



TAX LAW FOR BUSINESS

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*BDB Law's "Tax Law for Business" appears in the opinion section of **Business Mirror** every Thursday.*

Tax refund on rescinded contracts

Rescission has been defined in law as the unmaking of a contract, or its undoing from the beginning and not merely its termination. The consequential effect of it is to bring back the parties to their original situation prior to the commencement of the contract.

Given the above jurisprudential pronouncements, the rule is clear that rescission nullifies the contract from the beginning and requires a mutual restoration of benefits received.

The tax consequence in rescission of contracts has been passed upon in the Court of Tax Appeals (CTA) Case 6617. In the said case, the parties mutually rescinded the contract to sell since the occupants of the subject lot refused to vacate and surrender the possession. However, in restoring the benefits received, the seller can no longer refund the value-added tax for the simple reason that the same was already remitted to the Bureau of Internal Revenue (BIR).

Citing a regulation and a 1995 BIR ruling, the CTA ruled that taxpayers are entitled to the value-added tax refund. Likewise, the CTA ruled in passing that the capital gain tax and documentary stamp tax may also be refunded.

In 2013 however, the BIR clarified in its ruling that a documentary stamp tax cannot be refunded in cases of rescission. Referring to a Supreme Court (SC) case (GR 119446), the BIR ruled that the subsequent cancellation of the transaction to which the documentary stamp tax liability attaches does not have the effect of cancelling the documentary stamp tax liability.

This view is anchored on the fact that a documentary stamp tax is a tax not upon the business transacted but is an excise upon the privilege, opportunity, or facility offered at exchanges for the transaction of the business. It is an excise upon the facilities used in the transaction of the business separate and apart from the business itself. As such, the documentary stamp tax must be paid, without regard to whether the contracts which gave rise to them are rescissible, void, voidable, or unenforceable. The above ruling, though, did not discuss whether a capital gain tax may also be refunded in the event of rescission.

Such is the case in the recent decision of the CTA Consolidated Case 8919 and 8920. In this case, the parties mutually rescinded the contract of sale. However, the capital gains tax has already been remitted to the BIR. This prompted the taxpayers to file a tax refund with the BIR on the ground that the said taxes were erroneously or illegally collected. It is argued, however, by the BIR that at the time the same were paid, the contract is very much legal and valid.

In resolving in favor of the taxpayer, the CTA emphasized that capital gains tax is a tax on gain from the sale of the taxpayer's property forming part of capital assets. In case, however, of rescission, any resulting gain will have the effect of not being realized, since the proceeds of the sale will eventually be returned to the seller. Further, when a contract is rescinded, it is deemed inexistent, and the parties are returned to their *status quo ante*. Considering, therefore, that there is no gain realized in the subject transactions, the collected capital gains taxes are considered as "levied without statutory authority".

The CTA went a step further to clarify the legality of the capital gains tax refund in rescission. According to the CTA, the claim for refund is based on the principle of quasi-contract or *solution indebiti*. This principle is a time-honored doctrine that no person shall unjustly enrich himself at the expense of another. And the government is not exempted from the application of this doctrine.

Given the above circumstances, the taxpayer must be guided by the rule that in cases of rescission, the same includes the restoration of any value-added tax and capital gains tax already remitted to the BIR.

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