



REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Date: FEB 04 2022

REVENUE MEMORANDUM CIRCULAR NO. 19-2022

SUBJECT : Providing Clarification and Guidance on Section 8 of Revenue Regulations (RR) No. 5-2021 on the Tax-Free Exchanges of Properties Under Section 40(C)(2) of the National Internal Revenue Code (Tax Code) of 1997, as Amended by Republic Act (RA) No. 11534 or the CREATE.

TO : All Internal Revenue Officers and Others Concerned

I. BACKGROUND:

Section 8 of RR No. 5-2021, on the tax-free exchanges of properties under Section 40(C)(2) of the 1997 Tax Code, as amended by CREATE, provides in part that:

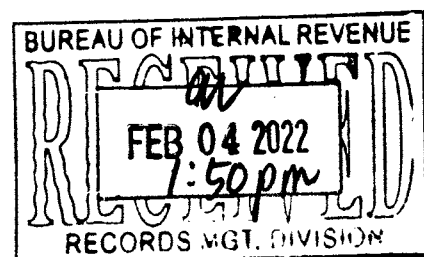
“In all of the foregoing instances of exchange of property, prior Bureau of Internal Revenue (BIR) confirmation or tax ruling shall not be required for purposes of availing the tax exemption. The concerned parties can implement the transaction covered by this Section including, but not limited to, the issuance of the Certificate Authorizing Registration (CAR) by the Revenue District Office (RDO) where the property is located, in case of real properties, or to the RDO where the business is registered, in case of shares of stocks, subject to post-transaction audit by the Bureau.”

Notably, for income tax purposes, Section 40(C)(2) of the 1997 Tax Code, as amended by CREATE, merely defers recognition of gain or loss on said exchanges of properties. Any gain or loss shall be recognized when the properties or shares are subsequently transferred. It is, thus, imperative that the substituted basis of the properties transferred and shares received are established and properly monitored in order that in case of their subsequent sale or disposition, they shall be taxed accordingly.

This Circular is, therefore, issued to provide clarification and guidance to the RDO, other internal revenue officers and others concerned on Section 8 of RR No. 5-2021, particularly on the mandate to issue CAR sans a prior BIR confirmation or tax ruling on the tax-free exchanges of properties, while at the same time ensuring that the proper taxes due the Government on their subsequent sale or disposition are protected and collected thru the establishment and proper monitoring of their correct substituted basis.

II. COVERAGE:

Under Section 40(C)(2) of the 1997 Tax Code, as amended by CREATE, the following transactions are covered by the tax-free exchanges of properties:



A. Reorganization – which shall mean any of the following instances:

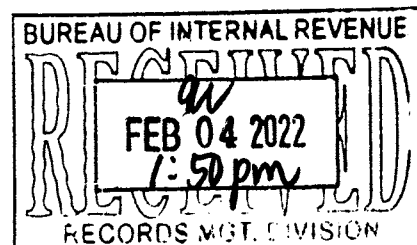
1. A corporation, which is a party to a merger or consolidation, exchanges property solely for stock in a corporation, which is a party to the merger or consolidation; or
2. The acquisition by one (1) corporation, in exchange solely for all or a part of its voting stock, or in exchange solely for all or part of the voting stock of a corporation which is in control of the acquiring corporation, of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation, whether or not such acquiring corporation had control immediately before the acquisition; or
3. The acquisition by one (1) corporation, in exchange solely for all or a part of its voting stock or in exchange solely for all or part of the voting stock of a corporation which is in control of the acquiring corporation, of substantially all of the properties of another corporation. In determining whether the exchange is solely for stock, the assumption by the acquiring corporation of a liability of the others shall be disregarded; or
4. A recapitalization which shall mean an arrangement whereby the stock and bonds of a corporation are readjusted as to amount, income, or priority or an agreement of all stockholders and creditors to change and increase or decrease the capitalization or debts of the corporation or both; or
5. A reincorporation, which shall mean the formation of the same corporate business with the same assets and the same stockholders surviving under a new charter.

B. Transfer to a Controlled Corporation – which means transfer of property to a corporation by a person, alone or together with others, not exceeding four (4) persons, in exchange for stock or unit of participation in such a corporation of which as a result of such exchange, the transferor or transferors, collectively, gains or maintains control of said corporation: Provided, that stocks issued for services shall not be considered as issued in return for property.

The term “*control*”, when used in a tax free-exchange of properties, shall mean ownership of stocks in a corporation after the transfer of property possessing at least fifty-one percent (51%) of the total voting power of all classes of stocks entitled to vote: Provided, That the collective and not the individual ownership of all classes of stocks entitled to vote of the transferor or transferors shall be used in determining the presence of control.

III. DETERMINATION OF SUBSTITUTED BASIS:

Under Section 40(C)(5) of the 1997 Tax Code, as amended, the substituted basis of the properties transferred shall be determined as follows.



A. Stock or Securities - The substituted basis of the stock or securities received by the transferor on a tax-free exchange shall be:

1. The original basis of the property, stock or securities to be transferred;
2. Less: (a) money received, if any, and (b) the fair market value of the other property received, if any;
3. Plus: (a) the amount treated as dividend of the shareholder, if any, and (b) the amount of any gain that was recognized on the exchange, if any.

However, the property received as 'boot' shall have as basis its fair market value. The term "boot" refers to the money received and other property received in excess of the stock or securities received by the transferor on a tax-free exchange.

If the transferee of property assumes, as part of the consideration to the transferor, a liability of the transferor or acquires from the latter property subject to a liability, such assumption or acquisition (in the amount of the liability) shall, for purposes of computing the substituted basis, be treated as money received by the transferor on the exchange.

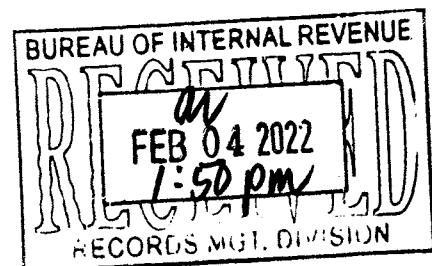
Finally, if the transferor receives several kinds of stock or securities, the Commissioner is authorized to allocate the basis among the several classes of stocks or securities.

B. Property in the Hands of the Transferee - The substituted basis of the property transferred in the hands of the transferee shall be:

- (a) the original basis in the hands of the transferor;
- (b) Plus: the amount of the gain recognized to the transferor on the transfer.

C. Original Basis - The original basis of the property to be transferred, as mentioned herein, shall be the following, as may be appropriate:

- (a) The cost of the property, if acquired by purchase on or after March 1, 1913;
- (b) The fair market price or value as of the moment of death of the decedent, if acquired by inheritance;
- (c) The basis in the hands of the donor or the last preceding owner by whom the property was not acquired by gift, if the property was acquired by donation.



If the basis, however, is greater than the fair market value of the property at the time of donation, then, for purposes of determining loss, the basis shall be such fair market value; or,

- (d) The amount paid by the transferee for the property, if the property was acquired for less than an adequate consideration in money or money's worth.
- (e) The adjusted basis of (a) to (d) above, if the acquisition cost of the property is increased by the amount of improvements that materially add to the value of the property or appreciably prolong its life less accumulated depreciation.
- (f) The substituted basis, if the property was acquired in a previous tax-free exchange under Section 40(C)(2) of the Tax Code of 1997.

Illustrations and further explanations on the determination of the substituted basis of the properties transferred and stocks received in the exchange are found in existing revenue issuances listed in **Item VII** hereof.

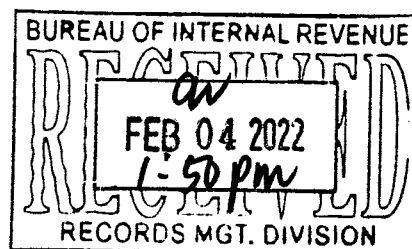
IV. BASIS FOR DETERMINING GAIN OR LOSS ON THE SUBSEQUENT SALE OR DISPOSITION OF PROPERTIES:

The substituted basis, as determined in **Item III** hereof, shall be the basis for determining gain or loss on a subsequent sale or disposition of properties subject of the tax-free exchange transactions under Section 40(C)(2) of the 1997 Tax Code, as amended, by CREATE.

V. MONITORING OF THE SUBSTITUTED BASIS OF PROPERTIES:

For proper monitoring of the substituted basis, the parties to the tax-free exchange/reorganization should comply with the following requirements as set forth under Revenue Regulations No. 18-2001:

1. Each corporation, which is a party to the reorganization, shall file, as part of its return for the taxable year within which the reorganization occurred, a complete statement of all facts pertinent to the non-recognition of gain or loss in connection with the reorganization.
2. Every taxpayer, other than a corporation, party to the reorganization, who received stock or securities and other property or money upon a tax-free exchange in connection with a corporate reorganization shall incorporate in his income tax return for the taxable year in which the exchange takes place a complete statement of all facts pertinent to the non-recognition of gain or loss upon such exchange.
3. The parties thereto shall include as a note to their respective audited financial statements for the taxable year in which the exchange occurred a statement to the effect that they hold such assets/shares acquired in a tax-free exchange and the year in which such



exchange occurred, and in the taxable years until the subject properties are subsequently transferred to another transferee.

4. The parties shall cause to annotate, at the back of the Transfer Certificate of Title (TCC), Condominium Certificate of Title (CCT) and Certificates of Stock, the date the deed of exchange was executed, the original or historical cost of acquisition of the properties or shares of stock transferred, and the fact that no gain or loss was recognized as a result of such exchange.
5. A photocopy of the TCT/CCT/Certificate of Stock that bears the annotation of substituted bases of the real properties/shares of stock transferred/received in connection with the transaction, as duly certified by the RD/Corporate Secretary, should be submitted to the RDO which issued the CAR, within ninety (90) days from the date of the receipt of the CAR, by any of the parties to the exchange transaction. Otherwise, the RDO shall refer the docket of the case to the Legal Division for appropriate action.
6. Moreover, the shareholders of the absorbed/transferor corporation and the surviving/transferee corporation shall record in their respective books the mandatory accounting entries stated in **Annexes "A" "A-1" and "A-2"** hereof, as the case may be, pursuant to RMO No. 17-2016.

VI. TAX TREATMENT OF EXCHANGES OF PROPERTIES MADE PURSUANT TO SECTION 40(C)(2) OF THE 1997 TAX CODE, AS AMENDED:

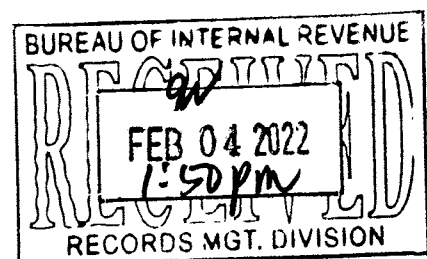
The transfers of properties in exchange for shares of stocks made pursuant to Section 40(C)(2) of the 1997 Tax Code, as amended, shall be exempt from the following taxes:

- a. Capital Gains Tax (CGT);
- b. Creditable Withholding Tax (CWT);
- c. Income Tax (IT);
- d. Donor's Tax (DT);
- e. Value-Added Tax (VAT); and
- f. Documentary Stamp Tax (DST) on conveyances of real properties and shares of stocks

However, the original issuance of shares in exchange for the properties transferred shall be subject to the DST under Section 174 of the 1997 Tax Code, as amended.

VII. APPLICATION OF EXISTING REVENUE ISSUANCES:

The following revenue issuances shall continue to apply on exchanges of properties made pursuant to Section 40(C)(2) of the 1997 Tax Code, as amended by CREATE, particularly on the establishment and monitoring of substituted basis of the properties transferred and stocks received in case of their subsequent sale or disposition, including their tax treatment:



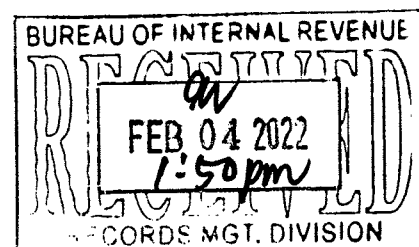
1. RR No. 18-2001 – providing the guidelines on the monitoring of the basis of property transferred and shares received, pursuant to a Tax-Free Exchange of Property for Shares under Section 40(C)(2) of the Tax Code of 1997, as amended; prescribing the penalties for failure to comply with such guidelines; and, authorizing the imposition of fees for the monitoring thereof.
2. RMR No. 1-2001 – providing the tax consequences of Tax-Free Exchange of Property for Shares of Stock of a controlled corporation pursuant to Section 40(C)(2) of the Tax Code of 1997, as amended.
3. RMR No. 1-2002 – providing the tax consequences of *De Facto* Merger pursuant to Section 40(C)(2) and (6)(b) of the Tax Code of 1997, as amended.
4. RMR No. 2-2002 – providing the guidelines in the determination of substituted basis of property transferred and shares received, pursuant to Section 40(C)(5) of the Tax Code of 1997, as amended.
5. RMO No. 32-2001 – providing the 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, as amended, 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.
6. RMO No. 17-2016 – providing the supplemental guidelines for the non-recognition of gain or loss on the transfer of property in exchange for shares of stock pursuant to Section 40 (C) (2) in relation to Section 40 (C) (6) (c) of the Tax Code of 1997, as implemented by RR No. 18-2001.

VIII. VENUE FOR THE ISSUANCE OF THE CERTIFICATE AUTHORIZING REGISTRATION (CAR):

For purposes of the issuance of the CAR for the transferred properties pursuant to the tax-free reorganization/exchange, the parties to the transaction shall submit the documentary requirements listed in **Annex “B”** hereof to the RDO having jurisdiction over the place where the property is located, in case of a real property, or in case of shares of stock, the RDO where the issuing corporation is registered.

In case the transaction involves transfer of multiple real properties and/or shares of stocks situated in various locations covered by different RDOs, the CAR shall be processed with the RDO having jurisdiction over the place where the transferee corporation is registered.

The CAR should specify, among others, that the transaction involved is a tax-free exchange under Section 40(C)(2) of the Tax Code of 1997, as amended by CREATE, the date of transaction, and the substituted basis of the properties subject therefor.



IX. CONDUCT OF POST-TRANSACTION AUDIT:

Following issuance of the corresponding CAR on the transactions falling under Section 40(C)(2) of the Tax Code, as amended by CREATE, the concerned RDO shall conduct a post-audit of said transactions pursuant to existing revenue issuances on tax audit and assessment, to determine the taxability thereof.

If after audit, the transaction is found to be not entitled to the tax deferral treatment under Section 40(C)(2) of the Tax Code, as amended by CREATE, the transaction shall be subject to the applicable taxes, plus interest, penalty and surcharge. However, the result of the audit shall not invalidate the CAR previously issued for the transfer of the properties.

The parties to the transaction are duty bound to prove compliance with the conditions laid down by the law and the requirements set forth under existing revenue issuances in the availment of the tax exemption.

X. OPTION TO REQUEST FOR LEGAL OPINION/RULING TO CLARIFY LEGAL ISSUES THAT MAY AFFECT THE TRANSACTION:


In all the foregoing, the taxpayer is not precluded from requesting a ruling/legal opinion with the Law and Legislative Division (LLD) of the National Office in order to clarify legal issue/s that may affect the transactions made pursuant to Section 40(C)(2) of the 1997 Tax Code, as amended, including the taxability of such transaction.

The LLD shall evaluate whether or not the request involves question/s of law that would merit the issuance of a ruling. Otherwise, it shall endorse the request to the concerned RDO for appropriate action.

XI. EFFECTIVITY:

All concerned revenue officials and employees are hereby enjoined to give this Circular as wide a publicity as possible.

This Circular takes effect immediately.


CAESAR R. DULAY
 Commissioner of Internal Revenue
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