CAPITAL GAINS TAXATION

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TYPES OF ASSETS
The assets of the business are classified as:

1. **Ordinary assets** – includes:
   a. stock in trade of the taxpayer, or other property of a kind which would properly be included in an inventory of the taxpayer if on hand at the end of the taxable year
   b. properties held by the taxpayer primarily for sale to customers in the ordinary course of trade or business;
   c. properties used in trade or business of a character which is subject to allowance for depreciation; and
   d. real properties used in trade or business
      Examples: inventories, property, plant and equipment

2. **Capital assets** – any other assets that does not fall under the definition of ordinary assets
   Examples: investment properties, notes receivables and investment in equity or debt securities (for a non-security dealer taxpayer)

Gains arising from sale of ordinary assets are called “ordinary gains.” Gains arising from sale of capital assets are called “capital gains.” All ordinary gains are taxable under regular income taxation. Capital gains are taxable either under final tax or under regular income tax.

CAPITAL GAINS SUBJECT TO FINAL TAX

A. **Capital gains tax on sale, barter, exchange and other disposition of domestic shares of stock directly to buyer**
   Requisites:
   a. There is a net gain.
   b. The capital asset sold is a domestic stock.
   c. The sale is made directly to buyer.

   **Capital Gains Tax Rates:** 15%

   **Note to candidates:**
   This rule on capital gains on sale of domestic stocks directly to buyer is uniform to all income taxpayers (individuals or corporate) regardless of classification.

   The rule does not apply to:
   1. **Gains on sale shares of stock that is traded in the Philippine Stock Exchange (PSE)**
      ⇒ This is subject to a transaction tax (percentage tax) of ½ of 1% of selling price.
   2. **Gains under similar conditions by security brokers or dealers**

   **When to file the Capital Gains Tax Returns?**
   1. **Per transaction basis:** Within 30 days after each transactions
   2. **Annual basis:**
      a. For individuals – On or before April 15 of the following year
      b. For corporations – On or before the 15th day of the fourth month following the close of the taxable year

   **When to pay the capital gains tax?**
   1. **Lump sum** – Upon date of filing the return with the Bureau (within 30 days from date of sale)
   2. **Installment** – tax on installments is due within 30 days from receipts of each installment

   **Documentary Stamp Tax**
   - **Par value stock:** P1.50/P200 or fractional part of the par value of due bill, certificate of obligation or stock
   - **No-par stock:** 25% of the documentary stamp tax paid on the original issue of said stock. (The documentary stock on original issue of non-par stock is based on actual consideration for the issuance – Sec. 174 NIRC)
   - **Limit:** Only one tax shall be collected on each sale or transfer of stock or securities from one person to another regardless of whether or not a certificate of stock is issued or obligation is issued, indorsed, or delivered in pursuance of such sale or transfer.
B. **Sale, exchange or other disposition of real property in the Philippines classified as capital asset**

Requisites:
- The real property is located in the Philippines.
- The property is classified as capital asset.
- The taxpayer is an individual or a domestic corporation.
- The taxpayer is other than a foreign corporation.

**Tax Rate and Tax Basis:** 6% x (the higher of Gross Selling Price or Fair Market Value)

The **fair market value** for purposes of the capital gains tax is whichever is higher of:
1. Zonal value as prescribed by the Commissioner of Internal Revenue
2. Assessed value as determined by the Provincial or City Assessor’s Office

**Gross selling price** – The amount of any money received plus the fair market value of any property received. Interest on the selling price shall be treated separately as *Other Income* taxable under regular income taxation.

**Excess Mortgage Assumed**
The excess of the mortgage assumed over the cost of the property is included both in initial payment and selling since it is a constructive receipt of income; in other words, it represents “extra consideration”.

**Note to Candidates:** The basis of the tax is on the gross selling price or gross fair market value. This treatment presumes the existence of gain and is applied regardless of the existence of actual gain.

**SCOPE OF THE 6% CAPITAL GAINS TAX:**

<table>
<thead>
<tr>
<th>Location of Real Property</th>
<th>Individuals</th>
<th>Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Citizen</td>
<td>Alien</td>
</tr>
<tr>
<td>Philippines</td>
<td>×</td>
<td>×</td>
</tr>
<tr>
<td>Abroad</td>
<td>×</td>
<td>×</td>
</tr>
</tbody>
</table>

**Note to Candidate:**
Regular income taxation, being the general rule, applies where the 6% final capital gains tax do not apply. Under regular taxation, the *actual net gain* is subject to regular income tax.

**How is the capital gains tax paid?**
1. The tax is withheld at source – the seller and buyer files a joint capital gains tax return (one return per sale or foreclosure sale).
2. Installment (one return for each installment payment receive)
   The tax is withheld at source in installments when the taxpayer qualifies and opted to be taxed on installments.

**Alternative Taxation:**
The actual net gain on the sale of real property may be included under progressive income taxation.

Requisites:
- the seller is an individual
- the buyer is the government, its political subdivisions or agencies or GOCCs

**Tax Exemption:**
The sale may be exempted from the payment of capital gains tax provided the following conditions are met:
1. The seller is an individual citizen or resident alien.
2. The real property sold is his *principal residence*.
   *Principal Residence* – the place where an individual person resides comprising of the house and the lot to where it erects; in case the interest on the land component is held by other persons, only the dwelling house is considered principal residence.
   The residential address indicated in the latest income tax return immediately before the date of sale is conclusive presumed to be the true residence. The Barangay Captain Certification or Building Administrator Certification in the case of condominium residences is no longer honored.
3. The full proceed of the sale is utilized in acquiring another residence.
4. A new residence must be acquired or constructed within 18 calendar months from the date of sale.

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**Deadline:** Documentary stamp tax return shall be filed *within 10 days after the close of the month* when the taxable document was made, signed, issued, accepted or transferred, and the tax thereon shall be paid at the same time the return is paid.
5. The BIR is duly notified by the taxpayer of his intention to avail of the tax exemption within 30 days from the date of sale through a prescribed return.
6. The capital gains tax thereon is held in escrow in favor of the government.
7. The exemption can only be availed once every 10 years.
8. The historical cost or adjusted basis of the real property (principal residence) sold shall be carried over to the new principal residence built or acquired

Should there be any portion of the proceeds of sale not utilized for the reconstruction of a new residence, the same shall be taxable. The tax on the unutilized portion shall be determined as follows:

\[
\text{New cost basis} = \left( \frac{\text{Gross selling price or Fair Market Value at the date of sale, whichever is higher}}{\text{Utilized Selling Gross Selling Price}} \right) \times \left( \frac{\text{Unutilized portion}}{\text{Gross selling price}} \right) \times 6% \]

**Tax Basis of New Principal Residence:**

*Tax Basis* refers to the cost or adjusted cost of a property for tax purposes and hence the amount deductible for tax purposes in determining gain or losses in disposal of the related property if the related transaction is taxable under the progressive system of taxation. Generally, when a property is acquired by purchase, the cost is the tax basis.

A tax basis reduction may result if the proceeds of the disposition of a principal residence is not fully utilized in the acquisition or construction of a replacement. Likewise, a tax basis increase results when additional expenditures were incurred by the taxpayer in securing a replacement principal residence.

**Less than full utilization of proceeds:**

\[
\text{New cost basis} = \left( \frac{\text{Utilized Selling Gross Selling Price}}{\text{Basis of the old principal residence}} \right) \times \left( \frac{\text{Basis of the old principal residence}}{\text{Gross selling price}} \right) \times 6% \]

**More than full utilization of proceeds:**

\[
\text{New cost basis} = \left( \frac{\text{Basis of the old principal residence}}{\text{Utilized Selling Gross Selling Price}} \right) + \left( \frac{\text{Additional expenditure in excess of the proceeds}}{\text{Gross selling price}} \right) \times 6% \]

**Documentary Stamp Tax**

- **Amount:**
  - P15 – if selling price after allowance for encumbrances does not exceed P1,000
  - P15 – for each P1,000 or fractional excess above P1,000 of such selling price
- **Deadline:** Documentary stamp tax return shall be filed and the tax thereon paid within 10 days after the close of the month when the taxable document was made, signed, issued, accepted or transferred.

**DRILL PROBLEMS: ORDINARY OR CAPITAL ASSETS**

**Illustration 1: Relative classification**

Classify the following assets by indicating OA for ordinary assets or CA for capital assets:

<table>
<thead>
<tr>
<th>Asset</th>
<th>Realty Developer</th>
<th>Security Dealer</th>
<th>Merchandiser</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vacant lot</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office supplies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic stocks</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bonds</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts/notes receivables</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office building</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office equipment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land where the office building stands</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal car of the business proprietor-taxpayer</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal house and lot of the proprietor-taxpayer</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jewelry of the proprietor-taxpayer</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Illustration 2: Classification**

1. The term “capital assets” includes
   a. Stock in trade or other property included in the taxpayer’s inventory.
   b. Real property not used in the trade or business of the taxpayer.
   c. Real property primarily used for sale to customers in the ordinary course of trade or business.
2. Lots being rented when subsequently sold are classified as  
a. Capital assets 
b. Liquid assets 
c. Ordinary assets 
d. Fixed assets

3. A non-profit school has a school building and a parking lot that is leased out to the public for a fee. It placed some funds in a bond investment out of its extra cash. At the end of the period, it has uncollected P400,000 fees.

Required: Identify the ordinary assets and capital assets.

4. In transferring properties, which asset classification prevails?  
a. Classification to the transferor 
b. Purpose of use of the transferee 
c. Classification of the transferor if the transfer is taxed 
d. Classification of the transferor if the transfer is exempt

5. Identify the asset classification  
a. A lot purchased to be used as a future building site for his business but remained unused for 5 years due to political instability in the area  
b. An a currently unused back-up equipment  
c. A building that is converted as residence of the taxpayer  
d. A used equipment that remained unused for more than 2 years  
e. A warehouse building that is abandoned for more than 2 years  
f. A brand new machinery acquired for the business but remained unused for more than two years due to delays in the acquisition of permits for the business  
g. A fully depreciated truck that is still in use  
h. An unsold open lot of a real estate developer who changed business to a hotel and restaurant business  
i. Construction equipment of a real estate developer that remained unused for more than two years  
j. A church building  
k. A foreclosed collateral property held by the bank

DRILL PROBLEMS: CAPITAL GAINS ON THE DISPOSAL OF DOMESTIC STOCKS

A. Transactional Capital Gains Tax
For each of the following scenarios, compute the capital gains tax:

<table>
<thead>
<tr>
<th>Illustrative Cases</th>
<th>CGT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Andy sold domestic stocks through the PSE at a gain of P400,000.</td>
<td></td>
</tr>
<tr>
<td>2. Andy, a security dealer, sold domestic stocks through the PSE at a gain of P400,000.</td>
<td></td>
</tr>
<tr>
<td>3. Andy, a security dealer, sold domestic stocks directly to a buyer at a gain of P400,000.</td>
<td></td>
</tr>
<tr>
<td>4. Andy, a realty dealer, sold domestic common stock to DEF, Inc. at a gain of P300,000.</td>
<td></td>
</tr>
<tr>
<td>5. ABC, Inc. sold domestic stocks through the PSE at a gain of P400,000.</td>
<td></td>
</tr>
<tr>
<td>6. ABC, Inc. issued its shares of stock at P300,000 in excess of its par value.</td>
<td></td>
</tr>
<tr>
<td>7. ABC, Inc. exchanged the shares of DEF, Inc. it acquired for P1M for a lot valued at P1.4M.</td>
<td></td>
</tr>
<tr>
<td>8. Andy sold domestic bonds directly to buyer at a gain of P400,000.</td>
<td></td>
</tr>
<tr>
<td>9. ABC, Inc. acquired DEF stock rights for P200,000. It disposed this rights for P400,000.</td>
<td></td>
</tr>
<tr>
<td>10. Andy purchased a stock option which he sold at a gain of P50,000.</td>
<td></td>
</tr>
<tr>
<td>11. Andy purchased domestic common stock for P1M and sold the same for P1.8M. At the date of sale the stock has a fair market value of P2.4M.</td>
<td></td>
</tr>
<tr>
<td>12. Andy purchased ordinary shares for P200,000 from DEF, Inc., a resident corporation. After 2 years, he sold the same to buyer for P300,000 when the fair market value was P280,000.</td>
<td></td>
</tr>
</tbody>
</table>

B. Annualized Capital Gains Tax
Alien, resident alien, taxpayer made the following dispositions of shares of stock during 2020:

<table>
<thead>
<tr>
<th>Date</th>
<th>Security</th>
<th>Selling price</th>
<th>Cost</th>
<th>Settlement mode</th>
<th>CGT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/18/20</td>
<td>Domestic common stocks</td>
<td>P 400,000</td>
<td>P120,000</td>
<td>Directly to buyer</td>
<td></td>
</tr>
<tr>
<td>2/12/20</td>
<td>Domestic bonds</td>
<td>200,000</td>
<td>180,000</td>
<td>Directly to buyer</td>
<td></td>
</tr>
<tr>
<td>3/14/20</td>
<td>Domestic preferred stocks</td>
<td>280,000</td>
<td>250,000</td>
<td>Through PSE</td>
<td></td>
</tr>
<tr>
<td>4/22/20</td>
<td>Resident corp. stocks</td>
<td>180,000</td>
<td>120,000</td>
<td>Directly to buyer</td>
<td></td>
</tr>
<tr>
<td>6/18/20</td>
<td>Domestic stock options</td>
<td>150,000</td>
<td>120,000</td>
<td>Directly to buyer</td>
<td></td>
</tr>
<tr>
<td>8/15/20</td>
<td>Resident corp. bonds</td>
<td>200,000</td>
<td>240,000</td>
<td>Directly to buyer</td>
<td></td>
</tr>
<tr>
<td>9/2/20</td>
<td>Domestic common stocks</td>
<td>310,000</td>
<td>320,000</td>
<td>Through PSE</td>
<td></td>
</tr>
<tr>
<td>9/24/20</td>
<td>Domestic preferred stocks</td>
<td>280,000</td>
<td>300,000</td>
<td>Directly to buyer</td>
<td></td>
</tr>
<tr>
<td>10/28/20</td>
<td>Domestic stock rights</td>
<td>150,000</td>
<td>110,000</td>
<td>Directly to buyer</td>
<td></td>
</tr>
</tbody>
</table>
12/11/20 | Domestic preferred stocks | 400,000 | 380,000 | Directly to buyer

Assume all capital gains or losses on stocks and other equity securities are short-term while those on bonds are long-term. The taxpayer has other regular income of P400,000 and P150,000 in deductible expenses.

Required: Compute the following:
1. Capital gains tax payable per transaction ________
2. Stock transaction tax withheld by brokers ________
3. Taxable net income of Allen ________

C. Installment CGT
On July 1, 2020, Andy sold his domestic stocks with aggregate par value of P250,000 and acquisition cost of P300,000 to Betty for P500,000. Betty made a downpayment of P50,000 and signed a note for the balance payable in 9 semi-annual installments starting December 31, 2020. Andy paid for the documentary stamp tax.

Required:
1. Compute the 2020 capital gains tax ________
2. Compute the documentary stamp tax on the sale ________

D. Special cases
1. Meiko Acebo is a security dealer. He had 10,000 ordinary stock of San Miguel Corporation, a domestic corporation, which he acquired at P100 per share. Meiko sold his stock investment to Zeus Millan on April 30, 2018 at P115 per share. How much is the capital gains tax payable on the transaction?
   a. P5,000  
   b. P10,000  
   c. P5,750  
   d. P 0

2. Mr. Bosun disposed various stocks at a total consideration of P400,000 and paid thereon stock transactions tax of P2,000. Aggregate gains realized totaled P98,000 after the stock transaction tax. What is the capital gains tax?
   a. P 0  
   b. P4,900  
   c. P 9,800  
   d. P 14,700

3. A certain taxpayer had the following gains and losses in dealing domestic stocks directly to buyer:

<table>
<thead>
<tr>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital gains</td>
<td>P 200,000</td>
</tr>
<tr>
<td>Capital losses</td>
<td>250,000</td>
</tr>
</tbody>
</table>

Required: Compute the capital gains tax in 2020. ________

E. Wash sales
Romeo had the following transactions in the stocks of ABC Corporation:

<table>
<thead>
<tr>
<th>Date</th>
<th>Transaction</th>
<th>Shares</th>
<th>Net price</th>
</tr>
</thead>
<tbody>
<tr>
<td>7/17/2020</td>
<td>Buy</td>
<td>20,000</td>
<td>P 30</td>
</tr>
<tr>
<td>9/29/2020</td>
<td>Sell</td>
<td>16,000</td>
<td>28</td>
</tr>
<tr>
<td>10/13/2020</td>
<td>Buy</td>
<td>12,000</td>
<td>24</td>
</tr>
<tr>
<td>12/27/2020</td>
<td>Sell</td>
<td>10,000</td>
<td>32</td>
</tr>
</tbody>
</table>

Required: Compute the capital gains tax for 2020. ________

F. Tax free exchanges
Raymund exchanged his A Company shares pursuant to a plan of consolidation where A Company will be integrated with B Company. The following relates to the exchange:

| Basis of A Company shares given | P 1,200,000  |
| Cash paid to B Company         | 100,000      |
| Fair value of A Company shares given | 1,300,000  |
| Fair value of B Company shares received | 1,100,000  |
| Fair value of other properties received from B Company | 350,000 |

Required:
1. Compute the capital gains tax.
   a. P 0  
   b. P 22,500
2. What is the tax basis of the B Company received by Raymund?
   a. P 1,000,000   c. P1,200,000
   b. P1,100,000   d. P1,350,000

3. What is the basis of the “boot” or the other properties received by Raymund?
   a. P 150,000   c. P350,000
   b. P 250,000   d. P400,000

4. What is the basis of the A Company shares received by B Company?
   a. P 0    c. P1,200,000
   b. P1,100,000   d. P1,350,000

**DRILL PROBLEMS: CAPITAL GAINS TAX ON THE DISPOSAL OF REAL PROPERTY**

**A. Scope of the 6% Capital Gains Tax**

<table>
<thead>
<tr>
<th>Illustrative Cases</th>
<th>Capital Gains Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. ABC, Inc. disposed a vacant lot costing P2,000,000 at a gain of P1,000,000. The lot has a fair value of P2,500,000 at the date of disposal.</td>
<td></td>
</tr>
<tr>
<td>2. ABC, Inc. disposed its old warehouse with a carrying amount of P2,000,000 at a gain of P1,000,000. The lot has a fair value of P2,500,000 at the date of disposal.</td>
<td></td>
</tr>
<tr>
<td>3. DEF, Inc., a resident foreign corporation, disposed its investment in condominium units for P3,000,000. The units have fair value of P4,000,000 at the date of disposal.</td>
<td></td>
</tr>
<tr>
<td>4. Andy, a dealer of cars, sold a vacant lot in Baguio City <strong>at a loss</strong>. The lot has an assessor’s fair value and zonal value of P800,000 and P1,200,000, respectively.</td>
<td></td>
</tr>
<tr>
<td>5. Andy sold one of his house and lot in Japan for P6M.</td>
<td></td>
</tr>
<tr>
<td>6. ABC Realty Corporation sold an undeveloped lot costing P2M for P3M.</td>
<td></td>
</tr>
</tbody>
</table>

**B. Special Cases**

**Scope of Exemption**

1. Information for the property with the following values:

<table>
<thead>
<tr>
<th>Zonal value</th>
<th>Property appraisal value</th>
<th>Assessor’s fair value – land</th>
<th>Acquisition costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>P 2,500,000</td>
<td>P 5,000,000</td>
<td>1,500,000</td>
<td>2,000,000</td>
</tr>
<tr>
<td>Assessor’s fair value – building</td>
<td>1,000,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For each of the following independent cases, indicate the capital gains tax:

<table>
<thead>
<tr>
<th>Illustrative Cases</th>
<th>CGT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Andy sold his principal residence for P4M. He immediately repurchased a new residence for P4.2M.</td>
<td></td>
</tr>
<tr>
<td>2. Andy sold his principal residence for P2.5M. He immediately repurchased a new residence for P2M.</td>
<td></td>
</tr>
<tr>
<td>3. Andy sold his principal residence for P2.5M. He immediately repurchased a new residential lot for P2M.</td>
<td></td>
</tr>
<tr>
<td>4. Andy sold one of his residential property for P4M. He immediately repurchased a new residence for P4.2M.</td>
<td></td>
</tr>
<tr>
<td>5. Andy sold his residential lot for P4M. He immediately repurchased a new residence for P4.2M.</td>
<td></td>
</tr>
<tr>
<td>6. Andy’s house and lot was expropriated by the government. Andy leased his residence after receiving P3M settlement. Andy opted to be subjected to capital gains tax.</td>
<td></td>
</tr>
<tr>
<td>7. Andy’s house and lot was foreclosed after his failure to pay the P2M mortgage on the property. The bank paid him P1.5M after the auction sale.</td>
<td></td>
</tr>
</tbody>
</table>

**Installment CGT**

2. Andy sold his house and lot with fair value of P3,500,000 for P3,000,000 on July 1, 2019. The house and lot, which was subject to a mortgage was acquired for P1,500,000 in 2017. The buyer assumed the mortgage on the property and signed a note payable for the balance payable in 5 semi-annual installments starting December 31, 2019.

**Required:** Compute the following under the following mortgage assumptions:

<table>
<thead>
<tr>
<th>Mortgage is P1,000,000</th>
<th>Mortgage is P2,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Initial payment</td>
<td></td>
</tr>
</tbody>
</table>
b. Contract price

c. Capital gains tax due in 2019

d. Documentary stamp tax

3. After long years of ownership, Ms. Shiela Longboan sold her residential lot to a government-owned and controlled corporation at 20% discount of its fair value under the following terms:

Cash received, January 10, 2019 P 200,000
Amount received, July 1, 2019 200,000
Installment due, July 1, 2020 1,200,000

Additional Information:
- Cost of the land 300,000
- Mortgage assumed by the buyer 400,000
- Mortgage on the land executed by the buyer in favor of the seller to guarantee payment 1,200,000

**Required**: Compute the following:
1. Selling price
2. Contract price
3. Initial payments
4. Capital gains tax in 2019
5. Reportable gain if Shiela opted to regular tax
6. Documentary stamp tax

4. Mark, a resident of Baguio City, sold his second house in Angeles, Pampanga for P 4,000,000 to a buyer who is doing business in Makati City. The lot has an assessed value of P500,000 and zonal value of P2,000,000. The house has a fair value of P2,000,000.

**Required**: Determine the following
1. Capital gains tax
2. Venue where to file BIR Form 1706
3. Net proceeds of the sale

----- END OF HANDOUTS -----