By Filbert Tsai

Let’s talk about the tax reform in the Philippines (Part 1)

Understanding tax law and regulations is a challenging task for all. Business owners, accountants, business consultants and advisors need to understand the tax implication of their action and advice.

A few weeks ago, House Bill No. 5636 or the Tax Reform for Acceleration and Inclusion (‘TRAIN’) was approved by the House of Representatives. While the government’s propaganda to disseminate information about the tax reform is focused on the lowered personal income tax rate resulting from the bracketing changes, these changes affect more than your personal income tax.

As a business, the effect of personal income tax rate changes is subtle. There are loads of articles and materials released by the government to propagate the impact of tax changes to personal income tax, this article will focus on the business impact of the envisioned changes in tax law and rules.

Let me start on the area on taxation of fringe benefits. Most businesses pay fringe benefits (e.g., car allowances, groceries, housing benefits), aside from salaries, to the founders as well as key management personnel. Under current tax regulations, fringe benefits are subjected to a fringe benefit tax (‘FBT’) at a rate of 32% based on the grossed-up monetary value of the fringe benefit paid to the employee (e.g., Php32.00 of FBT for a Php68.00 worth of fringe benefit).

The proposed tax changes call for a lowering of the FBT rate to 30% beginning 2018 which would mean a lowering of the overall tax burden for the company (i.e., continuing the example above, this would mean an FBT of Php29.14 instead of Php32.00).

While this looks positive for business entities, the proposed change also includes a poison pill for your employee. Under the current tax code, FBT is considered a final tax – meaning, the benefit received by the employee is not subject to personal income tax. However, TRAIN proposes that effective 2022, “fringe benefit shall form part of the gross income of its recipient employee subject to the regular income tax rates.” This would heavily change the dynamics of how employees would welcome receiving benefits in kind in lieu of benefits in cash.

Further, current tax regulations allow the business to take as an expense the grossed-up monetary value of the fringe benefit as a deduction (i.e., continuing above example, Php100.00 is allowed as deduction from income tax instead of the amount actually paid to the employee – Php68.00). The proposed changes now only allow the actual amount paid to be claimed as a deduction (i.e., Php68.00).

Subjecting fringe benefits to personal income tax erases the benefit of receiving salaries. Perhaps, this could be the most crucial aspect of how you can retain top caliber talents without the non-cash benefits that employees previously enjoy. Further, reducing the tax deductible amount to the actual fringe benefit paid eliminates the benefit that the total payment (i.e., Php68.00 of fringe benefit and Php32.00 of FBT) can be claimed to reduce income tax. In essence, this is a double taxation – subjecting the fringe benefit to both fringe benefit tax and corporate income tax.

I will discuss in my next article the other changes that are proposed in TRAIN that will impact the start up businesses.

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This column accepts contributions from accountants, especially articles that are of interest to the accountancy profession, in particular, and to the business community, in general. These can be e-mailed to boa.secretariat.@gmail.com.