Study on the
TAX AVOIDANCE AND
EVASION SCHEMES
on the Transfer of
Real Properties*

I. INTRODUCTION

Real property includes all the rights, interests, and benefits related to the ownership of real estate.\(^1\) Ownership of real estate is evidenced by a Certificate of Title, Free Patent or Tax Declaration in the absence of Certificate of Title.\(^2\)

The tax on real property is a stable source of revenue because of the permanency of the tax object. Real property related transactions are also subject to different taxes imposed by the national and local governments. Transactions such as sale, donation, barter or exchange, or inheritance of real properties are subject to creditable withholding tax (CWT), value-added tax (VAT), capital gains tax, donor's tax, or estate tax, as the case may be, and documentary stamp tax which are all imposed by the national government. The province, city or municipality within Metropolitan Manila Area, on the other hand, impose a tax on the transfer of real property ownership pursuant to Section 135 of the Local Government Code of 1991 (LGC).

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\(^1\) Real estate refers to the physical land and all those items which are attached to the land. It is the physical, tangible entity which can be seen or touched, together with all the additions on, above, or below the ground. (Philippine – Australia Land Administration and Management Project, *Philippine Valuation Standards, Report B4*, December 2004)

The taxes on real property transactions differ in terms of rates and bases. The
differences in tax rates and bases give an opportunity to taxpayers to minimize their tax
liabilities by choosing the type of transaction which is most advantageous to them.

The purpose of this study is to present the different modes of transferring real
properties and their respective tax treatment and identify tax avoidance and evasion\(^3\) schemes
employed by the taxpayers with the end in view of recommending measures to address these
problems and possible ways to make the system more equitable.

II. BACKGROUND INFORMATION

A. Modes of Transferring Real Properties

There are different modes of transferring real property to another. Some of the
most common modes are the sale, donation, and succession or inheritance.

1. Sale

By the contract of sale, one of the contracting parties obligates himself to
transfer the ownership of and to deliver a determinate thing to the other party who
will then pay a price certain in money or its equivalent.\(^4\) There are two principal
kinds of sale: (a) absolute sale; and (b) conditional sale.\(^5\) An absolute sale is an
outright sale without any conditions imposed. The ownership is immediately
passed to the vendee/buyer upon delivery of the object, and payment of the
purchase price.

The contract of sale is deemed \textit{conditional} when the object of sale is
subject to resolutory conditions as when the contract of sale provides a right to
repurchase; or if the seller reserves the right of possession or ownership until the
fulfillment of certain conditions.

2. Donation

Donation is defined as “an act of liberality whereby a person disposes
gratuitously of a thing or right in favor of another, who accepts it.”\(^6\) Donation

\(^3\) Tax evasion is the avoidance of tax by unlawful means, i.e., the taxpayer pays less tax than he is
legally obligated to pay. Tax evasion can be carried out by the omission of taxable income or transactions from
tax declarations, failure to file a return, sham transactions, or reduction of the amount properly due by
fraudulent misstatement or misrepresentation. The element of illegality distinguishes tax evasion from tax
(Amsterdam: 1988) p. 92]

\(^4\) Article 1458, Civil Code of the Philippines.

\(^5\) Ibid.

\(^6\) Article 725, Civil Code of the Philippines.
may be *inter vivos* or *mortis causa*. The donation is *inter vivos* if made between living persons and the donor intends that the donation shall take effect during his lifetime. The donation is *mortis causa* if made in the nature of testamentary disposition that is to take effect upon the death of the donor.

According to purpose, donations may be categorized as follows:

a. Pure or simple;
b. Remuneratory or compensatory;
c. Conditional or modal; and
d. Onerous.

A pure or simple donation is one where the underlying cause is plain gratuity. On the other hand, a remuneratory or compensatory donation is one made for the purpose of rewarding the donee for past services, which services do not amount to a demandable debt. A conditional or modal donation is one where the donation is made in consideration of future services or where the donor imposes certain conditions, limitations or charges upon the donee, the value of which is inferior than that of the donation given. An onerous donation is that which imposes upon the donee a reciprocal obligation or, to be more precise, this is the kind of donation made for a valuable consideration, the cost of which is equal to or more than the thing donated. Unlike other forms of donation, the validity of and the rights and obligations of the parties involved in an onerous donation are completely governed not by the law on donations but by the law on contracts as provided under Article 733 of the New Civil Code.

3. Succession or Inheritance

Succession is a mode of acquisition by virtue of which the property, rights and obligations to the extent of the value of inheritance, of a person are transmitted through his death to another or others either by his will or by operation of law. There are four kinds of succession, namely: (a) testamentary; (b) legal or intestate; (c) mixed; and (d) partition *inter vivos*. Incidence of estate tax arises from these transactions.

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8 Article 733 provides that “donations with an onerous cause shall be governed by the rules on contracts, and remuneratory donations by the provisions of the present Title as regards that portion which exceeds the value of the burden imposed.”

9 A will is an act whereby a person is permitted with the formalities prescribed by law, to control in a certain degree the disposition of his estate, to take effect after his death (Article 783, Civil Code of the Philippines).

10 Article 774, Civil Code of the Philippines.
There is *testamentary succession* when the decedent left a valid will which must be duly probated because a will cannot transfer ownership or pass property unless it has been duly probated or allowed by the court. Aside from the presence of a valid will, it is essential that there are qualified heirs who will inherit. Otherwise, even if there is a will, if the designated heirs are not qualified, *intestacy*\(^\text{11}\) will govern. In testamentary succession, the wishes of the decedent are respected insofar as the free portion\(^\text{12}\) of the estate is concerned. As regards the *legitime*,\(^\text{13}\) it is the law and not the will of the decedent that governs.\(^\text{14}\)

In *intestate succession*, the estate of the decedent is divided in accordance with the provisions of the law. The law operates by presuming the will of the decedent. The decedent’s will is just presumed because either the decedent died without a will or he died with a void or ineffective will.\(^\text{15}\)

There is *mixed succession* when the estate of the deceased is distributed partly in accordance with the will of the testator and partly with the rules of intestacy. This can happen for instance, when the testator made a will but failed to cover and dispose of all properties in the will. Those covered by the will shall be distributed in accordance with the will and those not covered by the rules of intestacy.\(^\text{16}\)

Partition *inter vivos* refers to the partition of the estate of a person made by him during his lifetime. It is allowed but effective only after his death. It can be made in a will. Such partition is valid so long as no legitimes of compulsory heirs are impaired. (Article 1080).\(^\text{17}\)

**B. Taxes on the Transfer of Real Properties**

1. *Sale*

In a sale transaction, the tax treatment varies depending on the classification or nature, or value of real property. If the real property is an ordinary asset, its sale by

\(^\text{11}\) It is the state or condition of dying without having made a valid will, or without having disposed of by will a part of his property. (Black’s Law Dictionary, Revised Fourth Edition, p. 956)

\(^\text{12}\) It is that part of the inheritance which remains after the satisfaction of the legitimes of the compulsory heirs.

\(^\text{13}\) It is that part of the inheritance which the testator cannot dispose of because the law has reserved it for certain heirs which are called compulsory heirs. Compulsory heirs are those relatives by consanguinity of the decedent, in whose favor a part of the inheritance is reserved by law, of which part the decedent is under compulsion to reserve.


\(^\text{15}\) Ibid.

\(^\text{16}\) Ibid.

\(^\text{17}\) Ibid.
a seller/taxpayer who is habitually engaged in real estate business\(^{18}\) is subject to the regular income tax. To ensure proper collection, the BIR employs withholding of tax in accordance with the following schedule:\(^{19}\)

<table>
<thead>
<tr>
<th>Rate of CWT</th>
<th>Exempt</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Where the seller/transferor is exempt from creditable withholding tax in accordance with Section 2.57.5 of RR No.2-98, as amended;(^{20})</td>
<td>-</td>
</tr>
<tr>
<td>b. With a selling price of P500,000.00 or less</td>
<td>1.5%</td>
</tr>
<tr>
<td>c. With a selling price of more than P500,000.00 but not more than P2 million</td>
<td>3.0%</td>
</tr>
<tr>
<td>d. With selling price of more than P2 million</td>
<td>5.0%</td>
</tr>
</tbody>
</table>

\(^{18}\) To be considered as habitually engaged in real estate business, a seller/transferor must show proof of registration with Housing and Land Use Regulatory Board (HLURB) or Housing and Urban Development Coordinating Council (HUDCC).

\(^{19}\) Per Revenue Regulations No. 2-98, as amended.

\(^{20}\) Sec. 2.57.5 of RR 2-98, as amended provides that the withholding of CWT prescribed therein shall not apply to income payments made to the following:

a. National government agencies and its instrumentalities including provincial, city, municipal governments and barangays except government-owned and controlled corporations;

b. Persons enjoying exemptions from payment of income taxes pursuant to the provisions of any law, general or special, such as but not limited to the following:

1. Sales of real property by a corporation which is registered with and certified by the HLURB or HUDCC as engaged in socialized housing project where the selling price of the house and lot or only the lot does not exceed P180,000 in Metro Manila and other highly urbanized areas and P150,000 in other areas or such adjusted amount of selling price for socialized housing as may later be determined and adopted by the HLURB, as provided under RA 7279 and its implementing regulations;

2. Corporations duly registered with the Board of Investments, Philippine Export Processing Zones and Subic Bay Metropolitan Authority enjoying exemption from income tax pursuant to EO 226, as amended, RA 7916, the Omnibus Investment Code of 1987 and RA 7227, as amended, respectively;

3. Corporations which are exempt from the income tax under Sec. 30 of the NIRC, to wit: the GSIS, SSS, PHIC, PCSO, and PAGCOR; However, the income payments arising from any activity which is conducted for profit or income derived from real or personal property shall be subject to a withholding tax as prescribed in these regulations;

4. General professional partnerships; and

5. Joint ventures or consortium formed for the purpose of undertaking construction projects or engaging in petroleum, coal, geothermal and other energy operations pursuant to an operating or consortium agreement under a service contract with the government.
On the other hand, the sale of real property classified as ordinary asset by a seller/taxpayer not habitually engaged in real estate business is subject to CWT of 6% of gross selling price.

If the value of real property classified as ordinary asset is more than P1 million, its sale is subject to VAT of 10%. 22

If the real property is classified as capital asset, the sale thereof is subject to capital gains tax. However, subject to certain conditions, the sale of a principal residence, and land for socialized housing or land covered by the Comprehensive Agrarian Reform Program (CARP) is exempted from the payment of capital gains tax. The capital gains tax rate is 6% of the gross selling price or fair market value of the property as determined by the Commissioner of Internal Revenue in accordance with Section 6 (E) of the National Internal Revenue Code of 1997 (NIRC), whichever is higher. The fair market value refers to whichever is higher between the (1) zonal value and (2) fair market value as shown in the Schedule of Values prepared by the provincial or city assessor. Thus, aside from the gross selling price, these values are considered in computing the capital gains tax.

2. Donation

If the transfer or conveyance of real property is done through a donation inter vivos, the transaction is subject to the donor’s tax which is a graduated tax with progressive rates up to 15% of the value of the net gift. 24 If the donee is a

21 Increased under RA No. 9337 to more than P1.5 million if the property is residential lot and to more than P2.5 million if the properties are house and lot and other residential dwellings. The implementation of RA No. 9337 on July 1, 2005 has been deferred following the issuance by the Supreme Court of a temporary restraining order on July 1, 2005.

22 Section 106 (A) (1) (a) in relation to Section 109 (w) of the NIRC.

23 The term “capital assets” means property held by the taxpayer (whether or not connected with his trade or business) but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property used in the trade or business, of a character which is subject to the allowance for depreciation provided in Subsection (F) of Section 34; or real property used in trade or business of the taxpayer. (Section 39 (A), NIRC).

24 The donor’s tax is computed in accordance with the following schedule:

<table>
<thead>
<tr>
<th>Over</th>
<th>But Not Over</th>
<th>The Tax Shall Be</th>
<th>Plus</th>
<th>Of Excess Over</th>
</tr>
</thead>
<tbody>
<tr>
<td>100,000</td>
<td>100,000</td>
<td>Exempt</td>
<td>0</td>
<td>2%</td>
</tr>
<tr>
<td>200,000</td>
<td>200,000</td>
<td>2,000</td>
<td>4%</td>
<td>200,000</td>
</tr>
<tr>
<td>300,000</td>
<td>300,000</td>
<td>14,000</td>
<td>6%</td>
<td>500,000</td>
</tr>
<tr>
<td>400,000</td>
<td>400,000</td>
<td>44,000</td>
<td>8%</td>
<td>1,000,000</td>
</tr>
<tr>
<td>500,000</td>
<td>500,000</td>
<td>204,000</td>
<td>10%</td>
<td>3,000,000</td>
</tr>
<tr>
<td>600,000</td>
<td>600,000</td>
<td>404,000</td>
<td>12%</td>
<td>5,000,000</td>
</tr>
<tr>
<td>700,000</td>
<td>700,000</td>
<td>1,004,000</td>
<td>15%</td>
<td>10,000,000</td>
</tr>
</tbody>
</table>

Tax Avoidance and Evasion Schemes on the Transfer of Real Properties
stranger, the donor’s tax rate is 30%. On the other hand, if the donation is mortis causa, that is to take effect upon the death of the donor, it is not subject to donor’s tax but to estate tax.

3. Succession or Inheritance

If the transfer of real property is through succession or inheritance, it is subject to the estate tax. The estate tax is a tax on the right to transmit property upon death of the decedent and on certain transfers by the decedent during lifetime which is made by law equivalent of testamentary disposition. The base of the tax is the net estate of the decedent. Net estate means gross estate less allowable deductions and specific exemptions. Gross estate refers to the value at the time of death of all property, consisting of real and personal property, whether tangible or intangible, or mixed, wherever situated, provided that where the decedent was a non-resident alien at the time of his death, his real and personal property so transferred but which are situated outside the Philippines shall not be included as part of his gross estate.

The net estate is computed by deducting from the gross estate the expenses, losses, indebtedness, property previously taxed, standard deduction, etc. The estate

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25 For the purpose of donor’s tax, a “stranger” is a person who is not a: (1) brother, sister (whether by whole or half-blood), spouse, ancestor, and lineal descendant; or (2) relative by consanguinity in the collateral line within the fourth degree of relationship. (Section 99 (B), NIRC).

26 Sec. 86, NIRC provides that the following are deductible from the estate of a citizen or resident of the Philippines:

a. Expenses, Losses, Indebtedness, and Taxes - Such amounts —
   a.1. For actual funeral expenses or in an amount equal to 5% of the gross estate, whichever is lower, but in case to exceed P200,000;
   a.2. For judicial expenses of the testamentary or intestate proceedings;
   a.3. For claims against the estate;
   a.4. For claims of the deceased against insolvent persons where the value of decedent’s interest therein is included in the value of the gross estate; and
   a.5. For unpaid mortgages.

b. Property previously taxed.

c. Transfers for Public Use.

d. The Family Home - up to the value of P1 million.

e. Standard Deduction – an amount equivalent to P1 million.

f. Medical expenses incurred by the decedent within one year prior to his death duly substantiated with receipts but not to exceed P500,000.

g. Amount received by heirs from the decedent employer as a consequence of the death of the decedent-employees in accordance with Republic Act No. 4917.
tax is computed pursuant to a graduated tax structure with rates ranging from 0% to 20% of the net estate. 27

4. Taxes Common to a Sale, Donation, and Succession or Inheritance

Whether the transaction is a sale, donation, or succession, the transfer of real property ownership is subject to a documentary stamp tax at the rate of P15 for every P1,000 or fraction thereof based on the consideration or fair market value as determined by the BIR Commissioner, whichever is higher. 28 The conveyance is also subject to the transfer tax imposed by the province or city or municipality within Metro Manila. It is a percentage tax of not exceeding fifty percent (50%) of one percent (1%) in the case of province, or a maximum of 75% of 1% in the case of a city or municipality within Metro Manila, of the total consideration involved in the acquisition of property or fair market value of the property, whichever is higher. Exempted from this tax is the transfer of ownership pursuant to Republic Act No. 6657 or the Comprehensive Agrarian Reform Law of 1988. 29

III. TAX AVOIDANCE AND EVASION SCHEMES

Taxes have never been popular among taxpayers. As much as possible, taxpayers seek ways to minimize taxes by scrutinizing the tax structure to look for loopholes or defects that will allow them to reduce their tax liabilities. Some even hire tax consultants for this purpose. Although tax avoidance 30 is legally allowed, its occurrence should be minimized because it undermines the effort of the government to collect more revenues. On the other hand, tax evasion is illegal and taxpayers who commit it are subject to prosecution and punishment under existing laws.

27 The schedule used in computing the estate tax is:

If the Net Estate is:

<table>
<thead>
<tr>
<th>Over</th>
<th>But Not Over</th>
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<tbody>
<tr>
<td>-</td>
<td>200,000</td>
<td>Exempt</td>
<td>0</td>
<td>5%</td>
</tr>
<tr>
<td>200,000</td>
<td>500,000</td>
<td>0</td>
<td>5%</td>
<td>200,000</td>
</tr>
<tr>
<td>500,000</td>
<td>2,000,000</td>
<td>15,000</td>
<td>8%</td>
<td>500,000</td>
</tr>
<tr>
<td>2,000,000</td>
<td>5,000,000</td>
<td>135,000</td>
<td>11%</td>
<td>2,000,000</td>
</tr>
<tr>
<td>5,000,000</td>
<td>10,000,000</td>
<td>465,000</td>
<td>15%</td>
<td>5,000,000</td>
</tr>
<tr>
<td>10,000,000</td>
<td>And Over</td>
<td>1,215,000</td>
<td>20%</td>
<td>10,000,000</td>
</tr>
</tbody>
</table>

28 Section 196, NIRC.

29 Section 135, RA No. 7160, otherwise known as the Local Government Code of 1991.

30 The term is used to denote the reduction of tax liability by legal means. It often has pejorative overtones where for example it is used to describe avoidance achieved by artificial arrangements of personal or business affairs to take advantage of loopholes, anomalies or other deficiencies of tax laws. (Source: International Bureau of Fiscal Documentation, International Tax Glossary, 2nd Revised Edition, 1992, p.20).
The following are some of the schemes employed by taxpayers to minimize or evade their tax liabilities on the transfer of real properties:

A. Tax Avoidance Schemes

1. Splitting of Gifts

The splitting of gifts over numerous calendar years is another way of reducing the donor’s tax because it is computed on the basis of the total net gifts made during the calendar year. To illustrate, A wants to donate his 2 parcels of land with a value of P1 million each to B. If A donates his P2 million parcels of land in 2002, the donor’s tax would be P124,000.00 computed as follows:

<table>
<thead>
<tr>
<th>Over</th>
<th>But Not Over</th>
<th>The Tax Shall Be</th>
<th>Plus</th>
<th>Of Excess Over</th>
</tr>
</thead>
<tbody>
<tr>
<td>P1,000,000</td>
<td>P3,000,000</td>
<td>P44,000</td>
<td>8%</td>
<td>P1,000,000</td>
</tr>
</tbody>
</table>

If A spreads the P2 million donation over two (2) years, P1 million in 2002 and the other P1 million in 2003, the annual donor’s tax would only be P44,000.00 computed as follows:

<table>
<thead>
<tr>
<th>Over</th>
<th>But Not Over</th>
<th>The Tax Shall Be</th>
<th>Plus</th>
<th>Of Excess Over</th>
</tr>
</thead>
<tbody>
<tr>
<td>P500,000</td>
<td>P1,000,000</td>
<td>P14,000</td>
<td>6%</td>
<td>P500,000</td>
</tr>
</tbody>
</table>

The total donor’s tax for two (2) years would only be P88,000 while for the donation made in one year, the donor’s tax is P124,000. The splitting of gifts results in a tax savings of P36,000. However, it is believed that the donor would not go to the extent of splitting gifts given the difficulty, hassles and cost involved in registering aforesaid subdivided real properties only to be consolidated later.

The use of the net gifts made during the calendar year and the graduated donor’s tax structure give way for this tax avoidance practice. The immediate solution to this appears to be the taxing of gifts on gross basis, removal of the period when the donation is made, and the adoption of a flat rate donor’s tax. The adoption of flat rate donor’s tax is simpler to administer but it may be criticized for being inconsistent with the Constitutional mandate on Congress to evolve a progressive system of taxation.\(^{31}\)

2. Simulation of Transaction

Simulating the transaction is also resorted to by taxpayers in order to reduce their tax liability. Simulation is possible due to the differences in the tax rates applicable to a certain value of properties since the taxpayers can choose which transaction is most advantageous to them. For instance, if the owner of real property with a fair market value of P 2 million wants to transfer to his heir/s such real property, it would be advantageous to him, insofar as taxation is concerned, to just

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\(^{31}\) Section 28 (1), Article VI of the 1987 Philippine Constitution.
wait for his death and let the heir/s inherit the property instead of fictitiously selling or donating the same to the latter. Through succession or inheritance, the heir will not probably pay estate tax because of the allowable deductions to the gross estate (e.g., standard deduction of P1 million, funeral and medical expenses, value of family homes up to P1 million, etc.) which will reduce or totally offset the gross estate. If the transfer is done through sale, the transaction shall be subject to 6% capital gains tax resulting in a tax due of P120,000. If the owner donates the property, the donation shall be subject to a donor’s tax of P124,000.

It should be noted, however, that the disposal of real property through simulated transaction especially by one contemplating eventual death does not guarantee the reduction of estate tax. Under Section 85 (B) of the NIRC, properties transferred in contemplation of death are includible in the gross estate of decedent. If the property is an ordinary asset and it is transferred for less than an adequate and full consideration in money or money’s worth, the amount by which the fair market value of the property exceeded the value of consideration is considered a gift subject to donor’s tax. If the consideration is fictitious, the entire value of the property is subject to donor’s tax.

If only to take away the opportunity to choose which transaction is advantageous to the taxpayers and to simplify the tax system, the imposition of a national transfer tax in lieu of capital gains tax, donor’s tax, and estate tax may be considered. The structure of the national transfer tax may be a progressive graduated tax or a flat rate tax. While the progressive graduated tax structure takes into account the value of the property, i.e., those with higher values have higher tax rates, it provides incentives to taxpayers to understate or lower the value of property in order not to be subject to a higher tax rate. Moreover, a graduated tax structure is

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32 The term “in contemplation of death,” as used in estate taxation, does not refer to the general expectation of death which all entertain. The word means that it is the thought of death, as a controlling motive, which induces the disposition of the property for the purpose of avoiding the tax. The decedent’s motive or intention is, of course, a question of fact. Thus, the imminence of death may afford convincing evidence of the impelling cause of the transfer. The following are examples of circumstances which may be taken into consideration in determining whether the transfer was made in contemplation of death:

a. Age and state of health of the decedent at the time of the gift, especially if he was aware of serious illness;

b. Length of time between the gift and the date of death. A short interval suggests the conclusion that the thought of death was in the decedents mind, and a long interval suggest the opposite; and

c. Concurrent making of a will or making a will within a short time after the transfer.


34 The imposition of documentary stamp tax as the only tax on the transfer of real property and the abolition of capital gains tax, donor’s tax, and estate tax are also one of the options recommended under the Philippine Australia Land Administration and Management Project.
less simple than a flat rate tax because the taxpayer or tax official has to determine the applicable rate for a particular value of the property. A flat rate tax, as earlier pointed out, is simple to administer since in determining the tax due, what the taxpayer will do is just to apply the rate to the value of the property.

3. Donation to a Foundation

The donor’s tax or estate tax may also be avoided if the donation is made *inter vivos* or *mortis causa* to a non-stock, non-profit charitable, educational, or religious foundation created by the donor himself or by the corporation where the donor or heirs have the controlling interests. It should be noted that the value of the donation to such foundation is deductible from the donor’s gross income\(^{35}\) as well as exempt from the donor’s tax.\(^{36}\) For corporations, it is advantageous to create a foundation that will take care of some of its social commitments and promote goodwill in the community and at the same time use such foundation as a tax shelter.

If the removal of the incentive to donate real property shall be pursued, an approach that may be considered is just to disallow its deductibility from the donor’s gross income.

4. Creation of Irrevocable Trusts\(^{37}\)

Aside from other purposes such as to shelter the real property from the claims of creditors or other claimants or to manage and distribute the property or income thereof according to the wish of the trustor, the creation of an irrevocable trusts may also be done to avoid payment of the estate tax and income tax on trust property. It should be noted that what is included in the gross estate is revocable transfer. An irrevocable trust, being excluded from the gross estate, is effectively exempt from the estate tax. An irrevocable trust is not included in the computation of gross estate considering that the trustor virtually cedes his interests over the trust property in favor

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\(^{35}\) Section 34 (H), NIRC.

\(^{36}\) Section 101, Ibid.

\(^{37}\) A trust is a fiduciary relationship concerning property which obliges the person holding it to deal with the property for the benefit of another (Pacheco v. Ara, 47 O.G. 4099). The person holding, in view of his equitable title, is allowed to exercise certain powers belonging to the owner of the legal title (54 Am. Jur. 27). [Source: Edgardo L. Paras, *Civil Code of the Philippines Annotated, Vol. IV, 6th Ed.* (Manila: Rex Bookstore, 1969) p. 631]; A trust is an arrangement created by will or by an agreement under which title to property is passed to another for conservation or investment with the income therefrom and ultimately the corpus (principal) to be distributed in accordance with the directions of the creator as expressed in the governing instrument. [Source: Hector S. De Leon, *The National Internal Revenue Code Annotated, 7th Edition,* (Manila: Rex Bookstore, 2000) p. 406]. An irrevocable trust is a trust which cannot be changed or canceled once it is set up without the consent of the beneficiary. [(Source: http://www.investorwords.com/2647/irrevocable_trust.html (20 August 2004))]
of the beneficiary. In other words, the trustor no longer owns the property transferred to the irrevocable trust.\textsuperscript{38}

5. Application of Lower CWT

The strategy used by those engaged in real estate business is to design the project or sales plan with the least tax attraction on the project or on their marketing activity. A prudent real estate dealer or developer usually identifies and plans from the start of the real estate project the taxes that it will attract. Depending on the target market, a real estate developer that wants no CWT on the sale of its project will make its project classified as socialized housing project.

Moreover, prior to its marketing activities, the real estate dealers or developers usually establish to the satisfaction of the BIR that they are habitually engaged in real estate business. This has significant impact on their cash flow since the CWT of those habitually engaged in real estate business is lower than those who are not. By having a lower CWT, the real estate dealer or developer gains from the time value of money available to them. Lower CWT improves the business' financial liquidity and saves them from looking at other sources of financing their business operations.

Depending on the financial targets, an installment sale\textsuperscript{39} is typically offered by a real estate dealer to individual buyers who are not engaged in trade or business. In this type of sale and buyer, the applicable CWT is withheld not on the periodic payments but only on the last installment or on installments immediately prior to such last installment. If the buyer on installment basis is engaged in trade or business, the CWT is collected on every installment payment.\textsuperscript{40} The advantage derived by the business in offering installment sale insofar as the payment of tax is concerned is that it is able to maximize the time value of money available to them.

6. Formation of a Joint Venture

A joint venture undertaking is usually resorted to by a real estate developer primarily not because of its tax advantage but because of insufficiency of capital or financing to acquire the property it wants to develop. On the other hand, an owner of the land may prefer a joint venture than outright selling if the property has physical impediments (e.g., squatters); if the property is mortgaged and about to be foreclosed; or the owner has no money to develop the property or no knowledge and time to manage the project. In a typical joint venture agreement, the landowner provides the land as his/her equity or capital share in the project while the developer usually


\textsuperscript{39} A sale is considered on installment plan if the payments in the year of sale do not exceed 25\% of the selling price. (RR No. 2-98 as amended)

\textsuperscript{40} Per RR No. 2-98 as amended.
provides the financing and technical expertise in developing, managing and marketing the project.

Under Section 22 (B) of the NIRC, for tax purposes, a joint venture or consortium formed for the purpose of undertaking construction projects is exempt from income tax and is likewise not subject to creditable (expanded) withholding tax under Section 57 (B) of the NIRC. The joint venture is also exempt from the payment of CGT, VAT and DST per Section 196 of the NIRC. However, the partners’ subsequent disposition of their respective shares is subject to CWT/ordinary income tax, DST, or VAT, as the case may be.  

The exclusion of a joint venture or consortium formed for the purpose of undertaking construction projects from the definition of taxable corporation is based on the following: (a) Local contractors contribute substantially to the development program of the country; (b) Local contractors are at a disadvantage in competitive bidding with foreign contractors in view of their limited capital and financial resources; (c) In order to be able to compete with big foreign contractors, it may be necessary for them to enter into joint ventures to pool their limited resources in undertaking big construction projects; and (d) To assist them in achieving competitiveness with foreign contractors, the joint ventures formed by them should not be considered an additional income tax lien.

7. Transfer to a Corporation

A real property owner wanting to have control of a corporation should, instead of selling the real property and using the proceeds thereof to purchase the stocks or units of participation of such corporation, just transfer his real property to the corporation in exchange for such shares of stock or units of participation. If the real property owner, alone or together with other persons not exceeding four (4), gains control of the said corporation as a result of such exchange, the transaction shall be exempt from the capital gains tax or creditable withholding tax, as the case may be, there being no recognition of gain or loss on the said transaction. However, such transfer is subject to documentary stamp tax pursuant to Section 196 of the NIRC.

Another instance where there is no recognition of gain or loss is when, in pursuance of a plan of merger or consolidation --- (a) a corporation, which is a party to a merger or consolidation, exchanges property solely for stock in a corporation, which is a party to the merger or consolidation; or (b) a shareholder exchanges stock in a corporation, which is a party to the merger or consolidation, solely for the stock

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of another corporation also a party to the merger or consolidation; or (c) a security holder of a corporation, which is a party to the merger or consolidation, exchanges his securities in such corporation, solely for stock or securities in another corporation, a party to the merger or consolidation.

The non-recognition of gain or loss on the above transactions is justified in the sense that the transfer is usually done for purely business purposes and not to avoid or escape taxation.

B. Tax Evasion Schemes

1. Reduction of the Tax Base

In a sale transaction, the most common approach employed by taxpayers to minimize the tax due is to understate the selling price. As previously discussed, the selling price is one of the bases of the CWT, capital gains tax and local transfer tax and any reduction thereto will correspondingly decrease the tax due on the sale transaction. It may be recalled that when the capital gains tax was still based on the net capital gains, the understatement of the selling price or the overstatement of the costs were identified to be some of the ways to reduce the capital gains tax. To plug this loophole, the government changed the tax base from net capital gains to presumed capital gains and the tax rates from a two-tiered schedular rates to a final percentage tax of 5% (later increased to 6%), which changes transformed the tax into more of a transaction tax than a tax on capital gains. The government also adopted as the base of the capital gains tax whichever is the highest among the gross selling price, zonal value or the fair market value as shown in the Schedule of Values prepared by the provincial or city assessor.

In the sale of ordinary assets, the practice of under-declaring the selling price is not much of a problem since the selling price of real property is usually fixed or predetermined by the seller and is known to the public, buyers and tax officials. However, a practice employed by the real estate dealer or developer which is tantamount to the reduction of the tax base is the non-inclusion of the reservation fee and other miscellaneous expenses in the documented gross selling price. It should be noted that in the buyer’s view, the reservation fee and other miscellaneous expenses they are required to pay form part of the total consideration to acquire the real property, hence, are considered by them in computing the effective price per square meter of the property.

The use of different tax bases gives taxpayers the opportunity to choose which tax base to use that will yield the least tax due. If the selling price is higher than the BIR’s zonal value or LGU’s fair market value, the tendency is to declare in the sale document an amount equivalent to the zonal or LGU’s value. Since in all probability, the selling price is much higher than the zonal value or the LGU’s fair market value which are considered way below market levels, the government loses substantial revenue because of the underdeclaration.
Another scheme employed, usually by an individual seller and buyer, to minimize the tax due on the sale transaction is the preparation of two (2) sets of documents covering the sale transaction. The first document, unnotarized yet binding between the parties thereto, reflects the true agreed selling price while the second document, the one to be presented to the BIR and Registry of Deeds and which becomes the basis in computing the taxes and other fees due on the sale transaction, contains a lower selling price. The second document is usually notarized because the notarization by a notary public converts a private document into a public document, making it admissible in evidence without further proof of its authenticity. A notarial document is, by law, entitled to full faith and credit upon its face.45

The understatement of the tax base also happens in the case of donation of a real property. Under the NIRC, the donor’s tax is also computed based on the zonal value or LGU’s fair market value. Because such values are not regularly updated, they are generally lower than the prevailing market value of the property, hence the base used for donor’s tax purposes may be considered systematically understated.

As regards the estate tax, the reduction of the tax base (net estate) is made possible through overstatement of allowable deductions or non-inclusion of other assets or properties in the gross estate of the decedent.

To lessen the Documentary Stamp Tax (DST) on documents involving the transfer of real properties, what taxpayers usually do is execute a single document covering two or more transactions involving the transfer of same real properties. For example, extra judicial settlements are accompanied by sale transactions to lessen the DST and registration or titling cost.

One of the measures that may be adopted to counter the practice of understating the selling price is to use only one valuation base, e.g., either zonal value or improved LGU value, in computing all real property related taxes. It is also imperative to regularly update these values in order to maximize the potential of the taxes computed based thereon.46

2. Non-Filing of Tax Returns

For the sale or disposition of real property classified as capital assets, the capital gains tax return must be filed within thirty (30) days following each sale or disposition.47 Likewise, the return on the donation of real property and the donor’s tax due thereon shall be made within thirty (30) days after the date the gift was


46 The adoption of a single valuation base and its regular updating are also among of the recommendations of the Land Valuation Study conducted under the Philippine-Australia Land Administration and Management Project (LAMP).

47 Section 51( C) (2) (b), NIRC.
made. In the case of the estate tax, the return therefor should be made within six (6) months from the decedent’s death, and in meritorious cases, the Commissioner of Internal Revenue is authorized to grant a reasonable extension not exceeding thirty (30) days for filing the return. Non-filing of tax return and non-payment of tax due thereon within the prescribed period is subject to a penalty of 25% or 50%, as the case may be, and 20% interest which is in addition to the basic tax liabilities. Notwithstanding the imposition of penalties and interest, the non-filing of tax returns and the corresponding non-payment of taxes due deprive the government of revenues.

The period within which the capital gains tax and donor’s tax should be paid is deemed reasonable considering that generally, the taxpayers concerned have the capacity to pay the corresponding tax on the transaction that took place. On the other hand, the longer period required for the settlement of estate tax is deemed to be a recognition of the fact that usually, the heirs of the decedent suffer financial hardships prior to and after the death of the decedent. The non-filing of tax returns usually occurs with taxpayers who have financial liquidity problems particularly the heirs of a decedent liable to payment of the estate tax.

3. Bribery or Connivance With Concerned Officials

Bribery or connivance with concerned government officials such as those involved in the examination of tax returns and registration of the transaction is sometimes resorted to by the taxpayer in order to reduce or evade the tax liabilities arising from the transaction. This practice is illegal and punishable under existing laws such as Anti-Graft and Corrupt Practices Act (R. A. 3019), Code of Conduct and Ethical Standards for Public Officials and Employees (R. A. 6713), National Internal Revenue Code (R.A. 8424) and Revised Penal Code (Act No. 3815).

The taxpayer and the concerned tax official gain from this practice by dividing the amount they save from tax. Anecdotal information reveals that only 50% of the correct amount of taxes accrues to the government while the other 50% is divided equally by and between the taxpayer and conniving official, thereby resulting in a taxpayer’s saving of 25% of the taxes due.

More disadvantageous to the government is when the concerned official, in exchange for bribe money which is usually less than the amount of taxes due,

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48 Section 103 (B), ibid.

49 Section 90 (B) and (C), ibid.

50 Sections 247, 248 and 249, ibid.

51 It is defined as the offering, giving, receiving, or soliciting of any thing of value to influence action as official or in discharge of legal or public duty. (Black’s Law Dictionary, Revised 4th Edition, 1968, p.239). It should be noted that bribery by itself does not constitute tax avoidance or evasion but only a means to achieve that goal.
registers the transfer of the property in favor of the transferee even without the payment of the taxes due.

4. Employment of Other Fraudulent Practices

Fraudulent practices such as misrepresentation and misstatement, falsification of supporting documents or using unauthorized accountable forms are also illegal and punishable under existing laws but are sometimes committed by a taxpayer wanting to reduce or evade taxes properly due from the real property transaction. Misrepresentation and misstatement is committed when for example, an heir does not include in the gross estate of decedent certain properties properly includible therein. This will result in a reduction of estate tax payable by the heir. Falsification of supporting documents such as tax declaration showing lower value of real properties is also sometimes done by a taxpayer in connivance with concerned government officials. The use of unauthorized Certificate Authorizing Registration (CAR)\(^2\) purportedly issued by the BIR also provides unscrupulous taxpayers an opportunity to reduce or altogether evade the correct taxes due. To prevent the unauthorized use of lost CAR, the BIR is generally observed to have been prompt and diligent in disseminating the information on the serial number of lost CAR. Another fraudulent practice is the use of lowest zonal value in the vicinity where the property subject to transfer is located. This is done either through misclassification of the type of property or changing of the location thereof to the place with lower zonal value. This happens with the connivance of the concerned tax official.

V. CONCLUSION AND RECOMMENDATIONS

Although legal, the employment of tax avoidance schemes could undermine the integrity of the tax system and efforts by the government to increase its revenues. As already pointed out in the study, there are many ways taxpayers can minimize through legal means the various internal revenue taxes imposed on the transfer of real properties. The differences in the tax rates, bases, and structures of the capital gains tax, donor’s tax, and estate tax are main factors which give rise to these tax avoidance schemes.

The application of a national transfer tax in lieu of the capital gains tax, donor’s tax and estate tax is seen to eliminate the opportunity for taxpayers to employ certain tax

\(^2\) A Certificate Authorizing Registration (CAR) is a certification issued by the Commissioner or his duly authorized representative attesting that the transfer and conveyance of land, buildings/improvements or shares of stock arising from sale, barter or exchange have been reported and the taxes due inclusive of the documentary stamp tax, have been fully paid. CARs shall now have a validity of one (1) year from date of issue. In case of failure to present the same to the Registry of Deeds (RD) within the one (1) year period, the same shall be presented for revaluation to the District Office where the CAR was issued. The revaluation, evidenced by stamping the phrase “revalidated on _______ to expire on _______” in a conspicuous space in the CAR, shall be good for another one-year period, after which the CAR loses its validity. (RMO 15-2003)
avoidance schemes. Whether this could be achieved by subjecting all transactions involving the transfer of real properties to regular income tax or fixed or graduated transfer tax should be the subject of a thorough study. Also, to put an end to the practice of underestimating the gross selling price and in simulating transactions to lessen the tax due thereon, the government may consider using a single tax base in the computation of all taxes relating to the transfer of real properties. The government should, however, ensure that the base to be used should be updated regularly to make it reflective of current market prices. A review of current exemptions granted to certain types of transfer of real properties should also be undertaken to determine their efficacy and whether they are still relevant given the various exigencies of the government.

To curb tax evasion, an effective audit of tax returns and stricter and speedier prosecution of offenses under the National Internal Revenue Code should be instituted by the BIR in coordination with other concerned government agencies.