



# Taxing the SEPs At A Glance



May 2014

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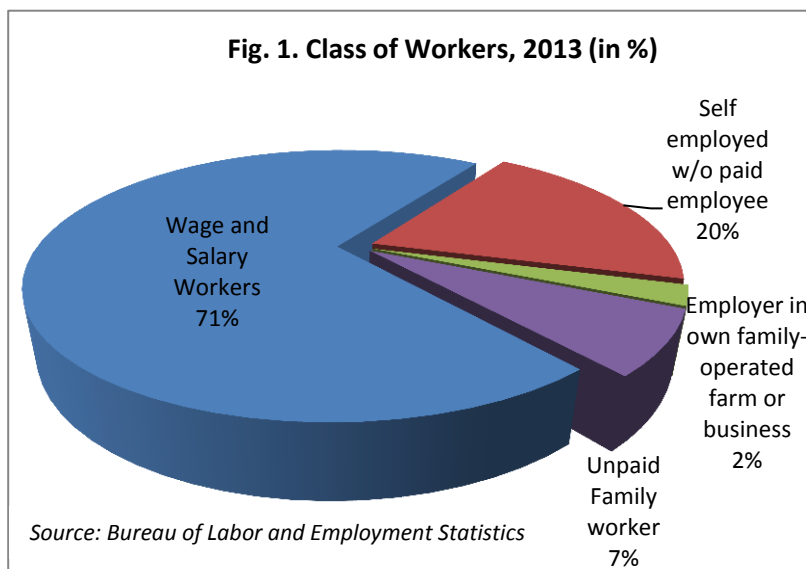
Self-employed individuals and professionals (SEPs) are traditionally known as a hard-to-tax group. To address this, the government through the Bureau of Internal Revenue (BIR) is currently undertaking initiatives and intensifying its campaign to strengthen the monitoring and enforcement of tax compliance among SEPs.<sup>1</sup>

## Self-Employed Individuals and Professionals Defined.

The National Internal Revenue Code (NIRC) of 1997, as amended, defines a person as *self-employed* if he/she is engaged in business and derives his/her personal income from such business. This includes single proprietorships (i.e., manufacturers, traders, market vendors, owners of eateries, farmers and service shops). On the other hand, a *professional* is defined as a person who derives income from the practice of his/her profession (e.g., lawyers, doctors, dentists, certified public accountants, etc.). The term “professional” also refers to one who pursues an art and makes his/her living therefrom such as artists, athletes and others similarly situated.

The Labor Force Survey (LFS) classifies the country’s workers into four classes (Fig. 1). In 2013, wage and salary workers accounted for the bulk of the labor force at 71 percent, followed by the self-employed without any paid employee at 20 percent. Employers in own family-operated farm or business make up 2 percent while unpaid family workers or those without pay in own family-operated farm or business comprise 7 percent.

**Individual Income Tax Structure.** The SEPs, just like any other individual income taxpayer, are subject to the following income tax rates (Table 1).<sup>2</sup> However, on top of the allowable exemptions and deductions enjoyed by all



**Table 1. Annual Individual Income Tax Structure in the Philippines (in PhP)**

Over	Not over	Rate
0-10,000	10,000	5 percent (%)
10,000	30,000	PhP500 + 10% of the excess over PhP10,000
30,000	70,000	PhP2,500 + 15% of the excess over PhP30,000
70,000	140,000	PhP8,500 + 20% of the excess over PhP70,000
140,000	250,000	PhP22,500 + 25% of the excess over PhP140,000
250,000	500,000	PhP50,000 + 30% of the excess over PhP250,000
500,000	-	PhP125,000 + 32% of the excess over PhP500,000

Source: Bureau of Internal Revenue

<sup>1</sup> On March 8, 2013, the BIR issued Revenue Memorandum Order No. 4-2013 which directed BIR personnel to prioritize the conduct of audit of the tax returns of professionals and sole proprietorships, especially those SEPs with income tax due of less than PhP200,000 per annum. Moreover, the BIR issued Revenue Regulations No. 4-2014 on March 3, 2014, prescribing the guidelines and policies in monitoring the service fees being charged by the SEPs. The Department of Finance (DoF) and the Department of Labor and Employment (DOLE) have also agreed to require professionals to submit their personal income tax returns (ITRs) upon license renewal with the Professional Regulation Commission (PRC) although to date, a resolution is yet to be promulgated.

<sup>2</sup> The progressive scheme of income taxation was introduced in the Philippine tax system to raise more revenues for the increasing needs of the government and at the same time, to correct inequalities in taxation by equitably distributing the tax burden based upon the principle of ability to pay (De Leon and De Leon, NIRC Annotated, 2003).

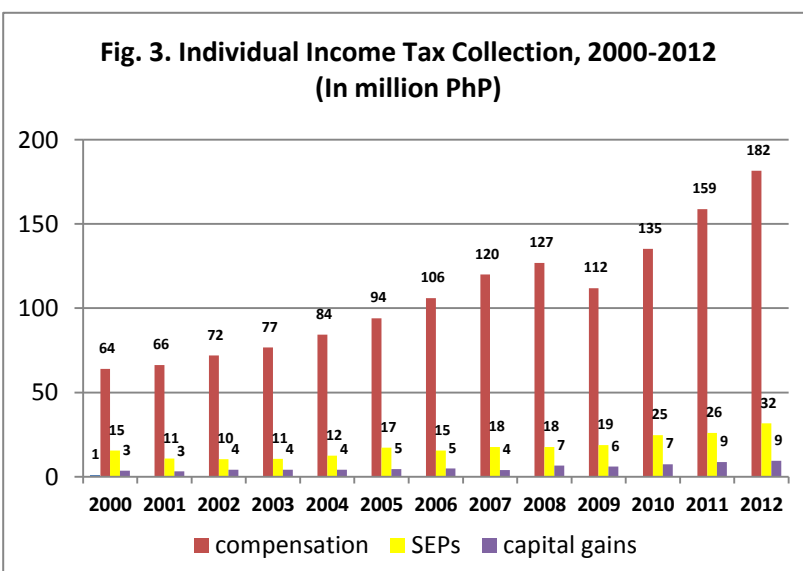
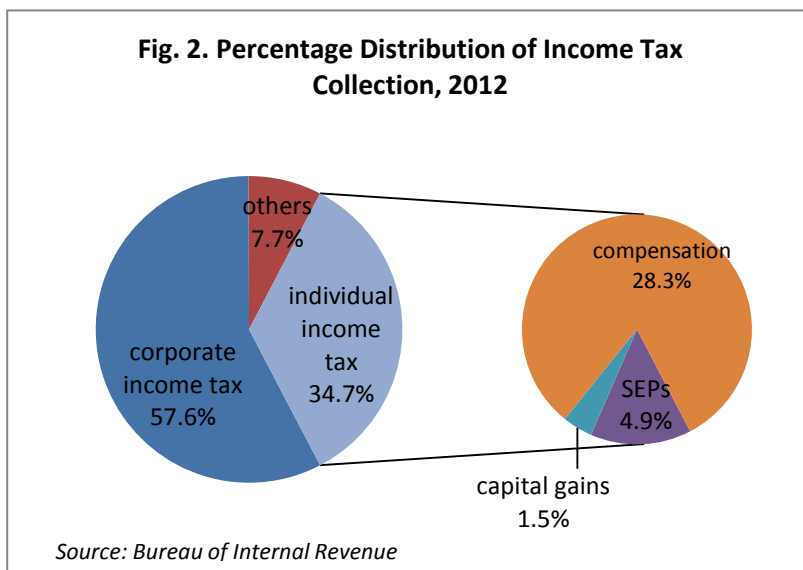
taxpayers, the SEPs are also allowed to claim tax deductions on expenses related to the conduct of their business or practice of profession. By virtue of Republic Act No. 9504, the SEPs have the option to claim for itemized deductions or utilize the optional standard deduction (OSD) of 40 percent of their gross sales or gross receipts.<sup>3</sup>

**Individual Income Tax Performance.** In 2012, corporate income tax (CIT) accounted for 57.6 percent of total income tax collected while 34.7 percent came from individual income tax. Compensation earners, whose income tax is automatically withheld at source, made up the bulk of the individual income tax collection at 28.3 percent while SEPs contributed merely 4.9 percent (Fig. 2).<sup>4</sup> In this light, compensation earners have higher effective income tax rate than SEPs.

From 2000 to 2012, compensation workers contributed an average of PhP107.5 billion to the national coffers annually, while SEPs and capital gains contributed PhP17.6 billion and PhP5.4 billion per year, respectively (Fig. 3).

The large gap in the tax collection between the compensation earners and the SEPs can partly be attributed to the number of taxpayers in each group. In 2012, there were 11.1 million BIR-registered compensation earners. During the same year, there were 3.2 million professionals registered with the PRC but only 1.9 million of which registered as SEPs with the BIR. Of this number, only 28.4 percent actually filed tax returns (Table 2).

One of the several tax advertisements released by the DoF as part of its Tax Watch Campaign reveals telling information on the amount of tax paid by some SEPs, particularly in Makati City.<sup>5</sup> It cites for instance, that in 2012, 54 percent of the SEPs in Makati paid less tax than a public school teacher. A public school teacher earning PhP21,500 every month pays an income tax amounting to PhP35,952 every year. The DoF infograph likewise divulged that out of 318 accountants in Makati, the top one paid PhP4 million but the 318<sup>th</sup> accountant paid merely PhP120. The 317<sup>th</sup> accountant paid PhP138, lower than the daily minimum wage in the National Capital Region (NCR). Moreover, one among 1,179 doctors in Makati paid PhP10 in taxes while another paid just



**Table 2. Taxfiler to Taxpayer Ratio, 2009-2012**

	2009	2010	2011	2012
Number of Registered SEPs w/ the BIR (in '000)	1,598	1,695	1,822	1,986
Number of Tax Returns Filed (in '000)	512	502	542	565
Taxfiler to Taxpayer Ratio	32.0%	29.6%	29.7%	28.4%

Source: Bureau of Internal Revenue

<sup>3</sup> The OSD rate was raised from 10 to 40 percent in order to improve compliance and to lessen the BIR's audit work due to limited manpower. It is not clear however, whether such objectives, particularly improvement in compliance, were met.

<sup>4</sup> SEPs include those who filed their tax returns with or without creditable withholding tax.

<sup>5</sup> Actual data were culled from Revenue District Office (RDO) 47, 48, 49 and 50 in Makati City.

Php82.50. Among 534 lawyers, one paid Php200 while another one paid only Php475.

Studies attribute the low tax collection from the SEPs to the tax collection method. Under the voluntary assessment method, the SEPs have the opportunity to avoid and/or evade taxes because they voluntarily disclose their own income and file their own tax returns. It should be noted that 51.6 percent of individual income tax leakage is attributed to the SEPs.<sup>6</sup> Given this, boosting their “willingness to pay” is indeed imperative.

**Policy Considerations.** It should be noted that tax compliance can be influenced by a combination of any of the following factors: a) quality of the service in return for taxes; b) tax system and perception of fairness; c) transparency and accountability of public institutions; d) level of corruption; and e) rule of law and fiscal jurisdiction.<sup>7</sup>



One of the tax advertisements released by the DoF.

In terms of administrative measures, utilizing third-party information can also improve enforcement because it enables tax administrators to validate the veracity of tax information declared by taxpayers. Requiring the submission of ITRs upon license renewal is a good mechanism to compel professionals to register with the BIR and to pay their corresponding income tax. Priority audits, on the other hand, will be able to help address the problem of under declaration of income by those already registered with the BIR. Based on the World Bank estimates, such administrative measures could raise tax revenue to around 2 percent of gross domestic product (GDP).<sup>8</sup>

Disparities in the tax burden between SEPs and compensation earners should also be addressed either through the amendment of the Simplified Net Income Taxation Scheme (SNITS) under Republic Act No. 7496 or by employing the presumptive income taxation (PIT) for SEPs. Under the PIT scheme, the income of business and professional income earners will be estimated to be used as basis in checking the accuracy of the declared income. Increasing the ceiling of the 13<sup>th</sup> month pay, Christmas bonuses and other benefits excluded in the computation of income tax for compensation earners which is currently pegged at Php30,000 would also somehow alleviate the tax gap between SEPs and compensation earners. At present, there are 7 legislative proposals pending at the Senate Committee on Ways and Means. These are Senate Bill Nos. (SBNs) 256, 452, 453, 1213, 1838, 1944 and 2157 which all seek to increase the ceiling of monetary benefits excluded in the income tax computation of salaried workers.<sup>9</sup>

With administrative measures and legislative proposals at hand, the SEPs can be well targeted in broadening the country's income tax base. Tapping this so-called hard-to-tax group will somehow help in boosting the country's tax effort to reach the level similar with other emerging economies in Asia. Moreover, it should be noted that an equitable tax system would enhance greater tax compliance. In this light, reforms toward an equitable tax system can be an effective strategy in promoting the government's trust for inclusive growth. Currently, 3 bills have been filed at the Senate to restructure the individual income tax system (i.e., SBNs 716, 1942 and 2149).<sup>10</sup>

<sup>6</sup> National Tax Research Center, “Comments on Proposed Senate Resolution No. 241 – Directing the Proper Senate Committee to Conduct an Inquiry, in Aid of Legislation, on the Reported Tax Evasion Committed by Self-Employed Professionals Costing the Philippines about Php388 Billion in Uncollected Potential Revenues,” May 20, 2014.

<sup>7</sup> Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), *Addressing Tax Evasion and Tax Avoidance in Developing Countries*, December 2010.

<sup>8</sup> World Bank's Philippine Economic Update, May 2013.

<sup>9</sup> SBNs 256, 452, 453, 1213 and 1944 were filed by Senator Ralph G. Recto, SBN 1838 by Senator Manuel “Lito” M. Lapid, and SBN 2157 by Senator Juan Edgardo “Sonny” M. Angara.

<sup>10</sup> As filed by Senators Recto, Paolo Benigno “Bam” Aquino IV and Angara, respectively.