Technical Report

Risk Assessment of Taxation in Motor Vehicle Registration & Land Transport Franchising: #6 of 6 reports for an

Integrated System of Motor Vehicle Registration, Land Public Transport Franchising, Insurance, and Taxation

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Preface

This report is the result of technical assistance provided by the Economic Modernization through Efficient Reforms and Governance Enhancement (EMERGE) Activity, under contract with the CARANA Corporation, Nathan Associates Inc. and The Peoples Group (TRG) to the United States Agency for International Development, Manila, Philippines (USAID/Philippines) (Contract No. AFP-I-00-00-03-00020-00 Delivery Order 800). The EMERGE Activity is intended to contribute towards the Government of the Republic of the Philippines (GRP) Medium Term Philippine Development Plan (MTPDP) and USAID/Philippines' Strategic Objective 2, "Investment Climate Less Constrained by Corruption and Poor Governance." The purpose of the activity is to provide technical assistance to support economic policy reforms that will cause sustainable economic growth and enhance the competitiveness of the Philippine economy by augmenting the efforts of Philippine pro-reform partners and stakeholders.

EMERGE received an unsolicited grant proposal from the Asian Institute of Management (AIM) Ramon V. del Rosario, Sr., (RVR) Center for Corporate Responsibility dated August 1, 2005, entitled "Improved Coordination among Regulatory and Tax Administration Agencies: Towards Improved Tax Collection." As the design of the activity was refined, it was endorsed on January 20, 2006, by the heads of four counterpart agencies: Chairperson Maria Elena Bautista, Land Transportation Franchising and Regulatory Board (LTFRB), Commissioner Jose Mario C. Buñag, Bureau of Internal Revenue (BIR), Commissioner Evangeline Escobillo, Insurance Commission (IC), and Assistant Secretary and Chief, Anneli Lontoc, Land Transport Office (LTO). The counterparts called for technical assistance through the proposed grant to help them develop an **"Integrated System of Motor Vehicle Registration, Land Public Transport Franchising, Insurance and Taxation**" program, in order to 1) reduce transaction costs and business risks in the registration and insurance of motor vehicles, and in franchising and insurance of land transportation, and 2) improve the collection of taxes and fees from land transportation franchising, motor vehicle registration and insurance through third party information.

The specific objectives of the activity were:

1. To review and analyze the business processes and their accompanying organizational structures and level of ICT support, which are pertinent to motor vehicle registration, land public transport franchising, and transport sector taxation;
2. To identify possible areas of interface and harmonization of requirements in the processes undertaken by the LTO, LTFRB, BIR, and IC, which include but are not limited to data generation, processing, and analysis;
3. To design an improved and integrated system for motor vehicle registration, land public transport franchising, and transport sector taxation; and
4. To design a change plan for the introduction and adoption of the integrated system in objective 3.

The EMERGE grant was approved by USAID on March 20, 2006. The AIM team consisted of Felipe Alfonso & Francisco Roman, Jr., Project Leaders, John Paul Vergara, Team Leader 1, Dennis Beng Hui, Team Leader 2, Romulo Miral, Jr., Task Manager, and others. Upon completion of its work the AIM/RVR Center submitted the following reports detailing the results of their work with the counterpart agencies:

I. **"Integrative Report,"** describing the project background and the major findings and recommendations of the study. Also included as appendices are:

- Draft MOA for Linkage on Compulsory Third Party Liability Insurance Reporting, among IC, LTO and BIR
- Draft MOA for Linkage on Colorum Vehicle Reporting, between LTO and LTFRB
- Draft MOA for Linkage on Tax-Related Information on Transport Operators, between LTFRB and BIR
- LTO Office Order No. 151-2006 dated May 17,2006 on the Creation of Study Group to Update LTO Operations Manual
- LTO Memorandum dated October 30,2006 on Monitoring and Reporting of Transaction Inefficiencies

II. **"Motor Vehicle Registration Report,"** containing the motor vehicle registration process documentation, diagnostics of the process, and proposed systems and process improvements;

III. **"Draft of Updated Land Transportation Office (LTO) Operations Manual,"** which was prepared by an LTO study group with the facilitation and guidance of the AIM project team;

IV. **"Land Transport Franchising Report,"** containing the land transportation franchising process documentation, diagnostics of the process, and proposed systems and process improvements;

V. **"Draft Land Transportation Franchising and Regulatory Board (LTFRB) Guidebook,"** which is a step-by-step guide in operationalizing the proposed process improvements in the Application/Extension of Validity of Franchise and Confirmation of Franchise, which represent the bulk of the transactions at the LTFRB; and

VI. **"Risk Assessment of Taxation in Motor Vehicle Registration and Land Transport Franchising,"** which looks at the problems and proposed systems improvements in motor vehicle registration and transport franchising within a tax revenue risk assessment framework.

The views expressed and opinions contained in these reports are those of the authors and are not necessarily those of USAID, the GRP, EMERGE or its parent organizations.

INTEGRATED SYSTEM OF MOTOR VEHICLE REGISTRATION,
LAND TRANSPORT FRANCHISING,
TAXATION, AND INSURANCE

RISK ASSESSMENT OF TAXATION IN MOTOR VEHICLE REGISTRATION AND LAND TRANSPORT FRANCHISING

HILLS PROGRAM ON GOVERNANCE-
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1. BACKGROUND

Tax evasion in the public land transport system may be said to be widespread among "colorum" operators that operate exclusively outside the purview of the Land Transport Franchising and Regulatory Board. While the LTFRB is a government body tasked to regulate the public land transportation system, it is well known that many operate as public utility vehicles even without valid transport franchises. It is also likely that these colorum operators are also non-taxpayers, since as part of its regulatory function, the LTFRB requires operators to present the Taxpayer Identification Number (TIN) and BIR registration during franchise renewal/extension or yearly confirmation. The absence of documents that point to their existence as potential taxpayers may embolden them to evade taxes collected by the BIR.

However, to assume that valid franchise holders are also taxpayers may not be entirely accurate, as shown by a recent collaboration between the BIR and LTFRB. In an exercise that confirmed the value of information sharing, the BIR had found that at least 28% of franchise holders do not have valid TINs. Having no TINs, it may be assumed that they are also non-taxpayers. A further analysis of the data, as assisted by the project, shows that only about 1% had actual tax payments in 2004. The estimates of the potential risk to taxation are computed in this paper, both as a result of weaknesses found in land transport franchising and motor vehicle registration, regulated by the Land Transportation Office. The estimated risks represent the potential benefits to the collection of taxes should the weaknesses in the systems be corrected.

Risk, in the context of this paper, pertains to uncertainties characterizing "losses" in internal revenue taxes collected from motor vehicle registration and franchising. Losses refer to actual uncollected taxes coming from foregone revenues that have persisted in this industry. The risks to revenues from motor vehicle registration and franchising therefore are factors that contribute to the leakage of taxes.

The value of uncollected amounts is substantial. Initial assessments show that owners of public utility vehicles (jeepneys and taxicabs) may be paying a mere 5% of potential taxes in the form of the common carriers tax (see Appendix C for computation). The incentive to do so is high since a provision of the Tax Law prescribes a minimum quarterly income[1] that operators must at least declare. Strict and fair application of the law must mean that one properly (higher) declare his true gross income for taxation purposes. However, the inability of tax administrators to verify these declarations by many transport operators against independent external data makes the possibility of paying the tax, in an amount that is much lower than what should be, very high.

[1] Section 117 of the current tax code provides for a minimum declaration of gross quarterly income for different operators in and around Metro Manila.

With the purpose of streamlining registration and franchising in the LTO and LTFRB, the project has also as its objective to raise tax revenues as a result of the streamlined processes. Efficient methods and streamlined procedures are thus developed, and at times weighed, in order to attain these twin-objectives.

It is hoped that the proposed methods can eliminate the risks to tax collections in the transport sector. But given the complexities and limitations set by the BIR itself, in relation to, and by the Transport Agencies themselves[2], it may be expected that not all of the risks can be eliminated. These residual risks will be identified in this paper, with the hope of helping to manage them in the future.

[2] For the BIR, risk arises because the geographical groupings of taxpayers are not similar to the groupings of operators found within the LTFRB. As a result, matching possibilities are limited because of taxpayer jurisdiction that BIR district offices practice. Risk may also persist because of difficulties linking with LTO data that is managed by Stradcom- a private, profit oriented IT provider of the LTO.

2. RISKS AND UNCERTAINTIES IN TAX COLLECTION FROM THE TRANSPORT SECTOR

2.1 Definition of risk

Risk analysis considers both the magnitude of an exposure or loss (in monetary value), as well as the width of confidence level associated with the estimated value. Formally, risk analysis or risk assessment measures the magnitude of the **potential loss (L)**, and the **probability (p)** that the loss will occur.

(1)	$R_i = L_i \, p(L_i)$	where R ~ risk, L ~ potential loss, p ~ probability
(2)	$R_{total} = \sum_i L_i \, p(L_i)$	i = 1,…,n

Determining risk is therefore a 2-step process. In the realm of taxation, the first step is to quantify the amount of taxes that is potentially lost (or remain uncollected) as a result of exploiting a particular vulnerability of a transaction, in this case from motor vehicle registration and land transport franchising. Next would be to determine the possibility or likelihood of tax-leakage occurring.

A vulnerability is a flaw or a weakness found within a system. Resulting tax leakages occur because vulnerabilities have been exploited. It is therefore useful to expose these vulnerabilities.

Risk assessment is one step in the total consideration and management of risk, called risk management[3]. In a series of steps that are sequentially carried out, risk management considers:

> First, the particular context in which the agency operates. It considers the environment, the goals, strategic directions, values and culture that affect the actual operation of the agency.

[3] "Risk Management – Practice Note". Centre for Tax Policy and Administration. OECD. 2001.

Second, measures the current and potential risk by estimating both the losses and probabilities of occurrence.

Third, assessment of risk to determine prioritization. This may be carried out by ranking the calculated risks.

Fourth, provides for the risks by avoiding where possible, reducing its likelihood, transferring the risk, or by retaining the residual uncertainty.

Changing systems that totally or partially eliminate the uncertainty is often the solution chosen to reduce or treat risks. On the other hand, transferring risk is usually possible by legislation or policy shifts[4].

In many instances, even after "treating" these risks, residual uncertainties remain and may have to be approached with appropriate contingency mechanisms.

Risk management therefore, is the process of identifying risk, assessing risk, and taking steps to reduce risk to an acceptable level.

In practice, calculating and ranking risks, for sequential risk management, is done quantitatively and/or qualitatively. The advantage of a quantitative risk analysis is that it provides a measurement of the magnitude of impact, which plays a major role when conducting a cost-benefit analysis leading to recommended risk controls. However, the disadvantage is that the meaning of the quantitative risk analysis is often unclear, requiring the result to be interpreted in a qualitative manner[5]. In addition, quantitative measures are also often viewed as misleading in that it creates an illusion of certainty and accuracy, analyzing risk by qualitative methods will often suffice for decision-making purposes.

This section interprets and presents the project objectives in a risk management framework.

First, it presents the tax environment within which the tax administration and the taxpayers function, highlighting the particular context of transport registration and public utility vehicle franchising.

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[4] A recent news article announced that the DOF has agreed with the BIR request to transfer the accountability of tax collections from T-Bills back to the government, even if the collections are internal revenue taxes. With about a P4 billion deficit from these taxes from Jan-Jun 2006, this move effectively transfers the revenue risk away from the BIR. This is effective beginning 2007.

[5] "Risk Management Guide for Information Technology Systems". National Institute of Standards and Technology. July 2002.

Second, within this context lie specific risks to the proper collection of taxes for each sector. Identifying these risks requires exposing vulnerabilities, whose exploitation necessarily leads to tax leakages.

Third, it will assess the risks by present estimates of losses in taxes that occur from the practice of particular vulnerabilities in the system of assessment and collection. It will also present the likelihood of the occurrence.

Lastly, to put the exercise in perspective, the paper will discuss the remaining risks, focusing on the future impact to the tax administration.

2.2 The Tax Environment: Administration and Taxpayer Behavior

The Bureau of Internal Revenue (BIR) is responsible for collecting about 78%[6] of the country's tax revenues. These are categorized into 5 major tax types as income taxes, VAT, excise taxes, percentage taxes and other business taxes. Of which in 2005 (or for any given year) the largest, and majority of taxes paid, are income taxes both corporate and individual.

Table 1. Contribution per Tax Type to Total 2005 BIR Collections

Tax Type		Contribution to Total BIR Collection (percent)
I	Income Tax	54
II	Excise Tax	9
III	VAT	22
IV	Percentage	6
V	Others	9

The contribution of VAT is expected to increase to 25% for 2006 because of the expansion in coverage of the tax, and the increase in rate from 10% to 12% as provided for by the expanded VAT law in 2005.

[6] In 2004, data from the DBM's Fiscal Planning Bureau shows that BIR taxes contributed 78% while the BoC contributed about 20%. The rest were collected from fees and taxes from other agencies.

The collection of taxes is split between 2 major groups, the Large Taxpayers Service (LTS) which is responsible for about 50-55% of total taxes, and 19 Revenue Regions (RR) each headed by a Regional Director. Collectively, they are responsible for the 45-50% of tax collections from all over the Philippines. The RR's are further subdivided into 115 Revenue District Offices (RDO) headed by a Revenue District Officer (also RDO).

Each RDO takes responsibility for assessing, collecting, auditing and educating taxpayers that fall within its geographical subdivision. It is also his responsibility to update its taxpayer database for any increase or decrease in the number within his jurisdiction. The latter occurs if taxpayers relocate to a different jurisdiction, or if they cease to exist. Historical payment performance and pending delinquencies by any single taxpayer is known best by the RDO to which he belongs.

The manner of paying taxes in the Philippines is often referred to as a system of "self assessment". This is so because a large majority of statutory taxes are declared by taxpayers and filed with the BIR according to a schedule of deadlines that is mapped out by the internal revenue code. Only a few taxes are collected on a "withholding" basis. These include withheld taxes on wages, creditable income, final income, and VAT for certain contracted services. For the most part, private revenues, costs, and resulting taxes are declared by the taxpaying public with the BIR. But this is not to say he has total control and freedom to declare any amount he wishes, for he does so with the risk of being investigated or audited by the Bureau.

The level of compliance for any tax administration is also dependent on taxpayer behavior, particularly on taxpayer's perception of the ability to enforce tax laws.

In assessing the effectiveness of tax administrations, it is indispensable to also study it in terms of taxpayer behavior[7]. In turn, taxpayer behavior is a consequence of different aspects such as:

- Risk of detection of non-compliance, and the severity of consequences.
- Quality of assistance provided by the RA to enable taxpayers to comply with their legal obligations.
- Effectiveness of the RA in resolving taxpayer problems.
- Public perception regarding the degree of corruption in the RA.
- RA morale and self-image.

[7] A Diagnostic Framework for Revenue Administration. World Bank Technical Paper No. 472. 2000.

In the Philippines it is well known that tax compliance is low. An SWS survey[8] on enterprises show that only 35% of the respondents say that all in their particular industry issue receipts. And that only 11% say that all pay their taxes honestly.

As stated above, part of the reason for low compliance is confusion from complex transactions and requirements. Respondents from the same survey lament that there has been no perceived improvement towards clearer and less complex transactions of the Bureau[9].

Part of the survey is a net sincerity rating of different government agencies in their drive against corruption. In this survey, the BIR was rated "very bad" for having garnered a net score of –50%.

Overall, many observers including the IMF and World Bank have been concerned about the BIR's relatively weak collection performance in recent years[10]. They cite a general incapability to enforce tax laws leading to widespread tax evasion or avoidance. Among other concerns, these institutions emphasize the need for the Bureau to focus on fundamental enforcement of basic taxpayer obligations, and on undertaking systematic audits based on analysis of compliance risks.

They also emphasize on the need to reduce compliance costs of the taxpayer. In this regard, simplifying tax rules and regulations as well as systems and processes affecting taxpayer behavior are very important to achieve increased knowledge of tax laws which would lead to better compliance.

However it is worth noting in recent developments, the BIR was placed at the top 4 in the government's "Anti-Corruption Report Card" for the first semester of this year (published in the Philippine Daily Inquirer, 28 September 2006). In all, 70 agencies are monitored by the Presidential Anti-Graft Commission (PAGC) in connection with its integrity evaluation program.

[8] SWS Survey of Enterprises on Corruption, 2000-2002/3

[9] 15% say transactions at the BIR have gotten more complex, 15% say less complex, for a net effect of 0. There has been no perceived improvement in recent years.

[10] As a ratio to GDP, BIR taxes have consistently fallen every year from about 13% in 1997 to less than 10% in 2004. A slight rebound did occur in 2005 and is projected to continue in 2006.

2.3 Taxes Due from Land Transport Franchising and Motor Vehicle Registration

2.3.1 Tax implications from land transportation franchising

Taxes due from land transportation franchising can be grouped into two broad categories. First, those filed and/or paid by the operator. These are income tax, business tax (VAT or percentage), DST and withholding tax (on compensation and expanded). Second, those paid and filed by the insurance company by way of non-life insurance coverage acquired by the operator on the vehicles. These are VAT and DST.

(a) On the taxes filed/paid by an operator

(i) Income tax as a tax on the net income of the operator, whether it is a corporation or an individual. This is governed by Title II of the National Internal Revenue Code of 1997 (NIRC), and primarily implemented by Revenue Regulations II. Revenue Regulations 16-2005, while a regulation primarily on the VAT, increased the corporate income tax rate to 35% from the previous 32%.

The income tax return (1701Q, 1702Q and 1701, 1702) is filed quarterly, 60 days after the end of a fiscal quarter (usually coinciding with the calendar quarter) or May 30, August 30 and November 30 for the 1st, 2nd and 3rd quarters of the same fiscal calendar. The 4th quarter income tax, plus any remaining balance is filed during the annual filing season in April 15 of the following calendar year.

Additionally, the LTFRB requires an operator to submit an Income Tax Return (ITR) and/or a Tax Clearance before a license to operate is renewed or issued.

A Tax Clearance is processed and issued by the Revenue Region which has jurisdiction over the operator or taxpayer. While applying for clearance, the operator’s tax history is checked for any under or non-payment of income, business and withholding taxes (called “open” cases), and for any unpaid tax dues (called delinquencies).

Any open cases and/or delinquencies are settled before the clearance is issued. Additional taxes include documentary stamps (2 pieces = P30 at P15 each) which are paid for by the operator, as well as fees charged by the Bureau as certification fee (P100) and annual registration with the BIR (P500) if yet unpaid.

(ii) Business Tax in the form of VAT (for cargo operators only) or Percentage Tax, also known as the Common Carriers Tax (for passenger and cargo operators). While an operator for passenger vehicles is subject to pay a percentage tax only, an operator for cargo vehicles will pay either the VAT, if annual gross sales of the preceding year exceed P1.5M. Otherwise the company will pay a percentage tax, that is if gross sales were equivalent to or are projected to be P1.5M at most.

The VAT return (2550M and 2550Q) is filed either monthly, on the 20^{th} (non EFPS filers) and 25^{th} (EFPS) of the following month, or quarterly (on the 25^{th} day of the next month following the end of the quarter.

The VAT rate was recently raised to 12% following the EVAT law of 2005. Computing the VAT due is roughly:

(eq.1) 12% x (gross receipts – creditable inputs), or

(eq.2) Output Tax – Input Tax

The Percentage Tax return (2555) is filed quarterly at the 20^{th} day of the month following the end of the quarter.

The Percentage Tax, or Common Carriers Tax due is computed as:

(eq.3) 3% x gross quarterly receipts

Section 117-"Percentage Tax on Domestic Carriers and Keepers of Garages" (1997 NIRC) assumes minimum quarterly gross receipts:

Jeepney for Hire –

1. Manila and other cities	P2,400.oo
2. Provincial	P1,200.oo

Public utility bus –

Not exceeding 30 passengers	P3,600.oo
Exceeding 30 but not Exceeding 50	P6,000.oo
Exceeding 50 passengers	P7,200.oo

Taxis –

1. Manila and other cities	P3,600.oo
2. Provincial	P2,400.oo

Car for hire (w/ chauffeur)	P3,000.oo
Car for hire (w/out chauffeur)	P1,800.oo

(iii) Documentary Stamp Tax on the Annual Report submitted by the operator to the LTFRB when renewing or applying for a license.

Title VII, Section 188 of the NIRC governs the DST levied from the operator and imposes a stamp tax of P15.oo per document.

(iv) Withholding Tax on Compensation as a tax on the net income of the employees of the operator.

Title II, Sections 78 to 83 govern the tax, and is implemented by RR's 2-98, 6 and 12-2001, 17 and 30-2003. The NIRC authorizes the employer to withhold the tax from the employee, but obligates the former to remit the tax in behalf of the latter.

The Withholding Tax return (1601C) is filed monthly, every 10th (non-EFPS filers) and 15th day (EFPS filers) of the following month. Along with the tax return, form 1604 CF, the "alphalist" is submitted to the BIR containing a list of employees, their gross income, amounts excluded from gross income, personal and additional exemptions, taxable income, taxes withheld from January to November and taxes to be withheld or refunded for December.

(v) Withholding Tax Expanded as a tax on the income of contractual or contracted workers or individuals. It is creditable, when the individual files a tax return on his income.

As with the withholding tax on compensation, Title II, Sections 78 to 83 govern the tax, and is implemented by RR's 2-98, 6 and 12-2001, 17 and 30-2003. The NIRC authorizes the employer to withhold the tax from the individual, but obligates the former to remit the tax in behalf of the latter.

The Withholding Tax return (1601E) is filed monthly, every 10th (non-EFPS filers) and 15th day (EFPS filers) of the following month.

The tax is computed as:

(eq.4) 2% x gross income (paid to contracted individual)

(b) On the taxes filed/paid by an insurance company

(i) VAT on the insurance premium paid by the operator to the insurance company, governed by Title IV, Sections 106 to 109 of the Tax Code.

The VAT return (2550M and 2550Q) is filed by the insurance company, either monthly, on the 20th (non EFPS filers) and 25th (EFPS) of the following month, or quarterly (on the 25th day of the next month following the end of the quarter.

(ii) Documentary Stamp Tax on the insurance premium.

Title VII, Section 184 of the NIRC governs the DST levied on the insurance premium and imposes a stamp tax of P0.50 for every P4.00 on the amount of premium, or fraction thereof. This is effectively equal to 12.5% of the value of the premium.

The Documentary Stamp Tax Return (form 2000) is filed monthly by the insurance company, on the 5th day of the succeeding month.

2.3.2 Tax implications from motor vehicle registration

There are two (2) major types of vehicle registration under consideration. First, the registration of motor vehicles used in business for the transport of goods, cargo, and passengers. And second, the registration of motor vehicles for private use. The two have separate tax implications.

(a) Tax implications when motor vehicles are used in business

As with land transport franchising, there are 2 sets of taxes levied when registering motor vehicles for business. Those filed by the company or operator, and those filed by the insurance company by way of non-life insurance coverage on the motor vehicles.

The company, also being an operator of a motor vehicle franchise, files identical taxes with the latter. These are income tax, a business tax (either VAT or percentage tax, and withholding tax (on compensation or expanded). The only difference being the payment of DST, which the operator pays upon submission of the annual report to the LTFRB.

The taxes implied by insurance coverage, filed by the insurance company, are also identical to those discussed earlier.

(b) Tax implications when motor vehicles are for private use

Only one type of tax is implied when registering motor vehicles for private use, this is the documentary stamp tax. A DST of P15 pesos is paid on the insurance premium, and filed monthly by the insurance company. If the motor vehicle is new and purchased on loan, a DST is levied on the contract of loan, and amounts to P1.50 for every P200.oo on the face value of the document. For second hand vehicles, a P15.oo DST is affixed on the deed of sale, paid for by either party.

To be of use for the BIR, the section on the Official Receipt of a registered vehicle concerning the Tax Identification Number or TIN of the individual must be filled up. And in addition, the LTO must also make sure used vehicles that are sold to other individuals must be reflected in the owners name of the registration documents at the soonest possible time after sale.

3. Assessing the Tax Risks

The methodology for assessing risk, potential loss multiplied by the probability of occurrence, shall be applied where data is available. Where data is not available or if available but does not allow the estimation of risk, a qualitative assessment shall instead be used. The following are likelihood definitions applied below.

Table 2. Likelihood Definitions in the Risk Assessment Framework

Likelihood Level	Likelihood Definitions
High	If the source of risk is highly motivated and sufficiently capable of exploiting the vulnerability.
Moderate	If the source of risk is motivated and capable, but there are other systems in place that may impede the successful exploitation of the vulnerability.
Low	If the source of risk is incapable of successfully exploiting the vulnerabilities.

Because of certain vulnerabilities existing in the system of land transport franchising and registration of "for hire" motor vehicles, the proper collection of taxes is at risk. These risks are manifested as non-declaration or under-declaration of taxes. The first corresponds to the non-payment of taxes by operators while the second, although payments are made, reflects amounts that are below what should be paid to the government. Non-declaration or non-payment of a tax, if proven and convicted, is punishable under Sections 254 (*Attempt to Evade or Defeat Tax*) or 255 (*Failure to File Return, Supply Correct and Accurate*

Information, Pay Tax, Withhold and Remit Tax and Refund Excess Taxes Withheld on Compensation) of the Tax Code. While non-payment occurs in both sections, 254 in addition requires a "willful attempt" by the individual. Under-declaration is not clearly defined under the Tax Code, but is an accepted accounting term that applies to a failure to declare the correct amount by understating or reducing the tax due. For purposes of imposing penalties, both non-declaration and under-declaration are considered under Revenue Memorandum Order 1-90.

For simplicity and clarity, the estimates for non-declaration are computed exclusively from that of under-declaration. Treating the two problems separately also reflects a more realistic scenario where the solution to one is not necessarily also the solution for the other.

Table 3 estimates the obligations of 33,500 transport operators that did not pay taxes for taxable year 2004, although they are registered as valid franchise holders for the same year. Table 4, on the other hand, estimates the obligations of 221 transport operators that filed and paid at least one tax during taxable year 2004.

The risk column reflects the potential benefits to taxation. The presence of these risks is a direct result of vulnerabilities, identified during the diagnostic phase of the project, of the systems of transport franchising and motor vehicle registration. While a total exploitation of these vulnerabilities can potentially cause huge losses to tax collections (potential losses), the computed risk may be reduced by the anticipated probabilities that these losses may occur. The assignment of probabilities is computed and directly based on actual data from the BIR for taxable year 2004. This method increases the certainty of the computations for 2004, but also mostly limits its accuracy to that year.

3.1 Land transportation franchising and registering "for hire" motor vehicles

(a) Small players: non-declaration/non-payment of taxes and under-declaration

It is obvious that non-declaration of dues, and the corresponding non-payment of the tax, occurs when transport firms remain unregistered with the BIR (this is true for all taxes that a transport operator must pay). This is indicated by the absence of a valid taxpayer identification number (TIN). At present the LTFRB is not equipped to verify the TIN's of transport operators, and neither is it able to verify the validity of tax returns that is presented when transport operators apply for extension of franchise once every 5 years, or when they apply annually for confirmation (see Diagnostic Report for further discussion). The problem is exacerbated because the LTFRB allows the continuance of extension and confirmation after the operator simply pays a fine for having no TIN.

However, analyzing actual tax data of transport operators for 2004 exposed the incidence of non-declaration that is far wider and not just limited to firms that are not registered with the BIR. In a recent exercise conducted to verify the validity of the TIN's of about 33,806 transport operators, the BIR found that at least 9,376, or

28%, were without valid TINs or possessing none at all. By further analyzing the data, it was revealed that out of the total population, only 258 operators had paid at least one tax in 2004. The rest, 33,548 operators, did not pay any tax in 2004. For the 258, the average gross income declared was about P5.9 billion per taxpayer. Treating the 258, therefore, as the "larger" taxpayers of the entire group is consistent with a known fact at the LTFRB that majority of franchise holders are small players or single proprietors, operating single taxicabs or jeepneys[11]. We therefore treat the 33,548 operators as "small" operators or single proprietors. By using known parameters, such as the average value of "boundary" as a proxy of daily revenue for the transport operator (Appendix C), the annual gross income of a single proprietor may be estimated. This amounts to about P218 thousand per jeepney operator, and about P253 thousand per taxicab operator.

Table 3 below shows the computed risk to taxation from small transport operators that are assumed to be operating as single proprietors. Non-payment of the tax occurs because of the inability of the LTFRB to validate the TIN's presented by operators during franchise application, extension or renewal and yearly confirmation. It is also unable to verify the validity of the tax returns presented during these processes.

The tax risk coming from the non-payment of income tax was estimated using the same rate of compliance by the 258 (about 0.17% of gross income) and applied to the estimated gross income of 33.5 thousand single proprietors. Although the compliance rate for income tax seems low, the determination of the extent of under-declaration for this tax is not computed in this paper. The rate of compliance will vary for each individual, being a single proprietor, depending on numerous mitigating circumstances allowed by the Code such that estimating an average independently may not be credible given available data.

[11] See Appendix for analysis of data and computations.

Table 3. Risks in Taxation in Land Transport Franchising (Small Players)

Risks to Tax Collections	Source of risk	Vulnerability	Potential Loss	Probability	Risk
Non declaration (Potential Risk reflects tax benefits by capturing into the tax net)	Nonpayment of Taxes (2004 data)		P13.5 M in IT	100%	P13.5 M
			P9.5 M in CCT		P9.5 M
	Invalid TIN	LTFRB currently unable to verify validity of operators' TIN.			
	Non-Filing (valid TIN)	LTFRB unable to check validity of tax returns.			
	No TIN	LTFRB allows renewal/ confirmation once fine for "No TIN" is paid.			
Under-declaration (In addition, making sure of proper declaration)	Under-payment of Taxes (2004 data)		P237 M in CCT	96%	P227 M
	Under-declaring income for CCT	BIR/LTFRB unable to verify actual income earned apart from that prescribed in Sec. 117.			

The computation of risk on the common carriers tax may be done using either of 2 methods. One, again by applying the average compliance rate of 3 operators that paid the tax in 2004 (only 3 paid the tax and declared gross income, even as 11 were qualified to pay CCT in 2004, based on RR16-2005), or two, by applying Section 117 of the Tax Code which prescribes a minimum quarterly gross income for different operators. In both cases the actual or estimated payments reflect an under-payment of 96% to 98% compared to the statutory rate of 3% of gross income.

In other word, if the validation of TIN and if proper payment could be imposed for the CCT during the annual confirmation process, and applied to the entire population of transport operators, the estimated additional collection from the common carrier's tax would have amounted to about P237 million in 2004 instead of just P9.5 million.

If the under-declaration in the common carrier's tax is corrected, then additional taxes amounting to P250 million (227+9.5+13.5) could have been collected in 2004. But the ability to have done so, or to do so, requires that the BIR have access to accurate third party information on the incomes or revenues earned by the operators. Merely accessing the income statements submitted during annual confirmation may not be enough as the incentive to under-state income is also strong on the part of the operator. The LTFRB mostly uses these statements to review petitions for rate hikes. And as such, a lower net income increases the chance for the petition for a higher fare to be granted[12].

(b) Large Players: Non-Declaration/Non-Payment of Taxes and Under-declaration

Table 4. Risks in Taxation in Land Transport Franchising (Large Players)

Risks to Tax Collections	Source of risk	Vulnerability	Potential Loss	Probability	Risk
<u>Non declaration</u> (Payment of IT but not for business tax)	Nonpayment of Taxes (2004 data)		P395 Th in CCT	2%	P6.4 Th
			P12.9 B in VAT	3%	P388 M
	Non-payment of VAT/CCT	LTFRB unable to verify validity of tax return.			
<u>Under-declaration</u> (Again, involves making sure of proper declaration of income)	Underpayment of Taxes (IT may be affected; 2004 data)		P19.6 M in CCT	98%	P19.2 M
	Under-declaring income for CCT	Income is understated to increase chance of fare hike. Further, Sec. 117 of NIRC (minimum gross income) is used when computing CCT.			

Although all of the 258 transport operators had valid TIN's and paid income taxes for 2004, not all paid the business tax.

The same method was applied to compute the risks to CCT and VAT from non-declaration. The average rate of compliance of those that paid was applied to those that did not pay, but who were qualified to pay the VAT (RR16-2005) and to those that fell below the threshold for VAT and thus liable to pay the CCT. These risks are brought about by the inability of the LTFRB to verify the validity of tax returns presented during annual confirmation. Thus, although it is required to submit tax returns for business taxes, spurious returns could not be identified.

[12] Actual information from the LTFRB reveals that petitions are assessed by comparing a declared ROI (net revenues/invested capital) to an allowed ROI of 12%. In the meantime, net revenues may be depressed by understating gross revenues or overstating operating expenses.

As shown in Table 4, the computed risk from non-declaration of VAT and CCT is small compared to the potential losses if a complete exploitation of the vulnerability happens. Thus the probability not to pay the business tax even as he pays the income tax is low, for both the VAT and CCT.

Under-declaration and the consequent underpayment of the common carrier's tax results from understating gross income. While busses issue tickets to every passenger indicating the price one pays for a single journey, taxicabs and jeepneys do not. This absence of any income recording system makes it very difficult for the BIR to determine whether the income declared by operators in their percentage tax returns are accurate or true.

The difficulty is compounded by 2 factors. First, it is exacerbated by a provision found in the National Internal Revenue Code itself. Section 117 prescribes a minimum quarterly gross income for different operators for the purpose of applying the percentage or common carrier's tax (CCT). Using estimates of income based on known parameters (average value of "boundary"), and when this is compared to the quarterly income prescribed by the Code for taxicabs and jeepneys, it is found that the latter could be understated by as much as 96% (Appendix C). Although Sec. 117 is a mere prescription of the minimum amounts that an operator may declare as his income, it appears to be common practice to apply the provisions of the Code no matter what the true earnings of the operator are.

Actual data from the BIR shows that when the actual payments for CCT by 3 operators were compared to the income declared for income tax purposes, the former was between 96% to 98% less than what should have been paid if the statutory rate of 3% were to be applied on gross income.

Second, although the LTFRB requires operators to submit their financial statements during extension and confirmation of franchise, the entries are used mainly to determine whether or not to grant petitions for fare/rate hikes. The Public Service Law of 1936, and E.O. 202 (law creating the LTFRB) explicitly require all common carriers to furnish the LTFRB with "annual reports of finances and operations", and allow the regulatory body to "determine…and periodically review…reasonable fares, rates and other related charges, relative to the operation of public land transportation services". The law, however, is silent on regulating the industry according to the financial health of transport operators. Because of this, the net income reflected in the annual reports submitted to the LTFRB may likely be depressed in order to increase the chances of fare hikes being granted.

Table 5. Risks in Taxation, BIR One-Stop-Shop at the LTFRB

Risks to Tax Collections	Source of risk	Vulnerability	Potential Loss	Likelihood
Implementing "One-Stop-Shop"	Transport Operators – Historical tax payments	Taxpayer grouping not the same as operator groupings.	Undermines future detection of under-declaration.	Moderate-High

The LTFRB and the BIR have agreed to put up a one-stop-shop at the LTFRB central office in order to assist operators with their tax requirements for franchising purposes. This was envisioned also to better compel operators to comply with tax laws. For expediency, the BIR has assigned RDO 39 (Cubao) to "man" the premises. But because taxpayer groupings differ from transport operator groupings, there are issues of jurisdiction that arise. Specifically, as RDO 39 lacks jurisdiction over certain operators, as taxpayers, their limited access to data prevents them from determining the validity of some tax returns that are presented during extension and confirmation of franchise. If RDO 39 is tasked to determine the tax compliance of all operators that are handled by the national office of the LTFRB, then this setup will limit the ability of the BIR to detect under-declaration by some taxpayers.

3.2 Motor vehicle registration for private use

With respect to the taxes generated by the registration of private motor vehicles, there are 2 major players involved – The private emissions testing centers (PETC) and the insurance companies that sell non-life insurance policies. Data, which may be found in the LTO, can assist the BIR in determining the tax liabilities of these players.

The LTO, through its private information technology provider Stradcom Corporation[13], manages data pertaining to the registration of motor vehicles. For the BIR, it is not the information on the motor vehicle/owner that is most important for taxation purposes, but the "peripheral" data from emissions testing and insurance that is readily useable.

The BIR has long recognized this (by the presence of at least 2 MOA's between the 2 agencies) and has repeatedly attempted to gain access to the data (discussed in the following section).

[13] Stradcom Corporation, by a BOO agreement in March 1998, was contracted by the DOTC-LTO to design, customize, construct and operate the information technology system for the LTO.

By gaining information, for instance, to the identification (including name and TIN) and service (number of vehicles tested multiplied by a standard price on testing) of emissions testing firms, the BIR may estimate the gross sales on a monthly, quarterly and annual basis. Monthly sales data may be used by RDO's for projecting or forecasting trends of collections. Quarterly sales may be used to compare with VAT payments, while annual sales are useful for income tax purposes in April.

Table 6. Risks in Taxation in Motor Vehicle Registration (private use)

Risks to Tax Collections	Source of risk	Vulnerability	Potential Loss	Probability	Risk
Non-declaration	PETC – Not in tax net	LTO has no access to BIR data on TIN.	No information	(likelihood) Moderate-High	
Under-declaration	By under-declaring Premium payments	Verification of COC authenticity is bypassed allowing registration even with fake or spurious COC's.	P350 M DST (2004).	77%	P270 M in DST alone.
			P336 M VAT (no data for IT)		P259 M in VAT.
	By under-declaring sales of PETC	BIR has no access to third party information on sales of PETC (but available at LTO).	P70.3 M DST (2004). No data for VAT and IT.	(likelihood) Moderate-High	

For the VAT, quarterly sales from the LTO data may be compared to the sales declared in the quarterly returns. While the annual sales may be compared to the sales declared in the annual income tax return. Any deviation could immediately trigger the need to perform at the very least an investigation into the tax return. Specific audits (involving specific tax types instead of the usual comprehensive audit of all taxes) could also be carried out.

Although gross sales cannot be directly used to compute either income tax or VAT, the BIR may still make use of it for estimation purpose, and as an indicator of tax compliance. For instance, the BIR may rank the ratio of tax payment (VAT and income separately) to gross sales for the entire sector, and subject all those at the bottom to further investigation and perhaps audit.

Techniques such as these to indicate compliance are not new for the BIR. In the past, the ranking of taxpayers by tax or tax to sales in order to determine and award "top taxpayers" during the BIR anniversary, is a similar activity. Except this time the ranking will used to "punish" or correct deviant behavior.

The problem surrounding the under-declaration by insurance firms is similar to that occurring at the LTFRB. The likelihood and incentive of insurance firms to under-declare revenues runs high, even with their submission of financial reports to the Insurance Commission.

By estimating the gap in insurance premiums paid and due for 2004, using data from the LTO and the Insurance Commission, the estimated potential risk to taxation amounted to about P150 million in DST alone. Although it is difficult to compute with certainty given the limited data (from insurance of motor vehicles alone), it is logical to assume that the under-declaration of revenues could result in the underpayment of the VAT and IT for insurance firms as well. A straightforward computation of the potential risk to VAT amounts to about P144 million for 2004. This estimate is based on the output tax (of VAT) alone. Although it may be assumed that input taxes claimed on non-life insurance premiums may be minimal, insurance companies could effectively reduce their effective rate by claiming inputs allowable under the law[14].

As of the date of completion of this paper, it is not clear whether the DST is also collected from certificates of emissions tests for motor vehicles. If it legally must be, then the potential revenue from this would be about P70 million for 2004 (P15.oo per certificate for 4.7 million motor vehicle registrants).

[14] Input tax could be claimed for expenses incurred from accredited repair shops, purchase of VAT-able supplies or capital equipment, etc.

4. PAST AND CURRENT EFFORTS BY THE BIR TO LINK WITH THE LTO AND LTFRB

The tax leakages occurring in the public land transportation system has long been recognized by the BIR. Below are important events and documents, reaching as far back as 1987, on the efforts by the BIR, the LTFRB and the LTO to share information by electronic interchange (or other) methods to help increase tax/revenue collections.

- Memorandum of Agreement between the BIR and LTO

  Date: September 10, 1987

  Purpose: "to plug all loopholes to ensure that all taxes due the government arising from the assembled or re-assembled motor vehicles using imported and/or locally manufactured parts and accessories are properly assessed and collected prior to their registration by the LTO"

- Memorandum of Agreement between:

Agency	Represented by
DOF –	Jose Isidro Camacho, Secretary
BIR –	Guillermo Parayno, Commissioner
DOTC –	Leandro Mendoza, Secretary
LTO –	Roberto Lastimoso, Assistant Secretary
LTFRB –	Dante Lantin, Chariman

  Date: February 27, 2003

  Purpose and Agreement:

  I. To set-up the infrastructure necessary for mutual exchange of information among the concerned parties for purposes of verifying the authenticity of the documents presented to the LTO and LTFRB to effect registration/transfer of ownership of motor vehicles and the grant of Certificate of Public Convenience to transportation operators/contractors, respectively.

  II. The DOF and DOTC shall monitor compliance by their respective subordinate agencies with the provisions of this agreement.

  III. The DOF, DOTC, BIR, LTFRB and LTO shall create an Inter-Agency Committee that shall oversee and monitor the proper implementation of this MOA and shall convene within 15 days from the signing of this MOA to prepare the necessary implementing rules and regulations.

- Draft “Implementing Guidelines on Electronic Information Interchange Between the Bureau of Internal Revenue and the Land Transportation Office and the Land Transportation Franchising and Regulatory Board” (attached).

  Date: as of February 30, 2005

Contents and Responsibilities:

1. For the LTO: validation of TIN (using TIN Verification Facility of BIR) for all applications, if MV for business then require the submission of a tax clearance (TCL)/certificate authorizing registration (CAR), if MV is imported then require submission of certificate of payment from BoC, furnish the BIR with an alphabetical list of owners of registered vehicles.
2. For the LTFRB: validation of TIN, submission of TCL/CAR, furnish BIR with a list of transport operators with renewed licenses.
3. For the BIR: Issue TCL/CAR, provide online access to TIN verification facility.
4. BIR/LTO/LTFRB: creation of inter-agency committee to oversee proper implementation of MOA, establish and maintain an information feedback loop to resolve problems arising from TCL/CAR.
5. Composition of the Inter-Agency Committee.

- Revenue Special Order 374-2005, BIR under CIR Jose M. Buñag

Date: August 2, 2005

Purpose: Creation of a Joint Technical Working Group, in line with the linkage project embodied in the MOA dated Feb. 27, 2003.

JTWG to prepare and submit the Interconnectivity Proposal to the head of each agency. To include the legal justification for determination of third party information requirement of BIR from LTO, the definition of technical requirements and an analysis of the project schedule and cost.

Composition: BIR only

Steering Committee

DCIR Lilia Guillermo – ISG

DCIR Lilian Hefti – OG

DCIR for Legal Group

Project Head

ACIR Alberto Pio De Roda - ISOS

Members

HREA Carolyn Reyes – ISDS

HREA Victoria De Leon – ISOS

HREA Marilou Del Rosario – CS

Olivia Lao – Audit Information Tax Exemption and Incentives

Romulo Arambulo – SOD

Elizabeth Costales – Systems Maintenance and Support

Mapemaroma Cantillet – Law Division

Artemio Santos – SOD

Concepcion Quevedo – Systems Standards

Jaime Zabala

Wilfred Eleria

- Presentation by Stradcom: Land Transportation Office
  Information Technology Project
  LTO-BIR Interconnectivity

Date: August 23, 2005

Purpose: To propose a facility for the exchange of information between the 2 Offices and enable the LTO to do the following:

Tax clearance authentication facility

Tax clearance issuance facility

Tax payment monitoring facility

TIN verification facility

In exchange, the BIR would be able to optimize collections for an additional P4.2 billion in 2004 prices, with P3.5 billion coming from item 1 below- withholding tax.

1. Withholding of creditable income tax on sale or transfer of motor vehicles (RR 2-91 used as reference).
2. DST and VAT on insurance premiums.
3. VAT on drug and emission testing.

Problems encountered:

BIR Response to Stradcom Proposal (October 3, 2005 Offline Meeting BIR-LTO Project).

1. RR 2-98, amending RR 2-91, no longer requires the withholding of creditable income tax on the sale or transfer of motor vehicles, thus the P3.5 billion additional collections proposed is not realizable.
2. DST and VAT collections specifically for insurance premiums are not separately classified in the BIR's ITS, thus payments may not be monitored accordingly. ATC's (alpha numeric tax codes) specific to the type of payment are needed.

Interconnectivity between LTO and BIR is purportedly NOT possible pending the approval of a "Second Amendment" by the NEDA Board on the Stradcom BOT contract.

1. 2 letters signed by CIR Jose M. Buñag dated September 19 and October 17, addressed to Asst. Sec. Anneli Lontoc of the LTO, requesting for motor vehicle and MV registration data along with emission and drug testing data for the years 2003 and 2004 (attached).
2. Letter response from the LTO dated December 12, 2005 deferring the BIR's data request pending the "approval of the Second Amendment by the NEDA Board" (attached).

The BIR continues to pursue the original request, for use in data matching activities pertinent to the proper collection of taxes, through a signed letter dated 23 June 2006 by Commissioner Buñag.

- Draft “Implementing Guidelines on Electronic Information Interchange Between the Bureau of Internal Revenue and The Land Transportation Franchising and Regulatory Board” (attached)

Date: as of May 2006

Contents and Responsibilities:

1. For the LTFRB: to provide a work space for the BIR including telephone lines; inform and require all applicants/operators to submit complete BIR requirements; provide updated alphabetical list of transport operators issued franchises, including those that cease operations; provide the Annual Report of operators.
2. For the BIR: validate TIN and all documents required and presented by the applicant and issue the Returns Compliance Certificate.
3. Creation of an Inter-Agency Committee to oversee proper implementation.

<u>Returns Compliance Certificate</u> (attached): A new document that will be issued by the BIR to transportation operators in lieu of the tax clearance (TCL) which was formerly required. It certifies that the operator has presented and completed the following documents:

For New Registrants

1. .BIR registration Certificate (BIR Form 2303)
2. Annual Registration Fee (Form 0605)

For Renewal

1. BIR registration Certificate (BIR Form 2303)
2. Annual Registration Fee (Form 0605)
3. Quarterly VAT return or Monthly percentage tax return for the immediate preceding year (4 quarters).
4. Annual income tax return for the immediate preceding year.
5. Payment of DST for Annual Report.
6. Permit to use taximeter or other machines used to generate receipts.
7. Documents as proof of purchase or transfer of motor vehicles used in business and proof of payment of pertinent taxes (ex. Transfer taxes).

5. CONCLUSION AND RECOMMENDATIONS.

Overall, the findings and recommendations in this report will impact on the non-declaration and underdeclaration of tax-related information.

The analysis of actual data revealed a flaw within the system of detection in the BIR. Whereas a strict application of the statutory percentage tax rate would have given the Bureau about P19 million more from CCT, only P0.4 million was collected in 2004. Matching of data found within the BIR itself would already have corrected this.

The calculated risks represent the potential benefits to collections. But meeting these expectations is dependent on 2 areas, namely, first that the recommended system changes are executed as planned, and second, that the assumptions made when the estimations were done are met. With respect to land transport franchising, in addition to the above, the recommended systems must be rolled out to the entire LTFRB national structure. In other words, it must encompass 33 thousand operators nationwide, and not just the operators handled by the LTFRB national office.

The benefits could rise even further given the existence of “colorum” operators that operate exclusively outside the purview of the LTFRB. Remember that the computations above are based on the number of transport operators that are registered/recognized by the LTFRB but not by the BIR. Calculating the risks from this is not possible at the moment since there is no given number on just how many colorum operators are currently operating nationwide. And from the number, how many are actually taxpayers?

Looking at table 3, it is apparent that the computed risk from under-declaration is larger than that from non-declaration by transport operators. As mentioned above, the recommendations of the study will impact non-declaration by “capturing” non-filing operators into the tax net. The potential benefit from under-declaration is large but is also more difficult to provide for at the moment.

Merely accessing the financial reports of operators from the LTFRB will not automatically lead to a successful matching process with the BIR’s own data. At present, the LTFRB mainly uses the entries of these reports for assessing petitions for rate hikes. As such the incentive to understate income and overstate expenses remains large for the operator because it increases his chances of being granted the rate or fare hike. The LTFRB may balance this by considering the financial strength as well when assessing an operators chances for extension of franchise. After all, a financially capable company has better chances of maintaining excellent service as a public utility provider by having more for capital investments and maintenance. Ensuring safe and quality service is within the purview of the LTFRB as a regulatory agency.

Although Section 117 of the NIRC merely prescribes a minimum or "price floor" on the allowable income declaration of transport operator the absence of mechanisms for the BIR to verify the revenues of operators has resulted in the widespread application of this provision for the purpose of applying the percentage tax. Given that it induces a 96% rate of under-declaration, it would serve the government well if the minimum incomes are updated to present prices. The NIRC was signed into law in 1997.

As mentioned in earlier reports, the main hindrance to the BIR-LTO sharing of information is the presence of a review currently being done on the BOO contract of Stradcom corporation. The review, purportedly, prevents the LTO from sharing information with other entities including the BIR.

Based on initial estimates or impressions (due to the absence of data), the benefits that may accrue to the BIR may not be large compared to the potential collections from sharing information with the LTFRB. Although this may be true, a successful campaign to rid the system off tax leakages requires the total cooperation between agencies of the entire government.

Lastly, the LTFRB and the LTO must enforce the provision of EO 98 that mandates all parties to include their TIN when transacting with the government, with no exceptions.

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Appendix A

The Data: Background and Analysis

- Tax data from 4 Revenue Regions, namely, Cebu, Makati, Manila and Quezon City for calendar year 2004.
- Total number of operators at 258 for 4 RR's. 26 did not declare gross income in their income tax return.
- Average gross income declared is P5.9 billion.
- 6 firms declared at least P50 B in gross sales, 24 declared at least P10 B, 74 declared at least P1 B.
- Of the 40 that did not pay VAT, only 3 paid the common carriers tax (CCT) for 2004.
- Considering the gross income declared by the 40, total business tax should have been about P407 million, instead only P392 thousand was paid in 2004 (for the CCT only).
- This is broken down as follows, P388.5 million for VAT and about P19 million in CCT.
- For the 3 that paid the CCT, the average underpayment was P96%.

Computing the Risks to Taxation for 33.5 thousand Operators/Taxpayers

- Total estimated operators are about 33.8 thousand nationwide. Of these, only 258 had made tax payments for 2004.
- It is deemed logical to consider the 258 as among the largest taxpayers of the group. For this paper, the remaining 33.5 thousand are considered as small players.
- A small player is defined as a single proprietor for taxi or jeepney.
- Applying the same rate of compliance as the 258 to the 33.5 thousand, we get an additional potential income tax of about P13.4 million for 2004.
- Additionally assuming that the small players pay the CCT as business tax, and assuming the same rate of compliance (or under-declaration), we get an estimated potential in CCT of about P9.5 million for 2004. If the CCT is strictly imposed (3% on gross income), then additional tax will amount to P237 million for 2004.
- Given that only 5 among the 258 can be considered as small players, the probability of small players not to pay the tax is considerably high, reaching 100%.
- The estimated value of the tax risks from small players due to non-declaration in 2004 is P23 million.

Computing the Risks to CCT and VAT from 258 Operators/Taxpayers

- 3 players that paid the CCT also declared gross income. 2 did not have records of gross income.
- 8 operators fall below the P1.5 million threshold for VAT registration (the threshold is applied to 2004 data for the purpose of estimating losses based on current rules).
- Based on the actual CCT payments of the 3 and their declared income, there is a tendency to underpay the CCT by as much as 96%.
- Considering all 11, the probability to underpay reaches a high of 98%.
- The potential CCT, based on the statutory rate of 3% of gross income, is P19.6 million for 2004.
- The estimated value of risk to the proper collection of CCT due to under-declaration is P19.1 million for 2004.
- The potential for VAT in 2004 is P12.9 billion, computed using an average effective VAT rate of 1.3% of gross income.
- The probability is computed at 3% (potential over actual) and the estimated risk from under declaration is placed at P388 million for 2004.

Appendix B

Under-declaring DST from Non-Life Insurance Premium

- Insurance Commission data shows that total premiums paid for insurance of motor vehicles was P1.6 B for 2004.
- Data from the Land Transportation Office shows that actual private motor vehicles registered for 2004 reached 4.68 million.
- Multiplying this by P600, which is the average insurance premium paid for each motor vehicle, gives us P2.8 billion representing the potential insurance premium that should have been paid in 2004.
- The discrepancy in insurance premiums paid, amounted to P1.2 billion in 2004.
- Total potential taxes from DST on insurance premiums amounted to P350 million in 2004 (the effective rate of DST on insurance premium is 12.5%).
- The potential risk is P150 million, representing 43% of total potential revenue from DST on insurance premiums.
- Applying the 12% VAT rate on P1.2 billion in insurance premiums gives an estimate of potential risk from VAT equal to about P144 million. This estimate is based on a computation of the output tax only.

Appendix C

Estimate of Tax Leakage from the Common Carriers Tax

Public Utility Jeep

Assuming an average daily "boundary"[15] of P700, the jeepney operator earns between P14,000 to P18,550 per month assuming the vehicle operates between 20 to 26.5 days a month. This implies gross earnings of between P42,000 to P55,650 per quarter.

Applying a 3 percent tax (Common Carriers Tax) on quarterly gross income results in potential tax revenues amounting to P1,260 to P1,669.5.

Section 117 of the NIRC assumes a quarterly minimum gross income of P2,400 for jeepneys plying routes within Metro Manila. This is equivalent to a mere 4.4% (if 26 days of operation per month) or 5.7% (if only 20 days of operation) of potential gross earning assuming the average daily boundary of P700.

Applying the 3% tax yields a quarterly payment of P72 for every jeepney plying the Metro Manila route.

Comparing the potential payment and the payment while applying the provision of the tax code reveals a potential tax leakage of between 94% to 96% for every jeepney operating within Metro Manila. Furthermore, the minimum gross quarterly income assumed by the tax code implies an average monthly operation of only 1.14, or only 3.4 days per quarter.

Taxicabs

Assuming an average daily "boundary"[16] of P850, the taxi operator earns between P17,000 to P22,525 per month assuming the vehicle operates between 20 to 26.5 days a month. This implies gross earnings of between P51,000 to P67,575 per quarter.

Applying a 3 percent tax (Common Carriers Tax) on quarterly gross income results in potential tax revenues amounting to P1,530 to P2,027.

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[15] Term used to describe the fees charged by operators from the public utility vehicle driver. Every amount above this is the driver's. Boundary ranges from P500 to P900 daily depending on the perceived profitability of the route. The information was gathered in a Focus Group Discussion held last 19 July 2006 at the AIM.

[16] Boundary ranges from P600 for a half-day operation to P1,200 for a 24-hour operation. The information was also gathered from the FGD.

Section 117 of the NIRC assumes a quarterly minimum gross income of P3,600 for taxi's plying routes within Metro Manila. This is equivalent to a mere 5.4% (if 26 days of operation per month) or 7.1% (if only 20 days of operation) of potential gross earning assuming the average daily boundary of P850.
Applying the 3% tax yields a quarterly payment of P108 for every taxi plying the Metro Manila route.

Comparing the potential payment and the payment while applying the provision of the tax code reveals a potential tax leakage of between 93% to 95% for every taxi operating within Metro Manila. Furthermore, the minimum gross quarterly income assumed by the tax code implies an average monthly operation of only 1.41, or only 4.2 days per quarter.