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Tax bulletin

SGV

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Highlights

BIR Rulings

- The conveyance of real property pursuant to a court-approved compromise agreement is subject to capital gains tax (CGT) and documentary stamp tax (DST). **(Page 3)**

- A corporation organized for scientific purposes but which is shown to be a profit-oriented enterprise whose activities do not pertain to any scientific or research purpose is not a tax-exempt entity under Section 30(E) of the Tax Code. **(Page 4)**

- The transfer of properties by the PCGG to private individuals in a sale at public auction is exempt from income tax, withholding taxes (WT), VAT, DST and CGT. **(Page 5)**

- During liquidation, the transfer of property by the dissolving corporation to its stockholders by way of liquidating dividend is not a sale subject to income tax, CWT and DST. However, it is a deemed sale transaction for VAT purposes.

  On the part of the stockholder, any liquidating gain shall be treated as a capital gain subject to the regular income tax rates under the Tax Code, and not to CGT. The liquidating gain shall be the difference between the adjusted cost basis of the shares and the fair market value (FMV) of the property received as liquidating dividends. **(Page 5)**

BIR Issuances

- Revenue Regulations (RR) No. 8-2014 amends the deadlines prescribed in Section 13 of RR No. 7-2014, requiring the affixture of internal revenue stamps on imported and locally manufactured cigarettes and the use of the Internal Revenue Stamp Integrated System. **(Page 6)**

- Revenue Memorandum Circular (RMC) No. 77-2014 clarifies certain requirements on the processing of applications for cash conversion of Tax Credit Certificates (TCCs). **(Page 7)**

BOC Issuances

- Customs Memorandum Order (CMO) No. 19-2014 repeals CMO No. 18-2014 on the guidelines on lifting an order of abandonment. **(Page 7)**

- CMO No. 21-2014 prescribes the procedures for the issuance and lifting of alert orders for formal entries filed in the e2m System. **(Page 7)**

- CMO No. 22-2014 prescribes the rules on tagging of arrival and date of last discharge in e2m for all vessel and aircraft arrivals. **(Page 9)**

PEZA Issuances

- PEZA informs PEZA-registered enterprises of their exemption from Fertilizer and Pesticides Authority (FPA) regulations on the importation of fertilizers, pesticides and other agrochemicals intended for industrial use. **(Page 9)**

- PEZA suspends field inspection and other site visits of developers' and locator-enterprises' facilities during the holiday season from 24 November 2014 to 09 January 2015. **(Page 10)**

BSP Issuances

- Circular No. 851 amends the rules on interlocking positions. **(Page 10)**

- Circular No. 852 amends Sections X410 and 4410Q of the MORB and MORNBFI to enhance the disclosure requirements of Unit Investment Trust Funds (UITFs) and to clarify certain features of the target fund of a fund-of-funds/feeder fund UITF. **(Page 11)**

- Circular No. 853 amends Subsections X410 and 4410Q of the MORB and MORNBFI, respectively, to allow for the creation of Multi-Class Unit Investment Trust Funds (UITF). **(Page 12)**

SEC Opinions

- A tourism enterprise which complies with the export percentage and three-year projection requirements under the Foreign Investments Act of 1991 (FIA) may apply for a license to do business in the Philippines as an export enterprise. **(Page 13)**

- A corporation engaged in overseas construction projects or private construction contracts may be wholly-owned by foreign nationals, provided its paid-in equity capital is not less than the equivalent of USD200,000 and it does not undertake other nationalized or partly nationalized activities. **(Page 13)**

Court Decisions

- The transfer of real property by an absorbed corporation to the surviving corporation pursuant to a merger is not subject to DST under Section 196 of the Tax Code. Section 196 imposes the DST on the transfer of realty by way of a sale and for a consideration, and does not apply to all conveyances of real property. **(Page 14)**

- Goodwill is connected to the business itself and cannot be allocated without regard to the business.

  The sale of a business through a spin-off of the assets to a new company (Newco) and subsequent sale of the Newco shares is a capital transaction subject to capital gains tax (CGT). The resulting transfer of goodwill may not be treated as a separate transaction subject to corporate income tax. **(Page 16)**

BIR Rulings

The conveyance of real property pursuant to a court-approved compromise agreement is subject to CGT and DST.

BIR Ruling No. 355-2014 dated September 9, 2014

Facts:

A Co., a domestic financing company, caused the consolidation and issuance of a new Transfer Certificate of Title (TCT) in its name over a parcel of land. Ms. X filed a case against A Co. for "Declaration of Absolute Nullity and/or Unenforceability of Promissory Note and Real Estate Mortgage, Quieting of Title and Damages." Subsequently, A Co. and Ms. X entered into a compromise agreement to amicably settle the dispute. The Regional Trial Court rendered a decision approving the Compromise Agreement where it was agreed that A Co. will apply for the issuance of a new TCT over the parcel of land in the name of Ms. X. A Co. filed a request for tax exemption from CGT and other related revenue taxes on the transfer of the real property to Ms. X.

Issue:

Is the transfer subject to CGT and DST?

Ruling:

Yes, the transfer is subject to both CGT and DST.

Under Sec 24(D) of the Tax Code, CGT is imposed on capital gains presumed to have been realized from the sale, exchange and other dispositions of real property located in the Philippines and classified as capital assets. The conveyance of real property pursuant to a Compromise Agreement entered into by the parties and approved by the court is covered by the clause "other dispositions of real property" and is thus subject to CGT and DST under Sections 188 and 196 of the Tax Code.

BIR Ruling No. 356-2014 dated September 17, 2014

A corporation organized for scientific purposes but which is shown to be a profit-oriented enterprise whose activities do not pertain to any scientific or research purpose is not a tax-exempt entity under Section 30(E) of the Tax Code.

Facts:

A Co. is a non-stock, non-profit (NSNP) corporation organized exclusively for scientific purposes. A Co. requested for a Certificate of Tax Exemption under Section 30(E) of the Tax Code. Its application letter for tax exemption states that A Co.'s major activities include the implementation of National Internship Matching Programs and other related activities, such as the accreditation of medical hospitals for internship and collaboration in the administration of the National Medical Admission Test. A Co.'s financial statements disclose that A Co. collects internship fees, accreditation fees, annual dues and other contributions.

Issues:

1. Is A Co. exempt from income tax under Section 30(E) of the Tax Code?
2. Is A Co. exempt from donor's tax on contributions it receives?

Ruling:

1. No. The documents submitted to the BIR show that A Co.'s actual activities do not pertain to any scientific and research purpose. The implementation of National Internship Matching Programs and other related activities, such as the accreditation of medical hospitals for internship and collaboration in the administration of national medical admission tests, do not fall within the definition of "scientific and research purpose" as contemplated under Section 30(E) of the Tax Code and as implemented by Revenue Regulations (RR) No. 13-98. Furthermore, the financial statements of A Co. show that it is a profit-oriented enterprise since it collects internship fees, accreditation fees, annual dues and other contributions for its services.

2. No. Under Section 101(A)(3) of the Tax Code, donations to an accredited research institution may be exempt from the donor's tax, provided that not more than 30% of those donations shall be used for administration purposes. A Co.'s administrative expenses from 2010 to 2012 exceeded 30% of its revenues collected for the same years.

The transfer of properties by the PCGG to private individuals in a sale at public auction is exempt from income tax, WT, VAT, DST and CGT.

BIR Ruling No. 360-2014 dated September 22, 2014

Facts:

In BIR Ruling No. 185-2013, the BIR ruled that the transfer of properties by the Presidential Commission on Good Government (PCGG) to private individuals in a sale at public auction is exempt from income tax, WT, VAT and DST. The ruling was issued pursuant to a Supreme Court decision which held that the Republic of the Philippines is the presumptive owner for taxation purposes of certain surrendered properties, and thus, the disposal of the properties to private individuals through public bidding is exempt from the aforementioned taxes. The PCGG filed a request for a supplemental ruling to extend the exemption granted under BIR Ruling No. 185-2013 to include exemption from CGT.

Issue:

Is the transfer of properties by the PCGG to private individuals in a sale at public auction exempt from CGT?

Ruling:

Yes. Section 32(B)(7)(b) of the Tax Code expressly excludes from gross income, and exempts from income tax, income derived from the exercise of any essential governmental function accruing to the Government of the Philippines or to any of its political subdivisions. Since the subject properties are presumptively owned by the Republic of the Philippines, and the PCGG is mandated by law to dispose of these properties, the sale at public auction of these properties is exempt from income tax, WT, VAT, DST, and CGT.

During liquidation, the transfer of property by the dissolving corporation to its stockholders by way of liquidating dividend is not a sale subject to income tax, CWT and DST. However, it is a deemed sale transaction for VAT purposes.

On the part of the stockholder, any liquidating gain shall be treated as a capital gain subject to the regular income tax rates under the Tax Code, and not to CGT. The liquidating gain shall be the difference between the adjusted cost basis of the shares and the FMV of the property received as liquidating dividends.

BIR Ruling No. 363-2014 dated September 22, 2014

Facts:

A Co., a domestic realty corporation, was dissolved via shortening of its corporate term. It executed a Deed of Assignment to transfer a parcel of land to its stockholder, Mr. X, as liquidating dividend.

Issues:

1. Is there a gain or loss on the part of A Co.?
2. Can there be capital gain or loss on the part of Mr. X?
3. Is the transfer subject to DST?
4. Is the transfer a "deemed sale transaction" for VAT purposes?

Ruling:

1. No. The transfer by a liquidating corporation of its assets to its stockholders in exchange for the surrender and cancellation of the shares held by the stockholders is not a sale, and therefore is exempt from corporate income taxes, creditable withholding tax and DST. Thus, a liquidating corporation does not realize gain or loss in a partial or complete liquidation. Conversely, a liquidating corporation is not subject to tax on its receipt of the shares surrendered by its shareholders pursuant to a partial or complete liquidation.

2. Yes. Under Section 73(A) of the Tax Code, as implemented by RR No. 6-2008, where a corporation distributes all of its assets in complete liquidation or dissolution, the gain realized or loss sustained by the stockholder shall be treated as capital gain or loss subject to regular income tax rates under the Tax Code, and not to the CGT on the sale of shares. The liquidating gain shall be the difference between the adjusted cost basis of the shares and the FMV of the property received as liquidating dividends.

3. No. Under Section 189 of RR No. 26, the distribution of assets of the corporation to its stockholders in liquidation of the business without consideration is viewed as a return of capital to the stockholders, therefore not subject to the DST imposed under Section 196 of the Tax Code.

4. Yes. Under Section 106(B)(4) of the Tax Code, transactions deemed sale include the retirement from or cessation of business, with respect to inventories of taxable goods existing as of such retirement and cessation. Thus, the conveyance of the real property as liquidating dividend is a "deemed sale transaction" subject to the 12% VAT.

BIR Issuances

RR No. 8-2014 amends the deadlines prescribed in Section 13 of RR No. 7-2014, requiring the affixture of internal revenue stamps on imported and locally manufactured cigarettes and the use of the Internal Revenue Stamp Integrated System.

Revenue Regulations No. 8-2014 dated October 1, 2014

- The transitory provisions under Section 13 of RR No. 7-2014 are amended as follows:

  "Sec. 13. *Transitory Provisions*. – The following transitory provisions shall be strictly observed:

  (a) xxx

  (b) xxx

  (c) No later than November 1, 2014, all locally manufactured packs of cigarettes shall be affixed with the internal revenue stamps prescribed by these Regulations.

  (d) xxx

  (e) Effective March 1, 2015, all locally manufactured cigarettes found in the market shall be affixed with the said stamps.

  No imported cigarettes shall be found in the market without the new stamps effective April 1, 2015; provided, however, that even prior to such date, imported cigarettes should bear either the old stamps or the new stamps.

  (f) xxx"

- RR No. 7-2014 shall take effect 15 days immediately after publication in a newspaper of general circulation.

(Editor's Note: RR No. 8-2014 was published in the Manila Bulletin *on October 17, 2014.)*

RMC No. 77-2014 clarifies certain requirements on the processing of applications for cash conversion of TCCs.

Revenue Memorandum Circular No. 77-2014 dated September 15, 2014

- All applications for cash conversion of Tax Credit certificates (TCCs) which have been filed with the concerned revenue office that issued the same, prior to the expiration of the validity period indicated on the face of the TCC, shall no longer be required to be revalidated for purposes of continuing the process for cash conversion.
- Revalidation only applies to TCCs with validity periods that are about to expire and which have to be revalidated because the holder has to apply the unutilized portion thereof on its/his/her tax liabilities.
- The processing of all applications for cash conversion of TCCs which were filed prior to, and were pending as of, the expiration of its validity period shall proceed accordingly, whether for verification, approval or for payment, without the need of revalidation.

BOC Issuances

CMO No. 19-2014 repeals CMO No. 18-2014 on the guidelines on lifting an order of abandonment.

Customs Memorandum Order No. 19-2014, dated October 7, 2014

- CMO No. 19-2014 repeals CMO No. 18-2014, which lays down the guidelines on lifting an order of abandonment, in response to legitimate concerns on the practicality of its implementation.
- Requests for lifting of abandonment should be made in accordance with procedures existing prior to the issuance of CMO No. 18-2014.
- CMO No. 19-2014 takes effect immediately.

CMO No. 21-2014 prescribes the procedures for the issuance and lifting of alert orders for formal entries filed in the electronic to mobile (e2m) System.

Customs Memorandum Order No. 21-2014, dated October 8, 2014

- *General Principles*

1. No shipments may be held by any Customs official for any reason, except if the shipment is the subject of an Alert Order issued in accordance with this CMO.

2. Except for shipments tagged "red" by the Risk Management Office and shipments subject to spot-check upon orders of District Collector, no shipments may be physically examined, except if the shipment is the subject of an Alert Order.

3. An Alert Order shall be issued under any of the following categories:

    - The government surveyor's seal on the container has been tampered with or broken, or the container shows signs of having been opened or having its identity changed;
    - The container is leaking or damaged;
    - The number, weight, and nature of packages indicated in the customs entry declaration and supporting documents differ from that in the manifest;
    - The importer disagrees with the findings as contained in the government surveyor's report;
    - The articles are imported through air freight where the Commissioner or Collector has knowledge that there is a variance between declared and true quantity, measurement, weight and tariff classification.

4. Once an Alert Order is issued on a shipment, that shipment may not be released except in accordance with the procedures outlined in this CMO.

5. The owner of a shipment has the right (i) to know whether an Alert Order has been issued on his or her shipment; and (ii) to a speedy disposition of any Alert Order issued on his or her shipment.

6. The public has a right to know about any Alert Order for which a shipment, or part of a shipment, was seized or charged additional duties, taxes, and/or penalties.

- *Who can issue and lift an Alert Order*

  1. Alert Orders may only be issued by the following Alerting Officers:

     - The Commissioner
     - The Deputy Commissioner, Intelligence Group
     - The Deputy Commissioner, Enforcement Group
     - All District Collectors, for shipments arriving within their District

  2. Decisions on the final disposition of the Alert Order (including whether specific items shall be released without payment of additional duties, taxes and/or penalties, released with payment of additional duties, taxes and/or penalties, or seized) shall be made by the Alerting Officer who issued the Alert Order on a shipment.

  3. Neither the issuance nor the lifting of an Alert Order shall require prior authorization from the Commissioner.

  4. Subject to the written approval of the Commissioner, the power to issue an Alert Order, to tag a shipment as "recommend for lifting," and to tag a shipment as "recommend for additional payment," as well as to enter the additional amount to be paid, may be delegated by the other Alerting Officers. The delegation of powers is not intended to empower the persons to whom the powers were delegated to make decisions on Alert Orders, but only to assist the Alerting Officers in using the e2m system. Decisions to issue Alert Orders and on their disposition shall be made at all times by the Alerting Officers.

- *Procedure for issuing Alert Orders*

  1. An Alert Order must be issued through the Hold and Alert System in the e2m system, by filling in a new "Hold and Alert Application Form" and entering the required information.

  2. If, and only if, the e2m system is not accessible, shall the Alerting Officer issue the Alert Order manually. As soon as possible, an Alert Order must also be issued in the e2m.

- *Tentative Liquidation and Payment Under Protest for Shipments under Alert Orders*

  1. Tentative liquidation and payments under protest may only be used to secure release of shipments under an Alert Order if, after examination, there is no undervaluation, misdeclaration in weight, measurement or quantity of more than 30% between the value, weight, measurement or quantity declared in the entry.

- *Sanction for Non-Compliance*

    1. Holding of any shipment without going through the process in this CMO shall be a Grave Offense and shall be punishable upon first offense by dismissal.

    2. Non-compliance with any provision in this CMO shall be an incidence of Simple Neglect of Duty, and shall be punishable upon second offense by dismissal.

- *Effectivity and Repealing Clauses*

    1. CMO No. 21-2014 shall take effect on November 3, 2014, and shall cover only formal entries processed through e2m.

    2. CMO Nos. 92-91 and 104-92 shall continue to apply for informal entries and manually processed formal entries.

CMO No. 22-2014 prescribes the rules on tagging of arrival and date of last discharge in e2m for all vessel and aircraft arrivals.

Customs Memorandum Order No. 22-2014, dated October 9, 2014

- Every port and sub-port shall have a responsible officer who must tag the arrival and discharge of shipments in the e2m system for every vessel or aircraft which arrives in that port or sub-port. The responsible officer may either be:

    1. Head of the Piers Inspection Division;
    2. Head of the Port Operations Division, Bay Service Division, Aircraft Operations Division, or other analogous units;
    3. Person designated by the District Collector or Sub-Port Collector; or
    4. In the absence of the above, the District Collector or Sub-Port Collector.

- Within three hours upon arrival, the responsible officer shall tag the registry number for a vessel or aircraft arrival as "arrived" in the e2m system.

- Within three hours of the completion of discharge of shipments, the responsible officer shall update the "date of last discharge" in the e2m system for the registry number of the vessel or aircraft arrival to the correct date.

- As a transitory provision, by October 31, 2014, responsible officers should tag all vessel or aircraft arrivals from October 1, 2014 as "arrived" in the e2m system. They should also verify and correct, if necessary, the date of last discharge in the e2m system. This shall be effective immediately.

- CMO 22-2014 shall take effect on November 1, 2014, except for the transitory provision, which is effective immediately.

PEZA Issuances

PEZA informs PEZA-registered enterprises of their exemption from FPA regulations on the importation of fertilizers, pesticides and other agrochemicals intended for industrial use.

PEZA Memorandum Order No. 2014 – 027 dated October 13, 2014

- FPA only regulates agricultural users of fertilizers and agrichemicals.
- PEZA-registered enterprises who are industrial users of fertilizers, pesticides and agrochemicals (e.g., urea, potash) are exempted from securing FPA permits. PEZA will readily approve the import permit of the industrial users of these chemicals but will require agricultural users to secure the FPA clearance prior to importation.
- PEZA has informed the Bureau of Customs of the said exemption.

PEZA suspends field inspection and other site visits of developers' and locator-enterprises' facilities during the holiday season from 24 November 2014 to 09 January 2015.

PEZA Memorandum Order No. 2014 – 028 dated October 22, 2014

- All PEZA engineers, building officials, enterprise service officers, environmental safety specialists, police officers, fire officers, and labor officers are directed to suspend inspection of buildings, machinery and equipment, other engineering/environmental-related facilities, including fire, labor, security and other industrial safety facilities and installations of developers and locator-enterprises. The prohibition also covers examination of accounting and other financial records, production/manufacturing documents and materials inventory.

- The prohibition is intended to isolate ecozone and IT parks enterprises and other clients from unnecessary and unwanted distractions during the season as well as to forestall any inappropriate perception by PEZA clients in the zone.

- In very exceptional cases, however, only critical inspections may be allowed for purposes of issuing original occupancy permits and/or permits to operate. Likewise, meetings and mediations between labor and management may be allowed only at the office of the Zone Administrator/Manager/ Officer-in-Charge in the presence of these zone officials. In such cases, only the Director General is authorized to issue and approve travel orders for the purpose.

BSP Issuances

Circular No. 851 amends the rules on interlocking positions.

BSP Circular No. 851 dated September 30, 2014

- Section X145 of the Manual of Regulations for Banks (MORB) on interlocking directorship and/or officerships is amended as follows:

  "c. Interlocking Officerships

  xxx

  As a general rule, there shall be no concurrent officerships, including secondment, between banks or, between a bank and a QB or an NBFI. xxx

  xxx

  However, subject to prior approval of the Monetary Board, concurrent officerships, including secondments may be allowed in the following cases:

  xxx

  (5) Concurrent officership positions as corporate secretary or assistant corporate secretary between bank/s, QB/s and NBFI/s, other than investment house/s, outside of those covered under item c (4) of this section: *Provided,* that proof of disclosure to and consent from all of the involved FIs, on the concurrent officership positions, shall be submitted to the BSP.

  xxx"

- Sections 4145Q and 4140N of the Manual of Regulations for Non-Bank Financial Institutions (MORNBFI) are amended as follows:

  "c. Interlocking Officerships

  xxx

  As a general rule, there shall be no concurrent officerships, including secondments, between QBs or between a QB and a bank or between a QB and an NBFI. xxx

  xxx

  However, subject to prior approval of the Monetary Board, concurrent officerships, including secondments may be allowed in the following cases:

  xxx

  (6) Concurrent officership positions in the same capacity which do not involve management functions, i.e., internal auditors, corporate secretary, assistant corporate secretary and security officer, between a QB and one (1) or more of its subsidiary QB/s and NBFI/s, or between a bank and one (1) or more of its subsidiary QBs and NBFIs, or between QB/s and/or NBFI/s or between bank/s, QB/s and NBFI/s, other than investment house/s: *Provided,* That in the last two instances, at least twenty (20%) of the equity of each of the banks, QBs and NBFIs is owned by a holding company or by any of the banks/QBs within the group.

  (7) Concurrent officership positions as corporate secretary or assistant corporate secretary between QB/s and/or NBFI/s or between bank/s, QB/s and NBFI/s, other than IH/s, outside of those covered by item c (6) of this section: Provided, That proof of disclosure to and consent from all of the involved FIs, on the concurrent officership positions, shall be submitted to the BSP.

  xxx"

- This Circular shall take effect 15 days after publication in the Official Gazette or in a newspaper of general circulation.

[Editor's Note: Circular No. 851 was published in The Manila Times *on October 8, 2014.]*

Circular No. 852 amends Sections X410 and 4410Q of the MORB and MORNBFI to enhance the disclosure requirements of UITFs and to clarify certain features of the target fund of a fund-of-funds/ feeder fund UITF.

BSP Circular No. 852 dated October 21, 2014

- The Key Information and Investment Disclosure Statement shall contain the key features and the prospective and outstanding investments of a Unit Investment Trust Fund (UITF). It shall use plain language presented in a concise manner, and shall comply substantially with the format prescribed in Appendix 62/Q-34. This document shall be updated and made available to participants at least every calendar quarter.

- On the distribution of investment units, the trustee may issue such conditions or rules as may affect the distribution of investment units subject to the minimum conditions enumerated below.

  (1) All marketing materials related to the sale of a UIT Fund shall clearly state:

  - The designated name and classification of the fund, the fund's trustee, and the classes of a UITF, if any.

  - Minimum information regarding:

    a. The general investment policy and applicable risk profile. There shall be a clear description/explanation of the general risks attendant to investing in a UITF, including risk specific to a type of fund. Technical terms should likewise be defined in laymen's terms.
    b. Particulars including administrative and marketing details, such as but not limited to, pricing, cut-off time for participation and redemption, early redemption penalty or penalties, and any special features of the UITF, as applicable.
    c. All charges made/to be made against the fund or class of a UITF, including trust fees and other related charges.
    d. The availability of the Plan Rules governing the Fund, upon the client's request and the contact details of the trustee.
    e. Client and product suitability standards.

  (2) With respect to Evidence of Participation, every UITF participant shall be provided with a Risk disclosure statement, which, in reference to Subsection X410.6c, shall describe the attendant general and specific risks that may arise from investing in the UITF. This statement shall be accomplished by the client every time he participates in a different fund and shall be substantially in the form as shown in Annex A of Appendix 62a/Q-34a.

- The Circular also prescribes the guidelines in preparing the key information and investment disclosure statement for UITFs.

- This Circular shall take effect 15 days after publication in the Official Gazette or in a newspaper of general circulation in the Philippines except for the amendments to Appendix 62/Q34 of the MORB/MORNBFI which shall take effect starting the reporting period ending 31 December 2014.

[Editor's Note: Circular No. 852 was published in The Philippine Star *on October 25, 2014.]*

Circular No. 853 amends Subsections X410 and 4410Q of the MORB and MORNBFI, respectively, to allow for the creation of Multi-Class UITFs.

BSP Circular No. 853 dated October 21, 2014

- A Multi-class Fund is a UITF structure which has more than one class of units in the fund and is invested in the same pool of securities and the same portfolio, investment objectives and policies.

- Subsections X410.2 and 4410Q.2 provide for the establishment of a UITF. A UITF may be allowed to operate as a 1) feeder fund, 2) fund-of-funds and/or 3) multi-class fund; provided, that the plan rules and related documents shall state that the UITF is a feeder fund, fund-of funds, and/or multi-class fund, and provides an explanation or illustration of such structures.

- Subsections X410.5/4410Q.5 provide for the operation and accounting methodology.

- This Circular shall take effect 15 days after publication in the Official Gazette or in a newspaper of general circulation in the Philippines.

[Editor's Note: Circular No. 853 was published in The Philippine Star *on October 25, 2014.]*

SEC Opinions

SEC-OGC Opinion No. 14-26 dated September 30, 2014

A tourism enterprise which complies with the export percentage and three-year projection requirements under the Foreign Investments Act of 1991 (FIA) may apply for a license to do business in the Philippines as an export enterprise.

Facts:

A Co. is a corporation and tour operator based in South Africa. A Co. provides hotel bookings, tours and travel-planning services to individuals and businesses. A Co seeks to establish a branch office in the Philippines to provide its foreign tourists with the convenience to pay for their accommodation during their stay in the Philippines, paying local suppliers in the Philippines easily and hiring personnel in the Philippines to give reliable information about the Philippines for A Co.'s foreign customers.

Issue:

Will the proposed services qualify A Co.-Philippine Branch as an "export market enterprise" under the FIA?

Ruling:

Yes. If A Co. complies with the export percentage and three-year projection requirements under the FIA, it may apply for a license to do business in the Philippines under the category of export enterprise.

The FIA defines an "export enterprise" to mean an enterprise wherein a service, including tourism, enterprise exports 60% or more of its output. For this purpose, the Tourism Act of 2009 defines "tourism enterprise" as one referring to facilities, services and attractions involved in tourism such as, but not limited to travel and tour services.

In addition, as required in the Application of a Foreign Corporation to Establish a Branch Office in the Philippines (SEC Form No. F-103), the applicant should include the projected sales volume or value for both domestic and export sales for at least three years, as well as its undertaking to export at least 60% of its output as projected.

SEC-OGC Opinion No. 14-27 dated October 2, 2014

A corporation engaged in overseas construction projects or private construction contracts may be wholly-owned by foreign nationals, provided its paid-in equity capital is not less than the equivalent of USD200,000 and it does not undertake other nationalized or partly nationalized activities.

Facts:

W Co. is a domestic corporation primarily engaged in the construction business pursuant to its primary purpose under its Articles of Incorporation. W Co. intends to undertake overseas construction projects and proposes to register with the Philippine Overseas Construction Board.

W Co. is 60% owned by a Filipino corporation and 40% by British nationals.

Issue:

Can construction corporations engaged in overseas construction projects or private construction contracts be wholly-owned by foreign nationals?

Ruling:

A construction corporation engaged in overseas construction projects or private construction contracts is not subject to the limitations on foreign ownership, and it can be majority-owned by foreign nationals, provided it is not engaged in any of the industries indicated in the current Foreign Investments Negative List (FINL) and the minimum capitalization requirement therein is satisfied. Private construction contracts used to be included in List A of the FINL with 40% foreign equity limitation. However, in the current FINL, said economic activity is no longer included.

However, a corporation engaged in private construction may be covered by the foreign equity restrictions for domestic market enterprises. Under the FIA, domestic market enterprises, with paid-in equity capital of less than the equivalent of USD200,000 are restricted to a maximum of 40% foreign equity.

Court Decisions

Commissioner of Internal Revenue vs. Pilipinas Shell Petroleum Corporation
Supreme Court (Third Division), G.R. No. 192398 promulgated September 29, 2014

The transfer of real property by an absorbed corporation to the surviving corporation pursuant to a merger is not subject to DST under Section 196 of the Tax Code. Section 196 imposes the DST on the transfer of realty by way of a sale and for a consideration, and does not apply to all conveyances of real property.

Facts:

Pilipinas Shell Petroleum Corporation (PSPC) entered into a Plan of Merger with its affiliate, Shell Philippines Petroleum Corporation (SPPC), whereby the entire assets and liabilities of SPPC will be transferred to, and absorbed by, PSPC as the surviving entity. Pursuant to the merger, the shareholders of SPPC shall surrender their shares of stock in SPPC in exchange for shares of stock of PSPC. PSPC paid to the BIR the DST on its original issuance of shares in exchange for the surrendered SPPC shares.

In a ruling, the BIR confirmed the tax-free treatment of the merger under Section 40(C)(2) and (6)(b) of the Tax Code, and held that no gain or loss shall be recognized if, pursuant to a plan of merger, a shareholder exchanges stock in a corporation which is a party to the merger or consolidation solely for the stock of another corporation which is also a party to the merger or consolidation.

However, the BIR ruled that the issuance by PSPC of shares of stock to the shareholders of SPPC in exchange for the surrendered certificates of stock of SPPC shall be subject to documentary stamps tax (DST) under Section 175 of the Tax Code. The BIR also ruled that the transfer of land and improvements by SPPC to PSPC in exchange for the latter's shares of stock shall be subject to DST imposed under Section 196 of the Tax Code.

PSPC paid the DST on the transfer of real property from SPPC. Subsequently, believing it erroneously paid the DST, PSPC filed with the BIR a claim for refund or tax credit of the DST erroneously paid on the transfer of real property. As the BIR failed to act on the claim, PSPC filed a Petition for Review with the Court of Tax Appeals (CTA).

The CTA ruled that the transfer of real property from the absorbed corporation to the surviving corporation pursuant to a merger or consolidation is not subject to DST under Section 196 of the Tax Code. The Commissioner of Internal Revenue (CIR) appealed to the Court of Appeals, which affirmed the decision of the CTA. The CIR appealed to the Supreme Court.

Issue:

Is the transfer of real property by SPPC to PSPC pursuant to a merger subject to DST?

Ruling:

No, the transfer of real property by SPPC to PSPC pursuant to a merger is not subject to DST.

Section 196 of the Tax Code imposes DST on all conveyances, deeds, instruments or writings whereby land or realty sold shall be conveyed to the purchaser. DST is imposed on the transfer of realty by way of sale, and for a consideration, and does not apply to all conveyances of real property. The fact that Section 196 refers to the words "sold," "purchaser" and "consideration" undoubtedly leads to the conclusion that only sales of real property are contemplated to be taxed under Section 196.

In a merger, the real properties are not deemed "sold" to the surviving corporation and the latter could not be considered as a "purchaser" of realty since the real properties subject of the merger were merely absorbed by the surviving corporation by operation of law. In a merger, the properties are deemed automatically transferred to, and vested in, the surviving corporation without further act or deed.

Section 185 of Revenue Regulations No. 26, otherwise known as the DST Regulations, provides that conveyances of realty, not in connection with a sale, to trustees or other persons without consideration are not taxable.

DST is in the nature of an excise tax because it is imposed upon the privilege, opportunity or facility offered at exchanges for the transaction of the business. DST is a tax on documents, instruments, loan agreements, and papers evidencing the acceptance, assignment, or transfer of an obligation, right or property incident thereto. DST is, thus, imposed on the exercise of these privileges through the execution of specific instruments, independently of the legal status of the transactions giving rise thereto. Thus, the transfer of real properties from SPPC to PSPC is not subject to DST considering that the same was not conveyed to or vested in PSPC by means of any specific deed, instrument or writing. There was no deed of assignment and transfer separately executed by the parties for the conveyance of the real properties. The conveyance of real properties not being embodied in a separate instrument but is incorporated in the merger plan.

Moreover, Republic Act No. 9243 entitled "An Act Rationalizing the Provisions of the DST of the NIRC", which took effect on April 27, 2004, exempts the transfer of real property of a corporation which is party to the merger or consolidation, to another corporation which is also a party to the merger or consolidation, from the payment of DST. This law removes any doubt and had made clear that the transfer of real properties as a consequence of merger or consolidation is not subject to DST.

Goodwill is connected to the business itself and cannot be allocated without regard to the business.

The sale of a business through a spin-off of the assets to a new company (Newco) and subsequent sale of the Newco shares is a capital transaction subject to CGT. The resulting transfer of goodwill may not be treated as a separate transaction subject to corporate income tax.

The Hongkong and Shanghai Banking Corporation Limited – Philippine Branch vs. Commissioner of Internal Revenue
CTA (Third Division) Case 8428 promulgated October 13, 2014

Facts:

Prior to July 2008, Hongkong and Shanghai Banking Corporation Limited (HSBC) carried on in the Asia Pacific Region, including the Philippines, a Merchant Acquiring Business, whereby it entered into Merchant Agreements with accredited merchants to honor credit cards it issued under various card associations of which it is a member.

HSBC then created Global Payments Asia Pacific Phils., Inc. (GPAP-Philippines) to transfer its Merchant Acquiring Business in the Philippines. Thus, in July 2008, GPAP-Philippines was incorporated whereby shares of stock were issued to HSBC-Philippine Branch in exchange for the Fair Market Value (FMV) of HSBC's Point of Sale (POS) Terminals, Merchant Agreements, and Merchant Acquiring Business. In a ruling dated January 23, 2009, the BIR confirmed that the transfer of the Merchant Acquiring Business in exchange for GPAP-Philippines shares is not subject to tax under Section 40 (C)(2) of the Tax Code.

Subsequently, HSBC and Global Payments Asia Pacific (Singapore Holdings) Private Limited (GPAP-Singapore) executed a Share Sale and Purchase Agreement covering the transfer of HSBC's GPAP-Philippines shares. The HSBC-Philippine Branch and GPAP-Singapore also executed a Deed of Assignment whereby the former transferred and assigned to the latter the GPAP-Philippines shares. The HSBC-Philippine Branch paid capital gains tax (CGT) on the transfer of the GPAP-Philippines shares.

On June 28, 2011, the CIR issued a Final Assessment Notice (FAN) against the HSBC-Philippine Branch for deficiency income tax arising from alleged gain on the sale of the Merchant Acquiring Business. The CIR argued that there was a sale of "goodwill" (difference between the aggregate consideration agreed in the Share Sale and Purchase Agreement and the total par value of the GPAP-Philippines shares) arising from the transfer of the Merchant Acquiring Business that is subject to the 35% (now 30%) corporate income tax. The HSBC-Philippine Branch protested the assessment. The CIR denied the protest and issued the Final Decision on Disputed Assessment.

At the CTA, the BIR alleged that the additional paid-in capital (APIC) account was used as a scheme to book the amount of goodwill in the financial statements of GPAP-Philippines and concluded that the Share Sale and Purchase Agreement is not just a sale of the GPAP-Philippines shares but also includes the sale of goodwill.

Issue:

Is HSBC-Philippine Branch liable for deficiency income tax on the transfer of goodwill arising from the sale of the Merchant Acquiring Business?

Ruling:

No.

The transaction involves the transfer of a capital asset and not a sale of an ordinary asset. A careful perusal and evaluation of the surrounding circumstances must be made to determine whether a property is a capital or ordinary asset. It is well-settled that a capital gain (or a capital loss) normally requires the concurrence of two conditions: (1) there is a sale or exchange; and (2) the thing sold or exchanged is a capital asset.

The creation of GPAP-Philippines to transfer the Merchant Acquiring Business of HSBC by way of APIC; the subscription of substantially all the shares of stock of GPAP-Philippines in exchange for HSBC's POS terminals; the subscription to one common share of GPAP-Philippines in exchange for HSBC's Merchant Agreements; and the subsequent assignment of the GPAP- Philippines shares subscribed by HSBC to GPAP-Singapore clearly show that the transaction is a sale of a capital asset under Section 39(A)(1) of the Tax Code, as amended, on which the HSBC Philippine Branch paid the CGT.

HSBC's main objective was to transfer the Merchant Acquiring Business to GPAP-Philippines, and not merely the sale of the goodwill thereof. The goodwill necessarily attaches to the transfer of the business. Goodwill is connected to the business itself, and cannot be allocated without regard to the business. Thus, the alleged sale of goodwill as APIC cannot be treated separately. The total consideration in the Share Sale and Purchase Agreement cannot be conveniently allocated and reclassified to accommodate the CIR's allegations that there was deficiency income tax.

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