

TOMAS CALASANZ, ET. AL., PETITIONERS, VS. THE COMMISSIONER OF INTERNAL REVENUE AND THE COURT OF TAX APPEALS, RESPONDENTS.

G.R. No. L-26284. October 09, 1986

Ponente: FERNAN, J.

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FERNAN, J.:

Appeal taken by Spouses Tomas and Ursula Calasanz from the decision of the Court of Tax Appeals in CTA No. 1275 dated June 7, 1966, holding them liable for the payment of P3,561.24 as deficiency income tax and interest for the calendar year 1957 and P150.00 as real estate dealer's fixed tax.

Petitioner Ursula Calasanz inherited from her father Mariano de Torres an agricultural land located in Cainta, Rizal, containing a total area of 1,678,000 square meters. In order to liquidate her inheritance, Ursula Calasanz had the land surveyed and subdivided into lots. Improvements, such as good roads, concrete gutters, drainage and lighting system, were introduced to make the lots saleable. Soon after, the lots were sold to the public at a profit.

In their joint income tax return for the year 1957 filed with the Bureau of Internal Revenue on March 31, 1958, petitioners disclosed a profit of P31,060.06 realized from the sale of the subdivided lots, and reported fifty per centum thereof or P15,530.03 as taxable capital gains.

Upon an audit and review of the return thus filed, the Revenue Examiner adjudged petitioners engaged in business as real estate dealers, as defined in Section 194 [s][1] of the National Internal Revenue Code, required them to pay the real estate dealer's tax[2] and assessed a deficiency income tax on profits derived from the sale of the lots based on the rates for ordinary income.

On September 29, 1962, petitioners received from respondent Commissioner of Internal Revenue:

- Demand No. 90-B-032293-57 in the amount of P160.00 representing real estate dealer's fixed tax of P150.00 and P10.00 compromise penalty for late payment; and
- Assessment No. 90-5-35699 in the amount of P3,561.24 as deficiency income tax on ordinary gain P3,018.00 plus interest P543.24.

On October 17, 1962, petitioners filed with the Court of Tax Appeals a petition for review contesting the aforementioned assessments.

On June 7, 1966, the Tax Court upheld the respondent Commissioner except for that portion of the assessment regarding the compromise penalty of P10.00 for the reason that in this jurisdiction, the same cannot be collected in the absence of a valid and binding compromise agreement.

Hence, the present appeal.

The issues for consideration are:

- Whether or not petitioners are real estate dealers liable for real estate dealer's fixed tax; and
- Whether the gains realized from the sale of the lots are taxable in full as ordinary income or capital gains taxable at capital gain rates

The issues are closely interrelated and will be taken jointly.

Petitioners assail their liabilities as "real estate dealers" and seek to bring the profits from the sale of the lots under Section 34 [b] [2][3] of the Tax Code.

The theory advanced by the petitioners is that inherited land is a capital asset within the meaning of Section 34[a][1] of the Tax Code and that an heir who liquidated his inheritance cannot be said to have engaged in the real estate business and may not be denied the preferential tax treatment given to gains from sale of capital assets, merely because he disposed of it in the only possible and advantageous way.

Petitioners averred that the tract of land subject of the controversy was sold because of their intention to effect a liquidation. They claimed that it was parcelled out into smaller lots because its size proved difficult, if not impossible, of disposition in one single transaction. They pointed out that once subdivided, certainly, the lots cannot be sold in one isolated transaction. Petitioners, however, admitted that roads and other improvements were introduced to facilitate its sale.[4]

On the other hand, respondent Commissioner maintained that the imposition of the taxes in question is in accordance with law since petitioners are deemed to be in the real estate business for having been involved in a series of real estate transactions pursued for profit. Respondent argued that property acquired by inheritance may be converted from an investment property to a business property if, as in the present case, it was subdivided, improved, and subsequently sold and the number, continuity and frequency of the sales were such as to constitute "doing business". Respondent likewise contended that inherited property is by itself neutral and the fact that the ultimate purpose is to liquidate is of no moment for the important inquiry is what the taxpayer did with the property. Respondent concluded that since the lots are ordinary assets, the profits realized therefrom are ordinary gains, hence taxable in full.

We agree with the respondent.

The assets of a taxpayer are classified for income tax purposes into ordinary assets and capital assets. Section 34[a][1] of the National Internal Revenue Code broadly defines capital assets as follows:

[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 thirty; or real property used in the trade or business of the taxpayer."

The statutory definition of capital assets is negative in nature.[5] If the asset is not among the exceptions, it is a capital asset; conversely, assets falling within the exceptions are ordinary assets. And necessarily, any gain resulting from the sale or exchange of an asset is a capital gain or an ordinary gain depending on the kind of asset involved in the transaction.

However, there is no rigid rule or fixed formula by which it can be determined with finality whether property sold by a taxpayer was held primarily for sale to customers in the ordinary course of his trade or business or whether it

was sold as a capital asset.[6] Although several factors or indices[7] have been recognized as helpful guides in making a determination, none of these is decisive; neither is the presence nor the absence of these factors conclusive. Each case must in the last analysis rest upon its own peculiar facts and circumstances.[8]

Also a property initially classified as a capital asset may thereafter be treated as an ordinary asset if a combination of the factors indubitably tend to show that the activity was in furtherance of or in the course of the taxpayer's trade or business. Thus, a sale of inherited real property usually gives capital gain or loss even though the property has to be subdivided or improved or both to make it salable. However, if the inherited property is substantially improved or very actively sold or both it may be treated as held primarily for sale to customers in the ordinary course of the heir's business.[9]

Upon an examination of the facts on record, We are convinced that the activities of petitioners are indistinguishable from those invariably employed by one engaged in the business of selling real estate.

One strong factor against petitioners' contention is the business element of development which is very much in evidence. Petitioners did not sell the land in the condition in which they acquired it. While the land was originally devoted to rice and fruit trees[10], it was subdivided into small lots and in the process converted into a residential subdivision and given the name Don Mariano Subdivision. Extensive improvements like the laying out of streets, construction of concrete gutters and installation of lighting system and drainage facilities, among others, were undertaken to enhance the value of the lots and make them more attractive to prospective buyers. The audited financial statements[11] submitted together with the tax return in question disclosed that a considerable amount was expended to cover the cost of improvements. As a matter of fact, the estimated improvements of the lots sold reached P170,028.60 whereas the cost of the land is only P4,742.66. There is authority that a property ceases to be a capital asset if the amount expended to improve it is double its original cost, for the extensive improvement indicates that the seller held the property primarily for sale to customers in the ordinary course of his business.[12]

Another distinctive feature of the real estate business discernible from the records is the existence of contracts receivables, which stood at P395,693.35 as of the year ended December 31, 1957. The sizable amount of receivables in comparison with the sales volume of P446,407.00 during the same period signifies that the lots were sold on installment basis and suggests the number, continuity and frequency of the sales. Also of significance is the circumstance that the lots were advertised[13] for sale to the public and that sales and collection commissions were paid out during the period in question.

Petitioners, likewise, urge that the lots were sold solely for the purpose of liquidation.

In *Ehrman vs. Commissioner*[14], the American court in clear and categorical terms rejected the liquidation test in determining whether or not a taxpayer is carrying on a trade or business. The court observed that the fact that property is sold for purposes of liquidation does not foreclose a determination that a "trade or business" is being conducted by the seller. The court enunciated further:

"We fail to see that the reasons behind a person's entering into a business - whether it is to make money or whether it is to liquidate - should be determinative of the question of whether or not the gains resulting from the sales are ordinary gains or capital gains. The sole question is - were the taxpayers in the business of subdividing real estate? If they were, then it seems indisputable that the property sold falls within the exception in the definition of capital assets ... that is, that it constituted 'property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.'"

Additionally, in *Home Co., Inc. vs. Commissioner*,[15] the court articulated on the matter in this wise:

"One may, of course, liquidate a capital asset. To do so, it is necessary to sell. The sale may be conducted in

the most advantageous manner to the seller and he will not lose the benefits of the capital gain provision of the statute unless he enters the real estate business and carries on the sale in the manner in which such a business is ordinarily conducted. In that event, the liquidation constitutes a business and a sale in the ordinary course of such a business and the preferred tax status is lost."

In view of the foregoing, We hold that in the course of selling the subdivided lots, petitioners engaged in the real estate business and accordingly, the gains from the sale of the lots are ordinary income taxable in full.

WHEREFORE, the decision of the Court of Tax Appeals is affirmed. No costs.

SO ORDERED.

Feria, (Chairman), Alampay, Gutierrez, Jr., and Paras, JJ., concur.

[1]

"Real estate dealer" includes any person engaged in the business of buying, selling, exchanging, leasing, or renting property as principal and holding himself out as a full or part-time dealer in real estate or as an owner of rental property or properties rented or offered to rent for an aggregate amount of four thousand pesos or more a year."

[2] Section 182 [3] [s] of the National Internal Revenue Code which prescribes an annual fixed tax on real estate dealers.

[3]

"Sec. 34[b] Percentage taken into account. - In case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

[1] One hundred per centum if the capital asset has been held for not more than twelve months;

[2] Fifty per centum if the capital asset has been held for more than twelve months."

[4] P. 6, Brief for Petitioners-Appellants, p. 48, Rollo.

[5] Nollado, Commentaries and Jurisprudence on the National Internal Revenue Code of the Philippines, 1973 ed., p. 314.

[6] Victory Housing No. 2 vs. Commissioner, 205 F. 2d 371.

[7] Tuason, Jr. vs. Lingad, 58 SCRA 170 citing Klarkowski, TCM 1965-328. Aff'd 385 F[2d] 398 [Ca-7, 1967] "which held that in determining the correct boundary between these two types of assets the following must be considered:

[1] the purpose for which the property was initially acquired;

[2] the purpose for which the property was subsequently held;

[3] the extent to which improvements, if any, were made to the property by the taxpayer;

[4] the frequency, number and continuity of sales;

[5] the extent and nature of the transactions involved;

[6] the ordinary business of the taxpayer;

[7] the extent of advertising, promotion, or other activities used in soliciting buyers for the sale of the property;

[8] the listing of property with brokers; and

[9] the purpose for which the property was held at the time of sale."

[8] Victory Housing No. 2 vs. Commissioner, Supra; Mauldin vs. Commissioner, 195 F. 2d 714.

[9] 34 Am Jur 2d., p. 92.

[10] P. 26, BIR Records.

[11] PP. 3-4, BIR Records.

[12] 34 Am Jur 2d., p. 89.

[13] P. 35, BIR Records.

[14] 9 Cir., 120 F. 2d 607. Also see Richards vs. Commissioner, 9 Cir., 81 F. 2d 369, and Commissioner vs. Boeing, 106 F. 2d 305.

[15] 212 F. 2d 637.

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