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Philippine Institute for Development Studies  
*Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas*

## Fiscal Decentralization and Local Finance Reforms in the Philippines

*Gilberto M. Llanto*

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The paper examines the progress being made in local finance reforms and indicates pathways to advance those reforms. A summary of the effects of decentralization is given as a contextual background for the discussion of local finance reforms. The inefficient tax assignment has constrained the mobilization of local tax revenues even as local government units have become very dependent on the intergovernmental fiscal transfer, called the “internal revenue allotment.” The paper raises the importance of revisiting the internal revenue allotment formula. It identifies the local finance reforms currently being undertaken and reports the progress being made at the local and national level. The final section comments on the outstanding issues in local finance reform and gives some recommendations.

Keywords: fiscal decentralization, intergovernmental fiscal transfers, internal revenue allotment, tax-expenditure assignment, Local Government Code

# Fiscal Decentralization and Local Finance Reforms in the Philippines<sup>1</sup>

Gilberto M. Llanto<sup>2</sup>

## I. Introduction

This paper discusses the recent local finance reforms in the Philippines. Its main interest is in examining the progress being made in local finance reforms and indicating pathways to advance those reforms. It is organized into four sections. The Introduction provides a summary of the achievement or effects of decentralization as a contextual background for the discussion of local finance reforms. Decentralization has given local government units in the Philippines the great responsibility of providing public goods and services to the local populace and this should convince policymakers about the importance of providing local government units the power and authority to raise the necessary revenues. Section 2 discusses how the inefficient tax assignment has created problems at the local level. It also presents the situation with the intergovernmental fiscal transfer, called the “internal revenue allotment”, which is a substantial source of revenue for local government units. The section raises the importance of revisiting the internal revenue allotment formula. Section 3 identifies the local finance reforms currently being undertaken in the area of local taxation and reports the progress being made at the local and national level. The final section comments on the outstanding issues in local finance reform and gives some recommendations.

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<sup>1</sup>This paper revises and extends the paper entitled “Decentralization, Local Finance Reforms and New Challenges: The Philippines,” which was presented at the Third Symposium on “Decentralization and Local Finance” at the Institute for Comparative Studies in Local Governance (COSLOG), National Graduate Institute for Policy Studies, Tokyo, Japan on March 10, 2009.

<sup>2</sup> Dr. Gilberto M. Llanto is Senior Research Fellow, Philippine Institute for Development Studies (PIDS) and Professorial Lecturer, National College of Public Administration and Governance, University of the Philippines. I am indebted to Francis Quimba for data on local revenues and to Rosario Manasan for insights and information on fiscal decentralization.

### *Brief review of the effects of decentralization*

A working definition of decentralization is that by Faguet (2005) who defines it as “the devolution by central, (that is, national) government of specific functions, with all of the administrative, political and economic attributes that these entail, to democratic local (i.e. municipal) governments which are independent of the center within a legally delimited geographic and functional domain”. In the last two decades, decentralization has been at “the center stage of policy experiments in a large number of developing and transition economies in Latin America, Africa and Asia” (Bardhan 2003, page 1) for a number of reasons. For example, a motivation for decentralization in Latin America pointed out by Shah (1997) was the disenchantment with military rule and dictatorships, which has created a political culture that places a premium on decentralized decision making to prevent a return to the past. In China, decentralization was seen as a means for social cohesion, faster economic growth and preservation of communist party rule.

Different countries, which have tried to implement it are in different stages of decentralization but a common denominator is the desire to improve the allocation problem in the economy. Viewed in this light, decentralization has improved the implementation of the allocative task of local government and has provided a framework for responsive and accountable local governance. It has given local constituents what they want and are willing to pay for and the opportunity for greater local responsiveness and political participation (Bird 1993). It has demonstrated a potential to lead to more appropriate and better utilised facilities, lower costs per unit of service and improved operations and maintenance (Klugman 1994)<sup>3</sup>. Devolution is based on the subsidiarity principle and on the view that it results in improved efficiency in the delivery of public services, and hence a more efficient allocation of resources in

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<sup>3</sup> However, according to Klugman (1994) greater efficiency need not necessarily accompany decentralisation, given the risk of loss of economies of scale, duplication and overlap.

the economy (Dabla-Norris 2006)<sup>4</sup>. This perspective draws from the classic distinction given by Musgrave about the different tasks of government in an economy: allocation (which is better done by local governments), stabilization and redistribution (which are better done by central government).

These views echo the *decentralization theorem* propounded by Oates (1972, page 55), which maintains that “each public service should be provided by the jurisdiction having control over the minimum geographical area that would internalize benefits and costs of such provision.” Oates (1993) later observes that decentralization is a mechanism to make policy more responsive to local needs and to involve the local populace in processes of democratic governance<sup>5</sup>. The economic case for decentralization is the enhancement of efficiency that it introduces because locally provided public goods that are responsive to local taste and preferences are superior to centrally-determined and more uniform bundles that are provided across various jurisdictions. Decentralization provides for “tailoring levels of consumption to the preferences of smaller, more homogeneous groups” (Wallis and Oates 1988, page 5). **Box 1** shows a list of arguments in favour of local provision and financing.

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<sup>4</sup> Shah (2004) points out that the principle of subsidiarity was introduced by the Maastricht Treaty for for assignment of responsibilities among members of the European Union. According to this principle, taxing, spending and regulatory functions should be exercised by the lowest levels of government unless a convincing case can be made for assigning the same to higher levels of government.

<sup>5</sup> While a discussion of the opposing views may be interesting, this paper will not dwell on it because it is outside the scope and objectives of the paper.

### Box 1. Arguments in favor of local provision and financing

Several arguments in favour of fiscal devolution have been developed in the literature, supporting the idea that the provision of public goods and its financing should be assigned to the lowest level of government with the capacity to achieve objectives. These arguments include:

**Response to local preferences.** The traditional theory of fiscal federalism contends that the central government should have the basic responsibility for macroeconomic stabilisation functions, national public goods, such as defence, and income redistribution in the form of assistance to the poor (Oates, 1972). However, a “one-size-fits-all” approach may not deliver a basket of public goods that is optimal for all citizens. By being closer to local citizens, sub-national governments are, in principle, better placed to respond to their preferences in term of local public goods, to assess willingness to pay and to target services at the right people. Hence, “Pareto efficiency” could be raised -- *i.e.* resources can be saved without making anyone worse off -- through fiscal decentralisation. Keeping incentives right does not necessarily entail an exact match between spending and revenue-raising powers at each level of government. Central government grants can play a role in sub-national government finances without jeopardising incentives. One important condition, however, is that grants do not accommodate extra spending decided upon by sub-national government, leaving the cost of a marginal change in local spending to be borne locally.

**Increased government accountability** may enhance the efficiency gain. Since local officials can be easily identified by voters and taxpayers, they are expected to be more accountable, especially if the costs of providing public services are borne locally. Being closer to residents may, however, trigger decisions that favour particular individuals or groups while the public interest sometimes takes a back seat (Tanzi, 1995). Where there is inadequate capacity for the population of some jurisdictions to hold their governments accountable through internal checks and balances, this could spill over into corrupt practices, though the degree of decentralisation and the level of corruption amongst public officials are not directly linked.

**Introducing competition across jurisdictions.** Diversity in fiscal packages offered by sub-national jurisdictions -- in terms of quantity and quality of public goods and the associated tax burden -- may introduce some competition across jurisdictions, and thus incentives for governments to raise public sector efficiency. Competition between jurisdictions relies on the assumption of mobile citizens (“citizens vote with their feet”). In practice, several factors limit the mobility of citizens, in particular in European countries, especially taxes on property transactions and other rigidities in the housing sector. Moreover, tax competition in areas where the tax base is mobile may be seen as weakening tax capacity. The introduction of competitive pressures across subnational jurisdictions has thus increasingly come to be seen as dependent on informational channels. Some countries (including Scandinavian countries) have developed high-quality information to enable citizens to benchmark the performance of their administration against others and to allow local governments to identify best practices.

**Supply-side efficiency.** Decentralisation may allow for experimentation in the management of public

responsibilities (Oates, 1999). In some decentralised countries, sub-national governments have taken the lead in designing innovative measures to increase public spending effectiveness. In Spain for instance, some regional pilot programmes focusing on containing pharmaceutical costs and reducing public hospitals' waiting lists have shown promising results. In Switzerland, new public management principles have been introduced by some cantons and communes and latter replicated at the Confederation level. In many countries however, an information-sharing forum is lacking, reducing the benefits of these experimentation gains.

Source: Joumard and Kongsrud (2003)

Decentralization has laid down the foundation of a new, major “institutional framework” for the provision of a range of benefits to local constituents and the harnessing of local energy for local development, which could make governments to be “more responsive and efficient;” at the same time decentralization offers a practical avenue for “diffusing social and political tensions and ensuring local cultural and political autonomy” (Bardhan 2003, page 1).

Joumard and Kongsrud (2003) add that it can strengthen the democratic process, allow governments to tailor the supply of public goods to local preferences and introduce some competition across jurisdictions, thus raising public sector efficiency. At the same time, it must be recognized that it can entail efficiency losses, and make it difficult to implement redistributive policies and complicate macroeconomic management (ibid). A contrarian view is that “decentralization may increase the participation of people at the local level but sometimes it is only a small privileged elite group who get to participate” (Conyers 1990, page 18) quoted by Oates (1993). Faguet (2005) pointing out that there is little agreement concerning the effects of decentralization in the empirical literature, says that pessimists argue local governments are too susceptible to elite capture, and too lacking in technical, human and financial resources, to produce a heterogeneous range of public services that are both reasonably efficient and responsive to local demand.

However, fears about the incompatibility of prudent monetary and fiscal management with a decentralized fiscal system (e.g., Prud'homme 1995, Tanzi, 1996) were belied by recent studies (King and Ma, 2001; Shah, 2005). For instance, Shah finds that regression results show



that growth of the money supply is primarily determined by central bank independence and fiscal decentralization has an insignificant positive impact. Similarly, fiscal decentralization has a positive but insignificant impact on price inflation. Finally, the impact of fiscal decentralization on inflation and macroeconomic balances was found to be insignificant. Econometric evidence supports the hypothesis that fiscal decentralization has a positive significant impact on the quality of fiscal management. He concludes that fiscal decentralization is associated with improved fiscal performance and better functioning of internal common market. Contrary to a common misconception, decentralized fiscal systems offer a greater potential for improved macroeconomic governance and regional fiscal equity than centralized fiscal systems.

In the Philippines, the 1991 Local Government Code has provided local government units the responsibility of delivering local and basic public services and raising local or own-source revenues for financing their expenditure assignment. Under the Local Government Code, local government units have autonomy in deciding on the composition of local spending, taxing and borrowing that they would need to meet local development objectives. Thus, local government units are now responsible for the following areas: land use planning, agricultural extension and research, community-based forestry, solid waste disposal system, environmental management, pollution control, primary health care, hospital care, social welfare services, local buildings and structures, public parks, municipal services and enterprises such as public markets and abattoirs, local roads and bridges, health facilities, housing, communal irrigation, water supply, drainage, sewerage, flood control and inter-municipal telecommunications.

The Local Government Code also transferred to local government units certain regulatory functions. The fiscal transfers to local governments were likewise increased, with 40% of internally generated taxes allocated to local governments through the Internal Revenue Allotment (IRA). In addition, the Code encouraged the local government units to explore alternative sources of revenue by exercising their corporate powers in partnership with the private sector. An innovation introduced by the Code is the provision of a framework for active participation of non-governmental organizations and civil society in local governance<sup>6</sup>. Indeed,

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<sup>6</sup> For a detailed discussion, see Brillantes, Llanto, Alm and Sosmena (2009).

the new institutional framework for local development has generated an enthusiastic response on the part of local government units (LGUs) to deliver better public services to local citizens. It has promoted local autonomy by devolving expenditure responsibilities and vested greater taxing powers on local government units<sup>7</sup>.

This is a ground-breaking type of legislation because it has unleashed tremendous opportunities for self-development at the local level quite unlike the period preceding its enactment when the central or national government exerted control over virtually all aspects of local governance. What have been the achievements and effects of decentralization?

Klugman (1994) observes that the impact of decentralization upon human development will obviously depend upon the share of local government in total government expenditure, which varies widely among developing countries. For example, Klugman reports a survey of sixteen developing countries showing that the share ranged from 55 percent in India down to 2.5 percent in The Gambia. For seven of countries in the survey, less than 10 percent of total government spending was conducted through local government. One interesting finding of Schwartz is that at the local level, multivariate results suggest that per capita expenditures increased immediately following devolution and continued to increase in 1995 and 1998 compared with per capita expenditure levels prior to devolution.

In the Philippines, there seems to be an absence of empirical studies on the effects of decentralization as a whole<sup>8</sup>. There, however, are studies on the sectoral effect of

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<sup>7</sup> The paper does not discuss the Organic Act of Muslim Mindanao, which transfers to the regional government of the Autonomous Region of Muslim Mindanao all powers, functions, and responsibilities heretofore being exercised by the central government except (a) foreign affairs, (b) national defense, (c) postal service, (d) fiscal and monetary policy, (e) administration of justice, (f) quarantine, (g) citizenship, naturalization and immigration, (h) general auditing, civil service and elections, (i) foreign trade, (j) maritime, land and air transportation and communications that affect areas outside the ARMM, and (k) patents, trademarks, trade names and copyrights. See Manasan (2005).

<sup>8</sup> Impact studies are almost nil. Rosario Manasan and Gilberto Llanto are currently engaged in an analysis of survey data on the delivery of local services in a sample of LGUs in the Bicol region. The survey gathered data on service delivery from a random sample of 300 households, interviews with local government officials and with service providers in the area, that is, water district and health units. The draft paper will be circulated in April 2009.

decentralization, e.g., on local government health expenditures (Schwartz and others, 2000), on the link between the quality of governance and local development (Capuno, 2007), on decentralized democratic governance (Brillantes, 1998), on decentralized democratic governance's positive impact on the quality of governance (Blair, 1996). There are several documented cases of cooperative undertakings of local government units in coastal resource management, solid waste management, water supply development and distribution, and construction of inter-municipal roads (ADB 2005). Mercado and Manasan (1999) find that inter-LGU cooperation has resulted in the emergence of metropolitan arrangements in many places around the country.

According to Loehr and Manasan (1999), the devolution of expenditure responsibilities to LGUs is generally consistent with the decentralization theorem. The devolved activities are those "that can be provided at lower levels of government . . . and few of them have benefits that spill over outside the territorial jurisdiction of the LGUs with exception of those related to environmental management" (Manasan 2005, page 37)<sup>9</sup>. During the period after the enactment of the Local Government Code, there seems to be a marked increase in LGU spending as more resources had been made available to LGUs. Examining the trend and composition of LGU expenditures over the period 1992-2003, Manasan (2005) find that total LGU spending increased from an average of 1.6 percent of Gross National Product in 1985-1991 to 3.3 percent of GNP in 1992-2003. The share of LGUs in total general government expenditure net of debt service rose from an average of 11 percent in the pre-Local Government Code period to an average of 21.2 percent in the post-Code period. The transfer to LGUs of functions previously discharged by the central government caused a major shift in the size and composition of LGU budgets. Further, among the major sectors, social services posted the fastest rate of growth in 1991-2003, increasing by 21.7 percent yearly on the average during the period compared to the overall growth in total LGU spending of 8.2 percent.

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<sup>9</sup> An exception is education (Manasan, 2005).

The increase in LGU spending on social services between 1991 and 2003 went to (in order of priority) health, education, housing/community development, and social welfare<sup>10</sup>.

Looking at local service delivery, ADB (2005) reports that surveys to assess satisfaction with public services point to mixed results on local government performance in the Philippines. Local areas continue to suffer from a myriad of problems — uncertain access to potable water and electricity, declining literacy rates, environmental degradation, rising unemployment rates, lack of low-cost housing, and unreliable police and fire department services. There is a need to invest in infrastructure and social services. In contrast, the ADB also cited a growing number of examples of excellence in service delivery, which seem to indicate that well-performing local governments may be distinguished by their ability to access resources more effectively, and manage them more transparently and accountably. These were also the same observations made by Capuno (2007) and Brillantes, Llanto, Alm and Sosmena (2009). A recent study by JICA (2008) notes that the top three service areas where improvement with devolution was noted in sample provinces, cities and municipalities are: 1) social welfare; 2) health and nutrition; and 3) agriculture and fisheries.

Klugman (1994) reports a Philippine study by Jimenez and others (1988) that for given levels of enrolment and quality, schools which rely more heavily on local funding are more efficient. There is a lower cost of delivery of education services. They also find that students at schools which relied more heavily upon local funding had better 'achievement scores'. A special education fund, a surcharge on taxes on real property is administered by the local school board composed of the school principal, local government representative and parents.

With respect to clarity of expenditure assignment, there is room for improvement. A particular section of the Code<sup>11</sup> has provided the opportunity for central government line

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<sup>10</sup> Details of the trend and composition of LGU expenditures in 1991-2003 are in Manasan (2005).

<sup>11</sup> Sections 17 c and 17 f of the Code.

agencies to continue to implement devolved public works and infrastructure projects and other facilities, programs and services provided funding is made available under the central government budget (The Annual General Appropriations Act), special laws, executive orders and those wholly or partly funded from foreign sources. Manasan (2005, page 39) calls this an obfuscation of “what initially appears to be a clear-cut assignment of expenditure responsibilities”. There is also some concern over delays in the release of the internal revenue allotment (IRA) for LGUs, that is, block fiscal transfers because of adverse impact on human capital and infrastructure spending of local governments.

A recent study (Brillantes, Llanto, Alm and Sosmena, 2009) finds that decentralization has encouraged local government units to take the lead in local development processes in partnership with other key stakeholders including the national government agencies, local businesses and civil society and non-governmental organizations (NGOs). Devolution has actually opened up great opportunities for LGUs to innovate and design programs and projects that can improve the welfare of the people. Please see **Box 2** for an example of one such innovation that has improved the well being of the local populace. The institutionalization of disaster preparedness and mitigation in the province of Albay was a Galing Pook Awardee in 2008.<sup>12</sup>

### **Box 2. Institutionalizing Disaster Preparedness and Mitigation: Province of Albay**

Albay Province has been hit not only by a volcanic disaster caused by Mayon Volcano almost every ten years but also by storm surges due to its location on a common typhoon route. Each year roughly 198,000 houses are threatened with destruction from storm surges at least 350,000 people need to be evacuated. Another 300,000 of the population are threatened by tsunamis. With an active volcano in its midst, three cities and five municipalities are under threat from volcanic eruptions from time to time. An estimated 12,000 families in 127 villages are also threatened by mudslides and eight municipalities and two cities are threatened by floods.

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<sup>12</sup> The Galing Pook Awards is a program that recognizes innovation and excellence in local governance. The Galing Pook Awards Program started in October 21, 1993 under the joint initiative of the Local Government Academy (DILG), the Ford Foundation and individual advocates of good governance from the academe, civil society and the government. In 1998, the Galing Pook Foundation was registered as a juridical institution to sustain the program.

The provincial government and the people of Albay built their capacities and created a permanent mechanism for preparing and responding to various types of disasters through the institutionalization of the Albay Public Safety and Emergency Management Office (APSEMO) in 1995.

The APSEMO is currently the only functional and permanent office in a local government unit which focuses on disaster risk management activities in a particular locality.

APSEMO pursued a community-based disaster risk management approach. The communities were involved in formulating early warning markers and disseminating alarm information and advisories for disaster avoidance. The communities are also involved in planning activities essential in disaster management before, during and after an emergency. There are assigned roles for everyone and designated pick up points have been identified to make evacuation more organized. The communities know when to undertake pre-emptive evacuation because they are properly informed and equipped with early warning devices and tools. The communities also conduct quarterly drills and exercises, which have enabled Albay to chalk-up zero casualties from typhoons and volcanic eruptions for the first five years.

APSEMO identified communities and areas that are prone to disasters through risk mapping. It also identified safe areas and drew up comprehensive land use plans. The program entailed the relocation of 10,076 households in eight resettlement sites. Since communities are involved in the planning and implementation of the program, the families willingly rendered labor as their counterpart in the construction of their relocation homes.

Albay shares its expertise in disaster preparedness and risk management with interested local government units. It has conducted several “peer to peer” replication and inception workshops in the provinces of Sorsogon, Sarangani and Pampanga, also disaster prone provinces. APSEMO has also been working with the Asian Disaster Preparedness Center and the European Commission in the creation of disaster management offices at the municipal level in Albay.

Source: Galing Pook Foundation

Overall, decentralization has transformed the policy and institutional framework for local development and governance and has motivated greater accountability on the part of local government units toward their constituents. Anecdotal evidence shows that it has resulted in better delivery of devolved public services especially in those local government units that have the politico-administrative and financial capacity to advance local development.

It cannot be denied that the past seventeen years have seen examples of many good and best practices at the local levels where many local governments have taken advantage of the powers devolved to them and have used these in a creative and innovative manner. The many local governments, and local government leaders recognized by various awards (e.g., Galing Pook, Gawad Pamana, Clean and Green, Lingkod Bayan, Magsaysay Awards, Konrad Adenauer Medal of Excellence, Local Government Leadership Award are testimony to this quiet revolution going on in the countryside (Brillantes, Llanto, Alm and Sosmena 2009). Since 1994, more than 230 programs from 152 local government units have already won recognition. The awardees are chosen based on positive results, promotion of people's participation and empowerment, transferability and sustainability, and efficiency of program service delivery.

Capuno (2007) citing figures from Galing Pook Foundation, comment that the increase in the number of enterprising LGUs is proof that decentralization is working. Innovative programs cover such areas as social services, the environment, public works and housing, and livelihood/economic projects, with "direct effect on welfare" (Capuno, 2007, page 221).

Referring to the experience with decentralization, the Philippine Development Forum<sup>13</sup> finds that a "number of LGUs, mostly cities . . . experienced the most improvement in service delivery and poverty reduction relative to other LGUs" and that "decentralization has been recognized as the means to pursue local economic development despite its problems (PDF 2009, page 2). However, a keen observer can note that the number of enterprising LGUs (143 as of 2002 reported in Capuno, 2007) pales in comparison with the thousands of LGUs without such innovative programs and services.

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<sup>13</sup> The Philippines Development Forum or PDF is the primary mechanism of the Government for facilitating substantive policy dialogue among stakeholders on the country's development agenda. It also serves as a process for developing consensus and generating commitments among different stakeholders toward critical actionable items of the Government's reform agenda. The PDF evolved from the Consultative Group Meetings, which were meetings held every 18 months or so among the Government and members of the international development partners community, which together comprised the Philippine Consultative Group (CG).

Decentralization as implemented in the Philippines does have its shortcomings and one can see the experience with decentralization from the proverbial half-empty or half-full glass. In this regard, the Philippines shares with governments, of mostly developing countries that currently are in various forms and stages of decentralization, both positive as well as negative experiences with decentralization. A recent study done by a team of experts from the World Bank and the Asian Development Bank in collaboration with Filipino policy analysts finds that there are mixed results with respect local government performance in the Philippines. There remain serious problems over access to potable water and electricity and other social services, declining literacy rates, environmental degradation, lack of low-cost housing, and unreliable police and fire department services and poor local infrastructure. Certain policies have constrained the access of local government units to private capital. On the other hand, there are well-performing local government units, examples of excellence in the delivery of public services that are able to raise resources more effectively and manage them in an accountable and transparent manner (ADB 2005).

On balance, admittedly, many weaknesses occur in the current arrangements for decentralized governance in most countries, and further reforms will undoubtedly be required (United Cities and Local Governments, 2007, page 203). Decentralization has spurred greater demand for even more and better public services and more effective local governance, among others, especially in those local government units where the impacts of national/central government policies and programs on local development outcomes appear muted or nil. The phenomenon of increasing demand for more and better quality public services to be provided by lower level governments may also be viewed in the light of what Klugman (1994) calls “the irrelevance of (*central government’s*) projects and policies to local needs and conditions, lack of adaptability, delays, under-utilisation of local resources and inadequate maintenance” (page 1). Depending on the quality of local leadership and the accessibility of resources, devolution can lead to “more appropriate and better utilized facilities, lower costs per unit of service and improved operations and maintenance” (ibid, page 1). Where local governments lack the skills and expertise often found in national administration, decentralization is not always appropriate



and can even lower the quality of governance (United Cities and Local Governments, 2007, page 198)<sup>14</sup>.

Thus, in the Philippine case, there remain outstanding problems and challenges in a decentralized regime notwithstanding the improvements and innovations that have been introduced in the past seventeen years. Citing a World Bank survey, Capuno (2007) observes that 74 percent of people were bypassing rural health units and 68 percent bypassing barangay health stations in favour of higher level government and private hospitals. He concludes that the high bypass rates indicate the still-low quality of primary health care services under decentralization, which is definitely an area clamouring for improvement. On the other hand, an outstanding problem is the need of local government units for substantial funding to cover their expenditure assignment. This was a common sentiment expressed by various local government participants in several workshops and this has motivated moves to reform local taxation and the intergovernmental fiscal transfers (Brillantes, Llanto, Alm and Sosmena, 2009)

There is a need for an appropriate matching of tax and expenditure assignments if local governments are to efficiently deliver public services. The rising expectations of the local populace for more and better quality public services has to be matched by the ability of local government units to find substantial funding and to have more efficient program and project implementation. A principal challenge, therefore, faced by LGUs is finding the means to raise adequate financing for local development. The LGUs are a heterogeneous group with varying administrative, financial and technical capacities. Some, especially the major cities have significant tax bases and consequently, buoyant revenue sources but the majority, especially those in the lower income categories, depend on IRA transfers to a large extent for funding local development activities.

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<sup>14</sup> Nevertheless, a wholesale return to centralized governance would be neither appropriate nor politically acceptable (United Cities and Local Governments, 2007, page 203).

The next section discusses the situation of tax assignment and IRA transfers to local government units in the Philippines<sup>15</sup> followed in Section 3 by an examination of the local finance reforms being advocated by various stakeholders.

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<sup>15</sup> The Code has also given local government units authority to borrow from both government and private financial institutions, and the private capital markets without need for prior central government approval. They also make use of grants from the donor community to finance a few small local projects. These are not discussed in the paper because its main focus is the traditional revenue sources, that is, local taxation and intergovernmental fiscal transfers.

## II. Tax Assignment, the Status of Local Taxation and Intergovernmental Fiscal Transfer

### *The problem of tax assignment*

It is an acknowledged principle that matching expenditure and tax assignments is desirable because this will enable the local governments to shape the supply of public goods according to local preferences and willingness to pay (Journard and Kongsrud 2003). However, implementing this funding principle “raise difficult issues and trade-offs” (ibidem, page 9). In revisiting the conventional issue of tax assignment in decentralized settings, Bird (2008) points out that standard literature considers only the real property tax and user charges as “proper sources of local government taxation” (page 6). This follows from what standard fiscal federalism theory suggests as taxes that should be assigned to sub-national governments<sup>16</sup>. The proposition is summarized by Oates (1996) and reported in Bird (2008) as follows:

- Lower levels of government should, as much as possible, rely on benefit taxation of such mobile economic units as households and mobile factors of production.
- To the extent that non-benefit taxes on mobile economic units are required, for example, for redistributive purposes, only higher levels of government should impose them.
- If any non-benefit taxes are imposed by lower levels of government, they should be levied only on tax bases that are relatively immobile across local jurisdictions.

The conventional model, therefore, posits that the best candidates for sub-national taxes are levies are (1) on relatively immobile bases, especially (2) when the base is relatively evenly distributed and (3) when yields are likely to be relatively stable (Ter-Minasian 1997)<sup>17</sup>. This proposition is acknowledged by Journard and Kongsrud (2003) who maintain that there are few taxing powers which can be transferred to sub-national governments without raising

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<sup>16</sup> According to Bird (2008), this flows directly from two key assumptions underlying what has sometimes been called the standard Tiebout-Oates-Musgrave (TOM) model. First, the role of sub-national governments is strictly allocative – to provide “sub-national public goods.” Second, sub-national taxation of such potentially mobile tax bases as trade, labor and capital is almost inevitably distorting (welfare-reducing) and hence a bad idea.

<sup>17</sup> From Bird’s excellent review of the issue of tax assignment.

efficiency and/or distributional concerns. This seems to imply a limited scope for fiscal autonomy, which may put local governments in a bind, so to speak, when implementing their expenditure assignments. Bird (2008) asserts that under its strongest form the conventional model, popularly known as the Tiebout-Oates-Musgrave model of tax assignment, there are no productive taxes assigned to sub-national governments. The basic assumptions of this model are the following: (a) the role of sub-national governments is strictly allocative, that is, to provide sub-national public goods and (b) sub-national taxation of potentially mobile tax bases as trade, labor and capital is almost inevitably distorting and welfare-reducing and hence a bad idea.

The standard model is of little help when the scale and scope of expenditure responsibilities given to local government units are taken into account. Following it to the letter will yield an imbalance between the expenditure and tax assignments, which may prove to be “economically undesirable and politically unsustainable” (Bird 2008, page 8). Secondly, it offers no practical guidance to the reality of varying sub-national tax structures seen in various countries. As Bird (1999, page 9) puts it: “the actual tax assignment that actually prevails in any country inevitably reflects more the outcome of political bargaining in a particular historical situation than the consistent application of any normative principles.”

The other view of the tax assignment problem maintains the opposite: sub-national governments should tax the mobile factors so as to motivate tax competition among local governments and eventually limit the greediness of the central government. Competition between such governments can limit the grasp of the Leviathan (Bird, 2008), that is the central government, which tends to arrogate for itself the bulk of resources and power. The Leviathan model propounded by Brennan and Buchanan (1980) portrays government as a monolithic Leviathan that maximizes revenue by exploiting the tax base to the maximum extent. Fiscal decentralization is a powerful response to the grasp of the Leviathan because it provides an institutional constraint to the reach of the state (Zhu and Krug, 2005). Thus, “total government intrusion into the economy should be smaller, *ceteris paribus*, the greater the extent to which taxes and expenditures are decentralized . . .” (Brennan and Buchanan, 1980, page185).

However, similar to the standard model, the Leviathan model “falls almost equally short of making any practically very useful recommendations” (Bird, 2008, page 11).

The upshot of the assessment of traditional and Leviathan models is that that guidance for a meaningful tax assignment could be as follows (Bird, 2008; McLure, 2000):

- Financing follows function and thus, tax assignment depends very much on the assignment of spending responsibilities.
- Local governments should have the power to determine their "own-source" revenues and should be able to set their own tax rates.

#### *Taxes assigned to local government units<sup>18</sup>*

**Table 1** summarizes the various taxes that are assigned to local government units by the Local Government Code. The Code (section 133) provides a detailed list of taxes that only the central government can impose. These include the individual and corporate income taxes, customs duties, value-added tax, and the excise taxes on alcoholic beverages, tobacco products and petroleum products.

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<sup>18</sup> This sub-section draws from Manasan (2005).

**Table 1. Tax assignment in cities, provinces and municipalities**

Tax base	Cities	Provinces	Municipalities	Barangays
Real property transfers	x	x		
Business of printing and publication	x	x		
Franchise	x	x		
Sand, gravel and other quarry resources	x	x	*	*
Amusement places	x	x	*	
Professionals	x	x		
Real property	x	x	*	*
Delivery vans and trucks	x	x		
Idle lands	x	x		
Business	x		x	x
Community tax	x		x	*
*shares in the proceeds of levy of province				

Manasan (2005) gives a succinct assessment of tax assignment to local government units in the Philippines.

- The Philippine tax assignment appears to be largely consistent with the traditional view of tax assignment.
- It scores low on the autonomy criterion because (a) the Code fixes the tax rate of some of the taxes that are assigned to LGUs; (b) the Code sets limits (floors and ceilings) on the tax rates that LGUs may impose and maximum allowable rates are rather low; (c) in terms of real property assessment levels, the Code sets maximum assessment rates for different classes of property; (d) the Code mandates that tax rates can only be adjusted once in five years and by no more than 10 percent.
- Future Code amendments should consider giving LGUs greater discretion in setting tax rates by raising the maximum allowable tax rates.
- There is a need to move away from tax rates that are not indexed to inflation.
- There is a need to simplify the structure of local business tax because different categories of firms are subject to different rate schedules.
- There is a need to improve the tax administration machinery of local governments, e.g., employ certified public accountants to improve tax audit capability; use automation to improve revenue performance, etc.
- There is a need to revise the schedule of market values for real property purposes because many provinces and cities have done a general revision of such schedules only once since 1991.
- There is a need for many LGUs to revise their tax codes since only a few have made revision since 1992 even if some tax rates are not indexed to inflation.

#### *Trend and composition of LGU revenues, 1991-2007*

**Tables 2 and 3** indicate that the central government controls the bulk of productive sources of revenue even in the post-Code period. Manasan (2005) also attributes the relatively low tax performance of local government units to: (a) the inability of LGUs to utilize their revenue-raising powers more effectively due to political constraints and (b) the disincentive

effect of the internal revenue allotment (IRA) distribution formula on local tax effort. Thus, updating Manasan’s figures, which ended in 2003, to 2007 (Table 2), it can be seen that the contribution of LGUs to total revenues of the general government (central government and LGUs combined) remains low and stagnant- an average of 7.0 percent in 2004-2007 compared to 6.9 percent in 1992-2003. The comparable figure in the period 1985-1991 was 4.9 percent.

Table 2. Share of national and sub-national governments to general government revenue  
(in percent)

	National Government			Local Government		
	Total	Tax	Non Tax	Total	Tax	Non Tax
1985	94.1	95.5	84.2	5.9	4.5	15.8
1987	95.5	96.2	92.2	4.5	3.8	7.8
1989	95.2	96.3	90.6	4.8	3.7	9.4
1991	95.4	96.3	91.6	4.6	3.7	8.4
1993	93.6	94.4	88.2	6.4	5.6	11.8
1995	94.1	94.8	90.0	5.9	5.2	10.0



1997	93.5	94.4	87.4	6.5	5.6	12.6
1999	92.8	93.8	84.3	7.2	6.2	15.7
2001	92.8	93.7	87.2	7.2	6.3	12.8
2003	92.1	92.7	88.4	7.9	7.3	11.6
2004	92.6	93.3	88.5	7.4	6.7	11.5
2005	92.6	93.4	87.7	7.4	6.6	12.3
2006	93.3	94.2	87.3	6.7	5.8	12.7
2007	93.7	94.2	91.5	6.3	5.8	8.5

Average

1992-2003	93.1	94.0	87.4	6.9	6.0	12.6
2004-2007	93.0	93.8	88.8	7.0	6.2	11.2

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Source of data: 1985-2003, Manasan (2005); 2004-2007, author's updates.

Local government revenue effort was an average of 0.08 percent of GNP in the pre-Code period, an average of 1.2 percent of GNP in 1992-2003 (Manasan 2005) and 1.1 percent of GNP in 2004-2007 (**Table 3**).

**Table 3. General government revenues by level of government as percent of GNP**

	General Government			National Government			Local Government		
	Total	Tax	Non Tax	Total	Tax	Non Tax	Total	Tax	Non Tax
1985	13.3	11.6	1.7	12.5	11.1	1.4	0.8	0.5	0.3
1987	16.2	13.4	2.8	15.5	12.9	2.6	0.7	0.5	0.2
1989	17.7	14.0	3.6	16.8	13.5	3.3	0.9	0.5	0.3
1991	18.4	15.1	3.4	17.6	14.5	3.1	0.8	0.6	0.3
1993	18.5	16.3	2.3	17.4	15.3	2.0	1.2	0.9	0.3

1995	19.6	16.7	2.9	18.4	15.9	2.6	1.2	0.9	0.3
1997	20.0	17.3	2.7	18.7	16.3	2.4	1.3	1.0	0.3
1999	16.4	14.7	1.8	15.3	13.8	1.5	1.2	0.9	0.3
2001	15.8	13.6	2.1	14.6	12.7	1.9	1.1	0.9	0.3
2003	15.0	12.8	2.2	13.8	11.9	1.9	1.2	0.9	0.2
2004	14.5	12.4	2.2	13.5	11.5	1.9	1.1	0.8	0.3
2005	15.0	12.8	2.1	13.9	12.0	1.9	1.1	0.8	0.3
2006	16.1	14.0	2.1	15.0	13.2	1.8	1.1	0.8	0.3
2007	16.7	13.7	3.1	15.7	12.9	2.8	1.1	0.8	0.3
Average									
2004- 2007	15.6	13.2	2.4	14.5	12.4	2.1	1.1	0.8	0.3

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Source of data: 1985-2003, Manasan (2005); 2004-2007, author's updates.

Another interesting dimension of the tax structure obtaining for local governments after the enactment of the Local Government Code is shown in **Table 4**. There appears to be a significant deterioration in the share of provinces and municipalities in total LGU own-source revenue from an average of 19.9 percent and 37.1 percent, respectively in 1985-1991 to 12.5 percent and 27.3 percent, respectively in 1992-2003, and more recently to 10.6 percent and 20.7 percent, respectively in 2004-2007. This contrasts with the continuous increase in the share of cities in total LGU own-source revenue, which grew from 60.2 percent in 1992-2003 to 68.7 percent in 2004-2007. This is explained by the broader taxing powers given to cities relative to those of provinces and municipalities (see **Table 1**).

In general, local tax collections are inadequate and cannot effectively cover the LGUs expenditure assignment. The vertical mismatch is evident in the local fiscal gaps noted by analysts. Manasan (2005) and ADB (2005) give an overall assessment of the results of tax assignment. Available revenue sources are significantly restricted, producing excessive dependence on the internal revenue allotment (IRA) to meet local budgetary needs. **Table 4** shows the revenues of local government units by type of revenue source. The dominance of IRA as revenue share is very obvious in **Table 5**.

A JICA study (2008) summarizes the situation on the IRA as follows:

- For the period 2002-2006, IRA has been the biggest source of revenue of LGUs, contributing, on the average, 63% of the total revenue.
- Locally-sourced revenue consisting of tax and non-tax sources contributed, on the average, 32% of the total revenue. Its share to the total revenue indicated a slightly increasing trend from 31% in 2002, to 33% in 2006.
- Revenues from the real property tax and business tax represent 24% of the total revenue.
- Except for a slight decline from the real property tax in 2004 and from the business tax in 2006, tax collection performed well during the period, recording their highest growths of 23% and 30%, respectively in 2005.

- Special revenue consisting of shares of LGUs from national taxes (other than IRA); extraordinary receipts such as grants and aid; loans; and inter-local transfers, represents 6% of the total revenue in 2006

**Table 4. Local government revenues by source of revenue, 2002-2006**

Particulars	2002	2003	2004	2005	2006
<b>TOTAL REVENUE</b>	<b>159,771</b>	<b>177,252</b>	<b>177,318</b>	<b>221,476</b>	<b>225,832</b>
IRA Share	107,118	113,680	112,883	136,690	137,521
Locally-Sourced	49,644	55,127	57,300	73,942	75,408
Tax Revenue	38,508	42,053	43,080	54,274	54,859
Real Property Tax	19,533	22,185	21,440	26,348	27,100
Business Tax	16,706	17,487	19,280	24,997	24,583
Other Taxes	2,269	2,381	2,360	2,929	3,176
Non-Tax Revenue	11,136	13,074	14,220	19,668	20,549
Regulatory Fees	2,894	3,414	3,577	4,910	4,495
Service/User Charges	1,301	1,630	1,910	2,985	3,379
Receipts from Economic Ent.	4,541	5,902	6,187	9,002	8,571
Other Receipts	2,400	2,128	2,546	2,771	4,104
Special Revenue	3,009	8,445	7,135	10,844	12,903
Share from Natl Taxes (Other than IRA)	524	2,020	2,073	4,598	3,590
Extraordinary Receipts/Grants/Aids	604	2,321	1,162	1,662	1,750
Loans and Borrowings	1,414	3,265	2,624	3,458	6,185
Inter-Local Transfers	467	839	1,276	1,126	1,378

Source of basic data: Bureau of Local Government Finance

**Table 5. Percent distribution of LGU revenue by source, 2002-2006**

Particulars	2002	2003	2004	2005	2006
<b>TOTAL REVENUE</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
IRA Share	67%	64%	64%	62%	61%
Locally-Sourced	31%	31%	32%	33%	33%
Tax Revenue	24%	24%	24%	25%	24%
Real Property Tax	12%	13%	12%	12%	12%
Business Tax	10%	10%	11%	11%	11%
Other Taxes	1%	1%	1%	1%	1%
Non-Tax Revenue	7%	7%	8%	9%	9%
Regulatory Fees	2%	2%	2%	2%	2%
Service/User Charges	1%	1%	1%	1%	1%
Receipts from Economic Ent.	3%	3%	3%	4%	4%
Other Receipts	2%	1%	1%	1%	2%
Special Revenue	2%	5%	4%	5%	6%
Share from Natl Taxes (Other than IRA)	0%	1%	1%	2%	2%
Extraordinary Receipts/Grants/Aids	0%	1%	1%	1%	1%
Loans and Borrowings	1%	2%	1%	2%	3%
Inter-Local Transfers	0%	0%	1%	1%	1%

Source: JICA (2008)

Provinces and municipalities are most dependent on IRA. In an extreme case, the IRA allocations sometimes account for 95 percent of local revenues and, in at least one case, 114 percent of total expenditures (ADB 2005). This situation is mainly explained by the limits on fiscal autonomy earlier described by Manasan (2005). Limits on sub-national government discretion to determine tax rates and tax bases significantly reduce local fiscal autonomy (Joumard and Kongsrud 2003).

### *Intergovernmental fiscal transfers*<sup>19</sup>

Intergovernmental fiscal transfers are a critical instrument for local government financing. Intergovernmental fiscal transfers finance about 60 percent of subnational expenditures in developing countries and transition economies and about a third of such expenditures in OECD countries: 29 percent in the Nordic countries and 46 percent in non-Nordic Europe (Shah, 2006).

Intergovernmental fiscal transfers are used to correct a vertical fiscal imbalance when the tax and expenditure assignments do not match<sup>20</sup>. They affect the efficiency and equity of local service delivery and the fiscal health of the local government units. The design of the intergovernmental fiscal transfer system is very important because wrong design may create a disincentive effect to tax revenue performance of local governments and thus, defeat the purpose of the grant system. Shah (1997) points out that successful decentralization cannot be achieved in the absence of a well designed fiscal transfers program. **Box 3** illustrates the key features of a sound intergovernmental fiscal transfer system.

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<sup>19</sup> I am indebted to Manasan (2005) for information and data in this sub-section.

<sup>20</sup> Intergovernmental fiscal transfers can also have a fiscal equalization objective. This is not discussed in the paper but the reader is directed to Shah (2006) and other studies, which provide a good source of ideas in this area. Shah explains that “fiscal need equalization is a complex and potentially controversial proposition, because by its very nature it requires making subjective judgments and using imprecise analytical methods. (*But*) fiscal capacity equalization is relatively straightforward to comprehend and feasible (with some difficulty) to implement once a (political) decision is made on the standard of equalization” (page 29).

### **Box 3. Key features of a sound intergovernmental fiscal transfer system<sup>21</sup>**

- Promotes budget autonomy at the sub-national level
  - ✓ Lump-sum versus conditional transfers
- Provide adequate revenue to sub-national governments
- Provide positive incentives to encourage higher tax effort, promote expenditure efficiency and discourage fiscal deficits
- Enhance equity and fairness
- Overall transfers should increase with fiscal expenditure needs and decrease with fiscal revenue capacity

Intergovernmental fiscal transfers impacts on allocative efficiency, distributional equity and macroeconomic stability. Performance-oriented or output-based transfers can provide an incentive for local government units receiving transfers to be more accountable for results. Output-based fiscal transfers link grant finance with service delivery performance (Shah, 2006). However, no uniform pattern of transfers is universally appropriate and transfers must be designed so that those receiving (i.e., local government units) them have a clear mandate, adequate resources, sufficient flexibility to make decisions and are accountable for results (Bahl, 1999). The key issue in the design is to match the intergovernmental transfer system with the objectives of the decentralization reform. Bird and Smart (2002) provide a good summary of the central issues that arise in designing intergovernmental fiscal transfers.

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<sup>21</sup> Compilation done by Rey Chang, Dunstan Decena and Felipe , PA 332, University of the Philippines National College of Public Administration and Governance.

Philippine intergovernmental fiscal transfers are of three types: (a) the internal revenue allotment (IRA), a formula-based grant, (b) share in national wealth and (c) *ad-hoc* conditional grants. **Table 6** shows these three types of transfers.

**Table 6. Fiscal transfers to local government units**

Fiscal transfers	Before the Code	After the Code
Revenue share	Internal revenue allotment Specific tax allotment LGU revenue stabilization fund Budgetary aid to LGUs Barangay development fund	Internal revenue allotment Share in national wealth Share in tobacco excise tax
Grants	Calamity fund Municipal development fund Countryside development fund	Calamity fund Municipal development fund Local government empowerment fund Countryside development fund DECS school building program

The discussion here focuses on the IRA, the major transfer from the central government to local government units, which is a fixed share (40 percent) of actual internal revenue tax collections of the central government three years prior to the current year. Before the Code, the IRA was equal to 20 percent of internal revenue taxes. Local governments almost have full discretion in the utilization of this type of fiscal transfer. The Local Government Code requires LGUs to set aside 20% of the IRA as development funds. The IRA is divided among LGUs as follows: 23 percent to provinces, 23 percent to cities, 34 percent to municipalities and 20

percent to barangays. Before the Code, the allocation was 25 percent to provinces, 25 percent to cities, 40 percent to municipalities and 10 percent to barangays. The distribution of the IRA is as follows: individual LGUs in each tier of local government receive the IRA share on the basis of population (70 percent), land area (25 percent) and equal sharing (25 percent). **Table 7** shows the allocation of IRA before decentralization and post-decentralization.

**Table 7. Comparison of the IRA allocation system**

Category	Pre-1973	PD 144	RA 7160
% of BIR collections	17%	20%	40%
Collection year	Preceding year	Third preceding year	Third preceding year
Sharing of LGUs			
- provinces	13%	25%	23%
- municipalities	4%	40%	34%
- cities	13%	25%	23%
- barangays	none	10%	20%
Distribution factors			
- population	70%	70%	50%
- land area	30%	20%	25%
- equal sharing	none	10%	25%
Development fund	none	20% of IRA received	20% of IRA received

Source: compiled by Rey Chang

The other types of fiscal transfers (a) share in national wealth and (b) conditional grants will only be mentioned in passing and will not be discussed in detail<sup>22</sup>. The share in national wealth comes from mining taxes, royalty from mineral reservation, forestry charges, energy resources production and tobacco excise tax and does not accrue to all LGUs. Conditional grants come from (i) lump sum allocations under the central government budget, (ii) allocations made by central government sector agencies from their own budgets and (iii) lump sum and/or line item appropriations for pork barrel funds of legislators. The problem with conditional grants is that they become available depending on the fiscal position of the central government

<sup>22</sup> These should be studied in the near future for their allocative effects, among others.



and/ or political objectives of legislators and the central government. For example, the Local Government Service Equalization Fund (LGSEF) created by Executive Order 48 of 1998 during the Estrada administration was funded from the aggregate IRA share of LGUs. The money for LGSEF was carved out of the IRA, which diminished block grant to LGUs. The government later discontinued the LGSEF. Through the congressional insertions or pork barrel, the legislator substitutes his own preferences to those of the local government units, which have their own preferences. Because of the information advantage, the LGUs would have a better idea of what programs, projects and activities that would lead to higher local welfare. In this light, congressional discretionary funds and the enjoyment to spend those funds according to the wish and whim of legislators would be welfare-reducing.

The following assessment of the status of central government transfers to LGUs from Manasan (2005) reveals the deficiencies in this instrument for addressing vertical fiscal imbalance.

- Since the enactment of the Code, there has been a remarkable increase in the size and composition of central government transfers to LGUs;
- There has been a movement away from *ad-hoc* grants in favor of the formula-based IRA block transfer;
- Vertical fiscal imbalance (before transfers) for all LGUs in the aggregate surged from 6.7 percent in 1985-1991 to 16.9 percent in 1992-2003. It was trimmed down to less than 4 percent in 1998-2000 and was more than 4 percent in 2003 because of unfunded mandates<sup>23</sup>.
- Local government units have become increasingly dependent on the IRA. The share of IRA to total LGU income net of borrowings increased from 38.0 percent in 1985-1991 to

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<sup>23</sup> Unfunded mandates refer to spending responsibilities arising from legislation without the benefit of a funding source (that is, absence of taxes to cover those spending mandates). In the case of LGUs, the unfunded mandates include the salary increases under the Salary Standardization Law, the additional personnel benefits under the Magna Carta for health workers, and the additional mandatory positions and sectoral representations under the Local Government Code.

as high as 65.1 percent in 1992-2003 for all LGUs. The IRA transfer has a disincentive effect on local revenue tax effort. Prior to the Code (1985), intergovernmental fiscal transfers had a neutral effect on local revenue performance but it substituted for local tax revenues in all levels of local governments in 1992 and 1993 (Manasan 1995).

- There is a need to improve the IRA distribution formula so that the varying fiscal capacities of the various levels of local government may match their expenditure needs more closely.

A graphical presentation of the outstanding issues in the IRA distribution formula is shown in **Figure 1** (JICA, 2008)

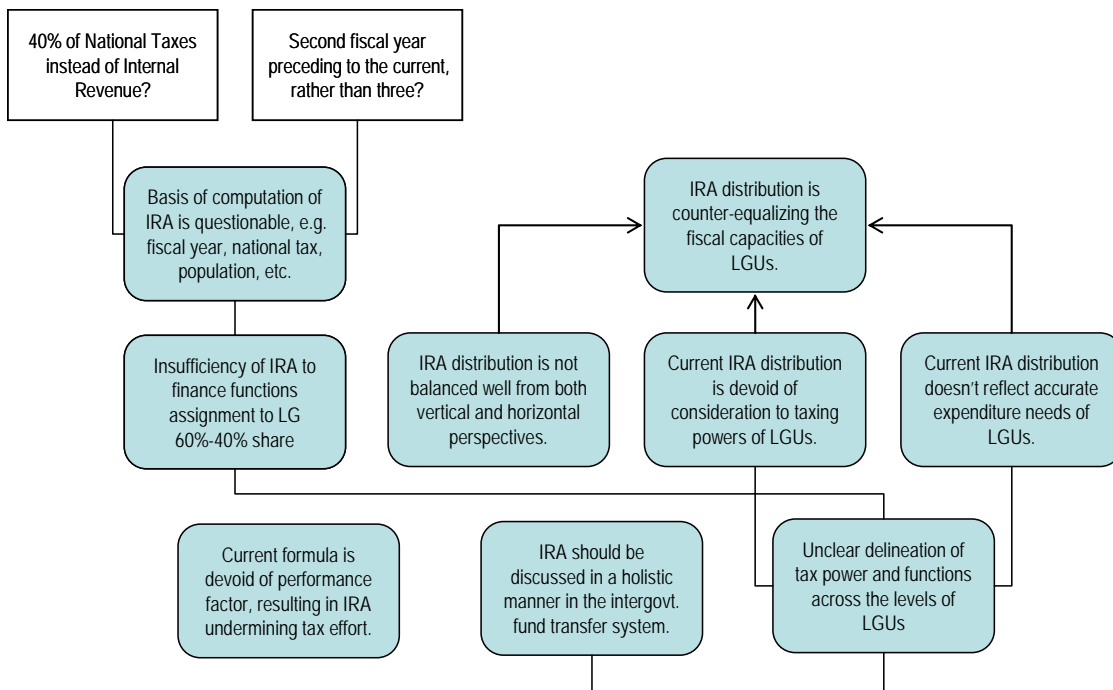


Figure 1. Major issues in the distribution of the internal revenue allotment

### III. Current Reform Efforts in Local Government Finance

This is stating the obvious: there is a need to eliminate the fiscal gap, that is, the difference between the expenditure and tax assignments. The principle to be applied is that the cost of providing local public goods should be borne locally at least at the margin (Joumard and Kongsrud 2003). The fiscal gap in many local government units has arisen from growing local spending demands and the narrow array of tax instruments that could be effectively imposed by local authorities. More vigorous revenue mobilization would be possible by strengthening the taxing powers of local government units. This calls for an amendment of the Local Government Code because as shown earlier in the paper, much of the weaknesses in local taxation stem from certain provisions of the Code that undercut fiscal autonomy. Local governments, the central government, development partners, legislators and other stakeholders have recognized and accepted the necessity of revisiting the tax and expenditure assignments, and the intergovernmental fiscal transfers through the internal revenue allotment (IRA). The discussion in this Section shows the contrasting as well as common approaches taken by interested parties in improving and strengthening local finance.

#### *Policies and/or measures taken by the central government and local governments for local finance reform*

Local finance reform efforts of the central government and local government units find a common forum in the Philippine Development Forum and in other forums and dialogues organized by the Department of the Interior and Local Government. The central government and the different leagues of local governments, representing provinces, cities and municipalities use these forums to debate on the tax proposals and drive a consensus on specific reform measures to be pursued to improve the tax assignment and IRA distribution formula. The different leagues of local government units such as the Leagues of Provinces,

Leagues of Cities, Leagues of Municipalities and the Union of Local Authorities of the Philippines have started to work with the Department of the Interior and Local Government (DILG) in reviewing and formulating various proposals for amending the Local Government Code, especially Book II (local taxation).

The emerging consensus is a set of proposals seeking to amend Book II (Local Taxation) of the Local Government Code, which has the common support of the DILG and the various leagues. Both the central government (represented by the Department of the Interior and Local Government and the Bureau of Local Government Finance of the Department of Finance) and the leagues of local government have agreed to focus first on the priority issue of raising local resources. The details of the proposed amendments to the Code on local taxation are shown in **Annex A**.

Both the central government and the various leagues of local governments have exerted efforts to coordinate with legislators in translating the different local tax proposals into legislative bills. Some of the legislative bills (presented below) reflect the tax proposals adopted by the central government through the DILG and the Leagues. At this stage, there are varying tax proposals and it is necessary to hammer an agreement among stakeholders on what will finally be subjected to the legislative mill. What is also lacking in these efforts is a sustained information and education drive with the public to generate widespread support for proposed tax amendments.

The proposed amendments are guided by the following guiding principles:

- Broader local taxing authority enhances ability of LGUs to raise revenues from local sources and consequently, promotes fiscal accountability.
- Local tax structure should be simple and flexible.
- Local tax structure and systems should enhance ease of tax administration

The proposed amendments in Book II of the Local Government Code is envisaged by the stakeholders (DILG, BLGF/DOF and the leagues of local governments) to address the vertical

fiscal imbalance, which has had an adverse effect on their ability to provide quality local services. The proposed amendments would to a large extent give LGUs more fiscal autonomy.

The proposed package of reforms is estimated to yield substantial revenues for local governments which will help address the vertical fiscal imbalance that has beleaguered local governments as explained above (**Table 8**).

**Table 8. Estimated Increase in Local Tax Collections due to Proposed Amendments to LGC**

Type of Local Tax	Actual collection in 2006	Estimated increase
(a) tax on transfer of real property ownership	Pesos 1.3 billion	Pesos 5.2 billion
(b) professional tax	Pesos 155 million	Pesos 620 million
(c) annual fixed tax on delivery vans and trucks	Pesos 90 million	Pesos 270 million
(d) tax on business	Pesos 21.8 billion	Pesos 54.5 billion
(e) individuals liable to community tax	Pesos 954 million	Pesos 1.9 billion
(f) special education fund of provinces	Pesos 2 billion	Pesos 3 billion
special education fund for cities	Pesos 8.3 billion	Pesos 18.7 billion
special education fund for municipalities	Pesos 2.3 billion	Pesos 3.4 billion
Source of data: Bureau of Local Government Development, DILG		

The internal revenue allotment (IRA) is a major source of financing for local government units, especially lower income class LGUs. At present, there are attempts to revisit the distribution formula of IRA to make it more responsive to the funding needs of local

government units, introduce more weight to the equity criterion in the formula, and other reasons. However, the consensus among the various leagues of local government units seems to be the retention of the current formula for IRA distribution but at the same time, lobby with Congress to increase the IRA share from 40 percent to 50 percent of national internal revenue tax collections. The guiding motivation behind this move is the desire to extract more resources from the central government and not to let potentially disruptive debates on a new IRA distribution formula to get in the way of resource extraction.

An alternative view that is also being discussed among academics, policy analysts and some local government units is to make local government performance (to be measured by agreed-upon indicators) as the basis for an incremental IRA, which will be over and above the current levels presently enjoyed by local government units. IRA is a relatively stable source of income for LGUs, especially those with undeveloped tax bases for reasons of poor local economy, unwillingness of the LGU to exercise its taxing power and others, but its known disincentive effect on local tax revenue collection has motivated the search for alternative ways to use local government performance as a basis for increasing the resource envelope for local government units. The motivation seems to be the intuitive appeal of giving a reward for effort and performance, a positive incentive that would minimize the negative effect of the existing IRA on local tax revenue collection.

Thus, the idea of a performance-based grant is gaining currency in various discussions proposing changes in the intergovernmental fiscal transfers in the Philippines. In particular, the central government and the World Bank are cooperating in the development of a performance-based grant system for local government units. Please see **Box 4**.

#### **Box 4. Performance-based grant for local government performance**

Typically, local government units must obtain a loan in order to access grants from a facility such as the Municipal Development Fund. Thus, the facility is only used by those LGUs that wish to, and have the capacity to, access loans. The proposed Performance-Based Grant (PBG) project aims to de-link access to grants from lending, thus enabling the Government to extend much needed grant funding to lower tier LGUs that demonstrate commitment to improving their performance in key functional areas. LGUs could opt to augment grant funding with loans sourced on the market.

The current emphasis on LGU performance in the Philippine Development Forum (PDF) and other Government Programs is aimed at ensuring that LGUs do not become complacent and work hard to maximizing benefits<sup>24</sup>

The PDF working group has among its priorities: to improve access to finance; introduce performance based systems; build capacity of LGUs; and support policy reform.

As envisioned the Performance Based Grant System (PBGs) would have four core components: (a) a performance assessment system, (b) development grant, (c) capacity building grant and (d) institutional strengthening program. These will be designed in a mutually reinforcing manner to ensure that LGUs are better positioned to accomplish their mandate:

- 1) *The performance assessment* – an annual assessment of eligible LGUs would be conducted to measure performance in relation to minimum conditions (performance targets). It is expected that the assessment mechanism would complement the existing Local Government Performance Measurement System (LGPMS) in order to reduce duplication of effort while also improving the quality of data collected through LGPMS;
- 2) *The development (capital) grant* – on an annual basis LGUs that meet minimum conditions would receive a development grant transferred through the government’s budget system. **The development grant would supplement the 20% mandated IRA allocation for development activities**, thus enabling LGUs to expand infrastructure and services, prepare viable projects and adequately budget for maintenance;
- 3) *The capacity building grant* – all LGUs would have access to capacity building grants to enable them to improve performance in core functional areas. The capacity building grant would support the training, equipment and technical assistance required to improve LGUs capacity to perform essential functions such as planning, budgeting, resource mobilization and financial management; and

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<sup>24</sup> A forum for dialogue on policy issues between government and development partners established in place of the Consultative Group.

4) *The institutional arrangement* - the capacity of the four oversight agencies responsible for monitoring LGU performance would be enhanced in order to ensure sustainability of the PBG. Institutional arrangements for supporting the PBGS would take cognizance of the role of the four oversight agencies in setting overall objectives, policies, and procedures for local government development; supervising and monitoring LGU performance; and maintaining the PGBS.

Source: Project information document (PID), Concept stage (Report No. AB3494), World Bank Office, Manila

### *Local finance reform efforts in the legislature*

The following is a summary of various legislative proposals currently under deliberation in the House of Representatives and the Senate (Brillantes, Llanto, Alm and Sosmena (2009). The various legislative bills prepared by legislators indicate the lively interest among legislators to improve the tax assignment and intergovernmental fiscal transfers to LGUs.

#### On the internal revenue allotment

- The Leagues, the Senate and the House have produced various proposals on local fiscal administration, yielding the greatest number of proposed amendments for Book II of the LGC, which is focused on local fiscal administration. Intergovernmental transfers and the IRA distribution formula have been the most contentious issue.
- The various leagues of local governments have proposed an increase from 40 percent to 50 percent the share of LUs in internal revenue taxes. The Leagues also propose an additional criterion, the poverty index, as a basis for the computation of the LGUs' share in the IRA or national taxes.
- The Senate proposes to raise the existing 40 percent IRA share of LGUs to 60 percent, stipulating that the amount should be retained automatically by the LGUs (Senate Bill 8, Senate Bill 119). It likewise proposes a reallocation of the IRA,



meaning that the cost of devolved functions is to be deducted before allocating the IRA to the LGUs (Senate Bill 520). Furthermore, it proposes to change the basis of LGU share from internal revenue taxes to national taxes (Senate Bill 118).

- The House has produced the most number of proposals amending the IRA allocation. It calls for the increase of the LGUs' share and for its automatic retention (House Bill (HB) 2768, HB 2413, HB 2937, HB 3533, HB 3708, HB 3845, HB 4232, HB 4258, and HB 4920).
- The House proposes a more equitable distribution of the IRA to LGUs (HB 0181).
- The House proposes to include the marine waters in addition to the land area of the LGUs in the IRA distribution formula (HB 3506).
- The House proposes the inclusion of "revenue capacity" of the LGU as a factor or criterion in computing for the IRA (HB 4988).

#### On local taxation

- The Senate proposes the creation of a Regional Technical Valuation Committee to prepare the Schedule of Fair Market Values of LGUs but with DOF's final approval (Senate Bill 2203). Another proposal from the Senate calls for the creation of a Local Assessment Council for the same purpose (SB 578).
- The Senate proposes to give additional sources of revenue to the cities and municipalities by removing from the provinces the power to levy taxes on sand, gravel and other quarry resources, and giving it to the cities and municipalities (SB1458).
- An increased rate of idle land tax from 5 percent to 10 percent has been proposed by the Senate, (SB 163). A decrease from 30 percent to 10 percent in the amusement tax rate has been proposed as well (SB 2325, SB 1426, SB 717, and SB 71).
- The House proposes to give an additional source of revenue to the provinces by requiring component cities to provide to its mother province a share of its real

property taxes (HB1607). The House proposes to make certain the revenues accruing to the barangays by (a) proposing the automatic release of the share of the barangay from the proceeds of national taxes and taxes from the utilization and development of the national wealth (HB 0121, HB 1792, and HB 1920), and by (b) proposing the automatic retention by the barangay of its 50 percent share from community taxes (HB 1112, HB 0202, and HB 1919).

The list of proposed legislative bills amending the Local Government Code and related legislative bills is long. Of great interest among policy makers, including the central government and the Leagues is finding the right strategy and approach to generate broad-based support for the proposed legislation in the Congress and the Senate. Some think that the right approach is to propose an omnibus bill that carries the different proposed amendments in one package. The aim is to have comprehensiveness and consistency of various local tax provisions. Others would rather adopt a more pragmatic approach of proposing specific amendments, e.g., proposed amendments to Book II (local taxation) or even proposing one specific amendment only rather than filing a comprehensive bill that would cover a wide ranging set of issues. It seems that legislators have varying appreciation of their stock of political capital that would be needed in getting support and approval for their pet legislation. Pragmatic politicians are careful to husband relatively scarce political capital and to use it for decisions that would yield the greatest political benefit for themselves.

Another important dimension of policy reform efforts is the ability of the central government to get the political support of the President of the Republic for a proposed legislation. In Philippine-style policy reform, which calls for legislation, it is seen as good practice to have the President to certify as “urgent” a proposed bill. It helps that there is a LEDAC, a forum composed of key legislators and department secretaries (ministers) where discussions on proposed legislation deemed critical for national development take place.

Thus, a central government agency concerned with the 'urgent' bill closely collaborates with a legislator or a group of legislators for its passage. It is well known that in Philippine politics, the incumbent (President) traditionally exercises strong suasion over congressmen (also called 'representatives'), who are willing to lend the executive their political capital in return for quick release of their pork barrel funds that are used for their projects and activities in their respective congressional districts. On the other hand, members of the Senate who are traditionally more politically independent of the executive, may have a tactical, albeit temporary, coalition with supporters of the 'urgent' bill to give support to an incumbent President's pet legislative bill/s. In either case, it is the pragmatic and self-interested political calculus of legislators that will lend support to or block the passage of a proposed legislation. The distribution of the pork barrel is controlled by the executive and this is a strong incentive for legislators, congressmen and senators alike, to line up and march behind the political drum of the President.

#### *Consultation through the Philippine Development Forum*

The Philippine Development Forum has provided an excellent venue for extensive consultations with government, the local government units (LGU) through their Leagues, development partners and stakeholders on local finance reforms. Through the PDF, the central government the various Leagues representing different levels of government and stakeholders are able to (a) present contrasting views on local finance reforms, discuss and build some form of consensus on possible amendments to the Code and (b) agree on the executive action that may be taken to improve local taxation. An example is shown in **Box 5**. The timely release of the LGU share in national wealth, e.g., energy resources in Palawan, has been a favourite advocacy of the Leagues. The Joint Memorandum Circular is a response to the clamor for timely release of the LGU share that has been constrained by documentation and procedural requirements of some government agencies, e.g., Bureau of Internal Revenue.

**Box 5. Automatic Appropriation of the Internal Revenue Allotment (IRA) and Simplification of Procedures for the Release of LGU Shares.**

Upon the recommendation of the Department of Budget and Management (DBM), Congress approved the automatic appropriation of IRA (section 4) through Republic Act 9358 on the supplemental appropriation for 2006. In addition, a Joint Memorandum Circular was signed by oversight agencies through the initiative of the DBM in early 2006 that simplified and reduced the requisite documents for the release of LGU shares in national wealth. These measures will resolve the delays in the release of IRA as well as enable LGUs to better program their activities.

Source: Accomplishment Report, Philippine Development Forum, 2007

At present, the PDF's Working Group on Decentralization and Local Government is occupied with several tax proposals that seek to improve the tax assignments across levels of LGUs. **Box 6** reports the specific issues currently under discussion by the Working Group on Decentralization and Local Government. It is noted that ideas of providing local governments with access to productive taxes, e.g. excise taxes on motor vehicle registration, piggyback rates on certain taxes (presumably those imposed by the central government) have finally reached the attention of central government and various leagues of local governments. The next step is to collaborate with legislators in framing legislative proposals.

**Box 6. LGU Concerns on Local Finance**

- Give provinces and municipalities discrete assignment of revenue sources e.g. property and business licensing to municipalities and business taxes to provinces.
- Allow LGUs to impose excise taxes on motor vehicle registration.
- Allow provinces to impose piggyback rates on certain taxes.
- Amend LGC restrictions on the frequency and rate of tax rate adjustment.

- Amend the provision in the LGC prohibiting the use of the private sector for tax collection.
- Develop standard valuation for real property tax for the entire country; assist LGUs in the revision of schedule of market values of real property
- Issue implementing rules and regulations enabling LGUs to provide fee-based services for assistance provided to other LGUs in core administrative functions.
- Strengthening of the Local Finance Committees
  
- Capacity building for local tax administration and payment of capital gains tax

*Source: PDF Proposed 2007-2008 Action Plan (April 2007 to March 2008)*

#### IV. Concluding Remarks

There were great expectations about the benefits of decentralization but available empirical evidence indicates that decentralization has produced mixed results. On balance, the positive effects seem to outweigh the inefficiency in local service delivery. One effect of decentralization is to make government more accessible to the people and more responsive to their needs as documented in Brillantes, Llanto, Alm and Sosmena (2009). As indicated by the successful experience of awardee-local government units under such programs as the Galing Pook Award Program, the local managerial, technical and fiscal capacity do matter in service delivery. The record shows that there is scope for building the managerial, technical and fiscal capacity of many other local government units, which have failed to meet the expectations of better quality service delivery and good governance. An important aspect of capacity building is the improvement of own-source taxation and the determination to have the political will to impose local taxes on constituents instead of depending on the internal revenue allotment as principal source of revenues. Local service delivery also stands great improvement.

There is a need for more empirical studies, e.g., on the impact of decentralization on economic growth and poverty reduction. A good understanding and assessment of the impact of decentralization will contribute to the framing of appropriate policies and strategies for local development.

The paper pointed out the inadequacy of tax revenues of local government units to cover their expenditure assignments. While the approach taken in the Philippines appears to be largely consistent with the conventional model of tax assignment, LGU fiscal autonomy is constrained because the Local Government Code limits the power of LGUs to set local tax rates and preserves the more revenue productive taxes in favour of the central government. The challenge is to find more revenue productive taxes for local government units. It should be mentioned that the great complexity of local revenue codes, e.g., local business taxes, stacked against the lack of technical and administrative capacities, especially among the lower income

LGUs has acted as an effective barrier to efficient local tax collection, which ultimately reinforces the vertical fiscal imbalance.

The dictum “finance must follow function” requires that local fiscal resources be commensurate with the expenditure assignments. If local government units are to play their expected role in a decentralized and devolved setting, they should have access to more productive revenue sources and have the latitude to use their taxing powers more effectively, that is, have unilateral authority in setting tax bases and tax rates. In short, the LGUs need real fiscal autonomy.

The other side of the issue of tax-expenditure assignment is the need to review the expenditure assignment itself. There may well be local government expenditure responsibilities that involve service provision with broader regional, and even national, implications. Some examples that were often mentioned in the consultative workshops include environmental, agricultural, and health services. For example, some local government units are currently advocating for the return to the central government of some devolved functions, e.g., health services. A rethinking of expenditures assignments to local governments may be warranted. Effective local service delivery depends on whether the concerned function has been devolved or assigned to a low enough level of government. Such rethinking should be done in line with widely accepted principles of expenditure assignments (e.g., the “subsidiarity principle”). It is important to review the expenditure assignment because economically efficient assignment of revenues requires knowledge of expenditure assignment as pointed out by Bahl (1999).

Intergovernmental fiscal transfers are important fillers to the vertical fiscal gap that is induced by the mismatch between tax and expenditure assignments and the complexity of local revenue codes. They are also important for addressing horizontal fiscal imbalance. However, even with the addition of the IRA, the total revenues accruing to LGUs still fall short of their expenditure assignments. Manasan (2005) estimated the vertical fiscal imbalance with the IRA at less than 4 percent in 1998-2000, 6.9 percent in 2001 and more than 4 percent in 2003. The remaining gap must be filled through other mechanisms such as borrowing from government

and private financial institutions and other grants from the central government and/or legislators.

It is not surprising that LGUs advocate for an increase in the size of the block grant. It is high time to review the IRA distribution formula to make it more responsive to the requirements of devolution. The IRA distribution formula has no bearing on the cost of devolved functions and services. It also does not consider the capacity of local governments to raise their own resources or to carry out devolved functions (Schwartz and others 2000). There are suggestions to include local government performance and poverty indices in computing the IRA shares of local governments. One legislative proposal asks to increase the IRA from 40 percent to 50 percent of internal revenue taxes. An outstanding policy issue concerns the size and appropriate distribution formula of the internal revenue allotment, evaluating the equalization features of the fiscal transfer system, and ensuring compliance.

The upshot of these findings is the need to revisit the tax-expenditure assignments of local government units and develop an intergovernmental fiscal transfer system that will reward performance instead of being a disincentive to local revenue generation. There is, however, a need for intensive empirical studies on the tax-expenditure assignment and more especially, on the IRA distribution formula. Thoughtful analysis is needed on the role played by intergovernmental fiscal transfers to address both vertical and horizontal fiscal imbalance. Policy makers should be made aware that there are many different kinds of intergovernmental transfer systems, and they have many different types of impacts on local government finances as explained by Bahl (1999). Some fiscal transfer systems stimulate local spending, some substitute for local revenue effort, some are equalizing, and still some lead to more local government fiscal autonomy than others (Bahl, 1999). The Philippines must explore alternatives and study their differential impacts before settling on a particular fiscal transfer design.

The emerging legislative bills and proposals for executive action, e.g., Joint Memorandum Circular among oversight agencies, which seek various local finance reform measures validate this observation. The challenge is to drive a consensus on the most feasible



tax-expenditure assignments and intergovernmental fiscal transfer mechanism. This will undoubtedly require a deep analysis of the appropriate fiscal package that will effectively support decentralization. A positive development is the emerging collaboration among the central government, the Leagues of Local Government Units, development partners, legislators and other stakeholders in local finance reforms. There is a heightened awareness of the need to improve local government performance, which can only happen if there could be a more effective synergy among these players. Political ownership of a local finance reform agenda will be an important condition for a successful campaign to strengthen local finance.

Somewhat paradoxically, successful fiscal decentralization requires a strong central government and a strong central government capacity to lead the process. There are a number of areas where such central leadership is crucial. For example, it is necessary for the central government to carry out analytical fiscal work to evaluate and to monitor decentralization on a continuous basis. This involves identifying tax effort performance, tracking local budgets, evaluating any proposed alternative fiscal reforms, and so on. The central government needs a fiscal information system to monitor the progress of decentralization and to serve as the database for research necessary to continue to fine-tune decentralization strategy and policies. Many large countries with significant intergovernmental fiscal programs have moved to develop a fiscal information system (e.g., Brazil, India, U.S., Canada, Australia). Further, to the extent the central government imposes rules and regulations and mandates some minimum performance standards, there must be a system to monitor compliance with these requirements. Examples include everything from compensation rates for employees, to environmental regulations, to the adherence with standards for schoolteachers, and others. The central government may take the leadership in providing technical assistance and training to local governments. The more technical the training, the more likely is the central government to lead the training and technical assistance (Brillantes, Llanto, Alm and Sosmena, 2009).

Along these lines, consolidation of some local governments should be considered. Given the inadequate fiscal capacity of many local governments, the difficulty of quickly

improving administrative capacity, and the often overlapping responsibilities and functions of these local governments, consolidation may well lead to stronger fiscal capacity and improved service delivery. An immediate salutary effect is the widening of the local tax base, which will yield higher tax revenue collections. However, some politicians have recently submitted proposals for creating more small local government units, cutting up provinces or creating new congressional districts ostensibly to better serve their constituents but without little regard to the inefficiencies and waste such fragmentation would lay at the door of the taxpayers. Policymakers should instead focus their energies on the consolidation of weak local government units, the improvement of the tax-expenditure assignments and the design of better intergovernmental fiscal transfers.

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**Annex A. Proposed Amendments to Book II of the Local Government Code of 1991**

**LOCAL TAXATION AND REAL PROPERTY TAXATION**

The proposed amendments are guided for the following guiding principles:

1. Broader local taxing authority enhances ability of LGUs to raise revenues from local sources and consequently, promotes fiscal accountability
2. Local tax structure should be simple and flexible
3. Local tax structure and systems should enhance ease of tax administration

Note: Proposed amendments are in CAPITAL LETTER CASE.

<b>Proposed Amendments</b>	<b>Comments</b>
<p><b>SEC. 130 Fundamental Principles-</b> The following fundamental principles shall govern the exercise of the taxing and other revenue-raising powers of local government units:</p> <p>(a) Taxation shall be uniform in each local government unit;</p>	<p>The proposed amendment to Section 130 (c) allowing LGUs to allow authorized banks to receive local tax payments will reduce compliance cost by making it easier on taxpayers to settle their tax liabilities. This proposal is made even more significant by the</p>

Proposed Amendments	Comments
<p>(b) Taxes, fees, charges and other impositions shall:</p> <p>(1) be equitable and based as far as practicable on the taxpayer's ability to pay;</p> <p>(2) be levied and collected only for public purposes AND SOLELY WITHIN THE TERRITORIAL JURISDICTION OF THE LOCAL GOVERNMENT UNIT IMPOSING THE TAX;</p> <p>(3) not be unjust, excessive, oppressive, or confiscatory;</p> <p>(4) not be contrary to law, public policy, national economic policy, or in restraint of trade;</p> <p>(c) LOCAL TAXES, FEES, CHARGES AND OTHER IMPOSITIONS MAY BE PAID THRU ANY BANKING INSTITUTION AUTHORIZED BY THE TAXING LOCAL GOVERNMENT UNIT PURSUANT TO GUIDELINES ADOPTED IN CONSULTATION WITH THE DEPARTMENT OF FINANCE.</p>	<p>fact that many LGUs, even the bigger ones, only accept tax payments in the form of cash.</p> <p>However, the Leagues should explore the possibility that the same result (i.e., allowing tax payments to be coursed through authorized banks) can be effected via a DOF circular or via an amendment of the IRR of the LGC.</p> <p>Insert in (c) <i>“The Collection of local taxes, fess, charges and other impositions shall in no case be let to any private person. However, these may be paid thru any banking ....”</i></p>
<p><b>SEC. 131 Definition of Terms</b></p> <p><b>SEC. 131(c)</b> “Amusement Places” ARE PLACES THAT PROVIDE AMUSEMENT OR RECREATION or relaxation places SUCH AS theatres, cinemas, concert halls, NIGHT CLUBS/BARS, CASINOS, MASSAGE PARLORS, SPA, KARAOKE BARS, circuses, BOXING STADIA, COUNTRY AND SPORTS CLUBS, BEACH AND OTHER RESORTS, RECREATIONAL PARKS, COCKPITS, and other places of amusement where one seeks [admission to] entertainment [oneself] by [seeing or viewing the show] WATCHING SHOWS or performances, OR [entertain oneself] BY PARTICIPATING IN ACTIVITIES OR USING THE FACILITIES THEREAT.</p>	<p>The addition of the phrase <i>“by participating in activities or using facilities thereat”</i> in Section 131 (c) broaden the definition of amusement places significantly beyond just “viewing of shows or performance” as in the 1991 LGC. The list of places, however, appears to be a mixed bag that includes, casinos, cockpits, karaoke bars, country and sports clubs, beach and other resorts, and massage parlors and spas, etc.</p>

Proposed Amendments	Comments
<p><b>(f) Barangay Micro Business Enterprise (BMBE) refers to any business entity or enterprise registered under the provisions of Republic Act Ninety-One Seventy Eight (R.A. 9178), otherwise known as “The Barangay Micro Business Enterprises (“BMBEs”) Act of 2002.”</b></p>	
<p><b>SEC. 131 (n)</b> "Gross Sales or Receipt" include the total amount of money or its equivalent representing the contract price, compensation or service fee, including the amount charged or materials supplies with the services and deposits or advance payments actually or constructively received during the taxable [quarter] <b>YEAR</b> for the services performed or to be performed for another person excluding discounts if determinable at the time of sales, sales return, excise tax, and value-added tax (VAT);</p>	
<p><b>SEC. 131 (p)</b> “Marginal Farmer or [Fisherman] FISHERFOLK” refers to an individual engaged in subsistence farming or fishing which shall be limited to the sale, barter or exchange of agricultural or marine products produced by himself and his immediate family;</p>	
<p><b>( ___ ) “MAXIMUM SUSTAINABLE YIELD” REFERS TO THE</b></p>	



Proposed Amendments	Comments
<p><b>LARGEST AVERAGE QUANTITY OF FISH THAT CAN BE HARVESTED FROM FISH STOCKS OR RESOURCE WITH-IN A PERIOD OF TIME ON A SUSTAINABLE BASIS UNDER EXISTING ENVIRONMENTAL CONDITIONS.</b></p>	
<p>(r) "Municipal Waters" includes not only streams, lakes, INLAND BODIES OF WATER and tidal waters within the municipality WHICH ARE NOT INCLUDED WITHIN THE PROTECTED AREAS AS DEFINED UNDER REPUBLIC ACT NUMBER 7586, OTHERWISE KNOWN AS THE NIPAS LAW, [not being the subject of private ownership and not comprised within the national parks,] public forest, timber lands, forest reserves or fishery reserves, but also marine waters included between two lines drawn perpendicularly to the general coastline from points where the boundary lines of the municipality or city touch the sea at low tide and a third line parallel with the general coastline INCLUDING OFFSHORE ISLANDS and fifteen (15) kilometers from [it] SUCH COASTLINE. Where two (2) municipalities or cities are so situated on the opposite shores that there is less than [fifteen (15)] THIRTY (30) kilometers of marine waters between them, the third line shall be equally distant from opposite shores of the respective municipalities or cities;</p>	
<p><b>( ) "RESOURCE RENT" REFERS TO THE DIFFERENCE BETWEEN THE VALUE OF THE PRODUCT PRODUCED FROM HARVESTING THE PUBLICLY- OWNED RESOURCE LESS THE COST OF PRODUCING IT, WHERE COST INCLUDES THE NORMAL RETURN TO CAPITAL AND LABOR;</b></p>	
<p><b>( ) "TAX" IS AN IMPOSITION, CHARGE OR BURDEN UPON</b></p>	

Proposed Amendments	Comments
<p><b>PERSONS, PROPERTY, OR PROPERTY RIGHTS FOR THE USE AND SUPPORT OF THE LOCAL GOVERNMENT UNIT TO ENABLE IT TO DISCHARGE ITS APPROPRIATE FUNCTIONS.</b></p>	
<p><b>( ) “TOTAL ALLOWABLE CATCH” REFERS TO THE MAXIMUM HARVEST ALLOWED TO BE TAKEN DURING A GIVEN PERIOD OF TIME FROM ANY FISHERY AREA, OR FROM ANY OR GROUP OF FISHERY SPECIES, OR A COMBINATION OF AREA AND SPECIES THAT WOULD NOT EXCEED THE MAXIMUM SUSTAINABLE YIELD;</b></p>	
<p><b>SEC. 133 Common Limitations on the Taxing Powers of Local Government Units.</b></p> <p><b>SEC. 133(d)</b> Custom duties AND registration fees of vessel WITH TONNAGE FIVE (5) TONS AND ABOVE [and] wharfage on wharves, tonnage dues, and all other kinds of customs fees, charges and dues except wharfage on wharves constructed [and] maintained OR OPERATED by the local government concerned OR BY A PRIVATE PERSON OR ENTITY.</p>	<p>How does one word the amendment to Section 133 if the intent is for LGUs to be able to impose registration fees on vessels with tonnage of five (5) tons and below but not for LGUs to impose customs duties on vessels with tonnage not in excess of 5 tons? It would be highly distortionary if different LGUs impose customs duties of varying rates on vessels with tonnage below 5 tons.</p>
<p><b>SEC. 133(f)</b> Taxes [, fees or charges] on agricultural and aquatic products when sold by marginal farmers or [fishermen] FISHERFOLK;</p>	

Proposed Amendments	Comments
<p><b>SEC. 133(h)</b> Excise taxes on [articles enumerated under the National Internal Revenue Code, as amended and taxes, fees and charges on] petroleum products</p>	
<p><b>Sec. 133(l)</b> [Taxes] fees, [or charges] for the registration of motor vehicles [and for the issuance of all kinds or licenses or permits for the driving thereof] except [tricycles] MOTOR VEHICLES REGULATED BY THE LOCAL GOVERNMENTS.</p>	
<p><b>Sec. 133(n)</b> [Taxes, fees, or charges on Countryside and Barangay Business Enterprises and cooperatives duly registered under R.A. 6810 and Republic Act Numbered Sixty-nine hundred thirty-eight (R.A. 6938) otherwise known as the “Cooperatives Code of the Philippines,” respectively, and]</p>	
<p><b>Sec. 133(o)</b> Taxes, [fees and charges] of any kind on the National Government, [its agencies and instrumentalities, and local government units] EXCEPT QUASI-PUBLIC CORPORATIONS, GOVERNMENT BANKS, FINANCING AND INVESTMENT INSTITUTIONS, REVENUE- GENERATING AGENCIES SUCH AS, BUT NOT LIMITED TO, PHILIPPINE PORTS AUTHORITY, MANILA INTERNATIONAL AIRPORT AUTHORITY, GAMBLING AND GAMING ENTERPRISES OPERATED BY THE National GOVERNMENT OR ITS AGENTS OR INSTRUMENTALITIES, OR CONTRACTED OUT BY IT TO FOREIGN AND DOMESTIC CORPORATIONS, INDIVIDUALS OR ENTITIES, WHICH HAVE BEEN GIVEN PERMITS BY THE LOCAL GOVERNMENT UNITS, AND OTHER SIMILAR ORGANIZATIONS AS DETERMINED BY THE DEPARTMENT OF FINANCE.</p>	

Proposed Amendments	Comments
<p><b>SEC. 135 Tax on Transfer of Real Property Ownership</b></p> <p><b>SEC. 135(a)</b> The province may impose a tax on the sale, donation, barter, or on any other mode of transferring ownership or title of real property at the rate of not more [fifty percent (50%) of one percent (1%)] than TWO PERCENT (2%) of the total consideration involved in the acquisition of the property or of the fair market value in case the monetary consideration involved in the transfer is not substantial, whichever is higher. The sale, transfer or other disposition of real property pursuant to R.A. No. 6657 shall be exempt from this tax.</p>	<p>The proposed amendment of Section 135 proposal will effectively increase the rate of the transfer tax from a maximum of 0.5% to a maximum of 2%. Beyond this, the IRR should specify that the basis for the computation of the tax should not be lower than the zonal valuation used in computing the capital gains tax. In practice, the transfer tax is computed based on a lower valuation of the real property than the capital gains tax.</p> <p>Revenue impact:</p> <p>Actual collection in 2006 – PhP 1.3 billion</p> <p>This could increase to as much as PhP 5.2 billion other things being equal</p> <p>The proposed formula will result to 300% increase. If we are paying P5,000 transfer tax, it will become P20,000. Tax base increase might be enormous.</p>
<p><b>SEC. 137. Franchise Tax.</b> - Notwithstanding any exemption</p>	<p>(subject to further study, taking the case of</p>

Proposed Amendments	Comments
<p>granted by any law or other special laws, the province, <b>HIGHLY URBANIZED AND INDEPENDENT COMPONENT CITIES</b> may impose a tax on ANY business[es] enjoying a franchise GRANTED BY CONGRESS, a National GOVERNMENT AGENCY OR A LOCAL GOVERNMENT UNIT, INCLUDING POWER GENERATION, TRANSMISSION AND DISTRIBUTION, TELECOMMUNICATIONS, ICE PLANTS AND STORAGE FACILITIES, LEGAL GAMBLING OR GAMING ACTIVITIES, AND OTHER SIMILAR BUSINESSES, BASED ON INCOME REALIZED WITHIN ITS TERRITORIAL JURISDICTION at a rate not exceeding fifty percent (50%) of one percent (1%) of the gross annual receipts for the preceding calendar year [based on the income receipt, or realized within its territorial jurisdiction].</p>	<p>Cebu)</p>
<p><b>SEC. 138 Tax on Sand, Gravel and other Quarry Resources.</b> - The province may levy and collect not more than ten percent (10%) of fair market value in the locality per cubic meter of ordinary stones, sand, gravel, earth, and other quarry resources, as defined under the National Internal Revenue Code, as amended, extracted from public lands or from the beds of seas, lakes, rivers, streams, creeks, and other public waters within its territorial jurisdiction.</p> <p>The permit to extract sand, gravel, and other quarry resources shall be issued [exclusively] by the provincial governor [pursuant to the ordinance of the Sangguniang Panlalawigan] UPON THE RECOMMENDATION OF THE MAYOR OF THE CITY OR MUNICIPALITY CONCERNED.</p> <p>The proceeds of the tax on sand, gravel and other quarry resources shall be distributed as follows:</p>	<p>Since the extraction of these resources has an effect on environment, the issuance of permit must not be the unilateral act of the Governor, therefore, The phrase “<i>pursuant to the ordinance of the Sangguniang Panlalawigan</i>” should not be deleted. However, we agree to add the phrase “<i>Upon the recommendation of the mayor of the city or municipality concerned</i>” to have a wider latitude of responsibility.</p>

Proposed Amendments	Comments
<p>(1) Province - Thirty percent (30%);</p> <p>(2) Component City or Municipality where the sand, gravel, and other quarry resources are extracted - Thirty percent (30%); and</p> <p>(3) Barangay where the sand, gravel, and other quarry resources are extracted - Forty percent (40%).</p>	
<p><b>SEC. 139 Professional Tax</b> - (a) The province may levy an annual professional tax on each person engaged in the exercise or practice of his profession requiring government examination at such amount and reasonable classification as the Sangguniang Panlalawigan may determine but shall in no case exceed [Three hundred pesos (P300)] ONE THOUSAND TWO HUNDRED PESOS (P 1,200). THE SANGGUNIANG PANLALAWIGAN MAY INCREASE THE CEILING ON THE PROFESSIONAL TAX ONCE EVERY THREE (3) YEARS BASED ON THE PAST THREE (3) YEAR AVERAGE OF THE CONSUMER PRICE INDEX AS OFFICIALLY PUBLISHED BY THE NATIONAL STATISTICS COORDINATING BOARD”.</p>	<p>The proposed adjustment to the professional tax (Section 139) reflects an increase of 300% compared to the 170% increase that is needed to maintain real value of the imposition.</p> <p>Actual collection in 2006 – PhP 155 million</p> <p>This could increase to as much as PhP 620 million other things being equal.</p>
<p><b>SEC. 141 Annual Fixed Tax For Every Delivery Truck or Van of Manufacturers or Producers, Wholesalers of, Dealers, or Retailers in, Certain Products</b> - (a) The province may levy an annual fixed tax for every truck, van or any vehicle used by manufacturers, producers, wholesalers, dealers or retailers in the delivery or distribution of distilled spirits, fermented liquors, soft drinks, cigars and cigarettes, and other products as may be determined by the Sangguniang Panlalawigan, to sales outlets, or consumers, whether directly or indirectly, within the province in an amount not exceeding [FIVE hundred pesos (P500)] ONE THOUSAND FIVE HUNDRED PESOS (P1,500). THE SANGGUNIANG PANLALAWIGAN MAY INCREASE THE CEILING ON THE</p>	<p>The proposed increase in the rate of imposition on fixed tax on delivery trucks or vans (Section 141) is largely consistent with inflation.</p> <p>Actual collection in 2006 – PhP 90 million</p> <p>This could increase to as much as PhP 270 million other things being equal.</p>

Proposed Amendments	Comments																		
<p>PROFESSIONAL TAX ONCE EVERY THREE (3) YEARS BASED ON THE PAST THREE (3) YEAR AVERAGE OF THE CONSUMER PRICE INDEX AS OFFICIALLY PUBLISHED BY THE NATIONAL STATISTICS COORDINATING BOARD”.</p>																			
<p><b>SEC. 143 Tax on Business.</b> – The municipality may impose taxes on [the following] ANY business[es], including those subject to Franchise Tax under SEC. 137, AT RATES NOT EXCEEDING TWO AND A HALF PERCENT (2.5%) OF GROSS SALES OR RECEIPTS OF THE PRECEDING CALENDAR YEAR.</p> <p>IN THE CASE OF EXPORTERS, INDIRECT EXPORTERS AND EXPORT SUB-CONTRACTORS, THE RATE SHALL BE ONE-HALF OF THE BUSINESS TAX RATE IMPOSED BY THE MUNICIPALITY IN ACCORDANCE WITH THE PRECEEDING PARAGRAPH.</p> <p><i>[ (a) On manufacturers, assemblers, repackers, processors, brewers, distillers, rectifiers, and compounders of liquors, distilled spirits, and wines or manufacturers of any article of commerce of whatever kind or nature, in accordance with the following schedule:</i></p> <p><i>With gross sales or receipts for the Amount of Tax preceding calendar year in the amount of:</i></p> <p><i>Amount of Tax Per Annum</i></p> <table data-bbox="56 1491 836 1835"> <tr> <td><i>Less than 10,000.00</i></td> <td><i>165.00</i></td> </tr> <tr> <td><i>P 10,000.00 or more but less than 15,000.00</i></td> <td><i>220.00</i></td> </tr> <tr> <td><i>15,000.00 or more but less than 20,000.00</i></td> <td><i>302.00</i></td> </tr> <tr> <td><i>20,000.00 or more but less than 30,000.00</i></td> <td><i>440.00</i></td> </tr> <tr> <td><i>30,000.00 or more but less than 40,000.00</i></td> <td><i>660.00</i></td> </tr> <tr> <td><i>660.00 40,000.00 or more but less than 50,000.00</i></td> <td><i>825.00</i></td> </tr> <tr> <td><i>50,000.00 or more but less than 75,000.00</i></td> <td><i>1,320.00</i></td> </tr> <tr> <td><i>75,000.00 or more but less than 100,000.00</i></td> <td><i>1,650.00</i></td> </tr> <tr> <td><i>100,000.00 or more but less than 150,000.00</i></td> <td><i>2,200.00</i></td> </tr> </table>	<i>Less than 10,000.00</i>	<i>165.00</i>	<i>P 10,000.00 or more but less than 15,000.00</i>	<i>220.00</i>	<i>15,000.00 or more but less than 20,000.00</i>	<i>302.00</i>	<i>20,000.00 or more but less than 30,000.00</i>	<i>440.00</i>	<i>30,000.00 or more but less than 40,000.00</i>	<i>660.00</i>	<i>660.00 40,000.00 or more but less than 50,000.00</i>	<i>825.00</i>	<i>50,000.00 or more but less than 75,000.00</i>	<i>1,320.00</i>	<i>75,000.00 or more but less than 100,000.00</i>	<i>1,650.00</i>	<i>100,000.00 or more but less than 150,000.00</i>	<i>2,200.00</i>	<p>By deleting the varying rate schedules for different types of transactions and activities subjected to the local tax on business (Section 143), the proposed amendment has the potential to simplify the local business tax. It also gives LGUs greater discretion in setting the tax rates.</p> <p>Should businesses subject to the local franchise tax be exempted from this imposition? Would that not be double taxation?</p> <p>The 2.5% ceiling on the local business tax is just about equal to the higher end of the schedule at present. However, it represents a big increase relative to the maximum allowable rates for the bigger establishments. A tax rate of 2.5% is 6.7 times the 0.375% maximum tax rate for manufacturers. It is 5 times the 0.5% maximum tax rate for wholesalers and contractors, 2.5 times the rate applicable to big retailers and 1.25 times the rate applicable to smaller retailers at present.</p>
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Proposed Amendments	Comments																																								
<p><i>calendar year of Fifty thousand pesos (P50,000.00) or less, in the case of cities, and Thirty thousand pesos (P30,000.00) or less, in the case of municipalities.</i></p> <p><i>(e) On contractors and other independent contractors, in accordance with the following schedule:</i></p> <p><i>With gross receipts for the preceding calendar year in the amount of:</i></p> <table data-bbox="56 604 844 1453"> <thead> <tr> <th colspan="2" style="text-align: center;"><i>Amount of Tax Per Annum</i></th> </tr> </thead> <tbody> <tr> <td><i>Less than P= 5,000.00</i></td> <td style="text-align: right;"><i>27.50</i></td> </tr> <tr> <td><i>P 5,000.00 or more but less than P 10,000.00</i></td> <td style="text-align: right;"><i>61.60</i></td> </tr> <tr> <td><i>10,000.00 or more but less than 15,000.00</i></td> <td style="text-align: right;"><i>104.50</i></td> </tr> <tr> <td><i>15,000.00 or more but less than 20,000.00</i></td> <td style="text-align: right;"><i>165.00</i></td> </tr> <tr> <td><i>20,000.00 or more but less than 30,000.00</i></td> <td style="text-align: right;"><i>275.00</i></td> </tr> <tr> <td><i>30,000.00 or more but less than 40,000.00</i></td> <td style="text-align: right;"><i>385.00</i></td> </tr> <tr> <td><i>40,000.00 or more but less than 50,000.00</i></td> <td style="text-align: right;"><i>550.00</i></td> </tr> <tr> <td><i>50,000.00 or more but less than 75,000.00</i></td> <td style="text-align: right;"><i>880.00</i></td> </tr> <tr> <td><i>75,000.00 or more but less than 100,000.00</i></td> <td style="text-align: right;"><i>1,320.00</i></td> </tr> <tr> <td><i>100,000.00 or more but less than 150,000.00</i></td> <td style="text-align: right;"><i>1,980.00</i></td> </tr> <tr> <td><i>150,000.00 or more but less than 200,000.00</i></td> <td style="text-align: right;"><i>2,640.00</i></td> </tr> <tr> <td><i>200,000.00 or more but less than 250,000.00</i></td> <td style="text-align: right;"><i>3,630.00</i></td> </tr> <tr> <td><i>250,000.00 or more but less than 300,000.00</i></td> <td style="text-align: right;"><i>4,620.00</i></td> </tr> <tr> <td><i>300,000.00 or more but less than 400,000.00</i></td> <td style="text-align: right;"><i>6,160.00</i></td> </tr> <tr> <td><i>400,000.00 or more but less than 500,000.00</i></td> <td style="text-align: right;"><i>8,250.00</i></td> </tr> <tr> <td><i>500,000.00 or more but less than 750,000.00</i></td> <td style="text-align: right;"><i>9,250.00</i></td> </tr> <tr> <td><i>750,000.00 or more but less than 1,000,000.00</i></td> <td style="text-align: right;"><i>10,250.00</i></td> </tr> <tr> <td><i>1,000,000.00 or more but less than 2,000,000.00</i></td> <td style="text-align: right;"><i>11,500.00</i></td> </tr> <tr> <td><i>2,000,000.00 or more</i></td> <td style="text-align: right;"><i>at a rate not exceeding fifty percent (50%) of one percent (1%)</i></td> </tr> </tbody> </table> <p><i>(f) On banks and other financial institutions, at a rate not exceeding fifty percent (50%) of one percent (1%) on the gross receipts of the preceding calendar year derived from interest, commissions and discounts from lending activities, income from financial leasing, dividends, rentals on property and profit from exchange or sale of property, insurance premium.</i></p> <p><i>(g) On peddlers engaged in the sale of any merchandise or article of commerce, at a rate not exceeding Fifty pesos (P50.00) per peddler annually.</i></p>	<i>Amount of Tax Per Annum</i>		<i>Less than P= 5,000.00</i>	<i>27.50</i>	<i>P 5,000.00 or more but less than P 10,000.00</i>	<i>61.60</i>	<i>10,000.00 or more but less than 15,000.00</i>	<i>104.50</i>	<i>15,000.00 or more but less than 20,000.00</i>	<i>165.00</i>	<i>20,000.00 or more but less than 30,000.00</i>	<i>275.00</i>	<i>30,000.00 or more but less than 40,000.00</i>	<i>385.00</i>	<i>40,000.00 or more but less than 50,000.00</i>	<i>550.00</i>	<i>50,000.00 or more but less than 75,000.00</i>	<i>880.00</i>	<i>75,000.00 or more but less than 100,000.00</i>	<i>1,320.00</i>	<i>100,000.00 or more but less than 150,000.00</i>	<i>1,980.00</i>	<i>150,000.00 or more but less than 200,000.00</i>	<i>2,640.00</i>	<i>200,000.00 or more but less than 250,000.00</i>	<i>3,630.00</i>	<i>250,000.00 or more but less than 300,000.00</i>	<i>4,620.00</i>	<i>300,000.00 or more but less than 400,000.00</i>	<i>6,160.00</i>	<i>400,000.00 or more but less than 500,000.00</i>	<i>8,250.00</i>	<i>500,000.00 or more but less than 750,000.00</i>	<i>9,250.00</i>	<i>750,000.00 or more but less than 1,000,000.00</i>	<i>10,250.00</i>	<i>1,000,000.00 or more but less than 2,000,000.00</i>	<i>11,500.00</i>	<i>2,000,000.00 or more</i>	<i>at a rate not exceeding fifty percent (50%) of one percent (1%)</i>	
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Proposed Amendments	Comments
<p><i><b>(h) On any business, not otherwise specified in the preceding paragraphs, which the sanggunian concerned may deem proper to tax: Provided, That on any business subject to the excise, value-added or percentage tax under the National Internal Revenue Code, as amended, the rate of tax shall not exceed two percent (2%) of gross sales or receipts of the preceding calendar year. The sanggunian concerned may prescribe a schedule of graduated tax rates but in no case to exceed the rates prescribed herein. ]</b></i></p>	
<p><b>SEC. 146. Payment of Business Taxes.</b> – (a) The taxes imposed under SEC. 143 shall be payable for every separate or distinct establishment or place where business subject to the tax is conducted and one line of business does not become exempt by being conducted with some other business for which such tax has been paid. The tax on a business must be paid by the person conducting the same.</p> <p>(b) In cases where a person conducts or operates two (2) or more [of the] businesses [mentioned in SEC. 143 of this Code] which are subject to the same rate of tax, the tax shall be computed on the combined total gross sales or receipts of the said two (2) or more related businesses.</p> <p>(c) In cases where a person conducts or operates two (2) or more businesses [mentioned in SEC. 143 of this Code] which are subject to different rates of tax, the gross sales or receipts of each business shall be separately reported for the purpose of computing the tax due from each business.”</p>	

Proposed Amendments	Comments
<p><b>SEC. 148 Fees for Sealing and Licensing of Weights and Measures.</b></p> <p><b>SEC. 148(b)</b> The Sangguniang Bayan shall prescribe the necessary regulations for the use of such weights and measures, subject to such guidelines as shall be prescribed by the Department of Science and Technology. The Sanggunian concerned shall, by appropriate ordinance, penalize fraudulent practices and unlawful possession or use of instruments of weights and measures and prescribe the criminal penalty therefore in accordance with the provisions of this Code. Provided, however, That the Sanggunian concerned may authorize the municipal treasurer to settle an offence not involving the commission of fraud before a case therefore is filed in court, upon payment of a compounded penalty AS PRESCRIBED BY THE SANGGUNIAN BUT of not less than [Two hundred pesos (P200)] ONE THOUSAND PESOS (P1,000). THE SANGGUNIAN MAY INCREASE THE CEILING ON THE PROFESSIONAL TAX ONCE EVERY THREE (3) YEARS BASED ON THE PAST THREE (3) YEAR AVERAGE OF THE CONSUMER PRICE INDEX AS OFFICIALLY PUBLISHED BY THE NATIONAL STATISTICS COORDINATING BOARD”.</p>	<p>The proposed adjustment on the penalty rate relative to the fees for sealing of weights and measures (Section 148) reflects an increase of 400% compared to the 170% increase that is needed to maintain real value of the penalty.</p>
<p><b>SEC. 149. Fishery Rentals, Fees and Charges.</b></p> <p><b>SEC. 149 (a)</b> Municipalities shall have the exclusive authority to grant fishery privileges in the municipal waters and impose rentals, fees or charges therefore in accordance with the provisions of this SEC. ___ PROVIDED THAT, RENTALS, FEES OR CHARGES ARE BASED ON ESTIMATES OF RESOURCE RENT AS DETERMINED BY THE SANGGUNIAN CONCERNED IN CONSULTATION WITH THE FISHERIES AND AQUATIC RESOURCE MANAGEMENT COUNCILS (FARMC) ESTABLISHED UNDER</p>	

Proposed Amendments	Comments
<p>REPUBLIC ACT NUMBER 8550, OTHERWISE KNOWN AS THE PHILIPPINE FISHERIES CODE OF 1998.</p>	
<p><b>SEC. 149(b)(3)</b> Issue licenses for the operation of fishing vessels of three (3) tons or less for which purpose the Sangguniang Bayan shall promulgate rules and regulations regarding the issuances of such licenses to qualified applicants under existing laws. PROVIDED THAT THE TOTAL NUMBER OF LICENSES ISSUED IN CONSONANT WITH THE TOTAL ALLOWABLE CATCH AS DETERMINED BY THE SANGGUNIAN CONCERNED, IN CONSULTATION WITH THE FISHERIES AND AQUATIC RESOURCE MANAGEMENT COUNCILS (FARMC).</p>	
<p><b>SEC. 150. Situs of the Tax.</b> - (a) For purposes of collection of the taxes under SEC. 143 of this Code, [manufacturers, assemblers, repackers, brewers, distillers, rectifiers and compounders of liquor, distilled spirits and wines, millers, producers, exporters, wholesalers, distributors, dealers, contractors, banks and other financial institutions, and other] ALL businesses[,] maintaining or operating branch or sales outlet elsewhere shall record the sale in the branch or sales outlet making the sale or transaction, and the tax thereon shall accrue and shall be paid to the CITY OR municipality where such branch or sales outlet is located. In cases where there is no such branch or sales outlet in the city or municipality where the sale or transaction is made, the sale shall be duly recorded in the principal office and the taxes due shall accrue and shall be paid to such city or municipality.</p> <p>The following sales allocation shall apply to [manufacturers,</p>	

Proposed Amendments	Comments
<p>assemblers, contractors, producers, and exporters] ALL BUSINESSES with factories, project offices, plants, and plantations in the pursuit of their business:</p> <p>(1) Thirty percent (30%) of all sales recorded in the principal office shall be taxable by the city or municipality where the principal office is located; and</p> <p>(2) Seventy percent (70%) of all sales recorded in the principal office shall be taxable by the city or municipality where the factory, project office, plant, or plantation is located.</p> <p>(c) In case of a plantation located at a place other than the place where the factory is located, said seventy percent (70%) mentioned in subparagraph (b) of subsection (2) above shall be divided as follows:</p> <p>(1) Sixty percent (60%) to the city or municipality where the factory is located; and</p> <p>(2) Forty percent (40%) to the city or municipality where the plantation is located.</p> <p>(d) In cases where a [manufacturer, assembler, producer, exporter or contractor] BUSINESS has two (2) or more factories, project offices, plants, or plantations located in different localities, the seventy percent (70%) sales allocation mentioned in subparagraph (b) of subsection (2) above shall be prorated among the localities where the factories, project offices, plants,</p>	

Proposed Amendments	Comments
<p>and plantations are located in proportion to their respective volumes of production during the period for which the tax is due.</p>	
<p><b>SEC. 151. Scope of Taxing Powers.</b> - Except as otherwise provided in this Code, the city, may levy the taxes, fees, and charges which the province or municipality may impose: Provided, however, That the taxes, fees and charges levied and collected by highly urbanized and independent component cities shall accrue to them and distributed in accordance with the provisions of this code.</p>	<p>The proposed amendment of Section 151 which will allow all cities (not just highly urbanized cities and independent cities) not to share the proceeds of the taxes, fees and charges they levy with the provinces will further decimate the revenue take of provinces.</p>
<p><b>SEC. 152. Scope of Taxing Powers.</b> - The Barangays may levy taxes, fees and charges, as provided in this Article, which shall exclusively accrue to them: (a) Taxes – On stores or retailers with fixed business establishments with gross sales or receipts of the preceding calendar year of [Fifty] ONE HUNDRED Thousand pesos [(P50,000)] (P100,000) or less, in the case of cities and [Thirty] SIXTY thousand pesos [(P30,000)] (P60,000) or less, in the case of municipalities, at a rate not exceeding one percent (1%) on such gross sales or receipts.</p>	<p>The proposed adjustment on the maximum gross receipts of business establishments that will be subject barangay taxes (Section 152) reflects an increase of 100% compared to a 170% increase that is needed to maintain the real value of the cut-off for city barangays and 200% in the case of municipal barangays.</p>
<p><b>SEC. 155 Toll Fees or Charges.</b> - The Sanggunian concerned may prescribe the terms and conditions and fix the rates for the imposition of toll fees or charges for the use of any public road, pier or wharf, waterway, bridge, ferry or telecommunication system funded and constructed by the local government unit concerned[: <i>Provided</i>, That no such toll fees or charges shall be</p>	

Proposed Amendments	Comments
<p>collected from officers and enlisted men of the Armed Forces of the Philippines and members of the Philippine National Police, on mission, post office personnel delivering mail, physically-handicapped, and disabled who are sixty-five (65) years or older.] EXCEPT GOVERNMENT VEHICLES.</p>	
<p><b>SEC. 157 Individuals Liable to Community Tax.</b> - Every inhabitant of the Philippines eighteen (18) years of age or over who has been regularly employed on a wage or salary basis for at least thirty (30) consecutive working days during any calendar year, or who is engaged in business or occupation, or who owns real property with an aggregate market value of One thousand pesos (P1,000) or more, or who is required by law to file an income tax return shall pay an annual community tax of NOT MORE THAN [Five] THIRTY pesos [(P5)] (P30) and an annual additional tax of NOT MORE THAN [One Peso (P1)] TWO PESOS (P2) for every One Thousand pesos (P1,000) of income [regardless of whether] from business, exercise of profession, EMPLOYMENT or from property [which in no case shall exceed Five Thousand pesos (P5,000)]. In the case of husband and wife, the additional tax herein imposed shall be based upon the total property owned by them and the total gross receipts or earnings derived by them. PROVIDED, THAT DISABLED PERSONS AND SENIOR CITIZENS NOT GAINFULLY EMPLOYED, NOT ENGAGED IN BUSINESS OR EARNING LESS THAN SIXTY THOUSAND PESOS (P60,000.00) ANNUALLY SHALL PAY A FIX AMOUNT OF THIRTY PESOS (P30).</p>	<p>The proposed adjustment in the minimum community tax on individuals (Section 157) reflects an increase of 500% compared to a 170% increase that is needed to maintain the real value of the imposition.</p> <p>In addition, the marginal tax rate is increased 100%.</p> <p>Actual collection in 2006 – PhP 954 million</p> <p>This could increase to PhP 1.9 billion other things being equal.</p>
<p><b>SEC. 158. Juridical Persons Liable to Community Tax.</b> - Every corporation no matter how created or organized, whether domestic or resident foreign, engaged in or doing business in the Philippines shall pay an annual community tax of [Five hundred]</p>	<p>The proposed adjustment in the minimum community tax on juridical persons reflects an increase of 100% compared to the 170% increase that is needed to maintain real value</p>



Proposed Amendments	Comments
<p>ONE THOUSAND pesos [(P=500)] (P1,000) and an annual additional tax [, which, in no case, shall exceed Ten thousand pesos (P=10,000)] in accordance with the following schedule:</p> <p>(1) For every [Five thousand pesos (P5,000.00)] ONE THOUSAND PESOS(P1,000) worth of real property in the Philippines owned by it during the preceding year based on the valuation used for the payment of the real property tax under existing laws, found in the assessment rolls of the city or municipality where the real property is situated – [Two Pesos (P2.00)] THREE PESOS (P3.00); and</p> <p>(2) For every [Five thousand pesos (P5,000)] ONE THOUSAND PESOS (P1,000) of gross receipts or earnings derived by it from its business in the Philippines during the preceding year - [Two Pesos (P2.00)] THREE PESOS (P3.00). The dividends received by a corporation from another corporation however shall, for the purpose of the additional tax, be considered as part of the gross receipts or earnings of said corporation.</p>	<p>of the imposition.</p> <p>In addition, the marginal tax rate is increased by 650%.</p>
<p><b>SEC. 162. Community Tax Certificate.</b> - A community tax certificate shall be issued to every person or corporation upon payment of the community tax. A community tax certificate may also be issued to any person or corporation not subject to the community tax upon payment of [One (1) peso.] THIRTY PESOS (P30).</p>	
<p><b>Sec. 171. Examination of Books of Accounts and Pertinent Records of Businessmen by Local Treasurers.</b> - The provincial, city, municipal or Barangay treasurer may, by himself or through any of his deputies duly authorized in writing, examine the books,</p>	

Proposed Amendments	Comments
<p>accounts, and other pertinent records of any person, partnership, corporation, or association subject to local taxes, fees and charges in order to ascertain, assess, and collect the correct amount of the tax, fee, or charge. Such examination shall be made during regular business hours, only once for every tax period, and shall be certified to by the examining official. Such certificate shall be made of record in the books of accounts of the taxpayer examined.</p> <p>In case the examination herein authorized is made by a duly authorized deputy of the local treasurer, the written authority of the deputy concerned shall specifically state the name, address, and business of the taxpayer whose books, accounts, and pertinent records are to be examined, the date and place of such examination, and the procedure to be followed in conducting the same. For this purpose, the records of the revenue district office of the Bureau of Internal Revenue shall be made available to the local treasurer, his deputy or duly authorized representative. THE REVENUE DISTRICT OFFICER SHALL, UPON REQUEST, FURNISH THE CITY OR MUNICIPAL TREASURER, SUCH OTHER PERTINENT INFORMATION REQUIRED IN SAID EXAMINATION. THE CITY AND MUNICIPAL TREASURERS SHALL AT ALL TIMES KEEP SAID INFORMATION RECEIVED BY HIM, HIS DEPUTY OR DULY AUTHORIZED REPRESENTATIVE AS STRICTLY CONFIDENTIAL AND SHALL BE USED ONLY TO ASCERTAIN, ASSESS, AND COLLECT THE CORRECT AMOUNT OF LOCAL TAX, FEE OR CHARGE. SUCH RECORDS SHALL NOT BE DIVULGED TO ANY THIRD PERSONS EXCEPT UPON ORDER OF COURT OF COMPETENT JURISDICTION. THE CITY OR MUNICIPAL TREASURER OR HIS DULY AUTHORIZED DEPUTY OR REPRESENTATIVE SHALL BE ADMINISTRATIVELY LIABLE FOR ITS DISCLOSURE TO ANY THIRD PARTY OR PERSON, WITHOUT PREJUDICE TO PROSECUTION UNDER EXISTING LAWS.</p> <p>THE EXAMINATION SHALL BE MADE DURING REGULAR BUSINESS HOURS NOT OFTENER THAN ONCE A YEAR FOR EVERY TAX</p>	

Proposed Amendments	Comments
<p>PERIOD, WHICH SHALL BE THE YEAR IMMEDIATELY PRECEDING THE EXAMINATION, AND SHALL BE CERTIFIED BY THE EXAMINING OFFICIAL. SUCH CERTIFICATION SHALL BE MADE OF RECORD IN THE BOOKS OF ACCOUNTS OF THE TAXPAYER EXAMINED.</p> <p>ALL BUSINESSES SHOULD KEEP PROPER BOOKS OF ACCOUNTS. IN THE CASE OF BUSINESSES WITH REVENUES ABOVE SIX HUNDRED THOUSAND PESOS (P600,000.00), THE FINANCIAL STATEMENTS MUST BE AUDITED BY A CERTIFIED PUBLIC ACCOUNTANT. FOR BUSINESSES WITH REVENUES ABOVE ONE HUNDRED THOUSAND PESOS (P100,000.00) BUT BELOW SIX HUNDRED THOUSAND PESOS (P600,000.00), THE ACCOUNTS SHOULD BE PREPARED BY A BOOKKEEPER.</p>	
<p><b>SEC. 188 Publication of Tax Ordinances and Revenue Measures -</b>  Within FIFTEEN (15) [ten] days after their approval, certified true copies of all provincial, city and municipal tax ordinances or revenue measures shall be published in full for three (3) consecutive days in a DAILY newspaper PUBLISHED AND CIRCULATED LOCALLY [of local circulation] OR ONCE A WEEK FOR THREE (3) CONSECUTIVE WEEKS IN CASE OF A WEEKLY NEWSPAPER PUBLISHED AND CIRCULATED LOCALLY [<i>Provided, however: That</i>], [i] In provinces, cities, and municipalities where there are no newspapers THAT ARE PUBLISHED AND CIRCULATED LOCALLY [of local circulation], the same [may] SHALL INSTEAD be posted FOR AT LEAST ONE (1) MONTH in PROVINCIAL CAPITOLS, CITY OR MUNICIPAL HALLS, ALL BARANGAY HALLS AND OTHER [at least two (2)] conspicuous and publicly accessible places.</p>	

Proposed Amendments	Comments
<p><b>SEC. 192 Authority to grant Local Tax Exemption Privileges</b> - UNLESS OTHERWISE PROVIDED IN THIS CODE, THE local government units [may], through duly [ordinances] approved ORDINANCES, MAY grant tax exemptions, incentives or reliefs FOR THE PURPOSE OF PROMOTING OR ENCOURAGING INVESTMENTS IN THEIR JURISDICTIONS, under such terms and conditions as they may deem necessary; PROVIDED THAT THE DURATION OF SUCH INCENTIVES SHALL NOT EXCEED FIVE (5) CONSECUTIVE YEARS FROM THE EFFECTIVE DATE GRANTING THE INCENTIVE: PROVIDED, FURTHER THAT SUCH INCENTIVE SHALL BE AVAILED ONLY ONCE.</p>	<p>The proposed amendment of Section 192 effectively puts a sunset clause on the grant of local tax exemption privilege for purposes of encouraging investments in the local jurisdictions. Good move.</p>
<p><b>SEC. 193 Withdrawal of Tax Exemption Privileges.</b> - Unless otherwise provided in this Code, tax exemptions or incentives granted to, or presently enjoyed by all persons, whether natural or juridical, including government-owned or controlled corporations, AND OTHER SIMILAR GOVERNMENT AGENCIES OR ENTITIES GENERATING REVENUES AS DETERMINED BY THE DEPARTMENT OF FINANCE SUCH AS, BUT NOT LIMITED TO PHILIPPINE PORTS AUTHORITY, MANILA INTERNATIONAL AIRPORT AUTHORITY, PHILIPPINE RECLAMATION AUTHORITY, PHILIPPINE RETIREMENT AUTHORITY [except local water districts, cooperatives duly registered under R.A. 6398, non-stock and non-profit hospitals and educational institutions,] are hereby withdrawn effective January 1, 2009.</p> <p>EXCEPT AS PROVIDED HEREIN, NO LAW PROVIDING TAX EXEMPTION FROM LOCAL GOVERNMENT TAXES, FEES AND CHARGES SHALL BE ENACTED WITHOUT PRIOR CONSULTATION WITH THE LEAGUE OF CITIES, LEAGUE OF PROVINCES, LEAGUE OF MUNICIPALITIES AND LIGA NG MGA BARANGAY AND PRIOR</p>	

Proposed Amendments	Comments
RECOMMENDATION OF THE DEPARTMENT OF FINANCE.	
<p><b>SEC. 235 Additional Levy on Real Property for the Special Education Fund (SEF).</b> A province or city, or a municipality within the Metropolitan Manila Area, may levy and collect an annual tax of [one percent (1%)] ONE AND ONE HALF PERCENT (1½%) on the assessed value of real property IN THEIR RESPECTIVE TERRITORIAL JURISDICTION [which shall be] in addition to the basic real property tax PROVIDED UNDER THIS CODE. The proceeds thereof shall exclusively accrue to the Special Education Fund (SEF).</p>	<p>The proposed increase in the SEF imposition from 1% to 1.5% (Section 235) will make the SEF imposition even larger than the basic tax on real property in the case of provinces. Such asymmetry is not consistent with the fact that the SEF imposition is earmarked for the education sector (which is not even fully devolved to LGUs) unlike the basic tax rate which is the main source of local tax revenues of provinces. Why not increase the maximum tax rate for the basic tax rate to 1.5% also for provinces, cities or municipalities within Metro Manila? This is warranted that many provinces are already imposing the maximum rate at present.</p> <p>Note that both the present provision and the proposed amendment is an all or nothing proposition; i.e., it says “LGUs may levy and collect an annual tax of 1%..” For greater discretion on the part of LGUx, it might be better to say: “LGUs may levy and collect an annual tax <i>not exceeding</i> 1.5% ...”</p> <p>Actual SEF revenues of provinces in 2006 – PhP 2 billion.</p> <p>This could increase to PhP 3 billion other things being equal.</p>

Proposed Amendments	Comments
	<p>Actual SEF revenues of cities in 2006 - PhP 8.3 billion</p> <p>This could increase to PhP 18.7 billion other things being equal.</p> <p>Actual SEF revenues of municipalities in 2006 – PhP 2.3 billion</p> <p>This could increase to PhP 3.4 billion other things being equal.</p>
<p><b>Section 240-A Creation of Local Road Maintenance Fund (LRMF).</b>  <b>The revenue generated under the special benefit levy shall accrue to the Local Road Maintenance Fund to be established by Local Government Units.</b></p> <p><b>Section (a). Disposition of Monies collected. All monies collected under the MVUC shall be earmarked solely and used exclusively (1) for road maintenance and the improvement of road drainage (2) for the installation of adequate and efficient traffic lights and road safety devices and (3) for air pollution control.</b></p> <p><b>Section (b). Special Local Road Fund – Shall be apportioned to provincial and city governments in accordance with the vehicle population and size of the road network under their respective jurisdiction and shall be exclusively for maintenance of local roads, traffic management and road safety devices.</b></p> <p><b>Section (c). Monies Collected under MVUC for SLRF- monies</b></p>	<p>Comments:</p> <ul style="list-style-type: none"> <li>• increase 10% share to 35%?</li> <li>• remove requirement of AWP</li> <li>• Base the release on available info. e.g. road length</li> <li>• Revisit “Better Road Philippines” study of WB</li> </ul>

Proposed Amendments	Comments
<p>collected under MVUC and allotted to Special Local Road Fund trust account in the National Treasury in the amount of 10% of the total collection shall be released directly to the province and city in accordance to the appointment approved by the Road Board. The released of fund will be subject to the submission of Annual Works Program (AWP) and Individual Work (IPW) of the provinces and cities. The review of the IPW will be done by the DILG and for final approval of Road Board.</p>	
<p><b>SEC. 272 Application of Proceeds of the [Additional One Percent] SEF Tax.</b> The proceeds from the additional [one percent (1%)] ONE AND ONE HALF PERCENT (1½%) tax on real property accruing to the Special Education Fund (SEF) OF THE PROVINCE, CITY OR MUNICIPALITY WITHIN THE METROPOLITAN MANILA AREA shall be automatically released to the local school boards; <i>Provided, however,</i> That in the case of provinces, the proceeds shall be divided equally between the province and the municipal school boards; <i>Provided, however,</i> That the proceeds shall be allocated for the operation and maintenance of public schools, construction and repair OR IMPROVEMENT of PUBLIC school buildings, AND/OR RELATED facilities and equipment, educational research, purchase of books and periodicals, HONORARIUM FOR TEACHERS CONDUCTING EXTENSION CLASSES and sports development as determined and approved by the Local School Board.</p>	

**Table 4. Distribution of LGU own-source revenue across levels of local government by type of revenue (in percent)**

	LG Total-own source revenue				Tax				Non Tax			
	Total	Provinces	Muns.	Cities	Total	Provinces	Muns.	Cities	Total	Provinces	Muns	Cities
1985	100.0	19.5	35.1	45.4	100.0	15.8	36.5	47.7	100.0	27.0	32.3	40.7
1987	100.0	17.4	37.8	44.8	100.0	16.6	36.1	47.3	100.0	19.5	41.6	38.9
1989	100.0	27.4	33.6	39.0	100.0	17.0	36.2	46.8	100.0	43.3	29.7	27.1
1991	100.0	18.4	38.9	42.7	100.0	13.3	40.7	46.0	100.0	28.4	35.5	36.1
1993	100.0	14.0	48.4	37.6	100.0	11.9	49.4	38.7	100.0	21.0	45.1	33.9
1995	100.0	14.8	31.7	53.5	100.0	13.1	29.5	57.4	100.0	19.7	38.3	42.0
1997	100.0	13.3	29.8	56.9	100.0	10.0	27.3	62.7	100.0	22.6	36.9	40.5
1999	100.0	12.8	25.5	61.7	100.0	11.7	21.9	66.4	100.0	16.1	37.1	46.7
2001	100.0	11.7	23.4	64.9	100.0	10.0	20.3	69.7	100.0	17.0	33.1	49.8
2003	100.0	10.0	22.1	67.9	100.0	8.4	18.8	72.8	100.0	16.2	34.4	49.4
2004	100.0	10.3	20.8	68.9	100.0	8.5	17.2	74.3	100.0	16.6	32.6	50.8
2005	100.0	10.9	21.9	67.2	100.0	9.0	18.5	72.5	100.0	17.2	32.7	50.1
2006	100.0	10.5	21.2	68.4	100.0	8.1	18.0	73.9	100.0	17.7	30.6	51.7
2007	100.0	10.6	19.0	70.4	100.0	8.4	15.6	76.1	100.0	17.4	29.6	52.9



Average

1985-1991	100.0	19.9	37.1	43.0	100.0	15.2	38.0	46.8	100.0	29.1	35.3	35.6
1992-2003	100.0	12.5	27.3	60.2	100.0	10.7	24.4	64.9	100.0	18.3	36.2	45.5
2004-2007	100.0	10.6	20.7	68.7	100.0	8.5	17.3	74.2	100.0	17.2	31.4	51.4

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