USAID
FROM THE AMERICAN PEOPLE

EGAT/EG, Public Financial Management Project **June 2011**

Philippines

Summary and Conclusion

- The Philippines provides an example of a country that entered the last decade facing a lengthy decline in revenues and focused on sustained efforts throughout the decade to strengthen tax administration, simplify the tax system, and improve tax policy through base broadening and rate increases for CIT and VAT.
- Over the 2000 to 2010 period, secular declines in revenues were halted and policy measures were adopted to improve the buoyancy of the tax system through policy reforms. As a result, the Philippines tax revenue effort only decreased tax by 0.7 percent of GDP.
- Results for the 2008-09 fiscal year suggest that the Philippines' revenue effort from VAT is below that of regional and income-group comparator countries.
- Personal income tax revenue effort roughly in line of regional and income group comparator countries on average but corporate income tax revenue effort is below that of comparator group countries.
- The Philippines corporate income tax rate is 7-8 percentage points higher than comparator group averages while its personal income tax rate is a 3-5 percentage points above that of comparator group averages.
- The VAT rate is higher than the East Asia & Pacific region average but lower than income group and world averages.
- Income tax and VAT productivity is well below comparator group averages.

Major Developments and Features of Current Tax System

Evolution of Revenue

Over the period 2000 to 2010, the Philippines tax effort decreased by 0.7 percent of GDP with the majority of the decline in tax effort from indirect taxes. The composition of revenues shifted somewhat as the Philippines relied less on taxes on trade and individual income taxes and relied more on taxes on businesses and general consumption. (See table below).

- Income tax revenue effort averaged about 6.0 percent of GDP over the period with declines in PIT and other income taxes being offset by increases in CIT.
- Over the period, revenue effort from taxes on goods and services averaged about 7.3 percent of GDP with declines in international trade taxes and excises being offset by increases VAT.
- VAT revenue effort increased by 2. 3 percent of GDP from 1.6 percent of GDP in 2000 to 3.9 percent of GDP in 2010 as the Philippines increased the VAT rate and broadened the tax base over the period.

Philippines Tax Revenue
(% of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Tax Revenue	13.7%	13.5%	12.5%	12.8%	12.4%	13.0%	14.3%	14.0%	14.2%	12.8%	13.0%
Income Taxes	6.1%	6.2%	5.7%	5.7%	5.7%	6.0%	6.3%	6.4%	6.5%	5.7%	5.9%
PIT	2.5%	2.2%	2.2%	2.1%	2.1%	2.2%	2.2%	2.1%	2.0%	1.8%	..
CIT	2.6%	2.7%	2.5%	2.7%	2.7%	2.8%	3.2%	3.6%	3.9%	3.3%	..
Other Income Tax	1.0%	1.2%	1.0%	1.0%	1.0%	1.0%	0.8%	0.7%	0.6%	0.6%	..
Indirect Taxes	7.7%	7.3%	6.8%	7.1%	6.7%	7.0%	8.0%	7.6%	7.7%	7.1%	7.1%
VAT	1.6%	1.6%	1.7%	1.9%	1.6%	1.6%	2.3%	2.2%	1.9%	2.2%	3.9%
Tariffs	2.9%	2.7%	2.5%	2.5%	2.5%	2.6%	3.3%	3.2%	3.5%	2.9%	1.1%
Excises	1.8%	1.6%	1.4%	1.3%	1.2%	1.1%	1.0%	0.8%	0.8%	0.8%	0.9%
Other Indirect Taxes	0.7%	0.8%	0.7%	0.6%	0.7%	0.8%	1.4%	1.4%	1.4%	1.3%	1.2%
Other	0.6%	0.6%	0.5%	0.8%	0.6%	0.9%	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Government Finance Statistics, IMF

Summary of Reforms

Over the 2001 to 2010 period, the Philippine's revenue mobilization efforts primarily focused on strengthening the tax administration. Early in the decade, tax administration reform efforts primarily focused on improving voluntary compliance and taxpayer services supported by tax simplification to mitigate the secular decline in tax revenue that began in the previous decade and continued roughly through 2004. In the latter half of the decade, tax administration reform efforts continued to focus on improving voluntary compliance in addition to strengthening enforcement and control. These efforts were supported by technical Assistance from the USAID, MCC and others.

Illustrative reforms undertaken over the last decade include:

- 2001/02
  - Move to tax payer focus by:
    - Reform tax system to make it simpler
    - Reengineer tax processes for simplicity, efficiency and transparency
    - Restructure BIR to give it financial and administrative flexibility
    - HR transformation to focus on taxpayer needs
  - Implementation of voluntary assessment program and improved dispute settlement program
  - Expansion of withholding tax regime
  - Introduction of e-filing and e-payments.
- 2002/06
  - Tax amnesty introduced in 2002.
  - Introduced program to identify under declarations of tax.
  - Expanded e-services to registration, payments, filing and reporting.
  - Special operations conducted to address high profile tax evaders.
  - Registration of cash registers and POS machines.
  - Created tax payer service center at HQ and e-service centers in regional offices.
- 2006/07
  - Anti-evasion program and clean up of taxpayer register.
  - Expanded e-tax services for payments and complaints.
  - Nation-wide rollout of the Integrated Tax System.
  - Donor funded project—National Program Support for Tax Administration Reform—launched to improve tax compliance, tax enforcement, and control, etc.
    - Contributed to 13% increase in revenues; stabilized as share of GDP.

- 2007/08
  - Strengthened business intelligence by introducing data matching income withholding against tax declarations.
  - Introduced information sharing between BIR and local governments to strengthen local tax enforcement and compliance.
  - Introduced computer-assisted audit selection tools.
- 2008/09
  - Intensive enforcement campaign closing delinquent establishments
  - eCompliance facility to report non-compliant BIR staff and businesses
  - Revived reward scheme for frontline offices
- 2009/2010:
  - Public awareness campaign on enforcement and taxpayer services
  - Intensified filing of tax evasion cases
  - Conduct of Taxpayers Lifestyle Check
  - Improved linkages to other organizations to improve tax administration

Over the period, several key reforms were implemented by the Philippines to improve revenue mobilization and the buoyancy of the tax system, including:

- Increase excises and introduce automatic bi-annual escalation of rates (2005)
- VAT reform/base expansion (2005)
- Increased CIT rate from 32 to 35 percent. (2005).
- VAT increased from 10 to 12 percent in February 2006.
  - The revenue impact of this reform was short-lived as improvements in tax administration did not materialize.

Tax System Profile (2008-09)

The attached tables provide a high-level profile of the Philippines tax system and compare it with the East Asia & Pacific Region, other low-middle-income countries, and the rest of the world.

Revenue Performance

- The Philippines revenue effort from personal income tax (2.0% of GDP) is below that of the EAP region (3.6% of GDP), the income group (2.5% of GDP) and world averages (3.4% of GDP).
- Corporate income tax revenue effort (3.8% of GDP) is broadly in-line with the EAP average (4.2% of GDP) and modestly above that of the income group (3.4% of GDP) and world averages (3.3% of GDP).
- The revenue effort from VAT (4% of GDP) is below that of regional (5.3% of GDP), income group (5.8% of GDP) and world averages (6.4% of GDP).

Tax Structure

- The maximum PIT rate in the Philippines, at 32 percent, is modestly above that of regional, income group and world averages.
- The Philippines corporate income tax rate, at 32 percent, is above that of regional, income group and world averages that are in the 24 percent to 25.3 percent range.
- The VAT rate, at 12 percent, is 1.5 percentage points higher than the regional average and below that income group and world averages that are in the 14.9 to 15.8 percent range.

Revenue Productivity

- Corporate income tax productivity, at 0.12 percent of GDP of revenue for each percentage point of tax rate, is well below the EAP region average of 0.18 and below that of income group and world averages, at 0.14.
- Personal income tax productivity, at 0.07, is half the regional average and world averages and below that of the income group average (0.11).
- Similarly, VAT productivity, at 0.33, is significantly below regional, income group and world averages. Similarly, the VAT gross compliance ratio is significantly below that of comparator country averages.

Taxpayer Burden and Corruption Evidence

- Enterprise surveys by WB indicate that the percentage of the Philippines business taxpayers "expected to give gifts in meeting with tax officials" is 21.8 percent which is above the East Asia & Pacific average of 19.1 percent and well above the world average of 16.7.

- The WB Doing Business survey estimates that the average time required for Paying Taxes by a medium-sized company in the Philippines amounted to 195 hours per year in early 2010 – somewhat lower the average of 218 hours for other East Asia & Pacific region countries and unchanged from the time estimated for the Philippines in 2006.

ANNEX A: The Philippine's Collecting Taxes Indicators (FY 2008-09)

Company Income Tax	CITR	CITY	CITPROD
	Tax Rate	Revenue as % GDP	Revenue Productivity
Philippines	32.00	3.80	0.12
East Asia and Pacific	24.00	4.20	0.18
Low-Middle-Income Economies	24.68	3.42	0.14
World	25.32	3.33	0.14

Income Taxes on People	PITMINR	PITMINL	PITMAXR	PITMAXL
	Minimum Tax Rate	Minimum Income Level (Multiples of GDP_{pc}	Maximum Tax Rate	Maximum Income Level (Multiple of GDP_{pc}
Philippines	5.00	0.37	32.00	6.34
East Asia and Pacific	8.98	1.19	29.03	15.65
Low-Middle-Income Economies	11.35	1.28	26.76	10.36
World	11.69	0.86	29.63	9.78

Income Taxes on People	PITY	PITPROD	SSR	WEDGE
	Revenue as % GDP	Revenue Productivity	Mandatory Combined Social Contribution Rates	Combined Rate of Personal and Labors Taxation
Philippines	2.00	0.07	9.70	12.90
East Asia and Pacific	3.58	0.14	13.91	16.81
Low-Middle-Income Economies	2.48	0.11	16.87	19.98
World	3.36	0.13	16.16	20.61

Value Added Tax	VATR	VATY	VATGGR	VATPROD	THRESHOLD
	VAT rate	Revenue as % GDP	Gross Compliance Ratio	Revenue Productivity	Mandatory registration/ filing (annual turnover in USD)
Philippines	12.00	4.00	47.30	0.33	32,492.00
East Asia and Pacific	10.42	5.25	74.48	0.48	76,803.95
Low-Middle-Income Economies	14.90	5.80	60.40	0.39	35,144.00
World	15.77	6.37	65.48	0.41	38,066.55

Deloitte.

Philippines Tax Highlights 2011

Currency: Philippine Peso (PHP)

Foreign exchange control: Foreign currency may be bought and sold freely by residents (including foreign corporations operating in the Philippines) and may be brought into or sent out of the country with minimal restrictions. Nonresidents also may hold foreign currency.

Accounting principles/financial statements: IAS/IFRS. Financial statements must be prepared annually and audited by an independent CPA.

Principal business entities: These are the corporation (stock/non-stock), partnership, sole proprietorship, regional headquarters (RHQ), regional operating headquarters (ROHQ), representative office and branch of a foreign company.

Corporate taxation:

Residence – A corporation is resident if it is incorporated in the Philippines or, if incorporated outside the Philippines, it has a branch in the Philippines.

Basis – Philippine corporations are taxed on worldwide income; nonresident companies are taxed only on Philippine-source income. A foreign corporation with a branch in the Philippines is taxed on Philippine-source income.

Taxable income – Corporate tax is imposed on a company's profits, which generally consist of business/trading income. Normal business expenses may be deducted in computing taxable income.

In lieu of itemised deductions, a domestic and resident corporation may elect to use the optional standard deduction (OSD), which may not exceed 40% of the total gross income, in computing taxable income for the taxable quarter/year. Once an election is made to use the OSD, it is irrevocable for the taxable year for which the return is made.

Taxation of dividends – Dividends received by Philippine and resident foreign companies are not subject to tax.

Capital gains – Capital gains are generally taxed as income. However, gains on the sale of shares not traded on the stock exchange are subject to a 5% withholding tax on the first PHP 100,000, and 10% thereafter. Gains on the sale of shares listed and traded on the stock exchange are taxed at one-half of 1% of the gross selling price. Gains derived from the sale of real property not used in a business are subject to a 6% final withholding tax based on the sales price or fair market value, whichever is higher.

Losses – Losses may be carried forward for 3 years unless the taxpayer benefits from a tax incentive or exemption. Losses may not be carried forward where the business undergoes a substantial change in ownership. The carryback of losses is not permitted.

Rate – Philippine corporations are taxed at a rate of 30%. The rate for regional operating headquarters is 10%.

Surtax – A 10% surtax is imposed on improperly accumulated earnings.

Alternative minimum tax – A minimum corporate income tax (MCIT) equal to 2% of gross income is imposed on both domestic and resident foreign corporations beginning in the fourth taxable year of operations. The MCIT is imposed in each quarter of the taxable year when a company has no or negative taxable income or when the amount of the MCIT is greater than the corporation's normal income tax liability. Any excess of MCIT over the normal income tax may be carried forward and credited against the normal income tax for the subsequent 3 taxable years.

Foreign tax credit – Foreign tax paid by a domestic corporation may be credited proportionately against Philippine tax on the same profits, but the credit is limited to the amount of Philippine tax payable on the foreign income.

Participation exemption – No

Holding company regime – No

Incentives – Incentives are provided under the Omnibus Investment Code of 1987 (administered by the Board of Investment) and Special Economic Zone Act of 1995. Incentives usually include fiscal (e.g. income tax holidays) and non-fiscal incentives (e.g. simplification of custom procedures for imports and exports). Other incentives are granted to enterprises engaged in specified business activities.

Withholding tax:

Dividends – Dividends distributed by a Philippine company to a nonresident are taxed at 15%, provided the country of the nonresident foreign corporation allows a tax credit of 15%. Otherwise, the dividends are taxed at 30%. The withholding tax may be reduced by a tax treaty, subject to a confirmatory ruling from the Bureau of Internal Revenue (BIR).

Interest – Interest paid to a nonresident is subject to a 20% withholding tax, unless the rate is reduced under a tax treaty, subject to a confirmatory ruling from the BIR.

Royalties – Royalty payments made to a nonresident are subject to a 30% withholding tax, unless the rate is reduced under a tax treaty, subject to a confirmatory ruling from the BIR. A 20% final withholding tax is levied on royalty payments made to a domestic or a resident foreign corporation.

Branch remittance tax – A 15% branch profits tax is levied on the after-tax profits remitted by a branch to its head office.

Other taxes on corporations:

Capital duty – No

Payroll tax – A corporate employer is required to withhold tax on the compensation of its employees.

Real property tax – A property tax is imposed on real property at a rate that depends on the location of the property. The tax should not exceed 3% of the assessed value per the tax declaration.

Social security – The employer makes monthly contributions to the social security system corresponding to the salaries of covered employees. The maximum monthly contribution for an employee in the highest salary bracket is PHP 1,090.

Stamp duty – Various rates of duty apply depending on the type of document.

Transfer tax – Gratuitous transfers of property are subject to a donor's tax at graduated rates ranging from 2% to 15% or 30% of the fair market value of the property at the time of the donation.

A local transfer tax on real property is levied at a rate of 50% of 1% of the gross sales price or fair market value of the property, whichever is higher, on the transfer or sale of real property.

Other – A percentage tax of 3% to 7% is imposed on certain types of businesses, such as banks, finance companies, insurance companies and common carriers, except domestic carriers that transport passengers by air, which is subject to VAT.

Anti-avoidance rules:

Transfer pricing – There are no formal transfer pricing rules, but the OECD transfer pricing guidelines are being used until the tax authorities issue transfer pricing regulations.

Thin capitalisation – No

Controlled foreign companies – No

Other – No

Disclosure requirements – No

Administration and compliance:

Tax year – A calendar year or fiscal year (an accounting period of 12 months ending on the last day of any month other than December) may be used.

Consolidated returns – Consolidated returns are not permitted; each company must file a separate return.

Filing requirements – The tax return must be filed, with or without payment, on or before the 15th day of the fourth month following the close of the taxpayer's taxable year.

Penalties – Late payments incur a penalty equal to 25% of the amount due. Annual interest of 20% is assessed on the unpaid amount from the due date until fully paid. A compromise penalty will be based on the tax due exclusive of the 25% surcharge and 20% interest.

Rulings – The tax authorities will issue advance rulings on the tax consequences of a contemplated transaction at the request of a taxpayer.

Personal taxation:

Basis – Resident citizens are taxed on worldwide income; resident aliens and nonresidents pay tax only on Philippine-source income. However, foreign individuals can avail themselves of preferential tax treatment or may be exempt from income tax under applicable tax treaties, subject to a confirmatory ruling from the BIR.

Residence – All citizens are ordinarily considered resident unless they meet the requirements to be deemed nonresident. The residence of foreign workers is generally established when the aggregate length of stay in any calendar year exceeds 180 days.

Filing status – Married couples in the Philippines who do not derive income only from compensation always must file a joint income tax return.

Taxable income – Taxable personal income is all income less allowable deductions and personal exemptions. It includes compensation, business income, capital gains (arising from the sale of real property and share transactions), dividends, interest, rents, royalties, annuities, pensions and a partner's distributive share of the net income of general professional partnerships.

Minimum wage earners (MWEs) are exempt from the payment of income tax on their taxable income. Holiday pay, overtime pay, night shift differential pay and hazard pay received by MWEs also is exempt. However, an employee who receives/earns additional compensation, such as commissions, honoraria, fringe benefits, benefits in excess of the non-taxable ceiling of PHP 30,000 taxable allowances and taxable income other than the exempt remuneration mentioned above, does not qualify as an MWE and, therefore, the individual's earnings are not exempt from income tax.

In lieu of itemised deductions, an individual may elect to use the optional standard deduction (OSD), which may not exceed 40% of total gross income, in computing taxable income for the taxable quarter/year. Once an election is made to use the OSD, it is irrevocable for the taxable year for which the return is made.

Capital gains – An individual is subject to capital gains tax on the sale of real property at a rate of 6% of the gross sales price or current fair market value, whichever is higher. An individual is also subject to capital gains tax on the sale of shares not traded on the stock exchange at a rate of 5% of the net gain not exceeding PHP 100,000, and 10% on the excess. Gains derived from the sale of shares listed and traded on the stock exchange are taxed at one-half of 1% of the gross sales price.

Deductions and allowances – Subject to certain restrictions, deductions are granted for premium payments on health and/or hospitalisation insurance. Personal allowances are available to the taxpayer and his/her spouse, and qualified dependent children.

Rates – Individual income tax is charged at progressive rates from 5% to 32%. Individuals occupying managerial and highly technical positions employed by RHQs, ROHQs, multinational companies, offshore business units and petroleum service contractors/subcontractors are taxed at 15% on their gross income.

Other taxes on individuals:

Capital duty – No

Stamp duty – Various rates of duty apply depending on the type of document.

Capital acquisitions tax – No

Real property tax – A property tax is imposed on real property at a rate that depends on the property's location. The tax should not exceed 3% of the assessed value per the tax declaration.

Inheritance/estate tax – Tax is imposed on the net estate of both residents and nonresidents at rates between 5% and 20%.

Net wealth/net worth tax – No

Social security – An employee is required to pay monthly contributions (ranging from PHP 33.30 to PHP 500) to the social security system based on his/her salary bracket. The employer also makes a contribution.

Administration and compliance:

Tax year – Calendar year

Filing and payment – Tax returns are due on or before 15 April after the close of the tax year. Tax on compensation income is withheld monthly by the employer either manually or through the Electronic Filing and Payment System on or before the 10th day of the month following the month in which withholding was made for the months of January to November, and on or before 15 January of the following year for the month of December.

Individuals receiving only compensation income from 1 employer during the taxable year may qualify for substituted filing provided the amount of tax due equals the amount of tax withheld by the employer at the end of the taxable calendar year. In case of married individuals, the same requirements must be met to qualify for substituted filing.

Penalties – Late payments incur a penalty equal to 25% of the amount due. Annual interest of 20% is assessed on the unpaid amount from the due date until fully paid. A compromise penalty will be based on the tax due exclusive of the 25% surcharge and 20% interest.

Value added tax:

Taxable transactions – VAT is imposed on most sales of goods and services.

Rates – The sale and import of certain goods and services are subject to a 12% VAT. Certain sales are zero-rated.

Registration – The registration threshold for VAT purposes is PHP 1.5 million.

Filing and payment – The return/declaration may be filed either manually or through EFPS not later than the 20th day following the close of the month (for the monthly returns) and not later than the 25th day following the close of each taxable quarter (for quarterly returns).

Source of tax law: National Internal Revenue Code of 1997, as amended and other regulations; Local Government Code of 1991; Tariff and Customs Code; and Supreme Court decisions

Tax treaties: The Philippines has concluded around 40 tax treaties.

Tax authorities: Bureau of Internal Revenue (national taxes); City/Municipal Treasurer's Office (local taxes); Bureau of Customs

International organisations: APEC, ASEAN, UN, IMF, G-24