

REVENUE MEMORANDUM CIRCULAR NO. 46-2002 issued on November 4, 2002 clarifies the implication of Article 12(2)(b) on Royalties of the RP-China tax treaty in relation to Article 13(2)(b)(iii), also known as the “most-favored-nation” clause, of the RP-US tax treaty.

Article 13(2)(b)(iii) of the RP-US tax treaty speaks of the “lowest rate of Philippine tax that may be imposed on royalties of the same kind paid under similar circumstances to a resident of a third state.” The purpose of this clause is to grant to the other Contracting State a tax treatment that is no less favorable than that which is granted to the “most favored” among other countries. Therefore, the tax treatment of royalty payments to a US entity must be taken in relation to other tax treaties, which provide for a lower rate of tax on the same type of income.

In this regard Article 12 of the RP-China tax treaty provides that the tax charged shall not exceed ten percent (10%) of the gross amount of royalties arising from the use of, or the right to use, any patent, trade mark, design or model, plan, secret formula or process, or from the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial, or scientific experience.

Article 23 of the RP-US tax treaty and Article 23 of the RP-China tax treaty, though differently worded, plainly reveal a similarity in the provisions on relief from or avoidance of double taxation to their respective residents. Thus, the tax on royalty payments to residents of US and China are paid under similar circumstances. US residents may, therefore, invoke the preferential tax rate of 10% on royalties, accruing beginning January 1, 2002, arising in the Philippines “from the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process, xxx, or for information concerning industrial, commercial or scientific experience” under the RP-China tax treaty, pursuant to the “most-favored-nation” clause of the RP-US tax treaty.

Before the 10% rate of withholding tax on royalties remitted to a resident of US and China may be availed of, it is necessary that there be an agreement or a contract whereby the royalties paid to the US must originate from the use of, or the right to use, any patent, trade mark, design or model, plan, secret formula or process, or from the use, or the right to use, industrial, commercial or scientific experiences. Moreover, for as long as the contract or agreement is subject to approval under the Philippine law, the same must be duly approved by the Philippine competent authorities.