**October 30, 2019**

# BIR RULING NO. 672-19

Secs. 28 (B) (1), 23 (F), 42 (C) (3) & 108 (A) of the Tax Code of 1997, as amended;
BIR Ruling No. 009-05

*Navarro Amper & Co.*
19th Floor Net Lima Plaza
5th Avenue corner 26th Street
Bonifacio Global City, Taguig

Attention: *AAA*

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Gentlemen :

This refers to your letter dated December 4, 2014, requesting for an opinion on behalf of your client, ESET Asia Pte. Ltd. (ESET), that the income payments related to the services performed outside the Philippines, shall not be subject to Income Tax and consequently, to withholding Tax and Value-Added Tax (VAT) in the Philippines, in connection to the Software Distribution Agreement between ESET and Valueline Systems & Solutions Corporation (Valueline).

Documents disclosed that Valueline is a corporation organized and existing under the laws of the Philippines and that the purposes for which it was incorporated is to engage in the business of trading and importation of goods such as Computer Hardware/Software/Office Equipment on wholesale/retail basis and allied services; that ESET, on the other hand, is a company organized and existing under the laws of the Republic of Singapore with principal office address located at 371 Beach Road, Keypoint Building #20-07, Singapore 199597; that ESET is not registered as a corporation or as partnership in the Philippines as evidenced by Certification of Non-Registration of Company issued by the Securities and Exchange Commission (SEC); that on January 01, 2013, ESET, spol. S.r.o., the parent company of ESET situated at Einsteinova 24, 851 Bratislava executed the principal agreement with Valueline, and the gist of the agreement are as follows:

a. ESET shall grant a limited exclusive distribution right for the distribution of the Software by the Distributor;

b. The Distributor shall not be entitled to modify or manipulate the

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Software, including, but not limited to modification of its object code and installation files, except where it is permitted by this Agreement or where ESET previously released the written approval hereof for the Distributor;

c. ESET shall make available and shall deliver the Software to the Distributor and End Users in the Form of digital downloads from dedicated server of ESET;

d. The Distributor shall be obliged to provide for the free support for the software in official languages of the territory. The helpdesk must be provided by sufficiently qualified employees of the Distributor and it must be available at least during the ordinary business hours of the distributor in business days;

e. The distributor hereby agrees that it is aware of the fact that ESET is the owner to all the rights to the Software. Nothing in the Agreement can be interpreted by means from which it would arise the ESET awarded the Distributor with any rights to the software and its documentation by any means of by any other laws

that the modes of transferring the software from ESET to the end-user of software in the Philippines:

a. On line sale

- Software is downloaded directly from est.com. Valueline will be the one who will provide the End-user the activation key which was ordered from ESET beforehand. The software gets activated in the systems once end-user enters the details of the activation key.

b. CD boxes sale

- Valueline purchases blank CD boxes from third parties in Philippines. Valueline has to download the software from ESET server located in Slovakia into tangible media (CD/DVD) and sell the software in a packaged box along with the documentation.

- Valueline is not in possession of any Master Copy of the software for preparing the copies of the software in the tangible media. It is only an installation CD whose purpose is to mass produce the software. The installation CD is not active software since an activation key is still needed to make software work (which is included separately in the boxes).

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- Then these boxes are distributed to retail store in Philippines where end-users may buy them. Once the end-user purchases the CD and installs the software in the systems hardware to log into the website of the ESET, end-user enters an activation key (part of the packaged software) for software activation. The software gets activated in the system in case the product sale details match with the ESET records.

- Once the software is activated, the CD containing the software cannot be activated in any other system since the activation key that comes with it has been used already. Unless, the end-user purchased another activation key of the same product

and that on December 31, 2013, an Assignment and Assumption Agreement was executed, transferring all the rights and obligation of ESET, spol. S.r.o. to ESET with due consent of Valueline.

In reply thereto, please be informed that Section 28 (B) (1) of the Tax Code of 1997 provides that —

*"SEC. 28. Rates of Income Tax on Foreign Corporations. —*

xxx xxx xxx

*(B) Tax on Nonresident Foreign Corporation.*

*(1) In General. — Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-five percent (35%) of the gross income received during each taxable year from all sources within the Philippines, such as interests, dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits and income, and capital gains, except capital gains subject to tax under subparagraph 5 (c): Provided, That effective January 1, 2009, the rate of income tax shall be thirty percent (30%). . . ."*

In the same manner, Section 23 (F), *supra* states that —

*"SEC. 23. General Principles of Income Taxation in the Philippines. —*

xxx xxx xxx

*(F) A foreign corporation, whether engaged or not in trade or business in the Philippines, is taxable only on income derived from sources within the Philippines."*

In the same vein, Section 42 (C) (3), *supra* provides that —

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"*SEC. 42. Income from sources within the Philippines. —*

*(C) Gross Income from Sources without the Philippines. — The following items of gross income shall be treated as income from sources without the Philippines:*

xxx xxx xxx

*(3) Compensation for labor or personal services performed without the Philippines:*

xxx xxx xxx"

Prescinding from the above-cited provisions, it is undisputed that a non-resident foreign corporation is subject to Philippine income tax of 30% only in respect of the gross income received from all sources within the Philippines. Conversely, if the gross income is received from sources outside the Philippines, the same is not subject to Philippine income tax. Thus, the situs of taxation for services is the place where the service is rendered.

The rule in this jurisdiction regarding tax situs is that the source of income is the property, activity or service that produced the income; the test of taxability is the "source" and the source of income is that activity which produced the income. [1] With regard to compensation for labor or personal services, services performed within the Philippines, regardless of the residence of the payor, or of the place in which the contract for services was made, or of the place of payment, is gross income from sources within the Philippines. [2] Stated differently, the situs of the income derived from labor or personal services is determined solely by the place where service is rendered. [3] Compensation from services performed abroad is considered income from sources without the Philippines. (BIR Ruling No. 009-05 dated August 2, 2005)

In this particular case, the source of income (*i.e.*, distribution of software) takes place in the Philippines. The distributor, Valueline, is a domestic company, located in the Philippines, and under the Agreement, the software shall be distributed in the Philippines; hence the service, being performed in the Philippines, is taxable in the Philippines.

Section 108 (A) of the Tax Code of 1997 provides that VAT shall be imposed on gross receipts derived from the sale or exchange of services, and the use or lease of properties. The same provision of the Tax Code provides that the phrase "sale or exchange of services" means the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration. In the case of Valueline and ESET, the services to be rendered by the latter to the former will be done in the Philippines. Consequently, payments of service fees by Valueline pursuant to the Agreement, shall be subject to VAT.

IN VIEW OF THE FOREGOING, this Office opines that the payments to be made by Valueline to ESET for services rendered in the Philippines are subject to Philippine

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income tax, withholding tax and VAT.

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 as null and void.

Very truly yours,

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

## Footnotes

1. *CIR v. British Overseas Airways Corporation*, G.R. Nos. 65773-74, April 30, 1987.
2. Section 155, Revenue Regulations No. 2.
3. *CIR v. Japan Air Lines, Inc.*, G.R. No. 60714, October 4, 1991.

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