LEGAL ALERT

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TRABAHO Bill approved as part of comprehensive tax reform package

The House of Representatives has approved on third and final reading House Bill No. 8083 or the Tax Reform for Attracting Better and High Quality Opportunities ("TRABAHO") Bill. Next to the Tax Reform for Acceleration and Inclusion ("TRAIN") law enacted at the beginning of this year, this is the second package in the Duterte Administration's comprehensive tax reform program.

The TRABAHO Bill primarily seeks to encourage investments by reducing corporate income tax rates gradually from 30% to 20% over a 10-year period (i.e. decrease of 2% for every 2 years until 2029). It also seeks to rationalise investment tax incentives to enhance fairness, improve competitiveness and attain fiscal sustainability in the long run through higher and more dispersed investments, more jobs, and better technology.

Apart from the reduced corporate income tax rates, the main features of the TRABAHO Bill include the following, among others:

1. Broader tax base by removing preferential tax rates through the following measures:
   a. The 15% Gross Income Tax ("GIT") option for corporations under certain conditions will no longer be available starting 2019.
   b. The availment of the special 10% tax rate on proprietary educational institutions and hospitals will be subject to established performance criteria to be determined by the Commission on Higher Education ("CHED"), Department of Education ("DepEd"), and Department of Health ("DOH"). Otherwise, these institutions may be subjected to a higher income tax rate at 15% or 20% depending on certain conditions.
   c. The 10% tax rate on Regional Operating Headquarters ("ROHQ") will no longer be available after 2 years from the effective date of the TRABAHO Act.
   d. The optional standard deduction for corporations will only be limited to those classified as micro, small, and medium-sized enterprises as determined by the Department of Trade and Industry ("DTI").

2. Stricter rules on transactions between related parties will be in place. The Commissioner of Internal Revenue ("CIR") will have an enhanced power to distribute or allocate gross income or deductions, as he can exercise it not only to prevent evasion of taxes but also to prevent avoidance of taxes. Moreover, if the transaction has the purpose or effect of tax avoidance, the CIR may consider such transaction as void for income tax purposes.

3. Only projects listed in the Strategic Investments Priority Plan ("SIPP") may be qualified for incentives. Every 3 years, the Board of Investments ("BOI") will formulate a SIPP for the approval of the President of the Philippines.

4. In the TRABAHO Bill, there will be one single incentives menu for income tax, customs duty and value-added tax ("VAT") covering all existing investment promotion agencies ("IPA"). At present, the incentives given to investors depend on the law creating the IPA.

5. Income Tax incentives include:
    a. Income tax holiday ("ITH") for a period not exceeding 3 years, provided that after the expiration of the ITH, the other income tax incentives may be applied for a period not exceeding 5 years, which includes the period of the ITH availment;
    b. Reduced corporate income tax rate of 18%;
    c. Depreciation allowance for qualified capital expenditure;
    d. Up to 50% additional deduction on the increment of direct labour expense;
    e. Up to 100% additional deduction on research and development expenses;
    f. Up to 100% additional deduction on training expenses;
    g. Up to 100% additional deduction on infrastructure development;
    h. Deduction for reinvestment allowance in the manufacturing industry; and
    i. Enhanced net operating loss carry-over ("NOLCO") wherein the NOLCO during the first 3 years may be carried over as a deduction within the next 5 years.

6. Customs duty incentives include an exemption from customs duty on importation of capital equipment and raw materials directly and exclusively used in the registered activity for a period not exceeding 5 years.

7. Registered export enterprises whose export sales meet the 90% threshold and are located within an economic zone, freeport, or those utilising customs bonded manufacturing warehouse may be given VAT zero-rating on export sales, or on importation or domestic purchases of capital equipment and raw materials used in the manufacture and processing of products.

8. A Fiscal Incentives Review Board is created to exercise oversight functions over IPAs.

9. The BOI shall consider the following criteria in determining the types of incentives and the duration thereof that may be granted:
    a. The project has a comprehensive sustainable development plan with clear inclusive approaches and innovations; or
    b. There is a minimum investment of USD200 million or a minimum direct employment generation of at least 1,500 within 3 years from the start of commercial operation.

10. Certain qualifications are considered for a registered enterprise to avail of tax incentives:
    a. The enterprise is engaged in an activity included in the SIPP;
    b. It has installed an adequate accounting system that shall identify the investments, revenues, costs of each registered project undertaken or establish a separate corporation for each registered project if the IPA should require it; and
    c. It complies with e-invoice and e-sales requirements of the TRABAHO Bill.

Nevertheless, government agencies have conflicting views on the consequences if the TRABAHO Bill is enacted into law. The Philippine Economic Zone Authority ("PEZA") warned that more than 50% of the existing workforce (i.e. approximately 700,000 workers particularly in the information technology, business process outsourcing and manufacturing sectors) inside the economic zones will be jobless if the government pushes for the approval of the TRABAHO Bill in its current form. On the other hand, the Department of Finance ("DOF") expects around 1.4 million jobs to be created between 2021 and 2029, should the TRABAHO Bill be enacted into law. DOF estimates show that the incremental lowering of corporate income tax rates would free up capital for firms through time in order to invest and hire more workers. This effect is particularly emphasised for small and medium enterprises that will gain more legroom to expand.

The TRABAHO Bill is expected to be enacted into law and come into effect at the beginning of 2019.

If you have any questions or require any additional information, please contact Felix Sy or Lorybeth Baldrias Serrano or the ZICO Law partner you usually deal with.

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