COMPREHENSIVE TAX REFORM PROGRAM

PROPOSED PACKAGE 2

Corporate income tax reform and fiscal incentives modernization

As of 23 January 2018

Content

I. Background: corporate income tax and fiscal incentives regime

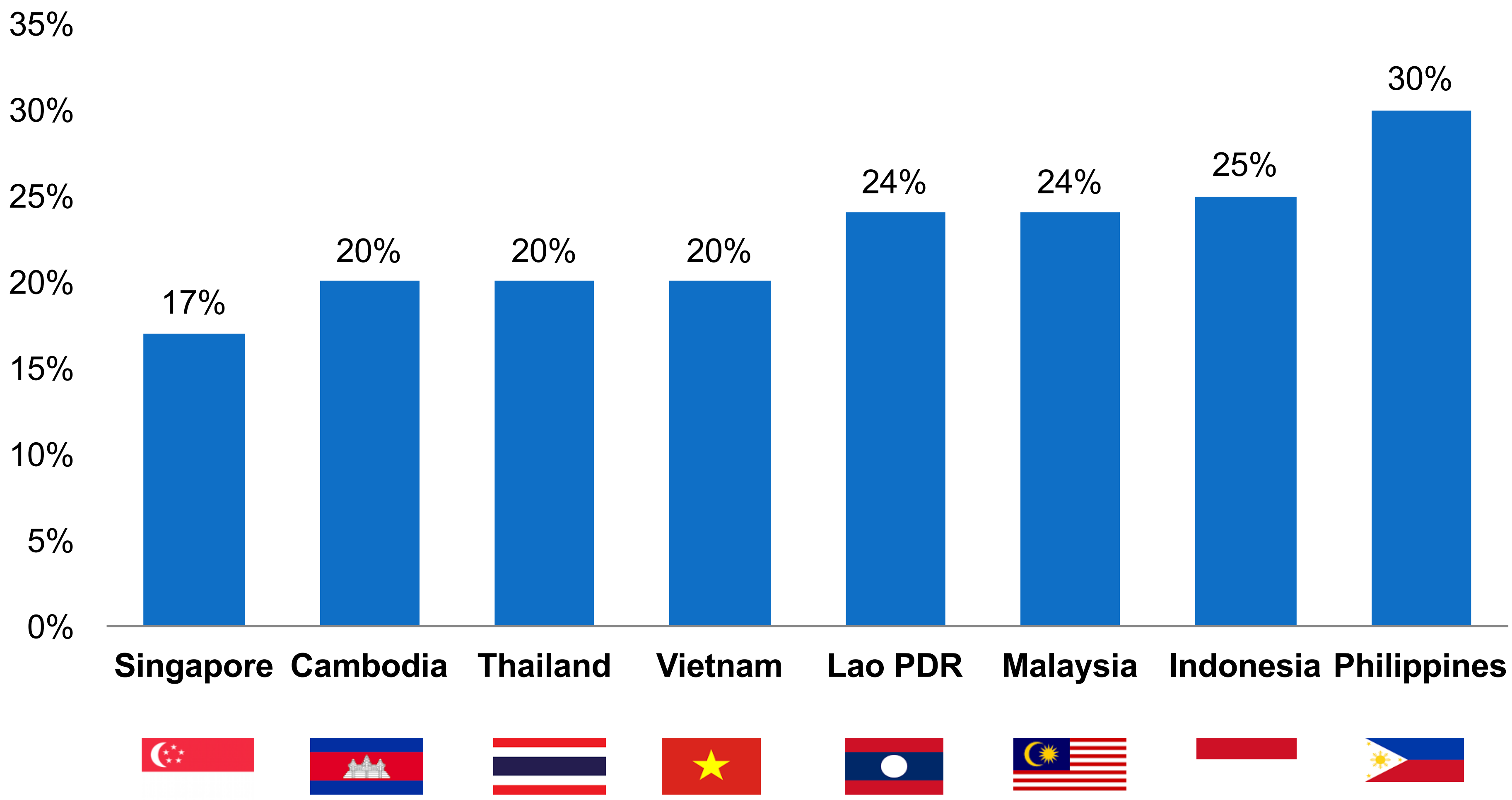
II. Rationale for reform: cost and benefits

III. Proposed reform

Regular corporate income tax (CIT) regime

Features	Rate	Legal basis
Regular corporate income tax (CIT) rate		
Domestic corporation and resident foreign corporations	30% of net taxable income	Sec. 27 (A) and 28 (A) of the National Internal Revenue Code (NIRC)
Non-resident foreign corporation	30% of gross income	Sec. 28 (B) of NIRC
Minimum CIT (MCIT) for domestic corporations and resident foreign corporations	2% of gross income	Sec. 27 (E) and 28 (A) (2) of NIRC
Optional standard deduction (OSD) in lieu of itemized deductions	40% of gross income	Sec. 34 (L) of NIRC

Comparative CIT rates in ASEAN



Source: PWC and ADB

Tax incentives system

BOARD OF INVESTMENTS
PHILIPPINES

Maximizing Opportunities for a Stronger Philippine Economy

- **14 Investment promotion agencies (IPAs)**: the BOI, PEZA, and 12 other special economic zone authorities, which are authorized to grant tax incentives under their respective charters.

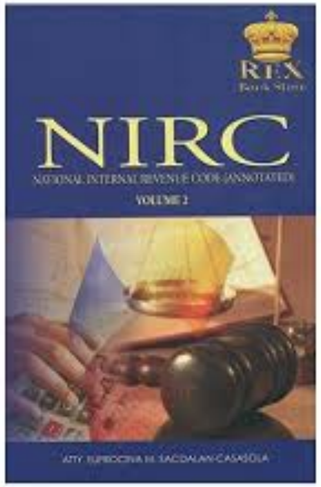
- **123** investment laws (3 NIRC, 69 special laws, and 51 franchise) and 192 non-investment laws that provide tax incentives.
- **Income Tax Holiday (ITH)** is the centerpiece of the incentives system followed by the **5% Gross Income Earned** (**GIE) tax**, and customs duty exemption. The GIE is given indefinitely and is in lieu of income, VAT, and local taxes.
- **Since 2015, Tax Incentives Management and Transparency Act (TIMTA) law** requires reporting of the tax incentives granted for registered investments.

- **50 years** of picking winners thru the IPP, which started in 1968 (RA 5186).

14 investment promotion agencies

Bataan Technology Park Inc.

National Internal Revenue Code
Exemptions and special rates



Special rate

ROHQ, International carriers, proprietary educational institutions and non-profit hospitals, non-resident corporations, cinematographic film owner, lessor, and distributor

Exemptions

GOCCs (GSIS, SSS, PHIC, PCSO*, LWDs)

Regional or area headquarters,

Sec. 30 (A to K) – labor, agricultural, mutual savings banks, non-stock corporations, chamber of commerce, non-stock and non-profit educational institutions, government educational institutions.

*** Taxable as of Jan 2018**

123 INVESTMENT-RELATED FISCAL INCENTIVE LAWS
by SECTOR

AGRARIAN REFORM/AGRICULTURE/FOOD……………………….	8
AIR TRANSPORT SERVICES …………………………………….	4
AUTOMOBILE ……………………………………………………….	1
BANKS/FINANCIAL INSTITUTIONS…………………………………..	5
BOOK PUBLISHING INDUSTRY……………………………………….	1
COMMUNICATION/POSTAL SERVICES……………………………..	42
DUTY-FREE SHOPPING ……………………………………………	1
ECOZONES (LOCATORS/DEVELOPERS/OPERATORS)…………	11
ENERGY/ OIL INDUSTRY …………………………………………….	14
ENVIRONMENT/ POLLUTION CONTROL…………………………..	3
EXPORTERS ………………………………………………………..	2
GAMES AND AMUSEMENT………………………………………….	5
HEALTH ………………………………………………….	1
HOUSING …………………………………………………….	1
INFRASTRUCTURE …………………………………………………….	1
IRON AND STEEL INDUSTRY……………………….........................	1

123 INVESTMENT-RELATED FISCAL INCENTIVE LAWS BY SECTOR

JEWELRY	1
LABOR	2
MICRO, SMALL AND MEDIUM SCALE ENTERPRISES..	2
MINING	2
SHIPPING INDUSTRY	3
SPORTS	1
TOURISM	2
VETERANS	2
VARIOUS SECTORS REGISTERED UNDER BOI..........	4
*LOCAL GOVERNMENT CODE	1
*NATIONAL INTERNAL REVENUE CODE	1
*CUSTOMS MODERNIZATION AND TARIFF ACT	1
TOTAL	123

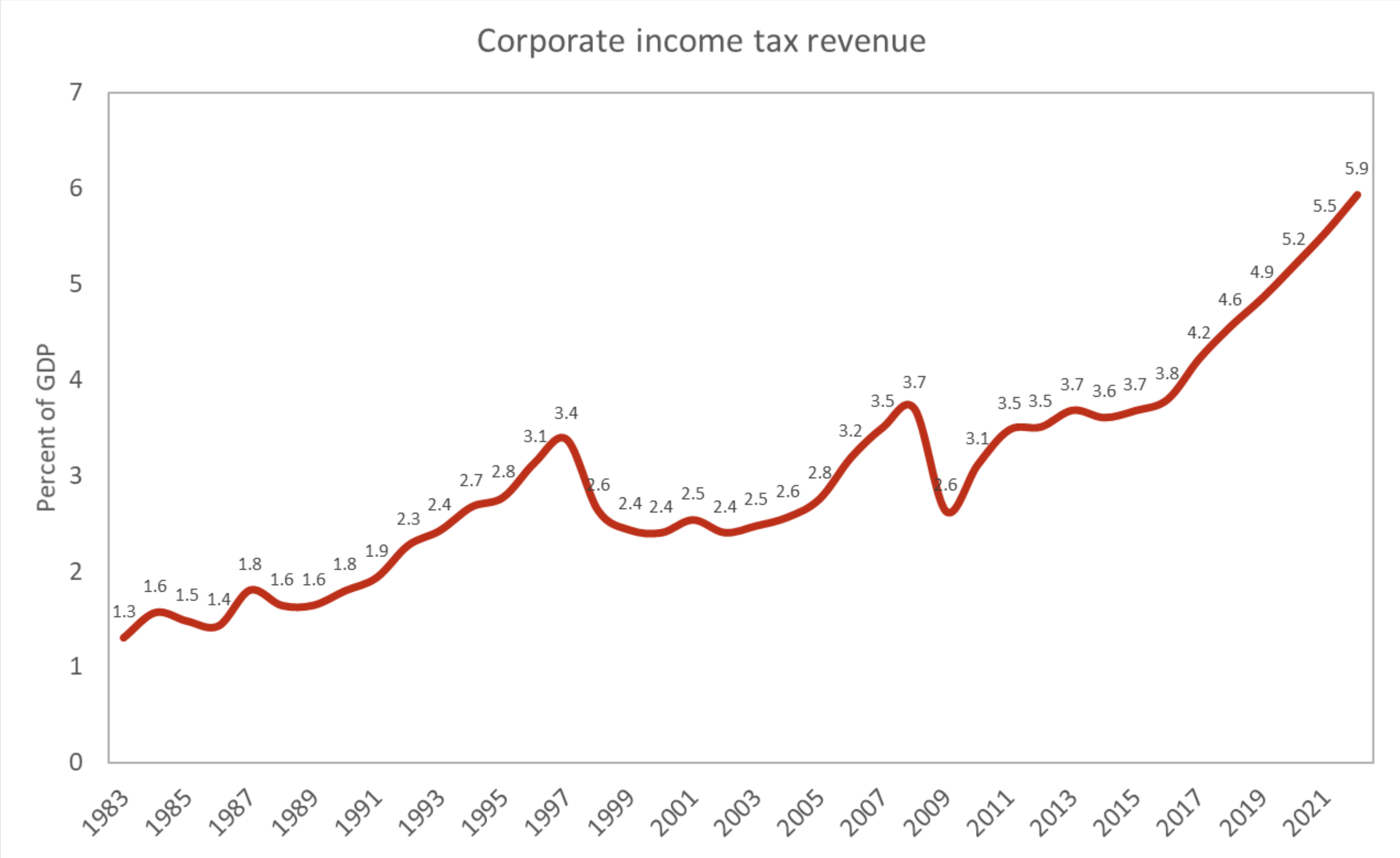
Comparative income tax holiday / special rate in ASEAN countries

Country	Maximum years of incentives
Philippines	**4 + 8 extension + GIE forever**
Brunei Darussalam	20
Cambodia	9
Indonesia	20
Lao PDR	20
Malaysia	5 + 5 extension
Myanmar	5 to 7
Singapore	3
Thailand	8
Vietnam	2 to 4

Other incentives

- Tax investment allowances
- Higher deductions for R&D, training, labor, etc.
- Accelerated depreciation
- Net operating loss carry over
- Customs duty exemption
- Export subsidies

CIT revenue is rising as the economy grows



Source: Bureau of Internal Revenue

However, efficiency is quite low.

Country	Year	CIT revenues (percent of GDP)	Headline CIT rate (percent)	Revenue productivity (percent)
Thailand	**2012**	**6.1**	**20**	**31**
Vietnam	2012	7.3	25	29
Malaysia	2015	6.5	24	27
Singapore	2015	3.5	17	21
China	2012	3.5	25	14
Philippines	**2015**	**3.7**	**30**	**12**
Indonesia	2015	2.7	25	11
Lao	2012	2.4	28	9
Cambodia	2012	1.3	20	7

Revenue productivity is calculated as the ratio of tax revenue as a share of GDP divided by the tax rate. Source: OECD iLibrary, IMF Fiscal Monitor database, World Bank, PWC

Investment Tax Incentives: Cost

2015 estimated forgone revenue due to tax incentives

Type of tax	Revenue (in billions PHP)
Income tax	86.3
Customs duties	18.1
Import VAT (gross)	159.8
Local VAT (gross)	37.0
Local Business Tax	TBD
Leakage	TBD
Total	**301.0**

Estimates of tax incentives From 2011 to 2014

Tax incentives (in billion PHP)	2011	2012	2013	2014
Income tax incentives	**61.3**	**87.3**	**77.5**	**88.2**
ITH	*45.6*	*64.4*	*56.4*	*58.4*
Special Rate	*15.7*	*22.9*	*21.2*	*29.7*
Customs duties incentives	**83.0**	**69.8**	**69.3**	**38.0**
Total	**144.3**	**157.1**	**146.8**	**126.2**
Ratio to GDP	**1.5%**	**1.5%**	**1.3%**	**1.0%**
Ratio to total NG expenditures	9.3%	8.8%	7.8%	6.4%
Ratio to total NG revenues	10.6%	10.2%	8.6%	6.6%

Note: VAT and local tax incentives were not included in the estimation.

2015 tax incentives estimates (following the TIMTA law)

Type of Incentive	Amount of tax incentives (in billion PHP)	Ratio to 2015 GDP (%)	Ratio to 2015 NG expenditures (%)	Ration to 2015 NG revenues (%)
Income tax holiday	53.8	0.4	2.4	2.6
Special Rate (5% GIE)	32.5	0.2	1.5	1.5
Total incentives on income Tax	**86.3**	**0.7**	**3.9**	**4.1**
Total incentives on customs duties	**18.1**	**0.1**	**0.8**	**0.9**
Total	**104.4**	**0.8**	**4.7**	**5.0**

2015 tax incentives by IPA and by type of tax incentive (in billions PHP)

IPA	Tax expenditure on income tax holiday (ITH)	Tax expenditure on special income tax rate	Tax expenditure on customs duties	Total tax expenditure
Philippine Economic Zone Authority (PEZA)	**25.9**	**25.8**	**14.9**	**66.6**
Board of Investments (BOI)	**26.8**	**1.9**	**0.7**	**29.4**
Clark Development Corporation (CDC)	0.3	2.1	1.6	4.1
Subic Bay Metropolitan Authority (SBMA)	0.6	2.0	0.4	3.0
Authority of the Freeport Area of Bataan (AFAB)	0.0	0.2	0.6	0.8
Cagayan Economic Zone Authority (CEZA)	-	0.5	0.0	0.5
Tourism Infrastructure and Enterprise Zone Authority (TIEZA)	0.1	-	-	0.1
Poro Point Management Corporation (PPMC)	-	0.1	0.0	0.1
Zamboanga City Special Economic Zone Authority (ZCSEZA)	0.0	0.0	-	0.0
Bases Conversion and Development Authority (BCDA)	0.0	-	-	0.0
Total	**53.8**	**32.5**	**18.1**	**104.4**

2015 top beneficiaries of tax incentives by sector (in billions PHP)

Sector	Total tax expenditure on income and duty	Percentage to total tax expenditure
Manufacturing *(industrial goods, machines, electronics, electrical products, etc.)*	**30.8**	**29.4**
Services *(call center, BPO, etc.)*	**14.0**	**13.4**
Services *(warehousing, logistics, utilities, operator of sea ports and airports, etc.)*	7.8	7.5
Manufacturing *(vehicles, vehicle accessories, transport equipment)*	7.6	7.3
Energy *(coal, diesel, etc.)*	6.1	5.9
Energy *(renewable)*	5.1	5.0
Services *(software development, IT-related services, gaming and other computer-related activities, etc.)*	4.8	4.6
Manufacturing *(wood, glass, paper, plastic, ceramic, rubber products, etc.)*	3.9	3.7
Economic and low-cost housing	3.6	3.5
Tourism *(accommodation, hotels, resort, etc.)*	2.6	2.5
Manufacturing *(food, food processing)*	2.4	2.3
Others *(agriculture and fishery, other manufacturing, other services, etc.)*	15.7	15.0
Total	**104.4**	**100.0**

Due to tax incentives, tax rates are very unequal.

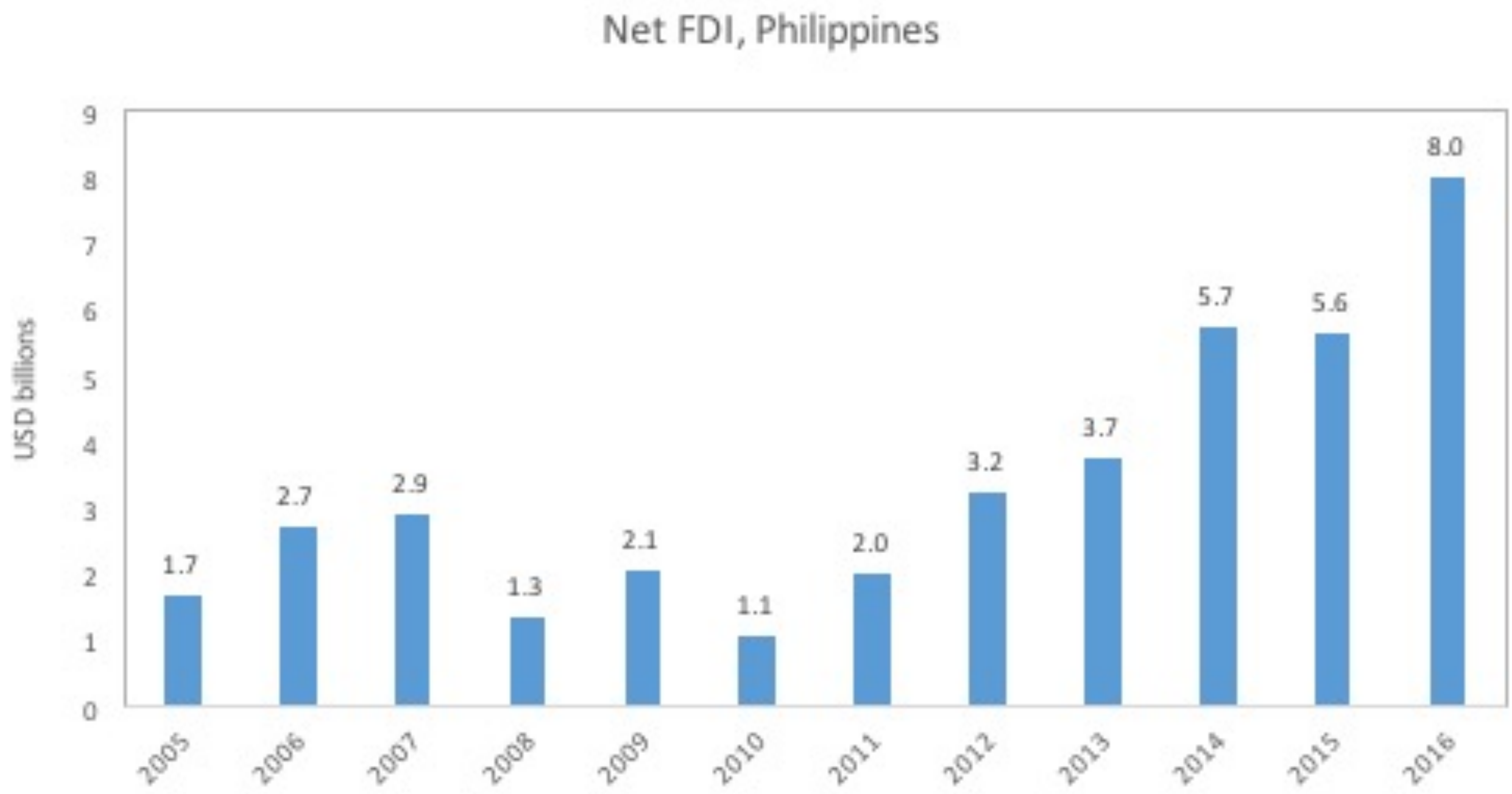
Major Sector	Special Regime (Special Income Tax Rate)	Regular Regime
	ETR of tax incentive recipients (%)	ETR of regular firms (%)
Agriculture and Fishery	6.3	30
Economic and Low-cost Housing	9.1	30
Energy	10.0	30
Manufacturing	10.2	30
Mining and Quarrying	-	30
PPP Projects	-	30
Services	12.0	30
Tourism	9.6	30
Unfilled/ Unspecified Registered Activity	13.5	30

2015 tax incentives on value added tax (VAT), per IPA (in millions PHP)

IPA	IMPORT VAT	LOCAL VAT	
	EXEMPT	EXEMPT PURCHASES	0% PURCHASES
AFAB	1,363.5	3.3	9.4
BOI	77.2	8,896.9	2,666.3
CDC	9,195.9	961.4	1,571.2
CEZA	1.7	0.2	30.3
PEZA	147,828.4	3,313.1	17,565.9
PPMC	0.2	0.0	0.3
SBMA	1,358.2	761.9	947.1
TIEZA	-	0.0	0.0
ZAMB	-	67.7	201.4
TOTAL	159,825.1	14,004.5	22,991.8

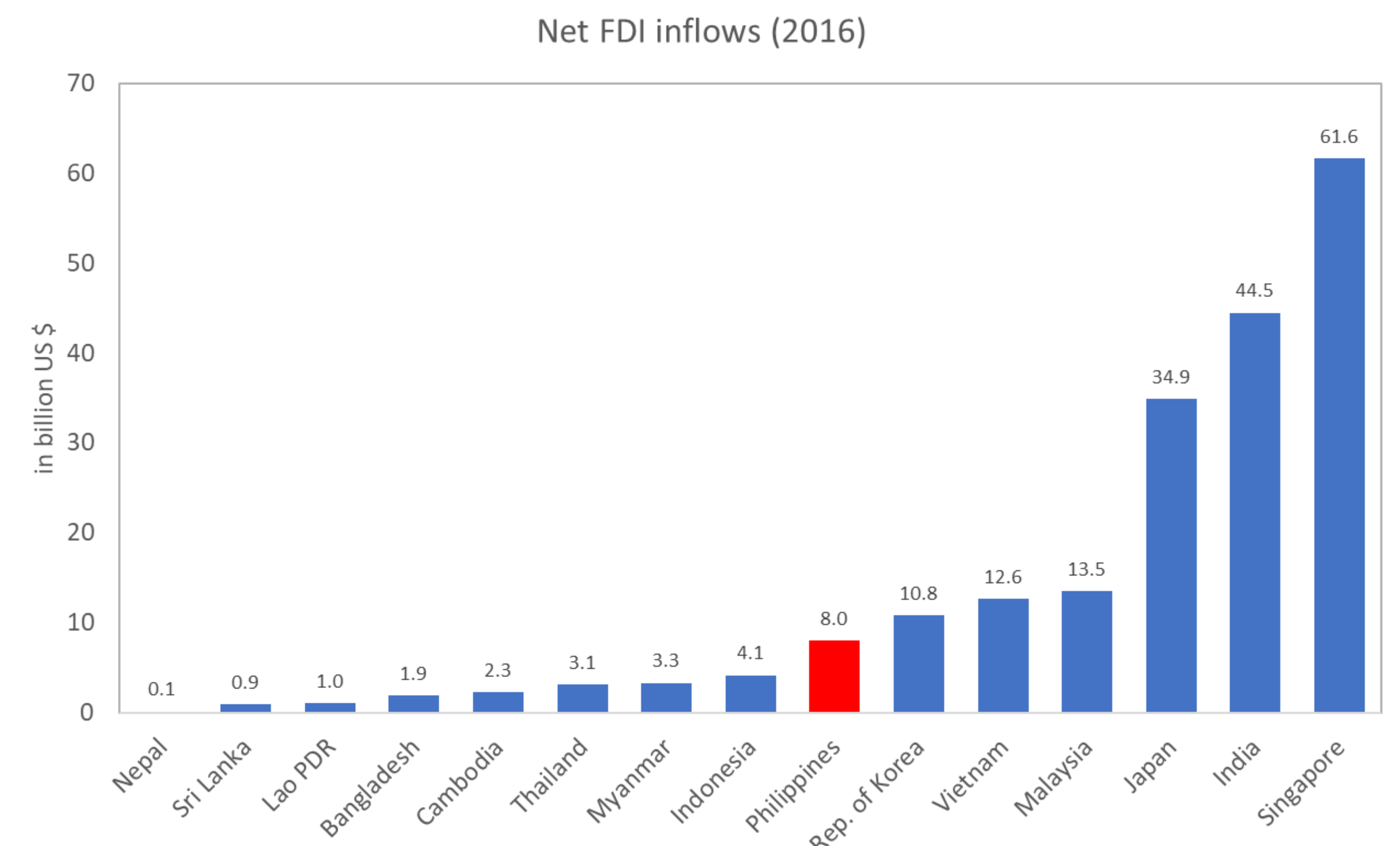
Investment Tax Incentives: Benefits

PHL Foreign direct investment (FDI) has been growing…



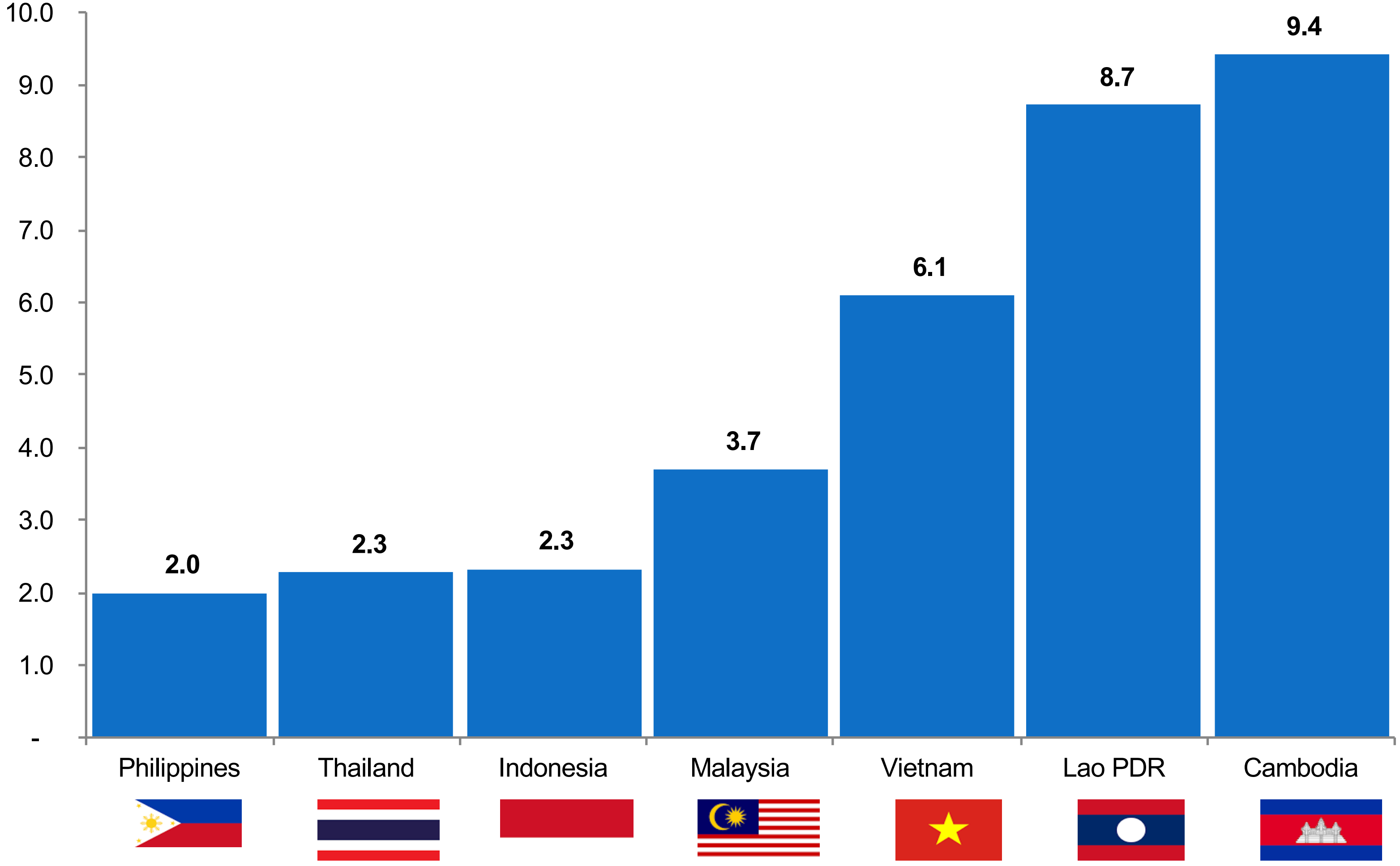
Source: BSP

But can be better…



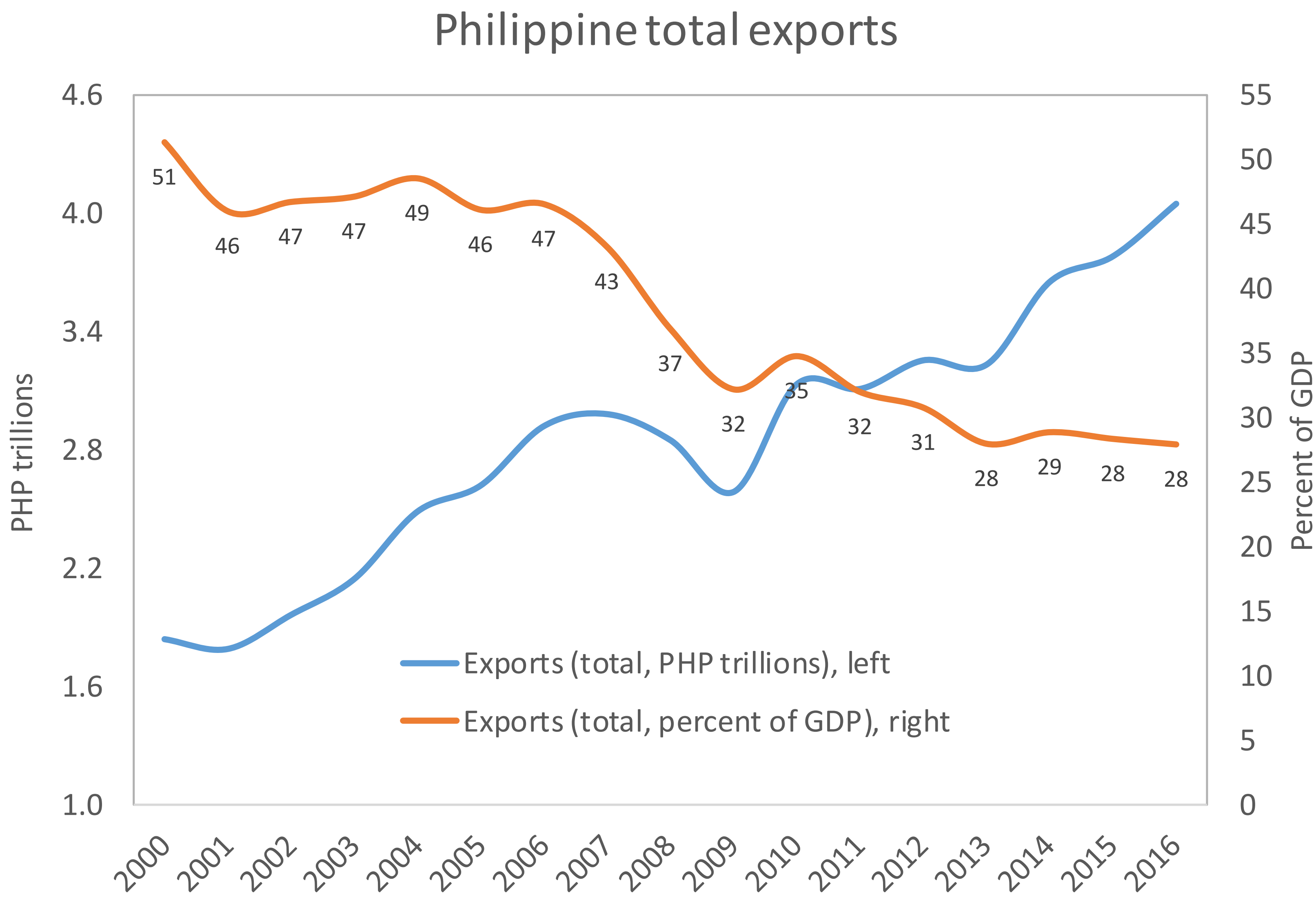
Source: IMF IFS

ASEAN FDI in 2015 (% of GDP)



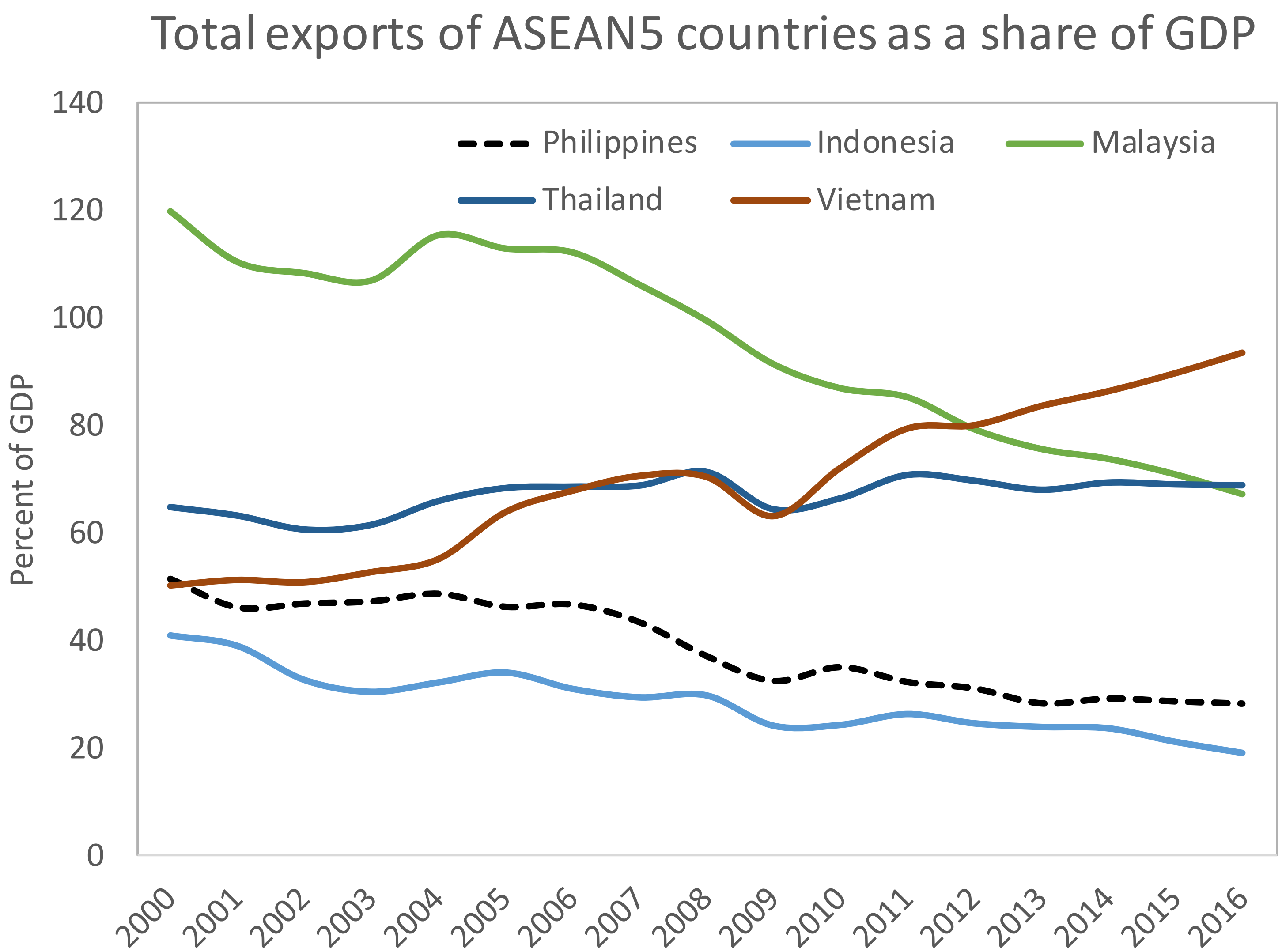
Source: World Bank

As a result, overall exports has dropped as a share of GDP, reflecting lack share of competitiveness.



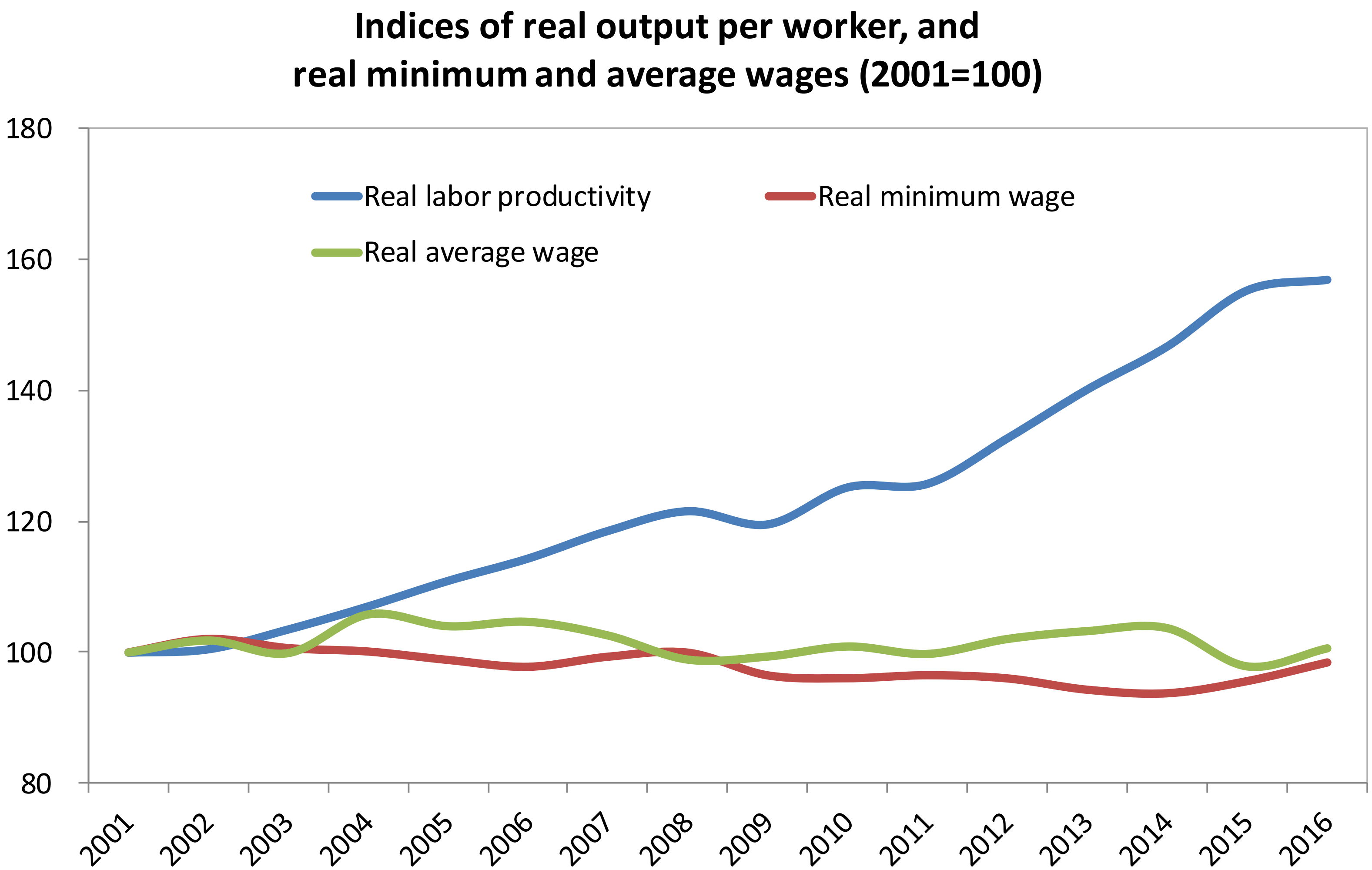
Sources: PSA, DOF staff estimates

The Philippines has one of the lowest exports as a share of GDP among the ASEAN5.



Sources: WDI, DOF staff estimates

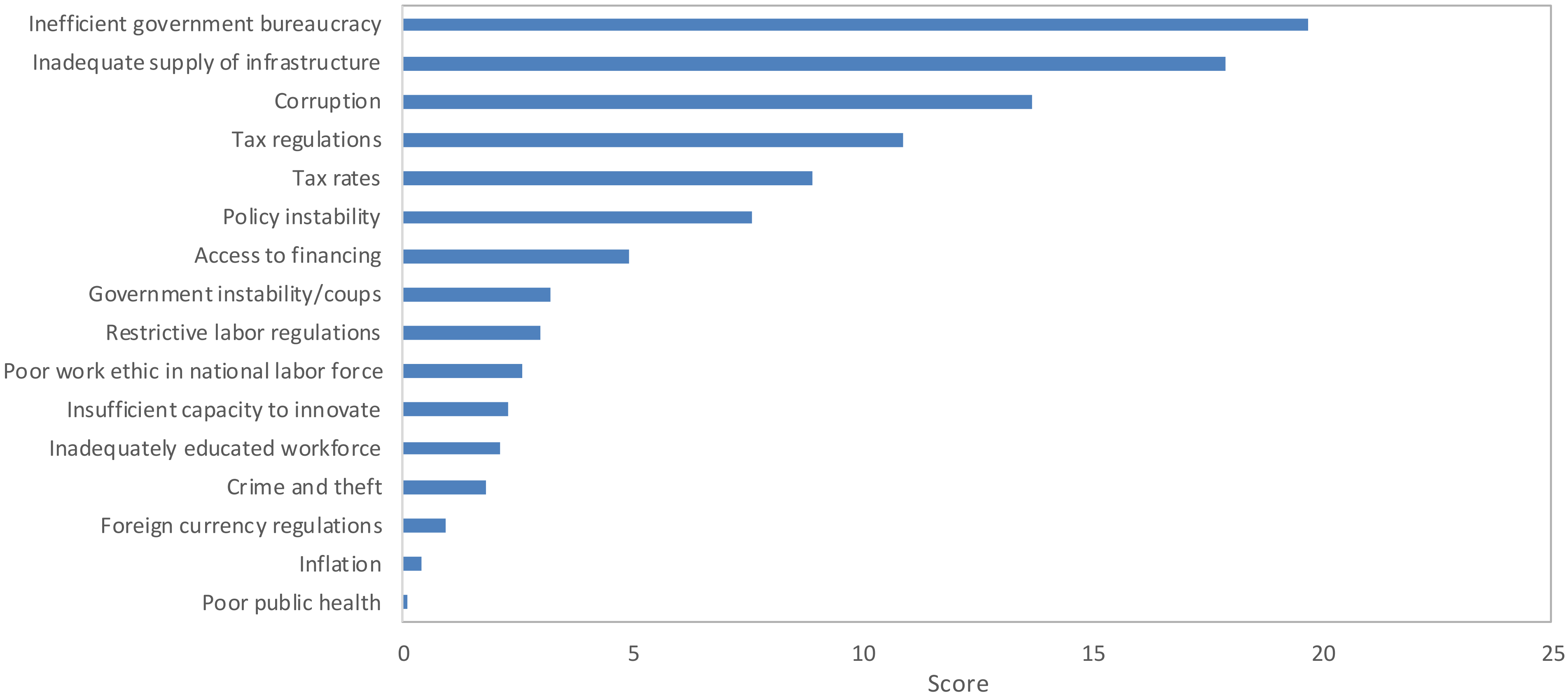
Real labor productivity has been increasing, yet real wages have been stagnant



Sources: National Wages and Productivity Commission, Philippine Statistics Authority, and DOF staff estimates

The lack of incentives is not a leading problem for doing business in the Philippines

Most problematic factors for doing business in the Philippines, 2017



Source: World Economic Forum

Note: From the list of factors, respondents to the World Economic Forum's Executive Opinion Survey were asked to select the five most problematic factors for doing business in their country and to rank them between 1 (most problematic) and 5. The score corresponds to the responses weighted according to their rankings.

Proposed Reform

Proposed reform

- **Lower the corporate income tax (CIT) rate**
  - Beginning Jan 1, 2020, reduce the CIT rate by 1 percentage point for every 0.15 percent of GDP (or PHP 26 billion in 2018) reduction of investment tax incentives two years ago.
  - The goal is to reduce the CIT rate from 30% to 25% by 2022, while expanding the tax base by 0.75 percent of GDP (or PHP 130 billion in 2018 prices).

Proposed CIT reform

- **Improve compliance by simplifying tax rules for corps.**
  - Improve general anti-avoidance rules: allocation of income and deduction (transfer pricing), gains and loss determination and recognition, international taxation, and stricter definition and implementation of related parties.
  - Reduce the OSD from 40 to 20% of gross income for both individuals and corporation.
  - Enforce the minimum corporate income tax.
  - Improve administration of allowable deductions.
  - Expand definition of large taxpayer: should be conglomerate basis.
  - Define medium taxpayer.
  - Simplify forms and process.
  - Allow BIR to prosecute tax cases.

General principles of the incentives reform

- **PERFORMANCE-BASED**

Clear attainment of actual investment, job creation, exports, country-side development, and research and development, else incentives are revoked.

- **TARGETED:**

To minimize leakages and distortion in the tax system, tax incentives should be given to activities with significant positive externalities as specified in the strategic investments priority plan.

- **TIME-BOUND**

There should be sunset provision in the grant of tax incentives.

- **TRANSPARENT**

Monitoring of tax incentives should be institutionalized and reported by government.

Proposed reform

- **Governance of incentives**
  - The Fiscal Incentives Review Board's (FIRB) function is expanded as follows:
    - To serve as the overall administrator of all IPAs and incentives
    - To review all IPA policy decisions
    - To approve all IPA grant of investment tax incentives
    - To grant tax subsidies to GOCCs and government offices (current function).
  - The DOF, as chair of FIRB, shall have veto power as the custodian of fiscal prudence and responsibility. The Secretary of Finance can cancel or suspend the grant of incentives upon the review and recommendation of the FIRB.
  - DOF to be co-chair of BOI, PEZA, and all other IPAs.
  - NEDA to be a member in all 14 IPAs.

Proposed reform

- **Broaden the tax base**
  - Repeal of 123 special laws on investment tax incentives and consolidate into a single omnibus incentives law.
  - Repeal NIRC exemptions of GOCCs, proprietary educational institutions and hospitals, RHQs, ROHQs, income of resident foreign corporation from foreign currency transactions, nonresident cinematographic film owner, lessor or distributor and owner or lessor, vessels, aircraft, machineries and other equipment.

Proposed reform

- **Rationalize investment tax incentives**
  - One single menu of incentives applicable to all IPAs.
  - No double registration of activities.
  - Only new investment/activities shall be granted income tax incentives. Expansions are signs of profitability and need not be given incentives.
  - Expansions can avail only of exemption from customs duty of capital equipment.
  - Definition of exporter: at least 90% of sales are actually shipped out to a foreign country.
  - Domestic firms allowed if in the strategic investments priority plan.
  - One-year relocation incentive for firms moving out of Mega Manila.
  - Superior incentives for lagging regions, conflict and calamity-stricken regions.

Proposed reform

- **Incentives menu**
  - Income tax holiday
  - Replace the 5% gross income earned (GIE) tax in lieu of all taxes with a reduced corporate income tax rate of 15% based on net taxable income.
  - Other income-based incentives: investment tax allowance, double deduction for research and development and training expenses, 50% deduction for labor, deduction for infrastructure and reinvestment of profit.
  - Exemption from customs duty.
  - No more VAT incentives: All firms to pay VAT and prove they export to be able to get a refund.
    - The VAT will not no longer be used as an investment incentive and cannot be used in the separate customs territory argument, especially for vertical zones (i.e., buildings).
  - No more local tax incentives: LGU local business tax will not be committed by NG.

Proposed reform

- **Only investments that meet these conditions will be given tax incentives:**
  - **Performance-based:** performance contract based on actual job creation, exports, countryside development, use of modern technology, actual investment, or extent of R&D (e.g., 5% of employment in R&D). An independent body or FIRB to measure performance.
  - **Time-bound**: 5 years ITH and/or reduced rate with no extension, except for customs duty of capital equipment.
  - **Targeted:** based on 3-year SIPP, which can cover both foreign and domestic firms (no nationality bias), and both exports and domestic market.
  - **Transparent:** name of beneficiaries and estimated tax incentives to be reported by the FIRB.

Proposed reform

– Existing income tax holiday (i.e., 4 years) will be allowed to continue but no extension.

– Existing GIE incentives will be allowed 2 to 5 more years as transition period.
  - Receiving for more than 10 years: 2 years
  - Receiving between 5 and 10 years: 3 years
  - Receiving below 5 years: 5 years

Number of firms registered with tax incentives for 15 years and above

No. of years	No. of firms
15-20	510
21-25	131
23-29	13

Proposed reform

- **Others**
  - A 3-year SIPP shall be formulated by BOI and approved by the President.
    - BOI shall ensure that the more targeted list include activities with significant positive externalities.
    - Only the President may grant tax incentives to economic activities not in the IPP.
  - Integrate tax expenditure reporting into the budget process. Incentives will not be budgeted but should be reported as a tax expenditure for transparency purpose.

Complementary reform: TIMTA amendments

- **TIMTA amendments**
  - Include in reporting all tax incentives, whether investment or non-investment incentives.
  - Include in reporting all types of taxpayers, especially cooperatives.
  - Mandate the inclusion of all taxes in the computation of tax expenditure, including VAT and local taxes.
  - Mandate submission of more benefits data such as investment, both approved and actual, jobs, export sales, and R&D at firm level.
  - FIRB to conduct cost benefit analysis in the future.

Complementary reform: Investment assistance & facilitation

- Strengthen investment assistance and facilitation mandate of BOI & IPAs
  - Ensure timely action of NGAs and LGUs on applications by projects covered by SIPP.
  - May have to be packaged as parallel amendment of EO 226.

Thank you!