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# SyCipLaw TIPS

## TAX ISSUES AND PRACTICAL SOLUTIONS

**1. Is a letter informing the Bureau of Internal Revenue *(BIR)* that the taxpayer is "in the process of compiling necessary documentation" a valid protest?**

No. In *Commissioner of Internal Revenue v. Court of Tax Appeals and CitySuper, Incorporated* (G.R. No. 239464, May 10, 2021), the Supreme Court ruled that such a letter is not a valid protest because it does not contain the requisite information and conditions prescribed under the National Internal Revenue Code, as amended *(Tax Code)* and BIR revenue regulations.

An administrative protest must be made in the form and manner prescribed by implementing rules and regulations. Section 3.1.14 of Revenue Regulations No. 18-2013 (*RR No. 18-13*), amending Revenue Regulations No. 12-99, states the requirements for a valid protest. Under these regulations, the taxpayer must state in his protest: *(i)* the nature of the protest whether reconsideration or reinvestigation, specifying newly discovered or additional evidence he intends to present if it is a request for reinvestigation, *(ii)* the date of the assessment notice, and *(iii)* the applicable laws, rules, and regulations or jurisprudence on which his protest is based. Failure to state any of these would render the protest void.

**SyCipLaw Tip 1:**
A taxpayer must not only be mindful of the deadline to ensure that the protest is filed within the required period. A taxpayer must also check whether the protest complies with the requisites prescribed under RR No. 18-13. Failure to comply with any of the requisites would render the protest void and without force and effect and the assessment final and executory.

While the declaration that the taxpayer was in the process of compiling the necessary documentation to support its protest could imply that it was requesting a reinvestigation, its failure to explicitly state this means that the Commissioner of Internal Revenue *(CIR)* had no way of knowing the period it should monitor under RR No. 18-13. The Supreme Court also said that "[a]ttaching copies of the audit results/assessment notices is not stating the date of the assessment notice, any more than attaching copies of assailed judgments to a petition without stating them in the petition itself complies with the rule on statement of material dates."

The Supreme Court held that the taxpayer's protest was void for failing to conform with the requirements under BIR regulations, as mandated by the Tax Code. There being no valid protest to speak of, there is no disputed assessment that may be raised to the Court of Tax Appeals *(CTA)*, and the CTA did not acquire jurisdiction over the subject matter of the case.

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**2. Under the Tax Code, should a representative office be taxed as a regional headquarters *(RHQ)* or a regional operating headquarters *(ROHQ)*?**

The representative office should be taxed similar to a regional headquarters.

In *Commissioner of Internal Revenue v. Shinko Electric Industries Co.* (G.R. No. 226287, July 6, 2021), respondent is a representative office of a foreign corporation organized and existing under the laws of Japan. It was assessed deficiency income and value-added taxes *(VAT)* by the Commissioner of Internal Revenue *(CIR)* on the ground that since respondent "'is engaged in the "promotion of the parent company's product' as stated in its SEC Registration, it should be taxed as a Regional Operating Headquarter (ROHQ) which derives income from the Philippines." The CIR further argued that once a foreign business entity performs qualifying services within the Philippines, it should be treated as an ROHQ for taxation purposes.

In deciding the case, the Court looked at the differences among an RHQ, an ROHQ, and a representative office:

> 1. A representative office and an RHQ are not allowed to engage in any income-generating activities in the Philippines. On the other hand, an ROHQ provides qualifying services that generate income in the Philippines;
> 2. Both representative office and an RHQ do not earn or derive income in the Philippines. An ROHQ is allowed to derive income in the Philippines;
> 3. Unlike an RHQ and an ROHQ, a representative office deals directly with the parent company's clients and not with the affiliates, branches, or subsidiaries;
> 4. Under the National Internal Revenue Code, as amended, RHQs are exempt from both income tax and VAT so long as they do not render any of the qualifying services, whereas ROHQs are subject to the then applicable tax rate of 10% of their taxable income from its qualifying services and 12% VAT.

From the foregoing, the Court agreed with the CTA that the representative office, while not defined under the Tax Code is akin to an RHQ and not to an ROHQ.

The representative office is allowed under the law to undertake only certain kinds of activities such as information dissemination, promotion of the parent company's products as well as quality control of the products. These activities, while directed to the parent company's client, are not income-generating, similar to the activities of the RHQ, in stark contrast with the qualifying services performed by the ROHQs. Since the representative office is primarily engaged in non-income generating activities like an RHQ, by analogy, it should be considered exempt from income tax and VAT.

Applying the discussion above to the evidence submitted by the respondent, the Court ruled that respondent has sufficiently established that it is a representative office and, therefore, not liable for income tax and VAT.

**SyCipLaw Tip 2:**
Although under the Tax Code a representative office is taxed similar to an RHQ, the taxpayer must prove not only that it is registered with the Securities and Exchange Commission *(SEC)* as a representative office, but also that its activities are limited to those allowed by law and regulations to be undertaken by representative offices

Thus, to successfully invoke the Supreme Court decision, a representative office should be able to meet the following characteristics: a) it is fully subsidized by its head office; b) it deals directly with the clients of its parent company; c) it undertakes activities such as but not limited to information dissemination, promotion of the parent company's products as well as quality control of its products; and d) it does not derive income in the Philippines.

**3. If a representative office earns income in the form of interest and dividends, does it become an income-generating ROHQ liable to pay income tax and VAT?**

No. In *Commissioner of Internal Revenue v. Shinko Electric Industries Co.* (G.R. No. 226287, July 6, 2021), the Supreme Court citing the case of *Chamber of Real Estate and Builders' Association, Inc. v. Romulo* (G.R. No. 160756, March 09, 2010) explained that "passive income, such as dividends or interest, are not generated in the active pursuit and performance of the corporation's primary purpose, rather, they arise from the company's assets." The Supreme Court added that "[a]s such, passive income is subjected to final taxes and are not covered by regular income tax."

More importantly, the law enumerates the qualifying services that may be performed by an ROHQ. Earning interest or dividend is not among the qualifying services of an ROHQ.

**SyCipLaw TIP 3:**
Earning passive income such as interest and dividends does not automatically transform a representative office into an ROHQ. (Please see also our TIP number 4.)

**SyCipLaw TIP 4:**
When elevating a disputed assessment to the CTA, the taxpayer must ensure that all the necessary documents to prove its claim are submitted and offered as evidence before the CTA. As a general rule, a party may not submit evidence for the first time on appeal to the Supreme Court.

**4. May the BIR submit proof of its issuance of a Preliminary Assessment Notice *(PAN)* and receipt thereof by the taxpayer – for the first time on a petition for review on certiorari before the Supreme Court?**

No. In *Commissioner of Internal Revenue v. Unioil Corporation* (G.R. No. 204405, August 4, 2021), the Supreme Court emphasized that it is not a trier of facts, and such evidence should have been submitted to the CTA. The CTA was especially created by law for the purpose of reviewing tax cases. The CTA undertakes trial on the issues brought before it and accordingly exercises the power to receive evidence. It is not the Supreme Court's duty to look and sift through the evidence of the parties.

The BIR's failure to offer proof of the taxpayer's receipt of the PAN as evidence before the CTA means that it failed to establish the fact of issuance of the PAN to the taxpayer, which means that it failed to comply with the notice requirements under the Tax Code. This effectively denied the taxpayer its right to due process and renders BIR's assessment void.

**5. Are intercompany advances subject to documentary stamp tax for intercompany advances even if no debt instrument is executed for the transaction?**

Yes. In *Commissioner of Internal Revenue v. San Miguel Corporation* (CTA En Banc Case No. 2167 and 2169, September 23, 2021), the CTA En Banc ruled that since documentary stamp taxes *(DST)* is an excise tax, it is imposed on the transaction rather than on the document. Accordingly, even if there is no debt instrument for intercompany advances made by a corporation, DST may still be imposed if the transaction is clearly established.

In this case, the BIR assessed San Miguel Corporation *(SMC)* deficiency taxes for the year 2009, including deficiency DST for intercompany advances. SMC asserted that the intercompany advances are not in the nature of a loan and that the BIR's basis for the DST assessment (*i.e.*, Revenue Memorandum Circular No. 48-2011, which was issued pursuant to *Commissioner of Internal Revenue v. Filinvest Development Corporation* [G.R. No. 163653, July 19, 2011], and which states that instructional letters, and journal and cash vouchers evidencing advances to affiliates qualify as loan agreements upon which DST may be imposed), having been issued only in 2011, cannot be applied retroactively to the 2009 transaction in this case.

The CTA En Banc ruled that judicial decisions applying or interpreting the law form part of the legal system of the Philippines and have the force of law. Thus, when the Supreme Court interpreted Section 180 of the Tax Code in the 2011 case of *Commissioner of Internal Revenue v. Filinvest Development Corporation*, it "became part of the Tax Code and constitutes part of it from the date it was originally passed". Accordingly, that ruling may be applied to this case without violating the principle of non-retroactivity of laws and rulings.

Furthermore, since DST is an excise tax, it is imposed on the transaction rather than on the document. Thus, even while there is no debt instrument identified by the BIR in the 2009 intercompany loans, DST may still be imposed as long as the transactions are clearly established. Additionally, Section 6 of BIR Revenue Regulations No. 09-94 provides for the imposition of DST even if there are no formal agreements or promissory notes executed. The CTA En Banc also noted that DST may be imposed on advances based on the Notes to the audited financial statements.

**SyCipLaw Tip 5:**
DST is due on loans even if they are not evidenced by a formal loan agreement or promissory note. As long as the transaction qualifies as a "loan" or "mutuum" under the Civil Code of the Philippines, i.e., one of the parties delivers to another money or other consumable thing, upon the condition that the same amount of the same kind and quality shall be paid, and such is clearly established in writing (such as in a note to an audited financial statement), DST is due.

A motion for reconsideration of the decision is currently pending.

CTA decisions, while persuasive, do not become the law of the land, unlike decisions of the Supreme Court.

**SyCipLaw Tip 6:**
In order to determine whether local business taxes may be imposed on a corporation for the privilege of doing business within a local government unit, it is essential to determine whether the corporation's branch or sales office actually conducted business in the local government unit, which means that there was trade or commercial activity regularly engaged in as a means of livelihood or with a view to profit.

CTA decisions, while persuasive, do not become the law of the land, unlike decisions of the Supreme Court.

**6. May a local government unit impose local business taxes on a branch or sales office that has the "capability" or "possibility" of conducting sales activities but has not actually engaged in such activities?**

No. In *The City Government of Makati and the City Treasurer of Makati City v. Eastbay Resorts, Inc.* (CTA AC No. 218, October 12, 2021), the CTA's Third Division ruled that what is controlling in the imposition of local business taxes is that "there was trade or commercial activity regularly engaged in by respondent, as a means of livelihood or with a view to profit."

In this case, the City Treasurer of Makati assessed Eastbay Resorts, Inc. *(Eastbay)* for local business taxes from 2009 to 2011. Eastbay filed a protest stating that it has no branch or sales office in Makati and that its office there is not operating as a hotel or restaurant but is merely an administrative office. The City Treasurer of Makati's justification in imposing the local business tax was that Eastbay's Makati office is classified as a "Service Establishment-Other Independent Contractor" and not merely an administrative office. Thus, the City Treasurer of Makati opined that Eastbay "is capable of conducting sales activities, such as reservations or bookings, or accepting payment for deposit or reservation fees in its Makati Office."

The CTA ruled that the City Treasurer of Makati's classification of Eastbay's Makati Office was not controlling. What is crucial would be to show that, for the subject period, Eastbay conducted business in Makati or that there was trade or commercial activity regularly engaged therein by Eastbay as a means of livelihood or with a view to profit. The "capability" or "possibility" in conducting sales activities by Eastbay in its Makati office is not a sufficient basis for the imposition of local business taxes. Furthermore, the imposition of local business taxes should be based on the *"gross sales or receipts for the preceding calendar year"*. Thus, such imposition must be based on actual figures of *"gross sales or receipts"* earned by, or attributable to, Eastbay's Makati office.

**7. HB8942: Tax Payments Made Easy**

On September 15, 2021, the House of Representatives approved on third reading House Bill *(HB)* No. 8942, or the "Ease of Paying Taxes Act", amending the Tax Code to simplify tax compliance and to make it easy for taxpayers to pay their taxes. HB 8942 was transmitted to and received by the Senate on September 16, 2021, where it remains pending.

**SyCipLaw Tip 7:**
The passage of HB 8942 into law will be a welcome development if it will make tax compliance, especially for small or medium taxpayers, more convenient and less burdensome. However, it also provides a new burden on sellers of services who will now be subject to VAT upon issuance of the invoice (usually after performance of the service) and not upon receipt of the payment. Since the bill is still pending before the Senate, changes may still be introduced to HB8942 which will hopefully further ease the burden of tax compliance on taxpayers.

HB 8942 introduces the following changes to the Tax Code, among others:

(i) Authority of the Secretary of Finance to establish the criteria for classifying taxpayers, taking into consideration various factors such as the taxpayers' capacity to comply with the tax rules and regulations, their gross sales or receipts, and economic and financial factors;

(ii) Classification of medium taxpayers and provision for other additional classifications as may be necessary and reasonable for better service and tax administration;

(iii) Simplification of tax returns and processes for taxpayers not classified as medium or large taxpayers;

(iv) Removing the distinction on required VAT documentation between sales of goods and sales of services. Under HB 8942, VAT-registered persons have to issue only one kind of VAT invoice for both sales of goods and services;

(v) Allowing the payment of income taxes during the filing of the tax return or before the taxes are due; thus, doing away with the "pay as you file" system. HB 8942 provides definitions for the terms "filing of return" and "payment of tax";

(vii) Making registration facilities available for non-resident taxpayers;

(viii) Providing for the cancellation of BIR registration upon the mere filing of the registration information update. Any audit that will be conducted by the BIR in case of the cancellation of registration will only be made based on a risk assessment evaluation;

(ix) Providing flexibility on the venue for tax payments by deleting the requirement that tax payments, if made at authorized agent banks, shall only be paid at banks within the jurisdiction of the revenue district office which has jurisdiction over the taxpayer's residence or principal place of business.

HB 8942 also sets out the fundamental rights of taxpayers (i.e., the taxpayers' bill of rights) and provides for the creation of the Office of the Tax Advocate that is independent from the BIR to ensure that the rights of taxpayers are protected and to provide assistance to them. The Office of the Tax Advocate will also be tasked to identify systemic problems within the BIR which hamper the efficient and fair administration of taxes and to propose changes in order to mitigate any identified problems.

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