

Headline	Tax-free and stress-free (?) exchange		
MediaTitle	The Philippine Star		
Date	23 May 2017	Language	English
Section	Business	Journalist	Ramon Christopher Ganan
Page No	B4	Frequency	Daily



Tax-free and stress-free (?) exchange

The power to tax is an incident of sovereignty. It is comprehensive, plenary and supreme. As a general rule, a state may levy taxes on anything and everything. Taxation is the rule and exemption is the exception. There are some instances, however, that our Tax Code allows imposition of lower tax rates or even tax exemptions. Among efficient tax-planning tool is the tax-free exchange of properties subdivided into two types: 1) transfer to a controlled corporation and 2) transfer pursuant to a merger or consolidation.

Under the first category, Section (40)(C)(2) of the Tax Code provides that no gain or loss shall be recognized if a person, in exchange for shares of stock, transfers a property to a corporation. The stock transferee, alone or together with other persons not exceeding four, should gain control of said corporation. Control means ownership of stocks of at least 51 percent of the total voting power of all classes of stocks entitled to vote.

Pursuant to this tax-free exchange, the BIR released several revenue issuances including Revenue Regulations (RR) No. 18-01 which provides guidelines in the proper monitoring of the basis of properties transferred and shares received. RR No. 18-01 states that Certificate Authorizing Registration (CAR) or Tax Clearance (TCL) shall be issued by the BIR based on a certification or ruling which shall state that the transaction qualifies as tax-free exchange.

BIR examiners used this proviso as basis in assessing taxpayers of deficiency taxes for failure to secure a ruling. Consequently, taxpayers are faced with enormous amounts of deficiency taxes which may include income tax, VAT, documentary stamp tax, etc.

However, taxpayers may find relief from the recent decision of the Court of Tax Appeals (CTA) in the case of Northern Tobacco Redrying Co. vs Commissioner of Internal Revenue which clarified whether a ruling is necessary to confirm the tax-free nature of an exchange transaction. In this case, Northern Tobacco and Fortune Landequities and Resources Inc (FLRI) entered into a deed of transfer whereby the former agreed to transfer ownership over certain parcels of land in exchange for the latter's common shares. After the transfer, Northern Tobacco gained 99.99 percent ownership of FLRI. No taxes were paid on the exchange transaction.

After several months, FLRI filed a request for tax-free exchange ruling with the BIR. After more than two years from date of execution of the deed of transfer, the BIR as-

TOP OF MIND



**RAMON
CHRISTOPHER
GANAN**

Headline	Tax-free and stress-free (?) exchange		
MediaTitle	The Philippine Star		
Date	23 May 2017	Color	Black/white
Section	Business	Circulation	303,808
Page No	B4	Readership	303,808
Language	English	ArticleSize	412 cm ²
Journalist	Ramon Christopher Ganan	AdValue	PHP 49,772
Frequency	Daily	PR Value	PHP 149,316

sessed Northern Tobacco for deficiency taxes arising from the alleged gains from the exchange of parcels of land for shares of stocks. The BIR argued that the failure of Northern Tobacco to secure a BIR ruling, which should declare the said transaction as tax-free, gave rise to a taxable transaction.

The CTA, however, ruled that a tax ruling is not a *conditio sine qua non* for the application of Section 40(C)(2) of the Tax Code considering that the law does not require said ruling.

The tax court further ruled that the certification required under RR No. 18-01 is for determining gain or loss on a subsequent disposition of property subject of the tax-free exchange and not a precondition for a taxpayer to be entitled to an exemption.

While this CTA pronouncement is a welcome relief on the part of the taxpayers, RR No. 18-01 still requires a BIR certification before the issuance of CAR/TCL. Hence, while there is no need to secure a ruling for a transaction to be declared as tax-free, property subject of the exchange may not be registered under the name of the transferee without a ruling. Ergo, in this sense, a certification may still be necessary not for the purpose of declaring a transaction as tax-free but to complete the process of transferring ownership of a property.

With this decision, taxpayers may now enjoy a certain level of comfort inasmuch as they should not be assessed deficiency taxes solely on the basis of absence of a ruling confirming the tax-free nature of the exchange. On the point of view of the taxing authorities, the examiners are not left without a recourse since they may assess deficiency taxes if the transaction does not qualify for exemption during a tax audit.

On a different light, securing a ruling should not always be viewed as burden for taxpayers because it has benefits as well. For one, in filing an application for tax-free exchange, a certification will serve as a clear guidance that will minimize discretion on the part of BIR officers who, depending on their individual interpretation, may or may not agree with the position taken by the taxpayers.

At the end of the day, BIR certification is still a main factor to consider in tax-free exchange of properties. Since it takes time for the BIR to issue a certification, it is a good tax planning strategy to apply for a ruling at the earliest possible opportunity.

Ramon Christopher Ganan is a supervisor from the tax group of KPMG R.G. Manabat & Co. (KPMG RGM&Co.), the Philippine member firm of KPMG International. KPMG RGM&Co. has been recognized as a Tier 1 tax practice, Tier 1 transfer pricing practice, Tier 1 leading tax transactional firm and the 2016 National Transfer Pricing Firm of the Year in the Philippines by the International Tax Review.

This article is for general information purposes only and should not be considered as professional advice to a specific issue or entity.

The views and opinions expressed herein are those of the author and do not necessarily represent the views and opinions of KPMG International or KPMG RGM&Co. For comments or inquiries, please email ph-inquiry@kpmg.com or rgmanabat@kpmg.com.