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Tax Obligation of a Permanent Establishment

A foreign corporation is a corporation that is organized under the laws other than that of the Philippines. For income taxation purposes, a foreign corporation may either be classified as resident foreign corporation (RFC) or a non-resident foreign corporation (NRFC). RFC applies to a foreign corporation engaged in trade or business within the Philippines. On the other hand, NRFC applies to a foreign corporation not engaged in trade or business within the Philippines.

The income taxation of RFC and NRFC in the Philippines are essentially the same. Both are subject to Philippine income taxes only with respect to income derived from sources within the Philippines and both are not subject to income taxes on income derived from sources outside the Philippines. The only difference is that the NRFC is subject to income tax at the rate of 30% on gross income while the RFC is, in general, subject to income tax at the rate of 30% on net taxable income, except when a special tax regime applies. Consequently, the RFC is required to file its income tax return and pay its own taxes. On the other hand, the NRFC shall not be required to file an income tax return. Its taxes are paid through the final withholding tax system. The payment of taxes of the NRFC, if any, is the responsibility of the payor/customer as withholding agent.

While that is based on our domestic law, there is also the concept of a permanent establishment (PE) found in various tax treaties concluded by the Philippines with other countries. As defined in most treaties, PE means a fixed place of business in the Philippines in which the business of a foreign enterprise is wholly or partly carried on. There are various instances where a PE may be considered to have been established. Among these are the presence of a place of management; a branch; an office; a factory; the presence of employees, agents or representatives in the Philippines for defined number of days and depending on the extent or nature of activities pursued in the Philippines; etc. When a foreign enterprise carries on business in the Philippines through a PE, the income that is attributable to that PE is subject to income tax in the Philippines.

The presence of a branch office of a foreign entity is one of the instances that results in the creation of PE. Apparently, a foreign corporation that is issued by the Philippine Securities and Exchange Commission a license to transact business in the Philippines though a branch is considered a resident foreign corporation. Thus, doing business in the Philippines through a branch makes the foreign corporation a resident. As such, a branch is also required to register with the tax bureau and comply with all the filing and reportorial requirements with the said office, including the payment of its own taxes.

There are, however, other forms of PEs which involve activities with short-term durations but sufficient to create a PE. May these be considered RFCs or NRFCs? Can they register with the tax bureau so that they can comply with their tax obligations as RFCs or will they remain as NRFCs and pay their taxes through the final withholding tax system?

In one case (*C.T.A. Case No. 6388, August 22, 2005*), the Tax Court ruled that a foreign corporation with a PE is still treated as NRFC for income taxation purposes. In this case, the Court took note of the fact that the foreign corporation was not issued a license to transact business in the Philippines by the SEC and neither was it registered with the BIR and paid its taxes. Accordingly, the withholding of final tax by the Philippine customer/payor was proper.

The BIR, on the hand, had issued conflicting rulings. There are a number of rulings confirming that the payments to a foreign corporation with a PE in the Philippines are subject to the final withholding tax. This notwithstanding, there are more recent rulings holding that a foreign corporation that has created a PE in the Philippines is treated as a foreign corporation engaged in trade or business in the Philippines otherwise known as an RFC. As such, they should pay their taxes like any RFC. Accordingly, they should be able to secure TIN and register as taxpayer. There is, however, no specific guideline provided for the registration of a PE so that it can comply with its tax obligations. In one ruling, it was stated that the foreign corporation may register using the business address of its permanent establishment. In another ruling, it is implied that the one-time TIN secured from RDO 39 as generally required for all foreign entities will suffice.

We believe that a foreign entity with a PE should be treated as resident foreign corporation, considering that to some extent, it is doing business in the Philippines. As such, it should comply with its tax obligation like any regular or special branch of a foreign entity. However, since it is not registered with the SEC, perhaps the tax authority should consider crafting a rule providing uniform guidelines for the registration of PEs and payment of their taxes.

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