REVENUE MEMORANDUM CIRCULAR NO. 44-2005 issued on September 8, 2005 provides guidelines for the taxation of payments for computer software.

The Circular covers the tax treatment of payments involving the sale of computer hardware bundled with software, where the software is bundled in the Philippines. On the other hand, computer hardware bundled with software, where the software is bundled abroad will be dealt with in another revenue issuance.

Payments made to a local copyright owner for a full or partial transfer of a copyright will be subject to Income Tax as follows:

a. Transfer by a resident individual owner of copyright – A resident individual owner of a copyright is subject to the graduated income tax rates (5% - 32%). The amount paid in consideration of the copyright or portions transferred shall form part of the copyright owner’s gross income, from which his taxable income shall be computed.

b. Transfer by a domestic corporation owner – The amount paid in consideration of the copyright or portions thereof transferred shall form part of the copyright owner’s gross income, from which his taxable income, subject to 32% Income Tax, shall be computed.

Payments made to a foreign copyright owner for a full or partial transfer of a copyright shall be subject to Income Tax as follows:

a. Transfer by a non-resident alien individual – A non-resident alien individual engaged in trade or business in the Philippines shall be taxed in the same manner as a resident individual owner of a copyright.

b. Transfer by a foreign corporation – The amount paid in consideration of the copyright or portions thereof transferred by a resident foreign corporation engaged in trade or business within the Philippines shall form part of the copyright owner’s gross income from which his taxable income, which is subject to 32% Income Tax, shall be computed.

The amount paid in consideration of the copyright or portions transferred by a non-resident foreign corporation shall be subject to a final tax of 32%, based on the gross income. However, if the foreign owner of the copyright is a resident of a country, which has an existing tax treaty with the Philippines, royalties paid to such owner are subject to the reduced tax rates on royalties under the relevant tax treaty, provided the conditions prescribed therein are complied with by the owner.

The payments made by a local subsidiary/reseller/distributor/retailer to a domestic corporation owner of a copyright or a reseller/distributor licensee of a copyright shall be subject to a final income tax of 20%, based on the gross amount of royalties, to be withheld by the local subsidiary/reseller/distributor/retailer making the payments.

Payments made by the local subsidiaries/resellers/distributors/retailers to a non-resident foreign licensor/owner of the software are royalties subject to 32% final income tax, based on the gross amount thereof, the full amount of which shall be withheld and collected by the subsidiary/reseller/distributor/retailer making the payments.

However, if the foreign licensor/owner is a resident of a country which has an existing tax treaty with the Philippines, royalties paid to such licensor/owner are subject to the reduced tax rates on royalties under the relevant tax treaty, provided that the conditions prescribed therein are complied with by the licensor/owner.
Payments made by the end-user to the local subsidiaries, resellers, distributors of resellers for the purchase of copyrighted articles are business income which is subject to 32% Income Tax, based on the net taxable income of a domestic corporation.

When making payments to the local subsidiaries, resellers, distributors of resellers, the end-user shall withhold 2% Income Tax of the gross amount of the payments creditable against the taxable income of the local subsidiaries, reseller or distributors, provided that the end-user is any of the following persons required to withhold such tax:

(a) A juridical person, whether or not engaged in trade or business;
(b) An individual, with respect to payments made in connection with his trade or business; or
(c) A government office including a government-owned or controlled corporation, a provincial, city, or municipal government.

A local end-user may acquire license to use software directly from the foreign licensor/owner of the software. The payments made by the end-user are royalties subject to 32% Income Tax, based on the gross amount thereof, imposed on royalties derived by a non-resident foreign corporation, which amount shall be withheld and collected by the end-user making the payments.

However, if the foreign licensor/owner is a resident of a country which has an existing tax treaty with the Philippines, royalties paid thereto are subject to the reduced tax rates on royalties under the relevant tax treaty, provided the condition prescribed therein are complied with by the licensor/owner.

The following payments for software transactions shall be subject to the 10% Value-Added Tax (VAT):

(a) Royalty payments for the use of a copyright over a software;
(b) Payments made to resellers/distributors/retailers who are engaged in the trade or business of distributing or selling software; and
(c) Payments for services rendered in the Philippines in connection with software purchased.

The payor in control of the payment of VAT in the software transactions shall be responsible for the withholding of VAT on such fees on behalf of the non-resident payee, by filing a separate VAT return for and on behalf of such payee using BIR Form No. 1600 (Monthly Remittance Return of Value-Added Tax and Other Percentage Taxes Withheld).

The duly filed BIR Form No. 1600 and proof of payment shall serve as sufficient basis for the claim of input tax to be applied against the output tax that may be due from the payor.

In addition, the payor is required to issue the Certificate of Creditable Tax Withheld at Source (BIR Form No. 2307) in quadruplicate upon the request of the non-resident payee, the first three (3) copies to be given to the payee and the fourth copy to be retained as payor’s file copy.