I. INTRODUCTION

A tax subsidy is a form of fiscal privilege under which taxes and duties due from an entity are assumed by the government through a budgetary appropriation, pursuant to the provisions of the General Appropriations Act (GAA), enacted on an annual basis by Congress and administered by the Department of Budget and Management (DBM). As a rule, an entity eligible for tax subsidy may be a national government agency (NGA), a government-owned and/or-controlled corporation (GOCC), or a local government unit (LGU). Private entities are not eligible for tax subsidy in view of the Constitutional prohibition on the use of public funds for private undertakings. For GOCCs, applications for tax subsidy are cours ed through the Fiscal Incentives Review Board (FIRB), an inter-agency committee created under Presidential Decree (PD) No. 776 on August 24, 1975. On the other hand, NGAs and LGUs file their tax subsidy applications directly with the DBM.

The grant of tax subsidy is intended to enable government entities to have enough financial flexibility by relieving them of the burden of taxes and duties so that they can concentrate their resources on other activities that will achieve their socio-development objectives. It is also made to augment the operational needs of certain government entities whose operations have significant contribution to economic growth and development.

Pursuant also to Executive Order (EO) No. 93 (issued on December 17, 1986 and effective on March 10, 1987), the grant of tax subsidy is preferred over outright tax and duty exemptions for reasons of fiscal transparency. Tax subsidies can be evaluated and monitored to enable the government to determine their fiscal and related repercussions. In contrast, there are monitoring problems as regards tax and duty exemptions.

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1 Prepared by Marcelino B. Obias, Jr., Senior Tax Specialist, Fiscal Incentives Branch, NTRC.

1 GOCCs are corporations which are generally created through an act of Congress. They may be classified into two principal types: (a) the wholly-owned corporations; and (b) those which operate under government control with private sector capitalization. Most GOCCs are engaged in commercial, financial and industrial activities.
Finally, tax subsidy promotes fiscal discipline since the applicants are aware that this is one of the criteria used, particularly by the FIRB, in deciding whether or not to grant the request for subsidy.

This study, therefore, determines the impact of tax subsidy on fiscal discipline, the latter being construed as an improvement in revenue generation and/or streamlining of expenditure of GOCCs. The general objective of the study is to enable the government to formulate policies to improve the effectiveness of tax subsidy as a means to achieve fiscal discipline.

II. BACKGROUND INFORMATION

A. Tax Subsidy: Historical Background

Prior to EO 93, GOCCs were generally granted tax and duty exemptions by their respective charters. However, these tax privileges were repealed by PD 1177 (July 30, 1977) and PD 1931 (June 11, 1984) due to emerging fiscal exigencies of the government. Tax and duty exemption privileges had resulted not only in serious tax base erosion but in a distortion in the tax treatment of similarly-situated enterprises. While PD 1931 provided for a mechanism for the partial or total restoration of withdrawn tax privileges through the action of the President and/or the Department of Finance (DOF) upon the recommendation of the FIRB based on certain criteria, some withdrawn tax and duty incentives were restored without the benefit of FIRB review through Presidential issuances. This resulted in the recurrence of the previous system of too many exemptions that diminished government revenues which could have been utilized for development purposes. As a consequence, tax base erosion, distortion in the tax system and manipulation/avoidance persisted, impairing the revenue mobilization effort of the government.

With the advent of the Aquino administration in 1986 and as part of its economic reform program, the fiscal incentive system (which was included in the 1986 Tax Reform Package) was rationalized in view of the country’s requirements for socio-economic development. As an initial step, EO 93 was issued withdrawing all tax and duty incentives granted to government and private entities with certain exceptions.

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2 The criteria involved the evaluation of the impact of the operations of the entities on such factors as price, income, employment, foreign exchange, among others. Through the review mechanism of the FIRB, 38 Resolutions were issued restoring tax and duty exemptions of certain entities.

3 These issuances consisted of ten (10) PDs, eight (8) Letters of Instruction (LOIs), four (4) Executive Orders, one (1) Presidential Proclamation, one (1) Memorandum Order, and two (2) marginal notations. (NTRC, “Guidelines for Reforming the Philippine Fiscal Incentive System,” August 20, 1988).

4 Exceptions were granted to enterprises registered with the Board of Investments pursuant to PD 1789, as amended; Export Processing Zone Authority under PD 66, as amended, and the Phividec Industrial Authority under PD 538, as amended; those provided under the National Internal Revenue Code, Tariff and Customs Code, Real Property Tax Code and Local Tax Code; those provided under international agreements; those
general objective in removing all tax and duty exemptions is predicated on the need to restore efficiency and equity in the fiscal incentive system. The FIRB was given, among others, the responsibility of restoring the withdrawn tax and duty exemptions, revising their scope and coverage, and imposing conditions for the restoration thereof.

The convening of Congress on July 27, 1987 has relieved the FIRB of the function to restore tax and duty exemptions granted to GOCCs because such function is legally vested on the former. The FIRB, however, continues to evaluate applications for the restoration of tax and duty exemptions and submit its recommendations to proper authorities.

One of the significant features of EO 93 is the institutionalization of the grant of tax subsidy as a more effective system of assistance to deserving government entities in lieu of outright tax and duty exemptions. As envisioned, the subsidy system provides funds, withdrawable against the Tax Expenditures Fund (TEF), to qualified beneficiaries to be used by them to discharge their tax and duty obligations. As implemented, however, tax subsidy is merely a wash transaction with no cash outlay since the subsidy is recorded both as an expenditure of the national government and income of the revenue collecting agency, i.e., the Bureau of Internal Revenue (BIR) or Bureau of Customs (BOC), as the case may be.

The system of tax subsidy is implemented by the FIRB in the case of GOCCs and the DBM in the case of NGAs and LGUs, pursuant to the provisions of Joint DOF and DBM Circular Nos. 4-87, 3-90 and 2-91 (Rules, Guidelines and Procedures for the Implementation of Subsidy) and the annual GAA. In this respect, NGAs and LGUs in need of tax subsidy apply directly with the DBM, while GOCCs course their application through the FIRB.

The system of tax subsidy was introduced in 1987 with the issuance of Joint DOF and DBM Circular No. 4-87 (April 1, 1987) implementing the provision of subsidy under the terms and conditions of EO 93. However, due to some transitional constraints, the system of tax subsidy was only put in place in 1988.

From 1988-1990, the tax subsidy of NGAs, GOCCs and LGUs was charged against a TEF – a yearly appropriation entered in the Unprogrammed Fund portion of the GAA and administered by the DBM. The TEF is set up by the DBM based on the requirements for taxes and duties of NGAs, GOCCs and LGUs which are reflected in their respective budget proposals. In 1988, when the TEF was first operationalized, its appropriations amounted to P4.2 billion; in 1989, P1.0 billion; and in 1990, P3.2 billion. Actual utilization of the TEF, however, amounted to P1.0 billion in 1988 and 1989 and P1.3 billion in 1990. The bulk of subsidy availment for the period 1988-1990 covered previous years’ tax and duty liabilities of GOCCs which were incurred under the deferred payment scheme\(^5\) (Table 1).

\(^5\) The deferred payment scheme was phased out in 1990 in view of the many problems associated with it, e.g., unwarranted fiscal leakages, inability of revenue collecting agencies to enforce collection of taxes and duties, etc.
Table 1. AMOUNT AND ACTUAL UTILIZATION OF THE TEF, 1988-1990
(In Billion Pesos)

<table>
<thead>
<tr>
<th>Year</th>
<th>TEF</th>
<th>Utilized</th>
<th>% of TEF</th>
<th>Unutilized</th>
<th>% of TEF</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>NGAs and LGUs</td>
<td>GOCCs</td>
<td>Total</td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>4.20</td>
<td>0.40</td>
<td>0.60</td>
<td>1.00</td>
<td>24</td>
</tr>
<tr>
<td>1989</td>
<td>1.00</td>
<td>-</td>
<td>1.00</td>
<td>1.00</td>
<td>100</td>
</tr>
<tr>
<td>1990</td>
<td>3.20</td>
<td>-</td>
<td>1.30</td>
<td>1.30</td>
<td>41</td>
</tr>
<tr>
<td>Total</td>
<td>8.40</td>
<td>0.40</td>
<td>2.90</td>
<td>3.30</td>
<td>5.10</td>
</tr>
<tr>
<td>Average</td>
<td>2.80</td>
<td>0.13</td>
<td>0.97</td>
<td>1.10</td>
<td>39</td>
</tr>
</tbody>
</table>

Source: FIRB

The low utilization ratio of the TEF in 1988 (i.e., 24%) was due to the fact that the Rules and Regulations to Implement the Subsidy Provision under EO 93 were approved only towards the end of the year.

It was because of this low utilization ratio that the TEF appropriation in 1989 was drastically cut down to P1.0 billion. The TEF utilization in the same year was 100%, with only GOCCs availing of the tax subsidy.

In 1990, in view of the budget deficit, actual utilization of the TEF amounted to P1.3 billion, representing about 41% thereof. This amount was purely utilized by GOCCs since the tax subsidy provisions to NGAs and LGUs were made available through the deemed-automatically appropriated provision of the GAA, making it effectively open-ended.

Starting 1991, the tax subsidy to GOCCs was put in the same situation as the tax and duty provisions to NGAs and LGUs which were not subject to any specific limitations/ceilings, in contrast with the specified TEF earlier mentioned. Thus, the subsidies became more flexible. With an open-ended provision, tax subsidy can respond immediately to the GOCCs’ requirements specially if such were not anticipated and/or programmed.

Despite the open-ended provision of tax subsidy in the GAA, the FIRB, as an internal policy, has adopted a working cap thereon starting 1990. This cap, however, was formalized in 1993 at a level of P2.2 billion. In 1994, the cap was pegged at P2.2 billion and was reduced to P1.7 billion in 1995. In 1996, the ceiling was P1.2 billion. This was reiterated in 1997.
In 1998, the government suspended the provisions of tax subsidy by virtue of Administrative Order (AO) No. 372 (December 27, 1997), as part of its economy measures, in the light of the financial crisis that affected the country and the entire Asian region. For consistency, the President on February 14, 1998 also vetoed Section 13 of the General Provisions of Republic Act (RA) No. 8522 (1988 GAA). The veto removed the budgetary appropriation basis for the grant of tax subsidies. In effect, the payments of national internal revenue taxes as well as customs duties and taxes on the importations of GOCCs were absorbed by them from their own funds. Accordingly, GOCCs were directed to set aside a part of their revenues to meet their tax and duty liabilities.

In 1999, the tax subsidy provisions were revived pursuant to RA 8745 or the 1999 GAA but only on a limited basis. GOCCs qualified for tax subsidy were the Light Rail Transit Authority (LRTA), Home Development Mutual Fund (HDMF), National Food Authority (NFA), insofar as its tax and duty liabilities for 1988 were concerned, and the specialty hospitals, namely, the Philippine Heart Center (PHC), National Kidney and Transplant Institute (NKTI), Lung Center of the Philippines (LCP) and the Philippine Children’s Medical Center (PCMC).

For the year 2000, the GAA (RA 8760) again identified the GOCCs qualified for tax subsidy. These are the LRTA (Metro Manila Strategic Mass Rail Transit Development-Line 2 Package 4), HDMF, NFA for its 1999 tax and duty liabilities, Cultural Center of the Philippines (CCP) and the specialty hospitals.

B. Scope and Coverage of Tax Subsidy

The tax subsidy provisions to GOCCs cover income tax, premium tax, value-added tax (VAT) and excise taxes and taxes and duties on importations of equipment, materials, spare parts, supplies, etc. (Table 2). The importations of GOCCs are usually acquired through grants, donations, loan proceeds or commercial means. Most GOCCs availed of tax subsidy to cover the taxes and duties due on such importations. The HDMF requested for tax subsidy to cover its income tax liabilities to enhance its financial effectiveness in the different areas of its mandated activities particularly in the provision of socialized housing and dividend distribution. Commissary stores (AFPCES and PNPSSS) availed of tax subsidy to cover their liabilities to VAT and excise tax on local purchases, including income tax to lower the prices of goods traded by them for the benefit of commissary members. On the other hand, the tax subsidy to the Philippine Crop Insurance Corporation (PCIC) covered premium tax to support its social amelioration program to assure farmers of continuing provisions of crop and livestock insurance and guarantee program at affordable prices to them.

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6 Pursuant to Joint DBM and DOF Circular No. 3-98 (March 3, 1998) implementing the suspension of tax subsidies.

Tax Subsidy as an Instrument of Fiscal Discipline
### Table 2. NATURE OF SUBSIDY REQUEST

<table>
<thead>
<tr>
<th>Applicant</th>
<th>Nature of Tax Subsidy Request</th>
</tr>
</thead>
<tbody>
<tr>
<td>AFPCES/PNPSSS</td>
<td>Taxes on local purchases and income tax</td>
</tr>
<tr>
<td>NFA</td>
<td>Taxes and duties on the importations of rice and equipment</td>
</tr>
<tr>
<td>NABCOR</td>
<td>Taxes and duties on milk importations</td>
</tr>
<tr>
<td>PGI</td>
<td>Taxes and duties on cattle importations</td>
</tr>
<tr>
<td>MWSS/LRTA/PNR/PEZA/NEA</td>
<td>Taxes and duties on importations of machineries, equipment and materials</td>
</tr>
<tr>
<td>MMTC/QUEDANCOR</td>
<td>Taxes and duties on vehicle importations</td>
</tr>
<tr>
<td>SPDA/PHILRICE</td>
<td>Taxes and duties on importations of vehicles, machineries and equipment, and materials</td>
</tr>
<tr>
<td>PCSO</td>
<td>Taxes and duties on importation of ambulances</td>
</tr>
<tr>
<td>NKTI/LCP/PHC/PCMC</td>
<td>Taxes and duties on importations of medical supplies and equipment</td>
</tr>
<tr>
<td>HDMF</td>
<td>Income taxes</td>
</tr>
<tr>
<td>PCIC</td>
<td>Premium taxes</td>
</tr>
</tbody>
</table>

### Legend:

- AFPCES – AFP Commissary and Exchange Service
- PNPSSS – Philippine National Police Service Stores System
- NFA – National Food Authority
- NABCOR – National Agri-Business Corporation
- PGI – Philippine Genetics Incorporated
- MWSS – Metropolitan Waterworks and Sewerage System
- LRTA – Light Rail Transit Authority
- PNR – Philippine National Railways
- PEZA – Philippine Economic Zone Authority
- NEA – National Electrification Administration
- MMTC – Metro Manila Transit Corporation
- QUEDANCOR – Quedan and Rural Credit Guarantee Corporation
- SPDA – Southern Philippines Development Authority
- PhilRice – Philippine Rice Research Institute
- PCSO – Philippine Charity Sweepstakes Office
- NKTI – National Kidney and Transplant Institute
- LCP – Lung Center of the Philippines
- PHC – Philippine Heart Center
- PCMC – Philippine Children’s Medical Center
- HDMF – Home Development Mutual Fund
- PCIC – Philippine Crop Insurance Corporation

### C. Availment Procedures

The procedures for the availment of tax subsidy are specified under the Rules, Guidelines and Procedures for the Implementation of Subsidy. The approach uses criteria that conform with the prevailing policy thrusts of the government. The criteria include:

1. Effect of subsidy on relative price levels;
2. Relative contribution of the applicant to the revenue generation effort;
3. Nature of the activity engaged in by the applicant;
4. Greater national interest to be served;
5. Magnitude and source of funding for the system of subsidies;
6. Number of eligible applicants and their proportionate share in the system of subsidies;
7. Terms and conditions for the availment of subsidies, including reporting requirements;

8. Effect of the system of subsidies on international agreements in which the Philippines is a party/signatory, taking care that the availment of subsidies does not become the basis for countervailing action from other countries; and

9. Such other considerations as may be determined by the FIRB.

GOCCs applying for tax subsidy through the FIRB are also required to substantiate their applications with the following information:

1. Backgrounder of the applicant;

2. Endorsement from the Department/Office to which the applicant is attached;

3. Details of tax subsidy requirement, by type of taxes and duties and amount;

4. Justifications for the application;

5. Details of importations/purchases;

6. Loan/donation agreement;

7. Audited financial statements;

8. Income tax return;

9. Annual report;

10. Programs/accomplishments;

11. Statement under oath of investments and income therefrom;

12. Opinion/endorsement of the Corporate Affairs Group of the DOF;

13. Certification from the DTI (Bureau of Import Services) as to the non-availability of imported items;

14. Certification that items for which tax subsidy is sought shall be used exclusively in the pursuit of mandated functions, as stated in its charter and/or enabling law;

15. Other pertinent information.

Tax subsidy applications of GOCCs filed with the FIRB\(^7\) undergo a rigorous three-tiered review process: (1) at the Secretariat level; (2) at the Technical Committee level; and (3) at the Board Proper level. In the process, the FIRB may even require a presentation by the GOCC of its application for tax subsidy before the Board or the Technical Committee or both in a joint meeting for the Committee’s/Board’s appreciation. The FIRB may likewise undertake an ocular inspection of the operations of the GOCC before acting on its application.

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\(^7\) The FIRB and the Technical Committee are inter-agency bodies composed of representatives from the DOF, DBM, DTI, National Economic and Development Authority (NEDA), BIR, BOC and the National Tax Research Center (NTRC) which serves as the FIRB Secretariat.
The Secretariat, upon receipt of the documents, evaluates the application and makes the initial recommendation to approve or disapprove. Thereafter, the request together with the recommendation of the Secretariat, is elevated to the Technical Committee for its own evaluation and indorsement to the Board. The Board makes the final decision on the matter.

In case the Board proper approves the availment of tax subsidy, a Resolution and a Certificate of Entitlement to Subsidy (CES) are issued to the GOCC indicating among others, the following: (1) date and period of effectivity; (2) scope and coverage of subsidy availment; (3) conditions and reporting requirements; and (4) such other information as may be determined by the Board. The CES is a prenumbered and accountable form of the FIRB, signed by the FIRB Chairman and attested to by the Chairman of the Technical Committee and the Head of the Secretariat.

D. Magnitude of Tax Subsidy

From 1988-2000, the FIRB has granted a total of P33.94 billion in tax subsidy to GOCCs. Of the total amount, only around 42.3% or P14.36 billion were utilized by GOCCs for their tax and duty liabilities\(^8\) (Table 3). The difference between FIRB’s approval and utilization of tax subsidy by their recipients may be explained by gaps in project/program implementation, delays in shipment of imported equipment and/or material, gaps in documentation requirements, among others.

<table>
<thead>
<tr>
<th>Year</th>
<th>Granted</th>
<th>Utilized</th>
<th>% of Grant</th>
<th>Unutilized</th>
<th>% of Grant</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988</td>
<td>811.38</td>
<td>597.98</td>
<td>73.7</td>
<td>213.40</td>
<td>26.3</td>
</tr>
<tr>
<td>1989</td>
<td>1,993.00</td>
<td>1,000.00</td>
<td>50.2</td>
<td>993.00</td>
<td>49.8</td>
</tr>
<tr>
<td>1990</td>
<td>3,160.38</td>
<td>1,300.00</td>
<td>41.1</td>
<td>1,860.38</td>
<td>58.9</td>
</tr>
<tr>
<td>1991</td>
<td>1,780.96</td>
<td>1,040.00</td>
<td>58.4</td>
<td>740.96</td>
<td>41.6</td>
</tr>
<tr>
<td>1992</td>
<td>3,577.14</td>
<td>1,600.00</td>
<td>44.7</td>
<td>1,977.14</td>
<td>55.3</td>
</tr>
<tr>
<td>1993</td>
<td>1,558.47</td>
<td>900.00</td>
<td>57.7</td>
<td>658.47</td>
<td>42.3</td>
</tr>
<tr>
<td>1994</td>
<td>1,360.98</td>
<td>800.00</td>
<td>58.8</td>
<td>560.98</td>
<td>41.2</td>
</tr>
<tr>
<td>1995</td>
<td>1,431.99</td>
<td>1,190.00</td>
<td>83.1</td>
<td>241.99</td>
<td>16.9</td>
</tr>
<tr>
<td>1996</td>
<td>1,269.52</td>
<td>900.00</td>
<td>70.9</td>
<td>369.52</td>
<td>29.1</td>
</tr>
<tr>
<td>1997</td>
<td>1,068.15</td>
<td>760.00</td>
<td>71.2</td>
<td>308.15</td>
<td>28.8</td>
</tr>
<tr>
<td>1998</td>
<td>0.00</td>
<td>0.00</td>
<td>-</td>
<td>0.00</td>
<td>-</td>
</tr>
<tr>
<td>1999</td>
<td>14,999.32</td>
<td>3,356.00*</td>
<td>22.4</td>
<td>11,643.32</td>
<td>77.6</td>
</tr>
<tr>
<td>2000**</td>
<td>927.77</td>
<td>917.70</td>
<td>99.1</td>
<td>8.07</td>
<td>0.9</td>
</tr>
</tbody>
</table>

| Total | 33,939.06 | 14,363.68 | 42.3 | 19,575.38 | 57.7 |

* While a tax subsidy of P1.73 billion was granted to the HDMF, the SARO corresponding thereto was released only on February 29, 2000 and May 4, 2000 chargeable against the 2000 GAA. Moreover, only P3.36 billion of the P13.09 billion tax subsidy to the NFA was issued the corresponding SARO by the DBM.

** Preliminary
Source: FIRB and DBM

\(^8\) The utilized portion of the tax subsidy is covered by Advice of Allotment (AA) eventually replaced by Special Allotment Release Order (SARO) issued by the DBM.
By sector, it is observed that the largest slice of tax subsidy from 1988-2000 went to agriculture, amounting to P19.99 billion or 58.9% of the total. This can be explained by the fact that agriculture is a primary activity of the country. Moreover, the government granted a P13 billion tax subsidy in 1999 to the NFA covering its 1998 rice importation in anticipation of the adverse effects of the El Niño phenomenon. The other two leading sectors were socialized savings and rural electrification with a total tax subsidy of P5.46 billion and P3.0 billion, respectively (Table 4).

Since the institutionalization of tax subsidy up to 2000, only 33 GOCCs were granted the same. Despite the fact the NFA was granted tax subsidy only for three (3) years (i.e., in 1988, 1995 and 1999), it got the largest share of P13.47 billion from the tax subsidy pie, primarily because of the P13 billion tax subsidy it received in 1999, as earlier mentioned. The FPA shared the next largest slice from the tax subsidy pie from 1989-1995 amounting to P5.9 billion. This was given principally to imported fertilizers which are important in improving rice production in the country. The FPA, however, is no longer covered by the tax subsidy provision administered by the FIRB, but by the DBM-administered tax subsidy program. This is because of an opinion of the Department of Justice (DOJ)\(^9\) stating that the FPA is not a GOCC but an NGA. Thus, the next top three recipients of tax subsidies were the HDMF, NEA and AFPCES with a total amount of P5.46 billion, P3.00 billion, and P1.37 billion, respectively (Table 5). The grant of tax subsidy to the HDMF is in recognition of its significant contribution in the promotion of the economic welfare and social well-being of its members, especially those belonging to the rank-and-file or low income groups. The HDMF performs the following functions: (1) generation of savings, and (2) provision of shelter for workers. It should be noted that savings generation goes hand in hand with shelter financing, the first being the main source of funds to be used for housing. The NEA serves as the catalyst for the government’s countryside electrification program by promoting total electrification through electric cooperatives. The tax subsidy granted to the NEA generally covered the tax and duty components of its materials and equipment provisions to rural electric cooperatives. On the other hand, the AFPCES, like the PNPS, was granted tax subsidy equivalent to the taxes due on its purchases of commissary items for resale to qualified beneficiaries at prices much lower than the prices of other groceries and supermarkets. The grant of tax subsidy to the AFPCES is justified as its services uplift the morale and economic well-being of the men and women in uniform and their dependents.

By type of coverage, taxes and duties on importations constituted around P26.1 billion or 76.9% of the total tax subsidy grant of P33.94 billion from 1988-2000. Of this amount, the biggest share went to rice importations (P13.47 billion); followed by importations of plant, equipment, materials and supplies (P5.94 billion) and fertilizer importations (P5.9 billion); and lastly, by motor vehicle, cattle, sugar and milk importations (P0.82 billion). Income tax accounted for P5.46 billion or 16.1% of the total tax subsidy grant. Other subsidized taxes are: VAT and excise tax, P1.7 billion (5.0%), documentary stamp tax (DST), P0.5 billion (1.5%); and premium tax, P0.1 billion (0.4%) (Table 6).

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With the suspension of tax subsidy in 1998, a number of applications filed by GOCCs with the FIRB had been adversely affected. The applications had to do with ongoing projects such as the: (1) LRTA’s Line 1 Capacity Expansion Project, (2) PNR’s Main Line South Revitalization Project and Modernization of Commuter Line South Project, among others. The tax subsidy would have been used to pay for the taxes and duties due on importations of machinery, equipment, spare parts and the like which were all project-related.

Other applications adversely affected were those pertaining to the importation of hospital equipment by the four specialized hospitals. Estimates of the tax subsidy requirements of these GOCCs involved about P1.292 billion, the breakdown of which was as follows:

<table>
<thead>
<tr>
<th>GOCC</th>
<th>Amount</th>
<th>Scope</th>
</tr>
</thead>
<tbody>
<tr>
<td>PHC</td>
<td>P 9,728,000</td>
<td>Taxes and duties on the 1998 importation of hospital equipment/spare</td>
</tr>
<tr>
<td></td>
<td></td>
<td>parts and supplies.</td>
</tr>
<tr>
<td>NKT1</td>
<td>1,549,932</td>
<td>- do</td>
</tr>
<tr>
<td>LCP</td>
<td>3,237,500</td>
<td>- do</td>
</tr>
<tr>
<td>PCMC</td>
<td>799,769</td>
<td>- do</td>
</tr>
<tr>
<td>PNR</td>
<td>32,337,978</td>
<td>Taxes and duties on importation of materials and supplies for the Main</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Line South Revitalization Project, Phase II and the Improvement and</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Modernization of the Commuter Line South Project funded by the Export</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Finance and Insurance Corporation (Australia) and Overseas Economic</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cooperation Fund.</td>
</tr>
<tr>
<td>LRTA</td>
<td>1,243,996,000</td>
<td>Taxes and duties on importation of materials, spare parts and</td>
</tr>
<tr>
<td></td>
<td></td>
<td>equipment in connection with Automated Fare Collection System and</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Line 1 Capacity Expansion Projects (P507,951,000) and Metro Manila</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Strategic Mass Rail Transit Development-Line 2 Project (P736,045,000)</td>
</tr>
<tr>
<td>Total</td>
<td>P 1,291,649,179</td>
<td></td>
</tr>
</tbody>
</table>

When the tax subsidy provision was revived in 1999, the NFA, HDMF, LRTA and PHC applied for tax subsidy with their requests being granted, as shown below. The NKT1, LCP and the PCMC, although qualified for tax subsidy provisions, did not apply for the same.

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10 The number is now reduced to three as the Lung Center of the Philippines was totally destroyed by fire last May 17, 1998. This in effect reduces the estimated tax subsidy requirements to P1.288 billion.
<table>
<thead>
<tr>
<th>Date</th>
<th>Resolution No.</th>
<th>GOCC</th>
<th>Amount Granted (P)</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>10-14-99</td>
<td>2-99</td>
<td>NFA</td>
<td>13,087,941,166</td>
<td>Taxes and duties on importation</td>
</tr>
<tr>
<td>12-10-99</td>
<td>3-99</td>
<td>HDMF</td>
<td>1,725,527,888</td>
<td>1997-1998 income tax</td>
</tr>
<tr>
<td>12-10-99</td>
<td>4-99</td>
<td>LRTA</td>
<td>181,089,356</td>
<td>Taxes and duties on importation</td>
</tr>
<tr>
<td>12-10-99</td>
<td>5-99</td>
<td>PHC</td>
<td>4,760,393</td>
<td>Taxes and duties on importation</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>14,999,318,803</strong></td>
<td></td>
</tr>
</tbody>
</table>

Out of P14,999 million tax subsidy grant for 1999, however, only P3,356 million were utilized in favor of the NFA. Utilization ratio was only 22.4%, which means that 77.6% or P11,643.32 million tax subsidy grants were not issued the corresponding SARO by the DBM. As mentioned earlier, the SARO for the HDMF’s tax subsidy of P1.7 billion was released only in 2000 chargeable against the 2000 GAA.

In 2000, a total of P927.77 million worth of tax subsidy was granted in favor of the HDMF (P898.32 million), PHC (P20.14 million) and NKTI (P9.31 million). Of this amount, P919.7 million were issued the corresponding SARO.

### III. COMMENTS AND OBSERVATIONS

1. The government corporate sector has been instrumental in pursuing allocative, redistributive and stabilizing objectives of governments. In the Philippines, the number of GOCCs has grown significantly from a mere 65 corporations in 1970 to more than 300 in the early 1990s. This could be attributed to the expanding involvement of the government in providing essential goods and services which the private sector cannot provide either because of huge financial requirements or high economic risks as in the case of water provision by the MWSS or power generation by the National Power Corporation (NAPOCOR). However, in areas where the private sector is involved, the creation of GOCCs has raised the issue of unfair competition and there have been calls for their privatization. In this regard, the government set up the Committee on Privatization\(^{11}\) to implement the privatization of as many GOCCs as possible.

2. The continued existence of GOCCs raises certain fiscal and non-fiscal issues. On the fiscal issues, the question to ask is whether to give GOCCs: (a) outright tax exemptions and/or preferential tax and duty provisions; or (b) budgetary support in the form of tax subsidies, operating subsidies, equity investments, and loans and/or advances to take care of...

\(^{11}\) The COP is composed of representatives from the DOF, DOJ, DBM, DTI, National Development Council (NDC) and the NEDA.
guaranteed obligations. On the other hand, the non-fiscal aspects have to do with giving GOCCs priority as well as liberal and/or concessionary terms in loan acquisition, bidding, and access to government facilities and infrastructure.

3. The government is constrained by the burden of financially supporting GOCCs. Hence, it is committed to institute reforms to improve its effectiveness and efficiency in providing quality services to its constituents. One major reform program is the streamlining of government structures and procedures leading to a smaller, more efficient and more accountable public sector. Toward this end, privatization of the government corporate sector has been identified as one means to reduce its budgetary requirements (as in the case of losing GOCCs) and to limit involvement in economic activities to remove the accusation of unfair competition raised by the private sector and promote efficient delivery of services.

4. The privatization process may involve the conversion (sale) of existing public sector assets and facilities to provide the private sector access to an infrastructure market with the intention of increasing industry participation and creating a competitive market. Since the launch of the privatization program in December 1986 through Proclamation No. 50, the government has approved for privatization 132 GOCCs, 419 transferred assets entrusted to the Asset Privatization Trust, and several other properties, including those held by the Presidential Commission on Good Government (PCGG) and the Bases Conversion Development Authority (BCDA). Based on available information from the CAG, DOF, there are 124 existing GOCCs, 98 of which were retained, as of May 25, 2000, leaving 26 GOCCs for disposition. Of this number, 10 GOCCs were partially privatized, 13 slated for full privatization and 3 for dissolution, as of March 31, 2000.

5. From 1987 to 1999, the privatization program generated accumulated revenues of P97.02 billion.14

6. But even for GOCCs that have been retained by the government, the approach has been generally in the direction of reducing their fiscal dependence on the government. Expectedly, this approach would exert pressures on the concerned GOCCs to adopt a culture of fiscal discipline. Thus, provisions of subsidies to the public corporate sector have been undergoing serious reconsideration.

7. Tax subsidy has been subject to such reconsideration. The institutionalization of a working cap on tax subsidy since 1993 is an example of how the FIRD has operationalized government’s thrust to reduce or rationalize the provisions of fiscal support to GOCCs and instill fiscal discipline in them, as well. The working cap effectively reduces the amount of

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12 Among others, some benefits that can be derived from privatization are: (a) improvement in efficiency of enterprise due to limit in the scope of political interference in decision-making, increase in managerial incentives by making managers responsible to shareholders and imposition of financial discipline of private capital markets; (b) access of the enterprise to private sector financing and new markets; and (c) reduction in public sector deficits, especially if the privatized entity is a loss-making enterprise. (Richard Hemming and Ali M. Mansoor, “Privatization and Public Enterprises,” IMF Working Paper WP/87/9, February 25, 1987, p.8)


14 Source: Bureau of Treasury (BT).
tax subsidy available to the public corporate sector. Thus, some GOCCs would have to rely on their own resources to answer for their tax and duty liabilities forcing them to practice fiscal discipline.

8. Also in 1994, the government proposed the gradual phase out of tax subsidies to GOCCs. This was a major commitment of the Philippine Government with the International Monetary Fund (IMF) in the Memorandum of Economic Policy (MEP) drafted that year. Reducing subsidies to GOCCs was part of the comprehensive restructuring of government expenditures. They were targeted to be gradually phased out within a period of three years, until finally scrapped in 1997.\footnote{In 1997, the grant of tax subsidy pursuant to EO No. 93 was continued and the FIRB granted a total tax subsidy of Ph1.07 billion to 20 GOCCs.} This approach is consistent with the thrust to make GOCCs self-reliant and less dependent on government assistance. This would also impress upon GOCCs the need to operate under norms of fiscal efficiency and discipline.

9. The suspension of tax subsidy provisions in 1998 is an even drastic call for GOCCs to be more self-reliant and less dependent on government assistance. Said suspension effectively put GOCCs in a course of fiscal discipline as they have to assume their tax and duty liabilities on the basis of their own resources.

10. The total scrapping of tax subsidy to GOCCs would, however, have some impact on the financial viability of certain GOCCs. For GOCCs with favorable financial positions, using their own internal resources to settle their tax liabilities may not be a problem. But, for GOCCs with a barely break-even or losing nature of operations and unfavorable financial position, the settlement of their tax obligations could be a problem. These are mostly GOCCs engaged in the provision of social services, such as the specialized hospitals. Those in mass transit operation such as the LRTA and the PNR are also saddled with commitment for the rehabilitation and expansion of their facilities. Moreover, they also have debt service obligations to comply with. If these GOCCs are not able to avail of tax subsidy, then their capability in providing their services to the public is likely to be impaired. On this basis, the revival and continued provision of tax subsidy is justified.

11. Even as some GOCCs are to be considered for tax subsidy, the emphasis on fiscal discipline should not be compromised. Thus, the FIRB has looked at the programs and projects of these GOCCs to determine whether these are all consistent with their social service orientation. Also, where possible and without adversely affecting the welfare of the beneficiaries of their services, the FIRB has suggested to these GOCCs an examination of their fees and charges, with the end in view of adjusting these to enable the concerned GOCCs to relatively improve on their financial performance.

12. Other approaches resorted to by the FIRB to make tax subsidy an instrument of fiscal discipline include the following:

12.1 FIRB Resolution No. 32-92 generally limits current subsidy availment to cover current tax and duty liabilities. The limitation is intended to ensure the effective utilization of tax subsidy. In other words, at the time the subsidy is granted, efforts must be undertaken by the recipient to use said subsidy immediately to settle its tax obligations with the concerned
agencies. Postponing the use of tax subsidy defeats the purpose behind its grant. Moreover, if the subsidy would not be used anyway, then the same could have been granted to another user applicant. Finally, the limitation would exert pressures on the recipient to update its accounts and transactions and/or the conduct of the program or project to which the tax subsidy attaches.

12.2 FIRB Resolution No. 31-94 limits the grant of tax subsidy only to transactions which are related to the primary undertakings of applicants as specified in their charters and/or enabling laws. In relation to this, FIRB Resolution No. 43-94 added as a requirement for subsidy availment applications a statement under oath from the applicant that subsidized importations shall be used directly and exclusively in the pursuit of the applicant’s mandated functions. This requirement is necessary to see to it that tax subsidy is not used for reasons other than the attainment of the recipient’s primary undertakings. To ensure compliance with this policy, the FIRB conducts on-the-spot inspection of some GOCCs applying for tax subsidy, e.g., the cattle ranches supported by the Philippine Genetics, Inc., the depot of the LRTA and the commissary stores operated by the AFPCES and PNPS. The limitation also precludes opportunities for leakages/abuses.

12.3 FIRB Resolution No. 14-97 provides the guidelines on motor vehicle importations. This amended FIRB Resolution No. 16-95 to clarify and simplify the criteria so as to reduce opportunities for leakages/abuses in the grant of tax subsidy, particularly in the case of motor vehicles acquired through grants or donations. Pursuant thereto, motor vehicles acquired through grants or donations shall be entitled to the tax subsidy administered by the FIRB only if: (a) such grants or donations are sourced through a government, intergovernmental, regional or international institution; (b) the GOCC shall certify that the motor vehicle shall be for its official use only and/or report to the FIRB, as the latter may require, that the same is being used as such; and (c) the motor vehicles are left-hand driven. Motor vehicles acquired through loan arrangements or commercial importations shall only be entitled to tax subsidy provided: (a) such motor vehicles are of the specialized type such as ambulances, firetrucks, etc.; or for special purposes only; (b) the importing GOCC does not have the financial capacity to assume the burden of taxes/duties thereon; (c) the GOCC shall certify that the motor vehicle shall be for its official use only and/or report to the FIRB, as the latter may require, that the same is being used as such; (d) the motor vehicles are left-hand driven; and (e) the motor vehicles would have qualified under the corresponding rules and regulations of the Bureau of Import Services of the DTI thereon, e.g., quantity and engine displacement limitations, etc.

The guidelines, as earlier noted, are intended to prevent tax subsidy leakages/abuses, particularly as the items for which subsidy is sought are
quite a problem-area as these can be easily diverted to non-official use, in
the absence of strict guidelines thereon.

13. FIRB also requires a CAG financial evaluation of all GOCCs applying for tax
subsidy. Considering the comprehensive nature of this evaluation, the CAG is able to make
an objective assessment of the overall financial performance of the concerned GOCCs. In the
process, certain financial weaknesses are uncovered and relayed to the concerned GOCCs for
their own reactions/consideration. The requirement is deemed to encourage fiscal discipline
among government corporations, specially as it is used as a basis for granting tax subsidy.

14. Following the procedures and guidelines in tax subsidy availments, the FIRB
denied 19 original tax subsidy applications of GOCCs from 1990 to 1997 involving an
aggregate amount of around P790 million. It also imposes conditionalities, e.g., submission
of details of transactions being subsidized, labelling of items being subsidized as such, etc. to
preclude abuses/leakages in the availment of tax subsidy and ensure that the tax subsidy is
enjoyed only by the intended beneficiaries and not diverted to uses other than the principal
functions of the recipients.

IV. CONCLUSION AND RECOMMENDATIONS

The grant of tax subsidies is intended to allow GOCCs to have enough financial
elbow room to allow them to concentrate their resources on the effective achievement of their
socio-economic development objectives. In other words, tax subsidies free the GOCCs’
resources from the financial burden of taxation allowing them to use such resources in further
pursuit of their objectives. Also, in cases where other financial support (e.g., operational
subsidies) to GOCCs may be wanting, tax subsidies may compensate for this insufficiency.

Obviously, tax subsidy provisions have advantages over outright tax and/or duty
exemptions. Tax subsidy is more precise and direct and is easily measurable in terms of its
cost to the government, compared to a broad-based provision of exemption from all taxes and
duties. Moreover, tax subsidies are more transparent. Outright tax and duty exemptions are
difficult to monitor, hence opportunities for fiscal abuses/leakages are not remote. Under a
system of tax subsidy, the transactions (such as importations) for which fiscal assistance is
sought can be scrutinized as to their relevance to the functional thrust of the GOCC. In case
it is established that the transaction has no relation to the GOCC’s functional thrusts, tax
subsidy may be denied.

Any attempt to phase out tax subsidy will only serve as a further argument for the
grant of tax exemptions. GOCCs concerned may work out with the executive and/or the
legislature the passage of a law providing tax exemptions thereto. Once this is done, it would
be very difficult to reverse the case if and when overall fiscal requirements would call for the
withdrawal of tax exemptions or cost-cutting measures.

With the grant of tax subsidies, fiscal discipline is emphasized. Tax subsidies may be
capped at any time by a mere action on the part of the FIRB and may not be granted.
automatically even if there is an application therefor by concerned GOCCs as said application will still have to go through a thorough evaluation by the FIRB. Effectively, by not acting upon the application, the affected GOCC will be forced to exercise fiscal prudence if only to cope with its tax and duty liabilities.

The existing FIRB policies and guidelines for the evaluation of subsidy applications are utilized to guard against the incidence of unwarranted leakages or abuses and/or fiscal inefficiency. The advantage of using the prevailing policy and guidelines is that these are already institutionalized and understood by the GOCCs.

On this basis, the following are recommended:

1. To continue the use of tax subsidy as a proxy to outright tax and duty exemptions for reason of fiscal transparency and as an instrument of fiscal discipline.

2. To continue monitoring GOCC recipients of tax subsidy particularly as regards the actual impact of tax subsidy on their financial performance. In this connection, said recipients should submit to the FIRB on a regular basis a detailed report of the effects of tax subsidy on their revenues, expenditures and overall financial standing.

3. To reiterate existing FIRB policies and guidelines for the evaluation of tax subsidy applications and grant thereof.

4. To exclude GOCCs with favorable financial position, as indicated by the results of their operations, their cash balances or their investment portfolio, among others, from the tax subsidy provisions administered by the FIRB. In case said GOCCs are extended tax subsidy, the same should be done only on a last-claim basis, i.e., after satisfying the tax subsidy needs of less-financially capable GOCCs.

5. While financially incapable GOCCs may be extended tax subsidy, the same should be linked to some financial rehabilitation measures on the part of said GOCCs, if only to exert pressures on them to improve on their financial performance.