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TOP OF MIND

By ANA MARGARITA A. MORTEL

On the reacquisition of shares

It was in early 1923, in the case of Philippine Trust Co. vs. Rivera, when the Supreme Court articulated the trust fund doctrine in Corporation Law. Under the said doctrine, capital stock, property and other assets of a corporation constitute a fund from which creditors have a right to look for satisfaction of their claims. The doctrine finds its basis upon the need to preserve the assets and capital of the corporation for the protection of creditors, who are preferred over stockholders in the distribution of corporate assets.



Thus, corporate creditors have a right to assume that the assets of the corporation shall not be used to purchase its own shares, or dividends be declared when the corporation is insolvent.

The trust fund doctrine has found its way to today's Corporation Code, and finds particular application in the case of treasury shares. Be it recalled that one of the explicit powers granted by the law to the board of directors of a stock corporation is the power to acquire its own shares, subject to the existence of a legitimate corporate purpose and unrestricted retained earnings. One such kind of reacquired share is what we now know as treasury shares, otherwise described as those shares which have been issued and fully paid, but subsequently reacquired by the issuing corporation.

This power to re-acquire shares has a fairly interesting history. Originally, and pursuant to English Law, the reacquisition of shares were considered ultra vires for being akin to trafficking or speculating by a corporation in its own shares. It was also viewed as an indirect method of reducing capital without having to amend the articles of incorporation.

However, most American states recognize the right of a corporation to acquire its own shares. The recognition of this right came with limitations in view of the trust fund doctrine so that the allowance of the buyback is premised upon the existence of a legitimate corporate objective as well as surplus profits from which the acquisition will be made. Ultimately, the reacquisition of shares is allowed provided that there is no resulting injury to creditors.

Today, Section 41 of the Corporation Code grants the corporation such right to acquire its own shares. Similarly, this right can be exercised when the twin conditions of the existence of legitimate corporate purpose and unrestricted retained earnings are met. That is, the payment for reacquisition of corporate shares must come from the surplus profits of the corporation which, according to the rules governing redeemable and treasury shares, have not been "allocated for any managerial, contractual or legal purposes and which are free for distribution to the stockholders as dividends."

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The reacquisition of shares back into treasury does not disturb treasury stock must be recorded at cost regardless if these are acquisition of capital stock do not represent return of capital to amendment. the stockholders but an investment out of retained earnings on a saleable property known as treasury shares.

Frequently accompanying the issue of reacquisition of shares is the query on the required minimum subscribed and paid up capital stock under Section 13 of the Corporation Code.

incorporation, and at least 25 percent of the subscribed capital corporate capitalization and assure "(1) the State of the successful prosecution of the business of the corporation; and (2) the creditors of the means of obtaining satisfaction of their claims, at least to the extent of the payment of the required subscription." (SEC

Opinion No. 12-03)

However, the 25-25 percent requirement is only mandatory during the (1) pre-incorporation period, pursuant to Section 13 of the Corporation Code and (2) when the corporation increases its authorized capital stock, pursuant to Section 38 of the same Code. Whereas this statement may raise questions on the possibility of circumventing minimum capital requirements, the idea is that treasury shares continue to be part of issued shares and do not reduce the amount of stated capital. Moreover, even if these shares are acquired by the corporation as property, unlike the regular shares held by ordinary stockholders, treasury shares do not have voting rights nor do they earn dividends. Finally, considering that treasury shares can only be acquired from surplus profits, the safeguards against the depletion of assets and capital in protection of creditors are kept intact.

to SEC-SRC Rule No. 68, as amended. Said rule provides that

its issued status. In the recent SEC OGC Opinion No. 16-16, the acquired below or above par value. The total cost of treasury SEC reiterated that treasury shares do not revert to its unissued stock should be shown in the balance sheet as a deduction from status and remain part of issued capital. They are instead con- the total stockholders' equity and accounted for separately, if sidered as property acquired by the corporation which may be possible. Further, SEC OGC Opinion No. 16-16 also provides that reissued or resold at a price to be fixed by the board of directors. a corporation acquiring treasury shares must amend its financial The reason behind the same is that the "amount paid for the statements to indicate the same, with proper disclosures as to

If the treasury shares are intended to be made available for reissuance, they shall be subject to the provisions of the Securities Regulation Code on the registration of securities prior to sale thereof to the public. In SEC Opinion No. 16-16, the SEC had occasion to explain that the reissuance of shares may constitute distribution of stocks Pertinently, said Section provides that at least 25 percent of to the public, so that the requirement of prior registration with the the authorized capital stock must be subscribed at the time of SEC will apply. Granted that there are exemptions to registration provided in Sections 9 and 10 of the Securities Regulation Code, stock be paid upon subscription. In no case shall the paid-up the reissuance of treasury shares is not exempt per se. However, capital be less than P5,000. The raison d'être for this minimum the limited character of such transaction may qualify it for exempsubscription requirement is to ensure the existence of sufficient tion, albeit not automatically. The corporation must first secure an exemption from the SEC prior to any reissuance.

Finally, once treasury shares are allowed to be reissued, the treasury account must be credited for cost. SEC SRC Rule No. 68, as amended, also states that any gain from such sales must be credited to additional paid-in capital, while losses must be charged against additional paid-in capital but only to the extent of previous net gains from sales or retirements of the same class of stock; otherwise, "losses," should be charged to retained earnings.

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