

“DEEMED SALE”, FOR VAT PURPOSES, OF MERCHANDISE INVENTORIES IN CASES OF MERGERS/CONSOLIDATIONS OF CORPORATIONS

BIR REVENUE MEMORANDUM CIRCULAR NO. 19-99, February 25, 1999

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Quoted hereunder is the pertinent portion of BIR Ruling No. S34-263-97 dated October 16, 1997:

"Moreover, for value-added tax purposes, the transfer of the respective assets, including tangible and movable properties, by the 10 ABSORBED CORPORATIONS to USWCI pursuant to the merger shall not be subject to the value-added tax, and any unused input tax of each of the 10 ABSORBED CORPORATIONS as of the date of merger, will be absorbed by USWCI as the surviving corporation, pursuant to Section 5(b)(3) of the Revenue Regulations No. 5-87. (BIR Ruling No. 063-93 dated January 10, 1993; BIR Ruling No. 472-93 dated December 3, 1993)"

It is provided therein that (a) the transferred assets, which include the merchandise inventory of the absorbed corporations, "shall not be subject to the value-added tax" and (b) that the unused input taxes of the absorbed entities shall be transferred for the use or tax credit to the output tax of the surviving corporation.

The Ruling in question enunciated a twin illegality. The absorbed corporation, upon the merger, ceases or retires from doing business, so that its merchandise inventory transferred to the surviving corporation, by clear provision of law, is "deemed sale" for VAT purposes (Section 106, (B) (4), Tax Reform Code). The unused input taxes of the absorbed corporations cannot legally be transferred to the surviving corporation for the latter's use as tax credits to its output VAT. This could only be used as tax credit to the VAT payments of the absorbed corporations and the same is not transferable to a party not privy to the contracts from where the input taxes arose (Section 110 (A) (2) (a) of Tax Code, *supra.*, as implemented by Section 4.104-1 (d) of Revenue Regulations No. 7-95). In other words, only the direct buyers of goods/services to whom the input taxes were "passed on" could avail of the right to tax credit. Under the VAT law, the absorbed entity should pay the VAT on the merchandise inventory, there being a "deemed sale" transaction, after tax crediting the corresponding input taxes, with the right to claim refund, if the input exceeds the output tax. If the output tax is paid, this maybe "passed on" to the surviving corporation for its use as tax credit. BIR Ruling No. S34-263-97 is a flagrant violation of the VAT law, as above pointed out. It was aptly stated by the Supreme Court that —

"x x x that all such issuances must not override, but must remain consistent and in harmony with, the law they seek to apply and implement. Administrative rules and regulations are intended to carry out, neither to supplant nor to modify the law" (Commissioner of Internal Revenue vs. Court of Appeals, 240 SCRA 368[1995]).

- and -

"It seems too clear for serious argument that an administrative officer can not change a law enacted by Congress. A regulation that is merely an interpretation of the statute when once determined to have been erroneous becomes nullity. An erroneous construction of the law by the Treasury Department or the Collector of Internal Revenue does not preclude or estop the government from collecting a tax which is legally due." (Ben Stocker, et al.; B.T.A., 1351, underlining supplied, *Hilado vs. Comm. of Internal Revenue and CTA 100 Phil. 288*).

Regulations that are in conflict with the law are null and void (*Wise and Co. vs. Meer* 78 Phil. 655), so that the above quoted portion of Ruling S34-263-97 is hereby REVOKED/SET ASIDE. The portion thereof which pertains to the tax-free exchange, for income tax purposes, under Section 34 (c) (2) and 6 (b) of Tax Code, is retained and not covered by this revocation.

The Tax Code statute of limitations has three (3) years from the filing of return (Section 203) and ten (10) years from discovery of omission to file the return (Section 222), within which to assess tax liabilities. Section 4.108-2 (second paragraph) of Revenue Regulations No. 7-95 requires the filing of the "deemed sale" inventory of merchandise within 30 days after the retirement or cessation from business. This is in effect the return that will be the basis for the payment of the VAT by the entities that stopped business activities. Consequently, by reason of the revocation of Ruling S34-263-97, all VAT tax liabilities of all entities involved in mergers and availed of the two (2) preferential tax treatments under the revoked Ruling, should be assessed, if still unpaid, within the above-stated statute of limitations. This finds support in the ruling of the Supreme Court, thus:

"When the Commissioner determined in 1937 that the petitioner was not exempt and never had been, it was his duty to determine, assess and collect the tax due for all years not barred by the statutes of limitation. The conclusion reached and announced by his predecessor in 1924 was not binding upon him. It did not exempt the petitioner from tax. This same point was decided in this way in *Stanford University Bookstore*, 29 B.T.A., 1280; *affd.*, 83 Fed. (2d) 710". (*Southern Maryland Agricultural Fair Association vs. Commissioner of Internal Revenue*, 40 B.T.A., 549, 554).

"With regards to the contention that General Circular No. V-139 cannot be given retroactive effect because that would affect and obliterate the vested right acquired by petitioner under the previous circular, suffice it to say that General Circular No. V-123, having been issued on a wrong construction of the law, cannot give rise to a vested right that can be invoked by a taxpayer. The reason is obvious: a vested right cannot spring from a wrong interpretation. This is too clear to require elaboration. (emphasis supplied, *Hilado*, *supra*.)

The provisions of Section 246 on non-retroactivity of Rulings have been carefully considered, in the light of the two (2) cases decided by the Supreme Court wherein the revocatory administrative issuances were not given retroactive application. In the case of *ABS-CBN vs. Court of Tax Appeals* (108 SCRA 143), the Court opined that there will be an injustice and would be violative of fair play if the withholding agent would be made to pay additional withholding taxes for 1965 to 1968 under the provisions of a Circular later issued in 1971. The film rental payments were already long remitted before to the foreign film owner. In the case of *Commissioner of Internal Revenue vs. Burroughs Ltd. et al.* (142 SCRA 324), Burroughs paid its branch profit remittance tax in accordance with a Ruling of the BIR which, later on, was revoked by an RMC issued 3 years after payment, increasing the profit remittance tax. Again, it appears obvious that there has been a violation of the rules of justice and fair play. Nollado stated that the overpayment of the tax is a case of "*solutio indebiti*" (payment by mistake), so that the excess should be returned to Burroughs (footnote on page 1269, the NIRC, annotated, 1996 17th and revised edition).

The case covered by Ruling S34-263-97 is simply the grant of exemption and/or preferential tax treatments without any basis in law; and, the government is duty bound to collect the taxes due in the exercise of its power to tax as an attribute of sovereignty. There has been no vested right acquired by the taxpayer to the exemption/preferential tax treatments illegally granted under administrative issuances, so that there could be no prejudice to it if made to pay the VAT. Necessarily, the BIR would pursue the well-entrenched principle that the Government is never estopped from collecting taxes, within the statute of limitations, that remain uncollected by reason of mistakes or errors of its officials or agents. The non-retroactivity provision of Section 246 is not relevant in this case, inasmuch as no right, as aforesaid, of the taxpayer would be impaired or prejudiced.

The Coordinator of the Audit Team investigating interrelated taxpayers pursuant to RMO No. 61-98 should verify all mergers/consolidations in 1998 and prior years, and implement the provisions of this Circular with the end in view of collecting the value-added taxes due thereon.

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

Adopted: 25 Feb. 1999

(SGD.) BEETHOVEN L. RUALO
Commissioner of Internal Revenue

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