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

Comparative Assessment of Proposals to Amend the Personal Income Tax Law

Rosario G. Manasan

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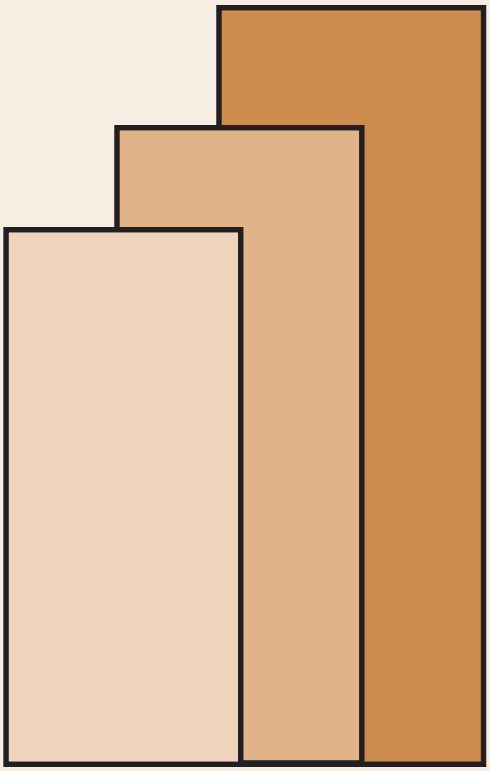

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Comparative Assessment of Proposals to Amend the Personal Income Tax Law

Rosario G. Manasan

PHILIPPINE INSTITUTE FOR DEVELOPNMENT STUDIES

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Abstract

Proposals to reform the personal income tax has gained prominence in recent months. To date, personal income tax reform is part and parcel of the platform of a number of the candidates in the 2016 Presidential elections. This paper aims to evaluate the various proposals in both houses of Congress to amend the existing personal income legislation.

Proposals to amend the personal income tax schedule appear to be well-justified from the perspective of (i) the need to eliminate the bracket creep, and (ii) easing the tax burden on Filipino personal income taxpayers relative to their ASEAN neighbors.

In terms of the progressivity of the personal income tax, all of the proposals to amend the personal income tax are progressive. However, two of the proposals, SB 2149 and HB 4829, are less progressive than the existing rate structure. In terms of revenue yield, all of the proposals are estimated to have a negative impact on government revenue.

The projected revenue loss from proposals to restructure the personal income tax is best seen in the context of the government's overall revenue and tax effort. Fiscal prudence dictates that new revenue measures be found to compensate for the projected revenue loss that will arise as a result of the implementation of any one of the various proposals to restructure the personal income tax. Thus, the questions that begs to be asked is: what new revenue measure or combination of measures will allow government to recover the revenue loss from the new personal income tax structure? Possibilities include increasing the VAT rate, excise tax on petroleum products and road user's tax.

Keywords: personal income tax, Philippines, tax reform, VAT, excise tax

Version 11

COMPARATIVE ASSESSMENT OF PROPOSALS TO AMEND THE PERSONAL INCOME TAX LAW

Rosario G. Manasan*

I. INTRODUCTION

Proposals to reform the personal income tax has gained prominence in recent months. To date, personal income tax reform is part and parcel of the platform of a number of the candidates in the 2016 Presidential elections. While President Benigno S. Aquino has adamantly refused to support any amendment of the personal income taxation, proponents of the reform, some of whom belong to his own party, have said they are still hopeful the law will be amended before elections and, failing that, promise to pass the amendment in the next Congress. Given this perspective, this paper aims to evaluate the various proposals to amend the existing personal income tax legislation.

A number of bills have been filed in both houses of Congress proposing to amend and restructure the existing personal income tax rate schedule (**Appendix Table 1**) for the purpose of easing the tax burden on personal income taxpayers. In particular, three such bills are filed at the Senate: Senate Bill 716 (Recto), Senate Bill 1942 (Aquino), and Senate Bill 2149 (Angara). On the other hand, there are two such bills at the House of Representatives: House Bill 4829 (Quimbo) and House Bill 5401 (Colmenares and Zarate). Similar proposals have been raised by the private sector, most notably the Tax Management Association of the Philippines (TMAP).

All of the proposals with the exception of HB 4829 propose to retain the existing global approach to the taxation of personal income from wages, entrepreneurship and practice of profession. That is, under these bills the same rate schedule will apply to personal income from said sources of personal income. In contrast, HB 4829 proposes a shift to a modified schedular approach to personal income taxation in lieu of the more global approach currently in place by applying a different rate schedule to wage income earners and another one to professional/ self-employed income earners.

SB 716 proposes to address bracket creep by adjusting the lower and upper limits of the existing personal income tax brackets by the rate of inflation between 1998 and 2014 without changing the existing basic rate structure (**Appendix Table 2**).[1] Like SB 716, HB 4829 proposes to apply the existing rate schedule on the inflation-adjusted lower/ upper limits of the existing personal income tax brackets on wage income. However, unlike SB 716, it proposes to levy a flat tax of 25% on the taxable personal income of self-employed individuals and professionals.[2]

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[1] Bracket creep occurs when inflation drives tax payers into higher income brackets thereby resulting in higher tax liability and lower disposable income in real terms.

[2] HB 4829 also proposes to reduce the corporate income tax rate to 25%.

On the other hand, Senate Bill 1942 (**Appendix Table 3**), SB 2149 (**Appendix Table 4**), HB 5401 (**Appendix Table 5**), and the TMAP (**Appendix Table 6**) all propose to alter the existing rate schedule by (i) exempting income below a given threshold and, and (ii) amending the top marginal tax rate. Although there is no tax-exempt income bracket under the existing tax structure *per se*, individuals earning less than or equal to the minimum wage are exempt from the payment of the tax. SB 2149 proposes to exempt income below PhP 20,000 from the personal income tax while the tax-exempt income cut-off is set at PhP 60,000 under SB 1942, PhP 300,000 under the TMAP proposal and PhP 396,000 under HB 5401.

On the other hand, HB 5401 and the TMAP both propose to reduce the top marginal tax rate from the current 32% to 30% while SB 2149 proposes to reduce the top marginal tax rate of 32% initially to 28% in the second year of implementation and then to 25% from the third year of implementation onwards. The top marginal tax rate income threshold (i.e., the taxable income level when the top marginal tax rate starts to become applicable) is set at PhP 1 million under SB 2149, PhP 2.5 million under the TMAP proposal and PhP 2.7 million under HB 5401. In contrast, SB 1942 proposes to increase the top marginal tax rate to 35% which will be applicable to taxable income in excess of PhP 12 million per annum.

All of the proposals with the exception of SB 716, SB 1942, and HB 4829 call for the reduction in the number of income tax brackets from the current 7 tiers to 6 in the case of SB 2149 (inclusive of the tax exempt tier) and HB 5401 and 5 in the case of the TMAP proposal. Moreover, SB 716, SB 1942 and HB 5401 all propose to introduce a mechanism that will automatically adjust the lower and upper limits of the personal income tax brackets via indexation to the Consumer Price Index (CPI). The automatic adjustment of the lower and upper limits of the personal income tax brackets is proposed to be conducted once every 3 years under HB 5401 and once every 6 year under SB 716 and SB 1942.

II. RATIONALE OF THE DIFFERENT PROPOSALS

Proposals to amend the personal income tax schedule appear to be well-justified from the perspective of (i) the need to eliminate the bracket creep, and (ii) easing the tax burden on Filipino personal income taxpayers relative to their ASEAN neighbors.

Bracket creep. The basic rationale of the various proposals to amend the personal income tax rate schedule (e.g., Senate Bills 716, 1942 and 2149) is anchored on the need to address bracket creep that has resulted from the non-indexation to inflation of the lower and upper class boundaries of the personal income tax brackets under Section 24 of the National Internal Revenue Code of 1997. To wit, the CPI in 2014 is 139.5, more than double that in 1998 (67.8), implying that the purchasing power of the peso in 2014 is slightly less than half of what it was in 1998.

Assuming that taxpayers pay the correct taxes, individual income taxpayers whose pre-tax incomes rose at the same rate as inflation between 1998 and 2014, such that the purchasing power of their income in 2014 is approximately the same as that in 1998, have had to pay higher taxes in 2014 (not just in peso terms but also in terms of effective tax rates) simply because their

taxable income in 2014 have been pushed into the next higher income tax bracket relative to their situation in 1998, a phenomenon that is known as bracket creep (**Table 1**). **Table 1** illustrates that, abstracting from individual income taxpayers with taxable income lower than PhP 10,000, not only is the tax burden higher for all individual income taxpayers with taxable income levels higher than what it would have been had the limits of the taxable income brackets been adjusted for inflation because of bracket creep, the relative increase in the tax burden is also higher for individual income taxpayers belonging to the lower taxable income brackets compared to those belonging to the higher taxable income brackets. This is true regardless of whether one is looking at the issue from the perspective of tax liability in nominal peso terms or effective tax rates. In this sense, it can be said that perpetuating bracket creep tends to discriminate against taxpayers in the lower income brackets, i.e., bracket creep tends to be regressive.

Table1. Computation of tax liability of individual income taxpayers with alternative levels of 2014 taxable income: an illustration of bracket creep at work

Alternative taxable income levels	Applicable tax bracket		Tax liability based on existing rate schedule		Counterfactual tax liability if limits of taxable income bracket were djusted to reflect purchasing power in 1998		Ratio of actual to counterfactual tax liability in terms of …	
In 2014 current prices	Under existing rate schedule	If limits of taxable income brackets were adjusted to reflect purchasing power in 1998	In pesos	Effective tax rate	In pesos	Effective tax rate	Effective tax rates	Tax liability in nominal pesos
col 1	col 2	col 3	col 4	col 5	col 6	col 7	col 8	col 9
9,000	First	First	450	5.0%	450	5.0%	1.00	1.00
18,000	Second	First	1,300	7.2%	900	5.0%	1.44	1.44
40,000	Third	Second	4,000	10.0%	3,000	7.5%	1.33	1.33
95,000	Fourth	Third	13,500	14.2%	10,250	10.8%	1.32	1.32
210,000	Fifth	Fourth	40,000	19.0%	31,000	14.8%	1.29	1.29
390,000	Sixth	Fifth	92,000	23.6%	72,500	18.6%	1.27	1.27
525,000	Top	Sixth	133,000	25.3%	107,500	20.5%	1.24	1.24
1,500,000	Top	Top	445,000	29.7%	410,000	27.3%	1.09	1.09
3,000,000	Top	Top	925,000	30.8%	890,000	29.7%	1.04	1.04
6,000,000	Top	Top	1,885,000	31.4%	1,850,000	30.8%	1.02	1.02
12,000,000	Top	Top	3,805,000	31.7%	3,770,000	31.4%	1.01	1.01

Source: Author's estimates

Higher tax burden relative to other countries in ASEAN. Proposals to amend the personal income tax rate schedule are also being justified on the grounds that Philippine individual income taxpayers are the most heavily taxed in the ASEAN region (**Table 2**). In particular, the Philippines' top marginal personal income tax rate of 32% is higher than that of all the ASEAN member countries with the exception of two countries, Thailand and Vietnam.

Top marginal personal income tax rates only tell half the story. The tax rate schedule itself and the allowable personal exemptions and deductions are just as important. To better clarify how

much higher the personal income tax burden in the Philippines is when compared to those in the other countries in the region, this study applied the personal income tax rate schedules of the different ASEAN countries to a broad range of alternative gross personal income levels by expressing said tax rate schedules in peso terms using the 2014 purchasing power parity (PPP) exchange rates. The simulations are done for an individual income taxpayer who is assumed to have two dependents and who is assumed be the sole income earner in the family. The results of the analysis are presented in **Table 3**.

Table 2. Comparative statutory tax rates in ASEAN, 2014

	Personal Income Tax		Corporate Income Tax	VAT/GST
	Top marginal rate	Number of tiers		
Brunei Darussalam	a/	a/	20%	n/a
Cambodia	20%	5	20%	10%
Indonesia	30%	4	25%	10%
Lao PDR	24%	7	24%	10%
Malaysia	26%	7	25%	6%
Myanmar	25%	6	25%	b/
Philippines	32%	7	30%	12%
Singapore	20%	9	17%	7%
Thailand	35%	8	20%	7%
Vietnam	35%	7	22%	10%

a/ no personal income tax in Brunei

b/ turnover tax ; no standard rate

Source: Ernst and Young 2014; KPMG 2014

Table 3 confirms that the effective tax rates as well as the nominal peso tax liability for a broad range (but not the *entire* range) of gross personal income levels are indeed higher when the Philippine rate schedule is applied compared to those when the rate schedules of the other ASEAN member countries are used. Some additional points are worth noting. One, Brunei Darussalam does not impose a personal income tax on both residents and non-residents. Two, all countries in the ASEAN region with the exception of the Philippines and Indonesia exempt personal income below a specified threshold from the personal income tax. However, there is a wide disparity in the tax-exempt income cut-off in these countries, reflective perhaps of varying levels of economic development, cost of living, and tax policy in the said countries. The tax-exempt taxable income cut-off is lowest in Lao PDR (equivalent to about PhP 7,000), moderate in Malaysia (PhP 64,000) and Cambodia (PhP 81,000), somewhat higher in Vietnam (PhP 142,000), Myanmar (PhP 155,000), Thailand (PhP 222,000) and Indonesia (PhP 240,000) and significantly higher in Singapore (PhP 424,000). Three, the effective tax rates and the nominal peso tax liability in Lao PDR are higher than those of the Philippines for gross income levels below PhP 400,000. Four, there is likewise a wide disparity in income threshold for the top bracket in the ASEAN member countries. The income threshold for the top bracket in all of the countries in the region is higher than the Philippines' PhP 500,000 with the exception of Lao PDR (whose thresholds is equivalent to less than PhP 300,000 per annum). In comparison, the income threshold for the top bracket is equivalent to about PhP 1.3 million in Malaysia, PhP 2.0 million – PhP 2.4 million in Cambodia, Vietnam, Myanmar and Indonesia, PhP 6.0 million in Thailand, , PhP 6.8 million in Singapore. Fifth, despite having higher top marginal tax rates than the Philippines, the said rates start to kick in Thailand and Vietnam at income levels that are 4-12 times higher than the Philippines' income threshold for the top bracket. Consequently, while the effective tax rates and nominal peso tax liability in Vietnam and Thailand are lower than those of the Philippines for a wide range of gross personal income levels, they are higher than those of the

Philippines at gross personal income levels above PhP 2.3 million in the case of Vietnam and PhP 6 million in the case of the Thailand. Sixth, the Philippines is only second to Lao PDR when ASEAN countries are ranked according to the effective tax rate applicable to their per capita GNI. Moreover, the marginal tax rate applicable to the per capita GNI of each of the ASEAN countries is also highest in the Philippines.

Table 3. Comparative tax liability and effective tax rates when the tax rate schedule of different ASEAN countries are applied to selected gross personal income levels (adjusted for purchasing power parity)

Selected gross income levels	Philippines	Cambodia	Lao PDR	Indonesia	Malaysia	Myanmar	Singapore	Thailand	Vietnam
Tax liability(in pesos)									
9,000	-	-	107		-	-	-	-	-
18,000	-	-	557		-	-	-	-	-
40,000	-	-	2,629		-	-	-	-	-
95,000	-	-	9,588		-	-	-	-	-
210,000	16,500	6,505	49,474	2,687	-	-	-	-	-
390,000	62,000	24,505	69,743	11,237	1,691	9,371	-	-	-
525,000	102,500	38,005	102,143	28,955	5,539	28,358	-	6,250	3,242
1,500,000	413,000	141,425	336,143	187,400	172,798	159,659	12,866	138,516	252,267
3,000,000	893,000	414,907	696,143	583,704	562,510	485,751	202,192	505,552	865,629
6,000,000	1,853,000	1,014,907	1,416,143	1,483,704	1,342,510	1,235,751	715,065	1,398,513	1,915,629
12,000,000	3,773,000	2,214,907	2,856,143	3,283,704	2,902,510	2,735,751	1,894,852	3,493,323	4,015,629
Effective tax rates									
9,000	-	-	1%	-	-	-	-	-	-
18,000	-	-	3%	-	-	-	-	-	-
40,000	-	-	7%	-	-	-	-	-	-
95,000	-	0%	10%	-	0%	0%	-	-	-
210,000	8%	3%	24%	1%	0%	0%	-	-	-
390,000	16%	6%	18%	3%	0%	2%	-	0%	-
525,000	20%	7%	19%	6%	1%	5%	-	1%	1%
1,500,000	28%	9%	22%	12%	12%	11%	1%	9%	17%
3,000,000	30%	14%	23%	19%	19%	16%	7%	17%	29%
6,000,000	31%	17%	24%	25%	22%	21%	12%	23%	32%
12,000,000	31%	18%	24%	27%	24%	23%	16%	29%	33%
Per capita GNI	4%	-	9%	2%	1%		3%	-	-
Marginal tax rate applicable to per capita GNI	15%	0%	12%	5%	6%		7%	0%	0%

Author's estimates

III. IMPACT OF THE DIFFERENT PROPOSALS ON TAX PROGRESSIVITY AND REVENUE TAKE

In this section, this paper evaluates the impact of the different proposals on the progressivity and the revenue yield of the personal income tax. While all of the proposals to amend the personal income tax are progressive, two, SB 2149 and HB 4829, are less progressive than the existing rate structure. All of the proposals are estimated to have a negative impact on government revenue. The revenue loss from SB 716, SB 1942, SB 2149 and HB 4829 ranges from 0.4%-1.0% of GDP while HB 5401 and the TMAP proposal are estimated to result in a revenue loss of 1.8% of GDP, more than 80% of actual revenues from the personal income tax in 2014.

Tax progressivity. To better appreciate the impact of the various proposals to restructure the personal income tax rate schedule on the progressivity of the personal income tax, this study estimated the tax liability and effective tax rates for a range of selected taxable income levels and compared these with those of the existing tax regime (**Table 4**).

All of the proposals to amend the personal income tax schedule are clearly progressive as indicated by the fact that the associated effective tax rates computed for various taxable income levels based on the tax rate structure of each of these proposals rises as the corresponding taxable income increases. At the same time, all of the proposals are more progressive than the existing tax regime with the exception of SB 2149 and HB 4829, as indicated by the higher Suits Index[3] of all these proposals compared to that of the existing personal income tax rate structure (see last row of **Table 4)**. Setting SB 2149 and HB 4829 aside for the moment, note how the ratio of the ETRs of each of the proposed amendments to the corresponding ETR of the existing rate schedule declines as taxable income increases over the entire range of taxable income. This indicates that if these proposals were implemented taxpayers belonging to the lower income groups will enjoy larger percentage reductions in their tax liability compared to taxpayers belonging to the higher income groups. Relative to the existing tax regime, House Bill 5401 provides the largest improvement in the progressivity of the personal income schedule followed by the TMAP proposal, Senate Bill 1942 and Senate Bill 716, in that order.

Now consider the columns referring to Senate Bill 2149. Note how the ratio of the ETRs under SB 2149 to the corresponding ETRs of the existing tax regime for taxable incomes between PhP 70,000 and PhP 500,000 in year 1 of its implementation and between PhP 70,000 and PhP 1 million in years 2 and 3 of its implementation declines as taxable income increases. This indicates that for taxpayers belonging to these income ranges, those with relatively lower income will enjoy smaller reductions in their tax liabilities compared to their better-off counterparts, i.e., the proposed tax rate schedule is less progressive than the existing tax rate schedule in these taxable income ranges. Moreover, the ratio of the ETRs under SB 2149 to the corresponding ETRs of the existing tax regime is higher than 1 for taxable incomes between PhP 70,000 and PhP 180,000 in year 1 of its implementation and for taxable income between PhP 70,000 and PhP 100,000 in year 2 of its implementation. This indicates that taxpayers with taxable income in these taxable income ranges will actually have to pay higher taxes under SB 2149 than they do at present.

In contrast, the ratio of the ETRs under SB 2149 to the corresponding ETRs of the existing tax regime for taxable incomes greater than PhP 500,000 in years 1 and 2 of its implementation and for taxable incomes greater than PhP 1 million in years 2 and 3 of its implementation goes up as taxable income increases. This implies that SB 2149 is more progressive than the existing personal income tax regime for taxable incomes larger than PhP 500,000 in year 1 of its implementation and for taxable incomes greater than PhP 1 million in years 2 and 3 of its implementation.

[3] The Suits Index is analogous to the Gini coefficient and is computed in the same manner as the Gini coefficient from a concentration curve that plots the cumulative distribution of income on the horizontal axis and the cumulative distribution of tax burden on the vertical axis. The index approaches 1 as the tax becomes more progressive. Conversely, the index approaches -1 as the tax becomes more regressive.

Table 4. Estimated effective tax rates based on statutory rates under alternative proposals over a range of selected taxable income levels

Selected taxable income levels	Existing schedule	SB 716	SB 1942	SB 2149 Year 1	SB 2149 Year 2	SB 2149 Year 3	HB 4829 a/	HB 4829 b/	HB 5401	TMAP c/	Ratio of ETRs of alternative proposals to ETRs of existing tax regime								
											SB 716	SB 1942	SB 2149 Year 1	SB 2149 Year 2	SB 2149 Year 3	HB 4829 a/	HB 4829 b/	HB 5401	TMAP c/
9,000	5%	5%	-	-	-	-	25%	12%	-	-	1.00	-	-	-	-	5.00	2.46	-	-
18,000	7%	5%	-	-	-	-	25%	12%	-	-	0.69	-	-	-	-	3.46	1.70	-	-
40,000	10%	8%	-	8%	7%	5%	25%	13%	-	-	0.75	-	0.75	0.65	0.50	2.50	1.30	-	-
70,000	12%	9%	9%	15%	13%	10%	25%	14%	-	-	0.76	0.76	1.24	1.07	0.82	2.06	1.16	-	-
95,000	14%	11%	11%	16%	14%	11%	25%	14%	-	-	0.76	0.76	1.15	1.01	0.80	1.76	1.02	-	-
100,000	15%	11%	11%	17%	15%	12%	25%	15%	-	-	0.76	0.76	1.14	1.00	0.79	1.72	1.01	-	-
150,000	17%	13%	13%	18%	16%	13%	25%	16%	-	-	0.76	0.76	1.06	0.94	0.76	1.50	0.96	-	-
180,000	18%	14%	14%	18%	16%	13%	25%	16%	-	1%	0.77	0.77	1.00	0.89	0.72	1.38	0.91	-	0.05
210,000	19%	15%	15%	19%	17%	14%	25%	17%	-	2%	0.78	0.78	0.98	0.87	0.71	1.31	0.88	-	0.09
250,000	20%	16%	16%	20%	18%	15%	25%	17%	-	3%	0.78	0.78	0.98	0.88	0.73	1.25	0.87	-	0.13
300,000	22%	17%	17%	21%	19%	16%	25%	18%	-	3%	0.77	0.77	0.95	0.85	0.72	1.15	0.84	-	0.16
350,000	23%	18%	18%	21%	19%	16%	25%	19%	-	4%	0.78	0.78	0.93	0.84	0.71	1.09	0.82	-	0.19
390,000	24%	19%	19%	22%	20%	17%	25%	19%	-	6%	0.79	0.79	0.91	0.83	0.70	1.06	0.81	-	0.24
400,000	24%	19%	19%	22%	20%	17%	25%	19%	0%	6%	0.79	0.79	0.91	0.83	0.70	1.05	0.80	0.00	0.25
500,000	25%	20%	20%	22%	20%	17%	25%	20%	2%	8%	0.80	0.80	0.89	0.81	0.69	1.00	0.80	0.08	0.33
550,000	26%	21%	21%	23%	21%	18%	25%	20%	3%	9%	0.82	0.82	0.90	0.81	0.69	0.98	0.80	0.11	0.35
600,000	26%	22%	22%	24%	21%	18%	25%	21%	3%	10%	0.83	0.83	0.90	0.81	0.69	0.96	0.80	0.13	0.38
700,000	27%	23%	23%	25%	22%	19%	25%	21%	5%	11%	0.85	0.85	0.91	0.80	0.69	0.93	0.79	0.18	0.41
800,000	28%	24%	24%	25%	22%	19%	25%	22%	6%	12%	0.86	0.86	0.91	0.80	0.69	0.90	0.79	0.22	0.44
900,000	28%	24%	24%	26%	22%	19%	25%	23%	7%	12%	0.87	0.87	0.92	0.80	0.69	0.89	0.80	0.25	0.44
1,000,000	29%	25%	25%	26%	23%	20%	25%	23%	8%	14%	0.88	0.88	0.92	0.79	0.69	0.88	0.81	0.28	0.48
1,100,000	29%	26%	26%	27%	23%	20%	25%	24%	9%	15%	0.89	0.89	0.93	0.80	0.70	0.87	0.82	0.31	0.51
1,300,000	29%	27%	27%	28%	24%	21%	25%	24%	11%	16%	0.91	0.91	0.94	0.81	0.71	0.85	0.83	0.36	0.55
1,400,000	30%	27%	27%	28%	24%	21%	25%	25%	11%	17%	0.92	0.92	0.94	0.82	0.72	0.85	0.83	0.38	0.57
1,500,000	30%	27%	27%	28%	24%	21%	25%	25%	12%	17%	0.92	0.92	0.95	0.82	0.72	0.84	0.84	0.40	0.58
1,600,000	30%	28%	28%	28%	25%	22%	25%	25%	12%	18%	0.93	0.93	0.95	0.83	0.73	0.84	0.84	0.42	0.59
3,000,000	31%	30%	30%	30%	26%	23%	25%	27%	18%	22%	0.96	0.96	0.97	0.85	0.75	0.81	0.88	0.59	0.72
6,000,000	31%	31%	31%	31%	27%	24%	25%	28%	24%	26%	0.98	0.98	0.99	0.86	0.77	0.80	0.90	0.78	0.83
12,000,000	32%	31%	33%	32%	28%	25%	25%	29%	27%	28%	0.99	1.05	0.99	0.87	0.77	0.79	0.91	0.86	0.88
Suits Index	0.486	0.503	0.547	0.461	0.463	0.472	0.448	0.448	0.654	0.645	0.503	0.547	0.461	0.463	0.472	0.448	0.448	0.654	0.645

a/ Assumes representative individual income taxpayer is one who receives 100% of his income from non-wage sources

b/ Assumes representative individual income taxpayer is a mixed income earner, 63.6% of whose income comes from wages and 36.4% from entrepreneurial and/ or professional income.

c/ Taxable income levels used for other proposals grossed up by the sum of PhP 50,000 (basic personal exemption), PhP 75,000 (equal to additional exemption for 3 dependent children) and bonuses/ cash benefits less than PhP 82,000

Author's estimates

Now consider HB 4829. The ratio of the ETRs of individual income tax payers receiving their income entirely from entrepreneurship and/ or practice of profession under HB 4829 to the corresponding ETRs under the existing tax regime declines as taxable income rises for the entire range of possible taxable incomes, indicating that HB 4829 is less progressive than the existing tax regime for this group of individual income taxpayers. Moreover, for this group of taxpayers, those with income below PhP 500,000 will have to pay higher taxes in nominal peso terms than they do at present.

In like manner, the ratio of the ETRs of individual income tax payers receiving mixed income (i.e., 64% from wages and 36% from entrepreneurship and/ or practice of profession[4]) under HB 4829 to the corresponding ETRs under the existing tax regime goes down as taxable income goes up for taxable incomes below PhP 1.5 million, indicating that HB 4829 is less progressive than the existing tax regime for individual income taxpayers with mixed income in this taxable income range. However, HB 4829 is shown to be more progressive than the existing tax regime for mixed income individual income taxpayers with taxable income greater than PhP 1.5 million.

Revenue implications. The revenue loss from the various proposals to restructure the personal income tax schedule was estimated based on the 2012 Family Income and Expenditure Survey (FIES) by using all the individual observations in the FIES weighted by the appropriate weights and differentiating between (i) pure wage income, (ii) pure entrepreneurial income and (iii) mixed income. The tax schedule including pertinent personal exemptions (for working individuals and for qualified dependents) for the various proposals were then applied to the universe of individuals with wage or entrepreneurial income to arrive at the estimated revenue yield under the different proposals. These estimates are then subtracted from the revenue yield under the existing tax regime to obtain estimates of the revenue loss arising from the various proposals. Subsequently, the results obtained from the direct application of the alternative tax schedules to the FIES income data are then adjusted to make the compensation income/ entrepreneurial income of households in the FIES comparable to that in the National Income Accounts and to take into account the collection efficiency/ tax evasion/ tax avoidance rates for both wage income earners and self-employed individuals/ professionals.

Table 5 presents the estimated revenue impact of the alternative proposals to restructure the personal income tax rate schedule. The indexation of the lower and upper limits of existing income tax brackets without changing the basic tax structure as proposed under SB 716 is estimated to result in a revenue loss of PhP 52 billion (or 0.4% of GDP) in 2014, roughly equal to the incremental revenues from the amendment of the excise tax on alcohol and tobacco products.

While the revenue loss resulting from the implementation of SB 2149 in year 3 is only slightly higher than that under SB 716, the distribution of the tax burden under these two proposals is distinctly different as discussed above. It is also interesting to note that SB 2149 will result in a small revenue gain during the first year of its implementation largely because the bill imposes higher effective tax rates on taxpayers whose taxable income fall in the PhP 70,000-PhP 180,000 range.

[4] These numbers represent the aggregate share of wage and non-wage income to total household income subject to the personal income tax in 2012 based on the National Income Accounts.

Table 5. Estimated revenue impact of alternative proposals

	SB 716	SB 1942	SB 2149 Year 1	SB 2149 Year 2	SB 2149 Year 3	HB 4829	HB 5401	TMAP
2012 (in million pesos)	(43,884)	(60,098)	8,810	(16,661)	(51,974)	(110,025)	(196,235)	(175,290)
% of GDP	(0.42)	(0.57)	0.08	(0.16)	(0.49)	(1.04)	(1.86)	(1.66)
2014 (in million pesos)	(51,909)	(71,089)	10,425	(19,703)	(61,473)	(130,047)	(232,116)	(207,344)
% of GDP	(0.41)	(0.56)	0.08	(0.16)	(0.49)	(1.03)	(1.836)	(1.640)

Author's estimates

In comparison, the estimated revenue loss arising from the implementation of SB 1942, at PhP 71 billion (or 0.6% of GDP) in 2014, is significantly higher than resulting from the implementation of SB 716. On the other hand, the revenue loss under HB 4829 is estimated to be equal to PhP 130 billion (1.0% of GDP) in 2014, more than double that under SB 716. It is notable that the estimated increase in the tax liability of taxpayers whose income are sourced entirely from entrepreneurship and practice of profession in the bottom half of the income distribution under HB 4829 is not enough to compensate for the reduction in the tax liability of those in the upper half of the income distribution as a result of the application of the flat 25% on entrepreneurial and professional income.

In contrast, the revenue loss from the TMAP proposal is estimated to be equal to PhP 207 billion (or 1.6% of GDP) in 2014 while the revenue loss from HB 5401 is estimated to be equal to PhP 232 billion (or 1.8% of GDP). The estimated revenue losses arising from the TMAP proposal and HB 5401 are, respectively, roughly equal to 77% and 86% of actual BIR collections from the personal income tax in 2014. It is notable that under the TMAP proposal only taxpayers in the eighth, ninth and tenth decile will actually be subjected to the personal income tax while under HB 5401 only taxpayers in the tenth decile will actually be subjected to the personal income tax.

IV. CONCLUSION

One of the basic principles of fiscal policy is the precept of fiscal responsibility, i.e., every proposed revenue or expenditure measure should have neutral implications on the overall fiscal position of the government so as to help ensure fiscal sustainability. This principle is particularly important when the government's revenue profile is far from ideal and/ or when there are many unmet public expenditure needs.

The projected revenue loss from various proposals to restructure the personal income tax is thus best seen in the context of the government's overall revenue and tax effort as well as its spending requirements. On the one hand, creditable improvements in national government total revenues and national government tax revenues have been achieved between 2010 and 2014 (**Figure 1**). However, total national government revenues stood at 15.1% of GDP in 2014, more than 2 percentage points below its peak level of 17.5% in 1997. Similarly, despite the gains made in recent years, national government tax revenues is equal to 13.6% of GDP in 2014, still some distance away from its peak level of 15.3% in 1997. The same is true of the revenues from the personal income tax and its components (**Figure 2**). It is notable that about 75% of improvement in personal income tax revenue-to-GDP ratio in 2009-2014 due to gains in collection efficiency.

Moreover, despite the Philippines' high statutory tax rates compared to its ASEAN neighbors, its tax effort ratio (i.e., tax revenues to GDP ratio) is lower than that of Vietnam, Thailand, Malaysia and Lao PDR in 2013 (**Table 6**).

Figure 1. National government total and tax revenues (% of GDP)

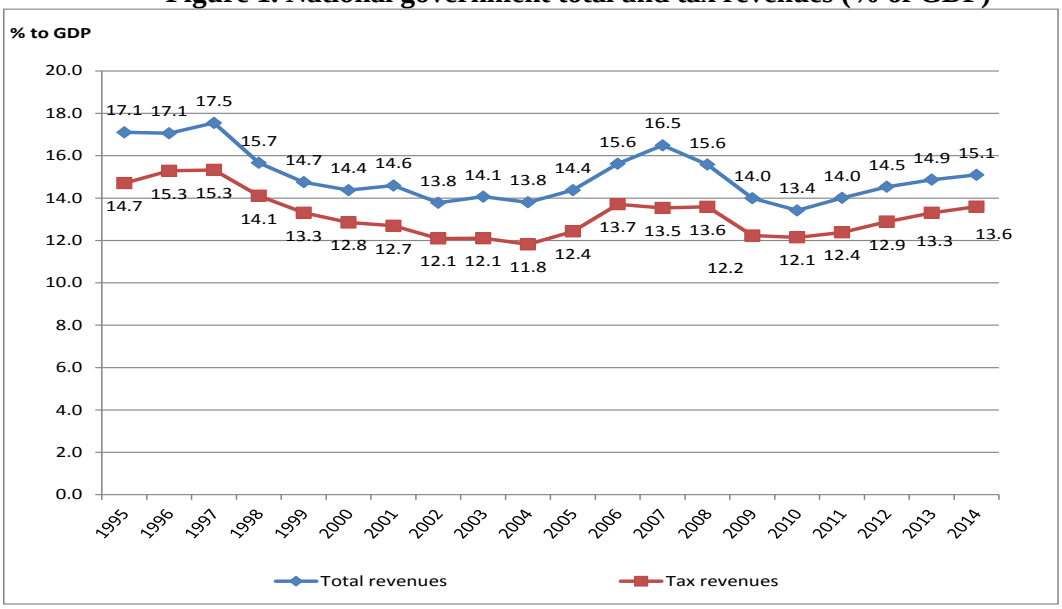


Figure 2. Revenues from the personal income tax and its components

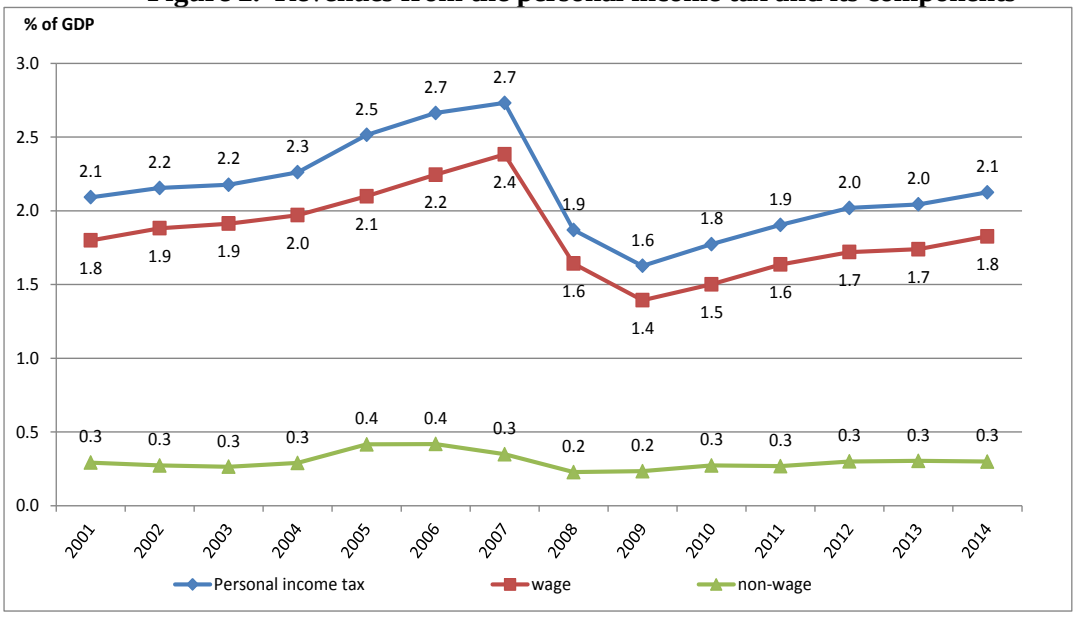


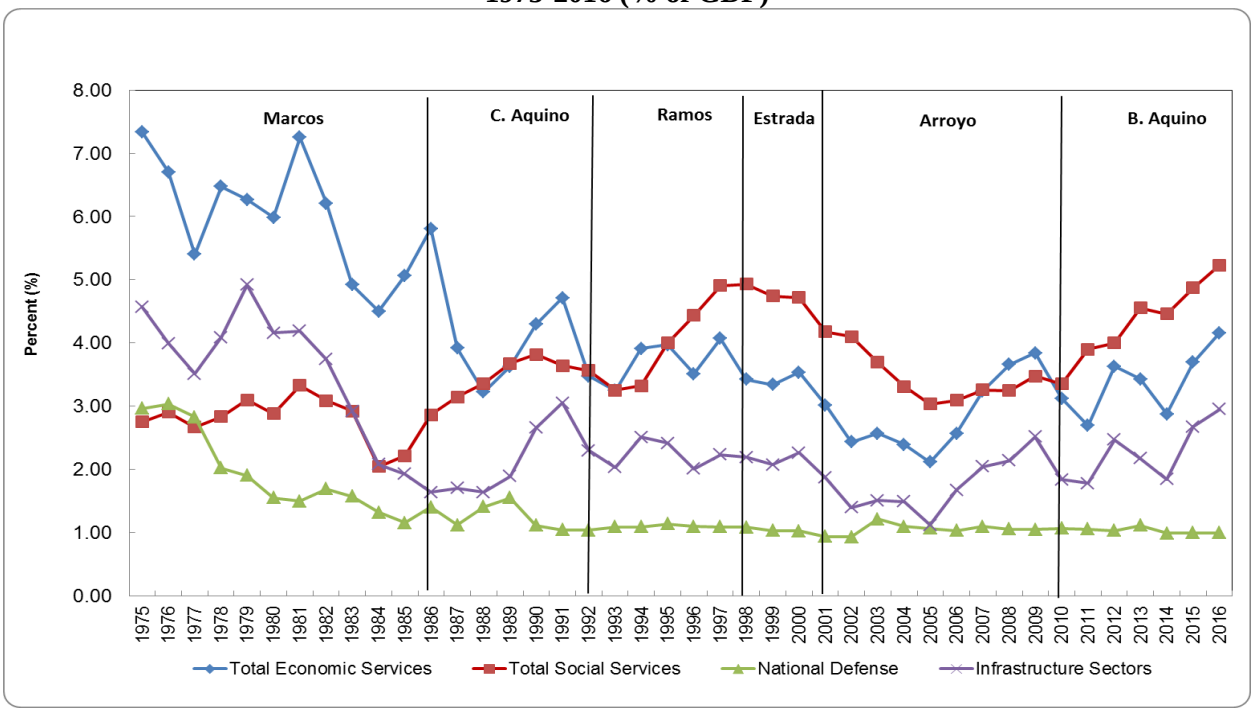
Table 6. Tax revenues[a/] in ASEAN member countries, 1990-2013

	1990	1995	2000	2005	2010	2011	2012	2013
Cambodia	2.3	5.3	7.3	7.7	10.7	10.9	12.2	12.4
Indonesia	17.8	16.0	8.3	12.5	11.2	11.8	11.9	11.8
Lao PDR	6.1	9.4	10.6	9.7	13.5	14.1	15.0	15.3
Malaysia	17.8	18.7	13.2	14.8	13.7	15.3	16.1	15.8
Myanmar	6.2	3.7	2.0		3.2	3.7	3.8	6.1
Philippines	14.1	16.3	12.8	12.4	12.1	12.4	12.9	13.3
Singapore	14.8	15.9	15.1	11.5	13.2	13.8	14.0	
Thailand	16.0	16.4	12.8	15.3	14.6	16.1	15.0	16.2
Vietnam b/	11.5	19.1	18.0	21.0	22.4	22.3	19.6	18.9

a/ excludes social security contributions
b/ includes subnational government revenues
Source: ADB Key Indicators

On the other hand, while an unparalleled increase in national government spending on all social services combined is apparent in 2011-2016 (**Figure 3**), the demand/ need for greater access to better quality basic social services given the thrusts of the newly minted Sustainable Development Goals (SDGs) will necessarily expand the government's financing requirements. At the same time, although a significant increase in national government spending on economic services, particularly on basic infrastructure, is evident in 2011-2016, with national government spending on these sectors in those years being higher on the average compared to the spending levels during the Ramos, Estrada and Arroyo years (**Table 7**), large unmet needs for better quality infrastructure services have to be addressed in order to sustain the economic growth momentum in 2012-2015.

Figure 3. National Government Expenditures (obligation basis), by Major Expenditure Group, 1975-2016 (% of GDP)



The gains made in increasing national government spending on the social services sectors and the economic services sectors in 2011-2016 have been achieved because of the greater fiscal space that resulted from the improvements in overall revenue and tax effort as well as the substantial reduction in national government debt service payments **(Figure 4**) following the reduction in national government outstanding debt stock (**Figure 5**) and the progress made in fiscal consolidation in those years. It should be emphasized that part of the apparent fiscal space in recent years is due to the low absorptive capacity of implementing national government agencies which is best viewed as being transitory in nature and which should be corrected via enhancements in the planning, programming and implementation of national government programs and projects. This implies that further improvements in the government's revenue effort would be necessary if government is to be able to finance the increased future demand for basic social services and infrastructure while ensuring the sustainability of its fiscal position.

Table 7. National government spending (obligation basis), by major sectors, 1975-2016 (% of GDP)

	Marcos 1975-85	C. Aquino 1986-92	Ramos 1993-98	Estrada 1999-2000	Arroyo 2001-10	B. Aquino 2011-16
GRAND TOTAL	13.4	16.9	17.7	18.5	17.1	19.3
Total Economic Services	5.7	4.1	3.7	3.4	3.0	3.9
of which:						
Agriculture	0.8	0.7	0.7	0.6	0.7	0.6
Transp. & Comm.	2.4	1.9	2.0	2.0	1.8	2.8
Total Social Services	2.7	3.5	4.3	4.7	3.4	5.1
of which:						
Education	1.7	2.5	3.1	3.4	2.6	3.2
o/w: Basic education	1.3	2.1	2.5	2.7	2.2	2.3
Tertiary education	0.3	0.4	0.5	0.5	0.3	0.3
Health	0.5	0.6	0.5	0.4	0.3	0.8
Soc. Security, Labor/ Emp., & Social Welfare Services	0.1	0.3	0.6	0.8	0.4	0.9
National Defense	1.7	1.2	1.1	1.0	1.1	1.0
Total Public Services	1.4	2.1	2.6	2.5	2.4	2.2
Public Administration	1.1	1.2	1.4	1.2	1.2	1.0
Peace and Order	0.4	0.9	1.1	1.3	1.3	1.2
Others	0.7	1.1	2.6	3.2	3.0	4.4
Debt Service	1.3	5.0	3.5	3.6	4.2	2.6
MEMO ITEM:						
Transfers to LGUs	0.5	0.7	2.5	3.1	2.9	2.8
Grand Total less Debt Service	12.1	11.9	14.2	14.9	12.9	16.6
Infrastructure	3.2	2.2	2.2	2.2	1.8	2.8

Figure 4. National Government Debt Service Expenditure, 1975-2016 (% of GDP)

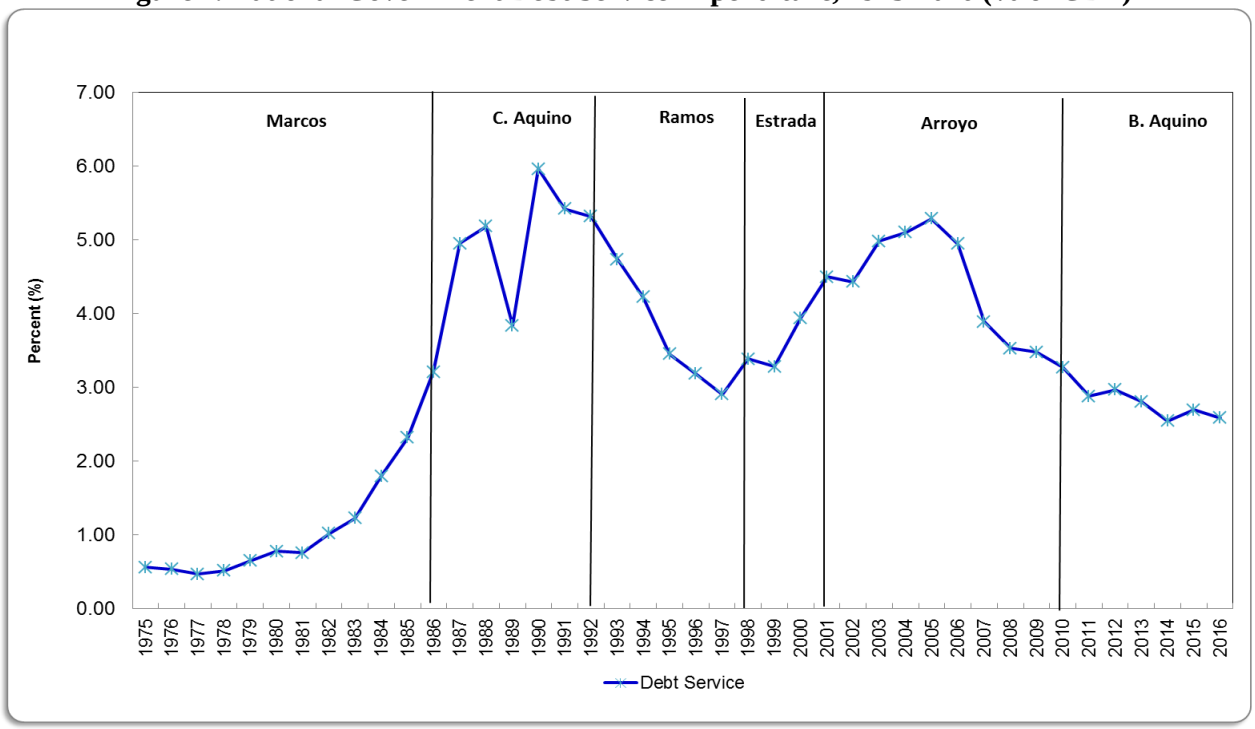
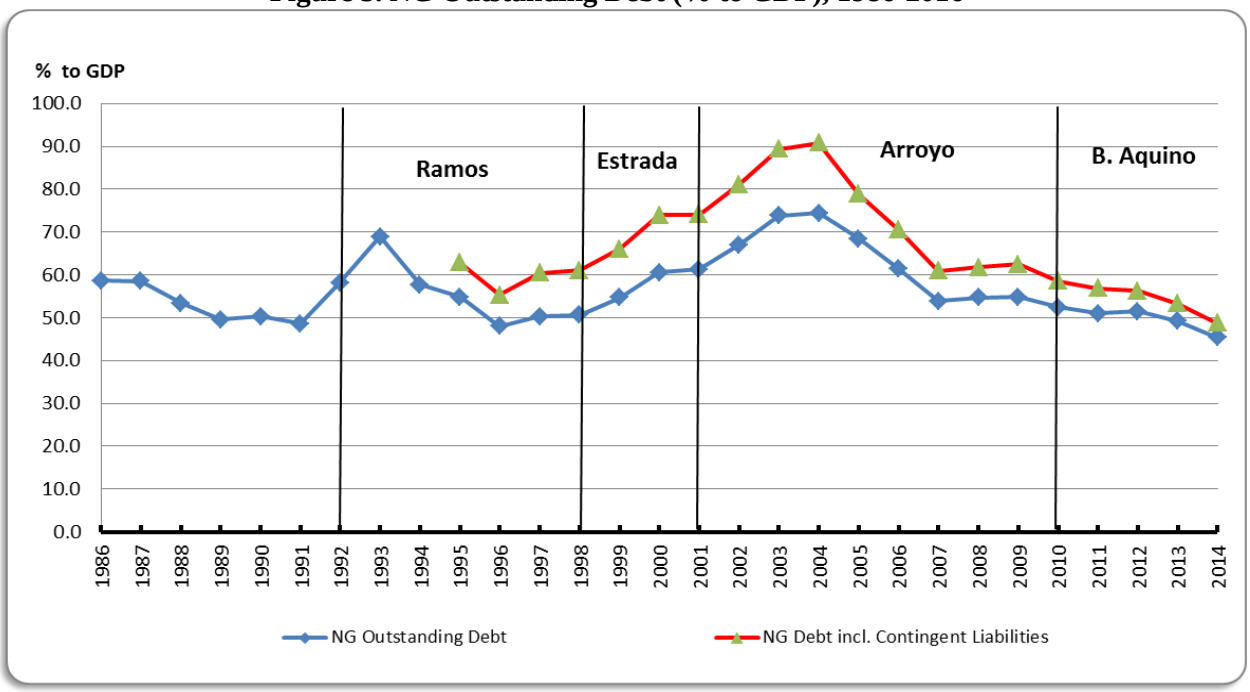


Figure 5. NG Outstanding Debt (% to GDP), 1986-2016



Thus, fiscal prudence dictates that new revenue measures have to be found to compensate for the projected revenue loss that will arise as a result of the implementation of any one of the various proposals to restructure the personal income tax. Given this background, the need for compensatory revenue measures to allow the recovery of the revenue loss from the reform of the personal income tax rate structure cannot be overemphasized. While one could argue that the PhP 52 billion reduction in the personal income tax take under SB 716 should not be viewed as "revenue loss" since the said amount should not have been collected anyway if the tax brackets were indexed to inflation as they should be if bracket creep is to be avoided, the need to offset the revenue loss beyond this amount is more difficult to justify given the country's low tax effort and large unmet demand for basic social services and basic infrastructure.

Also, some sectors have argued that there is no need for new revenue measures because the government can recover the revenue loss from the personal income tax restructuring from incremental VAT revenues that will be forthcoming as households' disposable income increases with the reduction in personal income tax liability. However, this argument is flawed. Even if the propensity to spend of all households is equal to 1 and even if 100% of the new spending is on VAT-able goods, the incremental VAT will only be equal to 12% of the revenue loss at best.

Thus, the questions that begs to be asked is: what new revenue measure or combination of measures will allow government to recover the revenue loss from the new personal income tax structure? One possibility is to increase the VAT rate. For instance, a 1 percentage point increase in the VAT rate is enough to recover approximately PhP 26.25 billion loss in revenue from other taxes, say the personal income tax. The VAT, being a consumption tax, has the advantage of being better able to tax non-wage income earners (i.e., individuals who are self-employed or who earn their income from practice of profession). This advantage is important considering the large difference in the effective personal income tax rate on wage vis non-wage income and the implied greater evasion in the non-wage income sector (**Table 8**). The proposal of the Department of Finance (DOF to amend the Bank Secrecy Law to better enable the Bureau of Internal Revenue to catch tax cheats is likewise aimed at addressing the same problem.

Table 8. Effective personal income tax rates on wage income vs. non-wage income

	2011	2012	2013	2014
Wage income a/	4.7	4.9	5.0	5.3
Income of self-employed individuals and professionals b/	1.3	1.5	1.5	1.5

a/ computed as a ratio of household compensation income gross of personal exemptions

b/ computed as a ratio of household income from net operating surplus gross of personal exemptions

Author's estimates

One of the concerns raised against recouping the revenue loss from the proposed changes in the personal income tax schedule by increasing the VAT rate relates to the regressivity of the VAT. It is conjectured that raising the VAT rate would nullify the increased purchasing power resulting from the modification in the personal income tax rate schedule, especially among the poorer segment of the population. **Table 9** shows the results of simulations done to assess the impact of simultaneously applying the personal income tax schedule under SB 716 and increasing the VAT rate by 2 percentage points on the total tax liability of individual income taxpayers from these two taxes over a wide range of taxable income. It shows that the aforementioned conjecture is true specifically for individual income taxpayers with annual taxable incomes lower than PhP 30,000 and those with taxable incomes higher than PhP 3 million.[5] [6] However, if the marginal personal income tax rate for the lowest income bracket under SB 716 were reduced to 2.5%, the combined personal income tax and VAT liability of individual income taxpayers with taxable incomes between zero and PhP 30,000 falls below what the same taxpayers would have to pay under the existing personal income tax rate and VAT regime. Moreover, the estimated incremental loss in revenue resulting from reducing the marginal personal income tax rate applicable to the lowest income bracket under SB 716 from 5% to 2.5% is only PhP 1.2 billion, an amount that is still largely recovered from the 2 percentage point VAT increase. Nonetheless, households with gross personal income less than the allowable personal exemptions will end up paying more taxes in the form of VAT if the VAT rate were to be increased from 12% to 14%.

Another way to offset the projected revenue loss from proposals to amend the personal income tax is to expand the coverage of the VAT. Still another option is to levy an excise tax on sugar-sweetened beverages. The revenue gain from this move is estimated by the DOF at about PhP 30 billion yearly.

Alternatively, government can apply an additional variable excise tax rate on petroleum products, which increases when world prices are below a given benchmark and decreases when world prices are above the benchmark. Still another possibility is to increase the road user's tax (or the motor vehicle user charge or MVUC). These two measures are also expected to have a positive impact on the environment through reduced pollution and congestion.

[5] The simulations assume that the propensity to spend is 1 and that all of the additional spending will be subject to 14% VAT.

[6] It is noted that many of the individual income taxpayers with taxable income levels below PhP 30,000 per annum are minimum wage earners and are, therefore, tax-exempt.

Table 9. Comparative personal income tax and value-added tax liability under the existing personal income tax schedule vis SB 716 + 2% VAT rate increase

Selected taxable income levels	Existing schedule	SB 716 orig	Existing incl of 12% VAT	SB 716 orig incl of 14% VAT	SB 716 adj incl of 14% VAT	SB 716 orig incl of 14% VAT Less Existing incl of addl 12% VAT	SB 716 adj incl of 14% VAT Less Existing incl of 12% VAT
	col 1	col 2	col 3	col 4	col 5	col 4 - col 3	col 5 - col 3
Tax liability(in pesos)							
9,000	450	450	1,476	1,647	1,454	171	-22
12,000	700	600	2,056	2,196	1,938	140	-118
15,000	1,000	750	2,680	2,745	2,423	65	-258
16,000	1,100	800	2,888	2,928	2,584	40	-304
17,000	1,200	850	3,096	3,111	2,746	15	-351
18,000	1,300	900	3,304	3,294	2,907	-10	-397
20,000	1,500	1,000	3,720	3,660	3,230	-60	-490
25,000	2,000	1,500	4,760	4,790	4,360	30	-400
30,000	2,500	2,000	5,800	5,920	5,490	120	-310
35,000	3,250	2,500	7,060	7,050	6,620	-10	-440
40,000	4,000	3,000	8,320	8,180	7,750	-140	-570
70,000	8,500	6,500	15,880	15,390	14,960	-490	-920
95,000	13,500	10,250	23,280	22,115	21,685	-1,165	-1,595
100,000	14,500	11,000	24,760	23,460	23,030	-1,300	-1,730
150,000	25,000	19,000	40,000	37,340	36,910	-2,660	-3,090
180,000	32,500	25,000	50,200	46,700	46,270	-3,500	-3,930
210,000	40,000	31,000	60,400	56,060	55,630	-4,340	-4,770
250,000	50,000	39,000	74,000	68,540	68,110	-5,460	-5,890
300,000	65,000	50,000	93,200	85,000	84,570	-8,200	-8,630
350,000	80,000	62,500	112,400	102,750	102,320	-9,650	-10,080
390,000	92,000	72,500	127,760	116,950	116,520	-10,810	-11,240
400,000	95,000	75,000	131,600	120,500	120,070	-11,100	-11,530
525,000	141,000	115,000	187,080	172,400	171,970	-14,680	-15,110
600,000	157,000	130,000	210,160	195,800	195,370	-14,360	-14,790
700,000	189,000	160,000	250,320	235,600	235,170	-14,720	-15,150
800,000	221,000	190,000	290,480	275,400	274,970	-15,080	-15,510
900,000	253,000	220,000	330,640	315,200	314,770	-15,440	-15,870
1,000,000	285,000	250,000	370,800	355,000	354,570	-15,800	-16,230
1,100,000	317,000	282,000	410,960	396,520	396,090	-14,440	-14,870
1,300,000	381,000	346,000	491,280	479,560	479,130	-11,720	-12,150
1,400,000	413,000	378,000	531,440	521,080	520,650	-10,360	-10,790
1,500,000	445,000	410,000	571,600	562,600	562,170	-9,000	-9,430
1,600,000	477,000	442,000	611,760	604,120	603,690	-7,640	-8,070
3,000,000	925,000	890,000	1,174,000	1,185,400	1,184,970	11,400	10,970
6,000,000	1,885,000	1,850,000	2,378,800	2,431,000	2,430,570	52,200	51,770
12,000,000	3,805,000	3,770,000	4,788,400	4,922,200	4,921,770	133,800	133,370

Author's estimates

APPENDIX TABLES

Appendix Table 1. Existing personal income tax rate schedule

For taxable income		Tax due
Not over PhP 10,000		5%
Over PhP 10,000	but not over PhP 30,000	PhP 500 + 10% of the excess over PhP 10,000
Over PhP 30,000	but not over PhP 70,000	PhP 2,500 + 15% of the excess over PhP 30,000
Over PhP 70,000	but not over PhP 140,000	PhP 8,500 + 20% of the excess over PhP 70,000
Over PhP 140,000	but not over PhP 250,000	PhP 22,500 + 25% of the excess over PhP 140,000
Over PhP 250,000	but not over PhP 500,000	PhP 50,000 + 30% of the excess over PhP 250,000
Over PhP 500,000		PhP 125,000 + 32% of the excess over PhP 500,000

Appendix Table 2. Proposed personal income tax rate schedule under Senate Bill 716 and House Bill 4829 a/

For taxable income		Tax due
Not over PhP 20,000		5%
Over PhP 20,000	but not over PhP 60,000	PhP 1,000 + 10% of the excess over PhP 20,000
Over PhP 60,000	but not over PhP 140,000	PhP 5,000 + 15% of the excess over PhP 60,000
Over PhP 140,000	but not over PhP 280,000	PhP 17,000 + 20% of the excess over PhP 140,000
Over PhP 280,000	but not over PhP 500,000	PhP 45,000 + 25% of the excess over PhP 280,000
Over PhP 500,000	but not over PhP 1,000,000	PhP 100,000 + 30% of the excess over PhP 500,000
Over PhP 1,000,000		PhP 250,000 + 32% of the excess over PhP 1,000,000

a/ Under HB 4829, the schedule shown above applies only to wage income

Appendix Table 3. Proposed personal income tax rate schedule under Senate Bill 1942

For taxable income		Tax due
Not over PhP 60,000		Exempt
Over PhP 60,000	but not over PhP 140,000	PhP 5,000 + 15% of the excess over PhP 60,000
Over PhP 140,000	but not over PhP 280,000	PhP 17,000 + 20% of the excess over PhP 140,000
Over PhP 280,000	but not over PhP 500,000	PhP 45,000 + 25% of the excess over PhP 280,000
Over PhP 500,000	but not over PhP 1,000,000	PhP 100,000 + 30% of the excess over PhP 500,000
Over PhP 1,000,000	but not over PhP 12,000,000	PhP 250,000 + 32% of the excess over PhP 1,000,000
Over PhP 12,000,000		PhP 4,000,000 + 35% of the excess over PhP 12,000,000

Appendix Table 4. Proposed personal income tax rate schedule under Senate Bill 2149

For taxable income		Tax due (Year 1 of implementation)	Tax due (Year 2 of implementation)	Tax due (Year 3 of implementation)
PhP 20,000	but not over PhP 70,000	15%	13%	10%
Over PhP 70,000	but not over PhP 200,000	PhP 10,500 + 20% of the excess over PhP 70,000	PhP 9,100 + 18% of the excess over PhP 70,000	PhP 7,000 + 15% of the excess over PhP 70,000
Over PhP 200,000	but not over PhP 500,000	PhP 36,500 + 25% of the excess over PhP 200,000	PhP 32,500 + 23% of the excess over PhP 200,000	PhP 26,500 + 20% of the excess over PhP 200,000
Over PhP 500,000	but not over PhP 1,000,000	PhP 111,500 + 30% of the excess over PhP 500,000	PhP 101,500 + 25% of the excess over PhP 500,000	PhP 86,500 + 22% of the excess over PhP 500,000
Over PhP 1,000,000	but not over PhP 1,000,000	PhP 261,500 + 32% of the excess over PhP 1,000,000	PhP 226,500 + 28% of the excess over PhP 1,000,000	PhP 196,500 + 25% of the excess over PhP 1,000,000

Appendix Table 5. Proposed personal income tax rate schedule under House Bill 5401

For taxable income		Tax due
Not over PhP 396,000		Exempt
Over PhP 396,000	but not over PhP 640,000	10% of the excess over PhP 396,000
Over PhP 640,000	but not over PhP 1,000,000	PhP 24,000 + 15% of the excess over PhP 640,000
Over PhP 1,000,000	but not over PhP 1,650,000	PhP 78,400 + 20% of the excess over PhP 1,000,000
Over PhP 1,650,000	but not over PhP 2,700,000	PhP 208,400 + 25% of the excess over PhP 1,650,000
Over PhP 2,700,000		PhP 470,900 + 30% of the excess over PhP 2,700,000

Appendix Table 6. Proposed personal income tax rate schedule under the TMAP proposal

For taxable income [a/]		Tax due
Not over PhP 300,000		Exempt
Over PhP 300,000	but not over PhP 500,000	10% of the excess over PhP 300,000
Over PhP 500,000	but not over PhP 1,000,000	PhP 20,000 + 20% of the excess over PhP 500,000
Over PhP 1,000,000	but not over PhP 2,500,000	PhP 120,000 + 25% of the excess over PhP 1,000,000
Over PhP 2,500,000		PhP 495,000 + 30% of the excess over PhP 2,500,000

[a/] Allowance for basic personal exemption and additional personal exemptions as well as the PhP 82,000 tax exempt bonus/ benefit will not be allowed under this proposal