

# 2018 BAR EXAMINATIONS

## TAXATION LAW

November 11, 2018

2:00 P.M. – 6:00 P.M.

### INSTRUCTIONS

1. This questionnaire contains ten (10) pages including this page. Check the number of pages and their proper sequencing. You may write notes on this questionnaire.

Read each question very carefully and write your answers in your Bar Examination Notebook in the same order as the questions. Write your answers only on the front page of every sheet. Note well the allocated percentage points for each question or sub-question. In your answers, use the numbering system in the questionnaire.

2. Answer the questions legibly, clearly, and concisely. Start each answer on a separate page. An answer to a sub-question under the same number may be written continuously on the same page and the immediately succeeding pages until completed.

3. Your answer should demonstrate your ability to analyze the facts, apply the pertinent laws and jurisprudence, and arrive at a sound or logical conclusion. Always support your answer with the pertinent laws, rules, and/or jurisprudence.

**A MERE “YES” OR “NO” ANSWER WITHOUT ANY CORRESPONDING EXPLANATION OR DISCUSSION WILL NOT BE GIVEN FULL CREDIT. THUS, ALWAYS BRIEFLY BUT FULLY EXPLAIN YOUR ANSWERS ALTHOUGH THE QUESTION DOES NOT EXPRESSLY ASK FOR AN EXPLANATION. DO NOT REWRITE OR REPEAT THE QUESTION ON YOUR NOTEBOOK.**

4. Do not write your name or any extraneous note/s or distinctive marking/s on your Notebook that can serve as an identifying mark/s (such as names that are not in the given questions, prayers, or private notes to the Examiner). Writing, leaving, or making any distinguishing or identifying mark in the Notebook is considered cheating and can disqualify you.

**YOU CAN BRING HOME THIS QUESTIONNAIRE**

  
JUSTICE MARIANO C. DEL CASTILLO  
Chairperson  
2018 Bar Examinations

## I

KM Corporation, doing business in the City of Kalookan, has been a distributor and retailer of clothing and household materials. It has been paying the City of Kalookan local taxes based on Sections 15 (*Tax on Wholesalers, Distributors or Dealers*) and 17 (*Tax on Retailers*) of the Revenue Code of Kalookan City (Code). Subsequently, the Sangguniang Panlungsod enacted an ordinance amending the Code by inserting Section 21 which imposes a tax on "Businesses Subject to Excise, Value-Added and Percentage Taxes under the National Internal Revenue Code (NIRC)," at the rate of 50% of 1% *per annum* on the gross sales and receipts on persons "who sell goods and services in the course of trade or business." KM Corporation paid the taxes due under Section 21 under protest, claiming that (a) local government units could not impose a tax on businesses already taxed under the NIRC and (b) this would amount to double taxation, since its business was already taxed under Sections 15 and 17 of the Code.

- (a) May local government units impose a tax on businesses already subjected to tax under the NIRC? (2.5%)
- (b) Does this amount to double taxation? (2.5%)

## II

Kronge Konsult, Inc. (KKI) is a Philippine corporation engaged in architectural design, engineering, and construction work. Its principal office is located in Makati City, but it has various infrastructure projects in the country and abroad. Thus, KKI employs both local and foreign workers. The company has adopted a policy that the employees' salaries are paid in the currency of the country where they are assigned or detailed.

Below are some of the employees of KKI. Determine whether the compensation they received from KKI in 2017 is taxable under Philippine laws and whether they are required to file tax returns with the Bureau of Internal Revenue (BIR). (2% each)

- (a) Kris Konejero, a Filipino accountant in KKI's Tax Department in the Makati office, and married to a Filipino engineer also working in KKI;
- (b) Klaus Kloner, a German national who heads KKI's Design Department in its Makati office;
- (c) Krisanto Konde, a Filipino engineer in KKI's Design Department who was hired to work at the principal office last January 2017. In April 2017, he was assigned and detailed in the company's project in Jakarta, Indonesia, which project is expected to be completed in April 2019;
- (d) Kamilo Konde, Krisanto's brother, also an engineer assigned to KKI's project in Taipei, Taiwan. Since KKI provides for housing and other

basic needs, Kamilo requested that all his salaries, paid in Taiwanese dollars, be paid to his wife in Manila in its Philippine Peso equivalent; and

- (e) Karen Karenina, a Filipino architect in KKI's Design Department who reported back to KKI's Makati office in June 2017 after KKI's project in Kuala Lumpur, Malaysia was completed.

### III

Kim, a Filipino national, worked with K-Square, Inc. (KSI), and was seconded to various KSI-affiliated corporations:

1. from 1999 to 2004 as Vice President of K-Gold Inc.,
2. from 2004 to 2007 as Vice President of KPB Bank;
3. from 2007 to 2011 as CEO of K-Com Inc.;
4. from 2011 to 2017 as CEO of K-Water Corporation, where Kim served as CEO for seven years until his retirement last December 12, 2017 upon reaching the compulsory retirement age of 60 years.

All the corporations mentioned are majority-owned in common by the Koh family and covered by a BIR-qualified multiemployer-employee retirement plan (MEERP), under which the employees may be moved around within the controlled group (*i.e.*, from one KSI subsidiary or affiliate to another) without loss of seniority rights or break in the tenure. Kim was well-loved by his employer and colleagues, so upon retirement, and on his last day in office, KSI gave him a Mercedes Benz car worth PhP 5 million as a surprise, with a streamer that reads: "You'll be missed. Good luck, Sir Kim."

- (a) Are the retirement benefits paid to Kim pursuant to the MEERP taxable? (2.5%)
- (b) Which internal revenue tax, if any, will apply to the grant of the car to Kim by the company? (2.5%)

### IV

Years ago, Krisanto bought a parcel of land in Muntinlupa for only PhP65,000. He donated the land to his son, Kornelio, in 1980 when the property had a fair market value of PhP75,000, and paid the corresponding donor's tax.

Kornelio, in turn, sold the property in 2000 to Katrina for PhP 6.5 million and paid the capital gains tax, documentary stamp tax, local transfer tax, and other fees and charges. Katrina, in turn, donated the land to Klaret School last August 30, 2017 to be used as the site for additional classrooms. No donor's tax was paid,

because Katrina claimed that the donation was exempt from taxation. At the time of the donation to Klaret School, the land had a fair market value of PhP 65 million.

- (a) Is Katrina liable for donor's tax? (2.5%)
- (b) How much in deduction from gross income may Katrina claim on account of the said donation? (2.5%)

## V

Spouses Konstantino and Korina are Filipino citizens and are principal shareholders of a restaurant chain, Korina's, Inc. The restaurant's principal office is in Makati City, Philippines.

Korina's became so popular as a Filipino restaurant that the owners decided to expand its operations overseas. During the period 2010-2015 alone, it opened ten (10) stores throughout North America and five (5) stores in various parts of Europe where there were large Filipino communities. Each store abroad was in the name of a corporation organized under the laws of the state or country in which the store was located. All stores had identical capital structures: 60% of the outstanding capital stock was owned by Korina's, Inc., while the remaining 40% was owned directly by the spouses Konstantino and Korina.

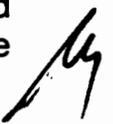
Beginning 2017, in light of the immigration policy enunciated by US President Donald Trump, many Filipinos have since returned to the Philippines and the number of Filipino immigrants in the US dropped significantly. On account of these developments, Konstantino and Korina decided to sell their shares of stock in the five (5) US corporations that were doing poorly in gross sales. The spouses' lawyer-friend advised them that they will be taxed 5% on the first PhP100,000 net capital gain, and 10% on the net capital gain in excess of PhP100,000.

Is the lawyer correct? If not, how should the spouses Konstantino and Korina be taxed on the sale of their shares? (5%)

## VI

Kria, Inc., a Korean corporation engaged in the business of manufacturing electric vehicles, established a branch office in the Philippines in 2010. The Philippine branch constructed a manufacturing plant in Kabuyao, Laguna, and the construction lasted three (3) years. Commercial operations in the Laguna plant began in 2014.

In just two (2) years of operation, the Philippine branch had remittable profits in an amount exceeding 175% of its capital. However, the head office in Korea instructed the branch not to remit the profits to the Korean head office until instructed otherwise. The branch chief finance officer is concerned that the BIR might hold the Philippine branch liable for the 10% improperly accumulated earnings tax (IAET) for permitting its profits to accumulate beyond reasonable business needs.



- (a) Is the Philippine branch of Kria subject to the 10% IAET under the circumstances stated above? (2.5%)
- (b) Is it subject to 15% branch profit remittance tax (BPRT)? (2.5%)

## VII

Karissa is the registered owner of a beachfront property in Kawayan, Quezon which she acquired in 2015. Unknown to many, Karissa was only holding the property in trust for a rich politician who happened to be her lover. It was the politician who paid for the full purchase price of the Kawayan property. No deed of trust or any other document showing that Karissa was only holding the property in trust for the politician was executed between him and Karissa.

Karissa died single on May 1, 2017 due to a freak surfing accident. She left behind a number of personal properties as well as real properties, including the Kawayan property. Karissa's sister, Karen, took charge of registering Karissa's estate as a taxpayer and reporting, for income tax and VAT purposes, the rental income received by the estate from real properties. However, it was only on October 1, 2017 when Karen managed to file an estate tax return for her sister's estate. The following were claimed as deductions in the estate tax return:

1. Funeral expenses amounting to PhP250,000;
  2. Medical expenses amounting to PhP100,000, incurred when Karissa was hospitalized for pneumonia a month before her death; and
  3. Loss valued at PhP6 million arising from the destruction of Karissa's condominium unit due to fire which occurred on September 15, 2017.
- (a) Should the beachfront property be included in Karissa's gross estate? (2.5%)
  - (b) Are the claimed deductions proper? (2.5%)

## VIII

Upon the death of their beloved parents in 2009, Karla, Karlo, and Karlie inherited a huge tract of farm land in Kanlaon City. The siblings had no plans to use the property. Thus, they decided to donate the land, but were not sure to whom the donation should be made. They consult you, a well-known tax law expert, on the tax implications of the possible donations they plan to make, by giving you a list of the possible donees:

1. The Kanlaon City High School Alumni Association (KCHS AA), since the siblings are all alumni of the same school and are active members of the organization. KCHS AA is an

organization intended to promote and strengthen ties between the school and its alumni;

2. The Kanlaon City Water District which intends to use the land for its offices; or
3. Their second cousin on the maternal side, Kikay, who serves as the caretaker of the property.

Advise the siblings which donation would expose them to the least tax liability. (5%)

### IX

Karlito, a Filipino businessman, is engaged in the business of metal fabrication and repair of LPG cylinder tanks. He conducts business under the name and style of "Karlito's Enterprises," a single proprietorship. Started only five (5) years ago, the business has grown so enormously that Karlito decided to incorporate it by transferring all the assets of the business, particularly the inventory of goods on hand, machineries and equipment, supplies, parts, raw materials, office furniture and furnishings, delivery trucks and other vehicles, buildings, and tools to the new corporation, Karlito's Enterprises, Inc., in exchange for 100% of the capital stock of the new corporation, the stock subscription to which shall be deemed fully paid in the form of the assets transferred to the corporation by Karlito.

As a result, Karlito's Enterprises, the sole proprietorship, ceased to do business and applied for cancellation of its BIR Certificate of Registration. The BIR, however, assessed Karlito VAT on account of the cessation of business based on the current market price of the assets transferred to Karlito's Enterprises, Inc.

- (a) Is the transfer subject to VAT? (2.5%)
- (b) Is the transfer subject to income tax? (2.5%)

### X

Klaus, Inc., a domestic, VAT-registered corporation engaged in the land transportation business, owns a house and lot along Katipunan St., Quezon City. This property is being used by Klaus, Inc.'s president and single largest shareholder, Atty. Krimson, as his residence. No business activity transpires there except for the company's Christmas party which is held there every December. Atty. Krimson recently grew tired of the long commute from Katipunan to his office in Makati City and caused the company to sell the house and lot. The sale was recorded in the books of Klaus, Inc. as investment in real property.

- (a) Is the sale of the said property subject to VAT? (2.5%)

- (b) Is the sale subject to 6% capital gains tax or regular corporate income tax of 30%? (2.5%)

### XI

Koko's primary source of income is his employment with the government. He earns extra from the land he inherited from his parents, and which land he has been leasing to a private, non-stock, non-profit school since 2005.

Last January, the school offered to buy the land from Koko for an amount equivalent to its zonal value plus 15% of such zonal value. Koko agreed but required the school to pay, in addition to the purchase price, the 12% VAT. The school refused Koko's proposal to pass on the VAT contending that it was an entity exempt from such tax. Moreover, it said that Koko was not regularly engaged in the real estate business and, therefore, was not subject to VAT. Consequently, Koko should not charge any VAT to the school.

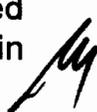
- (a) Is the contention of the school correct? (2.5%)
- (b) Will your answer be the same if Koko signed up as a VAT-registered person only in 2017? (2.5%)

### XII

The BIR Commissioner, in his relentless enforcement of the Run After Tax Evaders (RATE) program, filed with the Department of Justice (DOJ) charges against a movie and television celebrity. The Commissioner alleged that the celebrity earned around PhP 50 million in fees from product endorsements in 2016 which she failed to report in her income tax and VAT returns for said year. The celebrity questioned the proceeding before the DOJ on the ground that she was denied due process since the BIR never issued any Preliminary Assessment Notice (PAN) or a Final Assessment Notice (FAN), both of which are required under Section 228 of the NIRC whenever the Commissioner finds that proper taxes should be assessed.

Is the celebrity's contention tenable? (2.5%)

### XIII

The Collector at the Port of Koronadal seized 100 second-hand right-hand drive buses imported from Japan. He issued warrants of distraint and scheduled the vehicles for auction sale. Kamilo, the importer of the second-hand buses, filed a replevin suit with the Regional Trial Court (RTC). The RTC granted the replevin upon filing of a bond. 

Did the RTC err in granting the replevin? (2.5%)

**XIV**

The City of Kabankalan issued a notice of assessment against KKK, Inc. for deficiency real property taxes for the taxable years 2013 to 2017 in the amount of PhP 20 million. KKK paid the taxes under protest and instituted a complaint entitled "Recovery of Illegally and/or Erroneously-Collected Local Business Tax, Prohibition with Prayer to Issue TRO and Writ of Preliminary Injunction" with the RTC of Negros Occidental.

The RTC denied the application for TRO. Its motion for reconsideration having been denied as well, KKK filed a petition for *certiorari* with the Court of Appeals (CA) assailing the denial of the TRO.

Will the petition prosper? (5%)

**XV**

In 2015, Kerwin bought a three-story house and lot in Kidapawan, North Cotabato. The property has a floor area of 600 sq.m. and is located inside a gated subdivision. Kerwin initially declared the property as residential for real property tax purposes.

In 2016, Kerwin started using the property in his business of manufacturing garments for export. The entire ground floor is now occupied by state-of-the-art sewing machines and other equipment, while the second floor is used as offices. The third floor is retained by Kerwin as his family's residence. Kerwin's neighbors became suspicious of the activities going on inside the house, and they decided to report it to the Kidapawan City Hall. Upon inspection, the local government discovered that the property was being utilized for commercial use. Immediately, the Kidapawan Assessor reclassified the property as commercial with an assessment level of 50% effective January 2017, and assessed Kerwin back taxes and interest. Kerwin claims that only 2/3 of the building was used for commercial purposes since the third floor remained as family residence. He argues that the property should have been classified as partly commercial and partly residential.

- (a) Is the Kidapawan assessor correct in assessing back taxes and interest? (2.5%)
- (b) Is Kerwin correct that only 2/3 of the property should be considered commercial? (2.5%)
- (c) If Kerwin wants to file an administrative protest against the assessment, is he required to pay the assessment taxes first? With whom shall the protest be filed and within what period? (2.5%)

**XVI**

In an action for ejectment filed by Kurt, the lessor-owner, against Kaka, the lessee, the trial court ruled in favor of Kurt. However, the trial court first required

Kurt to pay the realty taxes due on the property for 2016 before he may recover possession thereof.

Kurt objected, arguing that the delinquent realty taxes were never raised as an issue in the ejectment case. At any rate, Kurt claimed that it should be Kaka who should be made liable for the realty taxes since it was Kaka who possessed the property throughout 2016.

Is Kurt correct in resisting the trial court's requirement to pay the taxes first? (2.5%)

### XVII

Kilusang Krus, Inc. (KKI) is a non-stock, non-profit religious organization which owns a vast tract of land in Kalinga.

KKI has devoted 1/2 of the land for various uses: a church with a cemetery exclusive for deceased priests and nuns, a school providing K to 12 education, and a hospital which admits both paying and charity patients. The remaining 1/2 portion has remained idle.

The KKI Board of Trustees decided to lease the remaining 1/2 portion to a real estate developer which constructed a community mall over the property.

Since the rental income from the lease of the property was substantial, the KKI decided to use the amount to finance (1) the medical expenses of the charity patients in the KKI Hospital and (2) the purchase of books and other educational materials for the students of KKI School.

- (a) Is KKI liable for real property taxes on the land? (2.5%)
- (b) Is KKI's income from the rental fees subject to income tax? (2.5%)

### XVIII

Kathang Isip, Inc. (KII) is a domestic corporation engaged in the business of manufacturing, importing, exporting, and distributing toys both locally and abroad. Its principal office is located in Kalookan City, Philippines. It has 50 branches in different cities and municipalities in the country. When KII applied for renewal of its mayor's permit and licenses in its principal office in January this year, Kalookan City demanded payment of the local business tax on the basis of the gross sales reported by the corporation in its audited financial statements for the preceding year. KII protested, contending that Kalookan City may tax only the sales consummated by its principal office but not the sales consummated by its branch offices located outside Kalookan City.

When Kalookan City denied the protest, KII engaged the services of Atty. Kristeta Kabuyao to file the necessary judicial proceedings to appeal the decision

of Kalookan City. Atty. Kabuyao is a legal expert, but resides in Kalibo, Aklan where her husband operates a resort. She, however, practices in Metro Manila, including Kalookan City. The counsel representing the city, in the case filed in Kalookan City by KII, questioned the use of Atty. Kabuyao's Professional Tax Receipt (PTR) issued in Aklan for a case filed in Kalookan City.

- (a) Is KII's contention that Kalookan City can only collect local business taxes based on sales consummated in the principal office meritorious? (2.5%)
- (b) Is the Kalookan City counsel correct in saying that Atty. Kabuyao's PTR issued in Aklan cannot be used in Kalookan? (2.5%)

### XIX

The BIR assessed Kosco, Inc., an importer of food products, deficiency income and value-added taxes, plus 50% surcharge after determining that Kosco, Inc. had under-declared its sales by an amount exceeding 30% of that declared in its income tax and VAT returns. Kosco, Inc. denied the alleged under-declaration, protested the deficiency assessment for income and value-added taxes and challenged the imposition of the 50% surcharge on the ground that the surcharge may only be imposed if Kosco, Inc. fails to pay the deficiency taxes within the time prescribed for their payment in the notice of assessment.

- (a) Is the imposition of the 50% surcharge proper? (2.5%)
- (b) If your answer to (a) is yes, may Kosco, Inc. enter into a compromise with the BIR for reduction of the amount of surcharge to be paid? (2.5%)

### XX

Krisp Kleen, Inc. (KKI) is a corporation engaged in the manufacturing and processing of steel and its by-products. It is both registered with the Board of Investments with a pioneer status, and with the BIR as a VAT entity. On October 10, 2010, it filed a claim for refund/credit of input VAT for the period January 1 to March 31, 2009 before the Commissioner of Internal Revenue (CIR). On February 1, 2011, as the CIR had not yet made any ruling on its claim for refund/credit, KKI, fearful that its period to appeal to the courts might prescribe, filed an appeal with the Court of Tax Appeals (CTA).

- (a) Can the CTA act on KKI's appeal? (2.5%)
- (b) Will your answer be the same if KKI filed its appeal on March 20, 2011 and CIR had not yet acted on its claim? (2.5%)

**-NOTHING FOLLOWS-**