

A large, abstract graphic of a network or sphere made of interconnected blue nodes and lines, positioned in the upper right background.

Philippines

Taxation

FUNDS AND FUND MANAGEMENT 2010

3.1 Taxation of funds

Taxation of mutual funds

A mutual fund company which is established in the Philippines is taxable like any domestic corporation. Hence, the following items of income are taxable:

- interest income on currency bank deposit and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangement - 20 percent final tax
- interest income derived from a depository bank under the expanded foreign currency deposit system – 7.5 percent final tax
- interest income from other debt instruments is subject to normal corporate income tax at the rate of 30 percent
- capital gains on sale of shares of stock listed and traded on the stock exchange – 0.5 percent gross selling price
- capital gains on sale of shares of stock listed but not traded on the stock exchange and unlisted shares: 5 percent on the first PHP 100,000 of net capital gains and 10 percent on net capital gains in excess of PHP 100,000
- dividend income on shares of stock of another domestic corporation is exempt from income tax
- capital gains from the sale of real estate which is deemed a capital asset is subject to a final tax of 6 percent on the gross selling price or current fair market value whichever is higher

Under the National Internal Revenue Code of 1997 (Tax Code), mutual fund shareholders are not subject to income tax on gains realized upon redemption of their mutual fund shares.

The unitholder of a mutual fund is not taxable on undistributed earnings of the fund.

Taxation of common trust funds

Common trust funds managed by trust department of banks are not taxable entities; hence, income paid to these funds is not subject to income tax. The income of the common trust fund is subject to final withholding tax upon distribution to the investors. The exception to this is interest income from long-term common trust funds (with maturity of at least five years) which is not subject to income tax when paid to resident individual investors. Should the resident individual pre-terminate the investment before the fifth year, a final tax shall be imposed on the entire income based on the length of time that the instrument was held by the taxpayer, as follows: four to less than five years – 5 percent; three years to less than four years – 12 percent; and less than three years – 20 percent.

3.2 Taxation of resident unitholders/investors in a resident fund

The cash or property dividends actually or constructively paid to individual shareholders of mutual funds are subject to a final tax of 10 percent.

Cash or property dividends paid to resident corporate shareholders are exempt from income tax.

Stock dividends continue to be exempt from income tax whether the recipient is an individual or corporate stockholder.

Capital gains from the redemption of shares in the mutual fund are exempt from income tax.

On the other hand, income received by investors of common trust funds is subject to 20 percent final withholding tax. The exception is income received by individual investors from long-term common trust funds (with maturity of at least five years), which is exempt from income tax.

3.3 Taxation of resident unitholders/investors in a non-resident fund

A resident citizen of the Philippines or a domestic corporation is taxable on all income derived from all sources within and outside the Philippines. As such, the income distributed from a foreign fund in which the resident citizen or domestic corporation holds a unit will be subject to income tax.

A resident alien individual or a resident foreign corporation is taxable only on income derived from sources within the Philippines. The income distributed from a non-resident fund will be considered as income derived from sources outside the Philippines. Thus, the resident alien individual or the resident foreign corporation will not be liable to income tax on such income.

Dividends received from a foreign fund is considered Philippine-sourced income if 50 percent or more of the gross income of the fund for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or such part of such period as the fund has been in existence) was derived from sources within the Philippines.

Unlike capital gains arising from the redemption of shares in local mutual funds, capital gains distributed by a foreign fund to resident citizen shareholders are taxable.

A resident citizen or a domestic corporation unitholder/shareholder liable to tax on income or gains arising from a foreign fund is entitled to a tax credit for foreign taxes withheld on the payment made by a fund, subject to conditions and limitations provided under Philippine tax laws. The shareholders cannot, however, claim credit for taxes paid by a fund including withholding taxes suffered by it. A fund, as a separate entity, cannot pass on the credit for taxes paid on its income to the unitholders/shareholders.

3.4 Taxation of non-resident unitholders/investors in a resident fund

Dividend income received by a non-resident unitholder or shareholder from a fund created in and resident in the Philippines is taxable in the Philippines. A non-resident alien individual engaged in trade or business in the Philippines who is a unitholder/investor is taxable at the rate of 20 percent; and a non-resident alien individual not engaged in trade or business in the Philippines is taxable at the rate of 25 percent. On the other hand, a non-resident corporate unitholder/investor is taxable at the rate of 30 percent. The rate may be reduced if a double tax agreement exists between the Philippines and the state where the unitholder or shareholder is a resident, or under the tax sparing provision of the Tax Code.

Gains realized by non-resident investors from the redemption of shares of stock in a mutual fund company are not subject to income tax.

On the other hand, gains realized by non-residents from common trust funds are subject to 25 percent final withholding tax, in the case of individual investors; and 30 percent final withholding tax, in the case of corporate investors.

3.5 Taxation of fund management/custodian companies

Resident fund investment management companies, trustees and depository companies are taxed in the same manner as other corporations at the rate of 30 percent of net taxable income. Management companies are subject to 12 percent VAT on their gross receipts/service fees.

3.6 Entitlement to income

In the Philippines, income from the mutual fund arises to the unitholder only when it is distributed by the fund by way of dividends and upon redemption of the shares of stock by the fund.

Income from the common trust fund arises to the unitholder when it is distributed in the form of interest.

3.7 Double taxation agreements

A foreign collective investment undertaking which is a resident of a state with which the Philippines has a tax treaty may be entitled to the preferential tax treatment depending upon the terms and coverage and interpretation of each respective agreement. If such an undertaking is regarded by the authorities as a person or body corporate for tax purposes and thus covered by the tax treaty, then it shall be entitled to the tax benefits, with respect to income derived from within the Philippines.

A collective investment undertaking created in and resident of the Philippines is considered as a person for tax purposes and is entitled to tax benefits on income derived from states with which the Philippines has double tax agreements. For Philippines tax purposes, a person means an individual, a trust, or estate, or corporation. Corporations are not limited to legally created or organized companies. The term also includes unincorporated associations. Hence, collective investment undertakings created through investment companies or trust funds are considered persons.

The Philippines presently has effective tax treaties with the following countries: Australia, Austria, Bahrain, Bangladesh, Belgium, Brazil, Canada, China, Czech, Denmark, Finland, France, Germany, Hungary, Indonesia, India, Israel, Italy, Japan, South Korea, Malaysia, the Netherlands, New Zealand, Norway, Pakistan, Poland, Romania, Russia, Singapore, Spain, Sweden, Switzerland, Thailand, United Arab Emirates, United Kingdom, United States, and Vietnam.

3.8 Other tax-favored vehicles

- Any income of non-residents, whether individuals or corporations, from transactions with depository banks (domestic or resident foreign) under the expanded foreign currency deposit system and with offshore banking units in the Philippines shall be exempt from income tax. Income derived by a depository bank under the expanded foreign currency deposit system (FCDU) or by an offshore banking unit (OBU) from foreign currency transactions with non-residents and other FCDUs or OBUs shall be exempt from all taxes. Interest income from foreign currency loans granted by FCDUs and OBUs to residents other than another FCDU or OBU in the Philippines shall be subject to a final tax at the rate of 10 percent. Interest

income received by an individual taxpayer (except a non-resident individual who is exempt from income tax), domestic corporations, and resident foreign corporations from a depository bank under the expanded foreign currency deposit system shall be subject to a final income tax at the rate of 7.5 percent.

- In March 2004, the Philippines Legislature enacted Republic Act No. 9267 which provides for the legal and regulatory framework and tax incentives to Special Purpose Entities (SPEs) that will be created either as special purpose corporations (SPCs) or special purpose trusts (SPTs) under the above-mentioned law for the sole purpose of securitizing the housing finance sector, particularly, the sale of real estate on installment. While the SPE shall be subject to tax on its income, transfer of assets to the SPE in contemplation, and pursuant to the requirements of the above-mentioned law shall be exempted from value-added tax (VAT) and documentary stamp tax (DST), or any other taxes imposed in lieu thereof. More importantly, the original issuance of asset-backed securities (ABS) and other securities related solely to such securitization transaction, such as, but not limited to, seller's equity, subordinated debt instruments purchased by the originator, and other related forms of credit enhancement shall be exempt from VAT, or any other taxes, except DST. In addition, all secondary trades and subsequent transfer of ABS, including all forms of credit enhancement in such instruments, shall be exempt from DST and VAT, or any other taxes. Finally, the law also provides for income tax exemption on the yield or income of investors from any low-cost or socialized housing-related ABS of government housing agencies.
- On 22 August 2008, Republic Act No. 9505 or the Personal Equity and Retirement Account (PERA) Act of 2008 was signed into law. It became effective on 1 January 2009.

The salient features of the PERA Act of 2008 are as follows:

PERA is defined as the voluntary account established by and for the exclusive use and benefit of the contributor for purposes of being invested solely in PERA investment products in the Philippines. The PERA is to be administered by an entity (administrator) accredited by the Bureau of Internal Revenue and the funds placed in the custody of another entity (custodian) accredited by the Bangko Sentral ng Pilipinas.

A contributor, defined as any person with capacity to contract and has a tax identification number, is allowed to maintain not more than five PERA at any one time and to designate only one administrator for all his/her PERA. Every contributor is allowed to make a total maximum yearly contribution of PHP 100,000 or its equivalent in foreign currency. If the contributor is married, each of the spouses will be entitled to make a contribution of PHP 100,000. An overseas Filipino worker contributor, however, is allowed to make a contribution double of the maximum. The contributor shall be given an income

tax credit equivalent to 5 percent of the total PERA contributions. While a contributor is allowed to contribute more than the total maximum contribution per year, all contributions in excess of PHP 100,000 per year shall no longer be entitled to the 5 percent tax credit. Refund of tax credits arising from the PERA contributions are not allowed.

Employers can likewise contribute to their employees' PERA, which contributions will be allowed as deductions in the employer's gross income. The contributing employer must, however, comply with the mandatory SSS contributions and retirement pay under the Labor Code.

All income earned from the investments and reinvestments of the maximum amount are tax exempt.

Distributions are allowed to be made upon reaching the age of 55 provided the contributor has made contributions to the PERA for at least five years. All allowed distributions are likewise tax exempt.

- On 17 December 2009, Republic Act No. 9856 or the Real Estate Investment Trust Act of 2009 ("REIT Act of 2009") lapsed into law.

The salient features of the REIT Act of 2009 are as follows:

REIT is a stock corporation established in accordance with the Corporation Code and the rules and regulations of the SEC primarily for the purpose of owning income generating real estate assets. Although designated as a trust, it does not have the same technical meaning as trust under existing laws but is used for the sole purpose of adopting the internationally accepted description of the company in accordance with global best practices.

In order to be a REIT under the law, it must be organized as a public company under the Corporation Code and listed in the Philippine Stock Exchange; it must maintain its status as a listed company and after listing must have at least one thousand public shareholders holding at least 50 shares of any class of shares; the public shareholders must own at least one third of the outstanding capital stock; minimum paid-up capital of PHP 300 million; and at least one third of the board of directors must be independent directors.

REITs are allowed to invest in the following: real estate located in the Philippines and real estate located outside the Philippines provided that such investment does not exceed 40 percent of its deposited property and with special authority coming from the SEC; real estate related assets; managed funds, debt securities and listed shares issued by local or foreign non-property corporations; government securities issued on behalf of the Philippine government or governments of other countries and securities issued by multilateral agencies; and such other similar investments as may be allowed by the SEC.

Further, a REIT must distribute annually at least 90 percent of its distributable income as dividends to its shareholders not later than the last day of the fifth month following the close of the fiscal year of the REIT.

The following are the tax incentives granted to REITs: It shall be subject to the regular corporate income tax of 30 percent, but not subject to the minimum corporate income tax of 2 percent. For purposes of computing the taxable net income, dividends distributed by the REIT are deductible from its gross income. Income payments to a REIT shall be subject to a lower creditable withholding tax of 1 percent. The sale or transfer of real property to a REIT shall be subject to only 50 percent of the applicable documentary stamp tax as well as registration and annotation fees. Any initial public offering (IPO) and secondary offering of investor securities shall be exempt from the IPO tax imposed under Section 127 (b) of the Tax Code. Cash or property dividends shall be subject to a final tax of 10 percent, unless the dividends are received by a non-resident alien individual or a non-resident foreign corporation entitled to a preferential withholding tax rate of less than 10 percent pursuant to an applicable tax treaty; and the dividends are received by a domestic corporation, or resident foreign corporation, or an overseas Filipino investor, in which case they are exempt from income tax or any withholding tax. In the case of overseas Filipino investors, they are exempt from the dividends tax for seven years from the effective date of the tax regulations implementing the REIT Act.

3.9 Transfer taxes, stamp duty, and capital duty

Documentary stamp tax is imposed on the issuance of share capital and is computed as follows:

On the original issue of shares by the investment company (Sec. 174, National Internal Revenue Code):

- PHP 1 on each PHP 200 of the par value of the shares issued or the actual consideration in case of no par value

On subsequent sale of the shares by the shareholder (Sec. 175, National Internal Revenue Code):

- PHP 0.75 on each PHP 200 of the par value of the shares issued or 25 percent of the documentary stamp tax paid upon the original issue in case of stocks without par value; however, the sale of shares of stock listed and traded through the local stock exchange shall be exempt from the documentary stamp tax.

3.10 Miscellaneous

The Monetary Board in its Resolution No. 1758 declared that investment company managers, which are performing purely agency functions in respect

of the investment company they manage, shall be outside the coverage of Bangko Sentral ng Pilipinas and therefore should be supervised by the Securities and Exchange Commission. The Capital Market Development Council assisted the Investment Company Association of the Philippines in persuading BSP to allow investment managers, also known as mutual fund managers, to manage more than one fund.

KPMG in the Philippines

Herminigildo G Murakami
KPMG Manabat Sanagustin & Co.
The KPMG Center, 9 / F 6787 Ayala Avenue
Manila
1226
Philippines

Tel. +63 (2) 885 7000
Fax +63 (2) 816 6595
e-Mail: hmurakami@kpmg.com

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.