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Comments on **Senate Bill No. 234**: "An Act Institutionalizing the Income Classification of Provinces, Cities and Municipalities, and for other Purposes"

SHORT TITLE: "**The Local Governments Units' Income Classification Act of 2016"**

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1. As indicated in **SB No. 234** There is a need to correctly reflect the financial capacity of local government units (LGUs) and to regularly assess any changes in such capacity to design and direct policy in an appropriate manner. This bill clearly, and correctly, mandates the DOF to regularly assess LGU income classification.

The main difference between this and previous laws/regulations pertaining to LGU income classification such as Executive Order No. 249 dated July 28, 1987 and Department of Finance (DOF) Department Order No. 23-08 dated July 29, 2008, is that SB No. 234 **reduces the number of years for reassessment of LGU income classification from four (4) years to three (3) years (Sec. 6, SB No.234)**. It should be noted that in some cases, depending on the passing and effectivity of SB No. 234, this might coincide with the term of a local chief executive (LCE) and may be used in two ways: (1) to increase the accountability of the LCE to the electorate; and, (2) be used by the LCE as a measure of performance in office.

Ultimately, the question is what the purpose of LGU income classification and what is the best way for income classification to reflect the characteristics of the LGU to serve its purpose. This requires answering the following questions:

a. What are the limitations/policy implications imposed by the 1991 Local Government Code of the Philippines (LGC) provisions on LGU income classification?

LGU income classification has an impact on (1) reclassification of lands (Sec. 20); (2) compensation of local officials and employees (Sec. 81); (3) LGU regular income imposes a limitation on the amount of debt servicing (Sec. 324); (4) general limitation on the use of provincial, city, and municipal funds for personal services (Sec. 325(a)); and; (5) procurement through personal canvass (Sec. 367).

b. What are LGU income classification used for? Some examples are:

- Is a limitation for appropriations, 1st to 3rd class (not exceed 45%) and 4th to 6th (not exceed 55%).
- Conditional cash transfers: The Pantawid Pamilyang Pilipino Program (4Ps) originally covered residents of the poorest municipalities, based on 2003 Small Area Estimates (SAE) of the National Statistical Coordination Board (NSCB). At present, beneficiary households must be poor based on LISTAHAN.
- Criteria for LGU borrowing and debt servicing.

Sec. 8 of SB No. 234 explicitly defines the uses of income classification and correspondingly includes a clause to be consistent with existing laws and regulations that require/prescribe the use of LGU income classification in their implementation but at the same time repeals all other laws that may be inconsistent (such as in **Sec. 14**. Repealing Clause – Executive Order No. 249, dated July 25, 1987 is hereby repealed. All laws, presidential decrees, executive orders, presidential proclamations, rules and regulations or parts thereof contrary or inconsistent with the Act are hereby repealed, superseded or modified accordingly) to avoid any confusion.

2. The definition of Annual Regular Income of the LGU is generally the same as previous definitions of LGU Income in that it still includes the Internal Revenue Allotment (IRA) **BUT** SB No. 234 explicitly adds "shares from national wealth, excise on tobacco, incremental collection form value-added tax (VAT) under R.A. No. 7643, and the gross income tax paid by businesses and enterprises in Special Economic Zones (ECOZONES) under R.A. No. 7916 as amended, and such other shares as may be granted by law to the province, city, or municipality, shall be considered as part of the annual regular income **(Sec. 3(a), SB No. 234)**.

Table 1. On the definition of Annual Regular Income

Section	Text	Comments
Sec. 3(a), p.1, L 10-15	Annual regular income refers to revenues, including fees and receipts actually realized which are reported yearly on cash basis by provinces, cities and municipalities from regular sources, including the IRA and other source provided for in Secs. 284, 290, and 291 of RA 7160 BUT	Same as in DOF Department Order No. 23-08
Sec. 3(a), p.1, L 15 - 17	Exclusive of non-recurring receipts, such as national aids, grants, financial assistance, loan proceeds, sales of assets, miscellaneous income/receipts and similar others.	Same as in DOF Department Order No. 23-08
Sec. 3(a), p.1 L 17-p. 2 L1-6	For the purpose of this Act, shares from national wealth, excise tax on tobacco, incremental collection from VAT under RA 7643. The gross income tax paid by businesses and enterprises in Special Economic Zones (ECOZONES) under RA 7916, as amended, and other such shares as may be granted by law to the PCM, shall be considered as part of the annual regular income.	This is would increase the computed Annual Regular Income for LGUs that receive such shares. For the LGUs that do not receive such shares, the difference between Annual Regular Incomes would be more evident.
Sec. 3(a), p. 2 L6-9	The annual regular income shall be computed from the Statement of Receipts and Expenditures (SRE) maintained by the Bureau of Local Government Finance of the Department of Finance.	This is new, what motivated articulating the source of the indicator?

Including shares from national wealth and others added by SB No. 234 would, in effect, increase the amount of Annual Regular Income received by LGUs that benefit from these and reflecting, more transparently, amount available for LGUs to spend. In the case of LGUs that do not receive allocations from these laws/regulations, this would also better reflect their financial capacity and ability to finance their expenditures, relative to other LGUs.

From a broader perspective, and though it would require further study, it could be that the disparity between LGU incomes, as defined by SB No. 234, could give a better picture of financial capacities of LGUs and therefore could better direct development efforts.

3. The proposed income classification brackets for LGUs are increased by give or take 100%, depending on the level of LGU. At the same time, **SB No. 234** (**Secs. 4 and 5)** proposes that provinces and cities be classified on the same terms **(see Tables 2 and 3).**

As mentioned above, the adjustment in income brackets for income classification is important, however, it would be useful if the basis of: (1) using the same income brackets for provinces and cities; and, (2) a brief explanation of why the increase in income brackets from between 80% to 100% is necessary.

Table 2. Proposed Income Classification for Provinces and Cities

Section	Income Class	Text	Comments/Previous Income classifications
Sec. 4		Income classification of Provinces and Cities - All provinces and cities shall be classified into six (6) income classes according to income ranges and based on the average annual regular income for three income ranges and based on average annual regular income for three (3) fiscal years preceding the general income reclassification.	Annual average income was computed based on the last four (4) calendar years in the previous DOF Circular No. 23-08.
Sec. 4(a)	First Class	Provinces and Cities more than P800M	P450 (Provinces)/400M (Cities)or more
	Second Class	Provinces and Cities P650M or more but less than P800M	P360M (Provinces)/320M (Cities) or more but less than P450M (Provinces) /400M (Cities)
	Third Class	Provinces and Cities P500M or more but less than 650M	P270M (Provinces)/240M (Cities) or more but less than P360M (Provinces)/320M (Cities)
	Fourth Class	Provinces and Cities P350M or more but less than P500M	P180M (Provinces)/P160M (Cities) or more but less than P270M (Provinces)/P240M (Cities)
	Fifth Class	Provinces and Cities P200M or more but less than P350M	P90M (Provinces)/80M (Cities) or more but less than P180M (Provinces)/160M (Cities)
	Sixth Class	Provinces and Cities less than P200M	Below P90M (Provinces)/80M (Cities)

Table 3. Proposed Income Classification for Municipalities

Sec. 5	Income Class	Proposed Income Classification of Municipalities	Comments/Previous Income classifications
	First Class	P90M or more	P55M or more
	Second Class	P80 M or more but less than P90M	P45M or more but less than P55M
	Third Class	P60 M or more but less than P80M	P35M or more but less than P45M
	Fourth Class	P40M or more but less than P60M	P25M or more but less than P35M
	Fifth Class	P30M or more but less than P40M	P15M or more but less than P25M
	Sixth Class	Below P30M	Below P15 M

4. In **Sec. 7(a) of SB No. 234**, the statement in lines 14 to 16 read, "In **cases of diminishing revenues**, the Secretary of Finance may order the re-computation and revision of income classification of provinces, cities and municipalities to reflect the actual financial situation of the local government units."

Perhaps "diminishing returns" could be more explicitly defined particularly the returns (i.e. does 'returns' refer to decreasing internal revenue collection of the national government or decreasing local source revenues). Whichever may be the case, it is also important to exercise caution because this section might soften the budget constraint of LGUs and not encourage fiscal discipline if it is believed that income classifications could be re-computed/revised with diminishing returns.

5. In **Sec. 7(c) of SB No. 234**, lines 25 to 29 reads "the basis of the **aggregate net share** of income from regular sources actually realized…, plus the corresponding estimated IRA of the newly created province."

It would be helpful to clearly define "aggregate net share of income" in terms similar to the definition in **Sec. 3** of the same bill. This would be to avoid confusion in the classification of the LGU.

References

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