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Clarifying local business taxes on holding companies

The Court of Tax Appeals (CTA) has recently released several decisions involving different holding companies questioning the applicability of local business tax on dividend income. Most, if not all, raise a central question in their petitions: Are dividend income earned by holding companies subject to local business tax? Despite the singular question posed before the tax court, the companies were met with varying degrees of success. This seeming inconsistency embodied in several CTA decisions may be clarified by looking closely at an emerging trend in the decisions themselves.

A closer inspection of the decisions will reveal that the outcome of the case largely depends on the Court's finding if the corporation concerned is actually a financial intermediary or not. The Court actually seem settled on the legal issue that dividend income of holding companies are not subject to local business tax. However, the law does allow imposing local business taxes on dividend income of financial intermediaries and holding companies on the receiving end of adverse decisions were found to be acting as such (i.e., as financial intermediaries).

This paradigm shift has been clear in two recently decided cases by different divisions of the tax court. In the cases of CTA AC 161 and CTA AC 148, the differing divisions of the Tax Court were unanimous in hinging their respective decisions on whether the respective holding companies may be considered as financial intermediaries.

It becomes apparent that the legal issue on taxability of holding companies seem settled. Both cases relied heavily on the earlier en banc decision in CTA EB 1093, where the Court discussed why dividend income may not be subject to local business tax.

Both divisions of the Tax Court also determined if the respective corporations were operating as financial intermediaries. The decisions diverge, however, in how the respective divisions appreciated the weight of a corporation's primary purpose in arriving to their own conclusions. On the one hand, the First Division of the Tax Court in CTA AC 161 explicitly mentioned that a corporation may not be assumed to be engaged as a financial intermediary based solely on its primary purpose. The First Division seem to place due emphasis on actually proving that the corporation is, indeed, primarily engaged in activities of a financial intermediary. On the other hand, the Second Division, in CTA AC 148 case placed more importance on an analysis of the primary purpose. Although the division did not make an extensive discussion, it may be inferred that the question of being a financial intermediary may be settled by an examination of the primary purpose.

Given that the weight of a corporation's primary purpose as stated in its Articles of Incorporation has not been clearly outlined, it is only prudent to ensure that the primary purpose of any holding company be stated in such a way as to clearly reflect its intended existence as such.

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