The Mergers & Acquisitions Review

Ninth Edition

Editor
Mark Zerdin

Law Business Research

The Mergers & Acquisitions Review

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This article was first published in The Mergers & Acquisitions Review - Edition 9
(published in August 2015 – editor Mark Zerdin)

For further information please email
Nick.Barette@lbresearch.com

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Ninth Edition

Editor
Mark Zerdin

Law Business Research Ltd

PUBLISHER
Gideon Roberton

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Nick Barette

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Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

www.TheLawReviews.co.uk

ISBN 978-1-909830-62-2

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

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THE DISPUTE RESOLUTION REVIEW

THE EMPLOYMENT LAW REVIEW

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THE BANKING REGULATION REVIEW

THE INTERNATIONAL ARBITRATION REVIEW

THE MERGER CONTROL REVIEW

THE TECHNOLOGY, MEDIA AND
TELECOMMUNICATIONS REVIEW

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INTERNATIONAL TAXATION REVIEW

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ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

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AGUILAR CASTILLO LOVE

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CONTENTS

EDITOR'S PREFACE

By a number of measures, it could be argued that it has been some time since the outlook for the M&A market looked healthier. The past year has seen a boom in deal making, with many markets seeing post-crisis peaks and some recording all-time highs. Looking behind the headline figures, however, a number of factors suggest deal making may not continue to grow as rapidly as it has done recently.

One key driver affecting global figures is the widely expected rise of US interest rates. Cheap debt has played a significant part in the surge of US deal making in the first few months of 2015, and the prospects of a rate rise may have some dampening effects. However, the most recent indications from the Federal Reserve have suggested that any rise will be gradual and some market participants have pushed back predictions for the first rate rise to December 2015. Meanwhile, eurozone and UK interest rates look likely to remain low for some time further.

The eurozone returned to the headlines in June as the prospect of a Greek exit looked increasingly real. Even assuming Greece remains in the euro (as now seems likely), the crisis has severely damaged the relationship between Greece and its creditors. The brinksmanship exhibited by all parties means that meaningful progress cannot occur except at the conclusion of a crisis: the idea that reform will benefit Greece has been lost and each measure extracted by creditors is couched as a concession. However, while the political debate has become ever more fractious, the market's response to the crisis has been relatively sanguine. This is largely a result of the fact that the volume of Greek debt is no longer in the market, but in the hands of institutions. But it is also a sign of the general market recovery and expectations that major economies will continue to grow.

Perhaps one of the more interesting emerging trends in the last year is the interplay between growth and productivity. Some commentators have suggested that the recent rise in deal making is a symptom of a climate in which businesses remain reluctant to invest in capital and productivity. Pessimistic about the opportunities for organic growth, companies instead seek to grow profits through cost savings on mergers. It is difficult to generalise about such matters: inevitably, deal drivers will vary from industry to industry, from market to market. However, if synergies have been the principal motivation in much of the year's deal making (it certainly has been in a number of large-cap deals) then it may be that the market is a little farther from sustainable growth than some would like to think.

I would like to thank the contributors for their support in producing the ninth edition of *The Mergers & Acquisitions Review*. I hope that the commentary in the following chapters will provide a richer understanding of the shape of the global markets, together with the challenges and opportunities facing market participants.

Mark Zerdin
Slaughter and May
London
August 2015

Chapter 52

PHILIPPINES

Rafael A Morales, Philbert E Varona, Hiyasmin H Lapitan and Patricia A Madarang[1]

I OVERVIEW OF M&A ACTIVITY

There is no centralised data available on M&A in the Philippines. However, based on the general investment data compiled by the National Statistical Coordination Board (NSCB), foreign investments approved by the country's seven investment promotion agencies amounted to 95.2 billion Philippine pesos in the last quarter of 2014.

Manufacturing remained the top industry to receive investment pledges. Administrative and support service activities came in second, followed by construction.

The NSCB also reported that the approved investments of foreign and Philippine nationals in the fourth quarter of 2014 totalled 231.2 billion Philippine pesos. Pledges from Philippine nationals stood at 136 billion Philippine pesos, which accounted for 58.8 per cent of the total approved investments during that quarter.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

M&A is primarily governed by the Corporation Code and the Civil Code of the Philippines, as well as the Securities Regulation Code (SRC) when listed companies are involved. Furthermore, M&A would have to comply with the nationality requirements in the Philippine Constitution, the Foreign Investments Act, and other laws as applicable. Most M&A does not require regulatory consent or approval except for some companies engaged in regulated businesses such as banking, insurance and telecommunications.

1 Rafael A Morales is the managing partner, Philbert E Varona and Hiyasmin H Lapitan are partners, and Patricia A Madarang is an associate at SyCip Salazar Hernandez & Gatmaitan.

Acquisitions in the Philippines are typically structured as share purchases, as these are generally simpler to implement and more tax-efficient. In some instances, however, an asset acquisition may be preferred, where the primary considerations are the ability to cherry-pick attractive assets and the desire to avoid being saddled with pre-existing obligations of the selling entity. A third method of acquisition is through merger or consolidation.

There is a potential need to comply with tender-offer rules if the target is a public company (such as one listed on the Philippine Stock Exchange, or PSE) and the buyer will acquire at least 35 per cent of such company's capital stock (in one or more transactions within 12 months). It may take at least two months to prepare for and complete the tender offer.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i Determination of compliance with foreign ownership ceilings

As a general rule, there are no restrictions on the extent of foreign ownership of Philippine enterprises. However, the Constitution and statutes impose ceilings on foreign equity in certain areas of economic activity, such as the ownership of land, operation of public utilities, and the exploration, development and utilisation of natural resources. The Tenth Regular Foreign Investments Negative List (issued on 29 May 2015) enumerates some of the more important investment areas and activities that are reserved for Philippine nationals.

In this connection, the Philippine Supreme Court ruled that compliance with the constitutional provision restricting the operation of public utilities to corporations at least 60 per cent of whose capital is owned by Philippine citizens, must be determined on the basis of the ownership of outstanding shares that are entitled to vote in the election of directors. According to the Supreme Court, other shares that are owned by Philippine citizens, but that are not entitled to vote for directors, must be disregarded, even if otherwise entitled to dividend and other rights.

The Securities and Exchange Commission (SEC) issued the Guidelines on Compliance with the Filipino-Foreign Ownership Requirements Prescribed in the Constitution and/or Existing Laws by Corporations Engaged in Nationalized and Partly Nationalized Activities. These Guidelines state that, for purposes of complying with constitutional or statutory ownership requirements, both: the total number of outstanding shares of stock entitled to vote in the election of directors; and the total number of outstanding shares of stock, whether or not entitled to vote in the election of directors, must meet the required percentage of Filipino ownership.

ii Relaxation of local currency conversion requirement

Foreign direct investment (FDI) is not required to be registered with the Philippine Central Bank (BSP), unless the foreign exchange needed to service the repatriation of capital and the remittance of dividends and earnings will be purchased from the Philippine banking system. FDI may be in cash or in kind (such as machinery and equipment, and raw materials). Foreign exchange funding investments must be remitted into the Philippine banking system to be eligible for registration. There is no need to convert the foreign exchange to pesos for BSP registration purposes.

iii Minimum public ownership rule

Publicly listed companies are required to maintain a minimum public ownership (MPO) of the higher rate of 10 per cent of their issued and outstanding shares, exclusive of treasury shares; or such percentage as may be prescribed by the SEC or the PSE. Listed companies that were not MPO-compliant on or after 1 January 2013 were suspended from trading for a period of not more than six months and thereafter delisted if they remained non-compliant. A tax regulation issued in late 2012 lends teeth to this policy by providing that the sale, barter, exchange or other disposition of shares of listed companies that fail to meet the MPO will be subject to capital gains tax on the net gain realised (5 per cent on the first 100,000 Philippine pesos net gain and 10 per cent on the net gain over 100,000 Philippine pesos) and documentary stamp tax of approximately 0.375 per cent of the par value of the shares sold. In contrast, an on-exchange sale of shares in an MPO-compliant listed company is subject to a preferential stock transaction tax of just 0.5 per cent of the selling price of the shares, and exempt from documentary stamp tax.

iv Proposal to raise threshold for tender offers

Apart from the tender offer rules in the SRC, there are no takeover regulations in the Philippines. Unlike other jurisdictions, the Philippines has not adopted 'squeeze out' regulations that would allow a company (or a new investor) to compel minority shareholders to sell their shares. However, under Section 41 of the Corporation Code, a stock corporation can acquire its own shares for a 'legitimate corporate purpose'; hence, it is possible for the majority shareholders to cause the purchase of the shares of the minority assuming that such a purpose exists.

There is a proposal to raise the threshold for a mandatory tender offer, which is currently at 35 per cent of a class of shares in a public company.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

The Philippines is situated in one of the fastest-growing regions in the world. Business confidence continues to improve based on the quarterly Business Expectations Survey conducted by the BSP.

Interest in the country has been attributed to strong macroeconomic conditions. Economic expansion in the country is 6.9 per cent in the last quarter of 2014 and is expected to continue to improve, especially with the positive outlook assigned to the country by Fitch Ratings, and Standard and Poor's. The World Economic Forum has ranked the Philippines 52nd out of 144 economies in its 2014–2015 Global Competitiveness Report.

For the fourth quarter of 2014, the majority of the investments coming into the country were pledged by the Netherlands. Its investment pledges of 23.0 billion Philippine pesos account for 24.1 per cent of the total foreign investments. Investments from the Netherlands targeted mostly manufacturing, administrative and support service activities, and information and communication. Second is Japan, which committed

20.9 billion Philippine pesos (21.9 per cent). The United States follows with 9.7 billion Philippine pesos (10.2 per cent).

The 23.0 billion Philippine peso commitment of the Netherlands in the fourth quarter of 2014 is 58.9 per cent higher than the 14.4 billion Philippine pesos it pledged in the same period in 2013.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

i Hot industries

The manufacturing industry maintained its edge over other areas of investment in the total amount of investments in 2014. Investment pledges in this area amounted to 109.5 billion Philippine pesos (or 58.6 per cent of the total investment pledges for 2014). Investments for manufacturing grew by 41.2 per cent, from 77.6 billion Philippine pesos in 2013.

The other top performing industries in 2014 are administrative and support service activities with investment of 29.6 billion Philippine pesos or 15.9 per cent of the approved foreign investments, and real estate activities at 15.6 billion Philippine pesos or 8.3 per cent of the total. The construction industry saw a huge increase in investment of 8.7 million Philippine pesos in 2013 to approximately 7.74 billion Philippine pesos.

ii Investment priority areas

Other industries that foreign investors could consider for 2013 are those identified in the Board of Investments' (BOI) Investment Priorities Plan (IPP). Investors in identified IPP industries are entitled to government incentives.

The eight regular priority investment areas identified in the IPP are manufacturing; agribusiness and fishery; services including creative industries and knowledge-based services; economic and low-cost housing; hospitals; energy; public infrastructure and logistics; and public-private partnership (PPP) projects.

Export activities remain a priority investment area. Other areas and activities included in the IPP are industrial tree plantation; mining; publication or printing of books; refining, storage, marketing and distribution of petroleum products; rehabilitation, self-development and self-reliance of persons with disabilities; renewable energy; and tourism.

Another list of priority projects is available from the regional BOI of the autonomous region in Muslim Mindanao.

iii Key trends

Also expected to see increased M&A activity is the banking sector, as local banks are encouraged by the BSP to merge or consolidate to be more competitive with their much larger regional counterparts. Recently, a law was passed (namely, Republic Act No. 10641) allowing a qualified foreign bank, with BSP approval, to:

a acquire up to 100 per cent of the voting stock of an existing bank;

b establish a wholly owned banking subsidiary; or

c forming a branch with full banking authority.

Another sector that could see increased activity is infrastructure. The Philippine government is accelerating the rollout of infrastructure projects to address the country's inadequate infrastructure, which has been identified as a constraint to economic growth. These projects include national roads and bridges, airports and seaports, classrooms and other educational facilities, irrigation, and potable water supply systems, among others. According to the Philippine Department of Budget and Management, the massive infrastructure programmes scheduled for 2015 are in line with the Philippine government's aim to reach an infrastructure spending level of 5 per cent of the projected gross domestic product (GDP) in 2016. The government is tapping the private sector for the financing, construction, operation, maintenance and rehabilitation of major infrastructure under its PPP programme. In 2012 alone, 16 projects amounting to 154 billion Philippine pesos were identified for bidding to the private sector – both local and foreign. Major PPP projects supported by the national government that are ongoing are the Tarlac-Pangasinan-La Union Toll Expressway, the Daang Hari-South Luzon Expressway (SLEX) Link Project, the North Luzon Expressway-South Luzon Expressway (NLEX-SLEX) Link Connector, the Cavite-Laguna Expressway (CALAX), the Laguna Lakeshore Expressway Dike (LLED), and the Ninoy Aquino International Airport (NAIA) Expressway.

The outsourcing industry is one of the fastest growing in the country. It is projected to reach US$25 billion in revenue by 2016 and take hold of a 10 per cent share in the global market.

Within the wide range of outsourcing services available in the country, voice-based BPO services continue to dominate. However, impressive performances have also been seen in higher value knowledge-based, non-voice services, such as software product development, animation, game development, health information management, and financial and accounting services.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Private equity firms appear to be particularly interested in investing in the infrastructure, power and renewable energy sectors in the Philippines. In July 2012, the Asian Development Bank approved an equity investment in the Philippine Investment Alliance for Infrastructure fund alongside commitments from the Government Service Insurance System, which administers the Philippine state-owned pension fund, as well as a Dutch pension fund asset manager and the Macquarie group. The said fund has been actively pursuing opportunities in Philippine infrastructure. Earlier this year, the Asian Development Bank also approved a private sector loan and equity assistance for the construction and operation of a 150MW wind farm power project in the province of Ilocos Norte.

Other areas of investment in which private equity groups have expressed interest include BPO and door-to-door freight businesses. Opportunities are also seen to exist in helping local family-owned enterprises either to consolidate or to diversify their business organisations.

VII EMPLOYMENT LAW

The Labour Code of the Philippines is silent on the effect of a merger on the status of the employees of the merging companies. However, under the Corporation Code, there is an automatic succession of employment rights and obligations from the surviving company to the employees of the absorbed company. The absorbed company is deemed substituted as employer, by operation of law, by the surviving company. This was confirmed by the Supreme Court in *Bank of the Philippine Islands v. BPI Employees Union – Davao Chapter – Federation of Unions in BPI Unibank* (2011). There, it was held that employment contracts of the absorbed company are automatically assumed by the surviving company even in the absence of an express stipulation to that effect in the articles or plan of merger.

It should be noted, however, that in an asset purchase, employment-related obligations and liabilities, as a general rule, do not extend to the acquirer. On the other hand, in share purchase, there is no concomitant change in the relations between the employer and the employee. Thus, unless specifically carved out in the agreement between the acquirer and the seller, the acquirer generally assumes the liabilities of the corporation with respect to its employees.

VIII TAX LAW

Generally, a transfer of shares of stock in a company incorporated in the Philippines or of real property located in the Philippines is subject to income tax and other taxes. A certificate authorising registration (CAR) from the Philippine Bureau of Internal Revenue (BIR) is required before the transfer can be recorded in the stock and transfer book of the Philippine company (in case of a sale of shares) and with the registry of properties (in case of a transfer of real property). The CAR is a certification that all taxes on the conveyance have been paid.

The sale of other movables within the Philippines is also subject to income tax, among other taxes. However, no CAR is required for the transfer of such assets.

The acquisition of shares in a company listed on the PSE is subject only to a stock transaction tax of 0.5 per cent of the gross selling price and exempt from documentary stamp tax (in contrast to a capital gains tax of five per cent on the first 100,000 Philippine pesos net gain and 10 per cent on the net gain over 100,000 Philippine pesos realised by the seller and a documentary stamp tax of approximately 0.375 per cent of the par value of the shares sold, in the case of unlisted shares). If the shares of stock in a Philippine company that are not listed at the PSE are sold at a price lower than their fair market value, the BIR may require the payment of donor's tax from the seller, at the rate of 30 per cent if the transfer is between corporations (the rate of tax on transfers between related individuals is based on a schedule depending on the value of the donation but the rate is also 30 per cent if between individuals who are strangers) of the difference between the fair market value of the shares and the selling price, before the BIR issues a CAR.

On the other hand, an asset acquisition from a Philippine-resident corporation may attract corporate income tax (generally at the rate of 30 per cent of the taxable income) and value added tax (generally at the rate of 12 per cent of the gross selling price), and other taxes, depending on the nature of the assets being sold.

The BIR issued Revenue Regulations No. 6-2013 in 2013, which amends the definition, under Revenue Regulations No. 6-2008 (Consolidated Regulations Prescribing the Rules on the Taxation of Sale, Barter, Exchange or Other Disposition of Shares of Stock Held as Capital Assets), of the fair market value of shares of stock issued by Philippine companies not listed or traded on the PSE.

The revised definition still makes reference to the book value of the shares under the latest audited financial statements (AFS) of the Philippine company. The adjusted net asset method, which is the prescribed method under Revenue Regulations No. 6-2013 for calculating the fair market value of the shares, requires the assets and liabilities of the investee corporation to be 'adjusted to fair market values' by taking into consideration the values under the AFS with other information available such as the report of an independent appraiser. The difference between the total assets (as adjusted) and the total liabilities (as adjusted) of the Philippine company is the fair market value of the shares.

An example set out in Revenue Regulations No. 6-2013 is the computation of the fair market value of real properties owned by the corporation that issued the shares sold. The adjusted net asset method requires the use of the highest figure for the fair market value of each real property by comparing the fair market value (1) reported as book value under the AFS of the investee corporation; (2) as determined by the Commissioner of Internal Revenue; (3) as provided in the schedule issued by the assessor of the province or city where the real property is located; and (4) as determined by an independent appraiser. The submission of the report of an independent appraiser may be required by the BIR for the processing of the CAR application.

Based on the sample calculation under Revenue Regulations No. 6-2013, to derive the adjusted net asset value of a real property, the highest fair market value (based on a comparison of amounts from various sources) must be deducted from the book value of the asset. The difference will be added to the book value of the asset. The sum of the adjusted values of all real properties and all other properties will be added to the total assets reported in the AFS. The fair market value of the shares will be the difference between the adjusted total assets and the adjusted total liabilities. The fair market value per share sold is the difference between the adjusted total assets less the adjusted total liabilities divided by the total number of outstanding shares as of the end of the period covered by the AFS.

The sale by a non-resident foreign company of shares in a Philippine company or of movables within the Philippines may be exempt from income tax or may be subject to a preferential tax rate under an applicable tax treaty.

The BIR requires, under Revenue Memorandum Order No. 72-2010 (Guidelines on the Processing of Tax Treaty Relief Applications (TTRA) Pursuant to Existing Philippine Tax Treaties), as a condition precedent to the availment of the tax exemption, or of the lower tax rate, the prior filing of an application for tax treaty relief before the taxable transaction. The favourable ruling of the BIR is required before a CAR is issued on the transfer of shares. Revenue Memorandum Order No. 72-2010 is still being implemented by the BIR even though the Supreme Court, in its decision dated 19 August 2013 in *Deutsche Bank AG Manila Branch v. Commissioner of Internal Revenue* (G.R. No. 188550), stated that:

The period of application for the availment of tax treaty relief as required by RMO No. 1-2000 should not operate to divest entitlement to the relief as it would constitute a violation of the duty required by good faith in complying with a tax treaty. The denial of the availment of tax relief for the failure of a taxpayer to apply within the prescribed period under the administrative issuance would impair the value of the tax treaty. At most, the application for a tax treaty relief from the BIR should merely operate to confirm the entitlement of the taxpayer to the relief.

Revenue Memorandum Order No. 72-2010 amended Revenue Memorandum Order No. 01-00 (Procedures for Processing Tax Treaty Relief Application), the regulation discussed in *Deutsche Bank AG Manila Branch v. Commissioner of Internal Revenue*.

The assignment of properties pursuant to a plan of merger or consolidation may also be exempt from income tax if the exchange is made solely for shares of stock in a corporation that is a party to the merger or consolidation, and provided that the requirements under Section 40(C)(2) of the National Internal Revenue Code of 1997 are met. The transfer of property pursuant to Section 40(C)(2) of this Code is also exempt from documentary stamp tax. However, other taxes (such as value added taxes and local transfer taxes) may still be payable depending on the type of property exchanged.

After the execution of documents, the parties to a merger or consolidation have to secure a BIR ruling that confirms the tax-free exchange status of the transfers in order to obtain CARs without having to pay taxes.

IX COMPETITION LAW

At present, there is no general antitrust or antimonopoly law in the Philippines. There are, however, pending bills on the subject in the Congress of the Philippines.

The Philippine Constitution adopts a general policy against monopolies and combinations in restraint of trade. In general, it mandates the regulation and prohibition of monopolies when public interest so requires. It remains for the Congress of the Philippines to pass a comprehensive enabling legislation.

However, monopolies and other combinations in restraint of trade are declared unlawful and penalised under the Revised Penal Code. Specifically, it penalises: any person who enters into any contract or agreement or takes part in any conspiracy or combination in the form of a trust or otherwise, in restraint of trade or commerce or to prevent by artificial means free competition in the market; any person who monopolises any merchandise or object of trade or commerce, or combines with any other person or persons to monopolise any merchandise or object in order to alter the price thereof by spreading false rumours or making use of any other article to restrain free competition in the market; and a manufacturer, producer, processor or importer, wholesaler or retailer who combines, conspires or agrees in any manner with any person likewise or with any other persons not so similarly engaged for the purpose of making transactions prejudicial to lawful commerce, or of increasing the market price in any part of the Philippines of any such merchandise or any article where such merchandise is used. There is a pending bill before the Philippine Congress that seeks to increase the penalties that can be imposed for these unlawful activities.

The Civil Code also provides for the recovery of damages in the case of unfair competition in agricultural, commercial or industrial enterprises.

By virtue of Executive Order No. 45 (2011), the Department of Justice was designated the Philippines' Competition Authority. The duties and responsibilities of the Competition Authority include enforcement of competition policies and laws to protect consumers from abusive, fraudulent or harmful corrupt business practices, and the investigation of all cases involving violations of competition laws and prosecution of violators to prevent, restrain and punish monopolisation, cartels and combinations in restraint of trade. On 2 March 2015, the Department of Justice issued Circular No. 005 containing the Guidelines in the Enforcement of Competition Laws.

X OUTLOOK

M&A in the Asia-Pacific region is expected to continue to increase in 2015 and 2016 as GDP in the region is anticipated to expand by 6.3 per cent as in 2014, according to Asian Development Bank's Asian Development Outlook 2015. With the projected economic integration of the ASEAN in 2015, M&A especially in the banking sector is expected to make local banks more competitive in relation to their much larger regional counterparts.

The Philippines is an attractive market for investors, mainly due to its fast economic growth, relative political stability and rising domestic consumption. According to the NSCB, the Philippines' gross domestic product grew by 5.2 per cent in the first quarter of 2015. The NSCB attributes this to the growth in the services, industrial, and agriculture sectors.

As stated above, Philippine banks are encouraged by the BSP to merge or consolidate to further strengthen the banking sector. To this end, the BSP has announced the grant of temporary rediscounting lines to newly merged or consolidated banks, in addition to the general incentives or relief already granted to them.

Appendix 1

ABOUT THE AUTHORS

RAFAEL A MORALES

SyCip Salazar Hernandez & Gatmaitan

Rafael A Morales is the managing partner of SyCip Salazar Hernandez & Gatmaitan. Previously, he was head of the firm's banking, finance and securities department. His areas of expertise include corporation and commercial law, as well as banking and financial law. He has extensive experience in mergers and acquisitions, project financings, securities offerings, and joint ventures.

PHILBERT E VARONA

SyCip Salazar Hernandez & Gatmaitan

Philbert E Varona is a partner and is a member of the firm's special projects and banking, finance and securities departments. His practice areas include mergers and acquisitions, finance and securities, foreign investments, infrastructure, and government contracts.

HIYASMIN H LAPITAN

SyCip Salazar Hernandez & Gatmaitan

Hiyasmin H Lapitan is a partner and is a member of the firm's tax, special projects and banking, finance and securities departments. Her practice areas cover, among others, corporate and tax matters relevant to privatisation, mergers and acquisitions, and project financing.

PATRICIA A MADARANG

SyCip Salazar Hernandez & Gatmaitan

Patricia A Madarang is an associate of the firm. Her practice areas include corporate law, labour law and litigation.

SYCIP SALAZAR HERNANDEZ & GATMAITAN
SyCipLaw Center
105 Paseo de Roxas
Makati City 1226
Metro Manila
Philippines
Tel: +632 982 3500 / 982 3600
Fax: +632 817 3896 / 817 3567
ramorales@syciplaw.com
pevarona@syciplaw.com
hhlapitan@syciplaw.com
pamadarang@syciplaw.com
www.syciplaw.com