June 7, 2021

BIR RULING NO. OT-194-21

Sections 27 (D) (4), Secs. 98, 106; Revenue Regulations No. 6-2008, as amended by RR No. 6-2013; BIR Ruling Nos. 277-93 and 1011-18

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Attention: AAA
BBB
and
CCC

Gentlemen :

This refers to your letter dated June 1, 2020 requesting on behalf of your client Wodel Financial, Inc. (Wodel) and J-Del Investments and Management Corporation (J-Del) for confirmation of your opinion that the distribution by Wodel consisting of its treasury shares and shares of stock in K Servico Trade, Inc. (KSTI) and EMCOR, Incorporated (EMCOR) to J-Del, by way of property dividend is exempt from income tax, final tax, capital gains tax (CGT), donor's tax and value-added tax (VAT).

It is represented that Wodel (TIN _____) is a corporation duly organized and existing under the laws of the Philippines, with principal office address at #34 San Luis Street, Pasay City; that it has an authorized capital stock of _____ Pesos (P_____), composed of Four undred Thirty Million (430,000,000) common shares with a par value of _____ (P_____) per share; that it currently owns Six Hundred Thirty-Seven Thousand Fifty-Three (637,053) common shares in Wodel held as treasury shares, Fifty-Four Million Five Hundred Forty-Two Thousand Nine Hundred (54,542,900) common shares in KSTI, and Five Hundred Forty-Three Million Nine Hundred Thirty-Seven

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Thousand Five Hundred Twenty-Three (543,937,523) common shares in EMCOR; and that as of March 31, 2020, it has a total retained earnings of _____Pesos (P_____).

On the other hand, J-Del is a corporation duly organized and existing under the laws of the Philippines (TIN _____) with principal office address at #34 San Luis Street, Pasay City; that J-Del currently owns Two Hundred Nineteen Million One Hundred Fifty Thousand Five Hundred Ninety-Two (219,150,592) common shares in Wodel, representing ninety-nine percent (99%) ownership; and that the total carrying cost of the treasury shares of Wodel, common shares in EMCOR and common shares in KSTI amounting to _____ Pesos (P_____), was declared as property dividends in favor of J-Del.

Based on the foregoing representations, you now request for the confirmation of the following:

1. That the distribution of the shares by way of property dividend is exempt from income tax on the part of J-Del;

2. That Wodel will not realize any income or gain in the distribution of the shares by way of property dividend, hence, not subject to income tax and/or CGT;

3. That the distribution of the shares is not subject to donor's tax;

4. That the distribution of dividend is not subject to VAT; and

5. That the shares, when declared by Wodel as property dividend and received by J-Del, shall be recorded at its book/carrying value.

In reply, please be informed as follows:

I. Exemption from Income Tax on the part of J-Del

Section 27 (D) (4) of the National Internal Revenue Code (Tax Code) of 1997, as amended, expressly states that:

> *"SEC. 27. Rates of Income Tax on Domestic Corporations. —*
>
> xxx xxx xxx

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(D) Rates of Tax on Certain Passive Incomes. —

xxx xxx xxx

(4) Intercorporate Dividends. — Dividends received by a domestic corporation from another domestic corporation shall not be subject to tax."

Clearly, the distribution of property dividends made by Wodel in favor of J-Del, both being domestic corporations is not subject to income tax pursuant to Section 27 (D) (4) of the Tax Code of 1997, as amended. Hence, the subject property dividends in the form of stocks in the amount of P_____ shall not be subject to income tax and consequently to withholding tax. (*BIR Ruling Nos. 277-93 dated June 28, 1993 and 197-93 dated May 7, 1993*)

II. Income Tax and CGT

On the part of the distributing domestic corporation, it is not liable for income tax and/or CGT considering that Wodel will not realize any income.

In distributing dividends, a corporation merely distributes its unrestricted retained earnings to its stockholders as return on capital, and thus there is no flow of wealth as to the distributing corporation. In the distribution of dividends, a corporation realized no taxable income since the distribution among stockholders is not a sale nor were assets used to discharge an indebtedness.

Similarly, the transfer made by Wodel of its treasury shares and shares in KSTI and EMCOR by way of property dividends is not deemed a sale or disposition of shares of stock within the meaning of Section 40 of the Tax Code of 1997, as amended, since, Wodel did not receive any consideration and did not realize any income from the said transfer.

Since Wodel will not realize any gains, it should not be liable for CGT. Revenue Regulations (RR) No. 6-2008, as amended, provides for the rules on the imposition of CGT on the stockholders, and is not applicable to the distribution of dividends.

The Court of Tax Appeals (CTA) in *Trans-Asia Oil and Energy Development Corp. vs. Commissioner of Internal Revenue* (CTA Case No. 9078, September 28, 2018) had occasion to rule that distribution of dividends is not covered by RR No. 6-2008 as it is an equity transaction where there could be no recognition of gain or loss, as follows:

"Clearly from all the foregoing, Petitioner's declaration and distribution of property dividends to its shareholders in the form of TAPC shares of stock is not within the ambit of the term "other disposition of shares of stock" in RR No. 6-2008, as amended by RR No. 6-2013. Instead, it is a mere equity transaction since petitioner did not

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recognize any gain or loss therefrom."

III. Donor's Tax

Well-settled is the rule that the essential elements of a valid donation are the following: (1) the reduction of the patrimony of the donor; (2) the increase in the patrimony of the donee; and (3) the intent to do an act of liberality (*animus donandi*).

Clearly there is no donative intent on the part of Wodel to donate its treasury shares and its shares of stock in KSTI and EMCOR to J-Del since the transaction is being undertaken purely for business purposes.

Under Section 98 of the Tax Code of 1997, as amended, donor's tax is imposed upon transfer by any person of a property by gift or donation *inter vivos*, which shall be made with a clear element of donative intent present in the transfer of property.

In the same case of *Trans-Asia Oil and Energy Development Corp. vs. Commissioner of Internal Revenue*, the CTA ruled that a corporation declaring dividends is not "*within the ambit of the term "other disposition of shares of stock" in RR No. 6-2008*" and instead as already mentioned above, is an equity transaction and thus no gain or loss, therefore, there could be "*no inadequacy of consideration to speak of*," to wit:

> *"Preliminarily, the court finds that Petitioner's declaration and distribution of property dividend is not within the ambit of the term "other disposition of shares of stock" that would recognize gain or loss from such disposal, as contemplated in RR No. 6-2008, as amended by RR No. 6-2013.*
>
> *Dividend has been defined in Section 73 of the NIRC of 1997, as amended, as follows:*
>
> > *"SEC. 73. Distribution of Dividends or Assets by Corporations. —*
> >
> > *(A) Definition of Dividends. — The term 'dividends' when used in this Title means any distribution made by a corporation to its shareholders out of its earnings or profits and payable to its shareholders, whether in money or in other property."*
> >
> > XXX XXX XXX
>
> *The term "dividend" both in the technical sense and its ordinary acceptation, is that part or portion of the profits of the enterprise which the corporation, by its governing agents, sets apart for ratable division among the holders of the capital stock. It means the fund actually set aside, and declared by the directors of the corporation as dividends and duly ordered by the director, or by the stockholders at a corporate*

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meeting, to be divided or distributed among the stockholders according to their respective interests.

Dividends comprise any distribution whether in cash or other property in the ordinary course of business, even though extraordinary in amount, made by a domestic or resident corporation to the stockholders out of its earnings or profits. Property dividend consists of a portion of corporate property paid to shareholders instead of cash or corporate stock.

Petitioner declared and distributed property dividends to its stockholders out of its earnings or profits. The said property dividends distributed were comprised of petitioner's shares of stock/investment in its wholly-owned subsidiary, TAPC, and were recorded in Petitioner's books at its carrying/book value. In recording the property dividends at their carrying/book value, there was no profit or gain realized or recognized in the transaction."

IV. VAT

Section 106 of the Tax Code of 1997, as amended, states that:

> *"Sec. 106. Value-Added Tax on Sale of Goods or Properties. —*
>
> *(A) Rate and Base of Tax. — There shall be levied, assessed and collected on every sale, barter or exchange of goods or properties, a value-added tax equivalent to ten percent of the gross selling price or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferor: Provided, That the President upon the recommendation of the Secretary of Finance, shall effective January 1, 2006, raise the rate of value-added tax to twelve percent (12%) . . ."*

Accordingly, Section 4.106-8 of RR No. 16-2005, as amended, provides:

"(a) Subject to output tax

The VAT provided for in Sec. 106 of the Tax Code shall apply to goods or properties originally intended for sale or use in business, and capital goods which are existing as of the occurrence of the following. . .

xxx xxx xxx

(b) Not subject to output tax

The VAT shall not apply to goods or properties existing as of the occurrence of the following:

(1) Change of control of a corporation by the acquisition of the controlling interest

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of such corporation by another stockholder or group of stockholders. The goods or properties used in business or those comprising the stock-in-trade of the corporation, having a change in corporate control, will not be considered sold, bartered or exchanged despite the change in the ownership interest in the said corporation."

Considering that Wodel shares are not held primarily for sale, barter or exchange in the ordinary course of its trade or business, the transfer by Wodel to J-Del of the subject shares is not subject to 12% VAT. *(BIR Ruling No. 024-05 dated December 23, 2005)*

V. Recording book/carrying value

As regards your opinion that the shares to be declared should be recorded in the books of the distributing and receiving corporation, the Court of Tax Appeals in *Trans-Asia Oil and Energy Development Corp. vs. Commissioner of Internal Revenue* (CTA Case No. 9078, September 28, 2018), has allowed the recording of the shares to be distributed as property dividends at book/carrying value.

Based on all of the foregoing, it is our considered view that property dividends in the character of intercorporate dividends from one domestic corporation to another domestic corporation are exempt from income tax under Sec. 27 (D) (4) of the Tax Code of 1997, as amended, exempt from CGT under Section 27 (D) (7) (c) of the Tax Code of 1997, as amended, donor's tax under Section 99 of the Tax Code of 1997, as amended and VAT under Section 105 of the Tax Code of 1997, as amended. This Office also confirms that the shares shall be recorded in the books of both distributor and receiving corporations at book/carrying value, provided that the book value of the shares distributed must be annotated at the back of the Certificate of Stocks which shall serve as the basis of the computation of the tax upon its subsequent disposition. (BIR Ruling No. 1011-2018 dated June 13, 2018)

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.

(SGD.) CAESAR R. DULAY
Commissioner of Internal Revenue

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