Tax Bulletin

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- No gain or loss shall be recognized on the transfer by a person of property to a corporation in exchange for stock, where as a result the transferor together with others not exceeding four persons, gains control of the transferee corporation.

  A prior BIR ruling is not required for transactions covered by Section 40 (C) (2) of the Tax Code to be exempt from tax. **(Page 14)**

BIR Rulings

Investment earnings of a retirement fund may be exempt from income tax, subject to compliance with certain conditions.

BIR Ruling No. 203-2017 dated 20 April 2017

Facts:

ABC Provident Plan earned income from investments, specifically from government securities issued by the Bureau of Treasury. No part of the earnings were used for or diverted to purposes other than for the exclusive benefit of the member-employees/officials or their beneficiaries.

Issue:

Are the earnings from investments of a retirement fund exempt from income tax?

Ruling:

Yes. Under Section 60 (B) of the Tax Code, earnings from investments, including those from the government securities issued by the Bureau of Treasury, may be exempt from income tax if the following conditions are met: (1) the contributions are made to the trust by the employer, or employees, or both; (2) such contributions are made for the purpose of distributing to such employees

the earnings and principal of the fund accumulated by the trust in accordance with such plan; and (3) under the trust instrument, it is impossible (in the taxable year and at any time thereafter prior to the satisfaction of all liabilities with respect to employees under the trust) for any part of the corpus or income to be used for or diverted to purposes other than for the exclusive benefit of the employees. Considering that ABC Provident Plan has met the above conditions, its earnings from investments are exempt from income tax.

BIR Ruling No. 212-2017 dated 24 April 2017

The importation of passenger or cargo vessels for domestic transport operations is exempt from VAT, subject to the requirements on restriction on vessel importation and mandatory vessel retirement program of the MARINA.

Facts:

A Co., a domestic corporation, imported two units of cargo ships and one unit of general purpose ship, which will be used exclusively for its transport operation business. A Co. obtained the necessary clearance or authority to import the vessels from the MARINA.

Issue:

Is the importation of the vessels exempt from VAT?

Ruling:

Yes. Pursuant to Section 109 (1) (T) of the Tax Code, the importation of a cargo vessel destined for domestic or international transport operations shall be exempt from VAT. Moreover, Section 4.109-1 (B) (1) (t) of RR No. 16-2005, as amended, which implements such cited Section 109 (1) (T), provides that the importation must comply with the requirements on restriction on vessel importation and mandatory vessel retirement program of the MARINA. Considering that A Co. obtained the necessary clearance and authority from the MARINA, its importation is exempt from VAT.

BIR Ruling No. 221-2017 dated 12 May 2017

The importation of agricultural products in their original state is exempt from VAT.

Facts:

B Co., a domestic corporation, imports and sells fresh mushrooms in their original state.

Issue:

Is the importation exempt from VAT?

Ruling:

Yes. Under Section 109 (1) (A) of the Tax Code, the sale or importation of agricultural products in their original state shall be exempt from VAT. Since fresh mushrooms are considered agricultural products in their original state, their importation is exempt from VAT.

BIR Issuances

RMO No. 12-2017 prescribes the guidelines and procedures to streamline the process and issuance of the CTE and eCAR on the transfers of raw lands to community/homeowners associations for socialized housing projects under RA No. 7279, otherwise known as the Urban Development and Housing Act of 1992.

RMO No. 12-2017 issued on 16 May 2017

- This RMO is applicable only to transfer of raw lands to the Community/ Homeowners Associations covered under the Community Mortgage Program (CMP) of RA No. 7279, as duly certified by the Social Housing Finance Corporation (SHFC).
- The application for the issuance of CTE shall be filed directly with the Office of the Commissioner and shall be processed only upon submission of all the following documents:

    1. Original certification signed by the SHFC President that the subject property qualifies and is actually a CMP Project;
    2. Certified true copy of the Deed of Sale executed by the landowner in favor of the Community/ Homeowners Association;
    3. Certified true copy of the Master List of Beneficiaries;
    4. Certified true copy of the Transfer Certificate of Title/ Original Certificate of Title and latest Tax Declaration of the property; and
    5. Extrajudicial Settlement of Estate, if title of the property is still in the name of a deceased landowner, together with proof of payment of appropriate taxes.

- Within 5 working days from the date of submission of the CTE, the concerned Revenue District Office (RDO) shall process and issue the necessary eCAR.
- No other document shall be required from the taxpayer/ landowner requesting for the issuance of an eCAR.
- The eCAR shall state that the raw land is covered by the CMP pursuant to RA No. 7279, with a lien on the title of the land annotated by the Register of Deeds having jurisdiction over the properties, to the effect that the same is to be applied or is being applied to a socialized housing project.
- A post-audit evaluation and verification may be conducted any time by the BIR in order to determine whether the raw land is actually covered under the CMP pursuant to RA No. 7279.

RMC No. 36-2017 prescribes the new BIR accountable form numbers and names for Certificates of Availment/ Approval and Notice of Denial in relation to Applications for Compromise Settlement and/or Abatement of Penalties.

RMC No. 36-2017 issued on 3 May 2017

- Pursuant to RMO No. 3-2017, the following are the new BIR accountable form numbers and names for the Certificate of Availment/Approval and Notice of Denial in relation to the Application for Compromise Settlement and/or Abatement of Penalties:

BIR Accountable Form No.	Form Name
2342	Certificate of Availment – Compromise Settlement
2343	Certificate of Availment – Abatement of Penalties
0427	Notice of Denial – Application for Compromise Settlement
0428	Notice of Denial – Application for Abatement of Penalties

- The above forms shall be accomplished in 3 copies to be distributed as follows: 1) Original – Taxpayer's Copy; 2) Duplicate – Copy of the Issuing Office; and 3) Triplicate – To be attached to the docket of the case.

BSP Issuances

Circular No. 958 provides for the Amendments to Items 4.1.2 to 4.2.4 of Appendices 75f and Q-59f of the MORB and MORNBFI, as well as to Subsection X177.9 of MORB and Subsections 4177Q.9, 4196S.9, 4193P.9 and 4196N.9 of MORNBFI-Authentication Controls.

BSP Circular No. 958 dated 25 April 2017

- The amendments to Appendices 75f and Q-59f of MORB and MORNBFI, respectively, and amendments to Subsection X177.9 of MORB, and Subsections 4177Q.9, 4196S.9, 4193P.9 and 4196N.9 of the MORNBFI were made in response to the increasing propensity and sophistication of cyber attacks involving fund transfers, payments, and other transactions via online channels. These amendments align existing regulations, to the extent possible, with leading standards and recognized principles on customer authentication.

- Item 4.1.2 of Appendix 75f and Q-59f of the MORB and MORNBFI, respectively, provide that the BSP-Supervised Financial Institution (BSFI) should use reliable and appropriate authentication methods to validate and verify the identity and authorization of customers.

- Authentication is facilitated by the use of factors, which are generally classified into three basic groups:

    1. Knowledge - Something the user knows (e.g., username, password, mobile PIN, card number, account number);

    2. Possession - Something the user has (e.g., payment card, token, one-time password); and

    3. Inherence - Something the user is (e.g., biometrics).

- The same items provide that BSFIs should adopt multi-factor authentication (MFA) or use a minimum of two factors in online transactions where the risk of compromise is heightened.

- These also provide that for transactions that do not require real-time or near real-time authentication/authorization, BSFIs may also opt to use positive confirmation in lieu of MFA. Positive confirmation refers to any form of communication that will enable the BSFI to timely and accurately verify the identity of the requesting customer.

- Items 4.1.3 to 4.2.4 of Appendices 75f and Q-59f of the MORB and MORNBFI, respectively, are amended by this Circular.

- All references to BSI in the following sections shall be changed to BSFI:

    1. Section X177 and its subsections and the related appendices of the MORB; and

    2. Sections 4177Q, 4196S, 4193P, and 4196N and their subsections and the related appendices of the MORNBFI.

- Subsection X177.9 of the MORB which provides for sanctions and penalties is amended by this Circular.

- Subsections 4177Q.9/41965.9/4193P.9/4196N.9 of the MORNBFI which provide for sanctions and penalties are also amended by this Circular.

- The following provision shall be incorporated as a footnote to Item 4.1.2 of Appendices 75f and Q-59f of the MORB and MORNBFI, respectively:

  BSFIs shall comply with the foregoing requirements on customer authentication by 30 September 2017. In this regard, a BSFI should be able to show its plan of actions with specific timelines, as well as the status of initiatives being undertaken to fully comply with the provisions of Item 4.1.2 of *Appendices 75f and Q-59f* of the MORB and MORNBFI, respectively, upon request of the Bangko Sentral starting May 2017. This transitory period, however, should not excuse BSFIs from immediately complying with the MFA requirements imposed by affiliated payment networks.

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

[Editor's Note: Circular 958 was published in The Manila Standard *on 4 May 2017.]*

Circular No. 959 provides for the Amendment of BSP Circular No. 939, dated 12 January 2017 - Extension of the Deadline for Submission of NDS Banknotes in the Custody of Authorized Agent Banks.

BSP Circular No. 959 dated 25 April 2017

- The following are the amendments to items 1 and 2 of BSP Circular No. 939, dated 12 January 2017:

  1. All head offices and branches of authorized agent banks (AABs) are required to accept/exchange/replace NDS banknotes from the general public, clients or non-clients, until **30 June 2017**.

  2. AABs may submit the NDS banknotes in their custody as of 30 June 2017 to the BSP-Cash Department or any of the BSP regional offices/branches not later than the close of business hours on **30 September 2017**. The submission of AABs shall be accompanied by a duly accomplished BSP form for exchange/deposit of banks.

- This Circular shall be effective immediately.

[Editor's Note: BSP Circular No. 959, s. 2017 was published in the Manila Bulletin *on 5 May 2017.]*

Circular No. 960 provides for the Investment in Readily Marketable Bonds and Other Debt Securities.

BSP Circular No. 960 dated 4 May 2017

- Pursuant to Monetary Board Resolution No. 623 dated 11 April 2017, allowing rural and cooperative banks to invest in readily marketable bonds and other debt securities without prior Bangko Sentral approval subject to compliance with certain requirements, the following provisions of the Manual of Regulations for Banks (MORB) are hereby amended.

- Section X101 is amended to include in the powers and scope of authority of Rural Banks (RBs) the power to acquire readily marketable bonds and other debt securities without prior approval of the Monetary Board. The same section is also amended to include in the powers and scope of authority of Cooperative Banks (Coop Banks) the power to acquire readily marketable bonds and other debts securities without prior approval of the Monetary Board.

- Subsection X388.5 is amended to provide for investment in readily marketable bonds and other debt securities by RBs and Coop Banks provided that these shall comply with the prudential criteria enumerated under Subsection X1101.2 of the MORB. In addition to the said criteria, the investment shall not be held for trading purposes.

- Subsection X191.4 is added to provide the guidelines on the accounting treatment of financial securities that shall be in accordance with the guidelines in *Appendices 33 and 33a of the MORB*.

- The provisions on penalties and sanctions under Subsection X191.3 are hereby transferred to a new Subsection, X191.5 to provide for penalties and sanctions that shall be imposed on BSP-Supervised Financial Institutions (BSFIs) and concerned officers found to violate the provisions of *Appendices 33, 33a and 97*.

- The titles of *Appendices 33, 33a and 97* are hereby amended to properly indicate the relevant subsection of the MORB to which they pertain.

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

[Editor's Note: Circular No. 960, s. 2017 was published in the Business Mirror *on 10 May 2017.]*

SEC Issuances

SEC MC No. 8 provides for the authorized signatories and penalties for late or non-submission of the MCG of Publicly Listed Companies.

SEC Memorandum Circular No. 8 dated 20 April 2017

Further to SEC MC No. 19-2016, which provides for the Code of Corporate Governance for Publicly-listed companies, the Commission *En Banc* has resolved that the signatories to the Manual on Corporate Governance (MCG) should be the Chairman of the Board and Compliance Officer. The Commission also resolved to impose basic and monthly penalties for the late/non-submission of the MCG.

[Editor's Note: SEC MC No.8 was published in The Philippine Star *and* The Manila Times *on 11 May 2017.]*

A contractor of public utility companies is covered by the 40% limit on foreign equity participation mandated by the Constitution and the Foreign Investment Negative List.

SEC-OGC Opinion No. 17-04 dated 10 May 2017

Facts:

D Corp., a 100% foreign-owned company, is engaged in providing ground handling services to private airlines. It claims that its business does not constitute an operation of a public utility for purposes of applying the 40% maximum foreign equity in public utilities as mandated by the 1987 Constitution. D Corp. argues that, as a contractor, it does not deal directly with the public (i.e. passengers). The liability for loss of baggage remains with the airline companies. It further avers that ground handling services is not one of those enumerated services defined as public utility under the Public Service Act, nor it is listed in the Tenth Regular Foreign Investment Negative List (FINL-10).

Issue:

May a contractor of airline companies be considered a public utility?

Held:

Yes. In DOJ Opinion No. 074, Series of 1998, the Secretary of Justice concluded that *"port service contractors and port facility operators, although mere contractors of the Philippine Ports Authority (PPA), in the execution of their respective contracts and undertakings with the PPA, aid the latter in the fulfillment of the PPA's mandate to provide services within the Port Districts and approaches thereof. This arrangement places the port service contractors and port facility operators under the category of public utility."* Applying the same rationale, ground handling services (which include both aircraft movement and baggage handling) are activities essential to airport operations and are considered included in the business of public utilities. The contractors who are actually aiding the airline companies in carrying out these services are likewise considered public utility companies.

Furthermore, on the argument that ground handling services is not in the FINL-10, an activity need not be expressly named in the FINL to be considered covered by the Negative List because the determining factor is the *nature* and not the name of the business.

Thus, being a wholly foreign-owned company, D. Corp. may not engage in the business of airport ground handling services.

PEZA Update

PEZA Memorandum Circular No. 2017-015 circularizes PNP Memorandum Circular No. 2017-11 or "Guidelines and Procedures for Accreditation of Logistics Providers, Brokers, Forwarders, Truckers, and Company-Owned Vehicles and FEO Nationwide Automation on the Transport of Chemicals."

PEZA Memorandum Circular No. 2017-015 dated 20 April 2017

- **Salient Features of PNP Memorandum Circular No. 2017-11**

    1. Logistics providers, brokers, forwarders, truckers, manufacturers, dealers, and purchasers with company-owned vehicles, engaged in the transport of PNP-controlled chemicals are required to seek mandatory PNP accreditation within 3 months from approval of PNP MC No. 2017-11 (N.B. MC No. 2017-11 was issued on 5 February 2017).

        - Applications for accreditation shall be submitted directly with the PNP Accreditation Board (PNPAB) at Camp Crame.

        - PNP shall conduct inspection of the vehicles to be accredited, through the Explosives Management Division (EMD) at Camp Crame for Metro Manila applicants, and the appropriate Regional Civil Security Unit (RCSU) or the Police Provincial Office (PPO) for provincial applicants.

- **Guidelines on accreditation**

    1. Applicants shall submit their applications with complete and valid documentary requirements to the PNP Secretariat using the prescribed Application Form.

    2. Accreditation Certificates shall be issued only upon compliance with all the requirements including the payment of the prescribed fees.

3. Accredited company-owned vehicles shall be exclusively used in the transportation and movement of controlled chemicals, which it will import, unload, move, transport, and transfer either for its own use or for the use of their clients.

4. The Accreditation Certificate shall be valid for a period of one year from date of issuance. The application for renewal must be filed within 30 calendar days prior to its expiration date.

5. Grounds for imposition of penalties

   - Failure to maintain a permanent record of all transactions
   - Failure to regularly submit reports on a monthly basis
   - Submission of erroneous report
   - Failure to observe the guidelines in the movement of controlled chemicals.

6. Grounds for revocation of accreditation

   - Movement and transportation of controlled chemicals of an unlicensed person and/or entity and/or not covered with the appropriate permit
   - Movement and transportation of controlled chemicals with unlicensed and/or unlisted driver
   - Submission of falsified document in the application for accreditation.

- **Others**

1. Firearms and Explosives Office (FEO) Nationwide Automation

   - Beginning 1 March 2017, qualified applicants may enroll in the EMD, FEO's Email Application System. Applications and renewal of various licenses and permits for transport of controlled chemicals may be done through email by submitting the scanned requirements to lpsemdfeo@gmail.com.

BOI Update

E.O. No. 22 extends for another year the duty-free incentive for importations of capital equipment and machinery, spare parts, and accessories of BOI-registered entities.

Executive Order No. 22 dated 28 April 2017

1. Importations by BOI-registered new and expanding enterprises of capital equipment and machineries, spare parts, and accessories classified under Chapters 40, 59, 68, 69, 70, 73, 76, 82, 83, 84, 85, 86, 87, 89, 90, 91, and 96 of the Customs Modernization and Tariff Act (CMTA) shall be subject to zero-percent duty subject to the following conditions:

   - A BOI Certificate of Authority is issued for the importation.

- The imported capital equipment, spare parts, and accessories are:

    a. Not manufactured domestically in sufficient quantity, of comparable quality, and at reasonable prices; and

    b. Reasonably needed and will be used exclusively by the enterprise in its registered activity.

- The BOI-registered enterprise cannot sell, transfer, or dispose the imported capital equipment, machinery, spare parts and accessories within 5 years from the date of importation without prior BOI approval. Otherwise, the BOI-registered enterprise shall be solidarily liable to pay twice the amount of the foregone duty or PHP500,000, whichever is higher, without prejudice to other applicable penalties under E.O. No. 226.

2. E.O. No. 22 shall take effect immediately upon complete publication and shall be valid for one year or until a new law is passed amending E.O. 226, whichever comes earlier.

3. The BOI shall promulgate an IRR to implement E.O. No. 22.

[Editor's Note: Executive Order No. 22 was published in The Manila Bulletin *on 18 May 2017.]*

Court Decisions

Medicard Philippines, Inc. vs. Commissioner of Internal Revenue
Supreme Court Third Division, GR No. 222743 promulgated 5 April 2017

A Final Assessment Notice issued on the basis of a Letter Notice is void, unless the CIR or his duly authorized representative authorized the taxpayer's examination through a Letter of Authority.

The amounts earmarked and eventually paid by an HMO to medical service providers do not form part of its gross receipts for VAT purposes.

Facts:

MEDICARD is a Health Maintenance Organization (HMO) that provides prepaid health and medical insurance coverage to its clients. Individuals enrolled in its health care programs pay an annual membership fee and are entitled to various medical services provided by licensed physicians and other professional technical staff.

The Commissioner of Internal Revenue (CIR) found discrepancies between MEDICARD's Income Tax Returns (ITR) and VAT Returns for 2006, informed MEDICARD, and issued a Letter Notice (LN). Subsequently, the CIR issued a Preliminary Assessment Notice (PAN) and Formal Assessment Notice (FAN) against MEDICARD for deficiency VAT.

According to the CIR, the taxable base of HMOs for VAT purposes is its gross receipts without any deduction under Section 4.108.3(k) of Revenue Regulations (RR) No. 16-2005 (or the Consolidated VAT Regulations). The CIR also argued that since MEDICARD does not actually provide medical and/or hospital services but merely arranges for them, its services are not VAT exempt.

MEDICARD argued, among others, that: (1) aside from arranging for medical and/or hospital services, it also actually and directly renders medical and laboratory services; (2) processing fees should be excluded from gross receipts because a part of it represents advances for professional fees due from clients which were paid by MEDICARD, while the remainder was already previously subjected to VAT.

After denial of its protest by the CIR, MEDICARD filed a Petition for Review before the Court of Tax Appeals (CTA), which sustained the CIR's position. Among others, the CTA ruled that the determination of deficiency VAT is not limited on the basis of the issuance of a Letter of Authority (LOA) alone as the CIR is granted vast powers to perform examination and assessment functions. In lieu of the LOA, an LN was issued informing MEDICARD of the discrepancies between its ITRs and VAT returns, a procedure authorized under existing rules. The assessment against MEDICARD contained the requisite legal and factual bases that put MEDICARD on notice of the deficiencies and MEDICARD availed of the remedies under the law without questioning the nullity of the assessment.

MEDICARD appealed to the Supreme Court.

Issues:

1. Did the absence of a Letter of Authority (LOA) violate MEDICARD's right to due process?

2. Were the amounts that MEDICARD earmarked and eventually paid to the medical service providers part of its gross receipts for VAT purposes?

Rulings:

1. Yes, the absence of an LOA violated MEDICARD'S right to due process.

   An LOA is the authority given to the appropriate revenue officer assigned to perform assessment functions. The LOA empowers or enables said revenue officer to examine the books of accounts and other accounting records of a taxpayer for the purpose of collecting the correct amount of tax.

   Section 6 of the Tax Code provides that "(A)fter a return has been filed as required under the provisions of this Code, the CIR or his duly authorized representative may authorize the examination of any taxpayer and the assessment of the correct amount of tax xx."

   Thus, unless authorized by the CIR himself or by his duly authorized representative, through an LOA, an examination of the taxpayer cannot ordinarily be undertaken.

   RMO No. 32-2005 prescribes the procedures in the resolution of LN discrepancies, conversion of LNs to LOAs, and assessment and collection of deficiency taxes. The RMO provides that a taxpayer who has been issued an LN may reconcile its records with those of the BIR within 120 days from issuance of the LN. If the discrepancies are unresolved at the end of the 120-day period, the revenue officer assigned to handle the LN shall recommend the issuance of an LOA to replace the LN.

In this case, no LOA was issued prior to the issuance of a PAN and FAN against MEDICARD. The LN that was issued was not converted into an LOA contrary to the provisions of the RMO. RMC No. 40-2003 considers an LN as a notice of audit or investigation only for the purpose of disqualifying the taxpayer from amending his returns.

Due process demands that after an LN has served its purpose, the revenue officer should have properly secured an LOA before proceeding with the further examination and assessment of MEDICARD. An LOA cannot be dispensed with just because none of the financial books or records physically kept by MEDICARD was examined. The requirement of authorization is not dependent on whether the taxpayer may be required to physically open his books and financial records but only on whether a taxpayer is being subject to examination.

2. No. The amounts earmarked and eventually paid by MEDICARD to the medical service providers do not form part of its gross receipts for VAT purposes.

   Since an HMO like MEDICARD is primarily engaged in arranging for coverage or designated managed care services that are needed by plan holders/ members for fixed prepaid membership fees and for a specified period of time, MEDICARD is principally engaged in the sale of services. Its VAT base and corresponding liability is determined under Section 108(A) of the Tax Code, as amended, which provides that "(T)here shall be levied, assessed and collected, a VAT of twelve percent of gross receipts derived from the sale or exchange of services xxx."

   Prior to RR No. 16-2005, an HMO, like a pre-need company, is treated for VAT purposes as a dealer in securities whose gross receipts is the amount actually received as contract price without allowing any deduction from the gross receipts.

   This was amended by RR No. 16-2005, which defined an HMO's gross receipts and gross receipts in general and provided that "(T)he compensation for their services representing their service fee, is presumed to be the total amount received as enrolment fee from their members plus other charges received."

   In 2007, the BIR issued RR No. 4-2007, amending portions of the VAT regulations, including the definition of gross receipts in general.

   "'Gross receipts' refers to the total amount of money or its equivalent representing the contract price, Revenue Regulations (RR) compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits applied as payments for services rendered and advance payments actually or constructively received during the taxable period for the services performed or to be performed for another person, excluding the VAT, except those amounts earmarked for payment to unrelated third (3rd) party or received as reimbursement for advance payment on behalf of another which do not redound to the benefit of the payor."

The definition of gross receipts under RR No. 16-2005 merely presumed that the amount received by an HMO as membership fee is the HMO's compensation for their services. As a mere presumption, an HMO is allowed to establish that a portion of the amount it received as membership fee does not actually compensate it but some other persons, which in this case are the medical service providers themselves.

As an HMO, MEDICARD primarily acts as an intermediary between the purchaser of healthcare services (its members) and the healthcare providers (the doctors, hospitals and clinics) for a fee.

In the course of its business, MEDICARD members can either avail of medical services from MEDICARD's accredited healthcare providers or directly from MEDICARD. In the former, MEDICARD members know that beyond the agreement to pre-arrange the healthcare needs of its members, MEDICARD would not be providing the actual healthcare service. Thus, based on industry practice, MEDICARD informs its would-be member beforehand that 80% of the amount would be earmarked for medical utilization and only the remaining 20% comprises its service fee. In the latter case, MEDICARD's sale of it services is exempt from VAT under Section 109(G) of the Tax Code.

By earmarking or allocating 80% of the amount it received as membership fee at the time of payment, MEDICARD unequivocally recognizes that its possession of the funds is not in the concept of owner but as a mere administrator of the same.

For purposes of determining the VAT liability of an HMO, the amounts earmarked and actually spent for medical utilization of its members should not be included in the computation of its gross receipts.

MEDICARD also established that upon its receipt of payment of the membership fee, it issued two official receipts, one pertaining to the VATable portion, representing compensation for its services, and the other representing the non-VATable portion pertaining to the amount earmarked for medical utilization.

Dominium Realty & Construction Corporation vs. Commissioner of Internal Revenue
CTA (Second Division) Case No. 8887, promulgated 6 April 2017

No gain or loss shall be recognized on the transfer by a person of property to a corporation in exchange for stock, where, as a result, the transferor together with others not exceeding four persons, gains control of the transferee corporation.

A prior BIR ruling is not required for transactions covered by Section 40 (C) (2) of the Tax Code to be exempt from tax.

Facts:

Petitioner Dominium Realty & Construction Corporation (Dominium), together with four other corporations, transferred several parcels of land to Fortune Landequities and Resources, Inc. (FLRI) in exchange for shares of stock. Prior to the exchange, Dominium and its co-transferors are existing shareholders of FLRI owning 99.99% of its capital stock. After the exchange, the transferors continue to collectively control FLRI by owning 99.99% of its capital stock.

Subsequently, Dominium and four other corporations exchanged their assets and liabilities to PMFTC, Inc. in exchange for shares of stock. As a result of the exchange, Dominium and the four other corporations gained control of PMFTC, Inc.

The BIR assessed Dominium for alleged deficiency income tax, VAT, and DST, arising from the transfer of its properties to FLRI and PMFTC. The BIR alleged that based on Dominium's audited financial statements (AFS), Dominium recognized a gain on such exchange. The BIR also alleges that since Dominium was not able to present a BIR ruling confirming that the transactions qualify as tax-free exchanges under Section 40(C)(2) of the Tax Code, the same are subject to tax.

Dominium protested the assessments. As the BIR failed to act on the protest, it filed a Petition for Review with the CTA.

Issues:

1. Did the transfers of property by Dominium to FLRI and PMFTC in exchange for shares of stock qualify as tax-free exchanges under Section 40(C)(2) of the Tax Code?

2. Is a BIR ruling necessary to exempt the transactions from tax?

Rulings:

1. Yes, the transactions qualified as tax-free exchanges under Section 40(C)(2) of the Tax Code. Under this provision, no gain or loss shall be recognized on the transfer of property to a corporation by a person in exchange for stock in the transferee corporation, where as a result of such exchange, the transferor together with others not exceeding four persons, gains control of the transferee corporation.

   The requisites for the non-recognition of gain or loss are:

   a. The transferee is a corporation;

   b. The transferee exchanges its shares of stock for property of the transferor;

   c. The transfer is made by a person, acting alone or together with others not exceeding four persons; and,

   d. As a result of the exchange, the transferor, alone or together with others not exceeding four, gains control of the transferee corporation.

   After careful study and analysis, the CTA ruled that Dominium's exchange transactions with FLRI and PMFTC, Inc. satisfied all of the above requisites.

   The transactions are in the nature of stock subscriptions and not sales of assets. Since the transactions do not constitute sale, the same are not subject to income tax. Moreover, the gain recognized in Dominium's books of accounts are recorded only in accordance with accounting rules but it is unrealized gain for income tax purposes.

2. No, a BIR ruling is not necessary to exempt the transactions from tax.

   Dominium need not secure a prior BIR ruling in order that the transactions may be exempt from tax under Section 40 (C) (2) of the Tax Code.

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