REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MAGSAYSAY LINES, INC.;
BALIWAG NAVIGATION, INC.;
FIM LIMITED OF THE MARDEN GROUP (HK);
AND NATIONAL DEVELOPMENT COMPANY,
Petitioners,

- versus - C.T.A. CASE NO. 4353

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

4/27/91

D E C I S I O N

Petitioners seek the refund of the value-added tax (VAT) paid on the sale by the National Development Company of its vessels under the privatization program of the government.

Petitioners Magsaysay Lines, Inc. and Baliwag Navigation, Inc. are domestic corporations organized and existing under Philippine laws, while petitioner FIM Limited of the Marden Group (HK) is a corporation organized and existing under the laws of Liberia. The National Development Company (NDC), a 100% government-owned corporation, is impleaded as indispensable party petitioner in its capacity as the seller of subject vessels and in whose name and in its behalf the 10% VAT imposed on the sale of said vessels were paid by petitioners Magsaysay Lines, Inc.; Baliwag Navigation, Inc., and FIM Limited of the Marden Group (HK) as purchasers.

During the period 1981 to 1984, NDC contracted with the Philippine Dockyard Corporation the construction of five (5) 3,700 DWT Tween-Decker, "Kloeckner" type vessels. They were then leased on a bareboat basis to Luzon Stevedoring Company, a wholly-owned subsidiary. These vessels were subsequently transferred and leased, on a bareboat basis, to the National Marine Corporation (NMC) another 100% fully-owned subsidiary of NDC [Exh. P].

In line with the privatization efforts of the government, the NDC offered for sale as one lot and by public bidding all of its shares of stock in NMC and five (5) NDC-owned "Kloeckner" vessels operated by NMC. The terms and conditions for the public auction sale of said shares of stock and vessels are contained in an "Information Memorandum" [Exh. B]. Included in the terms of the bidding are:

"VI. <u>CLARIFICATIONS ON TAX AND INSURANCE ISSUES</u>

1.1 <u>Taxes due</u>

1.1.1. Value Added Tax (VAT) - A <u>value added tax</u> of 10% on the value of the vessels <u>shall be paid by the winning bidder</u>. [<u>Underlining</u>

Ours.]

1.1.2. Documentary Stamps - The winning bidder shall pay for all the documentary stamps in connection with the implementation of the sale.

1.1.3. Capital Gains Tax - The capital gains tax on the NMC shares of stock shall be paid by NDC, the Seller." [Exh. B-1; par. 7, Petition; Admitted par. 1 of Answer].

The bidding was held on June 3, 1988. On that same date, petitioner Magsaysay Lines, Inc., for and in behalf of a new company still to be formed, offered to buy all of NDC's shares in NMC and the 5 vessels for P168,000,000.00. The new company to be formed will be composed of: Magsaysay Lines, Inc.; Baliwag Navigation, Inc. and FIM Limited of the Marden Group (HK) with a 30:30:40 ratio shareholdings respectively [Exh C]. An irrevocable Standby Letter of Credit with No. EO-DOM-STY 11327 was submitted infavor of NDC to the extent of P16,800,000.00 to cover at least 10% of the total bid [Exh. D].

In a "Notice of Award" dated July 1, 1988, NDC informed petitioner Magsaysay Lines, Inc. that its bid was approved by the Committee on Privatization (COP) in its meeting held on June 9, 1988 [Exh. E; see also Exh. G-1].

In the meantime, the law office of SyCip, Salazar, Hernandez & Gatmaitan in a letter dated September 27, 1988 requested respondent to issue a ruling on the applicability of the VAT on the sale of assets by NDC which, under the terms and conditions of the sale, the winning bidder, petitioners herein, will pay instead of the seller (NDC) [Exh F]. Petitioners believe that the sale of said vessels should not be subject to the VAT.

On September 28, 1988, the Contract of Sale implementing the award was executed between NDC and the petitioners [Exh G]. Paragraph 11.02 thereof provided that:

> "11.02. All capital gains taxes for the sale of the NMC Shares shall be for the account of the SELLER. All documentary stamp taxes for the transfer of the NMC Shares shall be for the account of the PURCHASER. <u>Value-added tax, if any, shall be for the account of the PURCHASER</u>." [Exh. G-2, <u>Emphasis Ours</u>.]

On the same date, NDC confirmed its previous agreement with petitioners that in lieu of the immediate payment of the VAT the irrevocable confirmed Letter of Credit filed as bidders bond will be accepted by NDC as security for the payment of the VAT, if any [Exh. H]. The Letter of Credit No. EO-DOM-STY-11327 amounting to P16,800,000.00 was amended to reflect the lower amount of P15,120,000.00 or 10% of the purchase price of the five (5) vessels [Exh. I]. It was further agreed upon that if no favorable ruling is received from the BIR, NDC may draw on said Letter of Credit upon written demand an amount needed for the payment of the VAT on due date, that is, December 20, 1988.

On December 15, 1988, petitioner Magsaysay Lines, Inc. requested respondent to waive any surcharges or penalties in the event BIR rules that VAT is payable on the sale of said vessels [Exh. J, par. 16, Petition; Admitted in par. 1 of Answer]. Respondent granted this request until such time as the question on the VAT has actually been settled. [Exh. J-1, par. 16, Petition; Admitted in par. 1 of Answer].

On January 4, 1989, petitioners received through the same law office, VAT Ruling No. 568-88 dated December 14, 1988 [Exh. R]. The pertinent portion of the ruling states:

> "In reply, please be informed that since NDC is VAT registered under VAT Registration No. 35-2-000880 on its sale of services, <u>its transactions incident to its normal VAT registered activity</u> of leasing out personal property including sale of its own assets that are movable, tangible objects which are appropriable or transferable <u>are subject to the 10% value-added tax</u>. This finds support in VAT Ruling No. 395-88." [<u>Emphsis Ours</u>.]

VAT Ruling No. 395-88 dated August 18, 1988 [Exh. P] addressed to the Senate - Chairman of the Blue Ribbon Committee specifically refers to the same transaction regarding the sale of NDC's five vessels. Respondent ruled that the sale would still be subject to VAT citing as reasons the following:

> "2. Since NDC operates like a holding company with various interests/investments in other companies operating for profit, its functions are purely proprietary. In spite of the fact that NDC is the owner of the vessel it does not pay 3% common carriers' tax but rather it registered for VAT purposes as a lessor of personal property pursuant to Section 102 of the Tax Code as amended by EO 273.
>
> 3. x x x. The following are provided in the terms of bidding in tax and insurance issues:
>
> "Taxes due
>
> 1. VAT - A value-added tax of 10% on the value of the vessels shall be paid by the winning bidder.
>
> x x x x x x x x x."
>
> xxx that even if the sale or disposition of assets is not within the normal business of NDC, it will still be subject to the VAT based on the bid price. Such activity requires the issuance of a VAT sales invoice before issuing a VAT-official receipt pursuant to Section 21 of Revenue Regulations 5-87. This finds support to VAT Ruling No. 366-88 and modifies VAT Ruling No. 196-88." [Underlining Ours.]

Petitioners moved for the reconsideration of VAT Ruling Nos. 395-88 and 568-88. On March 10, 1989, petitioner recieved VAT Ruling No. 007-89 dated February 24, 1989 [Exh. S] reiterating respondent's decision in VAT Ruling Nos. 395-88 and 568-88 that the sale of vessels by NDC (a VAT-registered taxpayer engaged in the leasing of said vessels) is subject to VAT.

Petitioner Magsaysay Lines, Inc. requested for reconsideration of VAT Ruling No. 007-89. Meantime, instead of joining the request, NDC insisted on drawing the Letter of Credit filed by petitioner (Magsaysay Lines, Inc.) to pay the VAT on the sales transaction. The VAT of P15,120,000.00 was paid on March 16, 1989 as evidenced by Central Bank Confirmation Receipt No. B 16374703 [Exh. T].

Without waiting for respondent's decision on the request for reconsideration of VAT Ruling No. 007-89, petitioners filed herein "Appeal and Petition for Refund" on April 10, 1989 and a "Supplemental Petition for Review" on July 14, 1989 praying for the reversal of VAT Ruling Nos. 395-88, 568-88 and 007-89 and the refund of VAT payment amounting to P15,120,000.00. Petitioners filed their claim for refund with respondent on July 13, 1989. [pp. 93-94, CTA record.]

The only issue before this Court is whether or not the sale by NDC of its vessels to petitioners is subject to the 10% VAT.

Before deciding the issue, this Court will first resolve the question raised by respondent Commissioner that petitioners Magsaysay Lines, Inc.; Baliwag Navigation, Inc.; and FIM Limited of the Marden Group (HK) are not the real parties in interest.

In his Answer, respondent argues that petitioners Magsaysay Lines, Inc.; Baliwag Navigation, Inc.; and FIM Limited of the Marden Group (HK) are not the real parties in interest entitled to the amount sought to be refunded or credited since they are not transferors or sellers as contemplated in Sections 99 and 100 of the Tax Code.

Section 99 provides:

> "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."

Respondent's theory is devoid of merit. Respondent has consistently ruled that VAT, as an indirect tax, can be passed on. [see VAT Ruling Nos. 235-89 dated September 13, 1989 and 256-89 dated October 13, 1989]. Indirect taxes are those that are demanded in the first instance from one person in the expectation and intention that he can shift the burden to someone else. [**Commissioner of Internal Revenue v. John Gotamco & Sons Inc.**, 148 SCRA 36 (1987); citing **Pollock v. Farmers, L&T Co.**, 1957 US 429, 15 S.CT. 673, 39 Law. Ed. 759.] The Supreme Court, speaking through Justice Feliciano, in the case of **Commissioner of Internal Revenue v. Procter & Gamble Philippine Manufacturing**

Corporation and The Court of Tax Appeals, G.R. No. 66838, December 2, 1991, had the occasion to rule in a Resolution En Banc that "a 'person liable for tax' has been held to be a 'person subject to tax' and properly considered a 'taxpayer'. [**Houston Street Corporation v. Commissioner of Internal Revenue,** 84 F. 2nd. 821 (1936); **Bank of America v. Anglim,** 138 F. 2nd. 7 (1943).] The terms 'liable for tax' and 'subject to tax' both connote legal obligation or duty to pay a tax. It is very difficult, indeed conceptually impossible, to consider a person who is statutorily made 'liable for tax' as not 'subject to tax.' By any reasonable standard, such a person should be regarded as a party in interest, or as a person having sufficient legal interest, to bring a suit for refund of taxes he believes were illegally collected from him."

In this case, it is undisputed that the questioned VAT collected on the sale of five (5) vessels was passed on the purchasers [Magsaysay Lines, Inc.; Baliwag Navigation, Inc. and FIM Limited of the Marden Group (HK)], pursuant to the terms of the bidding [Exh. B-1] and to the Contract of Sale [Exh. G-2]. Being the persons or entities liable to pay the VAT, petitioners as purchasers are considered to be persons subject to the VAT since the burden has been shifted to them. In truth and in fact NDC has drawn the amount of

P15,120,000.00 from the Letter of Credit charged to the account of petitioners [Exh. M]. Therefore, petitioners should not be precluded from filing this suit since they can be considered real parties in interest.

It is not amiss to state Section 2 of Rule 3, Revised Rules of Court, which provides in part:

> "SEC. 2. Parties in interest. - Every action must be prosecuted and defended in the name of the real party in interest. All persons having an interest in the subject of the action and in obtaining the relief demanded shall be joined as plaintiffs. xxx." [Underscoring supplied.];

and Section 11 of R. A. No. 1125, as amended, which provides:

> "SEC. 11. Who may appeal, effect of appeal. - Any person, association or corporation adversely affected by a decision or ruling of the Comissioner of Internal Revenue, or the Commissioner of Customs or any provincial or city Board of Assessment Appeals may file an appeal in the Court of Tax Appeals within thirty days after the receipt of such decision or ruling. x x x ." [Underscoring Ours.]

Again, the Supreme Court, interpreting these rules held: "the real party in interest is the party who would be benefited or injured by the judgment, or 'the party entitled to the avails of the suit' (1 Sutherland, Court Pleading Practice & Forms, p.11)." [**Salonga v. Warner Barnes & Co., Ltd.**, 88 Phil. 125, 131 (1951)]. Petitioners Magsaysay Lines, Inc.; Baliwag Navigation, Inc. and FIM Limited of the Marden Group (HK) are parties adversely affected by the ruling of respondent and therefore as such are entitled to file the instant appeal.

We go back to the main issue on the applicability of the VAT provisions on the sale by NDC of the five (5) vessels to petitioners.

Petitioners stress that the sale by NDC of the five (5) vessels does not fall within the purview of Section 99 of the Tax Code since said sale was not in the course of trade or business. Petitioners argue that: (a) NDC is not engaged in the business of selling vessels; and (b) the sale of the vessels was involuntary as the transaction was entered only to comply with the privatization program of the national government mandated by Proclamation No. 50.

Section 1 of Proclamation No. 50 reads:

> "SECTION 1. Statement of Policy. - It shall be the policy of the State to promote privatization through an orderly, coordinated and efficient programs for the prompt disposition of the large number of non-performing assets of the government financial institutions and certain government-owned or controlled corporations which have been found unnecessary or inappropriate for the government sector to maintain."

Respondent, on the other hand maintains that the sale is subject to the 10% VAT. He emphasized that since NDC is VAT-registered the sale of its five (5) vessels operated by NMC is incidental to its normal VAT-registered activity of leasing out personal property [VAT Ruling No. 568-88]. This position was reiterated in VAT Ruling No. 007-89 which also states "the fact that NDC carries on a business as a lessor of vessels which are capital assets used in the course of business, does not exclude said sale from the coverage of the value-added tax merely because its business is that of leasing and not of selling vessels".

Section 3 of Revenue Regulation No. 5-87 was cited by respondent as basis for its ruling. Section 3 provides in part that the "value-added tax is imposed on any sale or transactions `deemed sale' of taxable goods (including capital goods, irrespective of the date of acquisition) xxx."

Due to his decision to consider the sale of NDC-owned vessels as a transaction subject to VAT, respondent Commissioner now seeks from petitioners the payment of P734,534.89 as 20% interest for late payment on the 10% VAT of P15,120,000.00 for the period from December 21, 1988 (day following the due date of VAT payment) to March 16, 1989 (date of VAT payment) plus 20% interest on the deficiency VAT. The 25% surcharge was not imposed in view of the memorandum of the Commissioner dated December 20, 1988 waiving any surcharges and penalties.

The contention of respondent is not persuasive.

We hold for petitioners.

Central to the resolution of this case is an understanding of the meaning of the phrase "in the course of trade or business" or "doing business" or "carrying on business".

In **Imperial v. Collector of Internal Revenue,** G.R. No. L-7294, September 30, 1955 (97 Phil. 992), the term **"carrying on business"** does not mean the performance of a single disconnected act, but means conducting, prosecuting and continuing business by performing progressively all the acts normally incident thereof; while **"doing business"** conveys the idea of business being done, not from time to time, but all the time. [J. Aranas, UPDATED NATIONAL INTERNAL REVENUE CODE (WITH ANNOTATIONS), p. 608-9 (1988)]. **"Course of business"** is what is usually done in the management of trade or business. [**Idmi v. Weeks & Russell,** 99 So. 761, 764, 135 Miss. 65, cited in Words & Phrases, Vol. 10, (1984)].

What is clear therefore, based on the aforecited jurisprudence, is that "course of business" or "doing business" connotes regularity of activity. In the instant case, the sale was an isolated transaction. The sale which was involuntary and made pursuant to the declared policy of Government for privatization could no longer be repeated or carried on with regularity. It should be emphasized that the normal VAT-registered activity of NDC is leasing personal property.

Respondent would want to impress this Court that since NDC is VAT-registered on its sale of services, its transactions incident to its normal VAT-registered activity of leasing out personal property is subject to VAT (VAT Ruling No. 568-88). This ruling actually stretches the law when it concluded that because a person is VAT-registered and is subject to VAT on its normal VAT-registered activity, that all its other activities would also be subject to VAT.

In the particular case of NDC, while it is VAT-registered and its normal VAT-registered activity of leasing out personal property is subject to VAT, it does not follow that its other activities, not specified in the law, are likewise subject to VAT.

Respondent seeks support in the provisions of the aforecited Section 3 of Revenue Regulation 5-87 that the sale of NDC's vessels is a transaction 'deemed sale' subject to the 10% VAT.

As correctly argued by petitioners, this citation is out of context. It states the general coverage of VAT and omits the operative phrase in Section 99 of the Tax Code, which the Regulation seeks to implement, that to be subject to VAT, the sale must be "in the course of trade or business." The VAT Implementing Regulations (5-87) cited by respondent includes transactions "deemed sale" of taxable goods. These transactions are listed in Section 100 (b) of the Tax Code and Section 4 of the Revenue Regulations 5-87. For ease of reference, they are reproduced below:

> "SEC. 100. Value-added tax on sale of goods. - (a) Rate and base of tax. - x x x.
>
> (b) Transactions deemed sale. - The following transactions shall be deemed sale:
>
> (1) Transfer, use or consumption not in the course of business of goods originally intended for sale or for use in the course of business.
>
> (2) Distribution or transfer to:
>
> (A) Shareholders or investors as share in the profits of the VAT-registered person; or
>
> (B) Creditors in payment of debt.
>
> (3) Consignment of goods if actual sale is not made within 60 days following the date such goods were consigned.
>
> (4) Retirement from or cessation of business, with respect to inventories of taxable goods existing as of such retirement or cessation."

> "SEC. 4. Transactions 'deemed sale'. - The following transactions are 'deemed sale' pursuant to Section 100 (b):
>
> (A) Transfer, use or consumption, not in the course of business. Transfer of goods not

in the course of business can take place when the VAT-registered person withdraws goods from his business for his personal use;

(B) Distribution or transfer to shareholders or investors as share in the profits of the business;

(C) Transfer to creditors in payment of debt or obligation;

(D) Consignment of goods if actual sale is not made within 60 days following the date such goods were consigned. Consigned goods returned by the consignee within the 60-day period is not deemed sold; and

(E) Retirement from or cessation of business or death of an individual with respect to all goods on hand, whether capital goods, stock-in-trade, supplies or materials as of the date of such retirement or cessation, whether or not the business is continued by the new owner or successor, estate or heir. The following circumstances shall, among others, give rise to transactions 'deemed sale' for purposes of this Section:

(i) Change of ownership of business or incorporation of the business in the case of a single proprietorship;

(ii) Dissolution of a partnership and creation of a new partnership which takes over the business; and

(iii) Death of an individual who is VAT-registered person, even if the estate or heirs of the decedent shall continue to operate the business."

It will be noted that the circumstances of the sale of five (5) vessels would not fall under any of these two enumerations. In the first place, the sale by public bidding is definitely a sale, not a "deemed sale" transaction by operation of law. Neither is it a "transfer, use or consumption" as explained in Section 4 (a) of the Regulation quoted above, that is, "transfer of goods not in the course of business can take place when the VAT-registered person withdraws goods from his business for his personal use". Neither is it a "distribution or transfer" to shareholders, investors or creditors, nor a "consignment of goods". Neither do these vessels constitute "inventories of taxable goods" existing at the time of the retirement or cessation of business. It should be emphasized that NDC, by the sale of these vessels, has not retired from nor ceased business.

If there is any doubt regarding the issue, the same should be resolved in favor of petitioners. Section 99 of the Tax Code is not an exemption statute where claims for tax refund are construed strictly against the claimant, but a classification statute where the rule of interpretation is the reverse.

In **Commissioner of Internal Revenue v. Ledesma**, 31 SCRA 95, 111, the Supreme Court, citing American jurisprudence, held in part that:

> " x x x. The provision of Section 24 of the Tax Code excluding 'registered general co-partnership' from the payment of corporate income tax is not an exemption clause but a

> classification clause which must be construed liberally in favor of the taxpayer."
>
> "A classification statute, or one which specifies the persons or property subject and not subject to a tax, is not an exemption statute and the general rule x x x that a tax statute will be construed in favor of the taxpayer applies (C.J.S. Section 277, p. 443)."

Revenue laws imposing taxes on business must be strictly construed in favor of the citizen. [**Luzon Stevedoring Co. v. Collector of Internal Revenue**, 43 Phil. 803, 809]. In every case of doubt, such statutes are construed most strongly against the Government and in favor of the citizen, because burdens are not to be imposed, nor presumed to be imposed, beyond what the statutes expressly and clearly import. [**Manila Railroad Company v. Insular Collector of Customs**, 52 Phil. 950, 952 (1929); **Commissioner of Internal Revenue v. Fireman's Fund Ins. Co.**, 148 SCRA 315, 324 (1987)]. The same doctrine has been reiterated in the case of **Roxas v. Court of Tax Appeals**, 23 SCRA 276, 282 (1968). The Supreme Court in that case, held:

> The power of taxation is sometimes called also the power to destroy. Therefore it should be exercised with caution to minimize injury to the proprietary rights of a taxpayer. It must be exercised fairly, equally and uniformly, lest the tax collector kill the 'hen that lays the golden egg'. And, in order to maintain the general public's trust and confidence in the Government this power must be used justly and not treacherously. x x x."

If petitoners claim that NDC is exempt from VAT under the provisions of Section 103 of the Tax Code, then the contention of respondent that doubts should be construed strictly against petitioners would be valid as the issue involves an exemption statute. However, it is the contention of petitioners that pursuant to the provisions of Section 99, in relation to Section 100 of the Tax Code, the sale by NDC of the vessels is not subject to VAT as the sale is not in the course of trade or business of leasing personal property. A public auction sale of its assets in compliance with the privatization program of government clearly raises an issue involving a classification statute. For indeed the sale cannot be classified in the course of trade or business.

Respondent admitted that even if the sale is not in the course of trade or business still petitioners are subject to VAT as the transaction involving the sales of NDC's vessels are incidental to its normal trade of leasing said vessels. [see VAT Ruling No. 568-88 dated December 14, 1988, Exh. R].

The word "incidental" means depending upon or appertaining to something else as primary; something necessary, appertaining to, or depending upon another which is termed the principal. [The Robin Goodfellow, D.C. Wash., 20 F.2d 9924, 925; cited in Words & Phrases, Vol. 20, p.419 (1940)]. It must be remembered that the sale of NDC's vessels was pursuant to the government's privatization program beyond the control of NDC. The sale of the vessels as such are not necessary to carry out NDC's primary function of leasing personal properties. The act of selling capital assets does not necessarily follow the act of leasing these assets. The sales transaction was an isolated case. An isolated transaction do not thus warrant the imposition thereon of business taxes. [Imperial v. Collector, supra.]

WHEREFORE, finding the petition for review to be meritorious the same is GRANTED. Respondent's VAT Ruling Nos. 395-88; 568-88 and 007-89 are set aside. The Assessment Notice of the Acting Commissioner for Collection dated June 29, 1989, assessing petitioners for the payment of interest totalling P734,534.89, is hereby CANCELLED as the same was issued without legal basis.

ACCORDINGLY, respondent Commissioner of Internal Revenue is ordered to refund in favor of petitioners Magsaysay Lines, Inc.; Baliwag Navigation, Inc. and FIM Limited of the Marden Group (HK) for and in behalf of the National Development Corporation the VAT paid amounting to P15,120,000.00 under Confirmation Receipt No. B 16374703 dated March 16, 1989.

Without pronouncement as to costs.

SO ORDERED.

Quezon City, Metro Manila, April 27, 1992.

CONSTANTE C. ROAQUIN
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

STELLA DADIVAS-FARRALES
Acting Associate Judge

CERTIFICATION

I hereby certify that this decision was reached after due consultation among 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