



GERONIMO LAW

LEGAL ARTICLE

# SIMPLE AGREEMENT FOR FUTURE EQUITY (SAFE)

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# Simple Agreement for Future Equity (SAFE)

## Securities, Tax, and Accounting Treatment

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What is the nature of a SAFE in corporate and securities law? How to account for it in the books of the issuer? What is the tax treatment?

The SAFE has no statutory definition in law. It is an innominate contract, binding under the autonomy of contracts (Civil Code, Arts. 1305-1306), under which the investor pays a purchase amount today against the issuer's obligation to issue shares upon suspensive conditions (Civil Code, Art. 1181), such as a liquidity event or dissolution.

It is not a loan, since it bears no interest, has no maturity, and carries no unconditional repayment obligation; and it is not yet equity, since no shares are issued, the holder is not a stockholder, and no entry is made in the stock and transfer book (Revised Corporation Code [R.A. No. 11232, "RCC"], Sec. 73).

It is, however, a "security" as an investment contract under the Securities Regulation Code (R.A. No. 8799, "SRC"), Sec. 3.1, applying the Howey test as adopted in *Power Homes Unlimited v. SEC* (G.R. No. 164182, 26 February 2008) and *SEC v. Prosperity.com* (G.R. No. 164197, 25 January 2012). Its sale therefore requires registration (SRC, Sec. 8.1) unless exempt, typically as a sale to fewer than twenty persons in the Philippines during any twelve-month period (Sec. 10.1(k)) or to qualified buyers (Sec. 10.1(l)); a notice of exemption on SEC Form 10.1 is permissive but advisable (2015 SRC Rules, Rule 10.1).

### Authorization and Execution

Issuance of an instrument convertible into shares is an exercise of corporate power vested in the board (RCC, Sec. 22), so the SAFE requires a board resolution approving its terms. No entry is made in the stock and transfer book and the holder does not appear in the General Information Sheet, because no shareholding yet exists.

### Receipt of the Purchase Amount and Initial Booking

On remittance, the purchase amount becomes general corporate funds, usable for any lawful purpose absent any other contractual limitations, such as escrow or trust. The proceeds are not income of the issuer, being a capital-raising transaction outside gross income (NIRC, Sec. 32).

On the books, the issuer debits Cash and credits a financial liability (e.g., "SAFE notes payable"). Under the financial reporting framework mandated by SRC Rule 68 (PFRS), classification follows PAS 32, paras. 11 and 16: an instrument is equity only if it carries no contractual obligation to deliver cash and converts into a fixed number of shares for a fixed amount ("fixed-for-fixed"). The standard SAFE fails both elements, because the discount or valuation cap makes the number of shares variable, and the liquidity-event and dissolution clauses oblige cash payment.

It is therefore a financial liability measured at fair value through profit or loss under PFRS 9 (the conversion feature precludes amortized cost), remeasured each reporting date, with disclosures under PFRS 7 and PFRS 13.

Equity classification is available only if the instrument is structured fixed-for-fixed with no cash-settlement alternative and, where treated as a deposit for future subscription, all conditions of SEC Financial Reporting Bulletin No. 006 are met: (a) the unissued authorized capital stock is insufficient to cover the shares; (b) the board has approved an increase; (c) the stockholders have approved it; and (d) the application for the increase has been filed with the SEC. Absent all four, the SEC requires liability presentation.

## Holding Period

No interest accrues and no amortization runs; the only book movement is fair value remeasurement through profit or loss. No documentary stamp tax is yet due on original issuance of shares, because none are subscribed or issued (NIRC, Sec. 174 attaches on original issuance; CIR v. First Express Pawnshop, G.R. Nos. 172045-46, 16 June 2009, holding that amounts received for future subscription without a subscription agreement are not subject to DST).

The standard SAFE also sits outside the DST on debt instruments (NIRC, Sec. 179), having no fixed maturity and no interest.

## Conversion to Equity

Conversion to equity proceeds as follows:

- (1) the conversion price is fixed by the discount or cap formula and must not fall below par or issued price (RCC, Sec. 61);
- (2) the issuer verifies unissued authorized capital stock, failing which an increase is required under RCC, Sec. 37 (majority board approval, ratification by stockholders holding two-thirds of the outstanding capital stock, at least 25% of the increase subscribed and 25% of that subscription paid, treasurer's certificate, and SEC approval);
- (3) pre-emptive rights of existing stockholders are complied with or waived (RCC, Sec. 38);
- (4) a subscription contract is executed, the consideration being the cash previously actually received, or equivalently the settlement of previously incurred indebtedness, both valid consideration (RCC, Sec. 61);
- (5) the board allots and issues the shares, certificates issue only upon full payment (RCC, Sec. 63), the holder is registered in the stock and transfer book (RCC, Sec. 73), and the shareholding is reflected in the amended General Information Sheet; and
- (6) DST on original issuance is paid (NIRC, Sec. 174, as amended by R.A. No. 12214), through BIR Form 2000 within five days after the close of the month of issuance (NIRC, Sec. 200).

The books derecognize the liability at its then carrying (fair) value: debit SAFE liability; credit Share Capital at aggregate par; credit Share Premium for the excess. The premium is additional paid-in capital, a capital item and not income of the issuer.

### Alternative Exits: Liquidity Event or Dissolution

On a liquidity event (change of control or listing), the holder may take the cash-out amount; the issuer settles the liability and takes any difference between settlement and carrying amount to profit or loss (PFRS 9, para. 3.3.3).

On dissolution, the holder ranks as an unsecured contractual creditor under the rules on concurrence and preference of credits (Civil Code, Arts. 2241-2251), and must be paid before any distribution to stockholders, since corporate assets cannot be returned to shareholders until creditors are satisfied (trust fund doctrine; RCC, Sec. 139; Ong Yong v. Tiu, G.R. No. 144476, 8 April 2003; Halley v. Printwell, G.R. No. 157549, 30 May 2011).

In rehabilitation or insolvency, the claim is processed under the FRIA (R.A. No. 10142).

**Got questions?** E-mail us at [attorney@geronimo.law](mailto:attorney@geronimo.law) or visit us at [www.geronimo.law](http://www.geronimo.law).