REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

CEBU MABUHAY PAWNSHOP, INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 6266

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

MAR 25 2004

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DECISION

This case is a judicial appeal resulting from the inaction of the Commissioner of Internal Revenue on the administrative protest filed by petitioner involving Assessment No. 81-VAT-13-97-2000-1-022 for deficiency value-added tax in the amount of P2,570,808.93 for the year 1997.

Petitioner is a corporation duly existing and organized under the Philippine laws. It is engaged in the pawnshop business, with principal place of business at M. Lhuillier Bldg., Benedicto Street, North Reclamation Area, Cebu City.

On July 26, 2000, petitioner received a Preliminary Collection Letter from the Revenue District Officer of Revenue District No. 81, Cebu City North, demanding payment of the amount of P2,570,808.93 as deficiency value-added tax (VAT) under Assessment Notice No. 81-VAT-13-97-2000-1-022. Petitioner, however, did not receive the corresponding assessment notice (*Joint Stipulation of Facts and Issues, CTA Records, page 52*).

On August 29, 2000, petitioner filed a Motion for Reconsideration of the Preliminary Collection Letter questioning the legality and validity of the assessment.

Petitioner did not receive any ruling or decision from the respondent regarding its Motion for Reconsideration, hence, petitioner filed this present action through registered mail on March 27, 2001 (*Annex A, Petition for Review, CTA Records, page 10*).

Subsequently, summons was issued to respondent and in his *Answer* filed on May 22, 2001, respondent raised the following Special and Affirmative Defenses, to wit:

> "6. Petitioner, as a pawnshop operator, performs services for others for a fee, remuneration or consideration. Its services consist of lending money at interest on the security of personal property; and the interest is the fee, remuneration or consideration for such services. Hence, it is engaged in the sale of services subject to value-added tax (VAT) under Section 102 (a) of the Tax Code, as amended by R.A. 7716.
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> 7. Under Section 102(a) of the Tax Code, as amended by R.A. 7716, the VAT is equivalent to 10% of the gross receipts derived from the sale or exchange of services.
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> 8. Interest on pledge loans and past due loans and liquidated damages are part of petitioner's gross receipts subject to VAT;
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> 9. The assessment was issued in accordance with law and regulations;
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> 10. All presumptions are in favor of the correctness of tax assessments."

The parties filed their *Joint Stipulation of Facts and Issues* on December 7, 2001 manifesting their mutual agreement on the facts and issues involved in this case, to wit:

A. Stipulated Facts/Documents

1. That the petition was timely filed and the same was filed in accordance with the requirement of the tax code;

2. That petitioner did not receive Assessment Notice No. 81-VAT-13-97-2000-1-022;

3. That the assessed amount of VAT was computed by multiplying the rate of 10% on the gross amount;

4. That the 10% VAT was also imposed on the liquidated damages charged by petitioner to its customers;

5. That the machine copy of House Bill No. 11197 of the House of Representative *(sic)* and Senate Bill No. 1630 of the Senate of the Philippines are authentic copies of the

original now filed in both the House and Senate Libraries.

A. Stipulated Issues

1. Whether the preliminary collection letter received by the petitioner is eqiuvalent to final assessment notice to petitioner;

2. Whether pawnshop business is that of service or mere forbearance of money;

3. Whether pawnshop businesses are subject to VAT under the NIRC;

4. Whether pawnshop business is akin to a lending investor business;

5. Whether the VAT should be computed by multiplying the gross amount by 10% or 1/11;

6. Whether liquidated damages are income from service or a simple item of indemnification;

7. Whether respondent is legally empowered to impose and charge Value-Added Tax on the petitioner for the proceeds of the auction sale of pawned item.

The first issue raised by the petitioner is whether the preliminary collection letter received by the petitioner is equivalent to the final assessment notice.

There is no dispute that petitioner received the preliminary collection letter but not Assessment Notice No. 81-VAT-13-97-2000-1-022 itself. As stated earlier, after receiving the preliminary collection letter, petitioner filed a Motion for Reconsideration questioning the legality and validity of the assessment on August 29, 2000 but respondent did not issue any decision regarding petitioner's motion for reconsideration. Hence, on March 27, 2001, the petitioner filed a petition for review with this court which the parties stipulated as timely filed and in accordance with the requirements of the NIRC of 1997.

This court agrees with the action taken by the petitioner in treating the preliminary collection letter as "tantamount to a final assessment and demand letter" in itself. A review of the records submitted by the Bureau of Internal Revenue revealed that on February 23, 1999, petitioner paid a deficiency VAT due for the taxable year 1997 and that petitioner's chief accountant signed a document, denominated as "Agreement Form" (*BIR Records, page 540*), consenting to a further review and approval of the deficiency assessments by higher BIR authorities. The execution of the agreement form is a clear manifestation of petitioner's knowledge of an on-going review of its deficiency assessments for taxable year 1997.

Having received no other communication from the respondent regarding its deficiency income/VAT assessments, said preliminary collection letter constitutes an unmistakable notice to the petitioner of the result of respondent's investigation. In fact, the amount of income tax and value-added tax deficiencies due from the petitioner, as well as the corresponding assessment numbers, are indicated on the face of the preliminary collection letter (*BIR Records, page 539*). Petitioner could have easily requested Revenue District Office No. 81 for copies of the assessment notices referred to in the preliminary collection letter it received. Considering the foregoing facts, the preliminary collection letter constitutes sufficient notice to the petitioner regarding its deficiency assessments for income tax and value-added tax. Petitioner's recourse to the remedy provided in Section 228 of the NIRC of 1997 is, therefore, proper.

We shall discuss the second, third and fourth issues jointly since these issues are closely intertwined.

Petitioner advances the proposition that it is not subject to VAT because Section 102(a) does not include pawnshop business as one of those businesses engaged in the sale or exchange of services subject to VAT. According to petitioner, the history of the evolution of the expanded VAT law will explicitly show the legislative intent to exclude the business of herein petitioner from VAT.

Respondent, on his part, argues that since petitioner is a pawnshop operator, it performs services for others for a fee, remuneration or consideration. Its services consist of lending money at interest on the security of personal property and the interest is the fee, remuneration or consideration for such services. Hence, it is engaged in the sale of services subject to value-added tax (VAT) under Section 102(a) of the Tax Code, as amended by R.A. 7716.

We agree with the respondent.

Pawnshops are engaged in the business of providing services and as provider of services, their gross receipts are subject to the value-added tax. This conclusion finds support in Sections 99 and 102(a) of the National Internal Revenue Code (NIRC) of 1977 [*the law in force during the taxable year 1997*], as amended by R.A. 7716 and further amended by R.A. 8241, which provide:

> **SEC. 99.** ***Persons Liable***. --
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> "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. xxx xxx xxx"
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> **SEC. 102.** ***Value-Added tax on sale of services and use or lease of properties. –***
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> (A) *Rate and base of tax*. – There shall be levied, assessed and collected, a value-added tax equivalent to ten percent (10%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties.
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> The phrase *'sale or exchange of services'* means the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration, including those performed or rendered by construction and service contractors; stock, real estate, commercial, customs and

> immigration brokers; lessors of property, whether personal or real; warehousing services; lessors or distributors of cinematographic films; persons engaged in milling, processing, manufacturing or repacking goods for others; proprietors, operators or keepers of hotels, motels, resthouses, pension houses, inns, resorts; proprietors or operators of restaurants, refreshment parlors, cafes and other eating places, including clubs and caterers; dealers in securities; lending investors; transportation contractors on their transport of goods or cargoes, including persons who transport goods or cargoes for hire and other domestic common carriers by land, air and water relative to their transport of goods or cargoes; services of franchise grantees of telephone and telegraph, radio and television broadcasting and all other franchise grantees except those under Section 119 of this Code; services of banks, non-bank financial intermediaries and finance companies; and non-life insurance companies (except their crop insurances), including surety, fidelity, indemnity and bonding companies; <u>and similar services regardless of whether or not the performance thereof calls for the exercise or use of the physical or mental faculties</u>." (Underscoring supplied.)

On the basis of the aforequoted Section 102(a) [now Section 108(A)] of the Tax Code, this court, in a number of similar cases, the most recent of which is the case of ***A.L.L. Pawnshop, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6482, promulgated September 3, 2003***, elucidated further, thus:

> "Prescinding from the above law, any sale of services for others for a fee, remuneration or consideration is subject to 10% VAT. The phrase "sale or exchange or services" encompasses the performance of **all kinds of services** in the Philippines for others for a fee, remuneration or consideration. It includes the services enumerated therein and similar services regardless of whether or not the performance thereof calls for the exercise of physical or mental faculties.
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> xxx xxx xxx
>
> From the plain language of the law, the sale or exchange of services is subject to VAT and the phrase "sale or exchange of services" encompasses the performance of all kinds of services for others for a fee, remuneration or consideration. The enumeration of persons performing services for a fee, remuneration or consideration, such as construction and service contractors, stock, real estate, commercial, customs and immigration brokers, etc., is merely to give examples of businesses performing services for a fee, remuneration or consideration that are subject to VAT. The enumeration is not exclusive, which means that other persons performing services for a fee, remuneration or

consideration, who are not expressly mentioned in the enumeration, are also subject to VAT. In the case of ***Gomez vs. Ventura*, *54 Phil. 726,*** it was ruled that:

> "xxx The maxim *expressio unius est exclusio alterius* should be applied only as a means of discovering legislative intent and should not be permitted to defeat the plain indicated purpose of the legislature. It does not apply when words are mentioned by way of example, or to remove doubts. (See Cyc., 1122 xxx." (Underscoring ours.)

Section 108(A) [formerly Section 102(a)] does not limit its application to those enumerated therein because the law speaks of "all kinds of services". To limit its application to the enumeration would contradict the very clear meaning of the phrase "all kinds of services".

In addition, the phrase "including" should be construed merely as an enlargement and not of limitation.

> "The intention of an act will prevail over the literal sense of its terms. Thus, limited words in one part of an act may be expanded by general words in another part, if the general words more nearly express the legislative intent.
>
> A term whose statutory definition declares what it 'includes' is more susceptible to extension of meaning by construction than where the definition declares what a term 'means'. Thus, it has been said that 'the word 'includes' is usually a term of enlargement, and not of limitation… It, therefore, conveys the conclusion that there are other items includable, though not specifically enumerated…" [Sutherland, *Statutory Construction*, 4th Ed., Vol. 2A, p. 82, Sec. 47.07 citing United States Argosy Ltd. v. Hennigan, 404 F2d 14 (CA 5th, 1968); See United States v. Gertz, 249 F2d 662 (CA 9th, 1957); Federal Land Bank of St. Paul v. Bismarck Lumber Co., 314 US 95, 86 L Ed 65, 62 S Ct1 (1941)]. (Emphasis supplied.)

Hence, the terms "includes" and "including" do not exclude items otherwise within the scope of the defined term.

> The terms "includes" and "including" when used in the Code are not deemed to exclude items otherwise within the meaning of the term defined. Thus, where Section 1(e) applies to the taxable income of estates "including" and thereafter lists four types of income from trusts or estates

> that are taxable, other types of estates may also be subject to taxation under Section 1(e). To hold differently would, in effect, substitute the term "limited to" for "including". [Mertens, *Law of Federal Income Taxation*, 1995 Ed., Section 3.37, Chap. 3, pp. 55-56, citing *In re Joplin, Jr.*, 882 F2d 1507 (CA10 1989), applying IRC & 7701(c)].
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> xxx xxx xxx
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> Furthermore, Section 109 [formerly Section 103] of the Tax Code, as amended, enumerates the transactions that are exempt from VAT. Pawnshop transactions are not among the exempt transactions under the said section. Neither are there any express provisions of law exempting pawnshops from VAT. Since the transactions of pawnshops are not among those enumerated in Section 109 or any other express provision of law as VAT-exempt, it follows that the same are subject to VAT under Section 108(A). "

Considering that pawnshops are engaged in the sale of services for a fee, remuneration or consideration, they are subject to VAT under Section 102(a) of the NIRC of 1993, as amended. This pronouncement finds support in recent decisions laid down by the Court of Appeals (***Commissioner of Internal Revenue vs. Agencia Exquisite of Bohol, Inc.***, *C.A. G.R. SP No.59282, March 23, 2001;* ***Commissioner of Internal Revenue vs. Exquisite Pawnshop and Jewelry, Inc.***, *C.A. G.R. SP No. 59401, September 30, 2002;* ***Commissioner of Internal Revenue vs. Agencia Exquisite of Bohol, Inc.***, *C.A. G.R. SP No. 68180, February 10, 2003,* ***Commissioner of Internal Revenue vs. Exquisite Pawnshop and Jewelry, Inc.,*** *C.A. G.R. SP No. 70319, May 13, 2003;* ***Commissioner of Internal Revenue vs. Prime Asia Pawn & Jewelry Shop, Incorporated***, *C.A. G.R. SP NO. 70318, November 6, 2003),* where the Court categorically ruled that pawnshops are subject to the 10% VAT imposed under Section 108(A) of R.A. 8424.

It is significant to note that Section 3 of Presidential Decree No. 114, otherwise known as the "Pawnshop Regulation Act", defines a pawnshop as follows:

> "Pawnshop shall refer to a person or entity engaged in the business of lending money on personal property delivered as security for loans and shall be synonymous, and may be used interchangeably with, pawnbroker or pawnbrokerage."

Judicial notice may be taken of the fact that the principal activity of pawnshops is lending money at interest on personal property delivered as security for the loan. The act of lending money at interest constitutes the performance of a service for a fee, remuneration or consideration for such service. In other words, the liability of pawnshop operators to pay the VAT no longer depends on the classification of their business but on the services they render. As a consequence thereof, any allegation that pawnshops are not lending investors has lost its bearing. For as long as pawnshops are engaged in lending money on the security of personal property, they are still within the ambit of Section 102(a) [now Section 108(A)]. Petitioner, being engaged in the pawnshop business, is undoubtedly engaged in the sale of services like lending money. Hence, it cannot escape liability to pay the VAT.

Well settled is the jurisprudence that tax exemptions are strictly construed against the taxpayer ***(Cyanamid Phils., Inc. vs. Court of Appeals, 322 SCRA 639).*** In the absence of any clear provision of law exempting pawnshops from VAT, it is our conclusion that pawnshops are subject to VAT on their gross receipts considering that they are clearly engaged in the performance of services for a fee, remuneration or consideration.

In the case of ***Commissioner of Internal Revenue vs. Court of Appeals and Commonwealth Management and Services Corporation*, G.R. No. 125355, March 30, 2000,** the Supreme Court ruled that the taxpayer, not falling within the exemptions mentioned under Section 109 of the Tax Code, is subject to VAT. The High Tribunal held:

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> "Section 108 of the National Internal Revenue Code of 1997 defines the phrase "sale of services" as the "performance of all kinds of services for others for a fee, remuneration or consideration." xxx xxx xxx
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> xxx xxx xxx
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> Hence, it is immaterial whether the primary purpose of a corporation indicates that it receives payments for services rendered to its affiliates on a reimbursement-on-cost basis only, without realizing profit, for purposes of determining liability for VAT on services rendered. As long as the entity provides service for a fee, remuneration or consideration, then the service rendered is subject to VAT.
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> At any rate, it is a rule that because taxes are the lifeblood of the nation, statutes that allow exemptions are construed strictly against the grantee and liberally in favor of the government. Otherwise stated, any exemption from the payment of a tax must be clearly stated in the language of the law; it cannot be merely implied therefrom. In the case of VAT, Section 109, Republic Act 8424 clearly enumerates the transactions exempted from VAT." (Underscoring supplied)

We proceed to the remaining issues. Petitioner argues that the imposition by the respondent of VAT on the interest on pledge loans, interest on past due loans and liquidated damages is without legal basis, considering that interest is money and not of services and the liquidated damages imposed are incidental to the above-mentioned forbearance of money. Petitioner further alleges that, assuming for the sake of argument that petitioner is subject to VAT, Assessment Notice No. 81-VAT-13-97-2000-1-022 is void because respondent committed material error in his computation of the Value-Added Tax due by multiplying the rate of 10% to the gross amount. According to petitioner, the VAT due should have been computed in accordance with Section 102 (c) which provides:

> Section 102 (c) *Determination of the Tax* – The tax shall be computed by multiplying the total amount indicated in the official receipt by 1/11.

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Consequently, petitioner maintains that there being an error in the computation of principal amount of tax, the penalties and interest demanded under the assessment are also incorrect.

On the other hand, respondent argues that interest on pledge loans and past due loans and liquidated damages are part of the gross receipts subject to the value-added tax and that under Section 102(a) of the Tax Code, as amended, the VAT is equivalent to 10% of the gross receipts derived from the sale or exchange of services.

In the case of ***Michel J. Lhuillier vs. Commissioner of Internal Revenue, CTA Case No. 6533, promulgated on May 16, 2003***, the court had the occasion to rule on the issue of interest on pledge loans, interest on past due loans, and liquidated damages, thus:

> "Section 108 of the Tax Code provides:
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>> "The term '*gross receipts*' means the total amount of money or its equivalent representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits and advanced payments actually or constructively received during the taxable quarter for the services performed or to be performed for another person, excluding value-added tax." (*Underscoring supplied*)
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> On the basis of the above provision in the Tax Code, we believe that interest income, liquidated damages and gains from the sale of the rematados form part of the gross receipts of pawnshop business which are subject to value-added tax. All of these are payments which are actually or constructively received incidental to the pawnshop business and, therefore, within the contemplation of the law.
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>> In our recently decided case, we have passed upon the same issue in this wise:
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>> "By the very nature of the pawnshop business, money is being lent secured on personal property. The interest on pledge loans and past due loans are not compensation for forbearance of money. The same is true with liquidated damages in case the pawner fails to pay the borrowed money on time. Said loan having been secured on personal property, the pawnshop operator does not suffer

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> any damage if ever the pawner defaults in the payment of the borrowed money. This is because in the pawnshop business, the loaned amount is always very much lower than the actual worth of the personal property pawned.
>
> As regards the sale of the pawned items, what is being taxed by the respondent is the gain on auction sale and not the auction sale *per se*. xxx" *(Kwik Loan Pawnshop, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6424, promulgated on April 21, 2003)*

Anent the issue of what is the correct VAT rate, this court had ruled in the case of ***Jewel Pawnshop, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6235, promulgated on August 20, 2003,*** that:

> "Lastly, petitioner's contention that respondent committed material error in the computation of the VAT cannot be given credence. Where petitioner failed to subject to VAT the amounts received in the operation of its pawnshop business, its gross receipts must be multiplied by 10%. The provision in Section 102(c) of the Tax Code applies when the VAT has been imposed."

In the case at bar, petitioner imposed the value-added tax on its sales of jewelry but failed to impose the same on its gross receipts earned from interest on pledge loans, interest on past due loans, and service charges. Thus, petitioner's gross receipts from interest on pledge loans, interest on past due loans, and service charges shall be multiplied by 10% and not by 1/11 because the provision of Section 102 (c) of the NIRC of 1977 is applicable only when the VAT has been imposed on the corresponding items of gross receipts at time of the transaction.

The provisions of Section 102(c) of the NIRC of 1977, as amended, must be read in conjunction with Section 108(a)(2) of the same code which prescribes the invoicing requirements relative to the imposition of the VAT, to wit:

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SEC. 108. ***Invoicing and accounting requirements for VAT-registered persons*** –

(a) ***Invoicing requirements***. – A VAT-registered person shall, for every sale, issue an invoice or receipt. In addition to the information required under Section 238, the following information shall be indicated in the invoice or receipt:

(1) xxx xxx xxx

(2) The total amount which the purchaser pays or is obligated to pay to the seller with the indication that such amount includes the value-added tax (*Underscoring supplied*).

Hence, when the VAT has been imposed on the purchaser of services and the entire amount including the VAT is reflected on the invoice or receipt, the proper rate to use in determining the VAT is 1/11 [Sec. 102(c)] . However, as in the case of the petitioner herein, when the seller of services did not impose the VAT on the purchaser and the amounts reflected on the invoices or receipts pertain to the agreed fee, remuneration or consideration alone (without the VAT), the proper rate to use shall be 10% as provided for in Sec. 102 (a) of the NIRC of 1977, viz.:

SEC. 102. ***Value-Added tax on sale of services and use or lease of properties.*** **–**

(a) *Rate and base of tax*. – There shall be levied, assessed and collected, a value-added tax equivalent to 10% of gross receipts derived from the sale or exchange of services, including the use or lease of properties (Underscoring supplied).

IN VIEW OF THE ABOVE FINDINGS, the petition for review is hereby **DENIED** and petitioner is ***ORDERED TO PAY*** the deficiency value added tax and interest in the amount of P2,606,852.98, computed as follows:

Gross sales per return		P 2,058,187.50
Add: Revenue that should be subject to VAT:		
Interest Income-pledge loan	P 14,625,373.55	

2bd

Interest Income-past due	3,230,954.00	
Service Charges	732,312.50	18,588,640.05
Total amount that should be subjected to VAT		P 20,646,827.55
10% value added tax due		P 2,064,682.76
Less: VAT paid per return (BIR Records, pages 41, 44, 47 & 49)		205,818.73
Unpaid value added tax		P 1,858,864.03
Add: 20% Deficiency interest 1-26-98 to 2-20-2000		769,009.50
Total		P 2,627,873.53
Less: Partial payment of deficiency VAT (BIR Records, page 535)		21,020.55
Deficiency Value Added Tax Still Due		P 2,606,852.98

plus 20% delinquency interest from 2-21-2000 until fully paid pursuant to Section 249(c) [now Section 249(C), of the 1997 Tax Code] of the Tax Code, as amended.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Judge

WE CONCUR:

(On Leave)
ERNESTO D. ACOSTA
Presiding Judge

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

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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.

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

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