

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

December 27, 2002

REVENUE REGULATIONS NO. 7-2003

SUBJECT: 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.

TO : All Internal Revenue Officials and Others Concerned.

SECTION 1. SCOPE. – Pursuant to Section 244 of the National Internal Revenue Code of 1997 (Code), these Regulations are hereby promulgated to implement Sec. 39(A)(1), in relation to Secs. 24(D), 25(A)(3), 25(B) and 27(D)(5), and Secs. 24(A), 25(A) & (B), 27(A) or 27(E), 28(A)(1) or 28(A)(2), and 28(B)(1), all of the said Code, providing for the purpose the guidelines in determining whether a particular real property is a capital asset or an ordinary asset.

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.

Real properties acquired by banks through foreclosure sales are considered as their ordinary assets. However, banks shall not be considered as habitually engaged in the real estate business for purposes of determining the applicable rate of withholding tax imposed under Sec. 2.57.2(J) of Revenue Regulations No. 2-98, as amended.

- 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*.”
- d. **Real estate dealer** shall refer to any person engaged in the business of buying and selling or exchanging real properties on his own account as a principal and holding himself out as a full or part-time dealer in real estate.
- 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.
- f. **Real estate lessor** shall refer to any person engaged in the business of leasing or renting real properties on his own account as a principal and holding himself out as lessor of real properties being rented out or offered for rent.
- g. **Taxpayers engaged in the real estate business** shall refer collectively to real estate dealers, real estate developers, and/or real estate lessors. Conversely, the term “**taxpayers not engaged in the real estate business**” shall refer to persons other than real estate dealers, real estate developers and/or real estate lessors. A taxpayer whose primary purpose of engaging in business, or whose Articles of Incorporation states that its primary purpose is to engage in the real estate business shall be deemed to be engaged in the real estate business for purposes of these Regulations.

SEC. 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.,).

A property purchased for future use in the business, even though this purpose is later thwarted by circumstances beyond the taxpayer's control, does not lose its character as an ordinary asset. Nor does a mere discontinuance of the active use of the property change its character previously established as a business property.

b. *Taxpayer not engaged in the real estate business.* - In the case of a taxpayer not engaged in the real estate business, real properties, whether land, building, or other improvements, which are used or being used or have been previously used in the trade or business of the taxpayer shall be considered as ordinary assets. These include buildings and/or improvements subject to depreciation and lands used in the trade or business of the taxpayer.

A depreciable asset does not lose its character as an ordinary asset, for purposes of the instant provision, even if it becomes fully depreciated, or there is failure to take depreciation during the period of ownership.

Monetary consideration or the presence or absence of profit in the operation of the property is not significant in the characterization of the property. So long as the property is or has been used for business purposes, whether for the benefit of the owner or any of its members or

stockholders, it shall still be considered as an ordinary asset. Real property used by an exempt corporation in its exempt operations, such as a corporation included in the enumeration of Section 30 of the Code, shall not be considered used for business purposes, and therefore, considered as capital asset under these Regulations.

Real property, whether single detached; townhouse; or condominium unit, not used in trade or business as evidenced by a certification from the Barangay Chairman or from the head of administration, in case of condominium unit, townhouse or apartment, and as validated from the existing available records of the Bureau of Internal Revenue, owned by an individual engaged in business, shall be treated as capital asset.

- c. **Taxpayers changing business from real estate business to non-real estate business.** – In the case of a taxpayer who changed its real estate business to a non-real estate business, or who amended its Articles of Incorporation from a real estate business to a non-real estate business, such as a holding company, manufacturing company, trading company, etc., the change of business or amendment of the primary purpose of the business shall not result in the re-classification of real property held by it from ordinary asset to capital asset. For purposes of issuing the certificate authorizing registration (CAR) or tax clearance certificate (TCL), as the case may be, the appropriate officer of the BIR shall at all times determine whether a corporation purporting to be not engaged in the real estate business has at any time amended its primary purpose from a real estate business to a non-real estate business.
- d. **Taxpayers originally registered to be engaged in the real estate business but failed to subsequently operate.** – In the case of subsequent non-operation by taxpayers originally registered to be engaged in the real estate business, all real properties originally acquired by it shall continue to be treated as ordinary assets.
- 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.

f. **Treatment of real properties that have been transferred to a buyer/transferee, whether the transfer is through sale, barter or exchange, inheritance, donation or declaration of property dividends.**

Real properties classified as capital or ordinary asset in the hands of the seller/transferor may change their character in the hands of the buyer/transferee. The classification of such property in the hands of the buyer/transferee shall be determined in accordance with the following rules:

1. Real property transferred through succession or donation to the heir or donee who is not engaged in the real estate business with respect to the real property inherited or donated, and who does not subsequently use such property in trade or business, shall be considered as a capital asset in the hands of the heir or donee.
2. Real property received as dividend by the stockholders who are not engaged in the real estate business and who do not subsequently use such real property in trade or business shall be treated as capital assets in the hands of the recipients even if the corporation which declared the real property dividend is engaged in real estate business.
3. The real property received in an exchange shall be treated as ordinary asset in the hands of the transferee in the case of a tax-free exchange by taxpayer not engaged in real estate business to a taxpayer who is engaged in real estate business, or to a taxpayer who, even if not engaged in real estate business, will use in business the property received in the exchange.

g. ***Treatment of real property subject of involuntary transfer.*** - In the case of involuntary transfers of real properties, including expropriation or foreclosure sale, the involuntariness of such sale shall have no effect on the classification of such real property in the hands of the involuntary seller, either as capital asset or ordinary asset, as the case may be.

For example, real properties forming part of the inventory of a real estate dealer, which are foreclosed, shall, for purposes of determining the applicable tax on such foreclosure sale, be treated as ordinary assets. On the other hand, the nature of such real property in the hands of the foreclosure buyer shall be determined in accordance with the rules stated in sub-paragraph (f) hereof.

SEC. 4. APPLICABLE TAXES ON SALE, EXCHANGE OR OTHER DISPOSITION OF REAL PROPERTY. - Gains/Income derived from sale, exchange, or other disposition of real properties shall, unless otherwise exempt, be subject to applicable taxes imposed under the Code, depending on whether the subject properties are classified as capital assets or ordinary assets.

a. In the case of individual citizens (including estates and trusts), resident aliens, and non-resident aliens engaged in trade or business in the Philippines.

- (i) Capital gains presumed to have been realized from the sale, exchange, or other disposition of real property located in the Philippines, classified as capital assets, shall be subject to the six percent (6%) capital gains tax imposed under Sec. 24(D)(1) or 25(A)(3) of the Code, as the case may be, based on the gross selling price or current fair market value as determined in accordance with Sec. 6(E) of the Code, whichever is higher, provided, that if the buyer is the Government or any of its political subdivisions or agencies or a government owned-or-controlled corporation, the tax liability shall, at the option of the individual seller (including estate or trust), be computed on the basis of either the six percent (6%) capital gains tax under Sec. 24(D)(1)/ 25(A)(3) or the graduated tax rates under Sec. 24(A)(1)(c) or 25 (A)(1), all of the Code.
- (ii) The sale of real property located in the Philippines, classified as ordinary assets, shall be subject to the creditable withholding tax (expanded) under Sec. 2.57.2(J) of Rev. Regs. No. 2-98, as amended, based on the gross selling price or current fair market value as determined in accordance with Section 6(E) of the Code, whichever is higher, and consequently, to the ordinary income tax imposed under Sec. 24(A)(1)(c) or 25(A)(1) of the Code, as the case may be, based on net taxable income.

b. In the case of non-resident aliens not engaged in trade or business in the Philippines. - Capital gains presumed to have been realized by non-resident aliens not engaged in trade or business in the Philippines on the sale of real property located in the Philippines shall be subject to the six percent (6%) capital gains tax imposed under Sec. 25(B), in relation to Sec. 24(D)(1), of the Code, based on the gross selling price or current fair market value as determined in accordance with Sec. 6(E) of the Code, whichever is higher.

c. *In the case of domestic corporations. –*

- (i) Capital gains presumed to have been realized from the sale, exchange or disposition of lands and/or buildings located in the Philippines, which are classified as capital assets, shall be subject to a capital gains tax of six percent (6%) based on the gross selling price or current fair market value as determined in accordance with Sec. 6(E) of the Code, whichever is higher, of such land and/or buildings pursuant to Sec. 27(D)(5) of the Code.
- (ii) The sale of land and/or building classified as ordinary asset and other real property (other than land and/or building treated as capital asset), regardless of the classification thereof, all of which are located in the Philippines, shall be subject to the creditable withholding tax (expanded) under Sec. 2.57.2(J) of Rev. Regs. No. 2-98, as amended, and consequently, to the ordinary income tax under Sec. 27(A) of the Code. In lieu of the ordinary income tax, however, domestic corporations may become subject to the minimum corporate income tax (MCIT) under Sec. 27(E) of the Code, whichever is applicable.

d. *In the case of resident foreign corporations. –* Real property located in the Philippines, regardless of classification, sold by a resident foreign corporation shall be subject to the creditable withholding tax (expanded) under Sec. 2.57.2(J) of Rev. Regs. No. 2-98, as amended, and consequently, to the ordinary income tax under Sec. 28(A)(1) or to the MCIT under Sec. 28(A)(2), both of the Code, whichever is applicable.

e. *In the case of non-resident foreign corporations. -* The gain from the sale of real property located in the Philippines by a non-resident foreign corporation shall be subject to the final withholding tax at the rate of thirty-two percent (32%) imposed under Sec. 2.57.1(I) of Rev. Regs. No. 2-98, as amended, in relation to Sec. 28(B)(1) of the Code.

f. *Income on sale of real property not located in the Philippines. –* Gain realized from the sale, exchange, or other disposition of real property not located in the Philippines, regardless of classification, by resident citizens or domestic corporations shall be subject to the income tax imposed in Sec. 24(A)(1), or Sec. 27(A) or (E) of the Code, as the case may be. Such income/gain shall be exempt pursuant to Sec. 23(B), (D) and (F) of the Code, as the case may be, in the case of non-resident citizens, alien individuals and foreign corporations.

SEC. 5. REPEALING CLAUSE. – All existing BIR rulings, revenue rules, regulations and other issuances or portions thereof inconsistent with the provisions of these regulations are hereby modified, repealed or revoked accordingly.

SEC. 6. EFFECTIVITY. – These Regulations shall take effect after fifteen (15) days following publication in the Official Gazette or in any newspaper of general circulation.

(Original Signed)
JOSE ISIDRO N. CAMACHO
Secretary of Finance

RECOMMENDING APPROVAL:

(Original Signed)
GUILLERMO L. PARAYNO, JR.
Commissioner of Internal Revenue