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TAX LAW FOR BUSINESS

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Taxation of offshore gaming and its implications

In September 2016 the Philippine Amusement and Gaming Corp. (Pagcor) started issuing Philippine Offshore Gaming Operations licenses that allow entities to engage in the business of offshore gaming operations. The government's Pogo revenue in 2017 reached around P3 billion (\$56 million) and is expected to rise to a whopping P6 billion (\$115.2 million) this year. With its fast growth and profits, Philippine offshore gaming has caught the attention of the taxman. Revenue Memorandum Circular 102-2017 and the recently issued RMC 78-2018 provide the rules on the taxability of offshore gaming operations in the Philippines.

In RMC 102-2017, the Bureau of Internal Revenue (BIR) classified Pogo taxpayers as either: (1) the licensee, which pertains to the Pogo duly licensed and authorized by the Pagcor to provide offshore gaming corporations and which may either be a Philippine-based operator or an offshore-based operator; or (2) other entities, which refer to a licensee or any other business entity which provides a particular component of the offshore gaming activities, i.e. Pogo-gaming agent, service provider, and gaming support provider.

For tax purposes, the income of a Pogo taxpayer should be broken down between its income from gaming operations and its income from other services, shows and entertainment necessary and related to its gaming operations.

The entire gross gaming receipts/earnings or the agreed minimum monthly revenues from gaming operations, whichever is higher, shall be subject to the 5-percent franchise tax in lieu of all kinds of taxes, fees or assessments. This means that income from gaming operations is exempt from any other national and local tax. On the other hand, income from services

necessary and related to gaming operations shall be subject to the normal income tax, value-added tax and other applicable taxes.

Further, income payments made by Pogo taxpayers for all their purchases of goods and services shall be subject to expanded withholding taxes while compensation, fees, commissions, or any other form of remuneration for services rendered to Pogo taxpayers are subject to withholding taxes on compensation.

While the above tax rules are very much straightforward, the quandary here is its application and enforcement to offshore-based operators. Under the rules, an offshore-based operator is an enterprise organized in a foreign country who will engage the services of a Pagcor-accredited local gaming agent and service providers for its offshore gaming corporations. Considering the digital nature of the business, these offshore-based operators have no physical presence upon which current rules of taxation are premised.

To address this, RMC 78-2018 now requires that all Pogo licensees, whether foreign-based or Philippine-based, including those that have already been issued a license to register with the BIR. From the BIR's standpoint, "online activity is sufficient to constitute doing business in the Philippines." Thus, offshore-based operators are considered as resident foreign corporations (foreign corporations engaged in trade or business within the Philippines) and not nonresident foreign corporations (foreign corporations not engaged in trade or business within the Philippines).

The Pogo licensees shall register with the BIR Revenue District Office having jurisdiction over the place where the Head Office and/or branch or "Pogo Hub" is located. As offshore-based operators do not have a physical presence in the Philippines, the RMC introduces the concept of a Pogo Hub. A Pogo Hub pertains to a complex, which houses the operations, as well as other logistical, administrative, and support services for offshore gaming operations of Pogo licensees and service providers. Therefore, even if the offshore-based operator does not have a head office or branch in the country, the Pogo Hub operated by its contracted service provider will suffice for jurisdiction tax purposes.

The implications of these rules on the Philippine offshore gaming industry are far-reaching. Currently, there is an ongoing international debate on how to adapt existing tax rules to digital business activities. In March 2018, for example, the European Commission adopted a proposal that will enable the member-states of the European Union to tax profits generated in their territory by digital companies even if that company does not have a physical presence there. Such digital company shall be deemed to have a taxable "digital presence" or "virtual

permanent establishment” provided certain requirements be met. A law has yet to be passed carrying on this proposal.

In the Philippines the BIR, through RMC 78-2018, is of the position that mere online activity is sufficient to constitute “doing business” in the Philippines. Notably, however, this has only been enunciated in an opinion by the Securities and Exchange Commission and not by the Courts. Nowhere can this also be expressly found in the Tax Code or other laws. With this comes the billion-dollar question that the Courts may eventually have to resolve: Is there legal basis to consider offshore-based companies with digital business transactions here, including foreign-based Pogos, as deemed “doing business” in the Philippines?

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