July 4, 2019

BIR RULING NO. 375-19

Section 40 (C) (2) & (6) (b), Tax Code of 1997, as amended; BIR Ruling No. 214-12; BIR Ruling No. 075-18

Gervel, Inc.
7th Floor, Republic Glass Building
196 Salcedo St., Legazpi Village
1229 Makati City

Attention: *AAA*

Gentlemen :

This refers to your letter dated December 14, 2016 requesting confirmation of your opinion that the merger of **Salamin Development Corporation** ("SDC"), as the absorbed corporation, and **Gervel, Inc.** ("Gervel"), as the surviving corporation, is a tax-free merger pursuant to Section 40 (C) (2) in relation to Section 40 (C) (6) (b) of the Tax Code of 1997, as amended (Tax Code).

BACKGROUND

SDC is a corporation organized and existing under the laws of the Republic of the Philippines and is duly registered with the Securities and Exchange Commission (SEC) on July 23, 1979, with SEC Registration Number 87474. It is likewise registered with the Bureau of Internal Revenue (BIR), with Tax Identification Number 000-000-000-000. SDC has an authorized capital stock of Two Million Three Hundred Fifty Five Thousand (2,355,000) shares with a par value of _____ Pesos (Php_____) per share. The total capital stock issued and outstanding amounts to _____ Pesos (Php1_____). As of December 31, 2009, it has total assets amounting to _____ Pesos (Php_____) and total liabilities amounting to _____ Pesos (Php_____)

Gervel, on the other hand, is a corporation organized and existing under the laws of

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the Republic of the Philippines and is duly registered with the SEC on August 26, 1964, with SEC Registration Number 25637. It is also registered with the BIR on June 7, 1994, with Tax Identification Number 000-000-000-000. Gervel has an authorized capital stock of Five Million (5,000,000) shares with a par value of _____ Pesos (Php_____) per share. The total capital stock issued and outstanding amounts to _____ Pesos (Php_____). As of December 31, 2009, it has total assets amounting to _____ Pesos (Php_____) and total liabilities amounting to _____ Pesos (Php_____).

On December 21, 2010 the SEC has approved the Articles and Plan of Merger executed on April 27, 2010 by and between Gervel and SDC. For purposes of the merger and on the basis of the audited financial statements as of December 31, 2009, Gervel shall issue **190,000** shares to the stockholders of SDC. These shares are to be taken from the 3,402,699 unissued shares of the capital stock of Gervel. The present outstanding capital stock of SDC, on the other hand, shall be retired and cancelled.

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

1. The merger of SDC and Gervel qualifies for non-recognition of gain or loss for income tax purposes in accordance with Sections 40 (C) (2) in relation to Section 40 (C) (6) (b) of the Tax Code, and as such, neither SDC nor Gervel will be subject to income tax, withholding tax, or capital gains tax on the transfer.

2. The transfer of the assets of SDC to Gervel pursuant to the merger and the surrender by the Shareholders of their shares in SDC in exchange for Gervel's shares are not transfers of property for less than an adequate and full consideration, hence, do not give rise to a liability for donor's tax.

3. No documentary stamp tax (DST) shall be due on the transfer of properties by SDC to Gervel pursuant to Section 199 (m) of the 1997 Tax Code, as amended by Republic Act (RA) No. 9243.

4. The original issuance of shares by Gervel to the stockholders of SDC in proportion to their current respective shareholdings shall be subject to the DST at the rate of P1.00 per P200, or fractional part thereof, of the par value of such shares of stock.

5. The transfer of net assets of SDC to Gervel pursuant to the merger is not subject to value-added tax (VAT) pursuant to Section 4.106-8 (b) (3) of Revenue Regulations (RR) No. 16-2005, otherwise known as the

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Consolidated Value-Added Tax Regulations of 2005.

In reply, please be informed as follows:

1. The foregoing merger of SDC and Gervel is a merger within the contemplation of Section 40 (C) (2) in relation to Section 40 (C) (6) (b) of the Tax Code because Gervel's acquisition/assumption of all the assets and liabilities of SDC is being undertaken for a *bona fide* business purpose and not for the purpose of escaping the burden of taxation.

The merger of SDC and Gervel qualifies for non-recognition of gain or loss for income tax purposes in accordance with Section 40 (C) (2) of the Tax Code. Accordingly, no gain or loss shall be recognized by Gervel, as the transferee, on its receipt of the assets and liabilities of SDC pursuant to and as a consequence of the merger.

The basis of the shares of stocks to be received by Shareholders of SDC 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)

The basis of the property transferred in the hands of the transferee (Gervel) shall be the same as it would be in the hands of the transferor (SDC) increased by the amount of the gain, if any, recognized to the transferor on the transfer. (Sec. 40 (C) (5) (b), *supra*)

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 property transferred pursuant to such exchange, then such excess shall be considered as a gain 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 bases of the properties transferred by SDC to Gervel should strictly comply with the rule that cash and other cash items will be excluded from the computation of the adjusted bases of the properties 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 and the substituted basis of the properties transferred by SDC shall be as follows:

SDC

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Assets	Amount	Allocated Liabilities	Allocated Shares	Substituted Basis
Cash & cash equivalents			22,014	
Receivables (net of non-current portion)			35,064	
Other Current Assets			3,015	
Non-current portion of Receivables			7,232	
Investment Properties	[1]		122,667	
Property and Equipment			8	
TOTAL			**190,000**	

Liabilities	Amount
Loans Payable	-
Accounts payable & other current liabilities	
Current portion of payable to real estate developer	
Rental Deposits	
Disturbance Compensation fee payable	
Income Tax payable	-
Accrued Retirement Costs	
Retention payable	
Payable to real estate developer-net of current portion	
Deferred tax liability	
Total	

2. 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 any act of liberality *(animus donandi)*.

Clearly, there is no intention on the part of SDC to donate to Gervel 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.

3 & 4. No DST is due on the transfer made pursuant to the Plan of Merger under Section 199 (m) of the Tax Code, as amended by Republic Act (R.A.) No. 9243, in relation to Section 40 (C) (2) of the Tax Code. However, DST at the rate of P1.00 [1] on each P200.00 par value, or fractional part thereof, shall be imposed on the original issuance of shares by

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Gervel to the stockholders of SDC as a consequence of the merger as provided under Section 174 of the Tax Code.

5. The transfer of properties of SDC to Gervel as a consequence of merger will not be subject to any output VAT, pursuant to Section 4.106-8 (b) (3) of Revenue Regulations (RR) No. 16-2005, as amended by RR No. 4-2007 and as further amended by RR No. 10-2011. The conveyance of properties to effectuate a merger is not made in the course of business but by operation of law pursuant to the merger. Thus, any unused input VAT as of the effective date of merger will be absorbed by Gervel, as the surviving corporation, pursuant to Section 4.106-8 (b) (3) of RR No. 16-2005, as amended.

6. Any excess and unexpired MCIT of the absorbed corporation as of the Effective Date of the Merger shall be carried forward and credited against the normal income tax of the surviving corporation, Gervel, for the three (3) immediately succeeding taxable years pursuant to Section 27 (E) (2) of the 1997 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 the Absorbed Corporation, if any, is not one of the assets of the latter that can be transferred and absorbed by the surviving corporation, Gervel, as this privilege or deduction can be availed of by the absorbed corporation only. Accordingly, the tax-free merger between SDC and Gervel does not cover the NOLCO of the former.

In order that the above-described reorganization can be considered as merger under Section 40 (C) (2) and (6) (b) of the Tax Code, the parties to the merger should comply with the following requirements set forth under RR 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 the cost or other basis of all properties,

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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 or 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; and

(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, who is a 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 the stock or securities and other property or money received from the exchange, including any liability assumed upon the exchange, and any liability 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 exchange.

C. Permanent 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 liability assumed on the exchange, or any liability to which any of the properties received were subject), in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities and other property received from the exchange.

In addition to the foregoing requirements, the parties shall enclose with their

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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 stamped 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.

The parties shall cause to annotate at the back of the Transfer Certificates of Title 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 Corporate Secretary of this condition shall be penalized under Section 275 of the same Code. It is further required that within ninety (90) days from receipt of this ruling, the parties to the transaction must submit to the Legal and Legislative Division, Bureau of Internal Revenue, certified true copies by the Corporate Secretary, of duly annotated Certificates of Stock, in respect of the shares of stock of the transferee corporation, including the revised allocation of shares and re-computation of the substituted bases of the properties which shall be in accordance with RMR No. 2-2002.

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be ascertained 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

Footnotes

1. See Annex "A" for the list of investment properties.
1. Old DST rate is used since the transaction took place prior to the effectivity of Republic Act No. 10963 or the TRAIN Law.

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