Position Paper of the Department of Trade and Industry
on House Bill No. 2942, entitled
"*An Act Establishing a System for Tax Incentives Management and Transparency, and for Other Purposes*"
introduced by Congresswoman Leni Gerona-Robredo

The objective of HB 2942 is to promote fiscal prudence and transparency in the proper management and grant of tax incentives by developing means to measure the government's fiscal exposure from these expenditures and to enable the government to analyze and rationalize the fiscal cost and at the same time optimize the economic impact and benefit incidence of such incentives.

The salient features of the bill are as follows:

1. ***Accounting and Claiming of Tax Incentives.*** Amounts of tax incentives administered by Investment Promotion Agencies (IPAs) to private individuals and corporations and specified under Department of Finance (DOF) Schedule shall be treated as both revenue and expenditure of the General Fund. ***(Section 4, HB 2942)***

2. ***Tax Expenditure Account (TEA).*** A Tax Expenditure Account (TEA) shall be created in the General Appropriations Act (GAA), from which tax incentives, granted by the IPAs and other government agencies are accounted. ***(Section 5, HB 2942)***

3. ***Automatic Appropriation.*** Tax expenditures under the Act are automatically appropriated. Further, the Commissioner of Internal Revenue shall exercise his/her power to make assessments and prescribe additional requirements for tax administration and enforcement.***(Section 6, HB 2942)***

4. ***Administration, Implementation and Monitoring of Tax Incentives.*** IPAs and other government agencies (OGAs) shall be responsible for the administration and implementation of tax incentives to their registered enterprises and submit to the DOF their annual tax expenditures and such other data related to the grant of incentives as required by the DOF. Further, the IPAs and OGAs shall also be subject to the power of the Commissioner to obtain information and to summon, examine and take testimony of persons under Section 5 of the NIRC. ***(Section 7, HB 2942)***

5. ***Non-compliance with reportorial requirements; Penalties.*** Failure of the IPA or OGA to submit the tax expenditure report and other data by reason of fault of the registered enterprise shall be a ground for suspension of incentives. Further, the DOF shall issue to the concerned IPA or OGA a notice of non-compliance with the Act and direct the latter to explain its failure to comply and the actions it took to address the failure. ***(Section 8, HB 2942)***

6. Implementing Rules and Regulations. The DOF, in coordination with the DBM, BIR, and BOC and in consultation with all IPAs and OGAs shall promulgate the rules and regulations to implement the provisions of this Act.***(Section 10, HB 2942)***

Comments

The objective of the Bill to promote fiscal prudence and transparency in the grant of incentives is shared by this Department. Indeed, DTI-BOI supported a draft executive order entitled, "*Enjoining all Investment Promotion Agencies and other Government Entities to Provide Data for the Estimation of Foreign and Domestic Investments in the Country*", formulated by an Inter-Agency Committee on Investment Statistics (IACIS) through NSCB Memorandum Order No. 5, Series of 2013, composed of Philippine Statistics Authority (formerly NSCB), BOI, PEZA, BSP, CDC, SBMA, and SEC. Currently, the draft EO is for review of the PSA following the reorganization of the former NSCB into PSA[1].

We believe that an executive order setting forth a systems-based, regular reporting to the PSA and NEDA and legally sanctioned order will address transparency and information gaps in the grant of incentives.

Relative to the proposed measure, HB 2942 may tangle into possible legal challenges and create instability and unpredictability in the investment environment based on the following:

(1) public funds are appropriated and used for registered enterprises, thus, for private purposes, contrary to the public purpose requirement under Section 4 of Presidential Decree No. 1445[2];

(2) the provision of the amount of incentives explicitly funded under the appropriations law shows clear evidence of the subsidies granted to registered enterprises that may unwittingly drag the country to dispute for possible violation of our international commitment under the World Trade Organization – Subsidies and Countervailing Measures[3];

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[1] Republic Act No. 10625, otherwise known as the "Philippine Statistical Act of 2013" signed 12 September 2013

[2] Section 4 of P.D. No. 1445, otherwise known as "The State Audit Code of the Philippines" provides:

Section 4. Fundamental principles. Financial transactions and operations of any government agency shall be governed by the fundamental principles set forth hereunder, to wit:
(2) Government funds or property shall be spent or used solely for public purposes.

[3] AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES

Article 1
Definition of a Subsidy
1.1For the purpose of this Agreement, a subsidy shall be deemed to exist if:

(a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:
(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);

(3) we cannot rule out the possibility that Congress may not grant the amount of incentives programmed by the IPA or may be insufficient to cover the incentives to be granted. This may cripple the incentive administration of the country and may result to breach of contracts, apart from the possible damage to the country's investment image; and

(4) the rigid budgetary procedure of passing the GAA notwithstanding its automaticity could place the investment incentives in a precarious state.

More specifically, the following are our comments on the specific provisions of the proposed measure:

1. Accounting and Claiming of Tax Incentives

The treatment of incentives as a revenue runs counter to the definition of "*revenue funds*" under PD 1445 which reads: *"Revenue funds" comprises all funds derived from the income of any agency of the government and available for appropriation or expenditure in accordance with law.* Considering that there will be no income that will actually flow into the government that will be available for appropriation or expenditure, it is therefore incongruous to treat such incentives as revenue.

Further, the purpose for a "DOF Schedule" is vague. It is not defined nor is its scope and coverage articulated making the accounting and claiming of incentives uncertain.

2. Creation of Tax Expenditure Account (TEA)

Creating Tax Expenditure Account for the grant of incentives under the appropriation law may hamper the exercise and operations of the incentive administration mandate of the IPAs in view of the rigid government budgetary processes in the passage of the appropriation law as well as the actual implementation of this system for the purpose of the application of the grant of incentive. This will mean numerous steps, accounting for several signatories of various government agencies, will have to be undertaken before such amount of incentive will be funded until the same will be expended.

The TEF is an item in the National Expenditure Program (NEP) and budgeted under the GAA refers to the subsidy released by the Department of Budget and Management (DBM) to state-owned and controlled corporations and government financial institutions

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(iii) a government provides goods or services other than general infrastructure, or purchases goods;
(iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; or

(a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and (b) a benefit is thereby conferred.

1.2 A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is specific in accordance with the provisions of Article 2.

to settle customs duties and other taxes arising from the importation of goods[4].While the special laws covering these Government-Owned and Controlled Corporations (GOCCs) provide for automatic appropriation, their budget allocation is still subject to the FIRB process,*viz*:

a. GOCC requests from the Fiscal incentives Review Board (FIRB)
b. FIRB issues Resolution and Certificate of Entitlement to Subsidy (CES)
c. GOCC submits to DBM the FIRB Resolution, CES and the Billing of Statement (BOC)/Assessment (BIR)
d. DBM releases SARO to the Bureau of Treasury, which is the also the basis for recording income on the part of the collecting agency (i.e. BOC/BIR) and expense on the part of the National Government

Thus, despite the provision on automatic appropriation, the allocation for the "incentive fund" under the proposed measure will still be required to go through the regular budgetary processes of the DBM and for its treatment as "expense", another rigorous administrative processes.

Indeed, the VAT refund system[5] where amounts of tax refunds are provided for under the GAA is an operational nightmare to the Japanese and European investors. This is a recognized fact by the agencies citing the administrative difficulty encountered in this mechanism.

Verily, we are of the view that placing the grant of incentives under the appropriation law is not the best way to promote transparency and fiscal prudence in the grant of incentives. As stated, the IACIS has already taken the initiative to foster transparency of incentive administration and this proposed executive order will address transparency and information gaps concerns.

Automatic Appropriation

In addition to the rationale provided above for this Department's reservation on this proposed measure, we believe that the grant of incentives should not be placed under the appropriation law. As defined "*appropriation*[6]" is an authorization from Congress to make payments out of government funds under specified conditions and/or specific purpose. As noted, tax incentives can never be treated as revenue funds for no income will pour into the government coffers hence, provision of budget for incentives under the GAA is not proper.

Further, we cannot find any precedent in any part of the world of such system. Placing the grant of incentives of all IPAs under a system that has never been tried and tested

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[4] Technical Notes on the 2015 Proposed National Budget (http://www.dbm.gov.ph/wp-content/uploads/images/final%20technotes%20for%20ictss%20pdf.pdf and http://www.dbm.gov.ph/wp-content/uploads/BESF/BESF2015/GLOSSARY.pdf)

[5] EO No. 68-A, Amending Executive Order No. 68 (s. 2012) which established the Monetization Program of Outstanding Value-Added Tax Tax Credit Certificates

[6] http://www.dbm.gov.ph/wp-content/uploads/BESF/BESF2015/GLOSSARY.pdf

could place the whole incentive system in an undesirable state. The consequential damagemay be very difficult to unravel once enshrined under a law.

Administration, Implementation and Monitoring of Tax Incentives.

Monitoring of the registered projects is a very crucial part in the administration of incentives. This provides the IPAs determination on the viability and potential of an industry or sector. The information derived from this provides the foundation for national industry development and promotion investment strategies which are material aspects in the performance of the functions of the IPA.

Also, the BIR conducts post-audit function on all entities, hence, monitoring of tax incentives for tax purposes is already well within their mandates. Submission of the annual tax expenditures and such other data related to the grant of incentives as required by the DOF can be undertaken even without this measure.

Non-compliance with the Reportorial Requirements

The principle of co-equal agencies of the government provides that each government agency is entrusted with specific powers and is not permitted to encroach upon the powers confided to the other. This principle was motivated by the belief that arbitrary rule would result if the same person or body were to exercise all the powers of the government.

Subjecting the IPAs to the BIR or BOC administrative and penal powers runs counter to the principle of co-equal agencies of the government. Further, there are several settled existing laws that impose sanctions for agencies that fail to undertake their mandate, such as Republic Act No. 3019, otherwise known as "Anti-Graft And Corrupt Practices Act" and Republic Act No. 6770, otherwise known as "The Ombudsman Act of 1989". Clearly, this provision is not required.

DOF to promulgate the IRR of the Act

The formulation of the IRR should rightfully be lodged to the IPAs as this pertains to fiscal incentives.

The two (2) investment related laws, namely: RA 9593 also known as the Tourism Act of 2009 or TIEZA Law and, RA 9400, An Act amending RA 7227, otherwise known as the BCDA Law, where DOF was mandated to formulate their IRR reveal that: *(1)* under RA 9593, an unreasonable delay in the formulation of the IRR occurred, and *(2)* under RA 9400, the IRR is currently the subject of an arbitration before the DOJ (between SBMA and DTI, DOF).

In summary, the proposed measure is not feasible nor necessary to meet the objective of fiscal prudence and transparency. This Department reiterates that an executive order

laying down a systematic mechanism for data sharing and capturing information gaps could ably address transparency.