REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE
National Office Building
Quezon City

Sec. 50, NIRC; RR 20-2020; RR 02-2013
GR Nos. 72992/240163
OT- 006-2025
JAN 06 2025

RS GALLARDO LAW OFFICE
Unit 300 Valero Plaza,
124 Valero St., Salcedo Village,
1227 Makati City, Metro Manila

Attention: **RAYMUND S. GALLARDO**
Managing Partner

Sir:

This refers to your letter dated October 7, 2022 on behalf of your client Ayala Land Inc. (ALI), requesting a confirmatory ruling on the taxability of (1) the selling price of shares that are lower than the published rate or when there is no standard selling price of the shares sold; (2) the applicability of documentary stamp tax on infusion of additional paid in capital (APIC); and (3) the application of Section 50 of the National Internal Revenue Code of 1997 (Tax Code), as amended.

The present case stems from the following issues and arguments raised:

(1) The selling price of shares is lower than the published rate, or there is no standard selling price for the shares sold.

Your position is that for purposes of determining the selling price in the case of a sale, transfer, or exchange of shares not listed in the stock exchange, they shall be valued at their book value nearest the valuation date. This book value of the unlisted shares of stock shall then be *prima facie* considered as their fair market value. However, if there have been previous bona fide sale/exchanges of the unlisted shares of stock, the price at which these shares exchanged hands should be taken/considered as its fair market value.

You cited the different factors considered in determining the relevant valuation of shares of stock from Revenue Audit Memorandum Order No. 1-00, titled *Updated Handbook on Audit Procedures and Techniques Volume I*, from March 17, 2000.

You also opined that the use of published rates applies only to the sale of the shares in the secondary market.

(2) The applicability of documentary stamp tax (DST) on the Subscription Agreement where additional paid in capital (APIC) was infused but did not result in the issuance of shares of stock.

Your understanding is that since the infusion of the APIC did not result in the issuance of shares of stock, it is not subject to DST. No additional DST should be imposed on the P550 million contribution as APIC as described in the Subscription Agreement pursuant to Section 174 in relation to Section 175 of the Tax Code, as amended.

(3) The allocation of additional paid in capital to Class "A" shares.

Your argument is that Section 50 of the Tax Code does not apply if the buyer and seller of the shares are not owned or controlled directly or indirectly by the same interests. You also opined that the exercise of the Commissioner's (CIR) power under Section 50 is premised on evidence of fraud or evasion in the payment of taxes.

We reply as follows:

(1) Revenue Regulations (RR) No. 06-2008, as amended by RR No. 20-2020, prescribes the rules for determining the value of unlisted shares. Section 7 of RR No. 06-2008, as amended, provides that:

> "SEC. 7. Sale, Barter or Exchange of Shares of Stock Not Trade Through a Local Stock Exchange Pursuant to Secs. 24(C), 26(A)(3), 25(B), 27(D)(2), 28(A)(7)(c), 28(B)(5)(C) of the Tax Code as Amended. –
>
> xxx xxx xxx
>
> (c.2) Definition of "fair market value" of the Shares of Stock. – For purposes of this Section, "fair market value" of shares of stock sold shall be:
>
> (c.2.1) . . .
>
> (c.2.2) In case of shares of stock not listed and trade in the local stock exchanges, the following rules shall apply:
>
> 1) For common shares of stock, the book value based on the latest available financial statements duly certified by an independent public accountant prior to the date of sale, but not earlier than the immediately preceding taxable year, shall be considered as the prima facie fair market value.
>
> 2) For preferred shares of stock, the liquidation value, which is equal to the redemption price of the preferred shares as of balance sheet date nearest to the transaction date, including any premium and cumulative preferred dividends in arrears, shall be considered as fair market value.
>
> 3) In case both are common and preferred shares, the book value per common share is computed by deducting the liquidation value of the preferred shares from the total equity of the corporation and dividing the result by the number of

outstanding common shares as of balance sheet date nearest to the transaction date.

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4) For this purpose, the book value of the common shares of stock or the liquidation value of the preferred shares of stock, need not be adjusted to include any appraisal surplus from any property of the corporation not reflected or included in the latest audited financial statement. In order to determine the fair market value of shares of stock. The latest audited financial statements shall be sufficient in determining the fair market value of the shares of stock subject of the sale, barter, exchange, or other disposition.

XXX XXX XXX"

Since no distinction is made under the law on whether the basis for computation should be used on the first sale of the share or its subsequent sales, the abovementioned provisions must therefore be applied in all instances. Hence, in determining the capital gains derived from the sale of the shares, the market value of the same, if they were common shares, shall be based on the book value; if they were preferred shares, it shall be based on the liquidation value; and in cases where both are common and preferred, the book value per common share computed by deducting the liquidation value of the preferred shares from the total equity of the corporation and dividing the result by the number of outstanding common shares, all subject to the rules prescribed under Section 7 of RR No. 06-2008.

(2) We agree with your submission that APIC without the issuance of additional shares of stock is not subject to DST pursuant to prevailing jurisprudence.

However, this does not apply to the instant case. In your letter request, you argued that the DST is imposed on the "actual consideration" received for the issuance of shares of stock. You also mentioned that the subsequent capital contribution, by way of APIC, is not included in the definition of actual consideration.

We disagree. The contribution, albeit subsequently made, already forms part of the actual consideration for the shares of stock in this case. In the original Subscription Agreement, which you claim to be the one where the DST must be imposed, the "additional paid-in capital" was already determined and annotated, to wit:

"ALI shall contribute semi-annually, by way of additional paid-in capital or a premium on its Class B and Class C shareholdings, the amount of all the project development costs and expenses that the Subscriber shall have actually incurred in relation to the planning, development, and construction of the facilities of the Club in an aggerate amount which shall not be less than Pesos: 464,000,000.00 (the *"Project Development Costs"*).

In the conveyance by ALI of the Project Development Costs, it is the express intention of ALI that the amount of additional paid-in capital to be contributed as premium on the Class C Shares shall be twice the amount of additional paid-in capital to be contributed as premium on the Class B Shares."

The abovementioned provision can be found in the Subscription Agreement for the original subscription of shares under **SECTION 1. SUBSCRIPTION TO SHARES.** This means that from the start, the parties already agreed and determined the amount to be paid by ALI for the Class B and Class C shares which only shows that such amount is already part of the consideration for the initial issuance of shares to ALI.

(3) The application of Section 50 of the Tax Code.

Your claim is that unless and until the transfer of shares is made between related parties or otherwise owned or controlled directly or indirectly by the same interest, Section 50 of the Tax Code finds no application. This is in relation to the allocation of the additional paid in capital to Class "A" shares.

You also noted that jurisprudence suggests that the exercise of the Commissioner's power under Section 50 is premised on evidence of fraud or evasion in the payment of taxes by citing Filinvest Development Corporation vs. CIR[1].

We disagree. The Commissioner's power to allocate income or deductions under Section 50 of the Tax Code, as amended, is not premised on evidence of fraud or evasion. The Supreme Court, in the very recent case of DOF and BIR vs. AUB, et al., emphasized the authority of the CIR by citing the explanation of Justice Dimaampao, to wit:

> "In determining the true net income of a controlled taxpayer in transactions with another controlled taxpayer, **the CIR is not restricted to the cases of improper accounting, fraudulent transactions, or distortion or shifting of income and deductions to reduce or avoid tax.** Its power extends to cases where, inadvertently or by design, the net income is other than what it would have been had it been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer. In other words, Section 50 of the Tax Code places a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true net income from the property and business of a controlled taxpayer[2]." (Emphasis ours)

Further, the actual transfer of shares is immaterial for the CIR to exercise his powers under Section 50. The provision provides:

> "SEC. 50. Allocation of Income and Deductions. - In the case of two or more organizations, trades or businesses (whether or not incorporated and whether or not organized in the Philippines) **owned or controlled directly or indirectly** by the same interests, the Commissioner is authorized to distribute, apportion or allocate gross income or deductions between or among such organization, trade or business, **if he determined** that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organization, trade or business[3]." (Emphasis ours)

[1] CA-G.R. SP No. 72992, 16 December 2003.
[2] G.R. Nos. 240163 & 240168-69. December 1, 2021.
[3] Section 50, National Internal Revenue Code of 1997, as amended.

Moreover, Section 4 of RR No. 02-13[4] provides the definition of "control" which means "any kind of control, direct or indirect, whether or not legally enforceable, and however exercisable or exercised. Moreover, control shall be deemed present if income or deductions have been arbitrarily shifted between two or more enterprises."

In this particular case, the BIR allocated the additional paid in capital to Class "A" shares. Keep in mind that Section 2 of RR No. 02-13 states that "These Regulations seek to provide guidelines in applying the arm's length principle for cross-border and domestic transactions between associated enterprises". In this case, control is demonstrated by the mere special privilege allotted to Class "A" shares. If no additional paid in capital is allocated to it, it would have the effect of selling shares with the status of "Founders' Shares" along with all the rights and privileges of the other shares for sale at a lower price.

Under Section 10 of RR No. 02-13, the rule provides that:

> "The CUP [Comparable Uncontrolled Price] method evaluates whether the amount charged in a **controlled transaction is at arm's length by reference to the amount charged in a comparable uncontrolled transaction** in comparable circumstances. Any difference between the two prices may indicate that the conditions of the commercial and financial relations of the associated enterprises are not arm's length, and that the price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction."

Control is then demonstrated when a certain class of shares has more privileges than the others, making them far cheaper than those shares that are inferior in class. Under normal circumstances, shares with more privileges should, at the very least, be valued the same as other classes of shares. This would mean that the price of the shares in the particular case would not be at par with a comparable uncontrolled price.

Under the abovementioned provision, the power may be exercised by the CIR in cases where entities are owned or controlled directly or indirectly. This implies that actual transfer of shares is not necessary. As long as the CIR determines that control or ownership is present and it used to evade taxes or hide the actual income of the entity, the CIR can exercise its power. The determination of whether the power would be exercised is within the purview of the CIR's prerogatives.

Please be guided accordingly.

Very truly yours,

ROMEO D. LUMAGUI, JR.
Commissioner of Internal Revenue

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[4] Transfer Pricing Guidelines