Position Paper

The Illegality of the Creditable Withholding Tax

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THE LEGAL IMPLICATION

We are not aware of any provision of law authorizing the imposition of a CWT – payable at the time of transfer – on gross sales of real property classified as ordinary assets or stock-in-trade.

Under existing law as we understand it, sales of real property classified as capital assets are subject to a final capital gains tax, payable within a specified period from the date of the transaction; whereas sales of real property classified as ordinary assets are subject to the tax on net income, computed as gross income less the allowable deductions, and payable at the time of filing of the return.

If the CWT scheme is intended to equate capital asset with ordinary asset, or as a transaction tax, this would require amendments to existing law before it may be legally effected.

On the other hand, if the CWT is intended to represent an advance payment on the income tax, again this may not be legally tenable, as withholding of income tax appertains only to those items of income that are fixed and/or determinable at the time of payment of the tax. The law enumerates these income items as wages, fixed yields on financial instruments, dividend income, royalties, and other income of a similar nature. It should be noted that sale of real property classified as ordinary asset is neither included in the aforementioned enumeration, nor is it similar in nature to those enumerated, such as to justify its inclusion by Departmental regulation.

Application of the CWT assumes that net income is certain to be realized from the transaction. It is admitted that in the subdivision and realty development business, there is probability that income may be realized. However, as in the case of any other corporate venture (particularly those involving production or manufacturing) where operations and sales transactions are regular or habitual, and where the object of transaction represents stock-in-trade, net income is neither fixed nor certain.

In these cases, it is virtually impossible to determine at the time of the transaction, on a per-transaction basis, the actual net income that will be realized. This is so because net income does not solely depend on the value of the consideration; it also takes into account all costs expended -- not only before, but also during and after, consummation of the transaction.

Furthermore, pre-selling is a standard industry practice. This means that the contract price is agreed upon, and the sale effected, even before the units are actually developed or constructed. Also, under the mortgage lending program of Government whether under the ULP, SSS, GSIS or Pag-IBIG system – without which it is virtually impossible to develop or sell social housing packages – it is a requirement that transfer of title must be effected prior to receipt of the consideration by the developer/seller. Full payment of the consideration is effected under the scheme of "mortgage takeout", the release of which may take anywhere from three to six months after title transfer and submission of all documentary requirements.

Within the context of these operating conditions peculiar to this business, the risk is great that a loss, rather than a gain, on the pre-selling transaction would actually ensue. This is because the long gestation period intervening from the time the sales contract is consummated to the time of project completion, renders the transaction highly vulnerable to losses occasioned by, among others, sudden

price spiral of construction materials and other development inputs, legislated wage hikes, sharp rise in lending rates, increase in power rates, and the like.

Moreover, unprojected delays in the already lengthy waiting period between title transfer and full payment of the consideration (release of mortgage takeout), would serve to further increase holding costs. Where project development is highly dependent on borrowed funds, this item alone could wipe out the entire income expectation of a social housing transaction.

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Admittedly, the administrative remedy of filing a claim for tax refund exists. However, in view of the uncertainty, delays and excessively burdensome requirements associated with this process, it virtually amounts to no remedy at all – particularly when damage would have been done in terms of seriously impairing cash flow and financial positions.

In essence, the legal implications of a CWT imposed on the subdivision and realty development business may be stated thus: if such imposition is to be justified, logic and considerations of equity would dictate that it be similarly imposed – by law rather than by mere Departmental Order – on all other businesses involving the regular production and sale of various stock-in-trade.

THE ECONOMIC & ADMINISTRATIVE IMPLICATIONS

The CWT, as applied to gross selling price, seems to imply that (1) the taxpayer's net income before tax is certain to range, at the minimum, from 7.5% to 21.4% of gross sales; (2) costs of inputs remain at constant levels; and (3) property development or production activity is so perfectly predictable as to eliminate any risk or possibility of loss.

With all due respect, these implicit assumptions are highly unrealistic. Real estate projects are increasingly being rendered marginal by the spiraling costs of raw land and other inputs as aforementioned, not to mention the considerable "invisible costs" associated with graft and delays in the various bureaucratic processes that property development has to undergo. In the case of projects of the "economic" type, the subsidy aspect of the mandatory social housing quota serves as an added aggravation. This cost situation is further compounded by the continuing decline in the affordability levels of homebuyers, which seriously impairs the marketability of housing packages.

In such a situation, a CWT that is not representative of the applicable tax on the actual income (if any) that may be realized, would only result in claims for tax refunds. In effect, what the BIR would take at the time of transaction would not necessarily represent revenue for Government, as it would likely be returned or reserved for tax refund purposes.

The entire scheme, therefore, would only compound the BIR's difficulties in tax administration. It may prove to be a daunting if not a needlessly expensive task, considering that the CWT is to be imposed on an uncertain volume of sales transactions – which may range anywhere from 5 to 5,000 transactions per project, at an uncertain volume of projects nationwide in any given year.

Worse, it would seriously impair the viability of our industry, and consequently result in a net loss for Government, which would be deprived of the industry's exceptional pump-priming and revenue-generating potentials. To our mind, these are situations that our economy and our society can ill-afford at this time.