REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PROGRESSIVE DEVELOPMENT
CORPORATION,
Petitioner,

versus

CTA CASE No. 1549

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

Aug. 5, 1970

D E C I S I O N

Petitioner appealed from the decision of respondent Commissioner of Internal Revenue, dated November 6, 1964, demanding from it as a contractor during 1960 and 1961 payment of ₱92,998.17 representing fixed and percentage taxes, plus 25% surcharge for late payment, computed as follows:

Gross cost of finished projects and equipment	₱2,168,122.64	
ADD: 15% mark-up on cost of projects and equipment	310,761.94	
Total gross receipts	₱2,478,884.58	
3% tax due thereon		₱74,366.54
25% surcharge		18,591.63
PTR, 1960-61		40.00
TOTAL AMOUNT DUE		₱92,998.17

Petitioner is a duly organized corporation with principal office at Araneta Enterprises Building, Cubao, Quezon City. It is engaged, among others, in the general construction business. In the investigation and verification of its corporate income tax returns for 1957 to 1961, inclusive, seven (7) revenue examiners recommended to respondent that petitioner be assessed as a contractor the sum of ₱12,235.68 representing fixed and percentage taxes, plus 25% surcharge for late payment, computed as follows:

Gross receipts on finished projects	₱2,168,122.64
15% thereof as administration fee received by Progressive Development Corp.	325,218.40
3% contractor's tax thereon	9,756.55
25% surcharge for late payment	2,439.13
1960-1961 fixed tax c-4(6)B at ₱20 p.a.	40.00
TOTAL AMOUNT DUE & DEMANDABLE	₱ 12,235.68

Despite the recommendation of the seven (7) revenue examiners and for reasons which are not found in the BIR records, the respondent Commissioner of Internal Revenue ignored the examiners' recommendation and demanded upon petitioner payment of the fixed and percentage taxes, plus 25% surcharge, amounting to ₱92,998.17, supra.

In August, 1959, petitioner started the construction of a warehouse in Pulupandan, Negros Occidental, where bulk sugar could be stored. The construction was apparently made for the account of petitioner. As of

November, 1960, petitioner had spent the amount of ₱723,582.91 for the project (Exhibit H). Meanwhile, on November 11, 1960, or fifteen (15) months after the construction of said warehouse, Mr. J. Amado Araneta organized the Philippine Bulk Corporation (Exhibit C) and that more than 99% of its outstanding stock was owned by the said organizer. The new entity is a sister corporation of petitioner, Progressive Development Corporation, about 90% of its outstanding stock was owned by Mr. J. Amado Araneta and his family.

The Philippine Bulk Corporation was organized to undertake the business of bulk-handling all kinds of goods sold, transferred or carried in bulk, particularly grains and sugar. The system dispenses with the use of bags and other containers in shipping grains or sugar to a vessel or steamer. The new corporation, therefore, needed bulk-handling terminals and other necessary structures, buildings, and equipment for its operation.

Petitioner constructed and built for the newly organized sister corporation the following: sugar warehouse, wharf approach and landing, seawall and reclamation, office building, artesian wells and water system, power house and plant installation, receiving and batch scale houses, roads and railroads, garage, conveyor support, and mechanical and electrical installations amounting to ₱2,132,684.34. It also supplied its sister corporation with tools and office equipment, motor boat, electrical appliances, furniture, water tank, and utensils valued at ₱35,438.35 (Exhibit O).

From the foregoing facts, there are two issues to be resolved by this Court, namely:

1. Whether or not petitioner is an independent contractor under Section 191 of the Tax Code; and

2. In the affirmative case, what is the taxable gross receipt of petitioner subject to the 3% tax.

First Issue

Petitioner contends that it is not a contractor within the purview of Section 191 of the National Internal Revenue Code because it undertook the construction in question not as a business or occupation but merely to accommodate a newly organized sister corporation. In fact, the construction of the warehouse was commenced by petitioner in August, 1959 for its own account. It is argued, therefore, that petitioner can not be considered a contractor in the absence of a formal contract between itself and the Philippine Bulk Corporation; no contract price or lump sum consideration was agreed upon by the said parties; and petitioner was not impelled by any profit motivation in undertaking the said construction. A contractor, it is alleged, is considered as such if it runs the risk of making a profit or incurring a loss in the construction. In the absence of a formal contract, it is claimed, petitioner cannot be placed in the same category as an independent contractor whose gross receipts are subject to the 3% tax imposed by Section 191 of the National Internal Revenue Code.

Respondent admitted that no written contract existed between petitioner and the Philippine Bulk Corporation as to the construction of its bulk-handling terminal and other structures, buildings, and equipment for its operation. However, the revenue examiners of respondent maintained that a <u>verbal contract</u> existed between petitioner and the Philippine Bulk Corporation involving the construction in question because of the entries recorded in the books of accounts of petitioner and the admission made by its accountant, a certain Baby Araneta. Moreover, the existence of an oral agreement to continue the construction of projects for the account of Philippine Bulk Corporation is admitted in petitioner's reply memorandum dated July 6, 1970 (CTA rec., p. 117).

We have carefully weighed the evidence of both parties, whether testimonial or documentary, and we are constrained to conclude that petitioner is a contractor because a verbal contract existed between petitioner and the Philippine Bulk Corporation for the construction of its bulk-handling terminal, structures, buildings, installations, etc. In the first place, the various construction projects handled by petitioner for the Philippine Bulk Corporation involve an outlay of more than two million pesos and, therefore, it is inconceivable that no contract or agreement existed between the contractor and the contractee regarding the construction of said projects. Secondly, even if a written contract was entered into between petitioner and the Philippine Bulk Corporation regarding the staggering amount involved in the various construction projects, still the sister corporations would not furnish the revenue examiners with a copy thereof as the same will prejudice their interests insofar as the contractor's fixed and percentage taxes are concerned. Thirdly, the reimbursements made by the Philippine Bulk Corporation of all the expenses incurred by petitioner in all the construction projects and equipment amounting to ₱2,168,122.64, plus the payment of ₱310,761.91 representing 15% as administration fee, indicate beyond doubt the existence of a verbal contract between the said parties regarding the constructions in question. Lastly, the existence of a verbal contract between the aforesaid parties is corroborated by the entries in petitioner's books of accounts and admitted in petitioner's reply memorandum.

After holding that petitioner corporation is a contractor, is it an independent contractor within the purview of Section 191 of the National Internal Revenue Code? In a general sense, every person who enters into a contract may be called a contractor. Under Section 191 of the Tax Code, however, a contractor refers to a person who, in the pursuit of an independent business, undertakes to do a specific piece of job or work for other persons, <u>using his own means and methods without submitting himself to control as to the petty details</u>. Thus, it was held:

> "x x The true test of a 'contractor' would seem to be that he renders the service in the course of an independent occupation, representing the will of his employer only as to the result of his work, and not as to the means by which it is accomplished. x x" (Luzon Stevedoring Co. vs. Trinidad, 43 Phil. 807-808; La Carlota Sugar Central vs. Trinidad, 43 Phil. 819.)

In the case at bar, no evidence was adduced that the Philippine Bulk Corporation intervened in anyway with the various constructions undertaken by petitioner. The only intervention made by the contractee with the contractor was to reimburse the latter for its expenses for labor, materials, and equipment. Consequently, we hold that petitioner, which was organized to engage in the business of general construction, is an independent contractor under Section 191 of the Tax Code.

Second Issue

Respondent, in disregarding the proposed assessment of his revenue examiners, based his assessment of the 3% contractor's tax on the total amount received by petitioner from the Philippine Bulk Corporation, that is, ₱2,168,122.64 plus ₱310,761.94, or a total of ₱2,478,884.58, representing the cost of the finished projects and equipment and the 15% mark-up thereon, respectively.

Section 191 of the National Internal Revenue Code provides that the contractors enumerated therein are subject to a tax of 3% of their gross receipts. There is no dispute that petitioner received from the Philippine Bulk Corporation the total amount of ₱2,478,884.58. Out of the said amount, petitioner spent the sum of ₱723,582.91 for the construction of the sugar warehouse on its own account covering the period from August, 1959 to November, 1960. In short, no verbal or written contract existed between petitioner and the Philippine Bulk Corporation with respect to the said construction expenses inasmuch as the latter corporation came into life only on November 11, 1960. The said amount of ₱723,582.91 cannot, therefore, be considered as a part of the taxable gross receipts of petitioner as an independent building contractor. The same treatment should be accorded to the total amount of ₱35,438.35 representing the value of tools, office equipment, motor boat, electrical appliances, furniture, water tank, and utensils, for which petitioner was reimbursed because said items do not form part of the taxable gross receipts of petitioner as an independent contractor.

Deducting the non-taxable receipts of petitioner in the sums of ₱723,582.91 and ₱35,438.35, or a total of ₱759,021.26, from its alleged taxable gross receipts of ₱2,168,122.69 leaves a balance of ₱1,409,101.43. This balance, therefore, poses a question as to whether or not the said amount is includible in the taxable gross receipts of petitioner as an independent contractor.

It is a cardinal rule that, in the imposition of the 3% contractor's tax on gross receipts, the expenses incurred by the said contractor for labor and materials are not deductible from his taxable gross receipts as an independent contractor. Be that as it may, the facts and circumstances ascertained in this case are different and unique. The two corporations, petitioner and Philippine Bulk Corporation, are practically owned and controlled by the same party, Mr. J. Amado Araneta. It is not surprising, therefore, that petitioner was made the agent of its sister corporation - the Philippine Bulk Corporation. Under the arrangement between the said corporations as reflected in the books of accounts of petitioner, the expenses incurred by the latter for labor and materials in the various construction projects were generally advanced and/or reimbursed by the former to petitioner. Consequently, the said expenses of petitioner amounting to ₱1,409,101.43 and made for the account of its principal cannot be considered a part of petitioner's taxable gross receipts.)

Respondent, however, insinuated in its memorandum that the subsequent organization of the Philippine Bulk Corporation was intended to avoid the contractor's fixed and percentage taxes. This allegation is not borne by the record and the evidence. After all, if the original project of petitioner was not transferred to its sister corporation, the disputed tax assessment now in litigation could not be the subject of respondent's assessment as there would be no case at all.

The books of accounts of petitioner show that it received from the Philippine Bulk Corporation the sum of ₱310,761.94 as the former's remuneration for the administration of the various construction projects of its sister corporation. The said amount, therefore, constitutes the only taxable gross receipt of petitioner as an independent contractor, in line with the recommendation of the seven (7) revenue examiners to respondent. While the said examiners claimed that the administration fees received by petitioner amounted to ₱325,218.40, the excess over ₱310,761.94 represents accrued taxes, licenses, and expenses which do not form part of petitioner's taxable gross receipts as an independent contractor.

Accordingly, we hold petitioner subject to the fixed and percentage taxes as a contractor in the amount of ₱11,692.58, computed as follows:

Taxable administration fees amounting to ------------	₱310,761.94
3% contractor's tax due thereon	9,322.86
25% surcharge for delinquency	2,330.72
Privilege Tax Receipt for 1960 & 1961	40.00
TOTAL AMOUNT DUE	₱ 11,693.58

WHEREFORE, the appealed decision of respondent Commissioner of Internal Revenue is modified. Petitioner is hereby ordered to pay respondent or his duly authorized collection agent the sum of ₱11,693.-58, representing the contractor's fixed and percentage taxes due from petitioner for the years 1960 and 1961. Without costs.

IT IS SO ORDERED.

Quezon City, August 5, 1970.

Estanislao R. Alvarez
ESTANISLAO R. ALVAREZ
Associate Judge

I concur:

R. M. Umali
ROMAN M. UMALI
Presiding Judge

(Associate Judge Ramon L. Avanceña who is on leave took no part.)