Republic of the Philippines
DEPARTMENT OF FINANCE
Roxas Boulevard Corner Pablo Ocampo, Sr. Street
Manila 1004

DOF Opinion No. 012.2018

DEPARTMENT OF FINANCE
Republic of the Philippines
112718USEC004520

DEGUZMAN CELIS & DIONISIO LAW OFFICES
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RE: REVIEW OF BIR RULING NO. 508-12 DATED 3 AUGUST 2012

Gentlemen:

This is in reference to your request for review, in behalf of your client Nutri-Asia, Inc. (NAI), of the Bureau of Internal Revenue (BIR) Ruling No. 508-12 dated 3 August 2012, which held that the transfer of assets of NA Prime Resources Corporation (NPRC) to NAI pursuant to a plan of merger is subject to donor's tax and that such has the effect of dissolution and liquidation without payment of taxes, to wit:

> "In reply thereto, please be informed that after a careful review of the above corporate re-organization, the intended re-organization is an upstream merger between a parent company [NAI] and its subsidiary [NPRC], where the former will not be issuing any shares to [NPRC], in exchange for the assets to be transferred by [NPRC] to NAI as a result of the merger. In effect, the said transfer partakes the nature of a donation made by a subsidiary to its parent company, contrary to what is contemplated on Section 40(C)(2) of the Tax Code of 1997, as amended. In the same manner, the intended merger has also the effect of dissolving and liquidating [NPRC] without payment of the corresponding taxes."

As culled from the records, the facts are as follows:

Nutri-Asia, Inc. (NAI) is a corporation duly existing and registered under Philippine laws. It has an authorized capital stock of One Hundred Million (P100,000,000.00) divided into Ten Million (10,000,000) shares with a par value of Ten Pesos (P10.00) per share; that the total capital stock issued and outstanding of NAI amounts to Sixty-Three Million Pesos (P63,000,000.00). NAI owns 100% of the outstanding capital stock of NA Prime Resources Corporation (NPRC), a domestic corporation also duly registered in the Philippines, with an authorized capital stock of Four Million Pesos (P4,000,000.00) divided into Forty Thousand (40,000) shares with a par value of One Hundred Pesos (sP100.00) per share, 10,000 of which may have been issued and outstanding.

At separate meetings on 16 August 2010, the Board of Directors and Stockholders of each corporation approved the Plan and Agreement of Merger of NAI and NPRC, with NAI, the parent corporation, as the surviving entity, for the following business reasons:

1. the integration of the administrative facilities of the constituent corporations will result in economies of scale and efficiency of operations;
2. the consolidation of the assets of the constituent corporations will allow the procurement and financing and credit facilities under more favorable terms; and
3. The merger will make possible the productive use of the properties of the constituent corporations.

In consequence, NAI shall be deemed to have acquired all the assets, rights and privileges, and assumed all the liabilities of NPRC and all the outstanding shares of the latter shall be deemed cancelled. NPRC shall cease to exist and its legal personality is considered terminated.

However, since NPRC is a wholly-owned subsidiary of NAI, NAI will not issue any shares in consideration of the merger. NAI justified its non-issuance of shares in exchange for the assets of NPRC by reasoning that it was done to avoid the shares from becoming treasury shares, as it would be issuing shares to itself since it wholly owns NPRC. NAI contended that the denial of the Commissioner of Internal Revenue of the applicability of Section 40(C)(2) on the merger of NAI and NPRC would defeat the purpose of the Congress in enacting said provision, which is to promote corporate unions or combinations for the economic development of the country.

NAI further argued that the dissolution of NPRC is an incidental consequence of the merger and that NPRC's dissolution pursuant to the merger is by operation of law. The merger resulted into the dissolution of NPRC without liquidation and NAI becomes the legal successor of the absorbed subsidiary.

Lastly, NAI further posited that there is no donation as there is no *animus donandi* or intent to donate on the part of the transferor, NPRC, and that the transfer of NPRC's properties to NAI was motivated purely by business considerations, as it was for the purpose of consolidating the assets of the constituent corporations to allow the procurement and financing of credit facilities under more favorable terms, and to make possible the productive use of the properties of the constituent corporations.

We find partial merit in this request.

As defined, merger pertains to the absorption of one or more corporations by another existing corporation, which retains its identity and takes over the rights, privileges, franchises, properties, claims, liabilities and obligations of the absorbed corporation(s). The absorbing corporation continues its existence while the life or lives of the other corporation(s) is or are terminated.[1]

The Tax Code describes such instance by which any gain or loss resulting from a merger between two or more corporations is not recognized, the reorganization having been considered as a tax-free merger. Section 40(C)(2) of the Tax Code, as amended, states:

> SECTION 40. *Determination of Amount and Recognition of Gain or Loss.* —
>
> -xxx-
>
> (C) *Exchange of Property.* —
>
> -xxx-
>
> (2) *Exception.* — No gain or loss shall be recognized if in pursuance of a plan of merger or consolidation —
>
> (a) A corporation, which is a party to a merger or consolidation, <u>exchanges property solely for stock in a corporation</u>, which is a party to the merger or consolidation;

A reading of this provision will reveal that in order for any gain or loss in pursuance to a merger to not be recognized, the same requires that the constituent corporation[2] exchanges its property solely for the stock of another constituent corporation. In this case, there was, however, no exchange of property solely for stock in another corporation. Although a reorganization may be deemed valid, but this alone is not sufficient to afford non-recognition to the gain or loss obtained in the transaction. Therefore, Section 40(C)(2) is inapplicable.

It is noteworthy that tax exemptions are to be construed in *strictissimi juris* against the taxpayer and liberally in favor of the taxing authority, that he who claims an exemption must be able to justify his claim by the clearest grant of statute.[3] A person claiming an exemption has the burden of justifying the exemption by words too plain to be mistaken and too categorical to be misinterpreted. Tax exemptions are never presumed and the burden lies with the taxpayer to clearly establish his right to exemption.[4]

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1 *Bank of Commerce v. Radio Philippines Network, Inc.*, G.R. No. 195615. 21 April 2014. 733 PHIL 491-581. *See* Title IX. Merger and Consolidation. Corporation Code of the Philippines, Batas PambansaBlg. 68

2 A constituent corporation pertains to a corporation who is a party to a proposed merger or consolidate. Section 76. Corporation Code of the Philippines.

3 CompagnieFinanciereSucres et Denrees v. Commissioner of Internal Revenue. G.R. No. 133834, 28 August 2006, 499 SCRA 664

4 *Digital Telecommunications Philippines, Inc. v. City Government of Batangas.* G.R. No. 156040. December 11, 2008. 594 PHIL 269-304.

Further, it is a cardinal rule in statutory construction that when the law is clear and free from any doubt or ambiguity, there is no room for construction or interpretation. There is only room for application. According to the plain-meaning rule or *verbalegis*, when the statute is clear, plain, and free from ambiguity, it must be given its literal meaning and applied without attempted interpretation. It is expressed in the maxims *index animi sermo* or "speech is the index of intention," *and verbalegis non estrecedendum* or "from the words of a statute there should be no departure."[5]

In the case at bar, the law granting exemption from taxation of any gain or loss incurred pursuant to a plan of merger is clear. There is no justification for us to liberally construe that law. In this jurisdiction, it has been the constant and uniform holding that exemption from taxation is not favored and is never presumed.[6]

In claiming exemption from taxation, NAI must discharge the burden of establishing the existence of such exemption, for which, in this case, NAI failed. Hence, the merger between NAI and NPRC does not qualify under Section (40) (C) (2) of the Tax Code.

Moreover, the agreement that NPRC (subsidiary) and NAI (parent) entered into provided, in substance, for the parent corporation's assumption of all of the wholly-owned subsidiary's debts and liabilities, for the surrender for cancellation of all of the subsidiary's stocks, and that all of subsidiary's assets will be transferred to the parent corporation, which verily, has the effect of winding up of the affairs of NPRC[7]which consequently necessitates the payment of corresponding taxes.

In which instance, even if NAI wholly owns NPRC, both corporations possess separate juridical personalities and are different taxable entities. Therefore, as Section 40(C)(2) is inapplicable, the imposition of proper taxes must follow.

However, NPRC's transfer of assets to NAI does not give rise to a donation made by a subsidiary to its parent company.

Jurisprudence elucidates that animus donandi (the intent to do an act of liberality) is an indispensable element of a valid donation, along with the reduction of the donor's patrimony and the corresponding increase in the donee's patrimony. However, not all elements of a donation are present in the case at bar. The consideration of gratuity is wanting as there is no intent to do an act of liberality on the part of the NPRC upon the transfer of its assets to NAI.

Further, such transfer of assets of a wholly-owned subsidiary to its parent corporation, having the effect of a taxable liquidation, negates the transaction from being a donation.

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5 *Padilla v. Congress of the Philippines.* G.R. Nos. 231671 & 231694. July 25, 2017 *citingBolos v. Bolos,* 648 Phil. 630, 63. 2010.

6 *Commissioner of Internal Revenue vs. A.D. Guerrero.* G.R. No. L-20942, 22 September 1967,

7 *Black's Law Dictionary.* Liquidation is the comprehensive process of gathering in the assets, converting them into cash and distributing them according to the legal rights of the parties interested; or to put it simply, liquidation pertains to the winding up of the affairs of a business.

In view of the foregoing, we partially approve the request for review and hold that in the transfer of the assets of NPRC to NAI, no donor's tax shall be imposed. However, the merger of NPRC into NAI does not qualify as a tax-free merger under Section 40(C)(2) of the Tax Code and proper taxes should be imposed for its dissolution and liquidation.

Respectfully yours,

CARLOS G. DOMINGUEZ
Secretary
NOV 19 2018

CC: **CAESAR R. DULAY**
Commissioner
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NOV 27 2018

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