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## Reacquisition of shares

THERE are various reasons for which a stockholder may return and, in certain instances, be obliged to surrender his or her shares in a corporation. Likewise, there are events in the life of a corporation that may require it to reacquire or retire issued shares. Thus, subject to compliance with certain legal requisites, shares of stock held in a corporation may be returned by the stockholder or reacquired by the issuing corporation. Based on various issuances, the tax implications of these to the stockholder may differ, depending on the reason for the acquisition.

Insofar as the stockholder is concerned, earlier rulings had not been consistent. Note that an ordinary sale or transfer of shares of stock in a domestic corporation is generally subject to the 5-percent or 10-percent capital-gains tax if the shares are not traded in the stock exchange, or to the stock-transaction tax of one-half of 1 percent of the gross selling price for shares of stock listed and traded in the local stock exchange. Some earlier rulings had applied the same tax treatment in case of the surrender of shares by a stockholder by reason of partial or complete liquidation or dissolution of a corporation. These rulings had equated the amount or properties received by the stockholder from the corporation, usually referred to as liquidating dividends, as proceeds from sale of shares. The transaction was treated, in effect, as sales of stock. Hence, any gain to the stockholder is treated as capital gain subject to the 5-percent or 10-percent capital-gains tax. But some other rulings, while still treating the gain from the transaction as capital gain, had imposed the regular income-tax rates.

This inconsistency was settled through the issuance of Revenue Regulations 06-08. The rule now states that the investor, upon surrendering his or her shares in exchange for cash and property distributed by the corporation upon its dissolution and liquidation of all assets and liabilities, shall recognize either capital gain or loss. The difference between the sum of the cash and the fair-market value of property received and the cost of the investment shall represent capital gain or loss, which shall be subject to the regular income-tax rates imposed on individual taxpayers, or the corporate income-tax rate imposed on corporations.

Similarly, under the same regulations, when preferred shares are redeemed at a time when the issuing corporation is still in its "going-concern" and is not considering to dissolve or liquidate its assets and liabilities, capital gain or capital loss upon redemption shall be recognized on the basis of the difference between the amount or value received at the time of redemption and the cost of the preferred shares. As in the case of gain or loss from the surrender of shares by reason of dissolution, the capital gain or loss derived as a result of the redemption of shares is subject to the regular income-tax rates imposed on individual taxpayers, or to the corporate income-tax rate imposed on corporations.

In effect, the liquidating gain derived by a stockholder as a result of the surrender of shares, either because of the dissolution of the corporation or the redemption/reduction of shares, is treated as a capital gain, which is subject to the regular income tax and not to the 5-percent or 10-percent capital-gains tax.

The rule is different when a corporation voluntarily buys back its own shares, which become treasury shares. In this case, the stock-transaction tax of one-half of 1 percent of the gross selling price applies if the shares are listed and traded in the trading system of a local stock exchange. If the shares are not listed and traded in a local stock exchange, any gain realized by the holder of the reacquired shares is subject to the 5-percent or 10-percent capital-gains tax. The rule now appears to have been settled, insofar as the stockholder is concerned.

But with respect to the corporation reacquiring its shares, the rule is still unclear. The issue usually related to this kind of transaction is whether or not the receipt of the surrendered or redeemed shares and the transfer of properties as consideration for the surrendered or redeemed shares is subject to income tax.

Earlier issuances have confirmed that the transfer by a liquidating corporation of its assets to its stockholders is not considered sale of the assets. Thus, a liquidating corporation does not realize gain or loss in partial or complete liquidation. Neither is a liquidating corporation subject to tax on the receipt of shares surrendered by shareholders pursuant to a complete or partial liquidation. For a while, this had been the tenor of the rulings until the issuance of a 2011 ruling, where a taxpayer-company precisely requested the Bureau of Internal Revenue (BIR) for confirmation that, based on previous rulings, it is not liable for income tax, either on its transfer of the properties to its stockholders as liquidating dividend or upon its receipt of the surrendered shares. The BIR denied the request for lack of a legal basis. While stating that there is no basis under the 1997 Tax Code, there was no discussion as to how the transaction should be treated. The effect on the distribution of assets by a dissolving corporation again became uncertain.

But in Revenue Memorandum Circular 3-2104, dated January 6, where the BIR circularized a memo on the modification of an earlier ruling regarding the tax implications of the redemption of shares paid by way of conveyance of a parcel of land, the BIR reconfirmed that, on the part of the corporation redeeming the shares, the transaction is not subject to income tax, considering that the redeeming corporation does not realize the gain or loss on the redemption of its shares.

The shares so redeemed or reacquired shall be considered retired by the redeeming corporation. Accordingly, a redeeming corporation is not subject to income tax on its receipt of shares surrendered pursuant to the redemption.

We hope that with this issuance, the rule becomes permanent—that the conveyance of property by a corporation reacquiring or redeeming its shares is not subject to income tax because it is not a sale or exchange. Neither is a liquidating corporation subject to tax on the receipt of shares surrendered by shareholders pursuant to a complete or partial liquidation.

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