Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

EN BANC

COMMISSIONER OF INTERNAL REVENUE, Petitioner,	**CTA EB CASE NO. 1257** (CTA Case No. 8428)
-versus-	Present: DEL ROSARIO, P.J., CASTAÑEDA, JR. BAUTISTA UY CASANOVA FABON-VICTORINO MINDARO-GRULLA COTANGCO-MANALASTAS RINGPIS-LIBAN, JJ.
THE HONGKONG SHANGHAI BANKING CORPORATION LIMITED – PHILIPPINE BRANCH, Respondent.	Promulgated: MAY 17 2016 4:15pm

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DECISION

MINDARO-GRULLA, J.:

Submitted for decision is a Petition for Review for the Court *En Banc* under Rule 4, Section 2(a)(1), in relation to Rule 8, Section 4(b) of the 2005 Revised Rules of the Court of Tax Appeals (RRCTA) [1], as amended, of the Decision [2] dated October 13, 2014, rendered by the Third Division of

[1] Sec. 2. *Cases within the jurisdiction of the Court en banc.*- The Court en banc shall exercise exclusive appellate jurisdiction to review by appeal the following:

(a) Decisions or resolutions on motions for reconsideration or new trial of the Court in Division in the exercise of its exclusive appellate jurisdiction over:

(1) Cases arising from administrative agencies- Bureau of Internal Revenue, Bureau of Customs, Department of Finance, Department of Trade and Industry, Department of Agriculture;

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Sec. 4. *Where to appeal; mode of appeal.*-
(a) xxx.
(b) An appeal from a decision or resolution of the Court in Division on a motion for reconsideration or new trial shall be taken to the Court by petition for review as provided in Rule 43 of the Rules of Court. The Court en banc shall act on the appeal.
(c) xxx.

[2] En banc Docket, pp. 35-52.

this Court in CTA Case No. 8428, and its Resolution[3] dated December 10, 2014.

Petitioner assailed both the aforesaid Decision and Resolution, the dispositive portions of which, respectively, read as follows:

Decision dated October 13, 2014:

*"**WHEREFORE**, the Petition for Review is hereby **GRANTED.** The Final Decision on Disputed Assessment dated January 18, 2012, and Final Assessment Notice dated June 28, 2011 are hereby **CANCELLED.***

SO ORDERED."

Resolution dated December 10, 2014:

*"**WHEREFORE**, the "Motion for Reconsideration (Re: Decision promulgated 13 October 2014)" is hereby **DENIED**.*

SO ORDERED."

The pertinent facts as narrated by this Court's Division in its Decision read as follows:

"Petitioner[4], The Hongkong and Shanghai Banking Corporation Limited- Philippine Branch, is a duly licensed branch of The Hongkong and Shanghai Banking Corporation Limited ("HSBC"), a corporation organized and existing under the laws of Hongkong, Special Autonomous Region. Its main office address is at the 7th Floor, Tax Department, HSBC Centre, 3058 Fifth Avenue West, Bonifacio Global City, Taguig City.

On the other hand, respondent[5] Commissioner of Internal Revenue is the head of the Bureau of Internal C

[3] En banc Docket, pp. 53-55.
[4] The Hongkong and Shanghai Banking Corporation Limited- Philippine Branch. was the petitioner while the Commissioner of Internal Revenue(CIR) was respondent in the Court's Division. Before the Court en banc, The Hongkong and Shanghai Banking Corporation Limited- Philippine Branch is the respondent while the Commissioner of Internal Revenue (CIR) is the petitioner.
[5] Ibid.

Revenue, an agency of the Philippine Government primarily tasked with the assessment, imposition and collection of national internal revenue taxes and enforcement of the National Internal Revenue Code.

Prior to July 2008, HSBC carried on in the Asia Pacific Region, including the Philippines, among other businesses, 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, through petitioner, then created Global Payments Asia Pacific-Phils., Inc. ("GPAP-Phils"), to transfer its Merchant Acquiring Business in the Philippines.

On July 22, 2008, GPAP-Phils was incorporated, wherein shares of stocks were issued to petitioner in exchange for the fair-market value of the Point-of-Sale ("POS") Terminals, Merchant Agreements, and transfer of the Merchant Acquiring Business of HSBC.

On July 24, 2008, a Share Sale and Purchase Agreement was executed between HSBC and Global Payments Asia Pacific (Singapore Holdings) Private Limited ("GPAP-Singapore") for the transfer of said shares.

On September 3, 2008, a Deed of Assignment between petitioner and GPAP-Singapore was executed, wherein the former assigned its GPAP-Phils shares to the latter.

On September 5, 2008, the Documentary Stamp Tax in the amount of ₱52,365.75, based on the par value of the shares, was paid.

On September 22, 2008, petitioner filed an Application and Joint Certification with respondent to secure a ruling on the tax-free exchange under Section 40(C)(2) of the 1997 National Internal Revenue Code ("NIRC"), as amended regarding the transfer of the POS Terminals and Merchant Acquiring Business.

On September 28, 2008, the Capital Gains Tax ("CGT") in the amount of ₱89,929,292.10 was paid, in relation to the above said Deed of Assignment dated September 3, 2008.

On January 23, 2009, a Certification/Ruling No. SN: 018-2009 was issued by Assistant Commissioner of Legal

Service, certifying that the transfer of POS Terminals and Merchant Acquiring Business with Substituted Basis, in exchange for the GPAP-Phils shares are not subject to tax pursuant to Section 40(C)(2) of the 1997 NIRC, as amended.

On September 8, 2010, however, respondent issued a Notice of Informal Conference addressed to petitioner; the same was received by the latter on September 17, 2010.

On January 7, 2011, respondent issued a Preliminary Assessment Notice ("PAN") against petitioner for deficiency Income Tax in the amount of ₱296,936,948.59, inclusive of interest, from its gain on the sale of the Merchant Acquiring Business; the same was received on January 18, 2011.

On February 2, 2011, petitioner filed its Protest of even date to the said PAN, as well as its Supplemental Position Paper dated March 7, 2011, filed on March 10, 2011.

On March 14, 2011, respondent issued a Letter, granting petitioner's request to refer the case to the Legal and Inspection Group for resolution; the same was received on March 30, 2011.

On March 15, 2011, petitioner then executed and duly filed a Waiver of the Statute of Limitations; the same was duly received and acknowledged by respondent.

On June 28, 2011, respondent, thus, issued a Final Assessment Notice ("FAN") against petitioner for deficiency Income Tax in the amount of ₱318,781,625.17, inclusive of interest, on the sale of "Goodwill," pursuant to Section 27(A) of the 1997 NIRC, as amended; the same was received by petitioner on July 11, 2011.11 To illustrate:

Actual Selling Price	*₱899,342,921.00*
Less GPAPPI Shares of Stocks	*13,964,100.00*
Gross Amount	*885,378,821.00*
Income Tax Rate	*35%*
Income Tax Due	*309,882,587.35*
Advance Payment (9-29-08)	*89,929,292.10*
Basic Income Tax Deficiency	*219,953,295.25*
Interest (April16, 2009 to July 15, 2011)	*98,828,329.92*
Income Tax Payable	*₱318,781,625.17*

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On July 26, 2011, petitioner filed its Administrative Protest, which was received by respondent on even date.

On January 18, 2012, respondent issued a Final Decision on Disputed Assessment, which was received by petitioner on January 24, 2012.

On February 16, 2012, petitioner, thus, filed the present Petition for Review.

On June 26, 2012, respondent filed her Answer interposing the following Special and Affirmative Defenses:

"5. The sale of GOODWILL in the amount of ₱885,378,821.00 is subject to the regular corporate income tax of 35% as provided under Section 27(A) of the National Internal Revenue Code of 1997, as amended;

6. The report or investigation conducted by Revenue Examiners reveal[s] that petitioner is liable for deficiency Income Tax computed as follows: xxx.

7. It is quite illogical for the petitioner to invoke mistake and impugn the amount stated in the Deed of Assignment which it did not even bother to correct. It was when it realized that a deficiency assessment was forthcoming that it voiced out objection to its very own document;

8. Petitioner's allegation that respondent relies too heavily on the Deed of Assignment is misplaced. Even for the sake of argument that the only document to rely on is the Share of Sale and Purchase Agreement, the said document clearly states that the total value of the 139,641 shares is THIRTEEN MILLION NINE HUNDRED SIXTY FOUR THOUSAND PHILIPPINE PESOS as can be gleaned in Clause C of the Whereas Clauses of the Share Sale and Purchase Agreement quoted below:

'The Philippine Subsidiary will, prior to Completion, be incorporated with an authorized capital stock of FOURTEEN MILLION PHILIPPINE PESOS of which Thirteen Million Nine Hundred Sixty Four Thousand Philippine Pesos will be ***SUBSCRIBED and FULLY PAID UP by the SELLER****. The seller shall pay for such subscription by contributing to the Philippine Subsidiary POS TERMINALS having an appraised value of at least THIRTEEN MILLION NINE HUNDRED SIXTY FOUR THOUSAND PHILIPPINE PESO, xxx'* L

9. It bears emphasis that by contributing, the above quoted amount, the total authorized capital stock of ₱13,964,000 has been FULLY PAID;

10. The 'GOODWILL of Merchant Acquiring Business' is valued at ₱885,378,821.00 as can be gleaned in Clause 'D' of the Whereas Clauses of the Share Sale and Purchase Agreement quoted as follows: 'The bank, prior to Completion, shall transfer by way of additional paid in capital to the Philippine Subsidiary the GOODWILL of its Merchant Acquiring Business, valued at EIGHT HUNDRED EIGHTY FIVE MILLION THREE HUNDRED SEVENTY EIGHTTHOUSAND EIGHT HUNDRED TWENTY ONE PHILIPPINE PESOS. (₱885,378,821.00). xxx'

11. As stated above, it is clear that the account Additional Paid-in Capital has been used as a scheme in order to book the amount of GOODWILL in the Financial Statement of GPAP-Philippines;

12. Therefore, to say that the object of the Share Sale and Purchase Agreement is only the 139,641 GPAP-Phils share valued at ₱899,342,921.00 is clearly in contrast with the statement found in the Share Sale and Purchase Agreement. Furthermore, petitioner's allegation pertaining to the application of 'Completion Date' is just a mere afterthought;

13. To contend that the Deed of Assignment of Shares is erroneous is at its best, an alibi to negate the true consideration of the transaction as well as the real intention of the contracting parties;

14. Contrary to petitioner's allegations that the BIR is confused with the interpretation of the provisions of the Share Sale and Purchase Agreement pertaining to GOODWILL, there is an express provision in the aforesaid agreement that GOODWILL of the Merchant Acquiring Business is valued at ₱885,378,821.00;

15. For ease of reference and to recapitulate, Clause 'D' of the Whereas Clauses of the Share Sale and Purchase is quoted as follows:

XXX XXX XXX

16. To reiterate, it is clear that the Account Additional Paid-in Capital has been used as a scheme in order to book the amount of GOODWILL in the Financial Statement of GPAP-Phils. Therefore, the Share Sale and

Purchase Agreement is not only a sale of GPAP-Phils shares of stocks but includes sale of GOODWILL;

17. Petitioner's contention that there is no 'Sale of GOODWILL,' stressing therein that GOODWILL is an integral part and inseparable to the business where it is incident; and its admission that GOODWILL is intertwined and inseparably connected with the business will affirm the profound intention of petitioner to sell its Merchant Acquiring Business which it intends to carry out in the total amount of ₱899,342,921.00 inclusive of the GOODWILL amounting to ₱885,378,821.00 which was transferred to the subsidiary as can be gleaned in both the 2009/2008 Audited Financial Statements and Share Sale and Purchase Agreement where it categorically reflected the item Goodwill beyond which the petitioner can deny;

18. Furthermore, the sale of GOODWILL is within the ambit of the definition Ordinary Income as provided under Section 22(z) of the NIRC as amended quoted below:

> *'The term ordinary income includes any gain from the sale or exchange or property which is not a capital asset or property described in Section 39(A)(1). Any gain from the sale or exchange of property which is treated or considered, under other provisions of this Title, as ordinary income shall be treated as gain from the sale or exchange of property which is not a capital asset as defined in Section 39(A)(1). Sale of Goodwill therefore, not being one of the exception is clearly an*

19. The taxpayer's own admission to the fact that what it sold was its Merchant Acquiring Business, although the manner that it was sold was by way of sale of shares, affirmed that the formation of GPAP-Phil[s] by petitioner HSBC, its wholly owned subsidiary, where shares of stocks was issued in exchange of the Merchant Acquiring Business owned by petitioner, through Tax-Free Exchange. Such sale and transfer was a mechanism only to comply with the condition of a subsequent sale of shares of stocks acquired through tax-free exchange as subject to 5% or 10% capital gains tax transaction, instead of the sale of the Merchant Acquiring Business and GOODWILL which could have been a clear ordinary transaction subject to 35% income tax on net income;

20. Petitioner insist[s] citing various rulings and court decisions where net capital gain realized from the subsequent sale of the shares of stock[s] acquired through *a Tax Free Exchange as provided under Section 40(C)(2) is subject to a final capital gains tax of 5% or 10% as provided under Section 27(d)(2);*

21. As opposed to the above stated provision, what was subjected to the regular corporate income tax rate of 35% is only the sale of GOODWILL in the amount of ₱885,378,821.00 and not the subsequent sale of shares of stocks for a consideration of ₱13,964,100.00;

22. The contracting parties clearly committed a tax evasion scheme, by transferring the GOODWILL of the Merchant Acquiring Business of petitioner HSBC to GPAP-Phils, a wholly[-]owned subsidiary of petitioner HSBC created for the purpose as embodied in the so[-]called 'Share Sale and Purchase Agreement' wherein GPAP-Phils allowed the purchase of 99% of its entire capital stock to GPAP-Singapore, the identified buyer of the Goodwill even before the Deed of Assignment was actually created. In effect, with the transfer to GPAP Singapore of the 99% ownership of GPAP-Phils shares, technically, GPAP-Singapore acquired possession, control and the Goodwill that was transferred to GPAP-Phils;

23. Contrary to the allegations of petitioner, there was material omission as it never fully disclosed the material facts when it applied for a tax-free exchange ruling which constitutes bad faith in the nature of fraud;

24. To reiterate respondent's position in the Final Assessment Notice that there is material omission of facts in the request for ruling, particularly number 6 is quoted as follows: 'The net capital gains, if any realized from the subsequent transfer of the GP APPI shares to the Global Payments Asia Pacific Singapore Holding Co. shall be subject to the capital gains tax at the rates prescribed under Section 28(7)(C) of the 1997 Tax Code, as amended, and GRT.'

25. In asking respondent as to the nature of tax imposable on the preceding transaction, it necessitates that petitioner disclose the actual value of its transaction rather than omit material facts. That the total value should have been ₱899,342,921.00 inclusive of Additional Paid-in Capital representing Goodwill and not only ₱13,964,100.00 solely for the value of GPAP-Phils' share of stocks at par value;

26. Consequently, giving credit to the facts stated in petitioner's request for ruling, it corroborated to the truth *that the value of GPAP-Phils' shares of stocks sold is only ₱13,964,100.00;*

27. Petitioner's effort to persuade respondent that there was no tax evasion specifically its vacillation that what transpired as it alleged is a 'valid permissible arrangement' and a legitimate business purpose is misplaced;

28. Subsequently, petitioner materially under - declared (sic) the actual consideration for the sale of the GPAP-Phils' share in the Deed of Assignment by declaring only ₱13,964,100.00 instead of ₱899,342,921.00;

29. Even as early as during the creation of GPAP-Phils, petitioner already had in mind its scheme to declare only the amount of ₱13,964,100.00 as the value of the GPAP-Phils' shares of stocks as expressly stated in its request for ruling on the Tax Free Exchange;

30. Consequently, giving credit to the facts stated in the request for ruling, it corroborated the truth that the value of GPAP-Phils' shares of stock[s] are only ₱13,964,100.00 and affirmed the correctness of the amount reflected in the Deed of Assignment. The contention that the Deed of Assignment of Shares is flawed is an excuse to negate the true consideration of the transaction as well as the real intention of the contracting parties;

31. Finally, the regl[e]mentary period of thirty (30) days within which to file protest to the Final Assessment Notice ('FAN') is also moot and academic considering that respondent did not initiate any action within the prescribed regl[e]mentary period of thirty (30) days from service of the FAN within which petitioner can refute the validity of assessment;

32. In as much as (sic) the alleged pro forma contents or presentation of the Final Assessment Notice is concerned, what will invalidate said assessment is the failure to state the facts and the related provision of the law relied upon as provided under Section 3(3.14) of Revenue Regulations No. 12-99 quoted

33. Petitioner's contention regarding a defective Final Assessment Notice is immaterial since the assessment sent was clear on the facts, laws, rules and regulations on which the assessment is based and clearly *indicated the deficiency internal revenue taxes referred to; and*

34. Based on the foregoing, the finding of deficiency tax liabilities against petitioner is proper in all respects. Worthy of note, are the words of the Supreme Court in the case of Commissioner of Internal Revenue vs. Bank of the Philippine Islands:

> *'Tax assessments by tax examiners are presumed correct and made in good faith. The taxpayer has the duty to prove otherwise. In the absence of proof of any irregularities in the performance of duties, an assessment duly made by a Bureau of Internal Revenue examiner and approved by his superior officers will not be disturbed. All presumptions are in favour of the correctness of tax assessments.'*

On August 6, 2012, petitioner filed its Reply thereto.

On October 18, 2012, the parties' entered their Joint Stipulation of Facts and Issues.

On November 8, 2012, the Court issued the Pre-Trial Order.

Trial ensued, and the parties presented and offered their respective evidence.

On July 22, 2014, the case was submitted for decision, taking into consideration the Memorandum (For Petitioner The Hongkong [and] Shanghai Banking Corporation Limited - Philippine Branch) and respondent's Memorandum."

On October 13, 2014, this Court's Division cancelled CIR's Final Decision on Disputed Assessment dated January 18, 2012, and Final Assessment Notice dated June 28, 2011. This Court's Division finding that the transaction is a sale of capital asset, and the objective is the transfer of the Merchant Acquiring Business and not merely the goodwill thereof, stated pertinently as follows:

"xxx based on the records of the case- the creation of GPAP-Phils to transfer the Merchant Acquiring Business of HSBC by way of additional paid-in capital; the

subscription of 139,640 shares of stocks of GPAP-Phils in exchange for HSBC's POS terminals; the subscription of 1 common share of GPAP-Phils in exchange for HSBC's Merchant Agreements; and the subsequent assignment of the total number of shares of 139,641, subscribed by HSBC to GPAP Singapore, clearly shows that it is a sale of capital asset, as earlier quoted under Section 39(A)(1) of the 1997 NIRC, as amended, to which petitioner paid the total amount of ₱89,929,292.10.

As the main objective of HSBC, through petitioner, GPAP-Phils was created to transfer its Merchant Acquiring Business in the Philippines, and not merely the sale of its "Goodwill" thereof; the "Goodwill" necessarily attaches to the transfer of the Merchant Acquiring Business.

xxx xxx xxx.

Therefore, "Goodwill" is connected to the business itself, and cannot be allocated without regard to the business. With this, the alleged sale of "Goodwill," as additional paid-in capital in the amount of ₱885,378,821.00, cannot be treated separately. Stated differently, the total consideration indicated in the Share Sale and Purchase Agreement, in the amount of ₱899,342,921.00, cannot be conveniently allocated and reclassified to accommodate respondent's allegations. The Share Sale and Purchase Agreement, and even the Deed of Assignment of Shares, relied upon by respondent cannot support her position.

In sum, the Court has no recourse but to nullify the Final Decision on Disputed Assessment dated January 18, 2012, as well as the Final Assessment Notice dated June 28, 2011.

WHEREFORE**, the Petition for Review is hereby **GRANTED.** The Final Decision on Disputed Assessment dated January 18, 2012, and Final Assessment Notice dated June 28, 2011 are hereby **CANCELLED."

Petitioner [6] filed a Motion for Reconsideration. Said motion was denied for lack of merit, hence, the present petition was filed.

Petitioner raised this sole issue:

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[6] Ibid.

"WHETHER OR NOT THE THIRD DIVISION OF THE HONORABLE COURT ERRED WHEN IT CANCELLED THE DEFICIENCY INCOME TAX ASSESSMENT AGAINST PETITIONER ON THE SALE OF THE "GOODWILL" OF ITS MERCHANT ACQUIRING BUSINESS FOR TAXABLE YEAR 2008 IN THE AMOUNT OF ₱342,886,095.88."

Petitioner claims that the findings of this Court's Division are contrary to the actual transaction of the parties. Petitioner claims that the intention of the respondent was to sell its Merchant Acquiring Business for a consideration of ₱899,342,921.00. Petitioner insists that the creation of GPAP-Phils is to circumvent the law to classify the transaction as a tax free exchange instead of the sale of the POS terminals and the goodwill which is an ordinary asset subject to 35% income tax.

The Court received respondent's comment on the petition on March 27, 2015. HSBC-Philippines did not dispute said transaction and claims that the transaction entered into by HSBC-Philippines and GPAP-Singapore is a "permissible arrangement" in the United States even if it has the effect of converting ordinary income into capital gain".

Thereafter, the Court directed the parties to file their respective memoranda. Respondent filed its memorandum on May 25, 2015. On June 18, 2015, the Court noted petitioner's manifestation adopting the arguments and discussions in the petition as its memorandum.

We resolve.

In a nutshell, HSBC-Philippines sold its Merchant Acquiring Business at a premium to GPAP-Singapore. As agreed, HSBC-Philippines will create GPAP-Philippines, transfer the Merchant Acquiring Business and Transferred Asset (including the point of sale terminal valued at ₱13,964,100.00) of HSBC-Philippines in exchange of 139,641 shares of GPAP-Philippines valued at

₱13,964,100.00. Thereafter, the shares of GPAP-Philippines were assigned by HSBC-Philippines to GPAP-Singapore. The consideration of the Merchant Acquiring Business was ₱899,342,921.00.

It is CIR's contention that the whole transaction of selling the Merchant Acquiring Business, HSBC-Philippines and GPAP-Singapore agreed to recognize and value goodwill in the Share Sale and Purchase Agreement at ₱885,378,821.00 which is an ordinary asset subject to 35% income tax. Thus, CIR assessed the alleged sale of goodwill valued at ₱885,378,821.00.

Petitioner failed to persuade us.

In the case of *WM H. Anderson vs. Juan Posadas, Jr.*, GR. No. 44100, September 22, 1938, the Supreme Court has defined goodwill as the reputation of good name of an establishment. If the goodwill, that is, the good reputation of the business is acquired in the course of its management and operation, it does form part of the capital with which it was established. It is an intangible moral profit, susceptible of valuation in money, acquired by the business by reason of the confidence reposed in it by the public, due to the efficiency and honesty shown by the manager and personnel thereof in conducting the same on account of the courtesy accorded its customers, which moral profit, once it is valuated and used, becomes a part of the assets, to wit:

> *"According to Reynolds, a witness for the plaintiff, the good will account of ₱155,000 was created "because the conditions of the business deserved the establishment of this item." The phrase "good will" is defined in 28 Corpus Juris, 729, section 1, as follows:*
>
> > *Goodwill may be defined to be the advantage or benefit which is acquired by an establishment, beyond the mere value of the capital stock, funds, or property employed therein in consequence of the general public patronage and encouragement which it receives from constant or habitual customers on account of its local position or common celebrity or reputation for skill, affluence, punctuality, or from*

> *other accidental circumstances or necessities, or even from accident partialities or prejudices. . . .*
>
> *According to the above-quoted definition, good will is the reputation of good name of an establishment. If the good will, that is, the good reputation of the business is acquired in the course of its management and operation, it does form part of the capital with which it was established. It is an intangible moral profit, susceptible of valuation in money, acquired by the business by reason of the confidence reposed in it by the public, due to the efficiency and honesty shown by the manager and personnel thereof in conducting the same on account of the courtesy accorded its customers, which moral profit, once it is valuated and used, becomes a part of the assets. The good will of ₱155,000 created by Anderson has been beneficial not only to him but also to Feldstein in the proportion of 7/12 for Anderson and 5/12 for Feldstein, which is the proportion of the participation of each in the shares of the corporation Erlanger & Galinger, Inc., that is, P90,412 for Anderson and ₱64,588 for Feldstein, inasmuch as Anderson's personal debt for the balance of the unpaid shares, was dismissed by said sum of ₱90,412 and Feldstein's capital account increased by ₱64,588."*

From the definition, goodwill forms part of the capital with which it was established and once it is valuated and used, becomes a part of the assets.

Furthermore, goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.[7] It is an intangible asset, cannot exist independently of the business, nor can it be sold, purchased or transferred separately without carrying out the same transactions for the business as a whole. Thus, goodwill is tagged to a company or business and cannot be sold or purchased independently.

In this case, as pointed by the petitioner, HSBC-Philippines and GPAP-Singapore agreed to recognize and value the goodwill of the Merchant Acquiring Business in the Share Sale and Purchase Agreement at ₱885,378,821.00.

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[7] Philippine Financial Reporting Standards 3 (Revised)

However, while goodwill was recognized and valued, the same cannot be sold or purchased independently of the Merchant Acquiring Business. As to whether said goodwill is an ordinary asset and subject to 35% income tax, we rule in the negative.

The gain or the loss is ordinary when the property sold or exchanged is not a capital asset. Goodwill is not an ordinary asset as it is not among the exceptions under the definition of capital assets. A capital asset is defined negatively in Section 39(A)(1) of the 1997 NIRC, as amended[8]; to wit:

> *(1) Capital Assets. - The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property used in the trade or business, of a character which is subject to the allowance for depreciation provided in Subsection (F) of Section 34; or real property used in trade or business of the taxpayer."*

Thus, We find that the Court's Division aptly ruled that it is a capital asset subject to capital gains tax, to wit:

> *For easy reference, Section 27(A) of the 1997 NIRC, as amended, provides:*
>
> > *"SECTION 27. Rates of Income Tax on Domestic Corporations. - (A) In General. - Except as otherwise provided in this Code, an income tax of thirty-five percent (35 %) is hereby imposed upon the taxable income derived during each taxable year from all sources within and without the Philippines by every corporation, as defined in Section 22(B) of this Code and taxable under this Title as a corporation, organized in, or existing under the laws of the Philippines: Provided, That effective January 1, 1998, the rate of income tax shall be thirty-four percent*

[8] China Banking Corporation vs. Court of Appeals, et. al, G.R. No. 125508, July 19, 2000

(34%); effective January 1, 1999, the rate shall be thirty-three percent (33%); and effective January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%)."

And Section 22(Z) of the Code clearly defines an "ordinary income," as follows:

"(Z) The term 'ordinary income' includes any gain from the sale or exchange of property which is not a capital asset or property described in Section 39(A)(1). Any gain from the sale or exchange of property which is treated or considered, under other provisions of this Title, as 'ordinary income' shall be treated as gain from the sale or exchange of property which is not a capital asset as defined in Section 39(A)(1). The term 'ordinary loss' includes any loss from the sale or exchange of property which is not a capital asset. Any loss from the sale or exchange of property which is treated or considered, under other provisions of this Title, as 'ordinary loss' shall be treated as loss from the sale or exchange of property which is not a capital asset."

Thus, Section 39(A)(1) of the 1997 NIRC, as amended, states:

"SECTION 39. Capital Gains and Losses. –

(A) Definitions. - As used in this Title –

(1) Capital Assets. - The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property used in the trade or business, of a character which is subject to the allowance for depreciation provided in Subsection (F) of Section 34; or real property used in trade or business of the taxpayer."

In the case of Tuason, Jr. v. Lingad, the Supreme Court ruled as follows:

"As thus defined by law, the term 'capital assets' includes all the properties of a taxpayer whether or not connected with his trade or business, c

> *except: (1) stock in trade or other property included in the taxpayer's inventory; (2) property primarily for sale to customers in the ordinary course of his trade or business; (3) property used in the trade or business of the taxpayer and subject to depreciation allowance; and (4) real property used in trade or business. If the taxpayer sells or exchanges any of the properties above enumerated, any gain or loss relative thereto is an ordinary gain or an ordinary loss; the gain or loss from the sale or exchange of all other properties of the taxpayer is a capital gain or a capital loss." (Boldfacing supplied and citations omitted.)*

And in the determination of whether a property is a capital or ordinary asset, a careful perusal and weighing of the surrounding circumstances must be made. In the case at bench, after a thorough review of the records of the case, the Court finds respondent's arguments to be without merit.

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.

Applying the foregoing, and based on the records of the case- the creation of GPAP-Phils to transfer the Merchant Acquiring Business of HSBC by way of additional paid-in capital; the subscription of 139,640 shares of stocks of GPAP-Phils in exchange for HSBC's POS terminals; the subscription of 1 common share of GPAP-Phils in exchange for HSBC's Merchant Agreements; and the subsequent assignment of the total number of shares of 139,641, subscribed by HSBC to GPAP-Singapore, clearly shows that it is a sale of capital asset, as earlier quoted under Section 39(A)(1) of the 1997 NIRC, as amended, to which petitioner paid the total amount of ₱89,929,292.10.

Concomitantly, the sale of the Merchant Acquiring Business of HSBC-Philippines at a premium to GPAP-Singapore whereby goodwill was recognized and valued in the Share Sale and Purchase Agreement for ₱885,378,821.00 is a sale of capital asset since (1) it is not included in stock in trade which would properly be included in the inventory at the close of the taxable year, (2) nor it is held primarily for sale to customers in the ordinary course of his trade or business, (3) nor it is a property used in the trade or business, of a character which is subject to the allowance for depreciation provided in subsection (f) of Section 34 of the NIRC, and (4) nor it is real property used in the trade or business.

Thus, while taxes are the lifeblood of the government, the power to tax has its limits, in spite of all its plenitude.[9] Accordingly, finding no reversible error, the Court En Banc finds no cogent reason or justification to disturb the conclusions reached by the CTA Third Division.

WHEREFORE premises considered, the petition is **DENIED** for lack of merit. The Decision of the Third Division of this Court in CTA Case No. 8428, promulgated on October 13, 2014 and its Resolution, promulgated on December 10, 2014, are hereby **AFFIRMED**. No pronouncement as to costs.

SO ORDERED.

CIELITO N. MINDARO-GRULLA
Associate Justice

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

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[9] Commissioner of Internal Revenue vs. Metro Star Superama, Inc., G.R. No. 185371, December 8, 2010.

ESPERANZA R. FABON-VICTORINO
Associate Justice

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

MA. BELEN RINGPIS-LIBAN
Associate Justice

C E R T I F I C A T I O N

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation among the members of the Court En Banc before the case was assigned to the writer of the opinion of the Court En Banc.

ROMAN G. DEL ROSARIO
Presiding Justice