REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MANILA MANDARIN HOTELS, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 5046

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
MAR 24 1997

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DECISION

This is an appeal from the decision of the respondent Commissioner of Internal Revenue, dated October 25, 1993, denying the petitioner's protest on the 1988 deficiency assessment issued for value-added tax and percentage tax in the total sum of P12,211,987.53.

Petitioner is a domestic corporation engaged in business as a hotel and restaurant operator. It is a VAT registered enterprise with VAT Registration No. 32-0-000281.

On July 8, 1992, petitioner received an assessment notice, dated June 22, 1992, demanding the payment of deficiency value-added and percentage taxes for the taxable year 1988, the details of which are enumerated hereunder, thus:

Deficiency Business Tax - 1988

	Value-Added Tax	Percentage Tax
Basic Tax	P 5,545,002.13	P208,390.65
Add: 25% surcharge	1,386,250.53	52,097.66
Int. fr. 1-20-89 to 6-30-92	4,774,801.35	179,445.19
Compromise	50,000.00	16,000.00
Total Amount Due	P11,756,054.03	P455,933.50

In a letter, dated July 27, 1992, received by the Office of the respondent on July 30, 1992, petitioner protested the assessments issued by the respondent. Petitioner alleged that the tax deficiencies stemmed from respondent's erroneous interpretation of various tax laws which resulted in a legally-flawed assessment. This protest cited four items of value-added tax and one item of percentage tax which petitioner claims to have been wrongly imposed by the respondent.

As a collateral information, it is to be noted that as early as November 28, 1991, the petitioner has signed a waiver of the statute of limitations for the running of the prescriptive period provided by the Tax Code with respect to the issuance of assessment and the consequent collection of its business taxes (see page 211, BIR records).

Petitioner received the final denial of its protest on November 10, 1993 in a letter, dated October 25, 1993, which prompted the petitioner to file a petition for review by this Court on December 10, 1993.

This petition for review was initially entitled "Mandarin Oriental Hotels, Inc. vs. The Commissioner of Internal Revenue" but was later changed to "Manila Mandarin Hotels, Inc. vs. The Commissioner of Internal Revenue" in an amended petition filed on June 9, 1994 as the latter title is petitioner's registered name with the Securities and Exchange Commission (see page 64, CTA records).

Respondent filed its Answer (p. 28-31, CTA rec.) on January 28, 1994 by registered mail, wherein she proposed the following Special and Affirmative Defenses, thus:

> 3. Petitioner was assessed for deficiency VAT and Percentage taxes for the year 1988 in the total amount of P12,211,987.33 as follows:

	Value Added Tax	Percentage Tax
	(ASS. NO. FAS-488-92-002804)	(ASS. NO. FAS-4-88-92-002805)
Basic Tax	P 5,545,002.13	P208,390.65
Add: 25% surcharge	1,386,250.53	52,097.66
Int. fr. 1-20-89 to 6-30-92	4,774,801.35	179,445.19
Compromise	50,000.00	16,000.00
TOTAL AMOUNT DUE	P11,756,054.03	P455,933.50

> 4. Petitioner is not engaged in the business of a common carrier as it transports its hotel guests merely as part of its hotel services. Hence, its transportation services

extended to the hotel guests is subject to VAT under Section 102 of the Tax Code.

5. Reimbursement cost of telephone billings of the petitioner form part of the gross receipts for VAT purposes. Therefore, the tax base for the purpose of computing the tax due must include the handling fees, the gross profit from petitioners telephone service activity rendered to hotel guests, plus the toll fees due to Philippine Long Distance Telephone Company.

6. The sale of property and equipment (Furniture and Fixture) from company/borrower to the financing company is considered sale of personal property subject to 10% value added tax.

7. The deficiency tax assessment of P455,933.50 for percentage tax is legal and justified in accordance with the provisions of Sec. 113 of the Tax Code.

8. In this jurisdiction, tax assessments by tax examiners are presumed correct and made in good faith. The taxpayer has the duty to prove otherwise (CIR vs. Construction Resources of Asia, Inc. 145 SCRA 671).

9. Likewise, all presumptions are in favor of the correctness of the tax assessments. The taxpayer has the burden of proof to impugn its validity (Interprovincial Autobus Co., Inc. vs. CIR, 98 Phil. 290; 290; CIR vs. Avelino, 8 SCRA 570).

The present dispute centers on two kinds of taxes namely: value-added tax (VAT) and the percentage tax. The Schedule of Deficiency VAT on other income for the year 1988, per examination of the revenue officer, in the amount of P11,756,054.03, is computed as follows: (p. 216, BIR records)

MANILA MANDARIN HOTEL, INC.
SCHEDULE OF DEFICIENCY VAT ON OTHER INCOME
FOR THE YEAR 1988

Department		Total Income	Output Tax
Telephone		P45,847,628.69	
Guest Laundry		4,988,665.83	
Health Center		893,554.58	
Business Center		4,662,142.87	
Garage		3,149,239.37	
Rent and Other Income		6,219,940.10	
TOTAL		P65,760,496.13	P 6,576,049.61
Add: Disposal of Assets		7,609,725.36	691,793.21
Total Subject to VAT		P73,370,221.49	
VAT Due thereon			7,267,842.82
Less: Payment			
Percentage tax payments			
Garage		P 84,954.06	
Other Income		241,410.81	
Total		P 326,364.87	
VAT Payments			
1st Qtr.		P 591,164.72	
2nd Qtr.		545,135.44	
3rd Qtr.		382,927.03	
4th Qtr.		481,137.42	
Total		P 2,000,364.61	
TOTAL		P 2,326,729.48	
Less: Disallowed Input Tax			
Total Claimed	P808,095.40		
Less: Allowed	204,206.61	603,888.79	
Total Allowable Payment			1,722,840.69
Deficiency Value Added Tax			P 5,545,002.13
25% Surcharge			1,386,250.53
Interest (1-20-89 to 6-30-92)			4,774,801.35
Compromise			50,000.00
Total VAT Due and Payable			P11,756,054.03

The Schedule of Deficiency Percentage Tax for the year 1988 in the amount of P455,933.50, is computed hereunder as follows: (p. 215, BIR records)

MANILA MANDARIN HOTEL, INC.
SCHEDULE OF DEFICIENCY PERCENTAGE TAX
FOR THE YEAR 1988

	Gross Receipt	Reservations (Receipts) Banquet	Total Taxable Receipts	Tax Due	Tax Paid	Deficiency Tax
Room Revenue	P155,083,830.66		155,083,830.66	18,610,059.68	18,610,059.68	P -
Food Revenue	76,215,586.95	1,436,725.39	71,652,312.28	2,866,092.49	2,808,623.49	57,469.01
Beverage Revenue	19,094,305.19	-	19,094,305.19	1,527,544.42	1,376,622.78	150,921.64
TOTAL	P244,393,722.80	1,436,725.33	245,830,448.13	23,003,696.59	22,795,305.94	P208,390.65
25% Surcharge						52,097.66
Interest from 1-20-89 to 6-30-92 (.68888)						179,445.19
Compromise						16,000.00
Total Deficiency Percentage Tax						P455,933.50

The assessment for VAT is subdivided into four items. This Court finds it appropriate in the interest of clarity to discuss each item individually.

VALUE-ADDED TAX

Petitioner contends that a substantial portion of the VAT assessment stems from the respondent's inclusion of an additional sum of P35,900,388.53 as part of its gross receipts subject to the 10% VAT. The additional amount of P35,900,388.53 represents the tolling charges of PLDT on the overseas calls of the guests of petitioner paid to PLDT and which respondent claims should form part of the petitioner's taxable base for VAT.

Petitioner disagrees with the respondent and opines that only the handling fees (the amount which actually accrued in favor of petitioner) should be the proper tax base for VAT purposes since the handling fees represent the actual gross receipts of the petitioner, and it should not include the amount that the petitioner pays to PLDT for the usage of its telephone lines because such amount pertains to revenues of PLDT and not petitioner's.

Respondent, on the other hand, theorizes that the VAT is based on gross sales or gross revenue, thus, it should include the handling fees, the gross profit from petitioner's telephone service plus the toll fees due to PLDT.

The issue is whether or not the amount that petitioner paid to PLDT should form part of the gross receipts subject to the 10% VAT.

Section 102 of the Tax Code which served as the basis of the 10% VAT on the sale of services provides as follows:

> Sec. 102. ***Value-added tax on sale of services.*** - (a) **Rate and base of tax.** - There shall be levied, assessed and collected a value-added tax equivalent to 10% of gross receipts derived by any person engaged in the sale of services. The phrase 'sale of services' means the performance of all kinds of

> services 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 personal property; lessors or distributors of cinematographic films; persons engaged in milling, processing, manufacturing or repacking goods for others; and similar services regardless of whether or not the performance thereof calls for the exercise or use of the physical or mental faculties: xxx.
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> 'Gross receipts' means the total amount of money or its equivalent representing the contract price, compensation or service fee, including the amount charged for materials supplied with the services and deposits or advance payments actually or constructively received during the taxable quarter for the services performed or to be performed for another person, excluding value-added tax.

The abovecited provision speaks of gross receipts as the basis of the 10% VAT. Section 2(m) of Revenue Regulation No. 5-87 defines gross receipts in exactly the same manner as that of Section 102(a) of the Tax Code, thus:

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

The definition of gross receipts refers to the amount of money actually or constructively received by the taxpayer. The facts show that the amount paid by the petitioner to PLDT as tolling charges for the overseas calls made by its guests were not actually nor constructively received by the petitioner as service fees but were instead charges of PLDT so there is no reason why the respondent should include these as part of petitioner's gross receipts.

In the cases entitled **The Collector (now Commissioner) of Internal Revenue vs. Manila Jockey Club, Inc., and The Commissioner (formerly Collector) of Internal Revenue vs. Manila Jockey Club, Inc., Nos. L-13887 and L-13890, June 30, 1960 (108 Phil. 821)**, the Supreme Court ruled, thus:

> "Needless to say, gross receipts of the proprietor of the amusement place should not include any money which although delivered to the amusement place has been especially earmarked by law or regulation for some person other than the proprietor."

In a more recent case entitled, **Commissioner of Internal Revenue vs. Tours Specialists, Inc., and The Court of Tax Appeals, G.R. No. 66416, March 21, 1990 (183 SCRA 402)**, the Supreme Court again delved into the concept of gross receipts in a broader sense than what was enunciated in the Manila Jockey Club case quoted earlier, thus:

> "As demonstrated in the above-mentioned case, *gross receipts* subject to tax under the Tax Code do not include monies or receipts entrusted to the taxpayer which do not belong to them and do not redound to the taxpayer's benefit; and it is not necessary that there must be a law or regulation which would exempt such monies and receipts within the meaning of gross receipts under the Tax Code." (Underscoring supplied)

Therefore, We find respondent's inclusion of the amount paid to PLDT as part of petitioner's gross receipts subject to 10% VAT erroneous and therefore must be cancelled in favor of the petitioner.

The second item in issue is the respondent's imposition of VAT on the gross receipts of petitioner stemming from the amount received on the transportation services extended by the petitioner to the guests of the hotel. Petitioner argues that the revenues it received from this type of service are already subject to the 3% tax on common carriers under Section 115 of the Tax Code hence, these should no longer be subject to VAT as clearly provided in Section 103(j) of the Tax Code which mentions that services rendered by persons subject to percentage tax under Title V are exempt from the payment of VAT.

Respondent disagrees with the contention of petitioner and proposes the argument that petitioner is not engaged in the business of a common carrier because it transports its hotel guests merely as part of its hotel service. This particular activity according to the respondent falls outside the ambit of Section 115 but falls squarely within the provision of Section 102 of the Tax Code subjecting such sale of service to VAT.

On this score, petitioner insists that it is a common carrier subject to the 3% common carrier's tax instead of the VAT.

The issue to be resolved here is whether or not the revenues received by the petitioner in providing transport service to its hotel guests are subject to the 10% VAT in accordance with Section 102 of the Tax Code.

Corollary to this issue is whether or not the petitioner in extending transport services to its hotel guests can be classified as a common carrier subject to the 3% common carrier's tax under Section 115 of the Tax Code.

We find petitioner's contention that it is a common carrier subject to the 3% tax under Section 115 of the Tax Code, bereft of merit.

Article 1732 of the New Civil Code defines a common carrier as follows:

> **ART. 1732.** Common carriers are persons, corporations, firms or associations engaged in the business of carrying or transporting passengers or goods or both, by land, water, or air, for compensation, offering their services to the public.

Petitioner is engaged in the hotel business and not in the business of transporting passengers. On the occasion when the petitioner extends transport services like providing limousine service and the like, it does so only for its hotel guests and not to the public in general.

In the case entitled **United States vs. Quinajon and Quitoriano, No. 8686, July 30, 1915 (31 Phil. 189)**, the Supreme Court defined a common carrier as follows:

> "A common carrier is a person or corporation whose regular business is to carry passengers or property for all persons who may choose to employ and remunerate him. A common carrier is a person or corporation who undertakes to carry goods or persons for hire." (Underscoring supplied)

Black's Law Dictionary, 6th ed., 1990, p. 275, defines a common carrier in this manner, thus:

> "Any carrier required by law to convey passengers or freight without refusal if the approved fare or charge is paid in contrast to the private or contract carrier. One who holds himself out to the public as engaged in business of transportation of persons or property from place to place for compensation, and who offers services to the public generally. (Tilson v. Ford Motor Co., D.C. Mich., 130 F. Supp. 676, 678)"

The petitioner does not fall within any of the aforequoted definitions and it was erroneous on its part to subject its gross receipts resulting from the transport service to percentage tax under Section 115 of the Tax Code. Respondent is correct in subjecting these revenues to the VAT in accordance with Section 102 of the Tax Code.

The third item of VAT assailed by the petitioner relates to its disposal of assets which respondent subjected to the 10% VAT pursuant to Section 100 of the Tax Code.

The disposal of petitioner's assets for the year 1988, consists of the following: (see Exhs. U, p. 212, BIR rec.; R-4, p. 177, CTA rec.; R-16, p. 188, CTA rec.; R-23, p. 195, CTA rec.)

	Buildings	Transportation Equipment	Operating Equipment	Total
Historical cost	P3,893,086	P106,621	P1,159,811	P5,159,518
Appraisal increase	2,450,207	-	-	5,450,207
	P6,343,293	P106,621	P1,159,811	P7,609,725
Accumulated depreciation:				
On cost	P1,137,886	P106,621	-	P1,244,507
On appraisal	570,881	-	-	570,881
	P1,708,767	P106,621	-	P1,815,388
Net appraised value	P4,634,526	P -	P1,159,811	P5,794,337

The disposal of these assets were assessed to be subject to the 10% VAT. It is petitioner's position that the amount of P6,343,293.00 represents the costs and the appraisal increment from civil works performed on account of the renovations made thereon. The demolition of the old civil works to give way to renovation of the hotel cannot be considered as subject to the VAT.

The transportation equipment which has been fully depreciated was sold in 1988. It was alleged that the transportation was used in the catering business which business is already subjected to the 4% caterer's tax under Section 114(1) of the Tax Code, as amended, therefore, should not be subjected to the 10% VAT under Section 103(j) of the Tax Code.

The operating equipment consisting of silverware, china and linen used in its hotel operations amounting to P1,159,811.61 after inventory count was found to have been lost, destroyed or no longer useful. In view thereof, the retirement of this equipment can not be considered a deemed sale transaction.

Respondent, on the other hand, subscribes to the theory that the sale of property and equipment is considered sale of personal property subject to 10% VAT.

This Court believes that the petitioner's disposal of its property and equipment after taking into consideration the manner for its disposal is not subject to the 10% VAT. The demolition of the civil works in the building of petitioner paving the way for a renovation thereof *per se* cannot be considered subject to the VAT. The same is true with the retirement of the operating equipment (siiverwares, etc.) because the reason for their retirement was due to loss or obsolescence but not the sale thereof subject to the VAT. Now with respect to the sale of transportation equipment it is noteworthy to point that the asset sold has been fully depreciated and is connected with the catering business of petitioner. Considering further, that the catering business is already subject to the caterer's tax under the other percentage taxes in Title V of the Tax Code, the same should not be subject to the VAT.

The Supreme Court in the case entitled **Standard Vacuum Oil Co. vs. Antigua, etc., et al., No. L-6931, April 30, 1955 (96 Phil. 909)**, ruled:

> "In conclusion, we hold that when a person or company is already taxed on its main business, it may not be further taxed for doing something or engaging in an activity or work which is merely a part of, incidental to and is necessary to its main business."

In the cases of **Insular Life Assurance Co., Ltd., vs. Commissioner of Internal Revenue, CTA Case No. 2336,**

and Filipinas Life Assurance Company vs. Commissioner of Internal Revenue, CTA Case No. 2337, both dated November 12, 1973, this Court had the occasion to rule:

> "We have had occasion to express the same view. xxx. Where the law taxes a business, it is presumed to be the legislative intent not to separately tax every activity which is merely incidental or necessary to the conduct of said business. (p. 7, supra.)"

Moreover, pursuant to Section 99 of the Tax Code, as amended, quoted hereunder:

> "**SEC. 99. Persons liable.** - Any person who, in the course of trade or business, sells, barters or exchanges goods, renders services, or engages in similar transactions and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 100 to 102 of this Code. (As added by EO 273)"

VAT shall be imposed only if the sale of goods is "in the course of trade or business of the taxpayer". The selling of unserviceable equipment and other assets including real property improvement are not subject to VAT. The selling of those assets are merely incidental to its renovation. Petitioner is in the hotel business. Besides, real property in 1988 are not yet included among those subject to VAT.

In conclusion, We find that respondent erred in subjecting the disposal of transportation equipment and the retirement of the operating equipment and the renovation of the building to the 10% value-added tax.

The last item relating to VAT involves the input taxes which petitioner claims to have been disallowed by the Revenue Examiner. Petitioner insists that such disallowance was arbitrary and was not based on factual findings. The Revenue Examiner who conducted the investigation explained the disallowance by stating that out of the claimed input tax in the amount of P808,095.40, only P204,207.21 was properly documented, thus, a total of P603,888.79 was disallowed.

An analysis of the records of this case including the BIR records submitted by the respondent reveal that the working paper prepared by the revenue examiner reflected the disallowed input taxes of P93.964.54 instead of P603,888.79, (see pages 39 to 47, BIR records). In summary, the overall findings with respect to petitioner's deficiency VAT assessment for 1988 are detalled hereunder:

MANILA MANDARIN HOTEL, INC.
SCHEDULE OF DEFICIENCY VAT ON OTHER INCOME
FOR THE YEAR 1988

Department	Total Income
Guest Laundry	P 4,988,665.83
Health Center	893,554.58
Business Center	4,662,142.87

Department		Total Income
Garage		3,149,239.37
Rent and Other Income		6,219,940.10
Total income subject to VAT		P19,913,542.75
VAT Due thereon		P 1,991,354.27
Less: a) Percentage tax payments		
Garage	P 84,954.06	
Other Income	241,410.81	
Total	P 326,364.87	
b) VAT payments		
Output Tax liabilities		
1st Qtr.	P 591,164.72	
2nd Qtr.	545,135.44	
3rd Qtr.	382,927.03	
4th Qtr.	481,137.42	
Total VAT liabilities	P 2,000,364.61	
Less: Allowable input tax		
Total input tax per return	P 808,095.40	
Less: unallowable	93,964.54	
Total allowable input tax	P 714,130.86	
Total VAT payments	P 1,286,233.75	
TOTAL		1,612,598.62
Deficiency Value Added Tax		P 378,755.65
Plus : a) 25% Surcharge		94,688.91
b) 20% Interest (1-20-89 to 6-30-92)		326,093.05
Total VAT Due and Payable		P 799,537.61

PERCENTAGE TAX

It is petitioner's analysis that the deficiency percentage tax assessment arose due to the imposition of the tax on deposits made by its clients for the use of the hotel facilities. Petitioner contends that these deposits, if not applied against hotel bills is not subject to percentage tax because these deposits partake of the nature of a security deposit which cannot be classified as income.

This Court disagrees with the respondent in the assessment of the deficiency percentage tax, primarily because the deposits made by petitioner's hotel clients should not be treated as part of Its gross income.

Under the realization principle, revenue is generally recognized when both of the following conditions are met: (a) the earning process is complete or virtually complete, and (b) an exchange has taken place. This principle requires that revenue must be earned before it is recorded. Thus, the amounts received in advance are not treated as revenue of the period in which they are received but as revenue of the future period or periods in which they are earned. These amounts are carried as unearned revenue, that Is, liabilities to transfer goods or render services in the future - untll the earning process is complete. (Compilation of Statements of Financial Accounting Standards No. 1-22, pp. 41-42).

As explained by the witness Ms. Fernando, its collection is in the nature of a security deposit to ensure that the other party will perform his end of the contract. It is only upon the use of the reserved facilities or the default of the reserving guest to cancel the reservation on time that the deposit is clearly convertible to revenues. Since the deposits are payment for future services it cannot be treated as part of its gross income until the earning process is complete.

From the above discussion, We find that the deficiency percentage tax assessment is erroneous and should be therefore be cancelled.

WHEREFORE, in view of the foregoing, petitioner is hereby **ORDERED** to **PAY** the sum of P799,573.61 representing its value-added tax deficiency for the taxable year 1988, plus 20% interest from June 22, 1992 until fully paid pursuant to Section 249(c) of the Tax Code, as amended.

It should be noted that the compromise penalty originally imposed by the respondent is deleted inasmuch as there was no mutual agreement reached between the parties. **(Ben L. Chuy, et al. vs. Collector of Internal Revenue, CTA Case promulgated in July 16, 1958).**

The assessment for deficiency percentage tax for 1988 is hereby **CANCELLED** for lack of merit.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

I CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

CERTIFICATION

I hereby certify that this 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
Court of Tax Appeals