Republic of the Philippines
DEPARTMENT OF FINANCE
Roxas Boulevard Corner Pablo Ocampo, Sr. Street
Manila 1004

DOF Opinion No. 004.2020

SYCIP GORRES VELAYO & CO.
6760 Ayala Avenue
1226 Makati City

THRU: **ATTY. VERONICA A. SANTOS**
Principal, Tax Division

SUBJECT: **Request for Review of Bureau of Internal Revenue International Tax Affairs Division Ruling No. ITAD 032-2018**

Dear Atty. Santos:

This refers to the Request for Review, on behalf of The Manufacturers Life Insurance Company-Canada (Manulife Canada), of Bureau of Internal Revenue International Tax Affairs Division (BIR-ITAD) Ruling No. ITAD 032-2018 dated 9 March 2018, which held that Manulife Canada is liable for donor's tax at the rate of 30% on excess of fair market value (FMV) of The Manufacturers Life Insurance Company Philippines, Inc. (Manulife Philippines) shares over the consideration received for said shares.

Manulife Canada and Manulife Century Holdings (Netherlands) B.V. (Manulife Netherlands) are foreign corporations, organized and existing under the laws of Canada and the Netherlands, respectively. Manulife Canada is principally engaged in insurance business while Manulife Netherlands' principal activity is holding and financing of international companies.[1] Manulife Canada has a wholly-owned subsidiary, Manulife Philippines, a domestic corporation organized and existing under the laws of the Philippines.

On 2 July 2012, Manulife Canada and Manulife Netherlands entered into five Deeds of Issuance where the former transferred to the latter its 930,000 Class B common shares in Manulife Philippines (including nine nominee shares), each with a par value of ₱1,000.00 or total **par value** of **₱930,000,000.00**. In exchange, Manulife Netherlands issued 17,950,948 new shares in favor of Manulife Canada, each share with a par value of 1.00 euro[2] or **total par value** of **₱959,546,384.00**.

[1] *See p. 10.* Project Exchange Document.

[2] Using the BSP Cross rate as of 2 July 2012, 1 Euro is equivalent to Php53.4538.

On 27 July 2012, Manulife Canada filed with the BIR a Request for Tax Treaty Relief Application (TTRA) asking for confirmation that the capital gains it derived from the transfer of its shares of stock in Manulife Philippines to Manulife Netherlands are exempt from capital gains tax pursuant to the Convention between the Philippines and Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (Philippines-Canada Tax Treaty).

Accordingly, the BIR ruled that the net capital gains derived by Manulife Canada for the transfer of its shares in Manulife Philippines to Manulife Netherlands are exempt from capital gains tax imposed under Section 28(B)(5)(c) of the Tax Code. This is pursuant to paragraph 3, Article XIII of the Philippines-Canada Tax Treaty which provides that gains from the alienation of shares of a corporation may be taxed in the Philippines if the *property of the corporation consists principally of immovable property* situated in the Philippines.

Manulife Philippines' Audited Financial Statements (AFS) reveal that the ratio of its real property over its total assets is **0.3849% in 2011** and **0.3574% in 2010**. Since the ratio of real property over total assets of Manulife Philippines is less than 50%, the BIR held that Manulife Philippines' assets do not consist principally of real property. Therefore, pursuant to the Philippines-Canada Tax Treaty, the net capital gains derived by Manulife Canada in the aforesaid transaction are **exempt from capital gains tax** imposed under the Tax Code.

Manulife Philippines' AFS likewise shows that as of 31 December 2011, Manulife Philippines has a total equity of ₱11,474,325,997.00 and total outstanding shares of 4,350,000. This balance, however, includes amounts representing reserve for fluctuation in value of available-for-sale financial assets which is described in the Notes to the AFS as unrealized fair value gains of AFS financial assets amounting to ₱6,379,344,057.00.

Notwithstanding, the BIR maintains that the fair market value (FMV) for each share is ₱2,699.84. Thus, the FMV for the 930,000 shares transferred to Manulife Netherlands is **₱2,510,852,512.28**, higher than the consideration of **₱959,546,384.00** purportedly received by Manulife Canada from Manulife Netherlands.

Consequently, the BIR ruled that Manulife Canada is liable for donor's tax at the rate of 30% of the excess of the FMV of Manulife Philippines shares over the consideration received for those shares, to wit:

"Under Section 100 of the Tax Code, as implemented by Section 7(c.1.4) of ***Revenue Regulations No. 6-2008,***[3] *the* ***excess between the higher FMV and the lower consideration is deemed a gift subject to donor's tax****, thus:*

> ***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." (emphasis supplied)*

Verily, you requested a review of the BIR ruling particularly on whether Manulife Canada is liable for donor's tax under Section 100 of the Tax Code, as amended on excess of the FMV of Manulife Philippines shares over the consideration received.

In claiming that it is not liable for donor's tax, Manulife Canada argues on two points: (a) that the par value of Manulife Netherlands shares should not be construed as its FMV, and (b) that it should be granted an exemption from donor's tax on the basis of reciprocity pursuant to Section 104 of the Tax Code, as amended.

Fair Market Value Basis

Section 6 of Revenue Regulations (RR) No. 6-2008 dated 22 April 2008, the prevailing regulations at the time of the exchange (2 July 2012), states that:

> *(c.1) Determination of Selling Price.* - In determining the selling price, the following rules shall apply:
>
> xxx
>
> **(c.2)** ***Definition of "fair market value" of the Shares of Stock.*** **- For purposes of this Section, "fair market value" of the shares of stock sold shall be:**
>
> xxx
>
> **(c.2.2) In the case of shares of stock not listed and traded in the local stock exchanges, the book value of the shares of stock as shown in the financial statements duly certified by an independent certified public accountant nearest to the date of sale shall be the fair market value.**
>
> *(emphasis supplied)*

[3] Consolidated Regulations Prescribing the Rules on the Taxation of Sale, Barter, Exchange or Other Disposition of Shares of Stock Held as Capital Assets.

While the BIR used the book value per AFS of Manulife Philippines to determine the FMV of Manulife Philippines shares, it used the par value of Manulife Netherlands as its FMV, so that the comparison was between the **₱2,510,852,512.28 (book value)** of Manulife Philippines and **₱959,546,384.00 (par value)** of Manulife Netherlands shares.

On the other hand, Manulife Canada claims that the FMV of Manulife Netherlands shares is higher than the FMV of Manulife Philippines shares and in support thereof, Manulife Canada submitted a formal valuation report[4] to determine the equity of Manulife Netherlands as of the date of transfer. Based on which, this Office believes that the FMV of the Manulife Netherlands shares issued to Manulife Canada is **Php1,658,732,246.42**, computed as follows:

Net assets of Manulife Netherlands (at carrying amount, in USD)		$52,190,000
Exchange rate per $1[5]		42.28
Net assets of Manulife Netherlands (in PH Peso)		₱2,206,593,200
Divided by		
No. of shares issued by Manulife Netherlands to Manulife Canada	17,950,948	
No. of shares before 2 July 2012	5,929,000	23,879,948
FMV per share		92.40
No. of shares issued by Manulife Netherlands		17,950,948
FMV of the shares issued by Manulife Netherlands		**₱1,658,732,246.42**

On the part of Manulife Philippines, we believe that the amount to be used as FMV for taxation purposes should exclude unrealized gains, i.e. ₱6,379,344,057.00 unrealized fair value gains of AFS financial assets. With this, the FMV of Manulife Philippines for taxation purposes amounts to **Php1,089,272,000.97**, computed as follows:

Net assets of Manulife Philippines (per AFS)	₱11,474,325,997
Less: Unrealized Gain	(6,379,344,057)
Value of Net assets of Manulife Philippines (for taxation purposes)	5,094,981,940
Divided by no. of Philippines shares transferred to Manulife Netherlands	4,350,000
FMV per share	1,171.26
FMV of Manulife Philippines shares	**₱1,089,272,000.97**

[4] Prepared by Ernst & Young (EY) Philippines, dated 9 May 2018. The valuation report used the adjusted net asset value approach to arrive at the equity of Manulife Netherlands as of 30 June 2012, the last month end closest to the transfer date of 2 July 2012.

[5] Based on the closing rates published by the *Bangko Sental ng Pilipinas* as of 29 June 2012

The unrealized gains should not have been considered in computing the FMV for tax purposes, being premature, as said gain has yet to be realized by Manulife Philippines. The prospective gain did not result from any alienation of AFS financial assets but represents merely an alleged increase in the value thereof. Such gain becomes taxable only if and when Manulife Philippines actually realizes the incremental value of its financial assets should it finally disposes the same.[6]

As it appears that the FMV of Manulife Netherlands amounting to **Php1,658,732,246.42** is higher than the FMV of Manulife Philippines amounting to **Php1,089,272,000.97** as calculated above, we believe that donor's tax as imposed under Section 100 of the Tax Code, as amended, is not applicable.

As Manulife Canada is not liable for donor's tax under Section 100 of the Tax Code, as amended, we find it unnecessary to discuss at this point its exemption from donor's tax on the basis of reciprocity under Section 104 of the Tax Code. The same has been rendered moot and academic.

In view of the foregoing, this Office grants the Request for Review. Kindly note that 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.

Respectfully yours,

CARLOS G. DOMINGUEZ
Secretary
JUN 22 2020

DEPARTMENT OF FINANCE
REPUBLIC OF THE PHILIPPINES
010328

CC: **CAESAR R. DULAY**
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The Manufacturers Life Insurance Company-Canada (Manulife Canada)

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[6] *See* Commissioner of Internal Revenue v. Filinvest Development Corp., G.R. Nos. 163653 & 167689. July 19, 2011. 669 PHIL 323-370, *see also* Commissioner of Internal Revenue v. Filinvest Development Corp., CA-G.R. SP No. 74510. January 26, 2005.