REPUBLIC OF THE PHILIPPINES

Court of Tax Appeals

QUEZON CITY

Third Division

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED – PHILIPPINE BRANCH,
Petitioner,

- *versus* -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 8428

Members:
BAUTISTA, *Chairperson,*
FABON-VICTORINO, *and*
RINGPIS-LIBAN, *JJ.*

Promulgated:

OCT 13 2014
11:30 a.m.

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DECISION

BAUTISTA, J.:

The Petition for Review,[1] filed pursuant to Section 11[2] of Republic Act No. 1125,[3] as amended by Republic Act No. 9282[4] and Republic Act No. 9503,[5] in relation to Section 228[6] of the 1997 National Internal

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[1] *Records*, pp. 6-422, with Annexes.

[2] SEC. 11. *Who May Appeal; Mode of Appeal; Effect of Appeal.* – Any party adversely affected by a decision, ruling or inaction of the Commissioner of Internal Revenue, the Commissioner of Customs, the Secretary of Finance, the Secretary of Trade and Industry or the Secretary of Agriculture or the Central Board of Assessment Appeals or the Regional Trial Courts may file an appeal with the CTA within thirty (30) days after the receipt of such decision or ruling or after the expiration of the period fixed by law for action as referred to in Section 7(a)(2).

[3] An Act Creating the Court of Tax Appeals, as amended.

[4] An Act Expanding the Jurisdiction of the Court of Tax Appeals (CTA), Elevating its Rank to the Level of a Collegiate Court with Special Jurisdiction and Enlarging its Membership, Amending for the Purpose Certain Sections of Republic Act No. 1125, as amended, Otherwise Known as the Law Creating the Court of Tax Appeals, and for Other Purposes.

[5] An Act Enlarging the Organizational Structure of the Court of Tax Appeals, Amending for the Purpose Certain Sections of the Law Creating the Court of Tax Appeals, and for Other Purposes.

[6] SEC. 228. *Protesting of Assessment.* – xxx

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Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final.

If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of the one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable.

Revenue Code, as amended, seeks the nullification of the Final Decision on Disputed Assessment dated January 18, 2012, as well as the Final Assessment Notice dated June 28, 2011, all issued by respondent.

FACTS OF THE CASE

Petitioner, 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 Commissioner of Internal Revenue is the head of the Bureau of Internal 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,[7] 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.

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[7] SECTION 40. *Determination of Amount and Recognition of Gain or Loss.* –

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(C) *Exchange of Property.* –

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(2) *Exception.* – No gain or loss shall be recognized if in pursuance of a plan of merger or consolidation –

xxx xxx xxx

(a) A corporation, which is a party to a merger or consolidation, exchanges property solely for stock in a corporation, which is a party to the merger or consolidation; or

(b) A shareholder exchanges stock in a corporation, which is a party to the merger or consolidation, solely for the stock of another corporation also a party to the merger or consolidation; or

(c) A security holder of a corporation, which is a party to the merger or consolidation, exchanges his securities in such corporation, solely for stock or securities in another corporation, a party to the merger or consolidation.

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.

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.[8]

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.[9]

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;[10] 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

[8] *Records*, p. 585.
[9] *Id.*
[10] 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 (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%). x x x.
[11] *Records*, p. 585.

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 (April 16, 2009 to July 15, 2011)	98,828,329.92
Income Tax Payable	**₱318,781,625.17**

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.[12]

On February 16, 2012, petitioner, thus, filed the present Petition for Review.[13]

On June 26, 2012, respondent filed her Answer,[14] 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:

INCOME TAX

Actual Selling Price	₱899,342,921.00
Less: GPAP-Phil 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 (April 16, 2009 to January 31, 2012)	122,932,800.63

[12] *Id.*
[13] *Supra*, note 1.
[14] *Records*, pp. 479-490.

Income Tax Payable	**₱342,886,095.88**

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'

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 EIGHT

THOUSAND 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 GPAPPI 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 below:

xxx xxx xxx

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 favor of the correctness of tax assessments.'"[15]

On August 6, 2012, petitioner filed its Reply thereto.[16]

On October 18, 2012, the parties' entered their Joint Stipulation of Facts and Issues.[17]

On November 8, 2012, the Court issued the Pre-Trial Order.[18]

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

On July 22, 2014, the case was submitted for decision,[19] taking into consideration the Memorandum (For Petitioner The Hongkong [and] Shanghai Banking Corporation Limited - Philippine Branch)[20] and respondent's Memorandum.[21]

[15] *Id.*, at pp. 480-488. Citation omitted.
[16] *Id.*, at pp. 500-526.
[17] *Id.*, at pp. 584-588.
[18] *Id.*, at pp. 956-962.
[19] *Id.*, at p. 1924.
[20] *Id.*, at pp. 1874-1921.
[21] *Id.*, at pp. 1863-1870.

Hence, this Decision.

THE ISSUES

The issues stipulated upon by the parties are as follows:

I. WHETHER OR NOT THE ENTIRE PROCESS OF FIRST CREATING GPAP-PHILS TO HOUSE THE SPUN-OFF MERCHANT ACQUIRING BUSINESS OF HSBC AND SUBSEQUENTLY SELLING GPAP-PHILS TO GPAP-SINGAPORE IS A VALID METHOD OF SELLING AN ENTIRE BUSINESS THROUGH A SHARES SALE;

II. WHETHER OR NOT PETITIONER'S ALLEGED SALE OF GPAP-PHILS TO GPAP-SINGAPORE, TRANSFERRING PETITIONER'S SHARES IN GPAP-PHILS TO THE LATTER, IS A SALE OF THE BUSINESS BY WAY OF A SHARES SALE AND NOT AN ASSET SALE; and

III. WHETHER PETITIONER IS LIABLE TO PAY DEFICIENCY TAX LIABILITIES REPRESENTING INCOME TAX IN THE AMOUNT OF ₱342,886,095.88 ON THE SALE OF "GOODWILL" FOR TAXABLE YEAR 2008, AS WELL AS PENALTY, DEFICIENCY AND DELINQUENCY INTEREST AS PROVIDED IN SECTIONS 248 AND 249 OF THE NIRC.[22]

In a nutshell, the issue to be resolved by the Court is whether petitioner is liable to pay the deficiency Income Tax in the amount of ₱342,886,095.88 for taxable year 2008.

THE RULING OF THE COURT

The Court finds the Petition for Review meritorious.

[22] *Id.*, at p. 586.

Based on the Share Sale and Purchase Agreement,[23] between HSBC and GPAP–Singapore, the Merchant Acquiring Business of the former was transferred to the latter's subsidiary, the GPAP-Phils. From GPAP-Phils authorized capital stock of ₱14,000,000.00, the amount of ₱13,964,000.00 was subscribed and fully paid by HSBC by contributing to GPAP-Phils, the POS Terminals of HSBC with an appraised value of the same amount. Also, HSBC transferred to GPAP-Phils its Merchant Agreements in exchange for 1 common share. Further, by way of additional paid-in capital, HSBC transferred its Merchant Acquiring Business to GPAP-Phils valued at ₱885,378,821.00. Thus, the aggregate consideration of the above is in the amount of ₱899,342,921.00; to compute:

Nature of Properties	*Amount*
POS Terminals	₱13,964,000.00
Merchant Agreements	₱100.00
Additional Paid-in Capital	₱885,378,821.00
TOTAL	**₱899,342,921.00**

And in the Deed of Assignment of Shares,[24] between HSBC and GPAP-Singapore, the earlier mentioned subscribed shares of stocks of GPAP-Phils - 139,641 - the former assigned the same to the latter, for and in consideration of the amount of ₱13,964,100.00.

Respondent hinges its claim on the portion of the Share Sale and Purchase Agreement,[25] to quote:

> "The Bank [HSBC], prior to Completion, shall transfer by way of additional paid-in capital to the Philippine Subsidiary [GPAP-Phils] the goodwill of its Merchant Acquiring Business, valued at EIGHT HUNDRED EIGHTY FIVE MILLION THREE HUNDRED SEVENTY EIGHT THOUSAND EIGHT HUNDRED TWENTY ONE PHILIPPINE PESOS (₱885,378,821.00). After such transfer, the total paid in capital of the Philippine Subsidiary [GPAP-Phils] shall be EIGHT HUNDRED NINETY NINE MILLION THREE HUNDRED FORTY [TWO THOUSAND NINE HUNDRED] TWENTY ONE PHILIPPINE PESOS (₱899,342,921.00)."

[23] *Exhibit "C."*
[24] *Exhibit "D."*
[25] *Exhibit "C."*

Accordingly, respondent argues that the difference between the amounts of ₱899,342,921.00 and ₱13,964,100.00, *i.e.*, in the amount of ₱885,378,821.00, represents the sale of "Goodwill," which is considered as an ordinary gain, and is thus, subject to the regular corporate Income Tax rate pursuant to Section 27(A) of the 1997 NIRC, as amended.[26]

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 (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

[26] *Supra,* note 10.

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,*[27] 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, 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

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[27] G.R. No. L-24248, July 31, 1974, 58 SCRA 170, 176.

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. [28]

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.

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.

In the case of *FCT v. Murry*,[29] the same ruled that "*goodwill is inseparable from the conduct of the business. It may derive from identifiable assets of the business, but it is an indivisible item of property, and it is an asset that is legally distinct from the sources – including other assets of the business – that have created the goodwill. Because that is so, goodwill does not inhere in the identifiable assets of the business, and the sale of an asset which is a source of goodwill, separate from the business itself, does not involve any disposition of the goodwill of the business.*"

It is well to note also that in the case of *China Banking Corporation v. Court of Appeals*,[30] albeit a mere obiter, the Supreme Court mentioned

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[28] China Banking Corporation *v.* Court of Appeals, G.R. No. 125508, July 19, 2000, 336 SCRA 178.
[29] (1998) 193 CLR 605; 39 ATR 139.
[30] *Supra*, note 28.

that "Goodwill," as an intangible asset, may or may not be given corresponding values in financial statements.

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,[31] in the amount of ₱899,342,921.00, cannot be conveniently allocated and re-classified to accommodate respondent's allegations. The Share Sale and Purchase Agreement,[32] and even the Deed of Assignment of Shares,[33] 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**.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ESPERANZA R. FABON-VICTORINO
Associate Justice

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

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31 *Exhibit "C."*
32 *Ibid.*
33 *Exhibit "D."*

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
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Section 13 of Article VIII 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's Division.

ROMAN G. DEL ROSARIO
Presiding Justice