Stakeholders Consultation on TRAIN Package 2
with DOF Usec. Karl Chua and DTI Usec. Ceferino Rodolfo
January 23, 2018, 9:00 AM – 11:00 AM
3/F SGV Caseroom, Asian Institute of Management
Paseo de Roxas, Makati City

OPENING REMARKS

[00:00-07:28 – Introduction]

HIROSHI SHIRAISHI
President,
Japanese Chamber of Commerce and Industry of the Philippines, Inc.

Hiroshi Shiraishi: My name is Hiroshi Shiraishi. My day job is managing the companies of Sumitomo in the Philippines. Our business philosophy pronounces that Sumitomo's business, while benefiting Sumitomo, must also benefit the nation and society.

On behalf of the Joint Foreign Chambers (JFC) and our many partners present this morning, we are pleased to host Undersecretary of Finance Karl Kendrick Chua, the principal official (along with Finance Secretary Dominguez) in charge of tax policy for the Philippine Government. I would like to thank the American Chamber of Commerce for organizing this important event.

Usec. Chua was already respected as an economist with the World Bank Philippines Office before joining government in 2016. Since then, in his current position, he has become better known as the “tax reform guy of the Philippines.”

Usec. Chua handled the majority of consultations of the Finance Department with Congress and stakeholders for TRAIN 1.

The JFC supported TRAIN 1, with few exceptions relating to the sweetened beverages tax and removal of the income tax incentive for highly-skilled employees at the 200 ROHQs located here. We understand the difficulties facing these employees and their employers and hope they will continue to work and invest in the Philippines.

More of our employees will benefit from lower personal income taxes (PIT). We support excise tax increases that yield revenues needed for better infrastructure, better education, and better health.

Last December, Usec. Chua asked the JFC to organize this consultation to explain proposed TRAIN 2 reforms. He said he wanted to know our position.

Today, we have a large turnout of investors to meet with Usec. Chua. Last January 12 he met with almost 200 investors from the vibrant business processing sector.

In our audience are members of the JFC, a coalition of the American, Australian-New Zealand, Canadian, European, Japanese, Korean chambers, and PAMURI. I would like to acknowledge the presidents of the Canadian and Korean chambers and senior officials of five others.

JFC members represent over 3,000 member companies engaged in over US$100 billion worth of trade in goods and services and some US$30 billion in investment in the Philippines and employ over two million Filipinos.

Also with us is the president of the Financial Executive Association of the Philippines, which just celebrated its 50th anniversary. Congratulations! The president of SEIPI, representing the industry producing over half the country's exports. Senior leaders from the US-ASEAN Business Council, PHILEXPORT, Makati Business Club, the Philippine Hotel Owners Association, and the Department of Trade and Industry have also joined us this morning. I apologize if I have not recognized everyone.

For almost 20 years, the JFC has been asked in every Congress to take a position on the Rationalization of Fiscal Incentives.

In every Congress, we appear at hearings with the same message:

First, we agree that old, redundant, and unnecessary fiscal incentives are no longer necessary.

But second, we must be careful not to reduce this country's ability to attract foreign investment into the PEZA zones and special economic zones. Around the world in successful economies such zones are hubs of investment, innovation, job creation, and progress, as they are in the Philippines.

Many companies here today were not here five or ten years ago. Some have been investing in the Philippines – like the top US and Japanese exporter firms here today – for more than 30 years – or the two top BPO firms here today – for only a little more than a decade.

Our firms have invested in this country because of the quality of Filipino workers and fiscal incentives promised by the Philippine Government. These incentives compensate for the comparative disadvantages of locating in the Philippines instead of in China, Malaysia, Thailand, Vietnam, or elsewhere.

In recent years, FDI in the Philippines has reached record levels nearing US$8 billion. Japanese companies have been leaders in investing in manufacturing. None of us want to stop expanding or to consider relocating.

We prefer the status quo, but we understand the government now wants to change that. We must work together and strengthen not weaken our public private partnership so that our businesses and the Philippines continue to prosper together.

Maraming salamat po. Arigato gozaimashita.

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DOF PRESENTATION
[07:28 - 32:19 – DOF Presentation]

USEC. KARL KENDRICK CHUA
Undersecretary, Strategy, Economics, and Results Group
Department of Finance

DOF Usec. Karl Chua: Thank you very much, John and everyone. Good morning to everyone. I would like to start by saying that this is not an easy task. I did not sign up for this, but someone has to do it, and that someone requires the support of many so that we can move this country towards a common, higher, and better objective.

This is the first time we are doing a tax reform where the main objective is not deficit or debt reduction, but poverty and inequality reduction. This is a milestone when we passed Package 1. This is also the first time we are doing a tax reform when there is no crisis and no external creditor or force telling the Philippines to raise taxes, which was the case for many decades. This is also the first time we are doing a tax reform and we passed Package 1, where the only possible success factor was forming a broad coalition, which counts many of you today.

Many of you are probably have been hit in one way or another, but I remember basically two things that inspired me to move this forward.

Number 1, back in 2004 when the Arroyo government did VAT reform, I think many of us probably did not like it because it was pain and no gain. There were a lot of concern about the impact on the economy, productivity, and competitiveness. But today, 14 years later, truly and without doubt, the product of that bitter medicine we took, which is the VAT reform, allowed this country to grow, poverty to go down, the stock market to rise, foreign investors to come in, and all the important stars aligned to show the world that our economy has been tremendously successful. We intend, in the Duterte Administration, to do even better to build on these past reforms.

The second is, I am inspired by a quote I took from 11 professors in the University of the Philippines when they wrote in 2004 a landmark paper, calling for the dean to support a tax reform. Basically what the 11 professors said, which I think is very valid and will be the philosophy around why we are doing tax reform, "there is no simple, clever, or painless solution even an adequate solution will demand sacrifice that should be fairly apportioned. Government should aim for a solution that is not only effective, but also just foster solidarity and understanding of the national predicament. The measures proposed by government must be seen to result from a judicious weighing of alternatives, a coherent program, and to have been guided by the economic principles and a concern for an equitable burden sharing." That why we did it as part of a comprehensive tax reform package.

Package 1 basically deals with taxes individuals pay. The VAT, oil, sugar-sweetened beverages, etc. I think people, the households, have begun to accept and carry their share of this reform. We very much hope that with the money we generate, the better tax system we have institutionalized, we will bring this country forward.

Package 2 will affect corporations. We will try to make an important balance. I hope this is a philosophy that we also share. We also need to contribute as we have benefited from these incentives for decades.

Package 3 will be on property taxation. Package 4 will be on financial taxes. In other words, the tax reform of this government has been designed basically to share the responsibility. There is no reform that will make everyone happy today, but I believe people will be happy one generation from today, because the objective of this administration by 2022 is to reduce poverty by 6 million people. Bringing down the rate from 21.5% to 14% and making sure that our country graduates and become an upper middle income country like Thailand and China today.

I think we are very much on track with the growth rates, which are going to be announced very soon, to be a high income country with per capita GDP in today's prices at US$12,000 by 2040 or one generation from today and extreme poverty eradicated

There is no shortcut, we have to grow inclusively, sustainable, and robustly. The only way to achieve that growth is to provide the most basic infrastructure and social services so that people grow up productively, healthy, educated, employed with above minimum wage, go to school, work, and come home within reasonable hours instead of 3 to 6 hours, as is the practice today.

Without further discussion, I will now go to the meat of the presentation. I am pleased to inform you that I will be co-presenting with Usec. Perry Rodolfo of DTI. We will present one common stand. I think this is very important going forward, instead of the past difficulties of having opposite positions.

I will discuss the first two agenda items and Usec. Rodolfo will discuss the proposed reforms.

As of today, we will stick with high levels. The devil is in the details, but we will be open to discuss with you those details. Let me start with the regular system. We have a 30% corporate income tax (CIT) on net taxable income. We also have a minimum CIT on gross income. We also have the 40% optional standard deduction. All of these are faced by 99% of taxpayers. The 99% includes the small, micro, and medium taxpayers. Probably their share of the national contribution is less than 50%.

In terms of where we are in the region, we are the highest levier in CIT at 30%. Most countries have gone down to 20% or 25%. Therefore, one objective of this reform, like the PIT, is to lower the CIT. We will target 25%, but we can go lower. But to be upfront, I cannot propose responsibly to lower the CIT rate without expanding my base and that is my next discussion.

Now we have a very complicated or interesting incentives system. We have 14 investment promotion agencies (IPAs), the typical big ones are PEZA and BOI. We have, as of the latest counting, 123 laws outside the tax code. These are special laws that grant investment incentives. In most countries I know, you have a mother tax or investment code, which all follow. In this country, you have 123 laws. Some people tell me that BIR or BOC should just audit and enforce better. To be honest, as an institutional economist, I cannot understand how anyone can navigate and do his job properly if he has to read 123 laws. Plus, we have 192 additional special laws with non-investment incentives, such as to the Boy Scout cooperatives and probably every sector that tries to get some form of incentive. This is adding to the confusion that we have. We have the income tax holiday (ITH) as the typical starting point. The 5% gross income earned (GIE), which is in lieu of all taxes and given forever. This is the difference that we have compared to other countries.

Fortunately, since 2016, we have the Tax Incentives Management and Transparency Act (TIMTA) law, which mandates the government to collect data from all the recipients so that it can be reported. I think this is basic transparency, if you avail of an incentive, bank loan, scholarship, or subsidy, someone pays for that. Those who pay for that are entitled to knowing how it is spent.

In summary, we have been giving incentives for 50 years and we (our economy) are unfortunately not close to our neighbors. That is why we need to revisit and understand.

I am making a general statement, I know some sectors are doing better than the others, but, today, we will limit my presentation to generics and we will listen to your respective sector experience.

Instead of 14 IPAs, most countries have only one or maximum of two. In Congress, I believe there are 20 bills being debated to create more ecozones. I think the goal is to have one per province.

In the tax code, we have these exemptions. They are not many. Some are valid, some lost their meaning. Our main problem is that outside the tax code, we have 123 investment incentive laws. Basically, in the Philippines, any law can amend any law. This slide is a breakdown of all incentives. I am not saying that all of them are not good. They are probably good for the sector and well thought of. But as a DOF policymaker, we are thinking of not only a sector or an industry, but the whole country. I have to balance thousands of interest that is why when we present a tax reform it is the outcome of intensive consultations and studies, which may not be perfect for certain industries, but we think is the best option we have for the country going forward. This is the balance of the incentives and related special laws.

Now, I will not dwell into the details of the comparison across countries, but let me just point one, income tax incentives. In the Philippines, we started with 4 years ITH followed by up to 8 years extension. Then we give the 5% GIE forever, in lieu of all taxes. Most countries I know in the region do not have indefinite grant of incentives. They usually cap it at most at 20 years. That is why I say this country appears to be giving the most generous because after you give the 5% GIE there is no more way to measure performance or to see if the company, industry, or sector is disciplined or taking very good use of the incentives.

There are other incentives, which I will not discuss, but we will be cognizant that they are different across countries.

Now, because of strong economic growth, our CIT revenues have been rising. They are growing every time the economy grows in peso terms, but important in the slide is that the share to GDP is also growing quite fast because the economy is simply growing 6 to 7% nominal terms is 10%. This is not the correct interpretation, but we are doing well. In reality, our efficiency is very low. Thailand, with a 20% headline tax rate collects 6.1% of GDP in corporate taxes, which gives it an efficiency of 31%. The Philippines, with a 50% higher tax rate at 30%, collects only 3.7% that gives us an efficiency of 12%. Clearly, this is a classic problem of high rate and narrow base tax system, which basically means that this is an inequitable tax system. We are about half of the productive output is due to incentives and the other half is due to the regular rate. I believe both sides are doing their fair share contributing to the economy.

Now, I will discuss the cost of the tax incentives. Because of the TIMTA law, passed by the previous government, we are able to determine who gets what incentives, how much, and some more details on the benefits. This is a law passed by the Aquino Administration. This is a very good first step because going forward we now have solid evidence about the cost of the incentives. This is our estimate for 2015. We granted PhP 86 billion in ITH. PhP 18 billion in customs duties, this has fallen tremendously because of the various free trade agreements (FTAs). We also granted almost PhP 160 billion in import VAT, and PhP 37 billion in local VAT although some of that will be refunded because they are from exporters. We have yet to compute the impact on local taxes because of the "in lieu of." We have yet to compute the impact on leakage.

Although there are many honest taxpayers, there are also some not so honest taxpayers. The problem with having a multiple tax system from an accounting perspective is that, if you have an ITH system within your company and a regular system, there is no stopping you and you know cannot be audited all the time to move your expenses from the ITH to the regular so that you can lower taxable income. Anyway, your expenses in the ITH do not count.

Second, if you have a system wherein you have a zero-rated VAT and regular VAT then there is also the possibility that you shift some of your taxes to the zero-rated VAT so you can claim more refund or credit. Now, I am not saying this is happening all the time, but the data I have seen by the hundreds of billions suggests that this is a typical practice that, if not managed well, can result in large leakages.

I think 5% of taxpayers are very honest, they will follow the rules all the time. 5% are always dishonest, and will try to violate the rules. But the 90% in the middle will need to be incentivized by the correct rules, they will follow if they know there is credible threat and they will not follow if they know there is no credible threat, similar to stopping on a red traffic light.

Total, estimated forgone revenue due to tax incentives for 2015, is PhP 301 billion. The question for the government is "is this worth the benefits we are receiving?" That is the biggest question.

In 2011 to 2014 prior to TIMTA, the government, with the help of some development partners, started estimating the tax incentives for income and customs duties. This is based on partial data and voluntary compliance. You see that the total runs PhP 100 to 150 billion up to 1.5% of GDP because of the TIMTA it is now mandated and this is the initial data that we have. Total ITH is PhP 53.8 billion., special rate is Php 32.5 billion, total incentives on income tax is Php 86.3 billion, and total incentives on customs duties is PhP 18.1 billion so total of PhP 104 billion. The reason why this is not PhP 301 billion is that the TIMTA law does not mandate the reporting of VAT and local taxes, which we are going to correct so that we see the complete picture.

In terms of the distribution across recipients of various IPAs we see that PEZA has PhP 66.6 billion, BOI has PhP 29.4 billion, and the smaller ones take a smaller share. These are all actual data submitted by the recipients. We cannot, I think, dispute that. The total is PhP 104.4 billion. Again, VAT and local taxes are not mandated that is why it is understated. We have to do it from the back end.

Now, in terms of sectors, typically, electronics manufacturing and related areas got the most incentives, followed by BPO type of services and the other types of manufacturing services follow. Total PhP 104.4 billion not counting yet the local taxes and the VAT forgone.

The problem with this system, as I mentioned, is that it has created a very unequal regime. Whereas, the regular taxpayers pay 30% net income tax and those in the special regime pay far less. I do not think that one side is contributing more than the other relative to their capacity. Sad part about it is most of the regular regime are the small, micro, and medium taxpayers who are the priority of the president. We also have to correct the system by narrowing the gap.

In terms of VAT, this is the breakdown. Many of them come from PEZA. The problem with freeports and ecozones is as follows: Originally, the idea was to have horizontal zones that can be guarded well by customs so that there is no leakage and that is typical of many countries. The problem with the Philippines is that the horizontal zones have mushroomed and the vertical zones have also more than mushroomed. We are not sure how to manage this. There are 20 more bills in Congress trying to create more zones. How we are going to manage all these zones who claim to be outside customs territory, outside Philippine tax area and expect the government to collect and collect and collect more to fund the PhP 8.4 trillion infrastructure spending? Somewhere, we have to balance these objectives.

Now on the benefits, this is work in progress, but let me start with the high level. We have been seeing a lot of FDI in recent years from US$1 to 2 billion per year to as high as US$8 billion. This is a very good start for a country that has failed to attract foreign investment that is why we have those incentives.

Let me at the start state that I do not mean to convey the message that tax incentives are the only reason. There are so many other reasons and I recognize them. You have your Arangkada, which lists all of the other reasons. We have to understand and be honest about these other reasons, but, today, I will focus on one reason why I think incentives need to be reviewed.

However, the increase of the FDI does not compare much to the rest of the region in US dollar terms or as a share of our GDP despite giving one of the most generous incentives, which is the 5% GIE forever without any disciplinary factor. We have to rethink and review the foreign ownership restrictions and infrastructures. We are doing them all together.

Now on exports, I would like to point out that the economy has lost its export edge. There are many other reasons why this is falling because economy is expanding. We are importing more, other countries are moving faster, but exports in the end are one of the most important indicators of competitiveness and productivity. If the exports continue to increase in US dollar terms, but fall as a share of GDP, by almost half, then we have to rethink our strategy. We have to support the sector, but maybe we have to support it differently instead of targeting selected industries, vertical targeting, perhaps we should think about horizontal targeting so that we provide opportunities for all types of firms. By horizontal targeting, I mean providing the basics: logistics support, port services, infrastructure, and human capital development so that any firm, local or foreign, big or small, can equally participate instead of trying to target selected industries.

Now compared to the region, I would like to highlight that Vietnam, with slightly less generous incentives, have been increasing export-wise as a share of GDP, but not the Philippines, with a more generous incentive. Again, there are many other reasons that we have to be aware of.

Now my favorite slide is this one, which you may have seen in many reports. The economy's labor productivity has been increasing tremendously over time, but real wages and real minimum wage have been flat for almost 2 decades. Why? Probably because the structure of the economy favors certain sectors, oligarchic or elite sector. Number 2, the general population is not competitive and therefore do not deserve higher wages. Number 3, there is some rent capture. Number 4, there is some inefficiency in the allocation of these resources. The conclusion here is that we should be investing in the productivity of these people. I believe the best solution is not to give more freebies, subsidies, incentives, or exemptions. The best solution is to invest in making mothers healthy so that their children are healthy, they finish school, get a job above minimum wage, and get a good job that means ramping up education, health spending, and social protection from childbirth. The second is we want to improve infrastructure. I commute at least 4 hours per day. My productive time is 12 hours, and some in government think it should be 18 hours, but it is like being taxed 33% of my productivity. I know someone, a cleaner in the office, who spends 8 hours in traffic coming and going to work from home—BGC to Montalban. This is a tremendous toll. He had to send his family back to Ormoc, Leyte because he could not afford. That is why I think going forward we need to go back to more basics and this is validated by unbiased and unpoliticized surveys, such as the World Economic Forum survey on investing in the Philippines, which lists not the incentives as the main concern in general, but more fundamental issues which you have identified in your Arangkada, the infrastructure, corruption, business regulation, and the efficiency of government service.

In summary, perhaps we have been giving incentives because they are a Band-Aid solution because we cannot provide the top four needs. However, as you have seen, this government is moving forwards and building on the success of previous government in providing the top four needs so that provide more and better services to the people.

Given these, we have to rethink very closely how we do incentives. We want to give incentives. We are not abolishing them, but moving forward we have to discipline them and make sure that the benefits we get back is going to be reaping a lot of profit, not only for your industry, but for the country in general.

With that, I will request my co-presenter, Usec. Rodolfo, to propose the reforms we are thinking. We would be happy to understand your comments. Thank you.

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DTI PRESENTATION
[32:20-51:14 – DTI Presentation]

USEC. CEFERINO RODOLFO
Undersecretary, Industry Development and Trade Policy Group
Department of Trade and Industry

DTI Usec. Ceferino Rodolfo: I just realized I am representing the more unpopular portion of the presentation. As Usec. Chua said this is already a joint position of DTI and DOF. This is also how Sec. Lopez and Sec. Dominguez presented it to the cabinet and to the president. The first two portions were represented by DOF, while the hit on the incentives were presented by DTI. Just very quickly, I think Sec. Lopez already gave a glimpse of the main elements of the proposed reform to the AmCham General Membership Meeting last week. We are looking forward to all of your comments. I am sure you are very excited to hear about certain elements.

Being a teacher before, I like to write on the whiteboard. We should try to answer basic questions, like what are the basic principles because it is easy to get lost in the slides I will be presenting. What are the incentives? To which activities can we apply these incentives? Who can be qualified for incentives? Which markets should you be serving to be qualified for incentives? And what is the process or the institutional arrangement?

Just very quickly, some numbers for the Board of Investments (BOI), so I head the BOI, and I also chair the secretariat for all IPAs, the 14 IPAs that Usec. Chua mentioned earlier. We have the secretariat for all IPAs, and I chair the secretariat. In terms of basic principles, what we intend to do is to lower the CIT rate. This has been mentioned by Sec. Dominguez. Beginning January 1, 2020 we will reduce the CIT rate by 1 percentage point for every 0.15% of GDP reduction of investment tax incentives compared with the baseline 2 years ago (i.e. 2015). This would make the TRAIN Package 2 felt by everyone. The goal is to reduce the CIT rate from 30%

to 25% by 2022 while expanding the tax base by 0.75% of GDP or some PhP 120 billion in 2018 prices.

Alongside these, we will also simplify the CIT system to improve compliance. We will also review the tax code and see how we can improve compliance. Our tax code follows the US tax code, so it is quite complex.

Now more importantly, these are the general principle that we are following for the fiscal incentive reform. Number 1, fiscal incentives should be <u>performance-based</u>: clear attainment of actual investment, job creation, exports, countryside development, and research and development. Otherwise incentives will be revoked. Number 2, they should be <u>targeted</u> on specific activities to minimize leakages and distortion of the tax system. Tax incentives should be given to activities with significant positive externalities specified in the Strategic Investments Priority Plan (SIPP). There will be a single SIPP that will be followed by all IPAs. Third, and this is probably where most comments will be on, incentives will be <u>time-bound</u>. There should be a sunset provision in the grant of incentives. And fourth, incentives will be <u>transparent</u>. The monitoring of tax incentives should be institutionalized and reported by government.

What are the proposed reforms? We currently have a Fiscal Incentives Review Board (FIRB). The functions of the FIRB will be expanded to serve as the overall administrator of the policies of all IPAs. The DOF currently chairs the FIRB. The FIRB shall have veto power on incentives being given by the different IPAs. The DOF will co-chair BOI and all IPAs, while NEDA will also be part of the board of all IPAs, including BOI. Currently, at the BOI, DOF and NEDA are not part of our board.

Next, we propose to repeal 150 special laws on investment incentives and put them together in one omnibus investment law to simplify the system. This way it will be straightforward and not confusing. We will also repeal exemptions in the tax code. By doing this, we will make the tax system fairer.

Next, we propose that we have one single menu of incentives available to all IPAs and there shall be no double registration of activities. Also, only new investment activities will be granted incentives. Expansions are really signs of profitability and need not be given incentives. However, expansions can still avail of exemption from customs duty of capital equipment. ITH will no longer be allowed for expansion.

On exports, we proposed to increase the 70% definition to 90% as the current situation causes leakage and concerns for BIR. Now, what is important, for instance, is a new relocation incentive for firms moving out of Mega Manila. The intention is to move activities outside Metro Manila. In the current IPP at the BOI we no longer give incentives for within Metro Manila in general, with certain very limited exceptions. We will provide incentives those relocating outside Metro Manila. Plus superior incentives for lagging regions, particularly those recovering from conflict or are calamity-stricken.

The incentive menu will not just be the ITH. At the BOI we see the opportunity to make the incentives more relevant because we know ITH will not be relevant for all firms which register at BOI. In fact, for the really capital intensive ones during the first years they incur losses. ITH is not really something they could use. In lieu of ITH, we are defining a menu of incentives that would be available for projects to be registered. We propose to replace the 5% GIE tax in lieu of all taxes, with a reduced CIT of 15% based on net taxable income.

Other income-based incentives in addition to the ITH. There will be a menu of other incentives made available, including investment tax allowance, double deduction for R&D and training expenses, 50% deduction for labor, and deduction for infrastructure and reinvestment of profits. Exemption from customs duty would continue, but no more VAT incentives. All firms will have to pay VAT and prove they export to be able to get a refund. Usec. Chua is committing to a 90-day period for the refund. The VAT will no longer be used as an investment incentive. It cannot be used in the separate customs territory argument. There will be no more exemption from local tax incentives. LGU local business tax exemptions will not be in our menu of incentives.

Only investments that meet the following conditions will be given tax incentives. First, the project should be <u>performance-based</u>: actual job creation, exports, countryside development, and moving out beyond Metro Manila or Mega Manila, use of modern technology, actual investment, extent of R&D. For those of you registered with BOI this should be very familiar. In fact, there would almost be no transition for you because from the very beginning BOI is really time-bound and focused on performance. You would remember that in BOI we only provided ITH for 4 years extendable to 6 or 8 years. We propose a time-bound 5 year ITH and or reduced rate with no extension except for exemption from customs duty for expansions.

<u>Targeted</u>, it is going to be based on the SIPP. The SIPP will be promulgated by the BOI and usually approved by the president. This is very important. The SIPP can cover both foreign and domestic firms. We will remove the nationality bias. Because now, when we go abroad to promote the Philippines as an investment destination for foreign companies or when they visit us we ask them to invest in the Philippines because we are the fastest growing economy in Asia. Yet, when they come here, we tell them, “Sorry we cannot give you incentives if you are registering with the BOI because we can only give incentives for the export market. For the domestic market, you cannot be given incentives.” That will now be removed. We are going to remove the nationality bias. Filipino and foreign investors will be treated alike. We are going to remove the export bias in the SIPP. This means that, regardless of the market you are catering, to as long as you are in the SIPP you can receive incentives. At the BOI, we are particularly excited about this addition to our menu of incentives, in addition to the ITH, that will make incentives more relevant and more modern and will remove the nationality bias and the export biases.

<u>Transparent</u>, the names of beneficiaries and estimated tax incentives are to be reported by the FIRB.

If you are already receiving an ITH that is time-bound, you will continue to receive that ITH until it expires. The problem is for existing companies that are receiving the GIE portion of the incentives, the 5% on GIE. You will be allowed 2 to 5 more years as a transition period. For those who have already been receiving, or the GIE incentive, for more than 10 years, the transition is 2 more years. For those who have been in GIE between 5 and 10 years the transition is for 3 years. For those who have been receiving GIE incentives for less than 5 years you will be allowed 5 more years to enjoy the 5% on GIE.

We looked at the IPAs and the number of firms belonging to the 15 to 20 year group which have been registered are 510 and the 21 to 25 year group which have been registered are 131, while those who have been registered and continue to enjoy the GIE perpetual 5% GIE of 23 to 29 years are 13 firms. A 3 year SIPP similar to what we do now in the BOI will still be formulated by BOI and approved by the president. But the president can also approve the grant of tax incentives for economic activities that fall under the SIPP. We will also integrate tax expenditure reporting into the budget process, but this does not mean that incentives will be part of the GAA.

We will also strengthen the TIMTA law with the following amendments, essentially to also include VAT incentives that are being enjoyed, to include reporting by all types of taxpayers especially cooperatives, to mandate the submission of more benefits data, to have a balanced cost-benefit analysis that should include jobs, exports, sales, and R&D at the firm level. We would also like to strengthen the investment assistance and facilitator mandate of the BOI and the other IPAs, providing us with the power to compel timely approval or timely decision on applications of projects within the SIPP.

In summary, basic principles: time-bound, performance-based, targeted, and transparent. What are the incentives? The ITH, renewal of other incentives, duty free capital equipment importation. To which activities? To those in the SIPP. To whom? Both foreign and local with no distinction. To which markets? Exports and the domestic market with no distinction. The process, institution or institutional arrangement? We will have the FIRB as the policy framework for looking at IPAs, including the BOI. And the DOF and NEDA will be part of the boards of all IPAs. That is the mix of good news and not so good news. Thank you!

REACTION PANEL
[51:15 - 1:12:20 – Reaction Panel]

DR. DANILO LACHICA
President
Semiconductors and Electronics Industries in the Philippines Inc.

ATTY. JULES RIEGO
Senior Partner, SGV & Co., and
Chairperson, Taxes and Tariffs Committee, American Chamber of Commerce of the Philippines, Inc.

John Forbes: Thank you Usec. Chua and Usec. Rodolfo. I am not sure how much of your briefing is good news and how much is bad news, but it contains both. We have a reaction panel consisting of Dr. Dan Lachica, President of SEIPI, the Semiconductor and Electronics Industries in the Philippines, Inc., of which almost 1,000 electronic companies in the country are members, and the Chairman of AmCham's Taxes and Tariffs Committee and Senior Partner of SGV Atty. Jules Riego.

Dr. Danilo Lachica: First of all, I would like to thank AmCham for convening this consultation and thank Usec. Chua and Usec. Rodolfo. While I represent the electronics industry, I am sure many of the issues I am going to raise would be shared by other industries. First, I think speaking for all of us, we do support the government’s initiatives towards inclusive growth and poverty alleviation. There is no question about the support of everybody for that. We just wanted some clarification and to articulate some concerns. Obviously, our preference would be to maintain the status quo, but that is not going to happen.

We certainly would like to work with the government in working towards areas of mutual interest. As background, the electronics industry is still the biggest exporter. We accounted for about US$29 billion of export in 2016. Last year (2017), we are probably going to reach the highest level of US$31 billion. For every export peso we generate there is about 12 centavos in indirect taxes the industry pays and 18 centavos in increased household income. Counting our direct and indirect workers, about 3.2 million Filipinos benefit.

Our concern is to minimize disruption for the industry and other sectors. Several things come to mind. For instance, when we go from a 5% GIE to 15% CIT, a survey of the major electronics companies showed this translates to about a 40% increase in cost. I agree with you that it is not just about incentives, but how do we mitigate this increased cost? I heard you talk about the need to improve infrastructure. The cost of power is a major issue. Labor cost is high. How do we mitigate these concerns? You talked about the transition period. Is the transition period enough to mitigate the concerns? At the end of the day, whether it is tax incentives or power costs, the multinationals will locate in a country where the overall operating cost—power, incentives, cost of land, and cost of labor—is going to be beneficial for them cost wise and operation wise. How do we do that in such a way that we do not prematurely go into this regime without considering the other factors?

Secondly, you also talked about putting a cap on expansions. For the electronics industry, I assume that these are expansions of an existing company.

DOF Usec. Karl Chua and DTI Usec. Ceferino Rodolfo: Project.

Dr. Danilo Lachica: Project, okay this can be. As we develop our new SEIPI roadmap, we propose to bring a new technology into the country. Existing companies will bring in new equipment, new technology, which will be beneficial to the country. Project is good.

Third, you talked about improving productivity. I know many of our multinationals come here because of the productivity of Filipino workers. Will there be incentives for companies who can prove that they have productivity initiatives? Would they get rebates or incentives for doing that because, speaking from experience, I ran two factories: parallel product and process, here in the Philippines and in another ASEAN country. Our productivity here was 25-30% better beyond doubt. It is not by accident, but because of the initiatives of the companies to do that. How do we give them credit for that?

Now, on the VAT. I am not sure if anything else can be done with that, but the concern is the 90 day period to do the VAT refund. The reality is it is not going to be 90 days because what happens is, as soon as a firm files for a VAT refund, BIR will ask for a tax audit. Who knows how long that will take?

Again, if we can just address these issues, I am sure that the companies will cooperate. I think the biggest point that I would like to make is, if we can reconsider the transition period so that we balance the impact of the increased 40% cost versus all the other considerations in terms of power, in terms of bandwidth, and in terms of the other infrastructure. Thank you.

Atty. Jules Riego: Thank you Usec. Chua and Usec. Rodolfo for your presentations. I attended the Ernst & Young Global Equality Forum last October. We did a country-by-country presentation of tax incentives being granted per country in ASEAN. They were very surprised to hear that the Philippines is actually going to limit tax incentives. They began to ask me "when are we going to think about the restructuring of your clients because they will most likely transfer to our countries." That is a very legitimate concern. This is causing a lot of apprehension and concerns from investors.

While we do agree and support—and we have been discussing this with Congress for 15 years—the rationalization of tax incentives in order for investors not to get lost in the midst of tax incentive laws in the Philippines, we are very concerned about limiting tax incentives. How would that make the Philippines more attractive than our neighbors? I am still grappling with the logic on how would that make us more attractive if other countries are granting at least the same incentives or better? They have better infrastructure. They have lower costs of power.

An observation on the presentation. You used the reports from TIMTA. Can we also know what benefits were brought about by ecozone registered enterprises? You only presented foregone revenues. How much have we lost, not only in terms of income tax collection, but gained in terms of jobs that were generated by these investors. Also, the tax collected by the government in terms of 5% income tax collection, from final withholding tax on interest, dividends, royalties? We have not seen this data.

I agree with you that we cannot grant tax incentives blindly, but we have to know the benefits being brought about by these investments so that we can have a complete picture of the real story.

In terms of the reduction of the CIT rate, I do not understand why we have to peg it or make the percentage of tax incentive expenditure to GDP a condition to lowering the CIT. We are already sticking out like a sore thumb compared to the ASEAN countries. We are at 30%, while others are on average at 25%. Why not reduce the CIT rate drastically to at least 25% to make us comparable to Malaysia or Vietnam?

John Forbes: Can we ask our 2 presenters to sit in front. These are the two hot seats.

DOF Usec. Karl Chua: We received a number of very useful questions and comments, and I want to be honest upfront.

Two things, number 1, you know your sectors and industries better than I do, and I respect that, and I know you contributed a lot, particularly the electronics sector that has brought so much benefit in the country

But let me also say two things to respond. First, it has been always very hard as a policy maker balance all interests, and there are almost a thousand of them from Package 1. I read 150 positions, some claiming the opposite of what others would claim. As a policy maker we have to strike a balance to move this country forward. To be honest, I respect and agree with all of your positions by your industry, but I have a country to help manage. Number 2, it is very hard as a budget handler to just give away incentives, subsidies, freebies, or exemptions no matter how noble they are, because I have to get revenue from someone. The needs of this country do not diminish but continuously increase.

For instance, to pay for the PhP 8.4 trillion, which all of you have been demanding for decades, someone has to pay for that. And of the PhP 8.4 trillion we are going to get PhP 2 trillion from tax reform. If I were to give one sector an incentive I have to tax another sector higher. And it is not true in general that you can squeeze and squeeze more from tax administration because tax administration is only as good as the policy. If you have a very complicated tax system with 143 vat exemptions, 123 investment incentive laws, and almost 200 non-investment incentive laws, that creates a lot of room for complexity and creates 4 inevitable outcomes: discretion, negotiation, corruption, and tax evasion. That is the principle logic why we are cleaning up the tax system. That is the initial response.

Now to go to details, number 1, to move from 5% GIE to 15% regular corporate will increase cost 40%, probably you are correct. I would like to appeal that maybe we can work together. Let us move this debate to evidence-based; we would like to understand it better, if you can share some non-confidential information I would try to incorporate it with our studies.

Number 2, on the cap of the expansion, yes it is project-based not firm-based. The idea is continuous innovation is the key to economic growth for productivity, as long as you meet the four criteria (performance-based, time-bound, targeted, and transparent).

For productivity of workers, we have a number of double deductions for labor, research and development, and so on. But let me tell you I believe the most important way to improve worker productivity is to invest from the very beginning and put half of the budget into human capital development, social protection, welfare, education, and health. If we had done that 50 years ago when we started giving incentives, we would probably have the best workers. The Filipino worker is a global brand that could be even better.

Next on the VAT refund. Yes, I very much understand. But now it is a law. VAT refund must be paid in cash within 90 days. Let us try to discard the 30 years thinking that it does not work. Let us give it a chance. It will be implemented starting January next year (2019).

Let me tell you what I am thinking, and I will report back once we have a final set. There are 4 main problems why refund has not worked.

Number 1, it is taken against BIR collection targets. BIR does not pay refunds because they lose their collection and look bad. We will remove the refund from their collection target. Instead of gross VAT it will be net VAT. Change the incentive structure.

Number 2, we will do post audits and will have a green and red lane for complying taxpayers. You get your refund and are post audited. If you are found to under declare or abuse, the post audit will be revoked.

Number 3, we will not budget it; we will put it in a Trust Fund. We will have money anytime ready to be used. A problem with the current system is its being budgeted. Once you have used up your PhP 5 million budget, you cannot get more refunds. We will put it in a Trust Fund then it does not go through legislation.

Number 4, there is a provision in Package 1 to do electronic invoicing. Instead of the paper transaction, we can do it faster. Give us the chance to show we can give refunds properly.

Last, transition period, I am open to your suggestion. You submit your position paper and tell us exactly so we can to avoid the lengthy debate in front of the Congress. Give us your concrete suggestions, what exactly are the incentives you need, the transition period, and so on, so we can consider them.

Now on Atty. Riego's question, fortunately some of those countries can afford to give incentives. That is the main difference, they can afford to give incentives. Thailand's tax to GDP ratio is 17%, Vietnam has 20%, and we are not even 14%, so that is the first comment.

Number 2, the TIMTA law, unfortunately does not mandate as much benefit data as we would like, so we are going to amend it. But you can share your benefit data. Show me the jobs, research and development, exports, countryside development, that you have done so you can improve our analysis

Finally, unfortunately, if we lower the CIT outright, we will lose PhP 130 billion. That is good for the corporate sector, but again, I am not sure how to fund PhP 8.4 trillion infrastructure spending, which is one of your top requests. Currently, of the PhP 8.4 trillion infra we are going to get PhP 2 trillion from taxes, and the rest will be borrowed. This will increase the burden on your children and grandchildren. As a budget handler I am not sure how to balance that. Unless you are the budget handler it would be difficult to empathize with me. But I have to make that balancing. Let me end here and maybe Usec. Rodolfo would like to respond. Thank you.

DTI Usec. Ceferino Rodolfo: I think Usec. Chua has already clarified a lot of things, particularly he has emphasized the project-based (1:09:07 inaudible). It is not really company based but based on the project. I think that should be given a lot of (1:09:12 inaudible). What we want to avoid is the company that is perpetually in a particular preferential tax rate. There has to be constant improvement, innovation that should be brought into the operation of the company. We cannot believe that the company has been operating 25 to 30 years without any improvement and yet still benefiting from the lower preferential tax rate vis-a-vis the rest of the country, so that is what we want to avoid.

The key here is to look at your registrations as projects. If you take the current IPP, the 3 year IPP 2017 to 2019, there are a lot of items there, for instance, modernization projects. We even incentivize for BPOs if, in case you want to train your workforce, to be able to provide a particular service, to be able to use a particular software. That is incentivized. Modernization also includes energy efficiency projects; that will also be incentivized. But we still do not have a lot of takers for these lines under the IPP. But these are things that you can take a look at, as an example of the vertical incentives that Usec. Chua mentioned. The key here to remember: project-based and also they have to comply. Any suggestion and recommendation from the industry will have a higher chance of being considered by the Executive Branch if it is time-bound, performance-based, and focused. Those are the key principles.

I would like to appeal to the business community. As mentioned by Atty. Riego earlier, they have been raising a lot of questions. For us, it is important if we can do this efficiently and very fast. Because the longer this lingers, it causes uncertainty. The longer we hold back on the terms for prospective investments, companies that want to invest in the Philippines might adopt a "wait and see" attitude. As you have seen, there is a give and take here, we have opened up markets for foreign investments we are removing some of the bias in the current EO 226. Just really work with us so we can move fast in Congress and remove all the uncertainty and be able to bring in investments as soon as possible. Thank you.

OPEN FORUM
[1:12:21-1:54:26 - Open Forum]

JOHN D. FORBES
Senior Adviser,
The American Chamber of Commerce of the Philippines

John Forbes: If there are no immediate further comments from the two undersecretaries or the reactors, it is time for the open forum.

Atty. Jules Riego: Just a quick clarification on the 90 day period for the VAT refund. That is a standalone provision in the TRAIN law. It is already effective January 1, 2018. That is a standalone provision, it is not related to the time when we will have an enhanced VAT refund mechanism. Any taxpayer who will file a VAT refund after January 1, 2018 will be governed by the 90 day period, even if there is no enhanced VAT mechanism yet. Which means, everybody will be forced to go to the court of tax appeals, if they are not able to process within 90 days. If the government's intent is to tie up the 90 day period with the enhanced VAT refund mechanism, then I think you should issue a revenue regulation to clarify that.

DOF Usec. Karl Chua: We will engage you.

John Forbes: Okay, positive comment, positive response. Let us keep this up. Yes, Mr. Shiraishi, president of the Japanese Chamber?

Hiroshi Shiraishi: Thank you for the explanation from Chua-san and Rodolfo-san. Here are my questions and suggestions. My general suggestion is for FDI, we observed that it fluctuates with sentiments that means we need to be concerned at this point because FDI is so sensitive, and fluctuates by the sentiments from government. This is very important.

We have a 3-point question:

First, is related to new investors. You may study the Vietnam case. Vietnam has the same idea as Philippines with its 15% of net tax. In Vietnam now the incentive is 10% of net. They have 3 categories. 15 years, 30 years, and no limitation. These 3 categories from Vietnam depend on how the investment is contributed. For high-tech programs, maybe 30 years. And more important is the program for companies with no limitation. We observe that your new idea may need to be more attractive. We do not have to compare with Vietnam. Vietnam is one very competitive rival of the Philippines. A more sharpened edge will be more attractive for new investors. And relating to these new investors, you are thinking about this in performance based on job creation, the investment amount. Can you explain more in detail what are the parameters in matrix.

And my last question. Existing investors really wish to retain the status quo. It is really challenging to retain the status quo, but we hope for a soft landing for investors to realize and understand. This means longer time for transition period. Thank you.

John Forbes: Next, Mr. Lee, president of the Korean Chamber.

Ho Ik Lee (KCCP): First, thank you very much for giving this kind of forum. As president of the Korean Chamber, we appreciate this. I think you should have more presentation for Korean companies, which we will appreciate.

Basically, I agree with your idea. You collect PhP 8.4 trillion and invest in infrastructure and social services.

Correct me if I am wrong. The Philippines is developing from two industries, one is overseas workers and the other is BPO. The Philippines is very much oriented to the service industry and not in manufacturing. There is maybe US$30 billion revenue in each, almost US$50 to 60 billion capital inflow. That is why Philippine high growth is achievable. You are one of the fastest growing countries in Asia. I always say this when I meet with the Korean government and Korean companies. Filipinos are very bright, and the economy is an emerging market.

But that is not all. I think the country needs to focus on manufacturing. As the Japanese Chamber said manufacturing is one of the key industries where a country grows.

When I was born in 1964, Korea was very poor, even one of the poorest in the world. Income was only US$178. Korea was developed by manufacturing. Now, the Philippines, as policymakers you should focus on manufacturing. CIT and incentives of IPAs are much related in to manufacturing.

Number 1, you are going to reduce the CIT to 25%, but this is still very high. Even the Trump Administration dramatically reduced CIT to 21%. Vietnam is only 20%.

Second, do not decrease any incentives for IPAs. What I understand there are 350 Korean companies located in PEZA zones. So far, they do not have any complaints. They are all okay with their PEZA location. If you decrease incentives, I think this will have a negative effect, especially for big Korean companies that invest here.

Lastly, I think Philippines needs big companies—like the "kingpin" of the Korean companies—to invest here, like Samsung Electronics.

I just want to cite one example, when Samsung invested in Vietnam, around 2009. The Vietnam government gave incentives to Samsung including—12 hectares for free and no CIT for 4 years, and 5% for the next 12 years, and then 10% for 34 years.

Considering higher costs, like electricity, labor, water, and telecommunication costs. I do not think the Philippines is more competitive than Vietnam.

The 25% proposed is not so attractive for foreign direct investment. Thank you.

DTI Usec. Ceferino Rodolfo: Maybe just to respond on manufacturing as it relates to BPOs and OFWs, in fact we are very fortunate to have here the presence of Assistant Secretary Fita Aldaba, the "Queen of the Manufacturing Resurgence Program" that was actually started during the time of Secretary Greg Domingo, who is also here. For your information, the manufacturing sector's growth has surpassed services for the past 5 or 6 years, growing at around 8 to 10% compared to the 6 year average prior to 2010, which was 0 to 2%. That is why at the heart of the Department of Trade and Industry, we would like to remove the export bias and the bias against foreign investment in terms of incentives.

We operate under EO 226 of 1987, when the WTO was not even formed, and when we still did not have any FTAs. Essentially, the Philippines was operating as a protected market with high tariff rates. That is why incentives in EO 226 are geared towards exporters who were going to face competition when they go out.

But now, the biggest incentive for the Philippines is really our domestic market. But the problem is that our domestic market is contestable. Meaning, you need not locate in the Philippines, but just locate in Thailand, Indonesia, or Vietnam, that also offer incentives for exports and import these goods to the Philippines at 0% duty.

What is happening is that our domestic manufacturers have been here since the ASEAN trade in goods agreement, they have been competing with imports coming from ASEAN countries that are incentivizing their exports to the Philippines. That is a highly anomalous situation.

Just very recently, there was an announcement from a Japanese car manufacturer that will invest in the e-vehicle sector of Thailand getting incentives. If this same company invests in the Philippines under EO 226, not under the Motor Vehicle Development Program, it cannot be given incentives if it is going to sell to the domestic market.

Under the 70-30 rule, they can get incentives but they have to export 70 percent of their production.

The bias really is for exports, while the biggest attraction of the Philippines right now is the domestic market that is why you will find in one of the slides that we are also going to provide incentives for import substituting activities. One of the sectors will be manufacturing.

We cannot go out and tell this to anyone because of certain WTO rules, but that is really the intention. To provide incentives for products we consume here. We will give incentives to those who will produce them in the Philippines. Hopefully, we will have more Korean companies who will take advantage of one of the biggest domestic markets in Asia, a market that also has good access. I do not know if you monitored that the US will be imposing tariffs on certain consumer goods coming to US, but we have already had discussions for an FTA with the US. If you locate in the Philippines, not only do you take advantage of the fastest growing market in Asia, but you can have access to the US market via the bilateral FTA that we will negotiate with the US. You must have you that we have passed the EU-GSP+ monitoring of EU. The European Commission will not be initiating withdrawal procedures against the Philippines for our GSP+. In what other market or location can you have access to the fastest growing economy, to the US market, to the EU market, to EFTA, to China, Australia, New Zealand, Japan, South Korea, and India?

We are not just from the "Board of Incentives," we are from the "Board of Investments" and take care of the whole trade and industry policy and provide all of these advantages to our investors. Thank you. Usec. Rodolfo may say something.

DOF Usec. Karl Chua: I do prefer to listen. Notwithstanding the very good inputs.

John Forbes: I see Julian Payne, followed by Don Felbaum, to ask questions.

Julian Payne (CanCham): Thank you very much for a very useful interesting presentation. It seems to me that overall you are reducing the net benefits of incentives, if you add everything together. You are offering a major advantage of a CIT reduction, which is what appears to be happening.

As an investor, the problem with second part is it is too little, too late, and too uncertain.

It is not clear to me why new CIT rate would not start in 2019. We certainly started the PIT rate right away. Why can't you start the CIT right away? First year being next year.

The second is, the point raised by Atty. Riego, is the level. You propose to lower the CIT to the highest level of another ASEAN country, not to the average ASEAN. Therefore, too little. Why not take advantage of this opportunity to reduce it to at least the ASEAN average?

The third, it is uncertain. The worst for business is uncertainty. It is not clear to me, if I am planning an investment, what the income rates are going to be in 2001 or 2002 because we do not know the second part here. It seems that the DOF is very uncertain about the effect of its rationalization, if they cannot predict this.

Frankly, businesses want to know what the CIT rate is and not some complicated calculation that is uncertain of its outcome. It is not clear to me why you would not put a 1% reduction a year from 2019? Now, the undersecretary did make the point that we did not want to burden future generations with debt. That is a nice emotional argument. Except, I do not believe the debt servicing problem of the Philippines is the worst in the world. The Philippines has made great progress in managing its debt.

Secondly, it may be that you should increase debt for the short term on the grounds that you will be paid off with the rationalization of fiscal incentives.

I will not comment on the incentives, but the bottom line is on the CIT it seems to me that you are being a little bit too cautious, a little bit too slow, and a little bit too uncertain, and this will discourage future business. Thank you.

DOF Usec. Karl Chua: I actually agree that we should make the CIT lower and more certain. But the trade-off is, I do not have the data that can make this effective immediately. Second, I would go for 20%, but I have to find PhP 260 billion. I am not sure where to get that, so I am doing some balancing. Number 3 is that I would like to remove that uncertainty. There might be some volunteers that would give up some of their incentives; I am just joking. We have gone through many iterations. We will be open to your suggestions and see how we can move toward those objectives moving forward.

John Forbes: Mr. Felbaum, Chairman of AmCham's ICT committee—the largest committee of AmCham.

Donald Felbaum (PAMURI): Thank you. I am representing PAMURI in this question. You mentioned very clearly that there would be a parallel amendment to EO 226. We are an ROHQ, and ROHQ falls under TRAIN 1. You have been successful in stripping away the preferential tax rate (PTR). But the question we would raise on uncertainty is what is going to happen with the regional structures for ROHQs? There has not been a single word, nor a single declaration. Is the ROHQ going to exist after this or not?

DTI Usec. Ceferino Rodolfo: Right now you are enjoying the 15% PTR that was removed from TRAIN 1. In TRAIN 2, you will get incentives based on what we have presented. For the ROHQ the 10% CIT will be removed and migrated to the regime that we presented earlier.

Donald Felbaum (PAMURI): Do we still exist as an entity? I am actually registered with the BOI and Securities and Exchange Commission under that structure.

DTI Usec. Ceferino Rodolfo: That will be existing, but the incentives will be different.

John Forbes: I see the hand of Atty. Lopez-Malvar from PAMURI / P&G

Atty. Mimi Lopez-Malvar: As a follow-up question, we are really still smarting from the veto on the PTR. I provided both DTI and DOF with our position in the hope that the status quo would prevail. We are currently having a dialogue with BIR on maintaining the status quo. But, I heard two things that you are offering that we hope can also apply to the ROHQs.

First is, the transition period. Our concern is that when the PTR was vetoed, it just gave the industry 12 days to respond. In terms of fairness to the investor, there was really no opportunity to respond to such a big threat and sudden increase in costs with a threat of mass resignation from our employees. That is one thing from ROHQs. Maybe the fairness is what we want to appeal to DOF and DTI to in both the veto and in Package 2.

Second, we are quite alarmed that Package 2 will now take out local business taxes as a component of the menu of the incentives because this really adds to policy instability. Even since the removal of the PTR, some of our members have already got an assessment from local LGUs. The local business tax exemption still remains for us as far as we know. But they see this as a signal that this industry is being dismantled piece-by-piece through government regulations.

It is really a dangerous time to be an ROHQ in the Philippines. We really hope that you can see the business perspective. We hope you can help us in this matter, as well as the VAT refund, as we have not yet claimed it at this point. We noted some good interventions on Package 1 to make the system very effective. We have yet to see the results of that.

DOF Usec. Karl Chua: Just a quick response. I really understand your sector's concern. But as mentioned, I have to also understand the other concerns of so many other sectors. I am trying to strike a balance.

Let me just comment on local taxes. It is the decision of this administration to respect the autonomy of local governments, and it believes that it cannot commit in a national law what the local government gives on tax autonomy. That is the decision of this government, especially as they are moving towards a more centralized structure. To commit the local governments will appear that this administration is not fair to them. That is why we are moving away from that.

Now on the VAT refund, we have 30 years of bad experience and are correcting that. I hope you will also grant me some patience and understanding. We are going to correct it.

On the fairness, I am going to bring this up with my superiors, but they have already made some pronouncements. But I will discuss with them.

John Forbes: One of our directors at AmCham, Mr. McGonegal.

Rick McGonegal (AmCham): Hi good morning, Rick McGonegal from RCG. Two questions, one on the front end, one on the back.

On the front end, you made a pretty good case that your percentage of GDP collections are pretty low. But has anybody thought that BIR should do better to collect all the taxes rather than dismantling ROHQs.

And on the back end, there is a public relations (PR) problem. Once you have made the decision to change the rules or promises, how can you get anyone to believe that new rules are going to last any longer?

DOF Usec. Karl Chua: Just a quick reaction, in 2010, when the Aquino Administration came into office, the tax to GDP ratio was 12.1% of GDP, when it left it was 13.6% of GDP. As of 2017, our estimate is almost 14%. Basically, without any change in tax policy, BIR was able to collect almost 2% of GDP more through tax administration. Except for 0.3% that came from sin tax. But at the same time, we gave away more incentives, and there more subsidies were given that practically means we have to acknowledge that BIR and BOC did collect more. However, I would back and say we cannot expect BIR to collect and do better if the tax policy we have is extremely complicated. That is why we have to clean it up. Otherwise, we are just opening the floor for more negotiation and discretion.

On the PR problem, I want to emphasize that all these incentives should be treated as privileges, not rights. I do not agree that there was some contract that was signed, and we have to stick to it forever. We have to look at the bigger picture. As mentioned from the slides, the biggest PR problem is not being able to provide the basic foundations which I believe this government intends to do. We have to balance those trade-offs.

Mike Montero (Convergys): Good morning Usec. I have several questions. On the first point, having a very complicated tax system given that we have we have several types of incentives. I beg to differ on that as I do not think that it is more difficult to administer ITH as opposed to CIT. Because an ITH simply states that you do not collect income tax. I guess, from the perspective of tax administration that might be really an erroneous assumption.

Second, I think the number that we have been working on the PhP 130 billion on the 25% reduction of CIT is confusing because, if we are working on that number, I think we are assuming that nobody is going to increase their investment in the Philippines to precisely recapture the loss of PhP 130 billion. Why are we reducing the CIT if we are anyway going to stagnate at an amount of tax collection that cannot capture the tax incentives that are being removed?

I think the point earlier is “Why don't we reduce it right off the bat” to realize what we can gain from the reduction of the CIT.

On the VAT refund, two things that you might reconsider are: Number 1, to make the 90 day period, instead of a deemed-denied period a deemed-approved period. Secondly, is to consider the EU model of imposing interest on tax refunds that are not being paid in the same way that we are levied on tax assessments that we are not able to pay.

Maybe the last point on ROHQ, just on rest the point stressed by Atty. Malvar, I know we had a discussion at the level of Congress and the Executive, and we did make our points to both that the 15% PTR is an investment incentive at the enterprise level. We had realized a position of the industry that was favorable at the level of the bicam. I think the issue now is "are we still governed by the rule of law"? What happened after the veto message? Almost all entities operating as ROHQs sought legal opinions from both tax advisers and big legal firms. And I can tell you from personal experience that all of these firms came back with a unanimous opinion that the PTR should be status quo, and yet we are hearing a different thing.

I think it is a perception thing that if we go to Package 2, the fear is that we went through a legal process that is replicated in all systems of government outside the Philippines. The version that came out everyone thought was to retain the status quo.

It goes back again to the question of stability. Which is if we go through the process and put our points forward before the legislature, and a law comes out. Is it really the ultimate version that is going to be implemented by the entity that is supposed to implement it?

The last point is really a question. One of the facets of Package 2 is to try and adopt some principles being practiced in other jurisdictions, such as the adoption of the General Anti-Avoidance Rules (GAAR). My question is has DOF looked at this and done some simulations on how much the government can make along those lines so that there will be some buffer in respect with eliminating some incentives.

The more that you can tilt the balance on undesirable practices and hopefully retaining those incentives, I hope you will be in a better position. Thank you.

DOF Usec. Karl Chua: Very quick response, on GAAR, no we have not simulated because there is no data. But we are instituting this factor. I agree on payment of interest, if we do not give the refund, we pay interest. I will bring it up. VAT deemed-approved, I will bring it up. I will not answer the ROHQ because the president made a decision. But I will respond on 2 items that I think should be clarified.

It is not true that the ITH is the simplest tax to administer, because all your deductions are useless. If you have a two-track system in which one project is ITH and another project is at the regular rate, there is a tendency to shift deductions from ITH because they are useful at the regular rate. This is a major problem every time we have a 2 or 3 track system, the transfer pricing issue.

Number 2, yes we are reducing the availment of incentives, but so long as you continue to innovate, perform, and produce jobs, you can potentially live through years of incentives so basically, instead of no accountability, we now encourage you to be more efficient and innovate.

And if you look at the bigger picture, many other factors will determine your bottomline. Not only incentives: the exchange rate, cost of transport, logistics, worker productivity, spending money on training at BPOs and workers turning over. Those are costs to you. Why don't we look at the bigger picture and address the most basic needs of the workforce so that your bottom line increases, even if the incentives are tamed.

Atty. Mel Hernandez (Dole Phils.): I am happy that this slide is actually saying "lack of incentives is not a leading problem for doing business in the Philippines." I would like to relate that to an earlier slide which shows FDI saying "it has been growing but it is not growing as much as we want." If we relate it to the earlier slide, I was just wondering why we are even touching the incentives. It seems we are changing the rules in the middle of the game. Perhaps we can consider parallel tracks: those who are already here can continue their incentives and those that will be relocating to the Philippines can avail of new ones.

DOF Usec. Karl Chua: Well, I have nothing to add, but my presentation explains it. But I will consider your suggestion.

John Forbes: Now, if I may ask a question. There was one slide that Usec. Rodolfo put up with the number of firms that currently enjoy 5% GIE incentives. It struck me that those numbers are low. If we take the current population of PEZA, it exceeds 4,000 firms. If we add the two largest economic zones at Clark and Subic, surely you must get another thousand. In the case of the shock that came to the ROHQs, that is 200 firms, but potentially, are not your numbers more like 5,000?

DOF Usec. Karl Chua: Well, this is based on 3 factors. One, this is incomplete data; some have yet to submit. Number 2, as mentioned, the note "some data are also limited in time." We started at 15 years so we have not counted from 1 to 14 years. The slide basically shows you the top winners. There could be more.

John Forbes: I have another quick question. Last week, when Sec. Lopez spoke at AmCham, I heard there was a study of DTI showed that for every dollar of incentives, 1.2 dollars of revenue was produced for the economy. I have not seen that study, have you heard of it? Because that shows that you are getting PhP 360 billion, or like you are getting 20% of your returns on incentive investments granted.

DTI Usec. Ceferino Rodolfo: That study is made by Dr. Linda Medalla, so maybe Asec. Fita can elaborate more on that. But for the BOI, of our registered companies, based on 2015 TIMTA submissions, our registered companies applied for PhP 42 billion worth of ITH in 2015. The BOI endorsed to BIR PhP 22 billion, and the net fiscal impact of BOI registered companies, including the ITH period is about PhP 700 million. But, Asec. Fita will might provide more details about Dr. Medalla's study?

DTI Asec. Rafaelita Aldaba: It is a cost benefit analysis study. Right now we do not want to upload it on the website because it is really full of equations and a lot of technical stuff. What we are doing is to simplify it. Hopefully by the end of this month we will be able to upload the policy brief, the non-technical version. But it covers only BOI incentives. It does not cover PEZA or others because we do not have the information. We only have access to BOI incentives.

Julian Payne (CanCham): Thank you very much. There was a very interesting slide which showed the incentives of the Philippines with other ASEAN countries. I would be very interested to see another slide which shows what the Philippines would look like with the new incentives put into effect. I would like to see how this compares with the new regime. That would be very helpful.

DOF Usec. Karl Chua: Very quick response, it can potentially still be forever as long as the projects are still innovating. You can do 5 years, bringing in new technology, new projects, etc. Unfortunately, I have to run to the Senate. But I hope this is a good start of a dialogue, I will remain open to your comments, positions, and suggestions. We will keep this going, and we can have as many of these as you may want.

CLOSING REMARKS
[1:54:27-1:55:07 – Closing Remarks]

DANIEL ALEXANDER
Vice President,
Australian-New Zealand Chamber of Commerce of the Philippines

John Forbes: Mr. Dan Alexander, vice president of the Australian-New Zealand Chamber will give concluding remarks.

Daniel Alexander: Thanks, John. Please join me in a round of applause for Usec. Rodolfo and Usec. Chua. They really were on the hot seat, and I do not think any of us in this room would want their jobs, for sure. Once again, thank you to everyone for coming along and thank you for your contributions. We certainly appreciate it and we know they have taken a lot of notes, so hopefully we see some reconsideration. Once again, thanks also to the American Chamber as well, Ebb (Hinchliffe) and John (Forbes) for pulling this together certainly. We appreciate it. Thank you.