COMMISSIONER OF INTERNAL REVENUE PETITIONER, VS. MAGSAYSAY LINES, INC., BALIWAG NAVIGATION, INC., FIM LIMITED OF THE MARDEN GROUP (HK) AND NATIONAL DEVELOPMENT COMPANY, RESPONDE...

G.R. NO. 146984. July 28, 2006

Ponente: TINGA, J.

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TINGA, J.:

The issue in this present petition is whether the sale by the National Development Company (NDC) of five (5) of its vessels to the private respondents is subject to value-added tax (VAT) under the National Internal Revenue Code of 1986 (Tax Code) then prevailing at the time of the sale. The Court of Tax Appeals (CTA) and the Court of Appeals commonly ruled that the sale is not subject to VAT. We affirm, though on a more unequivocal rationale than that utilized by the rulings under review. The fact that the sale was not in the course of the trade or business of NDC is sufficient in itself to declare the sale as outside the coverage of VAT.

The facts are culled primarily from the ruling of the CTA.

Pursuant to a government program of privatization, NDC decided to sell to private enterprise all of its shares in its wholly-owned subsidiary the National Marine Corporation (NMC). The NDC decided to sell in one lot its NMC shares and five (5) of its ships, which are 3,700 DWT Tween-Decker, "Kloeckner" type vessels.[1] The vessels were constructed for the NDC between 1981 and 1984, then initially leased to Luzon Stevedoring Company, also its wholly-owned subsidiary. Subsequently, the vessels were transferred and leased, on a bareboat basis, to the NMC.[2]

The NMC shares and the vessels were offered for public bidding. Among the stipulated terms and conditions for the public auction was that the winning bidder was to pay "a value added tax of 10% on the value of the vessels."[3] On 3 June 1988, private respondent Magsaysay Lines, Inc. (Magsaysay Lines) offered to buy the shares and the vessels for P168,000,000.00. The bid was made by Magsaysay Lines, purportedly for a new company still to be formed composed of itself, Baliwag Navigation, Inc., and FIM Limited of the Marden Group based in Hongkong (collectively, private respondents).[4] The bid was approved by the Committee on Privatization, and a Notice of Award dated 1 July 1988 was issued to Magsaysay Lines.

On 28 September 1988, the implementing Contract of Sale was executed between NDC, on one hand, and Magsaysay Lines, Baliwag Navigation, and FIM Limited, on the other. Paragraph 11.02 of the contract stipulated that "[v]alue-added tax, if any, shall be for the account of the PURCHASER."[5] Per arrangement, an irrevocable confirmed Letter of Credit previously filed as bidders bond was accepted by NDC as security for the payment of VAT, if any. By this time, a formal request for a ruling on whether or not the sale of the vessels was subject to VAT had already been filed with the Bureau of Internal Revenue (BIR) by the law firm of Sycip Salazar Hernandez & Gatmaitan, presumably in behalf of private respondents. Thus, the parties agreed that should no favorable ruling be received from the BIR, NDC was authorized to draw on the Letter of Credit upon written

demand the amount needed for the payment of the VAT on the stipulated due date, 20 December 1988.[6]

In January of 1989, private respondents through counsel received VAT Ruling No. 568-88 dated 14 December 1988 from the BIR, holding that the sale of the vessels was subject to the 10% VAT. The ruling cited the fact that NDC was a VAT-registered enterprise, and thus its "transactions incident to its normal VAT registered activity of leasing out personal property including sale of its own assets that are movable, tangible objects which are appropriable or transferable are subject to the 10% [VAT]."[7]

Private respondents moved for the reconsideration of VAT Ruling No. 568-88, as well as VAT Ruling No. 395-88 (dated 18 August 1988), which made a similar ruling on the sale of the same vessels in response to an inquiry from the Chairman of the Senate Blue Ribbon Committee. Their motion was denied when the BIR issued VAT Ruling Nos. 007-89 dated 24 February 1989, reiterating the earlier VAT rulings. At this point, NDC drew on the Letter of Credit to pay for the VAT, and the amount of P15,120,000.00 in taxes was paid on 16 March 1989.

On 10 April 1989, private respondents filed an Appeal and Petition for Refund with the CTA, followed by a Supplemental Petition for Review on 14 July 1989. They prayed for the reversal of VAT Rulings No. 395-88, 568-88 and 007-89, as well as the refund of the VAT payment made amounting to P15,120,000.00.[8] The Commissioner of Internal Revenue (CIR) opposed the petition, first arguing that private respondents were not the real parties in interest as they were not the transferors or sellers as contemplated in Sections 99 and 100 of the then Tax Code. The CIR also squarely defended the VAT rulings holding the sale of the vessels liable for VAT, especially citing Section 3 of Revenue Regulation No. 5-87 (R.R. No. 5-87), which provided that "[VAT] is imposed on any sale or transactions "deemed sale" of taxable goods (including capital goods, irrespective of the date of acquisition)." The CIR argued that the sale of the vessels were among those transactions "deemed sale," as enumerated in Section 4 of R.R. No. 5-87. It seems that the CIR particularly emphasized Section 4(E)(i) of the Regulation, which classified "change of ownership of business" as a circumstance that gave rise to a transaction "deemed sale."

In a Decision dated 27 April 1992, the CTA rejected the CIR's arguments and granted the petition.[9] The CTA ruled that the sale of a vessel was an "isolated transaction," not done in the ordinary course of NDC's business, and was thus not subject to VAT, which under Section 99 of the Tax Code, was applied only to sales in the course of trade or business. The CTA further held that the sale of the vessels could not be "deemed sale," and thus subject to VAT, as the transaction did not fall under the enumeration of transactions deemed sale as listed either in Section 100(b) of the Tax Code, or Section 4 of R.R. No. 5-87. Finally, the CTA ruled that any case of doubt should be resolved in favor of private respondents since Section 99 of the Tax Code which implemented VAT is not an exemption provision, but a classification provision which warranted the resolution of doubts in favor of the taxpayer.

The CIR appealed the CTA Decision to the Court of Appeals,[10] which on 11 March 1997, rendered a Decision reversing the CTA.[11] While the appellate court agreed that the sale was an isolated transaction, not made in the course of NDC's regular trade or business, it nonetheless found that the transaction fell within the classification of those "deemed sale" under R.R. No. 5-87, since the sale of the vessels together with the NMC shares brought about a change of ownership in NMC. The Court of Appeals also applied the principle governing tax exemptions that such should be strictly construed against the taxpayer, and liberally in favor of the government.[12]

However, the Court of Appeals reversed itself upon reconsidering the case, through a Resolution dated 5 February 2001.[13] This time, the appellate court ruled that the "change of ownership of business" as contemplated in R.R. No. 5-87 must be a consequence of the "retirement from or cessation of business" by the owner of the goods, as provided for in Section 100 of the Tax Code. The Court of Appeals also agreed with the CTA that the

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classification of transactions "deemed sale" was a classification statute, and not an exemption statute, thus warranting the resolution of any doubt in favor of the taxpayer.[14]

To the mind of the Court, the arguments raised in the present petition have already been adequately discussed and refuted in the rulings assailed before us. Evidently, the petition should be denied. Yet the Court finds that Section 99 of the Tax Code is sufficient reason for upholding the refund of VAT payments, and the subsequent disquisitions by the lower courts on the applicability of Section 100 of the Tax Code and Section 4 of R.R. No. 5-87 are ultimately irrelevant.

A brief reiteration of the basic principles governing VAT is in order. VAT is ultimately a tax on consumption, even though it is assessed on many levels of transactions on the basis of a fixed percentage.[15] It is the end user of consumer goods or services which ultimately shoulders the tax, as the liability therefrom is passed on to the end users by the providers of these goods or services[16] who in turn may credit their own VAT liability (or input VAT) from the VAT payments they receive from the final consumer (or output VAT).[17] The final purchase by the end consumer represents the final link in a production chain that itself involves several transactions and several acts of consumption. The VAT system assures fiscal adequacy through the collection of taxes on every level of consumption,[18] yet assuages the manufacturers or providers of goods and services by enabling them to pass on their respective VAT liabilities to the next link of the chain until finally the end consumer shoulders the entire tax liability.

Yet VAT is not a singular-minded tax on every transactional level. Its assessment bears direct relevance to the taxpayer's role or link in the production chain. Hence, as affirmed by Section 99 of the Tax Code and its subsequent incarnations,[19] the tax is levied only on the sale, barter or exchange of goods or services by persons who engage in such activities, in the course of trade or business. These transactions outside the course of trade or business may invariably contribute to the production chain, but they do so only as a matter of accident or incident. As the sales of goods or services do not occur within the course of trade or business, the providers of such goods or services would hardly, if at all, have the opportunity to appropriately credit any VAT liability as against their own accumulated VAT collections since the accumulation of output VAT arises in the first place only through the ordinary course of trade or business.

That the sale of the vessels was not in the ordinary course of trade or business of NDC was appreciated by both the CTA and the Court of Appeals, the latter doing so even in its first decision which it eventually reconsidered.[20] We cite with approval the CTA's explanation on this point:

> In Imperial v. Collector of Internal Revenue, G.R. No. L-7924, September 30, 1955 (97 Phil. 992), the term "carrying on business" does not mean the performance of a single disconnected act, but means conducting, prosecuting and continuing business by performing progressively all the acts normally incident thereof; while "doing business" conveys the idea of business being done, not from time to time, but all the time. [J. Aranas, UPDATED NATIONAL INTERNAL REVENUE CODE (WITH ANNOTATIONS), p. 608-9 (1988)]. "Course of business" is what is usually done in the management of trade or business. [Idmi v. Weeks & Russel, 99 So. 761, 764, 135 Miss. 65, cited in Words & Phrases, Vol. 10, (1984)].
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> What is clear therefore, based on the aforecited jurisprudence, is that "course of business" or "doing business" connotes regularity of activity. In the instant case, the sale was an isolated transaction. The sale which was involuntary and made pursuant to the declared policy of Government for privatization could no longer be repeated or carried on with regularity. It should be emphasized that the normal VAT-registered activity of NDC is leasing personal property.[21]

This finding is confirmed by the Revised Charter[22] of the NDC which bears no indication that the NDC was created for the primary purpose of selling real property.[23]

The conclusion that the sale was not in the course of trade or business, which the CIR does not dispute before this Court,[24] should have definitively settled the matter. Any sale, barter or exchange of goods or services not in the course of trade or business is not subject to VAT.

Section 100 of the Tax Code, which is implemented by Section 4(E)(i) of R.R. No. 5-87 now relied upon by the CIR, is captioned "Value-added tax on sale of goods," and it expressly states that "[t]here shall be levied, assessed and collected on every sale, barter or exchange of goods, a value added tax x x x." Section 100 should be read in light of Section 99, which lays down the general rule on which persons are liable for VAT in the first place and on what transaction if at all. It may even be noted that Section 99 is the very first provision in Title IV of the Tax Code, the Title that covers VAT in the law. Before any portion of Section 100, or the rest of the law for that matter, may be applied in order to subject a transaction to VAT, it must first be satisfied that the taxpayer and transaction involved is liable for VAT in the first place under Section 99.

It would have been a different matter if Section 100 purported to define the phrase "in the course of trade or business" as expressed in Section 99. If that were so, reference to Section 100 would have been necessary as a means of ascertaining whether the sale of the vessels was "in the course of trade or business," and thus subject to

VAT. But that is not the case. What Section 100 and Section 4(E)(i) of R.R. No. 5-87 elaborate on is not the meaning of "in the course of trade or business," but instead the identification of the transactions which may be deemed as sale. It would become necessary to ascertain whether under those two provisions the transaction may be deemed a sale, only if it is settled that the transaction occurred in the course of trade or business in the first place. If the transaction transpired outside the course of trade or business, it would be irrelevant for the purpose of determining VAT liability whether the transaction may be deemed sale, since it anyway is not subject to VAT.

Accordingly, the Court rules that given the undisputed finding that the transaction in question was not made in the course of trade or business of the seller, NDC that is, the sale is not subject to VAT pursuant to Section 99 of the Tax Code, no matter how the said sale may hew to those transactions deemed sale as defined under Section 100.

In any event, even if Section 100 or Section 4 of R.R. No. 5-87 were to find application in this case, the Court finds the discussions offered on this point by the CTA and the Court of Appeals (in its subsequent Resolution) essentially correct. Section 4 (E)(i) of R.R. No. 5-87 does classify as among the transactions deemed sale those involving "change of ownership of business." However, Section 4(E) of R.R. No. 5-87, reflecting Section 100 of the Tax Code, clarifies that such "change of ownership" is only an attending circumstance to "retirement from or cessation of business[,] with respect to all goods on hand [as] of the date of such retirement or cessation."[25] Indeed, Section 4(E) of R.R. No. 5-87 expressly characterizes the "change of ownership of business" as only a "circumstance" that attends those transactions "deemed sale," which are otherwise stated in the same section.[26]

WHEREFORE, the petition is DENIED. No costs.

SO ORDERED.

Quisumbing, (Chairperson), Carpio, Carpio-Morales, and Velasco, Jr. JJ., concur

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[1] Rollo, p. 58.

[2] Id.

[3] Id.

[4] Id. at 59.

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[5] Id. at 60.

[6] Id. at 61.

[7] Id.

[8] Private respondents also filed their claim for refund with the BIR on 13 July 1989. Id. at 63.

[9] Decision penned by Associate Judge Constante C. Roaquin, concurred in by Presiding Judge Ernesto D. Acosta and Acting Associate Judge Stella Dadivas-Farrales.

[10] The Court of Appeals initially dismissed the CIR's Petition for Review as it had been filed beyond the reglementary period of appeal, but such dismissal was subsequently reconsidered. The allowance of the appeal was the subject of a special civil action for certiorari eventually denied by the Court in Magsaysay Lines, et al. v. Court of Appeals, 329 Phil. 310 (1996), a decision limited solely to the propriety of the allowance of the CIR's appeal, without delving on any of the issues now subject for resolution in the present petition.

[11] Decision penned by then Associate Justice (now Supreme Court Associate Justice) Romeo J. Callejo, Sr., and concurred in by Associate Justices Gloria C. Paras and Ruben T. Reyes.

[12] See Rollo, pp. 53-54.

[13] See id. at 31. Resolution also penned by then Associate Justice (now Supreme Court Associate Justice) Romeo J. Callejo, Sr., and concurred in by Associate Justices Ramon Mabutas, Jr. and Ruben T. Reyes.

[14] Id. at 33-35.

[15] See Commissioner of Internal Revenue v. Benguet Corporation, G.R. Nos.134587 & 134588, 8 July 2005, 463 SCRA 28, 42.

[16] "[T]he amount of tax paid may be shifted or passed on by the seller to the buyer. What is transferred in such instances is not the liability for the tax, but the tax burden. In adding or including the VAT due to the selling price, the seller remains the person primarily and legally liable for the payment of the tax. What is shifted only to the intermediate buyer and ultimately to the final purchaser is the burden of the tax." Contex Corporation v. Commissioner of Internal Revneue, G.R. No. 151135, 2 July 2004, 433 SCRA 376, 385, citing Deoferio, Jr. and Mamalateo, The Value Added Tax In The Philippines 35-36 (1st ed. 2000).

[17] "There is another key characteristic of the VAT" that no matter the number of taxable transactions that precede the final purchase or sale, it is the end user, or the consumer, that ultimately shoulders the tax. Despite its name, VAT is generally not intended to be a tax on value added, but rather as a tax on consumption. Hence, there is a mechanism in the VAT system that enables firms to offset the tax they have paid on their own purchases of goods and services against the tax they charge on their sales of goods and services." Abakada Guro Party List v. Ermita, G.R. Nos. 168056, 168207, 168461, 168463, 168730, 1 September 2005, 469 SCRA 1, 282, J. Tinga, Dissenting and Concurring Opinion.

[18] "The VAT system assures that the government shall reap income for every transaction that is had, and not just on the final sale or transfer." Ibid.

[19] See, e.g., Section 105, Republic Act No. 8424 (National Internal Revenue Code of 1987). The said provision remained intact despite the passage of Republic Act No. 9337, which expanded the coverage of the VAT, in 2005.

[20] See rollo, p. 51.

[21] Id. at 69-70, emphasis omitted. See also Commissioner of Internal Revenue v. Court of Appeals, 385 Phil.

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875 (2000). "VAT is a tax on transactions, imposed at every stage of the distribution process on the sale, barter, exchange of goods or property, and on the performance of services, even in the absence of profit attributable thereto. The term "in the course of trade or business" requires the regular conduct or pursuit of a commercial or an economic activity, regardless of whether or not the entity is profit-oriented." Id. at 884.

[22] Pres. Decree No. 1648, entitled Reorganizing the National Development Company and Establishing a Revised Charter Therefor, dated 25 October 1979.

[23] See Pres. Decree No. 1648, Secs. 2 and 4.

[24] Notably, the CIR even expressly submits that the earlier decision of the Court of Appeals, which did rule the sale as an isolated transaction, "is correct." See rollo, p. 27.

[25] See Section 100(b)(3)(4), 1986 Tax Code, which reads: "Retirement from or cessation of business, with respect to inventories of taxable goods existing as of such retirement or cessation."

[26] Section 4 of R.R. No. 5-87 states:

SEC. 4. Transactions "deemed sale." - The following transactions are "deemed sale" pursuant to Section 100 (b):

(a) Transfer, use or consumption, not in the course of business. Transfer of goods not in the course of business can take place when the VAT-registered person withdraws goods from his business for his personal use;

(b) Distribution or transfer to shareholders or investors as share in the profits of the business;

(c) Transfer to creditors in payment of debt or obligation;

(d) Consignment of goods if actual sale is not made within 60 days following the date such goods were consigned. Consigned goods returned by the consignee within the 60 day period is not deemed sold; and

(e) Retirement from or cessation of business or death of an individual with respect to all goods on hand, whether capital goods, stock-in-trade, supplies or materials as of the date of such retirement or cessation, whether or not the business is continued by the new owner or successor, estate or heir. The following circumstances shall, among others, give rise to transactions "deemed sale" for the purposes of this Section:

i. Change of ownership of business or incorporation of the business in the case of a single proprietorship;

ii. Dissolution of a partnership and creation of a new partnership which takes over the business; and

`iii. Death of an individual who is a VAT-registered person, even if the estate or heirs of the decedent shall continue to operate the business.

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