MBC CongressWatch Report
Towards Greater Voter Involvement

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TRABAHO bill, House's version of TRAIN 2

The House Committee on Ways and Means sent its TRAIN 2 bill to the plenary on August 7, 2018. Chairman Dakila Cua named House Bill No. 8083 the "TRABAHO Bill," for Tax Reform for Attracting Better and Higher Quality Opportunities.

TRAIN, or Tax Reform for Acceleration and Inclusion, is the Duterte administration's bid for comprehensive tax reform. TRAIN 1, which lowered most personal income taxes while raising some excise taxes, was signed into law on December 2017. TRAIN 2 aims to "rationalize" corporate incentives while lowering corporate income tax rates.

The government originally proposed to lower the 30% corporate income tax rate by 1 percentage point for every 0.15% of GDP reduction in the estimated cost of incentives, but only until 25%. The government also sought to unify incentives granted by 14 investment promotion agencies, including Philippine Economic Zone Authority (PEZA), into one menu. The proposal included the removal of the 5% tax on gross income that companies were paying instead of the corporate income tax and all other national and local taxes.

The TRABAHO bill deviates from the government's previous proposal by proposing to reduce the corporate income tax rate to 20%. It also aims to encourage investment in the countryside through extended periods of investment perks there.

Advantaged Sectors

The estimated 915,000 businesses, most of which are SMEs currently paying the regular 30% CIT rate, will benefit from the reduced CIT rate. The bill proposes to gradually lower the CIT rate to 20% following a schedule running a period of 10 years. This will also make the Philippines' CIT rate competitive in the ASEAN region.

If passed into law, TRABAHO will also provide additional 2 years of investment perks for businesses relocating from Metro Manila and select areas of Regions III and IV-A, companies investing in lagging areas and recovering from disaster, and agribusinesses locating outside urban areas. Of course, this will greatly benefit lagging regions that are poised for growth with this additional investment incentive.

Businesses with registered projects and activities under the Strategic Investments Priority Plan (SIPP) will also be able to enjoy the tax perks.

With this revised version of the TRAIN 2 bill, the TRABAHO bill is also offering a compromise with proprietary educational institutions and hospitals. These institutions currently pay a 10% special tax rate that was previously threatened to be removed by DOF. Under the TRABAHO bill, this special tax rate can still be enjoyed by schools and hospitals granted they meet certain performance criteria.

Disadvantaged Sectors

The 654 firms that have been enjoying fiscal incentives for more than 15 years will be facing review and assessment, with the possibility of having their perks removed. Of this number, 463 firms are located in PEZA, representing various industries such as the manufacturing, IT, agro-industrial, tourism, and medical tourism sectors. This will come as the TRABAHO bill proposes to scrap the 5% special tax on GIE in lieu of local and national taxes, and to migrate to time-bound, performance-based incentives to be given for 5 years with a possible 2-year extension.

The Philippine Ecozones Association (Philea) has expressed opposition to the changing of current incentives enjoyed by ecozone locators, which are also proposed in the TRABAHO bill. Previously, PEZA and BOI have also discouraged the removal of existing tax perks. Both agencies highlighted the manufacturing sector as the source of most desirable outcomes from the incentives system, especially now with the alignment of the Investment Priorities Plan with the Manufacturing Resurgence Program.

However, despite calls for a longer transition period for companies currently enjoying the ITH and other tax incentives such as the 5% GIE, the TRABAHO bill carried over the original TRAIN proposal of availing the said incentives for a period of no more than 5 years.

Regional Operating Headquarters (ROHQs) and offshore banking units are bound to lose their 10% special tax privilege under the TRABAHO bill, which proposes to subject them to the regular CIT rate two years after the effectivity of the TRABAHO Act.

The details and differences between the current law, the original DOF proposal, and the TRABAHO bill's proposals are as follows:

1. CORPORATE INCOME TAX (CIT) RATE

At present, the CIT rate is at 30%. The DOF originally proposed to reduce the CIT rate by 1 percentage point for every 0.15% of GDP reduction in the cost of granting tax incentives to business investments beginning January 2020. However, the CIT rate must not go lower than 25%. The TRABAHO bill, on the other hand, is proposing to reduce the CIT rate down to 20% by 2029 following the schedule below:

January 2021: 28%
January 2023: 26%
January 2025: 24%
January 2027: 22%
January 2029: 20%

2. TAX AND DUTY INCENTIVES & APPLICATION

At present, there are 14 IPAs that grant their own set of fiscal and non-fiscal incentives, some of At present, there are 14 IPAs that grant their own set of fiscal and non-fiscal incentives, some of which are granted in perpetuity such as the 5% tax on gross income in lieu of the corporate income tax and other national and local taxes. The incentives scheme is governed by 123 investment laws and 192 non-investment laws. For at least 20 years, succeeding administrations have tried to "rationalize" these perks to ensure a more equitable and efficient incentives scheme - one that is easy to administer and monitor.

The matrix below compares the incentives that companies with **registered projects or activities under the Strategic Investments Priority Plan (SIPP)** can choose from under the original DOF and TRABAHO proposals:

Original DOF proposal	TRABAHO bill
OPTION 1 **A.** Income Tax Holiday up to 3 years (compared with current 4 years, extendable by 8 years); **B.** After ITH, avail of the following perks for not more than 5 years including the ITH years: i. Reduced CIT rate of **15%** ii. Up to 50% additional deductions on the increment of direct labor expense iii. **Tax allowance** for investments of up to 50% of actual capital expenditure iv. **200%** additional deduction on R&D v. **200%** additional deduction on trainings vi. Deduction for reinvestment allowance to manufacturing industry vii. **100% deduction on infrastructure development** **C.** Up to 100% duty exemption on capital equipment, machinery and spare parts (subject to conditions) for registered export enterprise qualified for incentives for up to 5 years; and **D.** 100% duty exemption on raw materials (subject to conditions) for registered export enterprise whether inside or outside ecozones/freeports	**OPTION 1** **A.** Income Tax Holiday up to 3 years (compared with current 4 years, extendable by 8 years); **B.** After ITH, avail of the following perks for not more than 5 years including the ITH years: i. Reduced CIT rate of **18%** ii. Up to 50% additional deductions on the increment of direct labor expense iii. Up to **100%** additional deduction on R&D iv. Up to **100%** additional deduction on trainings v. Deduction for reinvestment allowance to manufacturing industry vi. **Depreciation Allowance: 10% for buildings, 20% for machineries and equipment** **C.** *But VAT refund if exporter did not meet the 90% export threshold, or if it is located outside ecozones / freeports; and **D.** Same as DOF proposal *But VAT refund if exporter did not meet the 90% export threshold, or if it is located outside ecozones / freeports.
OPTION 2 Same as Option 1 except exchange income tax holiday to enjoy other Option 1 incentives for five years.	**OPTION 2 (May be granted by BOI on an industry-specific basis)** Same as Option 1 except exchange income tax holiday to enjoy other Option 1 incentives for five years.

**Words in blue indicate the key differences between the two proposals.*

Businesses also called for a long transition/adjustment period for remaining ITH and GIE incentives, however the TRABAHO bill retains DOF's original proposal. As such, tax incentives granted to existing registered activities shall be allowed to continue following this schedule:

- 2 years for activities enjoying the tax incentive for more than 10 years
- 3 years for activities enjoying the tax incentive between 5-10 years
- 5 years for activities enjoying the tax incentive below 5 years

In addition, the TRABAHO bill maintained that VAT shall follow the destination principle where exports are zero-rated while domestic sales are subject to regular VAT rate. This addresses exporters concerns on the TRAIN 2 DOF proposal that suggested the removal of VAT, together with local taxes, from the list of investment tax incentives.

3. <u>ADDITIONAL INCENTIVES FOR ENCOURAGED INVESTMENTS</u>

DOF proposal	TRABAHO bill
OPTION 1 **Incentives for Projects relocating from Metro Manila and selected areas of Regions III and IV-A:** One year of ITH.	**OPTION 1** **Incentives for Projects relocating from Metro Manila and selected areas of Regions III and IV-A:** Additional two (2) years of incentives (one of the Options above), of which one year may be additional year of ITH.
Incentives for Projects located in lagging areas and those recovering from armed conflict or disaster: Superior incentives will be granted to be determined by the SIPP	**Incentives for Projects located in lagging areas and those recovering from armed conflict or disaster:** Additional two (2) years of incentives (one of the options above), of which one year may be additional year of ITH.
NONE	**Incentives for Agribusiness located outside Metro Manila or other urban areas:** Additional two (2) years of incentives (one of the Options above), of which one year may be additional year of ITH.

4. <u>ROHQs</u>

Regional Operating Headquarters currently pay a special CIT rate of 10%. The original DOF is proposing to repeal the special rate, forcing registered ROHQs to pay regular taxes. The TRABAHO bill proposes a two-year phase-out before they migrate to the regular CIT rate.

5. <u>PROPRIETARY EDUCATIONAL INSTITUTIONS AND HOSPITALS</u>

Proprietary education institutions and hospitals which are nonprofit also currently enjoy a special CIT rate of 10%. The DOF originally proposed to repeal this incentive, forcing such institutions to pay regular taxes. The TRABAHO bill, on the other hand, offers to continue granting them the 10% CIT rate provided that they comply with established performance criteria to be determined by

CHED, DEPED and DOH. If they fail to pass the performance criteria, they shall enjoy the 10% rate for two years after the effectivity of the Act, 15% in the succeeding 3 years, and 20% thereafter. To avail of allowable deductions, the TRABAHO bill also requires Private Educational Institutions to meet the performance criteria to be determined by CHED and DEPED.

To avail of allowable deductions, the TRABAHO bill also requires Private Educational Institutions to meet the performance criteria to be determined by CHED and DEPED.

• **FRANCHISE TAX**

In the TRABAHO bill, the telecommunication business is added to the list of industries that will pay a Franchise Tax of 3%.

• **PENALTIES**

Another key feature of the TRABAHO bill that is not part of the original DOF proposal is its proposal to increase penal liability of erring entities by imposing higher fines and longer imprisonment periods. Below are some of the adjustments proposed:

Unlawful Act	Current Law	TRABAHO bill
Failure to File Return, Supply Correct and Accurate Information, Pay Tax Withhold and Remit Tax and Refund Excess Taxes Withheld on Compensation	Not less than P10K	P100K to P1.2M
Penal Liability of Corporations	P50K - P100K	P200K to P2.4M
Unlawful Pursuit of Business	P5K - P20K	P50K to P300K
Failure or refusal to Issue Receipts or Sales or Commercial Invoices, Violations related to the Printing of such Receipts or Invoices	P1K - P50K Imprisonment of 2 to 4 years	P100K - P400K Imprisonment of 4 to 8 years
Unlawful Possession or Removal of Articles Subject to Excise Tax without Payment of the Tax.		
LOWEST RANGE	If appraised value does not exceed P1,000: • P1K - P2K • Imprisonment of 30 to 100 days	If appraised value does not exceed P250,000: • P25K to P75K • Imprisonment of 30 days to 6 months

HIGHEST RANGE	If appraised value exceeds P150K: • P50K - P100K • Imprisonment of 10 to 12 years	If appraised value exceeds P200M: • P50M • Imprisonment of 20 years and 1 day but not more than 30 years

The **MBC CongressWatch Report** is a regular publication of the Makati Business Club. Its main mission is to promote accountability and transparency of elected government officials. For inquiries, suggestions, and additional information, please call CongressWatch at telephone nos. 751-1143 or email roxanne.lu@mbc.com.ph.

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