Philippines

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1. Introduction

1.1 General Comments on M&A in the Philippines

Mergers and acquisitions activities in the Philippines in the past three years have been very trivial. Major acquisitions involved Independent Power Producer companies that have existing Build-Operate-Transfer agreements with the government, call centres, banks and other financial institutions.

Nevertheless, the Philippine government promotes the principles of transparency and free enterprise, and believes that economic development is best led by the private sector. Inbound foreign investment is actively encouraged, and generous incentives are available for investment activities that will facilitate the country's development or export capacity. These incentives are granted to:

- Board of Investment registered enterprises;
- Philippine Economic Zone Authority registered enterprises;
- Subic Bay and Clark Freeport registered enterprises;
- regional headquarters; and
- regional operating headquarters.

Entities carrying on approved activities may take advantage of reduced / preferential tax rates or full exemption from income tax and certain taxes for a specified period (generally between four to eight years depending on the nature of tax incentives).

The most common forms of business entity in the Philippines are locally incorporated companies or branches of overseas companies. Other forms of business such as partnerships (generally for professionals) and joint ventures are also available.

Investment laws permit 100% foreign ownership in an enterprise in the Philippines, unless the enterprise will be undertaking activities listed in the Foreign Investment Negative Lists (FINL). For example, a maximum of 40% foreign equity is allowed for ownership of private land and operation of public utilities.

1.2 Corporate Tax

The Philippines imposes income tax on income derived in the Philippines and in the case of domestic corporations, on income including that derived from outside the Philippines.

The current corporate income tax rate which has been effective from 1 November 2005 is 35% (from the previous 32%). This increase is to help address budget concerns. However, the rate will be reduced to 30% starting from 1 January 2009.

A minimum corporate income tax rate (MCIT) of 2% of the gross income is imposed, if it is higher than the normal corporate income tax. MCIT is imposed on domestic and resident foreign corporations from the fourth taxable year following the year in which such corporations were registered with the Bureau of Internal Revenue. MCIT is computed on an annual basis. However, recent tax regulations require that beginning on the quarter ended September 2007, the computation and payment of MCIT shall also apply at the time of filing of the quarterly corporate income tax. Nevertheless, this requirement is still being contested.

Dividends received by a resident corporation from a domestic corporation are not subject to tax. Dividends received by a domestic corporation from a non-resident corporation are subject to corporate tax. However, the tax paid in the foreign country may be used as tax credit subject to certain limitations.

1.3 Withholding Tax

1.3.1 On Payments to Non-residents

Dividends, interest, leases, royalties and other technology transfer related services, management and other service fees paid by a resident of the Philippines to non-residents may be subject to withholding tax. The rates are as follows:

	Non-treaty rate%	Treaty rate%
Interest	20	10 – 15
Dividends	15 – 35*	10 – 25
Leases and royalties (technology transfer related services)	35*	4.5 – 25
Services and management fees	35*	Exempt if no PE

**30% starting 1 January 2009*

The Philippines has a comprehensive network of double tax agreements which operate to reduce withholding tax and exempt business profits derived by a company resident in a treaty country which does not have a permanent establishment (PE) in the Philippines.

1.3.2 Branch Profits Tax

Any profit remitted by a branch to its overseas head office is generally subject to 15% branch profit remittance tax unless reduced by a tax treaty. However, profits from activities registered with the Philippine Economic Zone Authority are not subject to branch profit remittance tax.

1.3.3 On Payments to Domestic Companies

- Interest Payments

  Interest payments made by a domestic company to another domestic company are generally not subject to withholding tax. However, if the payer belongs to the top ten thousand private corporations, the interest payments are subject to 2% expanded withholding tax (EWT).

  Moreover, interest payments on borrowings obtained from an expanded foreign currency deposit system of a domestic bank or offshore banking unit are subject to 10% final withholding tax.

  Interest paid on funds sourced from the public is subject to final withholding tax of 20%. Income derived by domestic corporations and individuals from a depository bank under an expanded foreign currency deposit system is subject to 7.5% final tax.

- Royalties

  Payments for royalties and services involving technology transfer by a resident to a domestic company are subject to 20% final withholding tax.

- Other Payments

  Certain domestic payments are subject to EWT which is creditable against income tax due by a recipient of the relevant income. Following are some of the payments, which are subject to EWT and the applicable EWT rates:

Nature of payments	Applicable EWT rates
Professional and talent fees for services paid to domestic corporations and resident individuals, including fees paid to medical practitioners	15% if the gross income for the current year exceeds P720,000 and 10%, if otherwise
Income payments to partners of general professional partnerships	15% if the income payment to the partner for the current year exceeds P720,000 and 10%, if otherwise
Rent for the use of real and personal properties	5%
Payments to customs, insurance, stock, real estate, immigration and commercial brokers and agents of professional entertainers	10%
Payments to certain contractors	2%
Certain payments by credit card companies	1% based on half of the gross amounts paid

1.4 Value Added Tax (VAT)

Generally, 10% or 0% VAT is imposed on the sale of goods and services. The 0% VAT applies only to specific transactions.

Further, payments to non-residents for services rendered in the Philippines are subject to 10% withholding VAT. In this event, the local payer, as the withholding agent, is required to remit the VAT to the government by filing a separate return on behalf of the non-resident payee. The duly validated VAT return, however, shall be used to support the input VAT claims of the local payer.

However, a new law (Republic Act No. 9337) was passed on 24 May 2005 which provides for (among others) an increase of VAT from 10% to 12% effective from 1 February 2006, after any of the following conditions has been satisfied:

- VAT collection as a percentage of Gross Domestic Product (GDP) of the previous year exceed 2.80%; or
- the national government deficit as a percentage of GDP of the previous year exceeds 1.5%.

1.5 Stamp Duty

The Philippines imposes stamp duty on certain transactions evidenced by documents including:

- issuance and transfer / sale of shares, at the rates of 0.5% and 0.375% respectively based on the par value of the shares;
- loan agreement / debt instruments, at the rate of 0.5% based on the issue price of debt instrument, provided that if the term is less than one (1) year, the tax shall be of proportional amount in accordance with the ratio of its term in days to 365 days;
- transfer of real estate, at the rate of 1.5% based on the selling price or the market value, whichever is higher.

1.6 Other Relevant Taxes

1.6.1 Fringe Benefit Tax (FBT)

FBT, at the rate of 32%, is imposed on the grossed-up monetary value of fringe benefits furnished or granted to the employee (except for rank and file employees) unless the fringe benefit is required by the nature of the trade, business or profession of the employer, or when the fringe benefit is for the convenience or advantage of the employer. The value of fringe benefits granted is divided by 68% to arrive at the grossed-up amount.

The term “fringe benefit” is defined to mean any goods, services or other benefits furnished or granted in cash or in kind by any employer to an individual who is a non-rank and file employee.

1.6.2 Local Business Tax (LBT)

LBT, at the rate not exceeding 0.75%, imposed on the gross sales / receipts of the preceding calendar year is payable to the local government units where its principal and / or branch office(s) is / are located. However, LBT is not imposed on an enterprise which has been granted certain tax incentives provided certain conditions are met.

1.6.3 Real Property Tax (RPT)

RPT, at the rate not exceeding 2%, is imposed on the assessed value of the real properties and fixed machineries and equipment of a domestic company. An additional 1% of the assessed value of the real property may be collected, in addition to the basic RPT, for the Special Education Fund. RPT is not imposed on an enterprise which has been granted certain tax incentives provided certain conditions are met.

1.6.4 Transfer Tax

Transfer tax of 0.5% is imposed on the selling price or the fair market value, whichever is higher, of the real property transferred.

1.6.5 Capital Gain

Generally, gains from sale of shares of stock (not traded in the stock exchange) are subject to capital gains tax of 10% (5% for the first P100,000) unless exempted under a tax treaty. Sale of shares listed and traded through the local stock exchange are also subject to stock transaction tax of 0.5% based on the gross selling price, which is payable by the seller or transferor.

Generally, gains on sale of real and personal property are subject to the normal income tax if the real property is used in trade or business. However, gains on sale of real properties which are treated as capital assets are subject to 6% final tax based on the gross selling price or fair market value, whichever is higher.

1.6.6 Percentage Tax / Gross Receipts Tax (GRT)

Percentage tax ranging from 3% to 30% is imposed on the sales or receipts of certain corporations engaged in activities or industries which are not subject to the VAT. Among such activities are banking, insurance, common carriers or transportation contractor, overseas dispatch, amusement, etc.

1.6.7 Excise Tax

Excise tax is imposed on certain goods or articles manufactured or produced in the Philippines for domestic sale or consumption, or for any other disposition, and to certain imported items. For imports, the excise tax is in addition to any applicable customs duties and VAT.

The Philippines has both specific excise tax (i.e. excise tax based on weight or volume capacity) and ad valorem excise tax (i.e. excise tax based on selling price or specified value of an article). Among the articles covered by excise tax are alcohol products, tobacco products, petroleum products, mineral products, jewelry, perfumes, automobiles and cinematographic films.

2. Acquisition

2.1 The Preference of Purchasers: Stock vs. Asset Deal

The Philippines has no restrictions on acquisitions, mergers or consolidations, unless they will result in unfair competition, or restrain trade to artificially prevent free competition in the market, or result in foreign ownership that violates the Foreign Investment Negative List.

Accordingly, general principles of taxation would apply while structuring a deal and choosing between an acquisition of assets or stock.

Whether a deal is structured as a stock deal or asset deal should largely depend on commercial considerations.

2.2 Stock Acquisition

The main advantage of a stock deal (for shares not traded in the stock exchange) over an asset deal is the lower capital gains tax of 10% as compared with the 35% (32% before 1 November 2005) corporate income tax, payable by the seller. Sale of shares listed in the stock exchange is subject to 0.5% stock transaction tax. Documentary stamp tax of 0.375% applies on the par value of the shares sold. Therefore, under a stock deal, even with any stock transaction tax applicable, the deal should be less tax burdensome to the seller because of the lower capital gains tax rate.

2.2.1 Tax Loss Carried Forward

Net operating losses may be carried forward by a company for a period of three consecutive years immediately following the year of such loss. However, net loss carry over shall not be allowed if there has been a substantial change (i.e. more than 25%) in the ownership of the company.

Where a Target Company has accumulated losses carried forward and the buyer wishes to preserve the losses, it will have to acquire the business through a stock deal as there are no provisions to transfer losses from one entity to another.

2.2.2 Unutilised Tax Depreciation Carried Forward

Unutilised tax depreciation is preserved under a stock acquisition. It is not subject to the three-year expiration period unlike the net loss carry over.

2.2.3 Incentives

If a Target Company has been granted tax incentives, the buyer will have to acquire the shares of the company if it wishes to preserve the incentives. However, approval from the relevant government body must be obtained.

2.3 Asset Acquisition

An asset deal allows a purchaser to select the desirable assets to be acquired and to transfer assets between one or various entities (including offshore entities) so as to optimise future intragroup payments. It often allows the buyer to step up the cost basis of acquired assets for tax purposes. This enables tax deductions to be maximised through depreciation or amortisation and / or additional interest costs if the acquisition is funded by debt.

However, in transferring the business, care should be taken to ensure that the income tax (on the gain), value added tax and local business tax (based on gross selling price), documentary stamp tax and transfer tax (particularly with respect to the transfer of property) are minimised.

Moreover, the sale / transfer of real property is subject to 0.5% transfer tax based on the selling price or the fair market value, whichever is higher.

Further, sales of assets may be covered by the Bulk Sales Law (BSL). The primary objective of BSL is to compel the seller to execute and deliver a verified list of his creditors to his buyer, and notice of intended sale to be sent in advance to said creditors. Non-compliance with the requirements under the law would not only render certain transactions void, but would also subject the violators to criminal liabilities. The sworn statement of the listing of creditors must be registered with the Department of Trade and Industry.

2.4 Transaction Cost

2.4.1 VAT

- Stock Deal

  Sale of shares is not subject to VAT.

- Asset Deal

  Sale of assets is subject to 10% VAT (12% starting from 1 February 2006), which may be passed on to the buyer, and 0.75% local business tax based on the gross selling price.

2.4.2 Stamp Duty

- Stock Deal

  Documentary stamp tax of 0.375% applies on the par value of the shares sold.

- Asset Deal

  In the case of an asset sale, documentary stamp tax applies only on sale / transfer of real property. Stamp duty is 1.5% based on the selling price or the fair market value, of the real property, whichever is higher.

2.4.3 Concessions Relating to M&As

For income tax purposes, no gain or loss shall be recognised if such gain or loss occurs in connection with a plan of merger or consolidation, such as:

- a corporation (which is a party to a merger or consolidation) exchanges property solely for stock in a corporation (which is a party to the merger or consolidation);
- a shareholder exchanges stock in a corporation (which is a party to the merger or consolidation) solely for the stock of another corporation (which is also a party to the merger or consolidation); or
- a security holder of a corporation (which is a party to the merger or consolidation) exchanges his securities in such corporation, solely for stock or securities in another corporation (which is also a party to the merger or consolidation).

Likewise, the transfer of property (assets or shares) may be done through a tax-free exchange. To qualify for a tax-free exchange, the property must be exchanged for shares of the transferee entity and as a result of such an exchange, the transferor would gain control of the transferee entity. However, a ruling from the Philippine tax authorities is required to confirm the tax-exempt status of the transaction.

In addition, transfers of properties (which qualify for a tax-free exchange and merger) are not subject to VAT, except for real properties held for sale or lease, and documentary stamp tax.

2.4.4 Tax Deductibility of Transaction Costs

- Stock Deal

  Under a stock deal, acquisition costs, which include, among others, professional fees and taxes passed on to the buyer, relating to the acquisition are not deductible for income tax purposes. The same may be capitalised or form part of the costs of the investment.

  The said expenses, however, shall be allowed as deduction for purposes of calculating the capital gains tax which is applicable in case of subsequent disposal of the shares.

- Asset Deal

  In the case of an asset deal, the transactions costs which may be attributed to the various assets shall form part of the costs of the relevant assets and may be depreciated or amortised based on the tax treatments of these assets.

  The professional costs, which cannot be allocated to the costs of specific assets, are charged to expense and may be claimed as a tax deduction.

3. Basis of Taxation Following Stock or Asset Acquisition

3.1 Stock Acquisition

A stock deal will not allow the buyer to step up the basis of the assets owned by the Target Company. Thus, it would not allow the buyer to maximise tax benefits which are generally available to an asset deal.

3.2 Asset Acquisition

An asset deal often allows the buyer to step up the cost basis of acquired assets for tax purposes. This would enable the buyer to maximise tax benefits through allocating (if possible) higher costs to inventories, depreciable assets and intellectual properties.

In addition, no tax deduction is available for the amortisation of goodwill. Therefore, the purchase price on an asset deal should (if appropriate) be allocated as much as possible to inventory, depreciable capital assets, and other items (such as intellectual property) that will generate a tax deduction.

4. Financing of Acquisitions

4.1 Thin Capitalisation

There are no thin capitalisation rules in the Philippines.

The decision to set a debt to equity ratio is generally governed by commercial considerations or by other government agencies (i.e. the Board of Investments in order for the Board to monitor if the company meets the requirements for the incentives granted). However, where a company is set up to take advantage of a tax concession or requires a special licence from the government (e.g. banking and insurance), the regulatory body may require certain ratio to be complied with.

4.2 Deductibility of Interest

4.2.1 Stock Acquisition

Interest expense incurred in respect of borrowings used to acquire shares may not be tax deductible.

4.2.2 Asset Acquisition

Interest incurred on funds used to acquire a business under an asset deal is tax deductible.

5. Merger

As mentioned earlier, there are no restrictions on mergers or consolidations in the Philippines unless they will result in unfair competition, or will restrain trade to artificially prevent free competition in the market, or will result in foreign ownership that violates the Foreign Investment Negative List.

However, mergers involving two corporations must be approved by a majority vote of the board of directors or trustees, by the stockholders owning or representing at least two-thirds of the outstanding capital of the constituent corporations, and by the Securities and Exchange Commission. Those involving specialised industries commonly also require approval from the appropriate government agency.

In a merger, the assets of the absorbed companies, including the tax assets (input tax and creditable input tax), are assumed by the surviving company. However, the absorbed company's net operating losses which have been transferred through a merger, may only be used by the surviving entity if as a result of the said merger, the shareholders of the absorbed companies gain control of at least 75% or more in nominal (par or stated) value of the outstanding issued shares or paid-up capital of the surviving company.

6. Other Structuring and Post-Deal Issues

6.1 Repatriation of Profits

Distribution of profits / dividends by a domestic corporation to a resident or domestic corporation shall not be subject to tax. Distributions by a domestic corporation to non-resident foreign corporations are generally subject to 35% (32% before 1 November 2005) income / withholding tax. However, the tax rate may be reduced to 15% if the country where the recipient is domiciled allows a credit against the tax payable by the said recipient in respect of taxes deemed to have been paid in the Philippines or if such country does not impose any tax on such dividends.

Moreover, the foreign company investor may be entitled to the preferential tax treaty rate (if any), if such treaty rate is more favourable.

There are other avenues whereby the profits of the Target Company may be repatriated to the home country by means other than dividends. These include the payment of license fees, royalties, interest and management fees. Such payments are generally subject to income / withholding taxes as follows:

Management fees	35% (30% starting 1 January 2009)
Interest	20%
Royalties	35% (30% starting 1 January 2009)
Technical assistance / service fees	35% (30% starting 1 January 2009)

However, appropriate tax treaties may reduce the applicable income / withholding tax rates or even exempt the relevant income from the Philippines tax. For example, interest payments to a Netherlands entity may be subject to 10% income / withholding tax in the Philippines provided certain conditions are met.

Management fees in consideration for services rendered outside the Philippines that are recharged at costs should not be subject to withholding tax. In addition, even if such fee is charged at a profit, it may also be exempt from the Philippines tax under an appropriate double tax agreement which exempt the fee from tax due to the non-existence of a permanent establishment in the Philippines.

The Philippines tax legislation does not contain specific anti-treaty shopping provisions and where an arrangement (with commercial substance) takes advantage of a tax treaty, the reduced rate provided under that treaty should generally prevail.

6.2 Losses Carried Forward

Net operating losses may be carried forward for a period of three consecutive years immediately following the year of such losses unless there is a substantial change (more than 25%) of ownership in these three years.

6.3 Tax Incentives

Where the Target Company enjoys any tax incentives, these would generally be lost when the business is transferred through an asset deal. However, it may be possible to obtain approval from the authority granting the incentive to ensure the continued applicability of the incentive to the transferred business.

Tax concessions enjoyed by a Target Company is generally preserved through a stock deal. However, prior approval from the respective government body is required.

6.4 Group Relief

The Philippines has no group relief system. Related companies are taxed separately.

7. Disposal

7.1 Preference of Sellers: Stock vs. Asset Deal

From a seller's view point, it would be less complicated to sell a Target Company through a stock deal.

7.2 Stock Sale

7.2.1 Profit on Sale of Stock

Generally, gains on sale of shares (not traded in the stock exchange) are subject to capital gains tax of 10% (5% for the first P100,000). Likewise, sale of shares traded in the stock exchange is subject to stock transaction tax of 0.5% based on the selling price. However, the sale may be exempted from capital gains tax and stock transaction tax under a tax treaty.

The Philippines taxes gains derived from any subsequent disposal of an investment in the Philippines. However, this may be minimised depending on the residence of the holding company of the Philippines target. For residents of countries such as the Netherlands and Singapore, any gains derived from the sale of the shares of the Philippines target should not be subject to tax in the Philippines. However, in respect of gains derived by the Singapore investors, the exemption would apply provided that the target's major assets do not consist of immovable properties.

For this purpose, when considering acquiring a Target Company in the Philippines, the residence of the holding company should be considered. One should note that the setting up of a holding company in the Philippines may no longer be tax efficient due to the imposition of the 10% improperly accumulated earnings tax on unreasonable retained profits. Retention due to reasonable business needs must be proven to avoid this tax. However, retention of profits in a holding company is prima facie evidence of unreasonable profit retention. Hence, a holding company within the Philippines may no longer be a tax efficient structure to park dividends.

7.2.2 Distribution of Profits

Dividends may only be declared out of the company's unrestricted retained earnings. Equity in net earnings in subsidiaries may not be declared as dividends unless received as dividends.

7.3 Asset Sale

7.3.1 Profit on Sale of Assets

Any gains / profits on the sale of inventories or tax depreciable assets would be subject to income tax in the hands of the seller. The gains are the difference between the selling price and the costs of the assets.

Likewise, any price received for sale of goodwill is taxable in the hands of the seller. However, the buyer may claim deduction only if the same form part of depreciable assets, amortisable intangibles and inventories.

A corporate seller may be willing to enter into an asset deal if it has tax losses to offset against any gains from the sale of assets.

7.3.2 Distribution of Profits

Dividends may only be declared out of the company's unrestricted retained earnings. Equity in net earnings in subsidiaries may not be declared as dividends unless received as dividends.

Please note, however, that in case of liquidation (after all the assets are sold) the proceeds of the sale of assets must be appropriated to payment to corporate debts and liabilities before any distribution among stockholders may be made. Debts secured by liens are entitled to some preferences. This preference is also applied to claims given a priority by stature. Stockholders are entitled to participate in the assets, after the payment of the creditors, in proportion to the number of shares held by each, unless the articles of incorporation regulate the distribution of corporate stock among stockholders.

8. Transaction Costs for Seller

8.1 VAT

As indicated previously, the VAT of 10% (12% starting from 1 February 2006) which is applicable on the sale of assets / business may be passed on to the buyer, while the sale of shares is not subject to VAT.

8.2 Stamp Duty

As indicated above, the sale / transfer of shares is subject to documentary stamp tax of 0.375% based on the par value of the shares. The said tax can be paid by either of the parties.

On the other hand, the sale / transfer of assets / business may also be subject to documentary stamp tax if it involves real properties.

8.3 Concessions Relating to M&As

As indicated previously, no gain or loss shall be recognised if such gain or loss occurs in connection with a plan of merger or consolidation.

In addition, transfers of properties, which qualify for a tax-free exchange and merger, are not subject to VAT and documentary stamp tax.

8.4 Tax Deductibility of Transaction Costs

Transaction costs involving sale of assets are deductible from gross income of the seller for income tax purposes while transaction costs involving sale of shares shall not form part of the cost of the shares for purposes of computing the gain subject to capital gain tax.

9. Preparation of Target for Sale

The target's management may conduct a tax due diligence review for purposes of determining deal issues which may have an impact on the success and the pricing of the deal. The management may decide on appropriate actions in respect of the issues identified during such review.

10. De-mergers

Business spin-off is the most common de-merger activity taking place in the Philippines. It usually occurs when a company with several business lines decides to sell one or more of its business segments, or split its business operations by creating a new company to undertake one or more of its business lines.

In either way, the tax effects of this procedure are similar to that of an asset sale or a tax-free exchange as discussed previously.

11. Listing / Initial Public Offer (IPO)

Another exit route for investors may be through an IPO. The acquisition vehicle / acquired company may be listed in the Philippines Stock Exchange provided certain requirements are complied with.

Generally, sale of shares through IPO is taxed at the rates specified below based on the gross selling price or gross value of the shares sold in accordance with the proportion of shares sold to total outstanding shares of stock after the listing in the local stock exchange:

Up to twenty-five percent (25%)	4%
Over twenty-five percent (25%) but not over thirty-three and one third percent (33 1/3%)	2%
Over thirty-three and one third percent (33 1/3%)	1%

However, the above tax may not apply if the holding company of the Philippines target is located in countries such as the Netherlands and Singapore as provided under the respective treaties of the said countries with the Philippines. However, in respect of gains derived by the Singapore investors, exemption will apply provided that the target's major assets do not consist of immovable properties.

Under existing rules, the availability of tax treaty protection needs to be preceded by an application for tax treaty relief with the Philippines tax authorities, not later than 15 days from the transaction date.