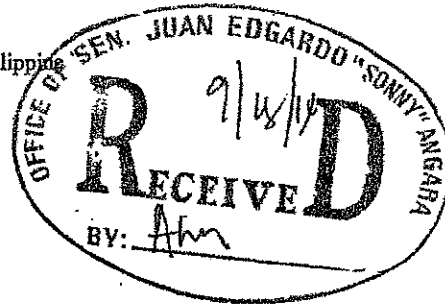




Republic of the Philippines
Senate
Pasay City



STSRO

MEMORANDUM

FOR : The Honorable Senator Sonny Angara
Chairman, Senate Committee on Ways and Means

SUBJECT : Materials for the 2014 Second Meeting of the Joint Congressional Oversight Committee on the Comprehensive Tax Reform Program (COCCTRP)

FROM : Senate Tax Study & Research Office (STSRO)

DATE : 17 September 2014

I. Background

The Joint Congressional Oversight Committee on the Comprehensive Tax Reform Program (COCCTRP) held its first meeting on 12 March 2014. On its agenda are the formal organization of the Oversight Committee and the review of the proper implementation of Republic Act (RA) 10351, otherwise known as the 2012 Sin Tax Act.

The formal organization of the committee was approved and the proposed rules of procedure were adopted. The review of the implementation of the Sin Tax Act of 2012 began with the examination of the issues that were raised during the deliberations of the said law. These include the effects on farmers, smuggling, the ability to curb consumption of cigarettes, raising revenues and the mobilization of the incremental revenues arising from the implementation of the law.

During the meeting, Department of Finance (DOF) Undersecretary Jeremias N. Paul, quoted his superior's – Secretary Cesar Purisima's – words that the law was a "win-win for all." He cited the increased revenues and the reduction in cigarette removals. He reported that the DOF is looking for explanations as to the slight increase in withdrawals of distilled spirits.

This Office furnished the Senate Panel with data requested from the manufacturers, in order to provide a perspective of the first year of implementation of the law in the alcohol and tobacco industries.

Tanduay Distillers Inc. reported that in 2013 its removals were 14.58 million cases, which is significantly lower (-30.4%) than their 2012 sales volume of 20.79 million cases. This is despite their decision not to increase their 2010 net retail prices. The lower removals resulted in the displacement of 238 employees, most of whom are regular daily employees. Their excise tax payment was Php2.82 billion.

Asia Brewery Inc. also reported a substantial reduction (-18.3%) in its removals of fermented liquor in 2013. From 127.81 million gauge liters of beer in 2012, the withdrawals fell to 104.39 million gauge liters in 2013. As a result of the 43.4% increase in the tax rate, their excise-tax payment reached Php1.57 million, 17.0% higher than its 2012 level.

The submissions by both alcohol manufacturers are attached as Tab A.

The four (4) local manufacturers of cigarettes submitted their reports, attached as Tab B.

In 2013, **Associated Anglo-American Tobacco Corporation (AAATC)** ceased production of cigarettes that were packed in 30s; that is, brands that were hand-packed were no longer produced. Moreover, the company discontinued production of a number of brands and instead "consolidated to ... more prominent brands." As a result of the closure of its entire native hand-packing department, about 30 workers lost their jobs.

In 2013, AAATC paid excise taxes amounting to Php459.18 Million for the withdrawals of 38.182 million packs of cigarettes. The 2013 NRP of a pack of cigarettes ranges from Php16.45 to Php22.74.

Despite the cessation of production of native cigarettes, the removals increased from 73,916 cases in 2012 to 76,363 cases in 2013.

In 2013, **La Suerte Cigar and Cigarette Corporation** paid Php136.01 Million in excise taxes for its removals of 22,668 cases (about 11.334 million packs, assuming each case has 500 packs) of cigarettes. All of its twelve (12) brands have NRP of Php10.77 a pack since 2013.

A very huge drop (-70.59%) in removals was experienced by the company in 2013; 2012 removals was pegged at 77,082 cases of cigarettes. Despite this reduction in production and discontinuance of production of four (4) brands, no workers were displaced in 2013.

Mighty Corporation's total excise tax payment in 2013 reached Php8.2 Billion for removals of 688,269,500 packs for domestic consumption.

The company also exported 11,069,500 packs in 2013. Mighty Corporation reported total volume of local sales of 1,364,997 cases and exports of 22,139 cases of cigarettes and 8,254,442 kilograms of cutrags. Moreover, it reported the following prices (in Php) and taxes (in Php) per pack of Mighty cigarettes:

Packaging	2013				2014			
	SRP	Excise tax	VAT	NRP ¹	SRP	Excise tax	VAT	NRP
Soft pack	22.00	12.00	2.36	7.64	28.00	17.00	3.00	8.00
Hard pack	24.00	12.00	2.57	9.43	30.00	17.00	3.21	9.79

Not a single worker was displaced in 2013.

A total of Php59.158 Billion was paid by **Phillip Morris Fortune Tobacco Corporation, Inc.**² (PMFTC) as excise tax on removals of 76.525 billion sticks of cigarettes (about 3.826 billion packs³ of 20s) by both companies in 2013. PMFTC had withdrawn 57.845 billion sticks of cigarettes (approximately 2.892 billion packs), while JTI withdrew 2.818 billion sticks of cigarettes (about 140.91 million packs⁴ of 20s). Of the total removals, 133.35 million sticks (approximately 6.67 million packs) were exported by PMFTC. Thus, withdrawals for which excises taxes were paid amounted to 2.86 billion packs.

Both companies ceased production of some of their brands in 2013. Most of these brands were those that resulted in a negative NRP, in the case of PMFTC. In 2014, JTI continued selling two (2) brands that resulted in a small loss to them – Winston FK Box 10s (-Php0.19) and Winston Lights Box 10s (-Php0.20).

A total of 260 workers were displaced, for various reasons, in 2013.

The Committee requested data from the Bureau of Internal Revenue (BIR), the Department of Trade and Industry (DTI) and the National Tobacco Administration (NTA) in order to assess the reports of violations of the 2012 Sin Tax Law. House Resolution 663 instructs the House Committee on Ways and Means to conduct an inquiry, in aid of legislation, on the alleged violations of this Sin Tax Law by Mighty Corporation and other manufacturers and the reported non-attainment of the objectives of this law. The Senate Committee on Ways and

¹ NRP refers to the retail price net of excise tax and value-added taxes.

² PMFTC manufactures cigarettes for Japan Tobacco Inc. (JTI), hence it pays up front for the withdrawals of JTI brands. It is recalled that the point of collection of the tax on locally produced alcohol and tobacco products is upon withdrawal from the factory. JTI is later billed by PMFTC.

³ Some PMFTC brands are packed in 5s wrapped/banded together to form 20s, and 10s wrapped/banded together to form 20s.

⁴ Some JTI brands are packed in 10s wrapped/banded together to form 20s.

Means is likewise directed to conduct the inquiry, in aid of legislation, under Philippine Senate Resolution Nos. 326 and 440.

II. Data Submissions

On 18 August 2014, the BIR submitted summaries of import and export of cigarette raw materials; summaries of manufacturer's declaration for domestic and exported cigarettes; acetate tow and tobacco leaf year-end inventory; and summaries of income tax, value-added tax (VAT) and excise tax payments for 2010 – 2013. DTI provided the Committee with data covering the period 2005 – 2013, in electronic form, as well as information on the prices of raw materials charged by Mighty Corporation's declared suppliers. The NTA, on the other hand, submitted electronic data and photocopies of the export and import commodity clearances submitted by tobacco players during the period 2010 – 2013.

Bureau of Internal Revenue (BIR). In its submission, the names of importers and manufacturers were in coded form, in compliance to the restriction on unlawful divulgence of trade secrets (Section 270, National Internal Revenue Code, as amended).

1. Summary of Imported leaf tobacco, 2010 – 2013. The Bureau reported 12 importers of tobacco leaf. The volumes of importation, in thousand kilograms, over said period are shown below. During the said period, several tobacco leaf importers whose total volumes are extremely low compared with other importers: ILT-7, ILT-8, ILT-10 and ILT-11. The details are shown in Tab C, Annex 1.

Volumes of imported leaf tobacco by importer, 2010 – 2013, in thousand kilograms

Importer	2010	2011	2012	2013	Total
ILT-1	546	158	69	1,391	2,164
ILT-2	23,335	1,334	1,477	-	26,146
ILT-3	119	610	455	844	2,028
ILT-4	6,824	9,669	14,317	30,968	61,778
ILT-5	23,442	8,242	11	352	32,047
ILT-6	9,958	50,026	37,267	38,545	135,796
ILT-7	7	5	6	-	18
ILT-8	2	2	2	2	8
ILT-9	8,199	575	1,139	-	9,913
ILT-10	-	-	1	Nil	1
ILT-11	-	-	10	Nil	10
ILT-12	-	-	645	-	645
Total	72,432	70,621	55,399	72,102	270,554

2. Summary of importation of acetate tow, 2010 – 2013. BIR records of volume of importation of acetate tow (in thousand kilograms) over the period 2010 – 2013 show that there are only 7 active, out of the 14 registered, importers during the said period:

Volumes of imported acetate tow by importer, 2010 – 2013, in thousand kilograms

Importer	2010	2011	2012	2013	Total
AT-1	99	18	-	72	189
AT-3	260	-	-	-	260
AT-4	457	968	1,315	2,227	4,967
AT-5	2,292	-	-	-	2,292
AT-6	4,717	9,603	11,401	10,515	36,236
AT-13	74	61	422	126	683
AT-14	-	-	60	20	80
Total	7,899	10,650	13,198	12,960	44,707

The BIR report on the importation is shown in Tab C, Annex 1.

3. Summary of export data for cigarettes and cutfillers/cuttrags. During the period 2010 to 2013, increases in the total volume of exports of cigarettes (in cases) and cutfillers/cuttrags (in

kilograms) of the five (5) manufacturers were reported by the BIR. It was only in 2012 that total cigarette export was lower than the previous year's.

Volume of exportation of cigarettes and cutfillers/cuttrags, 2010 - 2013

Manufacturer	Cigarettes (In thousand cases)					Cutfillers/cuttrags (In thousand kgs)				
	2010	2011	2012	2013	Total	2010	2011	2012	2013	Total
M001						228	75	120	169	592
M002	217	209	240	324	990				17	17
M003	118	222	218	27	585	253	362	6,741	8,284	15,640
M004	790	912	847	1,058	3,607	12,061	12,980	14,836	15,233	55,110
M004b	24	3	12	13	52	4	566	760	780	2,110
Total	1,149	1,346	1,317	1,422	5,234	12,546	13,983	22,457	24,483	73,469

The details are shown in Tab C, Annex 2.

4. Summary of manufacturer's declaration and suggested retail price by company and by brand for domestic market, 2010 – 2013. Tab C, Annex 3 provides the coded brands that four (4) cigarette manufacturers marketed locally over the given period. While Manufacturer 1 produced low- and medium-priced cigarettes, Manufacturers 2 and 3 produced only low-priced cigarettes. Manufacturer 4 produced and sold low-, medium- and high-priced brands.

5. Summary of manufacturer's declaration for export market, 2010 – 2013. Tab C, Annex 4 has the list of coded brands and their corresponding gross retail prices as declared by four (4) manufacturer-exporters. Manufacturers 1 and 2 export 12 brands each while Manufacturer 3, 225 brands. In the case of Manufacturer 4b, the export markets were identified as Thailand, Australia, French Polynesia, Hongkong, Malaysia Duty Free, Micronesia, Pakistan, Saudi East/West, and Qatar. Noticeable is the absence of a sworn statement for 2010 by Manufacturer 2.

6. Summary of tobacco leaf and acetate tow year-end inventory, 2010 – 2013. Tab C, Annex 5 shows seven (7) manufacturer-importers of tobacco leaf and five (5) manufacturer-importers of acetate tow during the four-year period.

Year-end inventory of tobacco leaf (In thousand kgs), 2010 - 2013

Importer	2010	2011	2012	2013
MLA - 1	968	-	388	-
MLA - 2	-	9	11	10
MLA - 3	7,943	16,812	22,622	32,773
MLA - 4	5,104	5,278	6,459	8,165
MLA - 5	61,191	68,129	43,548	44,012
MLA - 6	-	-	18	19
MLA - 7	-	-	46	-
Total	75,206	90,228	73,092	84,979

Year-end inventory of acetate tow (In thousand kgs), 2010 – 2013

Importer	2010	2011	2012	2013
MLA - 1	199	-	52	-
MLA - 2	-	68	117	531
MLA - 3	144	183	2	1
MLA - 4	106	58	314	294
MLA - 5	1,026	1,493	1,520	3,910
Total	1,475	1,802	2,005	4,736

7. Summary of tax liabilities of tobacco manufacturers, 2010 – 2013. Tab C, Annexes 6 – 8 provides the taxes due from six cigarette and two cigar manufacturers from 2010 to 2013. Except for taxpayers 4 and 5, the income tax due of cigarette producers in 2013 was lower than their due in 2012, prior to the enactment of the 2013 Sin Tax Law. No Income taxes were collected from cigar manufacturer 1 since 2010.

Except cigarette manufacturer 2, the 2013 value-added tax (VAT) payments of cigarette manufacturers increased over their 2012 liability. A tremendous increase in VAT was recorded for cigarette manufacturer 3.

No excise taxes were collected from cigarette manufacturers 4 and 5 in 2013. A remarkable increase over the 2012 amount was collected from manufacturer 3 in 2013.

Department of Trade and Industry (DTI). The Department submitted reports on the prices of major raw materials used in cigarette production, volumes of importation of tobacco leaf and acetate tow, and verification reports on the alleged export prices of Mighty Corporation.

1. **Prevailing export prices of tobacco leaf and acetate tow.** On 04 April 2014, the DTI reported that the prevailing export prices (in US dollars per kg) of tobacco leaf from Indonesia and Peoples Republic of China, and tobacco leaf and acetate tow from Argentina are as follows:

Product – HS Code/HTS Code	Source	Export Price (US\$/kg)
Tobacco leaf – 2401	Indonesia	5.70 – 6.40
	People's Republic of China	2.93 – 3.42
	Argentina	2.98
Acetate tow – 5601, 5502	Argentina	4.90

2. **Tobacco leaf importation.** The table below shows the volume (net mass, in million kilos) of importation of tobacco leaf by four (4) tobacco manufacturers, by entry code from 2010 to 2013. The entry code indicates whether the product is a transshipment (T); for warehousing thus not to be used for production of domestic goods (W); or raw material for production of cigarettes (C) to be marketed domestically. Under the Tariff and Customs Code, duties and import taxes are not collected from importations declared as transshipment or for warehousing. Importations for domestic use under consumption entries are subject to duties and taxes.

Volume of importation of tobacco leaf (in million kilograms), by manufacturer-Importer, by entry code, 2010 - 2013

Importer	Entry Code	2010	2011	2012	2013	Total
Assoc. Anglo American Tob. Corp.		0.093	0.995	1.319	2.745	5.152
	T	-	0.019	-	-	0.019
	W	0.093	0.942	1.264	1.437	3.736
	C	-	0.034	0.055	1.308	1.397
La Suerte Cig. & Cigt. Factory	C	-	-	0.099	0.455	0.554
Mighty Corp.		2.167	13.651	17.363	37.796	70.977
	T	-	2.129	2.516	12.030	16.675
	W	2.167	11.522	14.847	25.548	54.084
	C	-	Nil	Nil	0.218	0.218
Philip Morris Fortune Tob. Inc.	C	-	29.318	25.583	29.997	84.898
All importers (2)	T		2.148	2.516	12.030	16.694
All importers (2)	W	2.260	12.464	16.111	26.985	57.820
All importers (4)	C		29.352	25.737	31.978	87.067
Total		2.260	43.964	44.364	70.993	161.581

3. **Acetate tow importation.** The next table shows the volume (in net mass, in million kilograms) of importation of acetate tow by the four (4) tobacco manufacturers, by entry code, 2010 – 2013.

Volume of importation of acetate tow (in million kilograms), by manufacturer-importer, by entry code, 2010 - 2013

Importer	Entry Code	2010	2011	2012	2013	Total
Assoc. Anglo American Tob. Corp.	C	0.019	0.414	0.235	0.402	1.070
La Suerte Cig. & Cigt. Factory	C	0.143	-	0.381	0.759	1.283
Mighty Corp.		0.590	1.683	2.659	7.308	12.240
	T	-	0.124	0.285	3.457	3.866
	W	0.579	1.558	2.374	3.651	8.162
	C	0.011	0.001	Nil	0.200	0.212
Philip Morris Fortune Tob. Inc.	C	-	9.817	9.436	10.686	29.939
All importers (1)	T	-	0.124	0.285	3.457	3.866
All importers (1)	W	0.579	1.558	2.374	3.651	8.162
All importers (4)	C	0.173	10.232	10.052	12.047	32.504
Total		0.752	11.914	12.711	19.155	44.532

4. DTI report on verification of prices of raw materials with United States of America (USA) suppliers. DTI also submitted a report on 07 August 2014 indicating that the Philippine Commercial Counselor in Washington, DC, USA confirmed Mighty Corporation's suppliers' prices of acetate tow. The two suppliers – Supplier 1 and Supplier 2 – reported discrepancies between their information and that which was filed by Mighty Corporation with the Bureau of Customs (BOC). In particular,

1. Supplier 1 reported that for the years 2011 – 2013, "the summaries/entries for the imports of acetate tow from them by Mighty Corporation as found in the BOC data ... do not conform with the sales invoice issued to Mighty Corporation."
2. Supplier 1 shipped directly to Mighty Corporation acetate tow that was resold by Supplier 4, an Indonesian company. Hence, Supplier 1 wishes to have the records to show that it was Supplier 4, not Supplier 1, which transacts with Mighty Corporation.
3. Since December 2013, Supplier 1 has not sold any acetate tow to Mighty Corporation.
4. Supplier 1 indicated that the transaction of June 2011 was a single bale of tow shipped to Mighty Corporation and was invoiced at "no charge" but with an indicative invoice of an equivalent value of US\$281.13. This value does not conform to that provided by the Philippine Commercial Counselor in its inquiry.
5. The invoice for the January 2012 transaction between Supplier 2 and Mighty indicated a unit value of US\$5.22 per kilo of acetate tow. The 19,819 kg shipment has a total invoiced amount of US\$103,455.18. These values do not conform to that provided by the Commercial Counselor.
6. Supplier 2 indicated that "the summaries/entries for imports of acetate tow from them by Mighty Corporation as found in the BOC data ... for the years 2011 – 2013, do not accurately reflect their sales ... to Mighty Corporation."
7. Supplier 2 also noted that these summaries/entries "reflect inaccurate harmonized system codes, volumes and pricing."
8. Since November 2013, Supplier 2 has not sold any acetate tow to Mighty Corporation.
9. The price ranges of acetate tow, in USD per kilogram, sold by Supplier 2 were: 2011 – about 5.35; 2012 – 5.50-6.00; and 2013, about 6.20-6.70.

On 01 September 2014, DTI reported that another other alleged supplier of Mighty Corporation, Supplier 3, "did not have any direct sales to Mighty Corporation." Moreover, the unit price stated in the information provided by the Washington, D. C. Commercial Counselor which was culled from the BOC data is "definitely off of Supplier 3's export/selling price."

These DTI reports are attached as Tab D. These companies requested that the Philippine government agencies treat as confidential all disclosed information.

National Tobacco Administration (NTA). The office submitted the following documents:

1. Summary of unmanufactured tobacco import price by tobacco type, by company by country of origin for 2010 – 2013. NTA official records show that there were importation of Virginia tobacco leaf, burley tobacco leaf, native tobacco leaf, oriental tobacco leaf and other unmanufactured tobacco products such as scrap or tobacco waste, expanded stem, cast leaf, cutrags and reconstituted tobacco during the period. These are shown in Tab E.

Virginia flue-cured tobacco leaf import prices ranged from US\$0.68 to US\$7.15 in 2010, US\$0.68 to US\$7.39 in 2011, US\$0.68 to US\$8.76 in 2012 and US\$0.68 to US\$9.03 in 2013 varying based on country of origin. These prices (in US dollars per kilogram), reported by the manufacturers, are tabulated below:

Average price of imported Virginia tobacco leaf, by manufacturer-importer, 2010 - 2013

Importer	2010	2011	2012	2013
Assoc. Anglo American Tob. Corp.	3.91 – 6.75	4.00 – 6.03	3.39 – 5.64	3.07 – 5.29
La Suerte Cig. & Cigt. Factory	n/a	4.00 – 5.55	3.70 – 6.75	1.75 – 6.56
Mighty Corp.	0.46 – 1.03	0.68 – 0.77	0.68 – 0.71	0.68 – 4.58
Phillip Morris Fortune Tob. Inc.	n/a	2.71 – 7.39	2.83 – 8.35	2.68 – 9.03
Phillip Morris Phils. Mfg. Inc.	1.29 – 7.15	0.91 – 7.35	1.07 – 8.76	1.26 – 8.50

Burley type tobacco leaf import prices range from US\$0.68 to US\$6.41 in 2010, US\$0.68 to US\$8.20 in 2011, US\$0.68 to US\$8.79 in 2012 and US\$0.68 to US\$8.03 in 2013, varying based on country of origin. The price ranges (in US dollars per kilogram), reported by the manufacturers, were:

Average price of imported burley tobacco leaf (in US\$ per kilogram), by manufacturer-importer, 2010 - 2013

Importer	2010	2011	2012	2013
Assoc. Anglo American Tob. Corp.	3.37 – 4.75	2.71 – 4.44	2.66 – 3.90	2.55 – 4.53
La Suerte Cig. & Cigt. Factory	n/a	3.95 – 6.40	n/a	4.15 – 4.94
Mighty Corp.	0.68	0.68	0.68	0.68 – 6.39
Phillip Morris Fortune Tob. Inc.	4.09 – 6.41	3.85 – 7.10	2.85 – 7.13	2.79 – 7.60
Phillip Morris Phils. Mfg. Inc.	2.46 – 8.20	2.49 – 7.89	3.30 – 8.79	4.28 – 8.03

2. Summary of exported unmanufactured tobacco products for 2010 – 2013 including information on product type, quantity of exported product, destination, export value and name of consignee. During the period 2010 – 2013, the Philippines exported unmanufactured tobacco products such as Virginia tobacco leaf, burley tobacco leaf, native tobacco leaf and other products such as expanded stem, scrap/refuse/tobacco dust and cutrags.

3. Summary of importations of acetate tow for 2010 – 2013 including information by importer or buyer, by country of origin, total customs value, gross weight, net weight and unit price per kilogram. There were four (4) importers of acetate tow during the period: Associated Anglo American Tobacco Corporation, Mighty Corporation, Phillip Morris Fortune Tobacco Corporation and Phillip Morris Philippines Manufacturing, Inc. Their volumes of importation (net weight, in million kilograms) are

Volume of importation of acetate tow (in US\$ per kilogram), by importer, 2010 – 2013

Importer	2010	2011	2012	2013	Total
Assoc. Anglo American Tob. Corp.	0.179	0.193	0.256	0.126	0.754
Mighty Corp.	1.173	1.669	2.212	1.159	6.213
Phillip Morris Fortune Tob. Inc.	4.791	9.749	11.520	11.236	37.296
Total	6.143	11.611	13.988	12.521	44.263

Import prices of acetate tow, as reported by these importers, ranged from US\$0.36 to US\$5.01 in 2010, US\$0.36 to US\$5.35 in 2011, US\$0.36 to US\$6.02 in 2012 and US\$0.36 to US\$6.13 in 2013. Acetate tow importations came from Belgium, China, Germany, Indonesia, Japan, Korea, Mexico, Thailand, United Kingdom and the United States of America (USA). NTA reported that there is no local source for acetate tow. These information – importer, country

of origin, range of import prices as reported by the importer (in US dollars per kilogram) – are shown below:

Import prices of acetate tow (in US\$ per kilogram), by importer, by origin, 2010 – 2013

Importer	Country of Origin	2010	2011	2012	2013
Assoc. Anglo American Tob. Corp.	China			5.47	5.90
	Germany		5.34	5.62	6.13
	Mexico	5.00	5.35	5.38	
	USA	5.01	5.14		
Mighty Corp.	Belgium	0.36	0.36		
	China		0.36		
	Germany	0.36	0.36	0.36	0.54
	Indonesia		0.36	0.48	0.36
	Japan	0.36	0.36	0.36	0.36
	Korea		0.36		0.36
	Thailand		1.50		
	USA	0.40	0.36	0.36	0.36
Philip Morris Fortune Tob. Inc.	Germany			6.02	
	Japan	4.69	4.76	4.98	5.24
	Korea	4.83	5.17	5.49	5.55
	Mexico		5.05	5.05	
	United Kingdom	4.65	4.86		
	USA	4.88	5.02	5.28	5.41

NTA reported that it has no record of locally manufactured acetate tow.

5. Summary of local purchases/acceptances of tobacco and acetate tow, 2010 – 2013. Over the period, the average buying price per kilo of burley and native tobacco increased annually. In the case of Virginia tobacco, average buying price was lower in 2013 than its level in 2012.

III. Annual Report Required under Republic Act (RA) 10351

Section 10 of the 2012 Sin Tax Law requires the submission of annual reports by the Department of Agriculture (DA), Department of Budget and Management (DBM), Department of Health (DOH) and the Philippine Health Insurance Corporation (PhilHealth) to the Oversight Committee on the first week of August. These reports should provide details on the expenditures of the earmarked excise tax revenues. These agencies provided their reports, attached as Tab F.

1. Department of Agriculture (DA). The DA, through the National Tobacco Administration (NTA) reported that the programs and projects to be funded under this Act will only commence in CY 2015.

It was also reported that the implementing rules and regulations, Joint Circular No. 001.2014, has been issued by the Departments of Agriculture (DA), Budget and Management (DBM), Finance (DOF) and Health (DOH) and the Commissioner of Internal Revenue. Along this line, the DBM, DA and the NTA began the formulation of the Implementing Guidelines for Rules V, VII and VIII of this Joint Circular to assist local government units (LGUs) in their budget preparation. A copy of the Joint Circular is attached as Tab G.

The NTA began formulating the Road Map for the Philippine Tobacco Industry, which will be the basis for programs and projects to be funded by the shares of the LGUs from the incremental tobacco excise revenues, as provided under RAs 7171 and 8240. However, no mention has been made as the earmarked share of LGUs from RA 10351, inasmuch as the dedicated allocation of tobacco excise tax will commence in 2015 as provided under this new Joint Circular.

2. Department of Budget and Management (DBM). The DBM submitted a document on 11 September 2014, showing that for fiscal year 2014, Php22.68 billion was attributed to come from the alcohol and tobacco excise tax revenues. Hence, the agency claims that there is a hundred percent (100%) utilization of the excise tax allocation for insurance coverage. The

amount of Php35.3 billion is equivalent to an annual premium of Php2,400 for each of the 14.71 million indigent families.

3. **Department of Health (DOH).** The Department submitted the *Health Facilities Enhancement Program Funding Assistance 2010-2015 Report* detailing the type of health facilities which are funded under the said program. For 2013 to 2015, the amount is about Php13.1 billion to Php13.6 billion.

4. **Philippine Health Insurance Corporation (PhilHealth).** The agency provided the Committee with an Executive Summary of Premium Contribution for Fiscal Year 2014. The full government share of Php35.26 B shall cover about 14.71 million qualified indigent families listed under the National Household Targeting System (NHTS) of the Department of Social Welfare and Development (DSWD) during the calendar year 2014. A breakdown of the number of qualified indigent families and the amounts of premium by region are detailed in the PhilHealth report.

IV. **Tax Watch⁵ one-page article in the *Philippine Daily Inquirer* on 20 August 2014.** The Tax Watch printed *Customs Watch I Focus: Tobacco Industry* detailing several statistics regarding Importers of unmanufactured tobacco during for the first semester 2014.

1. **Industry average.** Out of the 27 importers, there were 6 whose imports fell 30% below this average; 3, 20% below; and 3, 10% below.

2. **Total imports and duties paid.** During the first semester, a total of 32.35 million kilograms was imported with corresponding duties paid amounting to Php282.95 million. The largest importer is Philip Morris Fortune Tobacco Corporation, followed by Mighty Corporation, Associated Anglo American Tobacco Corporation and Universal Leaf Phils., in that order.

Volume of importation and duties paid, 1st Semester 2014

Importer	Gross Mass (In Kg)	%	Duties Paid (In Php)	%
Apo Production Unit	357	nil	15,264	0.01
Assoc. Anglo American Tob. Corp.	1,078,910	3.34	12,597,392	4.45
British American Tobacco (Phils.) Ltd.	270,823	0.84	17,931	0.01
Golden Tobacco Corp.	300	0.00	32,684	0.01
Japan Tobacco Inc.	203,281	0.63	-	-
La Suerte Cig. & Cigt. Factory	141,611	0.44	528,669	0.19
Mighty Corp.	8,564,464	26.47	114,374,996	40.42
Philip Morris Fortune Tob. Inc.	21,034,068	65.02	140,236,613	49.56
Philip Morris Phils. Mfg. Inc.	269,048	0.83	6,369,466	2.25
Richie Import & Export Trading	53,086	0.16	90,916	0.03
Universal Leaf Phils.	734,539	2.27	8,689,318	3.07
Total	32,350,487	100.00	282,953,249	100.00

The declared prices of Virginia flue-cured tobacco increased in from 14% to 412% between 2013 and 2014 except for one importer that decreased declared import value by 20%.

Import prices of Virginia flue-cured tobacco in 2013 and 1st Semester 2014 (in pesos per kilogram)

Importer	2013	2014	Change (in percent)
Assoc. Anglo American Tob. Corp.	150.62	172.03	14.21
Mighty Corp.	36.46	186.99	412.86
Philip Morris Fortune Tob. Inc.	216.33	172.91	-20.07
Philip Morris Phils. Mfg. Inc.	249.36	324.07	29.96

2013 data from Tax Watch article in the *Philippine Daily Inquirer* on 29 January 2014.

⁵ Tax Watch is a joint campaign of the Department of Finance and the Bureau of Internal Revenue. Its goal is to increase transparency on tax payment and to encourage people to be conscientiously pay the correct taxes. Retrieved from <http://www.gov.ph/2013/07/13/tax-watch-a-campaign-for-transparency-and-conscientiousness> on 15 September 2014.

All import prices of burley type tobacco increased from the reported 2013 to the first half of 2014. The increases range from 7.89% to 169.79%, as shown in the table below.

Import prices of burley type tobacco in 2013 and 1st Semester 2014 (in pesos per kilogram)

Importer	2013	2014	Change (in percent)
Assoc. Anglo American Tob. Corp.	112.73	162.89	44.50
Mighty Corp.	81.70	220.42	169.79
Phillip Morris Fortune Tob. Inc.	163.63	176.54	7.89
Phillip Morris Phils. Mfg. Inc.	233.34	325.50	39.50

2013 data from Tax Watch article in the *Philippine Daily Inquirer* on 29 January 2014.

Both Tax Watch articles are attached as Tab H.

V. STSRO Comments and Recommendations

1. BIR data. These are the observations on the 2010 – 2013 data provided by the BIR:

- a. The total volume of importation of tobacco leaf remained in the level of 72 million kilograms over the period 2010 – 2013, except in 2011 when the total volume fell to 55 million kilograms.
- b. Only seven (7) out of the 14 registered importers of acetate tow, were active during the period. AT-3 and AT-5 stopped importing since 2011.
- c. In 2013, remarkable increases in export volumes of cigarettes and cutrags were noted for Manufacturer 4. Thus, the total export of cigarettes increased tremendously from just about 1.5 million kilograms in the past three (3) years to 24.5 million kilograms in 2013. Also noticeable is the absence of exportation of cigarettes by Manufacturer 1.
- d. There are no excise taxes collected from two (2) cigarette manufacturers in 2013: TP 4 and TP 5. Moreover, TP 5 did not pay any excise taxes since 2011. Despite this reduction in the number of excise tax liable cigarette manufacturers, 2013 collection is more than double that collected in 2012.

It is recalled that RA 10351 provided for hefty increases, ranging from 108% to 340%, on several cigarette brands effective 1 January 2013. In particular, the tax rate increased from Php2.72 to Php12.00 for low priced brands – representing a 340% increase; from Php7.56 to Php25.00, medium priced brands – 108%; and from Php12.00 to Php25.00, high priced brands – 230%. Moreover, RA 10351 effectively reclassified cigarette brands by using the 2010 BIR price survey as basis.

e. Inasmuch as the codes used in listing the cigarette manufacturers, it is difficult to verify whether any particular cigarette manufacturer produces and sells locally more than the tax-paid volumes.

2. DTI data. The data from the Department includes the entry code, allowing the identification of the use for the importation.

- a. Importation of tobacco leaf by the four (4) cigarette manufacturers grew over the period, 2010 – 2013. The bulk of the importations were entered as consumption goods, except in 2013 when tobacco leaf were imported for warehousing. During this period total importation for consumption was about 32 million kilograms while those for warehousing stood at nearly 27 million kilograms. This volume is attributed to the huge volume of importation by Mighty Corporation (25.6 million kilograms).
- b. The annual importations (in million kilograms) of tobacco leaf by each importer-manufacturer are shown below.

<i>Importer</i>	<i>Entry Code</i>	2005	2006	2007	2008	2009	2010	2011	2012	2013
Assoc. Anglo American Tob. Corp.	T	-	-	-	-	-	-	0.02	-	-
	W	0.07	0.31	0.61	0.94	0.028	0.09	0.94	1.26	1.44
	C	-	-	-	-	-	-	0.03	0.06	1.31
La Suerte Cig. & Cigt. Factory	C	-	0.45	0.58	0.73	0.79	-	0.10	0.46	0.84
Mighty Corp.	T	-	-	-	-	-	-	2.13	2.52	12.03
	W	0.29	2.46	5.24	8.27	7.06	2.17	11.52	14.85	25.55
	C	-	-	-	-	-	-	nil	nil	0.22
Phillip Morris Fortune Tob. Inc.	C	-	-	-	-	-	-	29.32	25.58	30.00

Associated Anglo American Tobacco Corp. (AAATC) has been importing cigarettes for warehousing since 2005. It had transshipment in 2011 only. Its volume of importation for use in production of cigarettes to be sold in the domestic market increased dramatically in 2013. From less than 100,000 kilograms in 2011 and 2012, the volume increased to 1.3 million kilograms in 2013.

La Suerte Cigar and Cigarette Factory imported tobacco leaf for production of cigarettes to be sold locally since 2005. It has no importations entered as transshipment or for warehousing. Except in 2010, its importations remained within the 450 thousand to 850 thousand kilograms band.

Mighty Corporation's volumes of importation of tobacco leaf, regardless of purpose/entry code, have been higher year-on-year, since 2005. It imported tobacco leaf for warehousing since 2005. Moreover, its importations for warehousing are very much higher than the previous year's since 2011. These imports accounted for at least 67% of its total imports.

Mighty Corporation's importation entered as transshipment and consumption started only in 2011. Its importation for use in producing cigarettes for local markets are extremely small compared with importations entered as transshipment or warehousing. Its importations for domestic consumption in 2011 and 2012 are miniscule, 100 kilograms and 127 kilograms, respectively.

Phillip Morris Fortune Tobacco Inc. (PMFTC) started importing tobacco leaf in 2011. All of its importations are for production of cigarettes destined for the domestic market.

c. Total volume of importation of acetate tow also increased over the period 2010 – 2013. Mighty Corporation is the only cigarette manufacturer that imported acetate tow with entry codes T (transshipment) and W (warehousing). The other three (3) imported acetate tow for production of cigarettes to be sold in the domestic market.

d. The annual importations (in million kilograms) of acetate tow by each importer/manufacturer are shown below.

<i>Importer</i>	<i>Entry Code</i>	2005	2006	2007	2008	2009	2010	2011	2012	2013
Assoc. Anglo American Tob. Corp.	C	-	-	-	0.09	0.09	0.02	0.41	0.23	0.40
La Suerte Cig. & Cigt. Factory	C	0.04	0.30	0.10	0.04	0.27	0.14	-	0.38	0.76
Mighty Corp.	T	-	-	-	-	-	-	0.12	0.29	3.46
	W	0.08	0.67	0.90	1.23	1.05	0.58	1.56	2.37	3.65
	C	-	-	-	-	-	0.01	nil	nil	0.20
Phillip Morris Fortune Tob. Inc.	C	-	-	-	-	-	-	9.82	9.44	10.69

Acetate tow importation by Associated Anglo American Tobacco Corp. (AAATC) began in 2008. All its importations are for use in the production of cigarettes for domestic consumption.

Just like AAATC, La Suerte Cigar and Cigarette Factory imported acetate tow for its production of cigarettes to be sold in the domestic market.

Mighty Corporation has been importing acetate tow for warehousing since 2005. The amounts for warehousing has been increasing over the years, except in 2009 and 2010 when the year's volume was lower than the previous year's. It has imports for transshipment since 2011. The volume has jumped significantly from 285,018 kilograms in 2012 to 3.46 million kilograms in 2013. Its importation for production of cigarettes for the domestic market began in 2010. In the case of importation with consumption entry code, there is a tremendous increase (nearly a thousand fold) in the volume from 201 kilograms in 2012 to 200,317 kilograms in 2013.

PMFTC started importing in 2011. Its importation was entered as raw materials used in the production of cigarettes for the domestic market. Over the period, the volume of importation is within the band 9.4 million kilograms to 10.7 million kilograms.

e. The reports transmitted by the Philippine Commercial Counselor in Washington, D.C. clearly indicate that the US companies which Mighty Corporation claimed to be its suppliers dispute its report to the Bureau of Customs with regards to its importation of raw materials. Supplier 1 stated that "Supplier 1 made no direct sales to Mighty." Supplier 2 reported that the summaries of acetate tow purchases by Mighty Corporation "do not accurately reflect our sales of acetate tow to Mighty." Supplier 3 "did not have any direct sales to Mighty."

3. NTA data. The data from this office indicated the countries of origin of the imported tobacco leaf and acetate tow, the volumes and prices of these cigarette materials.

a. The average price of imported tobacco varied widely every year. What is interesting to note is the nearly constant price of imported tobacco leaf by Mighty Corporation. Unlike other importers, including those not manufacturing cigarettes, its price for various types of tobacco leaf (Virginia, burley, oriental) and from different sources, stood at US\$0.68 from 2010 to 2012.

Another remarkable information from the NTA report is the price of tobacco leaf imported by Mighty Corporation. During all those years, 2010 to 2013, the price is way below that reported by any of importers in any given year.

Recalling Summary of Tobacco Production by Type of Tobacco, it is significant that the import price of tobacco leaf of less than a US dollar by Mighty Corporation is substantially lower than any of these prices, to wit:

Average prevailing market price of local tobacco, in Php per kilogram

Type of tobacco	2010	2011	2012	2013
Virginia tobacco	68.56	70.42	73.86	67.50
Burley tobacco	67.08	69.19	76.48	80.37
Native tobacco	52.78	52.22	57.49	59.72

b. Acetate tow prices paid by two (2) cigarette manufacturers steadily increased over the four-year period: Associated Anglo American Tobacco Corporation and Phillip Morris Fortune Tobacco Inc. The prices paid by Mighty Corporation on the other hand remained nearly the same every year.

Moreover, the prices of acetate tow imports of Mighty Corporation are the same (US\$0.36) regardless of the country of origin, with the exception of Germany (US\$0.54 in 2013), Indonesia (US\$0.48, 2012) and Thailand (US\$1.50, 2011).

Finally, within a given year, the prices of imports by Associated Anglo American Tobacco Corp. and Phillip Morris Fortune Tobacco Inc. are contiguous. The prices submitted to NTA by Mighty Corporation are outliers, not even a tenth of the prices paid for by either of the two (2) manufacturers.

4. Annual reports required under RA 10351. The Joint Circular 001.2014 of the DOF, BIR, DOH, DBM and DA provides for the distribution of the incremental revenues two (2) years after it was collected. Be that as it may, the current submissions of their annual reports will provide baseline information on the projects and programs presently undertaken by these agencies.

5. Customs Watch 1 Focus: Tobacco Industry. In 2013, the prices of Virginia and burley tobacco importation varied largely among the three local cigarette manufacturers. However in the first half of 2014, these prices were a little closer to each other. Noticeable is the considerably low price of imports by Mighty Corporation in comparison with the other manufacturers in 2013.

For Virginia tobacco imported in 2013, Mighty Corporation's price was Php36.46. In comparison, Associated Anglo American Tobacco Corporation's price was Php150.62 and Philip Morris Fortune Tobacco Inc.'s, Php216.33. Burley tobacco import price of Mighty Corporation was Php81.70, which is not comparable to Associated Anglo American Tobacco Corporation's price of Php112.73 and Philip Morris Fortune Tobacco Inc.'s, Php163.63. Hence, the increase in the prices from 2013 to the first half of 2014 is relatively huge than those of other manufacturers'.

6. Congruence of government data. The data provided by the different government agencies – the BIR, the DTI and the NTA – are not in agreement with each other. Moreover, government data do not coincide with the data submitted by the manufacturers. Unlike the DTI data, the BIR and the NTA data do not identify the use of the imported raw materials. However, the DTI dataset for 2010 appears to be quite incomplete.

a. The total/industry volume of importation of tobacco leaf (in million kilograms) as reported by the different government agencies are

Source of data	2010	2011	2012	2013	Total
BIR	72.43	55.40	70.62	72.10	270.55
DTI	7.04	46.84	48.97	75.18	178.02
NTA	52.57	39.62	62.54	62.54	217.27

b. The total/industry volume of importation of acetate tow (in million kilograms) as reported by the different government agencies are

Source of data	2010	2011	2012	2013	Total
BIR	7.90	13.20	10.65	12.96	44.71
DTI	1.87	11.91	12.71	19.16	44.53
NTA	8.51	11.61	13.99	12.52	46.63

c. The volume of importation of acetate tow over a period could provide a good indication of the removals of cigarettes for the domestic market. We note that the values of the total volume of acetate tow importation for the four-year period as reported by the three agencies are within a small range (44.53 to 46.63). The DTI data, which identifies the entry code of the material and the volumes of removals as submitted by the manufacturers to this Office, are used to illustrate this observation.

The table below shows that a high correlation may be established between the 2010 – 2013 acetate tow importation under consumption entry and the removals of cigarettes, except in the case of Mighty Corporation.

2010 – 2013 acetate tow importation and 2013 removals of cigarettes and excise tax payments by manufacturer

Manufacturer	2010 – 2013 Importation (in million kilograms)				Removals ^b (In million packs)	Excise Tax Payments (million pesos)
	W	T	C	Total		
Assoc. Anglo American Tob. Corp.	-	-	1.070	1.070	38.182	459.18
La Suerte Cig. & Cigt. Factory	-	-	1.283	1.283	11.334	136.01
Mighty Corp.	8.162	3.457	0.212	12.240	688.269	8,200.00
Phillip Morris Fortune Tob. Inc. ^a	-	-	29.939	29.939	3,826.255	59,158.43
Total	8.162	3.457	32.504	44.123	4,564.040	67,953.62

^a Includes production of Japan Tobacco Inc. brands

^b error on the removals in the STSRO report of 10 March 2014; rechecking the submissions provide these data

Sources: DTI for volume of importation and Manufacturers for Removals and Excise tax payments

d. Another indicator of the volume of production of cigarettes of each manufacturer is the sum of the volumes of tobacco leaf importation, local purchases and ending inventory of the previous year less the sum of volumes of export of tobacco leaf and cutrags and a certain allowance for wastage. However, not one of the data sources provide these complete information. Moreover, the Department of Science and Technology informed the Committee that it does not issue a certification as to the formula of conversion of tobacco leaf to cigarettes and cutrags/cutfillers. Finally, the Bureau of Customs has not provided the data requested during the meeting on 12 March 2014.

7. Recommendations. This office respectfully recommends

a. Accurate and timely data sharing between the government agencies. The disparities in the type and magnitude of data submitted by the different agencies that monitor/regulate the tobacco industry point to the need to put in place an inter-agency committee to ensure the sharing of timely and accurate data among themselves. Among the tasks of this inter-agency committee are the harmonization of the forms, procedures of filing the reports, and the reporting, as well as the institution of linkages with agencies that oversee the tobacco industry.

b. Further study to determine whether there are taxes and duties leakages. The above data from the agencies as well as the manufacturers indicate the need for closer analysis of the harmonized data inasmuch as these same data do not lend themselves to further analysis.

For the Chairman's Information.

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Enclosed: as stated.