REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

THIRD DIVISION

LUCIO L. CO, SUSAN P. CO, FERDINAND VINCENT P. CO and PAMELA JUSTINE P. CO, Petitioners,	CTA CASE NO. 8831
	Members:
-versus-	BAUTISTA, *Chairperson* FABON-VICTORINO, *and* RINGPIS-LIBAN, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	Promulgated: JUN 02 2016 3:28 p.m.

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D E C I S I O N

***Fabon-Victorino, J.*:**

This resolves the Petition for Review filed by Lucio L. Co, Susan P. Co, Ferdinand Vincent P. Co, and Pamela Justine P. Co for the refund of the amount of One Billion Six Hundred Forty-Seven Million Six Hundred Fifteen Thousand Two Hundred Ninety Pesos and 7/100 (P1,647,615,290.07), allegedly representing their erroneous payment of capital gains tax (CGT) including interests and/or compromise penalty arising from an exchange of shares of stock.

Petitioners Lucio L. Co, Susan P. Co, Ferdinand Vincent P. Co, and Pamela Justine P. Co are Filipinos, of legal age, with respective addresses at 563 M. De Santos St., Tondo, Manila, at 1414 Union St., Paco, Manila, at Fontana Leisure Park, Pampanga, and at 31 Tayuman St., Tondo, Manila.[1]

On the other hand, respondent is the Commissioner of the Internal Revenue (CIR) with authority to decide, approve, and grant claims for refund or tax credit of

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[1] Par. 1, Summary of Admitted Facts, Joint Stipulation of Facts and Issues (JSFI), docket, vol. II, p. 571.

erroneously or excessively paid taxes. She holds office at the Bureau of Internal Revenue (BIR) National Office Building, Agham Road, Diliman, Quezon City.

Petitioners are former shareholders of Kareila Management Corporation, a domestic corporation.[2]

On May 11, 2012, petitioners and another Kareila stockholder Anthony Sy entered into a Deed of Exchange with Puregold Price Club, Inc. wherein they agreed to transfer all their Kareila shares to Puregold in exchange for shares of stock in Puregold.[3]

Under the Deed of Exchange, petitioners and Anthony Sy would receive four hundred fifty (450) Puregold shares for every one (1) Kareila share that they would transfer to Puregold. In accordance with the agreement, Puregold issued to petitioners and Anthony Sy a total of 766,406,250 Puregold shares from its unissued but existing authorized capital stock in exchange for 1,703,125 Kareila shares.[4]

On June 26 and 28, 2012, petitioners collectively paid capital gains tax (CGT) including interests and/or compromise penalty on the said transfer pursuant to Section 24(C) of the National Internal Revenue Code (NIRC) of 1997, as amended, with the following breakdown:[5]

Taxpayer	Date of Payment (2012)	Capital Gains Tax	Interest	Compromise Penalty	Total Amount Paid
Lucio Co	June 26	₱ 652,291,875.00			₱ 652,291,875.00
	June 28	6,750,000.00	₱ 3,750.00		6,753,750.00
Susan Co	June 26	652,291,875.00			652,291,875.00
	June 28	6,750,000.00	3,757.50	₱ 5,000.00	6,758,757.50
Ferdinand Co	June 26	163,068,740.00			163,068,740.00
	June 28	1,687,495.05	5,624.98		1,693,120.03
Pamela Co	June 26	163,068,740.00			163,068,740.00
	June 28	1,687,495.04	937.50		1,688,432.54
Total		**₱1,647,596,220.09**	**₱14,069.98**	**₱5,000.00**	**₱1,647,615,290.07**

Petitioners however claim that their payment of CGT was erroneous since per Section 40(C)(2) of the NIRC, their

[2] Exhibit "P-39", docket, vol. II, pp. 1182-1189.
[3] Exhibits "P-23" to "P-23h", docket, vol. II, pp. 1055-1059.
[4] Exhibits "P-23" to "P-23h".
[5] Par. 3, Summary of Admitted Facts, JSFI, docket, vol. II, p. 572; Exhibits "P-1" to "P-16", docket, vol. II, pp. 895-928.

transfer of shares under the Deed of Exchange was a tax exempt transaction.

Thus on May 21, 2014, or within the two-year prescriptive period under Section 204(C) of the NIRC of 1997, as amended, petitioners Lucio Co[6], Susan Co[7], Ferdinand Co[8], and Pamela Co[9] separately filed their administrative claims for refund of CGT they paid, including interest and/or compromise penalty, with their respective Revenue District Offices (RDO).

Citing inaction on their claims for refund on the part of respondent, petitioners filed the instant Petition for Review on June 6, 2014.

In her Answer[10], respondent alleges that Revenue Regulations No. 18-2001, Revenue Memorandum Order Nos. 32-2001 and 17-2002 provide that there are certain conditions/requirements which should be complied with by the parties to an exchange transaction in order to avail of the non-recognition of gain under Section 40(C)(2) of the NIRC. Thus, for the subject transaction to qualify as a tax-free exchange, a prior application for a certification or ruling from the BIR must be secured. In the present case however, no such prior request for a certification/ruling from the BIR was made. And since the claims for refund are construed strictly against the taxpayer-claimant, the refund sought by petitioners should be denied.

In Reply,[11] petitioners contend that it was impossible for them to make any prior request for a ruling from the BIR since they were not aware that their transaction was tax free, rendering their payment of CGT erroneous. Further, Section 40(C)(2) of the NIRC does not impose such condition. Neither was the said requirement supported by any law or jurisprudence.

After a Pre-Trial Order[12] was issued, petitioner commenced presentation of their witnesses, namely, Mary

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[6] Exhibit "P-17", docket, vol. I, pp. 417-444.
[7] Exhibit "P-18", docket, vol. I, pp. 446-474.
[8] Exhibit "P-19", docket, vol. I, pp. 475-502.
[9] Exhibit "P-17", docket, vol. I, pp. 417-444.
[10] Answer dated July 18, 2014, docket, vol. I, pp. 294-297.
[11] Docket, vol. I, pp. 302-308.
[12] Docket, vol. II, pp. 590-598.

S. Demetillo, its consultant on accounting of personal financial transactions, and Atty. Candy H. Dacanay-Datuon, the Corporate Secretary of Kareila and Assistant Corporate Secretary of Puregold.

Witness **Mary S. Demetillo,** [13] declared that as petitioners' consultant on accounting of personal financial transactions for almost 5 years, she did the accounting and computation of tax for the subject share swap transaction.

By virtue of the Deed of Exchange dated May 11, 2012, petitioners and Anthony Sy transferred 1,703,125 their Karaeila common shares to Puregold Price Club, Inc. In return, petitioners received 766,406,250 common shares in Puregold. At the time of the transaction, Kareila shares had a par value of P100.00[14] per share, while Puregold had a par value of P21.50 per share. For the said share swap transaction, petitioners paid CGT of P1,647,615,290.07, including interest and penalty, on June 26 and 28, 2012.

Such payments of CGT, including interest and penalty were reflected in petitioners' Annual Income Tax Returns (AITRs) for the year 2012.

On May 21, 2014, petitioners separately filed administrative claims for refund of the erroneously paid CGT with their respective RDO followed by their filing of BIR form No. 1914 or the Applications for Tax Credits/Refund, for which she was consulted. She learned about the actual filing of such claims for refund only when she was preparing for her testimony before the Court. The said administrative claims for refund were not acted upon by respondent.

Attorney **Candy H. Dacanay-Datuon,**[15] the Corporate Secretary of Kareila since 2004 and the Assistant Corporate Secretary of Puregold since 2011, testified that she is the custodian of the records of the shares of stocks of Kareila and Puregold. She prepares and files the reportorial requirements under the law of both entities. Kareila is a

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[13] See Judicial Affidavit of Mrs. Mary S. Demetillo (Dated 18 September 2014), docket pp. 391-400

[14] See Judicial Affidavit of Mrs. Mary S. Demetillo (Dated 18 September 2014), docket pp. 395-396, par. A9

[15] See Amended Judicial Affidavit of Atty. Candy H. Dacanay-Datuon (Dated 21 November 2014), docket pp. 640-652

domestic corporation whose primary purpose is to act as managers, managing agents, consignor, concessionaire or supplier of businesses engaged in manufacturing or trading of general merchandise, the operation of resorts, hotels, supermarkets, groceries and the like. Puregold is also a domestic corporation whose primary purpose is to engage in the wholesale and retail of general merchandise.

She further testified that petitioners are shareholders of both corporations. Under a Deed of Exchange dated May 11, 2012, petitioners with Anthony Sy, transferred their 1,703,125 common shares in Kareila to Puregold in exchange for 766,406,250 common shares of Puregold.

Lucio Co and Susan Co each transferred 681,250 Kareila shares in exchange for 306,562,500 Puregold shares, while both Ferdinand Co and Pamela Co each transferred 170,312 Kareila shares for 76,640,400 Puregold shares.

The 1,703,125 Kareila shares were valued at P16.467 billion or P9,668.47 per share[16], while the 766,406,250 Puregold shares had a subscription price of P16,477,734,375.00 or P21.50 per share.

As a consequence of the share swap, Puregold acquired ownership of all 1,703,125 Kareila shares, while petitioners and Anthony Sy were each given in trust one share or .0001% of Kareila. On the other hand, petitioners collectively owned 1,331,440,820 Puregold shares or 66.55% of the outstanding capital stock of Puregold. After the share swap, petitioners gained further control of Puregold as their collective shareholdings therein increased from 66.55% to 75.83%.

The amount of P1,647,615,290.07 CGT was paid for the share swap transaction, including interest and penalty, and this amount is the subject of the instant claim for refund.

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[16] See Amended Judicial Affidavit of Atty. Candy H. Dacanay-Datuon (Dated 21 November 2014), docket p. 647,par. A24

With the admission of all its evidence, petitioners rested their case.[17]

On the other hand, respondent did not present any evidence on the ground that no investigation report was submitted to her counsel.[18]

STATEMENT OF ISSUES

The parties submit the following issues [19] for the resolution of the Court, to wit:

1. Whether or not the Court has jurisdiction to entertain the instant Petition for Review;

2. Whether or not petitioners are entitled to a refund or tax credit in the amount of P1,647,615,290.07, representing erroneously paid capital gains tax, including interest and/or compromise penalty; and

3. Whether or not petitioners are liable for interest and/or compromise penalty on the exchange.

THE RULING OF THE COURT

Respondent claims that one of the requirements for recovery of tax erroneously or illegally collected under Section 229 of the NIRC, as amended, is that a written administrative claim for refund must be filed by the taxpayer with the BIR. In the instant case, it was not petitioners but the Zambrano and Gruba Law Offices who filed on May 21, 2014 the administrative claim for refund of the subject amount, via the three letters, all dated May 20, 2014, with the RDOs concerned. In effect, no administrative claims for refund were filed by petitioners before resorting to judicial action, thereby depriving the Court of jurisdiction over the case.

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[17] Resolution dated April 17, 2015, docket, vol. II, pp. 1200-1201.
[18] Minutes of the hearing held on June 8, 2015, docket, vol. II, p. 1202.
[19] Issues, Pre-Trial Order dated October 20, 2014, docket, vol. II, pp. 591-592.

Respondent explains that while the Special Power of Attorney (SPA) in favor of Zambrano and Gruba Law Offices was executed by petitioners on May 20, 2014, it was notarized only on May 23, 2014. Thus, the SPA constituting Zambrano and Gruba Law Offices as duly authorized representative of petitioner became a public document binding upon third persons only after it was notarized on May 23, 2014. Hence, at the time the administrative claim for refund was filed on May 21, 2014, the said law firm was not yet deemed to be the duly authorized representative of petitioners. Accordingly, the filing of the administrative claim for refund on May 21, 2014, could not be deemed as valid written claims for refund or tax credit filed by petitioner-taxpayer with the BIR.

The requirement that the taxpayer must first file an administrative claim for refund of erroneously or illegally collected taxes with respondent before seeking judicial intervention is clearly provided in Sections 204(C) and 229 of the NIRC of 1997, as amended.[20]

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[20] "SEC. 204. *Authority of the Commissioner to Compromise, Abate and Refund or Credit Taxes*. – The Commissioner may –

xxx xxx xxx

(C) Credit or refund taxes erroneously or illegally received or penalties imposed without authority, refund the value of internal revenue stamps when they are returned in good condition by the purchaser, and, in his discretion, redeem or change unused stamps that have been rendered unfit for use and refund their value upon proof of destruction. **No credit or refund of taxes or penalties shall be allowed unless the taxpayer files in writing with the Commissioner a claim for credit or refund within two (2) years after the payment of the tax or penalty:** *Provided, however*, that a return filed showing an overpayment shall be considered as a written claim for credit or refund." *(Emphasis supplied)*

"SEC. 229. *Recovery of Tax Erroneously or Illegally Collected*. – No suit or proceeding shall be maintained in any court for the recovery of any national internal revenue tax hereafter alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessively or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress.

In any case, **no such suit or proceeding shall be filed after the expiration of two (2) years from the date of payment of the tax or penalty** regardless of any supervening cause that may arise after payment: *Provided, however*, That the Commissioner may, even

Section 204 applies to administrative claims for refund, while Section 229 to judicial claims for refund. In both instances, the taxpayer's claim must be filed within two (2) years from the date of payment of the tax or penalty. Section 229 however further requires that an administrative claim for refund must first be filed with respondent before the judicial claim may be maintained.[21] It must however be remembered that the two-year prescriptive period is mandatory regardless of any supervening cause that may arise after payment.[22]

In this case, petitioners Lucio Co[23], Susan Co[24], Ferdinand Co[25], and Pamela Co[26] timely filed their administrative claims for refund on May 21, 2014 as well as their Petition for Review on June 6, 2014, or within two years from the dates of payment of the subject CGT on June 26 and 28, 2014.

Notably, petitioners also filed the letters dated August 19,[27] and 27, 2014[28] addressed to Revenue District Office Nos. 34 and 21-A, respectively, submitting, among others, the original of the SPA they executed in favor of Zambrano and Gruba Law Offices or any of its lawyers.

Corollary to the foregoing, the presumption in favor of the counsel's authority to appear on behalf of a client is strong. In fact, a lawyer is not even required to present a written authorization from the client for this purpose.[29]

Further, even an unauthorized appearance of an attorney may be ratified by the client either expressly or

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without a written claim therefor, refund or credit any tax, where on the face of the return upon which payment was made, such payment appears clearly to have been erroneously paid." *(Emphasis supplied)*

[21] CBK Power Company Limited vs. Commissioner of Internal Revenue, G.R. Nos. 193383-84, January 14, 2015 and Commissioner of Internal Revenue, vs. CBK Power Company Limited, G.R. Nos. 193407-08
[22] Commissioner of Internal Revenue vs. Manila Electric Company (MERALCO), G.R. No. 181459, June 9, 2014
[23] Exhibit "P-17", docket, vol. I, pp. 417-444.
[24] Exhibit "P-18", docket, vol. I, pp. 446-474.
[25] Exhibit "P-19", docket, vol. I, pp. 475-502.
[26] Exhibit "P-17", docket, vol. I, pp. 417-444.
[27] Exhibits "P-32" to "P-32-b", docket, vol. I, pp. 549-556.
[28] Exhibits "P-33" to "P-33-b", docket, vol. I, pp. 557-564.
[29] *Land Bank of the Philippines vs. Pamintuan Development Co.,* G.R. No. 167886, October 25, 2005.

impliedly. Ratification retroacts to the date of the lawyer's first appearance and validates the action taken by him.[30]

In agency, ratification is the adoption or confirmation by one person of an act performed on his behalf by another without authority. The substance of ratification is the confirmation after the act, amounting to a substitute for a prior authority.[31]

In the subject SPA[32], petitioners gave Zambrano and Gruba Law Offices the authority to represent them in administrative cases and in any other proceedings in connection with their application and/or claim for tax refund of the CGT they paid as consequence of the share swap transaction. In the same SPA, petitioners also ratified all previous acts done or may lawfully do or cause to be done by the law office, by virtue of the authority granted unto them, thus:

> "We, Lucio L. Co, Susan P. Co, Ferdinand Vincent P. Co, and Pamela Justine P. Co xxx do hereby APPOINT the law firm of ZAMBRANO AND GRUBA LAW OFFICES or any of the lawyers of said law firm xxx to be our true and legal attorney-in-fact to act for and in our name and stead and to perform the following acts:
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> 1. **To represent us in** all civil, criminal, **administrative cases** as well as in any other proceeding **in connection with our Application and/or Claim for Tax Refund of Capital Gains Tax**, plus interest and/or penalties, as well as to negotiate, enter into, execute sign and deliver any settlement or compromise agreement on any account or matter prior to commencement of litigation, under such terms and conditions as they may deem just and equitable in connection with our Application and/or Claim for Tax Refund

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[30] *Land Bank of the Philippines vs. Pamintuan Development Co., supra.*
[31] *Prieto vs. The Hon. Court of Appeals, et al.*, G.R. No. 158597, June 18, 2012.
[32] Exhibit "P-32-a".

> of Capital Gains Tax, plus interest and/or penalties
>
> xxx xxx xxx
>
> **HEREBY GRANTING** unto our representative full power and authority required and proper for carrying into full force and effect any and all things necessary and proper in the premises above-mentioned as fully to all intents and purposes as we may lawfully do if present, and **we ratify and confirm, as we hereby ratify and confirm, all the said attorney-in-fact has heretofore done or may lawfully do or cause to be done by virtue hereof.**" *(Emphasis supplied)*

In fine, Zambrano and Gruba Law Offices had the authority to represent petitioners in their administrative claims for refund filed with respondent even if the SPA was notarized only after its filing. Consequently, the Court properly acquired jurisdiction over the instant Petition.

Recognition of gain on the exchange of Puregold and Kareila shares by petitioners

Respondent argues that Section 40(C)(2) of the NIRC of 1997, as amended, enumerates the transactions considered as tax-free exchange that require prior application for a certification or ruling from the BIR to that effect.

According to respondent, the said provision merely defers recognition of the gain or loss from such transaction. This must be so for in determining the gain or loss from a subsequent transaction of the real properties or of the stocks involved in the exchange, the original or historical cost of the properties or stocks is considered, pursuant to Section 40(C)(5)(a) and (b) of the NIRC of 1997, as amended.

Respondent further avers that there are certain provisions of the Tax Code requiring the prior application for a certification or ruling in view of the technical intricacies of Section 40(C)(2) of the NIRC of 1997, as amended.

Respondent points out that Section 40(C)(5)(a) and (b) of the NIRC of 1997, as amended, requires the proper monitoring of the basis of the properties transferred and shares received given that Section 40(C)(2) of the NIRC of 1997, as amended, defers the recognition of the gain or loss from such transation. Thus, there are certain conditions or requirements which must be complied with in order that parties to the exchange may avail of the non-recognition of gain provided for by law.

Moreover, the stock certificates of Puregold and of Kareila do not bear the annotation required under Section 58(E) of the NIRC of 1997, as amended, and Section 6 of Revenue Regulations No. 18-2001, which respectively provide, as follows:

> "SEC. 58. *Returns and Payment of Taxes Withheld at Source.* –
>
> xxx xxx xxx
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> (E) *Registration with Register of Deeds.* – **No registration of any document transferring real property shall be effected by the Register of Deeds unless the Commissioner or his duly authorized representative has certified that such transfer has been reported, and the capital gains or creditable withholding tax, if any, has been paid:** *Provided, however,* That the information as may be required by the rules and regulations to be prescribed by the Secretary of Finance, upon the recommendation of the Commissioner, shall be annotated by the Register of Deeds in the Transfer Certificate of Title or Condominium Certificate of Title: *Provided, further,* That in cases of transfer of property to a corporation, pursuant to a merger, consolidation or reorganization, and where the law allows deferred recognition of

> income in accordance with Section 40, the information as may be required by rules and regulations to be prescribed by the Secretary of Finance, upon recommendation of the Commissioner, shall be annotated by the Register of Deeds at the back of the Transfer Certificate of Title or Condominium Certificate of Title of the real property involved: *Provided, finally*, That any violation of this provision by the Register of Deeds shall be subject to the penalties imposed under Section 269 of this Code." *(Emphasis supplied)*
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> "SECTION 6. *Information to be annotated in the Transfer Certificate of Title or Condominium Certificate of Title issued by the Register of Deeds, and on the Certificate of Stock/Units of Participation issued by the Corporate Secretary*. – In cases of transfers or exchanges falling under Section 40(C)(2) of the Tax Code of 1997, the following information shall be annotated on the reverse side of the Transfer Certificate of Title or Condominium Certificate of Title or certificate of stock that is transferred or issued pursuant to such transfer or exchange:
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> > 'The acquisition of the property described in this title/certificate is by virtue of a tax-free exchange pursuant to Section 40(C)(2) of the National Internal Revenue Code of 1997 per Deed of Exchange/Assignment dated ________. The substituted basis pursuant to Section 40(C)(5) of the National Internal Revenue Code of 1997 is in the amount of ____________________.' "

There were also other requirements under RR No. 18-2001, Revenue Memorandum Order (RMO) Nos. 32-2001 and 17-2002 in relation to Section 40(C)(2) and (6)(c) of the NIRC of 1997, as amended, in order that the parties to the exchange transaction can avail of the non-recognition of gains, which petitioner failed to comply with.

To determine whether the exchange of shares in this case is a tax-free exchange, Section 40(C)(2) of the NIRC of 1997, as amended, relevantly provides:

> "SEC. 40. *Determination of Amount and Recognition of Gain or Loss.* -
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> xxx xxx xxx
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> (C) *Exchange of Property.* -
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> xxx xxx xxx
>
> (2) *Exception.* - xxx
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> No gain or loss shall also be recognized if property is transferred to a corporation by a person in exchange for stock or unit of participation in such a corporation of which as a result of such exchange said person, alone or together with others, not exceeding four (4) persons, gains control of said corporation; *Provided*, That stocks issued for services shall not be considered as issued in return for property."

From the above provision, the requisites for the non-recognition of gain or loss are as follows: (1) the transferee is a corporation; (2) the transferee exchanges its shares of stock for property/ies of the transferor; (3) the transfer is made by a person, acting alone or together with others, not exceeding four persons; and, (4) as a result of the exchange the transferor, alone or together with others, not exceeding four, gains control of the transferee.[33]

Based on the Deed of Exchange executed by petitioners with Anthony Sy and Puregold Price Club, Inc., petitioners and Anthony Sy subscribed to a total of 766,406,250 common shares of stock of Puregold. In payment and exclusively in exchange for the said shares, petitioners and Anthony Sy assigned, transferred and conveyed unto Puregold the Kareila shares equivalent to 450 Puregold common shares for every 1 Kareila share.

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[33] *Commissioner of Internal Revenue vs. Filinvest Development Corporation,* G.R. No. 163653 and G.R. No. 167689, July 19, 2011.

The record shows that in 2012, Kareila had an authorized capital stock of P500,000,000.00 divided into 5,000,000 common shares with a par value of P100.00 each.[34]

From the authorized capital stock, 1,703,125 shares were subscribed and fully paid. Before the exchange, petitioners owned 99.9999% of the total subscribed shares while Anthony Sy owned the remaining 0.0001%, broken down as follows:[35]

Shareholder	**No. of Kareila Shares Owned**	**Percentage of Ownership**
Lucio Co	681,250	40%
Susan Co	681,250	40%
Ferdinand Co	170,312	10%
Pamela Co	170,312	10%
Anthony Sy	1	0.0001%
	1,703,125	100%

Petitioners were also shareholders of Puregold, a corporation duly organized under the laws of the Republic of the Philippines.[36]

From Puregold's authorized capital stock of P3,000,000,000.00,[37] 2,000,000,000 shares were subscribed and fully paid. Before the said exchange, petitioners owned 66.55% of the total subscribed shares, to wit:[38]

Shareholder	**No. of Puregold Shares Owned**	**Percentage of Ownership**
Lucio Co	724,376,802	36.21%
Susan Co	539,691,310	26.98%
Ferdinand Co	33,686,354	1.68%
Pamela Co	33,686,354	1.68%
Total		66.55%

In accord with the terms in the Deed of Exchange executed on May 11, 2012, Puregold issued to petitioners

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[34] Exhibit "P-20", docket, vol. II, pp. 929-934.
[35] Exhibit "P-20".
[36] Exhibit "P-26", docket, vol. II, pp. 1095-1110.
[37] Exhibit "P-21", docket, vol. II, pp. 935-942.
[38] Exhibits "P-22" and "P-22-a", docket, vol. II, pp. 943 and 972.

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and Anthony Sy a total of 766,406,250 Puregold shares from its unissued but existing authorized capital stock in exchange for 1,703,125 Kareila shares, detailed as follows:[39]

Shareholder	No. of Kareila Shares Transferred to Puregold	No. of Puregold Shares Received by Petitioners and Anthony Sy
Lucio Co	681,250	306,562,500
Susan Co	681,250	306,562,500
Ferdinand Co	170,312	76,640,400
Pamela Co	170,312	76,640,400
Anthony Sy	1	450
Total	1,703,125	766,406,250

As a result of the exchange, Puregold acquired 100% of the total outstanding capital stock of Kareila.[40] On the other hand, petitioners, who prior to the exchange of shares already collectively owned 66.55% of the outstanding capital stock of Puregold, increased their stockholdings to 75.83% after the exchange of shares.[41]

Shareholder	No. of Puregold Shares Owned Prior to the Exchange[42]	Percentage of Puregold Ownership Prior to the Exchange[43]	Additional Puregold Shares Issued	Total No. of Puregold Shares Owned	Percentage of Ownership
Lucio Co	724,376,802	36.21%	306,562,500[44]	1,030,939,302	37.27%
Susan Co	539,691,310	26.98%	306,562,500[45]	846,253,810	30.59%
Ferdinand Co	33,686,354	1.68%	76,640,400[46]	110,326,754	3.99%
Pamela Co	33,686,354	1.68%	76,640,400[47]	110,326,754	3.99%
Anthony Sy	0	0	450[48]	450	
Public	-	Less than 33%		-	Less than 33%
	2,000,000,000	100%		2,766,406,250	100%

[39] Exhibits "P-23" to "P-23h", docket, vol. II, pp. 1055-1078.
[40] Exhibits "P-24" and "P-40" to "P-44", docket, vol. II, pp. 1079-1085 and pp. 1190-1194.
[41] Exhibit "P-48", docket, vol. II, pp. 640-650.
[42] Exhibits "P-22" and "P-22-a", docket, vol. II, pp. 943-972.
[43] Exhibit "P-22-a".
[44] Exhibit "P-34", docket, vol. II, p. 1177.
[45] Exhibit "P-35", docket, vol. II, p. 1178.
[46] Exhibit "P-36", docket, vol. II, p. 1179.
[47] Exhibit "P-37", docket, vol. II, p. 1180.
[48] Exhibit "P-38", docket, vol. II, p. 1181.

The table above shows that the transferee in the exchange transaction is Puregold, a corporation duly organized under the laws of the Philippines.[49] Puregold exchanged its 766,406,250 shares of stock for 1,703,125 Kareila shares of petitioners and Anthony Sy, the transferors. Evidently, the first, second, and third requisites are present for the subject transfer to qualify as a tax-free exchange.

As to the fourth requisite, the law requires that the transferor, alone or together with others, not exceeding four, gains control of the transferee as a result of the exchange.

The term **"control" is defined as "ownership of stocks in a corporation possessing at least fifty-one percent (51%) of the total voting power of all classes of stocks entitled to vote"** as provided under Section 40(C)(6)(c) of the NIRC of 1997, as amended.

The exchange of the shares between Kareila and Puregold resulted in an increase in petitioner Lucio Co's Puregold share to 37.27%, an increase in Susan Co's Puregold share to 30.59%, an increase in Ferdinand Co's Puregold share to 3.99%, and an increase in Pamela Co's Puregold share to 3.99%. Thus, petitioners collectively own 75.83% of Puregold shares after the exchange.

Considering that the combined ownership by petitioners of Puregold's outstanding capital stock amounted to 75.83% of the total Puregold shares, petitioners gained further control of Puregold, the transferee, after the exchange. Therefore, the fourth requisite is also satisfied. Accordingly, petitioners, as the transferors, should not have recognized any gain from the said transaction and should not have paid CGT thereon.

On the other hand, respondent insists that petitioners failed to comply with the requirements of RR No. 18-2001, RMO Nos. 32-2001 and 17-2002 in relation to Section 40(C)(2) and (6)(c) of the NIRC of 1997, as amended, which

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[49] Exhibit "P-26", docket, vol. II, pp. 1095-1110.

must be satisfied in order that the parties to the exchange transaction can avail of the non-recognition of gains.

On this matter, let it be stressed that petitioners filed the application for refund as they erroneously paid CGT on the exchange of shares which the Court found to be a tax-free exchange. Consequently, petitioners could not be expected to obtain a BIR ruling to be exempt from CGT as they previously believed that they were liable to pay the same based on the computation and erroneous recommendation of their accounting consultant, Mary S. Demetillo.[50]

Instructive on the matter is the ruling of the Supreme Court in *Deutsche Bank AG Manila Branch vs. Commissioner of Internal Revenue*[51], which concerns the availment of tax treaty relief. The High Court said that petitioner therein could not have applied for a tax treaty relief in the form of a BIR Ruling precisely because it erroneously paid the tax on the basis of the regular rate. The pertinent portion of the decision reads:

> "**The underlying principle of prior application with the BIR becomes moot in refund cases, such as the present case, where the very basis of the claim is erroneous or there is excessive payment arising from non-availment of a tax treaty relief at the first instance.** In this case, petitioner should not be faulted for not complying with RMO No. 1-2000 prior to the transaction. **It could not have applied for a tax treaty relief within the period prescribed**, or 15 days prior to the payment of its BPRT, **precisely because it erroneously paid the BPRT not on the basis of the preferential tax rate under the RP-Germany Tax Treaty, but on the regular rate as prescribed by the NIRC**. **Hence, the prior application requirement becomes illogical.** Therefore, the fact that petitioner invoked the provisions of the RP-Germany Tax Treaty when it requested for a confirmation from the ITAD before

[50] Transcript of Stenographic Notes taken on November 10, 2014, pp. 7-10.
[51] G.R. No. 188550, August 19, 2013.

> filing an administrative claim for a refund should be deemed substantial compliance with RMO No. 1-2000.
>
> Corollary thereto, Section 229 of the NIRC provides the taxpayer a remedy for tax recovery when there has been an erroneous payment of tax. **The outright denial of petitioner's claim for a refund, on the sole ground of failure to apply for a tax treaty relief prior to the payment of the BPRT, would defeat the purpose of Section 229**." *(Emphasis supplied)*

Clearly, petitioners could not have complied with the provisions under the Revenue Regulations and Revenue Memorandum Orders cited by respondent as it already paid CGT on the said transaction relying on the recommendation of their accounting consultant.

Besides, the BIR issuances cited by respondent show that they merely or primarily serve as guidelines for the proper monitoring and investigation of the basis of the properties transferred pursuant to a tax-free exchange.

The significant portions of the said BIR issuances state as follows:

> "REVENUE REGULATIONS No. 18-2001
>
> SUBJECT: **Guidelines on the Monitoring of the Basis of Property Transferred and Shares Received, Pursuant to a Tax-Free Exchange of Property for Shares under Section 40(C)(2) of the National Internal Revenue Code of 1997**, Prescribing the Penalties for Failure to Comply with Such Guidelines, and Authorizing the Imposition of Fees for the Monitoring Thereof." *(Emphasis supplied)*
>
> "REVENUE MEMORANDUM ORDER NO. 32-01
>
> SUBJECT: xxx

In order **to facilitate the monitoring of the basis of properties transferred and shares received in an exchange transaction**, and in the determination of whether a transaction involving the transfer of properties by individual/s or corporation/s in exchange for shares of stock of another corporation or unit of participation in a partnership, as well as a transaction involving a merger or consolidation, is a tax-free exchange that falls under Section 40(C)(2), in relation to Section 40(6)(b) and (c) of the Tax Code of 1997, the requirements hereunder stated must be complied with by both transferor(s)/absorbed corporation and transferee/surviving/consolidated corporation.

The procedures outlined hereunder implement and complement Revenue Regulations No. 18-2001 dated November 13, 2001, and **shall be observed in the monitoring and investigation of the basis of such properties transferred pursuant to a tax-free exchange**, to ascertain compliance with the conditions set forth in the Certification/Ruling issued by this Office, and in the consequent assessment of tax liabilities if any, due upon subsequent disposition of the properties involved in the exchange. xxx" *(Emphasis supplied)*

In fact, in one case, the Division of this Court, as affirmed on appeal by the Court En Banc, mentioned that Revenue Regulations No. 18-2001 merely provides for guidelines in monitoring tax-free exchange of property and in determining the gain or loss on a subsequent sale or disposition of property.[52] The relevant portion of the said decision is quoted below:

"As so aptly worded by the Court in Division:

'xxx Moreover, RR 18-2001 merely provides for guidelines in monitoring tax-

[52] *Commissioner of Internal Revenue vs. Dakudao & Sons, Incorporated,* CTA EB No. 1150, May 12, 2015 (CTA Case No. 8501).

> free exchange of property. The BIR ruling required thereon is for the monitoring of tax-free properties in order that in cases of subsequent sales of said properties, they shall be taxed accordingly. Stated differently, the BIR ruling/certification required under RR No. 18-2001 is for determining gain or loss on a subsequent sale or disposition of property subject of the tax-free exchange, and **not as a precondition for availment of a tax exemption.**'

> Furthermore, **RR No. 18-2001** which petitioner relies on for the denial of the claim for refund by respondent **merely provides for guidelines in the monitoring of** the properties as well as **shares of stocks**, which are **involved in a tax-free exchange under Section 40 (C) (2) of the NIRC.** The Revenue Regulation does not deal with a requirement to apply for a ruling as a prerequisite for the entitlement of the exemption. **RR No. 18-2001 shows nothing therein explicitly requiring a party, in exchanging property for shares of stocks, to first secure a BIR confirmatory certification or tax ruling before it can avail itself of tax exemption or tax refund.**" *(Emphasis supplied)*

To be sure, the Court cannot deprive petitioner of its claim for refund simply because it failed to comply with the provisions of the cited BIR issuances.

As to the allegation that the stock certificates of Puregold and of Kareila do not bear the annotation required under Section 58(E) of the NIRC of 1997, suffice to say that the pertinent law on the matter is Section 40(C)(2) of the NIRC of 1997, and as discussed, petitioners already proved compliance therewith.

Considering that the four requisites provided by law are present in this case, this Court finds that petitioners are entitled to the refund of the amount of CGT they paid for the exchange of shares[53], detailed as follows:

Taxpayer	Date of Payment (2012)	Capital Gains Tax	Interest	Compromise Penalty	Total Amount Paid
Lucio Co	June 26	₱ 652,291,875.00			₱ 652,291,875.00
	June 28	6,750,000.00	₱ 3,750.00		6,753,750.00
Susan Co	June 26	652,291,875.00			652,291,875.00
	June 28	6,750,000.00	3,757.50	₱ 5,000.00	6,758,757.50
Ferdinand Co	June 26	163,068,740.00			163,068,740.00
	June 28	1,687,495.05	5,624.98		1,693,120.03
Pamela Co	June 26	163,068,740.00			163,068,740.00
	June 28	1,687,495.04	937.50		1,688,432.54
Total		**₱1,647,596,220.09**	**₱14,069.98**	**₱5,000.00**	**₱1,647,615,290.07**

WHEREFORE, the instant Petition for Review is hereby **GRANTED**. Accordingly, respondent Commissioner of Internal Revenue is hereby **DIRECTED TO REFUND** in favor of petitioners Lucio Co, Susan Co, Ferdinand Co, and Pamela Co the amounts of P659,045,625.00, P659,050,632.50, P164,761,860.03, and P164,757,172.54, respectively, or a total amount of P1,647,615,290.07, representing erroneously paid capital gains tax.

SO ORDERED.

ESPERANZA R. FABON-VICTORINO
Associate Justice

We concur:

LOVELL R. BAUTISTA
Associate Justice

(On Leave)
MA. BELEN M. RINGPIS-LIBAN
Associate Justice

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[53] Exhibits "P-1" to "P-16", docket, vol. II, pp. 895-928.

ATTESTATION

I attest that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

LOVELL R. BAUTISTA
Chairperson

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairperson's Attestation, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ROMAN G. DEL ROSARIO
Presiding Justice