

FIRST DIVISION

[G.R. No. 241424, February 26, 2020]

**COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS.
LUCIO L. CO, SUSAN P. CO, FERDINAND VINCENT P. CO, AND
PAMELA JUSTINE P. CO, RESPONDENTS.**

DECISION

CAGUIOA, J:

Before the Court is a Petition for Review on *Certiorari*^[1] (Petition) under Rule 45 of the Rules of Court filed by petitioner Commissioner of Internal Revenue (CIR), assailing the Decision^[2] dated February 28, 2018 and Resolution^[3] dated August 14, 2018 of the Court of Tax Appeals *en banc* (CTA EB) in CTA EB No. 1522, which affirmed the CTA Third Division's (CTA Division) Decision^[4] dated June 2, 2016 in CTA Case No. 8831 granting respondents' claim for refund of erroneously paid capital gains tax (CGT).

Facts

The facts as summarized by the CTA are as follows:

As of March 2012, the four respondents[, Lucio L. Co, Susan P. Co, Ferdinand Vincent P. Co and Pamela Justine P. Co (respondents),] collectively were the majority shareholders of Kareila Management Corporation (Kareila), a domestic corporation engaged as managers, managing agents, consignor, concessionaire, or supplier of business engaged in the operation of hotels, supermarkets, groceries and the like.

[Kareila had an authorized capital stock of P500,000,000.00, wherein 1,703,125 shares were subscribed and fully paid. Respondents owned 99.9999% of the total subscribed shares while Anthony Sy (Sy) owned the remaining 0.0001%.]

[Respondents were also shareholders of Puregold Price Club, Inc. (Puregold), a corporation organized under the Philippine laws and primarily engaged in the wholesale and retail of general merchandise. From Puregold's authorized capital stock of P3,000,000,000.00, 2,000,000,000.00 shares were subscribed and fully paid. Respondents owned 66.55% of Puregold's total subscribed shares.]

x x x x

On March 27, 2012, the Board of Directors of [Puregold] x x x approved the issuance of 766,406,250 Puregold common shares to [respondents] and [Sy] in exchange for the transfer to Puregold of the 1,703,125 shares of Kareila.

On May 8, 2012, during the Puregold annual stockholders meeting, this exchange was approved by the stockholders representing two-thirds of Puregold's outstanding capital stock.

x x x x

On May 11, 2012, [respondents] and [Sy] entered into a Deed of Exchange with [Puregold] wherein they agreed to transfer all their Kareila shares to Puregold in exchange for Puregold shares.

Under the Deed of Exchange, [respondents] and [Sy] each would receive four hundred fifty (450) Puregold shares for every one (1) Kareila share that they would transfer to Puregold. Accordingly, Puregold issued to [respondents] and [Sy] a total of 766,406,250 Puregold shares from the unissued portion of its authorized capital stock in exchange for the 1,703,125 Kareila shares:

| Share swap per Deed of Exchange: | | |
|---|--|--|
| Shareholder | No. of Kareila Shares Transferred to Puregold | No. of Puregold Shares Exchanged for Kareila Shares |
| Lucio Co | 681,250 | 306,562,500 |
| Susan Co | 681,250 | 306,562,500 |
| Ferdinand Co | 170,312 | 76,640,400 |
| Pamela Co | 170,312 | 76,640,400 |
| Anthony Sy | 1 | 450 |
| Total | 1,703,125 | 766,406,250 |

As a result of the share swap under the Deed of Exchange:

1. Puregold acquired majority ownership of Kareila; and,
2. [Respondents,] who, prior to the share swap, already collectively owned 66.5720% of the outstanding capital stock of Puregold consequently increased their stockholdings to 75.8329% after the swap:

| Puregold Price Club Inc. | | | | |
|---------------------------------|----------------------------|-----------------------------|----------------------------|-----------------------------|
| | Before Swap | | After Swap | |
| Shareholder | No. of Shares Owned | Percentage Ownership | No. of Shares Owned | Percentage Ownership |
| Lucio Co | 724,376,801 | 36.2188% | 1,030,939,302 | 37.2664% |
| Susan Co | 539,691,310 | 26.9846% | 846,253,810 | 30.5904% |
| Ferdinand Co | 33,686,354 | 1.6843% | 110,326,754 | 3.9881% |
| Pamela Co | 33,686,354 | 1.6843% | 110,326,754 | 3.9881% |
| Total | 1,311,440,820 | 65.5720% | 2,097,846,620 | 75.8329% |

| | | | | |
|---|----------------------|--|----------------------|--|
| Total Subscribed Capital | 2,000,000,000 | | 2,766,406,250 | |
|---|----------------------|--|----------------------|--|

On June 26 and 28, 2012, [respondents] collectively paid capital gains tax (CGT) including interest and/or compromise penalty on the said transfer pursuant to Section 24(C) of the National Internal Revenue Code of 1997 (NIRC), as amended. x x x

x x x x

[Respondents], however, contend that their payments of CGT were erroneous because, under Section 40(C)(2) of the NIRC, their transfer of shares through the Deed of Exchange was a tax-exempt transaction.

Thus, on May 21, 2014, or within the two-year prescriptive period provided under Section 204(c) of the NIRC of 1997, as amended, [respondents] filed their administrative claims for refund of the CGT including interest and/or compromise penalty with their respective Revenue District Offices (RDO).

x x x x

[Due to the CIR's inaction, respondents filed a Petition for Review with the CTA Division.]

In the Answer, the CIR alleged that Revenue Regulations No. 18-2001, Revenue Memorandum Order Nos. 32-2001 and 17-2002 provide that there are certain conditions or requirements which should be complied with in order to avail of the non-recognition of gain under Section 40(C) (2). Specifically, for the share swap transaction to qualify as a tax-free exchange, a *prior* application for a BIR certification or ruling must have been secured. In this case, however, no such *prior* request from the BIR was made. Accordingly, the CIR contended that, since refund claims are construed strictly against the taxpayer-claimant, the refund sought by [respondents] should be denied.

In Reply, [respondents] contend that it was impossible for them to make any prior request for a ruling since they were not aware that their transaction was in fact tax free which, thus, establishes that their CGT payments were erroneously paid. Further, they maintained that Section 40(C)(2) of the NIRC, or any other provision of law or any existing jurisprudence does not impose such condition.^[5]

After a Pre-Trial Order was issued, respondents commenced presentation of their witnesses, namely, Mary S. Demetillo, their consultant on accounting of personal financial transactions, and Atty. Candy H. Dacanay-Datuon, the Corporate Secretary of Kareila and Assistant Corporate Secretary of Puregold.^[6]

x x x x

Witness **Mary S. Demetillo**, declared that as [respondents'] consultant on accounting of personal financial transactions for almost 5 years, she

did the accounting and computation of tax for the subject share swap transaction.

By virtue of the Deed of Exchange dated May 11, 2012, [respondents] and [Sy] transferred 1,703,125 [of] their Kareila common shares to Puregold Price Club, Inc. In return, [respondents] received 766,406,250 common shares in Puregold. At the time of the transaction, Kareila shares had a par value of P100.00 per share, while Puregold had a par value of P21.50 per share. For the said share swap transaction, [respondents] paid CGT of P1,647,615,290.07, including interest and penalty, on June 26 and 28, 2012.

Such payments of CGT, including interest and penalty were rejected in [respondents'] Annual Income Tax Returns (AITRs) for the year 2012.

On May 21, 2014, [respondents] separately filed administrative claims for refund of the erroneously paid CGT with their respective RDO followed by their filing of BIR form No. 1914 or the Applications for Tax Credits/Refund, for which she was consulted. She learned about the actual filing of such claims for refund only when she was preparing for her testimony before the Court. The said administrative claims for refund were not acted upon by [the CIR].

Attorney **Candy H. Dacanay-Datuon**, the Corporate Secretary of Kareila since 2004 and the Assistant Corporate Secretary of Puregold since 2011, testified that she is the custodian of the records of the shares of stocks of Kareila and Puregold. She prepares and files the reportorial requirements under the law of both entities. Kareila is a domestic corporation whose primary purpose is to act as managers, managing agents, consignor, concessionaire or supplier of businesses engaged in manufacturing or trading of general merchandise, the operation of resorts, hotels, supermarkets, groceries and the like. Puregold is also a domestic corporation whose primary purpose is to engage in the wholesale and retail of general merchandise.

She further testified that [respondents] are shareholders of both corporations. Under a Deed of Exchange dated May 11, 2012, [respondents] with [Sy], transferred their 1,703,125 common shares in Kareila to Puregold in exchange for 766,406,250 common shares of Puregold.

Lucio Co and Susan Co each transferred 681,250 Kareila shares in exchange for 306,562,500 Puregold shares, while both Ferdinand Co and Pamela Co each transferred 170,312 Kareila shares for 76,640,400 Puregold shares.

The 1,703,125 Kareila shares were valued at P16.467 billion or P9,668.47 per share, while the 766,406,250 Puregold shares had a subscription price of P16,477,734,375.00 or P21.50 per share.

As a consequence of the share swap, Puregold acquired ownership of all 1,703,125 Kareila shares, while [respondents] and [Sy] were each given in trust one share or .0001% of Kareila. On the other hand, [respondents] collectively owned 1,331,440,820 Puregold shares or

66.55% of the outstanding capital stock of Puregold. After the share swap, [respondents] gained further control of Puregold as their collective shareholdings therein increased from 66.55% to 75.83%.

The amount of P1,647,615,290.07 CGT was paid for the share swap transaction, including interest and penalty, and this amount is the subject of the instant claim for refund.

With the admission of all its evidence, [respondents] rested their case.

On the other hand, [the CIR] did not present any evidence on the ground that no investigation report was submitted to [its] counsel.^[7]

CTA Division Ruling

On June 2, 2016, the CTA Division rendered a Decision granting respondents' claim for refund, the dispositive portion of which reads:

WHEREFORE, the instant Petition for Review is hereby **GRANTED**. Accordingly, respondent Commissioner of Internal Revenue is hereby **DIRECTED TO REFUND** in favor of petitioners Lucio Co, Susan Co, Ferdinand Co, and Pamela Co the amounts of P659,045,625.00, P659,050,632.50, P164,761,860.03 and P164,757,172.54, respectively, or a total amount of P1,647,615,290.07, representing erroneously paid capital gains tax.

SO ORDERED.^[8]

The CTA Division found that the administrative and judicial claims for refund were timely filed. According to the CTA Division, respondents' legal counsel, Zambrano and Gruba Law Offices, had the authority to represent respondents in their administrative claims for refund filed with the CIR even if the Special Power of Attorney was notarized only after its filing.^[9]

The CTA Division further held that all the requisites for the non-recognition of gain or loss under Section 40(C)(2) of the National Internal Revenue Code (NIRC) of 1997, as amended, which effectively exempts the transaction from income tax, are all present in this case.^[10]

The CTA Division also brushed aside the CIR's contention that respondents failed to comply with the Bureau of Internal Revenue (BIR) issuances relating to the tax exemption under Section 40(C)(2), particularly the requirement of seeking a prior BIR Ruling. According to the CTA Division, respondents could not be expected to obtain a BIR Ruling for tax exemption as they previously believed that they were liable to pay the same based on the computation and recommendation of their accounting consultant. The CTA Division also noted that the BIR issuances cited by the CIR are mere guidelines in monitoring tax-free exchange of property and in determining the gain or loss on a subsequent sale or disposition of such property. Thus, respondents cannot be deprived of their claim for refund simply because they failed to comply with said guidelines.^[11]

The CIR moved for reconsideration but the same was denied by the CTA Division in its Resolution^[12] dated September 1, 2016.