REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Section 27 (A) and (D) (1) of the Tax Code of 1997, as amended
BIR Ruling No. 179-2022; BIR Ruling No. 323-2019
OT-5420-2022
OCT 07 2022

FIVE BRAD DRAGONS FOOD FRANCHISE CORPORATION
968 Marconi St., Lahug
Cebu City, 6000

Attention: **Robin G. Robins III**
CEO/President

Gentlemen:

This refers to your request for confirmation that the franchise fees, royalty income and other fees received by Five Brad Dragons Food Franchise Corporation ("5BDFFC" or "the Company") from its franchising activities are considered as ordinary income subject to normal corporate income tax under Section 27 (A) of the National Internal Revenue Code (Tax Code) of 1997, as amended.

It is represented that 5BDFFC is a domestic corporation duly organized and existing under the laws of the Philippines. It was primarily established to administer in the conduct of the franchise transactions.

The Company caused the registration of the trade name, trademark and service mark "Wingers Unlimited" and "New York Buffalo Brads Hot Wings" and authorized the Company to operate and carry on its franchise operations. The Company, as Franchisor, grants qualified persons (Franchisee) to set up and operate "Wingers Unlimited" and/or "New York Buffalo Brads Hot Wings" restaurants, which utilize 5BDFFC's System and Marks. A Franchisee who desires to use the marks and to operate a "Wingers Unlimited" and/or "New York Buffalo Brads Hot Wings" restaurant must apply for a franchise, subject to the approval of the Franchisor.

In 2022, the Company entered into several Franchising Agreements whereby it granted the Franchisees the right, license and privilege to set up and operate "Wingers Unlimited" and/or "New York Buffalo Brads Hot Wings" restaurant using the registered System and Marks. The Franchisees, on the other hand, undertook the obligation to operate the Franchised Facility and to use it solely in connection with the System, as may be changed or updated from time to time.

In consideration for the franchise granted to the them, the Franchisees shall pay to the Franchisor the following:

1. Franchise fee, which represents payment for the right and privilege to operate a franchise under the name "Wingers Unlimited" and/or "New York Buffalo Brads Hot Wings", using the registered System and Marks;

2. Set-up fee, which represents payment for the cost and expenses incurred by the Franchisor in assisting the Franchisee in setting up the Franchised Facility, such as, but not limited to, site evaluation costs, initial marketing expenses, training costs, opening assistance costs, general administrative expenses, and other related expenses;

3. Continuing Services Fee of two percent (2%) of the Franchised Facility's Gross Sales/Revenues. This refers to the payment for the continuing services rendered by the Franchisor under Paragraph XV of the Franchise Agreement (i.e. Franchisor's Operations Assistance); and

4. Royalty Fee of one percent (1%) of the Franchised Facility's Gross Sales/revenues. This refers to payment for the continuous use of the registered System and Marks.

In reply, please be informed that Section 27 (A) of the Tax Code of 1997, as amended, defines the general corporate income tax rates, *viz*:

> *"SEC. 27. Rates of Income tax on Domestic Corporations. –*
>
> *(A) In General. - Except as otherwise provided in this Code, an income tax rate of twenty-five percent (25%) effective July 1, 2020, is hereby imposed upon the taxable income derived during each taxable year from all sources within and without the Philippines by every corporation, as defined in Section 22(B) of this Code and taxable under this Title as a corporation, organized in, or existing under the laws of the Philippines.*
>
> *xxx xxx xxx"*

In contrast, 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 . . . ."

In the case of *Chamber of Real Estate and Builders Associations, Inc. vs. The Honorable Executive Secretary Alberto Romulo, et al.*[1], the Supreme Court, citing *BIR Ruling No. DA-501-2004*[2], defined passive income by stating what it is not:

"... if the income is generated in the active pursuit and performance of the corporation's primary purposes, the same is not passive income ..."

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 of 1997, as amended. Since the income derived by the Company from its franchise fees, royalty income and other fees received from its 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. Consequently, the payments received by the Company from the active conduct of trade or business is considered ordinary business income subject to the 25% regular corporate income tax. Stated differently, the royalty fees received by the Company 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 the Company which is to administer in the conduct of the franchise transactions as provided in its Articles of Incorporation.

In view of the foregoing, the franchise fees, royalty fees and other fees directly derived by the Company in the conduct of its franchising activities shall form part of its ordinary income subject to the 25% 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 disclosed that the facts are different, then this ruling shall be considered null and void.

Very truly yours,

LILIA CATRIS GUILLERMO
Commissioner of Internal Revenue

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[1] G.R. No. 160756 dated March 9, 2010
[2] Dated September 24, 2004