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

Secs. 27(D)(5); and 39(A)(1) of the Tax Code of 1997, as amended
RR No. 7-2003
BIR Ruling No. OT-102-2022
OT-284-2022
JUN 06 2022

MOSVELDTT LAW OFFICES
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Attention: **Rodolfo G. Tuazon Jr.**

Gentlemen:

This refers to your letter, on behalf of your client, Permafrost Cold Storage and Logistics Corporation ("Permafrost"), requesting for a confirmatory ruling on your opinion that the sale of its parcels of land is subject only to six percent (6%) capital gains tax (CGT) as these are capital assets pursuant to Section 27 (D) (5) of the National Internal Revenue Code (Tax Code) of 1997, as amended.

It is represented that Permafrost is a stock corporation registered with the Securities and Exchange Commission. It was organized on May 27, 2011 and was established to maintain, engage and/or carry on the business of operating a cold storage facility. However, from the time of its organization, the company never commenced commercial operations and was not able to serve its purpose as stated in its Articles of Incorporation. Currently, Permafrost owns two (2) parcels of land covered by Transfer Certificate of Title (TCT) Nos. and ("subject properties"). The subject properties, from the time of its acquisition, have been recorded in the books of accounts and were presented in Permafrost's audited financial statements as non-current assets/long term assets. As non-current assets/long term assets, the subject properties have remained undeveloped, unimproved, idle and vacant since they were acquired as per Certificate of No-Improvement issued by the Office of the City Assessor of Taguig City as well as Certifications issued by Barangay Ligid Tipas and Barangay Palingon-Tipas where the subject properties are located. Moreover, the subject properties have never been used by Permafrost in its trade or business, leased out and were never included in its stock in trade or inventory for sale to customers.

In reply, please be informed that Section 39 (A) (1) of the Tax Code of 1997, as amended, states that:

> *"SEC. 39. Capital Gains and Losses. —*
>
> *(A) Definitions. — As used in this Title —*
>
> *(1) Capital Assets. —* ***<u>The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or</u>***

> ***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 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.*" (Emphasis and underscoring supplied)

In relation thereto, Section 2 of Revenue Regulations (RR) No. 7-2003[1] dated December 27, 2002, states that:

> "*SECTION 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.*
>
> *xxx xxx xxx*"
>
> (Emphasis and underscoring supplied)

Under the above quoted provisions, it is undisputed that the yardstick for determining whether the property is capital asset or ordinary asset is the actual use of the said property. Thus, if the property is not actually used in trade or business of the taxpayer, whether or not connected with his trade or business, or not held for lease or sale to customers, it will be classified as a capital asset. Also, if the property is merely held for capital appreciation and investment purposes and remains vacant and idle, it is deemed a capital asset.

In stressing the rationale of the above-mentioned rule, this Office elucidated the matter in BIR Ruling No. 014-2003 dated October 28, 2003, as follows:

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[1] 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.

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"It is apparent under the foregoing provision that for a property to be considered an ordinary asset, it must be actually used in the business of the corporation. Accordingly, on the condition that Wendell Holdings Co., Inc. is not habitually engaged in the real estate business as represented, the property under consideration is capital asset. The property was neither held primarily for sale to customers nor actually used in the business of Wendell Holdings Co., Inc. xxx The property is not actually used in the business of Wendell Holdings, Inc. as it has remained idle and undeveloped. Therefore, the sale of the properly under consideration is a sale of capital asset, not an ordinary asset. As such, the transaction is subject to capital gains tax of 6% under Section 27(D) (5) and not to the creditable withholding tax."

In the instant case, Permafrost which is primordially engaged in the business of operating a cold storage facility is not considered as a company habitually engaged in the real estate business. Where the taxpayer is not engaged in the real estate business, a property not forming part of its inventory is considered a capital asset.

Furthermore, Section 3 (e) of RR No. 7-2003 provides that:

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

xxx xxx xxx

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.****"* (Emphasis and underscoring supplied)

In applying the above provision of RR No. 7-2003, real properties owned by taxpayers not engaged in the real estate business or referring to those persons other than real estate dealers, real estate developers and/or real estate lessors shall, 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 the said real properties, and though classified as ordinary assets, be automatically converted into capital assets.

In view of the foregoing, and considering that Permafrost is a taxpayer not engaged in the real estate business, being not a real estate dealer, developer or lessor and was organized as a cold storage facility; that the subject properties have been idle and vacant (for more than two years) per Certificate of No-Improvement issued by the Office of the City Assessor of Taguig City as well as Certifications issued by Barangay Ligid Tipas and Barangay Palingon-Tipas; and that the subject properties have been treated in the books of accounts and were reflected in the Permafrost's audited financial statement as non-current assets/long term assets and has not

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been used in the ordinary course of trade or business, it is the considered opinion of this Office that the subject properties described above are classified as capital assets.

Thus, the conveyance of which through sale is subject only to the CGT under Section 27 (D) (5) of the Tax Code of 1997, as amended, and documentary stamp tax (DST) under Section 196 of the same Code, and shall not be subject to creditable withholding tax (CWT) under Section 57 and value-added tax (VAT) under Section 106, both 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,

CAESAR R. DULAY
Commissioner of Internal Revenue
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