Package 4
COMPREHENSIVE TAX REFORM PROGRAM

Passive income and financial intermediary tax reform (PIFITA)

Why reform is needed

As of February 5, 2020

http://taxreform.dof.gov.ph/publication/recent-presentations/
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2. Ten reasons why we need to reform the passive income and financial intermediary tax system
   A. Problems
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Goal of the reform

Redesign financial sector taxation to be **simpler, fairer, more efficient, regionally more competitive, and revenue neutral within Package 4 in the short-term.**
Ten reasons why we need to reform the passive income and financial intermediary tax system:

Problems and solutions
Ten reasons why we need to reform the passive income and financial intermediary tax system.

1. To rationalize the **multiple tax rates and bases**
2. To lower the current **high rates**
3. To reduce the **tax burden** of low-income people
4. To deepen the **shallow capital market**
5. To level the **uneven playing field** among financial intermediaries
6. To harmonize the **unequal treatment** on insurance products
7. To reduce the **high friction cost** of documentary stamp taxes (DST)
8. To lower the **high DST on non-life insurance**
9. To lessen **administrative and compliance cost**
10. To broaden the narrow tax base due to **many exemptions and special rates**
Problem 1: Multiple tax rates and bases make the tax structure very complicated, causing arbitrage and unfairness.

1. By product (interest income, dividends, capital gains, banks, insurance, DST)
2. By currency (peso, foreign)
3. By maturity (short-term, long-term)
4. By type of lending (private, public)
5. By issuer (RBU, FCDU, OBU)
6. By taxpayer (individual, corporate)
7. By residency (resident, non-resident)
8. By business status (engaged in business, not engaged in business)
9. Under special laws (43 special laws)
Problem 1: Multiple tax rates and bases making the tax structure very complicated, causing arbitrage and unfairness.

Passive income

<table>
<thead>
<tr>
<th>Type of income</th>
<th>Description</th>
<th>Tax base</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Dividends, cash or property from a domestic source</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Interest on loans outstanding to domestic entities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Capital gains and dividends</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Other income (e.g., Internet service)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Financial intermediaries

<table>
<thead>
<tr>
<th>Type of financial institution</th>
<th>Description</th>
<th>Tax base</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Banks and non-bank Financial intermediaries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Brokers and dealers</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Investment advisors and consultants</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sub-total

<table>
<thead>
<tr>
<th>Sub-type</th>
<th>Description</th>
<th>Tax base</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

DST

<table>
<thead>
<tr>
<th>Description</th>
<th>Tax base</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Draft for discussion. Subject to change.
CTRP – Package 4: Top 10 (as of February 5, 2020)

### Solution 1. Reduce the number of unique rates and bases from 80 to 36.

<table>
<thead>
<tr>
<th>Type of income/financial intermediaries/transactions</th>
<th>Current number of unique rates and bases</th>
<th>Proposed number of unique rates and bases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>80</td>
<td>36</td>
</tr>
<tr>
<td>Tax on capital income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Interest</td>
<td>52</td>
<td>20</td>
</tr>
<tr>
<td>2. Dividends</td>
<td>13</td>
<td>8</td>
</tr>
<tr>
<td>3. Capital gains/STT</td>
<td>17</td>
<td>3</td>
</tr>
<tr>
<td>Tax on financial intermediaries (FIs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Gross receipts tax on banks and non-banks</td>
<td>8</td>
<td>5</td>
</tr>
<tr>
<td>2. Premium tax on FIs</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>3. VAT on other FIs</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>DST on financial transactions</td>
<td>20</td>
<td>11</td>
</tr>
</tbody>
</table>

Draft for discussion. Subject to change.
Problem 2: Among the highest passive income tax rates in the region, reducing competitiveness.

Tax on interest income is generally higher than ASEAN average.

Source: NTRC

Note: The broken line represents the average rate for all countries included in the chart.
Problem 2: Among the highest passive income tax rates in the region, reducing competitiveness.

Tax on dividend of resident individuals is almost double the ASEAN average.

Source: NTRC
Note: The broken line represents the average rate for all countries included in the chart.
Problem 2: Among the highest passive income tax rates in the region, reducing competitiveness.

Tax on capital gains is higher than ASEAN average.

Source: NTRC and Deloitte
Note: The broken line represents the average rate for all countries included in the chart.
Solution 2: Harmonize and generally lower the tax rates.

Generally lower the tax rates on interest income, dividends, equity and debt instruments, insurance, financial institutions, and other financial transactions.
Problem 3: Inequitable distribution of tax burden.

The rich pays lower taxes than the poor.

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Poor</th>
<th>Rich</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax rate on peso interest income</td>
<td>20</td>
<td>0, 5, 12, 20</td>
</tr>
<tr>
<td>Tax rate on foreign currency deposits interest income</td>
<td>Typically does not invest</td>
<td>15</td>
</tr>
<tr>
<td>Tax rate on a portfolio of investment (interest income, dividend, capital gains)</td>
<td>20</td>
<td>0, 10, 15, 20</td>
</tr>
</tbody>
</table>
Solution 3: Harmonize and lower the tax rates on interest income.

Proposed tax rate on interest income

20% → 15%

1. Interest income from short-term deposits are subject to 20 percent.

2. Interest income from long term and foreign currency deposits, where the rich can invest their money, are generally subject to lower tax rates ranging from 0 to 15 percent.
Solution 3: Harmonize the tax on dividends with interest income.

Proposed tax rate on dividend income

10% → 15%

This increase mainly affects the rich but they can reduce the tax exposure by diversifying their investment towards interest income.
# Impact on taxpayer’s passive income

**Call Center Agent**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A</strong></td>
<td>Annual savings from TRAIN: PHP 22,590</td>
</tr>
<tr>
<td><strong>B</strong></td>
<td>Number of earners in household: 2</td>
</tr>
<tr>
<td><strong>C</strong></td>
<td>Total household savings from TRAIN: PHP 45,180</td>
</tr>
</tbody>
</table>

## Regular savings deposit

### Annual interest income:

<table>
<thead>
<tr>
<th>System</th>
<th>C*D</th>
<th>Total interest income for 5 years: Σ_{t=1}^{5} C(1+D)^{t-1}−C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Tax System</td>
<td>2,259</td>
<td>36,230</td>
</tr>
<tr>
<td>Proposed Tax System</td>
<td>2,259</td>
<td>36,230</td>
</tr>
</tbody>
</table>

### Tax rate (percent):

<table>
<thead>
<tr>
<th>System</th>
<th>20%</th>
<th>15%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Tax System</td>
<td>Tax due: PHP 7,246</td>
<td>Tax due: PHP 5,435</td>
</tr>
<tr>
<td>Proposed Tax System</td>
<td>Tax savings: PHP 1,812</td>
<td></td>
</tr>
</tbody>
</table>
**Impact on taxpayer’s passive income**

- **Current Tax System**
  - Proceeds from sale of shares: **PHP 91,400**
  - Tax rate (percent): **0.6%**
  - Tax due: **PHP 548**

- **Proposed Tax System**
  - Proceeds from sale of shares: **PHP 91,400**
  - Tax rate (percent): **0.1%**
  - Tax due: **PHP 91**

**Tax savings:** **PHP 457**
Impact on taxpayer’s insurance cost

Customer analyst (Monthly income: PHP 117,601)

A. Annual savings from TRAIN: PHP 74,041
B. Number of earners in household: 1
C. Total household savings from TRAIN: PHP 74,041

Cost of insurance premiums

**Current Tax System**
- Annual HMO premium: PHP 36,000 (12%)
- Annual car insurance premium: PHP 20,000 (12.5%)

| Tax due: PHP 6,820 |

**Proposed Tax System**
- Annual HMO premium: PHP 36,000 (2%)
- Annual car insurance premium: PHP 20,000 (7.5%)

| Tax due: PHP 2,220 |

Tax savings: PHP 4,600
### Impact on taxpayer’s passive income

#### Assistant Vice President

- **Monthly income:** PHP 200,000

#### (Draft for discussion. Subject to change.)

<table>
<thead>
<tr>
<th>Current Tax System</th>
<th>Investments</th>
<th>Proposed Tax System</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bank deposit</strong></td>
<td><strong>Time deposit</strong></td>
<td><strong>Dividends</strong></td>
</tr>
<tr>
<td>Investment share (percent):</td>
<td>20</td>
<td>40</td>
</tr>
<tr>
<td>Return on investment (percent):</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Annual investment income: $C \cdot E \cdot F$</td>
<td>856</td>
<td>2,053</td>
</tr>
<tr>
<td>Total investment income:</td>
<td>13,722</td>
<td>33,379</td>
</tr>
<tr>
<td>Interest income: $\sum_{t=1}^{E} C(1+D)^{t-1} \cdot C$</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividend income: $\sum_{t=1}^{E} C \cdot D \cdot t$</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax rate (percent):</td>
<td>20</td>
<td>0</td>
</tr>
<tr>
<td>Tax due:</td>
<td>2,744</td>
<td>0</td>
</tr>
</tbody>
</table>

**Tax due:** PHP 5,311

**Tax increase:** PHP 5,604

**Tax due:** PHP 10,915
Problem 4: Shallow equity and debt capital markets.

Local currency bond market is weak compared to our neighbors.
Problem 4: Shallow equity and debt capital markets.

Broad money as a percent of GDP is among the lowest in the region, suggesting shallow capital markets.

![Broad money (M3), percent to GDP](chart)

- Indonesia: 38, 39, 39
- Philippines: 59, 70, 78
- Thailand: 120, 124, 123
- Malaysia: 120, 140, 125

Source: WDI
Problem 4: Shallow equity and debt capital markets.

Market capitalization in equity also very low.

Source: World federation of exchanges as cited in Refran (2017)
Problem 4: Shallow equity and debt capital markets.

Average value turnover also very low.

Average daily value turnover

Source: World federation of exchanges as cited in Refran (2017)
Solution 4: Lower the tax on passive income, and harmonize the tax treatment between equity and debt.

Proposed tax rate on interest income

20% → 15%

Lower the withholding tax rates on all debt instrument to better align with the region.
Solution 4: Lower the tax on passive income, and harmonize the tax treatment between equity and debt.

Proposed stock transaction tax on listed shares of stock

0.6% →

1. To promote investment in the equity capital market, stock transaction tax will gradually be reduced to 0.1% (DOF floor) or 0.0% (HOR version).

2. IPO tax will be removed.

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2021</td>
<td>0.5%</td>
</tr>
<tr>
<td>2022</td>
<td>0.4%</td>
</tr>
<tr>
<td>2023</td>
<td>0.3%</td>
</tr>
<tr>
<td>2024</td>
<td>0.2%</td>
</tr>
<tr>
<td>2025</td>
<td>0.1% (DOF floor)</td>
</tr>
<tr>
<td>2026</td>
<td>removed (HOR version)</td>
</tr>
</tbody>
</table>

Removal of Initial Public Offering (IPO) Tax

1% 2% 4%
Solution 4: Generally lower the tax on passive income, and harmonize the tax treatment between equity and debt.

Proposed capital gains tax on unlisted shares of stock

15% → 15%

No change
Solution 4: Generally lower the tax on passive income, and harmonize the tax treatment between equity and debt.

Proposed final tax on unlisted debt instruments

Regular income tax $\rightarrow$ 15%

Note: Currently, unlisted debt instruments are subject to regular income tax if maturity is at most 5 years. If the maturity is greater than 5 years, it is exempt from tax.
Solution 4: Generally lower the tax on passive income, and harmonize the tax treatment between equity and debt.

Proposed tax on listed debt instruments

To harmonize tax treatment of listed stocks and debt securities and improve equity, a transaction tax of 0.1% (DOF floor) will be introduced but will be removed (HOR version) eventually to promote the development of the debt market.
Problem 5: Uneven playing field among financial institutions (FIs).

Gives advantage to certain sectors.
1. Non-lending income of banks and quasi-banks subject to 7% but other FIs subject to 5%.
2. Lending income of banks and other FIs from long-term instruments are subject to 1% while short-term instruments are subject 5%.
Solution 5: Equalize the tax treatment for all FIs.

Proposed gross receipts tax for banks, quasi banks and non-bank financial intermediaries

To simplify the gross receipt tax (GRT) for banks, non-banks and financial intermediaries, a harmonized rate of 5% on gross receipts will be levied.
Problem 6: Unequal treatment for insurance products with similar nature.

Gives advantage to certain sectors.
1. Life insurance premium is subject to 2% premium tax, but pre-need contribution is subject to 12% VAT.
2. Life insurance levied graduated and fixed DST with P200 as maximum but non-life insurance levied 12.5% DST.

Source: flaticon.com
Solution 6: Harmonize the rates for life and health insurance, and non-life insurance.

Summary of proposed tax on life, health, HMO, and pre-need insurance

2% premium tax on life and health; 12% VAT on HMO and pre-need

To encourage participation on insurance products, a 2% premium tax will be applied on HMO, pre-need and pension plans, which will make it similar to life and health insurance. **Premium tax is appropriate since these products are more of investment, not consumption**
Solution 6: Harmonize the rates for life and health insurance, and non-life insurance.

Proposed tax rate on non-life insurance

12% VAT on non-life insurance

VAT is retained as these insurances are consumption, not investments (but DST will be lowered as explained later).

No change

12% VAT on non-life insurance
Problem 7: High friction cost due to DSTs.

Summary of issues on DST:
1. Not all DST rates are expressed in ad valorem (%) form.
2. DSTs on debt and equity instruments vary.
3. Non-life insurance products have high and varying DST rates.
4. Fees on domestic money transfers are subject to DST.
5. There are multiple “nuisance” DSTs with low revenue take.
Solution 7: Generally harmonize, rationalize or lower the rates on DST.

<table>
<thead>
<tr>
<th>Problem</th>
<th>Solution</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Not all DST rates are expressed in ad valorem (%) form.</td>
<td>1. Express all DST rates in ad valorem (%).</td>
<td>Sec. 179 (debt instruments)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Current: P1.50 on each P200, or fractional part thereof Proposed: 0.75% (no increase in rate)</td>
</tr>
<tr>
<td>2. DSTs on debt and equity instruments vary.</td>
<td>2. Equate DST on debt and equity.</td>
<td>Sec. 174 and 179 (original shares of stock and debt instruments)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Current: 1% and 0.75% Proposed: harmonized at 0.75% (lower for equity, same for debt)</td>
</tr>
<tr>
<td>3. Non-life insurance products have high and varying DST rates.</td>
<td>3. Unify all non-life insurance rates and lower them gradually.</td>
<td>Sec. 184, 185, and 187 (non-life insurance)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Current: 12.5% and 7.5% Proposed: harmonized and gradually lower at 7.5%</td>
</tr>
<tr>
<td>4. Fees on domestic money transfers are subject to DST.</td>
<td>4. Remove DST on domestic money transfer fees to support financial inclusion.</td>
<td>Sec. 180 (bills of exchange domestic to domestic)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Current: 0.3% Proposed: 0%</td>
</tr>
<tr>
<td>5. There are multiple “nuisance” DSTs with low revenue take.</td>
<td>5. Remove “nuisance” provisions with low revenue take.</td>
<td>Sec. 192 and 193 (proxies and powers of attorney)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Current: P 30 and P 10 Proposed: P 0</td>
</tr>
</tbody>
</table>
Problem 8: High DST increases the cost of non-life insurance which results in more Filipinos being underinsured from disaster.

1. DST on non-life insurance is currently very high at 12.5 percent of premiums.
2. Thus, many Filipinos are underinsured on their assets such as houses and cars.
Solution 8: Gradually lower the DST on non-life insurance.

Proposed DST on non-life insurance

12.5% →

2021: 11.5%
2022: 10.5%
2023: 9.5%
2024: 8.5%
2025: 7.5%

To help promote non-life insurance, DSTs on these will gradually be reduced to 7.5%.
Problem 9. High administrative and compliance cost.

1. Tedious and costly to check applicable taxes and remaining maturity every time, especially given bank secrecy law.
2. Prone to tax calculation errors.
3. Opens opportunity for tax avoidance and evasion.
Solution 9: Reduce administrative and compliance cost by simplifying tax policy.

1. Equal tax treatment regardless of maturity, currency, and/or instrument will ease tax compliance and reduce tax calculation errors.

2. The above will also reduce the opportunity for tax arbitrage, avoidance, and evasion.
Problem 10. Narrow tax base due to many exemptions and special rates.

Special laws

There are 43 laws outside the NIRC on passive income.

<table>
<thead>
<tr>
<th>Category</th>
<th>Number of laws</th>
</tr>
</thead>
<tbody>
<tr>
<td>GOCC</td>
<td>8</td>
</tr>
<tr>
<td>GFI</td>
<td>6</td>
</tr>
<tr>
<td>Retirement and savings</td>
<td>5</td>
</tr>
<tr>
<td>Property and housing</td>
<td>3</td>
</tr>
<tr>
<td>Power and water</td>
<td>5</td>
</tr>
<tr>
<td>Agriculture</td>
<td>4</td>
</tr>
<tr>
<td>Cooperatives and basic sectors</td>
<td>3</td>
</tr>
<tr>
<td>OFW</td>
<td>3</td>
</tr>
<tr>
<td>Non-banking</td>
<td>2</td>
</tr>
<tr>
<td>Banking</td>
<td>2</td>
</tr>
<tr>
<td>Special purpose vehicles</td>
<td>2</td>
</tr>
</tbody>
</table>

TOTAL 43
Solution 10. Repeal 33 laws, leaving only 10, but lower rates will mitigate the tax burden.

<table>
<thead>
<tr>
<th>Category</th>
<th>Number of laws</th>
<th>Number to be repealed</th>
<th>Number of laws</th>
<th>Number to be repealed</th>
</tr>
</thead>
<tbody>
<tr>
<td>GOCC</td>
<td>8</td>
<td>8</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>GFI</td>
<td>6</td>
<td>5</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Retirement and savings</td>
<td>5</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Property and housing</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Power and water</td>
<td>5</td>
<td>3</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Agriculture</td>
<td>4</td>
<td>4</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>43</strong></td>
<td><strong>33</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Of the 33 laws to be repealed, 19 are true repeals and 14 are housekeeping, cleaning-up repeals.
Solution 10. Repeal 33 laws, leaving only 10, but lower rates will mitigate the tax burden.

Of the 33 laws to be repealed, 19 are true repeals and 14 are housekeeping, cleaning-up repeals.

<table>
<thead>
<tr>
<th></th>
<th>Number of laws</th>
<th>Number to be repealed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repeal exemption</td>
<td>19</td>
<td>19</td>
</tr>
<tr>
<td>Housekeeping repeals</td>
<td>14</td>
<td>14</td>
</tr>
<tr>
<td>Retain exemption</td>
<td>10</td>
<td>0</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>43</strong></td>
<td><strong>33</strong></td>
</tr>
</tbody>
</table>
Ten reasons why we need to reform the passive income and financial intermediary tax system.

1. To rationalize the **multiple tax rates and bases**
2. To lower the current **high rates**
3. To reduce the **tax burden** of low-income people
4. To deepen the **shallow capital market**
5. To level the **uneven playing field** among financial intermediaries
6. To harmonize the **unequal treatment** on insurance products
7. To reduce the **high friction cost** of documentary stamp taxes (DST)
8. To lower the **high DST on non-life insurance**
9. To lessen **administrative and compliance cost**
10. To broaden the narrow tax base due to **many exemptions and special rates**
Summary of issues that P4 aims to address

1. Multiple tax rates and bases
2. Current high rates
3. High tax burden of low-income people
4. Shallow capital market
5. Uneven playing field among financial intermediaries
Summary of issues that P4 aims to address

6. Unequal treatment on insurance products

7. High friction cost due to DSTs

8. High DST on non-life insurance

9. High administrative and compliance cost

10. Narrow tax base due to many exemptions and special treatment
Proposed solution: PIFITA
I'm also asking Congress to pass the remaining packages of my administration's tax reform program...[including] the rationalization of capital income [taxation].

President of the Republic of the Philippines
Rodrigo Roa Duterte
State of the Nation Address 2019
Batasang Pambansa, Quezon City
July 22, 2019

We have a very complex system for capital income tax. We have 80 taxes applied to capital income, we want to be able to bring it down.

Finance Secretary Carlos G. Dominguez
on Package 4 of the Comprehensive Tax Reform Program
Thank you!

For more information, please visit:

http://taxreform.dof.gov.ph/publication/recent-presentations/

For questions, you may directly email us at:

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