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Philippine Tax Highlights 2015

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Philippine tax law and policy was thrust into the popular consciousness in 2015 as branches of government, opinion writers and makers, lobby groups, industry groups and the citizenry debated the merits of proposals to reform corporate and personal taxes. Below is a summary of the most significant developments.

I. Income Tax Reform Measures

At the center of these discussions were proposals championed by legislators such as Senator Juan Edgardo Angara and Marikina Representative Romero Quimbo, which sought to lower the income tax burden imposed on business profits, personal income and wages.

These proposals have not been successfully passed into law due to the express and strong objections by the executive branch of government, which argues that a dilution of the ability of the executive to collect taxes will imperil the infrastructure and social safety net programs of government. Executive department officials also raised the concern that the successive sovereign credit ratings upgrades enjoyed by the Philippines these past five years will be reversed if the ability of the government to raise revenue is threatened. They reason that lower tax collections will lead to higher borrowing costs for the government and the private sector. This may, in turn, limit the spending and investments which fuel the country's growth.

That said, it is likely that these proposals will resurface in 2016. The Philippines will elect all the members of Congress, half of the Senators, the Vice-President and the President in May 2016 and many of the candidates for these positions have promised to adopt some of the tax reform measures.

A. Personal Income Tax Reform

Noting that the Philippines has the highest personal income tax rate in the Association of South East Asian Nations ("ASEAN"), proponents for personal income tax reform suggested both a revision of the tax brackets and a drop in the personal income tax rates.

Under the National Internal Revenue Code ("NIRC") of the Philippines, the income of natural persons is taxed under a fixed schedule with tax rates that rise as the levels of income rise. The highest marginal tax rate is 32%. Annual personal income below 10,000 pesos ($220) is not subject to tax. Income between 10,000 pesos to 500,000 pesos is divided into separate brackets and higher income brackets are subjected to increasing tax rates (from 5% to 30%). Income above 500,000 pesos ($10,600) carry a 32% tax burden.

It is worthwhile noting that the personal income tax brackets in the NIRC have remained unchanged for almost 19 years. While the brackets may have been equitable when first imposed, there is no question that they have not kept up with the rise in nominal wages in the last two decades. Taxpayers have therefore seen their tax rates increase merely due to the rise in nominal wages, even if these wages have remained the same or decreased in real terms. Proponents of tax reform have explained their positions in terms of social and economic justice. Senator Angara stated in a press release:

> "P500,000 in 1997 does not have the same value today due to inflation. P1 in 1997 when adjusted for inflation is now worth only 44 centavos. Middle-income earners, who were mostly taxed at 25 percent in 1997, are now pushed into the top tax bracket at 32 percent together with the billionaires of our country because of our outdated tax system. Is this equitable and progressive? Clearly, it is not."

Among the approaches embodied in the bills filed in the Senate and the House of Representatives are:

(i) rebasing of the personal income tax brackets in the NIRC; and

(ii) automatic adjustment of the brackets based on the national inflation rate.

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The measures also propose a drop in the tax rates with the highest marginal rate falling to 25%.

B. Corporate Income Tax Reform

Legislators in the Senate and in the House of Representatives have also noted that while the rest of the members of the ASEAN have been lowering their corporate tax rates (excluding the Philippines, ASEAN corporate tax rates currently range from 17% to 25%), the Philippines has maintained its corporate tax rate at 30%. Policy makers fear that this will make the Philippines uncompetitive in an integrated ASEAN market. The legislative proposals include amendment of the NIRC to drop the Philippine corporate tax rate to 25%.

II. Additional Exemptions for Philippine Wage Earners

While the proposals to lower personal income tax burden across the board were defeated, wage earners enjoyed a decrease in their overall tax burden under Republic Act No. 10653 (RA 10653).

The NIRC excludes certain personal income from the determination of the income that will be subject to tax. Among these exclusions are the 13th month pay and other benefits such as bonuses provided to wage earners. RA 10653 raises the exclusion from 30,000 pesos ($650) to 82,000 pesos ($1780). The new provision also requires the President to adjust the exclusion threshold based on the consumer price index every three years.

The relevant section of the NIRC now reads as follows:

> "SEC. 32. Gross Income. —
>
> "* * *
>
> "(B) Exclusions from Gross Income. — The following items shall not be included in gross income and shall be exempt from taxation under this Title:
>
> "* * *
>
> "(7) Miscellaneous Items. — "* * *
>
> "(e) 13th Month Pay and Other Benefits. — Gross benefits received by officials and employees of public and private entities: Provided, however, That the total exclusion under this subparagraph shall not exceed eighty-two thousand pesos (P82,000) which shall cover:
>
> "* * *
>
> "(iv) Other benefits such as productivity incentives and Christmas bonus: Provided, That every three (3) years after the effectivity of this Act, the President of the Philippines shall adjust the amount herein stated to its present value using the Consumer Price Index (CPI), as published by the National Statistics Office (NSO)."

In March 2015, the Department of Finance and the Bureau of Internal Revenue ("BIR") issued the implementing rules through Revenue Regulation No. 03-2015. The rules provide that the increased threshold applies to the benefits paid or accrued beginning January 1, 2015.

III. Rationalization of Tax Incentives

In December 2015, the President signed into law Republic Act No. 10708 (RA 10708) or the Tax Incentives Management and Transparency Act. The Act seeks to promote fiscal accountability and transparency in the grant of tax incentives and disciplines the provision of fiscal incentives by Investment Promotion Agencies ("IPA").

The covered IPAs are:

- Board of Investments;
- Philippine Economic Zone Authority;
- Bases Conversion and Development Authority;
- Subic Bay Metropolitan Authority;
- Clark Development Corporation;
- John Hay Management Corporation;
- Poro Point Management Corporation;
- Bataan Technology Park, Inc.;
- Cagayan Economic Zone Authority;
- Zamboanga City Special Economic Zone Authority;
- Phividec Industrial Authority;
- Aurora Pacific Economic Zone and Freeport Authority;
- Authority of the Freeport Area of Bataan;
- Tourism Infrastructure and Enterprise Zone Authority (TIEZA); and
- all other similar authorities that promote investments, administer tax and non-tax incentives and which oversee freeport and economic zones which may be created by law in the future.

The law regulates the grant of fiscal incentives that come in the form of income tax holidays, exemptions, deductions, credits, and exclusions from the tax base.

The main features of the law are as follows:

- **Additional reporting requirements for entities receiving tax incentives**. Under the law, any individual, partnership, corporation, Philippine branch of a foreign corporation, or other entity incorporated and/or organized and existing under Philippine laws and registered with an IPA must:
  - — file its tax returns and pay its tax liabilities, on or before the deadline as provided under the NIRC, using the electronic system for filing and payment of taxes of the BIR; and
  - — file with its IPAs a complete annual tax incentives report of its income-based tax incentives, value-added tax and duty exemptions, deductions, credits or exclusions from the tax base within 30 days from the statutory deadline for filing of tax returns and payment of taxes.
- **Reporting requirements for IPAs**. IPAs are required to submit to the BIR within 60 days from the end of the statutory deadline for filing of the relevant tax returns their respective annual tax incentives reports based on the list of the registered business entities who have filed said tax incentives report.
- **Monitoring of tax incentives**. The Department of Finance and its agencies, the BIR and the Bureau of Customs is tasked with monitoring the provision of tax incentives. The DOF is required to maintain a single database for monitoring and analysis of tax incentives granted. The Department of Budget and Management also plays a role in the monitoring of incentives as it is required to reflect in a report to be

submitted to a congressional oversight committee the aggregate data on a sectoral and per industry basis:
- — amount of tax incentives availed by registered business entities;
- — estimate claims of tax incentives in the year immediately preceding the current year;
- — programmed tax incentives for the current year; and
- — projected tax incentives for the following year.

- **Cost benefit analysis**. The IPAs are also mandated to cooperate with the National Economic and Development Authority which is tasked with conducting cost-benefit analysis on the investment incentives to determine the impact of tax incentives on the Philippine economy.

IV. More Liberal Tax Treaty Application Procedure

The BIR has finally softened its stance on the procedure to apply the provisions of Philippine Double Tax Treaties ("DTTs") through its issuance of a ruling. Previously, the BIR's position was that a taxpayer must file the request for treaty availment prior to the occurrence of the taxable event. If the request was made after the occurrence of the taxable event, the BIR consistently refused to apply the provisions of the treaty. In March 2015, the BIR reversed its position as explained below.

A. Treaty Availment under RMO 72-2010

The BIR issuance covering treaty relief availment is Revenue Memorandum Order ("RMO") No. 72-2010. Under this RMO, the application to apply DTTs must be submitted before the occurrence of the first taxable event.

B. Challenge to RMO 72-2010 Procedure

The above administrative rule has been successfully challenged in cases resolved by the Philippine Supreme Court and the Court of Tax Appeals ("CTA").

In the 2013 case of *Deutsche Bank AG Manila Branch v. Commissioner of Internal Revenue* ("the Deutsche case"), the BIR denied the application of Deutsche Bank AG Manila Branch to apply the Philippine-Germany DTT on the ground that the application was filed after the subject income was paid by the branch to its headquarters in Germany. The Supreme Court repudiated the BIR action, held the limit to file relief application invalid and ordered the BIR to apply the preferential provisions of the Philippines-Germany DTT. The Supreme Court applied the principle of *pacta sunt servanda* and held that the Philippines is bound to comply with its treaty obligations in good faith pursuant to internationally accepted principles. Thus, the Supreme Court said, "the BIR must not impose additional requirements that would negate the availment of the reliefs provided for under international agreements." It also stated that "at most, the application for a tax treaty relief from the BIR should merely operate to confirm the entitlement of the taxpayer to relief."

CTA Decisions were subsequently issued which adopted the Deutsche decision and ordering the BIR to allow the application of treaty rules even if the request for treaty relief was not filed prior to the first taxable event.

It took the BIR some time to officially change its rules. It eventually started applying the substance of the Supreme Court's decision in the Deutsche case in a ruling issued by its International Tax Affairs Division ("ITAD")—BIR ITAD Ruling No. 058-15 (March, 2015).

C. BIR ITAD Ruling No. 058-15

In a 2013 ruling, the BIR denied the request of the Purefoods-Hormel Co., Inc. ("Purefoods"), a Philippine corporation, to apply the preferential tax rates in the Philippines-Netherlands DTT on the ground that the request for treaty relief was filed on the same day that the dividends were distributed. According to the BIR, the failure to file the request before the issuance of the dividends was fatal.

After the Deutsche decision was promulgated, Purefoods requested the BIR to revisit its previous ruling. The BIR responded by issuing BIR ITAD Ruling No. 058-15 where it reversed its 2013 ruling and allowed Purefoods to apply the preferential tax rate under the DTT. The BIR expressly stated that it revised its earlier rulings in light of the Deutsche case.

Hence, the time limit to apply for the treaty application has effectively been lifted. However, for practical considerations, it is still prudent to apply for a treaty ruling as soon as possible.

V. Tax Treaty Updates

The BIR issued Revenue Memorandum Circular 72-2015 in October 2015 acknowledging that the DTT between the Philippines and Qatar will be effective starting January 1, 2016. The agreement between the Government of the Republic of the Philippines and the Government of the State of Qatar for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains entered into force on May 19, 2015. Pursuant to Article 28(2) of this DTT, the agreement shall have effect in respect of taxes covered by the beginning on or after the first day of January following the year in which the DTT entered into force.

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