REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Sec. 40(C)(2)&(6)(b) of the Tax Code of 1997, as amended; RR 18-01
BIR Ruling No. 214-12 BIR Ruling No. 100-17 BIR Ruling No. 075-18
S40M- 389-2022
SEP 08 2022

LAND BANK OF THE PHILIPPINES
Landbank Plaza, 1598 M.H. Del Pilar
Corner Dr. J. Quintos Sts., Malate,
Manila, Philippines 1004

Attention: **<u>Mr. Cesar S. Cabanes</u>**
OIC *Vice-President*
Legal Service Group

Gentlemen:

This refers to your letter requesting on behalf of Land Bank of the Philippines (LANDBANK) and United Coconut Planters Bank (UCPB) for confirmation of your opinion that the merger between LANDBANK and UCPB, with LANDBANK as the surviving corporation, is a tax-free merger in accordance with Section 40(C)(2) and 6(b) of the National Internal Revenue Code (Tax Code) of 1997, as amended.

<u>Background</u>

1. LANDBANK, with Taxpayer Identification No. (TIN) , is a government financial institution created and existing under and by virtue of the provisions of Republic Act (RA) No. 3844, as amended, with principal office address at LANDBANK Plaza, 1598 Del Pilar corner Dr. J. Quintos Sts., Malate Philippines. At present, LANDBANK has authorized capital stock of divided into ( ) common shares. At the time of merger, LANDBANK has a total capital stock issued and outstanding amounting to

2. UCPB, with TIN 000- was likewise a government financial institution duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal office address at UCPB Corporate Offices, 7907 Makati Avenue, Makati City. It had an authorized capital stock of

SAOM- 389-2022
SEP 08 2022

Pesos (P .00) divided into ( ) common shares and special preferred shares, all with par value of P) per share. The total capital stock issued and outstanding amounts to Pesos (P common shares and Pesos (P) preferred shares.

3. On December 14, 2021, LANDBANK and UCPB executed a Plan and Articles of Merger, with LANDBANK as the surviving corporation, wherein the effective date of the merger is on the first day of the month after the lapse of the 40-day period following the issuance by the Securities and Exchange Commission (SEC) of a certificate approving the Plan of Merger and the corresponding Articles of Merger.

4. On June 25, 2021, Executive Order (EO) No. 142, series of 2021 was issued approving the Plan and Articles of Merger by the Republic of the Philippines, which holds 100% of the outstanding capital stock of LANDBANK. On the other hand, on December 14, 2021, in a special meeting held in Metro Manila, of which quorum was present, the stockholders of UCPB representing at least 2/3 of its outstanding capital stock, voted for and approved the Plan of Merger.

5. The respective Board of Directors of the Constituent Corporations have determined that the merger is in furtherance of and consistent with their respective interests and the best interest of their respective stockholders, except for the fact that LANDBANK can only issue shares to eligible private sector provided under Section 75 of Republic Act (RA) No. 3844, as amended by RA No. 10878.

6. In accordance with the Plan of Merger and pursuant to the eligibility requirements of Section 75 of RA No. 3844, as amended by RA No. 10878, all issued and outstanding shares of UCPB and any unpaid portion of existing subscription in UCPB shall automatically be cancelled and all issued and outstanding UCPB shares, which are not in the name of LANDBANK shall, pursuant to an independent valuation conducted by the Development Bank of the Philippines (DBP) dated January 25, 2021 and Supplemental Report dated September 6, 2021, have the right to receive P per share in cash without interest. Moreover, the UCPB shares covered by a share purchase agreement with LANDBANK shall be paid. Perforce, LANDBANK will no longer issue shares to minority stockholders of UCPB representing 11.09%, since such stockholders are not eligible to hold LANDBANK shares pursuant to RA No.

3844, as amended by RA No. 10878, and to the 88.91% shares in UCPB which is already owned by LANDBANK.

Based on the foregoing representations, you now request confirmation of your opinion that the merger of LANDBANK and UCPB is a tax-free merger under Section 40(C)(2) and (6)(b) of the Tax Code of 1997, as amended.

At the outset, please be informed that Section 40 (C) (1) & (2) of the Tax Code of 1997, as amended, provides as follows:

> *"SEC. 40. Determination of Amount and Recognition of Gain or Loss.*
>
> *xxx xxx xxx*
>
> *(C) Exchange of Property. —*
>
> *(1) General Rule. — Except as herein provided, upon the sale or exchange of property, the entire amount of the gain or loss as the case may be, shall be recognized.*
>
> *(2) Exception. — No gain or loss shall be recognized if in pursuance of a plan of merger or consolidation —*
>
> *(a) A corporation, which is a party to a merger or consolidation, exchanges property solely for stock in a corporation, which is a party to the merger or consolidation;" (Emphasis supplied)*

From the afore-quoted provision of Section 40 (C) (2) of the Tax Code, as amended, it is clear that in order to qualify as an exception to the recognition of the gain or loss upon the sale or exchange of property, a corporation which is a party to a merger exchanges its property solely for stock in another corporation which is also a party to the merger. *(BIR Ruling No. S40M-210-21 dated June 16, 2021)*

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

For tax purposes, in order to be considered as tax-free merger, it is required that there must be an issuance of shares of stocks by the surviving corporation in favor of the stockholders of the absorbed corporation to retain the identity of the latter while the surviving corporation took over the rights, privileges, franchises, properties, claims,

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[1]*Bank of Commerce v. Radio Philippines Network, Inc., G.R. No. 195615, April 21, 2014, Phil. 491-581.*

SAOM-389-2022
SEP 08 2022

liabilities and obligations of the absorbed corporation. Said scenario results in the continuance of ownership by the stockholders of the absorbed corporation and terminating the life of the absorbed corporation causing the continuance of ownership of its previous rights, privileges, franchises, properties, claims, liabilities and obligations of the absorbed corporation. In the present case, however, LANDBANK, as the surviving corporation cannot issue shares of stocks to minority stockholders of the absorbed corporation (UCPB) representing 11.09% of its outstanding stockholders, since said stockholders are not eligible pursuant to the prohibition provided under Section 75 (15) of Republic Act (RA) No. 3844, as amended by RA No. 10878, to wit:

"*xxx xxx xxx*

> *(15) To offer and issue common and preferred shares of stocks to ARBs, small farmers and fisherfolk through their organizations, cooperatives, federations and cooperative banks; development partners and strategic investors such as multilateral and bilateral institutions; rural banks and their associations, in quantities to be determined by the Board of Directors and in accordance with applicable laws, rules and regulations: Provided, However, That the National Government shall maintain, at all times, at least two-thirds (2/3) ownership of the total outstanding common shares of the Bank.*
>
> *Preferred shares of stock shall be non-voting. Other features of preferred shares shall be determined by the Board of Directors in accordance with applicable laws and regulations."*

Clearly, Section 75 (15) of RA No. 3844, as amended by RA No. 10878, allows LANDBANK to offer and issue shares only to specific individual and groups, such as, agrarian reform beneficiaries, small farmers and fisherfolk through their organizations, cooperatives, federations and cooperative banks; development partners and strategic investors such as multilateral and bilateral institutions; rural banks and their associations, in quantities to be determined by the Board of Directors and in accordance with applicable laws, rules and regulations. In compliance thereof, LANDBANK and UCPB, agreed for a merger consideration where shares of stocks in UCPB will automatically be cancelled in exchange for the right to receive from LANDBANK a cash-out price on effectivity date of the merger, except for those UCPB shares in LANDBANK's name and shares which have become subject of a share purchase agreement with LANDBANK entered into before the approval by the respective stockholders of LANDBANK and UCPB of the Plan of Merger.

It is axiomatic in statutory construction that a statute must be interpreted, not only to be consistent with itself, but also to harmonize with other laws on the same subject matter, as to form a complete, coherent and intelligible system. The rule is expressed in the maxim, *"interpretare et concordare legibus est optimus interpretandi,"* or every statute must be so construed and harmonized with other statutes as to form a uniform system of jurisprudence.[2]

In the case of Butuan Sawmill, Inc. vs. City of Bututan, the Supreme Court had the occasion to hold that *it is a canon of statutory construction that a special law prevails over a general law — regardless of their dates of passage — and the special is to be considered as remaining an exception to the general.*[3]

In view of the foregoing, this office is of the view as it hereby opines that the foregoing merger of LANDBANK and UCPB is a merger within the contemplation of Section 40 (C) (2) (a) in relation to 40 (C) (6) (b) of the Tax Code of 1997, as amended, because LANDBANK shall acquire/assume all the assets and liabilities of the UCPB and the same is desirable and advantageous to the constituent corporations and their respective stockholders, thus, it is being undertaken for a *bona fide* business purpose and not for the purpose of escaping the burden of taxation.

Since the merger of LANDBANK and UCPB qualifies for non-recognition of gain or loss for income tax purposes in accordance with Section 40(C)(2) of the Tax Code of 1997, as amended, no gain or loss shall be recognized by UCPB as the transferor of all assets and liabilities, to LANDBANK pursuant to the Plan of Merger.

In the same vein, no gain or loss shall be recognized by LANDBANK, as the transferee, on its receipt of the assets and liabilities of UCPB pursuant to and as a consequence of the merger.

The basis of the properties transferred in the hands of the transferee (LANDBANK) shall be the same as it would be in the hands of the transferor increased by the amount of the gain, if any, recognized to the transferor on the transfer. (*Sec. 40 (C) (5) (b), supra*)

Finally, if the amount of the liabilities assumed plus the amount of the liabilities to which the property is subject exceed the total of the adjusted basis of the properties transferred pursuant to such exchange, then such excess shall be considered as a gain, on the part of the transferor, from the sale or exchange of a capital asset or of property which is not a capital asset, as the case may be. (Sec. 40 (C) (4) (b), *supra*)

The substituted basis of the properties transferred by UCPB to LANDBANK shall comply with the rule that cash and other cash items will be excluded from the computation of the adjusted basis of the properties transferred for purposes of determining whether liabilities assumed and to which the property is subject do not exceed the adjusted basis of the property transferred pursuant to No. IV(A)(2) of Revenue Memorandum Ruling (RMR) No. 2-2002 dated June 10, 2002.

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[2] *G.R. No. 159747, 13 April 2004, 427 SCRA 46*
3 Butuan Sawmill, Inc. v. City of Butuan, No. L-21516, April 29, 1966, 16 SCRA 755.

On the other hand, Section 105 of the Tax Code of 1997, as amended, identifies the persons liable for the value-added tax (VAT). Thus,

> *"SECTION 105. Persons Liable. – Any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value-added-tax (VAT) imposed in Sections 106 to 108 of this Code. xxx."*

However, Section 4.106-8(b)(3) of Revenue Regulations (RR) No. 16-2005, as amended by RR No. 4-2007[4], specifically excludes mergers from being subject to output tax. Hence,

> *"**SECTION 4.106-8**. Change or Cessation of Status as VAT-registered Person. –*
>
> *xxx*
>
> *(b) **Not subject to output tax**.*
>
> *The VAT shall not apply to goods or properties existing as of the occurrence of the following:*
>
> *1. xxx*
>
> *2. xxx*
>
> *3. Merger or consolidation of corporations. The unused input tax of the dissolved corporation, as of the date of merger or consolidation, shall be absorbed by the surviving or new corporation."*

Thus, the above-mentioned merger shall not be subject to VAT, and any unused input VAT of UCPB as of the effective date of merger will be transferred to and absorbed by LANDBANK pursuant to Section 4.106-8(b)(3) of RR No. 16-2005, as amended, the said transfer being considered a transaction "not subject to output tax" under the said Section.

Moreover, well-settled in our jurisprudence is the fact that the essential elements of a valid donation are: (1) the reduction of the patrimony of the donor, (2) the increase in the patrimony of the donee, and (3) the intent to do an act of liberality *(animus donandi)*.

Clearly, there is no intention on the part of UCPB to donate to LANDBANK its assets since the transaction is purely for legitimate business purpose. Thus, the aforesaid

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[4] *now exempted from VAT under Section 34 of RA No. 10963, amending Section 109 of RA Nos. 8424 and 9337*

merger will not be subject to donor's tax since there is no intention to donate, and the transaction is a *bonafide* merger effected solely for business reasons.

Furthermore, no DST is due on the transfer of assets made pursuant to the Plan of Merger under Section 199 (m) of the Tax Code of 1997, as amended by Republic Act No. 9243, in relation to Section 40 (C) (2) of the Tax Code of 1997, as amended. *(BIR Ruling No. 100-2017 dated March 2, 2017)*

In the case of *Pilipinas Shell Petroleum Corporation vs. Commissioner of Internal Revenue* (C.T.A. Case No. 6477 dated April 20, 2003), the Court stated that all the integral parts of the merger including the surrender of shares in exchange for shares, should be treated as a single and continuing transaction subject only to one DST. The Court held, as follows:

> *"As earlier stated, DST is in the nature of an excise tax because it is really imposed on the privilege to enter into a transaction. Its imposition, therefore, should be only once. And in a statutory merger, there is only one transaction, i.e., the issuance by the surviving corporation of its own shares of stock to the stockholders of the absorbed corporation in exchange for the shares surrendered by the shareholders of the absorbed corporation. All other transactions which are an integral and inherent part of the merger, such as the absorption of real property, should no longer be subject to another round of DST. In other words, all the integral parts of the merger (e.g., surrender of shares in exchange for shares, transfer of assets, assumption of liabilities, etc.) should be treated as a single and continuing transaction subject only to one DST. The transfer of real property is not a transaction separate and distinct from the merger but an integral part or a mere continuation of the initial transaction which was previously consummated."*

Any excess and unutilized creditable withholding taxes (CWT), which form part of the assets to be transferred by UCPB as of the effective date of the merger, shall be transferred to and vested in LANDBANK, as the surviving corporation, and such excess CWT may be utilized by the latter. *(BIR Ruling No. 100-2017 dated March 2, 2017)*

The excess and unexpired minimum corporate income tax (MCIT) of UCPB, as of the effective date of the merger, if any, shall be carried forward and credited against the normal income tax due of LANDBANK for the three (3) immediately succeeding taxable years pursuant to Section 27(E)(2) of the Tax Code of 1997, as amended.

It is to be emphasized, however, that the net operating loss carry-over (NOLCO) under Section 34(D) (3) of the Tax Code of 1997, as amended, and as implemented by RR No. 14-2001, of UCPB, if any, is not one of its assets that can be transferred and absorbed by the Surviving Corporation, LANDBANK, as this privilege or deduction can be availed

SAOM-389-2022
SEP 08 2022

of by UCPB only. Accordingly, the tax-free merger between LANDBANK and UCPB does not cover the NOLCO of the former.

Furthermore, the parties shall cause to annotate at the back of the Transfer Certificates of Title (TCT) and Certificates of Stock of the properties transferred, the date the merger was executed, the original or historical cost of acquisition of the properties or shares of stock involved, and the fact that no gain or loss was recognized as a result of such merger; provided however, that any violation by the Register of Deeds or by the Corporate Secretary of this condition shall be penalized under Section 269 or 275, as the case may be, of the Tax Code of 1997, as amended.

Finally, the parties are required to submit to the Law and Legislative Division, Bureau of Internal Revenue, proof of annotation of the substituted basis of the shares of stock and/or real properties involved in the transfer within ninety (90) days from receipt of this ruling. Violation of this requirement is subject to the penalties provided in Section 275 of the Tax Code of 1997, as amended.

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be disclosed that the facts are different, then this ruling shall be considered null and void.

Very truly yours,

LILIA CATRIS GUILLERMO
Commissioner of Internal Revenue

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