L-18

REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

TOURIST TRADE AND TRAVEL CORPORATION,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. Case No. 4806

Promulgated:
JAN 19 1996

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# DECISION

This is an appeal by way of a petition for review from the decision of the Commissioner of Internal Revenue denying petitioner's request for reinvestigation/ reconsideration of the assessments issued for alleged unpaid income tax and value-added tax for the year 1988 in the total amount of P38,955,565.07.

Petitioner is a domestic corporation duly organized and existing under and by virtue of the laws of the Philippines. The Articles of Incorporation of petitioner indicate that its primary purpose is "to engage and carry on the business of tourism and travel, to undertake and promote the development of tourist attractions and operate and maintain essential facilities for tourist and travellers like resorts, hotels, restaurants and other tourist services; to operate ferry boats to transport tourists and other persons in connection with or to carry out the aforementioned purpose". (see Exhibit "S")

In line with this purpose, petitioner leased from the City of Manila in 1971 a parcel of land upon which a shopping complex was built now known as Harrison Plaza. This lease contract entitled petitioner to a leasehold right over the property for a period of twenty (20) years (see Exhibit "F").

On June 7, 1991, petitioner received two notices of assessment issued by respondent demanding payment of alleged unpaid income and value-added taxes for the year 1988 detailed as follows:

A. INCOME TAX - 1988

| | | |
|---|---|---|
| Net income per return | | P 2,684,077.00 |
| Add: a) Income from SM & Rustan's | P20,810,208.00 | |
| b) Undeclared rental income | 23,172,317.42 | 43,982,525.42 |
| Taxable Income | | P46,666,602.42 |
| Tax due thereon | | 16,333,311.00 |
| Less: Tax paid | | 835,268.00 |
| Deficiency Income Tax | | P15,498,043.00 |
| Add: 25% Surcharge | | 3,874,510.75 |
| 50% Surcharge | | 7,749,021.50 |
| Total | | P27,121,575.25 |
| Add: Interest from 4/16/89 to 6/15/91 (34.99) | | 9,489,839.17 |
| Total Amount Due and Collectible | | P36,611,414.42 |

B. VALUE-ADDED TAX - 1988

| | |
|---|---|
| Basic Tax (P10,103,998.64 x 1/11) | P 918,545.33 |
| Add: 50% Surcharge | 459,272.67 |
| 25% Surcharge | 229,636.33 |
| Total | P 1,607,454.33 |
| Add: Interest from 1/20/89 to 6/15/91 (45.83) | 736,696.32 |
| Total Amount Due and Collectible | P 2,344,150.65 |

On July 8, 1991, petitioner filed a letter with respondent requesting for a reinvestigation/ reconsideration of the findings made by the BIR examiners regarding their tax liabilities. This request for reinvestigation was well within the thirty-day period prescribed by law as July 7, 1991 fell on a Sunday thus it was finally filed on the next working day which was July 8, 1991.

On April 20, 1992, petitioner received a letter from respondent denying petitioner's request for reinvestigation. The reasons for the denial remain disputed as both parties gave a different version of the events which led to the rejection of the request of petitioner. Respondent maintains that such request was denied due to petitioner's refusal to turn over several documents necessary to support the grounds for reconsideration. Petitioner denies this and stressed that it was willing to hand over the documents but the BIR enforcement officers had rescheduled the investigation as it was the month of December and there was then a temporary ban on tax investigations.

From this denial, petitioner elevated its case to this Court on May 19, 1992 praying for the nullification of the aforementioned assessments.

During the hearing of this case, petitioner wrote a letter to the respondent, dated June 21, 1993, offering to settle this dispute by requesting that it be allowed to pay an amount equivalent to 30% of the basic tax due. Respondent has not taken any action with respect to this offer of compromise made by petitioner.

The issue that confronts this Court is whether or not petitioner is liable for the payment of unpaid income and value-added taxes as its tax liability for 1988. However in resolving this issue, a far more complex task lies ahead which entails an analysis of the theories formulated by the BIR examiners leading to the questioned assessments. A portion of such assessment pertains to the rentals paid by Shoemart and Rustan's which respondent insists belong to petitioner and as such are to be considered part of its income. Petitioner denies having received the rentals from these two establishments as its income because it claims that it does not wholly own Harrison Plaza. In fact, it stressed that there are two other corporations who share ownership with them and that the spaces leased and occupied by Rustan's and Shoemart properly belong to Multiplex Marketing Corporation (MMC) and Plaza Amusement Co., Inc. (PACI), respectively, therefore the conclusion of the BIR examiners assessing them for income which pertains to the two aforecited corporations is misdirected. Furthermore, petitioner refuses to admit the assertion of respondent that PACI and MMC are its sister companies as they have no common stockholders or stock owners. To prove the points so far asserted, petitioner presented as evidence the contract of lease between the City of Manila and petitioner (Exhibit "F"); the contracts of sub-lease entered into between petitioner and Multiplex Marketing Corporation and Plaza Amusement Companies Inc. subleasing portions of the lot leased by petitioner from the City of Manila (Exhibits "G" and "H"); Articles of Incorporation of the petitioner, MMC and PACI (Exhibits "Q", "R" and "S", respectively).

This Court finds that the rental income generated from Rustan's and Shoemart for the spaces leased by them do not belong to petitioner. The BIR records submitted indicate that originally petitioner was the lessor of the space occupied by Rustan's and a lease agreement was executed on September 5, 1983 whereby Rustan's Commercial Corporation as lessee agreed to pay monthly rentals to petitioner as lessor (see page 173, BIR records), however on January 15, 1985, an assignment of ownership and lease rights over the building was entered into between petitioner and MMC (see page 169, BIR records) whereby petitioner assigned the ownership, rights, interest and obligations over the building rented by Rustan's in favor of Multiplex Marketing Corporation (MMC). The consideration for such assignment was to enable petitioner to pay MMC for the financial assistance extended by the latter to the former in the construction of this particular building. As a consequence of the assignment, MMC assumed the rights of the petitioner as lessor to Rustan's whereby the latter paid MMC rentals for the lease of the property starting in 1985. Similarly, a deed of assignment of ownership and lease rights over the building occupied and rented by Shoemart was executed between petitioner and the Plaza Amusement Companies, Inc. (PACI) on December 24, 1984. This assignment had identical arrangements as that between petitioner and MMC, thus rentals were no longer paid to petitioner but to PACI (see page 157, BIR records). The conclusion of the Revenue Examiners that such assignments of ownership were only paper agreements that did not really exist in fact because the financial statement of MMC "marked no increase in its property and equipment account in 1985 when the alleged assignment took place" is erroneous. No transfers of ownership over the buildings occupied by Rustan's and Shoemart were effected but merely assignments of the rights of ownership such as the lease rights to enable petitioner to pay the debts it owes to MMC and PACI, therefore there were really no increases in the "building" accounts of MMC and PACI which could be reflected in their financial statements. What was reflected however in MMC's financial statement in 1985 was the rental income that it received from Rustan's as a result of the assignment (see page 162-165, BIR records). In conclusion, we find that petitioner is not liable for the income tax corresponding to the rental income generated from the lease of the buildings occupied by Rustan's and Shoemart.

The second aspect of the assessment issued by respondent concerns the alleged undeclared rental income of petitioner in 1988 in the amount of P23,172,317.42. Petitioner claims that this amount corresponds to the six-month rental advances and six-month rental deposits given by its lessees pursuant to the lease agreement and should not be considered as income for the following reasons:

> 1) The advance rentals received by petitioner as lessor are eventually returned to

the lessees on a quarterly basis over the lifetime of the lease contract;

2) The rental deposits are kept intact during the lifetime of the said contract and are to be returned to said lessees upon the expiration of the contract.

Petitioner presented as evidence samples of lease contracts it executed with some of its lessees, such samples having been picked at random by the Commissioner appointed by the Court among the many contracts submitted. All of the lease contracts selected and eventually offered as evidence provide the following:

> 5. Upon the execution of this contract, LESSEE shall deposit in cash with the LESSOR an amount equivalent to 6 months Rental Deposit and 6 months Rental Advance to be rebated on quarterly basis throughout the lease period as imposed in this Contract which shall be non-interest bearing as a guarantee to secure the faithful compliance by the LESSEE of all the covenants and conditions of this contract and to answer for damages which may be suffered by the LESSOR and such other monetary liabilities and obligations as the LESSEE may have under this Contract. In case of any rental adjustment, there shall be a corresponding adjustment in the security deposit, proportionate to the increase.
>
> Said security deposit shall not be applied to any unpaid rental and shall be kept intact throughout the term of the Contract and shall be returned to the LESSEE without interest only upon the expiration of this Lease Contract after LESSEE shall have completely and satisfactorily vacated and

> redelivered the Leased Premises to the LESSOR, less whatever amount LESSEE may owe LESSOR or what may be due as payment of unpaid bills by LESSEE.
>
> Should LESSEE terminate this Contract before its expiry, for any cause, or in any case of a breach of any term or condition of this Contract, the security deposit shall automatically be forfeited without prejudice to the LESSOR's exercise of his rights in accordance with Par. 6-E of this Contract, provided that LESSEE's liability for any breach of this Contract or any obligation on the Leased Premises shall in no case be limited to the amount of said security deposit.

In addition, petitioner presented samples of statements of account issued by petitioner to its lessees reflecting therein the quarterly rebates it gave to its lessees corresponding to the security advances the latter made at the start of the lease period as stipulated in the contract. (see Exhibits "X", "Y", "Z")

A review of the evidence presented convince Us that the assessed undeclared rental income corresponding to the security advances and security deposits should not be considered as income for tax purposes. By their very nature, the amount received by the petitioner either as security advances or deposit is eventually returned to the lessees hence petitioner did not earn any gain or profit therefrom. In the case of Madrigal vs. Rafferty, 38 Phil. 414, the Supreme Court defined income as follows:

> Income as contrasted with capital or property is to be the test. The essential difference between capital and income is that capital is a fund; <u>income is a flow.</u> A fund of property existing at an instant time is called capital. A flow of services rendered by that capital by the payment of money from it or any other benefit rendered by a fund of capital in relation to such find through a period of time is called income. Capital is wealth, while income is the <u>service of wealth.</u> (*See* Fisher, "The Nature of Capital and Income.") The Supreme Court of Georgia expresses the thought in the following figurative language: "The fact is that property is a tree, income is the fruit; labor is a tree, income the fruit; capital is a tree, income the fruit." (Waring vs. City of Savannah [1878], 60 Ga., 93.) <u>A tax on income is not a tax on property.</u> "Income," as here used, <u>can be defined as "profits or gains."</u> (London County Council vs. Attorney-General [1901], A.C., 26; 70 L.J.K.B.N.S., 77; 83 L.T.N.S., 605; 49 Week. Rep., 686; 4 Tax Cas., 265. *See further* Foster's Income Tax, second edition [1915], Chapter IV; Black on Income Taxes, second edition [1915], Chapter VIII; Gibsons vs. Mahon [1890], 136 U.S., 549; and Towne vs. Eisner, decided by the United States Supreme Court, January 7, 1918.) (Underscoring ours)

In the instant case, the security deposits as stipulated are to be returned to the lessees upon the expiration of the contract "less whatever amount lessee may owe lessor or what may be due as payment of unpaid bills by lessee". Likewise, the security advances are to be rebated on a quarterly basis throughout the lease period.

The last part of the assessment issued by respondent is for alleged unpaid value-added taxes for 1988 in the amount of P2,344,150.65. Respondent observed that petitioner charges its lessees for electricity, air-conditioning, water, common facilities and janitorial services based on the floor area occupied by each tenant and it is his contention that such service income must be subjected to the value-added tax. Petitioner maintains that the payments made by its lessees are mere reimbursements for whatever advances it had made for the payment of electric, water, and telephone bills and for the janitorial services provided. In effect, petitioner insists that they are not the ones directly providing for these services thus they cannot be made liable for value-added taxes.

We agree with the petitioner.

Evidence adduced during the trial as well as testimonies made by witnesses reveal that all electric, water, telephone bills as well as expenses for the maintenance of common facilities and janitorial and security services were all paid by the petitioner and the lessees are made to reimburse these advances made in accordance with the lease agreements (see Exhibits "T-2", "T-3", "T-4", "T-5" and "T-6"). For instance, the whole Harrison Plaza complex has only one electric meter in the name of the petitioner, hence initially it is the petitioner who pays for all the electric bills and since all the tenants have sub-meters, their share in the payment shall be determined by their own individual consumption as reflected in such sub-meters.

Section 99 of the Tax Code provides the following:

> 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.

It is clear from the above-described arrangement that petitioner does not fall under the aforequoted provision of the law. It is not the petitioner who directly supplies electricity, water and similar other goods to the lessees, neither does it render security and janitorial services. What petitioner does is to pay PLDT, Meralco, MWSS and similar other establishments for the services that they render and the goods that they supply for the whole Harrison Plaza Complex. Therefore, reimbursements sought from the tenants for advances made by petitioner are not subject to value-added tax.

WHEREFORE, judgment is rendered in favor of the petitioner. The presumption in favor of the correctness of the assessments issued by the respondent for alleged tax liability for 1988 has been overcome by sufficient evidence submitted by the petitioner.

Accordingly, respondent Commissioner is hereby ordered to cease and desist from enforcing the aforesaid assessments for the abovementioned reasons.

SO ORDERED.

RAMON O. DE VEYRA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

MANUEL K. GRUBA
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