Joint Foreign Chambers of the Philippines

American Chamber of Commerce of the Phils., Inc. ◆Australian-New Zealand Chamber of Commerce (Phils.), Inc.
Canadian Chamber of Commerce of the Phils., Inc. ◆ European Chamber of Commerce of the Phils., Inc.
Japanese Chamber of Commerce & Industry of the Phils., Inc. ◆ Korean Chamber of Commerce of the Phils., Inc.
Philippine Association of Multinational Companies Regional Headquarters, Inc.

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PAMURI

November 8, 2018

SEN. JUAN EDGARDO M. ANGARA
Chairman
Committee on Ways and Means
Senate of the Philippines
Pasay City, Manila

Dear Chairman Angara:

Thank you for giving the Joint Foreign Chambers the opportunity to raise the following comments on House Bill 8083 that is now for deliberation in your Committee.

We hope you can consider the following inputs which, in our view, will help the TRABAHO bill truly achieve its objective of promoting job-creation and economic activity in the country:

Section 7 of HB 8083 amending Sections 27 and 28 of the NIRC

We believe that the proposed reduction of corporate income tax (CIT) of two percentage points (2%) every two years, which will only begin to take effect in 2021, is "too little, too slow." The Philippines has long suffered from high corporate tax rates, which has proven to have been ineffective compared to the experience of our ASEAN neighbours.

We note that the mean average CIT in Asia is only 22.5% and globally is only 23%.[1] Thus, the CIT rate alone (all things being considered equal) unfortunately will not encourage foreign investors to invest in the country.

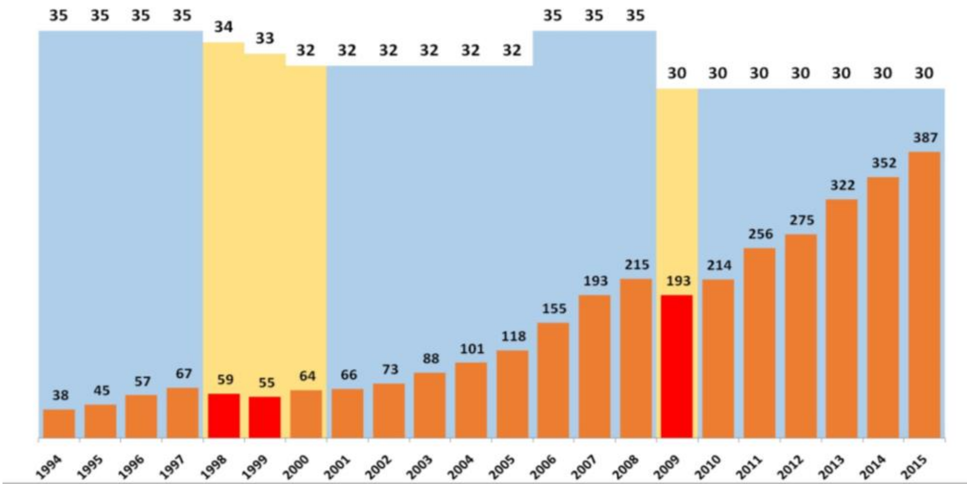
We strongly believe that the Department of Finance (DOF) computation that PhP 130 billion revenue loss will result from outright reduction of CIT from 30% to 25% is erroneous. It is based on a **wrong assumption that the tax base will not increase if the CIT rate is reduced**. Precisely, the reason for the reduction of CIT is to attract more investments that widen the tax base.

The DOF's assumption also goes against the experience of our ASEAN neighbors and many other countries who reduced their CIT rate. Their experience has reflected a **steady increase in tax compliance and increase in tax collection over the years following the reduction of their CIT rate.** The reduction of CIT, as a global trend, shows that high tax rates do not necessarily result in high revenue collection as the tax base is the most critical factor.

[1] https://taxfoundation.org/corporate-income-tax-rates-around-the-world-2017

Based on past experience **we dispute DOF's assumption that the reduction of the CIT rate will result in drastic revenue loss for the country.** Our own experience in 1998 saw only a momentary fall in revenue collection by PhP 8 billion, following the reduction of the CIT from 35% in 1997 to 34% in 1998, another PhP 4 billion reduction in collection in 1999 when CIT was reduced to 33%. However, revenue collection rapidly recovered and steadily increased from **year 2000 to 2005** when the CIT was even further **reduced to 32%.** In those years, **revenue collection steadily increased from PhP 64 billion to PhP 155 billion.**

Corporate income tax rates and revenue collection, 1994-2015



Source: BIR data, as presented by DOF, December 19, 2017

Moreover, there was only momentary reduction in CIT collection of PhP 22 billion when our CIT rate was reduced from 35% in 2008 **to 30% in 2009, but CIT collection steadily increased from 2010 to 2015.** In fact, in 2008, the total CIT collection was PhP 215 billion while the CIT collection in 2010 almost immediately recovered to PhP 214 billion or just one year after the CIT rate was reduced from 35% down to 30%.[2] From 2011, the CIT collection of PhP 256 billion that year steadily grew and resulted in amounts of collection (to PhP 387 billion) that were never achieved when the country was under the 35% CIT rate.

In this regard, **we strongly recommend a reduction of the CIT rate from 30% to 20% to make the Philippines more competitive and attractive as an investment destination compared to other Asian countries.**

Furthermore, we suggest accelerating the reduction in corporate income tax rate by a 5% reduction starting upon enactment then followed by annual 1% reductions until 20% is reached.

[2] Source: Slide No. 8 of DOF presentation about Package 2 dated December 19, 2017

Section 8 of HB 8083 amending Section 28 (A) (4) of the NIRC

The removal of the preferential taxation of Offshore Banking Units (OBUs) as well as the tax exemption of income of non-resident (individuals or corporations) from transactions with said OBUs must be carefully studied for its effects on potential capital flight.

We support the proposal of Senate Bill 1906 to retain the preferential taxation of OBUs and the tax exemption of income of non-resident (individuals or corporations) from transactions with said OBUs.

Section 8 of HB 8083 amending Section 28 (A) (5) of the NIRC

The **removal of the exemption from Branch Profit and Remittance Tax (BPRT) of PEZA-registered branch offices must be retained** to promote consistency of policy. At the very least, the removal of the exemption from BPRT of PEZA-registered branch offices should only be made to apply prospectively by specifying that only profits earned and earmarked for remittance beginning January 1, 2019 should be subject to BPRT.

Section 8 of HB 8083 amending Section 28 (A) (6) (b) of the NIRC

We object to the removal of the preferential taxation of Regional Operating Headquarters (ROHQs). The Philippines is just starting to be noticed as a potential site for shared services of multinational companies (MNCs). Thus, if ROHQs are subjected to the regular CIT rate of 30% two years after the TRABAHO bill becomes a law, we highly doubt it if the country can still compete with Hong kong, Singapore, and Malaysia as a site of shared services of MNCs. These three jurisdictions are fierce competitors of the Philippines in this industry and offer a CIT rate that is much lower than 30% of the Philippines, as shown below.

RANKING	1	2	3	4	5
DATA POINT	HONGKONG	SINGAPORE	MALAYSIA	PHILIPPINES (Current)	THAILAND
Corporate Income Tax - Regular	16.50%	17%	24%	30%	20%
Corporate Income Tax - ROHQ	16.50%	15%	Tax-exempt	10%	10%

Our suggestion is to retain the present preferential income tax rate of ROHQs for a period of at least 10 years, to encourage the increasing growth of this sector. **Faced with the possibility of losing the 10% CIT and coupled with the fact that the 15% employee preferential tax rate was removed last year, many ROHQs have stated they will close their ROHQ operations or hold off expansion plans.** This is not an empty threat as we have already seen the contraction of the industry after the implementation of TRAIN and the veto provision which sought to remove the grandfathering of existing ROHQs' preferential employee tax rate. **Board of Investments data suggests that between 10 and 20 ROHQs have filed for closure within 2018 – the 1st year of the implementation of TRAIN.** We trust that the intention of the legislators is not to completely forego this subsector and cease promoting it—especially given its potential to generate many thousands of high-level jobs in the future and to retain existing ones as well.

Section 9 of HB 8083 amending Section 34 (L) on Corporations' Optional Standard Deduction

We strongly suggest retaining the Optional Standard Deduction (OSD) for corporations because this has actually resulted in ease of doing business and can improve overall revenue administration in the Philippines.

Currently, OSD allows for utmost convenience in preparing tax returns of business because the taxpayer just needs to deduct 40% of gross income from revenue to compute for income tax due, and there is no need to itemize their expenses. This simplifies the operations of businesses who avail of the OSD.

Firms contemplating investment are not only concerned about the formal tax system, but also about how the system works. A revenue administration that is perceived to be arbitrary or predatory discourages investments. Further, weaknesses in the enforcement capacity of the revenue administration put law-abiding firms at a competitive disadvantage, as their competitors in the informal sector are allowed to get away with tax evasion. Hence, maximizing voluntary compliance is a major objective of a revenue administration to do away with the need for an annual BIR audit. Moreover, the total cost of undertaking annual BIR audits may not be commensurate with the total amount of deficiency taxes that is being collected from BIR investigations.

The Philippine Tax System is based on the principle of voluntary compliance, that is, pay as you file. However, for this to be effective in achieving high levels of compliance, tax laws should be capable of convenient, effective and just administration. The tax system should be as simple as possible, clear, concise and capable of enforcement and convenient as to time and manner of how taxes are assessed, collected and complied with. Unfortunately, the determination of the validity of deductions from gross income under Section 34 of the Tax Code, as amended, has always been the subject of major dispute between taxpayers and revenue officers. This resulted in the issuance of assessments against taxpayers that exacerbated the clogging of the records of the BIR on unsettled assessments and which runs into billions of pesos.

To avoid being caught in such a scenario and to enable taxpaying firms to focus more on running their business rather than spending so much time and effort with revenue officers, many taxpayers have opted to avail of the OSD and paid taxes on the resulting taxable income thereon. This resulted in increased voluntary tax compliance and allowed the BIR to re-channel its resources to other more important revenue generating initiatives. Hence, to remove the OSD for corporations subject to tax under Section 27(A) and 28(A)(1) of the Tax Code, as amended, except for small, micro and medium enterprises as determined by the DTI would negate whatever benefit the OSD has generated through the years that it has been in place.

Section 10 of HB 8083 amending Section 40 (C) (2) (d) of the NIRC

The word "recapitalization" must be defined or at least must be illustrated by example so as to guide taxpayers. In other words, what qualifies as recapitalization? Is this restricted to infusion of additional capital without issuance of shares or otherwise known as additional paid-in capital? We would also suggest that the last paragraph of this proposed amending provision be reworded as follows:

> "All sale, exchange or transfer of property falling under subsection 40 (C) (2) shall not be subject to value-added tax."

Section 11 of HB 8083 amending Section 50 of the NIRC

The **definition of "tax avoidance" being introduced by this proposed amendment is dangerously so vague and general** that it practically closes all room for any taxpayer (whether individual or corporate) to engage in tax planning to minimize his/her taxes.

One of the key considerations of the Philippine government's tax reform program should be to improve Philippine competitiveness and attractiveness for investments and business growth. Stable, clear, and predictable tax rules and tax administration are critical in improving the Philippine investment environment. As regards intercompany transactions under Sec. 50, it is **time to be at par with regional neighbors by adopting best practices and developments in international taxation,** such as compliance with the arm's length principle, implementing transfer pricing rules, and allowing for agreement procedures and advance pricing agreements between treaty countries. The Philippines should **formalize in the amendment of Sec. 50 the adoption of the arm's length principle** (as mentioned in Revenue Regulations No. 2-2013) and follow the best practices and developments in international taxation.

Under the proposed amendment of Section 50, the Commissioner is authorized to make an adjustment or reconstruct a transaction as he or she wishes when the transaction is effected for bona fide business reasons as long as there is a tax impact. This section can be interpreted to mean that only transactions which the Commissioner will not adjust are those that result in tax increases. However, it is "tax evasion" that has been held to be illegal. In the Supreme Court case of CIR vs. The Estate of Benigno P. Toda (G.R. No. 147188 September 14, 2004), tax evasion is aptly differentiated from tax avoidance as follows:

> "Tax avoidance and tax evasion are the two most common ways used by taxpayers in escaping from taxation. <u>Tax avoidance is the tax saving device within the means sanctioned by law.</u> This method should be used by the taxpayer in good faith and at arm's length. Tax evasion, on the other hand, is a scheme used outside of those lawful means and, when availed of, usually subjects the taxpayer to further or additional civil or criminal liabilities.

> Tax evasion connotes the integration of three factors: (1) the end to be achieved, i.e., the payment of less than that known by the taxpayer to be legally due or the non-payment of tax when it is shown that a tax is due; (2) an accompanying state of mind which is described as being "evil," in "bad faith," "willful," or "deliberate and not accidental"; and (3) a course of action or failure of action which is unlawful." [Underscoring ours.]

We believe that, if the intention is to adopt general anti-avoidance rules (GAAR) similar to what other jurisdictions have, it should be embodied in a detailed manner through a special law for that purpose and not in some nebulously worded amendatory provision in the Tax Code. Otherwise, the lack of clarity of this provision will give the Bureau of Internal Revenue (BIR) a very wide latitude and unbridled discretion to question virtually any transaction that it feels is primarily tax-driven, thereby putting uncertainty to transactions and allowing potential harassment of taxpayers.

Section 13 of HB 8083 amending Section (A) and 112 (B) of the NIRC

We strongly recommend that a separate provision be inserted to amend Section 113 (Invoicing Requirements) of the Tax Code to state that the only details required for the valid recognition of input taxes from an official receipt or invoice shall be limited to: 1) name of the purchaser and 2) tax identification number, and nothing more.

Section 16 of HB 8083 amending Section 222 of the NIRC

We disagree with the proposal that the waiver of Statute of Limitations by the taxpayer can be done by simply writing a letter of application to the Commissioner of International Revenue. The benefit of the Statute of Limitations is all too important for taxpayers that strict rules against its waiver should not be relaxed.

We submit that the current rules consistently upheld by jurisprudence governing execution of waivers must be retained.

As so aptly stated by the Supreme Court in many cases, "rules derogating taxpayers' right against prolonged and unscrupulous investigations are strictly construed against the government." "The law on prescription should be interpreted in a way conducive to bringing about the beneficent purpose of affording protection to the taxpayer within the contemplation of the Commission which recommended the approval of the law. To the Government, its tax officers are obliged to act promptly in the making of assessment so that taxpayers, after the lapse of the period of prescription, would have a feeling of security against unscrupulous tax agents who will always try to find an excuse to inspect the books of taxpayers, not to determine the latter's real liability, but to take advantage of a possible opportunity to harass even law-abiding businessmen. Without such legal defense, taxpayers would be open season to harassment by unscrupulous tax agents." (SMI-ED Phil. Technology, Inc. v. Commissioner of Internal Revenue, G.R. No. 175410, November 12, 2014, citing Commissioner of Internal Revenue v. FMF Development Corporation, 579 Phil. 174 (2008).

Therefore, the current stringent requirements regarding waiver of the statute of limitations should be maintained, Otherwise it will be too easy for the BIR to extend the period of its tax audit of taxpayers.

Section 17 of HB 8083 amending Section 237 on E-invoicing

We commend the government's plan to address the difficulties faced by taxpayers in using manual invoices/receipts through the introduction of e-invoicing. However, we **highly suggest for the government to further simplify the e-invoicing process by adopting the best practice in our region on e-invoicing, that is, the experience of Korea.** We have compared the Korean practices and found that we only need to consider the following:

(1) **Clarity on receipt of e-invoice** – We **suggest the addition of a clause** that will recognize e-invoice upload to portal by supplier as "deemed receipt" by customer to avoid uncertainty on timing of receipt of e-invoice by customer. This will also enable transparency in the tax base that is readily available in the portal thereby allowing quicker and efficient combating of fraudulent transactions.

> "When an electronic receipt or commercial invoice has been sent to the electronic channel by a person supplied with goods or services, the person supplied with goods or services shall be deemed to have received the electronic tax invoice."

(2) **Archiving** – We **suggest the removal of the section requiring issuer of e-invoice to archive for 3 years** because it is better for the government to ensure that the portal is able to archive invoices. This will further bolster the need to adopt e-invoicing by taxpayers given that this reduces the compliance burden and costs incurred in archiving documents.

(3) **Standard/simplified format of invoices** – Removing the requirement for official receipts will avoid complexity in designing the e-invoice system, as the official receipt is unique to the Philippines. Other countries issue "invoice or tax invoice" only for simplification. Having the invoice as a standard document will also result in removing confusion of taxpayers on what to use for each transaction that only has resulted in input VAT disallowance during audits.

<u>FISCAL INCENTIVES</u>

Section 34 of HB 8083 introducing new Section 294 of the Tax Code

Limiting the incentives to three years of ITH and only two years of reduced CIT of 18% will definitely **make the Philippines less attractive** as an investment destination than its Asian counterparts, who not only offer better incentives but have better infrastructure, market size, and population with higher income levels.

We strongly recommend that the current arrangements for export firms located in PEZA and special economic zones continue for at least a decade in order to encourage existing export investors to expand, which will create more direct and indirect jobs and revenues.

The JFC, together with PEZA, IBPAP, CONWEP, and other stakeholders have already submitted data and studies that refute the DOF's proposition that this drastic reduction of incentives will be beneficial to the country. We trust that this information will be carefully considered by your Committee and by the esteemed Senators of this Chamber in deciding the final outcome of this important piece of legislation.

We also raise the following question about the new Section 294 of HB No. 8083 that creates confusion. Section 294 of HB No. 8083 provides that registered projects or activities under the strategic investments priority plan shall be qualified for any of the following income tax incentives:

1. ITH
2. Reduced CIT of 18% of the taxable income
3. Depreciation allowance of the assets acquired for the entity's production of goods and services (qualified capital expenditure)
4. Up to fifty percent (50%) additional deduction on the labor expense in the taxable year as a consequence of an increase in direct local employment
5. Up to one hundred percent (100%) additional deduction on the increment of research and development incurred in the taxable year
6. Up to one hundred percent (100%) additional deduction on trainings incurred
7. Up to one hundred percent (100%) deduction on infrastructure development
8. Deduction for reinvestment allowance to manufacturing industry
9. Enhanced net operating loss carry-over (NOLCO)
10. Up to fifty percent (50%) additional deduction on the increment of the domestic input expense incurred in the taxable year

From the above, we noticed that the additional allowable deductions (item nos. 3 to 10) were enumerated separately from the reduced CIT of 18% of the taxable income (item no. 2). In relation thereto**, is our understanding correct that these additional allowable deductions enumerated above (item nos. 3 to 10) will be allowed as deductions when the taxpayer is under the reduced CIT of 18%, or are they going to be allowed only as deductions when the taxpayer is under the regular CIT of 30%?**

The confusion is brought about by the 2nd provision of the proposed new Section 294 (A) (10) which provides thus:

> *"Provided, further, that in no such case shall an income tax incentive be extended beyond the initial grant of five (5) years, except those provided under Section 294 (A) (7) and (9), Sections 295, 296, and 297."*

Lastly, we recommend the retention of the phrase "in lieu of all national and local taxes" whether the registered exporter will be under the 15% CIT or 5% GIE, to protect the foreign investors from the arbitrary and whimsical tax assessments and regulatory requirements of LGUs.

We note that the reason why many foreign investors prefer to be registered under PEZA is because of the relative peace they enjoy from LGUs given the protection afforded to them by the existing provisions of the PEZA Law.

New Section 294 (B) – Exemption from Customs Duty

We are unclear on the rationale for the proposal to apply the 5-year limit on customs duty exemption (on importation of capital equipment and raw materials) to other non-Freeport Zone enterprises, when other ecozones like PEZA zones are also treated as separate customs territory. Is there substantial distinction between ecozones and freeport zones as far as customs duties are concerned? If there is none, why should ecozone enterprises be discriminated against?

Expansion Projects

Also **worrisome is the proposal** under the new Section 294 (B) **to limit the incentives of expansion projects** to duty exemption only of imported capital equipment and nothing else. What will then encourage foreign investors to expanding their operations in the country? We believe this will be counterproductive and will lead to investors expand their operations in other countries and generating employment in countries other than the Philippines.

New Section 294 (C) – Value Added Tax

We believe that the 90% export requirement for ecozone and freeport zone enterprises is very high before their importation can be exempt from VAT as well as their local purchases of capital equipment and raw materials, particularly during this time when the export market is very volatile due to ongoing tariff disputes between developed countries.

We propose to maintain the current 70% export requirement. Also, an exemption must be provided, that is, the 70% export requirement must be relaxed in cases of force majeure or unforeseen events that are beyond the control of registered export enterprises.

We also propose to maintain the VAT exemption of all PEZA and Freeport enterprises for all local purchases of goods and services as they normally do not have any use for input taxes passed on to them, instead of requiring them to go through the cumbersome and expensive process of filing of claims for refund.

There is frustration over the Philippine government's assurance to implement an effective VAT refund system as it has failed to do so in the last 30 years. Hence, it will be an administrative nightmare for the government to have to process the claims for refund of more than 4,000 PEZA-registered enterprises alone. Needless to state, this **system of refund will only result to trapped cash for many foreign investors, another cost of money they cannot afford**, not to mention the actual and real costs of having to hire tax counsels and/or accountants to process their claims for refund. Also, it goes against the intent of RA 11032 or "Ease of Doing Business Law," as experience has shown us that **processing of claims for refund in this country has never been easy but is in fact tedious and costly**.

New Section 294 (C) (3)

This provision, in relation to new Section 307 being proposed, **needs further clarification** as it seems to imply that all export enterprises (regardless of location) who fail to meet the 90% export requirement will be subject to VAT on their importation and local purchases of goods and services.

New Sec. 298 – Expanding the Function of Fiscal Incentives Review Board
New Section 299 – Composition of the FIRB

There is great wisdom in the saying that "why fix it, if it ain't broken." PEZA, which has consistently been tried and tested, is intended to be put under the FIRB. However, we believe that the integrity and efficiency of PEZA are beyond reproach with a **reputation worldwide of being the most reliable government agency in the Philippines makes this proposal unnecessary.**

We are wary of the proposal to give the Secretary of Finance veto power over the decision of the FIRB, a collegial body, when the former is already being proposed to sit as Chairman of the said Board and Co-Chair of all existing and future Investment Promotion Agencies (IPAs). It is a fundamental tenet in administrative law that an appointive government official is not supposed to review his own decision. We believe there is wisdom in not giving so much concentrated power to just one person.

Rather, **we support the idea that the Secretary of Trade and Industry (DTI) continue as head of the PEZA and the BOI** rather than giving an apex agency headed by the Secretary of Department of Finance (DOF) approval power over all IPAs as proposed by HB 8083. We believe that the determination of the qualification and registration of eligible registrants at all IPAs is primarily within the province of DTI and all IPA heads as **the registration and granting of incentives is precisely for the purpose of attracting foreign investments to promote inclusive growth and is only partly a fiscal decision.** Representation of the DOF and NEDA on the boards of the IPAs is already sufficient to give these agencies a stronger role in approving investment incentives in the context of their targeted costs and benefits to the economy and conformity to national economic development planning.

New Section 306 – Customs Duty Exemption on Capital Equipment

We suggest that a new paragraph be included in this provision to provide that transfers of machinery or equipment to TESDA or public schools (elementary or high school) due to technical obsolescence should be **exempt from all duties and taxes** like donor's tax and VAT even if done within 5 years but not less than 3 years.

New Section 307

This provision should be clarified in relation to the new Section 294 (C) (2) and (3) being proposed. It is not clear if exporters within ecozones and freeport zones are still exempt from VAT on local purchases of capital equipment and raw materials even if they fail to meet the 90% export requirement.

New Section 310 (Transitory Provision) Investments Prior to Effectivity of this Act

This new Section 310 **needs further clarification** in relation to Section 38 (Repealing Clauses) of HB 8083. This new Section 310 of HB No. 8083 provides that existing registered activities granted the ITH shall be allowed to continue with the availment of the said incentive for the remaining period of the ITH or for a period of five (5) years only, whichever comes first; Provided, that other tax incentives granted to existing registered activities, such as the five percent (5%) tax on gross income earned in lieu of all taxes, both national and local, shall be allowed to continue following the schedule stated herein:

A. Two (2) years for activities enjoying the tax incentive for more than ten (10) years;

B. Three (3) years for activities enjoying the tax incentive between five (5) and ten (10) years;

C. Five (5) years for activities enjoying the tax incentive below five (5) years.

Based on the foregoing, it appears that the period of availment of fiscal incentives (i.e., ITH and 5% GIT) for registered enterprises currently enjoying fiscal incentives is for a **maximum of five (5) years.**

However, one of the provisions in the repealing clauses reads, as follows:

> "Section 38. Repealing Clauses
>
> b. The provisions of the following laws, including the tax incentives, that are inconsistent with this Act **are hereby amended or repealed effective two (2) years from the**

implementation of this Act; Provided, that the tax treatment provisions of entities covered by special laws pertaining to energy, agriculture, and telecommunications shall be deferred for an additional two (2) years:

13. Sections 23 and 24 of Republic Act (RA) No. 7916, entitled "An Act Providing for the Legal Framework and Mechanisms for the Creation, Operation, Administration, and Coordination of Special Economic Zones in the Philippines, Creating for the Purpose the Philippine Economic Zone Authority (PEZA), and for Other Purposes"."

In relation to the above provisions, **is our understanding correct that the registered enterprises currently enjoying fiscal incentives will still enjoy the fiscal incentives provided under the current rules for two years from the effectivity of the Act** as provided in the repealing clause of HB No. 8083. After which, the provision in Section 310 of HB No. 8083, which provides for the duration of fiscal incentives **(i.e., maximum of 5 years)** of registered enterprises currently enjoying fiscal incentives, will apply. In other words, **is the period of availment of fiscal incentives for registered enterprises currently enjoying fiscal incentives for a maximum of 7 years**?

We hope and trust that our comments, suggestions, and questions will merit your considerations in the deliberations of this bill.

We sincerely appreciate your consideration of our comments, and look forward to any questions you may have on our proposals.

Sincerely yours,

JAMES WILKINS President American Chamber of Commerce of the Philippines, Inc of	**DAN ALEXANDER** President Australia-New Zealand Chamber Commerce of the Philippines	**JULIAN PAYNE** President Canadian Chamber of Commerce of the Philippines, Inc.
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