



Republic of the Philippines
DEPARTMENT OF FINANCE

Roxas Boulevard Corner Pablo Ocampo, Sr. Street
Manila 1004

DOF OPINION NO. 003.2020

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ATTENTION : ATTY. ERIC R. RECALDE
ATTY. KAREN ANDREA T. TORRES
ATTY. ARMAND LOUIS T. DULAY

SUBJECT : Request for Review of Bureau of Internal Revenue
(BIR) International Tax Affairs Division ("ITAD")
Ruling No. 033-18

GENTLEMEN,

This refers to the Request for Review dated 17 May 2018 ("Request for Review") filed by your firm, on behalf of CAE INTERNATIONAL HOLDINGS LTD. ("CAE"), with this Department to request the review of BIR ITAD Ruling No. 033-18 dated 9 March 2018 ("BIR Ruling").

CAE and Asian Aviation Centre of Excellence SDN. BHD ("Asian Aviation") are foreign corporations organized and existing under the laws of Canada and Malaysia, respectively. They are not licensed to do business in the Philippines based on the Certification of Non-Registration issued by the Securities and Exchange Commission ("SEC").¹

Philippine Academy for Aviation Training, Inc. ("PAAT") is a domestic corporation organized and existing under the laws of the Philippines. PAAT has an authorized capital stock of 900,000 shares divided into Class A common shares with par value of Php1.00 per share, and Class B common shares with par value of Php2.00 per share.²

¹ Certification of Non-Registration of Company issued on 17 October 2014, p. 7 of the BIR docket.

² General Information Sheet for 2014, p. 58-64 of the BIR docket.

The majority shareholder of PAAT are Cebu Air, Inc. and CAE with the following distribution of shareholdings:

Shareholders	Common Shares	Number of Shares	Value of Shares (In Php)	% of Ownership
Cebu Air, Inc.	Class A	135,000,000	135,000,000	60%
CAE	Class A	45,000,000	45,000,000	40%
	Class B	90,000,000	90,000,000	

On 29 December 2014, two (2) nominee shareholders sold their individual shares in PAAT to Asian Aviation for Php2.00; while on 31 December 2014, CAE sold its PAAT shares to Asian Aviation for Php148,291,495.00.³

On 5 January 2015, CAE filed with the BIR a request for confirmation that any gain resulting from the sale of CAE of its PAAT shares to Asian Aviation is exempt from capital gains tax ("CGT") pursuant to the Philippines-Canada Tax Treaty.

On 9 March 2018, the BIR issued the subject BIR-ITAD Ruling No. 033-18 which ruled that:

- i. CGT is imposable on the transaction pursuant to paragraph 3, Article XII of the Philippines-Canada Tax Treaty;
- ii. Donor's Tax is imposable on the transaction pursuant to Section 100 of the National Internal Revenue Code ("NIRC") as amended, and Section 7 (c.1.4) of Revenue Regulations ("RR") No. 6-2008, as amended; and
- iii. Documentary Stamp Tax ("DST") is imposable on the transaction under Section 175 of the NIRC.

Based on Revenue Memorandum Circular ("RMC") No. 40-A-2002 and Department of Finance ("DOF") Department Order ("DO") No. 07-2002, the "taxpayer who receives an adverse ruling from the Commissioner of Internal Revenue may, within thirty (30) days from the date of receipt of such ruling, seek its review by the Secretary of Finance."

On 17 April 2018, Angara Abello Concepcion Regala & Cruz Law Office ("ACCRA Law"), counsel of CAE, received a copy of the BIR Ruling. Applying RMC No. 40-A-2002 and DOF DO No. 07-2002, CAE had until 17 May 2018 to file its Request for Review with the Secretary of Finance. On 17 May 2018, CAE through its legal

³ Deed of Assignment of Shares of Stock dated 31 December 2014, p. 82-86 of the BIR docket; Deed of Assignment of Shares of Stock dated 29 December 2014, p. 75-79 of the BIR docket.



counsel filed the subject Request for Review with the Secretary of Finance. Accordingly, the Request for Review was filed on time.

Relevantly, the Department further requested for an itemization of the simulators component appearing in PAAT's 2014 Audited Financial Statements and a copy of the lease agreement between Clark Development Corporation and Cebu Air, Inc., PAAT's sub-lessor. CAE complied with said request in a letter dated 9 November 2018.

The Request for Review raises the following issues for the review of the Secretary of Finance, to wit:

- i. Whether Capital Gains Tax is due on the sale of CAE's shares in PAAT in light of the RP-Canada Tax Treaty; and
- ii. Whether CAE is liable for Donor's Tax on said sale of shares.

We find the Request for Review of Ruling to be meritorious.

The flight simulators owned by PAAT are not real property

According to the BIR Ruling, CAE's sale of PAAT shares is subject to capital gains tax pursuant to Section 28(B)(5)(c) of the NIRC at the rate of 5% or 10%.

Based on paragraph 3, Article XIII of the Philippines-Canada Tax Treaty, gains from alienation of shares of a domestic corporation may be taxed in the Philippines if the assets of the corporation consist principally of immovable property in the Philippines, thus:

"3. Gains from the alienation of shares of a company, the property of which consists principally of immovable property situated in a Contracting State, may be taxed in that State. x x x"

According to the BIR, the word "principally" means more than 50% of the entire assets of the corporation in terms of value, as defined in RR No. 4-86, which states:

"Section 2. Definitions – For purposes of these regulations, the following terms and phrases shall be understood to mean –



x x x

“b) ‘Principally’ – ‘wholly or principally’, ‘directly principally’ or ‘attributable’ – more than fifty percent of the entire asset in terms of value.”

Using the abovementioned bases, the BIR’s review of PAAT’s Audited Financial Statement as of December 31, 2014 and 2013 showed that the ratio of real property over total assets of PAAT is 76% in 2014 and 82% in 2013. In reaching said conclusion, the BIR included, among others, flight simulators, airbus procedures trainer, furniture and office equipment, computer equipment, and office rental deposit detailed as follows:

Assets	As of December 2014	As of December 2013
Total Assets	1,033,278,374.00	997,455,695.00
Real Property		
<ul style="list-style-type: none"> • Property and equipment (flight simulators; airbus procedures trainer; furniture and office equipment; and computer equipment) 	758,639,875.00	797,955,106.00
<ul style="list-style-type: none"> • Office rental deposit 	8,009,553.00	8,009,553.00
<ul style="list-style-type: none"> • Various lease 	566,375.00	240,130.00
<ul style="list-style-type: none"> • Software installed into computer equipment 	13,085,572.00	14,721,268.00
Total Real Property	780,301,375.00	820,926,057.00
Ratio of real property over total assets	76%	82%

As mentioned in the preceding paragraph, the BIR considered the flight simulators owned by PAAT as real property. The BIR based its finding on a Wikipedia article and a photograph therein which purportedly depicts the flight simulator to be attached to the ground it stands on.

Meanwhile, CAE argues that the flight simulators are movable property since it is not provided in the exclusive list of real property provided under Article 415 of the New Civil Code and RR No. 4-86.

Furthermore, CAE argues that the flight simulators neither fall under paragraph 3 nor paragraph 5 of Article 415 of the New Civil Code, which CAE thinks could be the BIR’s possible basis for classifying the flight simulators as immovable property.

We agree with CAE.



To determine if the property is an “immovable property”, the Philippines-Canada Tax Treaty provides that the term “immovable property” shall be defined in accordance with the law of the Contracting State in which the property in question is situated.

Article 415 of the New Civil Code provides for an exclusive list of what constitutes immovable property. A perusal of the said article would show that the flight simulator does not fall under any of the types of immovable property listed therein, more specifically, paragraphs 3 and 5, to wit:

“Article 415. The following are immovable property:

x x x

(3) Everything attached to an immovable in a fixed manner, in such a way that it cannot be separated therefrom without breaking the material or deterioration of the object;

x x x

“(5) Machinery, receptacles, instruments or implements intended by the owners of the tenement for an industry or works which may be carried on in a building or on a piece of land, and which tend directly to meet the needs of the said industry or works.”

With regard to paragraph 3 of Article 415 of the New Civil Code, contrary to the findings of the BIR, CAE was able to show that the base of the flight simulators are superficially anchored on the ground and can be easily dismantled and moved from place to place without damage to the building.⁴ In fact, CAE showed that one of the flight simulators was transferred from Jose Abad Santos Avenue, Clark Freeport Zone to C.M. Recto Highway, Clark Freeport Zone demonstrating the transportability of the flight simulators.⁵

As for paragraph 5 of Article 415, for a machinery, receptacle, instrument or implement to become immobilized, it must be the owner of the tenement who places said machinery in his land.⁶ In the case at bar, the placement of the flight

⁴ CAE’s Request for Review of BIR ITAD Ruling No. 033-18, 17 May 2018; CAE’s Compliance Letter dated 9 November 2018s (“Letter-Reply”) to the DOF Letter Request dated 1 October 2018.

⁵ Annex B and B-1 of CAE’s Letter-Reply dated 9 November 2018.

⁶ Burgos, Sr., et al. v. Chief of Staff, Armed Forces of the Philippines, et al., G.R. No. 64261, 26 December 1984; Davao Sawmill Co. v. Castillo, G.R. No. L-40411, 7 August 1935.



simulators by PAAT on the property it leases with Clark Development Corporation⁷, does not have the effect of immobilizing said flight simulators.

Based on the foregoing, PAAT's flight simulators cannot be categorized as immovable or real property under paragraphs 3 and 5 of Article 415 of the New Civil Code, in relation to RR No. 4-86. With the flight simulators removed in determining the value of PAAT's real property, PAAT's ratio of real property over total asset is effectively reduced to just 5.59%. As presented below, the ratio of real property over the total assets excluding the flight simulators is well below the 50% threshold provided under RR No. 4-86 to contemplate predominance:

Total Assets	As of December 2014
Total Assets	1,033,278,374.00
Real Property	
<ul style="list-style-type: none"> • Property and equipment (airbus procedures trainer; furniture and office equipment; and computer equipment) 	36,073,774.00
<ul style="list-style-type: none"> • Office rental deposit 	8,009,553.00
<ul style="list-style-type: none"> • Various lease 	566,375.00
<ul style="list-style-type: none"> • Software installed into computer equipment 	13,085,572.00
Total	57,735,274.00
Ratio of real property over total assets	5.59%

Consequently, the gains from the sale by CAE of its shares in PAAT, a company whose assets do not consist primarily of real property, are not subject to capital gains tax in the Philippines pursuant to paragraph 4, Article XIII of the Philippines-Canada Tax Treaty, *viz*:

“4. Gains from the alienation of any property, other than those mentioned in paragraphs 1, 2, and 3 shall be taxable only in the Contracting State of which the alienator is a resident.”

CAE's sale of PAAT shares of stock to Asian Aviation is not subject to Donor's Tax

According to the BIR, it found that the sale of PAAT shares is likewise subject to Donor's Tax. It found that the fair market value (“FMV”) of the PAAT shares

⁷ Annex “B” of CAE's Compliance Letter dated 9 November 2018.



amounts to Php153,082,918.00, higher than the consideration of Php148,291,495.00 paid by Asian Aviation for the purchase of the PAAT shares.

The BIR cited Section 100 of the NIRC and Section 7(c.14) of Revenue Regulations No. 6-2008 wherein it is provided that the excess between the higher FMV and the lower consideration is deemed a gift subject to donor's tax of 30%.

On the other hand, CAE argues that the subject sale is not subject to donor's tax since the FMV of the shares transferred is greater than the selling price. To justify this, CAE provided for the following arguments:

- i. The sale by CAE of its PAAT shares is exempt from income tax; hence, Section 100 of the Tax Code on presumed donations is not applicable;
- ii. The sale by CAE of its PAAT shares was a bona fide transaction entered into pursuant to a legitimate business purpose (i.e., divestment of interest in a domestic corporation);
- iii. The consideration was valid and agreed upon based on a reasonable offer of the buyer. Moreover, mutual consent was reached between the parties;
- iv. The difference between the amount for which the shares were sold (i.e. Php148,291,497.00) and their acquisition cost (Php135,000,000.00) is significant, such that it cannot be denied that the selling price was already reasonable;
- v. Moreover, the difference between the alleged FMV of the shares at the time of the sale and the selling price is negligible – the difference being only 3%. Thus, the selling price could hardly be considered inadequate, such that the imposition of donor's tax is necessary to capture any alleged inadequacy;
- vi. It would be inequitable for the Commissioner to require from CAE to find a buyer who is willing to purchase the shares at their FMV;
- vii. As mentioned, the sale was made pursuant to a valid business purpose and the terms thereof were agreed upon mutually and any supposed inadequacy in the selling price is negligible. Thus, the transaction should be allowed as is.

CAE likewise noted that under Republic Act No. 10963, otherwise known as "Tax Reform for Acceleration and Inclusion" ("TRAIN Law"), Section 100 was amended to reflect the intention of recognizing transactions, which are *bona fide* at arm's length and free from any donative intent, to read as follows:



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CAE likewise noted that under Republic Act No. 10963, otherwise known as "Tax Reform for Acceleration and Inclusion" ("TRAIN Law"), Section 100 was amended to reflect the intention of recognizing transactions, which are *bona fide* at arm's length and free from any donative intent, to read as follows:

"Sec. 100. Transfer for Less Than Adequate and Full Consideration - Where property, other than real property referred to in Section 24(D), is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the fair market value of the property exceeded the value of the consideration shall, for the purpose of the tax imposed by this Chapter, be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year: Provided, however, That a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is a bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth."

We agree with CAE.

The DOF recognizes the amendment of Section 100 of the NIRC under the TRAIN Law that excludes *bona fide* transactions as a presumed donation. While this may appear as a new principle, the same exemption has been recognized even before the amendment was introduced by the TRAIN Law.

In order to curb the tax leak as a result of declaring a lower selling price than the actual amount of money exchanged, Section 100 of the NIRC, as amended imposes donor's tax on transfers made for less than an adequate and full consideration. This "adequate and full consideration" is deemed to be the fair market value of the property, such that donor's tax is imposed on the amount by which the fair market value of the property exceeded the value of the consideration.

The principal purpose of the "deemed gift" provision is to prevent a situation wherein parties to a sale endeavor to avoid/save in the payment of income taxes through the manipulation of the selling price of the sale. However, the same must not be applied rigidly even to dealings done in the ordinary course of business, which are *bona fide*, at arm's length, and free from any donative



intent. To do so would frustrate the duly established purpose and intent of the law.

Thus, as long as the transaction is conducted at arm's length such that a bona fide business arrangement is done in the ordinary course of business, and the evil sought to be avoided by the law does not exist, a sale for less than an adequate consideration is appropriately not subject to donor's tax.

This principle has been earlier adopted by no less than the BIR. In BIR Ruling [DA-652-06]⁸, the BIR concluded that as long as the transaction is conducted at arm's length, such that a bona fide business arrangement or the dealings are done in the ordinary course of business, a sale for less than an adequate consideration is not subject to donor's tax.⁹

Furthermore, in BIR Ruling [DA-[DT-065) 715-09]¹⁰, the BIR recognized that while the general rule is that the when the selling price of the shares not listed and traded through the local stock exchange is lower than the FMV, the difference between the FMV and the selling price of the shares is considered as a gift under Section 100 of the NIRC, "it should be borne in mind, however, that the application of this provision is obtaining only in the situation where a tax is sought to be avoided by the parties to a sale.

What can be gleaned from these BIR Rulings is that the facts surrounding the sale is taken into consideration to determine if there is donative intent in sale of shares. Section 100 of the NIRC is applied only when it can be shown by the acts of the parties that there is indeed donative intent.

Looking at the sale of PAAT shares, CAE correctly mentions factors that would lead to the conclusion that the there was no donative intent and, was made in the ordinary course of business.

First, the selling price is already reasonable considering the significant difference between the amount for which the shares were sold (Php148,291,497.00) and their acquisition cost (Php135,000,000.00). Aside from being a reasonable selling price, the fact that the selling price is higher than the acquisition cost shows that the seller gained from the sale, as such, no donative intent.

⁸ Filed by Itochu Corporation – Manila Branch, 6 November 2006.

⁹ *Id* citing BIR Ruling (UN-398-95), 14 November 1995.

¹⁰ Francisco G. Tagao Law Office on behalf of Metro Pacific Corporation, 27 November 2009.



Moreover, the difference of 3% between the selling price and FMV (Php153,082,918.00) is negligible and insignificant such that the selling price can be considered as inadequate and sufficient to conclude that there was donative intent.

With the intent of divesting its investment here in the Philippines, CAE entered into a legitimate business purpose wherein two (2) unrelated parties mutually reached into a reasonable consideration.

Considering all the circumstances surrounding the transaction, we deem that the sale was a bona fide transaction and was made in the ordinary course of business. Accordingly, the sale of PAAT shares by CAE to Asian Aviation is not subject to donor's tax.

The BIR shall authenticate if the DST for the sale of PAAT shares from CAE to Asian Aviation has been paid

Considering that CAE submitted BIR Form 2000-OT ("DST Return") stamped as received by the Development Bank of the Philippines ("DBP") on 5 January 2015¹¹ and the DBP Payment Deposit Slip dated 5 January 2015¹², we remand the Request for Review to the BIR for purposes of authenticating if the DST for the sale of PAAT shares by CAE to Asian Aviation was actually paid.

In view of the foregoing discussion, the Department grants the Request for Review, finding in favor of the taxpayer that the gains from the Sale by CAE of its shares in PAAT is not subject to CGT in the Philippines pursuant to paragraph 4, Article XIII of the Philippines-Canada Tax Treaty, and is not subject to Donor's Tax since the sale was a bona fide transaction and was made in the ordinary course of business.

With regard the DST due on the sale of the PAAT shares by CAE to Asian Aviation, the Department REMANDS the Request for Review to the BIR to authenticate if the DST due on the sale has been paid and fully settled.

¹¹ P. 54 of BIR docket.

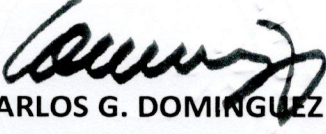
¹² P. 59 of BIR docket.



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 as null and void.

Thank you.

Sincerely yours,


CARLOS G. DOMINGUEZ
Secretary of Finance
JUN 23 2020



CC **Commissioner Caesar R. Dulay**
Bureau of Internal Revenue