February 24, 2020

BIR RULING NO. S40M-197-20

Sec. 40 (C) (2) & (6) (b); RR 18-01; BIR Ruling No. 214-12; BIR Ruling No. 100-17; BIR Ruling No. 075-18; BIR Ruling No. 1422-18

Puno Law
12th Floor, East Tower
Philippine Stock Exchange Road
Ortigas Center, Pasig City

Attention: *AAA*

Gentlemen :

This refer to your letters dated March 21, 2019 and June 27, 2019 requesting, on behalf of your client, Atorxa Primera, Incorporated ("Atorxa"), [1] a corporation organized and existing under the laws of the Philippines, for confirmation that the transfer of properties from AZ 17/31 Realty, Inc., ("AZ Realty"), [2] also a corporation duly organized and existing under the laws of the Philippines, to Atorxa pursuant to a statutory merger would qualify for non-recognition of gain or loss for income tax purposes in accordance with Section 40 (C) (2) of the National Internal Revenue Code of 1997 (the "Tax Code"), as amended, and as such, neither AZ Realty nor Atorxa will be subject to income tax, withholding tax, or capital gains tax in relation to such transfer.

Background

Atorxa is a domestic corporation organized and existing under the laws of the Philippines with office address at No. 51 Quezon Avenue, Brgy. Lourdes, Quezon City. Its primary purpose is "[to] acquire by purchase, lease, donation or otherwise, and to own, use, improve, develop, subdivide, sell, mortage, exchange, lease, develop and hold for investment or otherwise, real estate of all kinds, whether improved, managed or otherwise dispose of buildings, house, apartments, and other structures of whatever kind, together with their appurtenances, without acting as managers of real estate investment trusts nor engage in

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financial leasing." [3]

On August 14, 2018, the authorized representatives of Atorxa and AZ Realty, with office address at No. 51, Quezon Avenue, Brgy. Lourdes, Quezon City, signed the Articles of Merger and the Plan of merger both dated August 14, 2018, with Atorxa as the surviving corporation. The Articles of Merger and the Plan of Merger were approved by at least a majority of the Board of Directors of Atorxa on March 23, 2018 and by at least a majority of the Board of Directors of AZ Realty on March 23, 2018. After the approval by their respective Board of Directors, the relevant resolutions approving the merger was authorized, approved, ratified, and confirmed by stockholders holding at least two-thirds (2/3) of the outstanding capital stock of Atorxa on April 10, 2018 and by stockholders with at least (2/3) of the outstanding capital stock of AZ Realty on April 10, 2018. On September 7, 2018, Atorxa and AZ Realty filed the application for merger before the Securities and Exchange Commission ("SEC").

Pursuant to the merger, the net assets of AZ Realty shall be transferred to Atorxa, and Atorxa shall issue to the shareholders of AZ Realty capital stock in the amount of _____ (P_____) divided into Three Hundred Sixty-Eight Thousand Three Hundred Five (368,305) Preferred Shares with par value of _____ (Php_____) per share. [4]

For this purpose, Atorxa also filed with the SEC an application to increase its authorized capital stock from _____ (P_____) divided into Five Thousand (5,000) Common Shares with a par value of _____ (P_____) per share to _____ (P_____) divided into: (a) Five thousand (5,000) Common Shares with a par value of _____ (P_____) per share and (b) Three Hundred Sixty-Eight Thousand Three Hundred Five (368,305) Preferred Shares, with a par value of _____ (P_____) per share.

The net assets of AZ Realty in excess of the _____ Pesos (P3_____) to be used for the subscription to the increase in Atorxa's authorized capital stock, amounting to _____ Pesos and _____ (P_____), shall be treated as additional paid-in capital in the books of Atorxa. [5]

On March 14, 2019, the SEC approved the merger for which Atorxa was issued a Certificate of Filing of the Articles and Plan of Merger, Certificate of Filing Amended Articles of Incorporation and a Certificate of Approval of Increase of Capital Stock.

In reply thereto, please be informed as follows:

1. The foregoing merger of AZ REALTY and ATORXA is a merger within the contemplation of Section 40 (C) (2) (a) in relation to 40 (C) (6) (b) of

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the Tax Code of 1997, as amended, because ATORXA shall acquire/assume all the assets and liabilities of AZ REALTY and the same is advisable, expedient and in the best interest of the merging corporations and their respective stockholders, since the merging corporations are both engaged in real estate business. Hence, the merger of AZ REALTY and ATORXA is being undertaken for a *bona fide* business purpose and not for the purpose of escaping the burden of taxation.

The merger of AZ REALTY and ATORXA qualifies for non-recognition of gain or loss for income tax purposes in accordance with Section 40 (C) (2) of the Tax Code of 1997, as amended, that no gain or loss shall be recognized by AZ REALTY, as the transferor of all assets and liabilities, to ATORXA pursuant to the Plan of Merger.

Accordingly, no gain or loss shall be recognized by ATORXA, as the transferee, on its receipt of the assets and liabilities of AZ REALTY pursuant to and as a consequence of the merger.

On the other hand, the basis of the shares of stocks to be received by the shareholders of AZ REALTY upon the exchange shall be the same as the basis of the properties, stocks or securities exchanged, decreased by (1) the money received, and (2) the fair market value of the other property/ies received and increased by (a) the amount treated as dividend of the shareholders and (b) the amount of any gain that was recognized in the exchange. *(Sec. 40 (C) (5) (a) of the Tax Code of 1997, as amended)*

The basis of the properties transferred in the hands of the transferee (ATORXA), listed in Annex "A" hereof, shall be the same as it would be in the hands of the transferor (AZ REALTY) increased by the amount of the gain, if any, recognized to the transferor (AZ REALTY) on the transfer. *(Sec. 40 (C) (5) (b), supra)*

Finally, if the amount of the liabilities assumed plus the amount of the liabilities to which the property is subject exceed the total of the adjusted basis of the properties transferred pursuant to such exchange, then such excess shall be considered as a gain, on the part of the transferor, from the sale or exchange of a capital asset or of property which is not a capital asset, as the case may be. (Sec. 40 (C) (4) (b), *supra*)

The substituted basis of the properties transferred by AZ REALTY to ATORXA shall comply with the rule that cash and other cash items will be excluded from the computation of the adjusted basis of the properties

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transferred for purposes of determining whether liabilities assumed and to which the property is subject do not exceed the adjusted basis of the property transferred pursuant to No. IV (A) (2) of Revenue Memorandum Ruling (RMR) No. 2-2002 dated June 10, 2002.

Accordingly, the allocated shares, allocated liabilities and the substituted basis of the assets transferred by AZ REALTY to ATORXA, based on AZ REALTY's audited financial statements as of May 31, 2018 shall be as follows:

	Amount (in Php)	**Allocated Liabilities**	**Allocated Shares**	**Substituted Basis (in Php)**
Cash and Cash Equivalents				
Trade and Other Receivables				
Property, Plant and Equipment-net				
TOTAL				

Liabilities	**Amount (in Php)**
VAT Payable	
Withholding Tax Payable	
SSS/PhilHealth Payable	
Income Tax Payable	
Total	

2. Section 105 of the Tax Code of 1997, as amended, identifies the persons liable for the Value-Added Tax. Thus,

"SECTION 105. Persons Liable. — Any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 106 to 108 of this Code.

xxx xxx xxx."

However, Section 4.109-1 (B) (1) (x) of Revenue Regulations (RR) No. 13-2018, implementing Section 34 of Republic Act (RA) No. 10963, specifically excludes transfers of property pursuant to Section 40 (C) (2)

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of the Tax Code, as amended, from being subject to output tax. Hence,

"SEC. 4.109-1. VAT-Exempt Transactions. —

xxx xxx xxx

(B) Exempt transactions. —

(1) Subject to the provisions of Section 4.109-2 hereof, the following transactions shall be exempt from VAT:

xxx xxx xxx

(x) Transfer of Property pursuant to Section 40 (C) (2) of the Tax Code, as amended";

Thus, the above-mentioned transaction shall not be subject to VAT, and any unused input VAT of AZ REALTY as of the effective date of merger will be transferred to and absorbed by ATORXA pursuant to Section 4.109-1 (B) (1) (x) of RR No. 13-2018, the said transfer being considered a VAT-exempt transaction under the said Section. *(BIR Ruling No. 1422-2018 dated December 7, 2018)*

3. No DST is due on the transfer of assets made pursuant to the Plan of Merger under Section 199 (m) of the Tax Code, as amended by RA No. 9243, in relation to Section 40 (C) (2) of the Tax Code, as amended. Hence, the transfer of properties by AZ REALTY unto ATORXA pursuant to the Plan of Merger is exempt from DST. *(BIR Ruling No. 100-2017 dated March 2, 2017)*

However, DST at the rate of P2.00 on each P200.00 par value, or fractional part thereof, shall be due on the original issuance of shares by ATORXA to the stockholders of AZ REALTY resulting from the merger consonant to Section 2 of RR No. 4-2018 in relation to Section 174 of the Tax Code, as amended by Republic Act (RA) No. 10963 or the TRAIN Law.

4. Well-settled in our jurisprudence is the fact that the essential elements of a valid donation are: (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 intention on the part of any of the parties to the merger — AZ REALTY to donate to ATORXA its assets since the transaction is

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purely for legitimate business purpose. Thus, the aforesaid merger will not be subject to gift tax since there is no intention to donate, and the transaction is a *bona fide* merger effected solely for business reasons.

5. It is to be emphasized, however, that the net operating loss carry-over (NOLCO), under Section 34 (D) (3) of the Tax Code, and as implemented by RR No. 14-2001, of the Tax Code, of AZ REALTY, if any, is not one of the assets of the latter that can be transferred and absorbed by ATORXA, as this privilege or deduction can be availed of by AZ REALTY only. Accordingly, the tax-free merger between AZ REALTY and ATORXA does not cover the NOLCO of the former; and

6. The retained earnings of the absorbed corporation are subject to the ten percent (10%) final withholding tax on dividends constructively received by its shareholders pursuant to Section 24 (B) (2) of the Tax Code of 1997, amended. *(BIR Ruling No. 1422-18 dated December 7, 2018)*

In order that the above-described reorganization can be considered as merger under Section 40 (C) (2) and (6) (b) of the Tax Code of 1997, as amended, the parties to the merger should comply with the following requirements set forth under Revenue Regulations No. 18-2001:

A. The plan of reorganization should be adopted by each of the corporations, parties thereto, the adoption being shown by the acts of its duly constituted responsible officers and appearing upon the official records of the corporation. Each corporation, which is a party to the reorganization, shall file, as part of its return for the taxable year within which the reorganization occurred a complete statement of all facts pertinent to the non-recognition of gain or loss in connection with the reorganization, including:

   1. A copy of the plan of reorganization, together with a statement executed under the penalties of perjury, showing in full the purposes thereof and in detail all transactions incident to, or pursuant to the plan;

   2. A complete statement of all cost or other basis of all property, including all stocks or securities, transferred incident to the plan;

   3. A statement of the amount of stock or securities and other property or money received from the exchange, including a statement of all distribution of other disposition made thereof. The amount of each

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kind of stock or securities and other property received shall be stated on the basis of the fair market value thereof at the date of the exchange;

4. A statement of the amount and nature of any liabilities assumed upon the exchange, and the amount and nature of any liabilities to which any of the property acquired in the exchange is subject.

B. Every taxpayer, other than a corporation, party to the reorganization, who received stock or securities and other property or money upon a tax-free exchange in connection with a corporate reorganization shall incorporate in his income tax return for the taxable year in which the exchange takes place a complete statement of all facts pertinent to the non-recognition of gain or loss upon such exchange, including:

1. A statement of the cost or other basis of the stock or securities transferred in the exchange; and

2. A statement in full of the amount of stock or securities and other property or money received from the exchange, including any liabilities assumed upon the exchange, and any liabilities to which property received is subject. The amount of each kind of stock or securities and other property (other liabilities assumed upon the exchange) received shall be set forth upon the basis of the fair market value thereof at the date of the exchange.

C. Records in substantial form shall be kept by every taxpayer who participates in a tax-free exchange in connection with a corporate reorganization showing the cost or other basis of the transferred property or money received (including any liabilities assumed on the exchange, or any liabilities to which any of the properties received were subject), in order to facilitate the determination of gain or loss from subsequent disposition of such stock of securities and other property received from the exchange.

In addition to the foregoing requirements, the parties shall enclose with their respective income tax returns for the taxable year in which the merger occurred a copy of the request for ruling filed with, and the corresponding ruling issued by, the Bureau of Internal Revenue, both duly stamp-received by the appropriate office of the Bureau of Internal Revenue.

Such parties shall include as a note to their respective audited financial statements for

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the taxable year in which the merger occurred a statement to the effect that they hold such assets/shares acquired in a merger and the year in which such merger occurred, and in the taxable years until the subject properties are subsequently transferred to another transferee.

Moreover, the shareholders of the absorbed/dissolving corporation and the surviving/transferee corporation shall record in their respective books of account the mandatory entries stated in Annex "B" hereof, pursuant to Revenue Memorandum Order (RMO) No. 17-2016.

Furthermore, the parties shall cause to annotate at the back of the Transfer Certificates of Title (TCT) and Certificates of Stock, the date the merger was executed, the original or historical cost of acquisition of the properties or shares of stock involved, and the fact that no gain or loss was recognized as a result of such merger; provided however, that any violation by the Register of Deeds or by the Corporate Secretary of this condition shall be penalized under Section 269 or 275, as the case may be, of the Tax Code of 1997, as amended.

Finally, the parties are required to submit to the Law and Legislative Division, Bureau of Internal Revenue, proof of annotation of the substituted basis of the shares of stock and/or real properties involved in the transfer within ninety (90) days from receipt of this ruling. Violation of this requirement is subject to the penalties provided in Section 275 of the Tax Code of 1997, as amended.

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.

Very truly yours,

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

ANNEX A

Land in Property, Plant & Equipment

TCT No.	**Classification**	**Area**	**Original Cost** (per Substituted Basis appearing in BIR Certification Ruling No. SN: 076-2008 dated March 14, 2008)
N-323795	Commercial	90,239 sq. m.	P_____

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N-323796	Commercial	10,267 sq. m.	P_____
N-323797	Commercial	84,684 sq. m.	P_____
TOTAL			P_____

ANNEX B

Proforma Entries — Merger

Footnotes

1. Registered under Tax Identification No. (TIN) 000-000-000 with the Bureau of Internal Revenue ("BIR").
2. Registered under TIN No. 000-000-000 with the BIR.
3. Amended Articles of Incorporation of Atorxa dated March 14, 2019.
4. Clause 1.5 of the Plan of Merger.
5. Clause 1.7 of the Plan of Merger.

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