June 3, 2019

BIR RULING NO. 323-19

Sec. 27 (D) (1), Tax Code; BIR Ruling Nos. 069-16; 057-00

Isla Lipana & Co.
29th Floor, Philamlife Tower
8767 Paseo de Roxas, 1226 Makati City

Attention: *AAA*

Gentlemen :

This refers to your letter dated August 2, 2017 requesting on behalf of your client, **Goldilocks Bakeshop, Inc.** for confirmation that the royalty income received by it from its licensing and franchising activities is considered ordinary income, hence, subject to the normal corporate income tax of 30%.

As represented, **GOLDILOCKS BAKESHOP, INC. (GBI)** is a domestic corporation incorporated and registered with the Philippine Securities and Exchange Commission (SEC) under Company Registration No. 38459 dated May 9, 1969 primarily engaged in selling, baking, manufacturing, and distributing all kinds of food products such as, but not limited to, cakes, pastries, breads, and candies.

It is likewise engaged in the business of franchising Goldilocks Bakeshop stores and licensing of comprehensive manufacturing and baking plant systems to both affiliates and independent third parties. In relation to this, the Company receives royalty payments from its various franchised Goldilocks Bakeshop stores and licensed systems.

On July 27, 2015, GBI submitted to the SEC an amended Articles of Incorporation to reflect several additions to its primary purpose. Following the amendment, the purpose for which GBI was formed was changed as follows:

"PRIMARY PURPOSE

To carry on the business of buying and selling, baking, manufacturing and producing,

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dealing and distributing all kinds of goods, chattels and commodities which are or may be the subject of the commerce of man such as but not limited to cakes, pastries, bread and candies as well as to export and/or import the said goods, articles, products and merchandise, and generally to engage as a general merchant in local trading either by wholesale, retail or franchising; to establish, operate and maintain restaurants, refreshment parlors or other food outlets; to serve, arrange, cater food, drinks refreshments and other food or commodities, and to act as indentor, factor, manufacturer's representative, commercial broker, commission agent or in any other representative capacity for domestic or foreign companies, to offer such services to the public, and to do and perform such other acts and things necessary or incidental to the accomplishment of the foregoing corporate business and objects insofar as may be allowed by applicable laws and rules and regulations, including, without limitation, to invest, own or hold interest in similar businesses."

In reply thereto, please be informed that your opinion is hereby confirmed as follows:

Section 27 (D) (1) of the Tax Code of 1997, as amended provides —

"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: 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 tax at the rate of seven and one-half percent (7-1/2%) of such interest income."

As expressly denoted in the caption, to be subject to the 20% final withholding tax, the royalties must be in the nature of passive income as defined in Section 42 (A) (4) of the Tax Code.

Since the income derived by GBI from its licensing and franchising activities is income generated in the active pursuit and performance of its primary purpose, the same is clearly not passive income subject to the 20% final tax. Such being the case, the payments received by GBI from the active conduct of trade or business is considered ordinary business

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income subject to the 30% regular corporate income tax. Stated differently, the royalty fees received by GBI is in the nature of ordinary business income because the aforesaid income was derived or generated from activities that are in accordance with the primary purpose of GBI which is to operate and franchise Goldilocks Bakeshop stores as provided in its Articles of Incorporation.

In view of the foregoing, the royalty income derived by GBI in the conduct of its business shall form part of its ordinary income subject to the 30% regular corporate income tax.

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

Very truly yours,

(SGD.) CAESAR R. DULAY
Commissioner of Internal Revenue

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