[49]

It must be remembered that bad faith is never presumed. In this regard, the burden of proving bad faith rests on the one alleging it since basic is the principle that good faith is presumed and he who alleges bad faith has the duty to prove the same. Allegations of bad faith and fraud must be proved by clear and convincing evidence.[50]

Notably in the instant cases, no evidence was presented by respondent to establish petitioners' alleged bad faith. In fact,

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[49] *Francisco vs. Mallen, Jr.*, G.R. No. 173169, September 22, 2010.
[50] *Leus vs. St. Scholastica's College Westgrove and/or Sr. Edna Quiambao, OSB*, G.R. No. 187226, January 28, 2015.

respondent's counsel did not present counter-evidence in the instant consolidated cases. Hence, respondent's allegation of bad faith against petitioners must fail as the same is not supported by clear and convincing evidence.

The capital gains tax returns are not being withdrawn.

It is also the contention of respondent that the act of petitioners in rescinding the contract is in effect withdrawing the capital gains tax returns filed with the BIR, contrary to the provisions of Section 6 of the NIRC.

The contention is untenable.

Indeed, Section 6 of the NIRC of 1997 prohibits the withdrawal of tax returns, to wit:

> "SEC. 6. *Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement.—*
>
> xxx xxx xxx
>
> **Any return, statement or declaration filed in any office authorized to receive the same shall not be withdrawn**: *Provided*, That within three (3) years from the date of such filing, the same may be modified, changed, or amended: *Provided, further*, That no notice for audit or investigation of such return, statement or declaration has, in the meantime, been actually served upon the taxpayer." *(Emphasis supplied)*

However, in the instant cases, the Court does not find any indication that petitioners are requesting or praying for this Court to order the withdrawal of the capital gains tax returns filed in connection with the subject transactions.

Neither can We consider the filing of the instant refund cases as tantamount to a request or requirement for the withdrawal of the said capital gains returns. This is simply because an action for tax refund and the withdrawal of tax returns are totally different from each other.

The subject capital gains taxes are refundable.

Respondent likewise argues, in effect, that the capital gains taxes paid in these cases cannot be considered as erroneously or illegally collected taxes because at the time the same were paid, the contract is very much legal and valid.

We do not agree with respondent.

Capital gains tax is a tax on the gain from the sale of the taxpayer's property forming part of capital assets.[51] Thus, in the absence of a gain from, or the absence of, a sale, disposition or conveyance of real property considered as capital assets, the imposition of capital gains tax does not arise.

In case of rescission of a contract, any resulting gain will have the effect of not being realized, since the proceeds of the sale will eventually be returned to the seller. When a contract is rescinded, it is deemed inexistent, and the parties are returned to their *status quo ante*. Hence, there is mutual restitution of benefits received.[52] In other words, rescission abrogates the contract from its inception and requires a mutual restitution of benefits received.[53]

Considering the rescission of the contracts evidencing the subject transactions in these cases, the supposed gain that could have been realized therefrom had been abrogated, and the basis for the imposition of capital gains tax failed to exist. Correspondingly, the capital gains taxes paid must be refunded.

In this regard, Section 229 of the NIRC of 1997 allows the recovery of taxes erroneously or illegally collected, to wit:

> "SEC. 229. *Recovery of Tax Erroneously or Illegally Collected.* — No suit or proceeding shall be maintained in any court for the recovery of **any national internal revenue tax hereafter alleged to have been**

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[51] *Commissioner of Internal Revenue vs. B.F. Goodrich Phils., Inc. (now Sime Darby International Tire Co., Inc.), et al.*, G.R. No. 104171, February 24, 1999.

[52] *Pryce Corporation (formerly Pryce Properties Corporation) vs. Philippine Amusement and Gaming Corporation*, G.R. No. 157480, May 6, 2005.

[53] *Spouses Mariano Z. Velarde and Avelina D. Velarde vs. Court of Appeals, et al.*, G.R. No. 108346, July 11, 2001.

> **erroneously or illegally assessed or collected,** or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessively or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress.
>
> In any case, no such suit or proceeding shall be filed after the expiration of two (2) years from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment: *Provided, however*, That the Commissioner may, even without a written claim therefor, refund or credit any tax, where on the face of the return upon which payment was made, such payment appears clearly to have been erroneously paid." *(Emphasis supplied)*

An "erroneous or illegal tax" is defined as one levied without statutory authority, or upon property *not subject to taxation* or by some officer having no authority to levy the tax, or one which is some other similar respect is illegal.[54]

As mentioned earlier, considering that there is no gain realized in the subject transactions, as the same were rescinded by mutual agreement of the contracting parties, the collected capital gains taxes are considered as *"levied without statutory authority"*.

As a corollary, the Court favorably considers the instant tax refund claims of petitioners based on the principle of quasi-contract or *solutio indebiti*, and one of the pertinent laws governing this principle is found in Article 2142 of the Civil Code,[55] to wit:

> "Art. 2142. Certain lawful, voluntary, and unilateral acts give rise to the juridical relation of quasi-contract to the end that no one shall be unjustly enriched or benefited at the expense of another."

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[54] *Commissioner of Internal Revenue vs. Pilipinas Shell Petroleum Corporation*, G.R. No. 188497, April 25, 2012.

[55] *Commissioner of Internal Revenue vs. Acesite (Phils.) Hotel Corporation*, G.R. No. 147295, February 16, 2007.

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Enshrined in our basic legal principles is the time-honored doctrine that no person shall unjustly enrich himself at the expense of another. It goes without saying that the government is not exempted from the application of this doctrine.[56]

In fine, the rescission of the Deeds of Conveyance and the Supplemental Deeds of Conveyance have the effect of abrogating the same in all parts from their respective inception, and petitioners would then be restored to their previous positions prior to the subject transactions, as if they never entered into the said contracts/ agreements. Consequently, the obligation to pay the subject capital gains taxes to the BIR no longer exists, and the tax payments made by reason of the said conveyances must be returned to Spouses Genato in accordance with the principle of *solutio indebiti.*

Be that as it may, and as mentioned earlier, the entitlement to the refund or issuance of tax credit certificate of the subject capital gains taxes shall pertain only to Spouses Genato, and should not include petitioners CPI and LPI. This is because the said taxes were paid by said Spouses, as sellers of the subject real property, and not by petitioners CPI and LPI.

WHEREFORE, in light of the foregoing considerations, the instant Petitions for Review are **GRANTED**. Accordingly, respondent is **ORDERED TO ISSUE A TAX CREDIT CERTIFICATE** in favor of Spouses Eduardo X. Genato and Lydia M. Genato in the aggregate amount of **₱3,316,146.00**, representing the capital gains taxes paid on November 9, 2012 and on December 7, 2012.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

CIELITO N. MINDARO-GRULLA
Associate Justice

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[56] *Commissioner of Internal Revenue vs. Fireman's Fund Insurance Co., et al.*, G.R No. L-30644, March 9, 1987.

CERTIFICATION

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

ROMAN G. DEL ROSARIO
Chairperson
Presiding Justice