REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

MIGUEL J. OSSORIO and
PAZ Y. DE OSSORIO,
Petitioners,

versus CTA CASE NO. 1441

COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

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Nov. 29/71

D E C I S I O N

This is an appeal from the decision of the Commissioner of Internal Revenue denying the claim for tax credit of the amount of ₱592,218.60, representing deficiency income tax and interest alleged to have been erroneously paid by petitioners for the year 1958.

Petitioners, husband and wife, were American citizens and residents of the United States, until the death of the husband soon after the filing of this case.

Petitioner Paz Y. de Ossorio owned a paraphernal property consisting of a parcel of land located at Muelle de Binondo and San Gabriel Streets, Manila, which she inherited from her father, Luis R. Yangco, long before the Second World War. This parcel of land, hereinafter referred to as the San Gabriel property, had an area of 3,157 square meters. For inheritance tax purposes, it was appraised at ₱204,367.18. Inasmuch as petitioners were not residing in the Philippines, said property was administered by an attorney-in-fact, Claudio R. de Luzuriaga, Jr.

Prior to and during the year 1958, portions of this property were leased by the attorney-in-fact. Under the provisions of the contracts of lease, the lessees could set up improvements on the land and any such improvements which they failed to remove at the termination of the leases would be forfeited to petitioner Paz Y. de Ossorio. For the failure of the lessees to remove the structures constructed on the land, some of the structures ultimately belonged to the owner of the lot. The total assessed value of said structures was ₱54,000.00. During the year 1958, petitioners received as rental income from the tenants leasing portions of the San Gabriel property the amount of ₱34,165.00, itemized as follows:

Chavez, Salinas & Co.	₱12,600.00
Sy Suy	1,600.00
Tay Lian Grocery	6,050.00
Victorias Milling Co., Inc.	5,835.50
Leon C. Pineda	880.00
Yu Chnan	7,200.00
T O T A L	₱ 34,165.50

Aside from this rental property, petitioners also leased another one, which is called the "Del Pan" property, from which they received in the same year a rental income of ₱14,400.00. All in all, petitioners received a total rental income of ₱48,565.50 from said properties.

On December 5, 1958, attorney-in-fact Claudio R. de Luzuriaga, Jr., sold the San Gabriel property, including the structures thereon, for ₱2,000,000.00 to Gonzalo Puyat & Sons. After deducting the cost basis of the San Gabriel property in the amount of ₱204,367.18 and the expenses incurred in the sale and value of improvements of the property in the sum of ₱64,000.00 from the selling price of ₱2,000,000.00, petitioner realized a gain of ₱1,731,632.82.

The aforementioned rentals in the total amount of ₱48,565.50 plus 50% of the gain of ₱1,731, 632.82 realized from the sale of the San Gabriel property or ₱865,816.41, were returned in 1958 by petitioner for income tax purposes.

After investigation of the 1958 income tax return of petitioners, respondent, on October 10, 1961, decided to hold the said property as an ordinary asset, and 100% of the gain realized from the sale thereof was taxable. Accordingly, an assessment was made against petitioners for the amount of ₱592,218.60, as deficiency income tax for 1958, inclusive of ½% monthly interest thereon, computed as follows:

<u>90-AR-12/447-61-58</u>

Net income per return		₱2,015,539.01
Add: Gain from sale of the San Gabriel property:		
Gain from sale . . .	₱1,731,632.82	
50% declared as income	865,816.41	
Amount undeclared.		865,816.41
Net income		₱2,881,355.42
Less: Personal exemption . . .		1,200.00
Amount subject to tax		₱2,880,155.42
Tax due thereon		₱1,540,273.00
Less: Amount already paid. . .		1,020,783.00
B a l a n c e.		₱ 519,490.00
Add: ½% monthly interest from June 20, 1959 to Oct.16, 1961		72,728.60
TOTAL AMOUNT DUE		₱ 592,218.60

On October 27, 1961, petitioners protested the assessment and requested its cancellation and withdrawal but was denied by respondent in a letter dated December 28, 1961.

In a letter dated January 15, 1962, counsel for petitioners informed respondent that petitioner Paz Y. de Osorio had paid the aforesaid assessment, as evidenced by Official Receipt No. 777772 issued by the Collection Agent of Pasay City on November 9, 1961, and requested the refund or tax credit of the said amount. In a letter dated January 7, 1963, respondent denied the request of petitioners for tax credit for lack of legal basis. A subsequent request for reconsideration of the denial for tax credit was made by petitioners in a letter dated January 23, 1963 but was again denied by respondent on July 5, 1963. Hence, this appeal.

The only issue raised is whether the San Gabriel property sold by petitioners in 1958 was a capital asset by virtue of which only 50% of the gain realized therefrom is subject to income tax, or was an ordinary asset, the gain realized being taxable in full.

It is contended that the San Gabriel property was a capital asset for the reason that it was acquired by inheritance, and that the said property was not used in connection with any trade or business. Citing American authorities, and invoking the decision of the Supreme Court in the case of Roxas Argellies v. Meer (91 Phil. 146), petitioner Paz Y. de Ossorio insists that she was not a real estate dealer and the gain realized from the sale of the property is a capital gain taxable only to the extent of 50%.

On the other hand, respondent maintains that the property was held for rent until it was sold in 1958 and petitioner received rental income for that year in the amount of ₱34,165.50. He, therefore, concludes that said property was used in the trade or business, and when the property was sold the gain realized therefrom was an ordinary gain taxable in full.

The contention of petitioners is not well taken.

This Court held that taxpayers who received more than ₱3,000.00 (now ₱4,000.00) a year as rentals for the lease of real property are real estate dealers under Section 194(s) of the Revenue Code and the property rented is considered real property used in the trade or business of a real estate dealer and, hence, is an ordinary asset. (Belen T. Ramirez v. Comm. of Int. Rev., C.T.A. Case No. 544, September 14, 1959.)

> From the foregoing observation, we gather that Congress, in progressively amending Republic Act No. 588 upon the proper interpretation of which the resolution of the first issue in the case at bar hinges, was cognizant of the imperfection from which the then definition of real estate dealer suffered. The meaning intended by Congress for the term "real estate dealer" was hidden in a labyrinth of ambiguities created by the imperfect language of Republic Act No. 588. To retrieve the intended meaning from ambiguities, Congress enacted the amending Republic Acts Nos. 1612 and 2025. In the light of the progressive steps taken in enacting these amendments, it appears abundantly clear that Congress intended to classify an owner of rental property or properties rented or offered to rent for an aggregate amount of ₱3,000.00 or more a year as a real es-

tate dealer when it enacted Republic Act No. 588. Consequently, petitioner, who earned as rental from her property ₱1,700.00 per month or ₱20,400.00 yearly, was a real estate dealer within the contemplation of Section 194(s) of the Tax Code, as amended by Republic Act No. 588. The fact that petitioner did not then actually reside in the Philippines nor participate in the management of her property, nor reinvest the income of the property in rental-earning property is of no moment.

The property in question, being the same real property rented out by petitioner, was a real property used in her trade or business, and, therefore, was an ordinary asset pursuant to Section 34(a) (1) which provides:

> "(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 x x x; or real property used in the trade or business of the taxpayer." (Emphasis supplied.) (Section 34(1), National Internal Revenue Code.)

To the same effect is the decision in the case of Maria Rocha y Tuason v. Commissioner of Internal Revenue, C.T.A. No. 1448, October 6, 1967.

We note that petitioners paid real estate dealers fixed tax (C-8 No. 0494795) dated January 20, 1958. The San Gabriel property was being rented in 1958. This property was used by petitioners in the business of renting real property.

In the light of the aforecited decisions, said property was, therefore, an ordinary asset and the gain realized in the amount of ₱1,731,632.82 is taxable in full.

Petitioners, however, contend in the alternative that even if leasing real property is a business, only the gain realized from the sale of the structures should be considered as ordinary gain and that the gain realized from the sale of the lot should be considered a capital gain. It is alleged that the structures were the only ones rented and, hence, should be considered as ordinary assets for tax purposes, and not the lot on which the structures were constructed, citing the case of Estate of G. W. Topper (TC Memo-Opinion, DKT 5011 /1946/).

This alternative assertion of petitioner is without legal and factual basis. The contracts of lease of said property covered not only the structures but also the lot on which said structures were constructed. Moreover, it was established that the income in the amount of ₱34,165.50 declared in petitioners' income tax return for 1958 came from rentals of the San Gabriel property alone. This clearly show that both the structures and the lot on which they were constructed were rented properties. It will not be correct to say that the structures were rented while the lot on which they stood were not, yet both were owned by petitioners at the time from which they received rental income.

In the case of O. M. Topper, cited by petitioners, it was held that where inherited properties consisting of an apartment and a lot on which it stood were subsequently sold, the gain pertaining to the apartment was considered an ordinary gain taxable in full because it was depreciable property used in the real estate business, and the gain corresponding to the land was taxable as a capital gain because of the absence of a provision in the U. S. Federal Income Tax Law that rented real property is an ordinary asset.

The aforesaid case is inapplicable as authority in this case because Section 117(a)(1) of the U. S. Internal Revenue Code of 1938 considered all properties, whether or not connected with his trade or business, as capital assets, with the exception of only three (3) kinds of properties which are considered ordinary assets (Mertens, Law of Federal Income Taxation, Vol. 3, 1942 Ed, p. 658 citing Section 117(a)(1) of the U. S. Internal Revenue Code of 1938) and these are as follows:

> (1) Stocks in trade of the taxpayer or other property of a kind which would property be included in the inventory of the taxpayer if on hand at the close of the year;
>
> (2) Property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; and

(3) Depreciable property used in the trade or business.

Note that the enumeration of the ordinary assets under Section 117(a)(1) of the U. S. Revenue Law applied in the Topper case did not include real property used in trade or business. Real property used in trade or business not being ordinary assets under said law, the U. S. Tax Court correctly held that the lot on which the apartment house stood is a capital asset. Therefore, the gain realized from the sale of those properties was allocated proportionately between the building and the lot. Such is not the case under our law - Section 34(a)(1) of the National Internal Revenue Code. Said Section 34(a)(1) is different from the aforesaid Section 117(a)(1) of the U. S. Revenue Code in that it considers as an ordinary asset "real property used in the trade and business of the taxpayer." The claim of petitioners that Section 117(a)(1) of the U. S. Revenue Code of 1938 is "more or less the same as the provision of Section 34 of our Tax Code" is devoid of merit.

WHEREFORE, the decision appealed from is hereby affirmed, with costs against petitioner Paz Y. de Ossorio.

SO ORDERED.

Quezon City, November 29, 1971.

R M Umali
ROMAN M. UMALI
Presiding Judge

WE CONCUR:

Estanislao R. Alvarez
ESTANISLAO R. ALVAREZ
Associate Judge

Ramon L. Avanceña
RAMON L. AVANCEÑA
Associate Judge