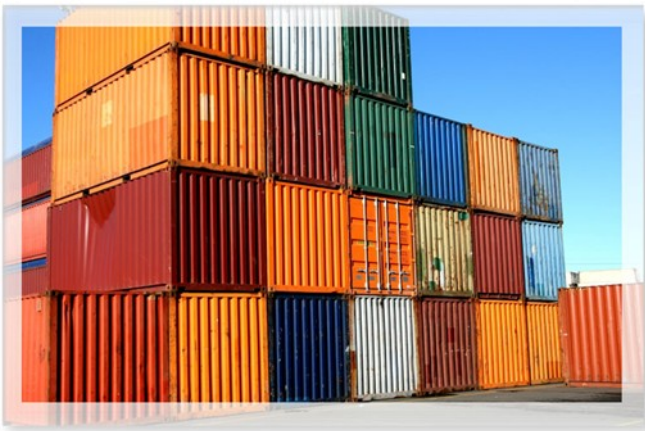


## POINTS TO CONSIDER IN EVALUATING AN ANTI-SMUGGLING BILL

by

**Atty. Emmanuel M. Alonzo**  
Director III, STSRO



The passage of an anti-smuggling bill is necessary ahead of other possible tax measures according to the Federation of Philippine Industries (FPI). According to the FPI an estimated one hundred twenty five billion pesos (P125B) in duties and taxes are not collected because of smuggling.

In this regard the FPI suggests that the incoming President Benigno Simeon C. Aquino should issue Executive Orders (EOs) or Administrative Orders (AO) in order to plug the financial leakage. The FPI chairman Jesus Arranza proposed the topics that should be contained the presidential issuances. It is worthwhile to note that these topics are in the anti-smuggling bill already drafted by the Senate Tax Study and Research Office (STSRO) prior to the recent election of May 2010.

Mr. Arranza mentioned the following topics: (a) the transmittal of the ship's inward foreign manifest (IFM) to the Bureau of Internal Revenue (BIR), and the industry groups; and (b) the electronic transmittal of all import entries and the bill of lading of incoming goods to the BIR to detect undervaluation and to prevent huge loses in the payment of the value added tax (VAT).

In this regard it is worthwhile to point out in a general way the provisions of the stalled anti-smuggling bill and the reasons behind the provisions.

Drafting an anti-smuggling bill is a delicate balancing act because opposing interests must be taken into consideration. The concern of the government is always the collection of taxes and duties, a major source of government revenues. Opposing the interest of the government is the concern of the domestic industries, who want to lower border taxes and duties. Equally important are the pertinent provisions of international agreements affecting export and import procedures.

Among the international agreements our country entered into, the World Trade Organization (WTO) has the biggest influence. It encompasses a major portion of customs practice considering that it contains provisions on customs valuation, anti-dumping, countervailing duties, safeguard measures and the like.

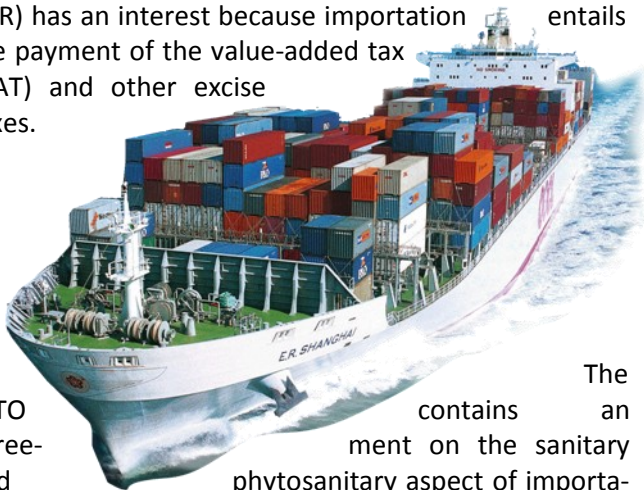
The Revised Kyoto Convention (RKC), a multilateral treaty recently ratified by the Senate, is considered as the most comprehensive instrument for promoting trade facilitation. The RKC would affect the anti-smuggling bill as well as the fiscal incentives bill. The RKC deals on the procedural aspect of importation, affecting imports regardless of the domestic port of entry, either in a regular port, or in a freeport.

The RKC has more impact on the fiscal incentives bill than on the anti-smuggling bill. In fact, the whole chapter of the RKC on freeports was rejected by the Philippine government because the provisions contained therein are too liberal. Unless the government later includes these rejected provisions regarding freeports, the fiscal incentives bill would still ran

contrary to the RKC.

The passage of the Electronic Commerce Act. RA 2001, is the first significant step towards the simplification of customs procedures by eliminating human intervention and its tendency to diminish smuggling cases.

Even before the arrival of the imports, critical data may now be sent to the BOC in preparation for the imports' arrival. The BOC may share pertinent data with the concerned government agencies. The (BIR) has an interest because importation entails the payment of the value-added tax (VAT) and other excise taxes.



The WTO contains an agreement on the sanitary and phytosanitary aspect of importation to avoid the spread of diseases as well as to avoid the introduction of harmful animal species to a particular ecological system. It is therefore imperative that pertinent government agencies have an advance notice regarding the importation at the port of importation. In fact, it is important that potential harmful importations should do not land in the Philippine territory. Among the government agencies needing advance notice are the Department of Agriculture (DA) and its attached agencies as well the Department of Health (DOH). In this area, the real time sharing of data is of utmost importance.

It is also necessary that the BOC share pertinent data electronically with the freeports and the economic zones because their imports are tax and duty free. In theory, the imports do not enter the Philippine tax jurisdiction, while the imports of economic zones definitely enter the tax jurisdiction of the Philippines. Although smuggling does occur in freeports and the economic zones. The anti-smuggling provisions should be included in another bill, the rationalization of fiscal incentives.

There are custom bonded warehouses (CBWs) operated by the BOC. There are also warehouses inside the freeports and economic zones, as is operated by their respective Freeport authorities while the latter are run by Philippine Economic Zone

Authority (PEZA). In this regard, monitoring of warehouses needs two separate bill. BOC operated warehouses must be covered by the anti-smuggling bill while warehouses under the jurisdiction of PEZA and freeports must be covered by the fiscal incentives bill.

Profiling is an important function of computerization. At present, the BOC does profiling on importers classifying them into levels of risks, measuring the probability of smuggling. Profiling should also be done on shipping lines, shipping companies, freight forwarders, consolidators, bulk agents, as well as the countries of origin. Furthermore, if the probability of smuggling is high, sanctions may be imposed on entities habitually transporting smuggled imports, in so doing their respective licenses may be revoked plus the imposition of fines and penalties.

The domestic industries provide employment and government revenues making it an important sector in drafting an anti-smuggling bill. This is the reason why this sector wants an active role in the importation process in order to protect its interest. However, the drafters of the bill must be careful that the private sector does not encroach in purely governmental functions.

Active participation of the private sector in the BOC operations would place both the BOC and the private in a delicate situation. BOC personnel are subject to the Civil Service rules and regulations, while a private entities are not. In case of a criminal offence only the government personnel would be subject to administrative sanction. Naturally, both the private as well as the government sector should be subject to both civil and criminal actions. Business-wise, the undue active participation of the private sector in purely governmental functions have the tendency to divulge trade secrets to competitors.

Any legislation containing fines and penalties become less effective in deterring crimes because they are expressed in monetary terms which devalues through time. Provisions on fines and penalties must therefore be updated to deter the commission of smuggling. To further make the penal provisions effective, the imprisonment portion must be increased. Furthermore, the penalty of imprisonment and the fines must be imposed together, not in the alternative.

If smuggling occurs in regular ports, it may not be accomplished without the participation of the government personnel, particularly the BOC. It is

therefore noteworthy to include provisions regarding the forfeiture of all retirement and separation benefits of participating government personnel.

The technical and specialized nature of the importation process needs prosecutors well versed in BOC operations. The BOC lawyers are in the best position to act as prosecutors in smuggling cases. It is suggested that the lawyers of the BOC handle these cases instead of the regular government prosecutors. Note that a special

court, the Court of Tax Appeals was specially created because of the technical nature of taxation.

Incentives and rewards should be given to the BIR lawyers in cases of successful prosecution of smuggling cases. Internal revenue taxes like the VAT and excise taxes are also involved in the prosecution of smuggling cases. In the same manner the BIR lawyers are in a better position to prosecute cases regarding the non-payment of internal revenue taxes.

## OVERVIEW OF RP'S FISCAL INCENTIVES

By

**Rechilda B. Gascon, MNSA**

Director III, STSRO



What are fiscal incentives? Fiscal incentives are in the form of tax holidays or exemption from payment of tax and duties to encourage and stimulate investments. Investors and

the business community argue that tax incentives are necessary to attract foreign investors considering the very stiff competition from neighboring countries that also offer incentives. However, studies show that fiscal incentives are not the main determinant to the inflow of investments. Investors are looking at factors such as: (a) economic and political stability, (b) adequate infrastructure, (c) trainable labor force, (d) adequate natural resources, and (e) well administered tax system<sup>1</sup>.

The recent survey conducted by the Asian Development Bank (ADB) revealed that the poor investment climate of the Philippines is not due to flawed policies or dysfunctional culture but due to the following factors: changing rules or arbitrary policies interpretation, red-tape procedures, interferences by LGU officials, and high cost of power, among others.

### Background of RP's Fiscal Incentives

The country's tax incentives are classified into five (5) categories, namely:

1. Tax incentives/exemptions granted under the Constitution and International Agreements;
2. Tax incentives/exemptions granted under the basic codes;
3. Tax incentives/exemptions granted under various special investment laws;
4. Tax incentives on merit goods; and
5. Tax incentives/subsidies granted to Government Owned and Controlled Corporations (GOCCs) and National Government Agencies (NGAs).

*A World Bank study indicates that "from efficiency viewpoint, by favoring one form of economic activity over another, tax incentive distort relative prices, and therefore misallocate resources"*

At present there are more than 140 laws granting fiscal incentives. Worth noting are eight (8) laws e.g., RA 7916 – The Special Economic Zone Act of 1995; PD 66 – Export Processing Zone Authority; Executive Order No. 226 – The Omnibus Investments Code of 1987; RA 7903 – Zamboanga Special Economic Zone Act of 1995; RA 7922 Cagayan Special Economic Zone Act of 1995; RA 7227 – Bases Conversion and Development Act of 1992; RA 9490 – Aurora Special Economic Zone Act of 2007; RA 9593 - Tourism Act of

<sup>1</sup> Article entitled : "Tax Incentives" by Dale Chua, IMF Tax Policy Handbook 1995

2009; and RA 9728 – Freeport Area of Bataan Act of 2009.

**LAWS GRANTING INCENTIVES CLASSIFIED BY  
SECTOR/INDUSTRY**

<b>By Sector/Industry</b>	<b>Number of Laws</b>
Agrarian Reform	7
Air Transport Services	3
Automobile	1
Autonomous Regions	2
Balikbayan	1
Banks/Financial Institutions	6
Barangay Micro Business Enterprise	1
BOI Registered Firms/ Industries Acquiring Capital Equipment	4
Book Publishing Industry	1
Boys Scout/Girls Scout	1
Communication/Postal Services	5
Cooperatives	1
Culture and Arts	3
Disabled Persons	1
Duty Free Shopping	10
Economic Zones	9
Education/Schools	18
Energy/Oil Industry	13
Environment/Pollution Control	4
Exporters	1
Filipino Investors	1
Games and Amusement	3
Health	4
Housing	2
Infrastructure	2
Domestic Manufacturing /Biding in Government Projects	1
Insurance System	2
Iron and Steel Industry	1
Jewelry	1
Labor	2
Local Government	1

Mining	1
Senior Citizens	1
Shipping	4
Sports/Athletes	2
Veterans	3
Wearables	1
Youth	1
International Agreements	6
The Philippines Constitution	1
National Internal Revenue Code	1
Tariff and Customs Code	1
Local Government Code	1
others	9
<b>TOTAL</b>	<b>144</b>

**Incentives Granted by Ecozones**

The incentives granted by the special economic zones include:

- Income Tax Holiday (ITH)
- 5% tax on Gross Income
- Tax and duty-free importation of capital equipment
- Net operating loss carry-over
- Accelerated depreciation
- Tax credit for taxes and duties on raw materials and supplies forming part of export products, exported directly or indirectly by registered enterprises
- Tax credit on tax and duty portion of domestic breeding stock
- Tax credit for local material input
- Exemption from local taxes and licenses, except real estate taxes
- Exemption of domestic and imported articles from customs and internal revenue laws/regulations as well as local ordinances
- Exemption from wharfage dues and export tax, impost on fees for non-traditional export production
- Additional deduction for labor expense
- Exemption on imported breeding stocks and genetic materials

Among the incentives enumerated above, the Income Tax Holiday (ITH) is considered inefficient, irrelevant and duplicative. Studies<sup>1</sup> have shown that ITH is the most redundant incentive. The study has

also show that among the investment promotion agencies<sup>2</sup>, the “redundancy rate”<sup>2</sup> of the Board of Investments (BOI) is markedly higher (80%) than that of Philippine Economic Zone Authority (PEZA) and Subic Freeport (10%). The study also reveals that 95% of the projects submitted for BOI approval generate a financial rate of return (FIRR)<sup>3</sup> of 15% or greater prior to the application of incentives.

Likewise, said study revealed that many investments approved and granted by the government do not really need tax incentives as 70% of the investments approved by BOI<sup>4</sup> were primarily induced by the strength and size of domestic market, while 13% were resource seeking (investors require the country’s rich resources which cannot be found in other countries, e.g., mining, tourist operators, and those putting up regional headquarters).

The Bureau of Internal Revenue (BIR) conducted a review and audit on the companies that have previously availed of ITH from PEZA and BOI and was able to collect an additional P 553 Million<sup>5</sup> as of April 10, 2010. This was a joint undertaking among the granting agencies (PEZA and BOI) and BIR in compliance with the Memoranda of Agreements made between the aforesaid agencies to monitor the availments of the ITH incentives.

BIR Collections from Companies Previously Availed of ITH As of April 2010 (in Million Pesos)							
Collection from Pre-Audit	TAXABLE YEAR/FISCAL YEAR UNDER AUDIT						Total
	BOI					PEZA	
	2000-2003	2004	2005	2006	Total	2004-2005	
2005	14.61				14.61		14.61
2006	4.55				4.55		4.55
2007		70.64	28.50		99.14		99.14
2008			393.28		393.28	4.52	397.8
2009			1.74	1.57	3.31	25.35	28.66
2010			0.01	8.24	8.25		8.25
Total	19.16	70.64	423.53	9.81	523.14	29.87	553.01

Source : BIR

The five percent (5%) tax on gross income is an incentive given only to locators inside the Special Economic Zone/Industrial Zone or Freeport Zones.

**2. Amount of Fiscal Incentives Granted**

The fiscal incentives granted by these government agencies amounted to P156.25 Billion in 2004. This amount is more than 50% of the P282.76 Billion total incentives granted by the government in 2004 which is considered as revenue foregone by the government, as shown below:

Incentives Granted by Major Incentive Category CY 2004	
Incentive Granting Agency	Amount in Billion Pesos
Granted by BOI, Ecozones, Freeports/ Industrial Estates	P156.25
Granted to other sectors	3.736
Granted to non-profit, non-stock educational institutions under the Philippine Constitution	0.089
Granted under International Agreements	0.318
Granted through FIRB Resolutions	0.695
Granted in the Tariff and Customs Code	1.744
Granted in the NIRC	113.950
Tax subsidies to GOCCs	5.981
<b>TOTAL</b>	<b>P282.76</b>

Source: Department of Finance

<sup>1</sup> Study conducted by Dr. Renato E. Reside, Jr., entitled: “Costs and Benefits of the Fiscal Incentives Bill” dated March 29, 2006.  
<sup>2</sup> Redundancy rate is the percentage of investors receiving ITH who would have come even if they had not been granted incentives. If tax incentives are given only to investors who would not otherwise have come, and are exactly the amount required to attract them, then there is no revenue loss from the incentives-zero redundancy.  
<sup>3</sup> FIRR of 15% is already an acceptable investment rate of return and hurdle rate for most infrastructure projects.  
<sup>4</sup> An article by Dr. Romulo M. Miral, Jr., entitled: “Reforming the Fiscal Incentives System, revealed the following: (a.) BOI incentives have aggravated the proliferation of inefficient industries; (b.) BOI incentives may have unduly promoted capital intensity; (c) resulting in low employment capacity of industry; (c). BOI incentives also appear to be biased towards large-scale firms; (d.) The Investment Priorities Plan (IPP) is too broad; (e). BOI procedure in the registration as well as approval procedures continue to be complicated and time-consuming.  
<sup>5</sup> Collection per RMC No. 15-2007 BIR and PEZA amounted to P29.87 Million and per RMC No. 17-2007 BIR and BOI amounted to P 523.14 Millions as of April 30, 2010. The RMCs institutionalize coordination between the BIR and IPA’s in order to effectively administer the ITH and other incentives enjoyed by registered enterprises.

As to type of incentives granted, the value-added tax (VAT) amounted to P219.658 Billion which is almost 80% of the total incentives granted in 2004, as shown below:

<b>Incentives Granted by Type of Tax CY 2004</b>	
Vat	P 219.658
Duty	34.448
Income Tax	27.139
Excise Tax	0.043
Capital Gains Tax	0.031
Documentary Tax	0.005
Withholding Tax	0.013
Franchise Tax	0.037
Percentage Tax	0.0137
Tax Credit Issued under EO 226 (with no breakdown as to type of tax)	1.345
<b>TOTAL</b>	<b>P 282.76</b>
Source : Department of Finance	

The foregone revenues for CY 2004 amounting to P282 Billion is understated as it excludes the 5% preferential tax enjoyed by free-ports/ecozone locators, and other tax exemptions such as exemption from income tax and other taxes granted under various special laws.

**ISSUES IN THE GRANT OF INCENTIVES**

1. Whether there should be uniform tax incentives to

all sectors of investments. What are the priority industries to be given incentives (agriculture, housing, infra-structure, power, environmental protection, SMEs)?

2. Whether the grant of incentives should have a sunset clause i.e. 10 years or 20 years from date of registration or commercial operation.
3. Whether there should only be single lead national agency to promote investment to strengthen the investment body of the country.
4. Whether to phase-out the Income Tax Holiday (ITH) incentive which is considered redundant.
5. Whether the grant of incentive should be given to strategic domestic enterprises.
6. Whether only exporters should be granted VAT and duty exemption on the importation of capital equipment and raw materials.
7. Whether the grant of incentive should have a corresponding tax expenditure program in the budget.

Some of the issues were already raised by concerned agencies during the last Congress. Hence, the new challenge is for the 15th Congress on whether to promulgate the new national framework policy on investment promotion by rationalizing and consolidating the fiscal incentives with twin strategy of fiscal sustainability and promotion of the country's competitiveness in the global economy.

**The Revised  
KYOTO CONVENTION,  
what is it all about?**

by  
**Atty. Emmanuel M. Alonzo**  
Director III, STSRO

From the ashes of the second world war ushered in newly independent countries making colonialism a thing of the past. In Asia, newly independent countries emerged like India, Pakistan, Ceylon (Sri Lanka), and the Philippines. The need therefore arose to rebuild economies destroyed by the war. One way of attaining such goal is to establish a uniform standard on international trading.



In 1947, both the World Customs Organization (WCO) and the General Agreement on Tariffs and Trade (GATT) were established. From GATT emerged the World Trade Organization (WTO) which came into ef-

fect in 1995. The WCO evolved into the Customs Cooperation Council (CCC), paving the way for the creation of the Kyoto Convention in 1974, aiming for the first time the simplification and harmonization of customs procedures.

Since then, international trade progressed tremendously including technological advancements such as the use of computers. A need rose again this time to review the relevance of the almost four decade old Kyoto Convention. The result is the Revised Kyoto Convention (RKC) which came into force on February 3, 2006.

The original target of the Philippines for the ratification of the RKC was before June 2008. The filing of the Instrument of Accession (IA) should have coincided with the annual membership meeting of the WCO. However, deliberations on the merits of the RKC took longer than usual that the Senate ratified the RKC on February 1, 2010, through Senate Resolution No. 220.

The idea of an internationally uniform customs procedure is laudable. However, different countries worldwide have different levels of development. For advanced countries revenues from international trade has little significance. But for a developing country like the Philippines, government income from taxes and duties arising from importations account for a major source of government revenues. The uneven development levels of different countries is the reason why the RKC allows member-countries to make reservations and rejections of the specific annexes of the treaty.

The RKC must implement within 36 months (3 years) the following: (a) all the provisions of the body of the convention, (b) the standards of the general annex without reservations, and (c) the accepted standards of the specific annex.

Within 60 months (5 years), the Philippines must implement the transitional standards in the general annex and the recommended practices of the specific annex.

The following government agencies made positive endorsements for the RKC ratification: (a) the Bureau of Customs (BOC), (b) the Department of Finance (DOF), (c) the Department of Trade and Industry (DTI), (d) the Department of Agriculture (DA), (e) the Manila International Airport Authority (MIAA), and (f) the Philippine Economic Zone Authority (PEZA). Private

businesses also endorsed the RKC. Note that the PEZA endorsed the RKC. Further note that areas covered by PEZA, like the freezones are considered as outside the customs territory of the Philippines contrary to the RKC provisions. One of the reasons why Philippines rejected the whole chapter on freeports in its Instrument of Accession.

However, after accession, if there is an urgent need to suspend any of the provisions of the specific annex, the country may temporarily suspend such provisions. Under Article XIII of the RKC, the country can apply for an extension of time to give importers a chance to prepare for its implementation. The *raison d'être* for the apparent laxity is before a country like the Philippines implement fully the RKC, all stakeholder must be aware of its implications as well as be fully equipped to implement the RKC provisions. During the public hearing of the Senate Committee on Foreign Affairs on May 15, 2008, the BOC suggested a six (6) month period to prepare all stakeholders by conducting awareness campaign and training program to all concerned.

Being a multi-national treaty, the framers of the RKC saw to it that the provisions do not contravene the spirit of other multi-national agreements like the WTO, the Association of South East Asian Nations (ASEAN) and the Asia Pacific Economic Cooperation (APEC).

In general, the RKC will facilitate international trade, ensure economic growth, maintain of the security of inter-national trade system, professionalize the BOC, and increase integrity in customs administration. In short, it is a blueprint for a modern and efficient customs procedure for the 21st century.

In particular, the RKC emphasizes risk management, audit base control, pre-arrival information, information technology-coordinated intervention, consultation with the pertinent entities and a system of appeal. Accession to the RKC would prevent backsliding from the best customs standards and practices. Customs brokers opposed a portion of the treaty adversely affecting them.

RA 9280, in Section 27 of the Customs Brokers Act of 2004, it provides for the following—"Import and Export entry declarations shall be signed only by a




customs broker under oath based on the covering documents submitted..”. The law provision runs counter with the RKC which states the following: “Any person having the right to dispose of the goods shall be entitled to act as the declarant.”

The current legal concept that freeports are outside the customs territory is against the RKC. According to the former BOC Commissioner Guillermo Parayno during a Senate public hearing on the RKC, he stated that the RKC considers freezones as part (or inside) of the customs territory of an acceding country. Fortunately, the RKC allows outright rejection of certain provisions for countries waiting to accede to the treaty.

That is why the whole chapter on freeports under the RKC is rejected by the Philippines. Perhaps in the future, when the Philippines should be pre-

pared and ready, and when all the necessary legislations are in place, our country would perhaps accept the RKC provisions regarding freeports.

Another example of a divergence in point of view between the RKC and the domestic law is that the Tariff and Customs Code does not have a provisions regarding the prescriptive period for the payment of taxes and duties for imports. This was also revealed during a Senate public hearing on the ratification of the RKC. The General Annex, Standard 4.10 provides for the following - “National legislation shall specify the period within which Customs may take legal action to collect duties and taxes not paid by the due date ... “. A law must be passed on debt prescription or a debt write off which will remedy the current difficulty of the BOC with billions of pesos in its books of accounts that have no more chance of being collected.



**TAX BITS** is an official publication of the Senate Tax Study and Research Office (STSRO) located at Rm. 524, Senate of the Philippines, Financial Center, Pasay City  
 Website : <http://www.senate.gov.ph>  
 Email: [attydascil@yahoo.com](mailto:attydascil@yahoo.com), [taxbits@yahoo.com](mailto:taxbits@yahoo.com)  
 Telefax No. : 552-6849  
 Tel. No. : 552-6850

**Contributing Writers and Editors**

<b>Atty. Rodelio T. Dascil, MNSA</b> Director General, STSRO	<b>Erlinda Aguja</b> Director III, STSRO	<b>Rechilda B. Gascon, MNSA</b> Director III, STSRO
<b>Atty. Emmanuel M. Alonzo</b> Director III, STSRO	<b>Vivian A. Cabiling</b> Director III, STSRO	<b>Ma. Lucrecia R. Mir, MNSA</b> Director II, STSRO
<b>Elvira P. Crudo</b> Director II, STSRO	<b>Julieta M. Fontiveros</b> Director II, STSRO	<b>Xerxes S. Nitafan</b> Director II, STSRO