REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PANAY ISLAND WATER CRYSTAL STORAGE CORPORATION rep. by its Manager BOANERJES I. BAUTISTA,
Petitioner,

- versus -

C.T.A. CASE NO. 6164

THE COMMISSIONER, BUREAU OF INTERNAL REVENUE,
Respondent.

Promulgated:
OCT 02 2001

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DECISION

Case before Us stems from an alleged erroneous imposition of capital gains tax on the extra-judicial foreclosure sale of Petitioner's property redeemed during the one (1) year period of redemption from the issuance of the Certificate of Sale.

The undisputed facts of the case are as follows:

Petitioner is a corporation organized and existing under and by virtue of the laws of the Philippines.

On November 11, 1996, Petitioner executed a Real Estate Mortgage and a Chattel Mortgage covering a parcel of land and some properties used in its business in favor of Metropolitan Bank and Trust Company (bank for brevity). Unable to pay its obligation, the said properties were foreclosed and a corresponding certificate of sale was issued on July 14, 1998.

As a consequence of the extra-judicial foreclosure sale, the bank being the highest bidder, paid on September 18, 1998 the 6% capital gains tax on the gain presumed to have been realized from the said sale and the corresponding documentary stamp tax in the total amount of P689,569.80.

On April 20, 1999, within one-year from the issuance of the Certificate of Sale, Petitioner was able to redeem the property in the amount of P7,587,184.14 which allegedly includes the said amount of P689,569.80 representing capital gains tax paid by the bank to the Respondent.

Believing as it does, that payment of capital gains tax in consequence of the extra-judicial foreclosure sale is erroneous and has no legal and factual basis, Petitioner filed an administrative claim for refund with the Respondent on May 12, 1999.

Unable to obtain an immediate and affirmative relief from the Respondent, Petitioner filed the instant Petition for Review with this Court on September 15, 2000.

While Petitioner reiterates its stance a quo, Respondent interposed the following Special and Affirmative Defenses, to wit:

> "4. He reiterates and repleads the preceding paragraphs of this Answer as part of his Special and Affirmative Defenses.
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> 5. Petitioner failed to demonstrate that the tax subject of the case at bar was erroneously or illegally collected.
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> 6. Taxes paid and collected are presumed to have been paid in accordance with law and regulations, hence, not refundable.
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> 7. The Petitioner's contention that no sale or transfer of property was realized since the right of redemption has been exercised by the mortgagor, hence, no capital gains tax should be paid, is without basis. As provided for in Sec. 27 (A) (5) of the National Internal Revenue Code as amended, a final tax of six percent (6%) is imposed on the gain presumed to have been realized on the sale,

exchange or disposition of lands and/or buildings which are not actually used in the business of a corporation and are treated as capital assets, based on the gross selling price or fair market value as determined by the Code. Since the law does not distinguish, sale should also include *pacto de retro* sale and other forms of conditional sales. Furthermore, as stated in BIR Revenue Memorandum Circular No. 41-86, a mortgage foreclosure sale is a form of conditional sale. In a *pacto de retro* sale, the vendee a retro who sells back the property to the vendor a retro is subject to the 6% tax based on the gross selling price. In foreclosures, the tax is on the selling price shown in the foreclosure sale (BIR Ruling No. 138-87 dated May 27, 1987). Thus, redemption of the property mortgaged does not exempt the parties to the contract of mortgage from payment of the capital gains tax. Accordingly, a 6% capital gains tax is due on the gains derived from said redemption.

8. Claims for refund are construed strictly against the claimant for the same partake the nature of exemption from taxation (**Commissioner of Internal Revenue vs. Ledesma, G.R. No. L-13509, January 30, 1970, 31 SCRA 95**) and such, they are looked upon with disfavor (**Western Minolco Corp. vs. Commissioner of Internal Revenue, 124 SCRA 121**).

After the parties have submitted their respective memorandum, this case was considered submitted for decision on April 30, 2001.

In its memorandum, Petitioner's argument hinges mainly on the premise that mere issuance of Certificate of Sale to the highest bidder does not constitute transfer of ownership and the mortgagor retains the ownership of the foreclosed property. Petitioner concludes that since there is no transfer of ownership in extra-judicial foreclosure sale, imposition of capital gains tax is, therefore, erroneous. Moreover, Petitioner opines that for capital gains tax to be validly imposed, there must be gain or profit derived by the taxpayer. In the case at bar, since there was no gain derived by the Petitioner when it redeemed the property, Petitioner believes that the said redemption cannot be subjected to capital gains tax.

Upon the other hand, Respondent asseverates that a mortgage foreclosure sale being a form of conditional sale, a 6% tax based on the gross selling price may be legally imposed pursuant to the provisions of Sec. 24 (D) (1) of the Tax Code, as amended, in relation to BIR Revenue Memorandum Circular No. 41-86 and BIR Memorandum Order No. 6-92. Respondent concludes that the 6% tax being legally due and demandable at the time of payment, redemption of the property, even if done during the one-year period of redemption, will not in any way, exempt the taxpayer from payment of the capital gains tax.

Central to the dispute of the contending parties are the provisions of Section 24 (D) (1) of the Tax Reform Act of 1997.

> "(D) Capital Gains from Sale of Real Property. –
>
> "(l) In General. – The provisions of Section 39(B) not withstanding a final tax of six percent (6%) based on the gross selling price or current fair market value as determined in accordance with Section 6(E) of this Code, whichever is higher is hereby imposed upon capital gains presumed to have been realized from the sale, exchange, or other disposition of real property located in the Philippines, classified as capital assets, including pacto de retro sales and other forms of conditional sales, by individuals, including estates and trusts x x x."

A cursory review of the attending circumstances reveals that the vortex of the controversy lies on the different interpretations of the parties as to the effects of the redemption of the foreclosed properties.

To this, We find Petitioner's ratiocination meritorious.

While it is true that under the aforequoted Section 24 (D) (1) of the Tax Code, conditional sale of real property includes foreclosure sale, this is subject to the condition that transfer of interest or ownership to the properties is effected. And well-settled is the rule that in a foreclosure sale, transfer of ownership ensues only upon expiration of the redemption period as provided in Section 6 of Act. No. 3135 as amended to wit:

> "**Section 6.** – In all cases in which an extra-judicial sale is made under the special power herein before referred to, the debtor, his successors in interest or any judicial creditor or judgment creditor, or any person having a lien on the property subsequent to the deed of mortgage or trust under which the property is sold, may redeem the same within the term of one year from and after the date of the sale."

Clearly from the above, the debtor/mortgagor is granted the opportunity to reacquire ownership of his foreclosed property within one-year counted from the date of registration of the Certificate of Sale as provided under Section 33 of Rule 39 of the 1997 Rules of Civil Procedure which provides, thus:

Rule 39

> **Section 33**. If no redemption be made within one (1) year from the date of registration of the certificate of sale, the purchaser is entitled to a conveyance or possession of the property x x x.

It must be borne in mind that what is being subjected to 6% capital gains tax is not the transfer of ownership per se but the profit or gain that was presumed to have been realized by the seller/mortgage arising from the transfer. It bears stressing that capital gains tax is an income tax. And the concept of income implies gain, profit or flow of wealth (**Madrigal vs. Rafferty, 38 Phil. 414**).

Prescinding from the above, it is necessary that the Petitioner should have profited, materially or otherwise, from the foreclosure sale where the properties were redeemed within the specified period under Act No. 3135. It appearing that Petitioner did not earn any income from the sale of the foreclosed properties, hence, they should not be made liable to pay the capital gains tax and documentary stamp tax.

In BIR Ruling No. 006-92, the Respondent acknowledged the inequity of collecting the capital gains tax before the expiration of the redemption period and provided for the solution of refunding the same in case the right of redemption is exercised to wit:

> "In foreclosure sales of mortgaged properties, the creditor-bank is the statutory seller, representing the owner-mortgagor of the property, so that said bank becomes liable for the capital gains tax due on such foreclosure sale based on the bid price in the auction sale. However, said bank could get reimbursement or recovery of the capital gains tax payment, if the right of redemption is exercised by the debtor-mortgagor or when the property is sold to any party whatsoever"

On March 9, 1999, the Secretary of Finance issued Revenue Regulations No. 4-99, in order to prevent the inequity that will arise if the capital gains tax is collected before the expiration of the redemption period. Section 3 (1) of Revenue Regulations No. 4-99 provides, thus:

> "In case the mortgagor exercises his right of redemption within one (1) year from the issuance of the certificate of sale, no capital gains tax shall be imposed because no capital gains has been derived by the mortgagor and no sale or transfer of real property was realized."

It is in view of the above categorical declaration of the Secretary of Finance that makes Us inclined to grant the claim for refund of the Petitioner. As no capital gains have been derived by the Petitioner in the foreclosure sale, hence the imposition of the corresponding capital gains tax is not warranted.

In the recently decided case involving an identical issue, this Court ruled in this wise:

> "It bears stressing that it is not the transfer of ownership per se that subjects the sale of the 5% capital gains tax but the profit or gain that was presumed to have been realized by the seller/mortgagor by means of said transfer as can be clearly seen from the provisions of Section 21(e) of the Tax Code (supra). Let us not forget that the capital gains tax is an income tax defined as a tax on a person's income, wages, salary, commissions,

emoluments, profits and the like (Black's Law Dictionary, 6th Edition). The concept of income implies gain, profit or flow of wealth (**Madrigal vs. Rafferty, 38 Phil. 414**). The question that should be asked at this point is: Did the Petitioners profit or gain anything form the foreclosure sale where the properties were redeemed within the specified redemption period? The answer is obvious. Petitioner did not earn any income from the sale of these foreclosed properties, hence they should not be made liable to pay the capital gains tax.

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As said RR 4-99 states, no capital gains having been derived by the mortgagor (Petitioners in the instant case), then no capital gains tax shall be imposed. It will be unjust to deprive the Petitioners their right to refund the capital gains tax which they already paid on the foreclosure sale of their properties when the facts show that they redeemed these properties within the period specified by the law." (**Spouses Arturo Soriano and Virginia T. Soriano vs. Hon. Liwayway Vinzons-Chato as Commissioner of Internal Revenue, CTA Case No. 5563, promulgated on June 22, 1999, with Entry of Judgment dated August 13, 1999**)

Anent the issue of documentary stamp tax imposed on the foreclosure sale, We find that the transaction is subject only to P15.00 documentary stamp tax pursuant to Section 4 of Revenue Regulations No. 4-99 which provides, thus:

Section 4. Documentary Stamp Tax. –

(1) In case the mortgagor exercises his right of redemption, the transaction shall only be subject to the P15.00 documentary stamp tax imposed under Section 188 of the Tax Code of 1997 because no land or realty was sold or transferred for a consideration.

While we agree that the Government needs to raise revenues to defray expenses of the government and for it to continuously serve the people, the same should not be done at the expense of justice and equity. Thus, in **Roxas vs. Court of Appeals, 127 SCRA 276**, the Supreme Court held:

"The power of taxation is sometime called the power to destroy. Therefore, it should be exercised with caution to minimize injury upon the proprietary rights of the taxpayer. It must be exercised fairly, equally and uniformly, lest the tax collector kills 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."

WHEREFORE, in view of all the foregoing, Respondent is hereby **ORDERED** to **REFUND** the amount of P689,569.86 in favor of the Petitioner, representing erroneously paid capital gains tax and documentary stamp tax paid by the latter on September 22, 1998.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

I CONCUR:

AMANCIO Q. SAGA
Associate Judge

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge