REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE, *Petitioner,*	**CTA EB No. 1180** (CTA CASE No. 8213)
	Present: DEL ROSARIO, P.J, CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA, FABON-VICTORINO, MINDARO-GRULLA, COTANGCO-MANALASTAS, and RINGPIS-LIBAN, *JJ.*
-versus-	
SHINKO ELECTRIC INDUSTRIES CO. LTD., *Respondent.*	Promulgated: JAN 04 2016 11:20 a.m.

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DECISION

MINDARO-GRULLA, J.:

Submitted for decision is a Petition for Review for the Court *En Banc* under *Section 4(b), Rule 8*[1] *of the 2005 Revised Rules of the Court of Tax Appeals (RRCTA), as amended,* of the Decision dated February 10, 2014[2] and the Resolution dated May 06, 2014[3] rendered by the Special

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[1] SEC. 4. *Where to appeal; mode of appeal.* –

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(b) An appeal from a decision or resolution of the Court in Division on a motion for reconsideration or new trial shall be taken to the Court by petition for review as provided in Rule 43 of the Rules of Court. The Court en banc shall act on the appeal.

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[2] Penned by Associate Justice Amelia R. Cotangco-Manalastas, concurred in by Associate Justice Lovell R. Bautista, *En Banc* Docket, pp. 13-30.
[3] *Id.*, pp. 32 36.

Third Division of this Court, the dispositive portions of which, respectively, read as follows:

Decision dated February 10, 2014:

"**WHEREFORE,** premises considered, the instant Petition for Review is hereby **GRANTED.** Accordingly, the Formal Assessment Notice dated May 12, 2010 and Assessment Notice No. IT-TVN50190-FY07-10-0320 for deficiency income tax, Assessment Notice No. VT-TVN50190-FY07-10-0320 for deficiency value-added tax and Assessment Notice No. MC-TVN50190-FY07-10-0320 for the compromise penalty all dated May 12, 2010, including surcharges and interests, in the aggregate amount of ₱1,129,201.69, issued by respondent against petitioner covering fiscal year ending March 31, 2007 are hereby **CANCELLED** and **WITHDRAWN** for lack of factual and legal basis.

SO ORDERED."

Resolution dated May 06, 2014:

"**WHEREFORE,** respondent's Motion for Reconsideration is hereby **DENIED** for lack of merit.

SO ORDERED."

The facts of the case, as recited by the Special Third Division in its Decision,[4] are as follows:

"Petitioner (Respondent herein) is a Philippine-registered representative office of Shinko Electric Industries Co., Ltd., a company organized and existing under the laws of Japan, with S.E.C. Reg. No. AF095-164. As a representative office in the Philippines, it is licensed to 'undertake activities such as but not limited to information dissemination, promotion of the parent company's products, quality control of products as well as all other activities which may be legally undertaken by a representative office'. It is registered

[4] *Supra*, note 2.

with the Bureau of Internal Revenue (BIR), with Taxpayer Identification No. 004-824-812-000, as evidenced by its Certification of Registration No. OCN9RC0000101346.

On the other hand, respondent (Petitioner herein) is the duly appointed Commissioner of the Bureau of Internal Revenue, vested under appropriate laws with the authority to carry out the functions, duties and responsibilities of said office, including, *inter alia*, the power to decide disputed assessments, cancel, and abate tax liabilities, pursuant to the provisions of the National Internal Revenue Code (NIRC) of 1997 and other tax laws, rules and regulations. She holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

On October 16, 2009, petitioner received a Letter of Authority (LOA) No. 2009 00003693 dated October 9, 2010 for the examination of petitioner's books of accounts and other accounting records for all internal revenue taxes for the period from April 1, 2006 to March 31, 2007.

Thereafter, respondent issued a Post Report Notice (PRN) dated February 22, 2010.

In a letter dated March 16, 2010, respondent issued a resolution on petitioner's protest to the PRN. On March 26, 2010, petitioner filed a letter-reply thereto.

On April 12, 2010, petitioner received a Preliminary Assessment Notice (PAN) dated April 8, 2010 from respondent for alleged deficiency income tax and VAT covering the fiscal year ending March 31, 2007, together with the Details of Discrepancies dated April 8, 2010 and a letter dated April 8, 2010 from the BIR addressed to petitioner which states that, after investigation, it was disclosed that petitioner failed to file VAT returns and quarterly income tax returns and pay the taxes due thereon, as required by existing revenue laws, rules and regulation in relation to Section 225 of the NIRC of 1997, as amended. However, in lieu of instituting criminal action, respondent is amenable to settle the same extrajudicially, subject to condition that petitioner pay the corresponding violations pursuant to the schedules of suggested compromise penalties prescribed under Revenue Memorandum Order (RMO) No. 1-90 and Revenue Regulations (RR) No. 8-2002, as amended.

On April 26, 2010, petitioner filed its protest to the PAN addressed to former BIR Commissioner Joel L. Tan-Torres.

On May 14, 2010, petitioner received the subject Formal Assessment Notice dated May 12, 2010, together with the Assessment Notices and Details of Discrepancies from respondent, requesting it to pay the following assessed deficiency tax liabilities for the fiscal year ending March 31, 2007:

1. Assessment Notice No. IT-TVN50190-FY07-10-0320 for deficiency income tax in the amount of ₱766,271.65, inclusive of interest;

2. Assessment Notice No. VT-TVN50190-FY07-10-0320 for deficiency value-added tax in the amount of ₱343,930.04, inclusive of twenty-five percent (25%) surcharge and interest; and

3. Assessment Notice No. MC-TVN50190-FY07-10-0320 for compromise penalty in the amount of ₱19,000.00.

Respondent assessed petitioner for deficiency income tax in the amount of ₱766,271.65, inclusive of interest, as a result of the adjustments/disallowances made on petitioner's taxable loss per return for alleged unsupported expenses, over-claimed representation and entertainment, disallowed expenses for non-withholding, non-withholding of dues and subscription, undeclared income, and net operating loss carry-over (NOLCO).

Respondent likewise assessed petitioner for deficiency VAT of ₱343,930.04 as a result of the 'unexplained source of funds resulting to undeclared income' which is 'also subject to VAT under Title IV, Section 105 and 108 of the NIRC'.

On June 11, 2010, petitioner duly protested the said FAN and Assessment Notices and filed the documents necessary to support its protest.

Due to respondent's inaction on the said protest, petitioner filed the (instant) Petition for Review with this Court on January 4, 2011."

The Special Third Division ruled that as a representative office, Shinko Electric Industries Co., Ltd., (Shinko) does not derive income from the host country and is fully subsidized by its head office, as defined under Section 1(c), Rule I of the Implementing Rules and Regulations of Republic Act (R.A.) No. 7042,[5] as amended by R.A. No. 8179. Being such, it is treated as a regional or area headquarter (RHQ or AHQ), a branch established in the Philippines by multinational companies and which headquarters do not earn or derive income from the Philippines and which act as supervisory, communications and coordinating center for their affiliates, subsidiaries, or branches in the Asia-Pacific Region and other foreign markets. Pursuant to Section 28(A)(6)(a)[6] of the NIRC of 1997, as amended, RHQ or AHQ, as well as representative office, shall not be subject to income tax.

This being the case, the unspent subsidy or foreign inward remittances from Shinko's parent company should not be treated as income subject to tax. That Shinko is a representative office was sufficiently proven through several

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[5] Foreign Investment Act of 1991.

[6] SEC. 28. Rates of Income Tax on Foreign Corporations. - (A) Tax on Resident Foreign Corporations. -

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> (6) Regional or Area Headquarters and Regional Operating Headquarters of Multinational Companies. –
>
> > (a) Regional or area headquarters as defined in Section 22(DD) shall not be subject to income tax.
> >
> > (b) xxx

documents presented as evidence, such as its Securities and Exchange Commission (SEC) license, several judicial affidavits stating that Shinko's business activity is limited to to information dissemination, promotion of the parent company's products, quality control of products as well as all other activities which may be legally undertaken by a representative office; that while "promotion of the parent company's product" is indicated in Shinko's license, such promotion is limited to mere promotion of the products of its Japan parent company and the negotiations for price, terms of payment and delivery of the product are all undertaken by the parent company; that Shinko's task is limited only to introducing the product to its client in the Philippines based on the product specifications dictated by the parent company; that Shinko was never involved in any sales transaction; that tasks such as signing a contract and invoicing are never done by Shinko; that Shinko is not allowed to determine anything regarding sales activities, including price and other conditions pertaining to obtaining an order; that local customers are aware that Shinko is only a representative office and not a sales office because they are given copies of Shinko Electric Industries Co., Ltd.'s Corporate Profile and brochures which clearly show that the Manila office is only a representative office. Moreover, Shinko is fully subsidized by Shinko Electric Industries Co., Ltd. in Japan as evidenced by the monthly Inward Remittance Advice from its parent company, Audited Financial Statement of Shinko for fiscal year ended March 2007 and Independent Certified Public Accountant Reports.

CIR's Motion for Reconsideration filed on March 05, 2014 was denied *via* the assailed Resolution, hence, this Petition.

CIR argues in her Petition for Review that Shinko is a foreign business entity which is allowed to derive income in the Philippines, and taxable as a regional operating headquarter. Citing Section 22(DD)[7] of the NIRC, and BIR

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[7] SEC. 22 Definitions - When used in this Title:

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(DD) The term "regional or area headquarters" shall mean a branch established in the Philippines by multinational companies and which headquarters do not earn or derive income from the Philippines and which act as supervisory, communications and coordinating center for

Ruling [DA-092-03], a regional or area headquarter should not render qualifying services like marketing control and sales promotion, as well as research and development services, and product development, which functions are applicable to a regional operating headquarter pursuant to Section 4(b)[8] of the Rules and Regulations implementing RA 8756.[9] The very SEC Registration of Shinko states that it

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their affiliates, subsidiaries, or branches in the Asia-Pacific Region and other foreign markets.

[8] "B. REGIONAL OPERATING HEADQUARTERS (ROHQ)

Section 4. Filing of Application. - Any multinational company may file, upon payment of filing fee, an application with the Securities and Exchange Commission through the Registration Division of the Board of Investments for the establishment of the regional operating headquarters in the Philippines, in accordance with the form prescribed for the purpose, accompanied by the following documents:

A. xxx

B. A duly authenticated certification from the principal officer of the foreign entity to the effect that the said foreign entity has been authorized by its Board of Directors or governing body to establish its regional operating headquarters in the Philippines:

1. Specifying any of the qualifying services it will render:
   - general administration and planning;
   - business planning and coordination;
   - sourcing/procurement of raw materials and components;
   - corporate finance advisory services;
   - <u>marketing control and sales promotion</u>;
   - training and personnel management;
   - logistics services;
   - <u>research and development services, and product</u> development;
   - technical support and maintenance;
   - data processing and communication; and business development.

2. The ROHQ shall not offer qualifying services to entities other than its affiliates, branches or subsidiaries, as declared in its registration with the Securities and Exchange Commission nor shall it directly and indirectly solicit or market goods and services whether on behalf of their mother company, branches, affiliates, subsidiaries or any other company. ROHQs cannot directly or indirectly engage in the sale and distribution of goods and services of its mother company, branches, affiliates, subsidiaries or any other company. The regional operating headquarters shall notify the Board of Investments, the Securities and Exchange Commission and in the case of ROHQs of banking and quasi-banking institutions the Bangko Sentral ng Pilipinas, of any decision to close down or suspend operations of its headquarters at least fifteen (15) days before the same is effected.

C. xxx" *(Underlining emphasized in the Petition for Review)*

[9] An Act Providing for the Terms, Conditions and Licensing Requirements of Regional or Area Headquarters, Regional Operating Headquarters, and Regional Warehouses

undertakes activities such as promotion and quality control of the parent company's products that makes it taxable as an ROHQ. The Independent Auditor's Report in fact showed that Shinko had investment in shares of stock of a local utility company during taxable year 2006 and 2007, earned income from its interest income from bank deposits and other short-term investments.

We rule to DENY the Petition for Review.

CIR mainly relies on Shinko's SEC Registration, which states that it performs "promotion and quality control of the parent company's products," that it is already involved in ROHQ's qualifying services such as marketing control and sales promotion, as well as research and development services and product development.

Thus, in construing this, this Court should be guided by the principle that tax statutes are strictly construed against the taxing authority.[10] The very fact that Shinko does not have its own Articles of Incorporation already strengthens its contention that it is a mere representative office of a foreign company, as stated in its application with the SEC itself.[11]

Moreover, as prohibited in R.A. 8756, ROHQs are only allowed to offer the mentioned qualifying services therein to their affiliates, branches or subsidiaries declared in their registration with the SEC, while Shinko herein deals directly with the clients of their parent company here in the Philippines. Thus:

> "2. The ROHQ shall <u>not</u> offer qualifying services to entities <u>other than</u> its <u>affiliates, branches or subsidiaries, as declared in its registration with the Securities and Exchange Commission</u> <u>nor</u> shall it directly and indirectly <u>solicit or market goods and</u>

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of Multinational Companies, Amending for the Purpose Certain Provisions of Executive Order No. 226, Otherwise Known as The Omnibus Investments Code of 1987.

[10] Commissioner of Internal Revenue v. Solidbank Corporation, G.R. No. 148191, 25 November 2003, 416 SCRA 436, citing Miller v. Illinois Cent. R Co., Ill. So. 559, 28 February 1927; Philippine Health Care Providers, Inc., vs. Commissioner of Internal Revenue, G.R. No. 167330, September 18, 2009.

[11] Annex "A," *Division Docket,* p. 631.

> <u>services whether on behalf of their mother company, branches, affiliates, subsidiaries or any other company</u>. ROHQs <u>cannot</u> directly or indirectly <u>engage in the sale and distribution of goods and services of its mother company, branches, affiliates, subsidiaries or any other company.</u> xxx"[12]

As mentioned above, Shinko has proven with sufficient evidence that it deals with the clients here in the Philippines on behalf of its parent company in Japan. Shinko's SEC Registration does not mention who are its declared affiliates, branches or subsidiaries that an ROHQ must only deal with in offering its qualifying services. The very precise purpose of Shinko, as proven by several judicial affidavits, is to promote and market the products of its parent company on behalf of the latter, which an ROHQ is not allowed to do so. Consequently, Shinko cannot be considered and consequently be taxed as an ROHQ.

As observed, the phrase "promotion of the parent company's products, quality control of products" in Shinko's SEC Registration should not be equated to the qualifying services done by ROHQs such as marketing control and sales promotion, as well as research and development services, and product development. Such qualifying services should be construed as having a meaning similar to that of words associated with or accompanied by it.[13] As explained:

> "xxx For a word or phrase in a statute is always used in association with other words or phrases, and its meaning may thus be modified or restricted by the latter. And taken by itself and in the abstract, a word or phrase might easily convey a meaning quite different from the one actually intended and evidence when the word or phrase is considered with those with which it is associated. Thus, an apparently general word or phrase may have a limited application if viewed with other companion words or phrases. xxx
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> xxx Differently put, a word with several meanings – i.e., limited and broad, ordinary and technical –

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[12] Section 4(b)(2), Implementing Rules and Regulations of R.A. 8756.

[13] Schmid & Oberly, Inc., vs. RJL Martinez Fishing Corp., 166 SCRA 493 (1988); Buenaseda vs. Flavier, 44 SCAD 1026, 226 SCRA (1993).

should be construed in, and given a meaning consistent with, the sense in which its companion words or phrases are used."[14]

Section 4(b) of the Implementing Rules of R.A. 8756, as well as the cited BIR Ruling [DA-092-03], enumerates the qualifying services that a RHQ/AHQ cannot render, which functions are applicable to an ROHQ, i.e., "General administration and planning; business planning and coordination; sourcing/procurement of raw materials and components; corporate finance advisory services; marketing control and sales promotion; training and personnel management; logistics services; research and development services, and product development; technical support and maintenance; data processing and communication; and business development." CIR argues that since Shinko renders activities such as "promotion of the parent company's products, quality control of products," it should not be categorized as a RHQ/AHQ and thus cannot benefit from its tax exemption.

However, pursuant to the rule of *noscitur a sociis,* the qualifying services of marketing control and sales promotion, as well as research and development services, and product development should be given the same sense as the other words with which it is associated,[15] more particularly, services in which the entity is operating an income-generating business here in the Philippines, and not limited in character, such as described in the SEC Registration of Shinko, whose functions related to any sales inquiries are merely referred to the parent company for its final decision.

BIR Ruling DA-092-03 which was relied upon by the CIR explains in fact that income derived from interest income from a savings account of an RHQ is already subject to tax, which already denies CIR's argument on such in this instant case. Moreover, in the said BIR Ruling, it merely clarifies that as long as the RHQ does not render any of the qualifying services, it will not be subject to income tax.

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[14] *Agpalo,* Ruben E. *Statutory Construction, 6th Ed.* Manila: 2009, citing Lu Do & Lu Ym Corp. vs. Central Bank, 108 Phil. 566 (1960); Aboitiz Shipping Corp., vs. City of Cebu, G.R. No. 14526, March 31, 1965; Santulan vs. Executive Secretary, G.R. No. 28021, December 15, 1977.
[15] *Ibid.*

However, as already discussed, the activities indicated in Shinko's SEC Registration does not make it an ROHQ.

On the contrary, these BIR Rulings held:

> "It is represented that Matiere SAS (Philippine Representative Office) xxx acts as a Representative Office of Matiere, a foreign corporation organized under the laws of France duly licensed to transact business in the Philippines under SEC Registration No. FS200708111; that as a representative office, Matiere SAS only acts as a liaison office and undertakes the following activities, *viz.*: creating a market presence in the Philippines, <u>conducting market research, advertising products</u>, disseminating information, acting as communication center, <u>promoting company products</u>, facilitating orders from its head office's customers and supervising the implementation of contracts between the parent company and local partners; and that, as a representative office, Matiere SAS derives no income from its activities.
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> In reply, please be informed that a representative office is a non-resident foreign corporation not engaged in any income generating business in the Philippines. As can be viewed from its licensed activities, Matiere SAS is a representative office. Accordingly, Matiere SAS is not subject to income tax. Hence, it is exempt from filing of the corporate income tax return (BIR Ruling No. 136-89 dated July 4, 1989)."[16] (Underlining Supplied)

> "xxx that China National Technical Import & export Corporation is a foreign corporation organized and existing under the laws of Peoples Republic of China duly licensed by the Securities and Exchange Commission (SEC) under SEC Registration No. A200008016 dated November 24, 2000 to act as coordinating office with the Asian Development Bank for the purpose of <u>conducting a continuing research on Philippine business data and market research information</u> relative to the acquisition of Chinese technology on any industrial project for the parent company's various foreign clients; xxx

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[16] BIR Ruling [DA-(VAT-093) 622-09].

In connection therewith, you now request exemption from the payment of income tax and other corresponding taxes since China National Technical Import & Export Corporation is a representative office and not engaged in trade or business in the Philippines.

In reply thereto, please be informed that a representative office is a non-resident foreign corporation not engaged in any income generation business in the Philippines. As can be viewed from its licensed activities, China National Technical Import & Export Corporation is a representative office. Accordingly, it is not subject to income tax. Hence, it is exempt from filing of the corporate income tax return. (BIR Ruling No. 136-89 dated July 4, 1989)."[17] (Underlining Supplied)

"It is represented that your client, Obtech Asia Pacific Pte. Ltd. ("Obtech") is a foreign corporation organized and existing under the laws of Singapore; xxx that consequently, your client established a representative office in the Philippines with address at 24th Floor, Pacific Star Building, Makati Avenue, Makati City; that said office shall perform in particular activities, which promote the interests of its parent company; that your client conducts:

1) conferences and dialogues for the purpose disseminating information regarding the company and its products;

2) promotion of the products and services of the company, through the process of demonstrations; and

3) referral of orders and technical assistance to persons or personnel who have the requisite, expertise and knowledge of the products and services

[17] BIR Ruling [DA-252-07].

In reply, please be informed that a representative office is a non-resident foreign corporation not engaged in any income generation business in the Philippines. As can be viewed by its licensed activities, Obtech is a representative office. Accordingly, your client, Obtech is not subject to income tax. Hence, it is exempt from filing of the corporate income tax return (BIR Ruling No. 136-89 dated July 4, 1989)."[18] (Underlining Supplied)

"It is represented that Zamil Steel Buildings Co. Ltd. Xxx has established a representative office in the Philippines; that its purposes are the following, namely:

"a) to conduct market research and feasibility study;

"b) to report to head office economic position of the Philippines, report on new and prospect projects;

"c) to contact government agencies for such information, and promote company's products for Pre-engineered Steel Buildings."

and that its representative office in the Philippines does not generate any income.

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However, considering that the representative office Zamil Steel Buildings Co. Ltd. does not generate income from its activities in the Philippines, it is exempt from the payment of taxes in the Philippines. (BIR Ruling No. 081-87 dated March 19, 1987)"[19] (Underlining Supplied)

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[18] BIR Ruling [DA-393-03].
[19] BIR Ruling [DA-099-98].

Although tax rulings cannot be cited as precedent by other taxpayers, they can provide useful information on how the BIR may treat a similar transaction.[20]

On the issue that Shinko acquired income from its interest bank deposits and dividends, this was already clarified in the Judicial Affidavit of Kazuyuki Sekiguchi,[21] stating that the amount received from such is passive income and was already subjected from final withholding tax, not to mention that such was the same ruling given by the BIR in BIR Ruling [DA-092-03]. In addition, this amount does not indicate that Shinko performs income-generating activities but are merely incidental to its operations as the shares from PLDT are automatically obtained through the use of the said utility.

Considering that Shinko is exempt from income, as the assailed flow of wealth was not proven to be taxable income, the same could not be subject to VAT. Consequently, the compromise penalty should also be cancelled.

WHEREFORE, premises considered, the instant Petition for Review is hereby **DENIED**. Accordingly, the Decision and Resolution dated February 10, 2014 and May 6, 2014 respectively are hereby **AFFIRMED**.

SO ORDERED.

Cielito N Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

WE CONCUR:

(INHIBITED)
ROMAN G. DEL ROSARIO
Presiding Justice

[20] Revenue Memorandum Order No. 9-2014.
[21] Exhibit "GGG," p.6, Q.16, Division Docket, p. 379.

(On Leave)
JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

Ma. Belen S-L

MA. BELEN M. RINGPIS-LIBAN
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation among the members of the Court *En Banc* before the case was assigned to the writer for the opinion of the Court *En Banc.*

ROMAN G. DEL ROSARIO
Presiding Justice