Article 13(2)(b)(i) of the PH-US Tax Treaty; and Sections 105 and 108 of the National Internal Revenue Code of 1997, as amended
BIR Ruling No. ITAD 012-25

14 APR 2025

ANGARA ABELLO CONCEPCION REGALA & CRUZ
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Gentlemen:

This refers to your request for confirmation that the royalties paid by **Global Restaurant Concepts Inc. (Global)** to **PFCCB International Inc. (PFCCB)**, a resident of the United States of America (US), are subject to the preferential income tax rate of 10% pursuant to Article 13(2)(b)(iii) of the Convention between the Government of the Republic of the Philippines and the Government of the United States of America with Respect to Taxes on Income (PH-US Tax Treaty) in relation to Article 12(2)(a) of the Convention between the Czech Republic and the Republic of the Philippines for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (PH-CZ Tax Treaty).

FACTS

Global is a corporation organized and existing under Philippine laws, with principal office address at Unit 2203, Antel Global Corporate Center, No. 3 Doña Julia Vargas Ave., Ortigas Center, Pasig City, and is primarily engaged in the establishment, operation, and maintenance of restaurants, coffee shops, refreshment parlors, cocktail lounges, and catering services. On the other hand, PFCCB is a corporation organized under the laws of the US, with registered office address at 7676 East Pinnacle Peak Road, Scottsdale, Arizona, United States, is a resident of the Philippines for tax purposes,[1] and is not registered as a corporation in the Philippines.[2]

On February 12, 2010, PFCCB and Global entered into an Area Development & Master License Agreement, in which the former granted to the latter "a personal, non-

[1] Based on the attached tax residency certificate issued by the United States Internal Revenue Service on April 05, 2010.
[2] Based on the attached Certificate of Non-Registration of Company issued by the Philippine Securities and Exchange Commission on August 23, 2011.

transferable, and exclusive License to use the Marks,[3] the Know-How[4] and the Developed Materials[5]" to open restaurants in the Philippines.[6]

In consideration thereof, Global would pay a royalty equivalent to five percent (5%) of the net revenue of each restaurant.[7] Finally, the term of the agreement would consist, collectively, of the following:

1. the Initial Development Term – from the effective date of the agreement to the last day of the fifth (5th) development year;[8]
2. the Operating Term of each restaurant – from the opening date of such restaurant to the last day of the calendar month on the tenth (10th) year;[9]
3. the Successor Development Term (if applicable) – five (5) years;[10] and
4. the Successor Operating Term (if applicable) – ten (10) years.[11]

RULING

Income Tax

In reply, please note that Section 28(B)(1) of the National Internal Revenue Code (NIRC) of 1997[12] states that:

> "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%)."

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[3] Defined under Item No. 1.35 of the contract as: "(i) the trademarks or service marks owned by, licensed by or used by Licensor or its Affiliates from time to time, which Licensor authorizes Developer to use in the Territory, as identified by Exhibit B and as may be amended from time to time, (ii) any transliteration or localization in the Territory of any such Marks, and (iii) any other Mark that Licensor approves Developer to use in the Territory from time to time pursuant to Section 10.4."

[4] Defined under Item No. 1.30 of the contract as: "all documents proprietary and non-proprietary information, trade secrets, skills experience accumulated by Licensor and its Affiliates regarding the operation of high quality Asian food restaurants presented in an upscale, casual atmosphere prior to and during the Term, including but not limited to information used in the operation of P.F. Chang's China Bistro Restaurants in the United States. The Know-How includes, but is not limited to, the Information."

[5] Defined under Item No. 1.14 of the contract as: "the Advertising and Marketing Programs, Innovations, Management Training Program, New Restaurant Promotional Program, Restaurant Opening Training Program, and System Standards developed or implemented by Developer pursuant to this Agreement; provided, however, that if anything incorporated into the Developed Material has been obtained under a license or other agreement with a person or entity other than Licensor then only Developer's rights therein will be included within the Developed Material."

[6] Item No. 2.1.1, Area Development & Master License Agreement.

[7] Item No. 11, Exhibit A, *ibid.*

[8] Item No. 3, *ibid.*

[9] Item No. 4, *ibid.*

[10] Item No. 13, *ibid.*

[11] Item No. 14, *ibid.*

[12] Under Republic Act No. 11534 (otherwise known as the CREATE Law), which took effect on March 26, 2021, the rate was subsequently lowered to 25%.

However, under Section 32(B)(5) of the same, income of any kind, to the extent required by any treaty obligation binding upon the Philippines, may be exempt from income tax in the Philippines.

In this case, the treaty provisions being invoked are the "most favored nation" clause under Article 13(2)(b)(iii) of the PH-US Tax Treaty in relation to Article 12(2)(a) of the PH-CZ Tax Treaty.

On one hand, Article 13 of the PH-US Tax Treaty provides:

"**Article 13**
ROYALTIES

1. Royalties derived by a resident of one of the Contracting States from sources within the other Contracting State may be taxed by both Contracting States.

2. However, the tax imposed by that other Contracting State shall not exceed:

a) In the case of the United States, 15 percent of the gross amount of the royalties, and

b) In the case of the Philippines, the least of:

(i) 25 percent of the gross amount of the royalties,
(ii) 15 percent of the gross amount of the royalties, where the royalties are paid by a corporation registered with the Philippine Board of Investments and engaged in preferred areas of activities, and
(iii) **the lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of a third State**. (Emphasis supplied)

3. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematographic films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or other like right or property, or for information concerning industrial, commercial or scientific experience. The term "royalties" also includes gains derived from the sale, exchange or other disposition of any such right or property which are contingent on the productivity, use, or disposition thereof.

xxx"

On the other hand, Article 12 of the PH-CZ Tax Treaty states:

"**Article 12**
ROYALTIES

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed:

a) 10 per cent of the gross amount of the royalties arising from the use of, or the right to use, any copyright of literary, artistic or scientific work, other than that mentioned in sub-paragraph (b), any patent, trade mark, design or model, plan, secret formula or process, or from the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience;

b) 15 per cent of the gross amount of the royalties arising from the use of, or the right to use, any copyright of cinematograph films, and films or tapes for television or radio broadcasting.

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations.

xxx"

In *Cargill Philippines Inc. v. Commissioner of Internal Revenue*,[13] the Philippine Supreme Court held that the following conditions must be established for a successful invocation of the most favored nation clause: "(1) similarity in subject matter, *i.e.* that royalties derived from the Philippines by a resident of the United States and of the third State are of the same kind; and (2) similarity in circumstances in the payment of tax, *i.e.* the same mechanism must be employed by the United States and the third state in mitigating the effects of double taxation." The Court went on to state that the failure of the taxpayer-applicant to meet these conditions means that the "most favored nation" clause cannot apply.

In this case, only the first condition was satisfactorily met. Under the contract, Global was granted a license to use "the Marks, the Know-How and the Developed Materials" to operate restaurants in the Philippines. As such, the payments made in consideration of the use of, or the right to use, these intellectual properties constitute royalties as defined under Article 13(3) of the PH-US Tax Treaty and Article 12(2) of PH-CZ Tax Treaty.

However, it is regarding the second condition – the mechanism of relief from double taxation – where the two tax treaties diverge significantly. To begin, Article 23(1) of the PH-US Tax Treaty provides:

"**In accordance with the provisions and subject to the limitations of the law of the United States** (as it may be amended from time to time without changing the general principle hereof), **the United States shall allow to a citizen or resident of the United States as a credit against the United States tax the appropriate amount of taxes paid or accrued to the Philippines** and, in the case of a United States corporation owning at least 10 percent of the voting stock of a Philippine corporation from which it receives dividends in any taxable year, shall allow credit for the appropriate amount of taxes paid or accrued to the Philippines by the Philippine corporation paying such dividends with respect to the profits out of which such dividends are paid. **Such appropriate amount shall be based upon the amount of tax paid or accrued to the Philippines, but the credit shall not exceed the limitations** (for the purpose of limiting the credit to the United States tax on income from sources within the Philippines or on income from sources outside the United States) **provided by United States law for the taxable year**. For the purpose of applying the United States credit in relation to taxes paid or accrued to the

[13] G.R. No. 203346, September 09, 2020.

Philippines, the rules set forth in Article 4 (Source of Income) shall be applied to determine the source of income. For purpose of applying the United States credit in relation to taxes paid or accrued to the Philippines, the taxes referred to in paragraphs 1(b) and 2 of Article 1 (Taxes Covered) shall be considered to be income taxes." (Emphasis supplied)

Meanwhile, Article 22(2)(a) of the PH-CZ Tax Treaty states:

"The Czech Republic, when imposing taxes on its residents, may include in the tax base upon which such taxes are imposed the items of income which according to the provisions of this Convention may also be taxed in the Philippines, but shall allow as a deduction from the amount of tax computed on such a base an amount equal to the tax paid in the Philippines. Such deduction shall not, however, exceed that part of the Czech tax, as computed before the deduction is given, which is appropriate to the income which, in accordance with the provisions of this Convention, may be taxed in the Philippines."

While it is apparent that both tax treaties adopted the ordinary credit method[14] as their preferred mode of relief from international double taxation, a perusal of their internal laws and regulations is necessary, since it is according to their precepts that the foreign tax credit limitation will ultimately be computed. This is so, even if only the PH-US Tax Treaty expressly references the internal laws of the United States.

On one hand, the general rule under Section 1.904-1(a) of Title 26 of the United States Code of Federal Regulations (CFR) provides that:

"**For each separate category described in § 1.904-5(a)(4)(v), the total credit for foreign income taxes** (as defined in § 1.901-2(a)) **paid or accrued** (including those deemed to have been paid or accrued other than by reason of section 904(c)) **to any foreign country** (as defined in § 1.901-2(g)) **does not exceed that proportion of the tax against which such credit is taken which the taxpayer's taxable income from foreign sources** (but not in excess of the taxpayer's entire taxable income) **in such separate category bears to the taxpayer's entire taxable income for the same taxable year**." (Emphasis supplied)

Moreover, Section 1.904-4(a) of the same states:

"A taxpayer is required to compute a separate foreign tax credit limitation for income received or accrued in a taxable year that is described in section 904(d)(1)(A) (section 951A category income), 904d(1)(B) (foreign branch category income), 904(d)(1)(C) (passive category income), 904(d)(1)(D) (general category income), paragraph (m) of this section (specified separate categories). For purposes of this section, the definitions in §1.904-5(a)(4) apply."

On the other hand, Section 38f(8) of *Zákon č.* 586/1992 *Sb.* (the Income Tax Law of the Czech Republic) expressly provides how the foreign tax credit limitation is computed, with respect to the ordinary credit method:

"**If the taxpayer receives income from several different countries with which the Czech Republic has concluded an international treaty regulating the avoidance of double taxation of all types of income, which is implemented, the**

[14] The Court described this method in *Cargill* as one "where the deduction allowed by the State of residence is restricted to that part of its own tax appropriate to the income from the state of source."

> **exclusion of double taxation using the simple credit method will be carried out separately for each state**. In the case of the full exemption method and the progression exemption method, the sum of all income from foreign sources that is exempt from taxation is excluded from the tax base in accordance with the preceding paragraphs. If, in the absence of double taxation, both the total exemption method or the progression exemption method and the simple set-off method are to be used, the exclusion of income from foreign sources shall be made first, followed by a simple set-off in accordance with the preceding paragraphs."[15] (Emphasis supplied)

From the foregoing, it is apparent that the United States and the Czech Republic differ in their manner of computation of the foreign tax credit limitation: the former computes on a per income category (basket) basis, while the latter computes on a per country/state basis.

Premises considered, since Global failed to prove all of the elements laid down by the Court in order to successfully invoke the "most favored nation" clause of the PH-US Tax Treaty in relation to the PH-CZ Tax Treaty, the royalties it paid to PFCCB for the license granted by the latter are **subject to Philippine income tax at the rate of 25%** pursuant to Article 13(2)(b)(i) of the PH-US Tax Treaty.

Value-Added Tax (VAT)

Section 105 of the NIRC states that any person who, in the course of trade or business, renders services, among others, shall be subject to VAT. Relevant thereto, Section 108 of the same imposes VAT equivalent to twelve percent (12%) of the gross sales derived from the sale or exchange of services. Such phrase is defined as "the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration", and includes, among others:

> (1) The lease or the use of or the right or privilege to use any copyright, patent, design or model, plan, secret formula or process, goodwill, trademark, trade brand or other like property or right;
>
> xxx
>
> (3) The supply of scientific, technical, industrial or commercial knowledge or information;
>
> xxx

Finally, the lease of property shall be subject to VAT, regardless of the place of execution of the lease contract or licensing agreement, so long as the property is leased or used in the Philippines.

The transaction in this case involved the grant by PFCCB to Global of the use of, or the right to use, marks, know-how, and developed materials owned by the latter in order to operate restaurants in the Philippines. The use of, or the right to use, these intellectual property rights in the Philippines constitutes a "sale or exchange of services" under the NIRC, thus making the transaction **subject to VAT at the rate of 12%**, based on the gross amount of royalties.

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[15] Machine translated from this URL: https://www.zakonyprolidi.cz/cs/1992-586.

The 12% VAT shall be withheld by Global before making any payment to PFCCB, and shall be remitted to the Bureau of Internal Revenue within ten (10) days following the end of the month the withholding was made.[16]

This ruling is issued on the basis of the foregoing facts as represented. However, if it shall be disclosed upon investigation that the actual facts are different, then this ruling shall be without force and effect insofar as the herein parties are concerned.

Very truly yours,

ROMEO D. LUMAGUI, JR.
Commissioner of Internal Revenue

[16] Section 4.114-2, Revenue Regulations (RR) No. 16-2005.