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

Sec. 39(A), Tax Code
BIR Ruling Nos. 296-14, 027-02, 59-99, 143-99 & 14-2003
OT- 0533-2020
SEP 23 2020

Global Business Holdings, Inc.
5th Flr GT Tower Int'l
6813 Ayala cor HV dela Costa Sts.
Makati City 1227

Attention: **Ms. Edita C. Encarnacion**
Chief Accountant

Gentlemen:

This refers to your letter dated June 20, 2018 requesting for a ruling on the following issues:

1. Is **Global Business Holdings, Inc.'s** (the "Company") real and other properties acquired (ROPA), by virtue of a merger, classified as capital assets or ordinary assets, since the Company is now a holding company?

2. If considered capital assets and the Company sells more than six (6) properties in a year, does this fall under "habitually engaged in the sale of properties" for the current year?

3. If the Company sells below six (6) properties this 2018, after it was adjudged to be habitually engaged in the sale of properties in the previous years, how does the Company classify assets sold?

As represented, the Company (formerly Global Business Bank, Inc.) is a product of three (3) banks which merged in 2000. In 2002, all banking assets and banking liabilities were bought by another bank leaving behind only acquired assets or real properties to the Company. The Company then converted its business activity from financial to a holding/investment company as well as its name from banking to a holding company in order not to mislead on the nature of its business activity.

The Company lodges the properties under ROPA and pays the corresponding real property tax (RPT) and caretaker fees to safeguard the assets. These properties are in idle state, except for two 2) properties wherein the Company leases them. Since the Company needs to be liquid to maintain its assets, the Company sells various properties. In a year, the Company sells more than six (6) properties and was considered to be habitually engaged in the sale of assets with classification as ordinary assets for tax purposes.

In reply, please be informed as follows:

Whether real and other properties acquired (ROPA) by merger are capital or ordinary assets will depend upon peculiar facts and circumstances.

Section 39 (A) of the Tax Code of 1997, as amended, provides for the definition of capital assets, to wit:

> *"Section 39. Capital Gains and Losses. —*
>
> *(A) Definitions. — As used in this Title —*
>
> *(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 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."*

In relation to the aforementioned provision, Section 2 (a) of Revenue Regulations (RR) 7-2003, issued on February 11, 2003, defines **capital assets** as referring 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."

Section 2 (b) thereof laid down what constitutes ordinary assets, as follows:

> "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

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OT- 0533-2020
SEP 23 2020

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." (emphasis supplied)

Moreover, Section 3 (a) of the same Regulations provides for the 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. — x x x

2. Real estate Developer. — x x x

3. Real Estate Lessor. — x x x

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.)." (emphasis supplied)

Section 3 (a) of RR No. 7-2003 should be read in connection with Revenue Memorandum Circular (RMC) No. 7-90 which provides that a vendor shall be considered "habitually engaged in real estate business" if he has consummated, during the preceding year, at least six taxable real estate transactions, regardless of amount. A vendor who has previously been accredited by the Chamber of Real Estate & Builders' Associations, Inc. (CREBA) and registered with the Housing and Urban Development Coordinating Council (HUDCC)/ Housing and Land Use Regulatory Board (HLURB) may still be considered habitually engaged in real estate business even if the number of sales made during the year falls below six. The duty of determining whether or not the vendor is habitually engaged in real estate business rests upon the BIR.

Even in the absence of registration therewith, a person may also be treated habitually engaged in the real estate business upon showing that he is in fact actually engaged in the said business. (BIR Ruling No. 296-14 dated July 24, 2014; BIR Ruling No. DA-081-00 dated February 7, 2000; BIR Ruling No.143-99 dated September 14, 1999; and BIR Ruling No. 059-99 dated April 30, 1999)

In BIR Ruling No. DA-(C-052) 185-09 dated April 7, 2009, citing BIR Ruling No. 014-2003 dated October 28, 2003, this Office used as basis the "actual use" of the property in determining its classification –

> "x x x 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. Moreover, if the property is merely held for investment purposes and remains vacant and idle, it is deemed a capital asset.
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> x x x x x x x x x
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> The phrase **"taxpayers engaged in the real estate business"** refers collectively to real estate dealers, real estate developers, and/or real estate lessors. Conversely, the term "taxpayer 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. 2 (g), Revenue Regulations No. 7-2003)
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> Inasmuch as POPI is not primarily engaged in real estate business, but is merely a holding company and as such has interests in real estate and property development, manufacturing and retailing/distribution, financial services and other allied services, organized under several intermediate holding companies, it is deemed not engaged in the real estate business. Consequently, the Mandaue Land is property not primarily held for sale or lease in the regular course of trade or business."

However, as stated by the Supreme Court in the case of *Calasanz, et al. vs. Commissioner of Internal Revenue, 144 SCRA 664*, there is no fixed formula to determine whether a piece of property is a capital asset or an ordinary asset. Although several factors have been recognized as helpful guides, none is decisive. Each case must, in the last analysis, rest upon its own peculiar facts and circumstances.

OT-0533-2020
SEP 23 2020

Determination of the classification of assets sold during the current year for purposes of imposing CGT / CWT.

It is necessary to first determine the character of the real property being sold (e.g. whether capital asset or ordinary asset) in order to determine whether its sale is subject to capital gains tax (CGT) or creditable withholding tax (CWT).

If the real property is not actually used in the business of the seller-corporation and is treated as a capital asset, as that term is defined in Section 39 (A) of the 1997 Tax Code, as amended, and as implemented by Section 2 (a) of RR 7-2003, and the seller-corporation is not considered as habitually engaged in the real estate business, the real property is considered as a capital asset.

Accordingly, the income derived from the sale thereof is not subject to the expanded withholding tax under Sec. 2,57.2 (J) of RR No. 2-98, as amended by RR 11-2018 but only to the 6% CGT imposed under Section 27 (D)(5) of the Tax Code of 1997, as amended. Section 27 (D)(5) of the Tax Code of 1997, as amended, applies whether or not the seller-corporation is engaged in the real estate business (BIR Ruling No. 027-02 dated July 3, 2002). Moreover, the seller-corporation will be subject to the documentary stamp tax under Section 196 of the same Code, based on the gross selling price or fair market value (FMV) as determined in accordance with Section 6 (E) of the Tax Code of 1997, as amended, whichever is higher. (BIR Ruling No. 027-02 dated July 3, 2002; BIR Ruling Nos. DA-217-99 dated April 12, 1979; and DA-010-02 dated January 29, 2002).

On the other hand, if the real property being sold is an ordinary asset, as that term is defined in Section 3 (a) of RR 7-2003, the withholding tax rates imposed under Section 2.57.2 of RR 2-98, as amended by RR 11-2018, shall apply. The rate of withholding tax will depend on whether, first, the seller is exempt or taxable; second, whether the seller is habitually engaged in real estate business or not; and third, the gross selling price, (as that term is defined in the above-mentioned RR) if the seller is habitually engaged in real estate business, (BIR Ruling No. DA-152-04 dated March 31, 2004; BIR Ruling No. 27-02 dated July 3, 2002). Likewise, the seller-corporation will be subject to the documentary stamp tax imposed under Section 196 of the same Code, based on the gross selling price or FMV as determined in accordance with Section 6 (E) of the same Code, whichever is higher. Moreover, since the real properties are treated as ordinary assets of the Company, the sale thereof shall be subject to the 12% value-added tax imposed under Section 108 (A) of the Tax Code of 1997, as amended (BIR Ruling No. DA-209-02 dated November 15, 2002).

Based on the foregoing, this Office is of the opinion and so holds -

1) Since real properties acquired by banks through foreclosure sales are considered as their ordinary assets, the Company's ROPA retained its classification as ordinary assets even after the Company has converted its business from a bank to a holding/investment company pursuant to Section 39 (A) of the Tax Code of 1997, as amended, and as implemented by Section 2 (a) of RR 7-2003.

OT- 0533-2020
SEP 23 2020

2) If the ROPA are considered as a capital asset and the Company sells more than six (6) properties in a year, the Company is considered as habitually engaged in the real estate business. Otherwise stated, if the Company sold less than six (6) real properties in the previous year, it will not be considered as habitually engaged in the real estate business for the current year. However, this is a non-issue since as previously stated, the Company's ROPA are considered as ordinary assets.

3) If the Company sells below six (6) real properties in the current year i.e., 2018, after he/it was adjudged to be habitually engaged in the sale of properties in the previous years, the Company is deemed to be engaged in the real estate business and all real properties owned and acquired by it shall be treated as ordinary assets. (BIR Ruling No. SH-(007) 106-09 dated February 18, 2009).

Very truly yours,

CAESAR R. DULAY
Commissioner of Internal Revenue

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