Library

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

INTER-ISLAND CONSTRUCTION
CORPORATION,
Petitioner,

- versus - C.T.A. CASE NO. 2799

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

x - - - - - - - - - - - - - - x

8/27/82

D E C I S I O N

From the decision of respondent Commissioner of Internal Revenue dated March 8, 1976 assessing against petitioner Inter-Island Construction Corporation in the sum of ₱77,632.52 representing deficiency percentage tax, surcharge and compromise penalties for the year 1965, petitioner appealed to this Court.

It appears that petitioner Inter-Island Construction Corporation is a domestic corporation organized and existing under and by virtue of the laws of the Philippines with principal office at Industria, Quezon City. (par. 1, petition; admitted, par. 1, Answer). It is engaged in the business of leasing heavy equipment and in supplying big hotels, housing projects, office buildings, and residential homes of their interior features like panels, kitchen cabinets, shoji and flush doors, lattice and sound proof partitions, louver dividing walls, sculptured lattice ceilings, bathroom vanities, handrails, etc. mostly of narra and other first class wood. It has registered and advertised itself as a general contractor and in the early part of its operation had been paying the 3% contractor's tax on its gross receipts. In 1965, it claimed liability as manufacturer subject to 7% tax on the net receipts after deductible materials.

The corporation, however, has not kept the records required of a manufacturer. Neither was it provided with any (C-14) manufacturer's, producer's or exporter's privilege tax receipt. However, it had a contractor's Privilege Tax Receipt. It was ascertained that the demand for its products were filled according to job orders and its invoices and stationary carried the bold print "General Contractors". Its Articles of Incorporation (Exh. 10, pp. 58-65, CTA rec.) showed that it was organized primarily "to conduct and carry on the business of builders and contractors". The corporation registered its business name and its books of accounts as a contractor. Bulk of its transactions were entered and posted in its books as Contracts Receivables. It manufactures its products according to customer's specification sketches, and/or drawings, or architect's plan with corresponding job order numbers. (Exh. 9, p. 71, BIR rec.) A number of jobs were either for services only or including installation of the article made. These array of facts have never been assailed by the taxpayer. (Exh. 1-1-A, pp. 86-90, BIR rec.)

On March 10, 1969, respondent through its agent, conducted an investigation of petitioner's business tax liabilities for the year 1965. (Exh. 1, supra.)

Consequently, on April 20, 1971, respondent issued an assessment notice to petitioner assessing and demanding payment from the latter the amount of ₱77,632.52 as deficiency contractor's tax for the year 1965, including surcharge and compromise penalties (Exh. B & 3, p. 98, BIR rec.) computed as follows:

Cash receipts as per cash register book	₱2,325,505.15
Add: Contracts receivable offset vs. payable	325,641.14
Total receipts	₱2,651,146.29
Deduct "As-is" or "C-13" sales	227,264.47
Amount subject to contractor's tax .	₱2,423,881.82
3% tax due thereon	72,716.45
Less: Amount paid as manufacturer's sales tax	11,090.43
Deficiency percentage tax	61,626.02
25% surcharge thereon	15,406.50
Total amount due	₱ 77,032.52
For late payment of percentage tax .	300.00
For failure to comply with bookkeeping regulations	300.00
TOTAL AMOUNT DUE AND COLLECTIBLE ...	₱ 77,632.52

On April 5, 1972, petitioner protested and questioned the validity of the said assessment and requested the withdrawal and cancellation of the same alleging that petitioner is engaged in manufacturing subject to manufacturer's tax, and is not subject to a contractor's tax, citing the decision of our Supreme Court in the case of Celestino Co & Company vs. Commissioner of Internal Revenue, G.R. No. L-8506, Aug. 31, 1956, 99 Phil. 841. (Exhs. C & 4, pp. 121-124, BIR rec.)

Warrants of Distraint of Personal Property and Levy on Real Property were issued on November 25, 1975 against the properties (real and personal) of petitioner Inter-Island Construction Corp., which were received for petitioner by E.E. Black Ltd. on November 25, 1975 at 2:59 P.M. (Exhs. 6 and 7, pp. 161-162, BIR rec.)

On March 8, 1976, respondent denied petitioner's request for the withdrawal and cancellation of the assessment and reiterated his demand for petitioner to pay the amount of ₱77,632.52 as deficiency percentage tax, surcharge and compromise penalties for the year 1965, which denial was allegedly received by petitioner on March 30, 1976. (Exhs. D & 5, pp. 184-188, BIR rec.)

A complaint for collection of said deficiency assessment was filed by respondent on April 13, 1976 against petitioner with the Court of First Instance of Manila, docketed as Civil Case No. 102035, entitled "Republic of the Phil. vs. Inter-Island Construction Corp." (Exh. 12, pp. 134-136, CTA rec.)

On April 23, 1976, petitioner, through counsel, filed its petition for review with our Court.

The issues to be resolved are, to wit:

(1) Whether or not petitioner was a manufacturer or contractor in the year 1965 when it was assessed for deficiency percentage tax, surcharge and compromise penalties in the amount of ₱77,632.52;

(2) Granting for the sake of argument that petitioner was a contractor, whether the inclusion of the following amount:

a. ₱915,537.18 representing rental income received by petitioner from leasing of heavy equipment for the year 1965.

b. ₱325,641.14, representing debit entries to contracts receivable for the year 1965.

to form part of the gross receipts totalling ₱2,423,881.82 subject to the computation of the 3% contractor's tax is proper; and

(3) Whether the right of the respondent to assess and collect the alleged deficiency percentage tax,

inclusive of surcharge and penalty, for the year 1965, has prescribed pursuant to the provisions of Section 331 of the Tax Code.

With respect to the first issue, petitioner maintains the view that during the year 1965 in question, it was a manufacturer. The mere fact that the articles it sold were made in accordance with certain specifications of its customers do not necessarily convert its operation from that of a manufacturer to that of a contractor. In support of its contention, petitioner cited the Supreme Court decision in Celestino Co & Company vs. Commissioner of Internal Revenue, G.R. No. L-8506, Aug. 31, 1956, 99 Phil. 841; wherein the Supreme Court had held that a factory which habitually makes sash, windows and doors, and sells the goods to the public, although in such form or combination as may suit the fancy of the purchaser, each new form does not divest its character as manufacturer. (Memo. of petitioner, pp. 87-93, CTA rec.)

Respondent, on the other hand, insistently maintains that petitioner was at the time a contractor subject to the 3% contractor's tax, and not a manufacturer subject to the 7% sales tax. He alleges that the term "independent contractor" is defined to include persons (juridical or natural), not enumerated in

Section 191 (now Section 205) of the Tax Code, but not including individual subject to the occupation tax under Section 12 of the Local Tax Code, whose activity consists essentially of the sale of all kinds of services for a fee regardless of whether or not the performance of the service calls for the exercise or use of the physical or mental faculties of such contractors or their employees, and that this term is now so expressly defined that its scope is made very clear to include any person, therefore, who without being included in the enumeration of persons engaged in the sale of all kinds of services is now indubitably considered an independent contractor. (Jose Arañas, <u>Annotations and Jurisprudence on the National Internal Revenue Code</u>, Vol. II, 5th Ed., p. 300.)

Furthermore, respondent argues, the word "contractor" has come to be used with special reference to a person who, in the pursuit of an independent business, undertakes to do a specific job or piece of work for other persons, using his own means and methods without submitting himself to control as to petty details. (Jose Arañas, <u>Ibid</u>, p. 318, par. 191(2), 1970 Ed.)

We find the view of respondent to the effect that petitioner is a contractor and not a manufacturer is well taken. Our Civil Code makes a distinction between a contract of sale and contract for a piece of work. Article 1467 of the Civil Code states thus -

> "A contract for the delivery at a certain price of an article which the vendor in the ordinary course of his business manufactures or procures for the general market, whether the same is on hand at the time or not, is a contract of sale, but if the goods are to be manufactured specially for the customer and upon his special order, and not for the general market, it is a contract for a piece of work." (Underlining supplied.)

The distinction between a contract of sale and one for work, labor and materials is tested by the inquiry whether the thing transferred is one not in existence and which would never have existed but for the order of the party desiring to acquire it, or a thing which would have existed and been the subject of sale to some other persons, even if the order had not been given. (Groves vs. Buck, 3; Maules &S. 178; Towers vs. Osborne, 1 Strange, 506; Benjamin on Sales, 90). (Jose Arañas, Annotations and Jurisprudence on the National Internal Revenue Code, as amended, Vol. II, Second Ed., 1963, p. 432.)

The facts and records of this case show that petitioner Inter-Island Construction Corporation, besides registering and advertising itself as a contractor, derived its receipts not from ready made articles of standard sizes for the average home, but from orders for a few projects like Dolfil (Dole Phil.) job, L and S Building partitioning, Queen Emma Garden project and Haas and Haynie Corporation project which were in accordance and in strict compliance with plans and specifications of architects (Exh. 9, pp. 67-71, BIR rec.). Petitioner does not, therefore, mass produce or habitually makes narra panels, kitchen cabinets, lattice and sound proof partitions, sculptured lattice ceilings, narra doors, partitions, and handrails. Its invoices show that orders were filled according to job orders made by its clients while others were for services only, like kiln drying and installation; that it is engaged in supplying big hotels, housing projects, office buildings and residential houses with interior features like panels, kichen cabinets, shoji and flusk doors, lattice and sound proof partitions, lower dividing walls, bathroom vanities, etc., and it does not manufacture these articles for the general market. (Exh. I, pp. 86-90, BIR rec.)

The above transactions are clearly contracts for a piece of work and, therefore, petitioner is considered as a contractor because the articles furnished by it were not in existence at the time needed and they existed only on account of the orders made by its customers. The distinction between a contract of sale and one for work, labor and materials, is tested by the inquiry whether the thing transferred is one not in existence and which never would have existed but for the order of the party desiring to acquire it, or a thing which would have existed and has been the subject of sale to some other persons even if the order had not been given. If the article ordered by the purchaser is exactly such as as the taxpayer makes and keeps on hand for sale to anyone, and no change or modification of it is made at customer's request, it is a contract of sale, even though it may be entirely made after the customer had ordered it. (Commissioner vs. Engineering Equipment and Supply Co., et al., 64 SCRA 590.) And the true test of being a contractor is that he renders service in the course of an independent occupation, representing the will of his employer only insofar as the result of his work is concerned, but not as to the means by which it is accomplished. (Luzon Stevedoring Co., vs. Trinidad, 43 Phil. 803, 807 and 808; La Carlota Sugar Central vs. Trinidad, 43 Phil. 816,819.)

The case of Celestino Co and Company vs. Commissioner of Internal Revenue, G.R. No. L-8506, August 31, 1956, cited by petitioner, is not on all tours with the instant case. In the cited case, the petitioner was a manufacturer claiming to be a contractor. While in the case at hand, petitioner is a contractor claiming to be a manufacturer. In that decision, the Supreme Court noted that the Oriental Sash Factory registered and advertised itself as a manufacturer, and that the bulk of its sales was derived from ready-made doors and windows of standard sizes for the average homes. Petitioner, however, in the instant case, had registered and advertised itself as a contractor, paid its Privilege Tax Receipt as a contractor, and that the bulk of its receipts was derived not from ready made articles of standard sizes for the average homes, but from specific orders for projects like the Dolfil (Dole Phil.) job, L and S Building partitioning, Queen Emma Garden project, Haas & Haynie Corporation project, aforesaid, and in accordance to and "in strict compliance with plans and specifications of architects." In the cited case, petitioner there does nothing more than sell the goods that it mass-produce or habitually makes. In the instant case, petitioner does not habitually makes narra panels, kitchen cabinets, lattice and sound proof partitions, sculptured lattice ceiling, narra doors, partitions and handrails, and the invoices showed that orders were filled according to job orders, but the services were for kiln drying and installation. In the cited case, the Supreme Court observed that petitioner there "could stock and/or probably had in stock the sash, mouldings and panels"; while petitioner, in the instant case, does not carry stock in trade or inventory of finished products. It is safe, therefore, to conclude, that petitioner is a contractor.

Since we adjudged petitioner as a contractor during the year in question, the second issue that confronts us is whether or not the inclusion of the amount of ₱915,537.18, representing rental income in the year 1965, and ₱325,641.14, representing debit entries to contracts receivables for the same year, or a total of ₱2,423,881.82 arrived at as follows:

Cash receipts (per cash receipt books)	₱2,325,505.15
Add: Contracts receivable offset vs. payable	325,641.14
Total receipts	₱2,651,146.29
Deduct as is or c-13 sales	227,264.47
Amount subject to Contractor's tax	₱2,423,881.82

as part of the gross receipts for the purpose of computing the 3% contractor's tax is legal and proper.

There is no dispute as to petitioner's cash receipt of ₱2,325,505.15 for the year 1965 appearing in the agent's Field Audit Report dated March 10, 1969 (Exhs. A & 2, pp. 84, BIR rec.) since this amount was verified to have been reflected in the books and found correct by petitioner's accountant (t.s.n., Hearing of April 20, 1977, p. 6). The controversy in the instant case is on the amount that should be considered as the tax base for purposes of computing the 3% contractor's tax.

A perusal of the records will show that the composition of the amount of ₱2,325,505.15 is as follows; (1) local items, (2) rental income, (3) export sales and (4) "as is" sales. (Exhs. E to E-15, Exhs. F to F-14, and Exh. G, pp. 35-36, CTA rec.; t.s.n., April 20, 1977, pp. 5-6.)

Petitioner claims that respondent's tax base of ₱2,423,881.82 was erroneous because it included the total amount of ₱918,537.18, representing its rental income for 1965 which was not then subject to the 3% contractor's tax, and the amount of ₱256,269.25 representing contracts receivables which were never collected and were cancelled from the books of petitioner. Respondent, contrarily, avers that the inclusion of said amount for purposes of the 3% contractor's tax was legal and valid.

We find the view of the petitioner well taken. We will discuss the first amount of ₱918,537.18 representing the rental income for 1965. The records will show (Exh. G, pp. 35-36, CTA rec.) that this amount was included in the computation of the 3% contractor's tax which inclusion is erroneous since rental income of contractors are not subject to the 3% contractor's tax, neither does the act of renting their equipment subject them to payment of any internal revenue business tax. Thus, BIR Ruling 105.02 dated November 8, 1954 states as follows:

> "The income derived by contractors from the rental of their equipments is not subject to the 3% contractor's tax; and neither does the act of renting their equipments subject them to the payment of any internal revenue business tax. However, if the renting should be in consequence or in virtue of any contract to be performed by the contractor himself, the rentals of such equipment shall form part of the contractor's gross receipts under such contract." (Underlining supplied.)

The second amount is ₱325,641.14 representing contracts receivables that have been offset against its accounts payable. This amount of ₱325,641.14 is composed of five (5) items in the amounts as follows:

Item (1)	₱107,468.92
Item (2)	24,000.00
Item (3)	69,371.89
Item (4)	40,277.72
Item (5)	84,522.61
	₱325,641.14

or a total of ₱325,641.14. Of this total amount, petitioner had admitted that the amount of ₱69,371.89 (Item 3) was actually offset against its payable, so that deducting said amount of ₱69,371.89 from ₱325,641.14, there is a remaining balance of ₱256,269.25. The amount of ₱325,641.14 in controversy had been reduced to ₱256,269.25. (t.s.n., April 20, 1977, pp. 31-40.).

The records will show that Items 1, 4 and 5 have one thing in common in that they refer to extra materials or goods sent to customers which were not included in the original purchase order, the payment of which were neither received by petitioner nor the goods and materials returned. So the original journal entries for these were reversed. Item 2 refers to debit Dividends Payable, ₱24,000.00 and credit Contract Receivable, E.E. Black, ₱24,000.00, and the explanation is reversal of dividends payable on 300,000 shares, 8% cummulative preferred stocks due to wrong entry. In effect, these four items have been cancelled in the books of petitioner. (Exhs. H and H-1, pp. 37-39, CTA rec.).

Since the amount of ₱325,641.14, now reduced to ₱256,269.25, were treated as a receivable in the books of petitioner but was written off the books by a reversing entry, said amount should not therefore form part of the gross receipts of petitioner in 1965. The Bureau of Internal Revenue had consistently ruled that the 3% contractor's tax should be based only on actual receipts. Thus, as "gross receipts" means the actual amount received by the contractor, only the realized or collected amounts are therefore subject to the 3% tax. (See Jose Arañas, Annotations and Jurisprudence on the NIRC, as amended, Vol. II, 1963, p. 436; BIR Ruling, 105.02, Dec. 26, 1956.) Likewise, in the case of Philippine Long Distance Telephone Company vs. Collector, 90 Phil. 674, it was held that the gross receipts within the meaning of Section 191 refer to amounts actually received, which does not include accounts receivable.

The correct tax base should instead be as follows:

Amount subject to contractor's tax (per respondent's computations)		₱2,423,881.82
Less: Rental income for 1965	₱918,537.15	
Contracts receivable written off and uncollected including wrong entry intended for declaration of dividend	256,269.25	1,174,806.25
Adjusted amount subject to 3% contractor's tax		₱1,249,075.57

With this new adjusted tax base, the alleged deficiency contractor's tax will, therefore, be as follows:

Amount subject to 3% tax	₱1,249,075.57
3% tax due thereon	37,472.26
Less: amount paid as manufacturer's sales tax	11,090.43
Deficiency percentage tax	₱ 26,381.83
25% surcharge thereon	6,595.45
TOTAL AMOUNT DUE AND COLLECTIBLE	₱ 32,977.28

With respect to the compromise penalty for late payment and for failure to comply with bookkeeping regulation, the same cannot be imposed or collected without the agreement and conformity of petitioner. (Manila Central University vs. Comm. of Int. Rev., CTA Case No. 2848, Oct. 19, 1978.)

Coming to the third and last issue, petitioner contends that the right of the respondent to assess and collect the deficiency percentage tax, inclusive of surcharge and penalties, for the year 1965 has already prescribed pursuant to the provisions of Section 331 of the Tax Code (now Section 318 of the National Internal Revenue Code of 1977.)

We find petitioner's contention untenable and without merit. The filing by petitioner of a manufacturer's percentage tax return cannot be considered as a return of the contractor's tax for the purpose of computing the period of prescription under Section 331 of the Tax Code as the taxpayer must file a return for the particular tax required by law in order to avail itself of benefits of Section 331 of the Tax Code (Butuan Sawmill, Inc. vs. Hon. Court of Tax Appeals, et al., G.R. No. L-20601, February 28, 1966, 16 SCRA 277.) Stated otherwise, if the taxpayer does not file the particular return required as in the instant case where petitioner had filed a manufacturer's percentage tax returns instead of a contractor's tax return, an assessment may be made within the period of ten (10) years from the omission or the filing of a false return as provided in Section 332(a) of the same Code. Thus, Section 332(a) of the Tax Code provides:

> "Sec. 332. Exceptions as to period of limitation of assessment and collection of taxes. - (a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in Court for the collection of such tax may be begun without assessment, at anytime within ten years after the discovery of the falsity, fraud, or omission. Provided, that in a fraud assessment which has become final and executory, the fact of fraud shall be judicially taken cognizance of in a civil or criminal action for the collection thereof. (as amended by Presidential Decree No. 69.)"

The filing by petitioner of a false return with intent to evade payment of a contractor's tax was discovered only by respondent's examiner on March 10, 1969, when petitioner was investigated in connection with its business tax case and its claim for refund of compensating taxes for the year 1965. (Exh. I, supra). Respondent has, therefore, up to March 10, 1979 within which to assess petitioner of its tax liabilities. As the assessment in this case was made on April 20, 1971, it is obvious that it was made within the period prescribed by law. And in accordance with Section 332(c) of the Tax Code, respondent has five (5) years after the assessment of the tax within which to effect collection of the same by judicial action. Since the assessment was made on April 20, 1971, respondent has a right to effect collection of the same up to April 20, 1976. The complaint for collection of this case was filed with the Court of First Instance of Manila on April 13, 1976 which is well within the period of five years from the date of assessment. The respondent's right to assess and collect the tax, therefore, has not prescribed.

WHEREFORE, the decision appealed from is hereby modified. Petitioner is hereby ordered to pay respondent Commissioner of Internal Revenue the sum of ₱32,977.28, as deficiency contractor's tax, inclusive of surcharge, plus interest at the rate of 14% per annum from January 1, 1973 until fully paid.

With costs against petitioner.

SO ORDERED.

Quezon City, August 27, 1982.

CONSTANTE C. ROAQUIN
Associate Judge

WE CONCUR:

AMANTE FILLER
Presiding Judge

ALEX Z. REYES
Associate Judge