Branch Office vs. Domestic Subsidiary

By Juris Bernadette M. Tomboc

There are two (2) basic modes of entry that foreign corporations seeking to do business in the Philippines may adopt. The first one is through a branch office and the other is to set up a domestic subsidiary. Which one is better? Let us examine the legal and tax implications of each type of business organization in weighing their advantages and disadvantages.

Setting up a domestic subsidiary involves incorporation under Philippine laws. By incorporation, the domestic subsidiary acquires a juridical personality that is separate and distinct from that of its parent company. *(Sec. 2, Corporation Code)* The parent company shall not be liable for the obligations of the domestic subsidiary beyond its subscription to the subsidiary's authorized capital stock, unless there are circumstances that warrant the piercing of the veil of corporate fiction, such as its use for the perpetration of fraud. From the viewpoint of taxation, the subsidiary becomes a ***domestic corporation*** while the parent company remains a ***non-resident foreign corporation***. *(Sec. 22 (C) and (I), Tax Code)*

On the other hand, doing business through a branch office involves the securing by the foreign corporation of a license to do business in the Philippines. Unlike a domestic subsidiary, a branch office does not acquire a separate juridical personality but becomes merely an extension of its parent company. *(Sec. 123, Corporation Code)* The parent company shall be liable for all of the obligations that the branch office may incur. From the point of view of taxation, the foreign company upon obtaining a license to do business through a branch office becomes a ***resident foreign corporation*** *(Sec. 22, (H), Tax Code)* with respect to the transactions that are effectively connected with its business in the Philippines. Otherwise, it shall be considered a ***non-resident foreign corporation*** with respect to transactions that are not effectively connected with its business here.

The domestic subsidiary and its parent company, i.e., non-resident foreign corporation, are also subject to tax separately. The domestic corporation is subject to tax based on its ***taxable income from all sources,*** i.e., within and without the Philippines, at the corporate tax rate of 32%. *(Sec. 27 (A), Tax Code)* Its parent company, the non-resident foreign corporation, on the other hand, is subject to tax based on its ***gross income from sources within the Philippines*** at the same tax rate. *(Sec. 28 (B) (1), Tax Code)*

Subject to the provisions of an applicable tax treaty, if any, the 32% tax rate on gross income imposed on a non-resident foreign corporation also applies to dividend income that it receives from a domestic corporation. However, the dividend tax may be reduced to 15% if the government of the country in which the parent company resides shall reduce the tax that it shall impose on the receipt of the said dividends by an amount that will at least equal the amount of tax equivalent to the 17 percentage points, i.e., 32% minus 15%, waived by the Philippine government. *(Sec. 28 (B) (5) (b), Tax Code)*

In contrast, a branch office is subject to tax based on its ***taxable income from sources within the Philippines*** at the rate of 32%. *(Sec. 28 (A) (1), Tax Code)* Branch profit remittances to the parent company, if they are effectively connected with its business in the Philippines (considered as income earned as a resident foreign corporation), are subject to the branch profit remittance tax of 15%. Other income that is ***not*** effectively connected with the business of the branch office (considered as income earned as a non-resident foreign corporation) may either be subject to the provisions of the applicable tax treaty, if any, or taxed at the gross amount at the rate of 32%.

In summary, therefore, it may be more advantageous for a foreign investor company to set up a domestic corporation for purposes of limiting its potential legal liability. For tax purposes, however, the decision must take into consideration whether there is an applicable tax treaty that can reduce the rate of tax on dividends received by a foreign company from a domestic corporation to 15% or less. Otherwise, it may be more advantageous for tax purposes to set up a branch office. Another tax advantage of setting up a branch office is that it may be allowed to deduct a ratable portion of the expenses and other deductions of its parent company from its taxable income from the Philippines if these expenses and deductions are effectively connected with its business being conducted here. *(Sec. 42 (B) (1), Tax Code)*

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