REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

LUISITA INDUSTRIAL PARK CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 5754

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
MAY 21 2001

x -

DECISION

This Petition for Review is seeking for the refund or issuance of a Tax Credit Certificate in the amount of P1,630,527.79, allegedly representing unutilized input value-added tax (VAT, for brevity) on domestic purchases of capital goods and services for the calendar quarters ended March 31, 1997 and June 30, 1997.

The following facts are undisputed:

Petitioner is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines with principal office located at 11th Floor, Makati Sky Plaza, Oledan Square, 6788 Ayala Avenue, Makati City. Its business is to acquire and own, hold, use, sell, lease, assign, transfer, mortgage, exchange, dispose, develop, and manage industrial and residential estates, and to provide support infrastructure and facilities therefor. It is registered with the Bureau of Internal Revenue as a VAT taxpayer with Taxpayer Identification No. 050-005-036-196-VAT issued on March 6, 1997.

On April 21, 1997, Petitioner seasonably filed its 1997 first Quarterly Value-Added Tax Return with the Bureau of Internal Revenue reflecting a total unutilized input VAT on domestic purchases of goods/services in the amount of P635,314.35.

On July 21, 1997, Petitioner filed its second Quarterly Value-Added Tax Return, showing an accumulated input VAT in the amount of P1,630,527.79 as of June 30, 1997.

On May 7, 1998, Petitioner registered with the Philippine Economic Zone Authority as an ecozone developer/operator of Luisita Industrial Park II in San Miguel, Tarlac, Tarlac as evidenced by Certificate of Registration No. EZ-98-05.

On February 11, 1999, Petitioner filed with the Revenue District Office No. 50, South Makati, a written application for refund of input taxes paid for the period January 1, 1997 to June 30, 1997, in the aggregate amount of P1,630,527.79 on the ground that it had not yet started its commercial operations but was already incurring business expenses from which value-added taxes were imposed.

On March 29, 1999, Petitioner lodged its appeal with this Court in order to toll the running of the two-year prescriptive period under Section 230 of the Tax Code, as amended.

In his Answer, Respondent raised the following Special and Affirmative defenses:

> 5. Petitioner's claim for refund is under verification/investigation by respondent Commissioner of Internal Revenue;
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> 6. In an action for tax refund, Petitioner must show that taxes were paid erroneously or collected illegally. Failure to sustain this burden is fatal to the action for refund;
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> 7. Claims for refund are construed strictly against the claimants since they are in the nature of exemptions from taxation (Manila Electric Co. vs. Commissioner of Internal Revenue, 76 SCRA 351); and

8. Taxes are presumed to have been paid and collected in accordance with law.

In support of its claim for refund, Petitioner presented the following documentary exhibits:

1. The Value-added Tax Returns for each of the four calendar quarters of the years 1997, 1998, and 1999 (Exhibits A, B, E, E-1, F, F-1 O, P, Q, R, S, T, U, and V);

2. Schedule of input taxes for the months of March, April, May and June of the year 1997 (Exhibits C and D);

3. Audited Balance Sheets of Petitioner for the years 1997 and 1998 (Exhibits G, G-1, H, and H-1);

4. Application for refund with the BIR (Exhs. I);

5. Summaries of input taxes prepared by SGV & Co for the first and second quarters of 1997 together with the corresponding pre-marked official receipts and/or invoices (Exhibits. J, J-1, K, K-1 to K-16, L, L-1 to L-3, M, and M-1 to M-56); and

6. The report of the commissioned independent CPA (Exhibit N).

The case was submitted for decision on February 8, 2001, without the evidence and memorandum of the Respondent.

The issues jointly stipulated by the parties are as follows:[1]

1. Whether or not Petitioner has unutilized input VAT for the 1st and 2nd quarters of taxable year 1997 in the amount of P1,630,527.79;

2. Whether or not the amount of P1,630,527.79 represents input VAT paid on Petitioner's domestic purchases of capital goods and services; and

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[1]Joint Stipulation of Facts and Issues, CTA records, pp. 40 to 42.

3. Whether or not the said input taxes have remained unutilized for the succeeding quarters.

We answer the aforementioned numbers one and three issues in the affirmative.

The records reveal that Petitioner registered with the Securities and Exchange Commission on October 24, 1996 and did not start its commercial operations until after December 31, 1998 as can be seen from Note No. 1 of the Balance Sheets (Exhibits G-1 and H-1). Therefore, for the year 1997, Petitioner has no taxable income from which it can be held liable for value-added tax. However, during the same year, Petitioner was already engaged in the construction of its initial project which was the development of a 300-hectare property into a first class industrial park called "Luisita Industrial Park 2" located at the Hacienda Luisita in San Miguel, Tarlac, Tarlac (Note No. 1 of the Balance Sheets, Exhibits G and H, CTA records, pp. 83 and 90). Hence, all of Petitioner's input taxes paid on various purchases of goods and services relative to its pre-commercial operations and the construction of its initial project remain unapplied (Exhibits A, B, E, F, O, P, Q, R, S, T, U, and V).

Anent the second issue, Petitioner claims that it is entitled to the refund of input taxes paid on domestic purchases of capital goods based on Section 106(b) of the Tax Code.

For easy reference, Section 106(b) of the Tax Code is hereby quoted as follows:

> **Section 106. Refunds or tax credits of creditable input tax.** –
>
> (b) Capital goods. – A VAT-registered person may apply for the issuance of a tax credit certificate or refund of input taxes paid on capital goods imported or locally purchased, to the extent that such input taxes have not been applied against output taxes. The application for

refund may be made only after the expiration of 2 succeeding quarters following the quarter in which the importation or local purchase was made.

The subject input taxes are categorized into the following account titles as shown in Petitioner's schedules of input taxes, to wit: (Exhibits C and D)

Account Titles	March	April	May	June	Total
Office Equipment	16,736.37	6,570.45	515.09		23,821.91
Office Supplies	1,311.57	2,071.62	735.59	418.44	4,537.22
Travel	4,996.81	12,024.07	3,600.00	(7,325.00)	13,295.88
Telephone/Facsimile	2,018.73	1,075.31	914.33	2,471.96	6,480.33
Professional Services	250.17	1,014.39	1,314.35	178.40	2,757.31
Project Development Cost	610,000.00			915,000.00	1,525,000.00
Rent		12,696.68	12,696.68	12,696.67	38,090.03
Representation		134.26	274.90	6,164.34	6,573.50
Books & Subscription		1,124.38			1,124.38
Advertisement		2,266.91		5,136.36	7,403.27
Repairs & Maintenance		1,443.27			1,443.27
Total	635,313.65	40,421.34	20,050.94	934,741.17	1,630,527.10

Petitioner capitalized all the expenses related to the development of the project, including interest during the development period, as part of "Project Development Cost" (Note No. 2, Notes to Balance Sheets, Exhibit G, CTA records, p. 83). While the expenses incurred prior to its start of commercial operations are capitalized and charged to "Pre-operating Expenses and Deferred Charges" account in the balance sheets and will be amortized over a period of five (5) years upon the start of the Petitioner's commercial operations (Exhibits G-1). Petitioner believes that the aforementioned input taxes are in the nature of capital goods and therefore are qualified for refund based on Section 106(b) of the Tax Code as amended.

However from the point of view of the commissioned independent CPA, only the input taxes paid on "Project Development Cost" in the amount of P1,525,000.00 are related to capital goods (Exhibit N).

On the other hand, the Respondent's revenue officers opined that both the input taxes on pre-operating expenses and project development cost are not paid on capital goods. They explained this in their memorandum in this manner, thus:

> "Pre-operating expense, though classified as an asset and amortized for an estimated number of years, is not subject to wear or tear or obsolescence. Project development cost which is likewise an asset account will eventually be a part of its inventory since subject taxpayer is engaged in the business of acquiring, holding, selling, leasing, assigning, transferring and managing industrial and residential estates. Inventories or stock in trade cannot also be depreciated and therefore cannot be classified as capital goods. Based on these facts, it is clear that the input taxes being claimed are not paid on capital goods as alleged by SGV. x x x". (Exhibit 2).

Given the above different views, the Court is now tasked to resolve a corollary issue of what comprises capital goods. Section 2(o) of Revenue Regulations No. 5-87 of the Value-Added Tax Regulations defines capital goods as:

> (o) "Capital goods" refer to goods with estimated useful life greater than one year and which are treated as depreciable assets under Section 29(f), used directly or indirectly in the production or sale of taxable goods or services (Underlining supplied).

The Court noted from the balance sheets of Petitioner that only the following property and equipment were subjected to depreciation, to wit: (Note No. 4, Notes to Balance Sheets, Exhibit G, CTA records, p. 84)

Leasehold improvements	P1,960,916
Office equipment	976,753
Furniture and fixtures	48,066

Total	P2,985,735
Less depreciation and amortization	1,212,163
Book Value	P1,773,572

Accordingly, only the input taxes paid on leasehold improvements, office equipment, and furniture and fixtures are qualified for refund pursuant to the provisions of Section 106(b) of the Tax Code in relation with Section 2(o) of Revenue Regulations No. 5-87 of the Value-Added Tax Regulations. The Court further noted that from among the aforementioned depreciable assets, Petitioner is only claiming the refund of input taxes paid on office equipment in the amount of P23,821.94 based on the tabulated schedule of input taxes (Exhibits C and D). Out of the aforesaid sum, only the amount of P23,306.82 is duly substantiated for VAT purposes, to wit:

Supplier	Exh.	Input Tax
Compex Sales Corp.	K-1	P12,281.82
Compex Sales Corp.	K-5	4,454.55
Compumedics	M-26	752.73
Compex Sales Corp.	M-27	727.27
Compex Sales Corp.	M-35	5,090.45
Total		P23,306.82

We do not agree with the Petitioner and the independent CPA that expenses related to project development cost are in the nature of capital goods. The project development cost although classified as a capital expenditure is not within the meaning of the term "capital goods". The argument of Petitioner to the effect that roads, electrical posts and perimeter fence are assets not for sale hence should be treated as capital goods is bereft of merit. They are not among the aforementioned list of Petitioner's depreciable assets. Although the roads, electrical posts and perimeter fence are assets that cannot be sold, they are improvements needed to be completed first before Petitioner could sell or lease its developed lots. Once the development of the land is completed, the costs of these improvements will eventually be realized by the increase in the selling price of the lot, rental or lease. The improvements on the industrial park are evidently not subject to depreciation and therefore are not classified as capital goods.

It has been consistently held that the cost of improvements of subdivided real estate held for sale are capital expenditures, allocable on the basis of the various unsold lots to be realized by the developer upon his ultimate sale of the property (5 MERTENS Law of Federal Income Taxation, S25.26, p. 178). Road construction expenditures in connection with the development of a subdivision of rental property are not deductible (5 MERTENS Law of Federal Income Taxation, S25.26, p. 178, supra).

We find it appropriate to quote a United States tax case entitled **Frank B. and Pauline Cooper, vs. Commissioner of Internal Revenue, 31 T.C. 1155**, which resolved an issue of whether or not the improvements made by Petitioners on their real estate business are subject to depreciation expense. The US Tax Court ruled in this wise:

> "The only issue before the Court is whether or not petitioners are entitled to a deduction for depreciation of the various improvements made by them to the Hilltop Addition subdivision. In the event it should be held that they are entitled to that deduction, the parties have agreed on a basis of $19.848.12, and a useful life of 10 years for the property, and have further agreed to the use of the declining balance method of depreciating it.
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> Section 167 of the 1954 Internal Revenue Code, provides an allowance for depreciation for property "used in the trade or business" or "held for the production of income." See also sec. 1.167(a)-1, Income Tax Regs. This allowance is based on the fact that property used by a taxpayer in his trade or business, or held for the production of income, gradually approaches a point where its usefulness is exhausted. Thus, through annual depreciation, a taxpayer is allowed to recoup, as an operating expense for a given taxable period, that portion of the cost of the property

estimated to have been consumed in producing the income earned during the period. However, it is well settled that property held for sale does not constitute depreciable property within the meaning of the statute. Nulex., Inc., 30 T.C. 769 (1958); Camp Wolters Enterprises, Inc., 22 T.C. 737 (1954), aff'd. 230 F.2d 555 (C.A., 1956).

The property here sought to be depreciated consists of improvements made to real estate which was subdivided and held by the petitioners for sale. These improvements included the construction of roads, and the installation of curbs, gutters, waterlines, and storm sewers. Insofar as this record is concerned, there is nothing to indicate that all or any part of these improvements were, during the taxable period under consideration, used by petitioners in their trade or business or held by them for the production of income. In point of fact, the record establishes that they were held for disposal either as part of each lot sold, or by dedication to public use. Moreover, it has consistently been held that the cost of improvements such as these is a capital expenditure, allocable to the basis of the various unsold lots, to be realized by the developer upon his ultimate sale of the property. Wood v. Commissioner, 245 F. 2d.888 (C.A. 5, 1957), affirming in part T.C. Memo. 1955-301; Commissioner v. Laguna Land & W. Co., 118 F. 2d 112 (C.A.9, 1941); Fairview Co., 13 B.T.A. 743 (1928). We are therefore of the opinion that petitioner have not shown the improvements made to the Hilltop Addition constitute depreciable property within the meaning of section 167 of the Code, and, accordingly, we deny the claimed deduction."

WHEREFORE, in view of the foregoing, the Petition for Review is hereby *PARTIALLY GRANTED*. Respondent is **ORDERED to REFUND or ISSUE a TAX CREDIT CERTIFICATE** in the amount of P23,306.82 in favor of Petitioner.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Judge

I CONCUR:

AMANCIO Q. SABA
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