

Global Rewards Update: Philippines – Clarification on the tax treatment of share-based awards

February 2015

Background

The Philippine tax authorities issued Revenue Memorandum Circular 79-2014 ("RMC 79-2014") on 31 October 2014, to clarify the tax treatment of share option plans.

Although the Circular was issued in relation to the tax treatment of share option plans, historically other plan types (e.g. Restricted Stock Units, Performance Share Plans) have been treated as benefits-in-kind in the same way as share option plans. Therefore, the clarifications provided in the Circular should apply to all share plan types.

Taxable amount

Previously, it was common practice for share options to be taxable on exercise, based on the difference between the Fair Market Value (FMV) at exercise and the exercise price.

RMC 79-2014 clarified that the taxable amount on the exercise of share options should be the difference between the book value (value in the company's accounts) at exercise or the FMV of the shares at exercise (whichever is higher) and the exercise price.

Although the Circular does not directly address other award types (e.g. Restricted Stock Units, Performance Share Plans), it implies that the taxable amount for share awards should be the higher of the book value at delivery and the FMV at delivery.

Fringe benefit tax

Managerial and supervisory employees

Previously, it was unclear whether share options/awards received by **managerial employees** (i.e. those vested with powers to lay down and execute management policies and/or to be involved in all functions of hiring other employees) **or supervisory employees** (i.e. 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) should be taxed as compensation or fringe benefits. The tax treatment of awards received by such employees was dependent on the rules and structure of the relevant plan.

RMC 79-2014 clarified that share options/awards received by managerial or supervisory employees should be treated as fringe benefits and subject to fringe benefit tax, regardless of the plan rules and structure.

Fringe benefit tax is an employer liability in the form of a final withholding tax imposed on the grossed-up monetary value of the benefit received by the individual. Employers will therefore be required to pay fringe benefit tax (at up to 32%) on the grossed up taxable amount of share options/awards received by managerial or

supervisory employees.

It should be noted that fringe benefit tax is only applicable if 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 this is not the case, then no fringe benefit tax would be payable, even for managerial and supervisory employees. Instead, the awards would be subject to income tax. No employer withholding would be required; instead the employee should settle any taxes due via their annual tax return.

Rank and file employees

Share options/awards received by **rank and file** (i.e. non-managerial or non-supervisory) employees have historically been clearly defined, and therefore treated, as compensation. Such awards continue to be liable to income tax, subject to employer withholding in certain circumstances. While income tax is applied at the same rate (up to 32%) as fringe benefit tax, this is payable on the taxable value with no gross-up being applied and is an employee, rather than an employer, liability.

Additional filling requirements

RMC 79-2014 also introduced the following new reporting requirements for companies granting share options (which should also be applicable to share awards):

Share option/share award grant

Within 30 days of the date of grant, the grantor should submit to the relevant Revenue District Office, a statement under oath indicating the following:

- Terms and conditions of the share option/award;
- Names, TINs and positions of the grantees;
- Book value, fair market value, par value of the shares at the grant date (if applicable);
- Exercise price, exercise date and/or period (if applicable);
- Taxes paid on the grant, if any;
- Amount paid for the grant, if any.

These apply to all awards granted after 1 November 2014.

Share option exercise/share award delivery

The grantor should file a report on or before the 10th day of the month following the month of exercise/delivery including the following:

- Exercise/delivery date;
- Names, TINs and positions of those who exercised the option/received the share award;
- Book value, fair market value, par value of the shares at the exercise/delivery date;
- Type of settlement (i.e. cash or equity);
- Taxes withheld at exercise/delivery, if any;
- Fringe benefits tax paid, if any.

These apply to all awards exercised/delivered after 1 November 2014.

The new requirements apply in addition to existing reporting requirements in relation to share options/awards treated as compensation or as fringe benefits.

Deloitte view

Employers should ensure they calculate the taxable amount arising in relation to share option exercises and share awards deliveries using the method specified in RMC 79-2014.

Employers should ensure they are applying the correct tax treatment to awards received by their employees, taking into account the employee's role and position and whether there is a recharge of costs to the 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.

Employers should ensure they comply with the new additional reporting requirements in relation to the grant and exercise of share options/delivery of share awards, whilst continuing to comply with existing applicable reporting requirements.

People to contact

For assistance with these issues, or any other issue related to the operation of your global equity plans, please contact your usual Deloitte adviser or email us at globalshareplans@deloitte.co.uk, and an adviser will contact you.

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