



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

DOF OPINION NO. 006.2022

ATTY. LAWRENCE C. BISCOCHO

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SUBJECT: Request for Review of Bureau of Internal Revenue International Tax Affairs Division Ruling No. 041-21 dated 29 September 2021

Dear Atty. Biscocho:

This refers to the subject letter dated 02 November 2021 ("Request for Review"), that you filed with this Department seeking the review of Bureau of Internal Revenue ("BIR") International Tax Affairs Division (ITAD) Ruling No. 041-21 dated 29 September 2021. In this ruling, the Commissioner ruled that the transfer made by Mitsubishi Heavy Industries, Ltd. ("MHI") of its shares in MHI Technical Services Corporation ("MTSC") to Mitsubishi Hitachi Power Systems, Ltd. ("MHPS") is subject to donor's tax.

BACKGROUND

Mitsubishi Heavy Industries, Ltd. ("MHI") is a foreign corporation organized and existing under the laws of Japan based on its Articles of Incorporation and Certificate of Residence issued by the Shiba Tax Office of Japan on 06 December 2013.

On the other hand, Mitsubishi Hitachi Power Systems, Ltd. ("MHPS") is also a foreign corporation organized and existing under the laws of Japan.

MHI Technical Services Corporation ("MTSC") is a domestic corporation engaged in rendering specialty and technical services to foreign corporations. MHI is the immediate and ultimate parent of MTSC.

MHI owns one million (1,000,000) common shares of MTSC, inclusive of the sixty-nine shares held by nominee shareholders ("MTSC Shares"), or 100% of the latter's capital stock. The said shares have a par value of One Hundred Pesos (Php100.00) per share or a total par value of One Hundred Million Pesos (Php100,000,000.00).

On 31 July 2013, MHI and MHPS entered into an Absorption-Type Company Split Agreement ("Agreement"). Under the Agreement, MHI, which is the splitting company, is transferring to MHPS, which is the absorbing company, the following businesses operated by MHI ("businesses subject to company split"):

- a. Thermal Power Generation Systems Business;
- b. Geothermal Power System Business;
- c. Environmental Equipment Business;
- d. Fuel Cell Business;
- e. Thermal Power Control System Business;
- f. Electric Power Selling Business;
- g. Product Development Function incidental to the business described in item F; and
- h. Engineering Function incidental to the business described in items A to F.

As a consequence of the Agreement, MHPS succeeded to any and all rights and obligations or assets and liabilities that belong to MHI's business subject to the company split. Based on review of the Agreement, the assets transferred cover the shares of stock held by MHI in 31 subsidiaries and affiliate worldwide which include the MTSC shares.

In exchange for the aforesaid assets and liabilities, MHPS issued 682 common shares to MHI for a 65% ownership in the former. Later on, MHI and MHPS executed an amendment to the Agreement whereby the effective date of the Absorption-Type Company Split Agreement was moved to 01 February 2014. On the same date, MHI and MHPS entered into a Deed of Assignment of Shares to formalize the transfer of the MTSC shares previously owned by MHI.

On 28 February 2014, MHI filed with the BIR a tax treaty relief application requesting for confirmation that the capital gains derived by MHI from the transfer of its shares in MTSC to MHPS are exempt from capital gains tax pursuant to Article 13 of the Republic of the Philippines – Japan (“RP-Japan”) Tax Treaty.

On 29 September 2021, the BIR issued the subject ITAD Ruling No. 041-21 ruling that the gains realized by MHI in the transfer of its MTSC shares to MHPS are not subject to income tax under the RP-Japan Tax Treaty. However, MHI is liable for a 30% donor’s tax under Section 100 of the Tax Code, as amended, in relation to Section 99(B) of the Tax Code, since the fair market value (FMV) of MTSC’s shares as of 31 January 2014 is higher than the FMV of the 682 MHPS common shares received by MHI, to wit:

In regard to the computation of the FMV of the MTSC shares, Section 7(c.2.2) of Revenue Regulations (RR) No. 06-2008 clarified that the FMC of shares not listed and traded in the local stock exchange is equivalent to the book value of such shares as shown in the issuing domestic corporation’s audited financial statements nearest to the date of such shares. The book value is computed by dividing the total stockholder’s equity of the corporation or net assets by the number of its outstanding shares. Based on this formula, the FMV of the common shares in MTSC, the amount of deemed gift and the corresponding donor’s tax are as follows:

Shareholders’ Equity of MTSC based on its Audited Financial Statements as of 31 January 2014	Php 236,701,505.42
<i>Divided by:</i> Outstanding Shares	1,000,000
FMV per shares	Php 236.70
<i>Multiply by:</i> Alienated MTSC shares	1,000,000
FMV of the MTSC shares as of 31 January 2014	Php 236,701,505.42
<i>Less:</i> FMV of the MHPS shares received in exchange for the MTSC shares	Php 230,209,436.02
Deemed gift	Php 6,492,069.40

<i>Multiply by: Donor's tax rate</i>	30%
Donor's tax due	Php 1,947,620.82

In its Request for Review, Isla Lipana & Co., argues that MHI's transfer of MTSC's shares to MHPS is not subject to donor's tax because the transfer of shares is part of a reorganization undertaken by MHI group of companies and is purely driven by business considerations. Hence, the transfer of MTSC shares did not arise out of liberality or gratuity which is an essential requisite for there to be a valid donation.

DISCUSSION

The subject Request for Review was filed within the prescribed reglementary period.

Section 3 of DOF Department Order ("DO") No. 007-02 provides that a taxpayer who receives an adverse ruling from the Commissioner of Internal Revenue ("CIR") may seek its review by the Secretary of Finance within 30 days from the date of receipt of said ruling.

The subject BIR ITAD Ruling was received by MHI, through counsel, on 01 October 2021. The last day to file a request for review is on 31 October 2021, which falls on a Saturday. The next working day is on 02 November 2021.

MHI submitted its request for review on 02 November 2021 but the subject request does not include the duplicate copy of the records on file with the BIR. Nevertheless, this Department sent a letter dated 05 November 2021 informing MHI to submit the BIR docket on file within 30-days from receipt of the letter.

On 10 December 2021, MHI, through its counsel, submitted the complete duplicate copy of the records on file with the BIR within the 30-day period. Hence, the subject Request for Review was given due consideration accordingly.

There is no donor's tax in the transfer of MHI of its MTSC shares of stock to MHPS.

According to the BIR, MTSC's shares of stock were transferred for less than adequate and full consideration under Section 100 of the Tax Code since the FMV of the 1,000,000 MTSC common shares transferred as of 31 January 2014 is higher than the FMV of the 682 MHPS common shares received by MHI, as follows:

FMV of the MTSC shares as of 31 January 2014	Php 236,701,505.42
<i>Less:</i> FMV of the MHPS shares received in exchange for the MTSC shares	230,209,436.02
Difference	Php 6,492,069.40

Hence, under Section 100 of the Tax Code, as amended, in relation to Section 7(c.14) of Revenue Regulations (RR) No. 6-2008 and Section 10(B) of RR No. 2-2003, the excess between the FMV of the MTSC and MHPS shares is subject to 30% donor's tax.

This Department notes that under Republic Act No. 10963, otherwise known as "Tax Reform and Acceleration and Inclusion Law" ("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, free from any

donative intent), will be considered as made for an adequate and full consideration in money or money's worth.

We note, however, that the foregoing exceptions have been recognized even before the amendment was introduced under the TRAIN Law.

The principal purpose of the "deemed gift" provision under Section 100 of the Tax Code, as amended, is to prevent a situation where parties to a sale endeavor to avoid/save in payment of income taxes through the manipulation of the selling price of the sale. Hence, to curb tax leaks as a result of declaring a lower selling price than the amount of money exchanged, the same section 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.

In BIR Ruling [DA-(DT-065)715-09], the BIR recognized that while donor's tax is imposed on the difference when the selling price of the shares is lower than the FMV of the shares exchanged under Section 100 of the Tax Code, as amended, it should be borne in mind 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.

In this case, the equivalent value of the MHPS shares received by MHI amount to Php 230,209,436.02. Compared to the acquisition cost of the MTSC shares by MHI amounting to Php 100,000,000.00, a capital gain of P130,209,436.02 was realized by MHI in the transfer. However, as ruled by the BIR in this case, the capital gain derived by MHI is exempt from income tax under Article 13 of the RP-Japan Tax Treaty. In fine, MHI could not have intended to avoid the income tax due on the transfer as any gain derived from the transfer is covered by the exemption.

Furthermore, we believe that the "deemed gift" provision should 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.

In BIR Ruling [DA-652-05], the BIR concluded that as long as the transaction is conducted at arm's length, that it is a bona fide business arrangement, a sale for less than an adequate consideration is not subject to donor's tax.

We believe that the transfer made by MHI of shares it owned in 31 subsidiaries and affiliates worldwide for a 65% ownership in MHPS was made in the ordinary course of business under a bona fide business arrangement between two companies, therefore, not subject to donor's tax.

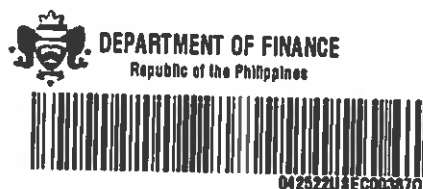
In view of the foregoing, this Office grants the request for review. The Commissioner's ruling is reversed accordingly. This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be disclosed that the facts are different, then this ruling shall be considered as null and void.

Thank you.

Very truly yours,


CARLOS G. DOMINGUEZ
Secretary of Finance

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Carlos G. Dominguez
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CC: **COMMISSIONER CAESAR R. DULAY**
Bureau of Internal Revenue