

A Conversation with DOF

January 10, 2018

Yesterday, we visited the DOF to speak about tax reform with economists Ms. Ira Camarao and Ms. Mitch Abdon. Below is a synthesis of our meeting, followed by a per sector rundown on the effects of TRAIN1, and finally by the compilation of tax amendments.

How do you plan to address the shortfall in revenue from CTRP1?

DOF is working on Package 1B, which they aim to pass to Congress within the month. It will then go through the same process of deliberation as Package 1A. 1B is expected to generate around PhP40bn in revenue, which will bring DOF to their PhP130bn target. It consists of amendments to the bank secrecy law, sin excise tax, and general and estate amnesty. A rough estimate from Undersecretary Chua puts collections from the tax amnesty at PhP26bn. Implementation is targeted within 1H.

What's the timeline for CTRP2?

The target is to submit CTRP2 to Congress within the month as well. Approval may even be ahead of Package 1B. CTRP2 is a revenue-neutral measure; it will slash corporate income tax but rationalize fiscal incentives. Packages 3&4 are also set to be passed to Congress within the year.

Which VAT exemptions do you plan on removing?

Nearly all, with the exception of raw agricultural products, medical care, and education. This will include removal of perks enjoyed by senior citizens. DOF estimates at least PhP300bn in lost revenue per year from tax incentives. Package 1 already repealed 54 VAT exemptions. The plan is to lower the VAT when the other unnecessary exemptions are lifted.

What problems are you encountering on the implementation side?

The focus is on improving the VAT refund system. This is aimed towards building government trust from the private sector to increase tax compliance, especially once VAT exemptions are stripped and the income tax base is broadened.

Why is the PH focused on removing tax incentives when most ASEAN countries are adding them in?

Unlike other ASEAN nations, the PH cannot afford lowering government revenue as its focus is on improving infrastructure through government spending --- a necessity to spur long-term investment growth.

How much of the population will benefit from tax reform?

The PH population is at around 100mn. More than 40mn people make up the country's labor force. However BIR data shows that there are only 8mn taxpayers (20% of the workforce and <8% of PH population). The remaining 92mn are likely to be adversely affected by inflationary pressure.

How will the government aid negatively affected citizens?

DOF estimates that unconditional cash transfers up to 15k/year/household will more than offset inflationary pressure. On top of the current 4.4mn recipients of the conditional cash transfers, additional 6mn households will be given the unconditional cash transfers. PhP25.7bn of the 2018 budget is allocated for the said program.

How will tax reform affect inflation? GDP growth?

The projection depends on who you ask. DOF expects an additional 0.7% on top of the current rate of inflation, BSP projects +0.5%, and NEDA puts it at +0.4%. As for GDP, DOF is looking at an additional 0.7% in growth.

How does government plan on addressing the disbursements bottleneck?

DBM is trying to fastrack projects by implementing a strict 1 year time limit for spending project funds. Otherwise, the funds must be returned and the unit's next budget allocation will be slashed. Previously, project spending was extendable for another year.

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Impact of TRAIN1 by sector

Power

CTRP1 increases costs for coal and oil plants. But ultimately, we think coal plants will still produce cheaper electricity vs RE and maintain their edge when contracting capacity. For coal plants, we expect higher bunker fuel tax (from PhP0.30/l to PhP6/l by 2020) and coal tax (from PhP10/MT to PhP150/MT) to raise plant cost/KWh by ~24% assuming 70% capacity factor. Note that the %increase in cost rises as capacity factor and coal quality used declines. The incremental charge will be passed down to consumers who will have to pay an additional PhP0.08/KWh (+PhP24 for households consuming 300KWh/mo) possibly starting next month. However, we think it unlikely that this will slow down power consumption growth. Interestingly, according to MER, higher coal and oil tax will only contribute +PhP0.01/KWh to the added charge. The remaining PhP0.07 increase is actually from the newly imposed VAT on transmission services.

We also wrote a piece on how SCC's coal mining is affected by coal tax viewable [here](#).

Property

Despite keeping VAT exemptions on ROHQs themselves, the removal of personal income tax perks for ROHQ employees may be negative for the office segment as it becomes more expensive to staff operations in the country. Meanwhile, lower personal income tax rates for the rest of the population may spur consumer demand, and to a lesser extent, residential units. The retail segment may benefit from higher consumer appetite via greater spending power and elevated foot traffic.

Telecoms

Telcos could benefit indirectly from tax reform as allowance for discretionary spending will also increase. A PhP500 monthly load for mobile data would now only account for 2.6% of individuals with an average net monthly salary of Php 19.0k, down from the initial 3.0% (gross: Php20.0k). Smartphone penetration could also increase as an entry level smartphone worth Php5.0k would now only account for 26.3%, down from 30.2% based on the same income level.

Oil retailers

Oil retailers will be minimally affected as demand for oil products are typically inelastic. Further impact of the excise tax would be mitigated by the rising global crude oil prices as excise taxes would be suspended once the average Dubai crude oil price based on Mean of Platts Singapore for three months prior to the scheduled increase of the month reaches or exceeds US\$80.0 per barrel.

Banking

Higher consumer spending power would pave the way for larger bank deposit accounts and augment banks' funding requirements. Latest data from the BSP show only 14% of households have a deposit account with median outstanding balance at PhP5,300. Likewise, higher net incomes will result in better capacity to service debt. Aside from obvious beneficiaries such as BDO, MBT, and BPI who corner 49% of the banking system loans, the smaller players could get a boost as well from lower potential NPLs. In particular, EW and RCB have niche markets in consumer lending and SMEs which would benefit from higher incomes to support loan repayment. With lower loan default and higher incomes, banks can further expand their reach in offering services.

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Consumer-retail

We believe that the retail sector will be the primary beneficiary of the tax reform program. We expect the impact of higher discretionary spending will boost modern retail (e.g. hypermarkets, specialty stores, e-commerce, etc) from traditional retail and result in higher SSSG. In addition, lower-income citizens who will benefit from the unconditional cash transfers of up to PhP15k/household/year are likely spend the additional income on food items. Thus, groceries are likely to feel the biggest impact in terms of disposable income allocation.

Consumer-non retail

Higher take-home pay is positive for the QSR and food manufacturing segment especially since ~40% of household spending goes to food and beverages. This may also lead to higher SSSG for QSRs like JFC, MAXS, and PIZZA. While food manufacturers like PF and CNPF will also have an advantage, the tax reform will now be less negative for URC as only its RTD beverage segment (~4% of URC's sales) will be affected by the sugar-sweetened beverage tax.

Gaming

Increased disposable income may increase participation in leisure activities, including gaming. While there will be a new 10% tax imposed on prizes and winnings above PhP10k, we do not think this will be a deterrent to gaming activities.

Cement

Cement players may see costs rising from the excise taxes on coal, fuel and limestone. Cement production needs both coal and electricity while quarrying operations will be taxed at a higher rate. Distributors may request more concessions from manufacturers as the higher fuel costs eat into distributor margins.

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Amendments to the Tax Code

RA 10963 amends various sections of RA 8424, the Tax Code from 1997. The tables below are titled as Sections of RA 10963 amending/inserting sections in RA 8424.

Section 5 Amends Section 24. Income Taxes on Residents

Old		New: Jan 1, 2018 - Dec 31, 2022	
Bracket	Tax	Bracket	Tax
<P10k	5%	<250k	0
<P10k - <P30k	P500 + 10% of <P10k	>P250k - <P400k	20% of >P250k
<P30k - <P70k	P2,500 + 15% of <P30k	>P400k - <P800k	P30k + 25% of >P400k
<P70k - <P140k	P8,500 + 20% of <P70k	>P800k - <P2mn	P130k + 30% of >P800k
<P140k - <P250k	P22,500 + 25% of <P140k	>P2mn - <P8mn	P490k + 32% of >P2mn
<P250k - <P500k	P50k + 30% of <P250k	>P8mn	P2.41mn + 35% of >P8mn
<P500k	P125k + 32% of <P500k		
		New: Jan 1, 2023 onwards	
		Bracket	Tax
		<P250k	0
		>P250k - <P400k	15% of >P250k
		>P400k - <P800k	P22,500 + 20% of >P400k
		>P800k - <P2mn	P102.5k + 25% of >P800k
		>P2mn - <P8mn	P402.5k + 30% of >P2mn
		>P8mn	P2.2mn + 35% of >P8mn

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Section 5 Amends Section 25. Income Taxes on Non-resident aliens (Red = Higher Tax Rate; Green = Lower Tax Rate)

	Old	New
Alien individual employed by Regional or Area HQ and ROHQ of multinational	15%	15%*
Alien indiv in OBU (offshore banking unit)	15%	15%*
Alien indiv employed by petroleum service contractor and subcon	15%	15%*
		*Starting 1/1/18, these rates won't apply. Aliens will be taxed accdg to sched above unless for existing positions.
Special treatment of fringe benefit	32%	35%
Optional standard deduction	<10% of gross income	<40% of gross income
Tax on sale/barter/exchange of shares via local stock exchange	1/2 of 1% of gross value	6/10 of 1% of gross value

Section 42 Amends Section 145. Excise Taxes on Cigarettes (Red = Higher Tax Rate; Green = Lower Tax Rate; Black = No Change)

	Old	New	
Excise tax on cigarettes	4%/yr starting 1/1/18	Jan 1, 2018	P32.50/pack
		July 1, 2018	P35.00/pack
		Jan 1, 2020	P37.50/pack
		Jan 1, 2022	P40.00/pack
		Jan 1, 2024	4%/yr

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Section 43 Amended Section 148. Excise Taxes on Manufactured Oils and Fuels (Red = Higher Tax Rate; Green = Lower Tax Rate; Black = No Change)

	Old	New		
		1/1/18	1/1/19	1/1/20
Lubricating oils (PHP/l or kg)	4.50	8.00	9.00	10.00
Processed gas (PHP/l)	0.05	8.00	9.00	10.00
Waxes and petrolatum (PHP/kg)	3.50	8.00	9.00	10.00
Denatured alcohol for motive power (PHP/l)	0.05	8.00	9.00	10.00
Naphtha, regular gasoline (PHP/l)	4.35*	7.00	9.00	10.00
Unleaded premium gasoline (PHP/l)	4.35	7.00	9.00	10.00
Aviation turbo jet fuel (PHP/l)	3.67	4.00	4.00	4.00
Kerosene (PHP/l)	0.00*	3.00	4.00	5.00
Diesel fuel oil (PHP/l)	0.00*	2.50	4.50	6.00
LPG (PHP/kg)	0.00	1.00	2.00	3.00
LPG for motive (PHP/l)	0.00	2.50	4.50	6.00
Asphalts (PHP/kg)	0.56	8.00	9.00	10.00
Bunker fuel oil (PHP/l)	0.00*	2.50	4.50	6.00
Petroleum coke (PHP/ton)	N/A	2.50	4.50	6.00

* As amended under RA 9337, May 24, 2005

Section 45 Amended Section 149. Excise Taxes on Automobiles

Old*		New	
Mfg/import price	Excise Tax	Mfg/import price	Excise Tax
≤P600k	2%	≤P600k	4%
>P600k - <P1.1mn	P12k + 20% >600k	>P600k - <P1mn	10%
>P1.1mn - <P2.1mn	P112k + 40% >P1.1mn	>P1mn - <P4mn	20%
<ul style="list-style-type: none"> Buses, trucks, cargo vans and special purpose vehicles are not considered automobiles Hybrid automobiles are taxed at 50% of the excise 			

* amended under RA 9224, August 29, 2003

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Section 46 Inserted Section 150-A. Excise Taxes on Non-essential cosmetic services (Red = Higher Tax Rate; Green = Lower Tax Rate; Black = No Change)

	Old	New
Tax on non-essential services	0%	5%

Section 47 Inserted Section 150-B. Excise Taxes on Sweetened Beverages (Red = Higher Tax Rate; Green = Lower Tax Rate; Black = No Change)

	Old	New
Caloric sweeteners	N/A	P6/l
Non-caloric sweeteners	N/A	P6/l
HFCS	N/A	P12/l
Purely coconut sap sugar	N/A	Exempted
Purely steviol glycosides	N/A	Exempted

Exclusions to Excise Tax on Sweetened Beverages

(1) all milk products
(2) 100% natural fruit juices
(3) 100% natural vegetable juices
(4) meal replacement and medically indicated beverages
(5) ground coffee, instant soluble coffee, pre-packaged powdered coffee

Section 48 Amends Excise Tax on Mineral Products (Red = Higher Tax Rate; Green = Lower Tax Rate; Black = No Change)

	Old	New	
Coal	P10/ton	1/1/18	P50/ton
		1/1/19	P100/ton
		1/1/20	P150/ton
Nonmetallic minerals (% of market value)	2%	4%	
Metallic minerals	2%	4%	
Indigenous petroleum	3%	6%	

* amended under RR 8-96, August 29, 2003

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Various Sections that Amend Stamp Taxes (Red = Higher Tax Rate; Green = Lower Tax Rate; Black = No Change)

Sec	Tax Type	Old	New	
174	Stamp Tax on Original Issue of Stock*	P1.00 on P200	P2.00 on P200	
175	Stamp tax on sales, agreements to sell, memoranda of sales, deliveries or transfer of shares or cert of stock*	P0.75 on P200	P1.50 on P200	
177	Stamp tax on cert of profit or int in prop or accumulation	P0.50 on P200	P1.00 on P200	
178	ST on bank checks, drafts, CD no-int, others	P1.50	P3.00	
179	ST on all debt instruments*	P1.00 on P200	P1.50 on P200	
181	Tax upon acceptance of bills of exchange and others	P0.30 on P200	P0.60 on P200	
182	ST on all bills of exchange or drafts	P0.30 on P200	P0.60 on P200	
183	Stamp tax on life insurance policies*	P0.50 on P200	<P100k	exempt
			>P100k - <P300k	P20
			>P300k - <P500k	P50
			>P500k - <P750k	P100
			>P750k - <P1mn	P150
			>P1mn	P200
186	ST on policies of annuities*	P0.50 on P200; Pre-need - P0.20 on P200	P1.00 on P200; Pre-need - P0.40 on P200	
188	ST on Certificates	P15	P30	
189	ST on warehouse receipts	P15 on P200 max	P30 on P200 max	
190	ST on jai-alai, horse race, tickets, lotto, etc	P0.10 + P0.10 on P1.00	P0.20 + P0.20 on P1.00	
191	St on bills of lading or receipts	P1 on P100; P10 on P1k	P2 on P100; P20 on P1k	
192	ST on proxies	P15	P30	

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193	ST on SPA	P5	P10
194	ST on leases and other hiring agreements	P3 on P2k + P1 on addl P1k	P6 on P2k + P2 on addl P1k
195	ST on mortgages, pledges, deeds of trust	P20 on 1st P5k + P10 on each addl P5k	P40 on 1st P5k + P20 on each addl P5k
196	ST on deeds of sale, conveyances, donation of real property	P15 on P1k + P15 on each addl P1k	P15 on P1k + P15 on each addl P1k
197	ST on charter parties and similar instruments	<1k ton, <6mos = P50 on P1k	<1k ton, <6mos = P100 on P1k
		>1k - <10k tons, <6mos = P100	>1k - <10k tons, <6mos = P200
		>10k tons, <6mos = P150	>10k tons, <6mos = P300
*Revised under RA 9243 (Feb. 17, 2004)			

VAT Exemptions were also revised (Section 106, 108 and 109 of RA 8424, the Old Tax Code)

Green = maintained in new version

Blue = changed in new version

Red = new item found in new version

Black = found in old version but not explicitly mentioned in new version

Old Section 106. VAT on Sale of Goods or Properties

A(2) ff sales by VAT-registered persons are exempted

(a) export sales

- (1) sale & shipment from Phils to foreign country
- (2) sale of raw mat to non-resident buyer to resident local exporter in foreign currency
- (3) sale of raw mat to exporters with 70% of volume exported
- (4) sale of gold to BSP - moved to sec 109
- (5) export sales under EO 226

New Section 106. VAT on Sale of Goods or Properties

A(2) sales by ff VAT-registered persons are exempted

(a) export sales

- (1) sale & shipment from Phils to foreign country
 - (2) sale and delivery of goods to:
 - (i) registered cos in separate customs territory under special laws
 - (ii) registered TIEZA enterprises
 - (3) sale of raw mat to non-resident buyer to resident local exporter in foreign currency
 - (4) sale of raw mat to exporters with 70% of volume exported
 - (5) export sales under EO 226
 - (6) sale of goods/supplies/eqpt/fuel to intl shipping/air transport provided used for these
- *Provided (3), (4), (5) will not be exempted with VAT refund system

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Old Section 108. VAT on Sale of Services and Use or Lease of Properties

- (B) The following services performed in Philippines by VAT-registered persons shall be subject to 0% rate
- (1) Processing/manufacturing/repacking for persons ex-PH, for export, paid in foreign currency
 - (2) scvs other than those mentioned in (1), paid in foreign currency
 - (3) scvs rendered to persons under special/intl law, subjecting it to 0%
 - (4) scvs rendered to vessels engaged exclusively in intl shipping
 - (5) scvs performed by subcon/cont in processing/converting/manufacturing goods with export sales >70% of annual volume

New Section 108. VAT on Sale of Services and Use or Lease of Properties

- (B) The following services performed in Philippines by VAT-registered persons shall be subject to 0% rate
- (1) Processing/manufacturing/repacking for persons ex-PH, for export, paid in foreign currency
 - (2) scvs other than those mentioned in (1), paid in foreign currency
 - (3) scvs rendered to persons under special/intl law, subjecting it to 0%
 - (4) scvs rendered to persons engaged in intl shipping/air transport provided these are used for ops
 - (5) scvs performed by subcon/cont in processing/converting/manufacturing goods with export sales >70% of annual volume
 - (6) transport of passengers/cargo by domestic air/sea vessels from PH to foreign country
 - (7) sale of power or fuel generated through renewable sources of energy and other emerging energy sources
 - (8) scvs rendered to:
 - (i) registered enterprises in separate customs territory as provided by special law
 - (ii) registered enterprises in TIEZA
- Provided: B(1) and B(5) are subject to creation of VAT refund system

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Legislative History of Tax Code

Date Passed	Republic Act No.	Topic	Effect
December 11, 1997	8424	Tax Code	Overhaul of tax code
February 16, 2000	8761	VAT	Revised transitory provisions for VAT on certain items
August 29, 2003	9224	Excise Tax on Autos	Rationalized excise tax on automobiles
February 5, 2004	9238	VAT on banks	Excluded some services from VAT and reimposed gross receipts tax on quasi-banking functions
February 17, 2004	9243	DST	Rationalized documentary stamp taxes
April 28, 2004	9294	Tax exemption	Restored tax exemption of Offshore Banking Units and Foreign Currency Deposit Units
December 21, 2004	9334	Excise tax on alcohol and tobacco	Increased excise tax on alcohol and tobacco
July 1, 2005	9337	VAT exemption	Amended VAT exemptions
November 21, 2006	9361	Administrative provisions	Amended tax credits provision
June 17, 2008	9504	Personal income tax	Amended personal income tax rates and related provisions
June 30, 2009	9648	Shares on stock exchange	Exempted exchange of shares via stock exchange from Documentary Stamp Tax
February 23, 2010	10001	Tax on life insurance	Reduced taxes on life insurance policies
March 8, 2010	10021	Administrative provisions	Amended powers of commissioner and administration of tax returns
March 11, 2010	10026	Tax exemption	Granted income tax exemption to local water districts
December 19, 2012	10351	Excise tax on alcohol and tobacco	Restructured excise tax on alcohol and tobacco products
March 7, 2013	10378	VAT exemption	Amended VAT exemptions on international carriers
February 12, 2015	10653	Personal income tax	Adjusted values for 13th month pay excluded from taxable income

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Legislative History of Tax Amnesty

Date Passed	Republic Act No.	Topic	Effect
May 24, 2007	9480	Amnesty	Amnesty on all unpaid taxes up to year 2005
March 20, 2007	9399	Amnesty	Amnesty on unpaid taxes of PEZA enterprises