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

Date: January 6, 2014

REVENUE MEMORANDUM CIRCULAR NO. 3-2014

SUBJECT : Circularizing Modification of BIR Ruling DA (C-133) 431-2008

TO : All Internal Revenue Officers and Others Concerned

For the information and guidance of all internal revenue officers and other concerned, quoted hereunder is the full text of memorandum to the Regional Director of Revenue Region No. 8, Makati, modifying BIR Ruling No. DA (C-133) 431-2008 dated November 17, 2008:

"January 2, 2014

Francisco G. Tagao Law Office
Lot 23 Block 56, Francisco Reyes St.
BF Homes Parañaque Subd.
Parañaque City

Attention: Atty. Francisco G. Tagao

Gentlemen:

This refers to the request of then Revenue District Officer (RDO) Gerry Dumayas of Revenue District Office No. 44- Taguig City for further review of BIR Ruling DA (C-133) 431-2008 dated November 17, 2008 issued to Fort Bonifacio Development Corporation (FBDC), holding that the transfer of FBDC's real properties (TCT No. 2156-P with an area of 6,147 sq. m. and a portion of the lot covered by TCT No. 38167 with an area of 5,020 sq. m.) to the Bases Conversion and Development Authority (BCDA), in redemption of its preferred shares held by BCDA, is not subject to income tax, VAT, donor's tax, and DST. Another query raised is the applicability of BIR Ruling DA (C-133) 431-2008 to similar transaction involving the conveyance of a lot (covered by TCT No. 2097-P with an area of 3,710 sq. m.) by FBDC to BCDA, but which property is not specifically identified in the ruling.

RDO Dumayas is of the view that the transaction between FBDC and BCDA as subject to VAT being a transaction "deemed sale" since FBDC is engaged in the real estate business and all its inventory of real properties primarily for sale or lease are classified as ordinary assets under Revenue Regulations (RR) No. 7-2003.

In this regard, please be informed as follows:

Income Tax

Redemption is repurchase, reacquisition of stock by a corporation which issued the stocks in exchange for property, whether or not the acquired stock is cancelled, retired or held in treasury.[1]

Revenue Regulations (RR) No. 6-2008 dated April 22, 2008 consolidated the rules on the taxation of shares redeemed for cancellation or retirement, to wit:

> **"SEC. 9. TAXATION OF SHARES REDEEMED FOR CANCELLATION OR RETIREMENT.** - When preferred shares are redeemed at a time when the issuing corporation is still in its "going-concern" and is not contemplating in dissolving or liquidating its assets and liabilities, capital gain or capital loss upon redemption shall be recognized on the basis of the difference between the amount/value received at the time of redemption and the cost of the preferred shares.
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> Similarly, the capital gain or loss derived shall be subject to the regular income tax rates imposed under the Tax Code, as amended, on individual taxpayers or to the corporate income tax rate, in case of corporations.
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> This section, however, does not cover situations where a corporation voluntarily buys back its own shares, in which it becomes treasury shares. In such cases, the stock transaction tax under Sec. 127(A) of the Tax Code shall apply if the shares are listed and executed through the trading system and/or facilities of the Local Stock Exchange. Otherwise, if the shares are not listed and traded through the Local Stock Exchange, it is subject to the 5% and 10% net capital gains tax." (Underscoring supplied)

Accordingly, when preferred shares are redeemed for retirement in accordance with its nature, pursuant to RR No. 6-2008, the capital gain or capital loss derived upon redemption shall be recognized on the basis of the difference between the amount/value received at the time of redemption and the cost of the preferred shares. The capital gain or capital loss shall be subject to the regular income tax rate under the Tax Code, as amended, on individual taxpayers or to the corporate income tax rate under the Tax Code, in case of corporations.

On the part of BCDA, any gain realized by it on the redemption of shares by FBDC shall be subject to corporate income tax pursuant to Section 27(A) of the Tax Code of 1997 and consequently, to creditable withholding tax as prescribed in Section 57 of the same Code.

On the part of FBDC, the transaction is not subject to income tax considering that the redeeming corporation does not realize any gain or loss on the redemption of its shares. The shares so redeemed or reacquired shall be considered retired and no longer issuable, and hence, no gain shall be realized by the redeeming corporation. Accordingly, FBDC as a redeeming corporation, is not subject to income tax on its receipt of the shares surrendered by BCDA pursuant to the redemption.

Value Added Tax

Revenue Regulations (RR) No. 7-2003 lays down the guidelines in determining whether a particular real property is a capital asset or an ordinary asset. The pertinent provision reads:

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

[1] Goodyear Philippines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 8188, March 25, 2013.

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:

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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."

Considering that FBDC is a real estate developer which owns substantial parcels of land, all real properties it acquired, whether developed or undeveloped as of the time of acquisition; all real properties it holds primarily for sale or for lease to customers in the ordinary course of its trade or business or which would properly be included in its inventory if on hand at the close of the taxable year; and all real properties used in its trade or business are considered its ordinary assets.

In general, the sale of real properties held primarily for sale to customers or held for lease in the ordinary course of trade or business of the seller shall be subject to VAT.[2] In the instant case, the transfer of the subject real properties by FBDC to BCDA to redeem its shares, although not occurring in the regular conduct or in the course of FBDC's trade or business and is a transaction which is not done with regularity, is nevertheless subject to VAT the same being considered a transaction "deemed sale."

Section 106(B)(1) of the Tax Code of 1997 provides:

"**Sec. 106. *Value-added tax on Sale of Goods or Properties***. —

(B) ***Transactions Deemed Sale***. — The following transactions shall be deemed sale;

(1) Transfer, use or consumption not in the course of business of goods or properties originally intended for sale or for use in the course of business."

Sections 4.106-1 and 4.106-7 of RR No. 16-2005, as amended, provide that:

"**SECTION 4.106-1. *VAT on Sale of Goods and Properties***. — VAT is imposed and collected on every sale, barter, exchange, or transactions 'deemed sale' of taxable goods or properties at the rate of twelve percent (12%) (starting February 1, 2006) of the gross selling price or gross value in money of the goods or properties sold, bartered, or exchanged, or deemed sold in the Philippines.

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SECTION 4.106-7. *Transactions Deemed Sale*. —

(a) The following transactions shall be 'deemed sale' pursuant to Section 106(B) of the Tax Code:

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[2] Sections 105 and 106 of the Tax Code of 1997; Section 4.106-3 of Revenue Regulation No. 16-2005

(1) Transfer, use or consumption not in the course of business of goods or properties originally intended for sale or for use in the course of business. Transfer of goods or properties not in the course of business can take place when VAT-registered person withdraws goods from his business for his personal use;"

Such being the case, the conveyance by FBDC of its real properties to BCDA in partial redemption of the Preferred "B" shares owned by BCDA is in the nature of a transfer, use or consumption not in the course of business of goods or properties which are originally intended for sale or for use in the course of business. It is a transaction "deemed sale" which is subject to VAT under the above-cited provisions.

The VAT shall be based on the gross selling price defined as the consideration or the fair market value of the properties, whichever is higher. Section 4.106-4 of RR 16-2005, as amended, provides:

"***SECTION 4.106-4. Meaning of the Term 'Gross Selling Price'***. — xxx

In the case of sale, barter or exchange of real property subject to VAT, gross selling price shall mean the consideration stated in the sales document or the fair market value whichever is higher. The term 'fair market value' shall mean whichever is the higher of: 1) the fair market value as determined by the Commissioner (zonal value), or 2) the fair market value as shown in schedule of values of the Provincial and City Assessors (real property tax declaration). However, in the absence of zonal value, gross selling price refers to the market value shown in the latest real property tax declaration or the consideration, whichever is higher. If the gross selling price is based on the zonal value or market value of the property, the zonal or market value shall be deemed inclusive of VAT. If the VAT is not billed separately, the selling price stated in the sales document shall be deemed to be inclusive of VAT."

In the instant case, the gross selling price is whichever is higher of the consideration received by the FBDC (i.e., the redemption price for the preferred shares) and the FMV of the real property transferred (i.e., the FMV as shown in the Real Property Tax Declarations issued by the Assessor's Office or the zonal value, whichever is higher).

Documentary Stamp Tax

Likewise, the Tax Code of 1997 imposes a Documentary Stamp Tax (DST) on the sale and conveyances of real property under Section 196 thereof, to wit:

"**SECTION 196. Stamp Tax on Deeds of Sale and Conveyances of Real Property.** — On all conveyances, deeds, instruments, or writings, other than grants, patents or original certificates of adjudication issued by the Government, whereby any land, tenement or other realty sold shall be granted, assigned, transferred or otherwise conveyed to the purchaser, or purchasers, or to any other person or persons designated by such purchaser or purchasers, there shall be collected a documentary stamp tax, at the rates herein below prescribed, based on the consideration contracted to be paid for such realty or on its fair market value determined in accordance with Section 6(E) of this Code, whichever is higher: *Provided*, That when one of the contracting parties is the Government, the tax herein imposed shall be based on the actual consideration:"

In view of the above, BIR Ruling DA (C-133) 431-2008 dated November 17, 2008 is hereby modified. The conveyance of a certain real properties by FBDC in partial redemption of Preferred "B" shares owned by BCDA is subject to income tax, documentary stamp tax, and VAT.

Please be guided accordingly.

Very truly yours,

(Original signed)
KIM S. JACINTO-HENARES
Commissioner of Internal Revenue"

Modification of BIR Ruling No. DA (C-133) 431-2008 is hereby circularized for the guidance and information of all Revenue District Offices. All concerned are hereby enjoined to be guided accordingly and to give this Circular as wide publicity as possible.

(Original signed)
KIM S. JACINTO-HENARES
Commissioner of Internal Revenue