Republic of the Philippines
DEPARTMENT OF FINANCE
Roxas Boulevard Corner Pablo Ocampo, Sr. Street
Manila 1004

DOF Opinion No. 005.2021

QUASHA LAW
Don Pablo Building
114 Amorsolo Street
Makati City
Metro Manila

ATTENTION : **Atty. Abel C. Coloma**

SUBJECT : **Request for Review of Bureau of Internal Revenue Ruling ITAD No. 061-2020 dated 23 September 2020**

Dear **Atty. Coloma:**

This refers to your letter dated 23 December 2020 ("Request for Review"), which you filed with this Department on behalf of the Government of the Commonwealth of Australia ("Australian Government") and its Embassy to the Philippines ("Australian Embassy") to request for the review of Bureau of Internal Revenue ("BIR") Ruling ITAD No. 061-2020, which ruled that the sale of the Australian Government's real property is subject to the 6% Capital Gains Tax ("CGT") based on the gross selling price or current fair market value, whichever is higher.

The Australian Government acquired ownership over a parcel of land situated at One Molave corner Banaba Streets, South Forbes Park, Makati City, Metro Manila ("subject property") when it purchased the same from Erlanger & Galinger, Inc., a domestic corporation organized in the Philippines, on 21 September 1971.

Thereafter, Transfer Certificate of Title (TCT) No. 176123 was issued in favor of the Australian Government. Since its purchase, the Australian Government has used such property as the official diplomatic residence of the Australian Embassy.

On 28 November 2019, the Australian Government sold the entirety of the property to Triumph Petroleum Philippine Corporation ("TPPC") for One Billion One Hundred Three Million Six Hundred And Twenty-Five Thousand Pesos (PhP 1,103,625,000.00).

On 05 December 2019, the Australian Government, through counsel, served a letter to the Office of Protocol of the Department of Foreign Affairs asking the endorsement to the International Tax Affairs Division ("ITAD") of the BIR of their Request for Ruling confirming that the gain derived from the sale of the subject property is exempt from Capital Gains Tax ("CGT") and Value-Added Tax ("VAT"), pursuant to the Vienna Convention on Diplomatic Relations ("VCDR").

The Commissioner of Internal Revenue ("CIR"), on 23 September 2020, issued BIR Ruling No. ITAD 061-2020, where he ruled that, while the sale of the subject property is not subject to VAT, the Australian Government is nonetheless liable to pay the CGT and the Documentary Stamp Tax ("DST"). In BIR Ruling ITAD No. 061-2020, the BIR ratiocinated:

> It can be gleaned from the foregoing that for tax exemption to attach to the sending state, it is indispensable that property subject of the sale forms part of the "premises of the mission" and is used for any of the functions of the mission at the time of sale.
>
> In this case, the subject property did not meet the aforesaid requisite because it was neither used in furtherance of the functions of the mission, i.e., to represent the Australian Government in the Philippines, to negotiate with the Philippine

government, to protect the interest of the Australian government and its nationals, to promote the friendly relations between the Philippines and Australia, among others, nor was it used as the residence of the head of the mission at the time of the sale.

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The determining factor here should be the use and purpose of the subject property prior to its sale. Undeniably, the subject property ceased to be a premise of the mission after the Australian Government vacated or discontinued the use of such property for the purposes of the mission or as a residence of the head of the mission.

It must be emphasized that exemption from tax in respect of the premises of the mission does not extend to unoccupied or unofficial premises of the sending state. Neither does diplomatic ownership alone automatically vest immunity from taxation upon the sending state in respect of premises alleged to have been used, at one time or another, for the purposes of the mission, or as a residence of the head of the mission. Every case has to be examined independently in order to determine whether or not the sending state is exempt from taxation.

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Considering that the Australian Government is not exempt from national taxes with regard to the sale of the subject property, it may be held liable for the payment of the DST imposed herein. The liability for the DST may, however, be shifted to the buyer if so agreed upon by the parties.

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The sale by the Australian Government of the subject property was not made in the course of trade or business since it does not regularly sell properties; hence, it is not liable to VAT.

In summary, the Australian Government is liable for the payment of CGT of 6% based on the higher amount between the selling price and the fair market value of the property, and DST as prescribed under Section 196 of the NIRC, as amended.

On the other hand, in your Request for Review, you argued that:

a. The sale of the subject property, which was used as a diplomatic residence of the Australian Embassy, is exempt from all national taxes, specifically, CGT, under Article 23 (in relation to Article 1) of the VCDR;

b. The BIR, in requiring that the subject property must be used as residence of the head of mission at the time of the sale, imposed an additional condition for the grant of tax exemption under the VCDR not otherwise required;

c. The VCDR should be interpreted in good faith, in accordance with the ordinary meaning to be given to the terms of the treaty, in its proper context, and in light of its object and purpose;

d. The exemption of diplomatic agents from all dues and taxes, personal or real, national or regional or municipal under Article 34 of the VCDR should logically and necessarily extend to the sending State itself;

e. The Tax Code does not contain any provision which imposes CGT on real property not used in trade or business (capital asset) for an equal Sovereign such as the Australian Government; and

f. Remaining extant records show that the subject property was, in fact, used as an official diplomatic residence of Australian diplomats.

The sole issue that needs resolution in the present case is whether the Australian Government's sale of its real property is subject to CGT.

Ruling

This Office finds the Request for Review meritorious.

The subject property forms part of the premises of the mission, and hence, the Australian Government is exempt from any taxes related thereto.

At the outset, this Office recognizes the fact that the Australian Government is entitled to certain immunities and privileges as a sovereign state under international law, particularly under the 1961 VCDR. Among these immunities is the exemption from taxes in the Philippines.

Article 23 of the VCDR provides, to wit:

> The **sending State** and the head of the mission **shall be exempt from all national, regional or municipal dues and taxes in respect of the premises of the mission**, whether owned or leased, other than such as represent payment for specific services rendered. (*Emphasis ours*)

The Philippines, being a signatory and party to the VCDR,[1] is bound to perform its treaty obligations in good faith. The time-honored principle of *pacta sunt servanda*, embodied in Article 26 of the 1696 Vienna Convention on the Law of Treaties ("VCLT"), where the Philippines is also a party, demands the performance in good faith of treaty obligations on the part of the states that enter into an agreement.[2] In fact, treaties have the force and effect of law in our jurisdiction.[3] No less than the 1987 Constitution requires the observance of international legal obligations in good faith when it adopted the generally accepted principles of international law in Section 2, Article II.

Consequently, the Philippines must recognize the exemption from all national, regional, or municipal dues and taxes of the Australian Government in respect of the premises of its mission in the Philippines provided for in the VCDR. The subject property, while actually and physically detached from the Australian Embassy, still forms part of the premises of the mission.

Article 1 (i) of the VCDR defines "premises of the mission" as the buildings or parts of buildings and the land ancillary thereto, irrespective of ownership, used for the purposes of the mission **including the residence of the head of mission.**

Through its Embassy in the Philippines, the Australian Government has used the subject property as a residence for its Minister-Counsellors and Senior Trade Commissioners.

Additionally, under Article 14 of the VCDR, heads of mission are divided into three classes, namely:

a. That of ambassadors or nuncios accredited to Heads of State, and other heads of mission of equivalent rank;

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[1] The Philippines signed the VCDR on 20 October 1961.
[2] *Deutsche Bank v. CIR*, G.R. No. 188550, 19 August 2013.
[3] *Luna v. Court of Appeals*, G.R. No. 100374-75, 27 November 1992.

b. That of envoys, **ministers** and internuncios accredited to Heads of State; and

c. That of chargé d'affairs accredited to Ministers for Foreign Affairs.

In the present case, the subject property was used as the residence of several heads of mission. In the Request for Review of the Australian Government, it was disclosed that Minister-Counsellors occupied the subject property from 2004 to 2007 and again from 2011-2016. Other than Minister-Counsellors, the subject property was occupied by Senior Trade Commissioners of the Australian Trade and Investment Commission ("Austrade").

Considering that the subject property was utilized as the residence of several heads of mission, the same clearly qualifies as part of the mission's premises as defined in Article 1 (i) of the VCDR.

We also note that diplomatic residences held by a sovereign state for high-ranking diplomatic agents further the purpose/s of a diplomatic mission situated in a foreign country and thus enjoy certain tax and duty exemptions pursuant to the VCDR. Arguably, the heads of mission and diplomatic agents both perform indispensable duties while posted in a foreign state. It can be said that providing the necessary board and lodging for them allows such a foreign state to pursue the functions of the mission with more efficiency and efficacy.

We wish to highlight further that Article 34 of the VCDR clarifies that if a **diplomatic agent** holds a **private immovable property** on behalf of the sending State for the purposes of the mission, said diplomatic agent is exempt from all dues and taxes on such property. Thus, we believe that similar treatment should be made to properties owned by the Sending State per se, which is exempt from all national, regional, or municipal dues and taxes in respect of the premises of the mission.

The BIR has also impliedly admitted that the subject property forms part of the premises of the mission when it stated that:

> Undeniably, the subject property ceased to be a premise of the mission after the Australian Government vacated or discontinued the use of such property for the purposes of the mission or as a residence of the head of the mission.

Necessarily, therefore, we disagree with the BIR's position that the subject property did not meet the requirements under Article 1 (i) of the VCDR because it was "neither used in furtherance of the functions of the mission, i.e., to represent the Australian Government in the Philippines, to negotiate with the Philippine government, to protect the interest of the Australian government and its nationals, to promote the friendly relations between the Philippines and Australia, among others, nor was it used as the residence of the head of the mission <u>at the time of the sale</u>."

There is no indication that the Australian Government ceased classifying the subject property as a residence of its head of mission. Since 1971, it has been classified as such.

The Australian Government, through the Embassy of Australia, has confirmed in Diplomatic Note No. 547/19 dated 04 December 2019, and we see no reason to believe otherwise, that the subject property was used exclusively, and has always been used, as the diplomatic residence of its heads of mission and diplomats.

So long as there are no overt acts indicating the change in the purpose for the use of the property, it remains classified as a residence of its head of mission. Thus, when it was sold, it remained as a property intended for such purpose.

Therefore, Australia continues to enjoy tax exemption.

Further, the Australian Government, being a signatory to the 1961 VCDR and pursuant to the principles of comity and reciprocity, grants tax exemptions on CGT to the Government of the Philippines in like circumstances.

The BIR, in BIR Ruling DA-739-06,[4] had a chance to discuss the applicability of reciprocity in our jurisdiction. The case involved the sale of two (2) condominium units to *Agencia Española De Cooperacion Internacional*, a Spanish Technical Cooperation Office seconded to the Spanish Embassy in the Philippines.

In that specific instance, the BIR ruled that although, as a rule, the tax exemption privilege of a foreign embassy and its diplomatic agents does not include exemption from indirect taxes, VAT and *ad valorem* tax exemption may be extended to the Spanish Embassy on its local purchases of goods and/or services on the basis of the principle of reciprocity, to wit:

> As the Spanish Government allows similar exemption to the Philippine Embassy on its purchase of goods and services in Spain, the Spanish Embassy shall likewise be given the same treatment in accordance with the above-mentioned principle of international law.

Applied similarly in the present case, the Philippines must likewise extend the same exemption from CGT to the Australian Government on the basis of reciprocity.

Hence, this Office is constrained to rule that the Australian Government's sale of the subject property is not subject to 6% CGT.

[4] 27 December 2006.

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.

Thank you.

Sincerely yours,

CARLOS G. DOMINGUEZ
Secretary of Finance

AUG 24 2021

CC: **Commissioner Caesar R. Dulay**
Bureau of Internal Revenue