TAXATION LAW

IN THE MATTER OF DECLARATORY RELIEF ON THE VALIDITY OF BIR REVENUE MEMORANDUM CIRCULAR NO. 65-2012 "CLARIFYING THE TAXABILITY OF ASSOCIATION DUES, MEMBERSHIP FEES AND OTHER ASSESSMENTS/CHARGES COLLECTED BY CONDOMINIUM CORPORATIONS"
G.R. No. 215801, 15 January 2020, *FIRST DIVISION* (Lazaro-Javier, *J.*)

DOCTRINE OF THE CASE

RMC No. 65-2012 is invalid. In fine, the collection of association dues, membership fees, and other assessments/charges is purely for the benefit of the condominium owners. It is a necessary incident to the purpose to effectively oversee, maintain, or even improve the common areas of the condominium as well as its governance.

Membership fees, assessment dues, and other fees of similar nature only constitute contributions to and/or replenishment of the funds for the maintenance and operations of the facilities offered by recreational clubs to their exclusive members. They represent funds "held in trust" by these clubs to defray their operating and general costs and hence, only constitute infusion of capital.

FACTS

The First E-Bank (First E-Bank) filed a petition for declaratory relief seeking to declare invalid Revenue Memorandum Circular No. 65-2012 (RMC No. 65-2012). First E-Bank sought to clarify the taxability of association dues, membership fees, and other assessments/charges collected by condominium corporations as such collections were being charged by Income Tax and Value Added Tax (VAT) by the questioned memorandum circular. They claim exemption for payment of the taxes.

The Regional Trial Court (RTC) held that the petition for declaratory relief is proper but that there was nothing wrong with RMC No. 65-2012 as it was only an interpretation of the existing tax law. Upon appeal to the Court of Appeals (CA), it dismissed the petition for lack of jurisdiction.

ISSUES

(1) Is a petition for declaratory relief proper for the purpose of invalidating RMC No. 65-2012?

(2) Did the CA validly dismiss the twin appeals on ground of lack of jurisdiction?

(3) Is RMC No. 65-2012 valid?

RULING

(1) **NO.** A petition for declaratory relief is not the proper remedy for invalidating RMC No. 65-2012. The Court ruled that *Certiorari* or prohibition, not declaratory relief, is the proper remedy to assail the validity or constitutionality of executive issuances.

The remedies of *Certiorari* and prohibition are necessarily broader in scope and reach, and the writ of *Certiorari* or prohibition may be issued to correct errors of jurisdiction committed not only by a tribunal, corporation, board or officer exercising judicial, quasi-judicial or ministerial functions, but also to set right, undo, and restrain any act of grave abuse of discretion amounting to lack or excess of jurisdiction by any branch or instrumentality of the Government, even if the latter does not exercise judicial, quasi-judicial or ministerial functions." Thus, petitions for *certiorari* and prohibition are the proper remedies where an action of the legislative branch is seriously alleged to have infringed the Constitution.

RMC No. 65-2012 has far-reaching ramifications among condominium corporations which have proliferated throughout the country. For numerous Filipino families, professionals, and students have, for quite some time now, opted for condominium living as their new way of life. The matter of whether indeed the contributions of unit owners solely intended for maintenance and upkeep of the common areas of the condominium building are taxable is imbued with public interest. Suffice it to state that taxes, being the lifeblood of the government, occupy a high place in the hierarchy of State priorities, hence, all questions pertaining to their validity must be promptly addressed with the least procedural obstruction.

(2) **NO.** The Court of Appeals is incorrect. While the above statute confers on the CTA jurisdiction to resolve tax disputes in general, this does not include cases where the constitutionality of a law or rule is challenged. Where what is assailed is the validity or constitutionality of a law, or a rule or regulation issued by the administrative agency in the performance of its quasi-legislative function, the regular courts have jurisdiction to pass upon the same. The determination of whether a specific rule or set of rules issued by an administrative agency

contravenes the law or the constitution is within the jurisdiction of the regular courts.

(3) **YES.** RMC No. 65-2012 is invalid. In fine, the collection of association dues, membership fees, and other assessments/charges is purely for the benefit of the condominium owners. It is a necessary incident to the purpose to effectively oversee, maintain, or even improve the common areas of the condominium as well as its governance.

Membership fees, assessment dues, and other fees of similar nature only constitute contributions to and/or replenishment of the funds for the maintenance and operations of the facilities offered by recreational clubs to their exclusive members. They represent funds "held in trust" by these clubs to defray their operating and general costs and hence, only constitute infusion of capital.

Case law provides that in order to constitute "income," there must be realized "gain." Clearly, because of the nature of membership fees and assessment dues as funds inherently dedicated for the maintenance, preservation, and upkeep of the clubs' general operations and facilities, nothing is to be gained from their collection.

This stands in contrast to the tees received by recreational clubs coming from their income-generating facilities, such as bars, restaurants, and food concessionaires, or from income-generating activities, like the renting out of sports equipment, services, and other accommodations. In these latter examples, regardless of the purpose of the fees' eventual use, gain is already realized from the moment they are collected because capital maintenance, preservation or upkeep is not their predetermined purpose.

As such, recreational clubs are generally free to use these fees for whatever purpose they desire and thus, considered as unencumbered "fruits" coming from a business transaction.

COMMISSIONER OF INTERNAL REVENUE *v.*
DEUTSCHE KNOWLEDGE SERVICES PTE. LTD.
G.R. No. 234445, 15 July 2020, *SECOND DIVISION* (Inting, *J.*)

DOCTRINE OF THE CASE

A claimant's entitlement to a tax refund or credit of excess input VAT attributable to zero-rated sales hinges upon certain requisites which include that the taxpayer must be engaged in sales which are zero-rated or effectively zero-rated. Conversely, one of the requisites for a zero-rated sale is that the services are rendered to a person engaged in business conducted outside the Philippines or to a nonresident person not engaged in business who is outside the Philippines when the services are performed.

In this case, DKS is entitled to tax refund or credit of excess input VAT attributable to zero-rated sales only to the extent of the sales proven to be derived from foreign affiliates-clients. To be considered as foreign affiliates-clients, each entity must be supported, at the very least, by both SEC certificate of non-registration of corporation/partnership and certificate/articles of foreign incorporation/association.

FACTS

Deutsche Knowledge Services Pte. Ltd. (DKS) is the Philippine branch of a multinational company organized and existing under the laws of Singapore. The branch is licensed to operate as a regional operating headquarters in the Philippines that provides the following services to DKS's foreign affiliates/related parties, its foreign affiliates-clients: "general administration and planning; business planning and coordination; sourcing/procurement of raw materials and components; training and personnel management; logistic services; product development; technical support and maintenance; data processing and communication; and business development." Also, DKS is a value-added tax (VAT)-registered enterprise.

By virtue of several Intra-Group Services Agreements, DKS rendered qualifying services to its foreign affiliates-clients, from which it generated service revenues.

In 2011, DKS filed with the Bureau of Internal Revenue (BIR) an Application for Tax Refund/Credit. DKS declared that its sales of services to foreign affiliates-clients are zero-rated sales for VAT purposes. Thus, it sought to

refund the amount representing unutilized input VAT attributable to zero-rated sales.

Alleging that the Commissioner of Internal Revenue (CIR) had not acted upon their administrative claim, DKS filed a petition for review before the Court of Tax Appeals (CTA).

The CTA 2nd Division partially granted DKS' petition, ruling, among others, that to be considered as a non-resident foreign corporation (NRFC), each entity must be supported, at the very least, by both Securities and Exchange Commission (SEC) certificate of non-registration of corporation/partnership and certificate/articles of foreign incorporation/association. In this case, DKS established the NRFC status of only 15 foreign affiliates-clients. Thus, only sales to these 15 entities were proven to be derived from foreign affiliates-clients, the amount of which is the only extent that may be granted as a refund or credit of the excess input VAT.

On appeal, the CTA *En Banc* affirmed the CTA Division's ratiocinations, but found that DKS established the NRFC status of only 11 foreign affiliates-clients.

In filing a Petition for Review on *Certiorari*, the CIR claimed that DKS' judicial claim was filed prematurely, and that it failed to prove that its clients are foreign corporations doing business outside the Philippines.

ISSUES

(1) Was DKS' judicial claim filed prematurely?

(2) Was the CTA Division and *En Banc* correct in ruling that an entity, to be considered as an NRFC, must be supported by SEC certificate of non-registration of corporation/partnership and certificate/articles of foreign incorporation/association?

(3) Was DKS entitled to tax refund/credit?

RULING

(1) **NO.** Section 112 (C) of the National Internal Revenue Code of 1997 (Tax Code) gives the CIR 120 days from the date of submission of complete documents (date of completion) supporting the application for credit or refund excess input VAT attributable to zero-rated sales to resolve the administrative

claim. If it remains unresolved after this period, the law allows the taxpayer to appeal the unacted claims to the CTA within 30 days from the expiration of the 120-day period (120 and 30-day periods).

CIR cannot claim that the 120 and 30-day periods did not begin to run on the ground that DKS failed to submit the complete documents when it filed its administrative claim. The tax authorities had the full opportunity to opine on the issue of documentary completeness while DKS's claim was pending before them.

However, there was no action on the claim on the administrative level. Its belated response to the present claim only brings to light that the BIR had been remiss in their duties to duly notify the claimant to submit additional documentary requirements and to timely resolve their claim. The CIR cannot now fault DKS for proceeding to court for the appropriate remedial action on the claim they ignored.

(2) **YES.** The Court accords the CTA's factual findings with utmost respect, if not finality, because the Court recognizes that it has necessarily developed an expertise on tax matters. Significantly, both the CTA Division and CTA *En Banc* gave credence to the aforementioned documents as sufficient proof of NRFC status. The Court shall not disturb its findings without any showing of grave abuse of discretion considering that the members of the tax court are in the best position to analyze the documents presented by the parties.

The SEC Certifications of Non-Registration show that their affiliates are foreign corporations. On the other hand, the articles of association/certificates of incorporation stating that these affiliates are registered to operate in their respective home countries, outside the Philippines are prima facie evidence that their clients are not engaged in trade or business in the Philippines.

(3) **YES.** However, DKS was entitled to tax refund/credit to the extent of the sales proven to be derived from foreign affiliates-clients. Sales of those qualifying services rendered by DKS to its foreign affiliates-clients, shall be zero-rated pursuant to Section 108(B)(2) of the Tax Code if the following conditions are met:

First, the seller is VAT-registered;

Second, the services are rendered "to a person engaged in business conducted outside the Philippines or to a nonresident person not engaged in business who is outside the Philippines when the services are performed;" and

Third, the services are "paid for in acceptable foreign currency and accounted for in accordance with *Bangko Sentral ng Pilipinas* rules and regulations."

Conversely, under Section 4.112-1(a) of Revenue Regulations No. 16-05, otherwise known as the Consolidated VAT Regulations of 2005, in relation to Section 112 of the Tax Code, a claimant's entitlement to a tax refund or credit of excess input VAT attributable to zero-rated sales hinges upon the following requisites:

(a) the taxpayer must be VAT-registered;

(b) the taxpayer must be engaged in sales which are zero-rated or effectively zero-rated;

(c) the claim must be filed within two years after the close of the taxable quarter when such sales were made; and

(d) the creditable input tax due or paid must be attributable to such sales, except the transitional input tax, to the extent that such input tax has not been applied against the output tax.

MANILA ELECTRIC COMPANY *v.* CITY OF MUNTINLUPA and NELIA A. BARLIS
G.R. No. 198529, 09 February 2021, *EN BANC* (Hernando *J.*)

DOCTRINE OF THE CASE

The case of Legaspi v. City of Cebu explains the two tests in determining the validity of an ordinance, i.e., the Formal Test and the Substantive Test. The Formal Test requires the determination of whether the ordinance was enacted within the corporate powers of the LGU, and whether the same was passed pursuant to the procedure laid down by law. The Substantive Test primarily assesses the reasonableness and fairness of the ordinance and significantly its compliance with the Constitution and existing statutes.

The Court held that MO 93-35, particularly Section 25 thereof, has failed to meet the requirements of a valid ordinance. Applying the Formal Test, the passage of the subject ordinance was beyond the corporate powers of the then Municipality of Muntinlupa, hence, ultra vires. Based on the Substantive Test, the same section deviated from the express provision of R.A. No. 7160 as it was evidently passed beyond the powers of a municipality. MO 93-35 was passed by the Sangguniang Bayan of the Municipality of Muntinlupa and took effect on January 01, 1994. This is plainly ultra vires considering the clear and categorical provisions of Section 142 in relation to Sections 134, 137, and 151 of R.A. No. 7160 vesting to the provinces and cities the power to impose, levy, and collect a franchise tax. Muntinlupa being then a municipality had no power or authority to enact the subject franchise tax ordinance.

FACTS

Manila Electric Company (Meralco) is a public utility corporation duly organized and existing under Philippine laws. Pursuant to Republic Act No. 9209 (R.A. No. 9209), the statute granting its franchise, Meralco is enfranchised to construct, operate and maintain a distribution system for the conveyance of electricity in the cities and municipalities in the NCR, among others. On the flip side, the City of Muntinlupa is a local government unit that has been converted from a municipality into a highly urbanized city by virtue of Republic Act No. 7926 (R.A. No. 7926).

On January 01, 1994, MO 93-35 or the Revenue Code of the Municipality of Muntinlupa took effect. Section 25 thereof imposed a franchise tax on private persons or corporations operating public utilities within its territorial jurisdiction. Subsequently, R.A. No. 7926 was enacted and approved on March 01, 1995 which

converted the Municipality of Muntinlupa into a highly urbanized city, now the City of Muntinlupa.

On June 28, 1999, Nelia Barlis, the City Treasurer of Muntinlupa, sent a letter to Meralco demanding payment of the franchise tax it owed to Muntinlupa from 1992 to 1999 pursuant to Section 25 of MO 93-35 and paragraph 7 of the Bureau of Local Government Finance Circular No. 20-98.

Meralco did not pay such, and it ignored the August 2001 and September 2001 demand letters for payment of the franchise tax. It then instituted a Petition With Prayer for a Writ of Preliminary Injunction before the Regional Trial Court (RTC) to declare Section 25 of MO 93-35 as null and void for being contrary to law, unjust and confiscatory. Meralco maintained that municipalities are not endowed with the authority to impose a franchise tax, which power exclusively belongs to provinces and cities pursuant to R.A. No. 7160.

The City of Muntinlupa argues that Section 137 of R.A. No.7160 and Articles 227 and 237 of its Implementing Rules and Regulations allow the imposition of a franchise tax by a local government unity.

The RTC ruled in favor of Meralco. The Court of Appeals (CA) modified the decision of the RTC and held that while municipalities have no authority to levy and collect a franchise tax due to the *ultra vires* nature of Section 25 of MO 93-35, such was cured of its legal infirmities when the Municipality of Muntinlupa was converted into a highly urbanized city by virtue of its Charter in 1995. However, it held that the curative effect applies prospectively, hence the obligation to pay franchise tax begins only from March 01, 1995, the date when the Charter of Muntinlupa City was enacted. Hence this instant petition.

ISSUES

(1) Is Section 25 of MO 93-35 valid?

(2) Did Section 56 of the Charter of Muntinlupa City cure the infirmity of Section 25 of MO 93-35?

RULING

(1) **NO.** Section 25 of MO 93-35 is null and void for being *ultra vires*. The case of *Legaspi v. City of Cebu* explains the two tests in determining the validity of an ordinance, i.e., the Formal Test and the Substantive Test. The Formal Test

requires the determination of whether the ordinance was enacted within the corporate powers of the LGU, and whether the same was passed pursuant to the procedure laid down by law. The Substantive Test primarily assesses the reasonableness and fairness of the ordinance and significantly its compliance with the Constitution and existing statutes.

The Court held that MO 93-35, particularly Section 25 thereof, has failed to meet the requirements of a valid ordinance. Applying the Formal Test, the passage of the subject ordinance was beyond the corporate powers of the then Municipality of Muntinlupa, hence, *ultra vires*.

Based on the Substantive Test, the same section deviated from the express provision of R.A. No. 7160 as it was evidently passed beyond the powers of a municipality. MO 93-35 was passed by the Sangguniang Bayan of the Municipality of Muntinlupa and took effect on January 1, 1994. This is plainly *ultra vires* considering the clear and categorical provisions of Section 142 in relation to Sections 134, 137, and 151 of R.A. No. 7160 vesting to the provinces and cities the power to impose, levy, and collect a franchise tax. Muntinlupa being then a municipality had no power or authority to enact the subject franchise tax ordinance.

Municipalities may only levy taxes not otherwise levied by the provinces. Section 137 of R.A. No. 7160 particularly provides that provinces may impose a franchise tax on businesses granted with a franchise to operate. Since provinces have been vested with the power to levy a franchise tax, it follows that municipalities, pursuant to Section 142 of R.A. No. 7160, could no longer levy it. Therefore, Section 25 of MO 93-35 which was enacted when Muntinlupa was still a municipality and which imposed a franchise tax on public utility corporations within its territorial jurisdiction, is ultra vires for being violative of Section 142 of RA 7160.

Based on the foregoing, the then Municipality of Muntinlupa acted without authority in passing Section 25 of MO 93-35. It is null and void for being *ultra vires*.

(2) **NO.** Section 56 of the Charter of Muntinlupa City has no curative effect on Section 25 of MO 93-35, the latter being null and void.

The Court held that an ordinance which is incompatible with an existing law or statute is ultra vires, hence, null and void. Therefore, Muntinlupa City cannot hinge its imposition and collection of a franchise tax on the null and void provision of Section 25 of MO 93-35. Moreover, Section 56 of the Charter of Muntinlupa City cannot breathe life into the invalid Section 25 of MO 93-35. Section 56 of the transitory provision of the Charter of Muntinlupa City contemplates only those ordinances that are valid and legally existing at the time of its enactment.