



Republic of the Philippines
DEPARTMENT OF FINANCE

Roxas Boulevard Corner Pablo Ocampo, Sr. Street
Manila 1004

DOF OPINION NO. 010.2020

ATTY. RAMON J. QUISUMBING

Managing Partner
Quisumbing Torres
12th Floor, One/NEO Building
26th Street Corner 3rd Avenue
Crescent Park West
Bonifacio Global City
Taguig City 1634

**SUBJECT: Request for Review of Bureau of Internal Revenue Ruling
No. 0672-2019**

Dear **Atty. Quisumbing**:

This refers to the Request for Review dated 16 December 2019 ("Request for Review") which you filed with this Department on behalf of ESET Asia Pte. Ltd. ("ESET") of Bureau of Internal Revenue ("BIR") Ruling No. 0672-2019 dated 30 October 2019, which subjected to Philippine income tax, withholding tax, and value-added tax ("VAT") income payments made by Valueline Systems & Solutions Corporation ("Valueline") to ESET in relation to the Software Distribution Agreement of the parties.

ESET is a company organized and existing under the laws of the Republic of Singapore. It is not registered as a corporation or as a partnership in the Philippines as evidenced by Certification of Non-Registration of Company issued by the Securities and Exchange Commission.

Valueline is a corporation organized and existing under the laws of the Philippines and is engaged in the business of trading and importation of goods

A handwritten signature in black ink, appearing to be a stylized 'Q' or similar character.

such as Computer Hardware/Software/Office Equipment on wholesale/retail basis and allied services.

On 1 January 2013, ESET, spol. s.r.o., the parent company of ESET, executed a Software Distribution Agreement with Valueline to agree on the following:

- 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 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 servers 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; and
- 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 that ESET awarded the Distributor with any rights to the software and its documentation by any means of by any other laws.

The modes of transferring the software from ESET to the end-users of the software in the Philippines are as follows:

- 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 system once the end-user enters the details of the activation key.

- b. CD boxes sale



- Valueline purchases blank CD boxes from third parties in the Philippines. Valueline has to download the software from the 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 tangible media. It is only an installation CD whose purpose is to mass produce the software. The installation CD is not an active software since an activation key is still needed to make software work (which is included separately in the boxes).
- Then these boxes are distributed to retail stores 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 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 records of ESET.
- 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.

On 31 December 2013, an Assignment and Assumption Agreement was executed transferring all the rights and obligations of ESET, spol. s.r.o. to ESET with consent of Valueline.

On 4 December 2014, ESET filed an application for confirmatory ruling requesting the BIR for an opinion that the income payments of Valueline to ESET under the Software Distribution Agreement are for services performed outside the Philippines hence, are not subject to income tax and, consequently, to withholding tax and VAT in the Philippines.

On 15 November 2019, ESET received BIR Ruling No. 0672-2019 dated 30 October 2019. In this ruling, the BIR ruled against ESET's request holding that pursuant to Sections 28(B)(1), 23(F), and 42(C)(3) of the Tax Code of 1997 the situs of ESET's income from the performance of distribution services is in the Philippines, hence, subject to income tax, withholding tax and VAT.

On 16 December 2019, the Request for Review dated 16 December 2019 was received by the Department of Finance ("DOF").



On 6 February 2020, the set of records authenticated and certified by the BIR was received by the DOF.

We rule in the negative.

The definition of "royalties" includes payments for the use of copyright over software. Software is generally assimilated as a literary, artistic or scientific work protected by the copyright laws of various countries. Thus, payments in consideration for the use of or the right to use a copyright relating to software are generally royalties.¹

Under Section 5 of **Revenue Memorandum Circular ("RMC") No. 44-05**, the character of payments received in a transaction involving the transfer of computer software depends on the nature of the rights that the transferee acquires under the particular arrangement regarding the use and exploitation of the program. Under the said RMC, there are two (2) transfers distinguished, namely, transfers of copyright rights and copyrighted articles. The nature of the transaction out of which such payments are made will determine whether such should be treated as royalties, business income, rental income, or capital gains.

When only copyright rights are transferred, payments made in consideration therefor are **royalties**. On the other hand, when copyright ownership is transferred, payments made in consideration therefor are **business income**. A transfer of software is classified as a transfer of a copyright right if, as a result of the transaction, a person acquires any one or more of the rights described below:

- i. The right to make copies of the software for purposes of distribution to the public by sale or other transfer of ownership, or by rental, lease or lending;
- ii. The right to prepare derivative computer programs based upon the copyrighted software;
- iii. The right to make a public performance of the software;
- iv. The right to publicly display the computer program; or**
- v. Any other rights of the copyright owner, the exercise of which by another without his authority shall constitute infringement of said copyright.**² (emphasis supplied)

¹ Taxation of Payments for Software, Revenue Memorandum Circular No. 44-05, §3 (1 September 2005).

² Taxation of Payments for Software, Revenue Memorandum Circular No. 44-05, §5a (1 September 2005).



The determination of whether a transfer of a copyright right in a software is a sale or exchange of property is made on the basis of whether, taking into account all facts and circumstances, there has been a transfer of all substantial rights in the copyright. **A transaction that does not constitute a sale or exchange because not all substantial rights have been transferred will be classified as a license generating royalty income.**³

By virtue of the Software Distribution Agreement, Valueline acquired two (2) rights, specifically, the right to publicly display the computer program and other rights of the copyright owner, the exercise of which by another without his authority shall constitute infringement of said copyright.

Items 4 and 5 above are intertwined and can be discussed simultaneously. Important to note that Valueline is allowed to engage in the following: (1) Active Distribution of the Software in the Territory and Passive Distribution of the Software; (2) marketing activities on behalf of the brands and brand products of ESET; (3) finding of the potential End Users and Resellers; (4) providing Helpdesks; (5) elaboration of sales reports, marketing reports, marketing studies, market surveys, business plans, (6) cooperation with ESET during propagation and sales campaigns including participation in exhibitions and (7) other activities which it is obliged to do under the Software Distribution Agreement.⁴ Active and Passive Distribution are defined under the said agreement as:

“Active Distribution in this Agreement shall mean an active approach to the customers, particularly through direct post advertisements or visits, advertisements in the media or other advertisements specifically focused on the End Users, including the establishment of the Distributor’s branches, building a Reseller network, or establishment of the distribution warehouses.”⁵

“Passive Distribution in this Agreement shall mean the responses to the unrequested requests of particular customers including the delivery of the goods or services to such customers. The general advertisements, advertisements in the media or on the internet that address the customers in the exclusive territories of other distributors, which, however, adequately acquires customers beyond such territories, for example for acquiring

³ Taxation of Payments for Software, Revenue Memorandum Circular No. 44-05, §5a (1 September 2005).

⁴ Software Distribution Agreement, §1.1(q).

⁵ Software Distribution Agreement, §1.1(l).



customers in the non-exclusive territories or the Territory, shall be considered as Passive Distribution.”⁶

Moreover, Valueline is allowed to engage in several marketing activities.⁷ Even though Valueline is permitted to do all these under the agreement, ESET remains the owner of all the rights to the Software and nothing in the said agreement can be interpreted by means from which it would arise that ESET awarded Valueline with any rights to the Software and its documentation.⁸

The grant by ESET to Valueline of these rights shall be classified as a transfer of a copyright right if the acquisition and exercise of these rights by the latter without the authority of the former constitutes an infringement of such copyright. In order to determine if these rights can be the subject of infringement, Section 177 of Republic Act No. 8293 or the Intellectual Property Code of 1998 enumerates those rights of an author or owner of a literary, artistic or scientific work like software which can be the subject of infringement. It provides:

“SECTION 177. Copyright or Economic Rights. — Subject to the provisions of Chapter VIII, copyright or economic rights shall consist of the exclusive right to carry out, authorize or prevent the following acts:

- 177.1. Reproduction of the work or substantial portion of the work;
- 177.2. Dramatization, translation, adaptation, abridgment, arrangement or other transformation of the work;
- 177.3. The first public distribution of the original and each copy of the work by sale or other forms of transfer of ownership;
- 177.4. Rental of the original or a copy of an audiovisual or cinematographic work, a work embodied in a sound recording, a computer program, a compilation of data and other materials or a musical work in graphic

⁶ Software Distribution Agreement, §1.1(m).

⁷ (1) To ensure that all persons, who deal with Software distribution, are familiar with its properties and functions; (2) To demonstrate the Software to all interested persons during visits of such interested persons at the Distributor's premises or directly at such persons, on presentations, exhibitions, and workshops; (3) To disseminate marketing materials approved by ESET, including, but not limited to, product information, press releases and information on new products; (4) To include Software and a description of its key properties to all product catalogues, which the Distributor publishes or spreads; (5) To create, maintain and update web pages dedicated solely to the Software of ESET. For such purpose, ESET shall provide a template to build web pages through the Global Partner Centre. All materials provided through the Global Partner Centre (including, but not limited to, graphics, logos, texts, marketing materials) shall remain the sole property of the ESET; and (6) ESET may, at its sole discretion, contribute to the approved marketing activities of the Distributor, this also in the form of a contribution from the Market Development Fund (“MDF”). Conditions of the support from MDF as valid by the Day of Signature shall be provided in Annex No. 4. The Parties have agreed that ESET shall be entitled unilaterally to modify the Annex No. 4. (Software Distribution Agreement, §4.7(b).

⁸ Software Distribution Agreement, §9.1.



form, irrespective of the ownership of the original or the copy which is the subject of the rental; (n)

177.5. Public display of the original or a copy of the work;

177.6. Public performance of the work; and

177.7. Other communication to the public of the work. (Sec. 5, P.D. No. 49a)⁹ (emphasis supplied)

A reading of the Software Distribution Agreement points out that the agreement between Valueline and ESET does not constitute a sale or exchange because not all substantial rights have been transferred to Valueline. Moreover, the said Agreement grants Valueline rights the exercise of which without authority from ESET constitute infringement of said copyright. Taking into account all the discussions above, the income payments made by Valueline to ESET should be classified as royalties.

In **DA ITAD BIR Ruling No. 017-07 dated 9 February 2007** involving a similar non-resident principal licensor – distributor – end - user arrangement, the BIR ruled that income payments received by the non-resident principal licensor from the Philippine distributor are royalties subject to final withholding tax (“FWT”) and final withholding VAT (“FWV”), thus:

“In relation to the use of software by an end-user, it should be emphasized that the software payments made by an end-user are now treated as business income (or business profits for tax treaty purposes) under the new RMC 44-2005 and no longer as royalties under the old RMC 77-2003. Under RMC 44-2005, the rights generally acquired by the end-user to reproduce the software onto a computer or to reproduce the software for archival or backup purposes only is merely a *de minimis* right compared to other rights mentioned in Section 177 of the Intellectual Property Code. However, the grant of a right to distribute the software cannot be considered as *de minimis* as in the case of the end-user. The grant of this right to a distributor or reseller by the author or owner of the software pertains to rights which may be subject to infringement and as such gives rise to royalties. This is true even if payments to be made by the distributor or reseller to the author or owner are not literally termed as royalties but merely payments or fees in general and even if the contract between the parties are not literally termed license contracts but merely contracts of sale, contracts to sell, consignment contracts, etc., as those

⁹ Intellectual Property Code of the Philippines, Republic Act No. 8293, (6 June 1997).



generally used when the goods or merchandise involved are noncopyrighted works. What is essential is that copyright rights are granted under such contract and without which, the reseller or distributor may be regarded as infringing the copyright owner's rights, based on the provisions of the Intellectual Property Code."

"In view of the foregoing, this Office is of the opinion and so holds that payments to be made by CIM Technologies to Autodesk Asia under the renewed Autodesk Authorized Distributor Agreement continues to be in the nature of royalties and are not business profits under RMC 44-2005. These payments (in this case, termed Per Copy fees) shall be subject to 25% income tax based on the gross amount thereof pursuant to Article 12 (Royalties) of the Philippines-Singapore tax treaty in relation to RMC 44-2005."

"Finally, the sale of the Products by Autodesk Asia to CIM Technologies is subject to value-added tax (VAT) under Section 106(A) of the Tax Code, to wit:

"SEC. 106. Value-added Tax on Sale of Goods or Properties.

—

(A) Rate and Base of Tax. — There shall be levied, assessed and collected on every sale, barter or exchange of goods or properties, a value-added tax equivalent to ten percent (10%) of the gross selling price or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferor.

xxx xxx xxx"

"The gross amount of the Per Copy Fees payable to Autodesk Asia constitutes the gross selling price or gross value in money of the Products on which the appropriate VAT rate (now 12%) is imposed."

"With regard to the procedures for withholding and paying the VAT, Sections 4 and 6 of Revenue Regulations No. 4-2000, Section 3 of Revenue Regulations No. 8-2002, and Section 7 of Revenue Regulations No. 14-2002 and Section 4.114.2 of Revenue Regulations No. 16-2005, provide that CIM Technologies shall be responsible for



the withholding of the appropriate VAT rate (now 12%) on the Per Copy Fees before remitting them to Autodesk Asia. In remitting to the Bureau of Internal Revenue the VAT withheld on such fees, CIM Technologies shall use BIR Form No. 1600 (Monthly Remittance Return of VAT and Other Percentage Taxes Withheld). If a VAT-registered taxpayer, CIM Technologies may use as documentary substantiation for its claim of input VAT the duly filed BIR Form No. 1600 and the proof of payment accompanying it. If a non-VAT-registered taxpayer, CIM Technologies may include as part of the cost of the Products sold to it by Autodesk Asia the VAT consequently shifted or passed on to it and may treat such VAT either as expense or asset, whichever is applicable. In addition, CIM Technologies is required to issue the Certificate of Final Tax Withheld at Source (BIR Form No. 2306) in quadruplicate, the first three copies thereof to be given to Autodesk Asia upon its request, and the fourth copy to be retained by CIM Technologies as its file copy.

xxx''

Royalty payments to a non-resident licensor are subject to income tax and value-added tax

Income payments made by Valueline to ESET, a foreign licensor/owner, are subject to tax on royalties under the Convention Between the Republic of the Philippines and the Republic of Singapore ("PH-SG Tax Treaty") provided the conditions prescribed therein are complied with.¹⁰

Under Article 12 of the PH-SG Tax Treaty, it is provided that the tax so charged shall not exceed the following rates:

- (a) in the case of the Philippines, 15 per cent of gross amount of the royalties, where the royalties are paid by an enterprise registered with the Philippine Board of Investments and engaged in preferred areas of activities and also royalties in respect of cinematographic films or tapes for television or broadcasting;
- (b) in the case of Singapore, where the royalties are approved under the Economic Expansion Incentives (Relief from Income Tax) Act of Singapore, the royalties shall be exempt;

¹⁰ Taxation of Payments for Software, Revenue Memorandum Circular No. 44-05, §7(B)(1)(b) (1 September 2005).



(c) in all other cases, 25 per cent of the gross amount of the royalties.¹¹


Thus similar to DA ITAD BIR Ruling No. 017-07,¹² said income payments are subject to FWT on royalties and FWV on royalties. Valueline, who is in control of the income payments under the Software Distribution Agreement, shall be responsible for the withholding of FWT and FWV on such fees on behalf of ESET.

13

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 as null and void.

Thank you.

Sincerely yours,


CARLOS G. DOMINGUEZ
Secretary of Finance
SEP 08 2020



CC **Commissioner Caesar R. Dulay**
Bureau of Internal Revenue

Ronald V. Bernas
Maria Ana Camila Jacinto-Lagustan
Quisumbing Torres

¹¹ Convention Between the Republic of the Philippines and the Republic of Singapore, Article 12 (1 August 1977).

¹² Finally, the sale of the Products by Autodesk Asia to CIM Technologies is subject to value-added tax (VAT) under Section 106(A) of the Tax Code, to wit:

"SEC. 106. Value-added Tax on Sale of Goods or Properties. —

(A) Rate and Base of Tax. — There shall be levied, assessed and collected on every sale, barter or exchange of goods or properties, a value-added tax equivalent to ten percent (10%) of the gross selling price or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferrer.

xxx xxx xxx

The gross amount of the Per Copy Fees payable to Autodesk Asia constitutes the gross selling price or gross value in money of the Products on which the appropriate VAT rate (now 12%) is imposed.

¹³ Taxation of Payments for Software, Revenue Memorandum Circular No. 44-05, §7 (1 September 2005).