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Joint ventures: Taxation

FOR the past several years, the Bureau of Internal Revenue (BIR) has been issuing rulings confirming that joint ventures (JVs) formed by landowners and developers for the purpose of developing and/or constructing subdivisions or condominiums are not covered in the definition of a taxable corporation. As such, JVs are exempt from tax. Likewise, the contributions to the JV, as well as the distribution by the JV to members, are not taxable events. It is only the members who are subject to tax in their individual capacities upon their sale of their share in the developed properties.

However, in June 2012 the Department of Finance issued Revenue Regulations (RR) 10-2012, which defined the rules on the taxation and exemption of JVs or consortiums. The RR enumerated conditions that a JV or consortium must meet in order not to be considered as a corporation. These conditions require, among others, that the JV should be formed by local contractors engaged in the construction business. The contractors and the JV itself must be licensed by the Philippine Contractors Accreditation Board.

If any of those conditions is not met, a JV formed for the purpose of undertaking construction projects shall be considered as a taxable corporation. The implication is that the usual JVs formed with landowners (who are not licensed contractors) are considered taxable corporations. There is, however, no clear rule providing guidelines in the taxation of the various activities or stages involved in a JV. As a result, many projects following the same scheme were stalled or diverted to other models.

Last month the BIR issued BIR Ruling 263-2013, July 12, 2013, involving a JV between a landowner and developer for the construction of a condominium. Applying specifically the provisions of RR 10-2012, the BIR concluded that the said JV does not meet or satisfy the conditions enumerated in the said regulations. As such, it is taxable as a corporation.

In this particular JV, the developed condominium units were distributed from the JV to the parties. With respect to the landowner, the BIR ruled that he or she is subject to ordinary income tax, based on the current fair market value of the condominium units he or she received from the JV, less the fair market value (considering that this was acquired through inheritance) of the property contributed to the JV. On the part of the developer, the transfer of the condominium units shall also be subject to ordinary income tax, based on the current fair market value of the condominium units received, less the costs actually, directly and exclusively incurred for the construction of the condominium. Further, the subsequent sale of the condominium units received shall also be subject to ordinary income tax, as well as to the applicable withholding taxes, value-added tax and documentary-stamp tax.

It appears that the JV members are subject to income taxes in two stages: first, at the time of the distribution of the developed properties by the JV; and second, at the time of sale of the developed properties by the member.

Interestingly, while mentioning that the JV should be taxed as a corporation, the ruling did not mention how it should be taxed. Does this mean the JV is, after all, not taxable as a corporation? This must be so, because if the arrangement calls for the distribution of the developed units to the parties, their subsequent sale is done for the account of the members and not for that of the JV. In other words, there is no sales activity at the JV level. In the absence of selling activities on the part of the JV from which income may be derived, there should be no taxable income from which an income tax can be imposed.

Somehow, this ruling clarified some of the tax concerns related to a JV project. But there are still many more issues left to be clarified. One of these is the taxation of the JV itself. I personally believe that the taxability of the JV should depend on the extent of activities to be undertaken through it. In Pascual v. The Commissioner of Internal Revenue, G.R. 78133, October 18, 1988, the Supreme Court ruled that the sharing of returns does not, in itself, establish a partnership whether or not the persons sharing therein have a joint or common right or interest in the property. There must be clear intent to form a partnership, the existence of a juridical personality different from the individual partners, and the freedom of each party to transfer or assign the whole property. In that case, the transactions were considered isolated and did not result in the creation of a taxable corporation. This is differentiated from Evangelista v. The Collector of Internal Revenue, G.R. L-9996, October 15, 1957, where there was a series of transactions, characterized by habituality peculiar to business transactions engaged in for purposes of gain that lasted for several years. In other words, the mere fact that one of the requirements in RR 10-2012 is missing should not be the mere basis for considering that the JV is taxable as a corporation. The activities of the JV should be considered as well.

The taxation at the JV level should likewise be determinative of the nature of the distribution to the members and its taxation. RR 10-2012 itself states that the members of the JV not taxable as a corporation shall each be responsible in reporting and paying the appropriate income taxes on their respective share to the JV profit. In contrast, if the JV is taxable as a corporation, does this mean that the members no longer pay tax on their respective share in the JV profit?

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