REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE
Quezon City

May 5, 2016

REVENUE MEMORANDUM ORDER NO. 17-2016

SUBJECT : Supplemental Guidelines for the Non-Recognition of Gain or Loss on the Transfer of Property in exchange for Shares of Stock Pursuant to Section 40(C)(2) in relation to Section 40(C)(6)(c) of the Tax Code of 1997 as implemented by Revenue Regulations No. 18-2001.

TO : All Revenue Officials, Personnel and Others Concerned

This Revenue Memorandum Order is being issued to supplement the guidelines and requirements for securing a tax-free exchange ruling under Revenue Memorandum Order No. 32-2001 dated November 28, 2001 pursuant to Revenue Regulations No. 18-2001 dated November 13, 2001. Specifically, this Order prescribes the number of shares to be issued by the transferee corporation in exchange for the property it received from the transferor.

I. GUIDELINES. —

For purposes of tax-free exchange pursuant to Section 40 (C) of the Tax Code, as amended, the value of shares to be issued by reason of exchange should be equal to the fair market value of the property transferred (value for value exchange). Consequently, the number of shares to be issued will be computed on the basis of the fair market value of the property transferred. The following shall result from said transfer:

(1) To the transferee of the property/asset (Corporation issuing shares of stocks for assets otherwise referred to as the "Transferee Corporation"):

a. The property/asset transferred shall be recorded at fair market value;

b. For purposes of computing gains or loss for subsequent transfer of said property/asset, the substituted basis as defined in Revenue Regulation No.18-2001 shall be used in computing the gain or loss resulting from said sale;

c. In addition to the requirements set forth in previous issuance, such as but not limited to the requirement that the tax free exchange shall be annotated in the certificate of title of ownership of properties, otherwise the tax free exchange ruling shall be null and void, the Transferee Corporation shall place a note in the audited financial statements submitted to the Bureau of Internal Revenue (BIR) indicating that the property was acquired pursuant to Section 40(C) of the Tax Code, date of the transaction, the substituted basis of the property, the number of shares exchanged for the property, and the name of the shareholder(s) and the breakdown of shares to each.

(2) To the transferor of the property/assets (or recipient of the shares of stocks of the transferee corporation):

a. For tax accounting purposes, the shares of the transferee corporation received in exchange for the property/assets transferred shall be recorded at its substituted value;

b. In addition to the requirements set forth in previous issuance, such as but not limited to the requirement that the tax free exchange shall be annotated in the certificate of title of ownership of properties, otherwise the tax free exchange ruling shall be null and void, the transferor shall place a note in the audited financial statements submitted to the Bureau of Internal Revenue (BIR) indicating that these shares were acquired pursuant to Section 40(C) of the Tax Code, date of the transaction, the property transferred, the substituted basis of the property, the number of shares exchanged for the property, and the name of the Transferee Corporation.

In all instances, the Transferee Corporation and the transferor of the property/asset shall present a copy of the ruling relating to the tax-free exchange in the event the said property/asset and/or the shares of stocks given in exchange for the property/asset are to be subsequently transferred, assigned and/or sold.

For the purpose of this Order, if the property/asset being exchanged involves shares of the stocks, the value of the shares of stock shall be as follows:

a) In the case of listed shares, the closing price on the day when the shares are transferred or exchanged. When no sale is made in the Local Stock Exchange on the day when the listed shares are transferred or exchanged, the closing price on the day nearest to the date of transfer or exchange.

b) In the case of shares of stock not listed and traded in the local stock exchange, the book value of the shares of stock as shown in the annual financial statements duly certified by an independent certified public accountant submitted or should have been submitted to the Bureau of Internal Revenue nearest to the date of sale, with the assets therein adjusted to its fair market value as of a date not earlier than 90 days from the date of the transaction. If the company assets include shares in other corporation, the said shares shall be adjusted to its fair market value as of a date not earlier than 90 days from the date of the transaction. The adjustment to be made shall be made pursuant to Revenue Regulation No. 6-2013.

Illustrations:

A. Transfer of Properties to a Newly Incorporated Corporation

Assuming that XYZ is a newly incorporated corporation with Php100 par value shares and Mr A,B,C,D,E and F are incorporators. In payment for the subscription of Mr. F, he transferred his land with a fair market value of Php5,000,000. As such, Mr. F should receive 50,000 shares for his Php5,000,000 property. Additional paid up capital shall not be allowed.

B. Transfer of Properties to an Existing Corporation with Subsequent Sale, Disposition Or Transfer Of Properties Subject Of Tax-Free Exchange

For tax purposes, the substituted basis as defined in Section 40 (C)(5) of the Tax Code, as amended and implemented by Revenue Regulations (RR) No. 18-01 dated November 13,

2001 shall be the basis for determining gain or loss on the subsequent transfer of the properties subject of the tax-free exchange.

As such, if the stocks or securities (not listed and traded in the local stock exchange) received by the transferor on the tax-free exchange are eventually sold, disposed or transferred, the gain or loss shall be based on the selling price of the shares or securities and the substituted basis as defined in Section 2 (A)[1] of RR No. 18-01.

Similarly, if the properties transferred were subsequent sold, disposed or transferred, 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.[2] However, it must be emphasized that the input VAT, if any, on the property transferred shall be based on the fair market value of the properties transferred.

Illustration No. 1:

Assuming that Corporation ABC was incorporated in 2010 to engaged in the real estate business. Its authorized capital stock is Php100,000,000 divided into 1,000,000 shares at Php100 par value while its outstanding capital stock is Php30,000,000 divided into 300,000 shares . Furthermore, Corporation XYZ, also engaged in real estate business, transferred one of its properties in exchange for Corporation ABC's shares. The land owned by Corporation XYZ has a fair market value of Php250,000,000, exclusive of VAT. However, the subject land was purchased by Corporation XYZ for Php40,000,000. The property was exchanged for shares of Corporation ABC.

Journal Entry of Corporation XYZ (Transferor):

Investment (Shares of Stocks)*	70,000,000.00	
Land		40,000,000.00
Output VAT Payable		30,000,000.00

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[1] SECTION 2. Basis. — A. Substituted Basis of Stock or Securities Received by the Transferor. — The substituted basis of the stock or securities received by the transferor on a tax-free exchange shall be as follows:

1. The original basis of the property, stock or securities to be transferred;
2. Less: (a) money received, if any, and (b) the fair market value of the other property received, if any;
3. Plus: (a) the amount treated as dividend of the shareholder, if any, and (b) the amount of any gain that was recognized on the exchange, if any.

However, the property received as 'boot' shall have as basis its fair market value. The term "boot" refers to the money received and other property received in excess of the stock or securities received by the transferor on a tax-free exchange.

If the transferee of property assumes, as part of the consideration to the transferor, 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 computing the substituted basis, be treated as money received by the transferor on the exchange.

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

[2] Section 40(C)(5)(b) of the Tax Code as implemented by SECTION 2 (B) of RR No. 18-01. The latter provides as follows

"B. Substituted Basis of the Transferred Property in the Hands of the Transferee. The substituted basis of the property transferred in the hands of the transferee shall be as follows:

(a) the original basis in the hands of the transferor;

(b) Plus: the amount of the gain recognized to the transferor on the transfer."

To record the tax free exchange of Land with TCT No. 123456 for 2,800,000 common shares of Corporation ABC with par value of PhP 100.00.

Output VAT Payable	30,000,000.00	
Cash		30,000,000.00

To record the payment of output VAT due from the exchange of Land with fair market value of PhP 250,000,000.00.

Balance Sheet of Corporation XYZ (Transferror):

In addition, Corporation XYZ shall place a note in its balance sheet under Investments, as follow:

**Investment includes 2,800,000 common shares with par value in Corporation ABC resulting from the tax free exchange of a parcel of land covered by TCT No. 123456 which was acquired on _____ for the cost of PhP 70,000,000.00 which has a Fair Market Value as of the date of exchange amounting to PhP 250,000,000.00 excluding VAT.*

Journal Entry of Corporation ABC (Transferee):

Land**	250,000,000.00	
Input VAT	30,000.000.00	
Common Shares		280,000,000.00

To record the tax free exchange of Land with TCT No. 123456 from Corporation XYZ for 2,800,000 common shares with par value of PhP 100.00.

Balance Sheet of Corporation ABC (Transferee):

In addition, Corporation ABC shall place a note in its balance sheet under Investments, as follow:

***Land was acquired in a tax free exchange dated _____ from Corporation XYZ, the acquisition cost/substituted cost to Corporation XYZ of the land amounts to PhP 40,000,000.00. The land was previous covered by TCT No. 123456, and is now presently covered by TCT No. ABCDEF constituting _____ square meters located in the City of _____."*

Thus, Corporation XYZ should receive 2,800,000 shares or PhP 280,000,000 par value shares of Corporation ABC in exchange for its land. Further, considering that the property is classified as ordinary asset, the transfer of the said property by Corporation XYZ to Corporation ABC is subject to twelve percent (12%) VAT amounting to Php30,000,000 based on the Php250,000,000 fair market value of the property. Consequently, Corporation ABC can use the Php 30,000,000 as Input VAT.

Assuming, further, that Corporation XYZ sold all of its Corporation ABC's shares to DEF Holding Corporation for Php300,000,000. In this case, the net capital gain of Corporation XYZ subject to tax is as follows:

Selling Price	300,000,000.00
Less: Cost (Substituted Basis)	70,000,000.00
Net Capital Gain	230,000,000.00

Assuming, however, that the property transfer by Corporation XYZ was sold by Corporation ABC to UVW Development Corporation for Php350,000,000. Thus, for tax purposes, the gain on the sale of the transferred property is Php310,000,000. Further, the VAT on the transfer is Php42,000,000.

Selling Price	350,000,000.00
Less : Cost (Substituted Basis)	40,000,000.00
Net Gain	310,000,000.00
Gross Output VAT (PhP 350,000,000@12%)	42,000,000.00
Less: Input VAT	30,000,000.00
Net Output VAT Payable	12,000,000.00

Illustration No. 2:

Assuming that Corporation ABC was incorporated in 2010 to engaged in the real estate business. Its authorized capital stock is Php100,000,000 divided into 1,000,000 shares at Php100 par value while its outstanding capital stock is Php30,000,000 divided into 300,000 shares . Furthermore, Corporation XYZ, also engaged in real estate business, transferred one of its properties in exchange for Corporation ABC's shares. The land owned by Corporation XYZ has a fair market value of Php250,000,000 exclusive of VAT. However, the subject land was purchased by Corporation XYZ for Php40,000,000. The property was exchanged for shares of Corporation ABC with Corporation ABC shouldering the VAT liability, i.e. Corporation ABC will give Corporation XYZ the cash equivalent of the VAT.

Entry of Corporation XYZ (Transferor):

Investment (Shares of Stocks)*	40,000,000.00	
Cash	30,000,000.00	
Land		40,000,000.00
Output VAT Payable		30,000,000.00

To record the tax free exchange of Land with TCT No. 123456 for 2,500,000 common shares of Corporation ABC with par value of PhP 100.00 and cash received from Corporation ABC for the VAT

Output VAT Payable	30,000,000.00	
Cash		30,000,000.00

To record payment of output VAT for the tax free exchange of the Land with TCT No. 123456.

Balance Sheet of Corporation XYZ (Transferror):

In addition, Corporation XYZ shall place a note in its balance sheet under Investments, as follow:

**Investment includes 2,500,000 common shares with par value in Corporation ABC resulting from the tax free exchange of a parcel of land covered by TCT No. 123456 which was acquired on _____ for the cost of PhP 40,000,000.00 which has a Fair Market Value as of the date of exchange amounting to PhP 250,000,000.00 excluding VAT, however, cash was received from Corporation ABC to pay for the VAT resulting from the tax free exchange."*

Entry of Corporation ABC (Transferee):

Land	250,000,000.00	
Input VAT	30,000,000.00	
Common Shares		250,000,000.00
Cash		30,000,000.00

To record the tax free exchange of Land with TCT No. 123456 from Corporation XYZ for 2,500,000 common shares with par value of PhP 100.00.

Thus, Corporation XYZ should receive 2,500,000 shares or PhP 250,000,000 par value shares of Corporation ABC in exchange for its land. Further, considering that the property is classified as ordinary asset, the transfer of the said property by Corporation XYZ to Corporation ABC is subject to twelve percent (12%) VAT amounting to Php 30,000,000 based on the Php 250,000,000 fair market value of the property. Consequently, Corporation ABC can use the Php 30,000,000 as Input VAT.

Balance Sheet of Corporation ABC (Transferee):

In addition, Corporation ABC shall place a note in its balance sheet under Investments, as follow:

***Land was acquired in a tax free exchange dated _____ from Corporation XYZ, the acquisition cost/substituted cost to Corporation XYZ of the land amounts to PhP 40,000,000.00. The land was previous covered by TCT No. 123456, and is now presently covered by TCT No. ABCDEF constituting _____ square meters located in the City of _____."*

Assuming, further, that Corporation XYZ sold all of its Corporation ABC's shares to DEF Holding Corporation for Php 300,000,000. In this case, the net capital gain of Corporation XYZ subject to tax is as follows:

Selling Price	300,000,000.00
Less: Cost (Substituted Basis)	40,000,000.00
Net Capital Gain	260,000,000.00

Assuming, however, that the property transfer by Corporation XYZ was sold by Corporation ABC to UVW Development Corporation for Php350,000,000. Thus, for tax purposes, the gain on the sale of the transferred property is Php310,000,000. Further, the VAT on the transfer is Php42,000,000.

Selling Price	350,000,000.00
Less : Cost (Substituted Basis)	40,000,000.00
Net Gain	310,000,000.00

Output VAT (PhP 350,000,000@12%)	42,000,000.00
Input VAT (assuming this VAT has not been utilized as Input VAT in previous returns)	30,000,000.00
Net Output VAT	12,000,000.00

II. REPEALING CLAUSE. —

The provisions of Revenue Memorandum Order No. 32-2001 dated November 29, 2001 and all other rules, orders or portions thereof that are contrary to or inconsistent with the provisions of this Order are hereby modified and/or repealed accordingly.

III. EFFECTIVITY. —

This Order shall take effect immediately.

(Original Signed)
KIM S. JACINTO-HENARES
Commissioner of Internal Revenue