REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Quezon City

Bureau of Internal Revenue Ruling

Sec. 34(D)(1), Tax Code of 1997, as amended; RR No. 2	OT- 3	35 - 2022

Person to Contact: Chief, Law Division
Tel Nos. 926-55-36 / 927-09-63

Date JUN 30 2022

ISLA LIPANA & CO.
29th Floor, Philamlife Tower
8767 Paseo de Roxas
1226 Makati City

Attention: **Atty. Malou P. Lim**
Managing Partner, Tax

Gentlemen:

This refers to your request on behalf of your client, Smart Communications, Inc. ("SCI" or the "Company"), for confirmation that the loss in useful value pertaining to the Company's discontinued and decommissioned licenses for software maintenance, updates and upgrades in 2017, and the loss in useful value of decommissioned data network platform, hardware and technology equipment in the first two quarters of 2018, are deductible expenses for income tax purposes pursuant to Section 34 (D) (1) of the National Internal Revenue Code (Tax Code) of 1997, as amended.

Background

SCI is a corporation duly organized and existing under the laws of the Republic of the Philippines with address at 26th Floor Smart Tower, 6799 Ayala Avenue, Makati City. The Company is registered with the Bureau of Internal Revenue ("BIR") with Taxpayer Identification Number

The Company's primary purpose is to engage in telecommunications and to own, design, manufacture, assemble, install, purchase, rent, establish, manage, audit, repair, rehabilitate, integrate, operate, sell, lease or otherwise dispose of and generally deal in and with systems, facilities, equipment and devices involving the processing, storage, movement, monitoring and retrieval of information including but not limited to data, image, voice, audio and tone. SCI operates telecommunications equipment and maintains several licenses (*i.e.*, provisions for software maintenance, updates and upgrades) and corporate data network platform and hardware which are necessary to the carrying out of its telecommunications business.

In 2017, the Company started implementing transformation projects to improve and simplify its network and application systems. These projects are integral to and are needed to sustain the Company's telecommunications operations. Pursuant to the transformation projects, licenses were discontinued in 2017 while certain data network platform, hardware and technology equipment are to be completely decommissioned within the year 2018.

Accordingly, the Company has written off the licenses for software maintenance, updates and upgrades, which were fully decommissioned in 2017 due to technological obsolescence. The net book value of the licenses as of the date of writing off was claimed as a loss in useful value in the Company's 2017 Income Tax Return ("ITR").

Further, the Company claimed as a loss in useful value in the first two quarters of 2018 the net book value of decommissioned data network platform, hardware and technology equipment.

In reply, please be informed that Section 34 (D) (1) of the Tax Code of 1997[1] provides the statutory rules for determining the losses that are deductible for income tax purposes, to wit:

> "Sec. 34. Deductions from Gross Income. — Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section, in computing taxable income subject to income tax under Sections 24(A); 25(A); 26; 27(A), (B) and (C); and 28(A)(1), there shall be allowed the following deductions from gross income:
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> xxx xxx xxx
>
> (D) Losses. —
>
> (1) In General. — Losses actually sustained during the taxable year and not compensated for by insurance or other forms of indemnity shall be allowed as deductions:
>
> (a) If incurred in trade, profession or business;
>
> (b) Of property connected with the trade, business or profession, if the loss arises from fires, storms, shipwreck, or other casualties, or from robbery, theft or embezzlement.
>
> The Secretary of Finance, upon recommendation of the Commissioner, is hereby authorized to promulgate rules and regulations prescribing, among other things, the time and manner by which the taxpayer shall submit a declaration of loss sustained from casualty or from robbery, theft or embezzlement during the taxable year: Provided, however, That the time limit to be so prescribed in the rules and regulations shall not be less than thirty (30) days nor more

[1] As amended by Republic Act No. 10963

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than ninety (90) days from the date of discovery of the casualty or robbery, theft or embezzlement giving rise to the loss.

(c) No loss shall be allowed as a deduction under this Subsection if at the time of the filing of the return, such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

xxx xxx xxx"

Corollarily, Section 98 of Revenue Regulations ("RR") No. 2 provides that:

"Sec. 98. Loss of Useful Value. — *When through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use of such business, he may claim as deduction the actual loss sustained.* In determining the amount of the loss, adjustment must be made, however, for improvements, depreciation and the salvage value of the property. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost or change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible.

This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowance are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off in the books and fully explained in returns of income."

It is clear from the foregoing, that in order for a loss to be deductible, the following requisites must be met:

(1) the loss must be of the taxpayer;
(2) the loss must be actually sustained and charged off within the taxable year;
(3) the loss must have been incurred in trade, business or profession;
(4) the loss must be evidenced by a closed and completed transaction; and
(5) the loss must not have been compensated for by insurance or other forms of indemnity.[2]

[2] Manotok Realty Incorporated vs. Commissioner of Internal Revenue, Court of Tax Appeals Case No. 5485, 18 October 1999

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In the case of SCI, particular licenses for software maintenance, updates and decommissioned data network platform, hardware and technology equipment lost their useful value due to technological obsolescence in 2017 and 2018, in line with the Company's implementation of the transformation projects. In this regard, SCI had to permanently decommission or discontinue the use of these assets, and as a result, actually sustained business losses in 2017 and 2018.

WHEREFORE, in view of the foregoing, this Office hereby confirms your opinion that after showing compliance with the requirements for a loss to be deductible, the loss in useful value of decommissioned data network platform, hardware and technology equipment in 2017 and in the first two quarters of 2018, are deductible expenses for income tax purposes pursuant to Section 34(D)(1) of the Tax Code of 1997, as amended, in relation to Section 98 of RR No. 2.

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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gps (smart communications)