Evaluating BIR Revenue Regulations 16-2012 In Light of Its Impact on Nascent Domestic Capital Markets: A Public Governance Approach

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Abstract

A few months after the issuance by the Philippine Stock Exchange of the Amended Minimum Public Ownership Rule, the Bureau of Internal Revenue issued Revenue Regulations 16-2012, which had for its purpose the maintenance of a 10% minimum public float by publicly listed companies. Compliance therewith has also been made a *conditio sine qua non* for the enjoyment of stock transaction tax on every sale, barter, exchange, and other disposition of shares through the local stock exchange. Non-compliance with the Revenue Regulations subject the affected transactions to a much expensive capital gains tax as prescribed in Sections 24(C), 25(A)(3), 25(B), 27(D)(2), 28(A)(7)(c), and 28(B)(5)(c) of the National Internal Revenue Code.

The impact of Revenue Regulations 16-2012 on the domestic capital market underscores the need to shift from classical organization theory to the multiple constituencies perspective that espouses a regime of closely knit cooperation and coordination on three levels: (1) *agency to agency level*; (2) *agency to private sector regulator level*; and (3) *government-private sector regulator to market participant and shareholder level*.

Keywords: capital markets, Philippine Stock Exchange, public float, minimum public ownership, classical theory, multiple constituencies perspective, stock transaction tax, National International Revenue Code, BIR Revenue Regulations 16-2012

Background of the Study

Stock markets are a direct response to calls for public participation in capital markets of emerging economies. To date, emerging economies are dominated by closely held and family-owned and -controlled corporations. No matter how seemingly attractive benefits are with having their companies listed in the stock market, a number of factors must be considered as they weigh on the decision to go public. For one, there is a longstanding proposition that minority shareholders coerce the management into declaring dividends or dispose company assets. There is also a question of efficiency as there are instances when, despite urgency, certain decisions have to be made with a stamp of approval of shareholders.

To make it less cumbersome for families to decide whether to make their companies public or not, laws and regulations have been passed, favoring trades executed in the stock exchange (e.g., the imposition of a much lower stock transaction tax instead of the much higher capital gains tax). These concessions come with a corresponding duty on the part of publicly listed companies to abide by the rules of exchange controllers (i.e., compliance and disclosure requirements, corporate governance standards, and allotment of certain shares to be floated in the exchange).

One regulation that motivated this study is the Minimum Public Ownership Rule. Established in March 1999 by the Philippine Stock Exchange (PSE), with the concurrence of the Securities and Exchange Commission

(SEC), this rule has for its purpose the allotment of a certain percentage of outstanding capital stock for the public. This rule was eventually shelved as PSE got the impression from market participants that there was difficulty complying therein. Nonetheless, this rule came back into life in 2012. The PSE, with the concurrence of SEC, issued Memoranda No. 2010-0505, CN No. 2012-0003, and CN No. 2012-053 that effectively amended the 1999 rule. While the rule has been relaxed by removing certain requirements that made compliance difficult, the spirit remains the same: to allot certain shares of stock for the investing public.

It was not long before the tax authority began noticing the impact of this rule in capital markets. On November 7, 2012, The Bureau of Internal Revenue (BIR), issued BIR Revenue Regulations 16-2012. These required listed companies to follow the Minimum Public Ownership Rule prescribed by the PSE, otherwise any sale, barter, transfer, or assignment of shares would be subject to a final tax, at the rate of five percent (5%) or ten percent (10%) on the net capital gains, and documentary stamp tax.

A cross-reference of these regulations with Section 127 of the National Internal Revenue Code would reveal that these unduly imposed an additional requirement for the availability of stock transaction tax. Even a *prima facie* reading of Section 127 of the NIRC would show that the only requirement for the payment of stock transaction tax is that the sale, barter, transfer, or assignment of shares be made using the facilities of the exchange.

Statement of the Problem

A budding national economy underscores recognition of the indispensable and vital role of the private sector in creating a consistent and nourishing state policy on capital markets. Our study of BIR Revenue Regulations 16-2012 demonstrates the need for closely knit coordination and cooperation between the government and the private stakeholders on three levels:

1. at an *agency to agency level*, to create regulations that do not contradict state policy reflected in the 1987 constitution and the relevant statutes;
2. at an *agency to private sector regulator level*, to secure highly effective financial sector governance that fits a budding national economy;
3. at a *government-private sector regulator to market participant level*, to assess the impact of the regulations introduced by the government and the private sector regulator on market participants.

Why List?

The source of financing is crucial to the development of companies. An expanding company usually applies for loans from banks and financial intermediaries or seeks financial assistance from private individuals to fund its capital expenditures. It could also offer its shares to the public through the local stock exchange. When a company allows the public to purchase its shares through stock exchange, it becomes a publicly listed company.

A publicly listed company in the Philippines must abide by the rules and regulations of the SEC, by virtue of its oversight regulatory function and the PSE, not only as an exchange controller but also as a self-regulatory organization. For instance, a publicly listed company must observe the prescribed standards of corporate governance. It also has to make sure that shareholdings fall within the allowable range of foreign and public ownership percentile.

Despite the stringent requirements for publicly listed companies, listing shares in the local stock market has privileges. A company, upon listing, gains public recognition as a credible and stable organization, as it is being subjected to meticulous reportorial and disclosure requirements—not to mention the due diligence measures that underwriters put in place in support of its status as a listed company. Investors are also assured that their interests in a publicly listed company are secured since it follows that a listed company observes best governance standards, internationally recognized sound audit and accounting practices, succession planning, and conflict resolution strategies (Chapman, 2006). Price discovery is made easier and more accurate when shares are offered in the exchange (Harris, 2010). However, the enjoyment of the price discovery feature requires liquidity. When the demand for publicly offered shares of stock is not high, the price does not really reflect the sentiment of the market. Going public also gives companies the option of using their own shares as incentives for employees to develop a sense of loyalty to their employers (Molyneux & Valdez, 2010). Takeover situations are also much easier when companies have already been publicly listed. Instead of cash, shareholders of absorbed companies receive shares of the absorbing company, usually through share swaps. Going public gives them easier and faster means of financing for research and development endeavors. It also gives them opportunities to receive unsolicited funds from traders who buy their shares in the local stock exchange. Lastly, going public essentially results in free publicity in media outlets because the well-being and financial health of the publicly listed company becomes a concern of the business community.

Tax Incentives

There are also tax incentives that only publicly listed companies enjoy. As a general rule, any citizen who sells, barters, exchanges, or disposes of shares of stock of any domestic corporation is required to pay a final tax on the net capital gains realized during the taxable year at the following rates (National Internal Revenue Code, 1994):

Not over P100,000.00	5%
On any amount in excess of P100,000.00	10%

If the person disposing the shares is a nonresident alien, the same rule applies.

Aside from capital gains tax, a documentary stamp tax is likewise imposed on "every original issue of shares of stock" at a rate of two pesos (P2.00) for every two hundred pesos (P200.00), or a fractional part thereof, of the par value of the shares. If the shares have no par value, the rate is based on the actual consideration of the issuance of shares.

However, when these transactions are executed in the local stock exchange, they are subject to a much lower stock transaction tax at a rate of half of one percent (1/2 of 1%) of the gross selling price or gross value in money of the shares of stock disposed of by the seller or transferor. Meanwhile, if the shares of stock are sold or exchanged through an initial public offering (IPO), the issuing corporation or the seller, if it is a secondary offering, is liable to pay a final tax based on the gross selling price or gross value in money of the shares of stock at the following rates:

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%

Once the stock transaction tax is paid, the seller is exempted from paying capital gains, individual and corporate income, and documentary stamp taxes.

These tax incentives affirm the state's commitment to encourage private enterprise to offer their shares of stock to the public, which would in turn usher in a new era of a self-reliant and independent national economy. In particular, the Constitution underscores the mandate of the state to develop a self-reliant and independent national economy (Philippine Constitution Article II, §xix) characterized by a broad ownership base (Philippine Constitution Article XII, §i, ¶3) and affirm its commitment to recognize the indispensability of the private sector in nation-building and provide incentives that promote private enterprise (Philippine Constitution Article II, §xx). Fulfilling the dream of having a Filipino-controlled national economy has for its purpose "a more equitable distribution of opportunities, income, and wealth," "a sustained increase of production of goods and services," and "an expanding productivity" (Philippine Constitution Article XII, §i, ¶1), all of which resulting in benefiting and raising the quality of life of the people.

The same tenor could be observed in the Securities Regulation Code. Section 2 of the aforementioned law provides that the state has to encourage broad public ownership base, "democratize wealth," and develop the country's domestic capital market. It is also obliged to ensure a "fair and full disclosure" regime and build a "socially conscious, self-regulating free market" that "protect investors" (Security Regulations Code, Republic Act No. 8799, §2, 2000) and discourage unlawful and manipulative schemes that distort it.

Of course, these tax incentives would not even be valid had these been inconsistent with this state policy as reworded in the National Internal Revenue Code. Aside from "rationalizing the internal revenue system" to sustain economic growth, the state should also give "equitable relief" to taxpayers to "improve levels of disposable income" and "boost economic activity" and create an environment conducive for business to thrive and be competitive in international markets (National Internal Revenue Code, Republic Act No. 8424, §2).

The Minimum Public Ownership Rule

To date, the Philippine equities market has remained small. The bull run it currently enjoys does not trickle down to the rest of the economy, given its relatively small fraction of market participants, their unwillingness to offer more shares to the public, and miniscule public participation. To address this concern, the PSE, with the concurrence of the SEC, imposed the Minimum Public Ownership Rule. It has for its purpose the reservation of a certain percentage of shares of stock for the public. The percentage of shares was then made dependent on the market capitalization of a publicly listed company. The rule was later amended through the issuance of Memorandum No. 2010-0505, which was in turn amended by Memorandum CN No. 2012-0003 and Memorandum CN No. 2012-053.

Under the Amended Minimum Public Ownership Rule, publicly listed companies have to maintain a 10% minimum public float of their outstanding shares, excluding its treasury shares. It also penalizes erring companies with suspension or delisting. Since the predecessor does not contain any method by which public float could be monitored, the rules have been amended to require immediate disclosure by way of a Public Ownership Report to be submitted within 15 trading days after the end of each quarter (The Philippine Stock Exchange, 2008). This report helps the PSE monitor whether or not publicly listed companies maintain the minimum public float. It is also helpful in cases when companies consider voluntarily delisting—during which, tender offers are conducted in favor of their minority shareholders.

The Minimum Public Ownership Rule cannot be used without determining the public float. Given that the public float goes hand in hand with this rule, the PSE issued Guidance Note 24.6. It provides a detailed set of instructions in computing public float as well as instructions in the reporting of shareholders and their corresponding shareholdings.

Under this rule, computing for public float requires the inclusion of direct and indirect ownership of directors, officers, principal stockholders, and affiliates. If it so happens that one stockholder has an indirect ownership through another stockholder, this would be reflected in the latter's total shareholdings. The distinction among classified shares is also maintained. The grand total of shares held by these persons is deducted from the total issued and outstanding shares of stock to know the exact number of shares held by the public. Public float is then obtained by dividing the number of issued and outstanding shares with the total number of shares owned by the public.

Revenue Regulations 16-2012

The shock waves sent by the aforesaid rule across capital markets also reached the shores of the taxing authority. A few months after the issuance of the Amended Minimum Public Ownership Rule, the BIR issued Revenue Regulations 16-2012. The Revenue Regulations require publicly listed companies to comply with the Minimum Public Ownership Rule. It is even made a necessary condition for the enjoyment of stock transaction tax on every sale, barter, exchange, and other disposition of shares through the local stock exchange. Failing to comply therewith penalizes these transactions with a more expensive capital gains tax, as prescribed in the National Internal Revenue Code.

Evaluating Revenue Regulations 16-2012 from the Legal Standpoint

As it stands, compliance with Revenue Regulations 16-2012 has become a suspensive condition for the enjoyment of stock transaction tax. On that note, introducing an administrative regulation that effectively amends the letter and spirit of the law is void. Consider:

1. The authority of the BIR has been explicitly and conclusively determined by the National Internal Revenue Code. On that note, Section 18 of the aforesaid law provides:

   > Sec. 18. The Bureau of Internal Revenue. – The Bureau of Internal Revenue, which shall be headed by and subject to the supervision and control of the Commissioner of Internal Revenue, who shall be appointed by the President upon the recommendation of the Secretary [of the DOF], shall have the following functions:
   >
   > (1) Assess and collect all taxes, fees and charges and account for all revenues collected;
   > (2) Exercise duly delegated police powers for the proper performance of its functions and duties;
   > (3) Prevent and prosecute tax evasions and all other illegal economic activities;
   > (4) Exercise supervision and control over its constituent and subordinate units; and
   > (5) Perform such other functions as may be provided by law (National Internal Revenue Code, § 8).
   >
   > . . .

2. Using the completeness test, which finds out whether a law alleged to be complete "states in detail the policy to be executed, carried out or amended" (Pelaez v. Auditor General, 1965), the National Internal Revenue Code does not have any provision that the BIR could issue any Revenue Regulations that effectively amends the letter and spirit of law.

3. A perusal of the Senate and House records would reveal that it was not the intention of legislators to impose undue burden on companies that offer their shares to the public. In fact, the main thrust of

Section 127 of the NIRC, which had gone through a lot of amendments, remains the same, that is, to encourage family owned business to offer their shares to the public. In this regard, below is an excerpt of the Senate Interpellation of Republic Act 7717 (§ 1, 1994), the law that effectively removed stock transaction tax as a subcategory of capital gains and reclassified the same as percentage tax (IV Journal Session 64, 1994):

> The president: I thought there is a philosophy behind imposing a lower capital gains by way of ½ of 1% in case of publicly traded shares. *We want to encourage listing of, especially, family owned corporations in the stock exchange so that we will be able to disperse ownership. I think that is the main philosophy behind the distinction between 10% on privately held companies and ½ of 1 on publicly traded shares* [emphasis added].
>
> Senator Herrera: And also to develop capital market, Mr. President.
>
> . . .
>
> The president: I think we must not also disregard the philosophy behind this distinction. *If we eliminate this distinction or this incentive for listing, then we will never be able to develop our capital market. We can foresee the day when, even if there is only one bourse right now, they will be establishing regional bourses in the future once the capital market has expanded* [emphasis added]. But if we immediately nip in the bud incentives like this to expand the capital market, then we will really have a very small stagnant capital markets.
>
> . . .

This philosophy has been carried on during the senate interpellations of Tax Reform Act of 1997. In particular, in the senate interpellations dated August 5, 1997, Senator Juan Ponce Enrile, in response to the inquiry of Senator Miriam Defensor-Santiago of stock transaction tax being another provision intended to benefit the wealthy, averred thus (S. Journal, 1997):

> *It was a policy to encourage successful business enterprises to be listed in stock exchanges in order to disseminate a portion of these business enterprises in the hands of small investors* [emphasis added]. We ended up with the rate of 4%, 3%, and 1% under various levels or quantum of shares of stock of outstanding capitalization of a corporation that would be listed in the stock exchanges. Thereafter, every transaction would be subjected to a gross capital gain of half a percent**.**
>
> This is the purpose of the statute. This provision, that is now that subject of the question, is also intended for that purpose in order to *encourage closely held corporations not listed in the stock exchanges but are successful to unload a portion of their stockholdings to the public, so that the public can share in the benefits or the success of the enterprise* [emphasis added]. Right now, this high rate, which is actually 20% on the gross, is a disincentive to owners of closely-held corporations not listed in the stock exchanges and not the object of initial public offerings to unload a portion of their holdings in their corporation. That is the rationale of this provision. This is not really intended to benefit the rich, but precisely to encourage the unloading of these portions of these successful corporations to the public, so that the public could benefit out of this success.

> Senator Santiago: Thank you, Mr. President. I will now proceed to page 30, section 24, paragraph (E) sub-paragraph (2) of the bill.
>
> . . .

4. There was even no mention in the Senate and House Records that, prior to paying stock transaction tax, companies must ensure that a certain percentage of shares be held by the public.

Revenue Regulations 16-2012 stands to fail even if we were to analyze its validity in light of the exclusive authority given to the SEC and the PSE to regulate the capital markets.

As early as 1982, the SEC already had authority over capital markets, as provided in the Revised Securities Act of 1982 (Batas Pambansa Bilang 178, §3, 1982). This authority has been expanded in the Securities Regulation Code (Republic Act No. 8799, 2000). To date, the SEC has the sole authority to regulate capital markets (§38). Meanwhile, the PSE has been given by the SEC the permit to operate as a Self-Regulating Organization (SRO). As an SRO, the PSE is authorized to promulgate its own rules and regulations that are consistent with the Securities Regulations Code and other pertinent laws (§41). The Supreme Court has also acknowledged that the PSE, being the primary market for securities, "has the right to protect its name and goodwill through reasonable standards of propriety for companies that choose to conduct business using its platform" (The Philippine Stock Exchange, Inc. v. Court of Appeals, 1997).

Policy implications: Making Sense of Revenue Regulations 16-2012 from the Perspective of a Policymaker

As of today, no one has ever challenged the constitutionality of the questioned Revenue Regulations. This is partly because few understand the ins and outs of the stock market. Nonetheless, allowing Revenue Regulations 16-2012 to subsist brings to the fore several implications:

1. <u>Revenue Regulations 16-2012 is not administratively feasible.</u>

Revenue Regulations 16-2012 runs counter to administrative feasibility (Smith, 1904), which is one of the basic tenets of a sound tax system. An examination of Section 127 of the NIRC would reveal that what is merely asked from brokers is to remit the collections to the BIR. Below is the provision (National Internal Revenue Code, §127):

> (A) Return on Capital Gains Realized from Sale of Shares of Stocks-
>
> (1) Return on Capital Gains Realized from Sale of Shares of Stock Listed and Traded in the Local Stock Exchange**.-** *it shall be the duty of every stock broker who effected the sale subject to the tax imposed herein to collect the tax and remit the same to the Bureau of Internal Revenue* [emphasis added] within five (5) banking days from the date of collection thereof and to submit on Mondays of each week to the secretary of the stock exchange, off which he is a member, a true and complete return which shall contain a declaration of all the transactions effected through him during the preceding week and of taxes collected by him and turned over to the Bureau of Internal Revenue. (National Internal Revenue Code, Republic Act No. 8424, §2).
>
> . . .

Unless new Revenue Regulations are issued, prescribing the means whereby transactions from a particular company could be monitored, there is no way tracking can be administratively feasible. For one, there is no way that brokers can identify who the buyer or seller of their clients' stocks is because the PSE executes the trades anonymously. Assuming they do succeed, the swiftness, let alone the volume of matched transactions, will make it difficult, if not impossible, to track the trades continuously.

Section 5 of Revenue Regulations 16-2012 is also worth noting:

> SECTION 5. *Effect of Non-Payment of Tax*. – No sale, exchange, transfer or similar transaction intended to convey ownership of, or title to any share of stock shall be registered in the books of the corporation unless the receipts of payment of the taxes herein imposed in the instances herein specified and the Certificate Authorizing Registration (CAR) and/or Tax Clearance Certificate (TCL) under pertinent Revenue Regulations and issuances are filed with, and recorded by the stock transfer agent or secretary of the corporation. It shall be the duty of the aforesaid persons to inform the Bureau of Internal Revenue (BIR) any case of non-payment of tax (Bureau of Internal Revenue, 2012).

Under this Section, transfer of shares without payment of tax results in non-registration of these transactions in the books of the corporation. However, it must be re-emphasized that in a stock market setting, trades are executed swiftly and anonymously. Registration in the books is not necessary because there is a custodian corporation known as PCD Nominee Corporation that legally holds all the shares of stock traded in the stock market in behalf of the real owners. At the very least, Section 5 of the Revenue Regulations would only be applicable to the lifting and lodging of securities, where PCD Nominee Corporation transfers the title to stockholders who wish to buy and sell securities without the stock exchange.

From the foregoing, Revenue Regulations 16-2012 can already be declared void for not being administratively feasible.

2. <u>The company may be involuntarily delisted without due process</u>

Continuous implementation of Revenue Regulations 16-2012 causes failure of listing participants to: (1) comply with the Listing Agreement and the Listing and Disclosure Rules of the PSE; or (2) meet the trading volume requirement, both of which are grounds for involuntary delisting. Supplemental Rule "8" provides:

> **Supplement Rule "8"**
> **Rules on Delisting**
> **INVOLUNTARY DELISTING**
> **Policy on Delisting of Listed Securities**
>
> To ensure quality of companies listed in the Exchange and to afford additional protection to the investors, securities listed in the Exchange may be suspended from being traded or removed from the list at any time should, after due notice, the Exchange determines the issuer falls under any of the criteria listed below.
>
> **Criteria for Delisting**
>
> A listed company that is experiencing one of the following conditions shall be considered for delisting:
>
> **(a) The listed company has failed to comply with the Listing Agreement or the Listing and Disclosure Rules of the Exchange, now or hereinafter in effect, despite notice and after the lapse of the period specified**;

...

(c) In case the trading volume of the listed company falls below the trading volume requirement of the Exchange that will be published; (The Philippine Stock Exchange, Supplemental Rule 8 Delisting Rules 1, n.d.).

Since 1999, the PSE has included the Minimum Public Ownership Rule as a ground for delisting, following its 1999 Continuing Listing Requirements. Nonetheless, the PSE observes a process that gives erring companies not only an opportunity to be heard but also ample time to conduct private placements to push the company's public float upward. In a way, the PSE helps the erring company remain listed.

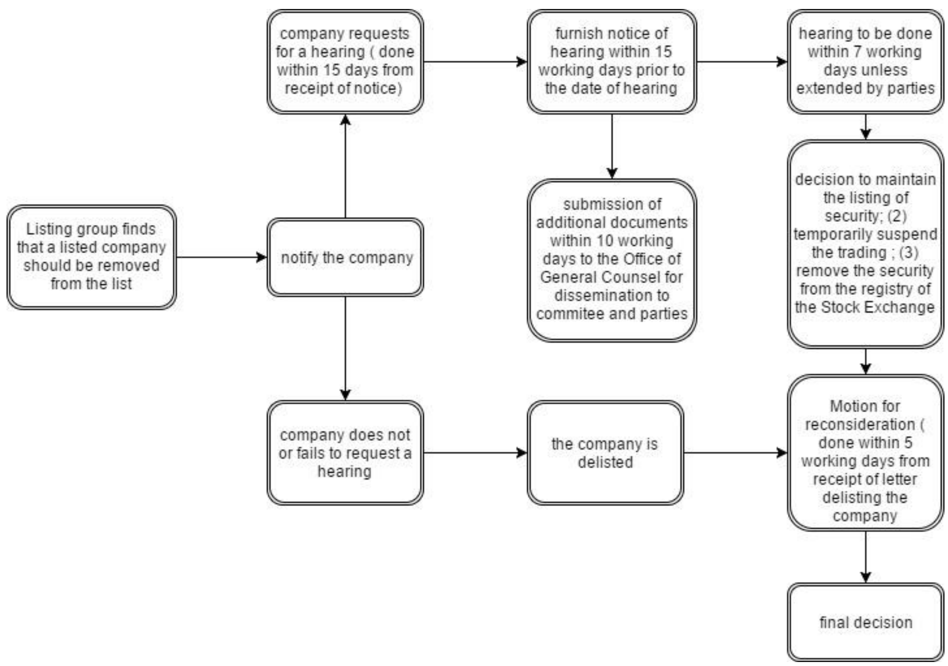

Figure 1. Flowchart for delisting

As observed in the flowchart above (Figure 1), the process of delisting does not happen automatically and on a whim. The PSE, through its Listings and Disclosure group, notifies the erring company, in writing, of the specific category it specifically belongs, the underlying basis for classification, and the company's right to request for hearing before the listing committee. If the company requests a hearing, it has fifteen (15) working days from notice to submit its request (The Philippine Stock Exchange, Supplemental Rule 8 Delisting Rules 1, n.d.). The rules also state that service of the notice of hearing must be done to all concerned parties within fifteen (15) days prior to the scheduled hearing. Companies are likewise given ten (10) working days to submit additional documents before the PSE's General Counsel, who has to distribute these documents to members of the Listing Committee and other concerned parties. A hearing is thereafter conducted within seven (7) working days. Parties are allowed to present testimonial and documentary evidence in support of their cause and cross-examine witnesses. The Listing Committee renders its decision in fifteen (15) working days, which could be: (1) the maintenance of the company's listed status; (2) temporary suspension; or (3) removal of security from registry of the exchange. Even as the company errs in requesting a hearing within the prescribed period, it can still stop the delisting if there is merit in its motion for reconsideration filed within five (5) working days from receipt of the order of delisting (The Philippine Stock Exchange, Supplemental Rule 8, Rules on Delisting, n.d.).

When the Revenue Regulations required the PSE to immediately suspend or delist an erring company, these effectively arrested its powers to implement its own delisting rules as an SRO. Companies have also been deprived of their right to due process—a defining characteristic of the Delisting Rules—because the Revenue Regulations require the PSE to immediately suspend or delist the erring company without the benefit of any hearing. In addition, when a market participant fails to comply with the MPO requirement and pay the corresponding taxes, all transfers of shares of stock pertaining to it are halted effectively. Hence, achieving the minimum volume of matched transactions is close to nil. The erring company may also then be involuntarily delisted on this ground.

3. <u>Since a non-compliant trading participant is delisted involuntarily, stockholders are not entitled to the Tender Offer rule.</u>

To add insult to injury, since the company would have to be delisted involuntarily, Tender Offer rules are not applicable. Under the Tender Offer rule, a company is required to buy back the shares of stockholders who voluntarily sold their shares within a certain period. It is an exit mechanism for shareholders who already lost their confidence in the company. However, the Tender Offer rule is only available to shareholders of companies that delisted voluntarily from the local stock market. It does not benefit shareholders of companies that were delisted involuntarily. Failure to comply with the MPO rule places these shareholders in jeopardy because they had not been given ample opportunity to sell their stakes through the Tender Offer Rule. They had no choice other than to take in all the losses and downside risks that come with falling public ownership level. Any stockholder who wishes to sell would have to go the PCD Nominee Corporation to uplift the shares before selling them to any third party. Given that the whole transaction is tedious, not to mention that selling the shares outside the stock exchange subjects it to a much expensive capital gains tax, the whole reason behind stock transfer tax, which is to encourage people to invest in the stock market, is defeated. No investor in his/her right mind would want to go through all the inconvenience just to pay more in case the company fails to comply with a government regulation through no fault of his/her own and which he/she has no control over.

4. <u>Shareholders who were not able to sell their shares before the Public Ownership percentile falls below the minimum and are forced to sell their shares at a much higher price—a clear disincentive for potential investors to invest in the stock market.</u>

Since the penalty of Revenue Regulations is immediate suspension and/or delisting, minority shareholders, who had no idea whatsoever with how the affairs of their company were being conducted, are forced to sell their shares through over-the-counter placements at prices much lower than their real value. At the same time, they had to absorb higher capital gains tax because the Revenue Regulations immediately cancels the enjoyment of stock transaction tax simultaneous with trading suspension or involuntary delisting. Even without considering this, taxpayers would have to pay capital gains tax just the same, since their trades are executed without the facilities of exchange. Below is a diagram summing up the effects of the Revenue Regulations (Figure 2):

COMPANY FALLS BELOW MPO		**COMPANY FALLS BELOW MPO**	
Hearing (7 working days) ⇩	**STILL WITH STOCK TRANSACTION TAX**	<u>Immediate</u> suspension/ delisting	**CAPITAL GAINS TAX AS CONSEQUENCE**
Decision (15 working days) ⇩			
Motion for reconsideration (5 days) ⇩			
Suspension/ Delisting	**CAPITAL GAINS TAX**		

Figure 2. Effect of Revenue Regulations 16-2012 on Minority shareholders

All inconveniences that this poor investor experienced as regards disposing the share of the company, whose public ownership level fell below the minimum, are enough to discourage any average rational person from investing in the stock market. With profit motive in mind, he/she would not have parted with his/her money on any investment that costs him/her more than his/her own capital.

5. <u>Revenue Regulations 16-2012 created an anomaly in Section 127 of the 1997 Tax Code</u>

The Revenue Regulations also created a rather odd and absurd outcome on whose shares must be considered “listed” and “traded” for purposes of enjoyment of stock transaction tax. When the Revenue Regulations imposed the Minimum Public Ownership Rule as a precondition for a company to be considered “listed,” it likewise rendered the word “traded” in Section 127 of the National Internal Revenue Code useless, given that for a company’s shares to be traded, it also had to remain listed.

6. <u>Revenue Regulations 16-2012 does not take into account the reason for Minimum Public Ownership rule</u>

Revenue Regulations 16-2012 fails to consider that the Minimum Public Ownership Rule is created to unlock the price discovery feature of the stock market. It is also made to help market participants raise capital by ensuring that from the time its shares are first offered to the public until it decides to leave the stock exchange, there is a consistent and real demand for its stock. The Minimum Public Ownership Rule ensures that no matter how bad the market could become, there would always be a buyer. While it may be argued that demand might somehow increase with a little push from the government, its effect may be superficial if not temporary. Sooner or later, the market would soon reflect the real sentiments of investors as regards the stock of the company that failed to meet the Minimum Public Ownership level. It could be that, in spite of all the road shows, investor briefings, and marketing strategies, investors might still find the stock unattractive or inexpensive. Hence, it is possible for the company not to meet its Minimum Public Ownership level for reasons completely outside of its control. Would it not be unfair to unduly burden, more so, penalize the company and its shareholders, when the company already gave its best shot to convince the market to take its stock?

Summing it up: Cooperation Towards an Affective and Efficient Public Governance of the Capital Markets

An ideal market economy is one "which all goods and services are voluntarily exchanged for money at market prices" (Samuelson & Nordhaus, 2005, p. 35). In this system, the government intervention is unnecessary as the invisible hand, so to speak, maximizes every possible benefit the economy gets from these exchanges. However, this does not happen in real life. Markets as we know it are fraught with imperfections that necessitate a powerful and legitimate entity, like the State, to step up and mitigate or remove entirely these imperfections. Governments have coercive powers, which enable it to do anything that could not be done in voluntary exchanges. Interventions are usually on things that no rational individual wants to do like providing incentives, regulate and impose sanctions, and even buy out companies that are too big to fail.

However, government intervention may prove disastrous if policymakers fail to recognize the importance of a well-thought-out policy borne out of a closely knit coordination and cooperation among key government agencies and private stakeholders at the following levels, to wit (1) agency to agency level; (2) agency to private sector regulator level; and (3) government-private sector regulator to market participant and shareholder level.

Agency to Agency level

Given the complexity, let alone overlap of issues concerning a developing country, no single government agency can be held responsible for providing solutions to these problems. For instance, inter-agency coordination and cooperation between the Department of Foreign Affairs, Department of Labor and Employment, and Department of Justice may be necessary to solve problems concerning illegal recruitment. In the same way, regulating a nascent domestic capital market requires the fusion of the Securities and Exchange Commission and of the Bureau of Internal Revenue. It is unfortunate that insofar as these agencies are concerned, they have compartmentalized their functions and consequently failed to recognize that contradicting policies only hamper the growth of what they are tasked to cultivate. To be more specific, what really happens is that one agency arrogates itself on a function that only the other agency has the power, let alone the expertise, to perform. On point with this observation are a number of instances when BIR arrogated itself into single-handedly regulating capital markets on the excuse that its power to regulate comes from its being given a plenary authority to issue regulations that concern tax matters.

The first incident where the BIR exceeded its boundaries was when it issued Revenue Memorandum Circulars 43-2005 (Bureau of Internal Revenue, 2005) and 73-2007 (Bureau of Internal Revenue, 2007), both pertaining to the tax treatment of block sales. In the 2015 Securities Regulation Code Implementing Rules, a block sale is defined "as a matched trade that does not go through the automated order matching system of an exchange trading system" but instead "has been pre-arranged by and among the Broker Dealer's clients and is then entered as a done deal into the trading system" (§30.2.8.2). On the other hand, the PSE Revised Trading Rules (n.d.) defines it as "a pre-arranged transaction which is executed through the facilities of the Exchange and compliant with the requirements of the Implementing Guidelines of these Rules as approved by the Commission" (p. 5).

The circulars made block sales and other similar transactions subject to capital gains tax on the reasoning that the aforementioned transactions exclude the public.

> *sale of shares of stock where the sale is pre-arranged or the buyer/s is predetermined is taxable* [emphasis added] under either Section 24 (C); Section 25(A)(3); Section 25(B); Section 27(D)(2); Section 28(A)(7)(c) and Section 28(B)(5)(c) notwithstanding the fact that the transaction passed through the Exchange or the said facility was used.

They qualified that transactions considered "traded" in the exchange are only those actively traded to the public. Evidently, imposing a rather odd rule on PSE, regarding what transactions could classify as "listed and traded" in its trading facility revealed the BIR's lack of jurisdiction. Aside from it being merely confined to ruling on issues and making rules pertaining to taxation, the BIR has no power to penalize the PSE for non-observance thereof. PSE is only liable to the SEC, by virtue of the latter's oversight and regulatory functions. On a positive note, the BIR (2008) subsequently issued Revenue Regulations 6-2008, which gave the criteria on what transactions could be considered "listed and traded through the local exchange"

> (n) "Shares Listed and traded through the Local Stock Exchange". For purposes of these Regulations, refers to all sales, trades or transactions of listed shares of stock executed through the trading system and/or facilities of the Local Stock Exchange. *This term includes block sale or other types of sales, trades or transactions in the Local Stock Exchange and executed through the trading system and/or facilities of the Local Stock Exchange* [emphasis added] in accordance with the rules of the Local Stock Exchange as approved by the Securities and Exchange Commission. (Bureau of Internal Revenue, 2008).

It corrected its previous issuances by categorically stating that block sales are within the purview of transactions "listed and traded through the local exchange."

Thanks to the BIR correcting itself through Revenue Regulations 6-2008, the issue of block sales has been put to rest.

Another example of the BIR's overreach is the tax treatment of all transactions that are within the purview of the Real Estate Investment Trust (REIT) Law. In an unpublished thesis (Callangan, 2015), it was established that BIR exceeded its jurisdiction when it adopted the Geothermal doctrine to classify REIT transactions as sale transactions that are liable to the value added tax (VAT). When the BIR (2011) issued Revenue Regulations 13-2011, all transfers or exchanges of real property classified as ordinary asset based on its fair market value for shares of stock are subject to a 12% value added tax:

> SECTION 7. Transfer of Real Property Pursuant to Section 40(c)(2) of the NIRC.
>
> (a) Transfer or exchanges of real property for shares of stock in a REIT falling under Section 40(C)(2) of the NIRC shall have the following tax consequences:
>
> i. Income tax. . . . .
>
> ii. *VAT. The transferor is subject to VAT on the transfer of property classified as ordinary asset based on the fair market value of the property transferred* [emphasis added]. (Bureau of Internal Revenue, 2011)
>
> . . .

The study emphasized the fact that as REIT transactions are mandated by the government, they cannot be classified as a sale, in accordance with Magsaysay Doctrine.

The aforementioned study also noted that the same Revenue Regulations required a minimum public ownership of 67% to be maintained by REIT for dividend payments to be considered as a deduction from its taxable income:

> Section 10. Income Taxation of REIT. . . . [B]y the end of the third year from its listing, at the latest and thereafter, *the REIT shall maintain the minimum public ownership of sixty seven percent (67%). Otherwise dividend payment shall not be allowed as a deduction from its taxable income* [emphasis added]. (Bureau of Internal Revenue, 2011)

. . .

This provision is largely absent in the original letter of law. It further adds that tax incentives would be withdrawn in case of non-compliance therein:

> SECTION 16. Withdrawal of Tax Incentives.
>
> (a) A REIT shall be subject to the applicable taxes, plus interests and surcharges, under the NIRC upon the occurrence of any of the following events, subject to the rule on curing period where applicable:
>
> i. *Failure of a REIT to maintain its status as a public company* [emphasis added]. (Bureau of Internal Revenue, 2011)

This Revenue Regulations also provides that the REIT shall place in escrow in favor of the BIR the amount declared as dividend as security for its fulfillment of the 67% public float on the third year:

> Section 5. Documentary Stamp tax on the Transfer of Real Property. In the event the sale or transfer of real property to REITs shall occur prior to its listing, the REIT, in addition to all other presently existing requirements for the issuance of a CAR, *shall (a) execute an undertaking that it shall list within two (2) years from the date of its initial availment of the incentive, and (b) place, for the benefit of the Bureau, in escrow the fifty percent (50%) DST given herein as an incentive in an Authorized Agent Bank acceptable to the Bureau. The amount held in escrow shall be released to the REIT only upon submission of proof of listing as identified under Section 8(3) of these Regulations* [emphasis added] within two (2) year period required herein, otherwise, it shall be released in favor of the government, in accordance with provisions of Section 16 of these Revenue Regulations. (Bureau of Internal Revenue, 2011)

. . .

If it complies, the amount is released to the REIT; otherwise, the amount is awarded to the local government. If and when the REIT fails to reach the required public float, the dividends declared shall not be deductible. Neither REIT law nor its Implementing Rules and Regulations provide for this escrow requirement.

Barring the fact that the issuances concerning Block Sales, REIT law and the tax treatment of Stock transfer tax are void for having unduly expanded the law. The apparent overreach reflects the taxing authority's lack of coordination between the Securities and Exchange Commission on the one hand and the Philippine Stock Exchange. However, this is not to say that the Bureau is solely to be blamed for these mishaps. It could be well noted that the government still operates under the regime of classical organization theory. Classical theory mainly operates on "specialization" and "division of labor," "hierarchy," "centralization," "authority," "a system of rules," "recruitment on the basis of merit," "discipline," "security of tenure," and "impersonal relationship". This theoretical framework has been largely criticized because of its negligence to "human interaction" and "the coordination of needs among administrative units, internal-external organizational relations, and organizational decision processes." Specialization is blamed for poor communication, lack of coordination and conflict, while all fingers point to its nonpartisan as the main culprit for indifference (Domingo, 1998, pp. 157-183).

Recognizing these problems, government agencies now place more emphasis on cooperation and coordination. Congress has adopted measures that required key government agencies to form inter-agency councils that promote a faster, more efficient flow of intelligence, and formulation of policies that address the issues the laws underscore. Specific provisions on cooperation and coordination among government agencies are in place on several laws concerning transnational crimes like Terrorism (The Human Security Act of 2007), importation and sale of illegal and prohibited drugs (Comprehensive Dangerous Act of 2002), and human trafficking (The Expanded Anti-Trafficking in Persons Act of 2012). Similar initiatives are being done in the executive department as well.

In this regard, it is hoped that notwithstanding the absence of a specific provision of law requiring inter-agency coordination, the Bureau of Internal Revenue and Securities and Exchange Commission would have the initiative to coordinate with each other in the formulation of consistent policies that govern capital markets. Just like any other agency, the BIR and SEC are to be guided by the principles enshrined by the constitution and the governing statutes on Capital Markets.

Agency to Private Sector Regulator Level

To date, the Philippine Stock Exchange is the only exchange regulator for equities in the country. As a by-product of a merger between the Manila (1927) and Makati (1963) Stock Exchanges in 1992, the PSE has grown into a leading institution and key player in the domestic financial market. Coupled with the fact that it was made an SRO by the Securities and Exchange Commission, the PSE has the expert know-how on what policies could best serve the following stakeholders, to wit: (1) market participants; (2) publicly listed companies; and (3) the national government. With ASEAN integration at the Philippines' doorstep, it is armed with valuable insights that further the overarching state policy of a bustling National Economy effectively controlled by Filipinos and usher the country to progress.

That said, it would be best if the government, through the coordinated efforts of the BIR and SEC, tap the PSE in creating a national and proactive policy framework that envisions sustainable and consistent growth of Capital Markets.

Government-Private Sector Regulator to Market Participant and Shareholder Level

The slow and gradual shift from the principles of the Classical theory to more participative theories saw the rise of consultations between the government and its stakeholders. It may well be said that the government is mainly working on a premise espoused by "multiple constituencies/market perspective," which posits that "organizations are but extensions of the individuals that are affected by their policies". Organizational success is now measured in terms of how they have served the interests of their stakeholders (Domingo, 1998, pp.157-183).

From the foregoing, it is highly encouraged that consultations be done between government and the market participants and shareholders whose transactions are done through the facilities of the stock exchange. Not only do consultations help the government pulse the current state of capital markets, it can also help them solve market imperfections and prevent regulatory capture, all the while ensuring that policies that are carved to solve them do not border the unconstitutional.

Recommendations

After an extensive evaluation of the Revenue Regulations 16-2012 in light of the prevailing rules and jurisprudence, it is submitted that:

(1) Revenue Regulations 16-2012 be nullified as issues concerning public float solely rest upon the SEC and PSE. Nullifying this Revenue Regulations would give them a free hand in prescribing rules and regulations that provide minority shareholders ample exit mechanisms without losing their eligibility to avail of the stock transactions tax;

(2) Section 22-L of the NIRC be amended to place the definition of "listed and traded" for purposes of stock transaction tax. The aforementioned provision shall be worded thus:

> **(L-1) "listed and traded" – "as used in this Section, it shall refer to "all sales, trades, or transactions of listed Shares of Stock executed through the trading system and/or facilities of the Local Stock Exchange". This term includes "block sale or other types of sales, trades or transactions in the Local Stock Exchange and executed through the trading system and/or facilities of the Local Stock Exchange in accordance with the rules of the Local Stock Exchange as approved by the Securities and Exchange Commission"."** (Bureau of Internal Revenue, 2008)

This definition is largely lifted from Revenue Regulations 6-2008. It is envisioned that the definition's curative effect with respect to the tax treatment of block sales as discussed in the previous chapter would likewise bring clarity on the taxability of transactions involving shares of stock of companies that failed to comply with the Minimum Public Ownership requirement. In particular, this definition intends to:

(a) Acknowledge the sole authority of the SEC and SROs, such as the PSE to prescribe and implement rules and regulations pertaining to capital markets;

(b) Rationalize the tax treatment of transactions involving sales, barters, exchanges, and disposition of shares of stock through local stock exchanges without unduly tampering the spirit and wisdom behind the law–to encourage family owned businesses to open for wider public participation and to nurture evolving and maturing capital markets;

(c) Provide the SEC and the PSE enough leeway to craft rules that give minority shareholders enough exit mechanisms without being removed of their right over stock transactions tax.

(3) Enforce the regime of closely knit cooperation and coordination on three levels: (1) agency to agency level; (2) agency to private sector regulator level; and (3) government-private sector regulator to market participant and shareholder level to prevent future arrogation of authority in capital markets, without sacrificing the state policy of ensuring growth and maturity of the financial system.

Conclusion

While it is commendable that the Bureau of Internal Revenue intended to rationalize the preferential tax treatment on the sale, barter, exchange, and disposition of shares of stock through the local stock exchange, to keep up with the times, and ensure that the purpose of the law, which is to nurture a vibrant stock market, is fulfilled, it can only do so within the letter and spirit of the law. Truth be told, the Bureau has to recognize the impact of ill-advised actions on its key stakeholders and bow down and recognize the supreme legislative authority, whose wisdom and power emanating from the people, guide the nation towards the principle of shared prosperity and financial independence.

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