AMCHAM PHILIPPINES
The American Chamber of Commerce of the Philippines, Inc.

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AMERICAN CHAMBER OF COMMERCE OF THE PHILIPPINES, INC.

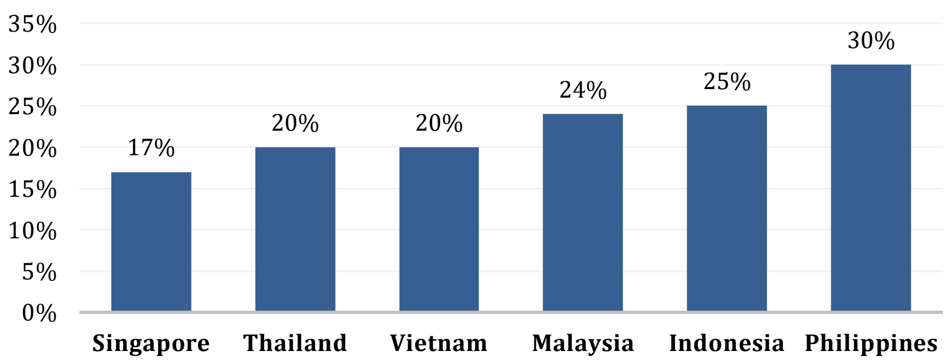
POSITION PAPER

CORPORATE INCOME TAX AND INCENTIVES REFORM ACT (TRAIN 2)

PART 1: INTRODUCTION AND BACKGROUND

1. The **corporate income tax (CIT)** in the Philippines of 30% is the highest among large ASEAN economies. The next highest is Indonesia at 25%. The average CIT of the ASEAN-6 largest economies is 22.7% (see figure 1). The 30% rate deters some investment by both domestic and foreign firms.[1] Internationally, the trend – including within ASEAN - is for governments to reduce their CIT. Most recently the United States reduced its CIT rate from 35% to 21% beginning January 1, 2018.[2] Within ASEAN, Brunei, Laos, Malaysia, Thailand, and Vietnam have reduced their CIT rates since 2009, the year when the current rate in the Philippines went into effect (see figure 2).

Figure 1: Comparative CIT Rates, ASEAN-6, 2017



Source: PwC and ADB

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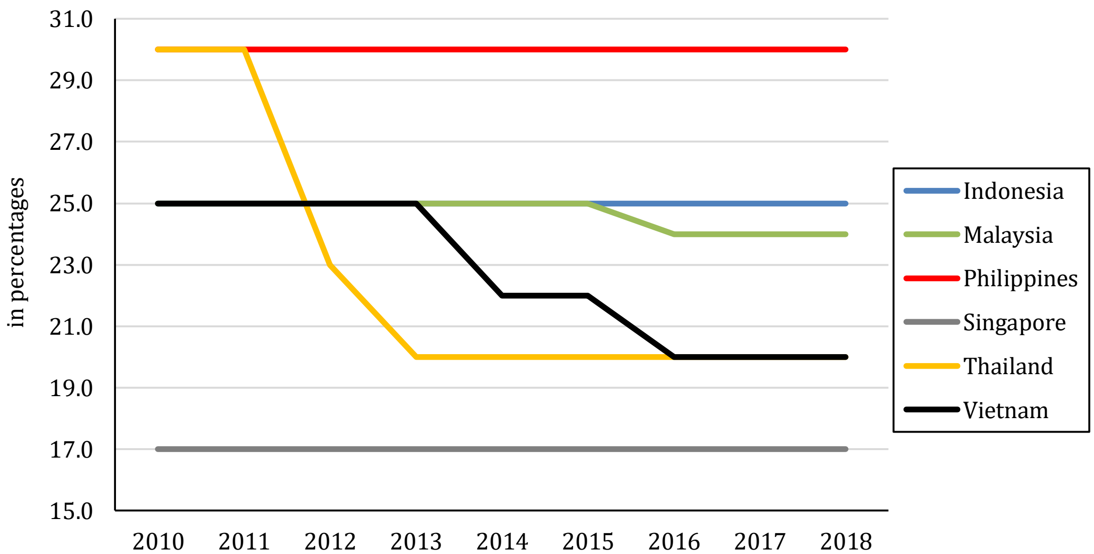
[1] World Economic Forum 2017 Global Competitiveness Index cited “tax rates” as the 4th of 16 problematic issues for doing business in the Philippines.

[2] Some companies headquartered outside the United States may move their headquarters to the United States because of the much lower CIT.

2. Over several decades the granting of **fiscal incentives** under a large number of Philippine laws to a multitude of business activities has created a highly complicated fiscal regime containing both positive and redundant incentives.

Figure 2: ASEAN-6 Comparison of CIT



Source: Ernst & Young[3]

Fiscal incentives rationalization (FIR) reform, first proposed in 1995, has failed to obtain the approval of successive Congresses, mostly recently in the 16th Congress. There is a consensus that rationalization and harmonization of these laws is a long-overdue reform. However, in each Congress the reform proposals failed because the Department of Finance (DOF) and Department of Trade and Industry (DTI) could not agree on all the details of the reforms in the "Investment and Incentives Code of the Philippines" bills, which sought to create a uniform code for all IPAs to follow and to rationalize fiscal incentives.

3. Under the current laws for **14 investment promotion agencies** (IPAs) fiscal incentives vary in their administration. The Board of Investments (BOI) awards incentives to domestic market and export investments in accordance with an Investment Priorities Plan (IPP) located anywhere in the country, while the other 13 IPAs are restricted to locators in almost 400 separate zones under the Philippine Export Zone Authority (PEZA), the Tourism Infrastructure and

[3] The Philippine CIT was reduced from 35% to 32% between 1997 and 2000 and to 30% in 2009.

Enterprise Zone Authority (TIEZA), and the Aurora, Bataan, Bases Conversion Development Authority (BCDA), Cagayan, Clark, John Hay, PHIVIDEC, Poro Point, Subic, and Zamboanga special economic zones (SEZ). Over the last two decades thousands of businesses, especially foreign investors engaged in the export of goods and services, were awarded fiscal incentives and established operations in these zones and elsewhere at a 5% GIE CIT rate in perpetuity. Most also benefited from a 4 year **income tax holiday (ITH)** in their first four years of operation. ITH awarded by the BOI were time-bound.

4. The practice of incentivizing investment has become increasingly common in developing as well as developed countries as national and local governments compete for multinational investors, as a tool to encourage development of selected industries and to accelerate creation of better-paying stable jobs for growing populations. The World Bank has created **The Developing Country Tax Incentives Database** with extensive information on 107 countries.[4]

PART 2: FISCAL INCENTIVES SUPPORT ECONOMIC GROWTH AND CREATE JOBS

1. Fiscal incentives have been granted at least since 1968 when RA 5186, the Investment Incentives Act was enacted, establishing the BOI, the IPP, and listing various fiscal incentives that the BOI could grant to domestic and foreign investors. RA 5186 was replaced by EO 226, the Omnibus Investments Code in 1987.

2. Over 50 years, the **BOI at the DTI** has been the premier government agency supporting investment and job creation, preparing the IPP, and administering fiscal incentives to investors in the sectors prioritized in the IPP.

3. To encourage foreign investment in manufacturing for export, the GPH established four industrial estates under President Marcos.[5] Under President Ramos, the **Philippine Economic Zone Act or RA 7916** was enacted in 1995.[6]

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[4] Chapter 3, Global Investment Competitiveness Report 2017/2018, Foreign Investor Perspectives and Policy Implications, World Bank Group, Washington, DC 2018.

[5] Located in Baguio, First Cavite, Mactan, and Mariveles, all but the latter are managed by PEZA. Mariveles was converted by law into the Bataan SEZ.

[6] Export processing zones account for about 20% of total merchandise exports of developing economies, according to the ILO and WTO. "By 2006, 130 countries had established over 3,500 EPZ's within their borders, with an estimated 66 million workers employed in those EPZs." China has been especially successful in attracting foreign

At that time, new export zones were being opened in China, Malaysia, Thailand, and other countries in competition with the Philippines. Ten other special economic zones were been established by additional laws authorizing each of their administrative bodies to grant incentives. There are some differences among the incentives granted by different IPAs, most notably that BOI firms are not VAT zero-rated while PEZA firms are VAT zero-rated.

4. **PEZA.** Investments administered in zones under PEZA have grown steadily in the last 22 years since established in 1995. As of December 2017, PEZA hosts 4,147 operating enterprises[7] nationwide located in 379 operating ecozones. The breakdown of the 379 ecozones is:

- Manufacturing (74)
- Medical Tourism (2)
- IT Parks and Buildings (261)
- Tourism (20)
- Agro-Industrial (22)

5. The cumulative total number of employees at all PEZA zones was 1.4 million as of October 2017 (see figure 3). The 5% GIE tax is paid 3% to the national government and 2% to the treasurer's office of the municipality or city where the registered enterprise is located.

6. From a modest beginning, PEZA has grown into a highly significant engine of economic growth and job creation for the Philippine economy. Over the decade ending in 2017, the annual job creation impact of PEZA ranged between 3,000 in 2009 (at the end of the global financial crisis) to 136,000 in 2013.[8] **PEZA has the potential to create the equivalent volume of new jobs every year of another Clark or Subic.**

7. It is estimated that for **every job created at PEZA, five indirect jobs are created** in the economy. Thus, were PEZA to disappear, over 6 million jobs would also disappear. So would US$ 63 billion worth of exports of goods and services, equal to approximately 20% of Philippine GDP (see table 1 for more details of the economic contributions of PEZA).

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investors to export processing zones. The first established was in Shenzen in 1980. *Martin Murray, Supply Chain Management, The Balance, November 16, 2016.*

[7] 1,583 exporting manufactured goods, 1,542 exporting IT-enabled services. Remaining locators are firms providing services to exporters.

[8] In 2013 PEZA created 136,000 new jobs, more than the total employment of both Clark (73,000) and Subic (89,000) in the same year. In 2017 PEZA experienced a growth of direct employment of 57, 490 or 4.26% over 2016.

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Table 1: PEZA Facts and Figures		
1	Operating Economic Zones Nationwide	379
	Industrial and Export Processing Zones	74
	IT Parks and Centers	261
	Tourism Ecozones	20
	Medical Tourism Parks	2
	Agro-Industrial Parks	22
2	Locator companies (1995-2017)	331 to 4,147
	Locators exporting manufactured goods (2017)	1,583
	Locators exporting IT-enabled services (BPO) (2017)	1,541
	Locators servicing exporters (2017)	1,023
3	Cumulative total investments (1995-2017)	PhP 3.6 trillion
4	Total PEZA Exports (2017)	PhP 2.6 trillion
5	Total PEZA Exports (2015 TIMTA Report)	PhP 773 billion
6	Total materials and inputs sourced domestically (2017)	PhP 296 billion
7	PEZA remittance to the national government (2017)	PhP 1 billion
8	Cumulative dividends, corporate income taxes, and loan payments to GPH (1995-2017)	PhP 19 billion
9	PEZA imports of equipment and materials for manufacturing (2017)	US$ 40 billion
10	PEZA additional direct employment (2017)	57,490
11	PEZA direct employment (1995-2017)	1,417,832
12	PEZA indirect employment (1995-2017)	7,089,160
13	Filipinos affected by PEZA's programs (1995-2017)	21,267,480

2015 PEZA Report to NEDA (TIMTA Law)		
14	GIE remitted to the government (2015)	PhP 7 billion
15	Tax expenditure on income tax holiday (2015)	PhP 26 billion
16	Tax incentives on value-added tax (import VAT, 2015)	PhP148 billion
17	Tax incentives on value-added tax (local VAT exempt purchases 2015)	PhP 3.3 billion
18	Tax incentives on value-added tax (local VAT 0% purchases, 2015)	PhP 18 billion
19	Withholding tax on compensation (2015)	PhP 42 billion
20	Expanded withholding tax (2015)	PhP 11 billion
21	Final withholding tax (2015)	PhP 8 billion
22	Final tax withheld by banks/sources on interest income, etc. (2015)	PhP 1 billion
24	Local tax remitted (real property, business, occupation/others, 2015)	PhP 3 billion
25	Cost for incentives (tax expenditures + VAT, 2015)	PhP235 billion
26	2015 PEZA report to NEDA (TIMTA Law): total actual investments	PhP 2 trillion
27	2015 PEZA report to NEDA (TIMTA Law): total employment	1,031,445
28	2015 total additional employment	94,246
29	2015 PEZA report to NEDA (TIMTA Law): local purchases	PhP215 billion
30	2015 PEZA report to NEDA (TIMTA Law): total value remitted	PhP 3.3 trillion

Source: PEZA

8. After the departure of US military forces in the early 1990s, a series of administrative orders and laws during the Ramos Administration established the **BCDA**, the **Subic** Special Economic and Freeport Zone, **Clark** SEZ, **John Hay** SEZ, and **Poro Point** SEZ to encourage rapid economic development of the former bases and to take advantage of their substantial physical infrastructure.

9. Clark and Subic were heavily damaged by heavy ash fall from the Mt. Pinatubo eruption in 1991.[9] While Subic was cleaned up by the US Navy, Clark was abandoned and left nearly completely desolate for several years. Along with John Hay and Poro Point, the Philippine Government was greatly challenged to stimulate economic activity at these large installations. Today, all three former military bases are well-regarded and admired as success stories for a government to convert former military bases into successful economic hubs.

10. Fiscal incentives have been essential tools used to attract investors to locate at the former bases. The government decided to grant an indefinite 5% GIE CIT incentive and an indefinite tax and duty-free exemption for importation of raw materials and equipment. Insulation from local government also made the new economic zones attractive. Red tape was eliminated and 2% of the GIE was paid directly to the local government in lieu of other taxes.

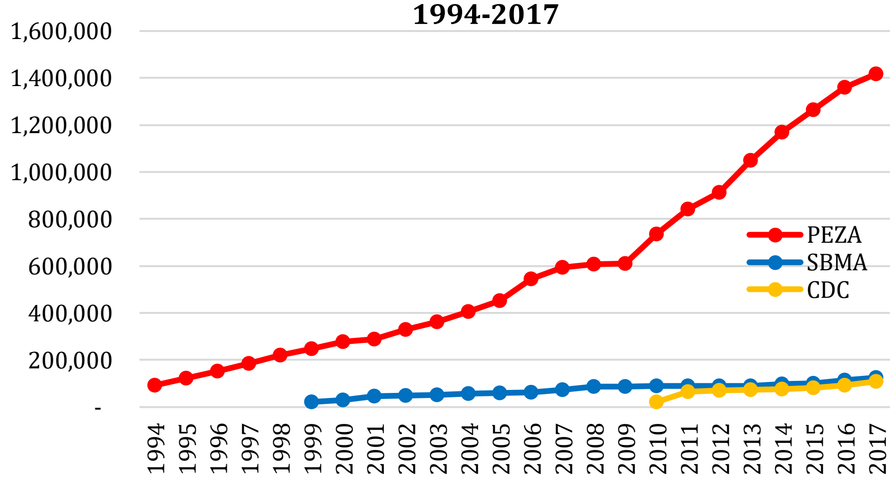
11. Under management of the **Subic Bay Management Authority**, the former naval base developed over almost three decades until today it hosts a workforce of 126,000 persons, up from 20,000 in 1999 (see figure 3).

12. The largest employer at Subic is Hanjin Heavy Industries, which employs more than 20,000 Filipinos workers at its shipyard on the Redondo Peninsula. The yard launched the world's largest container ship in 2017. The BOI has prioritized shipbuilding as a major sunrise industry in the Philippines.

13. Under the **Clark Development Corporation**, the former air base in Pampanga has also thrived. Today, Clark hosts a workforce of 108,000 persons, up from 20,000 in 2010 (see figure 3).

[9] The eruption on June 15, 1991 was the second-largest volcanic eruption of the 20th century and the largest eruption to affect a densely populated area.

Figure 3: Total Employment for PEZA, SBMA, and CDC, 1994-2017



Source: PEZA, SBMA, and CDC

14. Clark and Subic have become significant exporters. The value of exports from the two zones in 2017 was US$ 8.5 billion (Clark was US$ 6.7 billion and SBMA was US$ 1.8 billion) (see table 2).

15. Clark hosts several major foreign export investors, including Phoenix Semiconductors, SIA Engineering (Philippines) Corp. (a joint venture aircraft MRO between Singapore Airlines and Cebu Pacific), Sutherland Services, Texas Instruments, and Yokohama Tire.

Table 2: Export Value for CDC, PEZA, and SBMA, 2017	
CDC	US$ 6.9 billion
PEZA	US$ 51 billion ($40 billion exports for goods and $11 billion for services
SBMA	US$ 1.8 billion

Source: CDC, PEZA, and SBMA

PART 3: INCENTIVES NEEDED FOR PHILIPPINES TO WIN FOREIGN INVESTMENT

1. The World Bank divides FDI into three categories: **(1) market-seeking, (2) resource-seeking, and (3) efficiency-seeking.**[10] The Philippines seeks to attract foreign investors in each of these categories. Investing in real estate, a bottling plant, or an automotive factory are examples of market-seeking. Investing in farming or mineral ores is resource-seeking. Investing in providing goods or services for export is efficiency-seeking.

2. Investors consider a large number of factors in choosing where to invest, usually considering several countries in their decisions. Like a beauty contest, the Philippines must be competitive in enough of the factors a particular investor measures in order to win the firm's investment.

3. **Fiscal incentives are an important factor in most investment decisions** since taxes, duties, fees, and deductible expenses add to business expenses. When they are waived or reduced the cost of doing business is less, making the country more competitive. Some countries are able to offer a major investor extremely attractive menus of incentives including long ITH with reduced CIT thereafter with indefinite renewals, free land, new roads, etc.

4. Each **investor is highly sensitive to the costs of doing business** in the Philippines compared to other countries. Factors such as the availability, cost, and accessibility of the workforce are important. For example, the BPO-industry only took off when the factors of available English-speaking employees, the internet, and wage rates much below US levels came together. Conversely, employment in the garment export industry, which exceeded 1 million a decade ago, fell more than 80% when quota access to importing countries ended. Manufacturers shifted to countries with lower labor costs, such as Bangladesh, Cambodia, and Vietnam. Today almost 400,000 Vietnamese make products for Nike, while the Philippines imports Nike products from Vietnam.

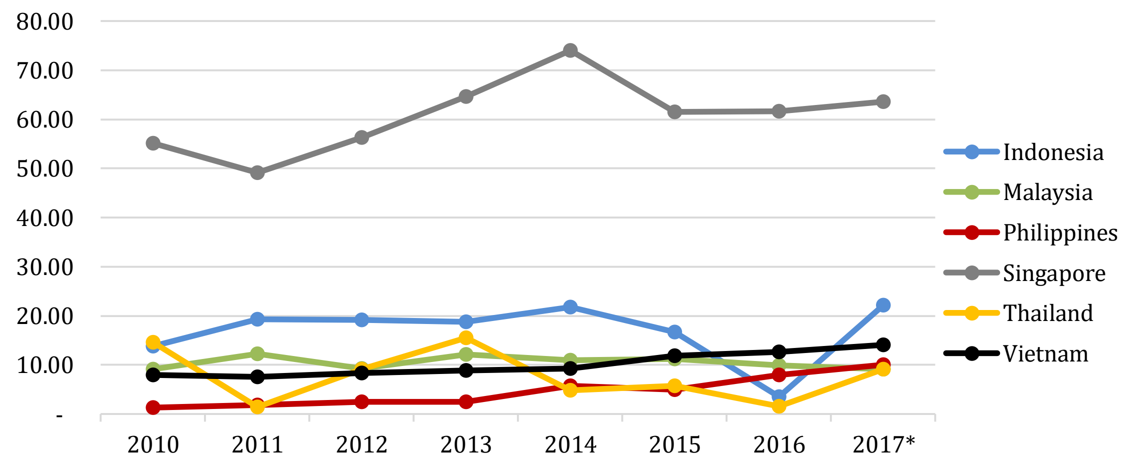
5. As a region, **ASEAN is one of the world's most attractive destinations for foreign investment**. The population of 633 million in 2015 is projected to grow at 0.85% per annum to 741 million in 2035. The Philippine population is projected to reach 127 million in 2030.[11] The IMF recently projected ASEAN's GDP growth rate to be 5.2% in 2018, 5.3% in 2019, and 5.4% in 2020.[12]

[10] 2017/2018 Global Investment Competitiveness Report: Foreign Investor Perspectives and Policy Implications, World Bank Group, 2018.
[11] ASEAN 2030, Asian Development Bank, 2018.
[12] World Economic Outlook, IMF, 2018.

6. **Foreign investment in ASEAN is very strong.** Total annual FDI of the ASEAN 6 is getting close to that flowing into the PRC. During the 8-year period 2010-17 total net FDI in the PRC reached US$1.016 trillion. FDI for the ASEAN-6 for the same period was $883.4 billion (see table 3).

7. **Substantial increase in Philippine net FDI.** After years of low FDI, inflows began rising in 2013, reaching US$10 billion in 2017, comparable to inflows of Malaysia and Thailand. However, in 2017 Indonesia reached US$ 22 billion and Vietnam $14 billion. Although the Philippines has 16% of ASEAN's population, it receives less than 8% of the total ASEAN FDI (see figure 4 and table 3).

Figure 4: Net FDI, ASEAN-6, 2010-2017



Source: *UNCTAD *2017 data comes from BSP*

Table 3: ASEAN-6 FDI, in US$ billion, 2010-2017								
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017***
Indonesia	13.77	19.24	19.14	18.81	21.81	16.64	3.52	22.17
Malaysia	9.06	12.19	9.24	12.11	10.88	11.21	9.92	9.06
Philippines	1.30	1.85	2.45	2.43	5.74	4.93	7.93	10.00
Singapore	55.07	49.15	56.23	64.68	73.98	61.5	61.59	63.57
Thailand	14.55	1.37	9.13	15.49	4.80	5.70	1.54	9.10
Vietnam	8.00	7.52	8.37	8.90	9.20	11.80	12.60	14.10
Total FDI	**101.75**	**91.32**	**104.66**	**122.42**	**126.41**	**111.78**	**97.1**	**128.00**
China	114.73	123.99	121.08	123.91	128.50	135.61	133.70	135.00[13]

*Source: UNCTAD *2017 data comes from BSP*

[13] Preliminary data for net FDI for 2017 is sourced from the Ministry of Commerce of the government of China

8. **FDI approvals of BOI and PEZA have decreased.** While total investment approved by the BOI in 2017 reached a record level of PhP 617 billion, the FDI component at PhP 22 billion was the lowest since 2009 when it was PhP 23 billion. PEZA also recorded sharp declines in approved new and expansion projects in 2017, almost 50% below the high levels in 2015 (see table 4).[14] Figure 5 shows the drop in FDI registrations at BOI and the decreased volume of registrations at PEZA, both for 2017. These decreases coincide with tax policy uncertainty created by new political leadership in the Philippines and the United States, scarcity of sufficient PEZA zone space for locators, and increased competition from other countries, especially Vietnam. Cost competitiveness and ease of doing business factors in the Philippines did not change significantly in 2016 and 2017.

Table 4: PEZA Approved Investments by Industry Sector, 2016-2017			
Industry Sector	**Jan-Dec 2016**	**Jan-Dec 2017**	**% Change**
Manufacturing	PhP 90 billion	PhP 48 billion	-46%
Information Technology	PhP 30 billion	PhP 16 billion	-49%
Ecozone Development	PhP 90 billion	PhP 154 billion	+71%
Others	PhP 8 billion	PhP 20 billion	+160%
Total	**PhP 218 billion**	**PhP 238 billion**	**+9%**

Source: PEZA

9. **Recent foreign investor uncertainty.** While Philippine net FDI inflow reached record volumes in recent years, reflecting the high growth and high potential of the country a large majority of inflows comprised “intercompany borrowings” involving existing locators who probably do not receive incentives. The BOI and PEZA approval data for new projects reflect a declining level of new foreign investor interest. There are troubling indicators that significant potential foreign investment, especially in information technology and manufacturing at PEZA zones, is being postponed and even going to competing countries.

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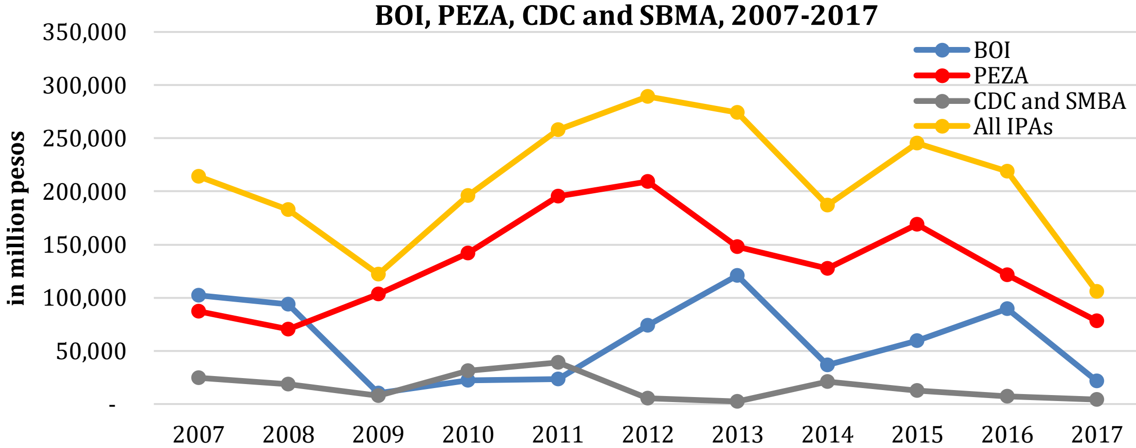
Figure 5: Approved IPA foreign Investments with BOI, PEZA, CDC and SBMA, 2007-2017



Source: Philippine Statistics

10. **Foreign manufacturing continues to move out of China.** Foreign investment from Asia, Europe, and the United States played a large role in China becoming a major global manufacturing and export hub. But in labor-intensive lower cost manufacturing sectors, China has lost competitiveness and is increasingly expensive. Many American, Chinese, European, Japanese, Korean, and Taiwanese firms that located in China over the last three decades are relocating out of China. Some are increasing operations already in the Philippines or opening new factories in this country.

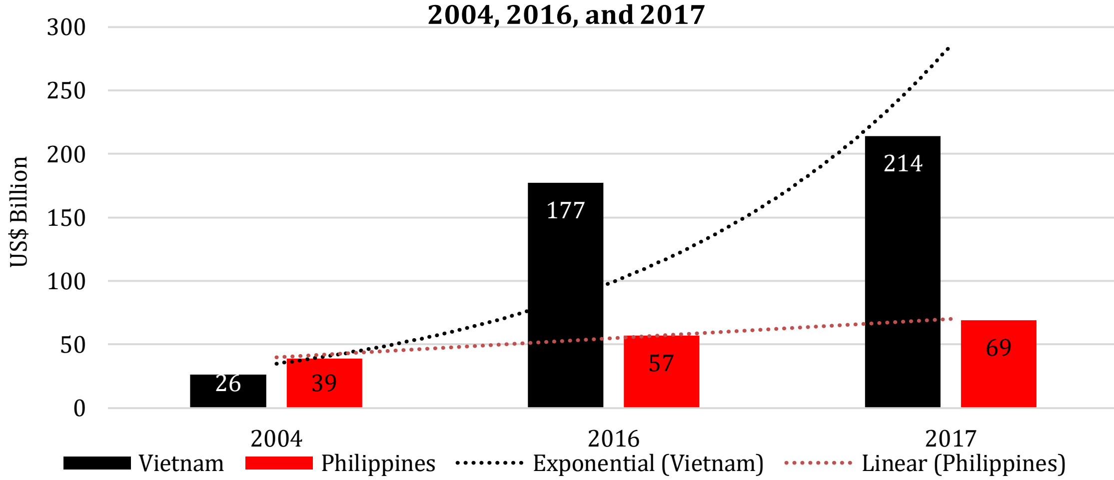
11. **Vietnam has become a major destination for FDI in ASEAN.** Vietnam is receiving increasing annual net FDI reaching US$ 14 billion in 2017 and had an extraordinary amount of approved FDI of US$ 36 billion in 2017. In the eight-year period 2010-2017, the net FDI flow to Vietnam reached US$ 80 billion, almost as much as Malaysia (US$ 84 billion) and more than Thailand (US$ 62 billion) and the Philippines (US$ 32 billion) (see table 3). Vietnam has attracted both low-end and high-end assembly manufacturing investment.

12. **The largest foreign investor in Vietnam is Samsung,** which assembles 50% of its global supply of mobile phones near Hanoi, and exported US$ 50 billion in 2017. Operations began in 2007 with a US$ 650 million plant and has grown to a total of US$ 17 billion invested in three mobile phone plants and a television and home appliance factory. Samsung employs 120,000-150,000 Vietnamese directly and another 250,000 through local suppliers. The government provides **rent-free land** near the principal airport and long-term fiscal incentives. The incentives include a **CIT holiday for the first four years** of operations, and a **preferential tax rate of 5% over the next nine years. From the 14th year of operations onward, the tax rate will be set at 10%.**

13. The **largest foreign-owned job creator in Vietnam is Nike**, which buys from 89 factories (59 making apparel and 26 footwear) in Vietnam that employ 397,000 workers.[15] These factories are Asian-owned, not owned by Nike.

14. As a consequence, **Vietnamese exports have grown very rapidly to over US$ 214 billion,** while Philippine exports of goods have grown very slowly. The entry of thousands of foreign manufacturers has created millions of decent factory jobs for Vietnamese workers. In 2004 Vietnam exported 33% less than the Philippines (see figure 6).

Figure 6: Philippines and Vietnam Exports of Goods Comparison, 2004, 2016, and 2017



Source: Bangko Sentral ng Pilipinas

15. **Could the Philippines receive as much FDI as Vietnam**? The sizes of the workforces of the Philippines and Vietnam are similar. The Philippines has an important advantage as an English-speaking nation. But major manufacturing cost factors (electricity, minimum wages, and number of non-working holidays) are considerably higher in the Philippines (see table 5). Experts agree the Philippines has the potential to compete with Vietnam in manufacturing. However, Philippines success will depend on how well the Philippines can reduce the gap in costs of production. Also critical is to preserve the value of PEZA and other economic zones and to manage carefully any transition from current fiscal incentives to the new regime under TRAIN 2.

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15 Nike shows no factories in the Philippines on its website of global locations where its goods are manufactured. In Asia these are Cambodia (8), India (10), Indonesia (39), Malaysia (9), Philippines (0), and Thailand (30).

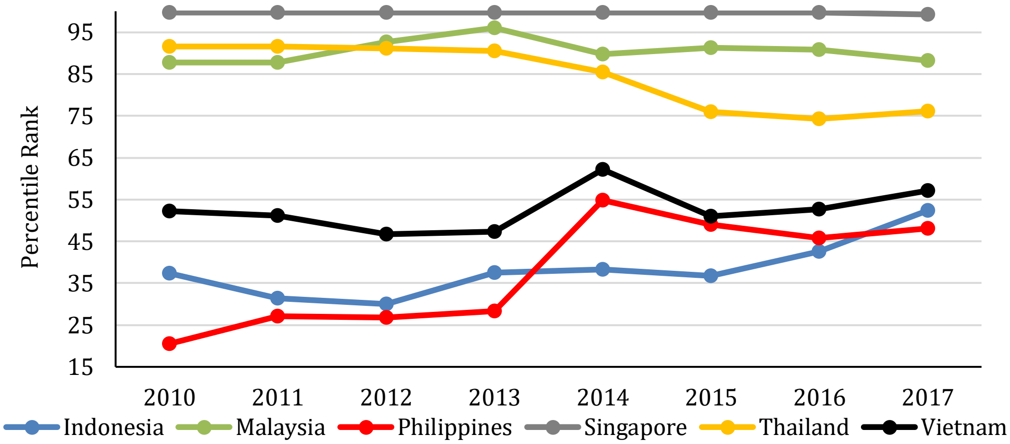
Table 5: Comparison of Electricity, Minimum Wage, and Non-working Holidays (Philippines vs Vietnam, April 2018)		
	Philippines	**Vietnam**
Electricity (per kilowatt-hour)	US$ 0.20 or PhP 10.55 *(April 2018)*	US$ 0.076 or VND 1,720 *(December 2017)*
Minimum wages (per day)	US$ 9.20 to US$ 9.92 (NCR) or PhP 475 to 512 *(April 2018)*	US$ 4.86 to US$ 5.49 (Region I and II) or VND 110,666.67 to 125,000.00 *(April 2018)*
Number of non-working holidays	21 *(January 2018)*	12 *(January 2018)*

Source:[16]

16. **Philippines rated poorly in Competitiveness and Ease of Doing Business**. Two widely-consulted global indexes rate the Philippines the lowest of the ASEAN-6 in key competitiveness rankings. In the Ease of Doing Business (see figure 7), the Philippines - while lowest-ranked - is close to Indonesia and Vietnam. In the Competeveness Index, the Philippines and Vietnam rank the same, while Indonesia is higher (see figure 8). Each of the three countries has advantages over the others - the Philippines with English, Indonesia has a large middle class market, and Vietnam offers lower labor costs. Also, both Indonesia and the Philippines subsidize power. These are among the reasons that Indonesia and Vietnam continue to attract much more FDI than the Philippines in 2017 (see figure 5).

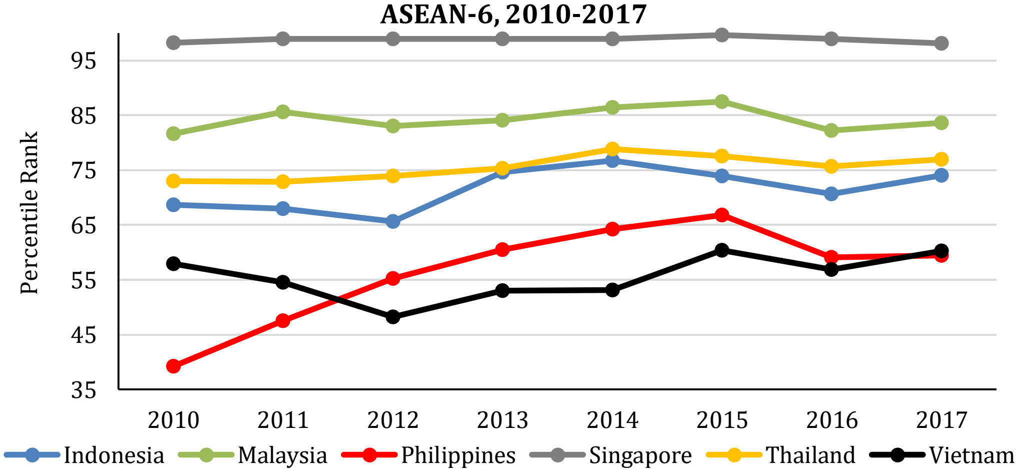
[16] Electricity:
http://powerphilippines.com/2018/04/06/electricity-rates-will-go-april-meralco/
http://vietnamnews.vn/economy/418630/average-electricity-price-rises-to-0076-per-kwk.html#LIOvhuCworDoAjTX.97
Minimum wage:
http://www.nwpc.dole.gov.ph/pages/statistics/stat_comparative.html
Holidays:
http://www.fedex.com/holiday/schedule/?noRedirect=true

Figure 7: WB Ease of Doing Business, ASEAN-6, 2010-2017



Source: WorldBank WDI

Figure 8: WEF International Competitiveness, ASEAN-6, 2010-2017



Source: WEF Global Competitiveness

17. **Philippine infrastructure lags in the ASEAN region.** Due to many years of underspending on infrastructure, the Philippines ranks lower than the other ASEAN-6 economies. It is low ranked in every aspect of infrastructure in Table 6, including overall infrastructure, overall transport, roads, railroads, ports, air transport, electricity supply, mobile phone subscriptions, and fixed telephone lines. The Aquino and Duterte Administrations are spending a higher percentage of GDP on infrastructure, targeting to reach the 7-8% range. However, it will take longer than two administrations to provide the country with modern, efficient infrastructure.

18. In 2012, JICA estimated economic losses of PhP2.4 billion a day in Mega Manila due to traffic congestion. Recently, JICA increased its estimate to PhP3.5 billion a day. Airport congestion at NAIA also has its cost in delayed flights and missed connections.

Table 6: General infrastructure rankings of ASEAN-6, 2017

Categories (Ranks out of 137)	**Indonesia**	**Malaysia**	**Philippines**	**Singapore**	**Thailand**	**Vietnam**
Infrastructure (2nd Pillar Rank)	52	22	97	2	43	79
Overall (transport, comm., energy)	68	21	113	2	67	89
Roads	64	23	104	2	59	92
Railroads	30	14	91	4	72	59
Ports	72	20	114	2	63	82
Air Transport	51	21	124	1	39	103
Electricity Supply	86	36	92	9	57	90
Mobile Phone Subscriptions	18	28	88	23	5	44
Fixed Telephone Lines	105	72	106	27	92	97

Source: World Economic Forum Global Competitiveness Report (2017-2018); includes all areas related to infrastructure, except availability of airline seats (index numbers 2.01-2.05, 2.07-2.09)

19. **Fiscal incentives compensate for higher costs in Philippines.** With higher costs of doing business in the Philippines, fiscal incentives play an important role in making an investment in the country more attractive to efficiency-seeking foreign investors. For this reason, the incentives the Philippines offers should go beyond being equal to competitors. They should be more attractive in order to narrow the marginal advantage of other locations.

PART 4: DO PHILIPPINE INCENTIVES MATCH THE COMPETITION?

1. **Foreign investors encourage the Philippine Government to make its menu of fiscal incentives more attractive than competitors**. As noted earlier (part 3, paragraphs 2-4) fiscal incentives are an important component of the multiple factors weighed during the investment decision process. The proposed scaling back in HB 7214 and HB 7458 would radically change the menu by ending the indefinite 5% GIE. Several ASEAN competitors currently offer more attractive incentives than the Philippines provides. These incentives not only include longer ITH or reduced CIT rates but also duty-free imports of capital equipment, raw materials, intermediate goods for exporters, and even free land. The table presented by DOF in February 2018 is not up-to-date and does not reflect current incentives offered by Singapore, Thailand, and Vietnam (see table 7).

Table 7: Comparative income tax holiday/special rate in ASEAN countries, 2017

Country	Maximum years of ITH incentives	Comments/Updates
Cambodia	9	
Indonesia	20	CIT reduction 10-100% for 5-15 years; can be extended to total of 20 years for $200 million.
Malaysia	5 + 5 extension	Incentive period: 5 to 10 years. ITH extension up to 10 years. Reinvestment allowance for manufacturing.
Philippines	4-8 + 5% GIE forever	BOI ITH expires; PEZA and other IPAs have 5% GIE benefit indefinitely.
Singapore	5-15	For pioneer enterprises ITH of 5-15 years and post-pioneer at reduced rate not less than 5%. Total incentive period limited to 40 years.
Thailand	8-15	Incentive period: 8 to 13 years. Strategic activities 15 years, including in new Eastern Economic Corridor. No extension unless additional or new investments. 50% CIT reduction available.
Vietnam	4-35	ITH commences after first profits (or year 4) then 4 years ITH and 50% reduction up to 9 years. A. Preferential tax rates - 10% for 15 years , 15% for 10 years, or 17% for 10 years; B. Preferential rate extension: 15 years maximum Also has Land Rental incentives schedule from 3 years up to whole project life.

Source: DOF briefing, 3/9/18; Ernst & Young (2018); PricewaterhouseCoopers (2018)

PART 5: FOREGONE REVENUE IS MISLEADING; COST/BENEFIT ANALYSIS IS MISSING

1. **Tax Incentives Management and Transparency Act (TIMTA).** RA 10708, enacted in 2015, has provided its first data on fiscal incentives granted to investors. According to the DOF, based on annual reports of thousands of IPA locators collected by the IPAs, the fiscal incentives granted in 2015 totaled PhP 301 billion.

2. Table 8 entitled "**2015 estimated foregone revenue due to tax incentives**" is copied from the DOF briefing on the proposed bill and shows the breakdown of foregone revenue type of fiscal incentive. PhP 86.3 billion was attributed to ITH. Incentives connected to imports amounted to PhP 214.9 billion or 71.5% of the total (customs duties PhP 18.1 billion, import VAT PhP 159.8 billion, and local VAT PhP 37 billion).

Table 8: Estimated forgone revenue due to tax incentives, 2015

Type	**Revenue** (in billions PhP)
Income tax	86.3
Customs duties	18.1
Import VAT (gross)	159.8
Local VAT (gross)	37.0
Local Business Tax	TBD
Leakage	TBD
Total	**301.0**

Source: DOF briefing, 3/9/18

3. Section 3 of RA 10707 the TIMTA requires "registered business entities availing of incentives administered by the IPAs…(to) file with their respective IPAs a complete annual tax incentives report of their income-based tax incentives, value-added tax and duty exemptions, deductions, credits or exclusions from the tax base as provided in the charter of the IPA concerned.

4. **Counting VAT and customs duties as "foregone revenues" is misleading.** How can an export firm forego revenue on a tax it should never have to pay? Exporters located at IPAs should not pay custom duties nor import VAT precisely because they are exporters. Charging VAT and customs duties is **equivalent to charging export taxes.** Philippine exports compete with goods

made in other countries for sale around the world. Their competitors do not pay domestic sales taxes and duties in their countries. Exporters already face higher costs of electricity, labor, and logistics in the Philippines, thus to charge them customs duties and taxes would strongly discourage investment in export industries in the Philippines, favor imports, and reduces job opportunities for Filipinos.

5. **PhP 215 billion of PhP 301 billion is not foregone revenue** and should not be counted as fiscal incentives when granted to exporters. Subtracting this sum from the PhP 301 billion, the 2015 estimated **foregone revenue reported by TIMTA is reduced to PhP 86 billion.**

6. Another source of estimated foregone revenue is the Budget of Expenditures and Sources of Financing (BESF) of the Department of Management and Budget (DBM). Table 9 shows its estimates for the period 2014-2017 for 7 of the 14 IPAs.

Table 9: Estimated revenue foregone due to fiscal incentives, by IPA, 2014-2017*

	2014**	2015	2016	2017
Board of Investment	32,217	33,609	37,227	41,231
Philippine Economic Zone Authority	53,512	56,186	62,280	68,954
Authority of Freeport Area of Bataan	140	144	160	177
Cagayan Economic Zone Authority	326	352	391	432
Clark Development Corporation	1,336	1,404	1,556	1,723
Poro Point Management Corporation	43	46	51	56
Subic Bay Metropolitan Authority	588	631	700	775
Total	**88,160**	**92,373**	**102,365**	**113,348**

**in millions*
***actual*

Source:[17]

[17] https://www.dbm.gov.ph/wp-content/uploads/BESF2017/K2.pdf

7. Another table from the DOF briefing (see table 10) compares estimated fiscal incentives (excluding VAT) to GDP, NG expenditures, and NG revenues.

Table 10: Tax incentives estimates (following the TIMTA law), 2015				
Type of Incentive	**Amount of tax incentives (in billion PhP)**	**Ratio to 2015 GDP (%)**	**Ratio to 2015 NG expenditures (%)**	**Ratio to 2015 NG revenues (%)**
Income tax holiday	*53.8*	*0.4*	*2.4*	*2.6*
Special Rate (5% GIE)	*32.5*	*0.2*	*1.5*	*1.5*
Total incentives on income tax	**86.3**	**0.7**	**3.9**	**4.1**
Total incentives on customs duties	**18.1**	**0.1**	**0.8**	**0.9**
Total	**104.4**	**0.8**	**4.7**	**5.0**

Source: DOF briefing, 3/9/18

8. **"Foregone revenue" data is only collected by the IPAs** in accordance with the TIMTA. There are hundreds of other laws that grant fiscal incentives and there are no laws that require an accounting of the "foregone revenue" data under these laws (see footnote for a list of the range of businesses benefiting from the many laws that authorize granting of specific incentives.)[18]

9. Section 6 of the **TIMTA mandates NEDA to "conduct cost-benefit analysis** on the investment incentives to determine the impact of tax incentives on the Philippine economy." All IPAs are required to submit "aggregate investment-related data, both on a sectoral and per industry basis, which may include, but not limited to, investment projects, investment cost, actual employment, and export earnings." As of early May, NEDA had not completed compiling the report. In the absence of the NEDA report, we can turn to some data from DBM and PEZA.

[18] Aside from replacing the fiscal incentives that the 14 IPAs are authorized to award, the bill proposes to replace incentives for a wide variety of businesses, including agriculture, airlines, barangay business enterprises, broadcasting, bio fuel, casinos, forestry, fishing, halal, healthcare, housing, hydroelectric power, iron and steel, Islamic banks, jewelry manufacturing, mining, MSMEs, petroleum, rural banks, schools, seed industry, solid waste management, shipbuilding and shipping, telecommunications, veterans (PHIVEDEC), and water.

10. Government reporting on the amount of GIE income appears inconsistent in the two sources consulted. According to BESF data, 2% of the 5% GIE tax at IPAs is remitted to local governments near PEZA zones, amounting to PhP 0.8 billion in 2015 and PhP 1.6 billion in 2016 (see table 11 and figure 8). However, PEZA reports PhP 7 billion paid in GIE in 2015 in its TIMTA report (see line 16 table 1). Based on this number, the 2% portion paid to LGUs would be PhP 2.8 billion in 2015.

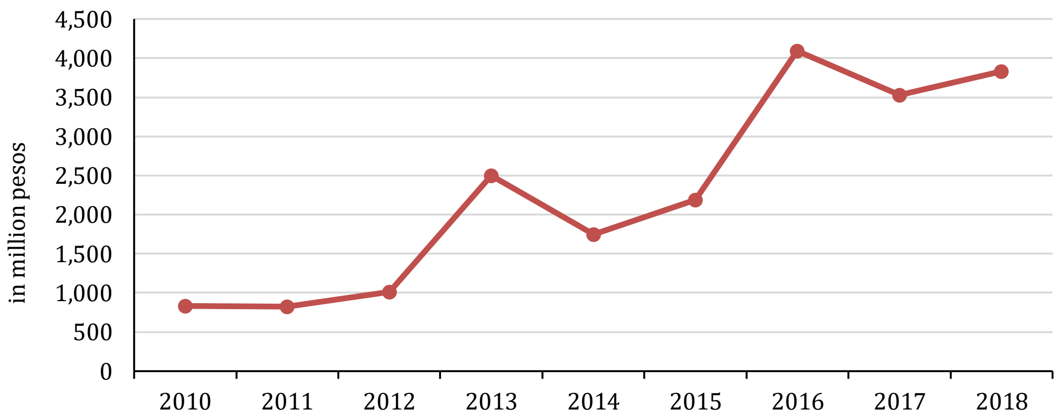
Table 11: Local government revenue paid from 5% GIE of locators, 2010-2018*

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Municipalities	449.51	450.33	587.36	697.06	903.04	784.15	867.57	449.37	529.11
Cities	376.98	358.41	407.46	1,790.92	839.40	917.90	3,198.83	3,057.22	3,273.04
Provinces	3.00	13.00	13.70	8.02	9.06	484.06	24.29	24.00	26.47
Total	**829.49**	**821.74**	**1,008.52**	**2,496.00**	**1,751.50**	**2,186.11**	**4,090.70**	**3,530.59**	**3,828.62**

**in million pesos*

Source: BESF Table F.4 (various years)

Figure 8: LGU revenue paid from 5% GIE of locators, 2010-2018



Source: BESF Table F.4 (various years)
Note: 2% of the GIE is remitted to the local government

11. **A cost benefit analysis is crucial to understanding the total value of and rationale for granting incentives.** There is no reason to grant incentives other than to benefit the economy by supporting economic development and job creation. If an investment results in little job creation or economic development than there is no reason to grant incentives. But when investments create cascading benefits and bring investors to the country that would otherwise not invest, incentives are valuable and worth the supposedly "lost revenue." Lost investments, lost direct and indirect jobs, lost technology transfer, lost exports, lost opportunities to work at home with family instead of abroad should also be

included in a balanced accounting when considering future fiscal incentive policy.

12. The **required PEZA report to NEDA has been made public** and estimates that PEZA zone locators purchase more than PhP 250 billion in local goods each year. Employees of PEZA locators pay personal income tax and VAT on their purchases. An estimated 5 indirect jobs are created for each job created by a PEZA manufacturing investor. A visitor to these zones easily sees the positive effect on the local economy of the spending in nearby communities. Good examples are the towns of Santa Rosa, Laguna and Lapu Lapu City in Mactan Island.

13. PEZA also reports national and local tax withheld and remitted by its locators (see table 12). This includes (1) withholding tax on compensation of employees, (2) GIE remitted to the government, and (3) two smaller taxes. These total PhP 72 billion for 2015.

Table 12: PEZA national and local tax withheld and remitted, 2015		
1	Withholding tax on compensation (2015)	PhP 42 billion
2	Expanded withholding tax (2015)	PhP 11 billion
3	Final withholding tax (2015)	PhP 8 billion
4	Final tax withheld by banks/sources on interest income, etc. (2015)	PhP 1 billion
5	Local tax remitted (real property, business, occupation/others) (2015)	PhP 3 billion
6	GIE remitted to the government (2015)	PhP 7 billion
	Total	**PhP 72 billion**
7	Forgone revenue due to ITH and special rate (2015)	PhP 56 billion
8	Tax revenue surplus	PhP 6 billion

Source: PEZA, DOF, and DBM

14. We believe that a **full cost-benefit analysis will show that the benefits fully outweigh the forgone revenue.** Without incentives, most of these investors would not have invested in the Philippines**.** The “foregone revenue” is a cost of attracting their investment into the Philippines where its value is multiplied in terms of jobs created, new tax revenue generated directly and indirectly, technology transferred, and income of small and medium-sized enterprises (SMEs) in the vicinity of zones increased. Companies that supply the PhP billion in local goods to PEZA locators and their employees pay income taxes, excise taxes, and VAT on their consumption.

15. DOF and DBM data and Table 8 estimates PhP 56 billion in PEZA foregone revenue in 2015. This is 6 billion less than the new revenue generated by PEZA (see table 12).

16. The DOF recorded foregone tax revenue in 2015 for PEZA at PhP 52 B (PhP 26 B for ITH and PhP 26 B for GIE.)[19] In the absence of data for benefits of other IPAs, we can ask the question "**Did PEZA bring more benefits in to the Philippine economy than the foregone PhP 52 billion in tax revenue?"**

17. **The answer must be YES**. According to the PEZA TIMTA report, PhP 72 B was remitted, of which PhP 2.8 B went directly to LGUs. In addition 1,417,832 Filipinos were employed at PEZA zones in 2017. By adding local purchases of locators and indirect jobs created, the value of PEZA is clearly many times that of foregone revenue. This ratio argues for leaving PEZA incentives in place and enhancing them in order to attract more investors.

18. **Php 1 = Php 2.5.** DTI Secretary Lopez infirmed the May 22 HWMC hearing that every one peso in incentive granted results in two and a half pesos of increased revenue.

PART 6: RESULTS OF SURVEY OF MEMBERS

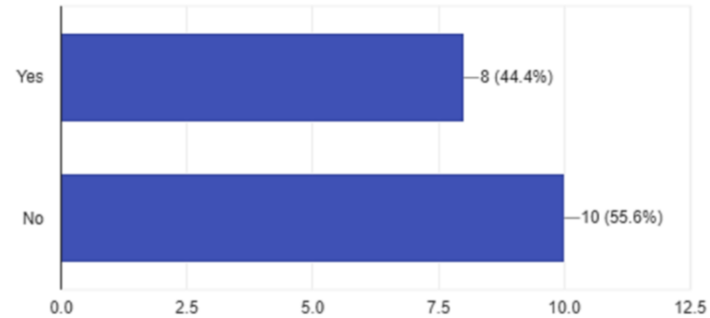
1. AmCham conducted a survey in March and April among multinational members likely to be affected by the fiscal incentive policy changes proposed for TRAIN 2. Most, but not all, of those who replied benefit from the current fiscal incentives.

2. Regarding proposed corporate income tax reduction to 25%, 72% of respondents agreed it will improve their business while 28% of respondents stated it will worsen their business. Those who believe a 25% CIT reduction will worsen are receiving the 5% GIE fiscal incentive.

   When asked if a 25% CIT will encourage their firms to invest more, around 56% said no (see figure 9)

[19] Slide 16 DOF briefing, 3/9/18. Customs duties not included because most locators are exporters.

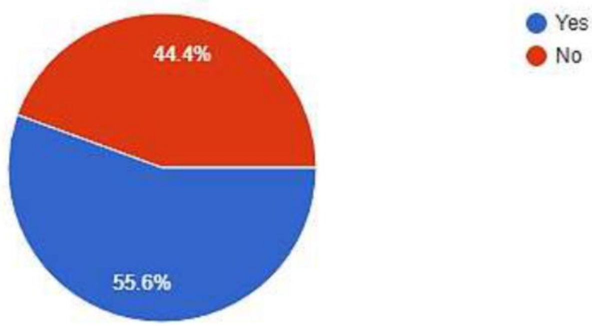
Figure 9: Would your company invest more in the Philippines with a 25% corporate income tax?



Source: AmCham survey on TRAIN 2, 3/18/18

Contrary to the former question, most of the respondents said that they will invest more at 20% CIT (see figure 10).

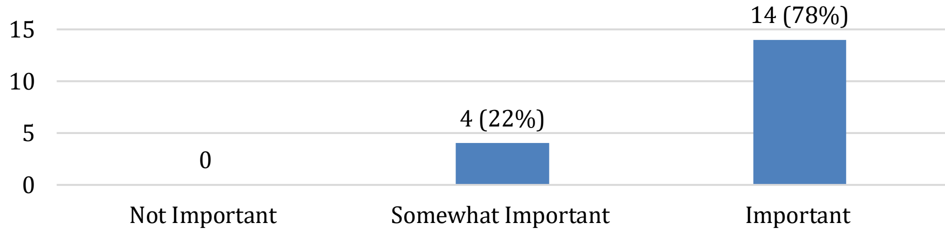
Figure 10: Would your company invest more in the Philippines with a 20% corporate income tax?



Source: AmCham survey on TRAIN 2, 3/18/18

3. Regarding the proposed time limit for fiscal incentives, 78% of respondents stated that this would worsen their business. In terms of the importance of fiscal incentives as a factor for companies to consider before investing, 22% of the respondents have said that it is somewhat, while 78% have said that it is very important (see figure 14).

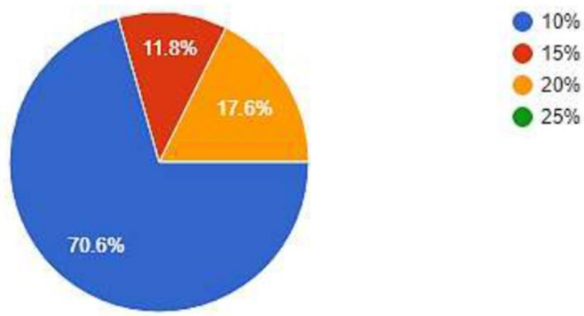
Figure 14: How important a factor were fiscal incentives in your company's decision to invest in the Philippines?



Source: AmCham survey on TRAIN 2, 3/18/18

4. Regarding fiscal incentives, 72% of the respondents stated that they are receiving the 5% GIE fiscal incentive while 28% said that they are not. Respondents were asked what level of CIT their firms are comfortable in lieu of their current 5% GIE incentive. <u>71% of respondents stated they are comfortable with a 10% CIT,</u> 12% with 15%, and 18% with 20% CIT (see figure 11).

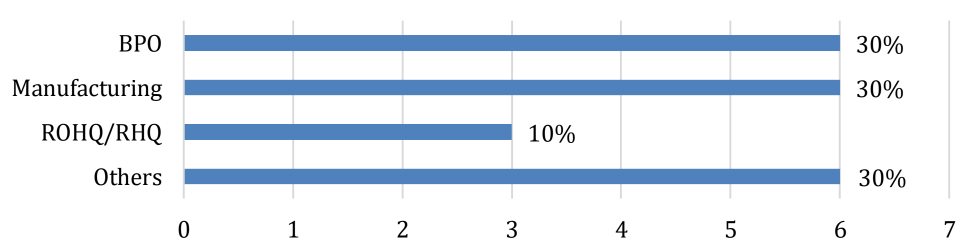
Figure 11: If your firm is receiving the indefinite 5% GIE incentive, what level of CIT would a firm like yours be comfortable paying in its place?



Source: AmCham survey on TRAIN 2, 3/18/18

Most of the respondents are involved in the BPO and manufacturing industries, many of which are PEZA locators (see figure 12).

Figure 12: Is your firm in the following sector?



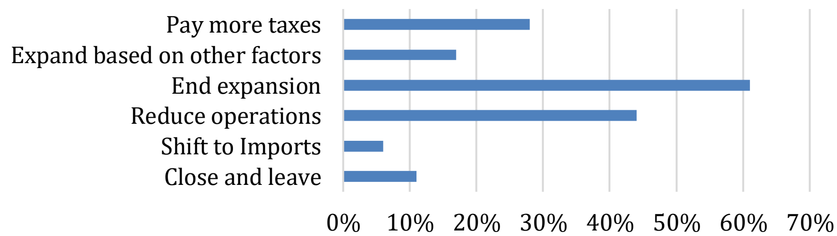
Source: AmCham survey on TRAIN 2, 3/18/18

AMCHAM PHILIPPINES

The American Chamber of Commerce of the Philippines, Inc.

5. Given the proposed transition periods in TRAIN 2, 61% of the respondents said the prosed transition would cause their firm to end further expansion. TRAIN 2 also proposes to end the fiscal incentive of exemption from local taxes. The survey inquired if paying local taxes will negate the reduced income tax benefit. Respondents replied with 61% saying yes, it will negate the reduced income tax benefit (see figure 13).

Figure 13: How do you think a firm like yours will react to this transition period?



Source: AmCham survey on TRAIN 2, 3/18/18

6. When asked if fiscal incentives compensate for higher costs of business and, if without such incentives, investors would go elsewhere, 83% of respondents agreed that they do compensate and without incentives investors will locate elsewhere. The DOF counts VAT and customs duties exemptions as fiscal incentives. The survey asked if not receiving such incentives will have a negative impact on competitiveness. Results showed 47% of respondents agreed it would have a negative effect. Most respondents commented it will significantly increase the costs of doing business for them as exporters.

7. When asked about the significance of PEZA or special economic zones, almost all the respondents agreed that PEZA and SEZs are very important to their industries.

PART 7: THE PROPOSED LEGISLATION

1. **Proposed legislation TRAIN 2.**[20] As part of the government's Comprehensive Tax Reform Program (CTRP), the DOF, and the DTI have proposed to Congress a bill:

    - to reform sections of the National Internal Revenue Code (NIRC) of the Philippines regarding CIT, and

    - to add a new article of the NIRC entitled "Fiscal Incentives" to replace fiscal incentives currently granted by 14 IPAs.

2. **Three bills have been introduced in the House.**

    - **HB 7214** introduced by Representatives Horacio P. Suansing, Jr. and Estrellita B. Suansing appears to represent the DOF position. HB 7214 would reduce CIT to by 1% beginning January 1, 2020 for every 0.15% of GDP reduction in the "cost of granting tax incentives to business investments two years prior to the effectivity of the new rate" but no lower than 25%. The Optional Standard Deduction will be lowered from 40% to 20% of gross income. The BIR will be allowed to prosecute tax cases. E-invoicing will be required.

      Existing fiscal incentives enjoyed by qualified locators at IPAs would terminate 2 to 5 years after enactment, depending on how long the investor has received incentives. ROHQs would lose their 10% CIT under RA 8756. The definition of exporter will be changed from a firm exporting 70% of production to a firm exporting 90% of production. Locators would be exposed to the BIR and no longer insulated from LGU taxes. The secretary of finance would be placed as co-chair of all IPAs and authorized to disapprove fiscal incentives awarded by IPAs.

      The bill would terminate fiscal incentives granted in some 300 investment and non-investment laws.[21] It would simplify the award of

[20] TRAIN 1 RA 10963 became effective on January 1, 2018 and included personal income and excise tax reforms.

[21] Aside from replacing the fiscal incentives that the 14 IPAs are authorized to award, the bill proposes to replace incentives for a wide variety of businesses, including agriculture, airlines, barangay business enterprises, broadcasting, bio fuel, casinos, forestry, fishing, halal, healthcare, housing, hydroelectric power, iron and steel, Islamic banks, jewelry manufacturing, mining, MSMEs, petroleum, rural banks, schools, seed industry, solid waste

future incentives in accordance with a Strategic Investment Priorities Plan (SIPP) and award them if they meet four principles of being (1) performance-based, (2) targeted, (3) time-bound, and (4) transparent. There would be only one menu of incentives that all IPAs will follow. Restrictions on foreign investment in domestic firms will be removed. Longer and superior incentives will be given for relocating out of Mega Manila and for investing in lagging regions and conflict and calamity-stricken regions.

Incentives will be allowed for investment sectors included in a SIPP updated every three years. Qualified new investors would no longer be offered the 5% GIE CIT incentive. They will be offered an ITH not exceeding 3 years. Following expiration of the ITH, a menu of incentives may be applied for up to 5 years, including (1) reduced CIT of 15%, (2) a tax allowance for investments of up to 50% of capital expenditure, (3) 200% deduction for R&D, (4) 200% deduction for training given to employees, (5) 50% deduction of wages of incremental direct labor, (6) 100% deduction of infrastructure development, and (7) 100% deduction of reinvestment by a manufacturing firm in SIPP activities.

- **HB 7458** introduced by Representatives Dakila Carlo E. Cua, Aurelio D. Gonzales, Jr., and Raneo E. Abu is very similar to HB 7214 except in three key respects:

    - It reduces the CIT to 20% at the rate of 1% a year,

    - This annual reduction is unconditional and predictable, and

    - The list of laws being repealed appears shorter than HB 7214.

- **HB 7364** introduced by Representatives Sharon S. Garin and Rodel M. Batocabe to be known as “The Fiscal Incentives Rationalization Act.” (This bill replaces HB 3359, a HB very similar to its predecessor bill also introduced by Representative Sharon S. Garin.)

    - The bill does not cover CIT,

    - The bill is not a part of the Internal Revenue Code,

management, shipbuilding and shipping, telecommunications, veterans (PHIVEDEC), and water.

- The bill contains most of the elements of HB 7214 and HB 7458, and

- Unlike HB 7214 and HB 7458, the bill contains no specific repeals of present laws providing FI.

PART 8: AMCHAM COMMENTS re Corporate Income Tax

1. **AmCham supports the proposed 25% CIT but would prefer 20%,** as proposed in HB 7458. As the country moves upwards on its path to becoming an advanced nation by 2040, the accompanying tax regime for this new era should ensure that growth is sustained and that new wealth is inclusively distributed to all Filipinos. A 20% rate would be closer to the ASEAN average, and these countries have more inclusive economies than the Philippines, as measured by levels of poverty.

   A lower rate should increases tax compliance and investment and produce more tax revenue. Over time the falling rate – moving down to 20% – should yield more revenue than the current 30% rate and support economic growth through increased domestic spending. A rate of 25% will not give the Philippines any significant advantage in comparison to other countries. Foreign firms will still find the 25% CIT tax rate a deterring factor when comparing the Philippines to other investment locations. A staggered reduction to 20% also protects against a potential decrease by Indonesia of its 25% CIT, which would leave the Philippines still the highest of the ASEAN-6 if its rate is only 25%. The footnote shows the ASEAN-6 comparison of this scenario.[22]

22

Table 13: Comparative CIT Rates, ASEAN-5

Singapore	17%		Singapore	17%
Thailand	20%		Thailand	20%
Vietnam	20%		Vietnam	20%
Malaysia	24%		Malaysia	24%
Indonesia	25%		Indonesia*	20%
Philippines	30%		Philippines*	25%
Average	**22.7%**		**Average**	**21.0%**

Source: PwC and ADB

*Note: assuming Indonesia reduces CIT to 20% and Philippines to 25%.

2. **AmCham supports a faster rate of reduction of the CIT.** The rate of reduction of the CIT should be faster than 1% a year, which will take a decade to reach the reduced rate of 20% as proposed in HB 7458. In reducing CIT several competing ASEAN countries reduced at faster rates. For example:

   - Singapore reduced by 9% from 26% to 17% over nine years.
   - Thailand reduced by 10% from 30% to 20% over two years.
   - Vietnam reduced by 10% from 25% to 20% over three years.

3. **AmCham does not support the 0.15% of GDP formula** of DOF/DTI. AmCham does not think the CIT reduction should be linked to the reduction of the amount of FI granted. By creating uncertainty about future tax rates, this formula makes it difficult for investors to plan future tax expenditures.

5. **Faster rate reductions could instead be linked to positive macroeconomic indicators.** AmCham suggests the Congress consider making a rate reduction of 2% a year conditional on a positive macroeconomic indicator such as (i) GDP growth of 5% or above the previous year and 1% if less than 5% GDP growth the previous year or (ii) 0.25% growth in annual national government revenue performance as a percentage of total GDP the previous year.[23] The rate reductions would end when 20% is reached. This would recognize increased tax revenues from growth of the economy while protecting against a sharp downturn in the rate of growth.[24]

6. **Congress may wish to consider passing the CIT reform separately from FIR.** Given the long history of delayed legislation of any FIR reform and the importance of reducing the current high CIT of 30%, the Congress should consider a separate bill to reduce the CIT effective January 1, 2019. The rate of reduction would have to be studied carefully, but 2% a year to 20% in five years conditioned on specific indicators of macroeconomic progress would be a possible formula to protect against an unforeseen downturn in the economy.

7. **We support the tax collection efficiency measures in the bills,** such as requirements for the use of electronic receipts and electronic filing. Table 14 shows that the tax efficiency rate of the Philippines of 12% in 2015 is considerably lower than countries such as Thailand at 31% and Vietnam at 29%. However, the authorization for BIR to prosecute civil and criminal violations may be considered a conflict of interest between an agency focused on revenue

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[23] The suggested rate of 0.25% is conservative. Whether it can be higher should be carefully studied by tax experts.

[24] Singapore did not experience losses in revenue after reducing its CIT from 26% to 17%.

collection and the rights of the taxpayer. We also encourage the BIR and BOC to improve their collection efficiency records by widening the taxpayer base and, with the Department of Justice, improving the record of successful prosecution of tax avoidance cases. The successful enforcement against a major cigarette firm that evaded taxes and the forthcoming implementation of an oil-marking program mandated in TRAIN 1 to fight the perennial problem of oil smuggling are welcome actions.

Table 14: Tax efficiency, ASEAN-6, 2012/2015				
Country	**Year**	**CIT revenues (% of GDP)**	**Headline CIT rate (%)**	**Revenue productivity (%)**
Indonesia	2015	2.7	25	11
Malaysia	2015	6.5	24	27
Philippines	2015	3.7	30	12
Singapore	2015	3.5	17	21
Thailand	2012	6.1	20	31
Vietnam	2012	7.3	25	29

Note: Revenue productivity is calculated as the ratio of tax revenue as a share of GDP divided by the tax rate.

Source: OECD iLibrary, IMF Fiscal Monitor database, World Bank, PwC; DOF briefing, 3/9/18

PART 9: AMCHAM COMMENTS re Fiscal Incentives

1. **General Comments on government analysis/proposals.**

   a. The **proposed bill creates uncertainty** for existing and new investors. Past bills on FI did not remove the 5% GIE unbound incentive. Until the proposed TRAIN 2 bill is enacted, investors will face uncertainty about the future CIT and FI. Tax projections, an important part of calculations of future revenues, will be handicapped by this uncertainty. CIT and FI in countries competing against the Philippines for investments will be more certain and predictable. The proposed formula for reducing the CIT, made dependent on reductions in total FI reported in TIMTA data, makes future reductions in the CIT to 25% very uncertain.

b. **The proposed bill degrades PEZA and special economic zones.** Over nearly two decades, the Philippines has created a group of impressive industrial sites at former US bases and numerous PEZA zones. The Philippine Government has successfully promoted these sites to foreign investors with attractive FI and promises of a "One Stop Shop." where investors focus on their businesses and experience minimal bureaucracy from national and local government agencies. This "One Stop Shop" and "Red Carpet" reputation of PEZA has been extremely important. PEZA exporters compete with other companies in export zones in other countries; they do not compete with non-subsidized companies selling in the Philippines. Several thousand foreign investors in business processing and manufacturing decided the Philippines has advantages over other ASEAN countries. Without PEZA and other special zones being different and preserving their unique reputation as efficient locations for doing business, more investors will no longer make the Philippines their first choice.

c. **TIMTA data should not include customs duties and VAT for exporters.** The TIMTA data reported by IPA locators for their FI in 2015 presents a misleading picture by including import VAT zero-rating incentives on raw materials, intermediate goods, and local services used to produce exports. Many investors would not locate operations in the Philippines to export goods and services without zero-VAT rating or a working VAT refund process. Adding the 12% VAT to operating costs is likely to make Philippine operations uncompetitive with other countries where operating costs are cheaper.

d. **Cost/benefit analysis is absent.** The DOF has only presented foregone tax revenue and not provided a full picture of the benefits that incentives have provided to the Philippine economy. A fuller picture will emerge **when important data is included that shows the total investment of some** 4,000 export locators at **IPAs**, the total direct and indirect jobs they have created, total spending on local goods and services, total taxes paid to national and local governments, indirect revenue generated, the value of technology transferred, the value of training and R&D services, and the like.

e. **The GPH conclusion that exports are low despite the FI granted is inaccurate.** Exports would be even lower without FI. Other costs of operating – including corruption, electricity, labor, political instability, policy uncertainty, transportation logistics, and red tape – are often higher in the Philippines than in competing locations. The Philippines awards FI to overcome the disincentives created by such higher costs. Electronics exports in 2017 totaled US$ 32.7 billion (60% of total exports of goods) made by foreign firms largely located in PEZA zones. BPO exports in 2017 generated US$ 24.5 billion. Most of the country's exports come from these two industries. If other countries, such as Thailand and Vietnam, are more successful at exporting it is because their costs are more competitive than the Philippines. In this respect, the Philippines, which certainly has high potential to be an exporting powerhouse, has failed where others have succeeded.

f. **Why are tax incentives not on the list of top business concerns?** It is difficult to understand the DOF argument that FI are not among top concerns of investors. High tax rates were the number four concern in the 2017 WEF ratings (see table 15). FI are not among the WEF investor concerns because they are already competitive, effective, and make up for the added costs of doing business created by top concerns such as bureaucratic red tape, lack of infrastructure, and corruption. Sudden removal of the incentives is now becoming a top concern of business.

Table 15: World Economic Forum, Global Competitiveness Report, Most problematic factors for doing business, Philippines, 2017

Country	Most problematic factors for doing business	Percentage
Philippines **GCI:** 56th of 137 **EODB:** 113th of 190	Inefficient government bureaucracy	19.7%
	Inadequate supply of infrastructure	17.9%
	Corruption	13.7%
	Tax regulations	10.9%
	Tax rates	8.9%
	Policy instability	7.6%
	Access to financing	4.9%
	Government instability/coups	3.2%
	Restrictive labor regulations	3.0%
	Poor work ethic in national labor force	2.6%
	Inefficient capacity to innovate	2.3%
	Inadequately educated workforce	2.1%
	Crime and theft	1.8%
	Foreign currency regulations	0.9%
	Inflation	0.4%
	Poor public health	0.1%

Source: World Economic Forum, 2017 Global Competitiveness Report

g. **Industry roadmaps may need reconsideration.** Over several years, the BOI has prepared several dozen roadmaps for manufacturing sectors. The Department of Agriculture has started preparing roadmaps for high potential crops. These roadmaps may need to be adjusted to account for the proposed FI reforms. If the reforms lead to a slowdown of investors and some exodus of present locators, this will create a negative impression of policy instability in the Philippines and discourage new investors. Likewise, new investors will be discouraged if the future menu of incentives for new investors is inadequate to overcome other cost and competitive disadvantages of operating in the country.

h. **Status quo for FI is preferred.** AmCham recommends that the current FI package of PEZA and leading IPAs be retained. Our main argument is that it has been successful in attracting a large number of foreign investors and creating millions of jobs. Our members have cautioned that the radical changes proposed in HB 7214 and HB 7458 will lead to an end to expansions by many foreign investors and a reversal of the success in recent decades in attracting thousands of foreign firms to invest in the country. The bills as drafted, if implemented, will most likely lead to reduced revenues and job losses on a large scale as a result of damaged investor confidence.

   The Philippine manufacturing sector is faster growing in Southeast Asia, only next to Vietnam in the last 5 years. Changing tax incentives to this industry could change affect our long awaited manufacturing resurgence that underpins our sustained economic growth by providing the highest multiplier effect in the economy. Manufacturing investments should continue to have the most competitive incentives in Asia. Midstream changes that impact on cost in a major way can materially affect the positive perception of the Philippine business environment and will influence in an irreversible way, decisions to remain, expand, or set up new companies in the country.

i. **The incentive package should be harmonized for all IPAs.** However, harmonization may mean different things to the government than it does to the investor. The ROHQ firm working with a 10% CIT could harmonize by shifting to a PEZA incentive of 5%. BOI export firms currently paying duties and taxes on purchases of local as well as imported inputs and applying for a refund (that comes very late and sometimes not at all) should harmonize with PEZA zero-rated firms. Paying first and applying later for a refund is bad for business and against the spirit of the president's instructions to lessen the burden of red tape on taxpayers.

While some other countries have a similar system, receiving the refunds is a reliable and efficient process.

j. **Re the proposed four principles for fiscal incentives:**

   i. **Performance-based** - AmCham supports measuring performance of businesses granted incentives. We note that the language in HB 7458 states "The activity's performance shall be measurable in terms of export sales, actual investments, actual job creation, investments in lagging regions as defined in the SIPP, investment and employment in research and development, linkages creation, and spill-over effects, among others." We note that the TIMTA Act requires NEDA to "conduct a cost-benefit analysis performance on the investment incentives to determine the impact of tax incentives on the Philippine economy."

   ii. **Targeted** – AmCham supports and encourages the government to closely consult with investors on composition of the target list. This has happened in past years in development of the periodic IPP, which will be replaced by the SIPP to be issued every three years.[25] The draft bill specifies "in coordination with the private sector."

   iii. **Time-bound** - AmCham recommends grandfathering for existing efficiency-seeking investors. These investors (both foreign and domestic) decided to invest in the Philippines with expectation of the current incentives regime continuing, which should be respected out of a sense of gratitude and the contractual nature of the investment. These investors are exporters of goods and services.

   In order to qualify for grandfathering a current beneficiary could be asked to meet a set of performance qualifications administered by the IPA that granted its benefits. These qualifications could include similar criteria to those used in developing the SIIP, such as export sales, actual investments, actual job creation, investments in lagging regions, investment and employment in research and development, use of modern technology, linkages creation, spill-over effects, payment of taxes, inclusive business activities, and the like.

[25] HB 7458 Chapter IV, Qualified Activities for Tax Incentives.

Time-bound incentives should be limited to new projects, but the period granted should be competitive with competitors in ASEAN. The proposed incentives in the three House bills are not competitive with current incentives granted by Malaysia, Thailand, Singapore, and Vietnam. These competitors can offer highly important projects fiscal incentives going many times longer than the five years in the proposed bills.

There is a provision (Section 295) for the president to decide to increase incentives to "highly desirable projects," which implies that the president should be able to match what a competing country offers an important potential investor in order to negotiate a favorable decision to invest in the Philippines.

iv. **Transparent** - AmCham supports.

k. The Philippine Government has explained that as part of fiscal incentives reform "**expansions** are a sign of profitability and need not be given incentives." However, efficiency-seeking investors usually consider multiple locations when they expand and are likely to choose the most competitive location. Market-seeking investors may also chose to offshore their activity if incentives for expansion are unavailable.

l. **Definition of export enterprise as exporting 90% of its products or sales is too restrictive.** (re Section 4 (F)). We support keeping the present requirement of 70%. Research by PHILEXPORT shows that only Thailand has such a restriction at a 50% export level. Other countries do not. A 90% requirement will reduce exports and the number of exporters and discourages the growth of SMEs.

m. **Exemption from the VAT and customs duties on imported** capital equipment, machinery, raw materials, and spare parts used in the manufacturing process and intermediate goods should be granted as long as an enterprise continues to export. To pay such VAT and duties will reduce the competitiveness of the enterprise.

n. **Double deduction for training.** (HB 7458 Section 294 (A) (e)). The proposed deduction is limited to training for employees alone. We suggest insertion of language to allow an additional deduction to encourage firms to train outside their employee base and thereby increase the skills of more Filipinos.

> "The same benefit of double deduction shall likewise extend to expenses paid or incurred by the registered export enterprise in its training projects in collaboration with schools and universities accredited by the Department of Education (DepEd) or Commission on Higher Education (CHED). The training expenses incurred shall be deductible from taxable income on the taxable year the said training expenses were incurred."

We believe training expenses should include training expenses for "potential" employees and training programs in collaboration with schools accredited by DepEd or CHED.

Companies are increasingly working directly with colleges, universities, and other schools to train students in skills to enable them to obtain better quality jobs in industry. The BPO and electronics industries are especially active in this regard, spending on training for potential employees. Given the funding limitations faced by many schools, this is an excellent way to supplement their limited resources and encourages closer government and industry collaboration to prepare the youth with skills necessary for higher-value future employment.

o. **Deduction for reinvestment allowance to manufacturing industry.** (HB7458 Section 294 (A) (h)). We recommend that this provision include agriculture, a slow-growing sector needing capital, by adding the word "agricultural" following the word "manufacturing."

p. **VAT zero-rating should be maintained**. We recommended deleting the phrase in Section 290 General Provision "in no such case shall the Value-Added Tax and local taxes be used as investment tax incentives." As explained elsewhere, VAT is a domestic sales tax and, if applied to export activities, will make such less competitive abroad. It thus becomes an export tax and, at 12%, would often exceed the margin of profit of exporters.

    Section 292 (B) should be amended to include VAT.
    Section 300 should be amended to include VAT.
    Section 301 should be amended to include VAT.

q. **Exemption from local taxes should be maintained.** The following language from the PEZA Act could be inserted.

> **SEC. 24.** Exemption from National and Local Taxes. - Except for real property taxes on land owned by developers, no taxes, local and national, shall be imposed on business establishments operating within the ECOZONE. In lieu thereof, five percent (5%) of the gross income earned by all business enterprises within the ECOZONE shall be paid and remitted as follows:
>
> a. Three percent (3%) to the National Government;
>
> b. Two percent (2%), which shall be directly remitted by the business establishments to the treasurer's office of the municipality or city where the enterprise is located.
>
> **SEC. 25.** Applicable National and Local Taxes. – All persons and services establishments in the ECOZONE shall be subject to national and local taxes under the National Internal Revenue Code and the Local Government Code.

r. We recommend that a last paragraph be added in Section 300 which will read, as follows:

> "Any transfer or disposition of capital equipment which partake of contributions or gifts in the exercise of its corporate social responsibility through activities such as, but not limited to, charitable, scientific, youth and sports development, cultural or educational purposes, services to veterans and senior citizens, social welfare, health, environmental sustainability and disaster relief and assistance shall be exempt from VAT, duties and taxes and donors tax."

Public schools and state colleges and universities in particular will benefit if this paragraph is added.

s. **DOF veto creates uncertainty and may be a conflict of interest.** Chapter III Administration of Tax Incentives states "The secretary of finance shall have veto power as the custodian of fiscal prudence and responsibility, and, as such, may cancel or suspend the grant of incentives upon the review and recommendation of the FIRB." This power is not usually present in other countries in the region. According to a 2018 OECD Investment in Southeast Asia only 3 of the 10 ASEAN countries have ministries of finance involved in offering incentives (see table 16). DOF and NEDA should be involved in the planning of incentive policies and measuring their costs and benefits. However, additional bureaucratic procedures involving the DOF to review the awards of incentives by the IPAs may delay and discourage investments.

Table 16: Main government agencies involved in offering incentives, 2018	
Brunei Darussalam	Ministry of Foreign Affairs and Trade
Cambodia	Council for the Development of Cambodia
Indonesia	Investment Coordinating Board, Director General of Taxation, MOF
Lao PDR	Investment Promotion Department
Malaysia	Malaysian Investment Development Authority, Ministry of International Trade and Industry, MOF
Myanmar	Directorate of Investment and Company Administration, Myanmar Investment Commission, Central Body for the Myanmar Special Economic Zone, SEZ Management Committee
Philippines	Board of Investment, PEZA, and other agencies for specific SEZs
Singapore	EDB, MOF
Thailand	BOI
Vietnam	Vietnam Foreign Investment Agency under the Ministry of Planning and Investment

Source: OECD Investment Policy Reviews, 2018