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Taxation in financial services under TRAIN

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In 2017, Republic Act 10963 or the Tax Reform for Acceleration and Inclusion (TRAIN) Act was signed into law. It has since been subjected to blame for the steep rise in inflation and slight slowdown in economic growth.

This *Policy Note* revisits the implementation of the National Internal Revenue Code as amended by TRAIN. The study employs key informant interviews (KIIs) of representatives from the financial services sector and reviews studies of the National Tax Research Center as regards taxes imposed by other countries within the Association of Southeast Asian Nations (ASEAN).

Tax and the liberalization of trade in the financial services sector

Liberalization is not limited to opening the market or ensuring that foreign companies are on equal footing with domestic ones. Its underlying thrust is the free flow of trade, which is hindered by high transaction costs. In the financial industry, such costs are termed as friction costs because they add to the total transaction price and inhibit the smooth flow of trade and investment. In this light, taxation becomes key in liberalizing trade. However, while the Philippine government has already effected measures to lower income taxes, other taxes remain burdensome as friction costs to industry players.

With this, TRAIN taxes should be evaluated on how they affect the liberalization thrusts of the government for the various sectors of the country, particularly the financial services sector. As aptly stated by Barcenas et al. (2017), liberalized trade in financial services would allow industry and consumers access to varied, quality, and competitively priced products.

Lifting barriers in the financial sector is seen to spur economic growth more than in any other sectors under the services industry (McGuire 2002). In the case of banks, deregulation has led to the rise of highly capitalized companies offering a wide array of financial products (Margallo 2013). The Philippine capital market, meanwhile, remains underdeveloped. This is evident in the Philippine Stock Exchange, which remains relatively smaller than that of other ASEAN countries, such as Malaysia and Thailand. High transaction costs are among the challenges facing the market, particularly high broker's fees and taxes (Abola 2016). With regard to the Philippine insurance industry, total density and penetration ratios were also lowest compared to Singapore, Thailand, Malaysia, and Indonesia in 2016.

Financial liberalization is very tricky. On one end, liberalization is necessary to increase competition and introduce the Philippine market to other financial instruments. On the other end is the need to manage risks in the system, as experience shows that banking regulation by the *Bangko Sentral ng Pilipinas* has insulated the industry from external shocks. Hence, a delicate balancing is needed in regulating the financial sector. This is likewise true in the case of taxation.

Table 1. Increase in taxes affecting the banking sector under TRAIN

Transaction	Tax Base	Old Rate	New Rate
Interest income from Foreign Currency Deposit Unit	Amount of interest income	7.50 percent	15 percent
Bank checks, drafts, certificates of deposits not bearing interests, and other instruments (DST)	Fixed amount on each document	PHP 1.50	PHP 3.00
Debt instruments (DST)	For every PHP 200.00 and its exceeding fraction	PHP 1.00	PHP 1.50
Bills of exchange or drafts (DST)	For every PHP 200.00 and its exceeding fraction	PHP 0.30	PHP 0.60
Upon acceptance of bills of exchange (DST)	For every PHP 200.00 and its exceeding fraction	PHP 0.30	PHP 0.60
Foreign Bills of Exchange and Letters of Credit (DST)	For every PHP 200.00 and its exceeding fraction	PHP 0.30	PHP 0.60
Mortgages	When amount secured does not exceed PHP 5,000.00	PHP 20.00	PHP 40.00
	On each PHP 5,000 and fraction exceeding every PHP 5,000.00	PHP 10.00	PHP 20.00

DST = documentary stamp tax
TRAIN = Tax Reform for Acceleration and Inclusion
Source: Author's compilation

Taxation of financial transactions under TRAIN

Based on the result of KIIs, the change in rates of taxes on financial transactions has increased friction costs. In terms of wholesale investments, these taxes become crucial for investors in choosing jurisdictions to place their money or business.

Banking

In the banking industry alone, taxes have gone up by as much as 100 percent (Table 1). In particular, the documentary stamp tax (DST), an excise tax levied on banking documents, instruments, loan agreements, and papers, has increased across the board. Higher DST means costlier financial transactions in the country. It is charged to each transaction and increases transaction costs and is thus viewed as a friction cost which could discourage investors or inhibit the flow of trade.

Equities

As to equities, stocks not traded in the stock exchange are now uniformly taxed at 15 percent on capital gains. Prior to the TRAIN regime, their tax was only at 5 percent if the gain were PHP 100,000.00 or less and 10 percent if over PHP 100,000.00. Meanwhile, taxes for stocks traded in the stock exchange and not sold by a dealer have increased by 20 percent under TRAIN, from 1/2 to 6/10 of 1 percent of the gross selling price (Table 2).

Insurance

On insurance transactions, TRAIN prescribes various DST rates for life insurance policies as well as changed the tax base, which moved from the effective rate of 12 percent on the premium. However, it increased the effective rate for preneed plans from 0.10 percent to 0.20 percent and also doubled the DST for certificates of damages (Table 3).

TRAIN taxes and ASEAN rates

This study also examines the TRAIN taxes in light of the rates prescribed by other ASEAN countries. This is not a quantitative or even qualitative assessment of the new rates of taxes, but a comparison of the rates imposed by the Philippines and its ASEAN neighbors.

Table 2. Taxes affecting the sale of shares of stock under TRAIN

Transaction	Tax Base	Old Rate	New Rate
Sale of stocks not traded in the stock exchange	Capital gains	5 percent if the gain were less than or equal PHP 100,000.00 and 10 percent if the gain is over PHP 100,000.00	15 percent
Sale of stocks traded in the stock exchange and not sold by a dealer	Gross selling price or value of the shares	1/2 of 1 percent	3/5 of 1 percent
Sales, agreements to sell, memoranda of sales, and deliveries or transfers of shares or certificates of stocks	DST on original issue of shares of stock (stock without par value)	25 percent	50 percent

DST = documentary stamp tax
TRAIN = Tax Reform for Acceleration and Inclusion
Source: Author's compilation

Table 3. DST on insurance under TRAIN

Transaction	Tax Base	Old rate	New rate
Life insurance	Old: Premium charged New: Amount of insurance	PHP 0.50 for every PHP 4.00 or fraction	a. Less than PHP 100,000.00: Exempted b. PHP 100,000–PHP 300,000: PHP 20.00 c. PHP 300,001–PHP 500,000: PHP 50.00 d. PHP 500,001–PHP 750,000: PHP 100.00 e. PHP 750,001–PHP 1,000,000: PHP 150.00 f. Over PHP 1,000,000: PHP 200.00
Preneed plan	On each specific amount or its fraction of the total value of the plan	PHP 0.50 for every PHP 500 or fraction	PHP 0.40 for every PHP 200 or fraction
Certificate of damage	On each certificate	PHP 15.00	PHP 30.00

DST = documentary stamp tax
TRAIN = Tax Reform for Acceleration and Inclusion
Source: Author's compilation

Banking

Only the Philippines and Thailand collect DST or its equivalent on letters of credit. The Philippines charges 0.15 percent on face value of the letter of credit (Fronteras and Rempillo 2015). Meanwhile, Thailand imposes a tax of PHP 28.00 if the value of the letter of credit is less than PHP 13,900.00, or PHP 42.00 if PHP 13,900.00 or higher (Fronteras and Rempillo 2015).

Tables 4 and 5 show comparisons of other DST rates in the Philippines against those charged by other ASEAN countries. While the DST imposed by the Philippines appears to be reasonable, its rates have significantly increased under TRAIN. It is difficult to assess the impact of these new rates on trade in financial services because checks and bill of exchange may be more relevant in the domestic sphere rather than in international trade.

Equities

Brokers and traders of equities may have cause to be discouraged by the new rates of taxes imposed on the trading of shares in the stock market. As pointed out earlier, the increase is as high as 20 percent, substantial in light of the taxes imposed by other ASEAN countries. In fact, most of our ASEAN neighbors do not impose a tax on the transfer of shares (Table 6). Indonesia is one exception, but its rate is but a small fraction of what the Philippines charges.

On sales of stocks, most ASEAN countries impose DST or its equivalent (Table 7). However, given the different tax bases of the Philippines and other ASEAN countries, a cost comparison is difficult to perform. If the tax base is the par value, the comparison would be easier, as par

Table 4. Sample DST imposed on the issuance of checks in the ASEAN region

Country	Tax Base	Rate
Philippines	Per check	PHP 3.00
Brunei Darussalam	Per check	PHP 4.00
Indonesia	Per value of check	a. If below PHP 915.00: Exempted b. PHP 915.00 to PHP 3,660.00: PHP 11.00 c. If over PHP 3,660.00: PHP 22.00
Malaysia	Per check	PHP 2.00
Singapore	None	n/a
Thailand	Per check	PHP 4.00

ASEAN = Association of Southeast Asian Nations
DST = documentary stamp tax
Source: Fronteras and Rempillo (2015); Author's compilation

Table 5. Sample DST on bills of exchange in the ASEAN region

Country	Tax base	Rate
Philippines	Face value	0.30 percent
Brunei Darussalam	Segmented amount and for additional fraction (PHP 4.00 for first PHP 3,526.00 and PHP 4.00 for every additional PHP 353.00 or fraction	0.11 percent for first PHP 3,526.00 and 1.13 percent for the additional amount
Thailand	Fixed rate	PHP 4.00 per bill

ASEAN = Association of Southeast Asian Nations
DST = documentary stamp tax
Source: Fronteras and Rempillo (2015); Author's compilation

Table 6. Sample of tax rates on sale of stocks traded in the stock exchange in the ASEAN region

Country	Tax Base	Rate
Philippines	Gross selling price	6/10 of 1 percent or 0.60 percent
Cambodia	Exempted	n/a
Indonesia	Transaction value	0.10 percent
Malaysia	Exempted	n/a
Thailand	Exempted	n/a

ASEAN = Association of Southeast Asian Nations
Source: Nejar and Rempillo (2015); Author's compilation

value is fixed. Meanwhile, the market value of shares may go up and down and may even be below a share's par value.

Insurance

Among the subsectors of the insurance industry, nonlife insurance was identified as the one heavily taxed. In fact, a significant portion of the cost of a nonlife insurance policy constitutes taxes imposed by the Philippine government.

While this may not be a friction cost to an investor, tax contributes to the high price of their product, which may inhibit the product's growth in the market. The cost may drive down demand for nonlife insurance and discourage the entry of investors in this particular sector. In the long run, this may have an adverse impact on the liberalization thrust of the government.

Table 8 also reveals that the value-added tax (VAT) imposed by the Philippines is 71 percent higher than what is imposed by Thailand. Meanwhile, other jurisdictions do not impose VAT on nonlife insurance products.

The KII also revealed the private sector's difficulty in entering into the crop insurance sector. Currently, the government is heavily involved in the said sector and the benefits are being poured into public institutions, such as the Philippine Crop Insurance Corporation (PCIC). Under Presidential Decree 1467, PCIC is exempt from taxes, which means PCIC would be able to provide services at lower costs.

A survey of taxes imposed by ASEAN countries also shows that life insurance is highly promoted in some jurisdictions. Moreover, insurance companies in certain jurisdictions enjoy reduced corporate income taxes. In Cambodia, for instance, life insurance companies are taxed at 5 percent on gross premiums (Jurado and Amurao 2015). In Singapore, while life insurance companies are taxed at 17 percent on their income like any other company, the policy holder enjoys the benefit of a tax rate on income of 10 percent (Jurado and Amurao 2015).

Table 7. Sample of DST or equivalent on sales of stocks in the ASEAN region

Country	Tax Base	Rate
Philippines	Par value	0.75 percent
Brunei Darussalam	Par value	1.13 percent
Cambodia	Market value	0.10 percent
Malaysia	Price on date of transfer	0.30 percent
Singapore	Purchase price or market value	0.20 percent
Thailand	Paid-up value or nominal value	0.07 percent

ASEAN = Association of Southeast Asian Nations
DST = documentary stamp tax
Source: Fronteras and Rempillo (2015); Author's compilation

Table 8. Sample of VAT on nonlife insurance policies in the ASEAN region

Country	Tax Base	Rate
Philippines	Gross premiums (except on crop insurance)	12 percent
Brunei Darussalam	Exempted	n/a
Cambodia	Exempted	n/a
Indonesia	Exempted	n/a
Malaysia	Exempted	n/a though Malaysia imposes a 5-percent service tax on the premium
Thailand	Gross premiums	7 percent

ASEAN = Association of Southeast Asian Nations
VAT = value-added tax
Source: Jurado and Amurao (2015); Author's compilation.

Meanwhile, the Philippines does not differentiate life insurance companies from any other firms and imposes a tax of 30 percent on their net taxable income.

Similar to the Philippines, other ASEAN countries also impose a standard corporate income tax on life insurance companies. However, the Philippine corporate income tax rate is the highest in the ASEAN region (Pabilona and Domo 2018). This means life insurance companies in the Philippines are subject to the highest income tax in ASEAN.

Table 9. Sample of DST or its equivalent imposed on life insurance in the ASEAN region

Country	Tax Base	Rate
Philippines	Amount of insurance	Graduated rates with highest rate at 0.02 percent
Brunei Darussalam	Sum insured	0.01 percent
Cambodia	Exempted	n/a
Malaysia	Policy exceeding PHP 63,300 (MYR 5,000.00)*	PHP 126.60
Singapore	Exempted	n/a
Thailand	Sum insured	0.05 percent
Viet Nam	Exempted	n/a

* Based on MYR to PHP exchange rate of PHP 12.66
ASEAN = Association of Southeast Asian Nations
DST = documentary stamp tax
Source: Jurado and Amurao (2015); Author's compilation

While the Philippine DST rate may be described as competitive compared to rates imposed by other ASEAN countries, at least three ASEAN countries exempt life insurance policies from DST (Table 9).

Recommendations

This study recommends a careful analysis of the imposition of taxes on financial services to prevent unintended consequences. While taxes are meant to raise funds for the government to pump prime the economy, they may also serve as discouragement to investors and businesses. These investors and businesses may turn to the Philippines' ASEAN neighbors instead, resulting in revenue losses from annual income taxes. The threshold for participants in the market should be determined to test their preference for Philippine financial services.

In certain respects, the comments expressed by certain sectors should be validated, as with the opposition to the increase in the stock transfer tax by players in the equities market. In the KIIs, the taxes on the sale or transfer of shares of stock were cited as one of the reasons for the decline in the volume of stocks traded daily.

The same is true for the insurance sector, where its development and promotion are dampened by the concomitant taxes. Nevertheless, it is hard to assess the impact of taxes on insurance vis-a-vis the rates imposed by neighboring states since insurance is not as easily traded as equities and usually remains in its *situs*. What could be measured is demand for insurance products and investments by insurance companies.

Even removing the aspect of competition from the Philippines' ASEAN neighbors in attracting investments, taxation should still be assessed in terms of improving the Philippine tax system. One aspect of which is the need to broaden the tax base (Pabilona and Domo 2018). If investors and businesses find taxes on transactions as burdensome costs and shun the Philippines for friendlier jurisdictions, then the tax base would not widen.

Tax rates under TRAIN have significantly increased. Such increases, particularly on DST, may be acceptable in single transactions. However, from the business standpoint, the cost of completing a transaction or delivering their service has already doubled. In wholesale investments, the increased costs accumulate, which may in turn reduce interest in the Philippines. In this regard, data on these sectors should be reviewed as soon as they become available.

In conclusion, what is apparent at the moment is that the increased taxes on the sale of equities contributed to the decline in the volume of trade. With ecommerce facilitating the transfer of funds in other markets, the effect on the Philippine equities market is immediately felt.

Meanwhile, on insurance, the taxes have increased the prices of insurance products. Whether such increases affected trade or entry into the Philippines, the data should be reviewed once they are consolidated.

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