REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE
Quezon City

Section 27 (A) and (D) (1), Tax Code of 1997, as amended
BIR Ruling No. 057-00
OT-[illegible]
APR 26 2022

REYES TACANDONG & CO.
Citibank Tower
8741 Paseo De Roxas
Makati City 1226

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

Gentlemen:

This refers to your request for confirmation that the franchise fees/royalty fees received by the Max's Group, Inc. [1] ("the Company") and its subsidiaries from third party franchisees of its various brands are not subject to the 20% final withholding tax (FWT) on passive royalty income under Section 27 (D) (1) but rather to the 25% regular corporate income tax imposed under Section 27 (A) of the National Internal Revenue Code (Tax Code) of 1997, as amended. You also seek confirmation that the Company's franchisees who are classified as among the top 20,000 private corporations should subject the franchise fee/royalty fees paid to the Company to 2% expanded withholding tax (EWT) pursuant to Section 2.57.2 (M) of Revenue Regulations (RR) No. 2-98, as amended. The Company's subsidiaries that are similarly receiving said franchise royalty fees/franchise fees as the Company include: (i) Max's Kitchen, Inc.[2]; (ii) Teriyaki Boy Group Inc.[3]; and (iii) The Real American Doughnut Company, Inc.[4].

It is represented that **Max's Group, Inc.**, with Taxpayer's Identification No.
is engaged in the business of establishing, operating, and maintaining restaurants, coffee shops, refreshment parlors, cocktail lounges, providing food catering and related services, and establishing and operating commissaries to manufacture, process and distribute food and food items. Incident to the pursuit of the foregoing business activities, the Company is authorized to engage in, conduct, carry on and deal in the business of acquiring, developing, managing and utilizing any and all tradenames, trademarks, service marks, brand names, copyrights, patents, charters, goodwills, master franchises, and licenses and accredit the use, employment, exploitation and availment of such for and in consideration of the payments fees, dividends, royalties, charges, dues, commissions and renumerations.

In the ordinary and regular pursuit of its business and operation and maintaining restaurants and acquiring, developing, managing and utilizing master franchises and licenses, the Company

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[1] Doing business in the name and styles of Max's Restaurant, Pancake House, Maple, Dencio's, Singkit, Yellow Cab, Teriyaki Boy, Sizzlin' Steak, Max's Corner Bakery, Max's Group Kitchen, Max's All About Chicken and All About Chicken, (formerly, Max's Group, Inc., doing business in the name and style of Pancake House, Maple, Dencio's and Singkit).
[2] Doing business under the names and styles of Max's Restaurant and Max's Kabisera (formerly: Max's Kitchen, Inc.)
[3] Doing business under the names and styles of Teriyaki Boy and Sizzling Steak
[4] Doing business under the names and styles of Krispy Kreme and Jamba Juice (formerly: The Real American Doughnut Company, Inc.)

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enters into Franchise Agreements with third parties for the establishment and operations of franchise fees and royalties from said third party operators of franchised restaurants. Under its standard Franchise Agreement, the Company undertakes the following (among others) for the franchised restaurant or franchisee:

- Conduct of training programs, refresher training programs, and seminars;
- Provision of support training team during soft operating phase of a franchised restaurant;
- Standardization of advertising and promotion; including maintenance of an advertising and development fund;
- Development of Proprietary recipes and products;
- Accreditation of suppliers and service providers;
- Other operations assistance activities.

The following subsidiaries' Amended Articles of Incorporation also contain provisions on developing, managing, marketing and utilizing master franchises and licenses, its brand or goodwill:

a. Max's Kitchen, Inc.
b. Teriyaki Boy Group, Inc; and
c. The Real American Doughnut Company, Inc.

In reply thereto, please be informed that Section 27 (A) of the Tax Code of 1997, as amended, defines the general corporate income tax rates, to wit:

"SEC. 27. *Rates of Income Tax on Domestic Corporations.* –

(A) In General. - Except as otherwise provided in this Code, an income tax rate of twenty-five percent (25%) effective July 1, 2020, is hereby imposed upon the taxable income derived during each taxable year from all sources within and without the Philippines by every corporation, as defined in Section 22(B) of this Code and taxable under this Title as a corporation, organized in, or existing under the laws of the Philippines.

Provided, That corporations with net taxable income not exceeding Five million pesos (P5,000,000.00) and with total assets not exceeding One hundred million pesos (P100,000,000.00), excluding land on which the particular business entity's office, plant, and equipment are situated during the taxable year for which the tax is imposed, shall be taxed at twenty percent (20%).

xxx xxx xxx"

Whereas, under Section 27 (D) (1) of the Tax Code, as amended, which deals on royalties, it states:

"SEC. 27. *Rates of Income Tax on Domestic Corporations.* –

xxx xxx xxx

***(D) Rates of Tax on Certain Passive Incomes.* –**

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(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: Provided, however, That interest income derived by a domestic corporation from a depository bank under the expanded foreign currency deposit system shall be subject to a final income tax at the rate of fifteen percent (15%) of such interest income.

In the case of ***Chamber of Real Estate and Builders Associations, Inc. vs. the Hon. Executive Secretary, G.R. No. 160756***, dated March 9, 2010 and citing BIR Ruling No. DA-501-2004 dated September 24, 2004, the Supreme Court states that:

> *"...if the income is generated in the active pursuit and performance of the corporation's primary purposes, the same is not passive income..."*

To be subject to the 20% FWT, the royalties must be in the nature of a passive income. The royalties and fees received by Max's Group, Inc. and its subsidiaries, are in the nature of "active and ordinary income" for tax purposes, since Section 27 (D) (1) of the Tax Code, as amended, denotes that the royalty income subject to passive income tax must be passive, unlike in the case at hand where the royalty income earned was one of the primary activities of the Company.

In the case of *Iconic Beverages Inc. vs. Commissioner of Internal Revenue, CTA Case No. 8604 dated August 14, 2015* and as upheld under *CTA EB No. 1412 and 1417 dated January 30, 2018*, it stated that:

> *"...Petitioner likewise contends that even assuming that petitioner's royalty income was derived in connection with the active conduct of trade or business, Section 27(D)(1) of the NIRC of 1997 does not distinguish between royalty earned in pursuit of the corporation's primary purpose and one that is not. On this matter, let it be noted that the rates of tax provided under Section 27(D) of the NIRC of 1997, as amended, pertains to certain passive income.* ***As previously mentioned, if the income is generated in the active pursuit and performance of the corporation's primary purposes, the same is not passive income.*** *In view of the Supreme Court's pronouncement as regards the definition of passive income, the determination as to whether the royalty income is passive income is necessary before the tax rates provided in Section 27(D) of the NIRC of 1997, as amended, may apply to the said royalty income. Thus, the Court finds petitioner's argument bereft of merit. All the foregoing only leads the Court to conclude that petitioner's income from licensing out its IP rights is income generated in active pursuit and performance of petitioner's primary purpose and thus, is not passive income."*

Given the foregoing, this Office hereby confirms that the subject income should be considered as "active income" subject to regular corporate tax rate and not the final tax on passive income on royalties.

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 states that:

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"Section 2.57.2. Income Payments subject to Creditable Withholding Tax and Rates prescribed therein. ----....

xxx xxx xxx

(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%)

xxx xxx xxx"

(Emphasis Supplied)

Accordingly, if the payor of royalties is one of the top 20,000 corporation designated by the Bureau of Internal Revenue (BIR), then the royalty shall be subject to the withholding tax of 2% which shall be credited against the tax due on the taxable income of Max's Group, Inc. However, if the payor of royalties is not one of the top 20,000 corporations designated by the BIR, then the royalty shall not be subject to withholding tax since the said income is not among those enumerated under R.R. No. 2-98, as amended, as being subject to withholding tax as required under Section 57 of the Tax Code of 1997, as amended.

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

Very truly yours,

CAESAR R. DULAY
Commissioner of Internal Revenue

By:
MARISSA O. CABREROS
Deputy Commissioner
Legal Group
Officer-in-Charge

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