

# Re-modeling the Philippine Tax System: The Key to National Survival and Growth\*

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## I. INTRODUCTION

The primary purpose of the tax system in any country is to distribute the funding cost of government activities as equitably as possible among the population.<sup>1</sup> If revenues generated are insufficient to meet expanding

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1. RICHARD M. BIRD, *TAX POLICY & ECONOMIC DEVELOPMENT* 85 (1992).

government expenditures, funding the deficit should be seen as a mere short-term remedial measure. Otherwise, the fiscal position of government will be compromised through an increasing debt burden.

Two macroeconomic issues that confront both the government and the private sector today are the escalating fiscal deficit and the dwindling tax effort ratio.<sup>2</sup> Hence, the two big questions that seriously bother government and business today are, first: how can the fiscal deficit<sup>3</sup> be reduced? And second, how can the country's tax effort ratio<sup>4</sup> be increased?

These two questions are very much related and are connected with each other. The first has to do with both public expenditures and revenues while the second has to do with revenues only. But both have a bearing on the type of tax system that the country has to adopt to abate and resolve the issues raised. These questions require paramount attention and immediate and appropriate action.

## II. THE PURPOSE AND REALITIES

The purpose of this paper is not to provide a direct prescription to the declining revenue collection and the increasing budget deficit both in relation to GDP. Rather, the purpose of this paper is to present a framework or roadmap that aims to address the twin problems of reducing the fiscal deficit and increasing the country's tax effort ratio. The government cannot simply disregard business. Similarly, business cannot dictate its own terms without taking into account the real needs of the government. It is essential that the interests of both are addressed and managed for the common and greater good. Hence, the proposed framework will consider the concerns of both government and business.

Acceptance of certain realities is indispensable if we are to discover the relevant, and realistic solutions. Some of the realities that should be recognized are: *First*, the revenue and deficit problems are systemic in nature. A hodge-podge approach, such as creating new taxes and/or increasing the rates, may prove to be unacceptable, and once implemented become difficult to correct. This has been seen in the past. More often than not, this kind of approach served to magnify the problems rather than solve them.

2. Asian Development Bank, *Philippines Economic Assessment*, ASIAN DEVELOPMENT BANK OUTLOOK (2004) available at <http://www.adb.org/Documents/Books/ADO/2004/phi.asp> (last accessed Aug. 29, 2004).

3. *Id.* The fiscal deficit stood at 5.6% of Gross Domestic Product (GDP) in 2003.

4. *Id.* The country's tax effort ratio was a mere 13.3% of the GDP in 2003.

*Second*, the country's total debt now stands at over four trillion pesos of which approximately 80% are owed to foreign creditors. This aggravates the problems as it exposes the Government to risks from foreign currency volatilities. As such, any addition will only serve to aggravate an already precarious fiscal position of government. In due course, the economy's growth prospects will also be imperiled.

*Third*, data from the National Statistical Coordination Board<sup>5</sup> shows poverty incidence at 33% and 34% of the population in 1997<sup>6</sup> and 2000,<sup>7</sup> respectively. Such figures are alarming, and have caused many to believe that there is a social volcano waiting to explode unless there be public commitment from the nation as a whole, which is focused on reducing these figures. This problem is likewise compounded by the 2.36% annual population growth.<sup>8</sup>

*Fourth*, the bloated bureaucracy is a big burden to the National Budget. The efficiency and effectiveness of the government leave much to be desired. Government must, therefore make a choice: Does it want to remain as the biggest employer in the country, or does it want to become a model service provider?

*Fifth*, the expenditure program of government is grossly misunderstood and mismanaged in many quarters of the government either by lack of proper administration or by corrupt practices. Hence, the predominant behavior of a typical Filipino taxpayer is to refuse to pay his taxes correctly.

These foregoing realities are intertwined. Finding the root cause of these problems, therefore, is a key to solving the government's problems. Undeniably, *taxation*, that is, *proper taxation*, is the *solution* to our fiscal dilemma. However, the possibility that taxes may also be part of the problem should not be discounted.

5. See National Statistical Data and Coordination Board *Online Reports available at* <http://www.nscb.gov.ph> (last accessed Aug. 29, 2004).

6. National Statistical Data and Coordination Board, *Poverty Statistics: 1997 Poverty Highlights*, available at <http://www.nscb.gov.ph/poverty/1997/00povin1.asp> (last accessed Aug. 29, 2004).

7. National Statistical Data and Coordination Board, *Poverty Statistics: 2000 Poverty Highlights*, available at <http://www.nscb.gov.ph/poverty/2000/00povin1.asp> (last accessed Aug. 29, 2004).

8. National Statistical Data and Coordination Board, *Population of the Philippines Census Years 1999-2000*, available at [http://www.nscb.gov.ph/secstat/d\\_popn.asp](http://www.nscb.gov.ph/secstat/d_popn.asp) (last accessed Aug. 29, 2004).

### III. THE PHILIPPINES' FISCAL MILIEU

It is imperative that before the government can evaluate the soundness and feasibility of any proposed tax measure, it is essential to first examine the country's fiscal situation and relate it to the tax reform measures previously undertaken by previous administrations.

During the early 1970's, the Philippines found itself in an economic crisis. This was reportedly due to the reckless spending of government funds. It was during this period that the government obtained a US\$27.5 million standby credit arrangement that involved renegotiating the country's external debt, then amounting to US\$2.3 billion, and devaluing the Philippine currency to P6.40 for every U.S. dollar.<sup>9</sup>

On 21 September 1972, martial law was declared on the pretext that the country was faced with revolutions by both the leftists and the rightists. The financial situation after the declaration of martial law was chronicled by the *US Congress Library* as follows:

In the beginning, Marcos's efforts to create a 'New Society' were supported widely by the business community, both Filipino and foreign, by Washington, and *de facto*, by the multilateral institutions. Foreign investment was encouraged: an export-processing zone was opened; a range of additional investment incentives was created, and the Philippines projected itself onto the world economy as a country of low wages and industrial peace. The inflow of international capital increased dramatically.

A general rise in world raw material prices in the early 1970s helped boost the performance of the economy; real GNP grew at an average of almost 7 percent per year in the five years after the declaration of martial law, as compared with approximately 5 percent annually in the five preceding years. Agriculture performed better than it did in the 1960s. New rice technologies introduced in the late 1960s were widely adopted. Manufacturing was able to maintain the 6 percent growth rate it achieved in the late 1960s, a rate, however, that was below that of the economy as a whole. Manufactured exports, on the other hand, did quite well, growing at a rate twice that of the country's traditional agricultural exports. The public sector played a much larger role in the 1970s, with the extent of government expenditures in GNP rising by 40 percent in the decade after 1972. To finance the boom, the government extensively resorted to international debt, hence the characterization of the economy of the Marcos era as 'debt driven.'

In the latter half of the 1970s, heavy borrowing from transnational commercial banks, multilateral organizations, and the United States and

9. See Bureau of Internal Revenue, *BIR History*, available at [http://www.bir.gov.ph/bri\\_hist.html](http://www.bir.gov.ph/bri_hist.html) (last accessed Aug. 29, 2004).

other countries masked problems that had begun to appear on the economic horizon with the slowdown of the world economy. By 1976 the Philippines was among the top 100 recipients of loans from the World Bank and was considered a 'country of concentration.' Its balance of payments problem was solved and growth facilitated, at least temporarily, but at the cost of having to service an external debt that rose from US\$2.3 billion in 1970 to more than US\$17.2 billion in 1980.

A financial scandal in January 1981 in which a businessman fled the country with debts of an estimated P700 million required massive amounts of emergency loans from the Central Bank of the Philippines and other government-owned financial institutions to some eighty firms. The growth rate of GNP fell dramatically, and from then the economic ills of the Philippines proliferated. In 1980 there was an abrupt change in economic policy, related to the changing world economy and deteriorating internal conditions, with the Philippine government agreeing to reduce the average level and dispersion of tariff rates and to eliminate most quantitative restrictions on trade, in exchange for a US\$200 million structural adjustment loan from the World Bank. Whatever the merits of the policy shift, the timing was miserable. Exports did not increase substantially, while imports increased dramatically. The result was growing debt-service payments; emergency loans were forthcoming, but the hemorrhaging did not cease.

It was in this environment in August 1983 that President Marcos's foremost critic, former Senator Benigno Aquino, returned from exile and was assassinated. The country was thrown into an economic and political crisis that resulted eventually, in February 1986, in the ending of Marcos's twenty-one-year rule and his flight from the Philippines. In the meantime, debt repayment had ceased. Real GNP fell more than 11 percent before turning back up in 1986, and real GNP per capita fell 17 percent from its high point in 1981. In 1990 per capita real GNP was still 7 percent below the 1981 level.<sup>10</sup>

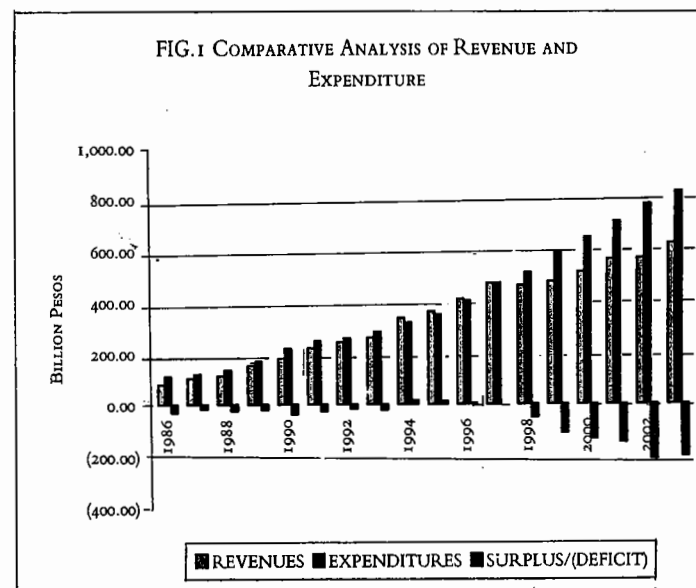
Between 1981 and 2002, the Philippines had budget surpluses only during the years 1994 to 1997 and budget deficits for the rest of the years. This resulted in a deficit that increased from just 1.9% of GDP in 1998 to about 4.7% in 2003. The two graphs below show the National Government's (NG) Fiscal Position. The first graph shows that government expenditures, excluding debt repayments and payments on non-budgetary expenditures, have mostly exceeded the government's revenues. In fact, out of more than 30 years, only four years have recorded a surplus.<sup>11</sup> This budget

10. US Library of Congress, *Martial Law and its Aftermath (1972-86)*, available at <http://www.countrystudies.us/philippines/57.html> (last accessed Aug. 29, 2004).

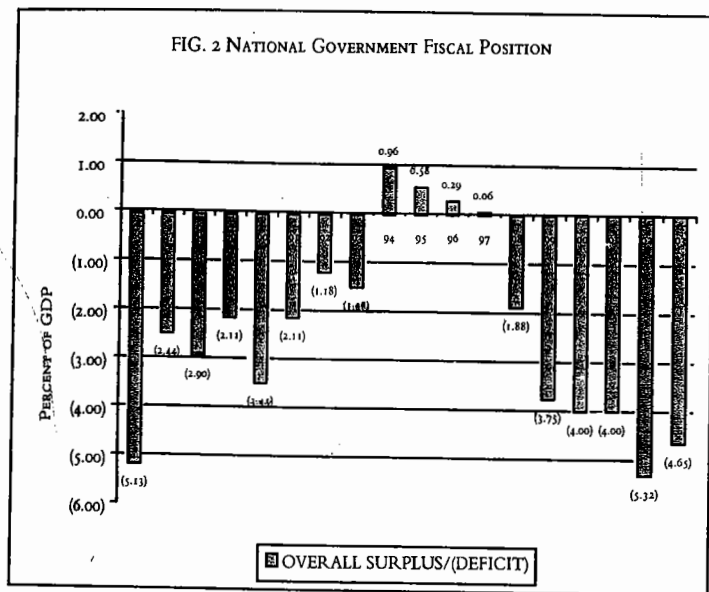
11. Philippine Institute of Development Studies, *Annual Budget*, available at <http://www.pids.gov.ph> (last accessed at Aug. 29, 2004).

surplus from 1994 to 1997 was primarily caused by three factors: the sale or privatization of public enterprises that helped raise total revenues, high growth rates that increased tax collections, which will be discussed later in the paper, and cutbacks in public expenditures.

The second graph shows the annual deficit and surplus from 1994 to 1997 as a ratio to nominal GNP.<sup>12</sup>



12. *Id.*



Recognizing the necessity for the Philippine Government to increase the level of public expenditures to meet urgent developmental needs against this factual backdrop of the buildup of debt service costs, one can surmise that to provide for increased expenditures, the same has to be financed from greater revenue collection.

It is interesting to note that each year, interest payments have grown faster than revenues. As an illustration of this, data from the Congressional Planning and Budget Office<sup>13</sup> show that in 1994 (the first of four years of a fiscal surplus), the government spent P17 for interest payments for every P100 of public revenues, and P31 for government projects and other needs which may be classified as *development funds*. But in 2003, interest payments grew to P28, while *development funds* dropped to just P19. This shows that the period 1994 to 2003, there was a fall in development funds by 39% but a hefty growth of 65% in interest payments.

These macroeconomic figures strongly suggest that the government needs to increase its revenue generation by as much as 3% of gross domestic product and to do it quickly. If the rate of growth of the debt service costs is higher than the rate of growth of revenues, then tax collections must be increased just to service past debts. But as this provides no improvement in

13. Annual Report of the Congressional Planning and Budget Office (1994).

public services, it becomes politically difficult to do, and the debt problem could quickly escalate into a financial crisis.

#### IV. THE HISTORY OF TAX REFORMS

##### A. Introduction

The power of taxation is inherent in the State<sup>14</sup> and is generally vested in the legislature.<sup>15</sup> While the Constitution does not expressly grant the power to tax, it however limits and restricts it by requiring that the rule of taxation shall be uniform and equitable, and further mandates Congress to evolve a progressive system of taxation.<sup>16</sup>

It is worthy to note that under the 1935 Philippine Constitution, it was provided that the rule of taxation shall be uniform.<sup>17</sup> Later, both the Constitution of 1973 and 1987 mandated that, in addition to being uniform, the rule of taxation shall likewise be equitable.<sup>18</sup>

Uniformity in taxation means that persons or things belonging to the same class shall be taxed at the same rate. It is distinguished from equitability in taxation in that the latter requires the tax imposed to be determined on the basis of the value of the property. The Constitution adds that the rule of taxation shall also be equitable, which means that the tax burden must be imposed according to the taxpayer's capacity to pay.<sup>19</sup>

In 1939, our tax laws were first codified into what was known as the National Internal Revenue Code of 1939, enacted through Commonwealth Act No. 466,<sup>20</sup> and in the Report of the Tax Commission of the Philippines in 1939, three basic principles of a sound tax system were discussed, specifically, fiscal adequacy, theoretical justice, and administrative feasibility.<sup>21</sup>

14. BENJAMIN B. ABAN, LAW OF BASIC TAXATION IN THE PHILIPPINES 4 (2d ed. 2001).

15. 51 Am. Jur. 71.

16. PHIL. CONST. art. VI, §28, ¶1.

17. 1935 PHIL. CONST. art. VI, §22, ¶1 (superseded 1973).

18. 1973 PHIL. CONST. art. VIII, §17 (superseded 1987).

19. ISAGANI A. CRUZ, PHILIPPINE POLITICAL LAW 180 (1998 ed.).

20. An Act to Revise, Amend and Codify the Internal Revenue Laws of the Philippines, Commonwealth Act No. 466 (1939).

21. I REPORT OF THE TAX COMMISSION OF THE PHILIPPINES 23-31 (1939).

Fiscal adequacy means that the sources of revenue should be sufficient to meet the requirements of government expenditure.<sup>22</sup> Whereas, theoretical justice requires that the taxes levied must be based upon the ability of the citizens to pay. On the other hand, administrative feasibility requires that each tax should be clear and plain to the taxpayers, capable of enforcement by an adequate and well-trained staff of public officials, convenient as to time and manner of payment, and not duly burdensome upon or discouraging to business activity.<sup>23</sup>

### B. Types of Income Tax Systems

In the Philippines, three basic types of income tax systems were adopted at varying periods.<sup>24</sup> These are (1) the global tax system, (2) the schedular tax system, and (3) the semi-schedular or semi-global tax system.

#### 1. Global Tax System

Under the global tax system, all items of gross income, deductions, and personal and additional exemptions, if any, are reported in one income tax return, and one set of tax rates are applied on the tax base.<sup>25</sup> In adopting this kind of system

Congress believed that the global tax system will ensure that the burden of taxation is distributed in accordance with the ability to pay. Also, it [was believed to be] in keeping with the Constitutional mandate that 'Congress shall evolve a progressive system of taxation.' The system is more equitable and makes the job of the tax authorities monitoring the reported income and networth of taxpayers easier. The global tax system was enforced until December 31, 1981, with maximum tax rate of 70% applied on the net income of individuals.<sup>26</sup>

#### 2. Schedular Tax System

Under the schedular tax system, which was adopted in the Philippines by virtue of Batas Pambansa Blg. 135<sup>27</sup> on 1 January 1982, different types of

22. Chavez vs. Ongpin, 186 SCRA 331, 338 (1990).

23. 1 REPORT OF THE TAX COMMISSION OF THE PHILIPPINES 23-31 (1939).

24. VICTORINO C. MAMALATEO, PHILIPPINE INCOME TAX 3-6 (2004).

25. *Id.* at 3.

26. *Id.*

27. An Act Amending Certain Provisions of the National Internal Revenue Code of 1977, as amended, and for Other Purposes, Batas Pambansa Blg. 135 (1982).

incomes are subject to different sets of graduated or flat income tax rates. Under this system, the adjusted gross compensation income, after deducting personal and additional exemptions, was subject to the graduated tax rates ranging from 0% to 35%, and it introduced for the first time the gross income taxation on compensation income of individuals.<sup>28</sup> Business, professional, and other incomes, net of allowable deductions, were subject to the graduated tax rates ranging from 5% to 60%.<sup>29</sup> Capital gains from sale of shares of stock of domestic corporations and real property as well as passive investment incomes were subject to final withholding taxes at preferential rates.<sup>30</sup> This system was enforced from 1 January 1982 to 31 December 1985.<sup>31</sup> The objective of Congress in reducing the tax rates was to mitigate the adverse effects of high marginal tax rates on productivity and savings.<sup>32</sup>

#### 3. Semi-Global/Schedular Tax System

Sec. 21 of the NIRC, as amended by Executive Order No. 37,<sup>33</sup> ushered in the return of the global taxation approach of personal income. As a first step in instituting the shift, the 0-35% tax schedule, then applicable only to compensation income under the schedular system, was adopted for both types of income. This resulted in lowering the earlier 5-60% tax rate schedule for business/professional income.<sup>34</sup> As a complementary measure, the Tax Reform Program package also included the institution of certain ceilings on business deductions that were supposed to be implemented simultaneously, so as to minimize the revenue erosion that was likely to result from the shift to the global approach. Whether this move had materialized is another issue.

The shift to the more superior global system of taxing income has been commendable. The equity goal of this tax measure, however, was only partially achieved since passive income sources like interest, royalties, capital gains and prizes were still taxed under a schedular system on the basis of the gross amount.

28. *Id.* §1.

29. *Id.*

30. *Id.*

31. VICTORINO C. MAMALATEO, PHILIPPINE INCOME TAX 4 (2004).

32. *Id.*

33. Further Amending Certain Provisions of the National Internal Revenue Code, as amended, Executive Order No. 37 (1986).

34. The tax rate was lowered to 0-35%.

On 1 January 1998, Republic Act No. 8424<sup>35</sup> took effect. This new law, while introducing some structural and administrative reforms, retained the semi-schedular or semi-global features of the existing tax system.<sup>36</sup> "The number of income tax brackets was reduced from ten to six, tax rates were made in multiples of five, and the maximum rate of tax was reduced by 1% every year. Thus, the maximum rate of tax for 1998 was 34%; for 1999, 33%; for 2000 and subsequent years, 32%."<sup>37</sup>

### C. Major Tax Reforms

Tax reform is not an unfamiliar term to most of us. It has existed in various forms in the past. Tax reform could either be tax policy reform or tax administration reform. The former refers to who will be taxed, what will be taxed, and at what rate, while the latter refers to how the tax agency will administer and enforce the tax rules.

Since the time of former Pres. Ferdinand Marcos, various tax reforms numbering to at least 300 have been carried out for various reasons. Unfortunately, only a few of them served to genuinely enhance the tax system. Most of them simply contributed to the present convoluted tax system we now have, which is riddled with loopholes, thus often subjecting the laws to conflicting legal interpretations.

As previously mentioned, the National Internal Revenue Code was enacted on 15 June 1939. During the latter part of January 1951, the implementation of the withholding tax system was adopted by virtue of Republic Act No. 590.<sup>38</sup> This method of collecting income tax upon receipt of the income resulted in the collection of approximately 25% of the total income tax during the period from 1952 to 1954. The withholding tax system helped achieve a balanced budget during this period. To strictly enforce the payment of taxes and to further discourage tax evasion, the

35. An Act Amending the National Internal Revenue Code, as amended and for Other Purposes, Republic Act No. 8424 (1998) [NIRC].

36. MAMALATEO, *supra* note 18, at 6.

37. NIRC, §§ 24 (A)(1)(a) and 27(A).

38. An Act to Amend Certain Sections of Commonwealth Act No. 466, as amended, otherwise known as the National Internal Revenue Code, and to Add to Title II thereof a Supplement Providing for Withholding of the Income Tax on Wages and for other Purposes, Republic Act No. 590 (1950). (The Supreme Court in the case of *Endencia v. David*, 93 Phil 696 (1951) held that this law was unconstitutional.)

Rewards Law<sup>39</sup> was passed on 19 June 1959 whereby informers were rewarded the 25% equivalent of the revenue collected from the tax evader.<sup>40</sup>

### I. Marcos Administration

#### a) Tax Revenue Prior to Martial Law

Revenue from taxation consistently increased from 1968 to 1972. The rather substantial rise in tax collection in 1971 is traceable to the enactment of Republic Act No. 6110<sup>41</sup> introducing omnibus amendments to the NIRC, the withdrawal of exemption from corporate income tax, and the expansion of the coverage of those required to file income tax returns. Also, the then export tax<sup>42</sup> was in force for the entire 1971, largely explaining the big boost in indirect tax collection in that year.

Between 1968 and 1972, there was a slight shift in the distribution of total collection between direct and indirect taxes. In 1968, direct taxes contributed 26.6 % to total collection. In 1972, it was 28.5 %. The relative share of indirect taxes, on the other hand, exhibited a decline in 73.4% in 1968 to 71.5 % in 1972. This can be regarded as a rough indication of some improvement in the income redistributive effects of taxes, following the widely-accepted view that indirect taxes tend to be regressive and as such fall more heavily on the poorer segments of the economy.

It was in 1970 when each taxpayer was provided with a permanent Taxpayer Account Number (TAN) which facilitated the identification of taxpayers and resulted to faster verification of tax records.<sup>43</sup> Similarly, under

39. An Act to Provide for Reward to Informers of Violations of the Internal Revenue and Customs Law, Republic Act No. 2338.

40. *Id.* §1.

41. An Act Amending Certain Provisions of the National Internal Revenue Code, as amended (1969).

42. An Act to Invigorate the Country's Export Trade as a Means of Accelerating Economic Growth by Granting Certain Incentives and Exemptions to Registered Export Producers, Export Traders, and Service Exporters, Repealing Export Incentives Granted under Republic Act No. 5186, and for Other Purposes, Republic Act No. 6135 (1970).

SECTION 1. *Short Title.* — This Act shall be known and cited as the "Export Incentives Act of 1970."

43. An Act Amending Certain Sections of the National Internal Revenue Code, Presidential Decree No. No. 69, § 337-A (1972).

EO No. 206,<sup>44</sup> the payment of taxes through bank facilities was introduced. This and the implementation of package audit investigation by industry contributed significantly to the improved collection of the Bureau.

b) Tax Reforms after Martial Law

During the martial law era, various presidential decrees and letters of instruction were issued. On 24 November 1972, Presidential Decree No. 69,<sup>45</sup> amending certain sections of the NIRC, was enacted. It is interesting to note that as early as 1972, the government already attempted to institutionalize tax reforms, which attempt was evident from the whereas clauses of said law, to wit:

WHEREAS, the Omnibus Tax Bill for 1972 is designed to institute basic reforms in our antiquated tax system by simplifying tax incentive policies, increasing the financial resources of the government, making it a more effective tool for redistribution of income and wealth and keeping it in step with modernization; ...

WHEREAS, it is imperative to adopt these proposed measures to make the tax system more responsive to the requirements of a developing economy, foremost of which is the speedy restructuring of the social, economic and political institutions of the country;

NOW, THEREFORE, I, FERDINAND E. MARCOS, ... in order to transform the tax system into an effective tool for the implementation of the desired changes and reform in our society, do hereby order and decree that the said amendments to the National Internal Revenue Code be adopted, as it is hereby adopted, and made part of the law of the land....<sup>46</sup>

It was likewise during this year that tax amnesty decrees<sup>47</sup> were promulgated to give erring taxpayers "a final opportunity to settle their tax

obligations consistent with the concept of reforms under the New Society."<sup>48</sup>

The revenue-raising measures covered by P.D. No. 69 have been directed at sectors of the economy which were deemed able to absorb additional levies and those which, prior to Martial Law, were not bearing their proportionate share of the costs of government. Additional revenues were expected to be generated by the withdrawal of certain exemptions, such as exemptions from the corporate income tax and compensating tax under P.D. No. 69 and tariff duties under P.D. No. 34.<sup>49</sup> It must be noted, however, that subsequent presidential decrees restored or revived with modifications some of the tax exemptions in meritorious cases.

The government was then of the view that while revenue is a primary consideration, there are equally significant objectives sought to be served by these tax reforms such as redistributing income and wealth, directing resources to priority areas, promoting equity, and strengthening the fiscal position of local governments.

Exemplifying the government's deliberate effort to make taxation a more effective income redistributive device is the drastic re-structuring of the gift and death taxes and the reduction of the sales tax on certain essential food items under P.D. No. 69. However, as previously mentioned, various presidential decrees having as their primary consideration the incentive objective were likewise enacted. Furthermore, to promote equity, P.D. No. 69 granted working wives with additional deductions and imposed taxes on certain businesses such as Jail-Alai, quasi-banking institutions, and sauna baths, among others. Improvements in tax administration were likewise introduced.

It was also during this period that taxation was utilized to enable local government units to participate more actively in promoting reforms. They have been provided with a more stable and equitable financial back-up from the national government as exemplified by the revised allotment under P.D. No. 144.<sup>50</sup>

A closer review of the provisions of P.D. No. 69 would indicate that while some of the rates of taxes were increased, some were likewise decreased and while grant of exemptions were cancelled, some new incentives and exemptions were revived or restored.

48. *Id.*

49. Amending the Tariff and Customs Code of the Philippines, Presidential Decree No. 34 (1972).

50. Revising the Present System of National Internal Revenue Allotments to Local Government, Presidential Decree No. 144 (1973).

44. Directing the Central Bank of the Philippines to Receive Payment through the Banking System, Executive Order No. 206 (1970).

45. Amending Certain Sections of the National Internal Revenue Code, Presidential Decree No. 69 (1972). The taxes under Presidential Decree No. 69 include income tax, estate and donor's tax, specific tax, privilege tax on business and occupation, documentary stamp tax, mining tax, miscellaneous taxes, namely, tax on banks and on finance companies and amusement taxes.

46. *Id.*

47. Proclaiming a Tax Amnesty Subject to Certain Conditions, Presidential Decree No. 23 (1972); Condonation of Delinquent Tax Accounts and Tax Amnesty on Contested Assessments Subject to Certain Conditions, Presidential Decree No. 23 (1972).

From July 1975 to 31 December 1976, most of the reforms introduced on direct taxes were in the form of tax exemptions.<sup>51</sup> There were also revisions on the rates of some direct taxes and the introduction of new taxes. Of these, notable was P.D. No. 778<sup>52</sup> which provided that incomes of building and loan associations and life insurance companies be taxed at the regular corporate tax rates of 25% and 35% and that profits remitted abroad by a branch office be taxed at 20%. Increases in tax rates were also effected by P.D. No. 778 with respect to withholding tax on dividends received by a domestic or foreign corporation from a domestic corporation.

In addition, registration fees on private automobiles, private motorcycles, scooters, bicycles, and the like were increased.<sup>53</sup> Annual energy taxes became imposable<sup>54</sup> on certain private passenger vehicles, certain aircrafts and motorized watercraft used for pleasure and recreation, respectively. The definition of the term "corporation" was significantly amended to exclude joint ventures formed for the purpose of undertaking construction projects

51. Of these, two were for housing, two for transportation, and one each for waterworks, coconut industry, education, local government financing, donation of American-owned lands acquired under the Laurel-Langley Agreement, stock transfer tax, International Development Research Center, rural development, fish industry, offshore banking units and foreign currency deposit units, and donations to the Samar Integrated Rural Development Project.
52. Amending Certain Sections of the National Internal Revenue Code, As Amended, Presidential Decree No. 778 (1975).
53. Amending Republic Act No. 4136, As Amended, Otherwise Known as The Land Transportation and Traffic Code by Increasing the Annual Registration Fee on Private Automobiles and Imposing an Ad Valorem Tax Thereon, and for Other Purposes, Presidential Decree No. 843 (1975); Further Amending Republic Act No. 4136, Otherwise Known as The Land Transportation and Traffic Code, Presidential Decree No. 896 (1976).
54. Amending Republic Act No. 4136, As Amended, Otherwise Known As The Land Transportation And Traffic Code By Increasing The Annual Registration Fee On Private Automobiles And Imposing An Ad Valorem Tax Thereon, And For Other Purposes, Presidential Decree No. 843 (1976); Imposing An Energy Tax on Aircraft Not Operated For Hire to the General Public by Inserting A New Provision (Sec. 50-A) to Republic Act No. 776, Otherwise Known as The Civil Aeronautics Act of the Philippines and Increasing the Registration Fees of Aircraft by Amending Paragraphs (6) and (7) of Section 50 Thereof, Presidential Decree No. 844 (1975); Imposing An Energy Tax on Motorized Watercraft Used For Pleasure and Recreation and Amending Section 3301 of Presidential Decree No. 34, Otherwise Known As The Tariff and Customs Code of the Philippines, Presidential Decree No. 845 (1975).

for income tax purposes.<sup>55</sup> Likewise, administrative reforms have also been instituted, one of which was the imposition of increased penalty on filers of false or fraudulent income tax returns.<sup>56</sup> With respect to indirect taxes, presidential decrees were likewise issued to increase the tax rates on insurance premiums,<sup>57</sup> cigarettes,<sup>58</sup> alcoholic beverages,<sup>59</sup> and petroleum products.<sup>60</sup>

There was also a withdrawal of the tax exemption on imported raw materials to be used by the importer in the manufacture of articles subject to specific tax from advance sales tax.<sup>61</sup> However, some of the exemptions withdrawn were subsequently restored under certain conditions.<sup>62</sup> Added to these, tax incentive decrees have been issued to promote social activities and certain economic undertakings, to grant relief under special circumstances, to ensure establishment of adequate social services, and to encourage investments.

In 1977, additional tax reforms were introduced which imposed a final tax on the interests derived from every commercial paper issued in the primary market,<sup>63</sup> increased the rates of specific tax on distilled spirits, wines

55. Amending Subparagraph (B) of Section 84 and Section 191 of the National Internal Code, Presidential Decree No. 929 (1976).
56. Amending Section Seventy-Three of the National Internal Code, As Amended, By Prescribing An Increased Penalty on Filers of False or Fraudulent Income tax Returns, is Presidential Decree No. 785 (1975).
57. Amending Section Two Hundred Fifty-Five and Three Hundred Fifty-Eight of the National Internal Revenue Code, Presidential Decree No. 739 (1975).
58. Increasing the Specific Tax Rates on Cigarettes by Amending Section 137 (B) of the National Internal Revenue Code as Amended Presidential Decree No. 753 (1975).
59. Increasing the Specific Taxes On Distilled Spirits, Wines and Fermented Liquors, Amending Thereby Sections 133, 134 and 135 of the National Internal Revenue Code, As Amended, Presidential Decree No. 820 (1975).
60. Increasing the Specific Tax on Gasoline, Diesel Fuel Oil, Bunker Fuel Oil and Other Similar Petroleum Products by Further Amending Sections 142, 144 and 145 of the National Internal Revenue Code, As Amended, Presidential Decree No. 874 (1976).
61. Providing Incentives and Protection to the Local Textile Industry and to Manufacturers of Certain Articles In Order to Encourage Exportation Thereof, Presidential Decree No. 750 (1975).
62. Amending Further Subsection (B) of Section 183 of the National Internal Revenue Code Presidential Decree No. 909 (1976).
63. Further Amending Certain Sections of the National Internal Revenue Code, As Amended, so as to Impose A Final Tax on the Interests Derived From Every



and fermented liquors,<sup>64</sup> applied the withholding tax system on interest on bank deposits,<sup>65</sup> and increased the rates of tax on winnings in Jai-alai and horse racing and the share of the government from sweepstakes total price fund.<sup>66</sup> And, on 3 June 1977, P.D. No. 1158, otherwise known as the National Internal Revenue Code of 1977, was decreed. This updated certain sections of the 1934 Tax Code.

An expansion of the withholding tax system<sup>67</sup> and an extension of the tax surveillance authority of the Commissioner of Internal Revenue<sup>68</sup> were likewise decreed. There was also a delineation of certain measures in strengthening the revenue law implementation.<sup>69</sup> Likewise, the rates of specific taxes on cigarettes and alcoholic beverages were increased,<sup>70</sup> and tax

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Commercial Paper Issued in the Primary Market, Presidential Decree No. 1154 (1977).

64. Amending Sections 133, 134 and 135 of the National Internal Revenue Code, As Amended, so as to Increase the Rates of Specific Tax on Distilled Spirits, Wines and Fermented Liquors Presidential Decree No. 1155 (1977).
65. Amending Section 30 and 53 of the National Internal Revenue Code Presidential Decree No. 1156 (1977).
66. A Decree to Consolidate and Codify All the Internal Revenue Laws of the Philippines, Presidential Decree No. 1158 (1977).
67. Amending Sections 30 and 53 of the National Internal Revenue Code of 1977 to Authorize the Secretary of Finance to Require Withholding of Creditable Income Taxes from Certain Income Payments and to Require Proof of Such Withholding as an Additional Condition for Deductions from Gross Income, Presidential Decree No. 1351 (1978).
68. Amending Section 16 of the National Internal Revenue Code by Authorizing the Commissioner of Internal Revenue Under Certain Conditions to Place Natural or Juridical Persons Under Surveillance for Two Months for the Purpose of Establishing a Prima Facie Basis for Assessing Taxes for the Other Months of the Same or Different Taxable Years, Presidential Decree No. 1356 (1978).
69. Amending Certain Sections of the National Internal Revenue Code of 1977, as Amended and for Other Purposes, Presidential Decree No. 1457 (1978).
70. An Act Increasing the Rates of Tax on Cigarettes and Amending for the Purpose, Items 4, 5, 6, 7, 8, 9, 10 and 12 of subparagraph (B) of the First Paragraph of Section 149 of the National Internal Revenue Code of 1977, As Amended, Batas Pambansa Blg. 3 (1978); An Act Providing for the Upward Revision of the Specific Taxes on Alcoholic Beverages and Amending, for the Purpose, Sections 145 and 147 of the National Internal Revenue Code of 1977, As Amended, Batas Pambansa Blg. 4 (1978).

was also imposed on compounded liquors.<sup>71</sup> These latter impositions were aimed at increasing the production and selling costs of said products to discourage consumers from purchasing such commodities which likely cause social problems.

The following tax measures were pursued in 1978: (1) updating of the assumed minimum taxable income of common carriers by land; (2) consolidation and revision of the amount of documentary and science stamp taxes; (3) expansion of the definition of royalties payable to entities abroad; (4) taxation of the income from property, real or personal, and activities conducted for profit of all income tax exempt organizations; (5) taxation of profits from shares of stock of Philippine corporations earned by a non-resident alien or foreign corporation when the sale is made abroad; (6) prescribing a statutory limit for representation or entertainment expenses; (7) collection of the three percent contractor's tax from agents and contractors for embroidery and apparel for export, as well as contractors rendering services to pioneer enterprises; (8) intensifying collections from import duties on raw materials; (9) making real and tangible personal property outside the Philippines part of the taxable gross estate if the owner is a Filipino citizen or a resident alien in the Philippines; and (10) increase of fixed taxes on certain businesses.

In 1979, tax was imposed on electric power consumption in excess of 650 KWH,<sup>72</sup> capital gains derived from the sale of real properties were subjected to final tax,<sup>73</sup> the provision of travel tax as well as increased the rates of tax thereon were amended and consolidated,<sup>74</sup> and the specific tax rates on gasoline were increased in view of the increase in the price of crude oil.<sup>75</sup>

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71. An Act Restoring the Specific Tax on Compounded Liquors Amending Further, for the Purpose Section 146 of the National Internal Revenue Code of 1977, As Amended, Batas Pambansa Blg. 5 (1978).
  72. An Act Imposing An Energy Tax on Electric Power Consumption, Batas Pambansa Blg. 36 (1979).
  73. An Act Amending Sections 34, 45, 51 and 72 of the National Internal Revenue Code of 1977, As Amended, By Subjecting to the Final Tax Capital Gains Derived from the Sale or Real Property, Batas Pambansa Blg. 37 (1979).
  74. An Act Consolidating the Provisions on Travel Tax BY Amending Certain Sections of Presidential Decree No. 1183, As Amended, Batas Pambansa Blg. 38 (1979).
  75. Revising the Rates of Specific Tax on Gasoline, Executive Order No. 550 (1979).

It was also during this period that the Omnibus Tax Law<sup>76</sup> was enacted. It amended Section 153 of the National Internal Revenue Code by increasing the tax rate per liter of volume capacity of Naptha to 50 centavos, gasoline and other similar products of distillation to 62 centavos, and premium & aviation gasoline to 67 centavos and 55 centavos, respectively. Section 196 (j) of the National Internal Revenue Code was also amended thus increasing the tax rate of imported air-conditioning units, components and parts to 35% based on the landed cost thereof plus mark-up.

## 2. Aquino Administration

After the 1986 People's Revolution, a renewed thrust towards an effective tax administration was pursued by the Bureau of Internal Revenue (BIR). Tax reform measures during the Aquino Administration were guided by the following general policy considerations: improving elasticity of the tax system, ensuring that similarly-situated individuals and entities bear the same tax burden, withdrawing or modifying taxes that impair incentives to production, and improving tax administration.<sup>77</sup> During this period,<sup>78</sup> a total of 61 tax measures, composed of presidential decrees, executive orders, and other forms of legislations were issued or enacted, as the case may be.

During the early part of the Aquino Administration, a project entitled "*Operation: Walang Lagay*" was launched to promote the efficient and honest collection of taxes.<sup>79</sup> In 1986, a package of tax measures referred to as the Tax Reform Package (TRP) of 1986 was designed to complement the economic recovery program of the new government. As a result, there were reforms in direct taxation, particularly the overhaul of the income tax system, which were primarily anchored on promoting domestic investment, equity, and administrative simplicity without necessarily impairing the revenue-generating capacity of the income tax system.<sup>80</sup>

76. An Act Further Amending Certain Provisions of the National Internal Revenue Code, Batas Pambansa Blg. 41 (1979).

77. See generally TAX REFORMS IN SELECTED COUNTRIES IN ASIA AND THE PACIFIC: A PROJECT OF THE STUDY GROUP ON ASIAN TAX ADMINISTRATION AND RESEARCH (SGATAP) 110 (1990).

78. For the period covering Jan. 1, 1986 to Sep. 30, 1989.

79. BIR History, available at [http://www.bir.gov.ph/bir\\_hist.html](http://www.bir.gov.ph/bir_hist.html) (last accessed Aug. 28, 2004).

80. The TRP included the introduction of the 35% single tax for corporations.

In 1988, the Value Added Tax (VAT)<sup>81</sup> was introduced and it replaced the complicated sales tax structure. The adoption of the VAT system was one of the structural reforms provided for in the TRP, which was designed to simplify tax administration and make the tax system more equitable. It was primarily intended to be revenue-neutral. To ensure that the tax system remained progressive, additional excise tax was imposed on luxury or non-essential items. In line with the same principle, exemptions from VAT were extended to necessities and primary agricultural products. Small businesses were also accorded preferential tax treatment under the VAT regime.

Reforms in tax administration, characterized by changes in the various organizational, functional, operational, and procedural aspects of the tax administration bureau, were also implemented. An amnesty program was implemented to further foster compliance and to widen tax base in the medium and long-run.

During the Aquino Administration, there was a decline in the share of direct taxes to total revenues and an increase in indirect taxes to total revenues.<sup>82</sup> This *decline* in direct taxes can be attributed to certain reform measures affecting the individual income tax which were not particularly intended to generate revenue. Moreover, passive income yielded a much lower collection than estimated due to the lower rate of interest during the period and the gradual phasing out of the tax on dividends. On the other hand, indirect taxes *increased* due to the following: rate adjustments of the excise on cigarettes, alcohol products and petroleum products (to balance tax progression);<sup>83</sup> imposition of a minimum 10% duty on imports in 1987; and changes in the sales tax structure to the VAT system to improve administration and compliance.

81. Adopting a Value-Added Tax, Amending for This Purpose Certain Provisions of the National Internal Revenue Code, and for Other Purposes, Executive Order No. 273 (1988).

82. Compared to the tax collection figures under the Marcos Administration, the share of direct taxes to total tax revenues from 1983 to 1985 displayed an increasing trend from 26% to 35% of total tax revenues. The high share of direct taxes in 1985 can be explained by the high interest rates that prevailed at that time which resulted to higher collections from interest income. However, for the period 1986-1988, the said share of direct taxes declined from 33% in 1986 to 31% in 1988.

83. An Act Modifying the Excise Tax on Distilled Spirits, wines, fermented Liquor and Cigarettes, Amending for the Purpose Sections 138(A) and (B), 139, 140 and 142(C) and (D) of the National Internal Revenue Code, As Amended, Republic Act No. 6956 (1990).

The year 1989 was the advent of the "Tax Administration Program (TAP)," which was the embodiment of the government's mission to improve tax collection and simplify tax administration. The TAP contained several tax reforms and enhancement measures, which included the use of the Taxpayer Identification Number (TIN) and the adoption of the New Payment Control System (NPCS) and Simplified Net Income Taxation Scheme (SNITS).<sup>84</sup>

It was during the Aquino Administration that the revenue potential of the excise tax on "sin" products was recommended to be fully exploited. The introduction of measures to make the vertical and horizontal equity of the income tax system more pronounced was also recommended. At this juncture, it was observed that the conflict of policy objectives between short-term revenue generation and industrial promotion should be further explored. On a final note, it is also worthy to stress that measures contained in the 1986 Tax Reform Package, such as ceilings on allowable deductions, among others, were not implemented.

### 3. Ramos Administration

During the Ramos Administration which began in 1993, a comprehensive and integrated program known as the "Action-Centered Transformation Program (ACTS)"<sup>85</sup> was undertaken in order to attain the government's vision of transformation, and to realign and direct the entire organization towards the fulfillment of its vision and mission. The next year, a "Tax Computerization Project (TCP)"<sup>86</sup> was undertaken by the Government. This involved the establishment of a modern and computerized Integrated Tax System and Internal Administration System.

Significantly, the Expanded Value Added Tax Law (EVAT)<sup>87</sup> was approved on 5 May 1994. It expanded the coverage of the VAT by the

inclusion of the sale, barter, exchange or lease of intangible and real properties, as well as the sale of services in the Philippines by a nonresident person. In 1995, the Comprehensive Tax Reform Program (CTRP) was drawn up by the government to raise annual revenues by removing opportunities for tax evasion and simplifying tax administration and compliance.

Two components of the CTRP, restructuring tax on the downstream oil industry and the shift from *ad valorem* to specific tax on "sin" products, were enacted into law in 1996. These two laws were the Excise Tax on Beers and Cigarettes Law<sup>88</sup> and the Law Restructuring Excise Tax on Petroleum Products.<sup>89</sup> Both laws shifted excise tax calculation from the *ad valorem* system, which calls for tax to be computed on the basis of the factory price, to the specific system, where tax is based on the volume of products sold. This was advantageous for the government because, by fixing specific tax rates per unit of a product, manufacturers could not reduce tax liability by selling their products at low factory prices to distribution companies that were owned by the manufacturers themselves.

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Repealing the Relevant Provisions of the National Internal Revenue Code, as Amended, and for Other Purposes, Republic Act No. 7716 (1994).

88. An Act Amending Sections 138, 139, 140, and 142 of the National Internal Revenue Code, as Amended, and for Other Purposes, Republic Act No. 8240 (1996). (This law imposes specific tax rates on beers and cigarettes to ensure the collection of uniform taxes from similarly priced beers, cigarettes and distilled spirits. Under this law, cigarettes with a net retail price of more than P10.00 per pack will be taxed by as much as P12.00, while those with a net retail price of more than P6.50 but not over P10 per pack will be taxed P8.00. Taxes go lower as the prices of cigarettes drop, to a minimum of P1.00 for those with net retail price of less than P5.00 per pack, and also P1.00 in specific tax for cigars.

Taxes for beer vary from P6.15 to P12.15 per liter, depending on the price. Collection of these taxes started on Jan. 1, 1997. Specific taxes further increased by 12% three years after.)

89. An Act Restructuring the Excise Tax on Petroleum Products, Amending for the Purpose Pertinent Sections of the National Internal Revenue, as Amended, Republic Act No. 8184 (1996). (This law seeks to simplify the taxation on crude oil and refined petroleum products. It raised the specific tax to be collected on the following petroleum products, per liter of volume capacity: naphtha, regular gasoline and other similar products of distillation, P 4.80; leaded premium gasoline, P 5.35; unleaded premium gasoline, P 4.35; aviation turbo jet fuel, P 3.67; kerosene, P 0.60; diesel fuel oil, P 1.63; and bunker fuel oil, P 0.30.)

84. An Act Adopting the Simplified Net Income Taxation Scheme for the Self-Employed and Professionals Engaged in the Practice of their Profession, Amending Sections 21 and 29 of the National Internal Revenue Code, as Amended, Republic Act No. 7496 (1992).

85. Transformation Program of the Bureau of Internal Revenue, Revenue Regulation No. 3-96 (Jan. 18, 1996).

86. Transformation Program of the Bureau of Internal Revenue; Revenue Memorandum Order No. 17-96 (June 13, 1996), Prescribing Guidelines and Procedures for the Pilot Implementation of the Systems for Philippine Integrated Revenue Information Technology (SPIRIT), Revenue Regulation No. 3-96 (Jan. 18, 1996).

87. An Act Restructuring the Value-Added Tax (Vat) System, Widening its Tax Base and Enhancing its Administration and for these Purposes Amending and

In the year 1996, in addition to bills restructuring excise taxes, the "Improved VAT Law,"<sup>90</sup> made remedial amendments to some provisions of Republic Act No. 7716.<sup>91</sup> The Improved VAT Law also granted additional exemptions from the coverage of EVAT to make the value-added tax more acceptable to the public.<sup>92</sup> Under the said law, presumptive tax credits were granted to selected agro-processors and government contractors.<sup>93</sup>

Furthermore, the individual and corporate income tax component of the Comprehensive Tax Reform Program was finally enacted into law after months of fierce Congressional debates. The "Tax Reform Act of 1997"<sup>94</sup> was the final component of the Comprehensive Tax Reform Package. The law simplified the income tax system to encourage compliance and strengthen the capacity of the BIR to prosecute tax fraud and tax evasion cases.

Significant changes were made on the taxes of nonresident individual citizens and non-resident aliens.<sup>95</sup> The law also raised the amount of

90. An Act Amending Republic Act No. 7716, Otherwise Known as the Expanded Value Added Tax Law, and Other Pertinent Provisions of the National Internal Revenue Code, as Amended, Republic Act No. 8241 (1996).
91. *Id.* §7. The law restored operators of taxicabs, utility cars for rent or hire driven by the lessees (rent-a-car companies), and tourist buses under the coverage of common carrier's tax.
92. *Id.* §2. Exempted from the imposition of the 10% levy are books, magazines, newspapers and other publications; lease of real properties with monthly rentals of P7,500; and sale of residential property valued at P1 million and below following the socialized low-cost housing program. The importation of meat produce in conformity with the terms of the World Trade Organization and molasses are likewise exempted from the E-VAT. Agricultural and electric cooperatives; non-agricultural and non-electric cooperatives which provide goods and services among its members and with gross receipts of up to P1 million are also exempted. Newspapers are also exempted from the VAT coverage but their income from advertisements will continue to be subjected to the VAT.
93. *Id.* §3. The grant of presumptive input tax to food processors is limited to milk at 0.43%, sardines and mackerel at 1.60%, refined sugar at 0.68% and cooking oil, 0.22%.
94. An Act Amending the National Internal Revenue Code, As Amended, and for Other Purposes, Republic Act No. 8424 (1997). The law took effect on Jan. 1, 1998.
95. An Act Amending the National Internal Revenue Code, As Amended, and for Other Purposes, Republic Act No. 8424 (1997), §23, §24, and §25. Nonresident individual citizens were taxed only on compensation and business income derived within the Philippines, including overseas contract workers and

exemption of the taxable income for fixed income earners and set the maximum rate of tax applicable for individual citizens and resident aliens.<sup>96</sup> Finally, it introduced, among others, the Minimum Corporate Income Tax,<sup>97</sup> Improperly Accumulated Earnings Tax,<sup>98</sup> and Fringe Benefits Tax.<sup>99</sup>

#### 4. Estrada Administration

One of the most significant reform measures in 1998, during the Estrada Administration, was the implementation of the Economic Recovery Assistance Payment (ERAP) Program,<sup>100</sup> which granted immunity from audit and investigation to taxpayers who have paid 20% more than the tax paid in 1997 for income tax, VAT and/or percentage taxes.

The most significant of the tax measures in 2000 include: full utilization of tax computerization in the Bureau's operations; expansion of the use of electronic Documentary Stamp Tax metering machine and establishment of

seamen. Non-resident aliens engaged in trade or business in the Philippines were taxed in the same manner as, citizens and resident aliens on income within the Philippines, except on dividend where they are taxed at 20%, and on income from use or distribution of cinematographic films and similar works, which is taxed at 25%. Non-resident aliens not engaged in trade or business in the Philippines became subject to 25% on gross income received in the Philippines, except capital gains tax on sale of shares of stock and real property which are subject to the regular rates.

96. An Act Amending the National Internal Revenue Code, As Amended, and for Other Purposes, Republic Act No. 8424 (1997), §24. Both compensation and business income for individual citizens (worldwide income) and resident aliens (income within) were subjected to the same rates of tax ranging from 5% to 34% based on net income, except that compensation income is still taxed on gross amount. Maximum rate was reduced to 33% in 1999 and to 32% in 2000 and thereafter.
97. An Act Amending the National Internal Revenue Code, As Amended, and for Other Purposes, Republic Act No. 8424 (1997), §27(E) and §28(A)(2).
98. An Act Amending the National Internal Revenue Code, As Amended, and for Other Purposes, Republic Act No. 8424 (1997), §29.
99. An Act Amending the National Internal Revenue Code, As Amended, and for Other Purposes, Republic Act No. 8424 (1997), §33.
100. Granting Immunity from Audit and Investigation of Income Tax, Value Added Tax, and Percentage Tax Returns for the Taxable Year 1998, Granted under the Economic Recovery Assistance Payment (ERAP) Program, Under Certain Conditions, Revenue Regulation No. 2-99 (Feb. 7, 1999).

tie-up with the national government agencies and local government units for the prompt remittance of withholding taxes;<sup>101</sup> and implementation of Compromise Settlement Program for taxpayers with outstanding accounts receivable and disputed assessments with the BIR.

In 2000, the Large Taxpayers Service (LTS) and the Excise Taxpayers Service (ETS) were established<sup>102</sup> to reinforce the tax administration and enforcement capabilities of the BIR. The functions of LTS and ETS were integrated under Executive Order No. 306.<sup>103</sup>

##### 5. Arroyo Administration

During the Arroyo Administration which began in 2001, the BIR's Transformation Program was introduced. The program was meant to reconstitute the tax administration agency as an efficient, accountable, de-politicized and effective institution. It aimed to introduce fundamental changes that would impact the very core of the organization, in terms of promoting a performance-based employee incentive system; accountability from the head of the agency all the way to the frontline employees; and fiscal, administrative, and legal autonomy that would allow the tax administration agency to mobilize the necessary human, technological and organizational resources to achieve steep performance deliverables.<sup>104</sup> Despite this, however, House Bill Nos. 5054 and 5465,<sup>105</sup> though identified as priority bills by the government, remain pending at the Lower House of Congress.

101. Mode of Payment and/or Remittance of the Documentary Stamp Tax, Under Certain Conditions; Revenue Memorandum Order No. 15-01 (June 16, 2001), Prescribing the Policies, Guidelines, and Procedures in the Use of Online Electronic Documentary Stamp Tax Metering Machine Pursuant to Revenue Regulation No. 9-2000, Revenue Regulation No. 9-2000 (Aug. 31, 2000).

102. Organizational Restructuring of Bureau of Internal Revenue to Improve Administrative Control Over Certain Categories of Taxpayers, Executive Order No. 175 (1999).

103. Further Streamlining the Bureau of Internal Revenue to Improve Administrative Control Over Certain Categories of Taxpayers and Enhance Effectiveness of its Computerized Integrated Tax System by Amending Certain Provisions of Executive Order 175, Executive Order No. 306 (2000).

104. See Rene G. Banez, *Transforming the Bureau of Internal Revenue*, Address to the Presidential Committee on Effective Governance on Oct. 4, 2001, available at [http://www.bir.gov.ph/upd\\_feature.html#transforming](http://www.bir.gov.ph/upd_feature.html#transforming) (last accessed Aug. 27, 2004).

105. An Act Creating the Internal Revenue Management Authority, Providing Funds Therefore, and for Other Purposes, House Bill No. 5054, 12th Congress, 2d Reg. Sess. (2004); An Act Creating the National Authority for Revenue

Since it cannot be denied that the gains from reforming the tax agency may be reaped only in the medium term, the program was complemented by measures to enhance the Bureau's revenue-generating capability. These measures included the implementation of the "Voluntary Assessment Program (VAP)"<sup>106</sup> and the "Compromise Settlement Program (CSP),"<sup>107</sup> and the expansion of the coverage and scope of the creditable withholding tax system.<sup>108</sup>

Likewise, the BIR, in its mission to provide an efficient and convenient service to the taxpayers, introduced the "substituted filing of returns."<sup>109</sup>

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Administration, Providing Funds Therefore, and for Other Purposes, House Bill No. 5465, 12th Congress, 2d Reg. Sess. (2004).

106. Voluntary Assessment Program Granting Taxpayers the Privilege of Last Priority in the Audit and Investigation of All Internal Revenue Taxes for the Taxable Year Ending December 31, 2000 and all Prior Years Under Certain Conditions, Revenue Regulation No. 8-2001 (Aug. 1, 2001); Amendment to Revenue Regulations No. 8-2001 Relative to the Period of Availment of the Voluntary Assessment Program (VAP), Additional Benefits to Taxpayers Who Availed of the VAP and Clarification of Some of the Conditions for the Availment Thereof, Revenue Regulation No. 10-2001 (Sep. 10, 2001); Extending Further the Deadline for Availment of Last Priority in Audit and Investigation Under the Voluntary Assessment Program (VAP) and Providing for a More Flexible Manner of Payment, Amending for this Purpose Revenue Regulations No. 8-2001 as Amended by Revenue Regulations No. 10-2001, Revenue Regulation No. 16-2001 (Oct. 31, 2001).

107. Implementing Sections 7(c), 204(A) and 290 of the Tax Code of 1997 on Compromise Settlement of Internal Revenue Tax Liabilities, Revenue Regulation No. 6-2000 (Sep. 25, 2000); Prescribing the Policies and Procedures in the Intensification of Collection/Settlement of Delinquent Accounts and Disputed Assessments through Compromise Settlement, Implementing Revenue Regulation No. 6-2000, Revenue Memorandum Circular No. 42-2000 (Sep. 26, 2000).

108. Amending Pertinent Provisions of Revenue Regulations Nos. 1-98, 2-98, as Amended, and 7-95, as Amended, and Revenue Memorandum Circular No. 1-98 Relative to the Inclusion of Additional Taxpayers to be Subject to Final Withholding Tax, Revision of the Withholding Tax Rates on Certain Income Payments Subject to Creditable Withholding Tax, Time for the Filing of Various Tax Returns and Payment of the Taxes Due Thereon And Others, Revenue Regulation No. 6-2001, (Aug. 1, 2001).

109. Amending Section 2.58 and Further Amending Section 2.83 of Revenue Regulations No. 2-98 as Amended, Relative to the Submission of the Alphabetical Lists of Employees/Payees in Diskette Form and the Substituted Filing of Income Tax Returns of Payees/Employees Receiving Purely Compensation Income from Only One Employer for One Taxable Year Whose Tax Due is Equal to Tax Withheld and Individual-Payees Whose

The substituted filing of individual income tax returns became mandatory for all qualified employees at the start of the 2002 tax year. Substituted filing is applicable when the Employer's Annual Return of Withholding Tax on Compensation and Final Tax<sup>110</sup> may be considered as the "substitute" income tax return of the employee, inasmuch as the information provided in the Employee's Certificate of Income Tax Withheld<sup>111</sup> would be exactly the same information contained in the employer's form. However, this does not apply to, among others, non-resident aliens engaged in trade or business in the Philippines.

Furthermore, a technology-based system that promotes paperless filing of tax returns and payment of taxes was adopted through the Electronic Filing and Payment System (EFPS).<sup>112</sup> Other electronic services that were subsequently adopted included electronic TIN application,<sup>113</sup> TIN verification,<sup>114</sup> eReport Card,<sup>115</sup> and e-Raffle.<sup>116</sup> Following the discovery of

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Compensation Income is Subject to Final Withholding Tax, Revenue Regulation No. 3-2002, (Mar. 27, 2002).

110. BIR Form 1604CF (Annual Information Return of Income Taxes Withheld on Compensation and Final Withholding Taxes).

111. BIR Form 2316 (Employer's Certificate of Compensation Payment / Tax Withheld For Compensation Payment With or Without Tax Withheld).

112. Electronic Filing of Tax Returns and Payment of Taxes, Revenue Regulation No. 9-2001 (Aug. 16, 2001); Guidelines and Procedures in the Adoption of Electronic Filing and Payment System (EFPS), Revenue Memorandum Order No. 5-2002 (May 27, 2002). (In line with the BIR's commitment to provide taxpayers an alternative to the traditional paper-based procedure of filing tax returns and paying of taxes, the BIR launched EFPS on June 1, 2001. The system uses state-of-the-art technology and BIR-supplied validation and computation rules to efficiently check the completeness and correctness of taxpayer input. Under EFPS, identified corporate taxpayers can file their tax returns and pay their taxes electronically through the BIR Website.)

113. Registering with the BIR has been made easier through the implementation of the "TIN on the Web" project (also known as the eTIN system) which started on Mar. 24, 2003. The eTIN system is currently limited to issuance of TIN for new registrants classified as professionals.

114. With the implementation of the TIN Verification System, authorized users can easily validate and inquire about an individual or corporate taxpayer's Taxpayer Identification Number (TIN).

115. The E-Report Card is an application intended to provide Tax Performance Information to taxpayers (particularly the Large Taxpayers of different industries) *vis-à-vis* pre-defined industry benchmarks. Reports and graphs on tax due, gross sales, tax ratio and tax payments are deployed through different mediums.

tax payment diversion scams, the BIR introduced the electronic broadcasting system,<sup>117</sup> which allows taxpayers to confirm the receipt by the BIR of their tax payments made through authorized agent banks.

In 2003, pursuant to the Constitution, two important tax measures lapsed into law:<sup>118</sup> the Gross Receipts Tax on Banks and Non-Bank Financial Intermediaries,<sup>119</sup> and the measure exempting medical services rendered by doctors of medicine duly registered with the PRC and services

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116. See Rowena G. Altura, *Bir At 99: Strengthening Tax Administration For A Strong Republic*, available at [http://www.bir.gov.ph/upd\\_feature.html#bir99](http://www.bir.gov.ph/upd_feature.html#bir99) (last accessed on Aug. 27, 2004).

117. The BIR eBroadcasting Service (eBroad) is a payment confirmation facility, which provides timely confirmation of tax payments received through BIR Accredited Agent Banks (AABs). eBroad was launched on Nov. 15, 2002 to secure the BIR payment system and address the problem of diversion of tax payments to the personal accounts of criminal elements. Through eBroadcasting, taxpayers are notified automatically *via* electronic media regarding all tax payments made by them to AABs within 48 hours from receipt of said payments.

118. PHIL. CONST. art. VI, §27. (1) Every bill passed by the Congress shall, before it becomes a law, be presented to the President. If he approves the same, he shall sign it; otherwise, he shall veto it and return the same with his objections to the House where it originated, which shall enter the objections at large in its Journal and proceed to reconsider it. If, after such reconsideration, two-thirds of all the Members of such House shall agree to pass the bill, it shall be sent, together with the objections, to the other House by which it shall likewise be reconsidered, and if approved by two-thirds of all the Members of that House, it shall become a law. In all such cases, the votes of each House shall be determined by yeas or nays, and the names of the Members voting for or against shall be entered in its Journal. The President shall communicate his veto of any bill to the House where it originated within thirty days after the day of receipt thereof; otherwise, it shall become a law as if he had signed it.

119. An Act Amending Certain Sections of the National Internal Revenue Code of 1997, as Amended, by Excluding Several Services from the Coverage of the Value-Added Tax and Re-imposing the Gross Receipts Tax on Banks and Non-Bank Financial Intermediaries Performing Quasi-Banking Functions and Other Non-Bank Financial Intermediaries Beginning Jan. 01, 2004, Republic Act No. 9238 (2004); Revenue Regulation No. 9-2004 (June 25, 2004), Implements Certain Provisions of Republic Act No. 9238, Re-Imposing the Gross Receipts Tax on Banks and Non-Bank Financial Intermediaries Performing Quasi-Banking Functions and other Non-Bank Financial Intermediaries beginning Jan. 1, 2004.

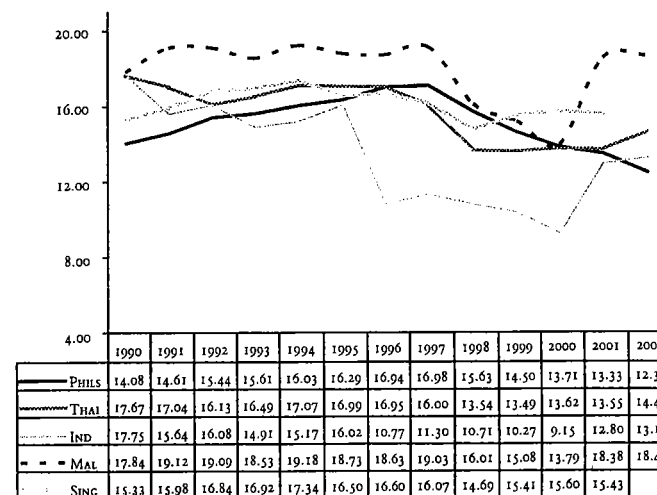
by lawyers duly registered with the IBP.<sup>120</sup> Also, to support the development of the domestic capital market, the Rationalization of Documentary Stamp Tax Bill was enacted into law.<sup>121</sup>

#### V. AN ANALYSIS

A useful measure of a country's efficiency in collecting taxes is the tax effort ratio, that is, the ratio of actual taxes collected within a year to the actual nominal value of GDP. This is a useful and important measure because it allows us to assess the country's efficiency in tax collection, vis-à-vis that of other countries of similar stature.

Below is a graph that portrays the Philippine's tax effort (total taxes) against four other Asean member countries. It shows that in 1990 the Philippines had the lowest tax effort ratio at just 14% of GDP. This climbed continuously until 1997 reaching about 17% of GDP. At this time, the country's tax effort was second highest behind only that of Malaysia's. However the decline since then has been continuous, and in 2002 the country again finds itself at an unenviable position of having the lowest tax effort among the group at 12.3%, even lower than that which was achieved 12 years ago.

FIG. 3 TAX EFFORT RATIO OF 5 ASEAN MEMBER COUNTRIES



In the Philippines, taxes are collected by two major agencies: the BIR, whose collection accounts for about 79%, and the Bureau of Customs (BoC), which accounts for about 20%, with other agencies contributing only about 1%.

The BIR is the primary revenue-generating agency of the government, and its performance through the years is shown below. Its contribution to total government revenues, as shown in Table 1, has been increasing, from 63.78% in 1991 to 79.16% in 2003.

TABLE 1. BIR SHARE IN NATIONAL GOVERNMENT TAX REVENUES  
CY 1986 – 2003 (IN BILLION PESOS)

	NATIONAL GOVERNMENT TAX EXPENDITURES	BIR COLLECTIONS	OTHER AGENCIES SHARE IN GOV'T TAX REVENUES (%)	BIR SHARE IN GOVERNMENT TAX REVENUE (%)
1986	65.49	46.80	28.53	71.47
1987	85.92	58.60	31.80	68.20
1988	90.35	63.72	29.47	70.53
1989	122.46	82.00	33.04	66.96
1990	151.70	103.99	31.45	68.55
1991	182.28	116.26	36.22	63.78

120. Implementing Section 109(bb) and (cc) of the National Internal Revenue Code, as Amended by Republic Act No. 9238, Excluding Services Rendered by Doctors of Medicine duly Registered with the Professional Regulatory Commission (PRC), and Services Rendered by Lawyers Duly Registered with the Integrated Bar of the Philippines (IBP) from the Coverage of the Value Added Tax, Revenue Regulation No. 7-2004 (May 21, 2004).

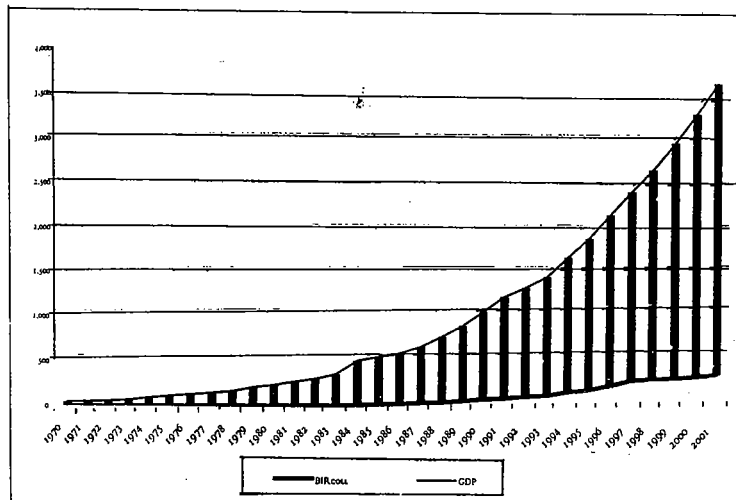
121. An Act Rationalizing the Provision on the Documentary Stamp Tax of the National Internal Revenue Code of 1997, Republic Act No. 9243 (2004). The law took effect on Mar. 20, 2004.

1992	208.71	133.90	35.84	64.16
1993	230.17	145.93	36.60	63.40
1994	271.31	187.45	30.91	69.09
1995	310.52	210.20	32.31	67.69
1996	367.90	260.78	29.12	70.88
1997	412.17	314.70	23.65	76.35
1998	416.59	337.18	19.06	80.94
1999	431.69	341.32	20.93	79.07
2000	460.03	360.80	21.57	78.43
2001	489.86	388.68	20.66	79.34
2002	496.40	394.55	20.52	79.48
2003	537.36	425.35	20.84	79.16

(Sources: Statistics Division, BIR; Bureau of Treasury; National Statistical Coordination Board)

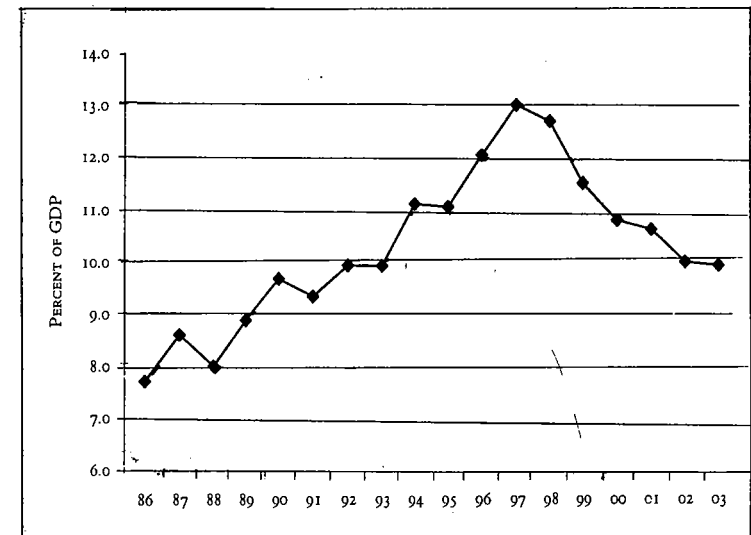
However, taken as one, the BIR's tax effort, that is internal revenue taxes as a ratio nominal GDP, has been declining since 1998, as illustrated below.

FIG 4. VALUE OF ACTUAL BIR COLLECTIONS AND NOMINAL GDP



(Sources: Statistics Division, BIR; Bureau of Treasury; National Statistical Coordination Board)

FIG.5 BIR TAX EFFORT RATIO



(Sources: Statistics Division, BIR; Bureau of Treasury; National Statistical Coordination Board)

The Graph shows that since 1986, there has been an upward trend in the BIR's tax effort ratio. From 1990 to the year 2000, BIR tax effort range from a low of 9.9% in 1993 to a high of 13% in 1997. As of CY 2002, it is at 9.92%, or about the same value achieved 9 years earlier.

#### A. The Rise and Decline of the BIR Tax Effort

##### Source of Increase in the BIR's Tax Effort from 1993 to 1997

The source of the increase, relative to the economy as a whole, is shown by Table 2 below. Broken down by major tax types (as usually presented in BIR data) 56% of the increase in collection performance by the BIR came from income taxes from corporations, individuals and passive incomes. A distant second is seen coming from excise taxes followed by the VAT.

TABLE 2. SOURCE OF THE INCREASE IN BIR TAX EFFORT RATIO FROM 93-97



	PERCENTAGE POINT	PERCENT
TAX ON INCOME AND PROFIT	1.72	56%
EXCISE TAX	0.55	18%
VALUE ADDED TAX	0.41	13%
PERCENTAGE TAXES	0.11	3%
OTHER TAXES	0.29	10%
TOTAL	3.07	

(BIR Blueprint for Development Towards 2010)

It is worth noting that the major reason for the growth in the tax effort was that the economy's growth drivers then were major tax contributors. For example, the manufacturing sector grew by an average of 12.32% (nominal terms) from 1994 to 1996, while the finance sector grew by 18.14% in the same period. During this period, tax collections also grew at its most robust at 21.52% annually. These figures are in contrast to the slower economic growth registered by these sectors from 1997 to 2002 at 5.6% for manufacturing and 11% for finance. During this period collections grew on average about 7.3% annually.

TABLE 3: GDP BY SECTOR  
(PERCENT GROWTH)

	1994-1996	1993-1997	1997-2002
GDP	13.78	12.44	10.61
AGRICULTURE	12.08	9.3	4.87
INDUSTRY	13.09	11.95	10.36
MANUFACTURING	12.32	8.94	5.61
SERVICES	15.08	14.34	14.53
FINANCE	18.14	14.41	10.99

(Source: BIR Blueprint)

The improvement in excise tax and VAT collections was due to an expanding economy which had brought about greater consumption of goods. This is seen in the economy's measure of Personal Consumption Expenditures (PCE) which used to account for about 74% of GDP from

1993 to 1997. Although PCE is still exhibiting robust growth, its contribution to the economy is slightly lower at around 70% of GDP.

But the main reason for the VAT's expansion came from tax policy specifically from the Expanded-VAT, which was implemented in 1996, and the Improved-VAT, which was implemented in 1997. These two laws essentially expanded the coverage of the VAT from its original form in 1988 to include within its coverage all sales of goods and services except those specifically exempted in Section 109 of the NIRC of 1997. When the EVAT was implemented in 1996, the Bureau also saw a 60% improvement in the relative contribution of the VAT (that is, relative to its peak tax effort ratio of 12.97% in 1997).

B. Causes for Decline in the BIR's Tax Effort from 1997 to 2002

TABLE 4: SOURCE OF THE DECLINE IN BIR TAX EFFORT RATIO FROM 97-02

	PERCENTAGE POINT	PERCENT
TOTAL	3.05	
TAX ON INCOME AND PROFIT	1.07	35%
EXCISE TAX	1.16	38%
VALUE ADDED TAX	0.29	9.5%
PERCENTAGE TAXES	0.24	7.8%
OTHER TAXES	0.29	9.5%

(BIR BLUEPRINT FOR DEVELOPMENT TOWARDS 2010)

It must be noted that the government slipped into fiscal deficit after 1997 and tax effort deteriorated. Below, the observations of former Finance Secretary Jose Isidro N. Camacho are cited:

Aside from the aggressive fiscal incentives provided to promote investments, trade and other special-interest groups and sectors, the CTRP included the reduction of income tax rate from a maximum of 35% to 32% and the imposition of specific taxes without indexation for such commodities as tobacco, alcohol, and petroleum products. Several revenue generating measures were also deferred or not implemented such as the VAT on professional services and limits on certain deductible expenses.

All told, the various components of the comprehensive tax reform program of the 1990's probably resulted in over 1% of GDP in lost revenues. The

above policy directions were clearly well-intended to induce economic growth and, perhaps, it did accomplish that by allowing the Philippines to suffer less after the 1997 Asian financial crisis with GDP in the last 10 years growing at 3.2% - 6% except for the 0.5% decline in 1998. It was also expected that the fiscal revenues forgone from these policies will be more than recovered in future years from the more robust economic growth. Unfortunately for the Philippines, the seeds of incentives and tariff reductions that were planted in the 1990's saw the expected harvest aborted by the storm of the 1997 Asian financial crisis.<sup>122</sup>

This is confirmed in a study by Dr. Rosario Manasan (PIDS-Policy Notes Dec. 2002), which cited that the causes of the decline in the Bureau's tax effort ratio from 1997 to 2001 are three-fold namely, economic structure, tax policy and increased evasion.

TABLE 5: CAUSE OF THE DECLINE IN TAX EFFORT FROM 1998 TO 2001

	ECONOMIC STRUCTURE	TAX POLICY	INCREASED EVASION
BIR	7.3%	46%	46%
VAT	0%	0%	100%
INCOME TAXES	0%	50%	50%
EXCISE TAX	23%	81%	12%

(Source Data: MANASAN, 2001 (PIDS))

As illustrated earlier, just as a robust economy in sectors that are large traditional sources of internal revenue brought about greater compliance among corporate and individual income taxpayers, the deterioration of growth in these sectors (or more appropriately, the deterioration of business outlook) had served to decrease compliance. According to Dr. Manasan, by the year 2001, 46% of the total decline was due to increased evasion; largely evident in income taxes and VAT. The reason for this was that the deterioration in the outlook of firms due in large to the Asian financial crisis had brought about an increased propensity to avoid or even evade taxes.

However, one cannot discount the negative effect of tax policy as a cause of the decline in tax effort of the BIR. And this was mainly due to the

122. Jose Isidro N. Camacho, *A Roadmap to Fiscal Deliverance*, (June 2003) available at <http://www.iro.bsp.gov.ph/downloads/062603%20A%20Roadmap%20to%20Fiscal%20Deliverance%200603.pdf> (last accessed Sept. 17, 2004).

non-indexation of excise taxes, and the lowering of the corporate income tax rate from 35% to 32% (this was also done for the top marginal rate of the individual income tax which was also gradually lowered to 32%). There are other provisions in the CTRP which experts say contributed to the decline in the BIR's effort ratio, like the adoption of the NOLCO and an increase in the level of exemptions for the individual income tax.

Aside from the foregoing economic perspective, it must also be stressed that the simultaneous pursuit of objectives are quite difficult, particularly in the short-run period, since these objectives could conflict with one another. In the long run, the harmonization of these objectives of the tax system is more manageable, thus making the tax system a more effective tool to attain a desirable economic growth rate.

Atty. Reynaldo Geronimo, in his article, opined that the:

[T]rickiest part of tax reform, however, is the inherent contradiction among these principles. Thus, an obsession for fiscal adequacy would have the tendency of making the system too onerous and therefore lacking in theoretical justice. An over-use of the system to favor some activities over others could result in complexity, which is an anathema to administrative feasibility, not to mention invite complaints of discrimination from the unfavored sectors.

The challenge, therefore, facing our legislature is how to get the right mix of measures that will keep enough funds flowing into the treasury, in a manner seen as fair by most, and therefore, inexpensive to enforce, blessing along the way the private choices made that enhance the public good.<sup>123</sup>

## VI. THE IMPACT OF THE TAX REFORM OF YESTERYEARS

From the Marcos era up to the present Arroyo government, at least three hundred (300) tax laws, PDs EOs and RAs were promulgated. With all of these issuances, are we better off today in terms of revenue collection, in particular, and fiscal conditions, in general?

First, it can be gleaned from the massive tax reforms that in terms of absolute figures, the revenue collections increased significantly. But the increase is not significant to meet the continuing and increasing expenditures of government. Second, the revenue statistics would indicate that more direct taxes were collected than indirect taxes. This is a clear indication that government indeed has evolved a progressive taxation as mandated by the Constitution. (see Figures 6 and 7 below) However, one should also take

123. Reynaldo Geronimo, *Needed: The Right Brew of Tax Measures*, at <http://www.thetrustguru.com/tax004.asp> (last accessed Aug. 29, 2004).

into account that direct taxes are mainly borne by salaried individuals, which somehow dilutes tax progression.

FIG. 6: PERCENTAGE CONTRIBUTION BY MAJOR TAX TYPE (2003)

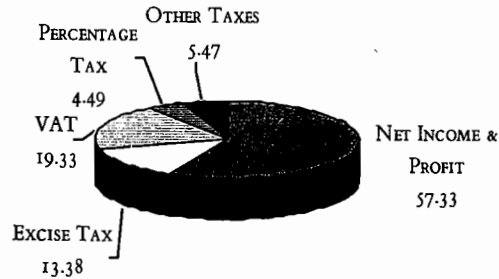
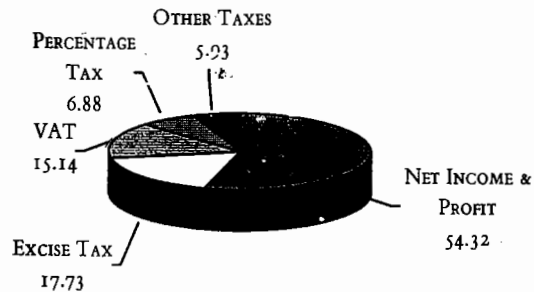


FIG. 7: PERCENTAGE CONTRIBUTION BY MAJOR TAX TYPE (1992-2002)



In addition to this, the withholding tax system has been an effective tool in capturing and monitoring the income taxes of salaried employees. In fact, it was widened to cover income payments to third parties like contractor's fees, broker's commission, professional fees, rentals and other similar payments. (see Figures 8 and 9 below). Furthermore, the simplified net income tax system (SNITS) applicable to individuals practicing their profession which entitles them to claim 40% optional standard deduction was well accepted and effective until it was abolished by the CTRP.

FIG. 8: PERCENTAGE CONTRIBUTION TO TOTAL TAXES: BY CORPORATE INCOME TAX

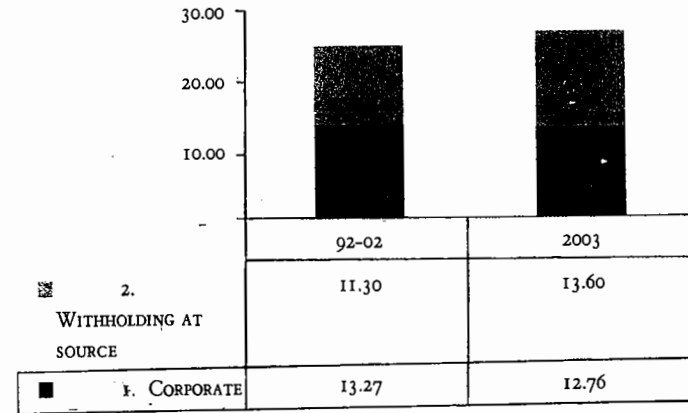
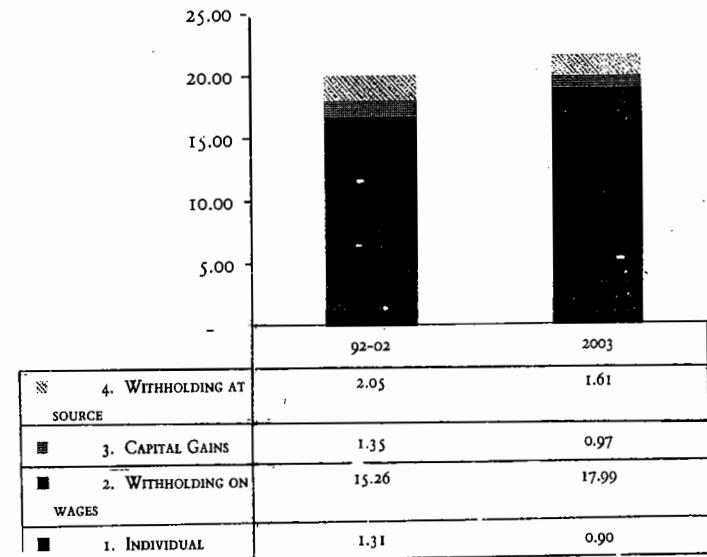


FIGURE 9. PERCENTAGE CONTRIBUTION TO TOTAL TAXES BY INDIVIDUAL INCOME TAX



It must also be noted that the adoption of the VAT system was a progressive idea. The rise of the VAT is an unparalleled tax phenomenon. Every continent

now uses the VAT, and each year sees new countries introducing it.<sup>124</sup> However, the enhancement of the system will depend largely on having a reliable database and benchmarking capability of the tax regulatory agency.

But the seesaw experience between ad valorem taxes and specific taxes is a clear manifestation of differing political and personal interests prevailing in the business environment, and their undue influence in the affairs of government. And although the tax amnesty programs generated the amount of revenues needed at that time, it failed to take advantage of the opportunity to develop a reliable taxpayers' data base.

The incentive system of the country had brought in a substantial amount of foreign investments which created employment in the process. However, there is no data to support that the benefits derived are greater than the revenue foregone. The incentive system currently in place is open ended in terms of the taxes and duties that government is willing to forego. Without an effective monitoring system therefore, abuses remain unchecked, consequently leading to the erosion of the tax base.

The Philippine Institute for Development Studies (PIDS) noted that fiscal incentive could not increase domestic investment, although it could possibly attract foreign investment. Studies, however, show that fiscal incentive system is not a very important factor in a firm's decision to locate in a certain country. A good overall climate for investment, both domestic and foreign, and an expectation of stability and consistency in the economic policy regime can actually be of greater importance than tax exemptions and credits.<sup>125</sup>

The array of tax administration reforms did not bring about efficiency and effectiveness in tax administration. To date, it is more costly to collect taxes. The capacity of the tax agency to collect relevant tax data, to monitor and detect under-payment, non-payment and late payment of taxes, as well as non-filing, late filing and erroneous filing of returns, is seriously wanting. The discretion of both taxpayers and tax enforcers has drastically impaired the capability of government to collect the right taxes.

Instead of improving the tax system, reforms served to complicate it further. The convoluted tax system has produced a double-edged sword as it made tax compliance more difficult for taxpayers and tax implementation and enforcement more inefficient for tax administrators. Under the Tax

124. ALLAN A. TAIT, *VALUE ADDED TAX, INTERNATIONAL PRACTICE AND PROBLEMS* 3 (1988).

125. Erlinda M. Medalla, *Fiscal Incentives*, PIDS Policy Notes, at 2, (Dec. 2002), <http://dirp4.pids.gov.ph/ris/pdf/pidspno218.pdf> (last accessed Aug. 28, 2004).

Code of 1997,<sup>126</sup> there are several types of taxes at varying rates.<sup>127</sup> Furthermore, under the income tax, there are still various sub-types of this tax, which are likewise levied at different rates, namely: the graduated income tax on individuals;<sup>128</sup> the normal corporate income tax on corporations;<sup>129</sup> the minimum corporate income tax on corporations;<sup>130</sup> the special income tax on certain corporations (*i.e.*, private educational institution,<sup>131</sup> FCDU of a local bank or foreign bank,<sup>132</sup> OBU,<sup>133</sup> PEZA-registered enterprise;<sup>134</sup> international air carrier<sup>135</sup> and shipping company;<sup>136</sup> foreign contractor or sub-contractor engaged in petroleum operations;<sup>137</sup> the capital gains tax on sale or exchange of shares of stock of a domestic corporation classified as capital assets;<sup>138</sup> the capital gains tax on sale or exchange of real property classified as a capital asset;<sup>139</sup> the final withholding tax on certain passive investment income paid to residents;<sup>140</sup> the final withholding tax on income payments made to non-residents;<sup>141</sup> the fringe

126. NIRC § 21.

127. Income tax, estate and donor's taxes, value added tax, other percentage taxes, excise taxes, and documentary stamp taxes.

128. NIRC §§ 24(A); 25(A).

129. *Id.* §§ 27(A); 28(A)(1); 28(B)(1).

130. *Id.* §§ 27(E); 28(A)(2); Revenue Regulation 9-98.

131. NIRC § 27(B); Revenue Memorandum Circular 45-95; Department Order (Secretary of Finance) 149-95.

132. NIRC § 27(D); Revenue Regulation 10-98.

133. NIRC § 28(A)(4); Revenue Regulation 10-98.

134. An Act Providing for the Legal Framework and Mechanisms for the Creation, Operation, Administration, and Coordination for Special Economic Zones in the Philippines, creating for this purpose, The Philippine Economic Zone Authority (PEZA), and for other Purposes, Republic Act No. 7916 §§ 24-26 (1994).

135. NIRC § 28(A)(3)(a); Revenue Regulation 15-2002.

136. NIRC § 28(A)(3)(b).

137. *Id.* § 25(E).

138. *Id.* § 24(C); 27(D)(5).

139. *Id.* § 24(D); 25(A)(3); 27(D)(5). 28(B)(5)(c); Revenue Regulation 8-98; Revenue Regulation 13-99; Revenue Regulation 14-2000; Revenue Regulation 7-2003.

140. *Id.* § 24(B)(1); 24(B)(2); 24(C); 24(D); 27(D); 28(A)(7); Revenue Regulation 10-98.

141. *Id.* § 25(A)(2).

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125. Erlinda M. Medalla, *Fiscal Incentives*, PIDS Policy Notes, at 2, (Dec. 2002), <http://dirp4.pids.gov.ph/ris/pdf/pidspno218.pdf> (last accessed Aug. 28, 2004).

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139. *Id.* § 24(D); 25(A)(3); 27(D)(5). 28(B)(5)(c); Revenue Regulation 8-98; Revenue Regulation 13-99; Revenue Regulation 14-2000; Revenue Regulation 7-2003.

140. *Id.* § 24(B)(1); 24(B)(2); 24(C); 24(D); 27(D); 28(A)(7); Revenue Regulation 10-98.

141. *Id.* § 25(A)(2).

benefits tax on fringe benefits of supervisory and managerial employees;<sup>142</sup> the branch profit remittance tax<sup>143</sup>; and the tax on improperly accumulated earnings of corporations<sup>144</sup>.

#### VII. MANAGING THE FUTURE OF TAX COLLECTION

Last 17 May 2004, the Business World<sup>145</sup> reported that the Development Budget Coordination Committee (DBCC) is lining up several new taxes that can help the next government earn an additional P50 billion annually. It proposed measures to the next Congress is to impose a tax on text messaging; a franchise tax on telecommunications; additional taxes on petroleum and cigarettes, and to adopt a corporate gross system of taxation. DBCC expects the tax measures to augment government revenues, which have been perennially short, so they can fund the ever-increasing public spending. Some sectors, however, believe that unless the President musters enough political will in eradicating graft and corruption and prosecuting tax evaders, the introduction of new or higher taxes may remain futile.

Can the proposed new taxes sufficiently trim the government's budget deficit? Will they bring about sustainable growth for the economy? The fiscal problem that the government is currently facing is not simple. It is complicated. It is also critical. It necessitates immediate and appropriate action. It demands a united action between the executive and the legislative. And it also requires public support.

In the past, so much time was spent looking for scapegoats to our revenue and deficit problem. Fingerpointing has become a national pastime and a favorite recipe to a number of misguided politicians who use tax issues for grandstanding. One can surmise that this is not for the common good.

In general, the citizens, and in particular, the taxpayers, have contributed to the problem by refusing to pay taxes properly and in a timely fashion. The apparent reason is the lack of accountability in the use of taxpayers' money.

142. *Id.* § 33(A)-(C); Revenue Regulation 3-98; Revenue Regulation 8-2000; Revenue Regulation 10-2000; *Collector v. Henderson*, 1 SCRA 649 (1961).

143. NIRC §28(A)(5); *Marubeni Corporation v. Commissioner of Internal Revenue*, 177 SCRA 500 (1994), *Bank of America NT & SA v. Court of Appeals and Commissioner of Internal Revenue*, 234 SCRA 302 (1994).

144. NIRC § 29, Revenue Regulation 2-2001, *Manila Wine Merchants, Inc. v. CIR*, 127 SCRA 483 (1984), *Commissioner of Internal Revenue v. Tuason*, 173 SCRA 397 (1989), *Basilan Estate, Inc. v. CIR*, 21 SCRA 17 (1967), *Cyanamid v. CA*, 322 SCRA 639 (2000).

145. Eric S. Boras, *Cabinet Body Lines Up New Taxes*, BUSINESS WORLD, May 17, 2004, at 1.

A survey conducted by the Social Weather Stations<sup>146</sup> in three major metropolitan areas from November 2003 to January 2004 showed that dishonest business practice is pervasive, with only 35% of the respondents saying that all companies in their sector *issue receipts*, only 21% saying that all in their sector *keep only one set of accounts*, and only 15% saying that all in their sector *pay taxes honestly*. The same survey, however, showed that two out of every three firms interviewed say they are willing to join an Anti-Corruption Program Fund and that there is universal agreement on using the fund for prosecution of corrupt officials, protection of whistleblowers, and lifestyle checks.

It is therefore evident that a band-aid solution is hardly the right approach for the tax problem. The approach needs to be far-reaching and holistic if we are to see meaningful and tangible improvement in our fiscal position. There is a need to re-model the current tax system. Furthermore, efforts cannot be solely focused on revenues. Equal attention also needs to be given to management of expenditures.

There are pre-conditions needed before re-modeling the tax system. First, the need for reformation cannot be dictated by any international financing or lending institutions. Rather, the decision to reform the tax system should be a result of a careful study of the desired outcome of reforms compelled by the pristine desire to really address the declining revenues and reduce the deficit. Second, the national leadership with a fresh mandate should have the unwavering political will to undertake the reforms regardless of their lack of popular support. Third, the changes must be rooted in the socio-economic, political, cultural and administrative conditions of the country. Fourth, the government must secure its own financial resources through efficient and effective collection of taxes. Relying too much on foreign investments, loans/borrowings and grants/aids simply breeds complacency and indirectly supports corruption in the system. Fifth, the political leadership must exert extra effort to manage conflicting political, business and personal interests. And last, the new model for the tax system needs to be practical and workable with the goal of producing better results than the present system. It also needs to be dynamic.

Of paramount importance is the adoption of a framework based on appropriate tax policies, which is very much needed to effectively analyze proposals to change a tax rule, as well as to change an entire tax system. In this regard, the American Institute of Certified Public Accountants (AICPA) issued a Tax Policy Concept Statement that contains the ten-principle

146. Mahar Mangahas, TAG Enterprises Survey: Business Willing to Give 3% of Net Income to Anti-Corruption Program Fund (June 11, 2004) available at <http://www.sws.org.ph/> (last accessed Aug. 27, 2004).

framework,<sup>147</sup> which is intended to aid in the development of federal tax legislation. The AICPA acknowledges the importance of these ten-guiding principles and recommends that proposals for changes in tax laws should strive to incorporate *all* ten principles, to wit:

1. *Equity and Fairness.* Similarly situated taxpayers should be taxed similarly.
2. *Certainty.* The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.
3. *Convenience of Payment.* A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.
4. *Economy in Collection.* The costs to collect a tax should be kept to a minimum for both the government and taxpayers.
5. *Simplicity.* The tax law should be simple so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner.
6. *Neutrality.* The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.
7. *Economic Growth and Efficiency.* The tax system should not impede or reduce the productive capacity of the economy.
8. *Transparency and Visibility.* Taxpayers should know that a tax exists and how and when it is imposed upon them and others.
9. *Minimum Tax Gap.* A tax should be structured to minimize noncompliance.
10. *Appropriate Government Revenues.* The tax system should enable the government to determine how much tax revenue will likely be collected and when.<sup>148</sup>

The AICPA poses that the main challenge is dealing with the reality that not all ten of the principles can always be achieved to the same degree for all proposed tax changes. To illustrate, to exclude a particular type of economic benefit from taxation may satisfy the simplicity principle, but not the equity or neutrality principles. The AICPA concludes that the lawmakers must carefully balance the ten principles to achieve an optimal law.

<sup>147</sup>Annette Nellen, *The AICPA's 10 Guiding Principles*, *The Tax Adviser* (Feb 2002), available at <http://www.aicpa.org/pubs/jofa/feb2002/fta.htm> (last accessed Aug. 27, 2004).

<sup>148</sup>*Id.*

## VIII. ACTION POINTS

Re-modeling the tax system is no longer an option – it is the choice. Neither is it a question – it is the answer. Nor is it an alternative – it is the prescription and the bitter pill to swallow. It is not popular. But it is the right thing to do.

A radical and holistic re-modeling of the tax system is necessary to improve the fiscal position of the government. It must cover both tax policy and tax administration. These two are inseparable.

### A. *Re-Modeling the Tax Framework*

In remodeling the tax framework, certain essentials must be taken into account. First, *the framework must embody a new tax vision*. The fiscal requirements of government, as well as the changing business environment here and abroad, necessitate a review of the tax direction and redefinition of the government's tax strategy.

Second, the stakeholders must be identified and their concerns and needs must be addressed collectively, with the three stakeholders being the revenue people, the taxpayers and the government.

Third, the new model of the new tax system must be simple, fair, enforceable, predictable, and sustainable. "Simple" means that the tax law should be easy for taxpayers to understand the rules and to comply with them correctly and in a cost-efficient manner, and must likewise be easily and effectively administered at the least cost to the government. "Fair" means that similarly situated taxpayers should be taxed similarly but equitably. "Enforceable" means that the tax law should be enforceable and easily implemented. "Predictable" means that the tax system should enable the government to determine how much tax revenue will be collected and when they will be collected. "Sustainable" means that the tax system should be capable of collecting the desired revenue for government for a much longer period of time.

Fourth, the tax reform must consist of both tax policy reform and tax administration reform. The former means rewriting the Tax Code, which has become complicated, while the latter means re-engineering the tax regulatory agency to improve its institutional capacity. The new tax system cannot lose sight of the constitutional mandate that it shall be uniform, equitable and progressive. But these principles must be aligned with the fiscal objective of collecting the desired but correct revenues.

Finally, the imposition and implementation of any new tax must be seriously considered, discussed and planned with the tax agency ahead of time. The appropriate budget should be provided at the outset to enable the agency to develop the processes and procedures, train and enhance the

competencies of revenue people, and educate the taxpayers on how to comply with the new tax laws.

*B. Addressing the Fiscal Needs to Establish a Sustainable Tax System*

Government is faced with the challenge of addressing the short-term fiscal needs and establishing a sustainable tax system.

For the short term, it is suggested that the government reconsider its plan to abolish the VAT System. To abolish the same would be a step backward for the Philippines. Alternatively, the VAT system can be made more effective if its monitoring capacity is enhanced and strengthened. Initially, this can be achieved if the tax agency can keep track of the transaction path of VAT taxpayers through third party information.

In addition, government ought to consider the need to understand the sources of revenue and the types of expenses that taxpayers earn and incur to further improve its tracking capability. A segmentation of taxpayers' population may aid in enabling the agency to realize this. At present, large taxpayers are managed and serviced by a separate group. The tax agency may consider creating three additional taxpayers' groups namely: SME taxpayers (small and medium enterprises/companies); individual taxpayers (salaried employees, professionals and single proprietors/entrepreneurs); and government and tax-exempt companies.

Moreover, government must consider establishing on-line data linkages with other regulatory agencies including the Bureau of Customs, Securities and Exchange Commission, Land Transportation Office, Land Registration Authority (LRA-Register of Deeds), Local Government Units (LGUs), and other regulatory agencies. Information is power. If the tax agency has the correct and relevant information, it can effectively and efficiently monitor tax compliance of taxpayers, and in the process, determine non-compliance and below-compliance.

In addition to these, it may introduce presumptive tax to hard-to-tax sectors of the economy such as, but not limited to, taxi and *jeepney* operators, and underground business proprietors. The importance of this is to instill the value that taxpayers, small and large alike, have a stake in the economic development of the country. To complement this, government may allow a reasonable standard optional deduction for professionals and business proprietors as an alternative to itemizing their business expenses. This particular recommendation should however be discussed with Congress to determine whether the same could be done without amending the NIRC.

For the long term, the government may take into account widening the coverage of the VAT by reducing the number of exemptions.<sup>149</sup> The lesser

149. Republic Act No. 8424, §109. *Exempt Transactions*. - The following shall be exempt from the value-added tax:

(a) Sale of nonfood agricultural products; marine and forest products in their original state by the primary producer or the owner of the land where the same are produced;

(b) Sale of cotton seeds in their original state; and copra;

(c) Sale or importation of agricultural and marine food products in their original state, livestock and poultry of or kind generally used as, or yielding or producing foods for human consumption; and breeding stock and genetic materials therefore.

Products classified under this paragraph and paragraph (a) shall be considered in their original state even if they have undergone the simple processes of preparation or preservation for the market, such as freezing, drying, salting, broiling, roasting, smoking or stripping.

Polished and/or husked rice, corn grits, raw cane sugar and molasses, and ordinary salt shall be considered in their original state;

(d) Sale or importation of fertilizers; seeds, seedlings and fingerlings; fish, prawn, livestock and poultry feeds, including ingredients, whether locally produced or imported, used in the manufacture of finished feeds (except specialty feeds for race horses, fighting cocks, aquarium fish, zoo animals and other animals generally considered as pets);

(e) Sale or importation of coal and natural gas, in whatever form or state, and petroleum products (except lubricating oil, processed gas, grease, wax and petrolatum) subject to excise tax imposed under Title VI;

(f) Sale or importation of raw materials to be used by the buyer or importer himself in the manufacture of petroleum products subject to excise tax, except lubricating oil, processed gas, grease, wax and petrolatum;

(g) Importation of passenger and/or cargo vessels of more than five thousand tons (5,000) whether coastwise or ocean-going, including engine and spare parts of said vessel to be used by the importer himself as operator thereof;

(h) Importation of personal and household effects belonging to the residents of the Philippines returning from abroad and nonresident citizens coming to resettle in the Philippines: Provided, That such goods are exempt from customs duties under the Tariff and Customs Code of the Philippines;

(i) Importation of professional instruments and implements, wearing apparel, domestic animals, and personal household effects (except any vehicle, vessel, aircraft, machinery other goods for use in the manufacture and merchandise of any kind in commercial quantity) belonging to persons coming to settle in the Philippines, for their own use and not for sale, barter or exchange, accompanying such persons, or arriving within ninety (90) days before or after their arrival, upon the production of evidence



satisfactory to the Commissioner, that such persons are actually coming to settle in the Philippines and that the change of residence is bona fide;

(j) Services subject to percentage tax under Title V;

(k) Services by agricultural contract growers and milling for others of palay into rice, corn into grits and sugar cane into raw sugar;

(l) Medical, dental, hospital and veterinary services subject to the provisions of Section 17 of Republic Act No. 7716, as amended;

(m) Educational services rendered by private educational institutions, duly accredited by the Department of Education, Culture and Sports (DECS) and the Commission on Higher Education (CHED), and those rendered by government educational institutions;

(n) Sale by the artist himself of his works of art, literary works, musical compositions and similar creations, or his services performed for the production of such works;

(o) Services rendered by individuals pursuant to an employer-employee relationship;

(p) Services rendered by regional or area headquarters established in the Philippines by multinational corporations which act as supervisory, communications and coordinating centers for their affiliates, subsidiaries or branches in the Asia-Pacific Region and do not earn or derive income from the Philippines;

(q) Transactions which are exempt under international agreements to which the Philippines is a signatory or under special laws, except those under Presidential Decree No. Nos. 66, 529 and 1590;

(r) Sales by agricultural cooperatives duly registered with the Cooperative Development Authority to their members as well as sale of their produce, whether in its original state or processed form, to non-members; their importation of direct farm inputs, machineries and equipment, including spare parts thereof, to be used directly and exclusively in the production and/or processing of their produce;

(s) Sales by electric cooperatives duly registered with the Cooperative Development Authority or National Electrification Administration, relative to the generation and distribution of electricity as well as their importation of machineries and equipment, including spare parts, which shall be directly used in the generation and distribution of electricity;

(t) Gross receipts from lending activities by credit or multi-purpose cooperatives duly registered with the Cooperative Development Authority whose lending operation is limited to their members;

(u) Sales by non-agricultural, non-electric and non-credit cooperatives duly registered with the Cooperative Development Authority: Provided, That the share capital contribution of each member does not exceed Fifteen thousand pesos (P15,000) and regardless of the aggregate capital and net surplus ratably distributed among the members;

(v) Export sales by persons who are not VAT-registered;

(w) Sale of real properties not primarily held for sale to customers or held for lease in the ordinary course of trade or business or real property utilized for low-cost and socialized housing as defined by Republic Act No.

the exemptions, the better for the tax agency to track down VAT transactions, thereby improving its monitoring system. The tax credit facility of the VAT is an effective tool in monitoring tax compliance.

Also, it may consider imposing fewer kinds of taxes. A review of the BIR's collections from 1992 to 2003 shows that certain taxes, such as the mining/mineral taxes,<sup>150</sup> tobacco fees,<sup>151</sup> travel tax,<sup>152</sup> among others, may be

7279, otherwise known as the Urban Development and Housing Act of 1992, and other related laws, house and lot and other residential dwellings valued at One million pesos (P1,000,000) and below: Provided, That not later than January 31st of the calendar year subsequent to the effectivity of this Act and each calendar year thereafter, the amount of One million pesos (P1,000,000) shall be adjusted to its present value using the Consumer Price Index, as published by the national Statistics Office (NSO);

(x) Lease of a residential unit with a monthly rental not exceeding Eight thousand pesos (P8,000); Provided, That not later than January 31st of the calendar year subsequent to the effectivity of Republic Act No. 8241 and each calendar year thereafter, the amount of Eight thousand pesos (P8,000) shall be adjusted to its present value using the Consumer Price Index as published by the National Statistics Office (NSO);

(y) Sale, importation, printing or publication of books and any newspaper, magazine review or bulletin which appears at regular intervals with fixed prices for subscription and sale and which is not devoted principally to the publication of paid advertisements; and

(z) Sale or lease of goods or properties or the performance of services other than the transactions mentioned in the preceding paragraphs, the gross annual sales and/or receipts do not exceed the amount of Five hundred fifty thousand pesos (P550,000): Provided, That not later than January 31st of the calendar year subsequent to the effectivity of Republic Act No. 8241 and each calendar year thereafter, the amount of Five hundred fifty thousand pesos (550,000) shall be adjusted to its present value using the Consumer Price Index, as published by the National Statistics Office (NSO).

The foregoing exemptions to the contrary notwithstanding, any person whose sale of goods or properties or services which are otherwise not subject to VAT, but who issues a VAT invoice or receipt therefor shall, in addition to his liability to other applicable percentage tax, if any, be liable to the tax imposed in Section 106 or 108 without the benefit of input tax credit, and such tax shall also be recognized as input tax credit to the purchaser under Section 110, all of this Code.

150. See e.g. An Act Instituting A New System Of Mineral Resources Exploration, Development, Utilization And Conservation, Republic Act No. 7942, Chapter XV, §§83-89.

151. See e.g. NIRC §§144-47.

dispensed with given their insignificant contribution *vis-à-vis* the cost of collecting them. It is imperative that a cost-benefit analysis of administering these taxes be conducted to test their viability as tax measures.

Furthermore, government may establish an independent revenue authority with fiscal and administrative autonomy. This is indispensable in strengthening the institutional capacity of the tax regulatory agency. Tax policies are only as good as their proper administration and implementation. Agency capacity is essential for enforcement.

To reduce the fiscal dependence of LGUs on the national government, it may also consider transferring to the former some national internal revenue taxes like capital gains tax on real properties. Considering that real property tax is currently assessed and collected by LGUs, greater efficiency would be achieved if both are consolidated with the LGUs. This will likewise eliminate the duplicity of zonal value and fair market value as the basis of the capital gains tax.

Government may also grant an absolute tax amnesty. There is a need to start clean. But as a condition, all taxpayers – filers and non-filers – shall be required to file a statement of assets and liabilities and/or clean and audited financial statements, and from these statements the tax agency should establish a data bank.

In addition, government should also address the inequity between salaried employees and professionals/business proprietors. Studies indicate that the effective tax rate of salaried employees is 32% versus only 10% for professionals/business proprietors.

Government should likewise consider merging the Bureau of Customs and the Bureau of Internal Revenue. The BIR's total revenue collections accounts for almost 80% of total revenue collections of the national government. On the other hand, BOC's total revenue collections has gone down to just 10%, more than 50% of which are internal revenues like VAT and excise taxes on imported articles.

The reality is that the government will continue to obtain loans or float bonds for the next three years to fund the budget deficit. The costs of borrowings and the attractiveness of RP bonds are important factors to consider in formulating a tax strategy. Laying the right foundation for a sustainable tax system would be a clear, and probably the best way of

152. See Amending And Consolidating The Provisions On Travel Tax Of Republic Act No. 1478 As Amended And Republic Act No. 6141, Prescribing The Manner Of Collection Thereof, Providing Penalties For Violations Thereof, And For Other Purposes, Presidential Decree No. No. 1183; An Act Instituting a Balikbayan Program, Republic Act No. 6768 (1989).

showing to the international community that the government is really serious about and committed to putting the Philippines back in fiscal shape.

At an appropriate time, there is a need to bridge the short term with the long term tax programs. The realization of the short-term programs will facilitate the transition towards implementing and attaining the long-term programs. It will also prepare both the tax personnel and taxpayers in enforcing and complying with new tax laws and rules.

Re-writing a simple Philippine Tax Code and re-inventing an efficient and performance-based tax regulatory agency may be tough, but it is a highly workable proposition.

### *C. Enhancing the Effectiveness of Government Agencies and Addressing the Budget Deficit Problem*

As mentioned above, no agency of government exists in a vacuum. Thus, to further enhance their effectiveness, and more importantly to help address the budget deficit problem, the government should also consider discontinuing the grant of government guarantees on borrowings of government owned and controlled corporations (GOCCs), scaling down the bureaucracy but improve the competencies and salaries of government employees, and abolishing and/or privatizing GOCCs that are not needed, whose functions are duplicated and better managed by the private sector.

Furthermore, the Country-Wide Development Fund should be revisited and realigned to conform to the new economic programs. The executive and legislative must agree on a proper and responsible way of addressing the needs of the latter's constituents. Lastly, government should spend taxes sensibly, properly and prudently. It ought to equate redistributive taxation to poverty alleviation. Taxing the rich more will not make them poor nor will taxing the poor less make them rich, "because the amounts of income and taxes involved are just too small."<sup>153</sup> This only means that the new tax system will need to ease the plight of the poor or at the least, not make them poorer than they already are. To achieve this, proper spending of public funds in improving basic social services and creating avenues for livelihood for the poor is imperative.

153. BIRD, *supra* note 1, at 49.

## IX. CONCLUSION

Fixing the applicable tax system of the country is not the sole responsibility of government. It is equally shared by the citizens as well. The success of this endeavor depends upon the executive and legislative branches of the government as well as the private sector who are called upon to set aside their own interests in favor of the common good. Indeed, this entails making great sacrifices.

This challenge is posed to every Filipino.

*Ruiz v. Court of Appeals: A Moral Hazard*

A. Edsel C.F. Tupaz\*

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## I. INTRODUCTION

The case of *Corazon G. Ruiz v. Court of Appeals and Torres*<sup>1</sup> appears to be the leading case that lays down the doctrine on unreasonable or exorbitant interest rates. In *Ruiz*, a contract of loan was entered into by and between a private lender and a private borrower. It was stipulated therein that the

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