October 4, 2019

BIR RULING NO. 559-19

Section 40 (C) (2) and (6) (b) of the
National Internal Revenue Code of 1997,
as amended; BIR Ruling No. 075-18

Usgabon Development Corporation
Johnny's Building, MacArthur Highway,
Balibago, Angeles City

Attention: *AAA*

Gentlemen :

This refers to your letter dated July 03, 2018, requesting confirmation of your opinion that the merger of **T'Souy Development Corporation ("T'Souy" for brevity)**, as the absorbed corporation, and **Usgabon Development Corporation ("Usgabon" for brevity)**, 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 National Internal Revenue Code (NIRC) of 1997, as amended.

BACKGROUND

T'Souy, with Tax Identification Number (TIN) 000-000-000-000, 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 January 24, 2007, with SEC Registration Number CS200618991. It is engaged in the administration of commercial properties, including, but not limited to constructing, improving, altering and operating in whole or in part building and apartments of the corporation or of third persons.

On the other hand, Usgabon, with TIN 000-000-000-000, is a corporation organized and existing under the laws of the Republic of the Philippines and is duly registered with the SEC on February 02, 2007, with SEC Registration Number CS200618995. It is engaged in the administration of commercial properties, including, but not limited to acquiring, selling, mortgaging, leasing, to such persons or entities and under such terms and conditions as the corporation may deem proper and convenient.

Usgabon and T'Souy have determined that it is to their best interest to merge into one (1) corporation, and that such merger will redound to their mutual advantage and

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welfare. Thus, on June 29, 2009, Usgabon and T'Souy, having the following corporate structure:

	Authorized Capital Stock	Par Value	Amount Subscribed	Paid-Up
Usgabon	13,000,000.00	1.00	13,000,000.00	13,000,000.00
T'Souy	13,000,000.00	1.00	13,000,000.00	13,000,000.00

executed Plan and Agreement of Merger and Articles of Merger, and agreed as follows, among others:

I. Effective Date

The effective date of the Merger shall be the date of approval of the Articles of Merger and the issuance of the corresponding Certificate of Merger by the SEC.

II. Transfer of Properties

On and as of the Effective Date, any all other rights and privileges, powers, immunities, licenses, businesses, assets and properties of T'Souy, whether, real, personal, or mixed, and trade name and all debts due to T'Souy, specifically reflected in the audited financial statements as of May 31, 2009, shall be deemed transferred to and vested in Usgabon, without need of further act or deed, unless by express requirement of law or of government agency, a separate or specific deed of conveyance to legally effect the transfer of assignment of any kind of property or asset is required, in which case, such documents or deeds shall be executed accordingly; and all properties, rights, privileges, businesses, powers, immunities, licenses and all appointments, designations and nomination, all other rights and interest of T'Souy shall be deemed and for all purposes be, as of the Effective Date, the properties of Usgabon as they were of T'Souy, and all debts, liabilities, obligations, duties and undertaking of T'Souy arising therefrom, whether contractual or otherwise, express or implied, actual or contingent, shall thenceforth attach to Usgabon, which shall be responsible therefor, and may be enforced against Usgabon to the same extent as if said debts, liabilities, obligations, duties and undertakings have been originally incurred or contracted by Usgabon subject, however, to all rights, privileges, defenses, set-offs and counterclaims of every kind and nature which T'Souy have or might have.

Any and all assets and properties, rights, privileges, powers, immunities, licenses, franchises, appointments, designations, nominations, businesses, interests acquired by and in the name of T'Souy after the Effective Date shall be deemed acquired by and shall accordingly pertain in ownership to Usgabon.

II. * Assumption of Liabilities

All of the liabilities, undertakings and obligations of T'Souy whether contractual or otherwise, express or implied, actual or contingent, enumerated in the audited financial statements as of May 31, 2009, shall be deemed transferred to and

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become the liabilities, undertakings and obligations of Usgabon in the same manner as if Usgabon had itself incurred such liabilities, undertakings, and obligations, subject, however, to Usgabon being able to exercise all the defenses, rights, privileges, set-offs and counterclaims of every kind and nature which T'Souy have or might have.

Any and all liabilities, undertakings and obligations incurred by and in the name of T'Souy after the Effective Date shall be deemed incurred by and shall accordingly become the liabilities, undertakings and obligations of Usgabon.

III. Issuance of Shares

Upon the Effective Date of Merger, all the outstanding shares of T'Souy shall be cancelled. Usgabon shall file an increase of its authorized capital stock from Thirteen Million Pesos (Php13,000,000.00) to Twenty Six Million Pesos (Php26,000,000.00) together with the filing of the Articles of Merger, to be able to issue 13,000,000 shares of Usgabon with a total amount of Thirteen Million Pesos (Php13,000,000.00) to the stockholders of T'Souy.

On October 07, 2009, the SEC has approved the Articles and Plan and Agreement of Merger executed on June 29, 2009 by and between Usgabon and T'Souy, including the increase of authorized capital stock of Usgabon from Thirteen Million Pesos (Php13,000,000.00) to Twenty Six Million Pesos (Php26,000,000.00).

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

1. The merger of T'Souy and Usgabon is a statutory and tax-free merger under Sections 40(C)(2) and 40(C)(6)(b) of the NIRC of 1997, as amended. Hence, no gain or loss shall be recognized on the transfer of assets and liabilities of T'Souy to Usgabon.

2. The transfer of assets of T'Souy to Usgabon 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, as amended.

3. The transfer of assets of T'Souy to Usgabon pursuant to the merger is not subject to documentary stamp tax (DST) pursuant to Section 199 (m) of the NIRC of 1997, as amended.

4. The transfer of the assets and liabilities by T'Souy to Usgabon for the latter's shares would not be considered as transfer of property for an insufficient consideration subject to donor's tax since there is no intention to donate on the part of the parties inasmuch as the transaction to be effected is purely for a business purpose.

In reply, please be informed as follows:

1. The foregoing merger of T'Souy and Usgabon is a merger within the

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contemplation of Section 40(C)(2) in relation to Section 40(C)(6)(b) of the NIRC of 1997, as amended, because Usgabon's acquisition/assumption of all the assets and liabilities of T'Souy is being undertaken for a *bona fide* business purpose and not for the purpose of escaping the burden of taxation.

The merger of T'Souy and Usgabon qualifies for non-recognition of gain or loss for income tax purposes in accordance with Section 40(C)(2) of the NIRC of 1997, as amended. Accordingly, no gain or loss shall be recognized by Usgabon, as the transferee, on its receipt of the asset and liabilities of T'Souy pursuant to and as a consequence of the merger.

The basis of the shares of stocks to be received by Shareholders of T'Souy 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 created as dividend of the shareholders and (b) the amount of any gain that was recognized in the exchange. [1]

The basis of the property transferred in the hands of the transferee (Usgabon) shall be the same as it would be in the hands of the transferor (T'Souy) increased by the amount of the gain, if any, recognized to the transferor on the transfer. [2]

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. [3]

The substituted basis of the properties transferred by T'Souy to Usgabon should strictly comply with the rule that cash and other cash items will be excluded from the computation of the adjusted basis 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 T'Souy shall be as follows:

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Assets	Amount	Allocated Liabilities [4]	Allocated Shares	Substituted Basis
Cash	808,655.12		273,495	808,655.12
Land [5]	37,629,000.00 [6]	0	12,726,505	37,629,000.00
Total	**38,437,655.12**	**0**	**13,000,000**	**38,437,655.12**

2. The transfer of properties of T'Souy to Usgabon as a consequence of merger will not be subject to any output VAT, pursuant to Section 4.106-8 (b)(3) of 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 Usgabon, as the surviving corporation, pursuant to Section 4.106-8 (b)(3) of RR No. 16-2005, as amended.

3. No DST is due on the transfer made pursuant to the Plan of Merger under Section 199 (m) of the NIRC of 1997, as amended by Republic Act (RA) No. 9243, in relation to Section 40 (C)(2) of the NIRC of 1997, as amended. However, DST at the rate of P1.00 [7] on each P200.00 par value, or fractional part thereof, shall be imposed on the original issuance of shares by Usgabon to the stockholders of T'Souy as a consequence of the merger as provided under Section 174 of the NIRC of 1997, as amended.

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 any act of liberality *(animus donandi)*.

   Clearly, there is no intention on the part of T'Souy to donate to Usgabon 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. 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, Usgabon, for the three (3) immediately succeeding taxable years pursuant to Section 27(E)(2) of the 1997 NIRC of 1997, as amended.

6. It is to be emphasized, however, that the net operating loss carry-over (NOLCO), under Section 34 (D)(3) of the NIRC of 1997, as amended, and as implemented by RR No. 14-2001, of the absorbed corporation,

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if any, is not one of the assets of the latter that can be transferred and absorbed by the surviving corporation, Usgabon, as this privilege or deduction can be availed of by the absorbed corporation only. Accordingly, the tax-free merger between T'Souy and Usgabon does not cover the NOLCO of the former.

7. The retained earnings of T'Souy, 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 NIRC of 1997, as amended.

In order that the above-described reorganization can be considered as merger under Section 40 (C) (2) and (6) (b) of the NIRC of 1997, as amended, 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, 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

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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 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 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 NIRC of 1997, as amended. It is further required that within ninety (90) days from receipt of this ruling, the parties to the transaction must submit to the Law and Legislative Division, Bureau of Internal Revenue, certified true copies by the Corporate Secretary, of duly annotated Certificates of Stock,

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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. Sec. 40 (C) (5) (a) of the NIRC of 1997, as amended.
2. Sec. 40 (C) (5) (b), *supra*.
3. Sec. 40 (C) (4) (b), *supra*.
4. As of May 31, 2009, T'Souy has no liabilities.
5. See Annex "A" for the list of real properties.
6. Based on Fair Market Value (See Annex "B" for the computation).
7. Old DST rate is used since the transaction took place prior to the effectivity of RA No. 10963 or the TRAIN Law.

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