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TAX LAW FOR BUSINESS

*BDB Law's "Tax Law for Business" appears in the opinion section of **Business Mirror** every Thursday.*

Tax treatment of stock options revisited

BEFORE December 27, 2012, the Bureau of Internal Revenue (BIR) issued inconsistent rulings on the treatment of stocks options granted by employers to their employees. One ruling stated that there is no income derived from the exercise of the option. Another ruling held that the difference between the market price of the share and the exercise price is a benefit subject to fringe-benefit tax, while a more recent ruling considered the discount as compensation subject to withholding tax.

To clarify the inconsistencies, the BIR issued Revenue Memorandum Circular (RMC) 88-2012. This circular stated that any income or gain obtained by the employees from the exercise of stock options is additional compensation subject to income tax and, consequently, to withholding tax on compensation. It, however, clarified that the income or gain obtained by employees in managerial or supervisory positions—which qualifies as a fringe benefit—is subject to the fringe-benefit tax. The tax on compensation or fringe-benefit tax applies, whether the shares of stock involved are those of a domestic corporation or a foreign one.

To further clarify the tax treatment of stock options, the BIR issued RMC 79-2014 last month. The new circular provides a more in-depth discussion on what should be the treatment of the grant, exercise and transfer of stock options, and adds new requirements for reporting.

In so far as the exercise of the option is concerned, the new circular, more or less, maintains the same rule if the involved shares are that of the employer or shares it owns. Thus, in the event the option is granted by an employer involving its own shares of stocks or shares it owns, additional compensation shall be recognized and subjected to income tax and, consequently, to withholding taxes on compensation upon the exercise of the option by a rank-and-file employee.

However, if the employee who exercises the option occupies a supervisory or managerial position, there shall be a fringe benefit subject to the fringe-benefit tax. The additional compensation or the recognized fringe benefit is equivalent to the difference of the book value or fair market value of the shares, whichever is higher, at the time of the exercise of the stock option and the price fixed on the grant date.

An added feature of this new circular is the treatment of the option in case the grantee is other than an employee. If the option is granted to a supplier of goods or services, the difference of the book value or fair market value of the shares, whichever is higher, at the time of the exercise of the stock option and the price fixed on the grant date shall be recognized as additional consideration for services rendered or goods supplied. However, the same shall be considered

a donation if the grantee is a person, natural or juridical, who is not an employee or supplier of goods and services.

Previous issuances did not specify the rules applicable at the time of grant. With the new circular, in the event that option is granted due to an employee-employer relationship, and where the grantor is the employer and the grantee is the employee, and no payment is received for the grant of this option, the grantor cannot claim deductions for the grant of the stock option. If the option is granted for a price, the full price of the option is treated as capital gains. Also, the issuance of the option is subject to documentary-stamp tax. If the option is sold, the same is treated as a sale of shares subject to capital-gains tax. And if the transfer is without consideration, the same is treated as a donation subject to donor's tax.

Other than dealing with the tax consequences of the issuance, grant, exercise and sale of an option, the new circular imposes new administrative reporting requirements not found in the old rules. The new circular requires that the issuing corporation must, within 30 days from the grant of the option, submit to the revenue district office where it is registered a statement executed under oath that indicates, among others, the terms and conditions of the stock options, book value, fair market value and par value of the shares subject of the option at exercise date, and the taxes and amount paid for the grant, if any.

Still under the new circular, during the exercise period, the issuing corporation is mandated to file a report on or before the 10th day of the month following the month of exercise stating therein, among others, book value; fair market value and par value of the shares subject of the option at exercise date; the mode of settlement; and the taxes withheld on the exercise and fringe-benefit tax paid, if any.

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