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; RR No. 7-2003
BIR Ruling No. VAT-334-2021; BIR Ruling No. OT-698-2020
OT-102-2022
MAR 25 2022

PHILIPPINE AIRLINES, INC.
PNB Financial Center
Pres. Diosdado P. Macapagal Ave.
CCP Complex, Pasay City

Attention: **Capt. Stanley K. Ng**
President & CEO

Gentlemen:

This refers to your request for confirmation of your opinion that the dacion en pago (payment in kind) of real properties owned by Philippine Airlines, Inc. ("PAL") which are being held for investment purposes shall be:

a) Subject to 6% capital gains tax (CGT);
b) Subject to documentary stamp tax (DST) on conveyance of real property; and
c) Exempted from creditable withholding tax (CWT) and value-added tax (VAT).

Background:

PAL is a domestic corporation duly registered with the Securities and Exchange Commission (SEC) with Company Reg. No. It was also registered with the Bureau of Internal Revenue (BIR) with Taxpayer Identification Number (TIN) No. under Line of Business Nos. s international air passenger transport and as domestic air passenger transport.

The purposes for which PAL was formed are "to engage in transport services for the transportation of passengers, express parcels, mail merchandise and freight by air, and all other services of a similar character which may from time to time be deemed advisable, to establish, purchase, own, acquire, operate and generally turn to account, airlines, operates aerial taxi, aerial advertising and sightseeing services, to own, purchase, construct, lease, operate and dispose of airports, hangars, transportation depots; aircraft service stations and agencies, and other objects and service of a similar nature which may be necessary, convenient or useful as an auxiliary to its transportation service, to service and repair aircraft and generally deal in all kinds of airplanes, seaplanes, oil, fuel, aircraft accessories and equipment and goods, wares and merchandise necessary for its transportation service, and to purchase, rent or otherwise acquire, to hold, own, mortgage, pledge, assign, transfer, lease or otherwise encumber or dispose of any property, right or interest which may be in any way connected with or useful to the business conducted by the Corporation, to borrow and lend money in aid of the Company's corporate purposes, and for such purposes, to issue, receive and hold bonds, notes and other obligations; to appoint subject at all times to the supervision and control of the Board of Directors, a manager or managers, to attend to the proper conduct of the business of the corporation, and further to engage in all other acts and business which may be necessary or

convenient in the furtherance of the air transportation business, including but not limited to the management of operations of, or investment in hotels, restaurants, cafes and amusement enterprises of all kinds and generally dealing in and with all facilities and appurtenances desirable or appropriate in the conduct of the foregoing activities".

PAL is the registered owner of one (1) parcel of land located in Araneta Street, Barangay Singcang, Bacolod City, (hereinafter referred to as the "Subject Property") which is recorded in its Audited Financial Statement (AFS) as "Investment Properties" under the Non-Current Assets caption and more particularly described as follows:

Transfer Certificate of Title (TCT) No.	Tax Declaration No.	Area (in Sq. m.)
		200,042

that per Certification dated December 20, 2021, issued by Barangay Singcang-Airport, Bacolod City, a small portion thereof with an area of approximately 200 square meters out of the 200,042 square meters is being used as PAL's ticket office and the rest remains undeveloped, without improvements and no business operations being conducted by PAL for the last two (2) years.

On September 03, 2021, a dacion en pago (payment in kind) has been agreed between PAL, as the Borrower, and Philippine National Bank, as the Lender, whereby PAL has offered to use the Subject Property on an "as is where is basis" as partial payment for PAL's unsecured loans, and the Lender has accepted such offer as payment in kind ("Transaction"). 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, states that:

> ***"SEC. 39. Capital Gains and Losses.*** –
>
> ***(A) Definitions.*** *- As used in this Title –*
>
> *(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."* (Emphasis and underscoring supplied)

In relation thereto, Section 2 of Revenue Regulations (RR) No. 7-2003[1] dated December 27, 2002, states that:

> *"SECTION 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***

[1] Providing the Guidelines in Determining Whether a Particular Real Property is a Capital Asset or an Ordinary Asset Pursuant to Section 39(A)(1) of the National Internal Revenue Code of 1997 for Purposes of Imposing the Capital Gains Tax under Sections 24(D), 25(A)(3), 25(B) and 27(D)(5), or the Ordinary Income Tax under Sections 24(A), 25(A) & (B), 27(A), 28(A)(1) and 28(B)(1), or the Minimum Corporate Income Tax (MCIT) under Sections 27(E) and 28(A)(2) of the Same Code

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"
(Emphasis and underscoring supplied)

Under the above quoted provisions, it is undisputed that the yardstick for determining whether the property is capital asset or ordinary asset is the actual use of the said property. Thus, if the property is not actually used in trade or business of the taxpayer, whether or not connected with his trade or business, or not held for lease or sale to customers, it will be classified as a capital asset. Also, if the property is merely held for capital appreciation and investment purposes and remains vacant and idle, it is deemed a capital asset.

In stressing the rationale of the above-mentioned rule, this Office elucidated the matter in BIR Ruling No. 014-2003 dated October 28, 2003, as follows:

"It is apparent under the foregoing provision that for a property to be considered an ordinary asset, it must be actually used in the business of the corporation. Accordingly, on the condition that Wendell Holdings Co., Inc. is not habitually engaged in the real estate business as represented, the property under consideration is capital asset. The property was neither held primarily for sale to customers nor actually used in the business of Wendell Holdings Co., Inc.... The property is not actually used in the business of Wendell Holdings, Inc. as it has remained idle and undeveloped. Therefore, the sale of the properly under consideration is a sale of capital asset, not an ordinary asset. As such, the transaction is subject to capital gains tax of 6% under Section 27(D)(5) and not to the creditable withholding tax."

In the instant case, PAL which is engaged in air transportation of passengers and cargoes is not considered as a company habitually engaged in the real estate business. Where the taxpayer is not engaged in the real estate business, a property not forming part of its inventory is considered a capital asset.

Furthermore, Section 3 (e) of RR No. 7-2003 provides that:

"SECTION 3. Guidelines in Determining Whether a Particular Real Property is a Capital Asset or Ordinary Asset. —

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e. Treatment of abandoned and idle real properties. - Real properties formerly forming part of the stock in trade of a taxpayer engaged in the real estate business, or formerly being used in the trade or business of a taxpayer engaged or not engaged in the real estate business, which were later on abandoned and became idle, shall continue to be treated as ordinary assets. Real property initially acquired by a taxpayer engaged in the real estate business shall not result in its conversion into a capital asset even if the same is subsequently abandoned or becomes idle.

Provided however, that properties classified as ordinary assets for being used in business by ***a taxpayer engaged in business other than real estate business*** *as defined in Section 2(g) hereof are automatically converted into capital assets upon showing of proof that the same have not been used in business for more than two (2) years prior to the consummation of the taxable transactions involving said properties."* (Emphasis and underscoring supplied)

In applying the above provision of RR No. 7-2003, real properties owned by taxpayers not engaged in the real estate business or referring to those persons other than real estate dealers, real estate developers and/or real estate lessors shall, upon showing of proof that the same have not been used in business for more than two (2) years prior to the consummation of the taxable transactions involving the said real properties, and though classified as ordinary assets, be automatically converted into capital assets.

In view of the foregoing, and considering that PAL is a taxpayer not engaged in the real estate business, being not a real estate dealer, developer or lessor and was organized as an airline company; that the Subject Property have been idle and vacant (for more than two years) per Certification dated December 20, 2021 issued by Barangay Singcang-Airport, Bacolod City and as shown from the pictures submitted; and that the Subject Property has been treated in the books of accounts and is reflected in the PAL's AFS as investment properties and has not been used in the ordinary course of trade or business, it is the considered opinion of this Office that the Subject Property described above is classified as capital asset. Thus, the conveyance of which through dacion en pago (payment in kind) is subject only to the CGT under Section 27(D)(5) of the Tax Code of 1997, as amended, and DST under Section 196 of the same Code, and shall not be subject to CWT under Section 57 and VAT under Section 106, both of the same Code. However, with regard to the 200 square meter portion being used as PAL's ticket office, such portion shall be considered as ordinary asset for taxation purposes.

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,

CAESAR R. DULAY
Commissioner of Internal Revenue

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