REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
**BUREAU OF INTERNAL REVENUE**

Quezon City

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| RA No. 7227<br>RR No. 16-99 | 000-00 | OT-701-2020 |

Person to Contact: Chief, Law & Legislative Division
Tel Nos. 926-55-36/927-09-63

Date: DEC 29 2020

**MR. KOJI MORISADA**
President, Sumidenso Automotive Technologies Asia Corporation
N2835 Jose Abad Santos Avenue corner Bayanihan St.
Clark Freeport Zone, Pampanga

Sir:

This refers to your letter dated June 6, 2018 requesting, in effect, for a ruling that the royalties being paid by **Sumidenso Automotive Technologies Asia Corporation** (SATAC or the Company) is deductible in computing gross income subject to the 5% preferential tax rate under the Republic Act (R.A) No. 9400 (An Act Amending R.A. No. 7227, as amended, otherwise known as the Base Conversion and Development Act of 1992), as amended.

As represented, SATAC is incorporated and domiciled in the Philippines. It is registered with the Securities and Exchange Commission (SEC) with office address and principal place of business at N2835 Jose Abad Santos Avenue corner Bayanihan Street, Clark Freeport Zone, Pampanga. The Company is a wholly owned subsidiary of Sumitomo Wiring Systems, Ltd. (SWS or the Parent Company), a company organized in Japan, and the ultimate parent company is Sumitomo Electric Industries, Ltd. (SEI), a company also organized in Japan.

The primary purpose of the Company is (1) the establishment and operation of technical center designing automotive wiring harness and other related automotive components; (2) design and development of automotive electrical, electronic and mechanical components, computer software, and software development of business processes and related systems support for its affiliate companies, both domestic and overseas but not engaging in electrical engineering profession; and (3) management activities in the aspect of quality, cost and delivery of automotive wire harness materials for its domestic and overseas affiliate companies.

As a registered enterprise under Clark Freeport Zone Authority (CFZ), the Company is entitled to the five percent (5%) special tax on gross income under section 2 of R.A. No. 9400 earned in lieu of national and local taxes.

SATAC and SWS entered into an Intangibles Licensing Agreement, whereby the former shall use the intagible property of the latter. As consideration, the SATAC shall pay royalties to the SWS.

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Since the royalty expense is only incurred as the service is rendered, it is recorded as part of the Company's cost of services.

Costs of services and general and administrative expenses are expenditures that arise in the course of the ordinary operations of SATAC. Cost of services include direct labor, depreciation of service equipment, utilities, and communication, supplies and other expenses related to services. Such costs are recognized when the related sales have been recognized. General and administrative expenses constitute costs of administering the business and are recognized in profit or loss as incurred.

In reply, please be informed that Revenue Regulations (RR) No. 16-99 implementing Section 12 (c) of Republic Act (RA) No. 7227, otherwise known as the "Bases Conversion and Development Act of 1992", as amended by RA 9400, allows enterprises registered in the Subic Special Economic and Freeport Zone to deduct royalty payments when calculating gross income subject to the 5% final tax. Section 3 thereof modifies the definition of "gross income earned," as follows:

> *"SECTION 3. Section 3 of Revenue Regulations No. 1-95 is hereby amended by adding paragraph (4) under sub-section (o) thereof and by adding thereto a sub-section (p), to read as follows:*
>
> *'o. Gross Income Earned. — . . .*
>
> *1) x x x  x x x  x x x*
> *2) x x x  x x x  x x x*
> *3) x x x  x x x  x x x*
> *4) Subic Bay Regional Enterprise. — For purposes of this paragraph, the term "Gross income earned" refers to the gross sales or gross revenues derived from the business activity within the zone, net of sales discounts and sales returns and allowances and minus the costs of sales or direct costs and other costs that are material in the operations of the business and involves a significant amount in determining the profitability and viability of the business (but before any deduction for administrative expenses or incidental losses during a given taxable period). For financial enterprises, gross income shall include interest income, gains from sales, and other income, net of allowable deductions. The following deductions shall be allowable for the calculation of gross income earned for the following specific types of enterprises:*
>
> *(a) x x x  x x x  x x x*
>
> *(b) Service enterprises*
>
> *Direct salaries*
> *Service supervision salaries*

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*Direct Materials, supplies used or resold to another SBMA registered enterprise*
*Depreciation of machineries, equipment and buildings owned and/or constructed*
*Equipment lease payments*
*Financing Charges associated with fixed assets*
*Rent and utility charges for buildings and capital Equipment*
*Corporate management salaries*
*Administrative salaries*
*Marketing and sales salaries*
*Advertising*
*Research & Development*
***Royalty Fees***
*Travel and Entertainment expenses*
*Communication expenses*
*Outside Professional Services*
*Interest & financial charges on working capital*
*Loss on foreign exchange translation' "* (Emphasis supplied)[1]

Based on the abovementioned Revenue Regulations, SBMA-registered Service enterprises are entitled to deduct Royalty Fees in calculating their gross income earned during a given taxable period.

In view of the foregoing, this Office holds that the royalties being paid by SATAC is deductible in computing gross income subject to the 5% preferential tax rate as defined under Section 12 (c) of RA No. 7227 and implemented by RR No. 16-99, provided that the agreement that gave rise to the royalty payment is actually and fully substantiated and provided further that the corresponding withholding taxes thereon are duly paid.

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 null and void.

Very truly yours,

**CAESAR R. DULAY**
Commissioner of Internal Revenue

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[1] BIR Ruling No. DA-280-05 dated June 23, 2005 and BIR Ruling No. DA 067-2005 dated February 28, 2005.