**April 30, 2018**

# BIR RULING NO. 743-18

Sec. 27 (A) & (D) (1) 1997 NIRC; RR 14-02; RR 2-98; RR 14-08; BIR Ruling No. 057-00

*Sycip, Gorres, Velayo & Co.*
6760 Ayala Avenue
Makati City

Attention: *AAA*

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Gentlemen :

This refers to your letter dated July 2, 2014, requesting for confirmation that the income derived by your client, The Walt Disney Company (Philippines), Inc. (Walt Disney Philippines), payable by its Philippine licensees under the License Agreements (LA) are subject to the 30% regular corporate income tax under Section 27 (A) of the Tax Code of 1997, as amended, and not to the 20% final withholding tax under Section 27 (D) (1) of the same Tax Code and that the said payments made by Philippine licensees classified as top 20,000 private corporations are subject to the 2% expanded withholding tax under Section 2.57.2 (M) of Revenue Regulations (RR) No. 2-98, as amended.

It is represented that Walt Disney Philippines (TIN 000-000-000) is a domestic corporation, established under the laws of the Philippines and registered with the Securities and Exchange Commission (SEC) in November 29, 2013 with Company Registration No. CS201317671, to engage in licensing in the Philippines for the use of intellectual property rights over licensed products, such as Disney and Marvel characters; that Walt Disney Philippines operates and falls under the Disney Consumer Product (DCP) business unit segment of The Walt Disney Company in the US which is involved in merchandising of the Disney brand and Disney properties worldwide; and that the ownership of such license or intellectual property rights over the Walt Disney brand is retained by The Walt Disney Company and its affiliates in the US.

It is further represented that Walt Disney Philippines' primary business, as stated in the Company's Articles of Incorporation approved by the SEC, is "to enter into contracts allowing the use of the Corporation's intellectual property rights by licensees in the Philippines"; and that, as of July 2014, Walt Disney Philippines has executed various

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LA's with thirty three (33) Philippine licensees covered by forty four (44) contracts, for the right to use Disney and Marvel characters and other licensed products and materials.

It is finally represented that under the LA, the Philippine licensees shall pay the following fees to Walt Disney Philippines:

1. Royalty fees for the grant of a non-exclusive, non-transferable license to use Disney and Marvel characters or Disney products and/or properties, as specifically provided under the Standard Terms and Conditions of the License Agreement;

2. Common Marketing Fund (CMF) as contribution to a pool of non-refundable amounts to support the overall Disney licensing program, including national or local advertising, marketing and promotion, market research, advertising, retail support of Licensed Products and/or other Disney properties; and

3. License administration fees collected to defray the costs incurred by Walt Disney Philippines in connection with the administration of the License Agreement, including the operation and maintenance of the digital media center.

Based on the foregoing, you now request for confirmation that:

1. The royalty fees, CMF contribution and license administration fees payable by the Philippine licensees are considered active income of Walt Disney Philippines that are subject to the 30% regular corporate income tax under Section 27 (A) of the Tax Code of 1997, as amended, and not to the 20% final withholding tax under Section 27 (D) (1) of the same Tax Code; and

2. The said payments to Walt Disney Philippines by its Philippine licensees classified as among the Top 20,000 private corporations are subject to the 2% expanded withholding tax pursuant to Section 2.57.2 (M) of RR No. 2-98, as amended.

In reply thereto, please be informed that:

1. Section 27 (A) of the 1997 Tax Code, as amended, prescribes that domestic corporations shall be subject to the regular corporate income tax of thirty percent (30%) imposed on the taxable income derived for each taxable year from sources within and without the Philippines. The term *'taxable income'* is defined in Section 31 of the 1997 Tax Code, as amended, as the pertinent items of gross income less the deductions and/or personal and additional exemptions, if any, authorized for such types of income by this Code or other special laws. Section 32 of the same Code provides that *'gross income'*

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includes all income derived from whatever source, such as but not limited to the following items:

> "(1) Compensation for services in whatever form paid, including, but not limited to fees, salaries, wages, commissions, and similar items;
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> (2) Gross income derived from the conduct of trade or business or the exercise of a profession;
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> (3) Gains derived from dealings in property;
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> (4) Interests;
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> (5) Rents;
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> **(6) Royalties**;
>
> (7) Dividends;
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> (8) Annuities;
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> (9) Prizes and winnings;
>
> (10) Pensions; and
>
> (11) Partner's distributive share from the net income of the general professional partnership." (Emphasis supplied.)

On the other hand, Section 27 (D) (1) of the 1997 Tax Code states:

> "(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 benefits 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 or a resident foreign 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." (Emphasis ours.)

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. On the other hand, the royalties, CMF contribution and license administration fees received by Walt Disney Philippines are in the nature of active income arising from the active pursuit of its business because these activities are in accordance with its primary purpose, which is "to enter into contracts allowing the use of the Corporation's intellectual property rights by licensees in

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the Philippines."

In *BIR Ruling No. 057-00 dated November 7, 2000*, this Office had the occasion to rule, *viz.*:

xxx xxx xxx

"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.

On the other hand, since the income derived by MKI-Phils. from the distribution of the Licensed Computer Systems to Philippine banks and the performance of support services is income generated in the active pursuit and performance of its primary purpose, this Office confirms your opinion that the same is clearly NOT passive income subject to the 20% final tax. Such being the case, the payments received by MKI-Phils. from the active conduct of trade or business is considered ordinary business income subject to the 33% for 1999 regular corporate income tax."

Accordingly, the said royalty fees, CMF contribution, and license administration fees paid to Walt Disney Philippines by its Philippines Licensees are subject to the 30% regular corporate income tax under Section 27 (A) of the Tax Code of 1997, as amended, and not to the 20% FWT under Section 27 (D) (1) of the same Code.

2. For withholding tax purposes, RR No. 2-98, as amended by RR No. 14-08 dated November 26, 2008 and RR No. 06-09 dated June 3, 2009 provide, as follows:

"SECTION 2.57.2. *Income Payments Subject to Creditable Withholding Tax and Rates Prescribed Thereon.* — Except as herein otherwise provided, there shall be withheld a creditable income tax at the rates herein specified for each class of payee from the following items of income payments to persons residing in the Philippines:

xxx xxx xxx

(M) *Income payments made by the top twenty thousand (20,000) private corporations to their local/resident supplier of goods and local/resident supplier of services other than those covered by other rates of withholding tax.*

— Income payments made by any of the top 20,000 private corporations, as determined by the Commissioner, to their local/resident supplier of goods and local/resident supplier of services, including non-resident aliens engaged in trade or business in the Philippines. Provided, however, that for purchases involving agricultural products in their original state, the tax required to be withheld under, this sub-section shall only apply to purchases in excess of the cumulative amount of Three Hundred Thousand Pesos (P300,000) within the same taxable year. For this purpose, agricultural products in their original state as used in these regulations, shall only include corn, coconut, copra, palay, rice, cassava, sugar cane, coffee,

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fruits, vegetables, marine food products, poultry and livestocks.

Supplier of goods — One percent (1%)

Supplier of services — Two percent (2%)

xxx xxx xxx"

In view of the foregoing, the local (Philippine) clients of Walt Disney Philippines should neither withhold 20% from their payments of royalty fees, CMF contributions and license administration fees to Walt Disney Philippines as these are already subject to 30% corporate income tax on the part of Walt Disney Philippines nor subject said payments to creditable withholding tax, except when payments are made by Philippine Licensees classified as among the Top 20,000 private corporations to which the 2% expanded withholding tax shall apply.

This ruling is being 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,

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

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