April 29, 2019

BIR RULING NO. 258-19

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. 1422-2018

Emmanuel C. Alcantara & Associates Law Offices
Unit 1008, 10th Floor, National Life Insurance Building
6762 Ayala Avenue, Makati City

Attention: *AAA*

Gentlemen :

This refers to your letters dated May 7, 2018 and July 3, 2018 requesting on behalf of your clients, Nippon Paint (Coatings) Philippines, Inc. ("NPCPI") and Nippon Paint Philippines, Inc. ("NPPI"), that the merger of said companies with the former as the surviving entity constitutes as a tax-free merger pursuant to Section 40 (C) (2) and (6) (b) of the Tax Code of 1997, as amended.

It is represented that NPCPI is a corporation duly organized and existing under Philippines laws with Securities and Exchange Commission (SEC) Company Registration No. ASO95-005153, with principal office address at No. 4 Hologram St., Light Industry and Science Park (LISP1), Diezmo, Cabuyao, Laguna, and with Tax Identification No. (TIN) 000-000-000-000; that it is engaged in buying, selling, distributing and marketing paint products and whose primary purpose as indicated in its amended articles of incorporation is —

> "To engage in, conduct, and carry on the business of buying, selling, distributing, marketing at wholesale insofar as may be permitted by law, all kinds of goods, commodities, wares and merchandise of every kind and description such as but not limited to paint whether or not produced, blended or manufactured by it; to enter into all kinds of contracts, and sub-contracts involving the use and/or application of the goods and commodities including paint in connection with the construction, repair and maintenance of buildings, houses, warehouses and all types of structures, for the export, import, purchase, acquisition, sale at wholesale, and other disposition for its own account as principal or in indentor, commission merchant, factors or agents, Contractor or Sub-contractor upon consignment of all kinds of goods, wares, merchandise or products whether natural or artificial."

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that on the other hand, NPPI is a corporation duly organized and existing under Philippine laws with SEC Company Registration No. 34462, with principal office address at #4 Hologram St., Light Industry & Science Park Cabuyao, Laguna and with Tax Identification No. (TIN) 000-000-000-000; that it is primarily engaged in the business of manufacturing chemical products, particularly protective coatings such as paints, varnishes, lacquers, synthetic resins, alkyd resins, dyes, waxes and other products and whose primary purpose as indicated in its amended articles of incorporation is —

> "To engage in the business of manufacturing, producing, compounding, processing and selling at wholesale basis only of:
>
> 1. Chemicals and chemical products including all types of protective coatings like paints, varnishes, lacquers, synthetic resins, alkyd resins, dyes, waxes, and other related products;
>
> 2. Raw materials to be used in the manufacture, compounding or processing of any of the above-mentioned products, including the chemicals or compounds necessary thereof;
>
> 3. Building materials of all kinds, hardware, fittings, trimming, cutlery, tools, machineries or parts thereof."

NPCPI and NPPI have decided to restructure their respective corporate entities and agreed to stream down their operations to promote and accomplish a more tax efficient and economic business by combining their resources and capabilities to bring about a bigger and stronger entity that will enable the surviving entity to compete in the market place. Thus, on March 12, 2018, to best serve the interests of both corporation and respective stockholders, the respective board of directors of NPCPI and NPPI decided to approve the statutory merger between NPCPI and NPPI, effective January 1, 2018, subject to the approval by the SEC, with NPCPI being the surviving corporation and NPPI being the absorbed corporation.

Consequently, pursuant to the Plan of Merger, all the respective rights, business assets and other properties of NPPI including, but not limited to, all real and personal properties, contractual rights, licenses, privileges, property rights, claims, bank deposits, stock accounts receivable, credit lines, supplies, equipment, and such other assets of NPPI, as of December 31, 2017 up to July 1, 2018 (the effective date of merger), shall be conveyed, assigned, and transferred to NPCPI without further act or deed; that NPCPI shall assume all debts and liabilities of NPPI in the same manner as though NPCPI had itself incurred such liabilities and obligations and any such claim, action or proceeding against NPPI shall be prosecuted by or against NPCPI without prejudice to the right of NPCPI to avail of all the defenses, rights, privileges, set offs and counterclaims which NPPI may have had under the premises; that for this purpose, NPCPI shall increase its authorized capital stock from P_____ to P_____ to accommodate the issuance of shares to stockholders of NPPI resulting from the merger and the assets transferred by NPPI will serve as their contribution for the increase in

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NPCPI's capital stock.

The authorized capital stock and issued and outstanding capital stock of each of NPCPI and NPPI as set forth in their respective audited Financial Statements filed with the SEC together with the Articles of Merger and the Plan of Merger, are as follows:

NPCPI (Prior to the Effective Date of Merger)

Type of Share	Authorized	Issued and Outstanding	Par Value	No. of Shares	Amount
Preferred	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -
Common	2,000,000 shares	1,590,004	P_____	1,590,004	P_____

NPPI (Prior to the Effective Date of Merger)

Type of Share	Authorized	Issued and Outstanding	Par Value	No. of Shares	Amount
Preferred	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -
Common	40,000,000 shares	39,315,000	P_____	39,315,000	P_____

Beginning on the Effective Date of merger, the authorized capital stock and issued and outstanding capital stock of NPCPI are as follows:

NPCPI (Beginning the Effective Date of Merger)

Type of Share	Authorized	Issued and Outstanding	Par Value	No. of Shares	Amount
Preferred	- 0 -	- 0 -	- 0 -	- 0 -	- 0 -
Common	546,782,830 shares	54,268,287	P_____	54,268,287	P_____

That the statements of financial position of the merging companies as of December 31, 2017 are summarized as follows:

	NPCPI (Surviving)	NPPI (Absorbed)
Total Assets	P_____	P_____
Total Liabilities	_____	_____
Capital Stock	_____	_____
Accumulated re-measurements of ret ben	-	(_____)

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Reserve on retirement fund	(_____)	-
Retained earnings (deficit)	(_____)	_____
Total Equity		_____
Total Liability & Equity (Cap Def)	P_____	P_____

Lastly, that the merger of NPCPI and NPPI, with NPCPI as the surviving entity, was duly approved by the SEC on June 29, 2018.

Based on the foregoing representations, you now request for a ruling that:

1. The statutory merger between NPCPI and NPPI qualifies as a tax-free exchange, whereby all the assets and liabilities of NPPI transferred to NPCPI in exchange for shares is a merger in contemplation of Section 40 (C) (2) in relation to Section 40 (C) (6) (b) of the Tax Code, as amended, and that no gain or loss are recognized by the parties;

2. The transfer of properties by NPPI to NPCPI is not subject to output value-added tax (VAT) and any unutilized input VAT of NPPI will be transferred and absorbed by NPCPI pursuant to Section 4.106-8 (b) (3) of Revenue Regulations (RR) No. 16-2005;

3. The transfer of properties by NPPI in favor of NPCPI is not subject to Documentary Stamp Tax (DST) pursuant to the Parties' Plan of Merger which is in line with Section 199 (m) of the Tax Code, as amended by Republic Act No. 9243, in relation to Section 40 (C) (2) of the Tax Code, as amended, *except*, however, that the original issuance of shares by NPCPI to the stockholders of NPPI as a consequence of the merger in accordance with Section 174 of the Tax Code;

4. The transfer of properties by NPPI to NPCPI as well as the issuance of shares by NPCPI of their stockholders in exchange for the common shares of NPCPI shall not be subject to Donor's tax absent any intent to donate; and

5. Any excess and unutilized creditable withholding taxes (CWT) of NPPI shall be transferred to NPCPI which may be applied as a tax credit by NPCPI against its income tax due for the succeeding taxable years or may be the subject of a claim for refund or issuance of a tax credit certificate (TCC).

In reply thereto, please be informed as follows:

1. The foregoing merger of NPPI and NPCPI is a merger within the

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contemplation of Section 40 (C) (2) (a) in relation to 40 (C) (6) (b) of the Tax Code of 1997 (the "Tax Code"), as amended, because NPCPI shall acquire/assume all the assets and liabilities of NPPI 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 the manufacture of chemical products. Hence, the merger of NPPI and NPCPI is being undertaken for a *bona fide* business purpose and not for the purpose of escaping the burden of taxation.

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

Accordingly, no gain or loss shall be recognized by NPCPI, as the transferee, on its receipt of the assets and liabilities of NPPI 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 NPPI 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 (NPCPI) shall be the same as it would be in the hands of the transferor (NPPI) increased by the amount of the gain, if any, recognized to the transferor (NPPI) 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)*

Accordingly, the allocated shares and the substituted basis of the assets transferred by NPPI to NPCPI, based on NPPI's audited financial statements as of December 31, 2017 shall be as follows:

	Amount	**Allocated Liabilities**	**Allocated Shares**	**Substituted Basis**
Cash	_____		_____	_____
Trade and Other Receivables	_____	_____	_____	_____
Inventories	_____	_____	_____	_____
Prepaid Expenses and other Current Assets	_____	_____	_____	_____

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Property, Plant & Equipment	_____	_____	_____	_____
Deferred Income Tax Assets	_____	_____	_____	_____
Other non-current assets	_____	_____	_____	_____
TOTAL	_____	_____	_____	_____

Liabilities	**Amount**
Accounts Payable and other current liabilities	_____
Bank Loans	_____
Current portion of obligations under finance lease	_____
Net retirement benefits liability	_____
Obligations under finance lease-net of current portion	_____
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) 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 NPPI as of the effective date of merger will be transferred to and absorbed by NPCPI 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*

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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 NPPI unto NPCPI 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 NPCPI to the stockholders of NPPI resulting from the merger consonant to Section 2 of RR No. 4-18 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 — NPPI to donate to NPCPI its assets since the transaction is 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. The excess and unutilized creditable withholding taxes (CWT) of the absorbed corporation, NPPI, if any, as of the effective date of the merger, which form part of the assets to be transferred by the absorbed corporation to NPCPI as a consequence of the merger, may be applied as a tax credit by NPCPI against its income tax due for the succeeding taxable years, or may be the subject of a claim for refund or issuance of a tax credit certificate (TCC), within the period allowed under the Tax Code.

6. The excess and unexpired minimum corporate income tax (MCIT) of NPPI, as of the effective date of the merger as of year 2017, if any, shall be carried forward and credited against the normal income tax due of NPCPI for the three (3) immediately succeeding taxable years pursuant to Section 27 (E) (2) of the Tax Code.

7. 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 NPPI, if any, is not one of the assets of the latter that can be transferred and absorbed by NPCPI, as this privilege or deduction can be availed of by NPPI only. Accordingly, the tax-free merger between NPPI and NPCPI does not cover the NOLCO of the former; and

8. The unrestricted retained earnings of NPPI 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. *(BIR Ruling No. 1422-2018 dated*

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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, 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 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

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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 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.

Finally, the parties are required to submit to the Legal 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.

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

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