FREQUENTLY ASKED QUESTIONS on Package 4 of the Comprehensive Tax Reform Program*

I. INTRODUCTION

Q1. What is Package 4 of the CTRP?

A1. Package 4 of the CTRP complements the recently-passed Tax Reform for Acceleration and Inclusion Act (RA 10963) by making the taxation of passive income, financial intermediaries, and financial transactions simpler, fairer, more efficient and regionally more competitive. It covers the following taxes under the National Internal Revenue Code (NIRC) of 1997, as amended:

1. Passive income taxes (on interests, dividends, capital gains on sale of shares of stocks not traded through the local stock exchange);
2. Stock transaction tax (STT) and initial public offering (IPO) tax;
3. Business taxes on financial intermediaries (gross receipts tax, premium tax and value-added tax on certain financial institutions); and
4. Documentary stamp tax (DST) on financial products and transactions.

Q2. What is the contribution of the taxes on passive income, financial services and transactions in the overall tax performance of the government?

A2. Passive income and financial sector taxes provide the government with significant revenue. In 2017, total revenue amounted to PhP214.3 billion, of which PhP107.2 billion or 50 percent came from passive income taxes; PhP47.9 billion or 22.4 percent from business taxes on financial intermediaries; and PhP59.2 billion or 27.6 percent from DST on financial products and transactions.

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Table 1
Tax Collection on Passive Income and Financial Sector: CY 2017

Particulars	Amount (in PhP billions)	Percent of total	Percent of BIR collection	Percent of GDP
Tax on passive income	**107.2**	**50.0**	**6.0**	**0.7**
Interest income	64.8	30.2	3.7	0.4
Dividends	27.9	13.0	1.6	0.2
Capital gains, STT, and IPO tax	14.5	6.8	0.8	0.1
Tax on financial intermediaries	**47.9**	**22.4**	**2.7**	**0.3**
Gross receipts tax	34.1	15.9	1.9	0.2
Premium tax on life insurance	1.6	0.8	0.1	0.0
VAT	12.2	5.7	0.7	0.1
Securities dealers/lending investors	5.9	2.8	0.3	0.0
Non-life insurance	5.1	2.4	0.3	0.0
Pre-need	1.0	0.5	0.1	0.0
Pension fund	0.2	0.1	0.0	0.0
Tax on financial transactions	**59.2**	**27.6**	**3.3**	**0.4**
DST on financial products[a]	59.2	27.6	3.3	0.4
TOTAL	**214.3**	**100.0**	**12.1**	**1.4**

Notes. [a] Excludes DSTs in Sections 189, 190, 191, 192, 193, 194, 196 and 197 of the NIRC as they are non-financial in nature. From BIR, official communication, 2018.

Q3. What are the key tax issues that Package 4 aims to address?

A3. Presently, the country's financial sector taxation is faced with the following issues:

1. **Complicated tax structure**. - Based on the current tax system, there are 80 tax base and tax rate combinations applicable to passive income, financial intermediaries, and financial transactions. The tax on income depends on many factors and conditions such as the type of product, type of lending, issuer, currency, maturity, taxpayer, residency, business status and various special laws. This results in the variations in the tax base and tax rate, even among comparable financial instruments and transactions.

2. **Susceptibility to arbitrage**. - The variations in tax rates and unequal tax treatment of equivalent or comparable financial instruments give rise to arbitrage. Different tax treatment among sectors, or between financial and non-financial institutions offering the same service and/or product, or between interests and dividends, open window for arbitrage and leveraging.

3. **Uneven playing field**. - Current tax system provides certain concessions or different tax treatments of certain transactions for some types of financial intermediaries (FIs) compared to similar transactions of other FIs. For instance, there are exemptions allowed on long-term investments, bank deposits, individual trust funds, and investment management accounts in favor of resident individuals. Such exemptions do not cover long-term savings offered by other FIs, such as life insurance, pre-need/pension plans, investment houses, among others.

   Also, classifications between different FIs cause unequal treatment, considering that some are subject to gross receipts tax (GRT), some are subject to premium tax and others are subject to value-added tax (VAT).

4. **Inequitable distribution of tax burden**. - Investments in equity and some forms of long-term instruments are subject to lower tax rates. Hence, those who have more money to place in these kinds of investments tend to pay lower taxes compared to working class individuals who are content with placing their funds in short-term investments or savings deposits with higher taxes.

5. **Uncompetitive tax system**. – A comparison of taxes in ASEAN member-countries shows that Philippine tax on passive income remains the highest in the region. Considering this, the Philippine capital market remains shallow and uncompetitive, and continues to lag behind ASEAN neighbors.

6. **High administrative and compliance cost**. - Complicated tax structure makes administration and compliance difficult and costly.

7. **Not supportive of capital market development**. – There are a number of taxes on financial transactions that hinder capital market development. Initial public offering (IPO) tax, for instance, is essentially a tax on capital. Such an imposition serves as a deterrent to public listing. This results in the Philippine Stock Exchange (PSE) lagging behind other ASEAN countries in terms of the number of IPOs and market capitalization. Also, the DST which is based on value imposes friction cost and puts heavy toll on compliance. High tax on interest income likewise impedes savings and thrift consciousness.

Q4. Given these issues, what does Package 4 aim to achieve?

A4. Package 4 aims to achieve the following objectives:

1. Provide neutrality in the tax treatment across FIs and financial products;
2. Simplify what has become a complex tax system;
3. Improve equity across investors and savers;
4. Minimize arbitrage opportunities; and
5. Promote capital market development and tax competitiveness within the context of financial globalization, increased capital mobility and financial inclusion.

Q5. What are the proposed reforms under Package 4?

A5. Package 4 proposes the following reforms:

1. **Reduction in the number of withholding tax rates** - From 80 tax base and tax rate combinations applicable to passive income, financial intermediaries and transactions, the number will be reduced to 41.

2. **Unification of tax rates on passive income** - A uniform rate of 15 percent will be imposed on interest income, dividends, and capital gains on the sale of shares of stock, debt instruments and other securities not traded in a local exchange or an organized marketplace. Moreover, some exemptions and preferential tax treatment will be removed to broaden the tax base.

3. **Harmonization of business taxes on financial intermediaries** - A single GRT rate of five percent will be imposed on banks, quasi-banks and other non-bank financial intermediaries. The distinction between lending and non-lending income as well as the maturity of the instrument will be removed. All types of income will be taxed at five percent except dividends and equity shares and net income of subsidiaries which will remain exempt.

   Pre-need, pension, life insurance and health maintenance organizations (HMOs) will be uniformly taxed at two percent of premiums.

4. **Removal or minimization of barriers to capital market development** - The IPO tax will be removed as this is seen to be detrimental to capital market development. It is essentially a tax on capital. Such imposition serves as a deterrent to public listing. This results in the Philippine Stock Exchange (PSE) lagging behind other ASEAN member-countries in terms of the number of IPOs and market capitalization.

5. **Rationalization of DST on financial transactions** - The guiding principles considered in reforming the DST structure are as follows: (a) Express all DST in percent instead of differentiated tax bases and tax rates (e.g. PhP2.00 for every PhP200.00 or fractional part thereof, PhP0.50 on each PhP4.00, etc.) which are not readily comparable; (b) Equalize DST on debt and equity; (c) Unify all non-life insurance rates; (d) Remove DST on domestic money transfers to support financial inclusion; (e) Remove "nuisance" provisions with low revenue take.

6. **Adoption of a regional competitive tax system** - Considering that the Philippine taxes are the highest in the ASEAN region, measures are taken towards the adoption of tax rates comparable to those of ASEAN neighbors and their best practices.

Q6. What is the proposed tax rate for passive income under Package 4?

A6. The proposed tax rate for interest income, dividends, and capital gains is 15 percent or the applicable tax treaty rate (TTR) in case of non-residents. However, inter-corporate dividends will remain exempt.

Q7. How is the proposed tax rate on passive income under the reform arrived at?

A7. The proposed rate of 15 percent is considered as it is the lowest tax on labor income under the TRAIN law. It is also within ASEAN range. In the case of interest income, 15 percent is the dominant TTR in 25 of 42 countries, including ASEAN, with which the Philippines has entered into tax treaty. Likewise, on dividends, 15 percent is the dominant TTR in 33 of 42 countries. Moreover, setting the proposed rate at 15 percent will harmonize it with the current tax rate imposed on foreign currency deposits and capital gains on the sale of shares of stocks not traded through the local stock exchange under the TRAIN law.

Q8. Is it true that lowering the final tax on interest income from 20 to 15 percent will favor large corporations and wealthy individuals?

A8. No. While it is true that the bulk (76 percent) of deposits come from large corporations and wealthy individuals, the reduction in the tax on interest income will benefit almost 75 percent of the total number of deposit account holders who are mostly small savers.

Q9. Why is the exemption of interest income and gains from long-term deposits and investments being repealed?

A9. The thrust of Package 4 is simplification and unification of tax rates, regardless of maturity or term, currency, issuer, recipient, among others, thus, improving equity across investors and savers. The tax on interest income will be lowered from 20 to 15 percent to align it with the tax on interest income on foreign currency deposits which is already taxed at 15 percent under the TRAIN law. Similarly, long-term deposits and investments and those pre-terminated before the fifth year will be uniformly taxed at 15 percent.

Adoption of a single rate is likewise perceived to address high administrative and compliance cost.

Q10. Do the proposed changes invalidate exemption and preferential treatment already granted to interest income and gains on long-term instruments and securities?

A10. No, they do not. The changes will apply prospectively depending on the effectivity of the law. Any tax exemption on interest income and gains granted to long-term instruments and securities prior to the effectivity of the law shall remain.

Q11. Why is the exemption of interest income of foreign currency deposit units (FCDUs) and offshore banking units (OBUs) derived from foreign currency transactions with nonresidents, OBUs and local commercial banks authorized by the Bangko Sentral ng Pilipinas being repealed?

A11. The exemption of interest income derived by FCDUs and OBUs from foreign currency transactions with non-residents was aimed at encouraging the inflow of foreign currency deposits to build up foreign currency reserves and/or properly channel the same to loans and investments in the Philippines. The country is now operating in a very different economic environment compared to when the exemption was first granted. Given the current volume of overseas Filipino workers' remittances and with the liberalization of entry of foreign banks, there is no longer a need for this exemption.

Q12. Why will the tax on dividends of individuals be increased from 10 to 15 percent while inter-corporate dividends will remain exempt?

A12. The proposed increase in the tax on dividends from 10 to 15 percent will align it with the thrust of Package 4 to simplify the present tax system by adopting a single tax rate on all types of passive income. The top 10 percent wealthy families who account for 93 percent of total dividends will be the ones that will be hit by the said proposal. It is to be noted though that they will also benefit from the proposed reduction in the tax rate on interest income from 20 to 15 percent. Hence, when taken as a package, there will be an offsetting in the loss and gain from the tax proposals on various mix of financial products.

On the other hand, the retention of the exemption of inter-corporate dividends is justified because taxing it represents double taxation of corporate profits. For instance, when a company declares corporate profit, it is levied corporate income tax. Any remaining profit after tax that the company redistributes to individual stockholders as dividends are also taxable. These dividends from one corporation to another corporate stockholder would form part of taxable gross income, and hence, subject to corporate income tax.

Q13. What are the reforms on capital gains tax (CGT) on non-traded shares of stock and stock transaction tax on listed and traded shares of stock?

A13. The current 15 percent final tax on capital gains on the sale or other disposition of shares of stock not traded through the local stock exchange under the TRAIN law will remain unchanged. On the other hand, the 0.6 percent stock transaction tax will be reduced gradually annually until it reaches 0.1 percent in 2024 to support capital market development.

The gradual reduction of the tax rate will help deepen the country's capital market since lower transaction cost will encourage higher market participation and greater volume of transactions as well as boost the liquidity that would eventually widen the tax base which will raise revenue for the government.

Q14. Why will the IPO tax be removed?

A14. The IPO tax is imposed only in the Philippines and in Indonesia. It will be removed as this is seen to be a deterrent to public listing. This results in the PSE lagging behind other ASEAN member-countries in terms of number of IPOs and market capitalization.

Q15. Why is there a need to reform the taxation of debt instruments?

A15. The goal is to harmonize the taxation of debt instruments with shares of stock by subjecting those listed and traded through a local exchange or an organized marketplace to a 0.1 percent transaction tax, while those not traded through the local exchange or organized marketplace to 15 percent CGT.

Q16. What are the reforms on the GRT on banks, quasi-banks and other non-bank financial intermediaries?

A16. A single 5 percent GRT will be levied on banks, quasi-banks and certain non-bank financial intermediaries to simplify the tax system of the industry. The rate will apply regardless of maturity of the financial instruments from which the gross receipts are derived and type of income except for dividends and equity shares and net income of subsidiaries which will remain exempt.

Q17. What are the reforms on life and non-life insurance companies?

A17. The taxation of pre-need, pension and HMOs will be harmonized at two percent of premiums. On the other hand, the imposition of VAT on non-life insurance (except crop insurance which is exempt) will be retained.

Q18. Why are life and non-life insurance taxed differently?

A18. While both are engaged on providing insurance services, the intrinsic nature of their business differs. For life insurance, generally, the premium received is not a payment purely for the cost of insurance, but it consists to a large extent of savings which the insured can recover in the future with earnings whereas in non-life insurance, the amount of premium paid is the full cost of insurance service and it can no longer be recovered once the term expires without the happening of the event insured against.

Q19. Why is there a need to rationalize the DST given that it has been recently amended by RA 10963?

A19. RA 10963 or the TRAIN law which took effect on January 1, 2018 merely doubled majority of the DST rates. It was done in order to raise revenue and not to simplify and rationalize the DST structure.

Q20. What are the issues/problems that need to be addressed given the present structure of the DST?

A20. The present DST structure has several deficiencies, namely:

1. Complicated DST structure, given that there are 25 major categories with varying tax rates and bases;
2. High rates which increase friction cost to transactions;
3. Imposition of multiple DST on single document;
4. Imposition of multiple DST on single continuous transaction; and
5. Varied rates for similar documents/instruments/ transactions.

Q21. What is meant by imposition of multiple DST on a single document?

A21. Under the current system, it is possible that multiple DST can be imposed on a single document. For instance, a certificate of shares of stock, is subject to DST at PhP2.00 for every PhP200, or fractional thereof, upon original issuance under Section 174 of the NIRC of 1997, as amended. However, the same document is being subjected to another DST under Section 175 at PhP1.50 for every PhP200, or fractional part thereof, when it is sold or transferred. Likewise, assignment or transfer of mortgage, lease or policy of insurance is subject to the same DST imposed on the original instrument under Section 198 of the NIRC of 1997, as amended.

Q22. How is the imposition of multiple DST on a single document addressed in Package 4?

A22. The reform intends to remove DST on the transfer/sale/assignment of a document/transaction which had already been subjected to the DST upon the original issuance. Specifically, it intends to delete the DST on sales, agreements to sell, memoranda of sales, deliveries or transfer of shares or certificates of stock under Section 175, and the DST on assignments of certain instruments under Section 198. The thrust of the reform is to limit the imposition of DST only upon the original issuance of a document.

Q23. What is meant by imposition of multiple DST on single continuous transaction?

A23. A single continuous transaction refers to transactions consisting of a single act and purpose but may have, as its component, more than one taxable transaction if taken separately.

This is possible when, say, a single importation undergoes two transactions that are both subject to DST – one is the letter of credit (LC), and the other one is the trust receipt. A LC is a letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase. On the other hand, a trust receipt secures indebtedness, pursuant to which a bank retains the ownership title of the goods released to a buyer. The former is currently taxed at PhP0.60 per PhP200.00 of the face value of the instrument or 0.30 percent under Section 182, while the latter is taxed at PhP40.00 if the amount secured does not exceed PhP5,000 and PhP20.00 on each PhP5,000 or 0.80/0.40 percent under Section 195.

Q24. How is the imposition of multiple DST on a single continuous transaction addressed in Package 4?

A24. Package 4 intends to put a condition that in the case of a LC in which the DST imposed under Section 182 is paid upon opening, the same shall not be subject again to DST under Section 195 (renumbered as Section 189 under the bill) on mortgages, pledges and deeds of sale upon availment of the trust receipt line where the property subject of the LC is made a security for payment.

Q25. What is meant by "collective investment schemes"?

A25. The term "collective investment schemes" or CIS means any arrangement whereby funds are solicited from the investing public and pooled together for the purpose of investing, re-investing, and/or trading in securities or other assets or different classes thereof as allowed under the law, which may either have a corporate structure, such as an investment company, or a contractual structure, such as a unit investment trust fund or similar scheme held by a trust corporation or a separate account fund established pursuant to a variable unit linked life insurance policy issued by an insurance company, and such other forms of collective investment schemes as may be determined by the appropriate government regulatory agencies such as the Bangko Sentral ng Pilipinas, the Securities and Exchange Commission and the Insurance Commission. A CIS may either be open-end or closed-end, defined as follows:

"Open-end CIS" means a CIS where securities are offered and are always redeemable by the CIS; and

"Closed-end CIS" means a CIS where a fixed number of securities are offered in an initial public offering and thereafter may be traded in an organized market as determined by the SEC, but may not be redeemed by the CIS. A closed–end CIS shall not be allowed to increase its number of securities.

Examples of CIS are mutual funds (MF), unit-linked investment trust fund (UTIF), and variable unit-linked insurance (VUL).

Q26. What is the current tax treatment of the three types of CIS?

A26. The three types of CIS are currently taxed differently primarily because of their legal structures. Currently, MF companies have corporate structure while UITF and VUL are contractual in nature. Investors in a MF are considered as shareholders. As a result, the original issuance of shares by a MF company is subject to DST of PhP2.00 on each PhP200 or fraction thereof of par value. On the other hand, VUL investors are liable to the graduated fixed DST from exempt to PhP200 depending on the insurable amount, while investors of UITF are liable to PhP30 DST on certificates of confirmation of their investment.

Income of CIS funds from investments such as interest income from bonds, and dividends from shares of stock, among others, is subject to final withholding tax (FWT) rates that range from exempt to 20 percent depending on the type of instruments. Other income not subject to FWT are treated as ordinary income that are subject to 30 percent regular corporate income tax (CIT), except income that are exempt from tax such as trading income from fixed-income instruments with maturity of more than five years.

Gains earned from redemption of MF and UITF are exempt from the tax. On the other hand, gains realized by the policyholder from the redemption of units of share in the VUL are taxable as ordinary income subject to regular personal income tax.

Unlike UITF and VUL, MF companies pay dividends to investors which are subject to FWT at applicable rates.

Q27. What is the proposed tax treatment of the three types of CIS under Package 4?

A27. Package 4 intends to harmonize the tax treatment of MF, UITF and VUL.

Table 2

Summary of Tax Reforms on CIS Under Package 4

Particulars	Proposed Tax Structure
A. Tax Structure	Requires contractual CIS such as UITF and VUL to get a separate tax identification number (TIN) and to file applicable tax returns (CIT, GRT, DST, premium tax, etc).
B. Issuance of shares/units of participation	Imposes a single rate of DST at 0.75 percent of par value on the original issuance of shares of stock or units of participation. In the case of CIS without par value, the taxable base is initial net asset value.
C. Income received from investments	Passive income remains subject to appropriate final tax rates. Other income not subject to final tax shall be subject to CIT.
D. Gains from redemption	Exempts redemption gains from all forms of CIS.
E. GRT	Exempts any form of CIS from GRT or equivalent tax provided that it has at least 1,000 participants/ owners, and its business undertaking is limited to investing/reinvesting/trading in securities.

Q28. What is the estimated revenue impact of Package 4?

A28. Package 4 is broadly revenue-neutral and is projected to bring in additional PhP5.6 billion in revenue in 2019 and PhP3.1 billion in 2020 based on a 70 percent tax efficiency rate. Revenue collections will start to taper off in 2021 as the unified and lower tax rates are set fully in place. The estimates are as of this writing and may be subject to change.

Table 3
Estimated Revenue Impact of Package 4

Particulars	Incremental revenue (PhP billions)			
	2019	**2020**	**2021**	**2022**
Tax on passive income	-4.0	-7.7	-11.6	-15.4
Tax on financial intermediaries	3.6	4.5	5.5	6.6
Tax on financial transactions	-3.3	-4.3	-5.3	-6.5
Repeal of NIRC provisions	10.3	10.6	10.8	11.1
Repeal of special laws provisions	1.3	1.3	1.4	1.5
Grand total	**7.9**	**4.4**	**0.7**	**-2.8**
Grand total (70% efficiency assumption)	**5.6**	**3.1**	**0.5**	**-2.0**

Notes. 1. STT goes down by 0.1 ppt annually from 0.6 percent until it reaches 0.1 percent.
2. The DST on premium on property insurance goes down by 1 ppt annually from 12.5 percent until it reaches 7.5 percent.
3. Excludes DSTs in Sections 189,190, 191, 192, 193, 194, 196, and 197 of the NIRC as they are non-financial in nature.
4. Estimates may be subject to change.