Tax Reform for Acceleration and Inclusion (TRAIN): HB 4774, HB 5636 and SB 1408 Compared

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Overview of presentation

- Background
  - Issues that anchor need for tax reform
  - Objectives of Duterte tax reform
  - Overall design of Duterte Tax Reform
- Features of the TRAIN (as per House Bill 4774, House Bill 5636, and Senate Bill 1408)
- Impact of TRAIN
  - Revenue
  - Tax incidence – who bears the burden; equity concerns
  - Efficiency implications
  - Compliance
- Conclusion

Tax policy and tax administration issues that anchor need for tax reform

Table _. Tax rates in ASEAN countries, 2017

	Personal Income Tax		Corporate Income Tax	VAT/GST	2015 Tax Revenue to GDP (%)
	Top marginal rate	Number of brackets			
Brunei Darussalam	a/	a/	18.5%	n/a	..
Cambodia b/	20%	5	20%	10%	14.8%
Indonesia	30%	4	25%	10%	10.7%
Lao PDR	24%	6/7 c/	24%	10%	15.6%
Malaysia	28%	11	24%	6%	14.3%
Myanmar	25%	6	25%	b/	8.8%
Philippines	32%	7	30%	12%	13.6%
Singapore	22%	11	17%	7%	..
Thailand	35%	8	20%	7%	16.4%
Vietnam	35%	7	20%	10%	18.2%

a/ no personal income tax in Brunei

b/ different brackets apply to wage income, on the one hand, and income from self-employment and business

c/ 6 for self-employed and 7 for wage income

Source: Deloitte 2017 for corporate income tax and E&Y 2017 for personal income tax; ADB 2015 Key Indicators for tax revenue to GDP ratio

Overarching issue – high tax rates but low revenue productivity

Tax policy and tax administration issues that anchor tax reform

- Personal income tax
  - Bracket creep and high marginal rates compared to ASEAN neighbors
- Corporate income tax
  - One of the highest in ASEAN vis competitiveness
- Fiscal Incentives
  - Redundant incentives ➔ need to rationalize

Tax policy and tax administration issues that anchor tax reform

- VAT
  - Too many exemptions
- Excise tax on petroleum
  - Erosion of peso denominated rates due to inflation
  - Efficiency issues
- Taxation of financial instruments
  - Lack of neutrality

Objectives of Duterte tax reform program

- Redesign tax system to be:
  - Simpler
  - Fairer
  - More efficient
- Raise more revenues to fund government's socio-economic agenda

Duterte administration's tax reform objectives

- To promote investments, job creation higher and sustained growth
  - ✓ Redesigned tax system envisioned to be characterized by low rates and broad base
- Consists of a number of tax reform packages that will be legislated in stages
  - ✓ Each package contributes to overall objectives of tax reform while at the same time protecting government's aggregate revenue take
- Earmarking of part of revenue gain for targeted subsidies

Components of Tax Reform Package 1 (TRAIN)

- Personal income tax (PIT) reform
- VAT reform
- Increase excise tax on petroleum products
- Increase excise tax on automobiles
- Reduce estate and donor's taxes
- Introduce excise tax on sugary drinks – in HB 5636 but not in HB 4774 nor SB 1408

Implications of Personal Income Tax (PIT) provisions of HB 4774, HB 5636 and SB 1408

HB 4774, HB 5636 & SB 1408 – same provisions on Personal Income Tax (PIT)

- Adopts different PIT regime for (i) compensation income earners [CIEs] and (ii) self-employed & professionals [SEPs]
  - CIEs – same treatment under all 3 bills
    - Tax base - modified gross income
      - ✓ no personal exemption and deductions allowed with the exception of (i) 13th month pay/ bonuses not in excess of PhP 82,000, and (ii) GSIS/ SSS, PhilHealth and Pag-ibig contribution
    - Tax rate – graduated rate schedule (with 6 brackets compared to the present 7)
      - ✓ 0% tax on incomes not over PhP 250,000 vs 5% on taxable income not over PhP 10,000
      - ✓ Top marginal rate – 35% vs present 32% applicable to incomes above PhP 5 M instead of incomes above PhP 500,000

NB: Based on 2015 FIES only 35% of households have annual income greater than PhP 250,000

Comparison of PIT rate schedule s: existing regime vs HB 4774, HB 5636, & SB 1408

I. Existing PIT regime - applies to both compensation income earners and self-employed/ professionals

For taxable income	Tax due
Not over PhP 10,000	5%
Over PhP 10,000 but not over PhP 30,000	PhP 500 + 10% of the excess over PhP 10,000
Over PhP 30,000 but not over PhP 70,000	PhP 2,500 + 15% of the excess over PhP 30,000
Over PhP 70,000 but not over PhP 140,000	PhP 8,500 + 20% of the excess over PhP 70,000
Over PhP 140,000 but not over PhP 250,000	PhP 22,500 + 25% of the excess over PhP 140,000
Over PhP 250,000 but not over PhP 500,000	PhP 50,000 + 30% of the excess over PhP 250,000
Over PhP 500,000	PhP 125,000 + 32% of the excess over PhP 500,000

II. HB 4774, HB 5636 & SB 1408 - applies to compensation income only;

For taxable year 2018-2019

For taxable income	Tax due
Not over PhP 250,000	0%
Over PhP 250,000 but not over PhP 400,000	20% of the excess over PhP 250,000
Over PhP 400,000 but not over PhP 800,000	PhP 30,000 +25% of the excess over PhP 400,000
Over PhP 800,000 but not over PhP 2,000,000	PhP 130,000 +30% of the excess over PhP 800,000
Over PhP 2,000,000 but not over PhP 5,000,000	PhP 490,000 +32% of the excess over PhP 2,000,000
Over PhP 5,000,000	PhP1,450,000 +35% of the excess over PhP 5,000,000

II. HB 4774, HB 5636 & SB 1408 - applies to CIEs only

For taxable year 2020 onwards

Tax due
0%
15% of the excess over PhP 250,000
PhP 22,500 +20% of the excess over PhP 400,000
PhP 102,500 +25% of the excess over PhP 800,000
PhP 402,500 +30% of the excess over PhP 2,000,000
PhP1,302,500 +35% of the excess over PhP 5,000,000

HB 4774, HB 5636 & SB 1408 – same provisions on Personal Income Tax (PIT)

- different PIT regime for (i) CIEs, and (ii) SEPs
  - Under 3 bills - SEPs divided into two groups
    - SEPs with gross sales/ receipts not over PhP 3 M – same treatment under 3 bills
      - ✓ Tax rate – 8%
      - ✓ Tax base – gross sales/ receipts
    - SEPs with gross sales/ receipts above PhP 3 M
      - ✓ Under HB 4774 & HB 5636
        - Tax rate – flat rate of 30%, i.e., same as corporate tax rate
        - Tax base – net income
        - Optional standard deduction reduced from 40% to 20%
      - ✓ Under SB 1408
        - Tax rate – has no provision; analysis assumes that it is same as HB 4774, HB 5636

PIT treatment of CIEs - HB 4774 , HB 5636 & SB 1408

- Individuals with compensation income below PhP 5 M will pay significantly lower PIT under HB 4774, HB 5636 and SB 1408 than under the existing PIT regime
  - Opposite is true for individuals with compensation income above PhP 5 M

- In particular, PIT liability of an entry level DepEd teacher who makes about PhP 20,000 per month will be zero under HB 4774, HB 5636 and SB 1408 compared with:
  - PhP 22,500 under the existing PIT regime if he/ she has two children, or
  - PhP 35,000 under existing PIT regime if he/ she has no children

PIT treatment of SEPs – HB 4774, HB 5636 & SB 1408

- SEPs with gross sales/ receipts higher than PhP 3 M
  - From 2020 onwards, SEPs with net income between PhP 3 M and PhP 8.95 M will be taxed more heavily than CIEs with comparable income levels under HB 4774 & HB 5636
    - Opposite is true for SEPs with net income above PhP 8.95 M

PIT treatment of SEPs – HB 4774, HB 5636 & SB 1408

- SEPs with gross sales/ receipts below PhP 3 M
  - SEPs – heterogeneous group which includes small store owners, food service providers, doctors, lawyers and other professionals
  - ETR (or the ratio of tax liability to net income) of SEPs under this category depends on their "profit margin" (or the ratio of their net income to their gross sales/ receipts)
    - o SEPs with lower profit margins will have higher ETRs than SEPs with higher profit margins ➔ SEPs with higher profit margins are given more favorable treatment than those with lower profit margins under TRAIN bills
      - ✓ In particular, SEPs with profit margins greater than 27% will get better tax treatment than SEPs with gross sales/ receipts greater than P 3 M, i.e., their ETR will be less than 30%
      - ✓ Moreover, SEPs with gross sales/ receipts between PhP 1.5 M and PhP 3 M and with profit margins higher than 60% get better tax treatment than SEPs with gross sales/ receipts greater than PhP 3 M as well as wage income earners with comparable income

Link to ILLUSTRATIVE EXAMPLES

Implications of PIT provisions of TRAIN bills on absolute tax burden (by decile) and revenue take

Income Decile	HB 4774, HB 5636, SB 1408 - year 1 & 2 *			HB 4774, HB 5636 & SB 1408 -year 3 onwards *		
	Comp. income	SEP income **	Total	Comp. income	SEP income **	Total
First (poorest)	-46	5,394	5,348	-46	5394	5348
Second	-226	6,495	6,269	-227	6495	6268
Third	-621	6,706	6,085	-621	6706	6085
Fourth	-2,103	7,094	4,991	-2109	7094	4985
Fifth	-4,108	7,528	3,420	-4117	7528	3411
Sixth	-7,831	7,867	36	-7905	7867	-38
Seventh	-13,528	8,104	-5,425	-13740	8104	-5636
Eighth	-22,187	8,445	-13,742	-22799	8445	-14354
Ninth	-37,807	7,681	-30,127	-40193	7681	-32513
Tenth (richest)	-89,723	9,574	-80,149	-103552	9574	-93978
Total	**-178,181**	**74,888**	**-103,293**	**-195310**	**74888**	**-120422**
% to GDP	**-1.3**	**0.6**	**-0.8**	**-1.5**	**0.6**	**-0.9**

* negative(positive) number indicates reduction (increase) in PIT liability

** assumes gross-up factor of 0.3 for SEP income of SEP with gross sale/ receipts below PhP 3 M and that 2015 collection efficiency is forthcoming under TRAIN

- On average, reduced PIT liability of CIEs in all deciles and higher PIT liability of SEPs in all deciles due to TRAIN
- On average, higher PIT liability for those in deciles 1-5 but lower PIT liability for those in deciles 6-10 due to TRAIN

Implications of PIT provisions of TRAIN bills on revenue take

- PIT collections from compensation income projected to decline by 1.5% of GDP under 3 TRAIN bills (based on year 3 rate schedule)
- PIT collections from SEP income projected to increase by 0.6% of GDP under 3 TRAIN bills using year 3 rate schedule and assuming that 2015 collection efficiency persists in outer years
- Overall PIT revenues projected to decrease by 0.9% of GDP under 3 TRAIN bills

Implications PIT provisions of TRAIN on effective tax rate (ETR)

Effective tax rate (i.e., ratio of tax liability to taxable income), across deciles

Income Decile	Existing Regime			HB 4774, HB 5636, SB 1408 - year 1 & 2			HB 4774, HB 5636, SB 1408 - year 3 onwards		
	Wage income	SEP income *	Total	Wage income	SEP income *	Total	Wage income	SEP income	Total
First (poorest)	0.04	0.01	0.03	0.00	4.53	2.25	0.00	4.53	2.25
Second	0.12	0.07	0.10	0.00	4.52	2.00	0.00	4.52	2.00
Third	0.27	0.16	0.22	0.00	4.49	1.81	0.00	4.49	1.81
Fourth	0.74	0.23	0.55	0.01	4.49	1.66	0.01	4.49	1.66
Fifth	1.23	0.39	0.93	0.01	4.50	1.59	0.01	4.50	1.59
Sixth	1.96	0.62	1.52	0.07	4.52	1.53	0.06	4.52	1.52
Seventh	2.91	0.95	2.30	0.17	4.53	1.54	0.13	4.53	1.51
Eighth	4.16	1.44	3.31	0.42	4.56	1.72	0.32	4.56	1.65
Ninth	6.30	2.21	5.05	1.31	4.52	2.29	0.99	4.52	2.07
Tenth (richest)	12.09	3.48	8.82	4.90	4.73	4.83	3.79	4.73	4.15
Total	**5.42**	**1.66**	**4.09**	**1.60**	**4.58**	**2.66**	**1.23**	**4.58**	**2.42**

* assumes gross-up factor of 0.3 for SEP income of SEP with gross sale/ receipts below PhP 3 M and that 2015 collection efficiency is forthcoming under TRAIN

- Average ETR on compensation income goes down from 5.4% under existing regime to 1.6% in years 1 & 2 of TRAIN implementation to 1.2% in year 3 of TRAIN implementation
- Average ETR on SEP income increase from 1.7% under the existing regime to 4.6% under TRAIN

Implications of PIT provisions of TRAIN bills on ETR

- Overall average ETR on SEP income under TRAIN more than 2.75 times than that under the existing regime
  - Raises risk that tax compliance/ collection efficiency may decline from the 2015 level of 18%
    - For instance, a 5 percentage point decline in collection efficiency of PIT from SEP income projected to result in a loss in PIT revenue equal to 0.25% of GDP

Implications of PIT provisions of TRAIN bills on ETR – horizontal inequity

- Unequal tax treatment of CIEs and SEPs under TRAIN bills ➔ overall average ETR on SEP income = 3.7 times of overall average ETR on wage income in year 3 of TRAIN implementation
  - Disparity in tax treatment of CIEs and SEPs more pronounced for those in lower deciles

- Marginal increase in gross sales/ gross receipts from PhP 3 M results in a dramatic increase in ETR of SEPs, particularly those with relatively high profit margins
  - Two alternative result
    - o More pronounced work-leisure tradeoff
    - o Greater incentive for SEPs to under-declare gross sales/ receipts

Winners and losers from PIT reform

Winners and losers from PIT reform under TRAIN (year 3)

Income decile	Distribution of change in PIT burden across deciles (HB 5636 -year 3) *			Change in PIT liability as % of income *		
	Wage income	SEP income **	Total	Wage income	SEP income **	Total
First (poorest)	0.0	7.2	4.4	0.0	4.5	2.2
Second	-0.1	8.7	5.2	-0.1	4.5	1.9
Third	-0.3	9.0	5.1	-0.3	4.3	1.6
Fourth	-1.1	9.5	4.1	-0.7	4.3	1.1
Fifth	-2.1	10.1	2.8	-1.2	4.1	0.7
Sixth	-4.0	10.5	0.0	-1.9	3.9	0.0
Seventh	-7.0	10.8	-4.7	-2.8	3.6	-0.8
Eighth	-11.7	11.3	-11.9	-3.8	3.1	-1.7
Ninth	-20.6	10.3	-27.0	-5.3	2.3	-3.0
Tenth (richest)	-53.0	12.8	-78.0	-8.3	1.3	-4.7
Total	**-100.0**	**100.0**	**100.0**	**-4.2**	**2.9**	**-1.7**

* negative(positive) number indicates reduction (increase) in PIT liability

** assumes gross-up factor of 0.3 for SEP income of SEP with gross sale/ receipts below PhP 3 M and that 2015 collection efficiency is forthcoming under TRAIN

- Biggest winners are CIEs belonging to the richest decile – as evidenced by highest reduction in their average ETR and by largest share in total reduction in PIT burden
- Biggest losers are SEPs from the poorest decile – this group has highest increase in their ETRs (although their share in total increase in tax burden of SEPS smaller than that of richer decile
- ➔ Direction of PIT reform not pro-poor

Winners and losers from PIT reform under TRAIN

- Biggest winners are CIEs belonging to the richest decile – as evidenced by highest reduction in their average ETR and by largest share in total reduction in PIT burden
  - CIEs from poorer deciles also projected to have lower ETRs under TRAIN but reduction in their ETRs significantly smaller than that of richer deciles
  - Share of CIEs from poorer deciles in total reduction in PIT burden also smaller than that of richer deciles
- Biggest losers are SEPs from the poorest decile – this group has highest increase in their ETRs (although their share in total increase in tax burden of SEPS smaller than that of richer decile)
- ➔ Direction of PIT reform not pro-poor

Implications of VAT provisions of HB 4774, HB 5636, SB 1408

HB 4774, HB 5636, & SB 1408 – same VAT provisions

- Expand VAT base
  - Remove VAT exemption of:
    - Sales of agricultural cooperatives & their importation of direct farm inputs, machineries and equipment *
    - Gross receipts from lending of credit & multi-purpose coops *
    - Sales of non-agri, non-credit, non-electric coops
    - Socialized and low cost housing
    - Lease of residential property with monthly rental below PhP 10,000
    - Power transmission

* Sales of agricultural food products in their original state of agri-coops and gross receipts from lending of credit and multi-purpose coops will still be VAT-exempt of Section 109 (1) (A) and Section 109 (1) (E) but "small" non-agri, non-credit and non-electric coops will no longer be exempt from payment of 3% "other percentage tax " on their gross sales/ receipts

HB 4774, HB 5636, & SB 1408 – same VAT provisions

- Expand VAT base
  - Change in VAT treatment of:
    - Indirect exports from zero-rated to VAT-able except when sold to PEZA locators
- Increase VAT threshold from PhP 1.5 M to PhP 3 M

HB 4774, HB 5636, & SB 1408 – different VAT provision wrt renewable energy

- Treatment of sales of power/ fuel from renewable energy
  - HB 4774 and SB 1408 – change from zero rated to VAT exempt
  - HB 5636 – zero rated as it is at present

- Making sales of power of renewable energy firms VAT exempt likely to result in tax cascaing
  - Final consumers of VAT exempt goods will bear the burden of the VAT paid on the VAT-able inputs going into the production of the VAT exempt good
  - Price of output of intermediate users of VAT exempt goods and all producers/ sellers down the production-distribution chain rises

Link to “How the VAT works: a digression”

Implications of VAT provision of TRAIN bills

- On revenue
  - As a result of the expansion of the VAT base VAT revenue is projected to increase by PhP 31.3 B (or 0.23% of GDP)

Incidence of increase in VAT burden under TRAIN

VAT burden as % of HH income

Income decile	Existing	TRAIN	Change in VAT regime
First	8.12	8.55	0.432
Second	7.63	8.03	0.406
Third	7.41	7.81	0.395
Fourth	7.29	7.68	0.391
Ffith	7.37	7.77	0.396
Sixth	7.37	7.77	0.397
Seventh	7.20	7.59	0.390
Eighth	7.12	7.51	0.388
Ninth	7.00	7.39	0.384
Tenth	6.09	6.42	0.332
Total	**6.95**	**7.32**	**0.376**
Suits index	-0.044	-0.043	

* VAT borne by households as % of household income

- VAT under TRAIN - slightly less regressive than existing VAT (refer to Suits index in last row)
- Change in VAT ETR due to TRAIN largest for 2 poorest deciles (refer to last column of table above)

Implications of VAT provision of TRAIN

- On economic efficiency
  - Change in VAT treatment of indirect exporters
    - o Impact on revenue – zero (as shown in next slide)
    - o Will likely have perverse effect in promoting backward linkage of export activity
    - o Will tend to increase cost of money borne by direct exporters as this move will likely increase the tax credit due them for the VAT on their inputs given the difficulties in using tax credits
    - o Proposed change appears to be driven by concern that zero-rating of indirect exports results in tax leakage
      - ✓ Concern may be misplaced in the case of indirect exporters which are PEZA locators given existing controls in moving their goods out of PEZA-supervised "customs territory" when they sell their goods in the domestic market

VAT liability of direct and indirect exporters under present system under TRAIN

VAT regime	Direct Exporter (I)	Indirect Exporter (II)	Total = (I) + (II)
Existing regime (1)	$-0.12\,(DX_{oi})$	$-0.12\,(IX_i)$	$-0.12\,(DX_{oi}) - 0.12\,(IX_i)$
HB 4774 (2)	$-0.12\,(IX_o) - 0.12\,(DX_{oi})$	$0.12\,(IX_o) - 0.12\,(IX_i)$	$-0.12\,(DX_{oi}) - 0.12\,(IX_i)$
Difference = (1) +(2)	$-0.12\,(IX_o)$	$0.12\,(IX_o)$	0

where

- IX_o denote output of indirect exporters which are used as intermediate inputs of direct exporters,
- IX_i denote intermediate inputs used in the production of IX_o,
- DX_{oi} denote other intermediate inputs used in the production of direct exports,

Implications of VAT provisions under TRAIN

- On cooperatives
  - Sales of agri-, non-agri, non-credit, non-electric coops will be VAT-able
    - But, coops' sales of agricultural food products in their original state and their gross receipts from lending will continue to be VAT-exempt because of Section 109 (1) (A) and Section 109 (1) (E)
    - "Small" agri-coops (i.e., coops with gross sales/ receipts below VAT threshold of PhP 3 M) will no longer be exempt from payment of the 3% "other percentage tax " on their gross sales/ receipts

Implications of VAT provision of HB 4774

- On cooperatives
  - Making non-food sales of agri-coops and all sales of non-agri, non-credit, non-electric coops VAT-able will likely:
    - Increase the price that final consumers of these products pay
    - Encourage enterprises which uses said products as intermediate inputs to buy the same from cooperatives (because they can now claim a tax credit for the VAT paid on said inputs)

Implications of Proposed Increase in Excise Tax on Petroleum Products under HB 4774, HB 5636, SB 1408

Excise tax on petroleum products under HB 4774, HB 5636, SB 1408 – the same

Proposed excise tax on petroleum products under TRAIN

Type of fuel	Demand (liters) 2015	Current tax (P/L)	Excise tax proposal		
			Year 1	Year 2	Year 3
Diesel	9,137,285	0.00	3.00	5.00	6.00
Fuel oil	2,297,332	0.00	3.00	5.00	6.00
Gasoline *	4,716,642	4.35	7.00	9.00	10.00
LPG	2,359,695	0.00	3.00	5.00	6.00
Kerosene	128,954	0.00	3.00	5.00	6.00
Aviation turbo, jet fuel	558,751	3.67	7.00	9.00	10.00
Others	1,330,352	2.74	5.72	7.72	8.72

* refers to tax rate for unleaded gasoline

Proposed excise tax rate on petroleum products

Implications of proposed increase in excise tax on petroleum products

- On revenue (estimated based on 2015 demand)
  - PhP 30.0 B in 2018
  - PhP 101.3 B in 2019
  - PhP 121.7 B in 2020 onwards

Incidence of proposed increase excise tax on petroleum products

Income decile	Existing	TRAIN (year 2)	Change* in excise tax - year 2	TRAIN (year 3)	Change* in excise tax - year 3
First	0.29	1.42	1.13	1.65	1.36
Second	0.28	1.37	1.09	1.59	1.31
Third	0.29	1.39	1.10	1.61	1.33
Fourth	0.29	1.40	1.12	1.63	1.34
Ffith	0.31	1.49	1.19	1.73	1.43
Sixth	0.32	1.53	1.22	1.78	1.46
Seventh	0.32	1.54	1.23	1.79	1.47
Eighth	0.32	1.57	1.25	1.82	1.50
Ninth	0.32	1.58	1.25	1.83	1.51
Tenth	0.32	1.55	1.23	1.79	1.48
Total	**0.31**	**1.52**	**1.21**	**1.76**	**1.45**
Reynolds-Smolensky index	0.0001	0.0003	0.0002	0.0004	0.0003

* change measured relative to existing levels

- Tax burden of excise tax on petroleum products marginally progressive as indicated by RS index (last row of table)
- Change in excise tax burden as % of HH income increases as HH income rises in deciles 2 to 9 (refer to columns 4 and 6)

Implications of increase excise tax on petroleum products

- On economic efficiency
  - Likely to reduce road congestion and pollution from both transportation
  - Likely to reduce use of relatively more pollutive fuel as tax on diesel increases from zero
  - Will have some impact on inflation - 0.6% in 2018, 0.4% in 2019 and 0.2% in 2020

Implications of Proposed Increase in Excise Tax on Automobiles under HB 4774, HB 5636, SB 1408

Excise tax on automobiles under HB 4774, HB 5636 and SB 1408

Excise tax on automobiles

	Excise tax			
Manufacturer's or importers net selling price	**Now**	**HB 4774, SB 1408**	**HB 5636 - year 1**	**HB 5636 - year 2**
up to PhP 600,000	2%	4%	3%	4%
over PhP 600, 000 to PhP 1.1 million	PhpP 20,000 + 20% of excess over PhP 600,000	PhpP 24,000 + 40% of excess over PhP 600,000	PhP 18,000 + 30% of excess over PhP 600,000	PhP 24,000 + 40% of excess over PhP 600,000
over PhP 1.1 million to PhP 2.1 million	PhP 112,000 + 40% of excess over PhP 1.1 million	PhP 224,000 + 100% of excess over PhP 1.1 million	PhP 168,000 + 60% of excess over PhP 1.1 million	PhP 224,000 + 60% of excess over PhP 1.1 million
Over PhP 2.1 million (to PhP 3.1 million)	PhP 512,000 +60% of excess over PhP 2.1 million	PhP 1,224,000 +200% of excess over PhP 2.1 million	PhP 1,468,000 + 90% of excess over PhP 2.1 million	PhP 824,000 + 100% of excess over PhP 2.1 million
Over PhP 3.1 million				PhP 1,824,000 + 120% of excess over PhP 3.1 million

- Increase in excise tax on automobiles – higher than 100% on the average under HB 4774 and SB 1408 with higher increases for higher-priced cars
- Increase under HB 5636 – lower than 100% on the average with highest increase for lowest priced brackets and highest priced brackets

Implications of proposed increase in excise tax on automobiles

- On revenue based on 2015 levels of demand
  - PhP 24 B

- On tax incidence
  - Incidence of proposed increase in excise tax on automobiles expected to be progressive – but incidence under HB 5636 less so

- Policy coordination issue vs CARS program – especially under HB 5636 which imposes higher tax rates on lower-priced cars produced under the program vis higher-priced cars

Implications of Imposition of Excise Tax on Sugar Sweetened Beverages under HB 5636

Implications of proposed increase in excise tax on sugar sweetened beverages

- On revenue
  - PhP 52 B (or 0.4% of GDP)
- On economic incentives
  - Advantage
    - Likely to discourage consumption of sugar-sweetened beverages which has associated health benefits (e.g., lower risk of diabetes, obesity)
  - Disadvantage
    - May hurt the poor who rely on some of these products as a cheap source of calories
    - More important, no externality involved in excessive consumption of sugary drinks which will justify imposition of such a tax (BW column of de Dios – July 10, 2017)

Summary and Conclusions

What is good about TRAIN?

- Overarching objective of reform – laudable
  - Improving fairness and efficiency of tax system while at the same time protecting national government's aggregate revenue take and simplifying tax system
- That it consists of a package of several tax measures
  - mix of revenue increasing and revenue losing measures
  - As such minimizes risk of Congress enacting revenue losing measures only
- Inclusion of some compensatory measure for those adversely affected

Overall impact on HB 5636 - on revenues

- High estimate* shown in table
  - Lower than DOF's initial estimate (PhP 200 B)
  - not likely to be achieved due to poor incentives to SEPs to improve their tax compliance

Revenue impact of tax reform under HB 5636 (in miilion pesos)

	2018	2019	2020
PIT on wage income [a/]	(178,181)	(178,181)	(195,310)
PIT on income of SEPs [b/]	74,888	74,888	74,888
PIT	(103,293)	(103,293)	(120,422)
VAT	31,273	31,273	31,273
Excise tax on petroleum prod	60,097	101,155	121,684
Other percentage tax [c/]	(3,784)	(3,784)	(3,784)
Excise tax on automobiles	20,000	24,100	24,100
Excise tax on "sugary" beverages [d/]	51,900	51,900	51,900
Total 1 (high estimate)	**56,194**	**101,352**	**104,752**
% to GDP	0.4	0.8	0.8
5 percentage point reduction in coll eff of PIT on SEP	(32,950)	(32,950)	(32,950)
Total 2 (low estimate)	**23,244**	**68,402**	**71,801**
% to GDP	0.2	0.5	0.5

a/ high probability of being realized

b/ subject to uncertainty

c/ reduction in revenues from "other percentage tax" collected from entities with gross sales/ receipts below VAT ceiling for "small enterprises" due to HB 5636

d/ based on DOF estimates

Overall impact on TRAIN bills – on revenues

- Risk of decline in compliance among SEPs even more worrisome given recent performance of key tax administration agencies – flat in the case of BOC and slight deterioration in the case of BIR in the second semester of 2016

- Highlights need for stricter enforcement and repeal of bank secrecy law

Tax to GDP ratio, semestral, 2009-2016

Year	BIR Revenues			BOC Revenues		
	S1	S2	Full Year	S1	S2	Full Year
2009	9.9	8.8	9.3	2.8	2.7	2.7
2010	9.4	8.9	9.1	3.0	2.7	2.9
2011	9.8	9.2	9.5	2.8	2.7	2.7
2012	10.4	9.7	10.0	2.8	2.6	2.7
2013	10.8	10.3	10.5	2.6	2.6	2.6
2014	10.9	10.4	10.7	2.9	3.0	2.9
2015	11.1	10.5	10.8	2.8	2.7	2.8
2016	11.4	10.4	10.8	2.8	2.7	2.7

Overall impact on HB 5636 - who bears the burden?

Change* in tax burden due to HB 5636 as % of HH income, 2020 onwards

Income decile	PIT	VAT	Excise tax on petroleum products	Total
First	2.22	0.43	1.36	4.01
Second	1.90	0.41	1.31	3.62
Third	1.59	0.40	1.33	3.31
Fourth	1.10	0.39	1.34	2.83
Ffith	0.66	0.40	1.43	2.48
Sixth	-0.01	0.40	1.46	1.86
Seventh	-0.78	0.39	1.47	1.08
Eighth	-1.66	0.39	1.50	0.22
Ninth	-2.98	0.38	1.51	-1.09
Tenth	-4.68	0.33	1.48	-2.87
Total	**-1.67**	**0.38**	**1.45**	**0.16**

* positive (negative) sign indicates increase (decrease) in tax burden

Change in tax burden as % of HH income (or HHY) – highest for poorest decile (increase of 4% of HHY) and declining as HH income rises (e.g., decrease of 2.8% of HHY for richest decile) ➔ indicating regressive character of reform when one abstracts from targeted cash transfer program to be financed by part of incremental revenues

Overall impact on HB 5636 – who bears the burden?

Distribution of change in tax burden due to HB 5636 across income deciles, 2020 or

Income decile	PIT (million pesos)	VAT (million pesos)	Excise tax on petrol (million pesos)	All tax changes (million pesos)
First	5,348	1,041	3,279	9,668
Second	6,268	1,342	4,333	11,943
Third	6,085	1,516	5,089	12,690
Fourth	4,985	1,769	6,076	12,831
Ffith	3,411	2,060	7,423	12,893
Sixth	(38)	2,451	9,036	11,449
Seventh	(5,636)	2,809	10,616	7,789
Eighth	(14,354)	3,348	12,928	1,922
Ninth	(32,513)	4,186	16,438	(11,888)
Tenth	(93,978)	6,669	29,683	(57,626)
Total	**(120,422)**	**27,190**	**104,901**	11,669

- HB 5636 results in a net income transfer from households in deciles 1 – 8 in favor of deciles 9 – 10
- RS index of taxes (PIT+VAT+excise tax on petrol) declines from 0.0152 under the present regime to 0.0014 ➔ system will become less progressive

Overall impact on HB 5636

- Finding in previous slide highlights importance of compensatory transfers (e.g., targeted cash transfer program) to the poorer deciles (especially, 3-4 poorest deciles) as provided under TRAIN
  - HB 5636 provision better than that under HB 4774 and SB 1408
    - Available for 3 years under HB 5636 and 1 year under HB 4774 and SB 1408

- Beyond compensatory transfers to the poor, it is important to ensure that higher government spending financed from incremental revenues from tax reform (say, government infra expenditures) result in growth that benefit the poor given sunset clause on said transfers

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Thank You!

PIT on SEPs with gross sales = PhP 2.999 M

Gross sales (GS)/ receipts (GR)	Ratio of NOS to GS or GR	Net operating surplus (NOS)	TL = 8% tax on GS or GR	TL/ NOS (%)	Tax if NOS were wage income	Equivalent ETR if NOS were wage income
2,999,999	0.1	300,000	240,000	80.0	7,500	2.5
2,999,999	0.2	600,000	240,000	40.0	62,500	10.4
2,999,999	0.267	801,000	240,000	30.0	102,750	12.8
2,999,999	0.3	900,000	240,000	26.7	127,500	14.2
2,999,999	0.45	1,350,000	240,000	17.8	240,000	17.8
2,999,999	0.5	1,500,000	240,000	16.0	277,500	18.5
2,999,999	0.6	1,799,999	240,000	13.3	352,500	19.6
2,999,999	0.7	2,099,999	240,000	11.4	432,500	20.6
2,999,999	0.8	2,399,999	240,000	10.0	522,500	21.8
2,999,999	0.9	2,699,999	240,000	8.9	612,500	22.7

- SEPs with profit margins greater than 26.7% will have ETRs that are lower than 30% ➔ they will get better tax treatment than SEPs with gross sales/ receipts greater than P 3 M
- SEPs with profit margins higher than 45% will have ETRs which are not only lower than 30% but also lower than the ETR on comparable wage income (using 2020 rate sked) ➔ they will get better tax treatment than SEPs with gross sales/ receipts greater than PhP 3 M as well as wage income earners with comparable income

PIT on SEPs with gross sales = PhP 2.0 M

Gross sales (GS)/ receipts (GR)	Ratio of NOS to GS or GR	Net operating surplus (NOS)	TL = 8% tax on GS or GR	TL/ NOS (%)	Tax if NOS were wage income	Equivalent ETR if NOS were wage income
2,000,000	0.1	200,000	160,000	80.0	0	0
2,000,000	0.2	400,000	160,000	40.0	22500	5.6
2,000,000	0.267	534,000	160,000	30.0	49300	9.2
2,000,000	0.3	600,000	160,000	26.7	62500	10.4
2,000,000	0.4	800,000	160,000	20.0	102500	12.8
2,000,000	0.515	1,030,000	160,000	15.5	160000	15.5
2,000,000	0.6	1,200,000	160,000	13.3	202500	16.9
2,000,000	0.7	1,400,000	160,000	11.4	252500	18.0
2,000,000	0.8	1,600,000	160,000	10.0	302500	18.9
2,000,000	0.9	1,800,000	160,000	8.9	352500	19.6

- SEPs with profit margins greater than 26.7% will have ETRs that are lower than 30% ➔ they will get better tax treatment than SEPs with gross sales/ receipts greater than P 3 M
- SEPs with profit margins higher than 51.5% will have ETRs which are not only lower than 30% but also lower than the ETR on comparable wage income (using 2020 rate sked) ➔ they will get better tax treatment than SEPs with gross sales/ receipts greater than PhP 3 M as well as wage income earners with comparable income

PIT on SEPs with gross sales = PhP 1.5 M

Gross sales (GS)/ receipts (GR)	Ratio of NOS to GS or GR	Net operating surplus (NOS)	TL = 8% tax on GS or GR	TL/ NOS (%)	Tax if NOS were wage income	Equivalent ETR if NOS were wage income
1,500,000	0.1	150,000	120,000	80.0	0	0
1,500,000	0.2	300,000	120,000	40.0	7,500	2.5
1,500,000	0.267	400,500	120,000	30.0	22,600	5.6
1,500,000	0.3	450,000	120,000	26.7	32,500	7.2
1,500,000	0.45	675,000	120,000	17.8	77,500	11.5
1,500,000	0.5	750,000	120,000	16.0	92,500	12.3
1,500,000	0.591	886,500	120,000	13.5	119,800	13.5
1,500,000	0.6	900,000	120,000	13.3	127,500	14.2
1,500,000	0.7	1,050,000	120,000	11.4	165,000	15.7
1,500,000	0.8	1,200,000	120,000	10.0	202,500	16.9
1,500,000	0.9	1,350,000	120,000	8.9	240,000	17.8

- SEPs with profit margins greater than 26.7% will have ETRs that are lower than 30% ➔ they will get better tax treatment than SEPs with gross sales/ receipts greater than P 3 M
- SEPs with profit margins higher than 59.1% will have ETRs which are not only lower than 30% but also lower than the ETR on comparable wage income (using 2020 rate sked) ➔ they will get better tax treatment than SEPs with gross sales/ receipts greater than PhP 3 M as well as wage income earners with comparable income

PIT on SEPs with gross sales = PhP 1.0 M

Gross sales (GS)/ receipts (GR)	Ratio of NOS to GS or GR	Net operating surplus (NOS)	TL = 8% tax on GS or GR	TL/ NOS (%)	Tax if NOS were wage income	Equivalent ETR if NOS were wage income
1,000,000	0.1	100,000	80,000	80.0	0	0
1,000,000	0.2	200,000	80,000	40.0	0	0
1,000,000	0.267	267,000	80,000	30.0	2,550	1.0
1,000,000	0.3	300,000	80,000	26.7	7,500	2.5
1,000,000	0.45	450,000	80,000	17.8	32,500	7.2
1,000,000	0.5	500,000	80,000	16.0	42,500	8.5
1,000,000	0.6875	687,500	80,000	11.6	80,000	11.6
1,000,000	0.7	700,000	80,000	11.4	82,500	11.8
1,000,000	0.8	800,000	80,000	10.0	102,500	12.8
1,000,000	0.9	900,000	80,000	8.9	127,500	14.2

- SEPs with profit margins greater than 26.7% will have ETRs that are lower than 30% ➔ they will get better tax treatment than SEPs with gross sales/ receipts greater than P 3 M
- SEPs with profit margins higher than 68.8% will have ETRs which are not only lower than 30% but also lower than the ETR on comparable wage income (using 2020 rate sked) ➔ they will get better tax treatment than SEPs with gross sales/ receipts greater than PhP 3 M as well as wage income earners with comparable income

How the VAT works: a digression

- VAT is a tax on consumption
  - It is an indirect tax which is collected at various stages of the production and distribution chain, much like the turnover tax / multi-stage sales tax
    - But, VAT does not result in tax cascading* (i.e., tax-on-tax) that is characteristic of the latter
      - ✓ The seller of any good liable to a multi-stage turnover tax pays government the turnover tax rate times the value of its output
      - ✓ If said good (good A) is an input to another product, the tax "content" of this second product (good B) not only includes the turnover tax directly levied on it but also the turnover tax previously levied on its inputs
    - Tax cascading distorts the way of doing business, and provides undue incentive for vertical integration of business activity

How the VAT works: a digression

- VAT-able good/ service
  - the seller of a VAT-able good pays government the VAT on its output (i.e., VAT rate times selling price before VAT) less the sum of VAT on all its VAT-able inputs
  - Typically, the invoice issued by the seller indicates the value of good sold before tax and the amount of VAT levied on the said good
    - Signals that VAT on output is passed on (shifted) to the buyer
    - ➔ VAT borne by producers is zero as (i) the VAT on their output is shifted forward to their buyers, and (ii) they are able to claim credit for the VAT they paid when they purchased their inputs
    - ➔ VAT borne by final consumer of VAT-able good is equal to the VAT levied on the selling price before VAT

All sales are VAT-able

ILLUSTRATIVE EXAMPLE* - ALL SALES ARE VAT-ABLE AT 10%

	Primary producer (P)	Manufac-turer (M)	Wholesa-ler (W)	Retailer (R)
A. Transactions exclusive of VAT				
1. Sales	400	1,200	1,400	2,000
2. Purchases (inputs)	-	400	1,200	1,400
3. Value-added	380	800	200	600
Wages	350	750	190	560
Capital income	20	50	10	40
B. If all sales are VAT-able at 10%				
1. Sales (or output) net of VAT	400	1,200	1,400	2,000
2.1. Purchases (or inputs) - VAT inclusive	-	440	1,320	1,400
2.2. Purchases (or inputs) - net of VAT credit	-	400	1,200	1,260
3. Value-added	380	800	200	600
Wages	350	750	190	560
Capital income	20	50	10	40
Memo item:				
Output sales before VAT	400	1200	1400	2000
Output sales inclusive of VAT	440	1320	1540	2200
VAT				
1. Output VAT	40	120	140	200
2. Input VAT	0	40	120	140
3. Net tax paid by seller to govt	40	80	20	60

* adapted from Cnossen (2011)

How the VAT works: a digression

- VAT exempt good/ service
  - seller of a VAT exempt good does not pay government any VAT on its output but he is also not able to claim credit for the VAT he paid on his VAT-able inputs
    - If the seller of VAT exempt goods is not able to shift the VAT he paid on his VAT-able inputs forward to his buyers:
      - ✓ No change in the price of VAT exempt good
      - ✓ Profits of producers of VAT-exempt goes down by the amount of the VAT on its inputs

If the seller of VAT exempt goods is not able to shift the VAT he paid on his VAT-able inputs forward to his buyers

ILLUSTRATIVE EXAMPLE* - ALL SALES ARE VAT-ABLE AT 10% EXCEPT THAT OF MANUFACTURER WHO IS VAT-EXEMPT

	Primary producer (P)	Manufac-turer (M)	Wholesa-ler (W)	Retailer (R)
A. Transactions exclusive of VAT				
1. Sales	400	1,200	1,400	2,000
2. Purchases (inputs)	-	400	1,200	1,400
3. Value-added	380	800	200	600
Wages	350	750	190	560
Capital income	20	50	10	40
B. If sales of manufacturer is VAT-exempt but all other sales are VAT-able at 10%; manufacturer assumed not to be able to shift VAT on inputs to wholesaler				
1. Sales (or output) net of VAT	400	1200	1400	2000
2.1. Purchases (or inputs) - VAT inclusive	0	440	1200	1540
2.2. Purchases (or inputs) - net of VAT credit	0	440	1200	1400
3. Value-added	380	760	200	600
Wages	350	750	190	560
Capital income	20	10	10	40
Memo item:				
Output sales before VAT	400	1200	1400	2000
Output sales inclusive of VAT	440	1200	1540	2200
VAT				
1. Output VAT	40	0	140	200
2. Input VAT	0	0	0	140
3. Net tax paid by seller to govt	40	0	140	60

* adapted from Cnossen (2011)

How the VAT works: a digression

- VAT exempt good/ service
  - seller of a VAT exempt good does not pay government any VAT on its output but he is also not able to claim credit for the VAT he paid on his VAT-able inputs
    - If the seller of VAT exempt goods is able to shift the VAT he paid on his VAT-able inputs forward to his buyers:
      - ✓ Price of VAT exempt good goes up by the amount of VAT on its inputs
      - ✓ Producers who makes use of VAT exempt good as intermediate inputs will not be able to claim credit for the VAT embedded in the price of their VAT exempt inputs ➔ less incentive for these producers to use VAT exempt inputs or to buy inputs from VAT exempt sellers; tax cascading occurs
      - ✓ Final consumers of VAT exempt goods will bear the burden of the VAT paid on the VAT-able inputs going into the production of the VAT exempt good
      - ✓ Price of output of intermediate users of VAT exempt goods and all producers/ sellers down the production-distribution chain rises

If the seller of VAT exempt goods is able to shift the VAT he paid on his VAT-able inputs forward to his buyers

ILLUSTRATIVE EXAMPLE* - ALL SALES ARE VAT-ABLE AT 10% EXCEPT THAT OF MANUFACTURER WHO IS VAT-EXEMPT

	Primary producer (P)	Manufac-turer (M)	Wholesa-ler (W)	Retailer (R)
A. Transactions exclusive of VAT				
1. Sales	400	1,200	1,400	2,000
2. Purchases (inputs)	-	400	1,200	1,400
3. Value-added	380	800	200	600
Wages	350	750	190	560
Capital income	20	50	10	40
B. If sales of manufacturer is VAT-exempt but all other sales are VAT-able at 10%; manufacturer assumed to be able to shift VAT on inputs to wholesaler				
1. Sales (or output) net of VAT	400	1240	1440	2040
2.1. Purchases (or inputs) - VAT inclusive	0	440	1240	1584
2.2. Purchases (or inputs) - net of VAT credit	0	440	1240	1440
3. Value-added	380	800	200	600
Wages	350	750	190	560
Capital income	20	50	10	40
Memo item:				
Output sales before VAT	400	1240	1440	2040
Output sales inclusive of VAT	440	1240	1584	2244
VAT				
1. Output VAT	40	0	144	204
2. Input VAT	-	0	0	144
3. Net tax paid by seller to govt	40	0	144	60

* adapted from Cnossen (2011)

How the VAT works: a digression

- VAT exempt good/ service
  - Will tend to result in administrative difficulties and encourage non-compliance
    - e.g., a multi-product firm will have to "allocate" the VAT credit on its VAT-able inputs to the production of its VAT-exempt product and VAT-able product

- Things get even more messy when you have VAT-exempt transactions (e.g., VAT exemption of sales of drugs and medicines, restaurant meals, etc. to senior citizens)

How the VAT works: a digression

- Zero-rated good/ service (e.g., exports)
  - seller of zero-rated VAT-able good does not pay government any VAT on its output and he is also able to claim credit/ refund/ rebate for the VAT he paid on his VAT-able inputs