KPMG

R.G. Manabat & Co.

Tax exemption to FCDUs and OBUs now on the brink?

Raynan A. Larosa

Top of Mind
October 16 2018

Removing the tax exemption can have a negative impact in the operations of FCDUs and OBUs and consequently adversely affect the country's economy.

Recently, the fourth comprehensive tax reform program under the Duterte Administration was filed with the House of Representatives. This is House Bill (HB) No. 8252, or the Capital Income and Financial Intermediary Taxation Act of 2019.

According to its Explanatory Note, HB No. 8252 aims to reform the taxation of capital income and financial services in the country, by redesigning the financial sector taxation into a simpler, fairer, more efficient, and revenue neutral tax system.

One of the tax reforms proposed under HB No. 8252 is the removal of the tax exemption granted to FCDUs and OBUs, specifically on their transactions with non-residents and other FCDUs and OBUs.

An FCDU, which stands for Foreign Currency Depository Unit, refers to a unit of a local bank or of a local branch of a foreign bank authorized by the Bangko Sentral ng Pilipinas (BSP) to engage in foreign currency-denominated transactions pursuant to the provisions of Republic Act 6426, as amended.

An OBU, on the other hand, stands for Offshore Banking Unit and it refers to a branch, subsidiary or affiliate of a foreign banking corporation which is duly authorized by the BSP to transact offshore banking business in the Philippines in accordance with the provisions of Presidential Decree (PD) No. 1034, as amended.

The taxation of FCDUs and OBUs has been the subject of several tax reforms in the past. Originally, in view of the country's desire to increase its links with foreign lenders and facilitate the flow of desired investments in the Philippines, a sweeping tax exemption was granted to OBUs and FCDUs.

The sweeping privilege was, however, lifted in 1998 when RA No. 8424 took effect. Under RA No. 8424, income earned by FCDUs/OBUs from foreign currency loans and/or transactions with non-residents and other FCDUs/OBUs is subject to 10% final tax based on the amount of the income.

In 2004, the Government restored the tax exemption granted to FCDUs and OBUs when it enacted RA No. 9294. Under RA No. 9294, income derived by FCDUs and OBUs from foreign currency transactions with nonresidents and other FCDUs and OBUs shall be exempt from all taxes.

At first glance, it may be apparent that removing the tax exemption granted to FCDUs and OBUs means more revenue for the government in the form of taxes. Revenues which can be used for social welfare and improving the country's infrastructure, among others.

However, one must keep in mind that FCDUs and OBUs are important institutions in the development of the country's economy. As one news article that quoted the representatives from the BSP and the banking sector puts it, the operations of the FCDUs and OBUs in the Philippines help attract foreign investments, mobilize foreign savings, stabilize sourcing of foreign currency, provide secondary source of dollar liquidity and improve capital markets in our country. Removing the tax exemption can have a negative impact in the operations of FCDUs and OBUs and consequently adversely affect the country's economy.

Hopefully, our legislators will be able to find a middle ground. Admittedly, increasing the country's revenue is a priority but what the country should sacrifice and how much should the country sacrifice should also be considered. Aesop's Fables could not have said it better: Do not kill the goose that lays the golden egg.

Raynan A. Larosa is an Assistant Manager from the Tax Group of KPMG R.G. Manabat & Co. (KPMG RGM&Co.), the Philippine member firm of KPMG International. KPMG RGM&Co. has been recognized as a Tier 1 tax practice, Tier 1 transfer pricing practice, Tier 1 leading tax transactional firm and the 2016 National Transfer Pricing Firm of the Year in the Philippines by the International Tax Review.