



Republic of the Philippines  
**DEPARTMENT OF FINANCE**

Roxas Boulevard Corner Pablo Ocampo, Sr. Street  
Manila 1004

DOF Opinion No. 009.2022

**ATTY. MARIA MARGARITA D. MALLARI-ACABAN**

*Partner*

SyCip Gorres Velayo & Co.  
6760 Ayala Ave.  
Makati City, 1226

**SUBJECT : Request for Review of Bureau of Internal Revenue  
Ruling No. S40M-017-2022 dated 17 January 2022**

**Dear Atty. Mallari-Acaban:**

This refers to your letter dated 9 March 2022 ("Request for Review"), which you filed with this Department on behalf of the Toyota Manila Bay Corporation ("TMBC") to request for the review of Bureau of Internal Revenue ("BIR") Ruling No. S40M-017-2022 dated 17 January 2022 confirming that the statutory merger between Toyota Cubao Incorporated ("TCI"), as the absorbed corporation, and TMBC, as the surviving corporation, is a tax free transfer/exchange pursuant to Section 40(C)(2) of the National Internal Revenue Code ("NIRC"), as amended, but that the unrestricted retained earnings of TCI are subject to the final withholding tax on dividends constructively received by its shareholders.

The Request for Review prays for the reversal of the BIR's findings that retained earnings of the absorbed corporation in a tax-free merger pursuant to Section 40(C)(2) are subject to the final withholding tax on dividends constructively received by its shareholders. The particular provision in BIR Ruling No. S40M-017-2022 states:

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“H. The retained earnings of TCI, the absorbed corporation, are subject to the final withholding tax on dividends constructively received by its individual shareholders and non-resident foreign corporate shareholders pursuant to Section 24 (B)(2), 25 (A)(2), and 28 (B)(5)(b) of the NIRC, as amended.”

On the other hand, in the Request for Review, TMBC asserted that the BIR’s theory that the unrestricted retained earnings of TCI as the absorbed corporation in the merger should be considered as constructive dividends to the stockholders of TCI subject to final withholding tax on dividends is misplaced for the following reasons:

- a. “The constructive dividends treatment violates Section 80 of the old Corporation Code (applicable at the time of merger) and Section 40 (C)(2) of the NIRC, especially considering that any retained earnings of TCI were already considered in the share exchange ratio for purposes of determining the number of TMBC shares to be issued to TCI’s shareholders pursuant to the merger;
- b. There is no income realized by the stockholders of TCI pursuant to the merger; and
- c. There is no receipt of the dividends – whether actual or constructive – by the shareholders of TCI pursuant to the merger.”

The issue in the Request for Review is whether in a tax-free merger pursuant to Section 40 (C)(2) of the NIRC, as amended, the unrestricted retained earnings of the absorbed corporation is subject to final withholding tax on constructive dividends to stockholders.

### **Ruling**

After reviewing the facts and laws presented, we find that the BIR made a reversible error when it declared that the unrestricted retained earnings of the



absorbed corporation in a tax-free merger pursuant to Section 40 (C)(2) of the NIRC, TCI in this case, is subject to final withholding tax on dividends.

A merger is the combining of two (2) or more corporations into one constituent corporation (surviving corporation).<sup>1</sup> This means that the separate existence of the constituent corporations shall cease,<sup>2</sup> and the surviving corporation shall possess all the rights, privileges, immunities, and franchises of each of the constituent corporations, including all property and receivables, including share subscriptions, and all other interest of each constituent corporation by operation of law.<sup>3</sup> Further, the surviving corporation shall be subject to responsible and liable for all the liabilities and obligations of each constituent corporations.<sup>4</sup>

From the foregoing, when all the assets and liabilities of the absorbed corporation TCI are transferred to the surviving corporation TMBC, solely in exchange for shares of stocks, this necessarily includes all the accumulated earnings outstanding in the books of the absorbed corporation as of the time of the merger. The retained earnings of TCI are considered in determining the number of shares to be issued by TMBC.

The shareholders of TCI will then receive the shares of the TMBC in exchange for their shares in TCI which ceased to exist by operation of law.

The provisions for tax-free exchanges (i.e. merger or consolidation) merely defer the recognition of gain or loss and our tax laws provide that this rule applies to both the surviving corporation and to the shareholders of the absorbed corporation.

The substituted basis of the properties or shares is used to determine the gain or loss in their subsequent transfers. The substituted basis of the stock received by the transferor and of the property transferred in the hands of the transferee

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<sup>1</sup> Section 76 of the Corporation Code of the Philippines.

<sup>2</sup> Section 80 (2), *Ibid.*

<sup>3</sup> Section 80 (4), *Ibid.*

<sup>4</sup> Section 80 (5), *Ibid.*



is the original basis which is often the original acquisition cost or the adjusted cost basis as defined in Revenue Regulations No. 18-2001, as amended. In later transfers, the substituted basis in the original tax-free exchange shall be used in computing the gain or loss resulting from said transfer.

In other words, the shareholders of the absorbed corporation keep the capital gains or losses on the transfer as unrealized upon receipt of the new shares from the surviving corporation. Only upon subsequent transfer of subject shares shall income tax be imposed on capital gains realized, if any.

It is for the foregoing reasons that this Office reverses the decision of the Commissioner of Internal Revenue in BIR Ruling No. S40M-017-2022 that the unrestricted retained earnings of TCI are subject to final withholding tax on dividends.

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 null and void.

Thank you.

Sincerely yours,

  
CARLOS G. DOMINGUEZ

Secretary of Finance

MAY 16 2022



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