

November 13, 2001

REVENUE REGULATIONS NO. 18-2001

SUBJECT: 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 National Internal Revenue Code of 1997, Prescribing the Penalties for Failure to Comply with such Guidelines, and Authorizing the Imposition of Fees for the Monitoring Thereof.

TO: All Internal Revenue Officers and Others Concerned.

SECTION 1. Scope. -- Pursuant to Section 244, in relation to Sections 40(C)(2), 58(E), 269, and 275 of the National Internal Revenue Code of 1997 (Tax Code of 1997), these Regulations are hereby promulgated for the purpose of providing the guidelines in the proper monitoring of the basis of properties transferred, and shares received, pursuant to a tax-free exchange under Section 40(C)(2) of the Tax Code of 1997, and to establish the policies governing the imposition of fees for the monitoring thereof.

SECTION 2. Basis. - A. Substituted Basis of Stock or Securities Received by the Transferor. The substituted basis of the stock or securities received by the transferor on a tax-free exchange shall be as follows:

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. Substituted Basis of the Transferred Property in the Hands of the Transferee. The substituted basis of the property transferred in the hands of the transferee shall be as follows:

- (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. The Original Basis of Property to be Transferred. The original basis of the property to be transferred 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.

D. Basis for Determining Gain or Loss on a Subsequent Sale or Disposition of Property Subject of the Tax-free Exchange.

The substituted basis as defined in Section 40(C)(5) of the Tax Code of 1997, and implemented in Section 2.A and 2.B above, shall be the basis for determining gain or loss on a subsequent sale or disposition of property subject of the tax-free exchange.

SECTION 3. Submission of Information on the Basis of Properties. - The parties to a tax-free exchange of property for shares under Section 40(C)(2) of the Tax Code of 1997

who are applying for confirmation that the transaction is indeed a tax-free exchange shall, together with such information as the Commissioner of Internal Revenue may require, submit the following:

- (a) A sworn certification on the basis of the property to be transferred pursuant to such exchange. The basis of each real property/share of stock or other property transferred must be itemized in the certification in order to enable the BIR to determine the basis for subsequent disposition and to make it possible for the Register of Deeds or the corporate secretary, as the case may be, to annotate the information on such basis for each property/share of stock on the reverse side of the Transfer Certificate of Title/Condominium Certificate of Title of the real property involved, or of Certificate of Stock. The sworn declaration must be executed by the transferor himself, or in case the transferor is a juridical entity, by an official with rank of no less than the Chief Financial Officer or his equivalent. The Commissioner of Internal Revenue is authorized to prescribe the form in which such sworn declaration shall appear.
- (b) Certified true copies of the Transfer Certificates of Title and/or Condominium Certificates of Title of the real properties to be transferred;
- (c) Certified true copies of the corresponding latest Tax Declaration of the real properties to be transferred. It is understood that any improvement is separately declared and therefore, covered by a Tax Declaration distinct from the Tax Declaration on the land. Further, if the tax declaration was issued three (3) or more years prior to the exchange transaction, the Transferor shall include in the certification by the local government unit's Assessor that such tax declaration is the latest tax declaration covering the real property;
- (d) Certified true copies of the certificates of stocks evidencing shares of stock to be transferred; and
- (e) Certified true copy of the inventory of other property/ies to be transferred.

No certification/ruling will be issued by the Bureau of Internal Revenue unless the foregoing requirements, in addition to such other documents that the Commissioner of Internal Revenue may require, are submitted.

SECTION 4. Information to be Contained in Certification/Ruling by the Bureau of Internal Revenue. - All certifications or rulings issued by the Bureau of Internal Revenue confirming that an exchange of property for shares complies with the provisions of Section 40(C)(2) of the Tax Code of 1997 shall include a statement on the substituted basis of the property transferred.

SECTION 5. Conditions for the Issuance of Certificate Authorizing Registration (CAR) or Tax Clearance (TCL). - The CAR/TCL for the real property or share of stock/unit of participation/interest involved in the exchange shall be issued by the Revenue District Officer/Authorized Internal Revenue Officer on the basis of the certification or ruling to be issued in triplicate by the Commissioner or his duly authorized representative to the effect that the transaction qualifies as a tax-free exchange under Section 40(C)(2) of the Tax Code of 1997.

The CAR/TCL to be issued shall specify, among others, that the transaction involved is a tax-free exchange under Section 40(C)(2) of the Tax Code of 1997; the date of exchange; and the substituted basis of the properties as stated in the certification or ruling issued by the Bureau of Internal Revenue.

SECTION 6. Information to be annotated in the Transfer Certificate of Title or Condominium Certificate of Title issued by the Register of Deeds, and on the Certificate of Stock/Units of Participation issued by the Corporate Secretary. -- In cases of transfers or exchanges falling under Section 40(C)(2) of the Tax Code of 1997, the following information shall be annotated on the reverse side of the Transfer Certificate of Title or Condominium Certificate of Title or certificate of stock that is transferred or issued pursuant to such transfer or exchange:

"The acquisition of the property described in this title/certificate is by virtue of a tax-free exchange pursuant to Section 40(C)(2) of the National Internal Revenue Code of 1997 per Deed of Exchange/Assignment dated _____. The substituted basis pursuant to Section 40(C)(5) of the National Internal Revenue Code of 1997 is in the amount of _____."

The following persons shall be responsible for making the above annotation:

- (a) The Registrar of Deeds, with respect to the Transfer Certificate of Title or Condominium Certificate of Title of real property that is transferred;
- (b) The Corporate Secretary or equivalent officer of the investee corporation/partnership whose shares/units are transferred by the Transferor to the transferee/surviving/consolidated corporation;
- (c) The Corporate Secretary of transferee/surviving/consolidated corporation, upon the issuance of the certificates of stock evidencing the original shares issued pursuant to the transfer or exchange.

The annotation shall be made on the reverse side of the Transfer Certificate of Title or Condominium Certificate of Title, or certificate of stock/unit of participation, as the case may be.

In addition to the foregoing, each Deed of Exchange/Assignment transferring such property must state that the parties thereto shall undertake to comply with the provisions of these Regulations.

SECTION 7. Submission of Proof of Annotation of Substituted Basis. - No certification/ruling issued by the Bureau of Internal Revenue shall be valid unless the parties to the exchange submit to the Bureau copies of the new Transfer Certificates of Title, Condominium Certificates of Title, or certificates of stock/units of participation, duly certified by the Register of Deeds or the Corporate Secretary, as the case may be, containing the information required in Section 6 of these Regulations, within ninety (90) days from receipt by any of the parties to the exchange transaction of the certification/ruling by the Bureau confirming that the transaction complies with Section 40(C)(2) of the Tax Code of 1997.

Section 8. Information to be Included in the Final Adjustment Return and in the Audited Financial Statements Accompanying the Final Adjustment Return; Records to be Maintained by Parties. -

(a) The transferor and the transferee or the surviving/consolidated corporation, as the case may be, as well as the shareholders of such surviving/consolidated corporation (in case of a merger or consolidation) shall enclose with their respective income tax returns for the taxable year in which the tax-free exchange occurred, a copy of the request for ruling filed with, and the corresponding certification/ruling issued by, the Bureau of Internal Revenue, both duly stamped received by the appropriate office of the Bureau of Internal Revenue.

(b) Such persons shall likewise include as a note to their respective audited financial statements for the taxable year in which such 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 succeeding taxable years until the subject property/ies is/are subsequently transferred to another transferee.

(c) In addition to the foregoing, the parties to the transaction shall maintain permanent records of the transaction, consisting of, among others, the request for ruling, certification or ruling issued by the Bureau of Internal Revenue, the Deed of Assignment/Exchange, or the Articles of Merger, as the case may be, and such other documents as may be required to facilitate the determination of gain or loss from a subsequent disposition of the stocks/unit of participation/interest/properties received or transferred in the exchange.

SECTION 9. Fees to be Paid by the Applicant/Taxpayer. -- Every applicant/taxpayer who wants to avail of the tax-free exchange in accordance with Section 40(C)(2) and 6(b) and (c) of the Tax Code of 1997 shall secure a form that the Bureau shall provide for such purpose and shall pay in advance a processing and certification fee of Five Thousand Pesos (P5,000.00) for each application not involving more than ten (10) real properties and/or Certificates of Stock.

An additional fee of One Hundred Pesos (P100.00) shall be paid for every Transfer Certificate of Title/Condominium Certificate of Title/ Certificate of Stock in excess of ten (10).

SECTION 10. Penalties. -- Every official, agent, or employee of the Registry of Deeds who is guilty of failing to annotate the information stated in Section 5 hereof shall, upon conviction for each omission, be punished by a fine of not less than Fifty Thousand Pesos (P50,000.00) but not more than One Hundred Thousand Pesos (P100,000.00) and suffer imprisonment of not less than ten (10) years but not more than fifteen (15) years and shall likewise suffer an additional penalty of perpetual disqualification to hold public office, to vote, and to participate in any public election pursuant to Section 58(E) in relation to Section 269 of the Tax Code of 1997.

Every Corporate Secretary or the duly authorized officer of the corporation who is guilty of failing to annotate the information stated above shall, upon conviction for each omission, be punished by a fine of not more than One Thousand Pesos (P1,000.00), or suffer imprisonment of not more than six (6) months, or both pursuant to Section 275 of the Tax Code of 1997.

Any other violation of the provisions of these Regulations by any of the parties to the exchange transaction or by any responsible public officer, shall be subject to the appropriate penalties provided under the Tax Code of 1997, and/or the Revised Penal Code.

SECTION 11. REPEALING CLAUSE. - Any Revenue Regulations or Revenue Memorandum Order, or provisions of any revenue issuance, inconsistent with these Regulations are hereby repealed accordingly.

SECTION 12. EFFECTIVITY CLAUSE. - These Regulations shall take effect fifteen (15) days after publication in any newspaper of general circulation.

(Original Signed)
JOSE ISIDRO N. CAMACHO
Secretary of Finance

Recommending Approval:

(Original Signed)
RENÉ G. BAÑEZ
Commissioner of Internal Revenue