Republic of the Philippines
Supreme Court
Manila

FIRST DIVISION

NOTICE

Sirs/Mesdames:

Please take notice that the Court, First Division, issued a Resolution dated **September 14, 2021** *which reads as follows:*

"G.R. No. 249439 ***(Commissioner of Internal Revenue v. Premium Tobacco Redrying and Fluecuring Corporation).*** — This resolves the Petition for Review on *Certiorari*[1] filed under Rule 45 of the Rules of Court assailing the Court of Tax Appeals (CTA) *En Banc*'s Decision[2] dated April 22, 2019, and Resolution[3] dated September 16, 2019, in CTA EB No. 1755, which upheld the CTA Division's Decision[4] dated July 18, 2017, in CTA Case No. 8897 and Resolution dated November 24, 2017, cancelling the deficiency income tax, value-added tax (VAT), and documentary stamp tax (DST) assessments for the taxable year 2009, against Premium Tobacco Redrying and Fluecuring Corporation (Premium Tobacco) arising from its *de facto* merger with Fortune Tobacco Corporation (FTC).

The sole issue for our resolution is whether a prior confirmatory ruling from the Bureau of Internal Revenue (BIR) is required before a transfer of substantially all assets of a corporation for shares of stock of another corporation qualifies as a tax-free exchange under Section 40 (C)(2)(a), in relation to Section 40 (C)(6)(b), of the 1997 National Internal Revenue Code, as amended[5] (Tax Code).

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[1] *Rollo*, pp. 33-50.

[2] Id. at 58-78; penned by Associate Justice Esperanza R. Fabon-Victorino, with the concurrence of Presiding Justice Roman G. Del Rosario and Associate Justices Juanito C. Castañeda, Jr., Erlinda P. Uy, Cielito N. Mindaro-Grulla, Ma. Belen M. Ringpis-Liban and Catherine T. Manahan.

[3] Id. at 80-83.

[4] Id. at 95-137; penned by Associate Justice Cielito N. Mindaro-Grulla, with the concurrence of Presiding Justice Roman G. Del Rosario and Associate Justice Erlinda P. Uy.

[5] Republic Act. (RA) No. 8424, cited as the "Tax Reform Act of 1997." Approved on December 11, 1997.

We deny the petition for lack of merit.

As the CTA aptly held, there is nowhere in Section 40 (C)(2)(a) in relation to Section 40 (C)(6)(b) of the Tax Code that requires prior BIR ruling validating a tax-free exchange before the transferor may reap the benefits of tax exemption. The provisions read:

> SEC. 40. Determination of Amount and Recognition of Gain or Loss. —
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> x x x x
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> (C) Exchange of Property. —
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> x x x x
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> (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; or
>
> x x x x
>
> (6) Definitions. —
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> x x x x
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> (b) The term 'merger' or 'consolidation', when used in this Section, shall be understood to mean: (i) the ordinary merger or consolidation, or (ii) the acquisition by one corporation of all or substantially all the properties of another corporation solely for stock: Provided, That for a transaction to be regarded as a merger or consolidation within the purview of this Section, it must be undertaken for a *bona fide* business purpose and not solely for the purpose of escaping the burden of taxation: Provided, further, That in determining whether *a bona fide* business purpose exists, each and every step of the transaction shall be considered and the whole transaction or series of transaction[s] shall be treated as a single unit: Provided, finally, That in determining whether the property transferred constitutes a substantial portion of the property of the transferor, the term 'property' shall be taken to include the cash assets of the transferor.

To be considered a tax-free exchange, two conditions must be met, namely, *first*, there must be a corporate restructuring or

reorganization, which may be (1) a statutory merger or consolidation, or (2) a *de facto* merger where one corporation acquires all, or substantially all the properties of another corporation in exchange of the shares of stock of the acquiring corporation;[6] and *second*, the corporate reorganization must be for a *bona fide* business purpose and not solely to escape the burden of taxation.

There is no quarrel that pursuant to the Plan of *De Facto* Merger[7] and Deed of Assignment,[8] Premium Tobacco transferred more than eighty percent (80%) of its total assets and a fraction of its liabilities to FTC in exchange for 1,215,526 FTC shares and additional paid-in-capital (APIC). The first requisite for the transfer to be considered a tax-free exchange was complied with.

Regarding the second condition, this is a question of fact outside the scope of a Rule 45 petition before the Court. It is doctrinal that the Court will not lightly set aside the conclusions reached by the CTA, which, by the very nature of its function of being dedicated exclusively to the resolution of tax problems, has developed an expertise on the subject.[9] The findings of fact of the CTA are generally regarded as final, binding, and conclusive upon this Court and will not be reviewed or disturbed on appeal unless there has been an abuse or improvident exercise of authority.[10] We do not find an abuse of discretion here. The CTA found that the merger was intended to "diminish operating and administrative expenses [of both parties] by eliminating unnecessary facilities, simplified management, as well

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[6] See REVENUE MEMORANDUM RULING (RMR) No. 01-2002. — Subject: "Tax Consequences of *De Facto* Merger Pursuant to Section 40(C)(2) and (6)(b) of the NATIONAL INTERNAL REVENUE CODE OF 1997," dated April 25, 2002. A *de facto* merger was defined as involving "the acquisition by one corporation of all or substantially all the properties of another solely for stock." Further, the phrase "substantially all the properties of another corporation" means "the acquisition by one corporation of at least 80% of the assets, including cash, of another corporation," which "has the element of permanence and not merely momentary holding."

See also *Bank of Commerce v. Radio Philippines Network, Inc.*, 733 Phil. 491, 513 (2014). In that case, the Court, quoting Dean Cesar Villanueva in his book, Philippine Corporate Law, characterized a *de facto* merger as one where "one corporation acquiring all or substantially all of the properties of another corporation in exchange of shares of stock of the acquiring corporation. The acquiring corporation would end up with the business enterprise of the target corporation; whereas, the target corporation would end up with basically its only remaining assets being the shares of stock of the acquiring corporation"

[7] *Rollo*, pp. 88-92.

[8] Id. at 84-87.

[9] *Commissioner of Internal Revenue v. Univation Motor Philippines, Inc.*, G.R. No. 231581, April 10, 2019.

[10] See *CIR v. Embroidery and Garments Industries (Phil.), Inc.*, 364 Phil. 541, 546 (1991), cited in *Commissioner of Internal Revenue v. Traders Royal Bank*, 756 Phil. 175, 191-192 (2015).

as to optimize utilization of resources within the business group."[11] The merger of Premium Tobacco and FTC was "mainly to streamline processes and maximize resources"[12] – a *bona fide* business purpose. Indeed, the second condition was also complied with.

Considering that the transfer of Premium Tobacco assets and liabilities to FTC solely for FTC shares of stock and APIC qualifies as a *de facto* merger under Section 40 (C)(2) of the Tax Code, any gain derived from the transaction is not subject to income tax.[13]

The transaction is likewise not subject to VAT under Section 4.106-8 of Revenue Regulations (RR) No. 16-2005, as amended.[14] Accordingly, the transfer of property pursuant to a plan of merger or consolidation, including a *de facto* merger,[15] is not subject to VAT. Furthermore, Section 199 (m)[16] of the Tax Code, as amended by Republic Act No. 9243,[17] exempts from DST all instruments, documents, and papers evidencing transfers of property in a merger or consolidation under Section 40 (C)(2) of the Tax Code.[18]

The Commissioner of Internal Revenue (CIR) argues that Premium Tobacco should have secured a certification from the BIR that the transaction is a tax-free exchange. It is the CIR's view that BIR confirmatory ruling is a condition precedent to the availment of tax exemption under Section 40 (C)(2) of the Tax Code, relying on

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[11] *Rollo*, pp. 68-69.

[12] Id. at 129.

[13] See RMR No. 01-2002. — Subject: "Tax Consequences of *De Facto* Merger Pursuant to Section 40(C)(2) and (6)(b) of the NATIONAL INTERNAL REVENUE CODE OF 1997,' dated April 25, 2002.

[14] REVENUE REGULATIONS NO. 04-07. — Subject: "Amending Certain Provisions of Revenue Regulations No. 16-2005, as Amended, Otherwise Known as the Consolidated Value-Added Tax Regulations of 2005," dated February 7, 2007.

[15] See RMR No. 01-2002. — Subject: "Tax Consequences of *De Facto* Merger Pursuant to Section 40(C)(2) and (6)(b) of the National Internal Revenue Code of 1997," dated April 25, 2002.

[16] SEC. 199. Documents and Papers Not Subject to Stamp Tax. — The provisions of Section 173 to the contrary notwithstanding, the following instruments, documents and papers shall be exempt from the documentary stamp tax:

x x x x

(m) Transfer of property pursuant to Section 40(c)(2) of the National Internal Revenue Code of 1997, as amended.

[17] AN ACT RATIONALIZING THE PROVISIONS ON THE DOCUMENTARY STAMP TAX OF THE NATIONAL INTERNAL REVENUE CODE OF 1997, AS AMENDED, AND FOR OTHER PURPOSES, approved on February 17, 2004.

[18] See *Commissioner of Internal Revenue v. Pilipinas Shell Petroleum Corp.*, 744 Phil. 313, 320-324 (2014); *Commissioner of Internal Revenue v. La Tondeña Distillers, Inc.*, 764 Phil. 42, 52 (2015). See also RMR No. 01-2002. — Subject: "Tax Consequences of *De Facto* Merger Pursuant to Section 40(C)(2) and (6)(b) of The National Internal Revenue Code of 1997," dated April 25, 2002.

Revenue Memorandum Order (RMO) No. 26-92.[19] The RMO prescribed the requirements and conditions for non-recognition of gains in the transfer of properties for stock under Section 34 (c)(2)[20] of the National Internal Revenue Code of 1977[21] (old Tax Code), the precursor provision of Section 40 (C)(2).

We do not agree.

A plain reading of Section 34 (c)(2), in relation to Section 34 (c)(6)(b), of the old Tax Code and the guidelines in RMO No. 26-92 shows that a prior ruling is not required for the transaction to be tax-exempt. On the other hand, the BIR ruling is administratively necessary to secure the Certificate Authorizing Registration (CAR) from the BIR on the real property.[22]

When the old Tax Code was re-codified in 1997,[23] Section 34 (c)(2) was renumbered to the present Section 40 (C)(2) and Section 34 (c)(6)(b) to Section 40 (C)(6)(b). Nevertheless, the provision on *de facto* merger remains unchanged. On November 13, 2001, the BIR issued Revenue Regulations (RR) No. 18-2001[24] prescribing the guidelines on monitoring the basis of property transferred and shares received under a tax-free exchange of property for shares in Section

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[19] Prescribing the Requirements and Conditions Precedent to the Non-Recognition of Gain in Transactions Involving Transfer of Properties in Exchange for Shares of Stock Under Section 34(c) (2) of the Tax Code, and the Procedure to be Observed in Monitoring Compliance with Said Conditions, approved on May 28, 1992.

[20] SEC. 34. Determination of amount of and recognition of gain or loss. —

(c) Exchange of property.

(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, (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.

x x.x x

[21] Presidential Decree No. 1158 — A DECREE TO CONSOLIDATE AND CODIFY ALL THE INTERNAL REVENUE LAWS OF THE PHILIPPINES, approved on June 3, 1977.

[22] Part II of RMO No. 26-92 provides that: "No CAR for the real property involved in the exchange shall be issued by the Revenue District Officer/Authorized Internal Revenue Officer concerned unless a determination letter/ruling has been issued by the Commissioner to the effect that the transaction qualifies as a tax-free exchange or corporate reorganization under Section 34(c) (2) of the Tax Code."

[23] RA No. 8424; Tax Reform Act of 1997, approved on December 11, 1997.

[24] Guidelines on the Monitoring of the Basis of Property Transferred and Shares Received, Pursuant to a Tax-Free Exchange of Property for Shares under Section 40(C)(2) of the National Internal Revenue Code of 1997, Prescribing the Penalties for Failure to Comply with such Guidelines, and Authorizing the Imposition of Fees for the Monitoring Thereof, November 13, 2001.

40 (C)(2). On November 28, 2001, the BIR issued RMO No. 32-2001,[25] repealing RMO No. 26-92 and implementing RR No. 18-2001. Notably, like RMO No. 26-92, the BIR certification/ruling in RR No. 18-2001 and RMO No. 32-2001 is necessary to secure the CAR or the Tax Clearance for the real property or share of stock involved in the exchange.[26] The CAR and Tax Clearance are vital in transferring legal title over the property. But all the same, the BIR ruling is not a pre-condition to the availment of tax exemption. The Court may not impose conditions or limitations when none is provided for.[27]

At any rate, Section 40 (C)(2) of the Tax Code cannot be amended or modified by a mere regulation.[28] An administrative agency issuing regulations, such as the BIR, may not enlarge, alter or restrict the provisions of the law it administers, and it cannot engraft additional requirements not contemplated by the legislature.[29] In *Commissioner of Internal Revenue v. Fortune Tobacco Corp.*,[30] the Court held that the CIR's "rule-making power must be confined to details for regulating the mode or proceedings in order to carry into effect the law as it has been enacted, and it cannot be extended to amend or expand the statutory requirements or to embrace matters not covered by the statute. Administrative regulations must always be in harmony with the provisions of the law because any resulting discrepancy between the two will always be resolved in favor of the basic law."[31] A regulation or any portion that is not adopted pursuant to law is no law and has neither the force nor the effect of law.[32]

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[25] Guidelines Implementing Revenue Regulations No. 18-2001 on the Monitoring of the Basis of the Property Transferred and Shares of Stock Received Pursuant to Section 40(C)(2) of the Tax Code of 1997, Revising and Updating the Requirements and Conditions Precedent to the Non-Recognition of Gain or Loss in Transactions Falling Thereunder, and Prescribing the Forms Therefor, November 28, 2001.

[26] RR No. 18-2001, Section 5 reads:

SEC. 5. **Conditions for the Issuance of Certificate Authorizing Registration (CAR) or Tax Clearance (TCL).** — The CAR/TCL for the real property or share of stock/unit of participation/interest involved in the exchange shall be issued by the Revenue District Officer/Authorized Internal Revenue Officer on the basis of the certification or ruling to be issued in triplicate by the Commissioner or his duly authorized representative to the effect that the transaction qualifies as a tax-free exchange under Section 40(C)(2) of the Tax Code of 1997.

The CAR/TCL to be issued shall specify, among others, that the transaction involved is a tax-free exchange under Section 40(C)(2) of the Tax Code of 1997; the date of exchange; and the substituted basis of the properties as stated in the certification or ruling issued by the Bureau of Internal Revenue.

[27] *Commissioner of Internal Revenue v. Philex Mining Corp.*, G.R. No. 230016, November 23, 2020, citing *Commissioner of Internal Revenue v. American Express International, Inc.*, 500 Phil. 586, 608 (2005).

[28] *Commissioner of Internal Revenue v. Central Luzon Drug Corp.*, 496 Phil. 307, 332 (2005).

[29] *Commissioner of Internal Revenue v. Fortune Tobacco Corp.*, 581 Phil. 146, 162 (2008), citing id., at 333.

[30] Id.

[31] Id. at 162-163.

[32] *Commissioner of Internal Revenue v. Central Luzon Drug Corp.*, *supra* note 28, at 333.

Most importantly, the BIR ruling merely operates to "confirm" whether the exchange of property for shares complies with the conditions for exemption under Section 40 (C)(2).[33] Thus, if all the requirements for exemption set forth under the law are complied with, the transaction is considered exempt, whether the taxpayer secured a prior BIR ruling.[34]

FOR THESE REASONS, the petition is **DENIED**.

SO ORDERED."

By authority of the Court:

LIBRADA C. BUENA
Division Clerk of Court

by:

MARIA TERESA B. SIBULO
Deputy Division Clerk of Court
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[33] See *Commissioner of Internal Revenue v. Co*, G.R. No. 241424, February 26, 2020.
[34] See id.