Fiscal Incentives for Export and Domestic Market-oriented Enterprises

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OUTLINE

1. The comprehensive tax reform program
2. CREATE
3. Policy trajectory
4. Policy recommendation

The tax reform packages were designed to provide income tax relief to the majority of the taxpaying community while generating revenues by increasing the tax on lifestyle products and services consumed by the top 1% wealthiest individuals.

	Increase/(decrease) in revenues
Provided **personal income tax** cuts for the lower income households, resulting in more disposable income.	**- P458.1 billion** *(from 2018 to 2022)*
Imposed **excise and VAT on lifestyle products and services** (sweetened beverages, tobacco, cosmetic procedures, and automobiles, among others).	**+ P1,104.2 billion** *(from 2018 to 2022)*
Enacted a **stimulus tax package for pandemic recovery,** through CREATE (by **lowering the corporate income tax** and providing time-bound tax relief covering selected establishments).	**- P148.4 billion** *(from 2021 to 2022)*
Increased documentary stamp taxes, provided tax amnesty on estate taxes, fuel marking, and financial taxes, among others.	**+ 212.2 billion** *(from 2018 to 2022)*
	+ P709.9 billion *(from 2018 to 2022)*

Prior to CREATE, at least 1,000 projects have enjoyed incentives for at least 20 years. Still, a 10-year transition period was provided to ALL existing projects.

Duration of incentive availment	Count of projects
0 to 9 years	6,152
10 to 19 years	3,069
20 to 29 years	**945**
30 to 39 years	**48**
40 years and above	**8**
Insufficient data provided	*519*
Total	**10,741**

Source: Pre-CREATE Masterlist representing data from IPA submissions as of 10 April 2021.

Prior to CREATE, tax incentives were granted **without** systematic assessment of fiscal costs and benefits.

CREATE modernized our fiscal incentives regime by enacting a performance-based, targeted, time-bound, and transparent tax incentives system.

Every peso granted as a tax incentive is a peso off the budget that could have been spent for infrastructure, health, education, and social protection that benefit all, and not only a few.

Performance based

Targeted

Time-bound

Transparent

From 2015 to 2020, we have granted P2.4 trillion in tax incentives, or an average of P407.4 billion per year, without a cost-benefit analysis to guide the grant.

Note: Tax incentives are composed of foregone revenues from the availment of income tax holidays, the use of the preferential 5 percent gross income earned tax, import VAT exemptions, and customs duties exemption. The data is sourced from the Bureau of Internal Revenue (BIR), the Bureau of Customs (BOC), and DOF staff computations.

CREATE modernized our tax code and follows OECD's guidance on enacting an effective and transparent framework for tax incentives.

1. Provide tax incentives **through tax laws only**. (Title 13 of the Tax Code)
2. Consolidate all tax incentives under the authority of **one government body.** (The expanded functions of the Fiscal Incentives Review Board includes the grant and monitoring of fiscal incentives.)
3. Administer tax incentives in a **transparent manner**. (CREATE required the Annual Tax Incentives Report and Annual Benefits Report for policy evaluation)
4. Calculate the amount of **revenue forgone**. (Captured under Investment Tax Expenditures of the Budget of Expenditures and Sources of Financing, as supplemented by the Annual Tax Incentives and Annual Benefits report.)
5. Carry out **periodic review** by assessing the extent to which they meet the stated objectives. (The continued availment of CREATE incentives is anchored on the realization of time-bound performance commitments.)
6. Collect data systematically and **monitor the overall effects and effectiveness of individual tax incentives**. (The Fiscal Incentives Review Board has standardized report templates that will soon be integrated into an online portal for incentives application and administration. The assessment of costs and benefits of providing tax incentives now form part of an annual review.)

Source: OECD (2019), OECD Investment Policy Reviews: Southeast Asia, retrieved from https://www.oecd.org/daf/inv/investment-policy/Southeast-Asia-Investment-Policy-Review-2019.pdf

The global policy trajectory is also noticeably shifting to consumption-based taxes.

Based on the IMF's Tax Change Indicator*, there is a sustained increase in the broadening of the VAT base and an increase in the VAT rate.

An opposite trend is observed covering income-based taxes, suggesting a deliberate shift in the revenue mix of governments, from income to consumption.

Source: Based on the Cross-Country Evidence on the Revenue Impact of Tax Reforms, as published by the IMF, the IMF Tax Policy Reform Database, OECD, and IBFD.
**Based on tax policy actions of 23 advanced and emerging market economies.*

The global policy trajectory is also noticeably shifting to consumption-based taxes.

Consumption taxes are less vulnerable to the effects of globalization.
(OECD, 2018)

Consumption taxes are seen to
be more progressive.
(ADB, 2022)

Consumption taxes are more neutral compared to income taxes,
as the former do not impact savings or investment decisions.
(Seidman, 1989; McCaffery, 2002; Frank, 2005; Bankman and Weisbach, 2006; Carroll and Viard, 2012)

There is consistent increase in the number of countries adopting the VAT.
(OECD Consumption Tax Trends 2022)

From 2016 to 2020, the Philippines posted the lowest VAT efficiency ratio in the ASEAN Region at 40 percent based on total consumption.

Philippines	**0.40**
ASEAN Average	**0.57**
Singapore	**0.71**
Vietnam	**0.70**
Malaysia	**0.48-0.29**
Thailand	**0.79**
Indonesia	**0.50**
Japan	**0.70**

Ideally, VAT exemptions are limited to essential goods and services, such as food, shelter, healthcare services, education, and selected medicines.

Prior to the passage of the reforms, the Philippine tax code contains **56 lines of exemptions*** and **84 additional exemptions in special laws.**

On average, or from 2016 to 2020, the Philippines collected **P723 billion** from VAT. This is **40%** of the expected VAT collection if **all consumption** were subjected to VAT.

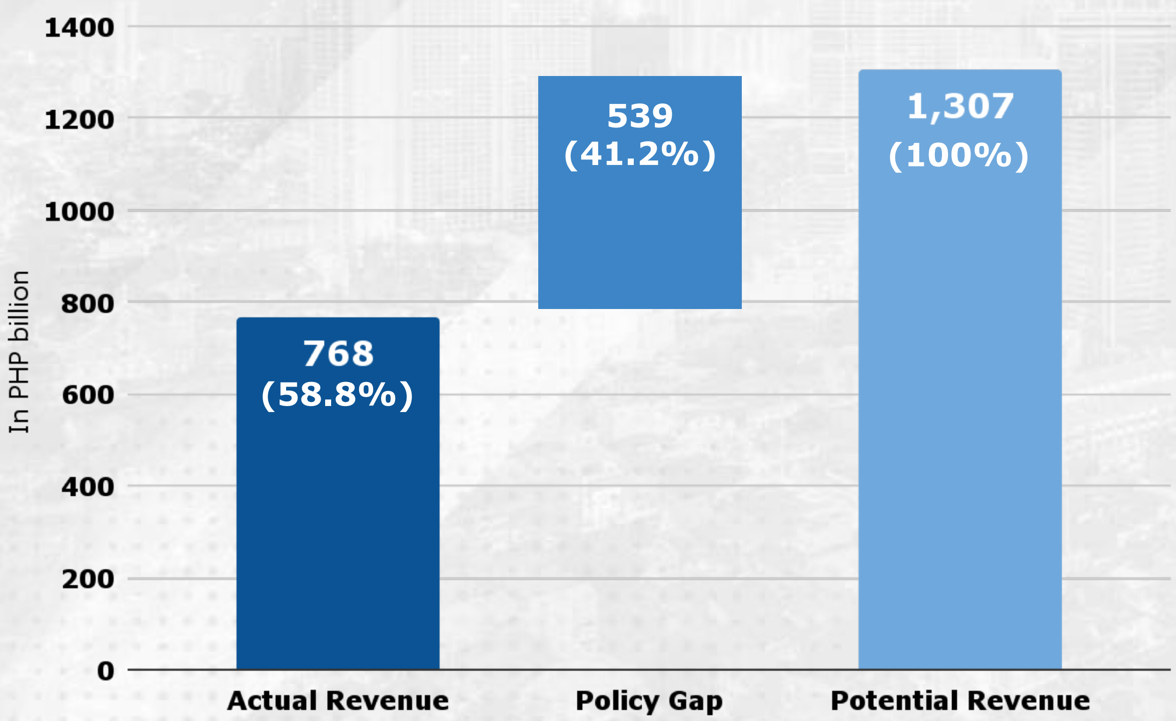
**of which 11 overlaps with special laws*

Note: The VAT efficiency represents the revenue obtained as a percentage of consumption or GDP, for each tax rate point.
For purposes of this slide, total consumption is used as the benchmark.

The Philippine tax system is also plagued with exemptions that are outside the tax code, which further complicates tax administration and dilutes the tax base.

Potential VAT revenues if administrative and enforcement issues are eliminated.

VAT Gap Analysis (World Bank, 2018)



Based on a 2018 study administered by the World Bank, the VAT exemptions provided, or the policy gap, amounts to P539 billion. *

**Using the existing rules and regulations covering VAT, and the related datasets, as of 2018.*

Note: Figures in parentheses are as a percent of potential revenue.
Source: World Bank

The Philippines has the highest VAT rate compared to ASEAN peers, but reports the lowest VAT efficiency.

Country	VAT/GST rate (2023)	VAT efficiency (2016-2020)	Local Purchases		Importations	
			REEs	DMEs	REEs	DMEs
Philippines	12%	0.40	0%	VATable	Exempt	VATable
Singapore	8%	0.71	0%	VATable	Exempt	VATable
Vietnam	8%	0.70	0%	VATable	Exempt	VATable, but may be exempted for certain goods and conditions
Malaysia	Goods: 10% Service: 6%	0.48 - 0.29	Exempt	VATable	Exempt	VATable
Thailand	7%	0.79	Exempt	Exempt, covering essential goods used in Industrial Estates and Customs Free Zones	Exempt	Exempt, covering essential goods used in Industrial Estates and Customs Free Zones
Indonesia	11%	0.50	Exempt	Exempt, covering selected goods used in Special Economic Zones	VATable, but may be exempted on certain goods	VATable, but may be exempted on certain goods

VAT efficiency = Ratio of VAT collection to total consumption, divided by VAT rate.
Note: *The comparative table is based on available resources and is subject to the detailed implementing rules and regulations of each country. The findings are primarily based on country-level tax summaries, as supported by the country-specific tax codes.*

REEs and DMEs are inherently different.

Data	REEs	DMEs
Target Market	International market	Domestic market
Type of Investment	Efficiency-seeking	Market-seeking
Reason for Investment	Decrease costs of production by transferring production to locations with lower costs	Expand customer base by penetrating the local market
Response to tax incentives	As exporters compete globally, overall cost reduction becomes their primary motivation, to further finance investments and better respond to the developing needs of the international market. Thus, the overall tax burden then becomes an important factor in the investment decision.	As market-seeking investments are designed to cater to the same domestic customers, the government must ensure a level playing field among competitors. However, incentives can be provided in domestic-oriented sectors that are nationally significant, to fast-track growth and nation building.

The distinction between registered exporters and domestic-market oriented enterprises must remain, to preserve the integrity of our tax framework.

1. **Consistent with the nature of VAT** - VAT is a **consumption tax**. Since goods produced by exporting firms are consumed outside the Philippines, it makes sense that they are not subjected to VAT. On the other hand, DMEs produce goods for local market consumption and are therefore subject to VAT.
2. **Consistent with Congressional intent** - Distinction is rooted in the intention of Congress acknowledging the **different needs, markets, and ability to generate profits** of REEs and DMEs.
3. **REEs and DMEs are inherently different** - Their customer base, their investment motivation, and their response to tax incentives are fundamentally distinct.
4. **Consistent with policy trajectory** - The policy of the government is to adhere to the principle of limiting the VAT zero-rating to exports.
5. **The VAT incentive policy is aligned with our ASEAN neighbors.**
6. **The revenue impact is significant, with an annual average of P34.1 billion, or P409.7 billion in one incentive cycle (for 12 years).**

For these reasons, we propose to preserve the existing rules.

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