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Global Reward Update

Philippines

Removal of FBT for equity-based compensation

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Headline

Fringe benefits tax (FBT) has, since 2015, applied to equity-based compensation awarded to managerial or supervisory employees. The Philippines Bureau of Internal Revenue have now released an update stating that such awards should be subject to income tax (and, potentially, social tax and withholding obligations), regardless of the employment status of the person granted the award.

Background

Since clarification issued in February 2015 (see our previous Global Reward Update on this subject here), it has been common practice for equity-based compensation (including stock options, restricted stock units, stock appreciation rights and restricted share awards) received by managerial or supervisory employees* to be treated as fringe benefits and subject to FBT, where costs are borne by the local entity or the relevant expense is recorded in the local entity's accounts.

FBT is an employer liability paid on the grossed up taxable amount of equity-based compensation received by managerial or supervisory employees, where:

- the award costs are recharged to the local Philippine entity;
- an expense relating to the awards is recorded in the Philippine entity's accounts; or
- a cash payment is made via the Philippine payroll.

If none of these conditions apply, no FBT is payable, even where equity compensation is paid to managerial and supervisory employees. Instead, the awards are subject to income tax.

Equity-based compensation received by rank-and-file (i.e. non-managerial or non-supervisory) employees is treated as compensation and liable to income tax. Social taxes (subject to an earnings cap) and employer withholding obligations also arise where one of the three factors set out above applies. These taxes are payable on the taxable value with (in general) no gross-up being applied because these are employee, rather than an employer, liabilities.

What has changed

In October 2022, the Philippines Bureau of Internal Revenue released an update relating to the income tax treatment of equity-based compensation of any kind (see Revenue Regulations No. 13-2022, a link to this announcement can be found here). This explains that equity-based compensation should be considered compensation and subject to income tax (and potentially social tax and withholding obligations), regardless of the employment status of the employee receiving the equity compensation.

The change is due to come into effect fifteen days following its publication in a newspaper of general circulation. As the Revenue Regulation was published on 14th October, the changes will come into effect on 29th October 2022. This means that any equity compensation awards vesting on or after 29th October will be subject to income tax, and, potentially, social tax and withholding obligations.

While confirmation from the Philippines tax authority is awaited, it is expected that employers will continue to be subject to the same reporting requirements under RMC 79-2014 (available here, with further information provided in the February 2015 GRU referred to above), although FBT will no longer be reported in respect of equity compensation.

Deloitte's view

Employers currently applying FBT to equity-based compensation received by managerial or supervisory employees should update their approach to align the income and social tax treatment in Philippines for all employees. In addition, employers should consider preparing communications for participants explaining the impact of these changes, particularly as the changes comes into force part way through the tax year.

We believe the change to align the tax treatment across all employees will be generally seen as a positive change. It will reduce the tax cost to employers of delivering equity-based compensation and we expect the alignment of approach will simplify the administration required to tax these awards. Set against that, this change ends a preferential tax regime for managerial and supervisory employees as the tax liability will be transferred from the employer to the employee. Employers may wish to consider increasing the size of future award grants for managerial and supervisory employees, to reflect the reduction in employer costs of delivering these awards and the increase in taxation for those employees.

As mentioned above, these changes come into effect on 29th October. As FBT reporting is completed on a quarterly basis, July to September 2022 equity-based compensation shall be reported as subject to FBT. For equity-based compensation vesting in October but before 29th October, FBT reporting may still be relevant. However any equity-based compensation vesting on or after 29th October will not be relevant for FBT reporting, and instead income tax, social tax and withholding obligations will need to be considered.

* Managerial employees are generally those with powers to lay down and execute management policies and/or to be involved in all functions of hiring other employees. Supervisory employees are those who, in the interest of the employer, effectively recommend such managerial actions if the exercise of such authority requires the use of independent judgment.

Who to contact

Senen M. Quizon
Partner
smquizon@deloitte.com

Menchie M. Marcos
Sr. Manager
memarcos@deloitte.com

Deloitte.