FIRST DIVISION

[G.R. No. 227121, December 09, 2020]

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. THE HONGKONG SHANGHAI BANKING CORPORATION LIMITED — PHILIPPINE BRANCH, RESPONDENT.

D E C I S I O N

CAGUIOA, J:

Before the Court is a Petition for Review on *Certiorari*[1] under Rule 45 of the Rules of Court filed by petitioner Commissioner of Internal Revenue (CIR), assailing the Decision[2] dated May 17, 2016 and Resolution[3] dated September 9, 2016 of the Court of Tax Appeals *en banc* (CTA EB) in CTA EB Case No. 1257, which affirmed the CTA Third Division's (CTA Division) Decision[4] dated October 13, 2014 and Resolution[5] dated December 10, 2014 in CTA Case No. 8428. The CTA Division granted respondent Hongkong Shanghai Banking Corporation Limited-Philippine Branch's (respondent) petition for review and cancelled the Final Decision on Disputed Assessment (FDDA) dated January 18, 2012 and Final Assessment Notice (FAN) dated June 28, 2011.[6]

Facts

The facts as summarized by the CTA Division are as follows:

> [Respondent], The Hongkong and Shanghai Banking Corporation Limited – Philippine Branch, is a duly licensed branch of The Hongkong and Shanghai Banking Corporation Limited [(HSBC)] x x x.
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> x x x x
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> Prior to July 2008, HSBC carried on in the Asia Pacific Region, including the Philippines, among other businesses, a Merchant Acquiring Business [(MAB)], whereby it entered into Merchant Agreements with accredited merchants to honor credit cards it issued under various card associations for which it is a member.
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> HSBC, through [respondent], then created Global Payments Asia Pacific-Phils., Inc. [GPAP-Phils. Inc.)] to transfer its [MAB] in the Philippines.
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> On July 22, 2008, GPAP-Phils[.] was incorporated, wherein shares of stocks were issued to [respondent] in exchange for the fair-market value of the Point-of-Sale ("POS") Terminals, Merchant Agreements, and transfer of the [MAB] of HSBC.
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> On July 24, 2008, a Share Sale and Purchase Agreement was executed between HSBC and Global Payment Asia Pacific (Singapore Holdings) Private Limited [(GPAP-Singapore)] for the transfer of said shares.

On September 3, 2008, a Deed of Assignment between [HSBC] and GPAP-Singapore was executed, wherein the former assigned its GPAP-Phils[.] shares to the latter.

On September 5, 2008, the Documentary Stamp Tax in the amount of P52,365.75, based on the par value of the shares, was paid.

On September 22, 2008, [respondent] filed an Application and Joint Certification with [petitioner] to secure a ruling on the tax-free exchange under Section 40(C)(2) of the 1997 National Internal Revenue Code [(NIRC)], as amended, regarding the transfer of the POS Terminals and [MAB].

On September 28, 2008, the Capital Gains Tax [(CGT)] in the amount of P89,929,292.10 was paid, in relation to the above said Deed of Assignment dated September 3, 2008.

On January 23, 2009, a Certification/Ruling No. SN:018-2009 was issued by Assistant Commissioner of Legal Service, certifying that the transfer of POS Terminals and [MAB] with Substituted Basis, in exchange for the GPAP-Phils[.] shares are not subject to tax pursuant to Section 40(C)(2) of the 1997 NIRC, as amended.

On September 8, 2010, however, [petitioner] issued a Notice of Informal Conference addressed to [respondent], the same was received by the latter on September 17, 2010.

On January 7, 2011, [petitioner] issued a Preliminary Assessment Notice ("PAN") against [respondent] for deficiency Income Tax in the amount of P296,936, 948.59, inclusive of interest, from its gain on the sale of the [MAB]; the same was received on January 18, 2011.

On February 2, 2011, [respondent] filed its Protest of even date to the said PAN. [It also filed a Supplemental Position Paper on March 10, 2011.]

On March 14, 2011, [petitioner] issued a Letter, granting [respondent's] request to refer the matter to the Legal and Inspection Group for resolution; the same was received on March 30, 2011.

On March 15, 2011, [respondent] then executed and duly filed a Waiver of the Statute of Limitations; the same was duly received and acknowledged by [petitioner].

On June 28, 2011, [petitioner], thus, issued a [FAN] against [respondent] for deficiency Income Tax in the amount of P318,781,625.17, inclusive of interest, on the sale of "Goodwill," pursuant to Section 27(A) of the 1997 NIRC, as amended; the same was received by [respondent] on July 11, 2011. x xx

x x x x

On July 26, 2011, [respondent] filed its Administrative Protest, which was received by [petitioner] on even date.

> On January 18, 2012, [petitioner] issued a Final Decision on Disputed Assessment, which was received by [respondent] on January 24, 2012.
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> On February 16, 2012, [respondent], thus, filed the present Petition for Review [with the CTA Division].
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> [In its Answer, the CIR claimed that the Deed of Assignment did not pertain to a sale of shares but to a sale or transfer of business or "Goodwill," which is subject to ordinary income tax and not CGT].[7]

CTA Division Ruling

In its Decision dated October 13, 2014, the CTA Division granted respondent's petition and cancelled the FDDA and FAN.

The CTA Division found that, contrary to the CIR's assertion, the evidence bears that the transaction in question is a sale or transfer of capital asset, and not a sale of an ordinary asset, to wit:

> x x x based on the records of the case – the creation of GPAP-Phils[.] to transfer the Merchant Acquiring Business of HSBC by way of additional paid-in capital; the subscription of 139,640 shares of stocks of GPAP-Phils in exchange for HSBC's POS terminals; the subscription of common share of GPAP-Phils[.] in exchange for HSBC's Merchant Agreements; and the subsequent assignment of the total number of shares of 139,641, subscribed by HSBC to GPAP-Singapore, clearly shows that it is a sale of capital asset, as earlier quoted under Section 39(A)(1) of the 1997 NIRC, as amended, to which [respondent] paid the total amount of P89,929,292.10.[8]

The CTA Division further ruled that "Goodwill" is connected to the business itself and cannot be allocated without regard to the business. Thus, the CIR cannot treat separately the alleged sale of "Goodwill" from the transfer of HSBC's MAB to GPAP Phils. and conveniently allocate and reclassify the same as a sale of ordinary asset subject to income tax.[9]

In its Resolution dated December 10, 2014, the CTA Division denied CIR's motion for reconsideration.

CTA EB Ruling

In the assailed Decision, the CTA EB affirmed the findings of the CTA Division.

The CTA EB reiterated that "Goodwill" is an intangible asset, cannot exist independently of the business, nor can it be sold, purchased or transferred separately without carrying out the same transactions for the business as a whole. Thus, while HSBC and GPAP-Singapore agreed to recognize and value the goodwill of the MAB in the Share Sale and Purchase Agreement, the same cannot be sold or purchased independently of the MAB.[10]

Further, the CTA EB agreed with the CTA Division that the sale of HSBC's GPAP-Phils. Inc. shares to GPAP-Singapore at a premium, whereby the goodwill of the MAB was recognized and valued, involves a sale of capital asset subject to CGT and not Income Tax.[11]

The CIR sought reconsideration but the same was denied m a Resolution dated September 9, 2016.

Hence, this petition.

Issue

Whether the CTA EB erred in cancelling the deficiency income tax assessment against respondent on the alleged sale of "Goodwill" of its MAB for taxable year 2008.

The Court's Ruling

The Petition lacks merit.

In its intention to restructure its MAB in the Asia-Pacific Region in order to achieve efficiency, HSBC, through respondent, entered into two transactions: (1) the transfer of its Point of Sales Terminals, other information technology assets and Merchant Agreements of its MAB in the Philippines, in exchange for GPAP-Phils. Inc. shares and (2) the subsequent sale or assignment of its GPAP-Phils. Inc. shares to GPAP-Singapore.

It is beyond dispute that the first transaction qualifies as a tax-free exchange under Section 40, paragraphs (C)(2)[12] and (6)(c)[13] of the 1997 NIRC, as amended. Pursuant to this provision, no gain or loss shall be recognized both to the transferor and transferee corporation on the transfer or exchange of property provided the following requirements are present: (1) the transferee is a corporation; (2) the transferee exchanges its shares of stock for property lies of the transferor; (3) the transfer is made by a person, acting alone or together with others, not exceeding four persons; and, (4) as a result of the exchange the transferor, alone or together with others, not exceeding four, gains control of the transferee.[14]

All the foregoing requirements are present in this case.

HSBC, through respondent, transferred the assets of its MAB in the Philippines to GPAP-Phils. Inc. as payment for the subscription of the 139,641 common shares of GPAP-Phils. Inc. As a result of such transfer, HSBC became the majority stockholder of GPAP-Phils. Inc. and gained 99.99% control of the transferee corporation. Thus, both HSBC and GPAP Phils. Inc. shall not recognize any gain or loss on the transfer of the MAB in exchange for shares. Consequently, respondent will not be liable for capital gains tax, income tax or creditable withholding tax arising from such exchange of properties. Notably, in its Certification[15] dated January 23, 2008, the CIR recognized that the first transaction between HSBC and GPAP-Phils. Inc. is not subject to income tax, capital gains tax, expanded withholding tax and gross receipts tax.[16]

It should be emphasized, however, that when the property or shares of stock acquired through a tax-free exchange is subsequently sold, the said subsequent sale shall now be subject to income tax.[17] This is because, in a tax free exchange, the recognition of gain or loss arising from the exchange is merely deferred.[18] Thus, the second transaction, wherein HSBC subsequently assigned its GPAP Phils. Inc. shares to GPAP Singapore, is now subject to capital gains tax,[19] to which respondent paid the total amount of P89,929,292.10.[20]

The CIR, however, insists the second transaction involves an alleged sale of the "goodwill" of the MAB, which makes HSBC liable for deficiency income taxes.[21] The CIR anchors its finding on the value of the "goodwill" indicated in the Share Sale and Purchase Agreement in the amount of P885,378,821.00.[22] Thus, in the FAN dated June 28, 2011, the CIR subjected to the regular corporate income tax of 35% as provided under Section 27(A) of the 1997 NIRC, as amended, the gain derived by HSBC on the sale of its GPAP-Phils. Inc. shares, *viz*.:

INCOME TAX

Actual Selling Price	899,342,921.00
Less GPAPPI Shares of Stocks	13,964,100.00
Gross Amount	P 885,378,821.00
Income Tax Rate	35%
Income Tax Due	309,882,587.35
Advance Payment 9-29-08	89,929,292.10
Basic Income Tax Deficiency	219,953,295.25
Interest (April 16, 2009 to July 15, 2011)	98,828,329.92
Income Tax Payable	**P 318,781,625.17**[23]

This is error. The Court agrees with the findings of the CTA that the assessment has no legal and factual bases because the subject transaction is covered by capital gains tax and not regular corporate income tax.

The records clearly show that the object of the transaction between HSBC and GPAP-Singapore is the 139,641 GPAP-Phils shares. The Share Sale and Purchase Agreement between HSBC and GPAP-Singapore states that:

> (E) The Seller has agreed to sell the Philippine Subsidiary Shares to the Purchaser, and the Purchaser has agreed to purchase the Philippine Subsidiary Shares in reliance (inter alia) upon the Seller's representations, warranties, indemnities, covenants and undertakings in this Agreement, for the Consideration and otherwise upon and subject to the terms and conditions of this Agreement.
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> x x x x
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> **ARTICLE 2**
>
> **SALE AND PURCHASE**
>
> **2.1** Sale and Purchase.
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> On the terms and subject to the conditions set forth in this Agreement, at Completion the Seller shall sell, and the Purchaser shall purchase, all outstanding shares of the Philippine Subsidiary free of all Encumbrances and together with all the rights now attaching thereto.[24]

Further, the Deed of Assignment provides: