render useless the New Rule 111 if read in connection with the view that quasi-delict comprehends both intentional and unintentional acts.[53]

The practical significance of the New Rule 111 is, to say the least, minimal. Justice Vasquez, whose proposed amendatory draft was made the basis of the new rule, admitted that he contemplated only civil actions which may be brought against the accused alone, and not against persons who may be held subsidiarily or vicariously liable for said accused's act or omission. Hence, the failure of the offended party to reserve the civil action in the criminal case, where subsidiary liability of a third person may be enforced; will not preclude the offended party from filing a separate civil action for the determination of the third person's primary liability based on Article 2180 of the New Civil Code. The objective of the Committee of preventing multiplicity of suits may thus be defeated. In real life, the offended party would reach for the coffers of the persons against whom subsidiary or vicarious liability for the offender's act may be fixed, since they are naturally more solvent than the latter.

VI. CONCLUSION

The success of the New Rule 111 will depend much on the proper appreciation by the courts of the substantive provisions it seeks to implement, i.e. Article 100 of the Revised Penal Code and Articles 32, 33, 34 and 2177 of the New Civil Code. The Revision Committee has undoubtedly well-reasoned bases for the amendments it introduced in the system of enforcement of civil liability for criminal conduct. Its discussions on the subject should not be taken lightly. Instead, the courts, in deciding the validity of the new rule should endeavor to address the basic issues raised in said discussions. Hopefully, in dealing with the new rule, the courts will be able to evolve doctrines which will serve as effective guides in the drafting of procedural rules on the subject, should the present ones be found legally untenable and practically unsatisfactory.

[53] Gupit, *Supra* note 4 at 7.

TAXATION OF FOREIGN CORPORATIONS A COMMENTARY ON MARUBENI v. COMMISSIONER OF INTERNAL REVENUE*

JOSELITO D. GONZALES
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I. INTRODUCTION

The past ten years saw the Bureau of Internal Revenue adopting a strict attitude towards foreign investors. During this period, well-reasoned rulings regarding taxation of foreign corporations were set aside to give way to new positions which allow the Government to collect more taxes from this class of taxpayers. In this pursuit, the Bureau of Internal Revenue found in the judiciary a veritable ally. In a line of cases, the Supreme Court sanctioned the interpretations of tax laws adopted by the Bureau of Internal Revenue that allow it to "catch", for taxation, the incomes of foreign corporations,[1] or to impose upon them the highest rate of tax legally possible.[2] This commentary singles out one of such cases - *Marubeni v. Commissioner of Internal Revenue*[3] - to illustrate the extreme to which this judicial policy may be carried. As will be shown later, the argument of the Government in the case, that received judicial approval, has no basis either in law or in jurisprudence.

* 177 SCRA 500 (1989).

** J.D. Candidates, 1992.

[1] British Overseas Airways Co. v. Comm'r of Internal Revenue, 149 SCRA 395 (1987).

[2] Comm'r of Internal Revenue v. Procter and Gamble PMC, 160 SCRA 560 (1988).

[3] 177 SCRA 500.

II. THE CASE

Marubeni Corporation, a Japanese corporation maintaining a branch in Manila, owns shares of stocks in Atlantic Gulf and Pacific Company (hereinafter referred to as AG & P), a domestic corporation. In 1981, AG & P declared dividends in favor of Marubeni Corporation in the amount of P1,699,440. The amount was remitted to the head office of Marubeni Corporation in Japan net, not only of the 10% final dividend tax, but also of the 15% branch profits remittance tax.

Marubeni Corporation filed a claim for the refund of the 15% remittance tax. It based its claim on a Bureau of Internal Revenue Ruling which stated that since the dividends received by Marubeni from AG & P were not effectively connected with its trade or business in the Philippines, they should not be made subject to the 15% remittance tax.

The Bureau of Internal Revenue denied the claim for refund on the ground that the amount withheld by AG & P was just sufficient to cover the tax liability of Marubeni Corporation as a non-resident foreign corporation under Article 10(2)(b) of tax treaty between the Republic of the Philippines and Japan.[4]

Marubeni Corporation appealed to the Court of Tax Appeals. The Court of Tax Appeals ruled in favor of the Government:

> Whatever the dialectics employed, no amount of sophistry can ignore the fact that the dividends in question are income taxable to the Marubeni Corporation of Tokyo, Japan ... a non-resident foreign corporation. The investments in the Atlantic Gulf & Pacific Company of the Marubeni Corporation of Japan were directly made by it and directly remitted to and received by the Marubeni Corporation of Japan. Petitioner Marubeni Corporation Philippine Branch has no participation or intervention, directly or indirectly, in the investments and in the receipt of the dividends. And it appears that the funds invested in Atlantic Gulf & Pacific Company did not come out of the funds infused by the Marubeni Corporation of Japan to Marubeni Corporation Philippine Branch ...
>
> ... While it is true that the Marubeni Corporation Philippine Branch is duly licensed to engage in business under Philippine laws, such dividends are not the income of the Philippine branch and are not taxable to said Philippine branch. We see no significance thereto in the identity concept or principal-agent relationship theory of petitioner because such dividends are the income of and taxable to the Japanese corporation ... and not to the Philippine branch.

Marubeni Corporation filed a petition for review with the Supreme Court. It reiterated its argument that following the principal-agent relationship theory, it should, like its branch, be considered a resident foreign corporation subject only to the 10% final dividend tax in accordance with Section 24(c)(2) of the National Internal Revenue Code (hereinafter referred to as NIRC) of 1977.[5] It likewise invoked in its favor the theory that the head office and its branch form only a single corporate entity and therefore, whoever made the investments in AG & P should not matter.

Hewing to the line of reasoning of the Bureau of Internal Revenue and the Court of Tax Appeals, the Solicitor General countered that the single corporate entity theory cannot be availed of when a foreign corporation enters into a business transaction independently of its branch. Thus,

> The general rule that a foreign corporation is the same juridical entity as its branch office in the Philippines cannot apply here. This rule is based on the premise that the business of the foreign corporation is conducted through its branch office, following the principal-agent relationship theory. It is understood that the branch becomes its agent here. So that when the foreign corporation transacts business in the Philippines independently of its branch, the principal-agent relationship is set aside. The transaction becomes one of the foreign corporation, not of the branch. Consequently, the taxpayer is the foreign corporation, not the branch or the resident foreign corporation.

In denying the petition of Marubeni Corporation, the Supreme Court added a new dimension[6] in the position of the Government by interpreting it in this wise:

> In other words, the alleged overpaid taxes were incurred for the remittance of dividend income to the head office in Japan which

[4] Section 24(b)(1) of the NIRC of 1977 imposes upon non- resident foreign corporations a 35% tax on income earned from Philippine sources. However Japanese corporations are made subject to a special treaty rate of 25% under Art. 10(2)(b) of the RP-Japan tax treaty.

[5] Pres. Decree No. 1158 (1977), *amended by* Exec. Order No. 37 (1986).

[6] *see infra* pp.

is a separate and distinct income taxpayer from the branch in the Philippines. There can be no other logical conclusion considering the undisputed fact that the investment (totalling 283,260 shares including that of nominee) was for purposes peculiarly germane to the conduct of the corporate affairs of Marubeni, Japan but certainly not of the branch in the Philippines. It is thus clear that petitioner, having made this independent investment attributable only to the head office, cannot now claim the increments as ordinary consequences of its trade or business in the Philippines and avail itself of the lower tax rate of 10%.

III. TAXATION OF DIVIDENDS RECEIVED BY FOREIGN CORPORATIONS PRIOR TO *MARUBENI*

There are generally two ways by which a foreign corporation may, in the economic sense, do business in the Philippines. It may incorporate a subsidiary or establish a branch.

Before 1975, the second option had a decided tax advantage. Then, the net income of a Philippine subsidiary of a foreign corporation was taxed at 25% to 35%.[7] When the after-tax net profits were distributed and remitted as dividends to a non-resident foreign corporation, a 15% or 35% withholding tax was imposed depending on whether or not the tax-sparing provision applied.[8] On the other hand, a foreign corporation doing business through a branch was made subject to only one layer of taxation, i.e., to 25% to 35% tax on its net business income[9] or to 8.75% tax on its gross dividend income.[10]

On August 24, 1975, Presidential Decree No. 778 was passed imposing a 20% tax on profits remitted by a branch to its head office. The idea behind the branch profits remittance tax, which was subsequently reduced to 15% to coincide with the tax-sparing provision, was to equalize the tax situation of a local branch and a Philippine subsidiary.[11]

The remittance tax was imposed on profits. As to what was comprehended in the term "profits" remained unclear until the Secretary of Justice rendered an opinion stating that dividends received from a domestic corporation by a foreign corporation doing business in the Philippines, though

[7] Pres. decree No. 69 (1972), sec. 24(a).

[8] *Id.*, Sec. 24(b)(1) *as amended by* Pres. Decree No. 369 (1974).

[9] *Id.*, Sec. 24(b)(2).

[10] *Id.*, Sec. 24(b)(2) *as amended by* Pres. Decree No. 369.

[11] H. DE LEON, NATIONAL INTERNAL REVENUE CODE ANNOTATED 74 (1989).

already subject to a 10% final tax on gross in accordance with Section 24(c) of the NIRC of 1939, as amended by PD 778, are still subject to the remittance tax when remitted by the branch to its head office.[12] The opinion was said to have been based on the theory that the act of remittance is a separate and distinct taxable act.[13] The theory negated the importance of determining the type of income involved for the purpose of imposing the remittance tax. It assumed that the term "profit" is synonymous to "income" and made the act of remittance of the income as the only factor determinative of the liability of a foreign corporation for the tax.

Some legal minds in the Bureau of Internal Revenue held a different view. Technically, they argued, the term "profits" refers only to income derived from the active conduct of a trade or business.[14] Hence, dividends, being mere passive income, are not subject to the remittance tax.[15] A contrary holding, they pointed out, would frustrate the policy sought to be implemented by the remittance tax.[16]

Victor C. Mamalateo of the Bureau of Internal Revenue elaborated on this in a paper presented in a tax convention held in 1980. Working within the framework of the NIRC of 1977, he compared the effective tax rates payable on corporate profits by an American corporation under three situations. He then concluded that the equality sought to be achieved by the remittance tax would be best maintained if no such tax were imposed on dividends received by a foreign corporation engaged in trade or business here. He likewise noted that the imposition of the remittance tax on such dividends would have the effect of increasing the tax rate on incomes received by foreign corporations to a level much higher than that which may be imposed by their home countries, thus deterring foreign corporations from investing in the Philippines. For better understanding, his analysis is hereunder quoted in full:

> Below is a comparison of the effective tax rates payable *on corporate profits* under three situations: a corporation with a Philippine subsidiary only; a corporation maintaining a Philippine

[12] J. NOLLEDO, COMMENTARIES AND JURISPRUDENCE ON THE NATIONAL INTERNAL REVENUE CODE OF THE PHILIPPINES 113 (Rev. Ed., 1976).

[13] *Id.*

[14] Mamalateo, *International Taxation*, Lecture delivered at the 16th & 17th Annual Institute on Tax Law of the University of the Philippines Law Center (1980-81), in ASPECTS OF PHILIPPINE TAXATION 75, 81 (1985).

[15] *Id.* at 82.

[16] *Id.* at 80-82.

as amended.[21] In fact, when the 10% tax on intercorporate dividends were removed by Executive Order No. 37[22], the Bureau of Internal Revenue ruled that dividends paid under similar circumstances are no longer subject to tax.[23]

The factual circumstance of a foreign corporation directly investing in a domestic corporation, instead of through its branch was not peculiar to *Marubeni*. The Bureau of Internal Revenue was confronted with the same situation in Bureau of Internal Revenue Ruling Nos. 49-86[24] and 180-86[25] in which it held that the foreign corporations therein involved were liable for only the 10% final tax on intercorporate dividends pursuant to Section 24(c) of the NIRC of 1977. These rulings were issued after the Government had successfully defended its position in the *Marubeni* case in the Court of Tax Appeals.

IV. STATUS OF FOREIGN CORPORATIONS FOR TAX PURPOSES

The argument of the Government in *Marubeni* centered on the proposition that the branch and the head office of a foreign corporation are two distinct taxpayers, each having a status that determines the manner by which each one should be taxed. The proposition is at once false and misleading. It is false because it assumes that a branch has a personality.[26] It is misleading because by emphasizing on the nominal term "status", it overshadows the real determinant of the taxability of a foreign corporation, i.e., the fact of doing business. A discussion of relevant corporate law principles may help clear the confusion on this point.

A corporation is an artificial being.[27] It has no existence until it has received the imprimatur of the state acting in accordance with law.[28]

[21] BIR Ruling No. 132-81 (July 1981); BIR Ruling No. 017-83 (January 6, 1983); BIR Ruling No. 087-83 (April 11, 1983); BIR Ruling No. 49-86 (April 23, 1986); BIR Ruling No. 180-86 (September 17, 1986).

[22] Exec. Order No. 37.

[23] BIR Ruling No. 026-87 (January 20, 1987).

[24] April 23, 1986.

[25] September 17, 1986.

[26] Medalla, *The Income Tax Treaty Between the Philippines and the United States*, 58 PHIL. L.J. 301, 310-11 (September 13, 1983).

[27] CORPORATION CODE OF THE PHILIPPINES, Batas Pambansa Blg. 68, Sec. 2 (May 1, 1980).

[28] *Id.*; Tayag v. Benguet Consolidated Mining Corp., 26 SCRA 242 (1968).

Although endowed with a personality separate and distinct from its shareholders, a corporation is a fiction and exists only in contemplation of law.[29] Any status attributed upon this fiction constitutes another fiction.[30] Practical considerations, however, of maintaining the rights and enforcing the liabilities of corporations require that this fiction of a fiction be indulged in.[31]

Consistently with the theory of concession[32], the citizenship, domicile and residence of a corporation are considered to be that of the country under whose laws it was incorporated.[33] This rule applies even if the corporation has an office and does business in other states whose laws permit it to do so.[34]

> A corporation can have no legal existence out of the boundaries of the sovereignty by which it is created. It exists only in contemplation of law, and by force of law; and where the law ceases to operate, and is no longer obligatory, the corporation can have no existence. It must dwell in the place of its creation, and *cannot migrate* to another sovereignty.[35]

Thus, a corporation cannot be considered a resident of a state other than that under whose laws it was created. Significantly, however, for purposes of determining the taxability of foreign corporations, the National Internal Revenue Code classifies them as "residents" and "non- residents".[36] This classification was not adopted for the purpose of fixing the residence of foreign corporations, but merely to conveniently refer to a foreign corporation which is doing business in the Philippines and to a foreign corporation which is not doing business in the Philippines. Were this not the case, a "resident foreign corporation" would be taxed by the Government on its income from all sources, consistently with the global system of taxation which uses

[29] 3 A. AGBAYANI, COMMENTARIES AND JURISPRUDENCE ON COMMERCIAL LAWS OF THE PHILIPPINES 11 (1984).

[30] 8 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, Sec. 4025 (1931).

[31] *Id.*

[32] This theory asserts that a corporation is only a creation of law and hence, where the law ceases to operate, the corporation ceases to have existence.

[33] 17 FLETCHER Sec. 8300.

[34] *Id.*

[35] 8 FLETCHER Sec. 4025 (citing Bank of America v. Earle, 10 L.Ed. 274 (1839).

[36] NATIONAL INTERNAL REVENUE CODE (NIRC), Pres. Decree No. 1158, Sec. 25(a) and (b).

citizenship or residence as the jurisdictional connection for the purpose of asserting world-wide taxing jurisdiction. As it is, however, resident foreign corporations are taxed only on income derived from sources within the Philippines.[37]

In determining the tax liability of Marubeni Corporation on dividends it received from AG & P, the Government should have *directly* addressed the issue of whether it was doing business in this jurisdiction.

No general rule can be laid down as to what act or acts constitute "doing business".[38] The test, however, that has been generally applied by the Supreme Court is whether "there is a continuity of transactions which are in pursuance of the normal business of the corporation".[39] The difficulty in making this factual determination is somewhat obviated by the Omnibus Investment Code[40] which specifies certain acts as falling within the concept. Thus,

> The phrase "doing business" shall include soliciting orders, purchases, service contracts; opening offices, whether called 'liason' offices or branches; appointing representatives or distributors who are domiciled in the Philippines or who in any calendar year stay in the Philippines for a period or periods totalling one hundred eighty days or more; participating in the management, supervision or control of any domestic business, firm entity or corporation in the Philippines; and any other act or acts that imply a continuity of commercial dealings or arrangements and contemplate to that extent the performance of acts or works, or the exercise of some of the functions normally incident to, and in progressive prosecution of, commercial gain or of the purpose and object of the business organization.[41]

Pursuant to this statutory definition, Marubeni Corporation should be classified as a foreign corporation doing business in the Philippines because it has opened a branch here. A different conclusion may be reached only by considering the act of investing in AG & P in isolation - an actuation that contravenes the directive of American authorities quoted with approval in

[37] *Id.*

[38] Mentholatum Co. Inc. v. Mangaliman, 72 Phil. 524 (1941).

[39] J. CAMPOS AND M. CAMPOS, CORPORATION CODE COMMENTS NOTES AND SELECTED CASES 999 (1981).

[40] Pres. Decree No. 1789 (1981).

[41] *Id.*, Art. 65.

Pacific Micronesian Lines, Inc. v. Del Rosario[42]: "[A]ll the combine[d] acts of the foreign corporations in the state must be considered, and every circumstance is material which indicates a purpose on the part of the corporation to engage in some part of its regular business in the states".

V. THE INTERPRETATION ADOPTED BY THE SUPREME COURT

A close reading of *Marubeni* reveals that the Supreme Court did not, as did the Government, dispute the fact that Marubeni Corporation of Japan is a foreign corporation doing business in the Philippines. What seemed not to have found favor with the Supreme Court was the manner by which Marubeni Corporation would like to be taxed on income that bore no connection with its Philippine business. Thus, the Court said:

> ... the investment ... was made for purposes peculiarly germane to the conduct of the corporate affairs of Marubeni, Japan but certainly not of the branch in the Philippines. It is thus clear that petitioner ... cannot now claim the investments as ordinary consequences of its trade or business in the Philippines and avail itself of the lower tax rate of 10%.[43]

This pronouncement has no statutory basis. Nowhere in the NIRC of 1977 is a connection between the income and the Philippine business of a foreign corporation required for the application of the lower tax rate of 10%. A review of the history of Philippine tax laws in relation to developments in the United States likewise shows that no such requirement was contemplated by the legislative authorities.

The first law imposing income taxes in the Philippine jurisdiction was the United States Income Tax Law of 1913 which was extended to the Philippines by the Act of Congress of October 3, 1913.[44] Under this law, foreign corporations were taxed in almost the same manner as domestic corporations, that is, on net basis.[45] The only difference was that with regard to the former, taxing jurisdiction was limited to income derived from sources

[42] 96 Phil. 23, 29 (1954).

[43] *Marubeni*, 177 SCRA at 509.

[44] C. REY, TAX CODE ANNOTATED (Rev. Ed., 1964).

[45] Ross, Stanford, *U.S. Taxation of Aliens and Foreign Corporations: The Foreign Investors Tax Act of 1966 and Related Developments*, 22 TAX L. REV. 280 (March 1967).

within the territorial jurisdiction of the taxing authority.[46] This pattern of taxation of alien corporations remained controlling in the Philippines until 1959, despite several amendments of the tax laws[47] in the interregnum.

In 1959, the Congress passed Republic Act No. 2343[48] which classified foreign corporations, for tax purposes, into "residents" and "non-residents". Resident foreign corporations or those which are engaged in trade or business in the Philippines continued to be taxed on net basis on all incomes derived from sources within the Philippines.[49] Non-resident foreign corporations or those which are not engaged in trade or business in the Philippines were taxed at a flat rate of 30% on interests, dividends, salaries, wages, premiums, annuities, compensation, remuneration, emoluments or other fixed or determinable annual or periodical gains, profits and income royalties and other incomes received from sources within the Philippines.[50]

This major revision in the system of taxing alien corporations escaped congressional scrutiny during the deliberations of House Bill No. 1825 , the bill that became Republic Act No. 2343. Its source was not even revealed during the deliberations. In justifying the higher rates of taxes the bill sought to impose upon individuals and corporations, the proponents constantly referred to the tax laws of the United States[51], where this tax pattern had been in effect as early as 1936.[52]

The manner of taxing foreign corporations in the United States was changed by the Foreign Investors Tax Act of 1966 which introduced the concept of "income effectively connected with the conduct of a trade or business within the United States".[53] This concept displaced the test of engaging in trade or business as the determining standard for taxing incomes derived by foreign persons from sources within the United States.[54] If the income is effectively connected with a U.S. business, it is subject to regular corporate rates on net basis.[55] Otherwise, a flat 30% rate is applied on the

[46] *Id.*

[47] Act. No. 2833 (1919); Comm. Act No. 117 (1936); Comm. Act 466 (1939)

[48] June 20, 1959.

[49] *Id.*, Sec. 3.

[50] *Id.*

[51] 1 HOUSE CONGRESSIONAL RECORD 2335-43; 2362-69;2626-55 (April 1958).

[52] Ross, *supra* note 45 at 282.

[53] 8 MERTENS,LAW OF FEDERAL INCOME TAXATION Sec. 45.20a (1978).

[54] *Id.*

[55] *Id.*

gross amount of income received by foreign corporations from U.S. sources.[56] One of the avowed purposes of this revision was to do away with the "anomalous result" of an "investment income of a foreigner derived from the United States [being] taxed at one rate if he was engaged in a business in the United States but taxed at another rate where he did not have such a United States business, *even though in either case the business had no relation or connection with the investment income*".[57]

This discussion on the Foreign Investors Tax Act of 1966 only shows that no connection between the income and the business of a foreign corporation was required under the Federal Internal Revenue Act of 1936, the apparent source of Republic Act No. 2343. The amendments made in Philippine tax laws relating to foreign corporations since 1959 do not merit a deviation from this interpretation. The most significant of these amendments, i.e., the segregation of dividends from that class of incomes of domestic and resident foreign corporations that is taxed at net[58] and the imposition of a tax on profits remitted by a branch to its head office[59], did not strike into the core of the system of taxation of alien corporations established by Republic Act No. 2343.

VI. CONCLUSION

The provisions of the NIRC involved in the *Marubeni* case are clear enough to require no interpretation. Even if there is an obscurity in these provisions, the conclusion reached by the Supreme Court is still not justified. Tax burdens should not be lightly presumed. In every case of doubt, tax statutes are construed most strongly against the Government and in favor of the citizen.[60]

[56] *Id.*

[57] *Id.*

[58] Pres. Decree No. 299-A (September 21, 1973).

[59] Pres. Decree No. 778.

[60] Comm'r. of Internal Revenue v. Trinidad, 43 Phil. 803 (1922); Manila Railroad Co. v. Collector, 52 Phil. 950 (1929).