July 5, 2019

BIR RULING NO. 377-19

Sec. 40 (C) (2) & (6) (c), Tax Code; 000-00

R.G. Manabat & Co.
9F The KPMG Center
6787 Ayala Avenue
Makati City

Attention: *AAA*

Gentlemen :

This refers to your letter dated December 22, 2011, requesting on behalf of CHARTIS SINGAPORE INSURANCE PTE. LTD. (CSI), for confirmation that the transfer of shares of stock of Chartis Philippines Insurance, Inc. (CP) by a nonresident foreign corporation to another nonresident foreign corporation by way of property dividend and capital contribution is not subject to Philippine income taxes, including capital gains tax.

As represented, **Chartis Overseas Limited (COL)** is a corporation incorporated under the laws of Bermuda with registered address at Chartis Building, 29 Richmond Road, Pembroke HM08, Bermuda. As of June 1, 2009, it is the owner of 5,810,567 shares including beneficial ownership of nine (9) shares issued to nominee directors in Chartis Philippines Insurance, Inc. (CP) with an aggregate book value of PhP_____. CP is a domestic corporation duly registered and validly existing under Philippine laws.

Chartis International, LLC (CIL) is a limited liability company incorporated under the laws of the United States of America with registered address at 175 Water Street, New York, New York 10038. It is the registered owner of 547,957 shares of stock in CP with an aggregate book value of PhP_____ as of March 8, 2010. It is the sole stockholder of COL.

Chartis Asia Pacific Pte. Ltd. (CAP) is a company incorporated in Singapore with registered address at 78 Shenton Way, Chartis Building #11-16, Singapore 079120. It is 100% owned by CIL.

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Chartis Singapore Insurance Pte. Ltd. (CSI) is a company incorporated in Singapore with registered address at 78 Shenton Way, Chartis Building #09-16, Singapore 079120. It is 100% owned by CAP.

In connection with the restructuring of the business operations of Chartis Group in the Asia Pacific Region, it was decided that the ownership in CP would be transferred to CSI, which would, in turn, infuse capital to CP. Hence, on December 1, 2011, the following transactions were undertaken:

1. COL, by way of property dividend, transferred all its interest in the 5,810,567 CP to its sole stockholder, CIL. This increased the shareholding of CIL in CP to 6,358,524 shares with an aggregate book value of PhP_____.

2. CIL transferred, conveyed and assigned all its interest in the 6,358,524 CP shares to CAP in exchange for 53,089,018 ordinary shares of the latter (CAP shares) at an issue price of SGD_____ per share or for a total issue price of SGD_____, credited as fully paid up. Using the exchange rate of PhP34.0455157788 to 1 SGD, the total issue price amounts to PhP_____. As a result of the exchange, CIL maintained its 100% ownership of CAP.

3. CAP then transferred the 6,358,524 CP shares to CSI in exchange for 53,089,018 ordinary shares of the latter (CSI shares) at an issue price of SGD_____ per share or for a total issue price of SGD_____, credited as fully paid up. Using the exchange rate of PhP34.0455157788 to 1 SGD, the total issue price amounts to PhP_____. As a result of the exchange, CAP maintained its 100% ownership of CSI.

Based on the foregoing, you now request confirmation of your opinion that:

1. The transfer of CP shares by COL to CIL as property dividend is not subject to Philippine income taxes including capital gains tax, either on the part of COL or CIL. It is, however, subject to documentary stamp tax (DST) under Section 176 of the 1997 Tax Code at the rate of PhP0.75 on each PhP200.00 or fractional part thereof, of the par value of the CP shares transferred.

2. The transfer of CP shares by CIL to CAP in exchange for CAP shares, and the subsequent transfer of the same shares by CAP to CSI in exchange for CSI shares, qualify as tax-free exchange under Section 40

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(C) (2) and (6) (c) of the 1997 Tax Code. Consequently,

a. No gain or loss shall be recognized on the transfer of the CP shares by CIL to CAP and by CAP to CSI;

b. The basis of the CAP shares received by CIL shall be the same as the basis of the CP shares exchanged; and the basis of the CP shares of stock transferred shall be the same as it would be in the hands of CIL;

c. The basis of the CSI shares received by CAP shall be the same as the basis of the CP shares exchanged and the basis of the CP shares transferred shall be the same as it would be in the hands of CAP;

d. The transfer of CP shares by CIL to CAP and by CAP to CSI are not subject to value-added tax (VAT);

e. The transfer of CP shares by CIL to CAP and by CAP to CSI are not subject to donor's tax; and

f. The transfer of CP shares by CIL to CAP and by CAP to CSI are not subject to documentary stamp tax (DST) under Section 199 (m) of the 1997 Tax Code.

3. Upon presentation of the BIR Ruling confirming the above, the Corporate Secretary of CP be authorized to record the transfer of the CP shares by COL to CIL, by CIL to CAP and by CAP to CSI in the Stock and Transfer Books of CP, and to issue new stock certificates in the name of CSI as the ultimate transferee.

In reply, please be informed as follows:

Transfer of CP shares by way of property dividend

Section 23 (F) of the 1997 Tax Code, as amended, provides that a foreign corporation, whether engaged or not in trade or business in the Philippines, is taxable only on income derived from sources within the Philippines. On the other hand, Section 42 (A) (2) (b) of the same Code provides that dividends shall be treated as gross income from sources within the Philippines unless less than fifty percent (50%) of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in

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existence) was derived from sources within the Philippines.

COL is an insurance company based in Bermuda with no office or branch in the Philippines. Based on its audited financial statements, its income consists mainly of premiums earned and investments income. Considering that COL is not engaged in insurance business in the Philippines, the premiums earned are deemed income from sources outside the Philippines. On the other hand, out of its total investments income, only about 12% comes from investments in its affiliates. Thus, even assuming all investment income from affiliates came from the Philippines, such income is still less than 50% of its total income.

Consequently, the property dividend that CIL received from COL in 2011 is income from sources without the Philippines, thus, not subject to Philippine income tax.

Likewise, the transfer of the CP shares by way of property dividend is not deemed a sale or disposition of shares of stock within the meaning of Section 40 of the Tax Code, as amended because COL did not receive any consideration and did not realize any income from the said transfer. Hence, COL is not subject to capital gains tax on the said transfer of the CP shares.

Transfer of CP shares as capital contribution

Income Tax

CIL, CAP and CSI are nonresident foreign corporations. The application of Section 40 (C) (2) of the 1997 Tax Code, as amended, to nonresident foreign corporation is well-settled.

Section 40 (C) (2) of the 1997 Tax Code does not make any qualification or distinction as to its application to a corporation. It provides that —

> *"No gain or loss shall also be recognized if property is transferred to a corporation by a person in exchange for stock or unit of participation in such a corporation of which as a result of such exchange such person, alone or together with others, not exceeding four (4) persons gains control of the said corporation: Provided, that stocks issued for services shall not be considered as issued in return for property."*

The underlying assumption of tax-free exchange provisions generally is that the new property received is substantially a continuation of the old investment still unliquidated. *(BIR Ruling No. 024-05 dated December 23, 2005)*

Based on the foregoing and considering that after the exchange CIL continues to own

the entire capital stock of CAP, the transfer of the CP shares from CIL to CAP qualifies as a tax-free exchange transaction.

In the same manner, the subsequent transfer of the same CP shares by CAP to CSI qualifies as a tax free exchange transaction because as a result of the exchange, CAP continues to own the entire capital stock of CSI.

Accordingly, no gain or loss shall be recognized on the transfer of the CP shares by CIL to CAP in exchange for the latter's 53,089,018 shares of stock. In the same vein, no gain or loss shall be recognized on the subsequent transfer of the CP shares from CAP to CSI in exchange for the 53,089,018 shares of stock of the latter.

However, it is to be emphasized that Section 40 (C) (2) and (6) (c) of the 1997 Tax Code, as amended, merely defers recognition of the gain or loss from such transaction, for in determining the gain or loss from a subsequent transaction of the properties or of the stocks involved in the exchange, the original or historical cost of the properties or stocks is considered. Thus, if the transferor later sells or exchanges the shares of stock it acquired in the exchange, it shall be subject to income tax on gains derived from such sale or exchange, taking into consideration that the cost basis of the shares shall be the same as the original acquisition cost or adjusted cost basis to the transferor of the property exchanged therefor; and that the cost basis to the transferee of the property exchanged for stocks shall be the same as it would be in the hands of the transferor. (Section 40 (C) (5), 1997 Tax Code, as amended)

Cost Basis

Section 40 (C) (5) (a) and (b) of the 1997 Tax Code, as amended, states:

"(5) Basis. —

> "(a) The basis of the stock or securities received by the transferor upon the exchange specified in the above exception shall be the same as the basis of the property, stock or securities exchanged, decreased by (1) the money received, and (2) the fair market value of the other property received, and increased by (a) the amount treated as dividend of the shareholder and (b) the amount of any gain that was recognized on the exchange: Provided, That the property received as *'boot'* shall have as basis its fair market value: Provided, further, That if as part of the consideration to the transferor, the transferee of property assumes a liability of the transferor or acquires from the latter property subject to a liability, such assumption or acquisition (in the amount of the liability) shall, for purposes of this paragraph, be treated as money received by the transferor on the exchange: Provided, finally, That if the transferor

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receives several kinds of stock or securities, the Commissioner is hereby authorized to allocate the basis among the several classes of stocks or securities.

"(b) The basis of the property transferred in the hands of the transferee shall be the same as it would be in the hands of the transferor increased by the amount of the gain recognized to the transferor on the transfer."

Indubitably, the basis of the CAP shares received by CIL upon exchange shall be the same as the basis of the CP shares exchanged; and the basis of the CP shares transferred shall be the same as it would be in the hands of CIL. Likewise, the basis of the CSI shares received by CAP upon the exchange shall be the same as the basis of the CP shares exchanged; and the basis of the CP shares transferred shall be the same as it would be in the hands of CAP.

Thus, CIL transferred 6,358,524 CP shares with a total book value of PhP_____ to CAP, as consideration for the transfer of the CP shares, CAP issued to CIL 53,089,018 ordinary CAP shares at an issue price of _____ SGD per share or a total of SGD_____. Converted to Philippine peso, this amounts to PhP_____, which is equivalent to the total book value of the CP shares transferred.

Subsequently, CAP transferred the 6,358,524 CP shares with an aggregate book value of PhP_____ to CSI. As consideration for the transfer of the CP shares, CSI issued to CAP 53,089,018 ordinary CSI shares at an issue price of SGD_____ per share or a total of SGD_____. Converted to Philippine Peso, this amounts to PhP_____, which is equivalent to the total book value of the CP shares transferred.

Value-Added Tax (VAT)

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

"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%). . ."

Corollarily, Section 4.106-8 of Revenue Regulations (RR) No. 16-2005, as amended,

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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 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." (Underscoring supplied.)*

Considering that the CP shares are not held primarily for sale, barter or exchange in the ordinary course of its trade or business, the transfer by CIL to CAP and the subsequent transfer of the same shares from CAP to CSI are not subject to 12% value-added tax. *(BIR Ruling No. 024-05 dated December 23, 2005)*

Donor's Tax

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 CIL or CAP to donate the CP shares since the transaction is being undertaken purely for business purposes, *i.e.*, restructuring of the business operations of Chartis Group in the Asia Pacific Region. Hence, the transfers of the CP shares by CIL to CAP and by CAP to CSI are not subject to donor's tax.

Documentary Stamp Tax

Section 199 (m) of the Tax Code of 1997, as amended by R.A. No. 9243 and as implemented by Revenue Regulations (RR) No. 13-2004, states as follows:

> *"Sec. 199. Documents and Papers Not Subject to Stamp Tax. — The provision of*

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Section 173 to the contrary notwithstanding, the following instruments, documents and papers shall be exempt from the documentary stamp tax:

xxx xxx xxx

(m) Transfer of property pursuant to Section 40 (c) (2) of the National Internal Revenue Code of 1997, as amended."

Considering that the transfer of the CP shares by CIL to CAP and by CAP to CSI qualifies as a tax-free exchange transaction under Section 40 (c) (2) of the 1997 Tax Code, as amended, the said transfer is exempt from DST.

Strict compliance of requirements to avail non-recognition of gains provided for in Section 40 (C) (2) and (6) (c) of the Tax Code

In order that the parties to the exchange can avail of the non-recognition of gains provided for in Section 40 (C) (2) and (6) (c) of the Tax Code of 1997, as amended, they should comply with the requirements hereunder mentioned.

The parties shall, pursuant to Section 58 (E) of the Tax Code of 1997, as amended, cause the Corporate Secretary to annotate at the back of the Certificates of Stock, the date the Deed of Assignment was executed, the original or historical cost of acquisition of the shares of stock involved, and the fact that no gain or loss was recognized as a result of such exchange; provided however, that any violation by the Corporate Secretary of this condition shall be penalized under Section 269 of the same Code.

It is further required that the Certificate of Shares of Stock that bears the annotation of substituted bases of the shares of stock transferred/received in connection with this transaction, as duly certified by the Corporate Secretary, should be submitted to the Law and Legislative Division, Bureau of Internal Revenue, 7/F National Office Building, Diliman, Quezon City within ninety (90) days from the date of the receipt of this Certification, by any of the parties to the exchange transaction. Otherwise, this ruling shall be void and without effect, and the Chief, Law and Legislative Division shall refer the docket of the case to the Prosecution Division for appropriate action.

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.

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Very truly yours,

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

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