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Fintech: Powering digital transformation in financial services

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Over the past five years, the Philippines has gained traction in financial technology (fintech), growing from strength to strength and quickly earning the attention of the global fintech community. The Global Fintech Index 2020, the fintech ecosystems ranking created by Findexable, grouped the Philippines along with a few others as countries to watch because it is one of the fastest growing fintech destinations.

In the first part of this article, we discussed the key themes expected to dominate headlines in the fintech market in Asia and the Philippines. In the second part of this series, we look at the taxation issues in a market that is experiencing phenomenal growth.

The dramatic change in the financial services industry landscape reflects the Philippines' astounding growth as a fintech destination. In 2017, the Philippines had only 115 fintechs, which is tiny when compared with Singapore, which had the highest concentration (490) out of the 1,268 fintechs in ASEAN, and Indonesia (262). However, the Philippine total nearly doubled to 212 by the end of 2020. Growth in the Philippine fintech industry has since slowed, but a study by the Philippine Institute for Development Studies notes that investment surged 762.5% from 2016 to 2018.

In its rankings, Findexable also found that the Philippines excelled in fintech categories like payments, enabling processes and technology, and banking and lending. Stunning growth in numbers posted by the largest mobile e-wallet service supports this observation as it breached its initial full-year target of P3 trillion in gross transaction value for 2021, or three times the record set in 2020.

Much of the growth of in the fintech market stems in part from a supportive regulatory environment. Financial regulators in the Philippines have been equally aggressive as their peers in the region in pushing for fintech innovation even as they strive not to lose sight of their responsibility to foster financial stability. The Philippines is among a few economies in Southeast Asia where regulators have issued licenses for digital banking, an area that is anticipated to post significant development that will alter the financial landscape in the next few years.

There can only be progress by leaps and bounds for the fintech industry in the years to come as the market nears a point where very few in the workforce will have known of life before the internet. Banks have had a good look into the digital space due to the limitations that the pandemic imposed, and this can only lead to more confident steps in incorporating fintech products with their offerings.

TEAMING UP ON REGULATION AND TAX

In anticipation of a further surge in fintech activity, regulators have begun to set standards for the industry. All eyes have been on the tax agency for an issuance that will provide guidance in connection with the tax regime for the industry.

At the end of 2021, the Bureau of Internal Revenue (BIR) and the Securities and Exchange Commission (SEC) said they were working together to ensure that fintech companies are properly regulated and taxed even as the government encourages their growth and continued innovation. The Department of Finance instructed the two agencies to closely monitor fintech firms and find out what new digital business models they have been adopting to determine how they should be regulated and taxed.

Given the dramatic changes that fintech has brought into the financial services landscape, market

participants have been on the lookout for clear guidelines or revenue regulations that explicitly apply to them. In the absence of such rules, fintech companies may have been advised to assess and analyze their transactions and apply the basic taxation principles and procedures to comply with tax obligations.

The tax agency said it will continue to impose the current Tax Code rules on compliance and taxation based on actual activities of fintech companies, which are similar to those of ordinary corporations or financial institutions. In the same vein, a previous article by this column titled “Taxation of fintech companies in the Philippines” noted that fintech companies are subject to regular income tax based on net taxable income at the rate of 25% effective July 1, 2020. The tax rate will be lowered to 20% for fintech companies with net taxable income not exceeding P5 million and with total assets not exceeding P100 million, excluding land on which the particular business entity’s office, plant, and equipment are situated during the taxable year for which the tax is imposed. But given the infancy of the industry, in lieu of this regular tax rate, a minimum corporate income tax (MCIT) of 2% may be imposed on a new fintech company beginning on the fourth taxable year immediately following the year in which it began business operations. This MCIT rate shall be 1% from July 1, 2020 until June 30, 2023. Withholding taxes on such income may also apply.

The ongoing joint initiative of the BIR and SEC aims to broaden the tax base of fintech-related enterprises by ensuring the two agencies have enough regulatory and collection capability to deal with these digital companies. The Finance department said the BIR will continue to gather information from other regulatory agencies on identifying, addressing and closing the gaps resulting from the development and proliferation of fintech entities not clearly or explicitly covered by existing regulations. In 2021, BIR planned to have a team that will evaluate the tax obligations of fintechs based on categories identified by the SEC and those regulated by the Bangko Sentral ng Pilipinas (BSP).

VAT ON DIGITAL TRANSACTIONS

Lawmakers are also considering a house bill that, once enacted, would subject the value created in the digital economy to withholding/income tax and value-added tax (VAT). House Bill 7425 (previously HB 6765) would impose a 12% VAT on the digital sale of services such as online advertising, subscription services, and the supply of other electronic and online services that can be delivered through the internet such as mobile applications, online marketplaces, online licensing of software, and webcasts, among others.

A key provision of the bill also seeks to add a new section in the National Internal Revenue Code of 1997 that would require foreign digital service providers to collect and remit VAT for all transactions made through their platforms.

In addressing concerns, the measure could unduly burden small enterprises and freelance workers who are dependent on digital channels to make a living, the BSP recently proposed VAT exemptions for low-value digital transactions and for service fees charged by payment service providers.

DIGITAL SERVICE TAX

In light of the infancy of the fintech services industry, it has become imperative for Philippine regulators to also find out what their peers in other countries have done for income tax purposes. The Finance department is monitoring developments in countries where digital services taxes have been imposed on online platforms.

In mid-2020, the department focused its efforts on collecting VAT on both local and cross-border digital transactions, similar to initiatives by neighbors in ASEAN. It said, however, that it was looking to review and propose tax reforms to levy income tax on cross-border digital transactions after international consensus has been reached on the taxation of the digital economy. Once passed into law, this digital service tax will come on top of the 12% VAT on online transactions.

As we look forward to guidance from the government on the taxation and regulation of fintech companies,

the fintech market continues to become more complex, as adoption deepens and its benefits broaden to further impact the lives of consumers.

It is imperative for fintech providers, particularly those that handle transactions, to keep abreast of tax regulations and staying compliant, as doing otherwise and relegating tax considerations as an afterthought can be detrimental to their customers, partners and even their own bottom line.

Government regulators want regulation that does not to impede growth in this young market that has the potential to power the digital transformation of financial services. However, they are also wary of appearing to provide support that can be interpreted as giving fintechs an unfair competitive advantage. Active engagement with the government on the part of market participants will be key as the policy regime for the fintech market takes shape.