

December 2013

# Tax bulletin



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PHILIPPINE TAX FIRM  
OF THE YEAR  
AND  
TRANSACTION TAX TEAM  
OF THE YEAR

# Highlights

## BIR Rulings

- ▶ The transfer of shares by a trustee to the beneficial owner of the shares, which is being made without monetary consideration and is merely in compliance with a court order, is not subject to capital gains tax (CGT), donor's tax and documentary stamp tax (DST). **(Page 3)**
- ▶ Under the RP-Japan Tax Treaty, interest on foreign loans will qualify for the 10% preferential tax rate if the recipient of such interest is also the beneficial owner thereof.

The loan agreement is subject to DST imposed under Section 179 of the Tax Code at the rate of P1.00 on each P200 or fraction thereof, of the amount of the loan. **(Page 4)**

## BIR Issuances

- ▶ Revenue Memorandum Circular (RMC) No. 74-2013 circularizes BIR Ruling No 398-2013 dated November 4, 2013, which clarifies the tax liabilities of electric cooperatives registered with the National Electrification Administration (NEA). **(Page 4)**
- ▶ RMC No. 75-2013 suspends all BIR audit and other field operations effective December 16, 2013. **(Page 5)**

## BOC Issuances

- ▶ Customs Memorandum Order (CMO) No. 14-2013 establishes the rules and regulations for the Authorized Economic Operator (AEO) Program. **(Page 6)**

## Executive Order

- ▶ Executive Order (EO) No. 155 dissolves the BOC's Post-Entry Audit Group (PEAG) and transfers its functions and operations to the Fiscal Intelligence Unit (FIU) of the Department of Finance (DOF). **(Page 9)**

## SEC Issuances

- ▶ SEC Memorandum Circular (MC) No. 20 requires all key officers and members of the board of directors of publicly-listed companies to attend a program on corporate governance at least once a year. **(Page 10)**
- ▶ SEC MC No. 21 prescribes omnibus guidelines on the use of corporate and partnership names. **(Page 10)**
- ▶ When a manning agency is owned 0.03% by Filipino individuals and 74.97% by another corporation which is owned at least 60% by Filipinos, the manning agency is considered 75% Filipino-owned, in compliance with the law. **(Page 14)**
- ▶ When the by-laws provide that the right to vote in a corporation is limited to voting proprietary members, Proprietary Ownership Certificate (POC) holders who are non-voting proprietary members shall not be allowed to vote. **(Page 15)**

## BSP Issuances

- ▶ Circular No. 820 provides for additional special regulatory reliefs to banks in areas severely affected by tropical depression “Yolanda”. (Page 17)
- ▶ Circular No. 821 amends Appendix P-2 in relation to Section 4162P of the Manual of Regulations for Non-Bank Financial Institutions-Pawnshops (MORNBFI-P). (Page 17)
- ▶ Circular No. 822 amends the capital framework of foreign bank branches. (Page 18)

## Court Decisions

- ▶ In determining the proportion of real property to total assets for purposes of the capital gains exemption under the Philippines-Singapore tax treaty, ‘Concession Fees’ or ‘Concession Accounts’, which represent fees paid pursuant to a Concession Agreement, cannot be considered as part of the real property interest of a Philippine company. Only the portion pertaining to ‘Network Assets’ may be classified as immovable property under the tax treaty as this relates to the “contract for public works.” (Page 19)
- ▶ The 70% local business tax (LBT) allocation prescribed in Section 150 of the Local Government Code (LGC) accrues only to the city or municipality where a factory, project office, plant, or plantation is located. An office that is not indispensable to the company’s main business cannot be considered a project office for LBT purposes. (Page 21)
- ▶ A Purchase and Sale Agreement cannot be taken to mean a merger between the contracting parties so as to make one party liable for the tax deficiency of the other. For a merger to take place, it is necessary that assets be acquired in exchange for shares of stock of the absorbing corporation, which shares are then distributed to the stockholders of the absorbed corporation in proportion to their respective shares. (Page 23)

## BIR Rulings

### BIR Ruling No. 448-13 dated November 27, 2013

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The transfer of shares by a trustee to the beneficial owner of the shares, which is being made without monetary consideration and is merely in compliance with a court order, is not subject to CGT, donor’s tax and DST.

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#### **Facts:**

P Co., a domestic corporation operating toll facilities by virtue of a franchise, held certain shares in various subsidiaries and joint venture companies in trust for the Government. In view of the expiration of its franchise, P Co. was ordered by the Supreme Court to transfer the shares in favor of the Government.

#### **Issue:**

Is the transfer of the shares subject to capital gains tax (CGT), donor’s tax and documentary stamp tax (DST)?

#### **Ruling:**

1. No. The transfer, being made without monetary consideration and merely as a confirmation of title/ownership in favor of the Government as beneficial owner, is not subject to income tax, and consequently, to CGT imposed under Section 27(A) and (D)(2) of the Tax Code.

2. No. The transfer, being made without intent to do an act of liberality on the part of the transferor and merely in compliance with a court decision, is not subject to donor's tax imposed under Section 98 of the Tax Code.
3. No. The transfer is not subject to DST on sales, agreements to sell, memoranda of sales, deliveries or transfer of shares or certificates of stock imposed under Section 175 of the Tax Code. The transfer document, however, is subject to DST on certificates under Section 188 of the Tax Code.

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### **BIR Ruling No. ITAD 327-13 dated December 2, 2013**

Under the RP-Japan Tax Treaty, interest on foreign loans will qualify for the 10% preferential tax rate if the recipient of such interest is also the beneficial owner thereof.

The loan agreement is subject to DST imposed under Section 179 of the Tax Code at the rate of P1.00 on each P200, or a fraction thereof, of the amount of the loan.

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#### **Facts:**

A Co., a non-resident foreign corporation based in Japan, extended a loan to B Co., a domestic corporation. B Co.'s first repayment of the principal amount plus interest was on March 25, 2011. A Tax Treaty Relief Application (TTRA) was filed with the BIR-ITAD on June 29, 2011 to claim the 10% preferential tax rate on interest payments under the RP-Japan Tax Treaty.

#### **Issues:**

1. Are the interest payments subject to the 10% preferential tax rate under the RP-Japan Tax Treaty?
2. Is the loan agreement subject to DST?

#### **Ruling:**

1. No. Under Revenue Memorandum Order (RMO) No. 72-2010, any availment of the tax treaty relief shall be preceded by a TTRA filed with the BIR-ITAD before the transaction. Since the first payment of interest subject of the loan was made on March 25, 2011, but the relevant TTRA was filed only on June 29, 2011, the interest payment on March 25, 2011 is not entitled to the 10% preferential tax rate. Instead, it should be subject to the regular income tax rate of 20% under Section 28(B)(5)(a) of the Tax Code. However, interest paid from June 30, 2011 onwards is entitled to the 10% preferential tax rate under Article 11(2) of the RP-Japan Tax Treaty.
2. Yes. The loan agreement is subject to DST imposed under Section 179 of the Tax Code at the rate of P1.00 on each P200, or a fraction thereof, of the amount of the loan.

*[Editor's note: This ruling still includes a discussion on the timing of TTRAs under RMO No. 72-10 despite the promulgation of the Supreme Court decision in Deutsche Bank AG Manila Branch vs. Commissioner of Internal Revenue (G.R. No. 188550 dated August 19, 2013).]*

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## **BIR Issuances**

RMC No. 74-2013 circularizes BIR Ruling No 398-2013 dated November 4, 2013, which clarifies the tax liabilities of electric cooperatives registered with the NEA.

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### **Revenue Memorandum Circular No. 74-2013 dated November 26, 2013**

In BIR Ruling No. 398-2013 dated November 4, 2013, the BIR ruled that all electric cooperatives registered with the National Electrification Administration (NEA) shall be subject to the following taxes:

- ▶ Income tax on revenue derived from electric service operations;
- ▶ 20% final income tax on interest from any currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements and royalties derived from sources within the Philippines;
- ▶ 7.5% final income tax on interest income derived from a depository bank under the expanded foreign currency deposit system;
- ▶ CGT on sales or exchanges of real property classified as capital assets or shares of stock;
- ▶ DST on transactions of cooperatives dealing with non-members, except transactions with banks and insurance companies, provided that whenever one party to the taxable document enjoys the exemption from DST, the other party who is not exempt shall be the one directly liable for the tax;
- ▶ VAT billed on purchases of goods and services;
- ▶ VAT on sales relative to the generation and distribution of electricity as well as their importation of machineries and equipment, including spare parts, which shall be directly used in the generation and distribution of electricity;
- ▶ Sale of power or fuel generated through renewable sources of energy such as, but not limited to, biomass, solar, wind, hydropower, geothermal, ocean energy, and other emerging energy sources using technologies such as fuel cells and hydrogen fuels, shall be subject to 0% VAT; and
- ▶ All other taxes for which the ECs are not otherwise expressly exempted by any law.

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RMC No. 75-2013 suspends all BIR audit and other field operations effective December 16, 2013.

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**Revenue Memorandum Circular No. 75-2013 dated December 16, 2013**

- ▶ All BIR field audit and other field operations relative to examinations and verifications of taxpayer's books of accounts, records and other transactions are ordered suspended for the period **December 16, 2013 to January 5, 2014**.
- ▶ No field audit, field operations, or any form of business visitation pursuant to Letters of Authority/Audit Notices, Letter Notices, or Mission Orders should be conducted during said period
- ▶ No written orders to audit and/or investigate taxpayer's internal revenue tax liabilities shall be served **except** in the following cases:
  1. Investigation of cases prescribing on or before April 15, 2014;
  2. Processing and verification of estate tax returns, donor's tax returns, CGT returns and withholding tax returns on sale of real properties and shares of stock together with the DST returns related thereto;
  3. Examination and/or verification of internal revenue tax liabilities of taxpayers retiring from business;
  4. Audit of National Government Agencies (NGAs), Local Government Units (LGUs) and Government Owned and Controlled Corporations (GOCCs) including subsidiaries and affiliates of GOCCs;
  5. Monitoring of privilege stores (*tiangges*);
  6. Stocktaking; and
  7. Other matters/concerns where deadlines have been imposed or under the orders of the Commissioner of Internal Revenue.
- ▶ Service of Assessment Notices, Warrants and Seizure Notices may still be effected.

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CMO No. 14-2013 establishes the rules and regulations for the AEO Program.

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## **BOC Issuances**

### **Customs Memorandum Order No. 14-2013 dated December 3, 2013**

#### ▶ ***Objectives of the Authorized Economic Operator (AEO) Program***

- ▶ To comply with the commitment of the Philippines to implement the World Customs Organization (WCO) Framework of Standards to Secure and Facilitate Global Trade (SAFE Framework).
- ▶ To establish a voluntary certification program, consistent and aligned with the WCO's AEO Program, which shall be administered by the BOC to help certain economic operators in the international supply chain adopt acceptable control measures to enhance the security of such chain.
- ▶ To enhance BOC-business partnership on trade security and trade facilitation based on trust and mutual respect.
- ▶ To establish accreditation procedures that offer certain benefits and incentives to economic operators who are considered as the BOC's trusted allies.

#### ▶ ***Scope and Phase of Implementation***

CMO No. 14-13 shall initially apply to exporters/locators inside the Clark Freeport Zone that are within the jurisdiction of the Port of Clark. Subsequently, and upon the directive of the Customs Commissioner, it shall cover AEO applicants in other selected air/sea ports.

#### ▶ ***General Provisions***

- ▶ The AEO Program shall be administered by the Port concerned but directly supervised by a Committee headed by the Deputy Commissioner for Assessment and Operations Coordinating Group (AOCG). The Committee shall be in charge of, among others, the following:
  1. Accreditation of AEOs;
  2. Gathering and evaluating relevant data for the implementation of the AEO Program in the Philippines;
  3. Conducting consultations with private sector/stakeholders;
  4. Establishing and enhancing the benefits and incentives of the AEO Program;
  5. Reviewing, revising and drafting rules and regulations for the AEO Program;
  6. Performing such other functions necessary for the implementation of the AEO Program.

The Committee shall be composed of officials designated by the Commissioner of Customs. The District Collector of the Port having jurisdiction over the AEO applicant shall sit as an ex-officio member of the Committee.

- ▶ The minimum standards for a company to apply for AEO Program Accreditation shall include, but not be limited to, the following:
  1. At least One Hundred Million Pesos (Php 100M) in authorized capital stock, or its equivalent in US Dollars;

2. No pending cases in matters such as intra-corporate disputes, tax and customs issues and other cases analogous to the foregoing; and
  3. A positive debt-to-equity ratio.
- ▶ An application for the AEO Program must include the following:
1. Duly filled out Application Form and Self-Assessment Questionnaire, both of which shall be under oath;
  2. Payment of the Application and Security Assessment Fees;
  3. Supporting documents which include certified true copies of the following:
    - a) Mayor's Permit and/or Certificate of Registration if applicant is a Freeport/Ecozone locator;
    - b) SEC/Board of Investments Certificate of Registration;
    - c) General Information Sheet;
    - d) Income Tax Return for the last three (3) fiscal years, when applicable;
    - e) Audited Financial Statements for the last three (3) fiscal years, when applicable;
    - f) Other documents as may be required by the BOC; and
    - g) The application and its supporting documents must be filed in triplicate and in Certified True Copy form.

Upon submission of the requirements, mandatory interview(s) and/or conference(s) shall be held by the Committee as part of the evaluation and accreditation process.

- ▶ AEO Accreditation shall be valid for two (2) years, commencing from the date of issuance as indicated in the Certificate of AEO Accreditation.

An AEO shall enjoy the benefits under CMO No. 14-13, subject to compliance with the terms of its accreditation and other existing customs rules and/or regulations.

An AEO whose accreditation has expired may file an application for renewal at least thirty (30) days prior to the date of expiration as indicated in its certificate. A renewal of accreditation after the date of expiration shall be considered as a new application.

- ▶ An AEO application for renewal shall include the following:
1. A duly notarized Omnibus Statement certifying that "No Material Changes" in the AEO's corporate structure and security measures have occurred, if applicable;
  2. A duly notarized statement to the effect that the company undertakes to abide by the commitments made in its original AEO Accreditation;
  3. Updated supporting documents for original AEO application.

Documents 1 and 2 above shall be executed by a duly authorized corporate officer as evidenced by a Secretary's Certificate.

- ▶ Accredited AEO Companies shall be recognized as trusted allies by the BOC and shall be entitled to the following:
1. Dedicated processing lanes for the AEO resulting in reduced processing periods;

2. Accreditation shall be effective for two (2) years;
  3. Last priority on post-entry audit;
  4. Recognition as a "low-risk" company;
  5. Reduced inspection or expedited clearance by other Customs authorities should certified status be also recognized by other countries under a Mutual Recognition Agreement established by bilateral or multilateral arrangement(s); and
  6. Such other trade facilitation benefits that may be accorded by the BOC under existing laws and regulations;
- ▶ In addition to the terms and conditions stated in the application form, an AEO shall have the following responsibilities:
    1. To update the BOC when there are significant changes in the company's security profile as well as if there is material information required for disclosure;
    2. To submit a Statement of Commitment;
    3. To inform the BOC of any non-conformity by the company with CMO No. 14-13;
    4. To inform the BOC of any material changes within five (5) working days from the occurrence of such material change.
  - ▶ Accreditation under the AEO Program shall be suspended and/or revoked if:
    1. The company does not abide by the terms and conditions of CMO No. 14-13;
    2. There is non-compliance by the company with Philippine laws and regulations;
    3. Substantial supply chain security risks in the company are identified by the BOC, unless rectified or satisfactorily explained by the company within 48 hours upon being advised in writing of such risk; or
    4. The company opts to withdraw from the program.
  - ▶ **Operational Provisions**
    - ▶ Applications for accreditation under the AEO Program shall be submitted to the point person designated by the AEO Committee.
    - ▶ If the minimum requirements are not met by the applicant, or if the application submitted is incomplete, the application shall be denied and the applicant shall be immediately notified thereof.
    - ▶ An application sufficient in form and substance shall be evaluated by the Committee. The evaluation process shall include, among others, interview of the applicant and/or its responsible officers, random site visit and validation of the material information provided by the applicant in its application. An application which meets all the qualifications and none of the disqualifications shall be subject to the approval of the Commissioner, upon favorable recommendation of the Committee.
    - ▶ The operations of an accredited AEO shall be monitored by an account officer, an examiner and enforcement and security officer to be designated by the District Collector of the Port concerned.

- ▶ To ensure trade security, packing/stuffing of the goods by the accredited AEO shall be witnessed by an examiner and enforcement officer from the port. The said customs officials shall make sure that the packed/stuffed items are the items declared in the export declaration filled up by the AEO.
- ▶ As soon as the packing/stuffing of the outbound container is completed, the required customs seal shall be placed on the container. The examiner and customs officer shall make sure the seal is properly attached and the seal is intact.
- ▶ Unless otherwise provided by subsequent countervailing issuances, outbound containers of AEO-accredited companies shall not be subject to underguarding.
- ▶ Prior to loading at the port of loading, the trade control examiner shall match the serial number of the customs seal attached during the packing/stuffing process.
- ▶ At any point in time, the AEO Committee may conduct random inspection of the AEO premises and the processes followed in the storage and exportation of goods by an AEO.
- ▶ ***Transitory Provision***

Without prejudice to the right of the government to collect fees, as soon as the proper amount to be imposed is determined, the provision on the Application and Security Assessment Fee is suspended during the initial implementation of the AEO Program. Only upon the issuance of an appropriate Order by the Commissioner of Customs, as confirmed by the Secretary of Finance, shall the suspension be lifted.

## **Executive Order**

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EO No. 155 dissolves the BOC's PEAG and transfers its functions and operations to the FIU of the DOF.

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### **Executive Order No. 155 dated December 18, 2013**

- ▶ Executive Order (EO) No. 155 amended EO No. 160 or the law creating the Post-Entry Audit Group (PEAG), and aims to maintain the independence and impartiality of audit functions which is consistent with the reform measures currently implemented in the BOC.
- ▶ The Fiscal Intelligence Unit (FIU) is an office created in the Department of Finance (DOF) primarily to identify potential revenue sources and leakages by analyzing data from the BOC and other revenue-generating agencies attached to the DOF and monitor their revenue performance.
- ▶ The FIU shall now perform all the specific functions previously exercised by the PEAG, as follows:
  - A. Trade Information and Risk Analysis
    - 1. Set the framework and benchmarks for compliance measurements of industry groups;
    - 2. In coordination with Management Information System and Technology Group (MISTG), direct the development of a computer-aided risk management system using the data warehousing technology and other statistical tools;

3. Implement the computer-aided risk management system to develop and establish audit selection parameters based on objective and quantifiable data;
4. Establish and recommend audit targets to the Commissioner of Customs;
5. Set policies, guidelines, manuals and standard operating procedures relating to the audit, and continuously assess how audit performance can be improved by better and more fine-tuned policies and guidelines; and
6. Perform other related functions.

B. Compliance Assessment

1. Formulate an audit work plan for approved audit targets;
2. Conduct audit examination, inspection, verification or investigation in accordance with the set policies, guidelines, manuals, and standard operating procedures;
3. Prepare and submit audit reports;
4. Develop and implement a customs compliance program; and
5. Perform other related functions.

- ▶ EO No. 155 took effect immediately upon publication in the Official Gazette or in a newspaper of general circulation.

*[Editor's Note: EO No. 155 was published in the Manila Bulletin on December 28, 2013.]*

## SEC Issuances

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SEC Memorandum Circular (MC) No. 20 requires all key officers and members of the board of directors of publicly-listed companies to attend a program on corporate governance at least once a year.

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### SEC Memorandum Circular No. 20 dated November 29, 2013

- ▶ SEC Memorandum Circular (MC) No. 20 requires all key officers and members of the board of publicly-listed companies to attend a program on corporate governance at least once a year.
- ▶ The program shall be conducted by training providers that are duly accredited by the SEC.
- ▶ Participants shall submit through the corporation a Certificate of Attendance within ten (10) days from the completion of the program.
- ▶ SEC MC No. 20 will take effect on January 1, 2014.

*[Editor's Note: SEC MC No. 20 was published in the Manila Bulletin and Manila Standard Today on December 6, 2013.]*

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SEC MC No. 21 prescribes omnibus guidelines on the use of corporate and partnership names.

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### SEC Memorandum Circular No. 21 dated December 4, 2013

- ▶ SEC MC No. 21 prescribes the following guidelines and procedures in the registration of corporate and partnership names:
  1. The corporate name shall contain the word "Corporation" or "Incorporated", or the abbreviations "Corp." or "Inc.", respectively.
  2. The partnership name shall bear the word "Company" or "Co." and if it is a limited partnership, the word "Limited" or "Ltd.". A professional partnership may bear the word "Company," "Associates," or "Partners," or other similar descriptions.

3. The corporate name of a foundation shall use the word "Foundation."
4. A term that describes the business of a corporation in its name should refer to its primary purpose. If there are two such terms, the first should refer to the primary purpose and the second to the secondary purpose.
5. The name shall not be identical, misleading or confusingly similar to a corporate or partnership name registered with the SEC or with the Department of Trade and Industry (DTI).

If the name applied for is similar to that of a registered corporation or partnership, the applicant shall add one or more distinctive words to the proposed name to remove the similarity, or to differentiate it from the registered name.

However, the addition of one or more distinctive words shall not be allowed if the registered name is coined or unique unless the board of directors or majority of the partners of the subject corporation or partnership gives their consent to the applied name.

Punctuation marks, spaces, signs, symbols and other similar characters, regardless of their form or arrangement, shall not be acceptable as distinguishing words for purposes of differentiating a proposed name from a registered name.

A name that consists solely of special symbols, punctuation marks or specially designed characters shall not be registered.

6. A business or trade name which is different from the corporate or partnership name shall be indicated in the articles of incorporation or partnership. A company may have more than one business or trade name.
7. A trade name or trademark registered with the IPO may be used as part of the corporate or partnership name of a party other than its owner if the latter gives its consent to such use.
8. The full name or surname of a person may be used in a corporate or partnership name if he or she is a stockholder, member or partner of the said entity and has consented to such use. If the person is already deceased, the consent shall be given by his or her estate.

The meaning of initials used in a name shall be stated by the registrant in the Articles of Incorporation, Articles of Partnership or in a separate document signed by an incorporator, director or partner, as the case may be.

9. The name of an internationally known foreign corporation, or something similar to it, cannot be used by a domestic corporation unless it is its subsidiary and the parent corporation has consented to such use.

However, a name written in a foreign language, even if registered in another country, shall not be registered if the name violates good morals, public order or public policy, or has an offensive or indecorous meaning in any of the country's official languages or major dialects.

10. The name of a local geographical unit, site or location cannot be used as a corporate or partnership name unless it is accompanied by a descriptive word or phrase, e.g., Pasay Food Store, Inc.

11. Pursuant to existing laws, the following words and phrases can be used as a corporate or partnership name in the manner enumerated below:
- a) "Finance Company," "Financing Company," "Finance and Leasing Company", and "Leasing Company," "Investment Company," "Investment House" - by entities engaged in the financing or investment house business (RA No. 8556 and PD No. 129);
  - b) "Lending Company" and "Lending Investor" - by lending companies (RA No. 9474), or "Pawnshop" - by entities authorized to operate pawnshops (PD No. 114);
  - c) "Bank," "Banking," "Banker," "Savings and Loan Association" (RA No. 8367), "Trust Corporation" or "Trust Company" or words of similar meaning - by entities engaged in the banking or trust business (RA No. 8791);
  - d) "United Nations," "UN," in full or abbreviated form - exclusively by the United Nations and its attached agencies (RA No. 226);
  - e) "Bonded" - by entities with licensed warehouses (RA No. 247);
  - f) "SPV-AMC: - by corporations authorized to act as special purpose vehicle (RA No. 9182).
12. The practice of a profession regulated by a special law which, among others, provides for the permissible use of the profession's name in a firm, partnership or association, shall govern the use of the name, e.g., "Engineer" or "Engineering" (RA No. 1582), "Architect" (RA No. 9266), or "Geodetic Engineer" (RA No. 8560).

Notwithstanding the limitations mentioned above, any association registered by entities engaged in the listed activities may use the profession's name, e.g., Association of Engineers of the Philippines, Inc.

13. Unless otherwise authorized by the SEC, the words and phrases enumerated below can be used only by the entities mentioned:
- a) "Investment(s)" or "Capital" - by entities organized as investment house, investment company or holding company;
  - b) "Asset/Investment/Fund/Financial Management," or "Asset/ Investment/ Fund/ Financial Adviser," or any similar words or phrases - by entities organized as investment company adviser or holders of investment management activities (IMA) license from the Bangko Sentral ng Pilipinas;
  - c) "National," "Bureau," "Commission," "State," and other words, acronyms, abbreviations that have gained acceptance in the Philippines - by entities that perform governmental functions;
  - d) "Association" and "Organization" or similar words which pertain to non-stock corporations - by entities primarily engaged in non-profit activities;
  - e) "Stock Exchange/Futures Exchange/Derivatives Exchange," "Stock Broker/Securities Broker/Derivatives Broker," "Commodity/Financial Futures Merchant/Broker," "Securities Clearing Agency/Stock Clearing

Agency," "Plans" or any similar words or phrases - by entities organized as an exchange, broker dealer, commodity futures broker, clearing agency, or pre-need company under the Securities Regulation Code (RA No. 8799).

14. The use of the words "red cross", "red crescent", or "red crystal" or their translation in any official language and dialect cannot be used or registered as part of a corporate or partnership name, unless with the consent of the Philippine Red Cross.
15. Notwithstanding the foregoing, the SEC shall, for the protection of the public interest and other justifiable causes, disallow the use of names that, in its judgment, are misleading, deceptive, confusingly similar to a registered name, or contrary to public morals, good customs or public policy.
16. The name of a corporation or partnership that has been dissolved or whose registration has been revoked shall not be used by another corporation or partnership within three (3) years from the approval of the dissolution or six (6) years from the date of revocation, unless its use has been allowed at the time of dissolution or revocation by the stockholders, members or partners who represent a majority of the outstanding capital stock or membership of the dissolved corporation or partnership, as the case may be.

No application for re-registration of corporations with dissolved or revoked certificates of registration shall be processed by the SEC unless the application is accompanied by the following documents:

- a) Board resolution, executed and signed under oath by the hold-over board of directors/trustees of the dissolved or revoked corporation, attesting that:
  - (i) The applicant for re-registration is a new corporation intending to use the name of the dissolved/revoked corporation (specially identifying the corporate name and registration number);
  - (ii) The re-registration is approved by the majority vote of the directors or trustees and the vote of the stockholders representing the majority of the outstanding capital stock or membership;
  - (iii) They shall include a statement in the articles of incorporation of the new corporation that the same is using the name of the dissolved or revoked corporation; and
  - (iv) If applicable, they will no longer file a petition to set aside the order of revocation.
- b) Latest General Information Sheet of the dissolved or revoked corporation, stamped "Received" by the SEC; and
- c) Affidavit, executed under oath by the hold-over corporate secretary, attesting that:
  - (i) There are no properties owned by the dissolved or revoked corporation due for liquidation;

- (ii) In case there are properties owned by the dissolved or revoked corporation, no property is transferred to the new corporation or, in case of stock corporations, used for subscription payment without undergoing the corporate liquidation process.

Upon approval of the re-registration, the certificate of registration to be issued to the new corporation shall indicate its new SEC registration number and pre-generated Tax Identification Number (TIN) as confirmation that the same is a separate and distinct entity from the dissolved or revoked corporation.

17. The reservation or notice of availability of a name shall not constitute an approval of the use of such name or an application for a change of name.

No erasures, changes, modifications or alterations on a name reservation form shall be allowed.

Appeals from or opposition to the approval of corporate and partnership names of new companies, or complaints against proposed new names of existing companies or partnerships, shall be resolved by the Company Registration and Monitoring Department (CRMD). The decisions of CRMD may be appealed to the SEC *En Banc* through the Office of the General Counsel.

18. At the time of its registration, a corporation or partnership shall submit an affidavit containing an unqualified undertaking to change its name, as originally registered or as amended thereafter, immediately upon receipt of the notice or directive from the SEC that another corporation, partnership or person has acquired a prior right to the use of that name, or that the name has been declared as misleading, deceptive, confusingly similar to a registered name, or contrary to public morals, good custom or public policy. The affidavit shall be signed by at least two (2) incorporators or partners in the form prescribed by the SEC. This affidavit shall not be required if the undertaking is already included as one of the provisions of the Articles of Incorporation or Partnership of the registrant.

- ▶ SEC MC No. 21 amends all issuances, orders, rules and regulations of the SEC that may be inconsistent with it.
- ▶ SEC MC No. 21 shall take effect immediately.

*[Editor's Note: SEC MC No. 21 was published in the Manila Bulletin and Manila Standard Today on December 6, 2013.]*

### **SEC-OGC Opinion No. 13-12 dated November 27, 2013**

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When a manning agency is 0.03% owned by Filipino individuals and 74.97% by another corporation which is owned at least 60% by Filipinos, the manning agency is considered 75% Filipino-owned, in compliance with the law.

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#### **Facts:**

A Co. was incorporated under Philippine laws and is engaged in the business of recruitment of Filipino seafarers for deployment on board vessels of its foreign principals. A Co. is 0.03% owned by Filipino individuals and 74.97% owned by S Co. S Co., on the other hand, is owned 60% by Filipinos and 40% by foreigners.

**Issue:**

Which test should be applied for the purpose of determining A Co.'s compliance with the 75% Filipino equity requirement for manning agencies - the "Control Test" or the "Grandfather Rule"?

**Ruling:**

There are two tests in determining the nationality of A Co. The first case is the "liberal rule" which states that shares belonging to corporations or partnerships at least 60% of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality.

The second test is the strict rule or the Grandfather Rule which states that if the percentage of Filipino ownership in the corporation or partnership is less than 60%, only the number of shares corresponding to such percentage shall be counted as of Philippine nationality.

In other words, where the 60-40% Filipino-Foreign equity ownership is not in doubt, the Grandfather Rule will not apply.

Since S Co. is 60% owned by Filipinos, its shareholdings of 74.97% in A Co. is considered owned by Filipinos for purposes of computing the required 75% Filipino equity for manning agencies. If the 74.97% shareholdings of S Co. in A Co. is added to the 0.03% shareholdings of the Filipino individuals, then A Co. is 75% Filipino-owned in compliance with the law.

**SEC-OGC Opinion No. 13-13 dated December 5, 2013.**

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When the by-laws provide that the right to vote in a corporation is limited to voting proprietary members, POC holders who are non-voting proprietary members shall not be allowed to vote.

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**Facts:**

C Country Club is a membership, non-stock corporation formed, among others, to maintain, operate, manage and carry on a social and recreational club. The Board of Directors of C Country Club was planning to propose to its members to renovate the club. The Board was also considering increasing the number of Proprietary Ownership Certificates (POCs) from its current limit of 800 certificates as an option to fund the project. Of the 800 POC holders, 100 are voting proprietary members.

During a meeting, the voting members of the club approved the plan to renovate its clubhouse and golf course. The Board was then given the authority to pursue the renovation project and to do and perform all acts necessary for such purpose. The Board was further given the authority to look for other options to fund the project, and the option being looked into is the lease of a portion of the club to a real estate developer. However, during said meeting, one of the members raised the issue of vested rights and co-ownership of its members of the properties of the club.

**Issues:**

1. If C Country Club will amend its Articles of Incorporation by issuing new POCs, the purpose of which is to fund the renovation project, will the voting be limited only to the 100 voting proprietary members or to all the 800 POC holders?
2. If the club enters into a long-term lease of a portion of its property, does the Board of Directors by itself have the authority to enter into such an agreement, or does it need the approval of the 100 voting proprietary members, or does it need to be ratified by all the 800 members?

3. Are the POC holders “co-owners” of the Corporation thereby giving them vested rights?
4. Assuming that C Country Club decides to issue 120 new and additional POCs, on top of its already existing and issued 800 POCs, the purpose of which is to sell them to members only, not to the public, and the proceeds thereof to be used to renovate its existing Club House with additional buildings and to remodel its existing golf course, can C Country Club be exempted from registration of securities for these 120 new POCs?

***Ruling:***

1. The voting will be limited to the 100 voting proprietary members. As a rule, Section 89 of the Corporation Code provides that the articles of incorporation or the by-laws may limit, broaden or even deny a member’s right to vote.

Since the by-laws provide that the right to vote in C Country Club is limited to voting proprietary members, only the 100 voting proprietary members, not the rest of the POC holders, shall be allowed to vote on the amendment of the C Country Club’s articles of incorporation.

2. The board of directors may enter into the lease without approval of the stockholders.

Any disposition which does not involve all or substantially all of the corporate assets made in the ordinary course of business does not require the approval of the stockholders or members. To determine if the sale is made in the ordinary course of business, the test is not the amount involved but the nature of the transaction. Hence, if the sale thereof will not render the corporation incapable of continuing its business or if the disposition is necessary in the usual and regular course of business, the board of directors, as it may deem expedient and in good faith, dispose the same without the approval of the stockholders.

3. The POC holders are not “co-owners” of C Country Club.

A corporation is a distinct legal entity to be considered as separate and apart from the individual stockholders or members who compose it; thus, a corporation is not affected by the personal rights, obligations and transactions of its stockholders or members. Consequently, the property of the corporation is its property and not that of the stockholders or members as owners, although to a certain extent, stockholders have equities in it. This means that the stockholders or members merely have inchoate rights over the corporate assets, and that until the corporation is dissolved and its assets are applied and distributed in accordance with the law, no stockholder or member could claim ownership or interest of any of the specific properties owned by the corporation.

4. Under the implementing rules and regulations of the Securities Regulation Code (SRC), some offering or distribution of securities will require a notice of exemption. However, whether or not such notice of exemption is required, C Country Club may opt to file with the SEC an application for confirmation or exemption.

Unless confirmation of the availability of such exemption is applied for, any person claiming an exemption has the burden, if challenged, to establish that the exemption is available and the SEC may challenge such exemption at any time. This means that although an application for confirmation is optional, a party may avail of such confirmation to defeat future challenge from SEC.

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## BSP Issuances

Circular No. 820 provides for additional special regulatory reliefs to banks in areas severely affected by tropical depression "Yolanda".

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### **BSP Circular No. 820 dated December 6, 2013**

- ▶ All banks with Home Office (HO) and/or branches located in the following areas which were severely affected by tropical depression "Yolanda" (international code name Haiyan) are entitled to additional special regulatory reliefs:
  1. Palawan in Region IV-B;
  2. Iloilo, Aklan and Capiz in Region VI;
  3. Cebu in Region VII; and
  4. Samar provinces and Leyte in Region VIII.
- ▶ The additional special regulatory reliefs are as follows:
  1. Staggered booking over a period of 5 years of losses arising from loan write-offs.
    - ▶ Condoned loans should be outstanding as of 7 November 2003;
    - ▶ Borrowers who benefited from the debt relief may be allowed to avail of new loans subject to appropriate credit underwriting standards;
  2. Staggered booking over a period of 5 years of losses arising from write-down of bank premises, furniture, fixtures and equipment and ROPA;
  3. Condonation of annual supervisory fees of thrift, rural and cooperative banks;
  4. Flexibility on branch relocation and temporary offices;
    - ▶ Banks availing of temporary relocation to cities/municipalities of higher classification shall be relieved from compliance with the additional capital requirement for a period of 6 months;
    - ▶ Banks in affected areas may be authorized to establish temporary banking offices for a period not exceeding 6 months;
  5. Submission of periodic reports is deferred for 6 months; and
  6. Relaxation on the presentation of required clients' documents.
- ▶ Banks entitled to the additional reliefs may avail themselves of the same by submitting a letter-request to the appropriate supervising department of the BSP.
- ▶ Circular No. 820 takes effect immediately upon publication either in the Official Gazette or in a newspaper of general circulation.

*[Editor's Note: Circular No. 820 was published in the Philippine Daily Inquirer on December 16, 2013.]*

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Circular No. 821 amends Appendix P-2 in relation to Section 4162P of the Manual of Regulations for Non-Bank Financial Institutions-Pawnshops (MORNBFI-P).

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### **BSP Circular No. 821 dated December 6, 2013**

- ▶ The deadline for submission of the Statement of Condition (SOC) and the Statement of Income and Expenses (SIE) of pawnshops is changed from 31 January to 30 April of every year.

- ▶ Circular No. 821 takes effect 15 calendar days after its publication in the Official Gazette or in a newspaper of general circulation.

[Editor's Note: Circular No. 821 was published in the BusinessWorld on December 13, 2013.]

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Circular No. 822 amends the capital framework of foreign bank branches.

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### **BSP Circular No. 822 dated December 13, 2013**

- ▶ Item d. of Subsection X105.4 of the Manual of Regulations for Banks (MORB), on "Capital of a Foreign Bank Branch Authorized to Operate as an Expanded Commercial Bank", and Subsection X105.5, on "Composition of Capital Accounts; Compliance with Capital Ratios", are consolidated under Subsection X105.4.b(1) of the MORB, as follows:
  1. A foreign bank branch shall comply with the same minimum capital requirements under Section X111 of the MORB and prudential capital ratios applicable to domestic banks of the same category.
  2. The total capital of the foreign bank includes permanently assigned capital plus *Net due* to account and other capital components.
  3. Any *Net due* from other offices outside the Philippines shall be deducted from the capital accounts for purposes of determining compliance with the minimum capital requirements.
  4. The *Net due* to which may be included in the total capital shall be the lower of the equivalent amount of the permanently assigned capital or the actual balance of the *Net due* to account.
  5. Current earnings/losses booked in "Undivided Profits" account shall be included in the *Net due* to account.
  6. In computing the actual balance of *Net due* to account, the amount of Accumulated Earnings shall be excluded.
  7. The bank may elect portion of earnings not remitted to the head office as part of assigned capital. Said earnings may no longer be remittable.
  8. The total capital shall be net of unbooked valuation reserves and other capital adjustments as may be required, total outstanding unsecured credit accommodations to DOSRI, and both direct and indirect and deferred income tax.
  9. The adjusted capital shall not fall below the amount required under Section X111.1 of the MORB.
  10. All branches or offices in the Philippines shall be treated as a unit for the purpose of determining compliance with the legal reserve requirement and with prescribed capital requirements.
- ▶ Subsection X105.6 of the MORB is renumbered as Subsection X105.5 and renamed "Prescribed Ratio of Net Due To Account". The new subsection provides for the following:
  - ▶ The amount of *Net due* to which may be included in Total Capital and Qualifying Capital shall not exceed the amount of permanently assigned capital, and shall exclude accumulated earnings.
  - ▶ The amount of *Net due* to included in Total Capital and Qualifying Capital, as well as the portion of accumulated earnings, shall be inwardly remitted and converted into Philippine currency. Amounts invested in productive enterprises or utilized by Philippine companies for export activities need not be subject to conversion.

- ▶ Subsection X105.6 of the MORB now contains the Risk-Based Capital for Foreign Bank Branches:
  - ▶ Foreign bank branches shall comply with the same risk-based capital adequacy ratios applicable to domestic banks of the same category. The minimum ratio of qualifying capital to risk weighted assets is 10%. Other ratios include Common Equity Tier 1 (CET1) and Tier 1 capital ratios of 6% and 7.5%, respectively. A capital conservation buffer of 2.5% comprised of CET1 capital shall also be imposed.
  - ▶ Tier 1 capital is generally composed of permanently assigned capital and *Net due* to account consisting of profits not remitted to the head office and accumulated earnings. Other accounts in the *Net due* to account are considered as Tier 2 capital.
- ▶ Foreign bank branches that would not be able to comply with the minimum capital requirements and risk-based capital adequacy ratios by 01 January 2014 must submit a capital build-up program not later than 01 April 2014.
- ▶ The Circular shall take effect on 01 January 2014. However, foreign bank branches are given up to 31 December 2014 to report their *Net due* to account in accordance with the old capital regime. Transactions entered by the bank on or before 31 December 2013 shall not be increased, but may be reduced but not thereafter increased, beyond the prudential and/or regulatory limits based on capital levels on 01 January 2015. New transactions in 2014 shall already consider the projected capital levels on 01 January 2015.

*[Editor's Note: Circular No. 822 was published in The Manila Times on December 20, 2013.]*

## Court Decisions

### **Lawl Pte. Ltd. vs. Commissioner of Internal Revenue**

CTA (Second Division) Case No. 8307 promulgated November 7, 2013

#### **Facts:**

Petitioner Lawl Pte Ltd. (Lawl), a Singaporean corporation, sold 236,000 Class B common shares of stock in Maynilad Water Services, Inc. (Maynilad) to Metro Pacific Investments Corp. (MPIC). Lawl filed with the BIR a capital gains tax (CGT) return covering the sale of the Maynilad shares, indicating therein that it is availing of the exemption under the Philippines-Singapore Tax Treaty. It also applied for tax treaty relief with the BIR International Tax Affairs Division (BIR-ITAD).

Despite its claim for CGT exemption, Lawl paid to BIR Revenue District Office (RDO) No. 39 the CGT and interest accrued on the sale in order to secure the BIR Certificate Authorizing Registration, which is necessary to complete the transfer of the Maynilad shares and deliver the stock certificate to MPIC.

The BIR issued ITAD Ruling No. 102-11 denying Lawl's tax treaty relief application on the ground that Maynilad's real property interest consisting of property, plant and equipment as well as service concession assets is more than 50% of its total assets. The BIR ruled that the Concession Agreement of Maynilad with Metropolitan Waterworks and Sewerage System (MWSS), for the sole right to manage, operate, repair, decommission and refurbish all fixed and movable assets required to provide water and sewerage services in the West Area in Metro Manila, is a contract for public works classified as an immovable property.

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In determining the proportion of real property to total assets for purposes of the capital gains exemption under the Philippines-Singapore tax treaty. 'Concession Fees' or 'Concession Accounts', which represent fees paid pursuant to a Concession Agreement, cannot be considered as part of the real property interest of a Philippine company. Only the portion pertaining to 'Network Assets' may be classified as immovable property under the tax treaty as this relates to the "contract for public works."

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Lawl filed with the Secretary of Finance a request for review of the ruling. It then filed with the BIR-ITAD a claim for refund of the CGT and interest paid for the share transfer. While its request with the Secretary of Finance and its refund claim with BIR-ITAD were pending, Lawl filed a Petition for Review with the Court of Tax Appeals (CTA) for the refund of the CGT and interest paid, on the basis that the sale of Maynilad shares is exempt from CGT under the Philippines-Singapore Tax Treaty.

On the other hand, Respondent Commissioner of Internal Revenue (CIR) argued that the BIR-ITAD has no authority to receive or process applications or claims for refund and that Lawl should have filed its claim with RDO No. 39 where it paid the CGT. The CIR further asserted that Lawl is not entitled to the refund sought as the sale of the Maynilad shares is not exempt from CGT under the Philippines-Singapore Tax Treaty.

**Issues:**

1. Is the BIR-ITAD authorized to process Lawl's claim for refund?
2. Is Lawl entitled to the refund of the CGT paid to the BIR?

**Ruling:**

1. Yes. The BIR-ITAD is authorized to process Lawl's claim for refund which was addressed to the CIR and coursed through the Chief of the BIR-ITAD.

While the Tax Code provides that a claim for refund or credit must be duly filed with the CIR, Revenue Administrative Order (RAO) No. 11-00 states that the BIR-ITAD, specifically its Tax Treaty Implementation and Exchange of Information Section, shall process claims for tax credit or refund of erroneously collected internal revenue taxes arising from the application of tax treaty provisions, including requests for exemptions.

2. Yes, Lawl is entitled to the refund of the CGT and interest paid to the BIR.

Article 13 of the Philippines-Singapore Tax Treaty states that any gain from alienation of shares of a company, the property of which consists principally (or more than 50%) of immovable property situated in a Contracting State, may be taxed in that State. The term "immovable property" shall be defined in accordance with the law of the Contracting State in which the property in question is situated.

The Civil Code of the Philippines includes in its enumeration of immovable properties "contracts for public works," which can be construed as referring to all fixed works constructed for public use or fixed public infrastructures for use of the public. It denotes works conducted, i.e. construction and maintenance of infrastructure facilities such as national highways, flood control, water resources development systems, etc.

Maynilad's audited financial statements show it had assets which include Service Concession Assets. Its Concession Agreement provides that Maynilad was granted the "sole right to manage, operate, repair, decommission and refurbish the Facilities in the Service Area, including the right to bill and collect for water and sewerage services supplied in the Service Area." The said agreement involves (a) making the necessary construction (repair, refurbishment, etc.) to the facilities, and (b) operating the same.

The Concession Agreement is therefore a “contract for public works” with respect to Maynilad’s obligation to make the necessary construction. However, it is not solely a contract for public works since Maynilad is likewise required to perform its service obligations, i.e. water supply services, sewerage services, etc.

Maynilad’s Service Concession Assets account is broken down into Concession Fees/Concession Accounts (which are fees paid by Maynilad to MWSS pursuant to the Concession Agreement) and Network Assets. Only the portion pertaining to Network Assets should be classified as immovable property as this relates to the “contract for public works.”

Maynilad’s immovable or real property interest (including the Network Assets) is only 41.73% of its total assets; hence its assets do not consist principally of immovable property situated in the Philippines. Consequently, the capital gains derived by Lawl from the sale of Maynilad shares are exempt from CGT in the Philippines, pursuant to Article 13 of the Philippines-Singapore Tax Treaty.

**The Municipality of Bakun vs. Luzon Hydro Corporation and the City of Makati**  
CTA AC No. 100 (Special First Division) promulgated November 8, 2013

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The 70% LBT allocation prescribed in Section 150 of the LGC accrues only to the city or municipality where a factory, project office, plant, or plantation is located. An office that is not indispensable to the company’s main business cannot be considered a project office for LBT purposes.

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**Facts:**

Respondent Luzon Hydro Corporation (LHC) operates a 70 MW hydroelectric power plant with facilities located in the Municipalities of Alilem, Ilocos Sur and Bakun, Benguet. Its principal office is located in Alilem and it also maintains an office in Makati City.

Upon expiration of its tax exemption as a Board of Investments (BOI)-registered entity, LHC commenced paying local business tax (LBT) in 2004 to Petitioner Bakun, Respondent Makati City, and Alilem. LHC allocated 70% of its annual gross sales and receipts equally among the three local government units (LGUs): Alilem and Bakun (as plant sites) and Makati City (as project office site).

In 2004, Bakun questioned the allocation of LBT to Makati and Alilem. In response to an inquiry, the Bureau of Local Government Finance (BLGF) issued an opinion that declared that Makati City is not entitled to share in the 70% allocation, since LHC’s office in Makati is an administrative office and not a factory, project office, plant, or plantation specifically enumerated in Section 150 of the Local Government Code (LGC) and its implementing rules. The BLGF stated that only Alilem and Bakun must share in equal portions in the 70% allocation, and that Makati can only collect mayor’s permit and other regulatory fees.

Bakun and Alilem agreed to abide by the BLGF opinion but Makati City continued to assess LHC for LBT. LHC filed a Special Civil Action for Interpleader with the Makati Regional Trial Court (RTC) to determine the LBT allocation of each LGU. The RTC declared all 3 LGUs as entitled to share in the 70% LBT allocation, with the RTC ruling that LHC’s Makati office is a project office.

Bakun filed a Petition for Review with the CTA and argued that the LHC office in Makati is not a project office since it does not handle the invoices or records of the sales of LHC, nor does it operate any aspect of the company’s business or primary purpose. Bakun further argued that since the main operations of LHC are conducted in Bakun and Alilem, only the 2 municipalities are entitled to the 70% allocation.

On the other hand, Makati City argued that LHC conducts its business, is registered, and has been paying LBT to Makati since 2004 under the classification producer/ power generation.

**Issue:**

Is Makati City entitled to share in LHC's 70% LBT allocation prescribed by Section 150 of the LGC?

**Ruling:**

No, Makati City is not entitled to the 70% LBT allocation as LHC's office located therein is not a project office.

Section 150 (a) of the LGC states that businesses maintaining or operating branch or sales offices shall record the sale in the branch or sales outlet making the sale or transaction, and the tax thereon shall accrue and shall be paid to the municipality where such branch or sales outlet is located. Section 150 (b) of the LGC provides that 30% of all sales recorded in the principal office is taxable in the municipality where the principal office is located, and 70% shall be taxable in the city or municipality where the factory, project office, plant, or plantation is located. In case a business has two (2) or more factories, project offices, plants or plantations, the 70% sales allocation shall be prorated among the localities where the said factories, project offices, plants or plantations are located, in proportion to their respective volumes of production during the period for which the tax is due. The sales allocation shall be applied irrespective of whether or not sales are made in the locality where the factory, project office, plant or plantation is located.

While Section 150 of the LGC does not specifically define "project office," the term is described in Local Finance Circular (LFC) No. 03-95 as "the field office in the construction site" and the "equivalent to the factory of a manufacturer." Although LFC 03-95 generally applies to construction contractors, its interpretation of the term project office as contemplated in Section 150 of the LGC may be applied. LHC's Makati office cannot be considered a project office that is deemed indispensable to the company's main business, which is the generation of hydroelectric power.

Moreover, the Makati office is not a branch or sales office. Article 243 of the LGC provides that a branch or sales office is a fixed place in a locality which conducts operations of the business as an extension of the principal office. Offices used only as display areas of the products where no stocks or items are stored for sale, although orders for the products may be received thereat, are not branch or sales offices. To be considered as a branch or sales office under the LGC, such office must be engaged in the sale of goods or services of the principal office.

The Makati office is not engaged in the sale of the hydro electric power being produced by LHC. The Makati office does not handle the invoices or records of all sales of LHC nor does it operate any aspect of the business or primary purposes of LHC, as provided in its Articles of Incorporation.

Since the Makati office is not a branch or sales office nor a project office but only an administrative office, Makati City is not entitled to share in the LBT payable by LHC.

## **Commissioner of Internal Revenue vs. Bank of Commerce**

Supreme Court (First Division) G.R. No. 180529 promulgated November 13, 2013

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A Purchase and Sale Agreement cannot be taken to mean a merger between the contracting parties so as to make one party liable for the tax deficiency of the other. For a merger to take place, it is necessary that assets be acquired in exchange for shares of stock of the absorbing corporation, which shares are then distributed to the stockholders of the absorbed corporation in proportion to their respective shares.

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### **Facts:**

Respondent Bank of Commerce (BofC) and Traders Royal Bank (TRB) executed a Purchase and Sale Agreement whereby TRB sold identified recorded assets to BofC, in consideration for BofC's assumption of identified recorded liabilities of TRB. The agreement expressly stated that BofC and TRB shall continue to exist as separate corporations with distinct corporate personalities.

Petitioner CIR issued to BofC a Formal Letter of Demand and Assessment Notice addressed to "Traders Royal Bank (now Bank of Commerce)", demanding payment of deficiency DST on the special savings deposit of TRB for taxable year 1999. TRB protested the assessment. BofC received the decision denying TRB's protest.

BofC filed a Petition for Review with the CTA and argued that it cannot be made liable for the deficiency DST of TRB as both BofC and TRB continued to exist as separate legal entities. BofC emphasized that the Purchase and Sale Agreement did not result in a merger with TRB, as confirmed by the CIR in BIR Ruling No. 10-06. BofC only acquired some assets of TRB in return for BofC's assumption of some of TRB's liabilities. The CIR countered that, at the time it requested the ruling, BofC failed to inform the CIR of TRB's deficiency DST assessment.

The CTA 2<sup>nd</sup> Division dismissed BofC's petition for lack of merit. On appeal, the CTA *En Banc* initially affirmed the decision of the CTA 2<sup>nd</sup> Division. On Motion for Reconsideration, the CTA *En Banc* reversed itself and ruled that BofC could not be held liable for the deficiency DST of TRB primarily on the ground that there was no merger between the parties. The CIR then filed a Petition for Review with the Supreme Court.

### **Issue:**

Is BofC liable for the deficiency DST of TRB?

### **Ruling:**

No, BofC is not liable for the deficiency DST of TRB since the Purchase and Sale Agreement cannot be interpreted as a merger between the two banks. The said agreement clearly states the intent of the parties and the purpose of its execution, i.e. BofC and TRB shall continue to exist as separate corporations with distinct corporate personalities, and the liabilities of TRB which are in litigation, both actual and prospective, are excluded from the liabilities to be assumed by BofC.

BIR Ruling No. 10-2006 was issued without any reference to TRB's tax liabilities. It was based on the Purchase and Sale Agreement, factual evidence on the status of both companies, and the Tax Code provision on merger. The CIR's knowledge then of TRB's tax liabilities would not have been material as to affect the ruling. The resolution of the issue on merger depended on the agreement between TRB and BofC as detailed in the agreement, and was not contingent on TRB's tax liabilities.

Moreover, for a merger to take place, it is necessary that acquisition of assets be made for shares of stock of the absorbing corporation, which shares are then distributed to the stockholders of the absorbed corporation in proportion to their respective shares. This is not the case between BofC and TRB.

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