August 22, 2018

BIR RULING NO. 1129-18

Section 39 (A), NIRC; RR 7-2003; BIR Ruling No. 253-16

Social Housing Finance Corporation
BDO Plaza, 8737 Paseo de Roxas, Makati City

Attention: *AAA*

Gentlemen :

This refers to your request for legal opinion on whether or not the lots transferred by the debtor-developers in favor of the Social Housing Finance Corporation (SHFC) by way of *dacion en pago* are classified as capital assets subject to capital gains tax (CGT) under Section 24 (D) (1) or Section 27 (D) (5) of the 1997 Tax Code, as amended.

As represented, certain property developers applied for loans with then National Home Mortgage Finance Corporation (now, SHFC), secured by real estate mortgage on various lands owned by debtor-developers for the development of *Abot-Kaya Pabahay Fund Projects* (AKPF Projects); that the debtor-developers failed to pay the loan amortizations as they fall due, and as such, they became due and demandable; that in order to settle their obligation, the debtor-developers offered to pay SHFC by way of *dacion en pago* of the mortgaged lands; and that you now inquire on whether these lands are capital assets of the debtor-developers subject to CGT under the applicable provisions of the 1997 Tax Code, as amended.

In reply, please be informed that Section 39 (A) of the 1997 Tax Code, 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) 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*

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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 (a) of RR 7-2003 defines capital assets as referring 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."* On the other hand, Section 2 (b) of the same Regulations laid down what constitutes ordinary assets as follows:

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"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.

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c. Real property shall have the same meaning attributed to that term under Article 415 of Republic Act No. 386, otherwise known as the "Civil Code of the Philippines."

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e. ***Real estate developer shall refer to any person engaged in the business of developing real properties into subdivisions, or building houses on subdivided lots, or constructing residential or commercial units, townhouses and other similar units for his own account and offering them for sale or lease.*** (underscoring supplied)

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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***." (underscoring supplied)

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Based on the above-quoted provisions, it is clear that all real properties owned or acquired by a taxpayer engaged in the business of real estate development are classified as ordinary assets. As represented, the debtors are all property developers, which makes their owned or acquired real properties as ordinary assets under the above provisions. Thus, the capital gains tax imposed under Section 24 (D) (1) or Section 27 (D) (5) of the 1997 Tax Code, as amended, will not apply on the transfer of lands, made by way of *dacion en pago*, by the debtor-developers in favor of the SHFC. The transfer, however, is subject to the regular income tax rate set forth under the applicable provisions of the 1997 Tax Code, as amended, as well as to the value-added tax (VAT) and documentary stamp tax (DST) imposed under Sections 106 and 196, respectively, of the same Code.

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,

(SGD.) CAESAR R. DULAY
Commissioner of Internal Revenue

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