REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

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COMMISSIONER OF INTERNAL REVENUE, Petitioner,	**CTA EB No. 995** (CTA Case No. 8190)
	Present:
- versus -	**DEL ROSARIO,** *P.J.*, **CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA, FABON-VICTORINO, MINDARO-GRULLA, COTANGCO-MANALASTAS,** and **RINGPIS-LIBAN,** *JJ.*
THOMAS C. ONGTENCO, Respondent.	**Promulgated:**
	JAN 30 2015 3:50 p.m.

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RESOLUTION

UY, J.:

For resolution is petitioner's **"MOTION FOR RECONSIDERATION (Re: Decision Promulgated June 30, 2014)"**[1] filed on July 22, 2014, with respondent's **"Manifestation"** filed on September 22, 2014, seeking the reconsideration of this Court's Decision dated June 30, 2014, the dispositive portion of which reads:

> "**WHEREFORE,** all the foregoing considered, the Petition for Review is hereby **DENIED** for lack of merit. Accordingly, the Decision dated December 12, 2012 and Resolution dated March 5, 2013 of the Court in Division in CTA Case No. 8190, are hereby **AFFIRMED.**

[1] Docket, pp. 123 to 132.

SO ORDERED."

In support of its Motion, petitioner raises the following grounds, to wit:

1. Respondent was assessed deficiency VAT, not as a lending investor, but for the interest income earned on loans extended to his affiliates for taxable year 2006. The interest income is revenue realized from the services rendered by respondent to his affiliates as part of its ordinary course of business.

2. The loan assistance extended by respondent to its affiliates, being incidental to its business, is deemed a transaction "in the course of trade or business." Thus, the interest income earned by petitioner from the loans extended to its affiliates is subject to value added tax.

3. Considering that the company's income from management services is subject to VAT, the interest income, being incidental income, shall also be subject to VAT.

4. The VAT applies notwithstanding the fact that the company does not profit from lending to its affiliates because it only passes on to its affiliates the interest that is charged by the bank from which the funds are sourced. Hence, when respondent extended interest bearing loans to its affiliates, it provided financial assistance for a fee or remuneration or consideration, regardless whether respondent has realized profit or not, such financial assistance is considered as sale of service that is subject to value added tax.

5. Consequently, the interest income of respondent from Intertrade Credit Corporation (ICC) amounting to ₱8,610,000.00 is subject to VAT. While his gross sales amounting to ₱1,390,770.00, is also subject to VAT even if he is registered as a non-VAT taxpayer, since the total gross receipts from the income from ICC and from the receipts not subject to expanded withholding tax exceed the threshold of ₱1,500,000.00, pursuant to Section 4.109-1 (B) (v) and Section 9.236.1 of Revenue Regulations No. 16-2005.

6. Finally, respondent does not fall under the exempt transactions provided under Section 109 of the NIRC of 1997. Nor did it present any BIR Ruling exempting it from the payment of VAT.

In his Manifestation, respondent submits that:

1. Petitioner merely rehashes her previous arguments in her Petition for Review dated April 5, 2013, which same petition was adopted be her, as her Memorandum for this case. Notably, these are the same arguments presented by petitioner before this Court. None of her arguments, which were considered fully in this Court's decision, provides a basis to alter or reverse the decision of this Honorable Court.

THE COURT *EN BANC'S* RULING

Petitioner's Motion lacks merit.

The loan that respondent extended to ICC is not an incidental transaction, nor is it part of the ordinary course of trade or business.

Section 105 of the NIRC of 1997, as amended, states that:

> "**SECTION 105.** ***Persons Liable***. — Any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 106 to 108 of this Code.
>
> The value-added tax is an indirect tax and the amount of tax may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services. This rule shall likewise apply to existing contracts of sale or lease of goods, properties or services at the time of the effectivity of Republic Act No. 7716.
>
> The phrase ***'in the course of trade or business'*** **means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto,** by any person regardless of whether or not the person engaged therein is a non-stock, non-profit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests), or government entity.
>
> "The rule of regularity, to the contrary notwithstanding, services as defined in this Code

> rendered in the Philippines by non-resident foreign persons shall be considered as being rendered in the course of trade or business." *(Bold emphasis supplied.)*

Based on the foregoing provision, in order to hold respondent liable for deficiency VAT, the transaction involved, *i.e.,* the act of extending a loan to ICC, must have been made *"in the course of trade or business."*

To be more specific, it means *"the regular conduct or pursuit of a commercial or economic activity, including transactions incidental thereto."*[2] As for what constitutes an incidental transaction, reference must be made to the definition of the word 'incidental,' which is that it must be "depending upon or appertaining to something else as primary; something necessary, appertaining to, or depending upon another which is termed the principal; something incidental to the main purpose."[3]

In this case, petitioner argues that "the interest income is revenue realized from the services rendered by respondent to his affiliates as part of its *(sic)* ordinary course of trade or business."[4]

Moreover, petitioner adds that, "loan assistance extended by respondent to its affiliates, being incidental to its business, is deemed a transaction 'in the course of trade or business.' x x x Considering that the company's income from management services is subject to VAT, the interest income, being incidental income, shall also be subject to VAT."[5]

We disagree.

In this case, it must be emphasized that there was yet no "trade or business" to speak of as of the time of the subject transaction between respondent and ICC.

When the respondent extended a loan to ICC in 2004,[6] he was not yet engaged in any trade or business, as his motorcycle business only started in November 2006, and subsequently registered with the BIR on December 19, 2006, as evidenced by Certificate of

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[2] Section 105 of the NIRC of 1997, as amended; *Commissioner of Internal Revenue vs. Court of Appeals, et al.,* G.R. No. 125355, March 30, 2000.
[3] Black's Law Dictionary, Sixth Edition, © 1990, p. 762.
[4] Docket, p. 124.
[5] Docket, p. 127.
[6] Exhibit "O," Judicial Affidavit of Mr. Thomas C. Ongtenco, Division Docket (CTA Case No. 8190), pp. 291 to 301, 298 to 299; and Exhibit "N," Judicial Affidavit of Ms. Thelma M. Idaba, Division Docket (CTA Case No. 8190), pp. 284 to 290, 287 to 288.

Registration No. OCN4RC0000567353,[7] and DTI Certification No. 00258044.[8] Besides, there was no indication that respondent's business existed, or was in operation, prior to the said dates of registration.

Consequently, respondent cannot be held liable for VAT for the interest income he earned from ICC, when the said transaction did not occur in the course of trade or business, nor was it incidental to, or dependent upon, the said motorcycle business.

In addition to the foregoing, petitioner cites the case of *Lapanday Foods Corporation vs. Commissioner of Internal Revenue,*[9] and appears to draw a parallel between the said case and the case at bench, concluding that because "the company's income from management services is subject to VAT, the interest income, being incidental income, shall also be subject to VAT."[10]

We are not convinced.

Petitioner's adherence to this Court's Decision in the *Lapanday* case is misplaced.

First, the Supreme Court, in no uncertain words, has declared that CTA decisions do not constitute as precedents, to wit:

> "Suffice it to state that CTA decisions do not constitute as precedents, and do not bind this Court <u>or the public</u>. That is why CTA decisions are appealable to this Court, which may affirm, reverse or modify CTA decisions as the facts and the law may warrant. <u>Only decisions of this Court constitute binding precedents, forming part of the Philippine legal system.</u>"[11] *(Underscoring supplied.)*

Considering that only decisions of the Supreme Court can be cited as binding precedents, petitioner's reliance on the *Lapanday* case is clearly misguided.

Second, and more importantly, the factual milieu in the *Lapanday* case is decidedly far from those extant in the instant case.

In the *Lapanday* case, the taxpayer involved was a "domestic

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[7] Exhibit "D," Division Docket (CTA Case No. 8190), p. 217.
[8] Exhibit "P," Division Docket (CTA Case No. 8190), p. 302.
[9] CTA EB No. 367 (CTA Case No. 7097), January 29, 2009.
[10] Docket, p. 127.
[11] *Commissioner of Internal Revenue vs. San Roque Power Corporation,* G.R. Nos. 187485, 196113 & 197156, February 12, 2013.

corporation engaged in the managing, promoting, administering or assisting in any business or activity of corporations, partnerships, associations, individual or firm. When (the taxpayer) extended loans to its affiliates, it provided assistance to corporations, and thus performed services incidental to its business."[12]

In stark contrast thereto, the respondent in this case is a sole proprietor who engaged in his motorcycle business sometime in 2006. His active participation in the management of ICC had nothing to do with his motorcycle business, and he did not provide management services to ICC or any other company in the course of trade or business. Rather, his involvement with ICC was directly related to his position as a member of the Board of Directors thereof.

With regard to the remuneration received by members of the Board of Directors, and whether they are subject to VAT, Revenue Memorandum Circular No. 77-2008[13] dated November 24, 2008, is instructive, to wit:

> "As can be gleaned from the abovementioned provision, it is clear that <u>the applicability of the VAT provisions generally pertain to those persons whose undertakings are intended to be pursued on a going-concern basis where the end view is to realize unrestricted amounts of pecuniary gains/profits</u> from those who may avail of the goods they sell or the services they render.
>
> A member of the board of directors therefore who is not an employee of the corporation does not fall under the foregoing category.
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> For one, such individual does not freely offer his services as director disparately to just any corporation. In order to be elected as a director of a corporation, Section 23 of the Corporation Code requires such individual to at least own one (1) share of the capital stock of said corporation.
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> Secondly, said section of the Corporation Code limits the term of the elected director for only one (1) year until his successor is elected. This means that his

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[12] *Lapanday Foods Corporation vs. Commissioner of Internal Revenue,* CTA EB No. 367 (CTA Case No. 7097), January 29, 2009.

[13] *Subject:* Taxability of Director's Fees Received by Directors Who are Not Employees of the Corporation for VAT or Percentage Tax Purposes as Espoused under Revenue Memorandum Circular No. 34-2008.

functions as a director of the company can only be exercised within this limited term period. Being so, such limited services can not be considered as one of those undertaken on a going-concern basis as would normally be expected from those who are in the regular conduct of selling goods and/or services upon whom the VAT is consequently imposed pursuant to Sec. 105 of the Code.

Moreover, the remuneration that a director may get from the corporation is fixed and subject to the ceiling prescribed by the Corporation Code, whereas the remunerations/gains or profits that a seller of goods/services may realize from his commercial transactions vary. As provided in Section 30 of the same Corporation Code, "in the absence of any provision in the by-laws fixing their compensation, the directors shall not receive any compensation, as such directors, except for reasonable per diems: Provided, however, That any such compensation other than per diems may be granted to directors by the vote of the stockholders representing at least a majority of the outstanding capital stock at a regular or special stockholders' meeting. In no case shall the total yearly compensation of directors, as such directors, exceed ten (10%) percent of the net income of the corporation during the preceding year."

Furthermore, as a director of a corporation, an individual is generally precluded from entering into a contract with the corporation of which he is a director subject to the conditions provided for under Section 32 of the Corporation Code. By this, such director is generally restricted from having business dealings directly with the corporation of which he is a director.

Based on the foregoing, it is therefore apparent that the fees, per diems, honoraria or allowances being given to a director of a corporation as such cannot be considered as derived from an economic or commercial activity that have been pursued "in the course of trade or business". Rather, said director's fees are remunerations paid in the exercise of a right of an owner in the management of a corporation. Thus, not "in the course of trade or business" as contemplated under Section 105 of the Code. Such fees, per diems, allowances and other income received by the director as such, are therefore, exempt from the imposition of the 12% VAT or 3% percentage tax, notwithstanding that the said payments

> are not among those enumerated under Section 109 of the said Code.
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> In view thereof, the penultimate paragraph of Revenue Memorandum Circular No. 34-2008 stating that directors receiving fees, per diems, allowances, and the like, from corporations of which they are directors but are not employees thereof "fall under the category of sellers of services under Title IV of the Code who are liable to pay the 12% VAT on their gross receipts pursuant to Section 108 thereof, or to the 3% percentage tax imposed under Section 116, should they fail to meet the VAT threshold", is hereby REPEALED." *(Underscoring supplied.)*

In light of the foregoing RMC, it is clear that the performance of the functions of a director does not equate to engaging in a trade or business, especially if the said director is not an employee of the corporation.

In this case, absent any indication that respondent was an employee of ICC, it is clear that his involvement in the management of ICC was in his capacity as a member of the Board of Directors, and not as part of his trade or business. Consequently, respondent necessarily falls within the purview of RMC 77-2008, and he cannot be considered to be engaged in a trade or business that provides management services to ICC.

Proceeding therefrom, it is clear that there is no basis for concluding that the loan that respondent extended to ICC was an incidental transaction, related to respondent's business. Thus, the interest income resulting from the said loan transaction is not subject to VAT.

Respondent's gross receipts did not exceed the VAT threshold as indicated in Section 109 (v) of the NIRC of 1997, as amended, and Section 4.109-1 (B) (1) (v) of Revenue Regulation No. 16-2005.

The threshold amount of a taxpayer's gross annual receipts, which would determine whether or not he should be subject to VAT, can be found in Section 109 (v) of the NIRC of 1997, as amended, which states:

"**SEC. 109 – *Exempt Transactions.* –**

(1) Subject to the provisions of Subsection (2) hereof, the following transactions shall be exempt from the value-added tax.

x x x x

(V) Sale or lease of goods or properties or the performance of services other than the transactions mentioned in the preceding paragraphs, the gross annual sales and/or receipts do not exceed the amount of One Million Five Hundred Thousand Pesos (₱1,500,000.00): *Provided,* That not later January 31, 2009 and every three (3) years thereafter, the amount herein stated shall be adjusted to its present value using the Consumer Price Index, as published by the National Statistics Office (NSO).

x x x x."

Related thereto, is Section 4.109-1 of Revenue Regulation No. 16-2005, to wit:

"SECTION 4.109-1. VAT-Exempt Transactions. —

x x x x

(B) Exempt transactions. —

(1) Subject to the provisions of Subsection (2) hereof, the following transactions shall be exempt from VAT:

x x x x

(v) Sale or lease of goods or properties or the performance of services other than the transactions mentioned in the preceding paragraphs, the gross annual sales and/or receipts do not exceed the amount of One Million Five Hundred Thousand Pesos (₱1,500,000.00); Provided, That not later than January 31, 2009 and every three (3) years thereafter, the amount of ₱1,500,000.00 shall be adjusted to its present value using the Consumer Price Index, as published by the NSO.

> For purposes of the threshold of ₱1,500,000.00, the husband and the wife shall be considered separate taxpayers. However, the aggregation rule for each taxpayer shall apply. For instance, if a professional, aside from the practice of his profession, also derives revenue from other lines of business which are otherwise subject to VAT, the same shall be combined for purposes of determining whether the threshold has been exceeded. Thus, the VAT-exempt sales shall not be included in determining the threshold."

Based on the foregoing provision, it is clear that as long as a taxpayer's gross annual sales/receipts do not exceed ₱1,500,000.00, the said transactions are exempted from VAT.

In this case, considering that respondent's interest income from the loan he extended to ICC was not derived from an incidental transaction, nor was it earned by respondent in the course of trade or business, the same is not subject to VAT. Consequently, the interest income was correctly excluded from the computation of respondent's gross annual sales/receipts.

With that in mind, We find that since respondent's gross annual sales/receipts, based on his Annual Income Tax Return,[14] is only One Million Three Hundred Ninety Thousand, Seven Hundred and Seventy Pesos (P1,390,770.00), it is well below the ₱1,500,000.00 threshold, and he is exempt from VAT, pursuant to Section 109 (v) of the NIRC of 1997, as amended, in relation to Section 4.109-1 of Revenue Regulation No. 16-2005.

WHEREFORE, premises considered, the instant Motion for Reconsideration is hereby **DENIED** for lack of merit.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

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[14] Exhibit "Q," Division Docket (CTA Case No. 8190), p. 303 to 305, 304.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

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

AMELIA R. COTANGCO-MANALASTAS
Associate Justice

Ma. Belen
MA. BELEN M. RINGPIS-LIBAN
Associate Justice