

# Assessment of RA 10963 (TRAIN law)

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# Overview of presentation

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## ❑ Background

- Issues that anchor need for tax reform
- Objectives of Duterte tax reform
- Overall design of Duterte Tax Reform

## ❑ Tax-by-tax analysis of TRAIN law

- 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 <sup>b/</sup>	20%	5	20%	10%	14.8%
Indonesia	30%	4	25%	10%	10.7%
Lao PDR	24%	6/7 <sup>c/</sup>	24%	10%	15.6%
Malaysia	28%	11	24%	6%	14.3%
Myanmar	25%	6	25%	b/	8.8%
<b>Philippines</b>	<b>32%</b>	<b>7</b>	<b>30%</b>	<b>12%</b>	<b>13.6%</b>
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

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- ❑ 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

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- ❑ 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

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- ❑ 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

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- ❑ 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 RA 10963

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1. Personal income tax (PIT) reform
2. VAT reform
3. Increase excise tax on petroleum products
4. Increase excise tax on automobiles
5. Reduce the estate and donor's taxes
6. Introduce excise tax on sweetened beverages
7. Increase the excise tax on cigarettes
8. Increase in the excise tax on coal
9. Increase documentary stamp tax on various transactions



# **Implications of Changes in Personal Income Tax (PIT) under RA 10963**

# PIT provisions under RA 10963

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- ❑ Adopted a graduated tax rate schedule with marginal tax rates that varies from 0% (applicable to annual taxable income not in excess of PhP 250,000 per year) to 35% (applicable to annual taxable income in excess of PhP 8 million)
- ❑ Adjusted the income tax brackets of the rate schedule such that a lower marginal tax rate is applicable to comparable annual taxable income levels with the exception of annual taxable income greater than PhP 8 million which will be subject to the new top marginal tax rate of 35% instead of 32% under the old system

# PIT provisions under RA 10963

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- ❑ Provides for different PIT regime for (i) compensation income earners [CIEs] and (ii) self-employed &/ or professionals [SEPs]
  - CIEs
    - Tax base - modified gross income
      - ✓ no personal exemption and deductions allowed with the exception of (i) 13<sup>th</sup> 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 7 under the old regime)
      - ✓ 0% tax on incomes not over PhP 250,000 vs 5% on taxable income not over PhP 10,000
      - ✓ Top marginal rate – 35% applicable to incomes above PhP 8 M vs 32% applicable to taxable income levels above PhP 500,000 under the old regime

# PIT provisions under RA 10963

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- ❑ Provides for different PIT regime for (i) compensation income earners [CIEs] and (ii) self-employed &/ or professionals [SEPs]
  - SEPs
    - Tax base – net income
    - Tax rate
      - ✓ SEPs with gross sales/ receipts in excess of VAT threshold tax based on graduated rate schedule
      - ✓ SEPs with gross sales/ receipts below VAT threshold given option:
        - To pay 8% of their gross sales/ receipts
        - To pay on the basis of graduated rate schedule

# Effective PIT rate under RA 10963

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## ❑ CIEs

- Lower effective PIT rate (i.e., tax liability/ taxable income) under RA 10963 compared to earlier PIT regime except those with annual taxable income in excess of 11.833 million in 2018-2022; but from 2023 onwards, CIEs will pay lower PIT compared to old regime regardless of their taxable income
  - RA 10963 more generous than HB 4774 and SB 1408, i.e., CIEs will be subject to lower effective PIT rate under RA 10963 compared to what would have been under HB 4774 or SB 1408

# Effective PIT rate under RA 10963

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## ❑ SEPs

- RA 10963 scores high in terms of providing the same tax treatment of similarly situated individuals by allowing SEPs with gross receipts/ sales below the VAT threshold to pay an 8% tax based on their gross sales/ receipts or to compute their tax liability by applying the graduated rate schedule to their net income
  - Absence of these 2 options under HB 4774 and SB 1408 → horizontal inequity

# Implications on PIT provisions under RA 10963 on effective tax rate

Income Decile	Effective tax rate (ETR)									Change in ETR - RA 10963 less old PIT regime					
	Prior to RA 10963			RA 10963 - 2018-2022			RA 10963 - 2023 onwards			RA 10963 - 2018-2022			RA 10963 - 2023 onwards		
	Wage income	SEP income	Total	Wage income	SEP income	Total	Wage income	SEP income	Total	Wage income	SEP income	Total	Wage income	SEP income	Total
First (poorest)	0.04	0.02	0.03	0.00	0.00	0.31	0.00	0.00	0.00	-0.04	-0.02	0.27	-0.04	-0.02	-0.03
Second	0.12	0.07	0.10	0.00	0.00	0.27	0.00	0.00	0.00	-0.12	-0.07	0.15	-0.12	-0.07	-0.10
Third	0.27	0.16	0.22	0.00	0.00	0.25	0.00	0.00	0.00	-0.27	-0.16	-0.02	-0.27	-0.16	-0.22
Fourth	0.74	0.23	0.55	0.00	0.00	0.23	0.00	0.00	0.00	-0.74	-0.23	-0.51	-0.74	-0.23	-0.55
Fifth	1.22	0.39	0.93	0.01	0.01	0.22	0.00	0.00	0.00	-1.21	-0.38	-1.00	-1.22	-0.38	-0.92
Sixth	1.95	0.62	1.52	0.04	0.02	0.24	0.03	0.01	0.03	-1.90	-0.60	-1.71	-1.91	-0.61	-1.49
Seventh	2.89	0.96	2.29	0.10	0.05	0.28	0.07	0.04	0.06	-2.79	-0.90	-2.62	-2.82	-0.91	-2.22
Eighth	4.13	1.44	3.29	0.22	0.16	0.39	0.17	0.13	0.15	-3.91	-1.28	-3.74	-3.97	-1.32	-3.14
Ninth	6.25	2.21	5.03	0.82	0.50	0.89	0.62	0.41	0.56	-5.43	-1.71	-5.37	-5.63	-1.80	-4.47
Tenth (richest)	12.01	3.48	8.78	3.52	2.33	3.17	2.72	1.97	2.44	-8.49	-1.15	-8.83	-9.29	-1.51	-6.35
<b>Total</b>	<b>5.38</b>	<b>1.66</b>	<b>4.07</b>	<b>1.12</b>	<b>0.78</b>	<b>1.18</b>	<b>0.86</b>	<b>0.66</b>	<b>0.79</b>	<b>-4.27</b>	<b>-0.88</b>	<b>-4.21</b>	<b>-4.52</b>	<b>-1.01</b>	<b>-3.28</b>
<b>RS index <sup>b/</sup></b>	<b>0.0213</b>	<b>0.0072</b>	<b>0.0167</b>	<b>0.0056</b>	<b>0.0044</b>	<b>0.0052</b>	<b>0.0043</b>	<b>0.0037</b>	<b>0.0042</b>						
<b>Change in RS index</b>				<b>-0.016</b>	<b>-0.003</b>	<b>-0.011</b>	<b>-0.017</b>	<b>-0.004</b>	<b>-0.013</b>						

a/ assumes that 2015 PIT collection efficiency is maintained and that SEPs with profit margin of 80% or better and with gross sales/ receipts below PhP 3 Mopt to pay the 8% tax on their gross sales/ receipts

b/ RS index refers to Reynolds-Smolensky index

- Average ETR on compensation income goes down from 5.4% under old regime to 1.1% in 2018-2022 and 0.9% from 2023 onwards under RA 10963
- Average ETR on SEP income goes down from 1.7% under the old regime to 0.8% in 2018 – 2022 and 0.7% from 2023 onwards under TA 10963

# Implications of PIT provisions under RA 10963 on ETR

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- ❑ Gap in the average ETR of CIEs and SEPs is projected to narrow, the average ETR of SEPS is projected to continue to be lower than that of CIEs from 2023 onwards
  - Substantial reduction in the average ETR of SEPs – positive development as this will likely improve their tax compliance



# Winners and losers from PIT reform under RA 10953

Table 5. Change in the PIT burden<sup>a/</sup> under RA 10963, by income decile, by type of income (in million pesos)

Income Decile	2018			2019-2022			2023		
	Wage income	SEP income	Total	Wage income	SEP income	Total	Wage income	SEP income	Total
First (poorest)	-46	728	682	-46	-18	-64	-46	-18	-64
Second	-228	812	584	-228	-96	-325	-229	-96	-325
Third	-621	715	94	-621	-242	-863	-621	-242	-863
Fourth	-2,121	649	-1,473	-2,121	-382	-2,503	-2,122	-383	-2,505
Fifth	-4,128	434	-3,695	-4,128	-701	-4,830	-4,133	-704	-4,836
Sixth	-7,952	38	-7,914	-7,952	-1,219	-9,171	-7,997	-1,228	-9,225
Seventh	-13,893	-644	-14,537	-13,893	-2,043	-15,935	-14,014	-2,066	-16,080
Eighth	-23,355	-1,830	-25,185	-23,355	-3,474	-26,829	-23,681	-3,558	-27,239
Ninth	-41,465	-3,887	-45,352	-41,465	-5,668	-47,133	-42,973	-5,977	-48,950
Tenth (richest)	-106,649	-6,632	-113,281	-106,649	-8,783	-115,432	-116,635	-11,493	-128,128
<b>Total</b>	<b>-200,459</b>	<b>-9,618</b>	<b>-210,077</b>	<b>-200,459</b>	<b>-22,626</b>	<b>-223,085</b>	<b>-212,450</b>	<b>-25,766</b>	<b>-238,216</b>
<b>% to GDP</b>	<b>-1.50</b>	<b>-0.07</b>	<b>-1.58</b>	<b>-1.50</b>	<b>-0.17</b>	<b>-1.67</b>	<b>-1.59</b>	<b>-0.19</b>	<b>-1.79</b>

a/E estimates refers to total reduction for all taxpayers belonging to a given income decile and assumes that 2017 PIT collection efficiency is maintained and that SEPs with profit margin of 80% or better and with gross sales/receipts below PhP 3 M opt to pay the 8% tax on their gross sales/receipts. Negative number means reduction in the PIT burden.

- Change in tax burden of CIEs and SEPs in peso terms projected to be negative for all income deciles under RA 10963 from 2019 onwards but positive for deciles 1-6 in 2018

# Winners and losers from PIT reform under RA 10953

Table 6. Percentage distribution of the reduction in PIT burden across income deciles under RA 10963

Income Decile	2018			2019-2022			2023		
	Wage income	SEP income	Total	Wage income	SEP income	Total	Wage income	SEP income	Total
First (poorest)	0.0	-7.6	-0.3	0.0	0.1	0.0	0.0	0.1	0.0
Second	0.1	-8.4	-0.3	0.1	0.4	0.1	0.1	0.4	0.1
Third	0.3	-7.4	0.0	0.3	1.1	0.4	0.3	0.9	0.4
Fourth	1.1	-6.7	0.7	1.1	1.7	1.1	1.0	1.5	1.1
Fifth	2.1	-4.5	1.8	2.1	3.1	2.2	1.9	2.7	2.0
Sixth	4.0	-0.4	3.8	4.0	5.4	4.1	3.8	4.8	3.9
Seventh	6.9	6.7	6.9	6.9	9.0	7.1	6.6	8.0	6.8
Eighth	11.7	19.0	12.0	11.7	15.4	12.0	11.1	13.8	11.4
Ninth	20.7	40.4	21.6	20.7	25.1	21.1	20.2	23.2	20.5
Tenth (richest)	53.2	69.0	53.9	53.2	38.8	51.7	54.9	44.6	53.8
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

- Biggest gains projected to accrue to CIEs belonging to the tenth (richest) decile who, as a group, receive largest share in the total reduction in PIT burden and to experience largest reduction in their PIT liability expressed as a percentage of their taxable income
- SEPs from poorest decile expected to gain the least from RA 10963 – having lowest reduction in ETR and lowest share in total PIT burden expressed in nominal peso reductions in their tax liability
- ➔ Direction of PIT reform not pro-poor – as indicated by decline in Reynolds-Smolensky index

# Implications of PIT provisions under RA 10963 on revenue take

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- ❑ Overall PIT revenues estimated to contract by PhP 210 billion (or 1.6% of GDP) in 2018, PhP 223 (or 1.7% of GD) in 2019-2022 and PhP 238 billion (or 1.8% of GDP) from 2023 onwards under RA 10963

# **Implications of VAT provisions under RA 10963**

# VAT provisions under RA 10963

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- ❑ VAT threshold increased from PhP 1.9 million to PhP 3 million
- ❑ Expand VAT base
  - Remove VAT exemption of sale of low cost housing units
  - Restricted VAT exemption of lease of residential property to those with monthly rental not exceeding PhP 15,000 instead of PhP 10,000
  - Removes zero rating of sale of raw materials or packaging materials to export-oriented enterprise whose export sales exceed seventy percent (70%) of total annual production; and those considered export sales under Executive Order NO. 226 when ...

# Implications of VAT provision under RA 10963

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## ☐ On revenue

- As a result of the expansion of the VAT base VAT revenue is projected to increase by PhP 15.5 B (or 0.1% of GDP) less than half of original TRAIN proposals

# Incidence of increase in VAT burden under RA 10963

Table \_\_. Change in VAT liability due to RA 10963 expressed as a percentage of household income and in absolute peso terms, by income decile

Income decile	VAT liability as % of household income			Change in VAT liability (in million pesos)	Change in VAT liability (Percent distribution)
	Old VAT regime	RA 10963	Change in effective VAT rate		
First	9.1	9.3	0.222	536	3.5
Second	8.5	8.8	0.334	698	4.5
Third	8.3	8.5	0.335	801	5.2
Fourth	8.2	8.4	0.355	969	6.3
Fifth	8.3	8.5	0.369	1,132	7.3
Sixth	8.3	8.5	0.370	1,376	8.9
Seventh	8.1	8.4	0.400	1,615	10.4
Eighth	8.1	8.3	0.407	1,960	12.7
Ninth	7.9	8.2	0.412	2,500	16.2
Tenth	6.9	7.1	0.362	3,875	25.1
<b>Total</b>	<b>7.9</b>	<b>8.1</b>	<b>0.376</b>	<b>15,461</b>	<b>100.0</b>
<b>RS index <sup>b/</sup></b>	<b>-0.00301</b>	<b>-0.00304</b>			
<b>Change in RS index</b>		<b>-0.00003</b>			

- Change in VAT ETR due RA 10963 rises with household per capita income from deciles 1 - 9
- VAT under RA 10963 - slightly more regressive than existing VAT (refer to RS index in last row)

# **Implications of Increase in Excise Tax on Petroleum Products under RA 10963**



# Excise tax on petroleum products under RA 10963

**Table \_\_. Petroleum excise tax rates before and after RA 10963**

Type of Petroleum	Tax prior to RA 10963 (peso per liter)	Tax after RA 10963 (peso per liter)			Tax-inclusive price per liter (2015)	Tax-inclusive price per liter (2017)	Increase in the price due to the change in the excise tax relative to end-2017		
		2018	2019	2020			2018	2019	2020
Diesel	0.00	2.50	4.50	6.00	26.98	36.35	7.70	13.87	18.49
Fuel oil	0.00	2.50	4.50	6.00	31.57	36.35	7.93	14.28	19.04
Unleaded gasoline	4.35	7.00	9.00	10.00	42.21	36.35	6.20	10.88	13.22
LPG	0.00	1.00	2.00	3.00	30.38	36.35	3.20	6.41	9.61
Kerosene	0.00	3.00	4.00	5.00	32.24	36.35	7.72	10.30	12.87
Aviation turbo, jet fuel	3.67	4.00	4.00	4.00	41.40	36.35	0.81	0.81	0.81
Others <sup>a/</sup>	2.48	7.71	9.00	10.00	38.00	36.35	13.89	17.31	19.96
<b>Average</b>							<b>7.08</b>	<b>12.21</b>	<b>15.90</b>

<sup>a/</sup> refers to lubricating oils and greases, waxes, denatured alcohol, naphtha, and asphalts

Source: Department of Energy

# Implications of proposed increase in excise tax on petroleum products

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- ❑ On revenue (estimated based on 2015 demand)
  - PhP 51.0 B in 2018
  - PhP 87.5 B in 2019
  - PhP 113.2 B in 2020 onwards
  
- ❑ RA 10963 – revenue gains more frontloaded than earlier TRAIN proposals

# Incidence of increase excise tax on petroleum products under RA 10963

**Table \_\_. Excise tax burden (petroleum products) as % of household income**

Income decile	Old tax regime	RA 10963 - 2018	Change <sup>a/</sup> in excise tax - 2018	RA 10963 - 2019	Change <sup>a/</sup> in excise tax - 2019	RA 10963 - 2020	Change <sup>a/</sup> in excise tax - 2019
First	0.33	0.99	0.659	1.47	1.131	1.80	1.463
Second	0.32	0.96	0.635	1.41	1.090	1.73	1.410
Third	0.33	0.97	0.642	1.43	1.102	1.75	1.425
Fourth	0.33	0.98	0.649	1.44	1.114	1.77	1.441
Fifth	0.35	1.04	0.690	1.53	1.184	1.88	1.531
Sixth	0.36	1.07	0.708	1.58	1.216	1.93	1.573
Seventh	0.36	1.07	0.713	1.59	1.224	1.94	1.583
Eighth	0.37	1.09	0.724	1.61	1.243	1.98	1.608
Ninth	0.37	1.10	0.729	1.62	1.251	1.99	1.619
Tenth	0.36	1.08	0.714	1.59	1.226	1.95	1.586
<b>Total</b>	0.36	<b>1.06</b>	<b>0.702</b>	<b>1.56</b>	<b>1.205</b>	1.91	<b>1.558</b>
<b>RS index <sup>b/</sup></b>	<b>0.00007</b>	<b>0.00021</b>		<b>0.00031</b>		<b>0.00038</b>	
<b>Change in RS index</b>		<b>0.00014</b>		<b>0.00024</b>		<b>0.00031</b>	

a/ change measured relative to old tax regime

b/ RS index refers to Reynolds-Smolensky index

- 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)
- Change in excise tax burden of poorest decile even higher than those of 2, 3, 4
- Tax burden of excise tax on petroleum products marginally progressive as indicated by RS index

# Implications of increase excise tax on petroleum products

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## ❑ Impact on inflation

- Other things being equal, CPI estimated to increase by 0.5% in 2018, and an additional 0.4% in 2019 and 0.2% in 2020

## ❑ Contribution of the increase in the excise tax on petroleum products to inflation varies depending on period being studied

- 44% of increase in CPI between Dec 31, 2018 and March 31, 2019 due to increase in excise tax on petroleum products
- 21% increase in CPI between Dec 31, 2018 and May 2019 due to increase in excise tax

# Implications of increase excise tax on petroleum products

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- ❑ 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

# **Implications of Increase in Excise Tax on Automobiles under RA 10963**

# Excise tax on automobiles under RA 10963

Prior to RA 10963		Under RA 10963	
Manufacturer's or importers net selling price	Tax	Manufacturer's or importers net selling price	Tax
up to PhP 600,000	2%	up to PhP 600,000	4%
over PhP 600, 000 to PhP 1.1 million	PhP 12,000 + 20% of excess over PhP 600,000	over PhP 600, 000 to PhP 1 million	10%
over PhP 1.1 million to PhP 2.1 million	PhP 112,000 + 40% of excess over PhP 1.1 million	over PhP 1 million to PhP 4 million	20%
Over PhP 2.1 million	PhP 512,000 +60% of excess over PhP 2.1 million	Over PhP 4 million	50%

- ❑ Increase in excise tax on automobiles – double that under old regime for cars whose net selling price do not exceed PhP 600,00
- ❑ Percentage increase in excise tax due declines from a high of 400% to a low of almost 0% as net selling price of cars goes up from PhP 600,001 to PhP 1.6 million and from 21% to almost 0% for cars whose NSP falls between PhP 1.6 million and PhP 4 million

# Implications of proposed increase in excise tax on automobiles

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- ❑ On revenue take, based on 2015 levels of demand
  - PhP 13 B as per DOF
- ❑ On tax incidence
  - Incidence of increase in excise tax on automobiles expected to make tax less progressive than before
- ❑ Likely to have a negative impact on CARS program
  - ➔ policy coordination issue



# **Implications of Imposition of Excise Tax on Sweetened Beverages under RA 10963**

# Implications of imposition of excise tax on sugar sweetened beverages

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## ❑ On revenue

- PhP 49 billion in 2018, 51 billion in 2019 and PhP 55 billion in 2020 (as per DOF)

## ❑ Tax mildly regressive

- tax liability due from each income decile declining as per capita household income increases
- share of households belonging to different income deciles goes up as per capita household income increases

# Implications of imposition of excise tax on sugar sweetened beverages

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## ❑ On economic incentives

### ■ Advantage

- Likely to discourage consumption of sweetened beverages which has associated health risks (e.g., higher risk of diabetes, obesity)

### ■ Disadvantage

- May hurt the poor who rely on some of these products as a cheap source of calories
- Burden of non-communicable disease associated with obesity and intake of SBs is borne by taxpayers in general to the extent that the majority of less well-off population rely on public health system which is largely financed by general taxation; also, government finances indigent program of PhilHealth – counter argument to no externality argument against the tax

# Summary and Conclusions

# What is good about RA 10963?

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- ❑ 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 of RA 10963 - on revenues

- Actual tax collection of the BIR and the BOC in January – October 2018 indicates that these two agencies may fall short of their collection targets for the entire year of 2018 by a combined total of PhP 88 billion.
- In particular, actual revenue from the PIT likely to below its 2018 target by PhP 43 billion which suggests that the revenue loss from PIT reform may actually be closer to PhP 190 billion, larger than the DOF's PhP 146 billion estimate by PhP 43 billion and higher than this paper's PhP 210 billion estimate by PhP PhP 20.5 billion.

	2018	2019	2020
PIT on wage income*	(200,459)	(200,459)	(200,459)
PIT on income of SEPs**	(9,618)	(22,626)	(22,626)
PIT	(210,077)	(223,085) <sup>✓</sup>	(223,085)
VAT	15,461	15,461	15,461
Excise tax on petroleum prod	50,980	87,482	113,169
Excise tax on cigarettes	13,256	17,675	26,513
Excise tax on automobiles <sup>al</sup>	12,875	13,651	14,474
Excise tax on SBs <sup>al</sup>	48,643	51,973	54,947
Excise tax on coal and coke <sup>al</sup>	696	1,495	2,411
Excise tax on mineral products <sup>a</sup>	2,070	2,130	2,200
<b>Total</b>	<b>-66,097</b>	<b>-33,218</b>	<b>6,090</b>
% to GDP	-0.38	-0.19	0.03

# Overall impact of RA 10963 - who bears the burden?

Income decile	PIT (in million pesos)	as % of HH income	Other taxes (in million pesos)	as % of HH income	All taxes (in million pesos)	as % of HH income
First	614.98	0.3	7,737	3.2	8,352	3.5
Second	526.53	0.2	10,061	3.0	10,587	3.2
Third	85.01	0.0	11,631	3.0	11,716	3.0
Fourth	-1,328.76	-0.3	13,494	3.0	12,165	2.7
Fifth	-3,333.99	-0.6	15,803	3.0	12,469	2.4
Sixth	-7,141.44	-1.2	18,604	3.0	11,462	1.8
Seventh	-13,117.19	-1.8	21,160	2.9	8,043	1.1
Eighth	-22,726.10	-2.6	24,523	2.8	1,797	0.2
Ninth	-40,922.97	-3.7	29,396	2.7	-11,527	-1.1
Tenth	-102,219.45	-5.1	46,656	2.3	-55,564	-2.8
<b>Total</b>	-189,563.37	-2.6	199,063	2.7	9,500	0.1

- overall distributional impact of the TRAIN law is regressive when one abstracts from the proposed targeted subsidies under the program → highlights importance of unconditional cash transfers
- the change in the tax burden as a percentage of household income as a result of RA 10963 is highest for the poorest decile (i.e., an increase of 3.5% of household income) and declines as income rises (e.g., a decrease of 2.8% of household income for the richest decile),

# Overall impact on the poor under RA 10963

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- ❑ Finding in previous slide highlights importance of compensatory transfers (e.g., targeted cash transfer program) to the poorer deciles as provided under TRAIN
  - This paper estimate of the size of the required compensatory transfers for the poor - PhP 300 per month for the poorest decile to about PhP 400 per month for households belonging to deciles 2 - 4.
    - higher than the unconditional cash transfers of PhP 200 per month in 2018 and PhP 300 per month in 2019-2020 under RA 10963
  - Actual implementation of UCT is much delayed in 2018
    - the payroll documents for the UCT to the 4Ps households (accounting for about 40% of the target UCT beneficiaries) were uploaded to the LBP as early as the first quarter of 2018,
    - the payroll documents for the rest of the Listahanan poor were uploaded only in the 3<sup>rd</sup> quarter of 2018
    - The payroll those for the social pensioners have not yet been uploaded to date



# Overall impact on the poor under RA 10963

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- ❑ 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 unconditional transfers



Philippine Institute for  
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# Thank you

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# Thank You!

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## 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 PhP 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 PhP 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 PhP 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

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- 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

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## □ 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)
<b>A. Transactions exclusive of VAT</b>				
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>B. If all sales are VAT-able at 10%</b>				
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
<b>Memo item:</b>				
Output sales before VAT	400	1200	1400	2000
Output sales inclusive of VAT	440	1320	1540	2200
<b>VAT</b>				
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

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## ❑ 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)
<b>A. Transactions exclusive of VAT</b>				
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>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</b>				
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
<b>Memo item:</b>				
Output sales before VAT	400	1200	1400	2000
Output sales inclusive of VAT	440	1200	1540	2200
<b>VAT</b>				
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

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## ❑ 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)
<b>A. Transactions exclusive of VAT</b>				
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>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</b>				
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
<b>Memo item:</b>				
Output sales before VAT	400	1240	1440	2040
Output sales inclusive of VAT	440	1240	1584	2244
<b>VAT</b>				
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

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- ❑ 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

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- ❑ 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





# 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
<b>Total</b>	<b>-178,181</b>	<b>74,888</b>	<b>-103,293</b>	<b>-195310</b>	<b>74888</b>	<b>-120422</b>
<b>% to GDP</b>	<b>-1.3</b>	<b>0.6</b>	<b>-0.8</b>	<b>-1.5</b>	<b>0.6</b>	<b>-0.9</b>

\* 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 all personal income taxpayers in deciles 1-5 but lower PIT liability for those in deciles 6-10 due to TRAIN