Frequently Asked Questions on the Proposed Passive Income and Financial Intermediary Taxation Act (PIFITA) of the Comprehensive Tax Reform Program*[1]

1. What is Package 4 of the CTRP?

Package 4 of the CTRP is aimed at making the taxation of passive income, financial intermediaries (FIs), and financial transactions simpler, fairer, and more efficient. The reform covers the following taxes under the National Internal Revenue Code (NIRC) of 1997, as amended:

a. Passive income taxes on interests, dividends, capital gains on sale of shares of stock not traded through the local stock exchange;

b. Stock transaction tax (STT) and initial public offering (IPO) tax;

c. Business taxes on financial intermediaries (e.g., gross receipts tax (GRT), premium tax and value-added tax (VAT) on certain financial institutions); and

d. Documentary stamp tax (DST) on financial products and transactions.

2. What is the contribution of the taxes on passive income and financial sector in the overall tax performance of the government?

Passive income and financial sector taxes provide the government with significant revenue. In 2018, the total collection on passive income and financial sector amounted to P255.7 billion, of which P112.7 billion or 44 percent came from passive income taxes; P55.7 billion or 22 percent from business taxes on financial intermediaries (FIs); and P87.2 billion or 34 percent from DST on financial products and transactions.

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[1] The original version of this article was published in the NTRC Tax Research Journal dated November – December 2018. This version is a slightly updated article based on **House Bill No. 304**.

Table 1

Tax Collection on Passive Income and Financial Sector: CY 2018

Particulars	Amount (in billion pesos)	Percent to total (in %)	Percent to BIR collection (%)	Percent to GDP (in %)
Tax on passive income	**112.7**	**44.1**	**5.8**	**0.6**
Interest income	68.8	26.9	3.5	0.4
Dividends	25.3	9.9	1.3	0.1
Capital gains, STT, and IPO tax	18.6	7.3	1.0	0.1
Tax on financial intermediaries	**55.7**	**21.8**	**2.9**	**0.3**
Gross receipts tax	41.1	16.1	2.1	0.2
Premium tax on life insurance	2.3	0.9	0.1	0.0
VAT	12.3	4.8	0.6	0.1
Securities dealers or lending investors	6.5	2.5	0.3	0.0
Non-life insurance	4.8	1.9	0.2	0.0
Pre-need	0.9	0.3	0.0	0.0
Pension fund	0.2	0.1	0.0	0.0
Tax on financial transactions	**87.2**	**34.1**	**4.5**	**0.5**
DST on financial products*	87.2	34.1	4.5	0.5
TOTAL	**255.7**	**100.0**	**13.1**	**1.5**

**Note:* Excludes DSTs in sections 189, 190, 191, 192, 193, 194, 196 and 197 of the NIRC as they are non-financial in nature.

Source: Official preliminary data submission from the BIR

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

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

a. Complicated tax structure - based on the current tax system, there are 80 tax base and tax rate combinations applicable to passive income, financial intermediaries (FIs) 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 equivalent financial instruments and transactions.

b. Susceptibility to arbitrage - the variations in tax rate and unequal tax treatment of equivalent financial instruments give rise to arbitrage. Different tax treatment among or between sectors open window for arbitrage and leveraging.

c. Uneven playing field – the current tax system provides different tax treatments on similar transactions for some types of FIs. Examples of FIs include banks, money remitters, lending companies, and mutual fund companies. Also, classifications between different FIs cause unequal treatment, considering that some are subject to GRT, some are subject to premium tax, and others are subject to VAT.

d. Inequitable distribution of tax burden - investments in long-term instruments are subject to lower tax rates compared to short-term investments. Hence, those who can afford to invest in long-term instruments pay lower tax rates compared to working class individuals who pay higher rates for short-term investments.

e. Uncompetitive tax system – data show that the Philippines charges the highest tax on passive income in the Association of Southeast Asian Nations (ASEAN) region. With this, the Philippine capital market remains shallow and uncompetitive, and continues to lag behind its ASEAN neighbors.

f. High administrative and compliance cost - complicated tax structure makes administration and compliance difficult and costly.

g. Hinders capital market development – There are a number of taxes on financial transactions that hinder capital market development. The 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.

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

Package 4 aims to achieve the following objectives:

a. Provide neutrality in the tax treatment across FIs and financial products;

b. Simplify what has become a complex tax system;

c. Improve equity across investors and savers;

d. Minimize arbitrage opportunities; and

e. Promote capital market development and tax competitiveness within the context of financial globalization, increased capital mobility and financial inclusion.

5. What are the proposed reforms under Package 4?

Package 4 proposes the following reforms:

a. Reduction in the number of withholding tax rates - from 80 tax base and tax rate combinations applicable to passive income, FIs, and transactions, the number will be reduced to 36.

b. Unification of tax rates on passive income - a uniform tax 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.

c. Harmonization of business taxes on financial intermediaries - a single GRT rate of 5 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 5 percent except for dividends, equity shares, and net income of subsidiaries which will remain exempt.

   Pre-need, pension, life insurance, and health maintenance organizations will be uniformly taxed at 2 percent of premiums.

d. Removal or minimization of barriers to capital market development - the IPO tax will be removed as it is seen as a tax on capital, and is detrimental to capital market development.

e. 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. P2.00 for every P200.00 or fractional part thereof, P0.50 on each P4.00, 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.

f. Adoption of a regional competitive tax system – the proposed tax rates are adjusted to make it comparable and competitive to the rates of our ASEAN neighbors.

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

The proposed tax rate for interest income, dividends, and capital gains on sale of shares of stock not traded through the local stock exchange is 15 percent or the applicable tax treaty rate (TTR) in case of non-residents. However, inter-corporate dividends will remain exempt.

7. How is the proposed tax rate on passive income under Package 4 arrived at?

The proposed rate of 15 percent is the lowest tax on labor income under the Tax Reform for Acceleration and Inclusion (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,[2] including ASEAN, with which the Philippines has entered into tax treaty. Likewise, on dividends, 15 percent is the dominant TTR in 33 of 43 countries. Moreover, setting the rate at 15 percent is harmonious to the current tax rate imposed on foreign currency deposits and capital gains on the sale of shares of stock not traded through the local stock exchange under the TRAIN law.

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

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.

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

The thrust of Package 4 is the 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, interest income on long-term deposits and investments, which are exempted from the tax if their maturities are more than five years, will also be uniformly taxed at 15 percent.

The adoption of a single tax rate is likewise perceived to address high administrative and compliance cost.

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

No, they do not. The changes will be applied prospective to 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.

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[2] The Philippines has bilateral tax treaty rates with 42 countries. These are: Indonesia, Malaysia, Singapore, Thailand, Vietnam, Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Hungary, Israel, Italy, Japan, South Korea, Netherlands, New Zealand, Norway, Poland, Spain, Sweden, Switzerland, Turkey, UK, USA, Bahrain, Bangladesh, Brazil, China, India, Kuwait, Nigeria, Pakistan, Qatar, Romania, Russia, Sri Lanka, the UAE and Mexico.

11. 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?

The exemption of interest income derived by FCDUs and OBUs from foreign currency transactions with non-residents OBUs, and local commercial banks 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, the more than sufficient gross international reserves, and with the liberalization of entry of foreign banks, this exemption is no longer needed.

12. Why will the tax on dividends of individuals be increased from 10 to 15 percent while intercorporate dividends will remain exempt?

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 wealthiest families who account for 93 percent of total dividends will be the ones that will be hit by the said proposal, though they will also benefit from the proposed reduction in the tax rate on interest income. 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 intercorporate dividends is justified because lifting it would be equivalent to double taxation of corporate profits. For instance, when a company declares corporate profits, it is levied on 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.

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

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 STT will be reduced gradually annually until it reaches 0.1 percent in 2025 to support capital market development.

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

14. Why will the IPO tax be removed?

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.

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

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.

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

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.

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

The taxation of pre-need, pension companies, and HMOs will be harmonized with life-insurance at 2 percent of premiums. On the other hand, the imposition of VAT on non-life insurance (except on crop insurance which is exempt) will be retained.

18. Why is there a need to rationalize the DST given that it has been recently amended by the TRAIN law?

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

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

The present DST structure has several deficiencies, namely:

a. Complicated structure, given that there are 25 major categories with varying tax rates and bases;

b. High rates which increase friction cost on transactions;

c. Imposition of multiple DST on a single document;

d. Imposition of multiple DST on a single continuous transaction; and

e. Varied rates for similar documents/instruments/transactions.

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

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 P2.00 for every P200, or fractional thereof, upon original issuance under Section 174 of the NIRC of 1997. However, the same document is being subjected to another DST under Section 175 at P1.50 for every P200, 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.

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

The reform intends to remove the 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 of the NIRC of 1997, and the DST on assignments of certain instruments under Section 198. The thrust of the reform is to limit the imposition of the DST only upon the original issuance of a document.

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

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. An 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 0.6 centavos per P200 of the face value of the instrument or 0.3 percent under Section 182, while the latter is taxed at P40 if the amount secured does not exceed P5,000 and P20 on each P5,000 or 0.8/0.4 percent under Section 195.

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

Package 4 intends to put a condition that in the case of an 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 on mortgages, pledges, and deeds of sale upon availing of the trust receipt line where the property subject of the LC is made a security for payment.

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

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, 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 unit investment trust fund (UITF) or similar scheme held by a trust corporation or a separate account fund established pursuant to a variable unit linked life (VUL) insurance policy issued by an insurance company, and such other forms of CIS as may be determined by the appropriate government regulatory agencies such as the Bangko Sentral ng Pilipinas, the Securities and Exchange Commission (SEC) and the Insurance Commission (IC).

A CIS may either be open-end or closed-end. "Open-end CIS" means a CIS where securities are offered and are always redeemable by the CIS, while "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), UITF, and VUL insurance.

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

The three types of CIS are currently taxed differently primarily because of their legal structures. Currently, MF companies have a corporate structure while UITF and VUL are contractual in nature. Investors in an MF are considered as shareholders. As a result, the original issuance of shares by an MF company is subject to DST of P2 on each P200 or fractional part thereof of the par value. On the other hand, VUL investors are liable to the graduated fixed DST from exempt to P200 depending on the insurable amount, while investors of UITF are liable to P30 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 P20 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.

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

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. 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.
B. Income received from investments	Passive income remains subject to appropriate final tax rates. Other incomes not subject to final tax shall be subject to CIT.
C. Gains from redemption	Exempts redemption gains from all forms of CIS.
D. GRT	Exempts any form of CIS from GRT, VAT or premium tax, as applicable, provided that it has at least 200 participants/owners, and its business undertaking is limited to investing/reinvesting/trading in securities.

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

Package 4 is broadly revenue-neutral and is projected to bring in additional P1.7 billion in revenue in 2020 and P0.2 billion in 2021 based on a 70 percent tax efficiency rate. Revenue collections will start to taper off in the latter years as the unified and lower tax rates are expected to be fully in place.

Table 3

Estimated Revenue Impact of Package 4

Particulars	Incremental revenue (in billion pesos)			
	2020	**2021**	**2022**	**2023**
Tax on passive income	-5.3	-6.8	-8.1	-8.8
Tax on financial intermediaries	4.3	5.3	6.4	7.7
Tax on financial transactions (not part of the grand total, added below)	-4.5	-5.7	-6.9	-8.3
Repeal of NIRC provisions	10.6	10.8	11.1	11.4
Repeal of special laws provisions	1.3	1.4	1.5	1.5
Grand total	10.8	10.7	10.9	11.8
Less: prospectivity clause	-3.9	-4.8	-5.9	-6.5
Less: TRAIN incremental revenue (IR) from DSTs	-4.5	-5.7	-6.9	-8.3
Total net prospectivity clause TRAIN IR (100% efficiency)	2.4	0.2	-2.0	-3.0
Total net prospectivity clause TRAIN IR (70% efficiency)	**1.7**	**0.2**	**-1.4**	**-2.1**

Notes:

a) STT is gradually phased out by 0.1 ppt annually from 0.6 percent until it reaches zero by 2026.

b) The DST on premium on property insurance goes down by 1 ppt annually from 12.5 percent until it reaches 7.5 percent by 2025.

c) Excludes DSTs in Sections 189, 190, 191, 192, 193, 194, 196, and 197 of the NIRC, as amended, as they are non-financial in nature.

d) Estimates are based on HB 304, thus subject to change.