REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PROGAM REALTY & DEVELOPMENT CORP.,
Petitioner,

- versus -

C.T.A. CASE NO. 3678

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

x - - - - - - - - - - - - - - x

3/26/93

D E C I S I O N

This case involves a deficiency income tax assessment against petitioner for the period 1976, 1977 and 1978 in the total amount of P300,938.83.

The antecedent facts are as follows:

Petitioner is a domestic corporation engaged in the real estate business. Petitioner entered into an agreement with Procter & Gamble Philippine Manufacturing Corporation whereby the former agreed to lease certain real properties located in Tondo, Manila; Makati and Baguio City in favor of the latter. The Contract of Lease stipulates that "all taxes, assessments and imposts on the leased parcel of land, including those which may be levied on the property walls, whether due the national or municipal governments, shall be for the account of the LESSEE including such taxes, assessments and any other imposts on the buildings, installations, improvement or machinery on the leased property."[1]

For the years 1976, 1977 and 1978, petitioner paid the real property taxes due from the leased properties.[2] The official receipts were in the name of petitioner. The lessee, Procter & Gamble PMC, reimbursed the amount of real property taxes paid by petitioner in accordance with the terms agreed upon in the contract of lease. The real property taxes were never deducted from the gross income of petitioner.

On December 21, 1981, petitioner received from the Bureau of Internal Revenue two assessment letters both dated October 14, 1981 one for alleged deficiency income taxes in the total amount of P300,938.83 and the other for deficiency business taxes in the total amount of P14,698.20 both the fiscal years ending June 30, 1976, 1977 and 1978.[3]

On January 20, 1982, petitioner filed a protest with respect to the alleged Deficiency Income Tax Assessments for 1976-1978, in the sum of

[1] Exh. F-2.
[2] Exhs. G, G-1 to G-38.
[3] Exhs. A, A-1 to A-7, pp. 5-9, CTA record.

P300,938.00.[4] But it did not contest the Deficiency Business Tax Assessments for the same period. In fact, petitioner even admits liability with regard to the business tax assessments totalling P14,698.20. Petitioner paid the amount of P14,698.20, representing deficiency fixed taxes for the years 1976-1978, evidenced by Revenue Tax Receipt No. 10033105 and Confirmation Receipt No. 10402241 dated October 20, 1982.[5]

The income tax assessments for the years 1976, 1977 and 1978 are itemized as follows:[6]

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Net taxable income per return		P2,135,106.48	
Add: Unallowable deductions and/or additional income			
Real estate taxes	P 71,855.11		
Documentary/science taxes	15,503.00	87,358.11	
Net taxable income per investigation		P2,222,464.59	
Tax due thereon		P 767,863.00	
Less: Taxes already paid per return		737,287.00	
Deficiency income tax		P 30,576.00	
14% interest (42% maximum)		12,841.92	P 43,417.92

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Net taxable income per return		P2,664,881.73
Add: Unallowable deductions and/or additional income		
Real estate taxes		248,063.13
Net taxable income per investigation		P2,912,944.86

[4] Exhs. B and B-1, pp. 10-12, CTA record.
[5] p. 202, BIR record.
[6] Exhs. A, A-1 to A-3, p. 5, CTA record.

Tax due thereon	P1,020,704.00	
Less: Taxes already paid per return	932,564.00	
Deficiency income tax	P 88,140.00	
14% int. fr. 10/16/77 to 7/31/80	34,474.80	
20% int. fr. 8/1/80 to 10/16/80 (max. 3 years)	3,662.39	P 126,277.19

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Net taxable income per financial statement	P2,734,659.00	
Add: Unallowable deductions and/or additional income		
Real estate taxes	80,703.16	
Net taxable income per investigation	P2,815,362.16	
Tax due thereon	P1,116,145.00	
Less: Taxes already paid per return	1,028,198.00	
Deficiency income tax	P 87,947.00	
14% int. fr. 10/16/78 to 7/31/80	22,052.92	
20% int. fr. 8/1/80 to 10/16/81 (max. 3 years)	21,243.80	131,243.72
Total Amount Due and Collectible		P 300,938.83

On August 25, 1983, petitioner received a copy of the Warrant of Distraint of Personal Property and Warrant of Levy on Real Property issued by Deputy Commissioner Tomas C. Toledo.[7] The service of the warrants is tantamount to the decision of respondent denying its protest. Thus, on September 26, 1983, petitioner filed a petition for review with preliminary injunction with respect to the alleged deficiency income tax assessments for 1976-1978.

Petitioner alleged that the real estate taxes paid for the years 1976, 1977 and 1978, although reimbursed by the lessee, was never claimed as a

[7] pp. 207-210, BIR record.

deduction. The reimbursement did not result in any taxable income on the part of the petitioner.

As regards the disallowed documentary stamps taxes, petitioner alleged that these were actually incurred and paid on certificates of stock issued by the corporation for stock dividends duly declared to its stockholders. Therefore, the same should be allowed as a valid deduction to gross income.

Respondent contends that petitioner claimed as a deduction from its gross income payments for real estate taxes in the amounts of P71,855.11, P248,063.13 and P80,703.16 for the fiscal years ending June 30, 1976, June 30, 1977 and June 30, 1978, respectively, and the documentary stamps tax of P15,503.00 for the fiscal year ending June 30, 1976. Petitioner has the burden of proof to show that it is entitled to the deductions claimed. All presumptions are in favor of the correctness of tax assessments.

The records of respondents show that the assessments issued against petitioner was brought about as a result of an examination conducted by respondent's revenue examiner pursuant to Letter of Authority No. 213127RR dated March 3, 1980. The pertinent portion of the "FINDINGS" of respondent's examiner dated May 23, 1980 is presented hereunder, to wit:[a]

"1. Subject corporation was formed on June 14, 1974.

2. That the said corporation has three (3) major stockholders namely, Ayala Corp., AEA Dev. Corp. and Procter & Gamble PMC, who controls 99.99% of subject corporation.

3. That subject corporation entered into a contract of lease with Procter & Gamble PMC, one of the stockholders of the firm.

4. That the lease contract stipulates that all municipal, city and national taxes due on said property leased shall be borne by the Lessee.

5. That all real estate taxes were paid by Program Realty & Dev. Corp. which were later charged to and subsequently reimbursed by PMC, the lessee.

6. That the real estate tax receipts had Program Realty & Dev. Corp. as payor of the taxes.

7. That a stock dividend and increase in capitalization were effected in 1977 and the corresponding documentary & Science Stamp taxes due thereon paid by Ayala Corp. and subsequently charged to and paid by the respective stockholders.

8. That subject taxpayer has never paid the Privilege (sic) tax as a Real Estate Dealer.

9. That Procter (sic) & Gamble PMC, having a sizeable investment in subject corporation receives a regular quarterly dividend which is subject to the 10% Final Tax while claiming totally the rental expenses paid to the Lessor to

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[a] p. 166, BIR record.

which they are part owners, thereby reducing their tax liability."

Respondent pointed as basis for the assessment Section 74 of Revenue Regulation No. 2, the text of which is cited hereunder, to wit:

> "*SEC. 74. Rentals.* — Where a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. ***Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter.*** The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment of capital, an annual deduction may be made from gross income of an amount equal to the cost of such improvements divided by the number of years remaining of the term of lease, and such deduction shall be in lieu of a deduction for depreciation. If the remainder of the term of lease is greater than the probable life of the buildings erected, or of the improvements made, this deduction shall take the form of an allowance for depreciation." (Italics provided.)

After the presentation of petitioner's evidence, respondent waived his right to present his evidence. Instead he submitted the case based on the pleadings and the BIR records.

The issues presented for resolution are as follows:

1. Whether or not the documentary and science stamps taxes paid for the issuance of stock dividends in 1976 constitutes a valid deduction to petitioner's gross income; and

2. Whether or not reimbursements by lessee of real property taxes paid by petitioner on the real property subject matter of the lease contract constitute additional income of the petitioner for the years 1976, 1977 and 1978.

We shall first discuss the first issue. The rule is documentary and science stamp taxes are deductible business expenses. [See Section 30(c)(1) NIRC.] The records of this case will reveal that petitioner did not deduct the documentary and science stamp taxes paid on the issuance of stock dividends for the year ending June 30, 1976. Nowhere in the Audited Financial Statements of petitioner, particularly the Income Statement ending June 30, 1976, nor in its Income Tax Return will show that the total amount of P15,503.00, representing the documentary and science stamp taxes paid for 1976, was ever deducted in its gross income for that same year.

Upon re-investigation the findings of the second examiner show that "the documentary and science stamps amounting to P15,503.00 incurred for stock dividends duly declared and issued to stockholders in 1976 is a valid deduction against the taxpayer's income."[9] However, after careful examination, the Court found that the amount thus paid was not deducted from petitioner's gross income for 1976. Therefore, the documentary and science stamp taxes should not have been disallowed considering that the same was never claimed as a deduction.

For while it is true that documentary and science stamp taxes are valid deductions to gross income, nothing in the records of this case show that the same were deducted by petitioner. Respondent did not even interposed any objection to petitioner's formal offer of evidence in support of its case. Neither did he present any evidence to rebut the evidence of petitioner. As a matter of fact, respondent merely submitted the case based on the pleadings and the records of this case.

We see no reason, therefore, why the documentary and science stamp taxes were disallowed

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[9] Exh. L-1, p. 261, BIR record.

by respondent when it fact it was not even claimed as a deduction.

With respect to the second issue, it would be best to cite the transaction that gave rise to the alleged deficiency income tax assessments for 1976-1978. Petitioner leases real properties to Procter & Gamble PMC. It was agreed upon by the parties that taxes incurred and imposed on the leased properties shall be for the account of the lessee. When petitioner paid the real property taxes for the leased properties it owned, petitioner sought for the reimbursement of the amounts paid therefor. The lessee reimbursed the amounts thus paid. The real property taxes were never deducted by petitioner from its gross income. The Income Statements of petitioner for the period ending June 30, 1976 to June 30, 1978 did not reflect as an expense the real property taxes paid for that period. The same is true with the Income Tax Returns of petitioner covering the same period which is the subject matter of this case.

Since the amounts paid by the lessee are mere reimbursements on real property taxes paid by petitioner there seems to be no basis why these should be treated as additional income considering that the real property taxes were never deducted from the gross income. Note that the amount reimbursed by the lessee did not inure to the benefit of petitioner but in favor of the government who received the taxes paid for real properties leased.

Taxes paid on real properties shall be borne by the lessee pursuant to the provision of the contract of lease. Thus, reimbursements of taxes made by the lessee form part of rent expenses. Ordinarily, the reimbursements shall form part of rental income on the part of the lessor. At the same time, the lessor can claim as a valid deduction from its gross income the amount of real property taxes paid. However, because of the peculiar circumstance of this case, petitioner did not deduct the amount of real property taxes it paid for the years 1976, 1977 and 1978. Therefore, it is apparent that nothing was gained from this transaction since nothing was deducted from gross income. It would have been different if petitioner actually deducted the amount of real property taxes paid and did not record and report as part of its income the amount reimbursed by the lessee. In that case, petitioner would have gained from the transaction by not reporting as additional rental income the amount reimbursed.

What was paid by petitioner to the government in terms of real property taxes were merely reimbursed by the lessee. Thus, it was not necessary for the petitioner to deduct the real property taxes as an expense. We are even persuaded by the findings of Revenue Examiner, Mr. Edgar Claveria, in his report on the re-investigation of petitioner's case, pertinent portion of which is hereunder reproduced:[10]

> "2. The reimbursements made by the lessee to the taxpayer for real estate taxes on the real property subject of the lease constitute an additional income to the taxpayer for 1976, 1977 & 1978 but the undersigned examiner see no reason why the previous examiner allowed it only as an income when the amount of the tax is an expense and being deductible by the taxpayer hence, giving rise to no additional taxable income."

We agree with the second findings as reported above. The first examiner failed to consider the taxes paid for real property as an expense on the part of the lessor. This conclusion does not run counter to the provision of Section 74 of Revenue Regulation No. 2 for it states: "Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the

[10] Exh. L-2, p. 261, BIR record.

landlord, the amount of the tax being deductible by the latter." If the reimbursements for taxes made by the lessee forms part of additional income on the part of the lessor the same shall also be allowed as a deduction on the part of the lessor. Thus, it states "the amount of tax being deductible by the latter (the landlord)." There being no deductions claimed by the lessor (herein petitioner) there appears to be no additional income earned. It is clear that the additional amounts received by the lessor are mere reimbursements and nothing more.

WHEREFORE, the petition for review is hereby **GRANTED.** The deficiency income tax assessments issued by respondent for the years ending June 30, 1976, June 30, 1977 and June 30, 1978, in the total amount of P300,938.83, are hereby cancelled. The Warrant of Distraint on Personal Property and the Warrant of Levy on Real Property are hereby lifted permanently. No costs.

SO ORDERED.

Quezon City, Metro Manila, March 26, 1993.

Ernesto D. Acosta

ERNESTO D. ACOSTA
Presiding Judge

WE CONCUR:

MANUEL K. GRUBA
Associate Judge

RAMON O. DE VEYRA
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