

Profile and Taxation of the Pre-Need Industry in the Philippines*

I. INTRODUCTION

Pre-need plans are significant financial innovations that allow Filipinos to save for future needs like funding expenses for education, retirement, and funeral. However, in the 1990s, a crisis gripped the pre-need industry, which devastated thousands of Filipino planholders and ultimately destroyed the products' reputation to the general public. The government has adopted significant reforms and interventions to revitalize the industry in the past years, but its revival still remains a challenge up to this day.

Long before the pandemic, the government has been pushing for the passage of Package 4 of the Comprehensive Tax Reform Program (CTRP), which aims to make the taxation of passive income and financial intermediary simpler, fairer, more efficient, and regionally competitive. As Filipinos become more aware of the importance of having savings and financial products during the pandemic to help rebuild their lives, Package 4 will provide tax reliefs on pre-need plans to encourage Filipinos to patronize these products and support the revitalization of the industry.

This paper provides basic information on the country's pre-need industry and its tax treatment and the industry's response to the COVID-19 pandemic to serve as valuable input to fiscal policymakers in the deliberation of Package 4 of the CTRP.

II. BACKGROUND INFORMATION

As defined under Republic Act (RA) No. 9829,¹ or the "Pre-Need Code of the Philippines," pre-need plans are contracts, agreements, deeds, or plans for the benefit of the planholders which provide for the performance of future service/s, payment of monetary considerations or delivery of other benefits at the time of actual need or agreed maturity date, as specified therein, in exchange for cash or installment amounts with or without interest or insurance coverage. A pre-need plan is simply a financial program designed to help Filipinos.

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¹ Entitled, "An Act Establishing the Pre-Need Code of the Philippines", (December 3, 2009).

It offers affordable means to prepare for certain future needs such as education for children, pension for retirement, and preparation for funerals. Unlike an insurance policy, a pre-need plan covers inevitable future events, such as old age and death.

Pre-need plans are delivered to the public by pre-need companies through sales counselors. A pre-need company may be a school, memorial chapel, bank, non-bank financial institution, or any other entities that have been duly authorized to sell or offer to sell pre-need plans insofar as their pre-need activities or businesses are concerned. On the other hand, a sales counselor is a natural person engaged in the sale of, or offer to sell, or counsel of prospective planholders for the purpose of selling, whether or not on a commission basis, pre-need plans upon the authority of the pre-need company. (Section 4, RA 9829, 2009)

A. Classification of pre-need plans

A pre-need plan can either be fixed or open-ended (traditional plan). A fixed value plan promises to pay the planholder a definite amount of compensation in the future in exchange for payments based on the guaranteed amount's current value. In this setup, the responsibility of covering the additional cost in case of higher inflation rates and other future shocks is on the planholder. On the other hand, a traditional plan refers to a pre-need plan where the benefits are guaranteed irrespective of the cost of said benefits upon availment of the plan. In this case, it is the responsibility of the pre-need company to cover additional costs brought about by higher inflation rates and other future shocks. At present, the Insurance Commission (IC) no longer grants licenses for selling open-ended policies. However, no law or issuance explicitly prohibits the sale of these policies (Remo, 2013).

Pre-need plans can also be classified in terms of their objects of cover as follows: (Du-Baladad, 2014)

- a. **Life or memorial plan** which guarantees financial protection from sudden expenses (memorial/burial services) in the untimely event of the death of the planholder;
- b. **Pension plan** wherein the planholder is guaranteed pension benefits, which may be received in a lump sum or monthly pension or a combination of both, at the time of their retirement; and
- c. **Educational plan** wherein the planholder, or in this case, the sponsor, pays an amount, in a lump sum or in installment, to cover the future educational expense of the planholder's designated scholar.

B. Regulatory Framework

The country's pre-need industry was then regulated by the Securities and Exchange Commission (SEC) pursuant to Section 16 of RA 8799,² otherwise known as "The Securities Regulation Code." However, RA 9829 transferred the supervision and regulation of all pre-need companies and agents to the IC, as the law recognized that pre-need products are more like insurance rather than investment products. Formally, the IC promulgated the said law's implementing rules and regulations (IRR) on March 8, 2010.

Section 7 of RA 9829 provides that, except upon favorable recommendation from the IC, the SEC shall not accept or approve articles of incorporation and by-laws of any pre-need company. Pursuant to Section 7(a), Rule 3 of the IRR, the IC will recommend registering a pre-need company to the SEC, provided that it complies with the minimum unimpaired paid-up capital required under Section 9 of the law, to wit: (See Table 1.)

Table 1

Minimum Unimpaired Paid-Up Capital for Pre-Need Companies

Particulars	Paid-up Capital
a. A pre-need company incorporated after the effectivity of the Pre-need Code (effectivity December 3, 2009)	P100 million
b. Existing pre-need companies selling	
▪ At least three types of plan;	P100 million
▪ Two types of plan; and	P75 million
▪ One type of plan	P50 million
c. Existing pre-need companies with traditional education plans	P100 million

Note. The IC may impose a higher paid-up capital on a pre-need company and adopt risk-based capital adequacy using internationally accepted standards, depending on the circumstances.

To further protect the planholders, the said law expressly mandates pre-need companies to establish a trust fund per the pre-need plan category to guarantee the delivery of the benefits provided under the pre-need plan contract. It is a fund set up from payments of planholders. A portion of the installment payment amount, as determined by an accredited actuary, will be deposited monthly to the trust fund for the exclusive benefit of the planholders. For pre-need plans paid in full, a minimum of 45% of the payment for life plans and 51% for education and pension plans shall be deposited to the trust fund or such a higher amount as determined by an

² Entitled, "The Securities Regulation Code", (July 19, 2000).

accredited actuary. In case of installment payments, the minimum deposit shall be in accordance with the following schedule: (See Table 2.)

Table 2

Schedule of the Minimum Deposit on Trust Funds for Installment Payments

Installment Payments	Life Plans (In %)	Other Plans (In %)
Collection of the 1st 20% of the contract price	5	5
Collection of the 2nd 20% of the contract price	10	10
Collection of the 3rd 20% of the contract price	70	80
Collection of the 4th 20% of the contract price	70	80
Collection of the 5th 20% of the contract price	70	80

Note. An Act Establishing the Pre-Need Code of the Philippines [Pre-Need Code of the Philippines], RA 9829, Section 31 (2009).

Pre-need companies shall entrust the management and administration of the trust fund to any reputable bank's trust management, a trust company, an investment house, financial institution, or any entity duly authorized to perform trust functions in the country. However, it is also prohibited for a pre-need company with an affiliate trust entity to establish a trust fund (Section 40, IRR of RA 9829). The trustee shall maintain a liquidity reserve³ sufficient to cover at least 15% of the trust fund but in no case less than 125% of the availing plans for the succeeding year. The investments qualified for liquidity reserve include treasury notes or bills, other government securities or bonds, and savings or time deposits with government-owned or commercial banks, among others (Section 39, IRR of RA 9829).

Further, through its Circular Letter (CL) 2015-27, the IC mandates pre-need companies to become members of the Philippine Federation of Pre-Need Plan Companies, Inc. to promote the industry's interest and foster cooperation, discipline, and harmony among such companies.

C. Profile of the pre-need industry in the Philippines

The country's pre-need industry started in the 1960s and has successfully grown into a multi-billion industry that contributed significantly to the growth of the financial sector. However, the industry was caught in a lingering crisis that started in the 1990s as a number of pre-need companies faced liquidity problems and failed to service the maturing plans of their clients. A number of factors

³ It refers to a portion of the trust fund set aside by the trustee to cover benefits due to planholders for the ensuing year. [Section 4(l), RA 9829].

contributed to the deterioration of major pre-need companies, which included a tremendous increase in tuition fees due to its deregulation in 1992; poor management and unsound investment decisions; and the Asian financial crisis that caused huge losses in their investments, among others (Sanchez, 2009). Because of this, the government pursued the rationalization of its legislative framework that gave way to the enactment of the Pre-need Code of 2009.

As of 2019, there were only 17 licensed pre-need companies with a total premium income of P20 billion. This was immensely lower than the more than 200 operating pre-need companies in the late 1990s (Senate of the Philippines, 2013). The total net premium income of the industry generally improved from P13 billion in 2014 to P22 billion in 2019. Still, its net income moved erratically, with the highest amount noted in 2018 at P2.38 billion then it became negative in 2019 due to the increase in pre-need reserves and commissions and other underwriting expenses and a decrease in other direct income and gross investment by the pre-need companies. (Insurance Commission, n.d.). (See Table 3.)

Table 3

Number and Income of Pre-Need Companies, 2014 - 2019

Year	Number of licensed pre-need companies	Total premiums (in billion pesos)	Net income (in billion pesos)
2014	14	13.28	2.00
2015	17	16.27	1.46
2016	18	16.09	1.79
2017	17	17.56	0.36
2018	16	19.53	2.38
2019	17	22.04	(0.30)
Average	16	17.46	1.28

Notes. IC. (2021, December 28). *Key statistical data 2016 – 2020* [Data Set]. Retrieved from <https://www.insurance.gov.ph/key-data/>

IC. (2018, December 28). *Key statistical data 2014 – 2018* [Data Set]. Retrieved from <https://www.insurance.gov.ph/key-data/>

Likewise, the number of pre-need plans sold was unsteady during the period under review. There was an increase from 674,149 in 2014 to 871,772 in 2017, went down to 778,033 in 2018, then up again to 925,370 in 2019. One reason for the said decline was due to one life pre-need company placed under conservatorship in the same year, banning it from selling memorial plans after failing to comply with the capitalization requirements (Vidal, 2018). By type of plans, on average, life plans recorded the highest number of plans sold at 756,620 or 97.81% of the total, followed by pension plans with 16,013 (2.07%), and education plans with 927 (0.12%). (See Table 4.)

Table 4

Number of Pre-Need Plans Sold by Type, 2014 - 2019

Year	Number of plans sold			Total
	Life	Pension	Education	
2014	650,373	22,445	1,331	674,149
2015	671,564	21,684	915	694,163
2016	680,649	16,328	892	697,869
2017	858,023	13,052	697	871,772
2018	764,328	12,859	846	778,033
2019	914,781	9,710	879	925,370
Average	756,620	16,013	927	773,559
% Share to Total	97.81%	2.07%	0.12%	100.00

Notes. IC. (2021, December 28). *Key statistical data 2016 – 2020* [Data Set]. Retrieved from <https://www.insurance.gov.ph/key-data/>

IC. (2018, December 28). *Key statistical data 2014 – 2018* [Data Set]. Retrieved from <https://www.insurance.gov.ph/key-data/>

In 2018, two of the largest pre-need companies in the country, namely St. Peter Life Plan, Inc. and PhilPlans First, Inc., landed a spot in the Top 1,000 Corporations in the Philippines published by BusinessWorld. St. Peter ranked 134th in terms of gross revenue with a total of P19.82 billion and 187th in terms of net income with a total of P1.76 billion. Meanwhile, PhilPlans landed the 518th and 553rd spot in terms of gross revenue (P5.22 billion) and net income (P217 million), respectively. (See Table 5.)

Table 5

Pre-Need Companies in the Top 1,000 Corporations in the Philippines, 2018
(Amounts in Billion Pesos)

Company	Gross revenue		Net income (Loss)	
	Amount	Rank	Amount	Rank
St. Peter Life Plan, Inc.	19.82	134	1.76	187
PhilPlans First, Inc.	5.22	518	0.22	553

Note. BusinessWorld. (2019). *Top 1,000 corporations in the Philippines*. BusinessWorld Publishing.

D. Pre-need companies during the COVID-19 Pandemic

As a response to the COVID-19 pandemic, the government has implemented community quarantine measures in the country, extended in increments beginning March 17, 2020. The pandemic has also temporarily halted almost all economic activities in the country, resulting in an unexpected loss of income for most Filipinos.

To mitigate the pandemic's negative impact on the economy, RA 11469,⁴ otherwise known as the “Bayanihan to Heal as One Act,” was enacted into law on March 24, 2020. The law provided an emergency subsidy to low-income households and individuals, tax reliefs, and a grace period for paying all taxes, loans, and rents, among others. However, premiums were not covered by the mandatory grace period in RA 11469 since these did not represent payments for loan obligations. Nevertheless, the IC encouraged all insurance companies, pre-need, and health maintenance organizations (HMOs) to extend the grace period for the payment of insurance premiums or contributions by at least another 31 days pursuant to CL 2020-18.⁵

On September 9, 2020, the government further enacted RA 11494, or the “Bayanihan to Recover as One” (BARO) Act, to address the unabated spread of the COVID-19 virus in the country and to mitigate the ensuing economic disruption therefrom through the provision of assistance, subsidies, and other forms of socioeconomic relief. One of its policy measures was the implementation of a one-time 60-day grace period for the payment of all existing, current, and outstanding loans falling due, or any part thereof, on or before December 31, 2020, including but not limited to salary, personal, housing, commercial, and motor vehicle loans, amortizations, financial lease payments, and premium payments, as well as credit

⁴ Entitled, “An Act Declaring the Existence of a National Emergency Arising from the Coronavirus Disease 2019 (Covid-19) Situation and a National Policy in Connection Therewith, and Authorizing the President of the Republic of the Philippines for a Limited Period and Subject to Restrictions, to Exercise Powers Necessary and Proper to Carry Out the Declared National Policy and for Other Purposes”, (March 24, 2020).

⁵ Entitled, “Guidelines Regarding the Extension of Grace Period of All Insurance, Pre-Need and HMO Policies/Plans/Agreements due to COVID-19 Corona Virus Outbreak in the Philippines”, (March 23, 2020).

card payments without incurring interest on interests, penalties, fees, or other charges and thereby extending the maturity of the said loans. (Underscoring supplied) Unlike RA 11469, the BARO Act expressly provided for a one-time 60-day grace period covering the premium payments for pre-need plans.

To further implement the one-time 60-day grace period, the IC issued CL 2020-95,⁶ which provided that the said payment moratorium must be implemented by insurance companies and mutual benefit associations, providing life insurance policies and pre-need companies until the prescribed period of December 31, 2020. Also, there shall not be any charge or apply interest on interests, penalties, fees, or other charges during the said grace period to future premium or installment payments of policyholders or planholders.

III. TAXATION OF PRE-NEED

Under the National Internal Revenue Code (NIRC) of 1997, as amended, pre-need companies are subject to the following taxes: (See Table 6.)

A. Income Tax

The income of pre-need companies is generally in the form of premium income from the sale of pre-need plans and operating fees and commissions. In general, as corporations, pre-need companies are liable to the corporate income tax (CIT) of 30%⁷ imposed upon taxable income derived during each taxable year from all sources within and without the Philippines pursuant to Section 27(A) of the NIRC of 1997, as amended.

Meanwhile, a minimum corporate income tax (MCIT) of 2%⁸ of gross income is imposed beginning on the fourth taxable year immediately following the year in which a company commenced its business operations if the MCIT is greater than the computed RCIT and shall be paid in lieu thereof. Any amount of the MCIT paid in excess of the RCIT shall be carried forward and credited against the RCIT for the three immediately succeeding years.

⁶ Entitled, "Guidelines in the Interpretation and Application of Section 4(uu) of Republic Act No. 11494, Otherwise Known as the "Bayanihan to Recover as One Act", (October 1, 2020).

⁷ Under the Corporate Recovery and Tax Incentives Enterprises (CREATE) Act Bill, the CIT rate will be reduced from 30% to 25% retroactive to July 1, 2020 and will further be reduced by 1% annually in the next six years until it reaches 20% by 2027 onwards. On the other hand, where the corporation's net income does not exceed P5 million and its total assets do not exceed P100 million (excluding land where the business is situated), the tax rate shall be 20%.

⁸ Under the CREATE Act Bill, the MCIT rate will be reduced to 1% effective July 1, 2020 until June 30, 2023.

With regard to the income from investments and other passive income, the taxation is the same with other corporations as they basically invest in the same kind of securities. The investment income of pre-need firms is subject to a final withholding tax (FWT) which ranges from exempt to 20%, depending on the type of security and passive income such as interests, dividends, and capital gains. For example, the interest income of a regular peso deposit of pre-need companies is subject to 20% FWT; capital gains from the sale of unlisted shares of stock are subject to 15% Capital Gains Tax; sale, barter, or exchange of shares of stock listed and traded through the local stock exchange is subject to 0.60% Stock Transaction Tax; and intercorporate dividends are exempt from income tax.

B. Value Added Tax

Pre-need plans are subject to the 12% value-added tax (VAT) based on the gross receipts from premiums or payments received from planholders, net of actual trust fund contribution as provided by BIR Ruling [DA-027-06]. As service providers, the gross receipts of pre-need companies for VAT purposes should only be the premium or payment collected from the planholders, excluding the mandated amount of trust fund contributions. Therefore, such an amount of trust fund does not form part of the gross receipts of the pre-need companies to determine their gross receipts subject to the then 10% VAT (now 12%) (BIR Ruling [DA-027-06], 2006).

The amount contributed to the trust fund must be indicated in the VAT official receipt issued by the pre-need company to its planholders as a requirement for exemption. Failure to comply would render the entire amount subject to the VAT (RMC 13-96,⁹ 1996).

C. Documentary Stamp Tax

Pre-need plans are also subject to a documentary stamp tax (DST) of P0.40 on each P200.00 (0.20%), or fractional part thereof, of premium or contribution collected pursuant to Section 186 of the NIRC of 1997, as amended.

⁹ Entitled, "Classification of Issues Affecting Dealers in Securities and Lending Investors under Republic Act No. 7716, Otherwise Known as the "Expanded VAT law", (January 15, 1996).

Table 6*Summary Tax Treatment of Pre-Need Plans*

Type of Tax/Section in the NIRC	Rate
CIT or MCIT [Sections 27(A) and 27(E)(1)]	30% or 2%*, whichever is applicable;
FWT on passive income [Sections 27(D)(1), 27(D)(2), 27(D)(4), 27(D)(5), and 127]	<ul style="list-style-type: none"> • 20% - interest from deposits and yield or any other monetary benefit from deposit substitutes, trust funds, and similar arrangements and royalties. • 15% - capital gains from the sale of shares of stock not traded in the stock exchange; • Exempt - intercorporate dividends; and • 0.60% - a tax on the sale, barter, or exchange of shares of stock listed and traded through the local stock exchange.
VAT (Section 109)	12% based on the gross receipts
DST (Section 186)	P0.40 on each P200.00 (0.20%)

Note. * Under the CREATE Act Bill, the CIT rate will be reduced from 30% to 25% retroactive to July 1, 2020, and will further be reduced by 1% annually in the next six years until it reaches 20% by 2027 onwards. On the other hand, where the corporation's net income does not exceed P5 million and its total assets do not exceed P100 million (excluding land where the business is situated), the tax rate shall be 20%.

Of the major taxes, the total collections from pre-need companies increased from P890 million in 2015 to P1.43 billion in 2019. On average, P830 million (66.11%) was paid as VAT, P360 million (28.63%) as CIT, P70 million (5.82%) as FWT, and the remaining P40 million as DST (3.00%). (See Table 7.)

Table 7

*Tax Collection from the Pre-Need Industry by Type of Major Taxes, 2015 – 2019
(Amounts in Billion Pesos)*

Year	CIT	FWT	VAT	DST	Total
2015	0.29	0.01	0.57	0.02	0.89
2016	0.16	0.05	0.67	0.02	0.90
2017	0.26	0.08	1.05	0.07	1.47
2018	0.66	0.18	0.86	0.04	1.74
2019	0.41	0.05	0.98	0.04	1.43
Average	0.36	0.07	0.83	0.04	1.25
% Share, to Total	28.63	5.82	66.11	3.00	100.00

Note. BIR. (official communication, various years).

IV. PROPOSALS UNDER PACKAGE 4 OF THE CTRP

As previously mentioned, Package 4, also known as the “Passive Income and Financial Intermediary Taxation Act (PIFITA)” of the CTRP, aims to achieve a simpler, fairer, more efficient, and regionally competitive tax system for passive income and financial intermediaries to support capital market development. The PIFITA, or House Bill (HB) No. 304, was approved on the third and final reading at the House of Representatives on September 9, 2019, and is being deliberated at the Senate of the Philippines. Below are the proposals under HB 304 affecting pre-need activities:

A. On Business Tax

Package 4 aims to harmonize the taxation of pre-need plans and health maintenance organizations by subjecting these to the 2% premium tax, similar to that of life insurance, in lieu of the 12% VAT. The rationale behind the said proposal is that both products are similar to life insurance than that of non-life since pre-need products mainly deal with human lives.

The proposed 2% gross premium will be imposed on the gross premium, plan payment, or installment payments collected without deduction for the amounts required by the appropriate government regulatory agencies to be earmarked for the benefit of the insured or planholder.

The Philippine Federation of Pre-Need Plan Companies, Inc. is in support of the proposed harmonization/alignment of business taxes among pre-need and life insurance companies as this will put the pre-need and life insurance products on an even playing field considering that both cater to the protection and savings needs of

individuals. Aside from providing a level playing field, the alignment will greatly simplify the tax calculation on the part of the company as well as easier verification on the part of tax authorities. Also, the harmonization makes good sense since both industries are under the regulation of the IC (Philippine Federation of Pre-Need Plan Companies, Inc., 2019).

B. On deductibility of reserve funds

Presently, only insurance companies, whether domestic or foreign, doing business in the Philippines, are allowed for special deductions of net additions, if any, required by law to be made within the year to reserve funds from their gross income pursuant to Section 37(A) of the NIRC of 1997, as amended. Thus, to further harmonize the taxation of life insurance products with products akin to the same, HB 304 proposes to expand the said tax privilege by including pre-need companies.

C. On investment income

There are differentiated final tax rates imposed on passive income derived by a pre-need company. A single final tax rate of 15% will be imposed regardless of whether or not the said income is in the form of interests, dividends, and capital gains (on the sale of shares of stock and debt instruments not traded through the local exchange), while intercorporate dividends will remain exempt.

D. On DST

HB 304 will retain the DST on pre-need products at 0.20% based on the premium or contributions collected.

Table 8

Proposed Reforms on the Taxation of the Pre-Need Industry Under Package 4

Particulars	Proposed Reforms
A. Business tax	The shift from 12% VAT to 2% premium tax
B. Special allowed deductions	Net additions, if any, as required by law to be made within the year to reserve funds may be deducted from gross income.
C. Income received from investments	Passive income will be subject to 15% final tax; except intercorporate dividends, which will remain exempt.
D. DST	No change

Although the proposed 2% premium tax on pre-need plans will result in revenue loss, Package 4, however, is anchored on a broadly revenue-neutral framework wherein there will be no change in the amount of revenue coming into the government's coffers as it is offset by corresponding cuts or increases within the said tax reform. It is noted that the main purpose of Package 4 is not to collect funds for the government but to fix the tax system so as to deepen the capital market and encourage financial inclusion.

Moreover, reducing some taxes on pre-need plans under Package 4 will make these products more affordable for Filipinos, thereby allowing them to invest thereon and safeguard their future. To some extent, the proposed reform will help revitalize the pre-need industry.

V. CONCLUSION

With the government's initiatives to revitalize the industry, more Filipinos are slowly regaining their confidence in pre-need products, judging from the steady growth of pre-need plans sold in recent years. The pandemic also highlighted how crucial it is to have safety nets in case of unexpected costs or expenses, especially for the most vulnerable.

Package 4 of the CTRP or the PIFITA pushes for the shift of the tax treatment of pre-need plans from the current 12% VAT to 2% premium tax to place them on equal footing with life insurance companies as both industries are in the life insurance business. The said tax reform would make pre-need plans more affordable, thereby encouraging more Filipinos to invest thereon and safeguard their future needs.

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