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SO ORDERED.

Nachura,[*] *Del Castillo, Abad,* and *Perez, JJ.,* concur.

EN BANC

[G.R. No. 160756. March 9, 2010]

CHAMBER OF REAL ESTATE AND BUILDERS' ASSOCIATIONS, INC., *petitioner, vs.* **THE HON. EXECUTIVE SECRETARY ALBERTO ROMULO, THE HON. ACTING SECRETARY OF FINANCE JUANITA D. AMATONG, and THE HON. COMMISSIONER OF INTERNAL REVENUE GUILLERMO PARAYNO, JR.,** *respondents.*

SYLLABUS

1. **REMEDIAL LAW; CIVIL PROCEDURE; COURTS; JURISDICTION OVER CONSTITUTIONAL QUESTION; REQUISITES.—** Courts will not assume jurisdiction over a constitutional question unless the following requisites are satisfied: (1) there must be an actual case calling for the exercise of judicial review; (2) the question before the court must be ripe for adjudication; (3) the person challenging the validity of the act must have standing to do so; (4) the question of constitutionality must have been raised at the earliest opportunity and (5) the issue of constitutionality must be the very *lis mota* of the case.

2. **ID.; ID.; ID.; ID.; ID.; ACTUAL CASE OR CONTROVERSY, CONSTRUED.—** An actual case or controversy involves a conflict of legal rights or an assertion of opposite legal claims

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[*] Designated additional Member of the Second Division in lieu of Associate Justice Antonio T. Carpio per Raffle dated March 1, 2010.

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which is susceptible of judicial resolution as distinguished from a hypothetical or abstract difference or dispute. On the other hand, a question is considered ripe for adjudication when the act being challenged has a direct adverse effect on the individual challenging it. x x x As we stated in *Didipio Earth-Savers' Multi-Purpose Association, Incorporated (DESAMA) v. Gozun*: By the mere enactment of the questioned law or the approval of the challenged act, the dispute is said to have ripened into a judicial controversy even without any other overt act. Indeed, even a singular violation of the Constitution and/or the law is enough to awaken judicial duty. If the assailed provisions are indeed unconstitutional, there is no better time than the present to settle such question once and for all.

3. ID.; ID.; ID.; ID.; ID.; LEGAL STANDING; DEFINED.— Legal standing or *locus standi* is a party's personal and substantial interest in a case such that it has sustained or will sustain direct injury as a result of the governmental act being challenged. In *Holy Spirit Homeowners Association, Inc. v. Defensor*, we held that the association had legal standing because its members stood to be injured by the enforcement of the assailed provisions: Petitioner association has the legal standing to institute the instant petition x x x. There is no dispute that the individual members of petitioner association are residents of the NGC. As such they are covered and stand to be either benefited or injured by the enforcement of the IRR, particularly as regards the selection process of beneficiaries and lot allocation to qualified beneficiaries. Thus, petitioner association may assail those provisions in the IRR which it believes to be unfavorable to the rights of its members. x x x Certainly, petitioner and its members have sustained direct injury arising from the enforcement of the IRR in that they have been disqualified and eliminated from the selection process.

4. TAXATION; MINIMUM CORPORATE INCOME TAX (MCIT); CONCEPT AND RATIONALE FOR ITS IMPOSITION.— The MCIT on domestic corporations is a new concept introduced by RA 8424 to the Philippine taxation system. It came about as a result of the perceived inadequacy of the self-assessment system in capturing the true income of corporations. It was devised as a relatively simple and effective revenue-raising instrument compared to the normal income tax which is more difficult to control and enforce. It is a means

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to ensure that everyone will make some minimum contribution to the support of the public sector. x x x Congress intended to put a stop to the practice of corporations which, while having large turn-overs, report minimal or negative net income resulting in minimal or zero income taxes year in and year out, through under-declaration of income or over-deduction of expenses otherwise called tax shelters. x x x The MCIT serves to put a cap on such tax shelters. As a tax on gross income, it prevents tax evasion and minimizes tax avoidance schemes achieved through sophisticated and artful manipulations of deductions and other stratagems. Since the tax base was broader, the tax rate was lowered.

5. ID.; TAXES, DEFINED.— Taxes are the lifeblood of the government. Without taxes, the government can neither exist nor endure. The exercise of taxing power derives its source from the very existence of the State whose social contract with its citizens obliges it to promote public interest and the common good.

6. POLITICAL LAW; INHERENT POWERS OF THE STATE; TAXATION; A POWER THAT IS PURELY LEGISLATIVE. — Taxation is an inherent attribute of sovereignty. It is a power that is purely legislative. Essentially, this means that in the legislature primarily lies the discretion to determine the nature (kind), object (purpose), extent (rate), coverage (subjects) and situs (place) of taxation. It has the authority to prescribe a certain tax at a specific rate for a particular public purpose on persons or things within its jurisdiction. In other words, the legislature wields the power to define what tax shall be imposed, why it should be imposed, how much tax shall be imposed, against whom (or what) it shall be imposed and where it shall be imposed. As a general rule, the power to tax is plenary and unlimited in its range, acknowledging in its very nature no limits, so that the principal check against its abuse is to be found only in the responsibility of the legislature (which imposes the tax) to its constituency who are to pay it. Nevertheless, it is circumscribed by constitutional limitations. At the same time, like any other statute, tax legislation carries a presumption of constitutionality.

7. ID.; CONSTITUTIONAL LAW; DUE PROCESS, VIOLATION OF; A TAX MEASURE WHICH AMOUNTS TO A

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CONFISCATION OF PROPERTY.— The constitutional safeguard of due process is embodied in the fiat "[no] person shall be deprived of life, liberty or property without due process of law." In *Sison, Jr. v. Ancheta, et al.*, we held that the due process clause may properly be invoked to invalidate, in appropriate cases, a revenue measure when it amounts to a confiscation of property. But in the same case, we also explained that we will not strike down a revenue measure as unconstitutional (for being violative of the due process clause) on the mere allegation of arbitrariness by the taxpayer. There must be a factual foundation to such an unconstitutional taint. This merely adheres to the authoritative doctrine that, where the due process clause is invoked, considering that it is not a fixed rule but rather a broad standard, there is a need for proof of such persuasive character.

8. TAXATION; INCOME TAX; INCOME, DEFINED; WHEN TAXABLE; REQUISITES.— Income means all the wealth which flows into the taxpayer other than a mere return on capital. Capital is a fund or property existing at one distinct point in time while income denotes a flow of wealth during a definite period of time. Income is gain derived and severed from capital. For income to be taxable, the following requisites must exist: (1) there must be gain; (2) the gain must be realized or received and (3) the gain must not be excluded by law or treaty from taxation. Certainly, an income tax is arbitrary and confiscatory if it taxes capital because capital is not income. In other words, it is income, not capital, which is subject to income tax. However, the MCIT is not a tax on capital.

9. ID.; MINIMUM CORPORATE INCOME TAX (MCIT); NATURE THEREOF, EXPLAINED.— The MCIT is imposed on gross income which is arrived at by deducting the capital spent by a corporation in the sale of its goods, *i.e.*, the cost of goods and other direct expenses from gross sales. Clearly, the capital is not being taxed. Furthermore, the MCIT is not an additional tax imposition. It is imposed **in lieu of** the normal net income tax, and only if the normal income tax is suspiciously low. The MCIT merely approximates the amount of net income tax due from a corporation, pegging the rate at a very much reduced 2% and uses as the base the corporation's gross income. Besides, there is no legal objection to a broader tax base or taxable income by eliminating all deductible items and at the

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same time reducing the applicable tax rate. Statutes taxing the **gross** "receipts," "earnings," or "**income**" **of particular corporations** are found in many jurisdictions. Tax thereon is generally held to be within the power of a state to impose; or constitutional, unless it interferes with interstate commerce or violates the requirement as to uniformity of taxation. xxx Absent any other valid objection, the assignment of gross income, instead of net income, as the tax base of the MCIT, taken with the reduction of the tax rate from 32% to 2%, is not constitutionally objectionable.

10. ID.; WITHHOLDING TAX SYSTEM; CATEGORIZED. – The withholding tax system is a procedure through which taxes (including income taxes) are collected. Under Section 57 of RA 8424, the types of income subject to withholding tax are divided into three categories: (a) withholding of final tax on certain incomes; (b) withholding of creditable tax at source and (c) tax-free covenant bonds. The differences between the two forms of withholding tax, *i.e.*, creditable and final, show that ordinary assets are not treated in the same manner as capital assets. Final withholding tax (FWT) and CWT are distinguished as follows: x x x FWT is imposed on the sale of capital assets. On the other hand, CWT is imposed on the sale of ordinary assets. The inherent and substantial differences between FWT and CWT disprove petitioner's contention that ordinary assets are being lumped together with, and treated similarly as, capital assets in contravention of the pertinent provisions of RA 8424. The fact that the tax is withheld at source does not automatically mean that it is treated exactly the same way as capital gains. As aforementioned, the mechanics of the FWT are distinct from those of the CWT. The withholding agent/buyer's act of collecting the tax at the time of the transaction by withholding the tax due from the income payable is the essence of the withholding tax method of tax collection.

11. ID.; ID.; AUTHORITY OF THE SECRETARY OF FINANCE TO PROMULGATE RULES AND REGULATIONS TO EFFECT LAW ENFORCEMENT.— The Secretary of Finance is granted, under Section 244 of RA 8424, the authority to promulgate the necessary rules and regulations for the effective enforcement of the provisions of the law. Such authority is subject to the limitation that the rules and regulations must not override, but must remain consistent and in harmony with,

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the law they seek to apply and implement. It is well-settled that an administrative agency cannot amend an act of Congress. x x x Respondent Secretary has the authority to require the withholding of a tax on items of income payable to any person, national or juridical, residing in the Philippines. Such authority is derived from Section 57(B) of RA 8424 which provides: SEC. 57. *Withholding of Tax at Source*. – x x x (B) *Withholding of Creditable Tax at Source*. The [Secretary] may, upon the recommendation of the [CIR], require the withholding of a tax on the items of income payable to natural or juridical persons, residing in the Philippines, by payor-corporation/persons as provided for by law, at the rate of not less than one percent (1%) but not more than thirty-two percent (32%) thereof, which shall be credited against the income tax liability of the taxpayer for the taxable year. The questioned provisions of RR 2-98, as amended, are well within the authority given by Section 57(B) to the Secretary, *i.e.*, the graduated rate of 1.5%-5% is between the 1%-32% range; the withholding tax is imposed on the income payable and the tax is creditable against the income tax liability of the taxpayer for the taxable year.

12. ID.; ID.; REASON FOR CREATION.— We have long recognized that the method of withholding tax at source is a procedure of collecting income tax which is sanctioned by our tax laws. The withholding tax system was devised for three primary reasons: first, to provide the taxpayer a convenient manner to meet his probable income tax liability; second, to ensure the collection of income tax which can otherwise be lost or substantially reduced through failure to file the corresponding returns and third, to improve the government's cash flow. This results in administrative savings, prompt and efficient collection of taxes, prevention of delinquencies and reduction of governmental effort to collect taxes through more complicated means and remedies.

13. POLITICAL LAW; CONSTITUTIONAL LAW; BILL OF RIGHTS; EQUAL PROTECTION CLAUSE; DEFINED AND CONSTRUED.— The equal protection clause under the Constitution means that "no person or class of persons shall be deprived of the same protection of laws which is enjoyed by other persons or other classes in the same place and in like circumstances." Stated differently, all persons belonging to the same class shall be taxed alike. It follows that the guaranty

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of the equal protection of the laws is not violated by legislation based on a reasonable classification. Classification, to be valid, must (1) rest on substantial distinctions; (2) be germane to the purpose of the law; (3) not be limited to existing conditions only and (4) apply equally to all members of the same class.

APPEARANCES OF COUNSEL

Isagani A. Cruz for petitioner.
The Solicitor General for respondents.

D E C I S I O N

CORONA, *J.*:

In this original petition for *certiorari* and *mandamus*,[1] petitioner Chamber of Real Estate and Builders' Associations, Inc. is questioning the constitutionality of Section 27 (E) of Republic Act (RA) 8424[2] and the revenue regulations (RRs) issued by the Bureau of Internal Revenue (BIR) to implement said provision and those involving creditable withholding taxes.[3]

Petitioner is an association of real estate developers and builders in the Philippines. It impleaded former Executive Secretary Alberto Romulo, then acting Secretary of Finance Juanita D. Amatong and then Commissioner of Internal Revenue Guillermo Parayno, Jr. as respondents.

Petitioner assails the validity of the imposition of minimum corporate income tax (MCIT) on corporations and creditable withholding tax (CWT) on sales of real properties classified as ordinary assets.

Section 27(E) of RA 8424 provides for MCIT on domestic corporations and is implemented by RR 9-98. Petitioner argues

[1] Under Rule 65 of the Rules of Court.

[2] The National Internal Revenue Code of 1997.

[3] In particular, these are Section 2.27 (E), Section 2.57.2 (J) (as amended by RR 6-2001) and Section 2.58.2 of RR 2-98 and Section 4 (a) (ii) and (c) (ii) of RR-7-2003.

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that the MCIT violates the due process clause because it levies income tax even if there is no realized gain.

Petitioner also seeks to nullify Sections 2.57.2(J) (as amended by RR 6-2001) and 2.58.2 of RR 2-98, and Section 4(a)(ii) and (c)(ii) of RR 7-2003, all of which prescribe the rules and procedures for the collection of CWT on the sale of real properties categorized as ordinary assets. Petitioner contends that these revenue regulations are contrary to law for two reasons: *first*, they ignore the different treatment by RA 8424 of ordinary assets and capital assets and *second*, respondent Secretary of Finance has no authority to collect CWT, much less, to base the CWT on the gross selling price or fair market value of the real properties classified as ordinary assets.

Petitioner also asserts that the enumerated provisions of the subject revenue regulations violate the due process clause because, like the MCIT, the government collects income tax even when the net income has not yet been determined. They contravene the equal protection clause as well because the CWT is being levied upon real estate enterprises but not on other business enterprises, more particularly those in the manufacturing sector.

The issues to be resolved are as follows:

(1) whether or not this Court should take cognizance of the present case;

(2) whether or not the imposition of the MCIT on domestic corporations is unconstitutional and

(3) whether or not the imposition of CWT on income from sales of real properties classified as ordinary assets under RRs 2-98, 6-2001 and 7-2003, is unconstitutional.

OVERVIEW OF THE ASSAILED PROVISIONS

Under the MCIT scheme, a corporation, beginning on its fourth year of operation, is assessed an MCIT of 2% of its gross income when such MCIT is greater than the normal corporate income tax imposed under Section 27(A).[4] If the regular

[4] Applying the 32% tax rate to net income.

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income tax is higher than the MCIT, the corporation does not pay the MCIT. Any excess of the MCIT over the normal tax shall be carried forward and credited against the normal income tax for the three immediately succeeding taxable years. Section 27(E) of RA 8424 provides:

> Section 27 (E). [MCIT] on Domestic Corporations.—
>
> (1) Imposition of Tax. – A [MCIT] of two percent (2%) of the gross income as of the end of the taxable year, as defined herein, is hereby imposed on a corporation taxable under this Title, beginning on the fourth taxable year immediately following the year in which such corporation commenced its business operations, when the minimum income tax is greater than the tax computed under Subsection (A) of this Section for the taxable year.
>
> (2) Carry Forward of Excess Minimum Tax. – Any excess of the [MCIT] over the normal income tax as computed under Subsection (A) of this Section shall be carried forward and credited against the normal income tax for the three (3) immediately succeeding taxable years.
>
> (3) Relief from the [MCIT] under certain conditions. – The Secretary of Finance is hereby authorized to suspend the imposition of the [MCIT] on any corporation which suffers losses on account of prolonged labor dispute, or because of *force majeure*, or because of legitimate business reverses.
>
> The Secretary of Finance is hereby authorized to promulgate, upon recommendation of the Commissioner, the necessary rules and regulations that shall define the terms and conditions under which he may suspend the imposition of the [MCIT] in a meritorious case.
>
> (4) Gross Income Defined. – For purposes of applying the [MCIT] provided under Subsection (E) hereof, the term 'gross income' shall mean gross sales less sales returns, discounts and allowances and cost of goods sold. "Cost of goods sold" shall include all business expenses directly incurred to produce the merchandise to bring them to their present location and use.
>
> For trading or merchandising concern, "cost of goods sold" shall include the invoice cost of the goods sold, plus

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import duties, freight in transporting the goods to the place where the goods are actually sold including insurance while the goods are in transit.

For a manufacturing concern, "cost of goods manufactured and sold" shall include all costs of production of finished goods, such as raw materials used, direct labor and manufacturing overhead, freight cost, insurance premiums and other costs incurred to bring the raw materials to the factory or warehouse.

In the case of taxpayers engaged in the sale of service, "gross income" means gross receipts less sales returns, allowances, discounts and cost of services. "Cost of services" shall mean all direct costs and expenses necessarily incurred to provide the services required by the customers and clients including (A) salaries and employee benefits of personnel, consultants and specialists directly rendering the service and (B) cost of facilities directly utilized in providing the service such as depreciation or rental of equipment used and cost of supplies: Provided, however, that in the case of banks, "cost of services" shall include interest expense.

On August 25, 1998, respondent Secretary of Finance (Secretary), on the recommendation of the Commissioner of Internal Revenue (CIR), promulgated RR 9-98 implementing Section 27(E).[5] The pertinent portions thereof read:

Sec. 2.27(E) [MCIT] on Domestic Corporations. –

(1) Imposition of the Tax. – A [MCIT] of two percent (2%) of the gross income as of the end of the taxable year (whether calendar or fiscal year, depending on the accounting period employed) is hereby imposed upon any domestic corporation beginning the fourth (4th) taxable year immediately following the taxable year in which such corporation commenced its business operations. The MCIT shall be imposed whenever such corporation has zero or negative taxable income or whenever the amount of minimum corporate income tax is

[5] Implementing [RA 8424], "An Act Amending the National Internal Revenue Code, as amended" Relative to the Imposition of the [MCIT] on Domestic Corporations and Resident Foreign Corporations.

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greater than the normal income tax due from such corporation.

For purposes of these Regulations, the term, "normal income tax" means the income tax rates prescribed under Sec. 27(A) and Sec. 28(A)(1) of the Code xxx at 32% effective January 1, 2000 and thereafter.

xxx xxx xxx

(2) Carry forward of excess [MCIT]. – Any excess of the [MCIT] over the normal income tax as computed under Sec. 27(A) of the Code shall be carried forward on an annual basis and credited against the normal income tax for the three (3) immediately succeeding taxable years.

xxx xxx xxx

Meanwhile, on April 17, 1998, respondent Secretary, upon recommendation of respondent CIR, promulgated RR 2-98 implementing certain provisions of RA 8424 involving the withholding of taxes.[6] Under Section 2.57.2(J) of RR No. 2-98, income payments from the sale, exchange or transfer of real property, other than capital assets, by persons residing in the Philippines and habitually engaged in the real estate business were subjected to CWT:

Sec. 2.57.2. Income payment subject to [CWT] and rates prescribed thereon:

xxx xxx xxx

(J) Gross selling price or total amount of consideration or its equivalent paid to the seller/owner for the sale, exchange or transfer of. – Real property, other than capital assets, sold by an individual, corporation, estate, trust, trust fund or pension fund and the seller/transferor is habitually engaged in the real estate in accordance with the following schedule—

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[6] Implementing [RA 8424] relative to the Withholding on Income subject to the Expanded Withholding Tax and Final Withholding Tax, Withholding of Income Tax on Compensation, Withholding of Creditable Value-Added Tax and Other Percentage Taxes.

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Those which are exempt from a withholding tax at source as prescribed in Sec. 2.57.5 of these regulations.	Exempt
With a selling price of five hundred thousand pesos (₱500,000.00) or less.	1.5%
With a selling price of more than five hundred thousand pesos (₱500,000.00) but not more than two million pesos (₱2,000,000.00).	3.0%
With selling price of more than two million pesos (₱2,000,000.00)	5.0%

xxx xxx xxx

Gross selling price shall mean the consideration stated in the sales document or the fair market value determined in accordance with Section 6 (E) of the Code, as amended, whichever is higher. In an exchange, the fair market value of the property received in exchange, as determined in the Income Tax Regulations shall be used.

Where the consideration or part thereof is payable on installment, no withholding tax is required to be made on the periodic installment payments where the buyer is an individual not engaged in trade or business. In such a case, the applicable rate of tax based on the entire consideration shall be withheld on the last installment or installments to be paid to the seller.

However, if the buyer is engaged in trade or business, whether a corporation or otherwise, the tax shall be deducted and withheld by the buyer on every installment.

This provision was amended by RR 6-2001 on July 31, 2001:

Sec. 2.57.2. Income payment subject to [CWT] and rates prescribed thereon:

xxx xxx xxx

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(J) Gross selling price or total amount of consideration or its equivalent paid to the seller/owner for the sale, exchange or transfer of real property classified as ordinary asset.— A [CWT] based on the gross selling price/total amount of consideration or the fair market value determined in accordance with Section 6(E) of the Code, whichever is higher, paid to the seller/owner for the sale, transfer or exchange of real property, other than capital asset, shall be imposed upon the withholding agent,/buyer, in accordance with the following schedule:

Where the seller/transferor is exempt from [CWT] in accordance with Sec. 2.57.5 of these regulations.	Exempt
Upon the following values of real property, where the seller/transferor is habitually engaged in the real estate business.	
With a selling price of Five Hundred Thousand Pesos (₱500,000.00) or less.	15%
With a selling price of more than Five Hundred Thousand Pesos (₱500,000.00) but not more than Two Million Pesos (₱2,000,000.00).	3.0%
With a selling price of more than two Million Pesos (₱2,000,000.00).	5.0%

xxx xxx xxx

Gross selling price shall remain the consideration stated in the sales document or the fair market value determined in accordance with Section 6 (E) of the Code, as amended, whichever is higher. In an exchange, the fair market value of the property received in exchange shall be considered as the consideration.

xxx xxx xxx

However, if the buyer is engaged in trade or business, whether a corporation or otherwise, these rules shall apply:

(i) If the sale is a sale of property on the installment plan (that is, payments in the year of sale do not exceed 25% of the selling price), the tax shall be deducted and withheld by the

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buyer on every installment.

(ii) If, on the other hand, the sale is on a "cash basis" or is a "deferred-payment sale not on the installment plan" (that is, payments in the year of sale exceed 25% of the selling price), the buyer shall withhold the tax based on the gross selling price or fair market value of the property, whichever is higher, on the first installment.

In any case, no Certificate Authorizing Registration (CAR) shall be issued to the buyer unless the [CWT] due on the sale, transfer or exchange of real property other than capital asset has been fully paid. (Underlined amendments in the original)

Section 2.58.2 of RR 2-98 implementing Section 58(E) of RA 8424 provides that any sale, barter or exchange subject to the CWT will not be recorded by the Registry of Deeds until the CIR has certified that such transfers and conveyances have been reported and the taxes thereof have been duly paid:[7]

Sec. 2.58.2. Registration with the Register of Deeds. – Deeds of conveyances of land or land and building/improvement thereon arising from sales, barters, or exchanges subject to the creditable expanded withholding tax shall not be recorded by the Register of Deeds unless the [CIR] or his duly authorized representative has certified that such transfers and conveyances have been reported and the expanded withholding tax, inclusive of the documentary stamp tax, due thereon have been fully paid xxx.

On February 11, 2003, RR No. 7-2003[8] was promulgated, providing for the guidelines in determining whether a particular real property is a capital or an ordinary asset for purposes of imposing the MCIT, among others. The pertinent portions thereof state:

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[7] This Certificate is commonly known as the "CAR" or the "certificate authorizing registration."

[8] Providing the Guidelines in Determining Whether a Particular Real Property Is a Capital Asset or an Ordinary Asset Pursuant to Section 39(A)(1) of the National Internal Revenue Code of 1997 for Purposes of Imposing the Capital Gains Tax under Sections 24(D), 25(A)(3), 25(B) and 27(D)(5), or the Ordinary Income Tax under Sections 24(A), 25(A) & (B), 27(A), 28(A)(1) and 28(B)(1), or the [MCIT] under Sections 27(E) and 28(A)(2) of the same Code.

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Section 4. Applicable taxes on sale, exchange or other disposition of real property. — Gains/Income derived from sale, exchange, or other disposition of real properties shall, unless otherwise exempt, be subject to applicable taxes imposed under the Code, depending on whether the subject properties are classified as capital assets or ordinary assets;

a. In the case of individual citizen (including estates and trusts), resident aliens, and non-resident aliens engaged in trade or business in the Philippines;

xxx xxx xxx

(ii) The sale of real property located in the Philippines, classified as ordinary assets, shall be subject to the [CWT] (expanded) under Sec. 2.57..2(J) of [RR 2-98], as amended, based on the gross selling price or current fair market value as determined in accordance with Section 6(E) of the Code, whichever is higher, and consequently, to the ordinary income tax imposed under Sec. 24(A)(1)(c) or 25(A)(1) of the Code, as the case may be, based on net taxable income.

xxx xxx xxx

c. In the case of domestic corporations. –

xxx xxx xxx

(ii) The sale of land and/or building classified as ordinary asset and other real property (other than land and/or building treated as capital asset), regardless of the classification thereof, all of which are located in the Philippines, shall be subject to the [CWT] (expanded) under Sec. 2.57.2(J) of [RR 2-98], as amended, and consequently, to the ordinary income tax under Sec. 27(A) of the Code. In lieu of the ordinary income tax, however, domestic corporations may become subject to the [MCIT] under Sec. 27(E) of the Code, whichever is applicable.

xxx xxx xxx

We shall now tackle the issues raised.

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EXISTENCE OF A JUSTICIABLE CONTROVERSY

Courts will not assume jurisdiction over a constitutional question unless the following requisites are satisfied: (1) there must be an actual case calling for the exercise of judicial review; (2) the question before the court must be ripe for adjudication; (3) the person challenging the validity of the act must have standing to do so; (4) the question of constitutionality must have been raised at the earliest opportunity and (5) the issue of constitutionality must be the very *lis mota* of the case.[9]

Respondents aver that the first three requisites are absent in this case. According to them, there is no actual case calling for the exercise of judicial power and it is not yet ripe for adjudication because

> [petitioner] did not allege that CREBA, as a corporate entity, or any of its members, has been assessed by the BIR for the payment of [MCIT] or [CWT] on sales of real property. Neither did petitioner allege that its members have shut down their businesses as a result of the payment of the MCIT or CWT. Petitioner has raised concerns in mere abstract and hypothetical form without any actual, specific and concrete instances cited that the assailed law and revenue regulations have actually and adversely affected it. Lacking empirical data on which to base any conclusion, any discussion on the constitutionality of the MCIT or CWT on sales of real property is essentially an academic exercise.
>
> Perceived or alleged hardship to taxpayers alone is not an adequate justification for adjudicating abstract issues. Otherwise, adjudication would be no different from the giving of advisory opinion that does not really settle legal issues.[10]

An actual case or controversy involves a conflict of legal rights or an assertion of opposite legal claims which is susceptible of judicial resolution as distinguished from a hypothetical or

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[9] *Jumamil v. Cafe*, G.R. No. 144570, 21 September 2005, 470 SCRA 475, 486-487. Citations omitted.

[10] *Rollo*, pp. 172-173.

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abstract difference or dispute.[11] On the other hand, a question is considered ripe for adjudication when the act being challenged has a direct adverse effect on the individual challenging it.[12]

Contrary to respondents' assertion, we do not have to wait until petitioner's members have shut down their operations as a result of the MCIT or CWT. The assailed provisions are already being implemented. As we stated in *Didipio Earth-Savers' Multi-Purpose Association, Incorporated (DESAMA) v. Gozun*:[13]

> By the mere enactment of the questioned law or the approval of the challenged act, the dispute is said to have ripened into a judicial controversy even without any other overt act. Indeed, even a singular violation of the Constitution and/or the law is enough to awaken judicial duty.[14]

If the assailed provisions are indeed unconstitutional, there is no better time than the present to settle such question once and for all.

Respondents next argue that petitioner has no legal standing to sue:

> Petitioner is an association of some of the real estate developers and builders in the Philippines. Petitioners did not allege that [it] itself is in the real estate business. It did not allege any material interest or any wrong that it may suffer from the enforcement of [the assailed provisions].[15]

Legal standing or *locus standi* is a party's personal and substantial interest in a case such that it has sustained or will

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[11] *Didipio Earth-Savers' Multi-Purpose Association, Incorporated (DESAMA) v. Gozun*, G.R. No. 157882, 30 March 2006, 485 SCRA 586, 598-599, citing *Board of Optometry v. Hon. Colet*, 328 Phil. 1187, 1206 (1996).

[12] *Id.*, citing *Integrated Bar of the Philippines v. Zamora*, 392 Phil. 618, 632-633 (2000).

[13] *Id.*

[14] *Id.*, p. 600, citing *Pimentel, Jr. v. Hon. Aguirre*, 391 Phil. 84, 107 (2000).

[15] *Rollo*, pp. 170-171.

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sustain direct injury as a result of the governmental act being challenged.[16] In *Holy Spirit Homeowners Association, Inc. v. Defensor*,[17] we held that the association had legal standing because its members stood to be injured by the enforcement of the assailed provisions:

> Petitioner association has the legal standing to institute the instant petition xxx. There is no dispute that the individual members of petitioner association are residents of the NGC. As such they are covered and stand to be either benefited or injured by the enforcement of the IRR, particularly as regards the selection process of beneficiaries and lot allocation to qualified beneficiaries. Thus, petitioner association may assail those provisions in the IRR which it believes to be unfavorable to the rights of its members. xxx Certainly, petitioner and its members have sustained direct injury arising from the enforcement of the IRR in that they have been disqualified and eliminated from the selection process.[18]

In any event, this Court has the discretion to take cognizance of a suit which does not satisfy the requirements of an actual case, ripeness or legal standing when paramount public interest is involved.[19] The questioned MCIT and CWT affect not only petitioners but practically all domestic corporate taxpayers in our country. The transcendental importance of the issues raised and their overreaching significance to society make it proper for us to take cognizance of this petition.[20]

CONCEPT AND RATIONALE OF THE MCIT

The MCIT on domestic corporations is a new concept introduced by RA 8424 to the Philippine taxation system. It came about as a result of the perceived inadequacy of the self-

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[16] *People v. Vera*, 65 Phil. 56, 89 (1937).

[17] G.R. No. 163980, 3 August 2006, 497 SCRA 581.

[18] *Id.*, pp. 591-592.

[19] *Joya v. Presidential Commission on Good Governance*, G.R. No. 96541, 24 August 1993, 225 SCRA 568, 579, citing *Dumlao v. COMELEC*, G.R. No. 50245, 22 January 1980, 95 SCRA 392.

[20] *Supra* note 11, p. 600. *Automotive Industry Workers Alliance (AIWA) v. Romulo*, G.R. No. 157509, 18 January 2005, 449 SCRA 1, 11, citations omitted.

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assessment system in capturing the true income of corporations.[21] It was devised as a relatively simple and effective revenue-raising instrument compared to the normal income tax which is more difficult to control and enforce. It is a means to ensure that everyone will make some minimum contribution to the support of the public sector. The congressional deliberations on this are illuminating:

> Senator Enrile. Mr. President, we are not unmindful of the practice of certain corporations of reporting constantly a loss in their operations to avoid the payment of taxes, and thus avoid sharing in the cost of government. In this regard, the Tax Reform Act introduces for the first time a new concept called the [MCIT] so as to minimize tax evasion, tax avoidance, tax manipulation in the country and for administrative convenience. … This will go a long way in ensuring that corporations will pay their just share in supporting our public life and our economic advancement.[22]

Domestic corporations owe their corporate existence and their privilege to do business to the government. They also benefit from the efforts of the government to improve the financial market and to ensure a favorable business climate. It is therefore fair for the government to require them to make a reasonable contribution to the public expenses.

Congress intended to put a stop to the practice of corporations which, while having large turn-overs, report minimal or negative net income resulting in minimal or zero income taxes year in and year out, through under-declaration of income or over-deduction of expenses otherwise called tax shelters.[23]

> Mr. Javier (E.) … [This] is what the Finance Dept. is trying to remedy, that is why they have proposed the [MCIT]. Because from experience too, you have corporations which have been losing year in and year

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[21] R. T. Dascil, *The National Internal Revenue Code 88* (2003).

[22] Senate Deliberations, Sponsorship Speech of Senator Juan Ponce Enrile, July 30, 1997, p. 41.

[23] Transcript, House of Representatives Committee on Ways and Means hearing, April 23, 1997, pp. 53-61; Oct. 9, 1997, pp. 95-99; Oct. 10, 1997, pp. 11-14.

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out and paid no tax. So, if the corporation has been losing for the past five years to ten years, then that corporation has no business to be in business. It is dead. Why continue if you are losing year in and year out? So, we have this provision to avoid this type of tax shelters, Your Honor.[24]

The primary purpose of any legitimate business is to earn a profit. Continued and repeated losses after operations of a corporation or consistent reports of minimal net income render its financial statements and its tax payments suspect. For sure, certain tax avoidance schemes resorted to by corporations are allowed in our jurisdiction. The MCIT serves to put a cap on such tax shelters. As a tax on gross income, it prevents tax evasion and minimizes tax avoidance schemes achieved through sophisticated and artful manipulations of deductions and other stratagems. Since the tax base was broader, the tax rate was lowered.

To further emphasize the corrective nature of the MCIT, the following safeguards were incorporated into the law:

First, recognizing the birth pangs of businesses and the reality of the need to recoup initial major capital expenditures, the imposition of the MCIT commences only on the fourth taxable year immediately following the year in which the corporation commenced its operations.[25] This grace period allows a new business to stabilize first and make its ventures viable before it is subjected to the MCIT.[26]

Second, the law allows the carrying forward of any excess of the MCIT paid over the normal income tax which shall be credited against the normal income tax for the three immediately succeeding years.[27]

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[24] *Id.*, April 23, 1997, p. 53.

[25] RA 8424, Section 27(E)(1).

[26] *Manila Banking Corporation v. CIR*, C.T.A. Case No. 6442, 21 April 2003.

[27] RA 8424, Section 27(E)(2).

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Third, since certain businesses may be incurring genuine repeated losses, the law authorizes the Secretary of Finance to suspend the imposition of MCIT if a corporation suffers losses due to prolonged labor dispute, *force majeure* and legitimate business reverses.[28]

Even before the legislature introduced the MCIT to the Philippine taxation system, several other countries already had their own system of minimum corporate income taxation. Our lawmakers noted that most developing countries, particularly Latin American and Asian countries, have the same form of safeguards as we do. As pointed out during the committee hearings:

> [Mr. Medalla:] Note that most developing countries where you have of course quite a bit of room for underdeclaration of gross receipts have this same form of safeguards.
>
> In the case of Thailand, half a percent (0.5%), there's a minimum of income tax of half a percent (0.5%) of gross assessable income. In Korea a 25% of taxable income before deductions and exemptions. Of course the different countries have different basis for that minimum income tax.
>
> The other thing you'll notice is the preponderance of Latin American countries that employed this method. Okay, those are additional Latin American countries.[29]

At present, the United States of America, Mexico, Argentina, Tunisia, Panama and Hungary have their own versions of the MCIT.[30]

MCIT IS NOT VIOLATIVE OF DUE PROCESS

Petitioner claims that the MCIT under Section 27(E) of RA 8424 is unconstitutional because it is highly oppressive,

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[28] *Id.*, Section 27(E)(3). The mechanism for the availment of the exemption has been spelled out in Section 2.27(E)(3) in relation to Section 2.27(E)(4)(b)(c) and (d) of RR 9-98.

[29] Transcript of the House Committee Meeting on Ways and Means hearing, Feb. 20, 1996, p. 24.

[30] KPMG's Corporate and Indirect Tax Rate Survey 2009.

<http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/KPMG-Corporate-Indirect-Tax-Rate-Survey-2009.pdf> March 1, 2010 [17, 22, 25-26, 29-30].

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arbitrary and confiscatory which amounts to deprivation of property without due process of law. It explains that gross income as defined under said provision only considers the cost of goods sold and other direct expenses; other major expenditures, such as administrative and interest expenses which are equally necessary to produce gross income, were not taken into account.[31] Thus, pegging the tax base of the MCIT to a corporation's gross income is tantamount to a confiscation of capital because gross income, unlike net income, is not "realized gain."[32]

We disagree.

Taxes are the lifeblood of the government. Without taxes, the government can neither exist nor endure. The exercise of taxing power derives its source from the very existence of the State whose social contract with its citizens obliges it to promote public interest and the common good.[33]

Taxation is an inherent attribute of sovereignty.[34] It is a power that is purely legislative.[35] Essentially, this means that in the legislature primarily lies the discretion to determine the nature (kind), object (purpose), extent (rate), coverage (subjects) and situs (place) of taxation.[36] It has the authority to prescribe a certain tax at a specific rate for a particular public purpose on persons or things within its jurisdiction. In other words, the legislature wields the power to define what tax shall be imposed, why it should be imposed, how much tax shall be imposed, against whom (or what) it shall be imposed and where it shall be imposed.

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[31] *Rollo*, p. 8.

[32] *Id.*, p. 7.

[33] *National Power Corporation v. City of Cabanatuan*, G.R. No. 149110, 9 April 2003, 401 SCRA 259, 270.

[34] *Pepsi Cola Bottling Co. of the Philippines, Inc. v. Municipality of Tanauan, Leyte*, G.R. No. L-31156, 27 February 1976, 69 SCRA 460, 465, citing Cooley, *The Law of Taxation*, Vol. 1, Fourth Edition, 149-150.

[35] *Id.*

[36] *Commissioner of Internal Revenue v. Santos*, G.R. No. 119252, 18 August 1997, 277 SCRA 617, 631.

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As a general rule, the power to tax is plenary and unlimited in its range, acknowledging in its very nature no limits, so that the principal check against its abuse is to be found only in the responsibility of the legislature (which imposes the tax) to its constituency who are to pay it.[37] Nevertheless, it is circumscribed by constitutional limitations. At the same time, like any other statute, tax legislation carries a presumption of constitutionality.

The constitutional safeguard of due process is embodied in the fiat "[no] person shall be deprived of life, liberty or property without due process of law." In *Sison, Jr. v. Ancheta, et al.*,[38] we held that the due process clause may properly be invoked to invalidate, in appropriate cases, a revenue measure[39] when it amounts to a confiscation of property.[40] But in the same case, we also explained that we will not strike down a revenue measure as unconstitutional (for being violative of the due process clause) on the mere allegation of arbitrariness by the taxpayer.[41] There must be a factual foundation to such an unconstitutional taint.[42] This merely adheres to the authoritative doctrine that, where the due process clause is invoked, considering that it is not a fixed rule but rather a broad standard, there is a need for proof of such persuasive character.[43]

Petitioner is correct in saying that income is distinct from capital.[44] Income means all the wealth which flows into the taxpayer other than a mere return on capital. Capital is a fund or property existing at one distinct point in time while income denotes a flow of wealth during a definite period of time.[45]

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[37] *MCIAA v. Marcos*, 330 Phil. 392, 404 (1996).

[38] 215 Phil. 582 (1984).

[39] *Id.*, pp. 587-588.

[40] *Id.*, p. 589.

[41] *Id.*, p. 588.

[42] *Id*.

[43] *Id.*, pp. 588-589.

[44] See *Madrigal and Paterno v. Rafferty and Concepcion*, 38 Phil. 414, 418-419 (1918).

[45] *Id*.

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Income is gain derived and severed from capital.[46] For income to be taxable, the following requisites must exist:

(1) there must be gain;

(2) the gain must be realized or received and

(3) the gain must not be excluded by law or treaty from taxation.[47]

Certainly, an income tax is arbitrary and confiscatory if it taxes capital because capital is not income. In other words, it is income, not capital, which is subject to income tax. However, the MCIT is not a tax on capital.

The MCIT is imposed on gross income which is arrived at by deducting the capital spent by a corporation in the sale of its goods, *i.e.*, the cost of goods[48] and other direct expenses from gross sales. Clearly, the capital is not being taxed.

Furthermore, the MCIT is not an additional tax imposition. It is imposed **in lieu of** the normal net income tax, and only if the normal income tax is suspiciously low. The MCIT merely approximates the amount of net income tax due from a corporation, pegging the rate at a very much reduced 2% and uses as the base the corporation's gross income.

Besides, there is no legal objection to a broader tax base or taxable income by eliminating all deductible items and at the same time reducing the applicable tax rate.[49]

Statutes taxing the **gross** "receipts," "earnings," or "**income**" **of particular corporations** are found in many jurisdictions. Tax thereon is generally held to be within the power of a state to impose; or

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[46] *Commissioner of Internal Revenue v. Court of Appeals*, G.R. No. 108576, 20 January 1999, 301 SCRA 152, 173.

[47] *Id.*, p. 181.

[48] Or "cost of goods manufactured and sold" or "cost of services."

[49] *Sison v. Ancheta, et al., supra* note 38, p. 591.

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constitutional, unless it interferes with interstate commerce or violates the requirement as to uniformity of taxation.[50]

The United States has a similar alternative minimum tax (AMT) system which is generally characterized by a lower tax rate but a broader tax base.[51] Since our income tax laws are of American origin, interpretations by American courts of our parallel tax laws have persuasive effect on the interpretation of these laws.[52] Although our MCIT is not exactly the same as the AMT, the policy behind them and the procedure of their implementation are comparable. On the question of the AMT's constitutionality, the United States Court of Appeals for the Ninth Circuit stated in *Okin v. Commissioner*:[53]

> In enacting the minimum tax, Congress attempted to remedy general taxpayer distrust of the system growing from large numbers of taxpayers with large incomes who were yet paying no taxes.
>
> xxx xxx xxx
>
> We thus join a number of other courts in upholding the constitutionality of the [AMT]. xxx [It] is a rational means of obtaining a broad-based tax, and therefore is constitutional.[54]

The U.S. Court declared that the congressional intent to ensure that corporate taxpayers would contribute a minimum amount of taxes was a legitimate governmental end to which the AMT bore a reasonable relation.[55]

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[50] *Commissioner of Internal Revenue v. Solidbank Corporation*, G.R. No. 148191, 25 November 2003, 416 SCRA 436, 454-455, citing Cooley, *The Law on Taxation*, Vol. II, 1786-1790 (1924) and *State v. Illinois Cent. R. Co.*, 92 NE 848, 28 October 14910.

[51] *Supra* note 30.

[52] *Bañas v. Court of Appeals*, G.R. No. 102967, 10 February 2000, 325 SCRA 259, 279, citations omitted.

[53] 808 F. 2d 1338 (9th Cir. 1987). See also *Freeman v. Commissioner*, T.C. Memo. 2001-254 (U.S. Tax Court, 2001); *Wyly v. United States*, 662 F. 2d 784 (5th Cir. 1982); *Klaasen v. Commissioner*, No. 98-9035 (10th Cir. 1999).

[54] *Id.*, p. 1342.

[55] *Id.*

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American courts have also emphasized that Congress has the power to condition, limit or deny deductions from gross income in order to arrive at the net that it chooses to tax.[56] This is because deductions are a matter of legislative grace.[57]

Absent any other valid objection, the assignment of gross income, instead of net income, as the tax base of the MCIT, taken with the reduction of the tax rate from 32% to 2%, is not constitutionally objectionable.

Moreover, petitioner does not cite any actual, specific and concrete negative experiences of its members nor does it present empirical data to show that the implementation of the MCIT resulted in the confiscation of their property.

In sum, petitioner failed to support, by any factual or legal basis, its allegation that the MCIT is arbitrary and confiscatory. The Court cannot strike down a law as unconstitutional simply because of its yokes.[58] Taxation is necessarily burdensome because, by its nature, it adversely affects property rights.[59] The party alleging the law's unconstitutionality has the burden to demonstrate the supposed violations in understandable terms.[60]

RR 9-98 MERELY CLARIFIES SECTION 27(E) OF RA 8424

Petitioner alleges that RR 9-98 is a deprivation of property without due process of law because the MCIT is being imposed and collected even when there is actually a loss, or a zero or negative taxable income:

Sec. 2.27(E) [MCIT] on Domestic Corporations. —

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[56] *Helvering v. Independent Life Insurance Co.*, 292 U.S. 371, 381 (1934), citing *Burnet v. Thompson Oil & Gas Co.*, 283 U.S. 301; *Stanton v. Baltic Mining Co.*, 240 U.S. 103 and *Brushaber v. Union Pac. R. Co.*, 240 U.S. 1.

[57] *New Colonial Ice v. Helvering*, 292 U.S. 435, 440 (1934).

[58] *Abakada Guro Party List v. Ermita*, G.R. No. 168056, 1 September 2005, 469 SCRA 1, 145.

[59] *Id.*, separate opinion of Justice Tinga, pp. 275-276.

[60] *Id.*, p. 277.

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(1) Imposition of the Tax. — xxx The MCIT shall be imposed whenever such corporation has **zero or negative taxable income** or whenever the amount of [MCIT] is greater than the normal income tax due from such corporation. (Emphasis supplied)

RR 9-98, in declaring that MCIT should be imposed whenever such corporation has zero or negative taxable income, merely defines the coverage of Section 27(E). This means that even if a corporation incurs a net loss in its business operations or reports zero income after deducting its expenses, it is still subject to an MCIT of 2% of its gross income. This is consistent with the law which imposes the MCIT on gross income notwithstanding the amount of the net income. But the law also states that the MCIT is to be paid only if it is greater than the normal net income. Obviously, it may well be the case that the MCIT would be less than the net income of the corporation which posts a zero or negative taxable income.

We now proceed to the issues involving the CWT.

The withholding tax system is a procedure through which taxes (including income taxes) are collected.[61] Under Section 57 of RA 8424, the types of income subject to withholding tax are divided into three categories: (a) withholding of final tax on certain incomes; (b) withholding of creditable tax at source and (c) tax-free covenant bonds. Petitioner is concerned with the second category (CWT) and maintains that the revenue regulations on the collection of CWT on sale of real estate categorized as ordinary assets are unconstitutional.

Petitioner, after enumerating the distinctions between capital and ordinary assets under RA 8424, contends that Sections 2.57.2(J) and 2.58.2 of RR 2-98 and Sections 4(a)(ii) and (c)(ii) of RR 7-2003 were promulgated "with grave abuse of discretion amounting to lack of jurisdiction" and "patently in contravention of law"[62] because they ignore such distinctions. Petitioner's conclusion is based on the following premises: (a) the revenue regulations use gross selling price (GSP) or fair market value

[61] BIR Ruling No. 018-03, November 24, 2003.

[62] *Rollo*, p. 13.

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(FMV) of the real estate as basis for determining the income tax for the sale of real estate classified as ordinary assets and (b) they mandate the collection of income tax on a per transaction basis, *i.e.*, upon consummation of the sale via the CWT, contrary to RA 8424 which calls for the payment of the net income at the end of the taxable period.[63]

Petitioner theorizes that since RA 8424 treats capital assets and ordinary assets differently, respondents cannot disregard the distinctions set by the legislators as regards the tax base, modes of collection and payment of taxes on income from the sale of capital and ordinary assets.

Petitioner's arguments have no merit.

AUTHORITY OF THE SECRETARY OF FINANCE TO ORDER THE COLLECTION OF CWT ON SALES OF REAL PROPERTY CONSIDERED AS ORDINARY ASSETS

The Secretary of Finance is granted, under Section 244 of RA 8424, the authority to promulgate the necessary rules and regulations for the effective enforcement of the provisions of the law. Such authority is subject to the limitation that the rules and regulations must not override, but must remain consistent and in harmony with, the law they seek to apply and implement.[64] It is well-settled that an administrative agency cannot amend an act of Congress.[65]

We have long recognized that the method of withholding tax at source is a procedure of collecting income tax which is sanctioned by our tax laws.[66] The withholding tax system was

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[63] *Id.*, p. 10.

[64] *Commissioner of Internal Revenue v. Court of Appeals*, G.R. No. 108358, 20 January 1995, 240 SCRA 368, 372.

[65] *Echegaray v. Secretary of Justice*, G.R. No. 132601, 12 October 1998, 297 SCRA 754, 791, citations omitted.

[66] *Filipinas Synthetic Fiber Corporation v. Court of Appeals*, G.R. Nos. 118498 & 124377, 12 October 1999, 316 SCRA 480, 485.

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devised for three primary reasons: first, to provide the taxpayer a convenient manner to meet his probable income tax liability; second, to ensure the collection of income tax which can otherwise be lost or substantially reduced through failure to file the corresponding returns and third, to improve the government's cash flow.[67] This results in administrative savings, prompt and efficient collection of taxes, prevention of delinquencies and reduction of governmental effort to collect taxes through more complicated means and remedies.[68]

Respondent Secretary has the authority to require the withholding of a tax on items of income payable to any person, national or juridical, residing in the Philippines. Such authority is derived from Section 57(B) of RA 8424 which provides:

> SEC. 57. *Withholding of Tax at Source*. –
>
> xxx xxx xxx
>
> *(B) Withholding of Creditable Tax at Source*. The [Secretary] may, upon the recommendation of the [CIR], require the withholding of a tax on the items of income payable to natural or juridical persons, residing in the Philippines, by payor-corporation/persons as provided for by law, at the rate of not less than one percent (1%) but not more than thirty-two percent (32%) thereof, which shall be credited against the income tax liability of the taxpayer for the taxable year.

The questioned provisions of RR 2-98, as amended, are well within the authority given by Section 57(B) to the Secretary, *i.e.*, the graduated rate of 1.5%-5% is between the 1%-32% range; the withholding tax is imposed on the income payable and the tax is creditable against the income tax liability of the taxpayer for the taxable year.

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[67] *Citibank v. Court of Appeals*, G.R. No. 107434, 10 October 1997, 280 SCRA 459, 467-468, citing Cesar C. Rey, *Tax Code Annotated*, p. 243, in turn citing the explanatory note to H. Bill No. 1127 and *Commissioner of Internal Revenue v. Malayan Ins. Co., Inc.*, G.R. No. L-21913, 18 November 1967, 21 SCRA 944, 949.

[68] *Supra* note 61.

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EFFECT OF RRS ON THE TAX BASE FOR THE INCOME TAX OF INDIVIDUALS OR CORPORATIONS ENGAGED IN THE REAL ESTATE BUSINESS

Petitioner maintains that RR 2-98, as amended, arbitrarily shifted the tax base of a real estate business' income tax from net income to GSP or FMV of the property sold.

Petitioner is wrong.

The taxes withheld are in the nature of advance tax payments by a taxpayer in order to extinguish its possible tax obligation.[69] They are installments on the annual tax which may be due at the end of the taxable year.[70]

Under RR 2-98, the tax base of the income tax from the sale of real property classified as ordinary assets remains to be the entity's net income imposed under Section 24 (resident individuals) or Section 27 (domestic corporations) in relation to Section 31 of RA 8424, *i.e.* gross income less allowable deductions. The CWT is to be deducted from the net income tax payable by the taxpayer at the end of the taxable year.[71] Precisely, Section 4(a)(ii) and (c)(ii) of RR 7-2003 reiterate that the tax base for the sale of real property classified as ordinary assets remains to be the net taxable income:

> Section 4. – *Applicable taxes on sale, exchange or other disposition of real property*. — Gains/Income derived from sale, exchange, or other disposition of real properties shall unless otherwise exempt, be subject to applicable taxes imposed under the Code, depending on whether the subject properties are classified as capital assets or ordinary assets;
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> xxx xxx xxx
>
> a. In the case of individual citizens (including estates and trusts), resident aliens, and non-resident aliens engaged in trade or business in the Philippines;

[69] *Supra* note 67, pp. 469-470, citing *Gibbs v. Commissioner of Internal Revenue*, G.R. No. L-17406, 29 November 1965, 15 SCRA 318, 325.

[70] *Id.*, p. 470, citations omitted.

[71] RR 2-98, Section 2.58.1.

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xxx xxx xxx

(ii) The sale of real property located in the Philippines, classified as ordinary assets, shall be **subject to** the [CWT] (expanded) under Sec. 2.57.2(j) of [RR 2-98], as amended, based on the [GSP] or current [FMV] as determined in accordance with Section 6(E) of the Code, whichever is higher, and consequently, to **the ordinary income tax imposed under Sec. 24(A)(1)(c) or 25(A)(1) of the Code, as the case may be, based on net taxable income**.

xxx xxx xxx

c. In the case of domestic corporations.

The sale of land and/or building classified as ordinary asset and other real property (other than land and/or building treated as capital asset), regardless of the classification thereof, all of which are located in the Philippines, shall be **subject to** the [CWT] (expanded) under Sec. 2.57.2(J) of [RR 2-98], as amended, and consequently, to **the ordinary income tax under Sec. 27(A)** of the Code. In lieu of the ordinary income tax, however, domestic corporations may become subject to the [MCIT] under Sec. 27(E) of the same Code, whichever is applicable. (Emphasis supplied)

Accordingly, at the end of the year, the taxpayer/seller shall file its income tax return and credit the taxes withheld (by the withholding agent/buyer) against its tax due. If the tax due is greater than the tax withheld, then the taxpayer shall pay the difference. If, on the other hand, the tax due is less than the tax withheld, the taxpayer will be entitled to a refund or tax credit. Undoubtedly, the taxpayer is taxed on its net income.

The use of the GSP/FMV as basis to determine the withholding taxes is evidently for purposes of practicality and convenience. Obviously, the withholding agent/buyer who is obligated to withhold the tax does not know, nor is he privy to, how much the taxpayer/seller will have as its net income at the end of the taxable year. Instead, said withholding agent's knowledge and privity are limited only to the particular transaction in which he is a party. In such a case, his basis can only be the GSP or FMV as these are the only factors reasonably known or knowable by him in connection with the performance of his duties as a withholding agent.

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NO BLURRING OF DISTINCTIONS BETWEEN ORDINARY ASSETS AND CAPITAL ASSETS

RR 2-98 imposes a graduated CWT on income based on the GSP or FMV of the real property categorized as ordinary assets. On the other hand, Section 27(D)(5) of RA 8424 imposes a final tax and flat rate of 6% on the gain presumed to be realized from the sale of a capital asset based on its GSP or FMV. This final tax is also withheld at source.[72]

The differences between the two forms of withholding tax, *i.e.*, creditable and final, show that ordinary assets are not treated in the same manner as capital assets. Final withholding tax (FWT) and CWT are distinguished as follows:

FWT	CWT
a) The amount of income tax withheld by the withholding agent is constituted as a full and final payment of the income tax due from the payee on the said income.	a) Taxes withheld on certain income payments are intended to equal or at least approximate the tax due of the payee on said income.
b)The liability for payment of the tax rests primarily on the payor as a withholding agent.	b) Payee of income is required to report the income and/or pay the difference between the tax withheld and the tax due on the income. The payee also has the right to ask for a refund if the tax withheld is more than the tax due.
c) The payee is not required to file an income tax return for the particular income.[73]	c) The income recipient is still required to file an income tax return, as prescribed in Sec. 51 and Sec. 52 of the NIRC, as amended.[74]

[72] RA 8424, Section 57(A) and RR 2-98, Section 2.57.1 (A)(6).

[73] RR 2-98, Section 2.57 (A).

[74] *Id.*, Section 2.57 (B).

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As previously stated, FWT is imposed on the sale of capital assets. On the other hand, CWT is imposed on the sale of ordinary assets. The inherent and substantial differences between FWT and CWT disprove petitioner's contention that ordinary assets are being lumped together with, and treated similarly as, capital assets in contravention of the pertinent provisions of RA 8424.

Petitioner insists that the levy, collection and payment of CWT at the time of transaction are contrary to the provisions of RA 8424 on the manner and time of filing of the return, payment and assessment of income tax involving ordinary assets.[75]

The fact that the tax is withheld at source does not automatically mean that it is treated exactly the same way as capital gains. As aforementioned, the mechanics of the FWT are distinct from those of the CWT. The withholding agent/buyer's act of collecting the tax at the time of the transaction by withholding the tax due from the income payable is the essence of the withholding tax method of tax collection.

NO RULE THAT ONLY PASSIVE INCOMES CAN BE SUBJECT TO CWT

Petitioner submits that only passive income can be subjected to withholding tax, whether final or creditable. According to petitioner, the whole of Section 57 governs the withholding of income tax on passive income. The enumeration in Section 57(A) refers to passive income being subjected to FWT. It follows that Section 57(B) on CWT should also be limited to passive income:

SEC. 57. Withholding of Tax at Source. —

(A) Withholding of **Final Tax** on Certain Incomes. — Subject to rules and regulations, the [Secretary] may promulgate, upon the recommendation of the [CIR], requiring the filing of income tax return by certain income payees, the **tax imposed or prescribed by Sections 24(B)(1), 24(B)(2), 24(C), 24(D)(1); 25(A)(2), 25(A)(3), 25(B), 25(C), 25(D), 25(E); 27(D)(1), 27(D)(2), 27(D)(3),**

[75] *Rollo*, pp. 11-12.

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27(D)(5); 28(A)(4), 28(A)(5), 28(A)(7)(a), 28(A)(7)(b), 28(A)(7)(c), 28(B)(1), 28(B)(2), 28(B)(3), 28(B)(4), 28(B)(5)(a), 28(B)(5)(b), 28(B)(5)(c); 33; and 282 of this Code on specified items of income shall be withheld by payor-corporation and/or person and paid in the same manner and subject to the same conditions as provided in Section 58 of this Code.

(B) Withholding of **Creditable Tax** at Source. — The [Secretary] may, upon the recommendation of the [CIR], require the withholding of a **tax on the items of income payable to natural or juridical persons, residing in the Philippines**, by payor-corporation/persons as provided for by law, at the rate of not less than one percent (1%) but not more than thirty-two percent (32%) thereof, which shall be credited against the income tax liability of the taxpayer for the taxable year. (Emphasis supplied)

This line of reasoning is *non sequitur*.

Section 57(A) expressly states that final tax can be imposed on certain kinds of income and enumerates these as passive income. The BIR defines passive income by stating what it is not:

…if the income is generated in the active pursuit and performance of the corporation's primary purposes, the same is not passive income…[76]

It is income generated by the taxpayer's assets. These assets can be in the form of real properties that return rental income, shares of stock in a corporation that earn dividends or interest income received from savings.

On the other hand, Section 57(B) provides that the Secretary can require a CWT on "income payable to natural or juridical persons, residing in the Philippines." There is no requirement that this income be passive income. If that were the intent of Congress, it could have easily said so.

Indeed, Section 57(A) and (B) are distinct. Section 57(A) refers to FWT while Section 57(B) pertains to CWT. The former covers the kinds of passive income enumerated therein and the latter encompasses *any income other than those listed in 57(A)*.

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[76] BIR Ruling No. DA-501-2004, September 24, 2004.

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Since the law itself makes distinctions, it is wrong to regard 57(A) and 57(B) in the same way.

To repeat, the assailed provisions of RR 2-98, as amended, do not modify or deviate from the text of Section 57(B). RR 2-98 merely implements the law by specifying what income is subject to CWT. It has been held that, where a statute does not require any particular procedure to be followed by an administrative agency, the agency may adopt any reasonable method to carry out its functions.[77] Similarly, considering that the law uses the general term "income," the Secretary and CIR may specify the kinds of income the rules will apply to based on what is feasible. In addition, administrative rules and regulations ordinarily deserve to be given weight and respect by the courts[78] in view of the rule-making authority given to those who formulate them and their specific expertise in their respective fields.

NO DEPRIVATION OF PROPERTY WITHOUT DUE PROCESS

Petitioner avers that the imposition of CWT on GSP/FMV of real estate classified as ordinary assets deprives its members of their property without due process of law because, in their line of business, gain is never assured by mere receipt of the selling price. As a result, the government is collecting tax from net income not yet gained or earned.

Again, it is stressed that the CWT is creditable against the tax due from the seller of the property at the end of the taxable year. The seller will be able to claim a tax refund if its net income is less than the taxes withheld. Nothing is taken that is

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[77] *Provident Tree Farms, Inc. v. Batario*, G.R. No. 92285, 28 March 1994, 231 SCRA 463, 469, citing 2 Am Jur 2d §340, pp. 155-156, in turn citing *Douglas County v. State Bd. of Equalization and Assessment*, 158 Neb 325, 63 NW 2d 449; *State ex rel. York v. Walla Walla County*, 28 Wash 2d 891, 184 P 2d 577, 172 ALR 1001.

[78] *Compania General De Tabacos De Filipinas v. Court of Appeals*, G.R. No. 147361, 23 March 2004, 426 SCRA 203, 210, citing *Commissioner of Internal Revenue v. Court of Appeals*, G.R. No. 108358, 20 January 1995, 240 SCRA 368, 372.

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not due so there is no confiscation of property repugnant to the constitutional guarantee of due process. More importantly, the due process requirement applies to the power to tax.[79] The CWT does not impose new taxes nor does it increase taxes.[80] It relates entirely to the method and time of payment.

Petitioner protests that the refund remedy does not make the CWT less burdensome because taxpayers have to wait years and may even resort to litigation before they are granted a refund.[81] This argument is misleading. The practical problems encountered in claiming a tax refund do not affect the constitutionality and validity of the CWT as a method of collecting the tax.

Petitioner complains that the amount withheld would have otherwise been used by the enterprise to pay labor wages, materials, cost of money and other expenses which can then save the entity from having to obtain loans entailing considerable interest expense. Petitioner also lists the expenses and pitfalls of the trade which add to the burden of the realty industry: huge investments and borrowings; long gestation period; sudden and unpredictable interest rate surges; continually spiraling development/construction costs; heavy taxes and prohibitive "up-front" regulatory fees from at least 20 government agencies.[82]

Petitioner's lamentations will not support its attack on the constitutionality of the CWT. Petitioner's complaints are essentially matters of policy best addressed to the executive and legislative branches of the government. Besides, the CWT is applied only on the amounts actually received or receivable by the real estate entity. Sales on installment are taxed on a per-installment basis.[83] Petitioner's desire to utilize for its operational and capital expenses money earmarked for the payment of taxes may be a practical business option but it is not a fundamental right which can be demanded from the court or from the government.

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[79] *Chavez v. Ongpin*, G.R. No. 76778, 6 June 1990, 186 SCRA 331, 337.

[80] *Id*.

[81] *Rollo*, p. 278.

[82] *Id.*, p.14.

[83] RR 2-98, Section 2.57.2(J).

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NO VIOLATION OF EQUAL PROTECTION

Petitioner claims that the revenue regulations are violative of the equal protection clause because the CWT is being levied only on real estate enterprises. Specifically, petitioner points out that manufacturing enterprises are not similarly imposed a CWT on their sales, even if their manner of doing business is not much different from that of a real estate enterprise. Like a manufacturing concern, a real estate business is involved in a continuous process of production and it incurs costs and expenditures on a regular basis. The only difference is that "goods" produced by the real estate business are house and lot units.[84]

Again, we disagree.

The equal protection clause under the Constitution means that "no person or class of persons shall be deprived of the same protection of laws which is enjoyed by other persons or other classes in the same place and in like circumstances."[85] Stated differently, all persons belonging to the same class shall be taxed alike. It follows that the guaranty of the equal protection of the laws is not violated by legislation based on a reasonable classification. Classification, to be valid, must (1) rest on substantial distinctions; (2) be germane to the purpose of the law; (3) not be limited to existing conditions only and (4) apply equally to all members of the same class.[86]

The taxing power has the authority to make reasonable classifications for purposes of taxation.[87] Inequalities which result

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[84] *Rollo*, p. 284.

[85] *Philippine Rural Electric Cooperatives Association, Inc. (PHILRECA) v. The Secretary, Department of Interior and Local Government*, G.R. No. 143076, 10 June 2003, 403 SCRA 558, 565, citing *Tolentino v. Board of Accountancy*, 90 Phil. 83, 90 (1951).

[86] *Coconut Oil Refiners Association, Inc. v. Torres*, G.R. No. 132527, 29 July 2005, 465 SCRA 47, 76, citing *Tiu v. Court of Appeals*, G.R. No. 127410, 20 January 1999, 301 SCRA 278.

[87] *Sison v. Ancheta, et al.*, *supra* note 38, p. 591, citing *Eastern Theatrical Co. v. Alfonso*, 83 Phil. 852, 862 (1949).

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from a singling out of one particular class for taxation, or exemption, infringe no constitutional limitation.[88] The real estate industry is, by itself, a class and can be validly treated differently from other business enterprises.

Petitioner, in insisting that its industry should be treated similarly as manufacturing enterprises, fails to realize that what distinguishes the real estate business from other manufacturing enterprises, for purposes of the imposition of the CWT, is not their production processes but the prices of their goods sold and the number of transactions involved. The income from the sale of a real property is bigger and its frequency of transaction limited, making it less cumbersome for the parties to comply with the withholding tax scheme.

On the other hand, each manufacturing enterprise may have tens of thousands of transactions with several thousand customers every month involving both minimal and substantial amounts. To require the customers of manufacturing enterprises, at present, to withhold the taxes on each of their transactions with their tens or hundreds of suppliers may result in an inefficient and unmanageable system of taxation and may well defeat the purpose of the withholding tax system.

Petitioner counters that there are other businesses wherein expensive items are also sold infrequently, *e.g.* heavy equipment, jewelry, furniture, appliance and other capital goods yet these are not similarly subjected to the CWT.[89] As already discussed, the Secretary may adopt any reasonable method to carry out its functions.[90] Under Section 57(B), it may choose what to subject to CWT.

A reading of Section 2.57.2 (M) of RR 2-98 will also show that petitioner's argument is not accurate. The sales of manufacturers who have clients within the top 5,000 corporations,

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[88] *Id.*, p. 590, citing *Lutz v. Araneta*, 98 Phil. 148, 153 (1955).

[89] *Rollo*, p. 285

[90] *Supra* note 77.

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as specified by the BIR, are also subject to CWT for their transactions with said 5,000 corporations.[91]

SECTION 2.58.2 OF RR NO. 2-98 MERELY IMPLEMENTS SECTION 58 OF RA 8424

Lastly, petitioner assails Section 2.58.2 of RR 2-98, which provides that the Registry of Deeds should not effect the registration of any document transferring real property unless a certification is issued by the CIR that the withholding tax has been paid. Petitioner proffers hardly any reason to strike down this rule except to rely on its contention that the CWT is unconstitutional. We have ruled that it is not. Furthermore, this provision uses almost exactly the same wording as Section 58(E) of RA 8424 and is unquestionably in accordance with it:

Sec. 58. *Returns and Payment of Taxes Withheld at Source*.—

(E) *Registration with Register of Deeds*. — **No registration of any document transferring real property shall be effected by the Register of Deeds unless the [CIR] or his duly authorized representative has certified that such transfer has been reported, and the capital gains or [CWT], if any, has been paid**: xxx any violation of this provision by the Register of Deeds shall be subject to the penalties imposed under Section 269 of this Code. (Emphasis supplied)

CONCLUSION

The renowned genius Albert Einstein was once quoted as saying "[the] hardest thing in the world to understand is the income tax."[92] When a party questions the constitutionality of an income tax measure, it has to contend not only with Einstein's observation but also with the vast and well-established jurisprudence in support of the plenary powers of Congress to impose taxes. Petitioner has miserably failed to discharge its

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[91] *Rollo*, p. 40.

[92] *Murphy v. Internal Revenue Service*, D.C. Cir. No. 05-5139, 22 August 2006, citing The Macmillan Book of Business and Economic Quotations, Michael Jackman ed., 195 (1984).

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burden of convincing the Court that the imposition of MCIT and CWT is unconstitutional.

WHEREFORE, the petition is hereby *DISMISSED*.

Costs against petitioner.

SO ORDERED.

Puno, C.J., Carpio, Carpio Morales, Velasco, Jr., Nachura, Leonardo-de Castro, Brion, Peralta, Bersamin, Del Castillo, Abad, Villarama, Jr., Perez and *Mendoza, JJ.*, concur.

THIRD DIVISION

[G.R. No. 160972. March 9, 2010]

LEIGHTON CONTRACTORS PHILIPPINES, INC., *petitioner, vs.* **CNP INDUSTRIES, INC.,** *respondent.*

SYLLABUS

1. REMEDIAL LAW; EVIDENCE; PAROL EVIDENCE RULE; EXCEPTIONS TO THE RULE; WHEN THE PARTIES SUBSEQUENTLY MODIFY THE TERMS OF THEIR ORIGINAL AGREEMENT.— The parol evidence rule, embodied in Section 9, Rule 130 of the Rules of Court holds that when the terms of an agreement have been reduced into writing, it is considered as containing all the terms agreed upon and there can be, between the parties and their successors in interest, no evidence of such terms other than the contents of the written agreement. It, however, admits of exceptions such as when the parties subsequently modify the terms of their original agreement.