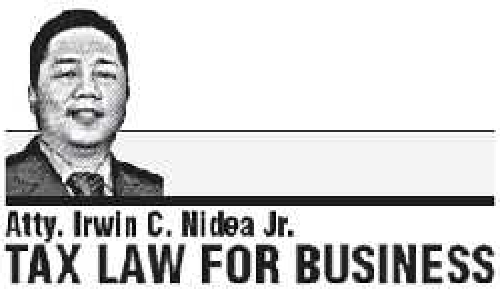

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Holding company and local business tax

IS a holding company subject to local business tax? Local government units (LGUs) are prohibited from imposing income tax, except when it is on banks and financial institutions. A holding company is not a banking institution. But can it be considered a financial institution that is liable for local business tax?

In the case of Michigan Holdings (Court of Tax Appeals [CTA] Case 1093, June 17, 2015) the court held that the local government court (LGC) defines "banks and other financial institutions" to include nonbank financial intermediaries, lending investors, finance and investment companies, pawnshops, money shops, insurance companies, stock markets, stock brokers and dealers in securities and foreign exchange. This enumeration appears to be exclusive of other entities. Nowhere in the entirety of the definition is a holding company mentioned.

If the business of a holding company is in the same class as that of a bank or other financial institutions, the court held that the law could simply have included holding companies in the same vein as banks and other financial institutions, instead of placing them all by themselves in a separate provision. Since holding companies, exclusively, were placed in a separate section, shows that they comprise a category distinct from the class of banks and other financial institutions.

The court also added that taxing holding companies on its dividend income shows a deliberate intent to circumvent the prohibition that the taxing powers of LGUs shall not extend to the levy of income tax, except on banks and other financial institutions.

This is the settled rule until the recent case of Fernandez Holdings, Inc. (CTA AC 133, July 21, 2016) came along. In this case, the CTA held that a holding company's act of investing in equity securities and holding of shares of stocks of another company may be considered an activity of a financial intermediary whose dividend income may be subjected to local business tax. Like in the Michigan case, the company is registered with the Security Exchange Commission as a holding company. However, the CTA said the purpose clause of the Articles of Incorporation of the company is extensive enough to cover most of the principal functions of a financial intermediary. It is worth noting that the purpose clause of Michigan and Fernandez Holdings are similarly worded.

The court added that, while the purpose for which the company was incorporated appears to set a qualification that it cannot act as an investment company or a securities broker or dealer nor exercise the functions of a trust corporation, the same cannot prevail over the real nature of the transaction of a holding company, which is mainly investing or placement of funds. The company according to the court cannot hide under the mantle of the qualifying provision as it is clearly a nonbank financial intermediary.

The court in Fernandez Holdings did not squarely destroy the argument that was upheld in Michigan, that since holding companies, exclusively, were placed in a separate section, shows that they comprise a category distinct from the class of banks and other financial institutions. Instead, it focused on how the company derives its income. The act of investing in equity securities, holding of assets consisting of shares of stocks and placement of funds on a regular and recurring basis affirms the conclusion that the company is a nonbank financial intermediary whose income may be subjected to local business tax.

The Fernandez Holdings case, although more recent, was decided by a division of the CTA, while the Michigan case was decided by the CTA en banc. These are conflicting decisions that the court will hopefully resolve in unison.

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