Supreme Court E-Library

FIRST DIVISION

[G.R. No. 226287; July 6, 2021]

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*, *v.* **SHINKO ELECTRIC INDUSTRIES CO., LTD.,** *Respondent*.

D E C I S I O N

CAGUIOA, *J.*:

This Petition for Review on *Certiorari*[1] (Petition) under Rule 45 of the Rules of Court filed by petitioner Commissioner of Internal Revenue (CIR) seeks the reversal and setting aside of the Decision[2] dated January 4, 2016 and Resolution[3] dated August 1, 2016 of the Court of Tax Appeals (CTA) En Banc (CTA EB) in CTA EB No. 1180. The CTA EB denied the CIR's petition for review and affirmed the Decision[4] dated February 10, 2014 and Resolution[5] dated May 6, 2014 of the CTA Special Third Division (CTA Division),which cancelled the Final Assessment Notice issued against respondent Shinko Electric Industries Co., Ltd. (Shinko), for lack of legal and factual bases.

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[1] *Rollo*, pp. 10-32.

[2] Id. at 487-501. Penned by Associate Justice Cielito N. Mindaro-Grulla with Associate Justices Lovell R. Bautista, Erlinda P. Uy, Caesar A. Casanova, Esperanza R. Fabon-Victorino, Amelia R. Cotangco-Manalastas, and Ma. Belen M. Ringpis-Liban, concurring. Presiding Justice Roman G. Del Rosario inhibited and Associate Justice Juanito C. Castañeda, Jr. was on leave.

[3] Id. at 513-517. Penned by Associate Justice Cielito N. Mindaro-Grulla with Associate Justices Juanito C. Castañeda, Jr., Lovell R. Bautista, Erlinda P. Uy, Caesar A. Casanova, Esperanza R. Fabon-Victorino, Amelia R. Cotangco-Manalastas, and Ma. Belen M. Ringpis-Liban, concurring. Presiding Justice Roman G. Del Rosario inhibited.

[4] Id. at 290-307. Penned by Associate Justice Amelia R. Cotangco-Manalastas with Associate Justice Lovell R. Bautista, concurring.

[5] Id. at 328-332.

Supreme Court E-Library

The Facts

Respondent Shinko is a Philippine-registered representative office of the foreign corporation Shinko Electric Industries Co., Ltd., a company organized and existing under the laws of Japan,[6] with Securities and Exchange Commission Registration Number AF095-164 (SEC Registration).[7] It is licensed in the Philippines as a representative office 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."[8]

On October 16, 2009, Shinko received a Letter of Authority No. 200900003693[9] for the examination of its books of accounts and other accounting records for all internal revenue taxes for the period from April 1, 2006 to March 31, 2007.[10]

On April 12,2010, Shinko received a Preliminary Assessment Notice[11] (PAN) together with the Details of Discrepancies[12] from the CIR for alleged deficiency income tax and value-added tax (VAT) covering the fiscal year ending March 31, 2007.[13]

Thereafter, Shinko filed its reply[14] to the PAN.

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[6] Id. at 11.

[7] Id. at 149-152.

[8] Id. at 149.

[9] Attached to the Petition as Annex "E", Letter of Authority No. 200900003693 dated October 9, 2009, id. at 67.

[10] Id. at 12.

[11] Attached to the Petition as Annex "F", Preliminary Assessment Notice dated April 8, 2010, id. at 68-69.

[12] Attached to the Petition as Annex "G", Details of Discrepancies dated April 8, 2010, id. at 70-72.

[13] Id. at 12.

[14] Id. at 73-76.

Supreme Court E-Library

On May 14, 2010, Shinko received from the CIR a Formal Assessment Notice[15] (FAN) with Details of Discrepancies[16] requesting it to pay the following assessed deficiency tax liabilities for the fiscal year ending March 31, 2007:[17]

1. Assessment Notice No. IT-TVN50190-FY07-10-0320 for deficiency income tax in the amount of Php766,271.65, inclusive of interest;[18]
2. Assessment Notice No. VT-TVN50190-FY07-10-0320 for deficiency VAT in the amount of Php343,930.04, inclusive of twenty-five percent (25%) surcharge and interest;[19] and
3. Assessment Notice No. MC-TVN50190-FY07-10-0320 for compromise penalty in the amount of Php19,000.00.[20]

Shinko duly protested the FAN and the Assessment Notices. Due to the CIR's inaction on the protest, Shinko filed a Petition for Review[21] with the CTA Division.

Shinko argued that it is a representative office of a foreign corporation, and, as such, it does not derive income from sources within the Philippines. Hence, it is not liable for deficiency income tax and VAT, as well as the compromise penalty.[22]

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[15] Attached to the Petition as Annex "H", Formal Assessment Notice dated May 12, 2010, id. at 77-78.

[16] Attached to the Petition as Annex "I", Details of Discrepancies dated May 12, 2010, id. at 79-81.

[17] Id. at 12.

[18] Attached to the Petition as Annex "J", Assessment Notice No. IT-TVN50190-FY07-10-0320 dated May 12, 2010, id. at 82.

[19] Attached to the Petition as Annex "K", Assessment Notice No. VT-TVN50190-FY07-10-0320 dated May 12, 2010, id. at 83.

[20] Attached to the Petition as Annex "L", Assessment Notice No. MC-TVN50190-FY07-10-0320 dated May 12, 2010, id. at 84.

[21] Id. at 197-212.

[22] Id. at 204-211.

Supreme Court E-Library

On the other hand, the CIR claimed that since Shinko 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.[23]

CTA Division Ruling

In a Decision dated February 10, 2014, the CTA Division granted Shinko's Petition for Review. Accordingly, the FAN and Assessment Notices issued against Shinko were cancelled and withdrawn for lack of factual and legal basis. The dispositive portion of the Decision stated:

> **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**.[24]

The CTA Division applied the definition of a representative office under Section 1(c),[25] Rule I of the Implementing Rules and Regulations[26] (IRR) of Republic Act (RA) No. 7042,[27] as

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[23] Id. at 70-72, 79-81.

[24] Id. at 306.

[25] Section 1 (c), Rule I of the Implementing Rules and Regulations (IRR) of RA No. 7042 as amended by RA No. 8179 reads:

> *Representative or liaison office* deals directly with the clients of the parent company **but does not derive income from the host country** and is **fully subsidized by its head office**.It undertakes activities such as but not limited to information dissemination and promotion of the company's products as well as quality control of products. (Emphasis supplied, italics in the original)

[26] IRR of RA No. 7042 as amended by RA No. 8179, July 9, 1996.

[27] FOREIGN INVESTMENTS ACT OF 1991, June 13, 1991.

Supreme Court E-Library

amended. According to the CTA Division, the closest to a representative office under the National Internal Revenue Code of 1997[28] (NIRC), as amended, is referred to as a Regional or Area Headquarter (RHQ). Pursuant to Section 28(A)(6)(a)[29] and Section 109 (p)[30] of the NIRC, as amended, an RHQ shall not be subject to income tax and VAT.

The CTA Division determined that Shinko has submitted sufficient evidence proving that it does not derive income from the Philippines and is fully subsidized by its head office in Japan.[31] As such, it is a representative office treated as an RHQ that is exempt from income tax and is not liable to pay VAT.[32]

The CIR moved for reconsideration but the CTA Division denied the same in its Resolution dated May 6, 2014.

CTA EB Ruling

In the Decision dated January 4, 2016, the CTA EB affirmed the Decision and Resolution of the CTA Division.

The CTA EB added that Shinko's not having its own Articles of Incorporation already bolsters its argument that it is merely a representative office of a foreign company.[33] Moreover, the CTA EB found that Shinko cannot be considered as an ROHQ because Shinko deals directly with its parent company's clients in the Philippines, an activity which ROHQs are prohibited by law to do.[34]

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[28] RA No. 8424, December 11, 1997.

[29] "(a) Regional or area headquarters as defined in Section 22 (DD) **shall not be subject to income tax**." (Emphasis supplied)

[30] "(p) Services rendered by regional or area headquarters established in the Philippines by multinational corporations which act as supervisory, communications and coordinating centers for their affiliates, subsidiaries or branches in the Asia-Pacific Region and do not earn or derive income from the Philippines[.]"

[31] *Rollo*, pp. 301-303.

[32] Id. at 305.

[33] Id. at 494.

[34] Section 4(b)(1) of the IRR of RA No. 8756 reads:

Supreme Court E-Library

The CTA EB further ruled that the phrase "promotion of the parent company's products, quality control of products" indicated in Shinko's SEC Registration should not be equated with the qualifying services performed by ROHQs.[35] Applying the rule of *noscitur a sociis*, the CTA EB noted that the qualifying services of marketing control and sales promotion, as well as research and development services, and product development, should be understood in the same sense as the other words with which they are associated, more precisely, services in which the entity operates an income-generating business in the Philippines.[36] In the case of Shinko, the promotion of its parent company's product is not an income-generating business.

In the Resolution dated August 1, 2016, the CTA EB denied the CIR's Motion for Reconsideration.

Hence, the instant Petition.

In compliance with the Court's Resolution dated December 1, 2016,[37] Shinko filed its Comment,[38] to which the CIR, through the Office of the Solicitor General, filed a Reply.[39]

Before the Court, the CIR maintains that Shinko should be treated as a taxable ROHQ because it renders "qualifying services" as enumerated in Section 22 (EE) of the NIRC, as amended. To

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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.

[35] *Rollo*, pp. 495-496.

[36] Id. at 496.

[37] *See* id. at 117.

[38] Id. at 117-148.

[39] Id. at 533-546.

support its argument, the CIR relies on Shinko's SEC Registration, which states that it performs "promotion x x x [and] quality control [of the parent company's products],"[40] thereby rendering it involved in an ROHQ's qualifying services.

Moreover, the CIR submits that once a foreign business entity performs qualifying services in the Philippine jurisdiction, the CIR has to treat the entity as an ROHQ for taxation purposes. It also adds that Shinko derived income from Philippine sources in its capacity as an ROHQ.[41]

In response thereto, Shinko argues in its Comment that it is neither an RHQ nor an ROHQ, but rather a representative office. It likewise asserts that Shinko has not engaged in any income-generating activity.[42]

In its Reply, the CIR repleads all prior arguments and reiterates that Shinko's books of accounts as well as the Independent Auditor's Report indicate that Shinko had investment in shares of stocks of a local utility company during taxable years 2006 and 2007, and earned interest income from its bank deposits and other short-term investments.[43]

The Issue

Whether the CTA Division and CTA EB erred in cancelling the subject deficiency income tax and VAT assessments issued against Shinko covering fiscal year ending March 31, 2007.

The Court's Ruling

The Petition lacks merit.

At the outset, it must be emphasized that this Court accords the CTA's factual findings with utmost respect, if not finality, because the Court recognizes that it has necessarily developed an

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[40] Id. at 149.

[41] Id. at 539-540.

[42] Id. at 129-142.

[43] Id. at 540.

Supreme Court E-Library

expertise on tax matters.[44] Significantly, both the CTA Division and CTA EB gave credence to the documents presented by Shinko as sufficient proof that it is a representative office of its parent company in Japan. This Court shall not disturb the CTA's findings without any showing of grave abuse of discretion considering that the members of the tax court are in the best position to analyze the documents presented by the parties.[45]

In any case, after a judicious review of the records, the Court still does not find any reason to deviate from the CTA Division and CTA EB findings. Thus, the Court upholds the CTA's determination that Shinko is a representative office treated similarly with an RHQ for tax purposes.

I

Tax treatment of a representative office under the NIRC, as amended

Shinko claims that the assessment for deficiency income tax and VAT issued against it has no factual or legal bases because, as a mere representative office of its parent company in Japan, it does not engage in any income-generating activities in the Philippines. The CIR, however, maintains, that Shinko is a taxable entity — an ROHQ — having engaged in "qualifying services" which generates income in the Philippines. In the assailed Decision, the CTA EB ruled in favor of Shinko and held that Shinko should be treated as an RHQ exempt from income tax and VAT.

Thus, to resolve the issue of Shinko's tax treatment, an examination of the relevant provisions of the NIRC, as amended, as well as other applicable laws on the matter is necessary.

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[44] *Commissioner of Internal Revenue v. Deutsche Knowledge Services Pte. Ltd.*, G.R. No. 234445, July 15, 2020, citing *Winebrenner & Iñigo Insurance Brokers, Inc. v. Commissioner of Internal Revenue*, G.R. No. 206526, January 28, 2015, 748 SCRA 591.

[45] Id., citing *Republic v. Team (Phils.) Energy Corporation (formerly Mirant [Phils.] Energy Corporation)*, G.R. No. 188016, January 14, 2015, 746 SCRA 41.

Supreme Court E-Library

The term "representative office" is not explicitly defined under the NIRC, as amended. However, a definition thereof can be found in Section 1(c), Rule I of the IRR of RA No. 7042, as amended, which states:

> x x x *Representative or liaison office* deals directly with the clients of the parent company but does not derive income from the host country and is fully subsidized by its head office. It undertakes activities such as but not limited to information dissemination and promotion of the company's products as well as quality control of products. (Italics in the original)

It can be gleaned from the foregoing that a representative office has 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 products; and
d) It does not derive income in the Philippines.

Relative thereto, an RHQ is defined under Section 22(DD) of the NIRC, as amended, and Section 2(2) of Executive Order No. 226,[46] as amended by RA No. 8756,[47] as follows:

> Sec. 22. *Definitions*.— When used in this Title:
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> x x x x
>
> (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

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[46] Omnibus Investments Code of 1987, July 16, 1987.

[47] An Act Providing for the Terms, Conditions and Licensing Requirements of Regional or Area Headquarters, Regional Operating Headquarters, and Regional Warehouses of Multinational Companies, Amending for the Purpose Certain Provisions of Executive Order No. 226, Otherwise Known as the Omnibus Investments Code of 1987, November 23, 1999.

Supreme Court E-Library

which act as **supervisory, communications and coordinating center for their affiliates, subsidiaries, or branches** in the Asia-Pacific Region and other foreign markets.

x x x x

Sec. 2. *Definition of Terms*.— For purposes of this Act, the term:

(2) *Regional or Area Headquarters (RHQ)* shall mean an office whose purpose is to act as an administrative branch of a multinational company engaged in international trade **which principally serves as a supervision, communications and coordination center for its subsidiaries, branches or affiliates** in the Asia-Pacific Region and other foreign markets and **which does not earn or derive income in the Philippines**[.] (Emphasis supplied; italics in the original)

An RHQ is an office principally intended to render administrative services. It is not allowed under the law to participate in any manner in the management of any subsidiary or branch office it might have in the Philippines or to solicit or market goods and services whether on behalf of its mother company or its branches, affiliates, subsidiaries or any other company.[48] RHQ's activities are limited to acting as supervisory, communications and coordinating center for its affiliates, subsidiaries or branch offices in the region. In performing such activities, an RHQ does not earn or derive income in the Philippines. Consequently, the NIRC exempts RHQs from income tax and VAT, *viz.*:

Sec. 28. *Rates of Income Tax on Foreign Corporations*.—

(A) ***Tax on Resident Foreign Corporations***.—

x x x x

(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**.

x x x x

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[48] RA No. 8756, Sec. 3.

Supreme Court E-Library

Sec. 109. *Exempt Transactions*.— The following shall be exempt from the value-added tax:

x x x x

(p) Services rendered by regional or area headquarters established in the Philippines by multinational corporations which act as supervisory, communications and coordinating centers for their affiliates, subsidiaries or branches in the Asia-Pacific Region and do not earn or derive income from the Philippines[.] (Emphasis supplied; italics in the original)

On the other hand, Section 22 (EE) of the NIRC, as amended, and Section 2 (3) of RA No. 8756 define an ROHQ in this wise:

Sec. 22. *Definitions*.— When used in this Title:

x x x x

(EE) The term '*regional operating headquarters*' shall mean a branch established in the Philippines by multinational companies which are engaged in any of the following services: general administration and planning; business planning and coordination; sourcing and procurement of raw materials and components; corporate finance advisory services; **marketing control and sales promotion**; training and personnel management; logistic services; **research and development services and product development**; technical support and maintenance; data processing and communication; and business development.

x x x x

Sec. 2. *Definition of Terms*.— For purposes of this Act, the term:

(3) *Regional Operating Headquarters (ROHQ)* shall mean a foreign business entity which is **allowed to derive income in the Philippines** by performing **qualifying services to its affiliates, subsidiaries or branches in the Philippines**,in the Asia-Pacific Region and in other foreign markets. (Emphasis supplied; italics in the original)

In stark contrast to an RHQ, an ROHQ is allowed by law to perform activities that generate income in the Philippines. These activities, termed as "qualifying services," include the following: (1) general administration and planning; (2) business planning and coordination; (3) sourcing/procurement of raw materials and components; (4) corporate finance advisory services; (5)

Supreme Court E-Library

marketing control and sales promotion; (6) training and personnel management; (7) logistics services; (8) research and development services, and product development; (9) technical support and maintenance; (10) data processing and communication; and (11) business development.[49] However, similar to an RHQ, an ROHQ performs services only with the head office's affiliates, branches or subsidiaries. ROHQs are also prohibited by law to directly or indirectly market the goods and services of their mother company and its affiliates.[50]

As regards taxes, inasmuch as an ROHQ is primarily engaged in activities that generate income in the Philippines, it is considered a taxable entity under the NIRC, as amended, and is subject to ten percent (10%) corporate income tax[51] and twelve percent (12%) VAT.[52]

In sum, the following are the similarities and differences among a representative office, an RHQ, and an ROHQ:

1. A representative office and an RHQ are not allowed to engage in any income-generating activities in the Philippines. An ROHQ, on the other hand, provides qualifying services that generate income in the Philippines.

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[49] Id., Sec. 4; See also Section 22 (EE) of the NIRC, as amended.

[50] Id.; IRR of RA No. 8756.

[51] Section 28(A)(6)(b) of the NIRC, as amended, reads:

(b) Regional operating headquarters as defined in Section 22 (EE) shall pay a tax of ten percent (10%) of their taxable income.

[52] Section 106(A) of the NIRC, as amended, reads:

(A) *Rate and Base of Tax*.— These shall be levied, assessed and collected on every sale, barter or exchange of goods or properties, a value-added tax equivalent to ten percent (10%) of the gross selling price or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferor.

(VAT is now twelve percent [12%] effective February 1, 2006 per Revenue Memorandum Circular No. 7-2006 dated January 31, 2006.)

Supreme Court E-Library

2. Both a 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 NIRC, 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 shall be subject to a tax rate often percent (10%) of their taxable income from its qualifying services and twelve percent (12%) VAT.

Proceeding from the foregoing, the Court agrees with the CTA that a representative office, while not defined under the NIRC, is akin to an RHQ and not to an ROHQ.

As discussed, a representative office is only allowed under the law to undertake activities such as but not limited to information dissemination, promotion of the parent company's products as well as quality control of products. These activities, while directed to the parent company's clients, are not income generating, similar to the activities of an RHQ and in stark contrast with the qualifying services performed by ROHQs. As such, a representative office should be treated and taxed in the same manner as an RHQ and not an ROHQ. Stated otherwise, since a 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.

II

Shinko has adequately shown that it is a representative office

Applying the foregoing discussion, the Court finds that Shinko is a representative office and not an ROHQ.

Supreme Court E-Library

First, Shinko is fully subsidized by its head office in Japan. Shinko's monthly Inward Remittance Credit Advice[53] from its parent company, Audited Financial Statement[54] for fiscal year ending March 31, 2007, and Independent Certified Public Accountant Reports[55] strengthen its position that its Japan parent company subsidizes its operations here in the Philippines. To be sure, certified remittances of the minimum paid-up capital[56] from the foreign parent company is one of the requirements to set up a representative office in the Philippines. All costs associated with establishing and maintaining a representative office are covered by remittances from the parent company. These remittances are necessary for the continued operation of representative offices in the Philippines, such as Shinko.

Second, Shinko deals directly with the clients of its head office as it undertakes activities limited to information dissemination, promotion of the parent company's products, including the conduct of quality control. Records show that all inquiries from Philippine clients are routed to its Japan head office, which, in turn, makes the final decisions.[57] As a representative office, Shinko promotes and provides information about the products offered by its Japan head office, but it does not enter into contracts on its own.[58] Instead, such contracts are referred to its parent company, which then enters into a contract with the clients within the Philippines.[59] The Japan parent company is responsible for all negotiations regarding the price, payment terms, and delivery of the product.[60] In fine, Shinko's role is limited to introducing the

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[53] *Rollo*, pp. 368-413-A.

[54] Id. at 350-365.

[55] CTA Division records, pp. 578-579.

[56] IRR of RA No. 7042.

[57] *Rollo*, p. 336.

[58] *Id.* at 336, 348.

[59] *Id.*

[60] *Id.* at 341.

Supreme Court E-Library

parent company's products to clients in the Philippines.[61] Nothing more. Nothing less.

The CIR, however, insists that Shinko is a taxable entity because it is engaged in taxable or income-generating activities. The CIR alludes to Shinko's SEC Registration which allegedly indicates that Shinko performs qualifying services like an ROHQ.[62]

The CIR is mistaken. The Court agrees with the findings and conclusions of the CTA that Shinko cannot be treated and taxed as an ROHQ.

First, the CIR's insistence that Shinko performs "qualifying services" is a misreading of Shinko's SEC Registration, which clearly states:

> WHEREAS, the applicant proposes to establish its representative office in the Philippines 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[.][63]

Shinko's SEC Registration makes no mention of it performing qualifying services. In fact, the activities specified therein, namely "information dissemination, promotion of the parent company's

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[61] Id.

[62] Section 22 (EE) of the NIRC, as amended, reads:

> (EE) The term '*regional operating headquarters*' shall mean a branch established in the Philippines by multinational companies which are engaged in any of the following services: general administration and planning; business planning and coordination; sourcing and procurement of raw materials and components; corporate finance advisory services; marketing control and sales promotion; training and personnel management; logistic services; research and development services and product development; technical support and maintenance; data processing and communication; and business development. (Italics in the original)

See also RA No. 8756, Sec. 4.

[63] *Rollo*, p. 149.

Supreme Court E-Library

products, quality control of products"[64] clearly fall within the scope of what a representative office is permitted to do.

Second, the CIR's claim that Shinko engages in qualifying services is completely unsupported by facts and evidence. To reiterate, Shinko is merely promoting its parent company's products. Contrary to the CIR's claim, Shinko does not render marketing control and sales promotion, nor does it provide research and development services, and product development that are considered taxable qualifying services performed by an ROHQ. Clearly, these qualifying services are in no way the same as the non-income generating activities that a representative office may perform, such as information dissemination, product promotion, and quality control of products. Owing to the fact that Shinko does not render any qualifying services, then with all the more reason that Shinko cannot be taxed in the same manner as an ROHQ because it does not earn any income from these qualifying services.

Third, unlike an ROHQ, Shinko, as a representative office, deals directly with the parent company's clients and not with the affiliates, branches or subsidiaries of the Japan parent company. As earlier discussed, an ROHQ performs taxable qualifying services only with the head office's affiliates, branches or subsidiaries. ROHQs are in fact prohibited by law to directly or indirectly market the goods and services of their mother company and its affiliates.

Another contention raised by the CIR is that Shinko, in its capacity as an ROHQ, derived income in the Philippines from its bank deposits and investments in shares of stocks. The CIR asserts that this belies Shinko's claim that its functions are only limited to information dissemination and liaising between the local client and the head office.[65]

The Court is not persuaded. In the assailed Decision, the CTA EB ruled:

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[64] Id.

[65] Id. at 540.

On the issue that Shinko acquired income from its interest bank deposits, such amount received is **passive income** and was already **subjected from final withholding tax**.This was the very same ruling in BIR Ruling [DA-092-03] cited by CIR. Its shares of stocks in PLDT as well cannot be considered as income generating business as it is **automatic upon acquisition of PLDT's services** for Shinko to run its activity here in the Philippines.[66]

Thus, as aptly found by the CTA, the interest and dividend allegedly earned by Shinko are considered as "passive income." In *Chamber of Real Estate and Builders' Association, Inc. v. Romulo*,[67] the Court explained that passive income, such as dividends or interest, are not generated in the active pursuit and performance of the corporation's primary purpose but arises from the company's assets. As such, passive income are subjected to final taxes[68] and are not covered by regular income tax.[69]

More importantly, that Shinko earned income in the form of interest and dividends does not automatically render it as an ROHQ liable to pay income tax and VAT. To be sure, the enumeration of qualifying services, which allows an ROHQ to generate or derive income, is specifically defined under Section 22(EE) of the NIRC, as amended, and Section 4 of RA No. 8756. There is nothing in both provisions which states that earning interest or dividend income is one of the qualifying services an ROHQ may provide. At the risk of being repetitive, Shinko merely provides information dissemination and promotion of the parent company's products — activities that a representative office is allowed by law

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[66] Id. at 516; emphasis supplied.

[67] G.R. No. 160756, March 9, 2010, 614 SCRA 605.

[68] Section 2.57(A) of Revenue Regulations No. 02-98, Implementing RA No. 8424, "An Act Amending the National Internal Revenue Code, as Amended" Relative to the Withholding on Income Subject to the Expanded Withholding Tax and Final Withholding Tax, Withholding of Income Tax on Compensation, Withholding of Creditable Value-Added Tax and Other Percentage Taxes, April 17, 1998.

[69] *Commissioner of Internal Revenue v. Philippine Airlines, Inc.*, G.R. No. 160528, October 9, 2006, 504 SCRA 90, 100.

Supreme Court E-Library

to perform. Also, Shinko does not render any of the qualifying services in the performance of its functions as a representative office in the Philippines.

III

Shinko is not liable for income tax and VAT for the subject taxable period

Having been established that Shinko is a representative office, the next question is whether Shinko is liable for the assessed deficiency income tax and VAT.

The Court answers in the negative.

Section 23(F) of the NIRC, as amended, states that "[a] foreign corporation, whether engaged or not in trade or business in the Philippines, is taxable only on income derived from sources within the Philippines." As discussed, a representative office, such as Shinko, does not engage in income-generating activities in the Philippines. Thus, akin to an RHQ, a representative office is considered exempt from income tax and VAT.

In the subject assessments, however, the CIR claims that Shinko has unsupported expenses, over claimed representation and entertainment, among other things, for fiscal year ending March 31, 2007 and subjected the same to deficiency income tax and VAT in the amounts of Php766,271.65 and Php343,930.04.[70]

However, as aptly found by the CTA, these amounts subject of the assessment are not considered income and thus, cannot be subject to income tax and VAT.

Income is "defined as an amount of money coming to a person or corporation within a specified time, whether as payment for services, interest or profit from investment. Unless otherwise specified, it means cash or its equivalent. [It] can also be thought of as a flow of the fruits of one's labor."[71]

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[70] *Rollo*, pp. 82-83.

[71] *Conwi v. Court of Tax Appeals*, G.R. Nos. 48532 & 48533, August 31, 1992, 213 SCRA 83, 87-88; citation omitted.

Supreme Court E-Library

Further, in defining income, the Court in case of *Madrigal and Paterno v. Rafferty and Concepcion*[72] differentiated it from capital and said that "[t]he essential difference between capital and income is that capital is a fund; income is a flow. A fund of property existing at an instant of time is called capital. A flow of services rendered by that capital by the payment of money from it or any other benefit rendered by a fund of capital in relation to such fund through a period of time is called income. Capital is wealth, while income is the service of wealth."[73] Thus, an income tax is arbitrary and confiscatory if it taxes capital because capital is not income. In other words, it is income, not capital, which is subject to income tax.[74]

Likewise, case law instructs that for income to be taxable, the following requisites must exist: (1) there must be gain; (2) the gain must be realized or received; and (3) the gain must not be excluded by law or treaty from taxation.[75]

In the case of Shinko, the amounts considered by the CIR as Shinko's income actually came from the subsidies remitted by its head office abroad, for Shinko's operations in the Philippines. Certainly, these remittances cannot be considered as income because they are not payment for the services rendered by Shinko. They cannot be regarded as a gain realized by Shinko or a flow of fruits from Shinko's labor. At the very least, the remittances Shinko received as subsidy from its parent company can only be regarded as capital which is intended for the continued operation of a representative office in the Philippines, and from which no income tax may be collected or imposed.

In the same way, Shinko is not liable for VAT. It is a basic principle in taxation that before a transaction is imposed VAT, a

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[72] 38 Phil. 414 (1918).

[73] Id. at 418; citation omitted.

[74] *Chamber of Real Estate and Builders' Association, Inc. v. Romulo,* supra note 67, at 628.

[75] Id. at 627; citation omitted.

Supreme Court E-Library

sale, barter or exchange of goods or properties, or sale of a service in the course of trade or business is required.[76] Section 105, Chapter I, Title IV of the NIRC, as amended reads:

> Sec. 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 nonstock, nonprofit 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 nonresident foreign persons shall be considered as being rendered in the course of trade or business. (Emphasis supplied; italics in the original)

Here, the subsidy given to Shinko was not derived in relation to any sale, barter or exchange of goods or services in the course of trade or business. The subsidy was not in payment for goods or properties sold, bartered or exchanged by Shinko.[77] As such, the subsidy Shinko received from its parent company cannot be subject to VAT.

In view of the foregoing, the subject assessments for deficiency income tax and VAT issued against Shinko are invalid for lack of factual and legal bases. Accordingly, the assailed Decision

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[76] *Association of Non-Profit Clubs, Inc. v. Bureau of Internal Revenue*, G.R. No. 228539, June 26, 2019, 906 SCRA 331, 338-339.

[77] *See Commissioner of Internal Revenue v. Sony Philippines, Inc.*, G.R. No. 178697, November 17, 2010, 635 SCRA 234.

Supreme Court E-Library

and Resolution of the CTA EB cancelling the subject assessment should be upheld.

WHEREFORE, premises considered, the instant Petition is **DENIED**.The Decision dated January 4, 2016 and Resolution dated August 1, 2016 of the Court of Tax Appeals En Banc in CTA EB No. 1180 are hereby **AFFIRMED**.

SO ORDERED.

Gesmundo, C.J. (Chairperson), Carandang, Zalameda, and *Gaerlan, JJ.*, concur.

APPEARANCES OF COUNSEL

The Solicitor General for petitioner.
Somera Javeloza & Associates for respondent.