REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE
Quezon City

Sections 27(D)(5) and 39(A)(1) of the Tax Code of 1997, as amended
Revenue Regulations No. 7-2003
BIR Ruling No. 634-17; BIR Ruling No. 480-17; BIR Ruling No. 187-17; BIR Ruling No. OT-611-20; and BIR Ruling No. OT-065-21
OT-079-2023

JUL 28 2023

EXPRESSION STATIONERY SHOP, INC.
113 Dagohoy Street Barangay 079
Caloocan City

Attention: **Mr. Joseph Lim Bon Huan**
Attorney-in-Fact

Gentleman:

This refers to your letter requesting on behalf of **Expressions Stationery Shop., Inc.** (ESSI) for confirmation that the real properties held by ESSI are classified as capital asset and are exempt from value-added tax (VAT).

It is represented that ESSI is a corporation duly organized and existing under the laws of the Republic of the Philippines with principal place of business at 113 Dagohoy St., Barangay 079, Caloocan City; that it is duly registered with the Securities and Exchange Commission (SEC) under Company Registration No. ; and that is also registered with the BIR on June 08, 1996 with Taxpayers Identification Number (TIN) No. under Line of Business 47610 – Retail sale of books, newspapers and stationary in specialized store, 47191 – Retail selling in Department stores, 47913 – Retail sale via internet, 62090 – Other information technology and computer service activities, 77307 – renting of office machinery and equipment (excluding computers) and 47521 – Retail sale of hardware materials; that ESSI owns parcels of land, as follows:

Registered Owner	TCT No.	Tax Declaration No.
Expression Stationery Shop, Inc.		

that the subject properties were never developed or used by ESSI in the ordinary course of its trade or business from the time of its acquisition; that they remained vacant and idle, and have not been held or owned primarily by the ESSI for sale to customers in the ordinary course of its trade or business; and that on October 28, 2022, to prove the non-use for business of the subject properties, a certification to that effect was issued by Office of the Punong Barangay of Barangay Bulihan where the subject properties are located.

Due to ESSI's lack of interest in maintaining the properties, on July 9, 2021, ESSI entered into a Memorandum of Agreement (MOA) with Ayalaland Estate, Inc. (ALEI) for the sale of the subject properties. Based on said MOA, ESSI shall sell and ALEI shall purchase the subject properties subject to the fulfillment by ESSI of the closing terms and conditions as set forth in the same MOA. In consideration for the acquisition of the subject properties, ALEI shall pay ESSI on a per unit basis or with a purchase price of Nine Thousand Eight Hundred Fifty Pesos (Php9,850.00) per square meter multiplied to the Gross Area of properties to be acquired less areas with encroachment and encumbrances.

On December 14, 2022, ESSI and ALEI entered into two (2) Contracts to Sell (CTS) involving the properties under the MOA with exceptions of those properties with annotations of liens and encumbrances, and less of those portions encroached by informal settlers[1], to wit:

TCT Nos.	Units to be acquired (Sqm.)
	228
	180
	6549
	40471
	1363
	1131
	277
	219
	224
	133
	270

Under the said CTS, the purchase price shall be payable by ALEI in four staggered payments, with each segment being subjected to compliance with the corresponding terms and conditions by ESSI.

Hence, this request.

In reply, please be informed that Section 39 (A) (1) of the National Internal Revenue Code (Tax Code) of 1997, as amended, provides for the definition of a capital asset, to wit:

"Section 39. Capital Gains and Losses. —

(A) Definitions. — As used in this Title —

[1] *Sworn affidavit dated May 11, 2023 submitted by ESSI.*



(1) Capital Assets. — 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."

The foregoing provision is being implemented by Revenue Regulations (RR) No. 7-2003, issued on February 11, 2003, providing for the guidelines in the determination of whether a particular real property is a capital asset or an ordinary asset.

Section 2 of the said RR laid down what constitutes capital assets and ordinary assets as follows:

SEC. 2. DEFINITION OF TERMS. – For purposes of these Regulations, the following terms shall be defined as follows:

a. Capital assets shall refer to all real properties held by a taxpayer, whether or not connected with his trade or business, and which are not included among the real properties considered as ordinary assets under Sec. 39(A)(1) of the Code.

b. Ordinary assets shall refer to all real properties specifically excluded from the definition of capital assets under Sec. 39(A)(1) of the Code, namely:

1. Stock in trade of a taxpayer or other real 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

2. Real property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; or

3. Real property used in trade or business (i.e., buildings and/or improvements) of a character which is subject to the allowance for depreciation provided for under Sec. 34(F) of the Code; or

4. Real property used in trade or business of the taxpayer.

xxx xxx xxx

In the instant case, perusal of ESSI's Audited Financial Statement as of December 31, 2021(AFS) has shown that the subject properties were neither included in its inventory held or owned primarily by ESSI for sale in the ordinary course of its trade or business from the time of their acquisition. It also shown that the same have not been subjected to the allowance for depreciation provided for under Sec. 34(F) of the Tax Code of 1997, as amended. In support thereof, the subject properties were certified as idle as by the Office of the Punong Barangay of Barangay Bulihan, and

have been found to have no improvements as confirmed in the certification issued by the Office of City Assessor of the City of Malolos.

Section 3 of RR No. 7-2003 provides for the guidelines in determining whether a particular real property is a capital asset or ordinary asset, to wit:

> *"**SECTION 3. Guidelines in Determining Whether a Particular Real Property is a Capital Asset or Ordinary Asset.** –*
>
> *a. Taxpayers engaged in the real estate business. — Real property shall be classified with respect to taxpayers engaged in the real estate business as follows:*
>
> *1. Real Estate Dealer. — All real properties acquired by the real estate dealer shall be considered as ordinary assets.*
>
> *2. Real estate Developer. — All real properties acquired by the real estate developer, whether developed or undeveloped as of the time of acquisition, and all real properties which are held by the real estate developer primarily for sale or for lease to customers in the ordinary course of his trade or business or which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year and all real properties used in the trade or business, whether in the form of land, building, or other improvements, shall be considered as ordinary assets.*
>
> *3. Real Estate Lessor. — All real properties of the real estate lessor, whether land and/or improvements, which are for lease/rent or being offered for lease/rent, or otherwise for use or being used in the trade or business shall likewise be considered as ordinary assets.*
>
> *4. Taxpayers habitually engaged in the real estate business. — All real properties acquired in the course of trade or business by a taxpayer habitually engaged in the sale of real estate shall be considered as ordinary assets. Registration with the HLURB or HUDCC as a real estate dealer or developer shall be sufficient for a taxpayer to be considered as habitually engaged in the sale of real estate. If the taxpayer is not registered with the HLURB or HUDCC as a real estate dealer or developer, he/it may nevertheless be deemed to be engaged in the real estate business through the establishment of substantial relevant evidence (such as consummation during the preceding year of at least six (6) taxable real estate sale transactions, regardless of amount; registration as habitually engaged in real estate business with the Local Government Unit or the Bureau of Internal Revenue, etc.).*

Based on ESSI's Articles of Incorporation, its primary purpose is to engage in operation and maintain the business of manufacturing, general trading, exporting, processing, assembling, importing, packing, repacking or otherwise dealing in all kinds of goods, wares and merchandise which are or may become articles of commerce, including food, drug and cosmetics duly approved by the Food and Drug Administration, as well as manufacturing of notebook, stationery, books and other related paper products.

ESSI's AFS also showed that it has no revenue from any of the subject properties held from the time that they were acquired. They were never used for lease/rent or being offered for lease/or rent pursuant to Section 3(a)(3) of RR No. 07-03.

Moreover, ESSI has neither applied for nor been issued a registration as a real estate dealer or developer by the Housing and Land Use Regulatory Board (HLURB) or Housing and Urban Development Coordinating Council (HUDCC). The fact that ESSI entered into a MOA does not make it habitually engaged in the real estate business. To be considered as habitually engaged in the real estate business, the taxpayer must consummate during the preceding year at least six (6) taxable real estate sale transactions. The fact that ESSI is a party in 2 separate CTS containing the agreed terms and conditions does not make it a real estate dealer contemplated under RR No. 7-03. In BIR Ruling No. 065-21, this Office had occasioned to rule that:

> *"The transaction between AAA and BGRCDC is considered only as one transaction considering the fact that the subject properties were sold under one Memorandum of Agreement, and the execution of different DOAs was consistent with the terms of the MOA that the delivery and execution of DOAs shall be dependent on the amount paid by the buyer.*
>
> *In view thereof and the pieces of evidence proffered, and further considering that AAA is a taxpayer not engaged in the real estate business, being not a real estate dealer, developer or lessor, it is the considered opinion of this Office that the subject real properties are classified as capital assets, the conveyance of which is subject to capital gains tax and documentary stamp tax but consequently not subject to VAT and creditable withholding tax."*

Moreover, in Luzon Development Bank v. Enriquez, G.R. Nos. 168646 & 168666, January 12, 2011, 639 SCRA 332, 351, the Supreme court held that *"contract to sell is one where the prospective seller reserves the transfer of title to the prospective buyer until the happening of an event, such as full payment of the purchase price. xxx xxx xxx. In other words, the full payment of the purchase price partakes of a suspensive condition, the nonfulfillment of which prevents the obligation to sell from arising and thus, ownership is retained by the prospective seller without further remedies by the prospective buyer.' It does not, by itself, transfer ownership to the buyer."*

In relation thereto, the Supreme Court in the case of Gaite vs. Fonacier (G.R. No. L-11827), discussed the concept of suspensive condition, to wit:

> *"What characterizes a conditional obligation is the fact that its efficacy or obligatory force (as distinguished from its demandability) is subordinated to the happening of a future and uncertain event; so that if the suspensive condition does not take place, the parties would stand as if the conditional obligation had never existed.*
>
> *Moreover, before the fulfillment of a suspensive condition, the demandability and acquisition/ effectivity of the rights arising from the obligation is suspended, but the creditor may bring the appropriate actions for the preservation of his right. After the fulfillment of a suspensive condition, the obligation arises or becomes effective. The obligor can be compelled to comply with what is incumbent upon him."*

Based on the foregoing, the terms and condition contained in a contract obliges parties to fulfill certain duties and responsibilities between them which oftentimes form part of a contract. It is normal

in contracts to have certain terms and condition and, in fact, the essence of some agreement between the parties.

In Tomas Calasanz, et al., vs. The Commissioner of Internal Revenue and the Court of Tax Appeals (G.R. No. L-26284 October 8, 1986), the Supreme Court held:

> *"There is no rigid rule or fixed formula by which it can be determined with finality whether property sold by a taxpayer was held primarily for sale to customers in the ordinary course of his trade or business or whether it was sold as a capital asset.[2] Although several factors or indices have been recognized as helpful guides in making a determination, none of these is decisive; neither is the presence nor the absence of these factors conclusive. Each case must in the last analysis rest upon its own peculiar facts and circumstances. Also a property initially classified as a capital asset may thereafter be treated as an ordinary asset if a combination of the factors indubitably tend to show that the activity was in furtherance of or in the course of the taxpayer's trade or business. Thus, a sale of inherited real property usually gives capital gain or loss even though the property has to be subdivided or improved or both to make it salable. However, if the inherited property is substantially improved or very actively sold or both it may be treated as held primarily for sale to customers in the ordinary course of the heir's business.[3]*
>
> *One strong factor against petitioners' contention is the business element of development which is very much in evidence. Petitioners did not sell the land in the condition in which they acquired it. While the land was originally devoted to rice and fruit trees, it was subdivided into small lots and in the process converted into a residential subdivision and given the name Don Mariano Subdivision. Extensive improvements like the laying out of streets, construction of concrete gutters and installation of lighting system and drainage facilities, among others, were undertaken to enhance the value of the lots and make them more attractive to prospective buyers."*

The inclusion of suspensive conditions precedent to payment partakes as a component of the contract in which ESSI and ALEI agreed upon. Those terms were merely part of the sale agreement as an added warranty and assurance to buyer, ALEI, of the properties legitimacy and their viability to the latter's purpose on said properties. It does not alter the condition of the properties but simply delivering to ALEI the corresponding promise to the sale agreement. Further, those terms and conditions spurred after ESSI and ALEI had the meeting of the minds and could not be considered as the cause to the party in entering into the agreement.

Be that as it may, it can be clearly gleaned that the Supreme Court, in Calasanz case, in using the term "Business Element of Development", denotes as those developments which are considered as hard infrastructure development, such as, paving roads, subdividing properties, constructing concrete gutters and other usual infrastructure development, that would alter the condition of the properties, thus, indubitably showing activities in furtherance of or in the course of the taxpayer's business.

Perforce, this Office is of the opinion that the subject properties are considered as capital assets. Thus, the sale of the said properties is subject to capital gains tax and documentary stamp tax but not

---

[2] *Victory Housing No. 2 vs. Commissioner 205 F. 2d 371.*
[3] *34 Am Jur 2d., p. 92.*

subject to VAT and creditable withholding tax. *(BIR Ruling Nos. 187-2017 dated April 17, 2017; 634-2017 dated December 19, 2017 and 480-2017 dated October 18, 2017)*

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be disclosed that the facts are different, then this ruling shall be considered null and void.

Very truly yours,

ROMEO D. LUMAGUI, JR.
Commissioner of Internal Revenue
011819

K-1

