REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE
National Office Building
Quezon City

Sections 27 (A) and (D) and 42 of the Tax Code, as amended; Revenue Regulations No. 2-1998, as amended.
BIR Ruling No. OT-420-2022; BIR Ruling No. OT-179-2022
OT- 015-2025
JAN 07 2025

REYES TACANDONG & CO.
BDO Towers Valero
8741 Paseo de Roxas
Makati City 1226 Philippines

Attention: **ELEANOR M. MONTENEGRO**
Tax Services

Gentlemen:

This refers to your request on behalf of your client, Julie's Franchise Corporation (JFC), for confirmation that:

1. The franchise fees received by JFC are subject to twenty – five percent (25%) regular corporate income tax and not to the twenty percent (20%) final withholding tax (FWT) on royalties and other passive income; and

2. The franchise fees are subject to the expanded withholding tax (EWT) of two percent (2%) if the franchisee/payor belongs to the top 20,000 corporations by the Bureau.

Background:

1. JFC is a domestic corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines and registered with the (a) Securities and Exchange Commission with Company Registration Number No. and (b) Bureau of Internal Revenue (BIR) with Taxpayer Identification Number

2. JFC is engaged in franchising business and, in relation thereto, one of its primary purposes is to conduct, carry on and deal in the business of acquiring, developing,

[1] Per Certificate of Filing of Amended Articles of Incorporation dated November 16, 2022.

managing and utilizing any and all tradenames, trademarks, service marks, brand names, copyrights, patents, charters, goodwill, master franchises and licenses, including other intellectual property rights, necessary to commence and operate the relevant business enterprise, as well as to grant, issue, allow, permit, authorize sanction and accredit the use, employment, exploitation and availment of such tradenames, trademarks service marks, brand names, copyrights, patents, charters, goodwill, master franchises and licenses and other intellectual property rights, for and in consideration of the payment of fees, dividends, royalties, charges, dues, commissions and remunerations, and in connection therewith, to set up, create and establish management services, techniques, technologies and networks for the expansion of the business enterprises relating to the acquisition, development, management and utilization of tradenames, trademarks, service marks, brand names, copyrights, patents, charters, goodwill, master franchises and licenses and other intellectual property rights (the Primary Purpose).[2]

3. JFC owns the valuable trademark, service mark, and tradename "Julie's Bakeshop" in addition to various trademarks, service marks, trade names, mascots, slogans, designs, insignias, emblems, symbols, package designs, distinctive building designs, and architectural features, logos, and other propriety identifying characteristics; and a distinctive system for merchandising its products through the operation of Julie's Bakeshop (collectively, the Systems and Marks).

4. JFC has existing Franchise Agreements with Ma. Ana C. Montenegro,[3] Angeli Marie F. Acasio,[4] and Lakambini Y. Chui,[5] (collectively, the Franchisees) for the grant of a non-exclusive license to construct, own and operate a Julie's Bakeshop and to use the System and Marks of JFC in the operation of the said Franchise.

5. Under the Franchise Agreements, JFC, among others: (a) retains all rights with respect to the operation of Julie's Bakeshops as well as the relating Systems and Marks;[6] (b) shall conduct training programs for the franchisees and their respective personnel;[7] and (c) at its option, make available to or specify for Franchisee an applicable software license for computer software packages designed and developed for the system by JFC or on its behalf.[8]

6. For the licensing of its operations, JFC is paid a franchise fee in the amount of PhP168,000.00 inclusive of 12% value added tax and a continuing license fee of five percent (5%) based on Franchisees' gross sales (the Royalty Fees).[9]

In reply, please be informed that Section 27 (D) (1) of the National Internal Revenue Code of 1997, as amended (Tax Code) provides that royalties received by domestic corporations from sources within the Philippines shall be subject to FWT at the rate of twenty percent (20%), to *wit*:

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[2] Per Amended Articles of Incorporation, as further amended on August 30, 2022.
[3] February 2, 2023; Franchise period is from January 1, 2023 to June 18, 2025.
[4] Executed by the parties but unnotarized; Franchise period is from January 1, 2023 to June 18, 2025.
[5] February 2, 2023; Franchise period is from January 1, 2023 to February 7, 2028.
[6] Article 1(c) of the Franchise Agreements.
[7] Article 2 of the Franchise Agreements.
[8] Article 3 of the Franchise Agreements.
[9] Article 7 of the Franchise Agreements.

"SEC. 27. Rates of Income tax on Domestic Corporations. —

xxx xxx xxx

(D) Rates of Tax on Certain Passive Incomes. --

(1) Interest from Deposits and Yield or any other Monetary Benefit from Deposit Substitutes and from Trust Funds and Similar Arrangements, and Royalties. — A final tax at the rate of twenty percent (20%) is hereby imposed upon the amount of interest on currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements received by domestic corporations, and royalties, derived from sources within the Philippines. xxx" (Underscoring supplied)

Section 42(A)(4) of the Tax Code provides that royalties received from the following transactions shall be treated as gross income from sources within the Philippines:

"SEC. 42. Income from Sources Within the Philippines

(A) Gross Income from Sources Within the Philippines. – The following items of gross income shall be treated as gross income from sources within the Philippines:

xxx xxx xxx

(4) Rentals and Royalties. – Rentals and royalties from property located in the Philippines or from any interest in such property, including rentals or royalties for –

(a) The use of or the right or privileges to use in the Philippines any copyright, patent, design or model, plan, secret formula or process, goodwill, trademark, trade brand or other like property or right;

(b) The use of, or the right to use in the Philippines any industrial, commercial or scientific equipment;

(c) The supply of scientific, technical, industrial or commercial knowledge or information;

(d) The supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right as is mentioned in paragraph (a), any such equipment as is mentioned in paragraph (b) or any such knowledge or information as is mentioned in paragraph (c); xxx." (Underscoring supplied)

Based on the foregoing provisions, it is clear that to be subject to the twenty percent (20%) FWT, the royalties must be in the nature of passive income as defined in Section 42 (A) (4) of the Tax Code.[10] Otherwise, said income shall be considered as ordinary or taxable income subject to the regular income tax rate of: (a) thirty percent (30%) for income earned before July 1, 2020; or (b) twenty-five percent (25%) for income earned after July 1, 2020 pursuant to Section 27 (A) of the Tax Code.

[10] BIR Ruling No. 57-2000 dated November 7, 2000.

In the case of *Commissioner of Internal Revenue v. Shinko Electric Industries Co., Ltd.,*[11] citing the case of *Chamber of Real Estate and Builders Associations, Inc. vs. The Honorable Executive Secretary Alberto Romulo, et al.,*[12] the Supreme Court explained that passive income refers to those income that is not generated in the active pursuit and performance of the corporation's primary purpose but arises from the company's assets. Therefore, such passive income is subject to final taxes and not covered by regular income tax.

Applied in this case, documents show that the Royalty Fees received by JFC from its Franchisees by virtue of its Franchise Agreements refer to income generated by JFC from activities that are in accordance with its Primary Purpose. Accordingly, such Royalty Fees are considered income generated in the active pursuit and performance of JFC's business, and therefore are classified as ordinary business income subject to regular corporate income tax.

Such being the case, this Office hereby rules that the Royalty Fees received by JFC from its Franchisees are not passive income subject to the twenty percent (20%) FWT but are considered ordinary or taxable income subject to the regular income tax rate of: (a) thirty percent (30%) for income earned before July 1, 2020; or (b) twenty-five percent (25%) for income earned after July 1, 2020.

On the issue on the applicable withholding tax rate, please be informed that Section 2.57.2 (I) of RR No. 2-98, as amended,[13] states that:

> *"Section 2.57.2. Income Payments subject to Creditable Withholding Tax and Rates prescribed thereon. —*
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> *xxx xxx xxx*
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> *(I) Income payment made by top withholding agents, either private corporations or individuals, to their local/resident supplier of goods and local/resident supplier of services other than those covered by other rates of withholding tax. [formerly under letters (M) and (W)] — Income payments made by any of the top withholding agents, as determined by the Commissioner, to their local/resident supplier of goods/services, including non-resident aliens engaged in trade or business in the Philippines, shall be subjected to the following withholding tax rates:*
>
> *Supplier of goods — One percent (1%)*
> *Supplier of services — Two percent (2%)"*

Based on the foregoing, if the payor of the Royalty Fees is one of the top withholding agents as determined by the BIR, then such Royalty Fees shall be subject to EWT of two percent (2%) which shall be credited against the income tax due on the taxable income of JFC. However, if the payor of the Royalty Fees is not one of the top withholding agents as

[11] G.R. No. 226287, July 6, 2021.
[12] G.R. No. 160756, March 9, 2010.
[13] As amended by RR No. 11-2018.

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determined by the BIR, then such Royalty Fees shall not be subject to EWT of two percent (2%) since the said income is not among those enumerated under RR No. 2-1998, as amended.

This ruling is issued on the basis of the foregoing facts as represented. However, if upon investigation it shall be disclosed that the facts are different, then this ruling shall be considered null and void.

Very truly yours,

ROMEO D. LUMAGUI, JR.
Commissioner of Internal Revenue

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