Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

SECOND DIVISION

DOMINIUM REALTY &, CONSTRUCTION CORPORATION,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA Case No. 8887

Members:
CASTAÑEDA, JR., *Chairperson*,
CASANOVA, *and*
MANAHAN, *JJ.*

Promulgated:

APR 06 2017

4:30 p.m.

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DECISION

CASANOVA, *J.*:

This is a Petition for Review[1] filed on September 4, 2014 by petitioner Dominium Realty & Construction Corporation against respondent Commissioner of Internal Revenue, praying that the Assessment Notices issued by respondent against petitioner for the taxable year 2010 covering alleged deficiency Income Tax, Value-Added Tax (VAT) and Documentary Stamp Tax (DST), in the aggregate amount of ₱131,608,280.71, broken down below, be declared null and void.

Tax Type	Basic	Surcharge	Interest	Total
Income Tax	₱ 54,943,311.30	₱ -	₱ 31,159,631.34	₱ 86,102,942.64
Value Added Tax	18,871,188.73	9,435,594.36	11,529,520.78	39,836,303.87
Documentary Stamp Tax	3,031,125.00	757,781.25	1,880,127.95	5,669,034.20
TOTAL	**₱76,845,625.03**	**₱10,193,375.61**	**₱44,569,280.07**	**₱131,608,280.71**

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[1] Docket (Vol. I), pp. 14-51.

Petitioner is a domestic corporation duly organized and existing under and by virtue of Philippine laws, with business address at Allied Bank Centre, Ayala Avenue, Makati City.[2] It is registered with the Bureau of Internal Revenue (BIR) with Certificate of Registration No. 9RC0000063594[3] dated January 3, 1996 issued by Revenue Region No. 8 – Makati City.[4]

Petitioner's primary purpose is to "purchase, hold, convey, sell, lease, rent, mortgage, encumber or otherwise, deal in such real and personal property in any part of the Philippines or elsewhere, and to engage in the business of construction, building and infrastructure works, land development, subdivisions and such other related purposes as may be convenient or necessary for the transaction of the lawful business of the corporation."[5]

Respondent is the duly appointed Commissioner of the BIR who has the power to decide disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto or other matters arising under the National Internal Revenue Code (NIRC) or other laws or portions thereof administered by the BIR. He holds office at the BIR National Office Building, Agham Road, Quezon City.

Petitioner, together with Fortune Tobacco Corporation (FTC), Parity Packaging Corporation (PPC), Northern Tobacco Redrying Co., Inc. (NTRCI) and Orecla Realty, Inc. (ORI), transferred several parcels of land in favor of Fortune Landequities and Resources, Inc. (FLRI) in exchange for the latter's shares of stocks.[6]

For its part, petitioner executed a Deed of Transfer[7] dated February 25, 2010 in favor of FLRI, transferring its title and ownership over its four (4) parcels of land located in Marikina City, in exchange for FLRI's shares of stock.

On the same date, petitioner, together with four (4) other corporations, namely, FTC, Philip Morris Philippines Manufacturing,

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[2] Par. 3, Admitted Facts, Joint Stipulation of Facts and Issues (JSFI), Docket (Vol. I), p. 289; Exhibit "P-2".
[3] Exhibit "P-3".
[4] Par. 6, JSFI, Docket (Vol. I), p. 289.
[5] Par. 5, JSFI, Docket (Vol. I), p. 289; Exhibit "P-2".
[6] Exhibit "P-19-B", IC-30 (III.a).
[7] Exhibit "P-10".

Inc. (PMPMI), PPC and NTRCI entered into a Deed of Transfer[8], exchanging their assets and liabilities for the shares of stock of PMFTC Inc.

On April 12, 2011, petitioner filed its Annual Income Tax Return[9] for the taxable year 2010.

On June 24, 2011, petitioner received Letter of Authority[10] (LOA) No. 047-2011-00000131 with SN: eLA201000051516dated June 16, 2011, authorizing Revenue Officers Diannah-Lynn Karim and Marilan Dela Cruz, to conduct an examination on the books of accounts and other accounting records for all its internal revenue taxes for the taxable year 2010.[11]

On September 28, 2012, petitioner received the Preliminary Assessment Notice[12] (PAN) dated September 17, 2012, with Details of Discrepancies, assessing it for alleged income tax, VAT and DST.[13] On October 24, 2012, petitioner filed its Reply[14] to the PAN dated October 3, 2012 with the Office of Regional Director Nestor Valeroso through the Assessment Division, Revenue Region No. 8 - Makati City.[15]

On January 8, 2014, petitioner received the Formal Assessment Notice[16] (FAN) dated January 2, 2014, with attached Details of Discrepancies and Assessment Notice Nos. IT-ELA51516-10-14-045,[17] VT-ELA51516-10-14-045,[18] DS-ELA51516-10-14-045,[19] assessing it for alleged income tax in the amount of ₱86,102,942.64, VAT in the amount of ₱39,836,303.87 and DST in the amount of ₱5,669,034.20.[20]

On February 7, 2014, petitioner filed an administrative protest by way of a Request for Reconsideration[21] dated February 4, 2014 with

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[8] Exhibit "P-19-B", IC-36 (III.a).
[9] Exhibit "P-12".
[10] Exhibit "P-4".
[11] Par. 7, JSFI, Docket (Vol. I), p. 289.
[12] Exhibit "P-5".
[13] Par. 8, JSFI, Docket (Vol. I), p. 289.
[14] Exhibit "P-7".
[15] Par. 9, JSFI, Docket (Vol. I), p. 289.
[16] Exhibit "P-6".
[17] Exhibit "P-6".
[18] Exhibit "P-6".
[19] Exhibit "P-6".
[20] Par. 10, JSFI, Docket (Vol. I), p. 289.
[21] Exhibit "P-8".

the Office of the Regional Director, Revenue Region No. 8 - Makati City.[22]

Due to respondent's inaction, petitioner filed the present Petition for Review on September 4, 2014.

Respondent filed his Answer[23], through registered mail, on November 12, 2014 and interposed the following Special and Affirmative Defenses:

> "**SPECIAL AND AFFIRMATIVE DEFENSES**
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> 5. She reiterates and repleads the preceding paragraphs of this answer as part of her Special and Affirmative Defenses;
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> 6. Petitioner was assessed for deficiency income tax, value-added tax and documentary stamp tax for taxable year 2010, for the reason that during the administrative investigation of its tax case by the Bureau of Internal Revenue (BIR), petitioner failed to substantiate or submit supporting evidence against the BIR findings, more specifically shown under the Details of Discrepancies attached to the Preliminary Assessment Notice (PAN) dated September 17, 2012 and Formal Assessment Notice (FAN) dated January 2, 2014, which are briefly discussed hereunder, viz:
>
> **INCOME TAX;**
>
> **A.) Gain on Exchange of Assets per Financial Statement amounting to P183,144,371.00:**
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> - Verification disclosed that during the taxable year, petitioner have recognized gain on exchange of assets in their financial statement in the total amount of P183,144,371.00, as a result of deed of absolute sale dated February 25, 2010 between them and Fortune Landequities & Resources Inc., and subscription agreement executed by petitioner with Tallyhoe Manufacturing Co. Inc., (to be renamed as PMFTC Inc.).

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[22] Par. 11, JSFI, Docket (Vol. I), p. 290.
[23] Docket (Vol. I), pp. 165-172.

The said gain was recognized under accumulated profit (Note 12) of the financial statement of which income tax was not paid as per petitioner's contention that the same was qualified as a tax-free exchange pursuant to Section 40 (c)(2) of the National Internal Revenue Code.

In view thereof, since petitioner have not presented specific ruling that applies to their transaction, the said gain on exchange of assets is subjected to income tax pursuant to Section 27 of the Tax Code in relation to Section 32(A)(3) of the same Code.

B.) Excess Tax Credit carried over to succeeding period amounting to P392,277.78:

- Excess tax credit carried over to succeeding taxable years in the amount of P392,277.78 was deducted from the available tax credit considering that the same was carried over and credit against the taxes due of the succeeding years pursuant to Section 76 of the Tax Code.

VALUE ADDED TAX;

C.) Exchange of Ordinary Asset not subjected to VAT amounting to P157,259,906.09:

- Verification disclosed that the tax-free exchange as discussed under Income Tax involved four (4) parcels of Land and Improvement. In view thereof, since petitioner have not presented specific ruling that applies to their transaction, the same shall be subjected to VAT pursuant to Section 106 of the Tax Code.

DOCUMENTARY STAMP TAX;

D.) Basic Tax Due amounting to P3,031,125.00:

- Since petitioner have not presented specific ruling that applies to their tax-free exchange transaction, the same shall be subjected to deficiency documentary stamp tax pursuant to Section 196 and 175 of the Tax Code.

PERIOD OF PRESCRIPTION;

- Since petitioner failed to report their receipt in an amount exceeding thirty percent (30%) of that declared per Value Added Tax return, the period of prescription, thereof, is extended at anytime within ten (10) years after the discovery of the falsity pursuant to the provision of Section 222 (a) of the Tax Code which states that '*In case of a false or fraudulent return with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, at any time within ten (10) years after the discovery of the falsity, fraud or omission.*'

Petitioner and Fortune Landequities & Resources Inc., entered into a valid sale transaction on February 25, 2010. Hence, gain on said transaction is subject to income tax.

7. A contract of sale is perfected at the moment there is a meeting of minds upon the thing which is the object of the contract and upon the price. Thus, for a contract of sale to be valid, all of the following essential elements must concur: a) consent or meeting of the minds; b) determinate subject matter; and c) price certain in money or its equivalent. **(Robern Development Corporation, et al. vs. People's Landless Association represented by Florida Ramos, et al., G.R. No. 173622, March 11, 2013)**

In this case, petitioner and Fortune Landequities & Resource Inc. has satisfied all the elements of a valid contract of sale, which was evidenced by a Deed of Absolute Sale executed on February 25, 2010 and discussed briefly herein below:

(a) consent or meeting of the minds- Fortune Landequities & Resources Inc., has offered to buy the parcels of land owned by petitioner and the latter has accepted said offer.

> **(b) determinate subject matter-** four (4) parcels of land owned by petitioner located in Marikina, Metro Manila which was covered by TCT No's N-30568, N-34155, N-34156 and N-34157.
>
> **(c) price certain in money or its equivalent- <u>for and in consideration</u>** of the issuance by Fortune Landequities & Resources Inc. of 13,555 common shares **<u>(for a value of Pesos 155,560,500.00)</u>** to the petitioner.
>
> Irrefragably, under Article 1469 of the New Civil Code, the price of the property sold may be considered certain if it be so with reference to another thing certain. It is sufficient if it can be determined by the stipulations of the contract made by the parties thereto or by reference to an agreement incorporated in the contract of sale or contract to sell or if it is capable of being ascertained with certainty in said contract; or if the contract contains express or implied provisions by which it may be rendered certain; or if it provides some method or criterion by which it can be definitely ascertained. As this Court held in Villaraza v. Court of Appeals, the price is considered certain if, by its terms, the contract furnishes a basis or measure for ascertaining the amount agreed upon. **(Boston Bank of the Philippines [formerly Bank of Commerce] vs. Perla P. Manalo and Carlos Manalo, Jr., G.R. No. 158149, February 9, 2006)**

Applying the same in the case at bar, the Deed of Absolute Sale executed by petitioner and Fortune Landequities & Resources Inc. clearly provides a basis or measure for ascertaining the amount agreed upon by the parties and that is the 13,555 common shares (for a value of Pesos 155,560,500.00). The acts and evidence shown by the parties was in perfect harmony with law and jurisprudence, as a consequence thereof, it leaves no doubt as to the Deed executed by the parties was one of Sale and not Exchange by way of subscription.

Petitioner further argued under paragraph 5.29 of the Petition that, 'Though the contract speaks of deed of sale, it is the intention of the parties to enter into a deed of exchange as embodied in the deed of sale. In order to reflect the true intention of the parties, petitioner and FLRI decided to execute a Deed of Transfer with respect to the same properties subject of the Deed of Sale.'

In **Salun-At Marquez and Nestor de la Cruz vs. Eloisa Espejo et. al., G.R. No. 168387, August 25, 2010,** the Supreme Court held that:

'In this regard, guidance is provided by the following articles of the Civil Code involving the interpretation of contracts:

Article 1370. **If the terms of a contract are clear and leave no doubt upon the intention of the contracting parties, the literal meaning of its stipulations shall control**.

If the words appear to be contrary to the evident intention of the parties, the latter shall prevail over the former.

Article 1371. In order to judge the intention of the contracting parties, their contemporaneous and subsequent acts shall be principally considered.

In the present case, the last paragraph of the Deed of Absolute Sale executed by petitioner on February 25, 2010 was reproduced herein below:

'NOW, THEREFORE, **for and in consideration of the issuance by the BUYER of 13,555 common shares (for a value of Pesos 155,560,500.00) to the SELLER, the SELLER by these presents does hereby SELL, TRANSFER and CONVEY unto the BUYER, its heirs, successors and assigns, absolutely and perpetually, tho said parcels of land.** All taxes and expenses relative to this transaction including, but not limited to, Documentary Stamp Tax, Transfer Tax, Value-Added Tax (if any), Capital Gains Tax (if any) and Registration Fees, any special assessments, premiums for property insurance, association dues and any other necessary expenses shall be for the account of the SELLER. **This deed of Absolute Sale may be executed in two or more counterparts, each of which shall be considered original**, but all of which together shall constitute but one and the same Agreement by and among the parties.'

<u>The document itself was entitled Deed of Absolute Sale.</u> It is also worthy to note the terms in the Deed are clear and leaves no doubt upon the intention of the parties that they have entered into a sale transaction, hence, on applying Article 1370 and Article 1371 of the Civil Code, the literal meaning of its stipulations in the Deed shall control and shall not consider the contemporaneous and subsequent acts of the parties. As a consequence, petitioner shall pay the income tax based on the gain realized on the subject sale transaction.

<u>Petitioner shall secure first a BIR Ruling confirming that the transaction is a tax-free exchange under Section 40 (C)(2) of the National Internal Revenue Code.</u>

8. **<u>It must be noted that petitioner never presented any evidence that it has applied for and has been issued a certification or ruling by the BIR confirming that the said assignment is indeed a tax-free exchange.</u>** In this connection, suffice it to state that the Court does not rule on allegations which are manifestly conjectural, as these may not exist at all. **(CE Philippines Ltd. vs. CIR, CTA EB 770 (CTA 7688), September 20, 2012)**

As ruled by this Honorable Court sitting En banc in the above-mentioned case, a taxpayer must secure first a certification or ruling by the BIR confirming that the transaction is indeed a tax-free exchange which petitioner failed to do so in this case as admitted in their Petition under paragraph 5.5, as a result thereof, this Honorable Court cannot rule on allegations which are manifestly conjectural. Thus, this declaration is to the effect, or at the very least, can be taken to mean, that the transaction involved in this case is not one of those tax-free exchange contemplated under Section Section 40 (C)(2) of the National Internal Revenue Code.

<u>Petitioner VAT returns were false returns, hence, the 10 year prescriptive under Section 222 (a) of the 1997 Tax Code shall apply in the instant case.</u>

9. Petitioner interposes prescription so as to exculpate it from its tax liabilities. To that, suffice it to state that allegations of prescription must be clearly shown. Since prescription is one of the affirmative defenses of the taxpayer, 'it is incumbent upon [it] to positively establish when the prescriptive period started to run and when the same ended.' **(Taligaman Lumber Co. v. Collector, G.R. No. L-15716, March 31, 1962)**

Under Section 222 (a) of the 1997 Tax Code, it is clearly provided that:

'In the case of a **<u>false</u>** or fraudulent **<u>return</u>** with intent to evade tax or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be filed without assessment, **<u>at any time within ten (10) years after the discovery of the falsity, fraud or omission</u>**.'

In relation thereto, this Court sitting En Banc in the case of **CDL Hotels (Phils.) Corporation vs. CIR, CTA EB Case No. 339, August 10, 2009**, held that:

In the case at bar**<u>, although petitioner filed its monthly return as mandated by law, it failed to declare thereto the income subject to the tax</u>** under the belief that the income supposedly subject to the withholding tax is not an income but a deductible expense. The returns filed by petitioner can be **<u>considered as false return</u>** because it deviated from the truth when no income was declared, when in truth there was an income subject to tax. Being considered as false return, it is immaterial if petitioner intentionally omitted to declare its income subject to final withholding tax or not.

<u>Considering that petitioner's return is false, the applicable prescriptive period would be ten years from the discovery of falsity</u>. In the case at bar, the latest return filed was on January 11, 1999, while the FAN was issued on January 29, 2002, such period being within the ten year period it follows that the assessment had not yet prescribed.

Moreover, the Supreme Court had ruled that the filing of deficient returns which prevent the Commissioner of Internal Revenue from computing the proper taxes is tantamount to non-filing. The Commissioner had to determine and assess the taxes on data obtained, not from the return, but from other sources. **Hence, the assessment for deficiency final withholding tax, therefore, has not prescribed**.' (Emphasis supplied)

Applying the foregoing rule and jurisprudence in the case at bar, a close scrutiny of the VAT returns filed by petitioner clearly revealed that respondent's declaration made therein were substantially deficient in amount. Such factual findings was clearly indicated under the Details of Discrepancies attached to the Preliminary Assessment Notice (PAN) dated September 17, 2012 and Formal Assessment Notice (FAN) dated January 2, 2014.

Hence, the FAN dated January 2, 2014 issued by the respondent for taxable year 2010 was validly made within the ten (10) years prescriptive period from the discovery of the **said falsity** under Section 222 (a) of the 1997 Tax Code.

10. The assessments issued against petitioner for deficiency income tax, value-added tax and documentary stamp tax for taxable year 2010 were made in accordance with law and regulations;

11. Assessment *(sic)* 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).***"

The Pre-Trial Conference[24] was scheduled on February 5, 2015 but was reset[25] on June 11, 2015. Respondent's Pre-Trial Brief[26] was filed, through registered mail, on February 2, 2015, while petitioner filed its Pre-Trial Brief[27] on February 16, 2015 and its Amended Pre-Trial Brief[28] on February 17, 2015.

The parties filed their Joint Stipulation of Facts and Issues[29] on June 24, 2015, which was approved by the Court upon issuance of the Pre-Trial Order[30] dated June 30, 2015.

Formal Offer of Evidence for the Petitioner[31] was filed on October 22, 2015, offering Exhibits "P-1", "P-2", "P-3", "P-4", "P-5", "P-6", "P-7", "P-8", "P-9", "P-10", "P-11", "P-12", "P-13", "P-14", "P-14-a", "P-15", "P-16", "P-18", "P-18-a", "P-19", "P-19-a", "P-19-a", "P-20" and "P-20-a", as its documentary evidence. Respondent filed on October 23, 2015, thru registered mail, his Comment to Petitioner's Formal Offer of Evidence[32].

In the Resolution[33] dated November 25, 2015, all the exhibits in petitioner's Formal Offer of Evidence were admitted.

Respondent filed his Formal Offer of Evidence[34], through registered mail, on January 22, 2016, offering Exhibits "R-1", "R-1-a", "R-1-b", "R-2", "R-2-a", "R-2-b", "R-2-c", "R-3", "R-3-a", "R-3-b", "R-4", "R-4-a", "R-4-b", "R-4-c", "R-5", "R-6", "R-7", "R-8", "R-9" and "R-9-a", as his documentary evidence. Petitioner filed its Comments (to the Respondent's Offer of Documentary Evidence)[35] on February 15, 2016.

In the Resolution[36] dated March 14, 2016, all the exhibits in respondent's Formal Offer of Evidence were, likewise, admitted.

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[24] Notice of Pre-Trial Conference, Docket (Vol. I), p. 174.
[25] Notice of Pre-Trial Conference, Ibid, pp. 277-278.
[26] Id., pp. 183-187.
[27] Id., pp. 241-249.
[28] Id., pp. 254-262.
[29] Id., pp. 288-293.
[30] Id., pp. 295-298.
[31] Docket (Vol. II), pp. 483-491.
[32] Ibid, pp. 598-599.
[33] Id., pp. 606-607.
[34] Docket (Vol. II), pp. 611-615.
[35] Ibid, pp. 620-623.
[36] Id., pp. 625-626.

Memorandum for Respondent[37] was filed, through registered mail, on April 15, 2016, while Memorandum for the Petitioner[38] was filed, through registered mail, on May 2, 2016. Hence, the case was submitted for decision.[39]

The parties stipulated on the following issues[40]:

1. Whether petitioner's transfer of its four (4) parcels of land to FLRI in exchange for the latter's common shares of stock is a tax-free exchange pursuant to the Tax Code.

2. Whether the Deed of Absolute Sale dated February 25, 2010 executed by petitioner and FLRI is subject to income tax, VAT and DST for taxable year 2010.

3. Whether petitioner is liable to pay respondent ₱131,608,280.71 for the taxable year 2010 representing alleged deficiency income tax, VAT and DST as regards its transaction with FLRI.

4. Whether or not the right of respondent to assess petitioner for alleged deficiency internal revenue taxes had already prescribed.

The Court shall first determine the timeliness in filing the present petition.

The Court has jurisdiction to entertain the present case.

Section 228 of the NIRC of 1997, as amended, governs the periods in filing an administrative protest, as follows:

> "**SEC. 228. Protesting of Assessment**. - When the Commissioner or his duly authorized representative finds that proper taxes should be

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[37] Id., pp. 631-637.
[38] Id., pp. 639-666.
[39] Resolution dated May 12, 2016, Id., p. 668.
[40] III. Issues, JSFI, Docket (Vol. I), p. 290.

> assessed, he shall first notify the taxpayer of his findings xxx
>
> xxx xxx xxx
>
> **Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment** in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.
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> **If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable.**" (*Emphasis supplied*)

In this case, petitioner received the FAN, with attached Details of Discrepancies and Assessment Notice Nos. IT-ELA51516-10-14-045, VT-ELA51516-10-14-045, DS-ELA51516-10-14-45 issued by Mr. Nestor S. Valeroso, Regional Director, Revenue Region No. 8 – Makati City, assessing petitioner for alleged deficiency income tax, VAT and DST, inclusive of interest and surcharge, for the taxable year 2010, on January 8, 2014. Within thirty (30) days from receipt of FAN on January 8, 2014, petitioner filed its administrative protest by way of a Request for Reconsideration[41] dated February 4, 2014 with the Office of the Regional Director, Revenue Region No. 8 – Makati City, on February 7, 2014.

Pursuant to Section 228 of the NIRC of 1997, as amended, respondent is given a period of 180 days to act on petitioner's protest from February 7, 2014 or until August 6, 2014 considering that no supporting documents were filed subsequent to the filing of the

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[41] Exhibit "P-8".

protest. Since the 180-day period lapsed without action on the part of respondent, petitioner had thirty (30) days from August 6, 2014 or until September 5, 2014, within which to file an appeal before the Court. Hence, petitioner's present Petition for Review, filed on September 4, 2014, is clearly within the prescriptive period in filing the petition.

The Court shall now determine the propriety of the deficiency tax assessments.

Deficiency Income Tax in the amount of ₱86,102,942.64.

Respondent computed the deficiency income tax assessment of ₱86,102,942.64 by imputing against petitioner an alleged undeclared gain on exchange of assets in the amount of ₱183,144,371.00 and disallowing petitioner's excess tax credits carried-over to succeeding year in the amount of ₱392,227.78, as shown below:

Taxable Income (Loss) per Return			₱ 21,846,205.43
Add: Adjustment per Investigation			
Gain on Exchange of Assets per Financial Statement			183,144,371.00
Adjusted Taxable Income per Investigation			₱ 204,990,576.43
Income Tax Due			₱ 61,497,172.93
Less: Tax Credits/Payments			
Unexpired Prior Year MCIT	₱ 49,684.06		
Prior Year's Excess Tax Credit	5,268,398.53		
Creditable Tax Withheld per BIR Form No. 2307	852,757.08		
Tax paid per Return	775,249.74	₱6,946,089.41	
Less: Excess Tax Credit carried over to succeeding year		392,227.78	6,553,861.63
Basic Deficiency Income Tax Due			₱ 54,943,311.30
Add: Interest (04/16/11 to 02/14/14)			31,159,631.34
TOTAL AMOUNT DUE			**₱ 86,102,942.64**

1. Gain on Exchange of Assets per Financial Statement in the amount of ₱183,144,371.00.

Based on the Details of Discrepancies attached to the FAN, respondent's verification disclosed that petitioner recognized a "Gain on Exchange of Assets" in its 2010 Financial Statements, specifically under the "Accumulated Profit"[42] account, in the total amount of ₱183,144,371.00 as a result of the Deed of Absolute Sale dated February 25, 2010 between petitioner and FLRI, and Subscription Agreement executed between petitioner and Tallyhoe Manufacturing Co., Inc., (renamed PMFTC, Inc.).

Respondent posits that since petitioner has not presented a specific ruling that the exchange transactions qualify as tax-free exchanges under Section 40(C)(2) of the NIRC, the resulting gain on exchange of assets is subject to income tax pursuant to Section 27 in relation to Section 32(A)(3) of the same Code.

Petitioner, on the other hand, asserts that its transfer of parcels of land to FLRI, in exchange for the latter's common shares of stock, as well as the subsequent transfer of such shares of stocks together with other assets to PMFTC Inc. to pay for the subscribed shares and additional shares of petitioner, constitute tax-free exchanges as contemplated under Section 40(C)(2) of the NIRC of 1997.

Petitioner contends that the subject transactions are not considered sales of assets but merely stock subscriptions; and that since they are not sales there is no gain derived from such transactions.

Petitioner further argues that what transpired is only a semblance of "enrichment" through an appraisal increase in the value of its land and building where there is no actual gain but only paper or theoretical gain (unrealized gain), which does not constitute income and, therefore, not yet subject to income tax.

The Court agrees with petitioner.

Section 40(C)(2) of the 1997 NIRC, as amended, provides as follows:

> "**SEC. 40.** ***Determination of Amount and Recognition of Gain or Loss.*** –
>
> xxx xxx xxx

[42] Exhibit "P-13", Notes to Financial Statements, Note 12.

(C) *Exchange of Property.* –

(1) *General Rule.* - Except as herein provided, upon the sale or exchange or property, the entire amount of the gain or loss, as the case may be, shall be recognized.

(2) *Exception.* - No gain or loss shall be recognized if in pursuance of a plan of merger or consolidation –

(a) A corporation, which is a party to a merger or consolidation, exchanges property solely for stock in a corporation, which is a party to the merger or consolidation; or

(b) A shareholder exchanges stock in a corporation, which is a party to the merger or consolidation, solely for the stock of another corporation also a party to the merger or consolidation; or

(c) A security holder of a corporation, which is a party to the merger or consolidation, exchanges his securities in such corporation, solely for stock or securities in another corporation, a party to the merger or consolidation.

No gain or loss shall also be recognized if property is transferred to a corporation by a person in exchange for stock or unit of participation in such a corporation of which as a result of such exchange said person, alone or together with others, not exceeding four (4) persons, gains control of said corporation: Provided, That stocks issued for services shall not be considered as issued in return for property." (*Emphasis supplied*)

The term "control" is defined as "ownership of stocks in a corporation possessing at least fifty-one percent (51%) of the total voting power of all classes of stocks entitled to vote."[43]

From the above provision, the requisites for the non-recognition of gain or loss are: (a) the transferee is a corporation; (b) the transferee exchanges its shares of stock for property/ies of the transferor; (c) the transfer is made by a person, acting alone or together with others, not exceeding four (4) persons; and, (d) as a result of the exchange the transferor, alone or together with others, not exceeding four (4), gains control of the transferee.[44]

After a careful study and analysis of the case, the Court found that petitioner's exchange transactions with FLRI and PMFTC Inc. satisfied all of the above requisites.

1.1 Tax-free exchange with FLRI

As can be gleaned from the General Information Sheet[45], filed by FLRI with the SEC on June 3, 2010, FLRI is a domestic corporation. Records show that petitioner, together with FTC, PPC, NTRCI, and ORI, transferred several parcels of land in exchange for FLRI's shares of stocks.[46] Petitioner, for its part, transferred its title and ownership over the following four (4) parcels of land, in exchange for shares in FLRI as evidenced by the Deed of Transfer[47] executed by petitioner and FLRI on February 25, 2010:

TCT No.	Area (Sq. M.)	Book Value	Fair Value	Difference Between Book Value And Fair Value
N-30568	17,512	₱ 325,348.91	₱ 78,804,000.00	
N-34155	6,491	258,998.84	29,209,500.00	
N-34156	8,047		36,211,500.00	
N-34157	2,519		11,335,500.00	
TOTAL		**₱ 584,347.75**	**₱ 155,560,500.00**	**₱ 154,976,152.25**

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[43] Section 40(C)(6)(c) of the NIRC of 1997, as amended.

[44] *Commissioner of Internal Revenue vs. Filinvest Development Corporation*, G.R. Nos. 163653 and 167689, July 19, 2011.

[45] Exhibit "P-19-B", IC-34 (III.a).

[46] Exhibit "P-19-B", IC-30 (III.a).

[47] Exhibit "P-10".

FLRI has an authorized capital stock of ₱96,000,000.00 consisting of 960,000 common shares with a par value of one hundred pesos (₱100.00) per share.[48]

The transferors are the existing shareholders of FLRI prior to the exchange. The capital structure of FLRI prior to the exchange is as follows[49]:

Subscriber	No. of Shares	% of Ownership	Amount Subscribed	Amount Paid
Fortune Tobacco Corporation	83,575	34.8222%	8,357,500	2,089,375
Parity Packaging Corp	7,380	3.0749%	738,000	184,500
Dominium Realty & Construction Corporation	3,615	1.5062%	361,500	90,375
Northern Tobacco Redrying Co., Inc.	1,430	0.5958%	143,000	35,750
Orecla Realty, Inc.	144,000	59.9989%	14,400,000	3,600,000
Harry C. Tan	1	0.0004%	100	100
Lucio K. Tan	1	0.0004%	100	100
Christopher Nelson	1	0.0004%	100	100
Varinia ELero	1	0.0004%	100	100
Raymond Miranda	1	0.0004%	100	100
Total	**240,005**	**100%**	**₱ 24,000,500**	**₱ 6,000,500**

The aforesaid capital structure reveals that the transferors are the controlling stockholders of FLRI by owning 99.998% of its total voting stocks.

After the completion of the exchange, the capital structure of FLRI is as follows:

Subscriber	No. of Shares	% of Ownership	Amount Subscribed
Fortune Tobacco Corporation	334,295	34.8224%	33,429,500
Parity Packaging Corp	29,522	3.0752%	2,952,200
Northern Tobacco Redrying Co., Inc.	5,722	0.5960%	572,200
Dominium Realty & Construction Corporation	14,459	1.5062%	1,445,900
Orecla Realty, Inc.	575,997	59.9997%	57,599,700
Harry Tan	1	0.0001%	100
Lucio Tan	1	0.0001%	100
Chris Nelson	1	0.0001%	100
VariniaELero	1	0.0001%	100
R. Miranda	1	0.0001%	100
Total	**960,000**	**100%**	**₱ 96,000,000**

[48] Exhibit "P-19-B", IC-34 (III.a).
[49] Exhibit "P-19-B", IC-30 (III.a).

It can be gleaned from the above tables that petitioner's number of shares increased from 3,615 to 14,459, which resulted in an increase of 10,844 common shares. These 10,844 shares are evidenced by the Subscription Agreement[50] between petitioner and FLRI. Also presented is the Share Certificate[51] from FLRI, which was signed on June 10, 2010, certifying that petitioner is the owner of 14,459 shares.

The result of the transfer of assets in exchange for new additional shares and payment of unpaid original subscriptions of stock is that the transferors continue to collectively control FLRI by owning 99.9995% of its total voting stocks.

1.2 Tax-free exchange with PMFTC Inc.

Records show that PMFTC Inc. is a domestic corporation.[52]

Petitioner, together with four (4) other corporations, namely, FTC, PMPMI, PPC and NTRCI exchanged assets and liabilities for the shares of stock of PMFTC Inc. which resulted to gaining control of the latter.

As indicated in the Deed of Transfer[53] entered into by petitioner and PMFTC Inc. and in the Application and Joint Certification[54] or BIR Form No. 1927 filed for the subject transactions, petitioner's contributions to the exchange consisted of the following:

Transferor/ Registered Owner	**Nature**	**Tax Declaration No.**	**Original/ Adjusted Basis**	**Higher of Zonal Value or Assessed Value in case of Land; Higher of Assessed Value or FMV in case of improvements**	**Transfer Value (value of Transferee-shares received in the exchange)**
1) Real Property					
Dominium Realty & Construction Corp. Building		E-0018-108012/ E-00180126612 / E-0018-125813	₱1,699,406.09	₱29,958,000.00	₱237,000.00

[50] Exhibit "P-14".
[51] Exhibit "P-19-B", IC-32 (III.a).
[52] Exhibit "P-19-B", IC-37 (III.a).
[53] Exhibit "P-19-B", IC-36 (III.a).
[54] Exhibit "P-19-B", IC-38 (III.a).

Transferor/ Registered Owner	Nature	Investee Company	Original/ Adjusted Basis	Transfer Value [value of Transferee-shares received in the exchange]
2) Shares of Stock				
Dominium Realty & Construction Corp.	Common Shares	Fortune Landequities and Resources, Inc.	₱564,347.75	₱1,238,000.00
3) Others				
Transferor/ Registered Owner	**Nature**	**Original/ Adjusted Basis**		**Transfer Value [value of Transferee-shares received in the exchange]**
Dominium Realty & Construction Corp.	Prepaid Expenses	₱444,934.75		₱4,000.00

With the transfer, petitioner's original subscription of 370 shares with par value of ₱370,000.00 increased to 1,480 shares with par value of ₱1,480,000.00.[55] Petitioner presented the Share Certificate[56] from PMFTC Inc., signed February 25, 2010, certifying that petitioner is the owner of 1,480 Class "A" common shares.

Prior to the transfer, petitioner together with the other four (4) transferors are the controlling stockholders of PMFTC Inc. by owning 99.995% of the voting stocks of PMFTC Inc.:

Subscriber	No. of Voting Shares	% of Ownership In Voting Shares	Amount Subscribed	Amount Paid
Fortune Tobacco Corporation	123,977	49.5936%	₱ 123,977,000.00	₱30,994,250.00
Philip Morris Philippines	124,988	49.9980%	124,988,000.00	31,247,000.00
Parity Packaging Corporation	535	0.2140%	535,000.00	133,750.00
Dominium Realty & Construction Corporation	370	0.1480%	370,000.00	92,500.00
Northern Tobacco Redryig Co., Inc.	105	0.0420%	105,000.00	26,250.00
Lucio Tan	1	0.0004%	1,000.00	1,000.00
Carmen Tax	1	0.0004%	1,000.00	1,000.00
Harry Tan	1	0.0004%	1,000.00	1,000.00
Luicio K. Tan	1	0.0004%	1,000.00	1,000.00
Michael Tan	1	0.0004%	1,000.00	1,000.00
Chris Nelson	1	0.0004%	1,000.00	1,000.00
Douglas Worth	1	0.0004%	1,000.00	1,000.00
Mitchell Gault	1	0.0004%	1,000.00	1,000.00

[55]Exhibit "P-19-B", IC-38 (III.a).
[56]Exhibit "P-19-B", IC-39 (III.a).

Raymond Miranda	1	0.0004%	1,000.00	1,000.00
VariniaElero	1	0.0004%	1,000.00	1,000.00
Vincent Nguyen	1	0.0004%	1,000.00	1,000.00
Total	**249,986**	**100.0000%**	**₱249,986,000.00**	**₱62,504,750.00**

After the transfer, the transferors continued to collectively control PMFTC Inc. by owning 99.9988% of its total voting stock as shown below:

Subscriber	No. of Voting Shares	% of Ownership In Voting Shares	Amount Subscribed and Paid
Fortune Tobacco Corporation	495,854	49.5954%	₱ 495,854,000.00
Philip Morris Philippines	499,895	49.9995%	499,895,000.00
Parity Packaging Corporation	2,140	0.2140%	2,140,000.00
Dominium Realty & Construction Corporation	1,480	0.1480%	1,480,000.00
Northern Tobacco Redryig Co., Inc.	420	0.0420%	420,000.00
Lucio Tan	1	0.0001%	1,000.00
Carmen Tan	1	0.0001%	1,000.00
Harry Tan	1	0.0001%	1,000.00
Luicio K. Tan	1	0.0001%	1,000.00
Michael Tan	1	0.0001%	1,000.00
Chris Nelson	1	0.0001%	1,000.00
Douglas Worth	1	0.0001%	1,000.00
Mitchell Gault	1	0.0001%	1,000.00
Raymond Miranda	1	0.0001%	1,000.00
Varinia Elero	1	0.0001%	1,000.00
Vincent Nguyen	1	0.0001%	1,000.00
Total	**999,800**	**100.0000%**	**₱ 999,800,000.00**

In fine, petitioner was able to sufficiently prove that the subject exchange transactions are tax-free pursuant to Section 40(C)(2) of the NIRC of 1997, as amended.

Moreover, as correctly pointed out by petitioner, the subject transactions are in the nature of stock subscriptions and not sales of assets. In the case of *Delpher Trades Corporation and Delfin Pacheco vs. Intermediate Appellate Court and Hydro Pipes Philippines, Inc.,*[57] the Supreme Court ruled:

> "After incorporation, one becomes a stockholder of a corporation by subscription or by purchasing stock directly from the corporation or from individual owners thereof.

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[57] G.R. No. L-69259, January 26, 1988.

> (Salmon, Dexter & Co. v. Unson, 47 Phil. 649, citing Bole v. Fulton [1912], 233 Pa., 609). In the case at bar, in exchange for their properties, the Pachecos acquired 2,500 original unissued no par value shares of stocks of the Delpher Trades Corporation. Consequently, the Pachecos became stockholders of the corporation by subscription. **'The essence of the stock subscription is an agreement to take and pay for original unissued shares of a corporation, formed or to be formed.**' (Rohrlich 243, cited in Agbayani, Commentaries and Jurisprudence on the Commercial Laws of the Philippines, Vol. III, 1980 Edition, p. 430) It is significant that the Pachecos took no par value shares in exchange for their properties.
>
> xxx xxx xxx
>
> **The 'Deed of Exchange**' of property between the Pachecos and Delpher Trades Corporation **cannot be considered a contract of sale. There was no transfer of actual ownership interests** by the Pachecos **to a third party**. The Pacheco family **merely changed their ownership from one form to another. The ownership remained in the same hands**. xxx (*Emphasis supplied*).

In the instant case, petitioner entered into an exchange transaction with FLRI, whose shares of stocks were, thereafter, assigned to PMFTC Inc. Thus, there was no sale since petitioner's assets were only transformed into another form of asset. The assets merely changed from land, building, etc.; to one of an intangible asset – shares of stock. Since the subject transactions do not constitute sales, it necessarily follows that the same are not subject to income tax.

As stated in the Details of Discrepancies, the basis of respondent in assessing petitioner was derived from the latter's own declaration contained in the Audited Financial Statements recognizing "Gain on Exchange of Assets" as part of its "Accumulated Profit" account. Petitioner reported "Gain on the exchange of assets" not to recognize income but only to present the fair value of its assets as of a certain period in accordance with the Philippine Accounting Standards (PAS) 16. This was disclosed in Notes 7 and 12 to the AFS[58], where for

[58] Exhibit "P-13".

purposes of booking up the shares of stock received on account of the transfer of assets, such shares were valued at fair market value of the assets (land, building) given up. What was compared for purposes of determining the "gain" was the historical cost of the assets (land, building) given up as against the fair market value of the same. This is mere appraisal increase in the recorded value of the asset given up in the exchange and not actual income, as when the shares of stocks received in the exchange have higher value than that of the asset given up.

Even assuming that the subject transactions are taxable, petitioner even suffered loss if the appraised value of the assets given up were compared against the par value of the shares of stocks acquired.

The assessed "Gain on Exchange of Assets" is merely a theoretical gain considering that petitioner did not actually or constructively receive said gain. Though reflected in petitioner's books as gain, it is, however, an unrealized gain for purposes of computing the income tax. In order that the same may be subjected to income tax, such income must be realized or received during the taxable year.[59]

Clearly, petitioner's transfer of assets in exchange for shares in FLRI and PMFTC Inc. qualifies as tax-free exchanges and need not require prior BIR ruling in order that the same may be exempted from income tax.[60] Accordingly, respondent's deficiency income tax assessment on the alleged "Gain on Exchange of Assets" of ₱183,144,371.00 should be cancelled.

2. Excess Tax Credits carried over to succeeding year in the amount of ₱392,227.78.

In arriving at petitioner's alleged deficiency income tax liability for the taxable year 2010, respondent disallowed petitioner's tax credits amounting to ₱392,227.78 on the ground that the same were

[59] *Chamber of Real Estate and Builders' Association, Inc. vs. The Hon. Executive Secretary Alberto Romulo, et. al*, G.R. No. 160756, March 9, 2010.

[60] *Commissioner of Internal Revenue vs. Dakudao & Sons, Incorporated*, CTA EB Case No. 1150 (CTA Case No. 8501), May 12, 2015; *Lucio Co, et. al. vs. Commissioner of Internal Revenue*, CTA Case No. 8831, June 2, 2016.

carried-over and credited against the taxes due for the succeeding year pursuant to Section 76 of the NIRC of 1997, as amended.

The Court finds it improper for respondent to deduct the amount of ₱392,227.78 because any tax benefit derived by petitioner from the carry-over thereof may be claimed in the succeeding year 2011. In sum, the Court resolves to cancel the deficiency income tax assessment for lack of factual and legal bases.

Deficiency Value-Added Tax in the amount of ₱39,836,303.87

On the basis that petitioner failed to present specific ruling on the non-taxability of its exchange transactions with FLRI and PMFTC Inc., respondent, citing Section 106 of the NIRC, assessed petitioner of deficiency 12% VAT on the following appraised values of the four (4) parcels of Land and Improvement:[61]

Schedule 1		
		Appraised Value
TCT No. N-30568	₱	78,804,000.00
TCT No. N-34155		29,209,500.00
TCT No. N-34156		36,211,500.00
TCT No. N-34157		11,335,500.00
Total	₱	155,560,500.00
Add:		1,699,406.09
TOTAL	**₱**	**157,259,906.09**

As discussed earlier, petitioner's transfers of properties in exchange for controlling shares in FLRI and PMFTC, Inc. do not constitute sales transactions but are merely stock subscriptions. Thus, these should not be subjected to VAT. Consequently, respondent's deficiency VAT assessment in the amount of ₱39,836,303.87 should be cancelled.

Deficiency Documentary Stamp Tax in the amount of ₱5,669,034.20

On the sole ground that petitioner did not present a specific BIR ruling as to the non-taxability of its exchange transactions with FLRI and PMFTC Inc., respondent assessed petitioner of deficiency DST in a

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[61] Exhibit "P-6".

the amount of ₱3,031,125.00, as computed below, pursuant to Section 196 and 175 of the NIRC of 1997, as amended.

	Exchange of Dominium Realty	**Exchange of Dominium Realty**	**TOTAL**
Total Consideration	₱155,560,500.00	₱ 186,055,934.75	₱341,616,434.75
Tax Rate	₱15.00/₱1,000.00	₱ .75/₱200.00	
Tax Due	**₱2,333,415.00**	**₱ 697,710.00**	**₱3,031,125.00**

As stated earlier, the need to secure a prior BIR ruling is not a condition to the availment of tax exemption. Section 199 of the NIRC of 1997, as amended by Section 9 of Republic Act No. 9243, explicitly exempts from DST transfers of properties by virtue of tax-free exchanges under Section 40(C)(2) of the NIRC of 1997, as amended, to wit:

> "SEC. 199. *Documents and Papers Not Subject to Stamp Tax.* – The provisions of Section 173 to the contrary notwithstanding, the following instruments, documents and papers shall be exempt from the documentary stamp tax:
>
> xxx xxx xxx
>
> (m) Transfer of property pursuant to Section 40 (C)(2) of the National Internal Revenue Code of 1997, as amended."

The exemption on transfer of property pursuant to Section 40(C)(2) referred to above pertains to the DST due on the deed transferring the property.

On the other hand, the original issuance of shares of stocks in exchange of the said property is subject to the DST pursuant to Section 174 of the NIRC of 1997, as amended. However, it is the transferee corporations, i.e., FLRI and PMFTC Inc., which are liable to pay the DST, and not the transferor-petitioner. For easy reference, Section 174 is quoted herein below:

> "SEC. 174. *Stamp Tax on Original Issue of Shares of Stock.* - On every original issue, whether on organization, reorganization or for any lawful purpose, of shares of stock by any association, company or corporation, there shall be

> collected a documentary stamp tax of One peso (P1.00) on each Two hundred pesos (P200), or fractional part thereof, of the par value, of such shares of stock: *Provided*, That in the case of the original issue of shares of stock without par value, the amount of the documentary stamp tax herein prescribed shall be based upon the actual consideration for the issuance of such shares of stock: *Provided*, *further*, That in the case of stock dividends, on the actual value represented by each share."

Hence, the Court resolves to cancel the DST assessment issued by respondent.

The prescriptive periods provided under Sections 203 and 222 of the NIRC of 1997, as amended, will not apply.

In view of foregoing discussion that petitioner is exempt from paying income, VAT and DST on the subject transactions, the Court will not belabor further on the issue of prescription.

WHEREFORE, premises considered, the Petition for Review is **GRANTED**. Accordingly, the assessments issued by respondent against petitioner for taxable year 2010 covering deficiency Income Tax in the amount of ₱86,102,942.64, VAT in the amount of ₱39,836,303.87 and DST in the amount of ₱5,669,034.20, are **CANCELLED AND WITHDRAWN**.

SO ORDERED.

CAESAR A. CASANOVA
Associate Justice

WE CONCUR:

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

Catherine T. Manahan
CATHERINE T. MANAHAN
Associate Justice

ATTESTATION

I attest 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's Division.

JUANITO C. CASTAÑEDA, JR.
Associate Justice
Chairperson, Second Division

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, 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
Presiding Justice