# Essays on taxes

**Nonoy Oplas**
July 2, 2008

### *Introduction*

The foregoing are my recent discussion materials on taxes. The first two were posted in www.thelobbyist.biz in my weekly column on dates indicated; the others were posted in my blog, http://funwithgovernment.blogspot.com.

## *I. Why RP's business taxes should be reduced*

6 December 2007

The World Bank (WB) and the Price Waterhouse Coopers (PWC) recently published their joint report, "Paying Taxes 2008: The Global Picture".

'Taxes" are defined by the paper as "paid to government, compulsory, used by the authorities as part of public finances, and with no direct return of value to payer" Hence, various fees and charges levied by various government agencies like DTI business permit fee, municipal/city business permit fee, and so on, officially referred here as "non-tax revenues" are actually taxes. Total business taxes is composed of corporate income tax + labor taxes + other taxes.

For Philippine-based companies, the total tax rate they have to pay to various national and local government units, is 52.8 percent of commercial profits. This is the highest among ASEAN member-countries. And not only that the Philippines has the highest tax rates, it also has among the plentiest business taxes in Asia and other countries in the world. See table below.

Table 1. Paying Taxes

| Country | Total number of tax payments | Total time to comply (hours/year) | Total tax rate (% of comm'l profits) |
|---|---|---|---|
| Hong Kong | 4 | 80 | 24.4 |
| Japan | 13 | 350 | 52.0 |
| Taiwan | 23 | 340 | 40.6 |
| China | 35 | 872 | 73.9 |
| Korea | 48 | 290 | 34.9 |
| Singapore | 5 | 49 | 23.2 |
| Brunei | 15 | 144 | 37.4 |
| Cambodia | 27 | 137 | 22.6 |
| Vietnam | 32 | 1,050 | 41.1 |
| Laos | 34 | 672 | 35.5 |
| Malaysia | 35 | 166 | 36.0 |
| Thailand | 35 | 264 | 37.7 |
| **Philippines** | **47** | **195** | **52.8** |
| Indonesia | 51 | 266 | 37.3 |
| Maldives | 1 | 0 | 9.1 |
| Bangladesh | 17 | 400 | 39.5 |
| Nepal | 33 | 408 | 32.5 |
| Pakistan | 47 | 560 | 40.7 |
| India | 60 | 271 | 70.6 |
| New Zealand | 8 | 70 | 35.1 |
| Australia | 12 | 107 | 50.6 |
| United Kingdom | 8 | 105 | 35.7 |
| United States | 10 | 305 | 46.2 |

Source: http://www.doingbusiness.org/documents/ Paying_Taxes_ 2008.pdf

One may wonder if the Philippines a socialist economy since it has more business taxes than socialist governments of Vietnam and China. Or the welfare states of North America and Europe. Since the Philippines is not a socialist economy, those multiple taxes were possibly meant to “correct” the loopholes of previous tax measures. Fine, but this gives tax administrators and legislators some arbitrary power in deciding to whom those taxes will apply and to whom they will not apply.

If the Philippine government is serious in making the economy more competitive compared to its Asian neighbors and other countries around the world, one very important measure it should do is to drastically cut the number of tax payments it imposes on productive enterprises. Cut into half, even three-fourth, those 47 business taxes. Then fully implement those taxes that are retained.

Private enterprises are doing the social welfare function of expanding domestic production of various goods and services, which fights high inflation, and in creating jobs, which fights high unemployment and poverty. Imposing several dozens of taxes on them is one goof formula to discourage if not kill them, or drive them to cheat their tax payments to preserve their earnings and their existence.

## *II. Low, flat tax, and economic growth*

22 June 2008

While the series of oil, food, and other commodity price hikes have punctured deep into the pockets of many Filipinos and other people around the world, they have also forced the Philippines to undertake what could be unthinkable if those price spikes did not happen: an income tax cut.

Under the Comprehensive Tax Reform Package (CTRP) that became a law in 1997, personal income tax system was among the most confiscatory in the world. Under that scheme, when a person has gross annual income of Php500,000 or more (net of a few deductions), the State will confiscate Php125,000 of the Php500,000 (leaving him/her with only Php375,000 disposable or after-tax income), and any amount above Php500,000, the State will further confiscate 32 percent of it. Perhaps a Php500,000 annual income was a “big” amount in 1997 when legislators made that law. But by mid-2000s, that amount was not that big and the tax system could push a middle income family into poverty level if there are plenty of expenses, like high health care cost for a sickly family member.

The new tax relief law, Republic Act No. 9502, promises to “correct” the confiscatory provisions by, among others, exempting minimum wage earners from paying personal income tax. In Metro Manila, at Php382 a day of basic pay and cost of living allowance, that’s equivalent to Php8,400 per month (22 working days/month) or Php109,200 per year (including 13th month pay). In addition, they increased personal exemption from Php25,000 to Php50,000 for all taxpayers, and additional deduction for qualified dependents from Php8,000 to Php25,000.

I think that the best tax policy that any government can give to its citizens is zero income tax, both personal and corporate, and for government to shift its main revenue source to consumption-based taxes. There are plenty of these types of taxes currently in place: value-added tax (VAT), excise tax, import tax, travel tax, amusement tax, real property tax, vehicle registration tax, and so on. An increase in VAT from the current 12 percent to 14 or 15 percent will not meet strong opposition if there is corresponding abolition, even a drastic cut, of income tax. In addition, there are plenty of business-related taxes currently in place: documentary stamp tax, percentage tax, franchise tax, capital gains tax, withholding tax on transactions with government, business permit tax, and so on.

Income tax is wrong both in theory and practice. *Theory*, income tax penalizes work and performance by productive people; while rewarding (recipient of tax collections) those in government bureaucracies and political leadership, and some less-industrious, less ambitious, or economically unlucky people. A number of people are poor because of laziness and personal irresponsibility, plus the incentives of various subsidies given by the state if one is poor.

*Practice*, out of 34 million employed Filipinos, both in public and private sectors, only less than 3 million are filing personal income tax. Well, if those who don't have to file because of automatic deduction are included, the figure could be around 10 million, but still too far from 34 million employed people. So many people are not paying income taxes, both rich and poor; professionals, and those in informal economies. In addition, those who work for multilateral institutions like the United Nations, the World Bank, the International Monetary Fund, the Asian Development Bank, the Organization Economic Cooperation and Development, USAID, the ASEAN Secretariat, and foreign embassies are not subject to automatic personal income tax deduction. If they file and pay income tax later, fine; if they don't, fine too. And people working in these institutions, especially the technical staff and consultants are earning big, many in six-digit monthly income, tax-free!

So a move to abolish personal income tax is simply to give justice to fixed-income earners, especially those in the private sector, and to correct the inefficiency of the tax system and the tax administration. In addition, any money retained in the paychecks of people and not taken in by the State in the form of income tax is money that will be spent on many other commodities and services. A tax cut is *de facto* "salary increase" and will go back to the economy in the form of higher domestic consumption, say repair or remodel an old house, or buy a new one, buy more hamburger and shoes, more office and school supplies, or hire a nanny for the kids, or more domestic travel. Even more international travels should not be spurned since other foreigners also come and spend their savings here.

In the case of corporate income tax, this is an illusion. This is because corporations do not pay taxes, people do – the firm owners and stockholders in the form of lower profit and investors equity, and the consumers in the form of higher prices. Corporations are just legal entity; they are not people.

Aside from higher domestic consumption, there will be billions of dollars of foreign investments that will come in – companies from high-tax countries in Europe and North America looking for "tax havens" that recognize their hard work. The jobs to be created locally will be enormous.

But a zero income tax is next to impossible to happen in this country. No country has also done it yet. So a low, flat income tax, say 10 percent – both personal and corporate – is the next best alternative which will give respite to many struggling businessmen and employees, as well as give additional revenues for the government. Even at this rate, the potential of big influx of foreign investors wanting to come in and escape the high taxes in Western Europe and North America should be considered. Think of the hundreds of thousands, if not millions, of jobs that will be created. Many Filipinos currently working abroad and endure the pain of being away from their families and relatives will have another employment alternative – right in the country itself.

One country that experienced fast economic growth because of the introduction of low, flat tax, is Slovakia. From being a communist state under the former Soviet Union, it adopted a market economy in 1991, after the Berlin wall collapsed. In 1994, it enacted a flat tax of 19 percent for both personal and corporate income. The effect was quick: in a few years, Slovakia became the "Detroit of Europe" with the entry of plenty of foreign car manufacturers – Western European, American, Japanese, and Korean car producers. GDP grew high and unemployment went down drastically.

Ireland is another "radical" economy: from 48 percent corporate income tax, it was cut down to a mere 12 percent! The volume of economic activity that transpired after this move, all other things being equal, was huge.

One consideration that other people ask if income tax has to come down to say, 10 percent flat rate, is where to get the money for more and better roads and other infrastructure. Simple: get the money from those consumption-based taxes. Better yet, allow more toll roads. Expenditures for these infrastructures will not come from taxes, but from corporate savings and investments that will make money from motorists who will use the road more often. This is very fair. If the toll road expressway is in Luzon, taxpayers from the Visayas and Mindanao will not be burdened in building and maintaining those highways. And even among those in Luzon, those who don't use the roads (say they don't have a car) need not fork out extra taxes for those roads; only those who frequently use those toll roads.

A citizens' movement to push a low, flat tax leading to an ultimate zero income tax after a few years transition, is now a big challenge for us.

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Below are short discussion papers posted this year in my blog, **Government and Taxes** <http://funwithgovernment.blogspot.com>, "A discussion venue about the role (and misrule) of big government and high taxes".

## *III. Tax havens, why they are important*

28 February 2008

In recent days and weeks, Germany and UK, even the US, have been pounding on a tiny European economy Liechtenstein for being a "tax haven" to many of their rich nationals and suspected tax cheats who park their big savings there which should have been heavily taxed in those countries.

Are tax havens just a way for the rich to escape their tax obligations in their countries, or do they serve some positive function in the global economy?

My vote is the latter, that tax havens have a positive function in the global economy. Some hard-working and innovative people in rich and industrialized countries are unhappy that a big portion of their income and savings are automatically confiscated by their governments in the form of high and multiple taxes to pay for an expensive welfare state with its huge bureaucracy and other government programs that they may not be in favor of.

For these hard-working people, one option is to work less, earn less, and pay less taxes. But a better option for them is to continue working hard, produce more goods and services that many people in the world need, earn big, and put their extra savings in tax havens. This latter option serves the global economy better.

Many Western European and North American investors have started leaving their country and do business in Eastern Europe, in East Asia, other countries/regions where taxes are lower and business regulations are more relaxed. Others opted to stay put and park their extra savings in tax havens.

Some of those savings temporarily parked in tax havens are invested in poorer countries in Asia and South America, which helps creates jobs there, make more people richer, so that they can also buy imported goods and services by companies from high taxes countries like W. Europe and N. America, and those countries receive more tax revenues from those firms. This is what "tax havens serve some function in the global economy" means.

## *IV. HK and Philippine taxes, some comparison*

4 March 2008

I have read a recent report by Horwath Hong Kong re some tax cuts and rise in exemption allowances in HK. Below are the tax changes; those in parenthesis are comments by a friend, Peter Wong, Exec. Dir. Of Lion Rock Institute (www.lionrockinstitute.org), HK's first and only free market think tank.

1. No tax on dividends, capital gains, interest from banks and other financial institutions (no change).

2. No tax on business registration (one-time).

3. No tax on wine, beer, other alcoholic beverages except spirits with immediate effects [high alcohol content drinks] (permanent cut).

4. No hotel accommodation tax (permanent cut).

5. Higher ceiling for tax-deductible donations (permanent).

6. Lower corporate profits tax from 17.5 percent to 16.5 percent (back to 2002 level).

7. 100 percent profits tax deduction for capex of environment-friendly machinery and equipment in the first year of purchase (newly introduce but some of us don't like it).

8. Reduce personal income tax from 16 percent to 15 percent (back to 2002 level).

9. Raise exemption allowances for individuals, single parents and married persons.

10. Lower property tax from 16 percent to 15 percent (back to 2002 level).

When you compare HK's and the Philippines' tax policies on these items alone, you can shake your head. Because in the Philippines:

1. There ARE taxes on dividends, capital gains, interest income on bank deposits (20 percent).

2. There ARE taxes and fees on business registration -- with SEC, BIR (Bureau of Internal Revenue), DTI, local governments, etc.

3. Att least double taxes on wine, beer, spirits -- excise tax and

value added tax.

4. There ARE hotel accommodation taxes -- VAT by the national government, and local government tax.

5. No change in ceiling on tax-deductible donations.

6. Corporate income tax raised from 32 percent to 35 percent by 2005; but will go down to 30 percent by 2009.

7. Am not aware of tax cut on environment-friendly equipment, but I think there's none.

8. Personal income tax still at 32% top rate for annual gross income of US$12,500 or more, after some deductions. If you have this annual income and after the state has removed the 32 percent tax, if you have 2 or 3 children and you're the sole bread winner, you can easily slide to poverty level!

9. Somehow, there is an increase in income tax exemption level (see above article on “Low, flat tax and economic growth”).

10. Property tax is applied even to houses and condo units, unlike in HK where only the landowners and building owners are taxed.

In the Philippines, if you own your house or condo unit, you will pay real property tax (RPT) to the city or municipal government. If you own a house or condo and you rent it to other people, you will pay at least 3 taxes -- RPT, value added tax (VAT) for rentals above PhP10,000 per month, and income tax for your rental income. But many people pay only the RPT and do not pay the latter 2 taxes.

## *V. Travel tax as extortion*

10 March 2008

The travel tax of P1,620 (about US$37 at PhP44/$) per Filipino passenger for international flights is a bummer. I think this is plain extortion because there is no corresponding service for the Filipino passengers for paying this tax. Foreigners are exempted from paying this tax. They just have to pay the terminal fee of P750 per passenger.

Where does the tax collection go, the Philippine Tourism Authority (PTA) and the Department of Tourism (DOT)? For what, considering that these agencies get annual subsidies from our taxes as authorized by Congress? Besides, PTA does not give "free lodging" or any service for its hotels to average taxpayers. It does provide free lodging though to certain government officials and personnel, and those friends of the PTA and DOT top officials.

A friend said that this tax was invented sometime in the 70s when the government (under Mr. Marcos) thought that foreign travel was a luxury and foreign exchange drainer; hence, Filipinos traveling abroad should be penalized by such tax. These days, international mobility of people is a necessity, both at the macro and micro levels. Retention of said travel tax is thus, plain extortion. Try asking citizens of other countries, especially of developed countries, if their governments are charging them a “travel tax”, most likely the answer is No.

Another friend who owns a travel agency told me that once the airline and travel agency sectors lobbied in Congress to remove that tax. The Congressmen according to my friend, just nodded their heads and did nothing after that.

Perhaps it is time to call again for the abolition of that tax.

## *VI. Taxes vs. Subsidy*

26 May 2008

A Malaysian friend, Wan Saiful Wan, head of Malaysia Think Tank London, shared with us a news story, "Making the rich pay more for fuel", May 23, 2008. The article went this way:

"Malaysia's rich will have to pay more for heavily subsidised items including fuel as part of a new two-tier scheme to reduce government spending, reports said today. "We need to have a good system for those who deserve the subsidy, such as the lower and middle-income groups," Second Finance Minister Nor Mohamed Yakcop was quoted saying by the Star daily."

I think the headline was wrong. It says "Government wants to tax the rich" when the story says the "government wants to reduce subsidy to the rich". These 2 -- taxes and subsidy -- are different things. The first is taking money away from the people. The second is giving money to the people, the money coming from various taxes.

My take on this and almost any other issues on other sectors is that subsidies should be kept to the minimum – and taxes should be kept to the minimum too. You encourage something, you'll have more (consumption) of it; you discourage it, you'll have less of it. That's one of the "7 Principles of sound public policy" made by Larry Reed. So you provide more fuel subsidies, you encourage more fuel consumption. You tax oil, you discourage more fuel consumption.

If oil taxes around the world are removed, or at least drastically cut by one-half of their current rates, especially in European and North American countries, retail price of oil will drastically go down, which will encourage more fuel consumption, which will result in ever-higher world crude prices, perhaps shot up to $200 a barrel within a year or less. But at least people will not complain of the artificially high retail oil prices caused by oil taxes. They can complain of high retail price because of the high crude oil prices, high cost of refinery, high cost of transporting refined oil, etc.

If government revenue from oil taxes will decline if not evaporate, where will government get money to build new roads, or improve and expand existing ones? Road, especially expressways, should be on user-pay via toll roads. Roads can be privatized. So that the more you use the road, say you drive 100 kms a day on average, the more you will pay toll fees. If you use less, say only 20 kms a day, you pay less. This still discourages high fuel consumption. The rich who have more meetings, more places to visit and work, will pay more on toll roads and fuel. There is still "equity" there.