9-2020

Assessing the Potential Impacts of Reducing Philippine Corporate Income Tax and Reforming Sectoral Incentives on Poverty and Employment

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POLICY BRIEF
RESPONDING TO THE COVID-19 PANDEMIC
Volume XIII, No. 8, OCTOBER 2020
ISSN # 2094-3342

De La Salle University
AKI
Angelo King Institute
for Economic and Business Studies

Will CREATE Resolve the Philippines' Unemployment Woes Amidst the COVID-19 Pandemic?

In response to the COVID-19 pandemic, there is a proposal to amend the Corporate Income Tax and Incentives Reform Act (CITIRA) into the Corporate Recovery and Tax Incentives for Enterprises Act (CREATE) Act. The proposed amendments are as follows: (a) An immediate five percentage point cut into the corporate income tax (CIT) rate starting July 2020; (b) Maintaining for up to nine years the status quo for registered business activities enjoying the 5% tax on gross income earned (GIE) incentive; and (c) More flexibility for the President to grant a combination of fiscal and non-fiscal incentives, which will be critical as the country competes internationally for high-value investments (Department of Finance (DOF), 2020).

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Policy Recommendations:

- **The government should consider retaining the gradual reduction of CIT, as stated in CITIRA, and redistribute the revenue to ensure MSME employment retention.** The DOF (2020) estimated a reduction in government revenue of PhP 40 billion for the second half of the year and highlights that micro, small, and medium enterprises (MSMEs) can use this savings to fund their operations and retain employees. The reduced revenue resulting from community quarantine restrictions may cause MSMEs to close their businesses. As an alternative, the government can implement the gradual reduction of CIT and redistribute the revenue to ensure MSME employment retention.
- **Implement a cap on the number of years that investors can take advantage of government incentives such as the special rate of 5% on gross income earned (GIE) in lieu of all taxes**. The DOF (2020) identified the country's tax incentive package as one of the most generous in the ASEAN region with no time limit. Despite the generous tax incentive, the Philippines is lagging in terms of attracting foreign direct investments (FDI) in comparison to our ASEAN neighbors.

Introduction

The Corporate Income tax Incentives Reform Act (CITIRA), which was passed by the Lower House in September 2019, has been revised and renamed as Corporate Recovery and Tax Incentives for Enterprises (CREATE) Act. The proposed amendment includes an outright 5% reduction of the CIT until 2022. Its aim is to make the tax reform more relevant and responsive to the needs of businesses that were negatively affected by the COVID-19 pandemic. The lowering of tax rates is said to boost the efforts of MSMEs to recover from the challenges they faced due to the global health crisis. The government expects that firms will reinvest the tax savings back to the economy and will help revive the economy.

The accelerated CIT rate reduction will cause government revenue from large corporations to decline by as much as Php42 billion this year, and another Php625 billion in the next five years. MSMEs comprise 99.52% of the total establishments in the country; however, in terms of employment, it only accounts for 63.19%. By looking at the top sectors that provided employment during the pre-pandemic period, MSMEs have the highest employment in the Trade Sector and Accommodation and Food Service Activities sector, but large firms still have the highest employment share in the Manufacturing sector and Administrative and Support Service Activities sector.

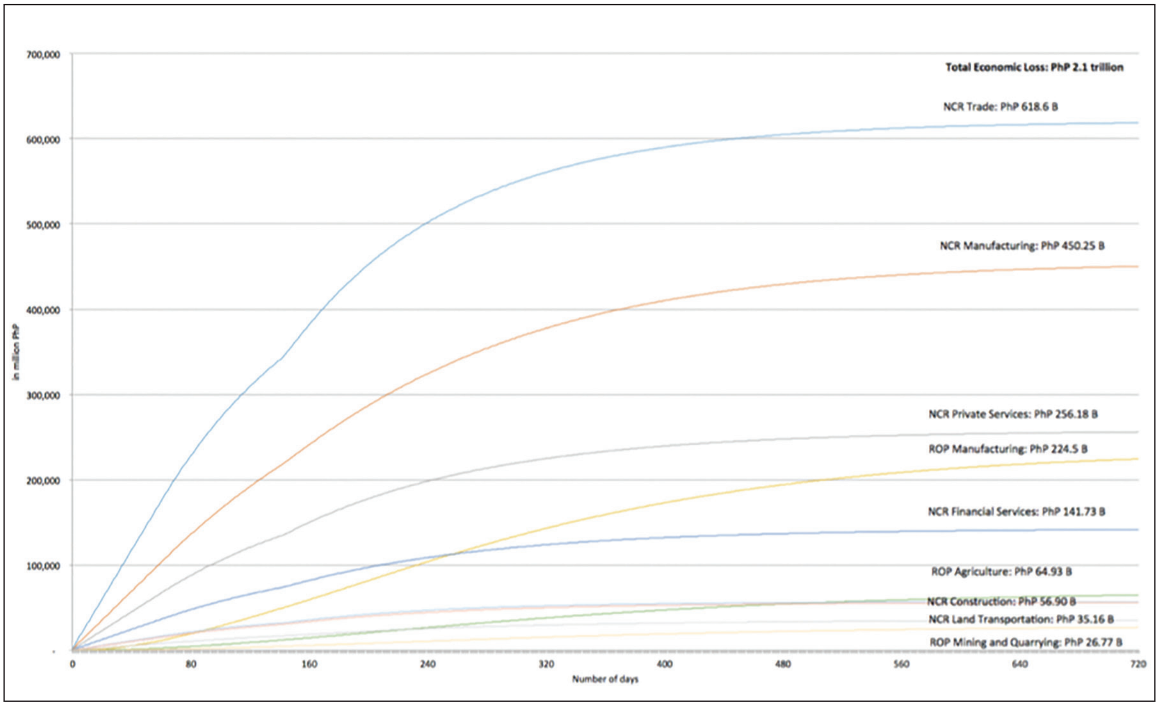
COVID-19 Impact on Employment

Overall, there has been a 19.1% decline in the number of employed in the country comparing April 2019 (41.75 million) to April 2020 (33.76 million) statistics. Aggravating the situation is the decline of the share of full-time employees from 68.1% to only 29.2% of total employed, whereas those who have a job but are not at work soared from 1.1% (447 thousand) to 38.4% (12.96 million). As community quarantine has taken more relaxed forms, an improvement was observed, but employment still declined by 2.86%, year-on-year, comparing July 2019 (42.52 million) to July 2020 (41.31 million). The number of employed on a part-time basis grew by 25.84%, but those employed full-time declined by 19.69%. Another alarming point is the number of those with a job but not at work tripled from the previous year. In general, the amount of work available in the economy decreased as the average number of hours declined from 41.8 hours in July 2019 to 38.2 hours in July 2020 (Philippine Statistics Authority (PSA), 2020).

Based on the Labor Force Survey (PSA, 2020), most sectors experienced a decline in employment in 2020 compared to the previous year. The most evident decline is in the Arts, Entertainment, and Recreation Activities, which experienced a significant decline, losing more than two-thirds of the number of jobs from 2019. Several sectors experienced an increase in the number of employed, such as the Mining and Quarrying sector (19.26), Agriculture and Forestry sector (17.92%), Electricity, Gas, Steam, and Air Conditioning Supply sector (12.18%), Human Health and Social Work sector (10.98%), Wholesale and Retail Trade and Repair of Motor Vehicles sector (4.05%), and Construction sector (0.39%). However, the increase in employment in these sectors is attributable to the growth in the number of employed part-time and those with a job but not at work. For example, hospitals may be employing more people, but they are required to take days off work for quarantine purposes. The same may be true for the other sectors that experienced an increase in the number of employed. Other sectors have suffered declines in the number of employed compared to 2019 but have improved since April 2020. For example, the Accommodation and Food Services sector consistently sustained a 35% decline year-on-year, although, since April, 83.6% of those who had a job but were not at work have returned either in a part-time or full-time capacity.

Figure 1 presents the estimated sectoral losses based on a paper that used a persistent inoperability input-output model developed by Yu et al. (2020). The model accounted for the inter-industry transaction flows across sectors in the National Capital Region (NCR) over the quarantine period.[1] Results suggest that the estimated impact of the NCR community quarantine is PhP 2.1 trillion. Almost a third of the economic losses is borne by the NCR Trade sector (PhP 618.7 billion). The NCR Manufacturing sector follows with PhP 450.25 billion in losses and the NCR Private Services sector at PhP 256.18 billion. Although this study focuses on the NCR community quarantine, it can show the interdependence among regions and sectors such that Rest of the Philippines (ROP) Manufacturing, ROP Agriculture, and ROP Mining and Quarrying posted significant losses amounting to PhP 224.5 billion, PhP 64.93 billion, and PhP 26.77 billion, respectively. This shows that losses are borne by sectors mostly composed of MSMEs.

Figure 1. Top 10 Affected Sectors in terms of Economic Losses.



COVID-19 Impact on Foreign Direct Investment

The Philippines is currently implementing one of the longest lockdowns in the world. Household consumption and investment are the two main drivers of the decline in GDP growth. Foreign direct investment (FDI) declined by 32.09% year-on-year for the period of January to April 2020 (Bangko Sentral ng Pilipinas, 2020). Although FDI has declined globally as a result of the pandemic, FDI in the Philippines has been declining since 2018.

To reverse the declining FDI, DOF (2020) recommends modernizing the tax incentives such that the government implements a sunset period for those enjoying the current special rate of 5% on GIE. In addition, future tax incentives will be subject to the approval of the Fiscal Incentives Review Board (FIRB). Under CREATE, tax incentives will be performance-based, targeted, time-bound, and transparent to encourage businesses to invest, create jobs, increase exports, and improve productivity.

The DOF (2020) already cites the current fiscal incentive program as the most generous in the ASEAN region. The government expects that CREATE will "attract highly desirable investments" (DOF, 2020, par. 7). Higher FDIs will partly offset partial reinvestment of corporate income, which could lead to higher income inequality (higher GINI coefficient, from 0.453 in 2020 to 0.521 in 2029) (Cororaton & Tiongco, 2019). With the more restrictive and subjective nature of the proposed fiscal incentive program compared to the current fiscal incentive program, it can further discourage foreign investors from choosing the Philippines.

Conclusion

By looking at these findings, the revenue government foregone from the accelerated reduction of the CIT will not help the MSMEs as the ones who pay the bulk of the CIT are large firms that also enjoy tax incentives, whereas almost two-thirds of MSMEs are reporting zero sales due to the temporary closures (National Economic and Development Authority, 2020). Supposing MSMEs pay CIT, but if their sales remain low, they will not be able to survive the pandemic. In fact, retaining the gradual reduction program and using government revenue to link employee retention to the MSMEs' continued operation can be a way to ensure that people still have jobs after the pandemic. Those who have jobs but are not at work are vulnerable to losing their jobs if the MSMEs are unable to survive the pandemic. Furthermore, FDI has been declining even before the pandemic, despite having the most generous fiscal tax incentive program in ASEAN. A more restrictive tax incentive program will not achieve the government's goal of attracting more investors into the country.

[1]This includes the different levels of community quarantines that have been implemented in the National Capital Region from March 15, 2020, up to September 30, 2020.

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