Taxation in financial services under TRAIN

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In 2017, Republic Act 10963 or the Tax Reform for Acceleration and Inclusion (TRAIN) Act was signed into law. It has since been subjected to blame for the steep rise in inflation and slight slowdown in economic growth.

This Policy Note revisits the implementation of the National Internal Revenue Code as amended by TRAIN. The study employs key informant interviews (KII) of representatives from the financial services sector and reviews studies of the National Tax Research Center as regards taxes imposed by other countries within the Association of Southeast Asian Nations (ASEAN).

Tax and the liberalization of trade in the financial services sector

Liberalization is not limited to opening the market or ensuring that foreign companies are on equal footing with domestic ones. Its underlying thrust is the free flow of trade, which is hindered by high transaction costs. In the financial industry, such costs are termed as friction costs because they add to the total transaction price and inhibit the smooth flow of trade and investment. In this light, taxation becomes key in liberalizing trade. However, while the Philippine government has already effected measures to lower income taxes, other taxes remain burdensome as friction costs to industry players.

With this, TRAIN taxes should be evaluated on how they affect the liberalization thrusts of the government for the various sectors of the country, particularly the financial services sector. As aptly stated by Barcenas et al. (2017), liberalized trade in financial services would allow industry and consumers access to varied, quality, and competitively priced products.

Lifting barriers in the financial sector is seen to spur economic growth more than in any other sectors under the services industry (McGuire 2002). In the case of banks, deregulation has led to the rise of highly capitalized companies offering a wide array of financial products (Margallo 2013). The Philippine capital market, meanwhile, remains underdeveloped. This is evident in the Philippine Stock Exchange, which remains relatively smaller than that of other ASEAN countries, such as Malaysia and Thailand. High transaction costs are among the challenges facing the market, particularly high broker’s fees and taxes (Abola 2016). With regard to the Philippine insurance industry, total density and penetration ratios were also lowest compared to Singapore, Thailand, Malaysia, and Indonesia in 2016.
Financial liberalization is very tricky. On one end, liberalization is necessary to increase competition and introduce the Philippine market to other financial instruments. On the other end is the need to manage risks in the system, as experience shows that banking regulation by the Bangko Sentral ng Pilipinas has insulated the industry from external shocks. Hence, a delicate balancing is needed in regulating the financial sector. This is likewise true in the case of taxation.

**Table 1. Increase in taxes affecting the banking sector under TRAIN**

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Tax Base</th>
<th>Old Rate</th>
<th>New Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest income from Foreign Currency Deposit Unit</td>
<td>Amount of interest income</td>
<td>7.50 percent</td>
<td>15 percent</td>
</tr>
<tr>
<td>Bank checks, drafts, certificates of deposits not bearing interests, and other instruments (DST)</td>
<td>Fixed amount on each document</td>
<td>PHP 1.50</td>
<td>PHP 3.00</td>
</tr>
<tr>
<td>Debt instruments (DST)</td>
<td>For every PHP 200.00 and its exceeding fraction</td>
<td>PHP 1.00</td>
<td>PHP 1.50</td>
</tr>
<tr>
<td>Bills of exchange or drafts (DST)</td>
<td>For every PHP 200.00 and its exceeding fraction</td>
<td>PHP 0.30</td>
<td>PHP 0.60</td>
</tr>
<tr>
<td>Upon acceptance of bills of exchange (DST)</td>
<td>For every PHP 200.00 and its exceeding fraction</td>
<td>PHP 0.30</td>
<td>PHP 0.60</td>
</tr>
<tr>
<td>Foreign Bills of Exchange and Letters of Credit (DST)</td>
<td>For every PHP 200.00 and its exceeding fraction</td>
<td>PHP 0.30</td>
<td>PHP 0.60</td>
</tr>
<tr>
<td>Mortgages</td>
<td>When amount secured does not exceed PHP 5,000.00</td>
<td>PHP 20.00</td>
<td>PHP 40.00</td>
</tr>
<tr>
<td></td>
<td>On each PHP 5,000 and fraction exceeding every PHP 5,000.00</td>
<td>PHP 10.00</td>
<td>PHP 20.00</td>
</tr>
</tbody>
</table>

DST = documentary stamp tax

**Taxation of financial transactions under TRAIN**

Based on the result of KIIIs, the change in rates of taxes on financial transactions has increased friction costs. In terms of wholesale investments, these taxes become crucial for investors in choosing jurisdictions to place their money or business.

**Banking**

In the banking industry alone, taxes have gone up by as much as 100 percent (Table 1). In particular, the documentary stamp tax (DST), an excise tax levied on banking documents, instruments, loan agreements, and papers, has increased across the board. Higher DST means costlier financial transactions in the country. It is charged to each transaction and increases transaction costs and is thus viewed as a friction cost which could discourage investors or inhibit the flow of trade.

**Equities**

As to equities, stocks not traded in the stock exchange are now uniformly taxed at 15 percent on capital gains. Prior to the TRAIN regime, their tax was only at 5 percent if the gain were PHP 100,000.00 or less and 10 percent if over PHP 100,000.00. Meanwhile, taxes for stocks traded in the stock exchange and not sold by a dealer have increased by 20 percent under TRAIN, from 1/2 to 6/10 of 1 percent of the gross selling price (Table 2).

**Insurance**

On insurance transactions, TRAIN prescribes various DST rates for life insurance policies as well as changed the tax base, which moved from the effective rate of 12 percent on the premium. However, it increased the effective rate for preneed plans from 0.10 percent to 0.20 percent and also doubled the DST for certificates of damages (Table 3).

**TRAIN taxes and ASEAN rates**

This study also examines the TRAIN taxes in light of the rates prescribed by other ASEAN countries. This is not a quantitative or even qualitative assessment of the new rates of taxes, but a comparison of the rates imposed by the Philippines and its ASEAN neighbors.
Banking

Only the Philippines and Thailand collect DST or its equivalent on letters of credit. The Philippines charges 0.15 percent on face value of the letter of credit (Fronteras and Rempillo 2015). Meanwhile, Thailand imposes a tax of PHP 28.00 if the value of the letter of credit is less than PHP 13,900.00, or PHP 42.00 if PHP 13,900.00 or higher (Fronteras and Rempillo 2015).

Tables 4 and 5 show comparisons of other DST rates in the Philippines against those charged by other ASEAN countries. While the DST imposed by the Philippines appears to be reasonable, its rates have significantly increased under TRAIN. It is difficult to assess the impact of these new rates on trade in financial services because checks and bill of exchange may be more relevant in the domestic sphere rather than in international trade.

<table>
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<th>Transaction</th>
<th>Tax Base</th>
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<th>New Rate</th>
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<tr>
<td>Sale of stocks not traded in the stock exchange</td>
<td>Capital gains</td>
<td>5 percent if the gain were less than or equal PHP 100,000.00 and 10 percent if the gain is over PHP 100,000.00</td>
<td>15 percent</td>
</tr>
<tr>
<td>Sale of stocks traded in the stock exchange and not sold by a dealer</td>
<td>Gross selling price or value of the shares</td>
<td>1/2 of 1 percent</td>
<td>3/5 of 1 percent</td>
</tr>
<tr>
<td>Sales, agreements to sell, memoranda of sales, and deliveries or transfers of shares or certificates of stocks</td>
<td>DST on original issue of shares of stock (stock without par value)</td>
<td>25 percent</td>
<td>50 percent</td>
</tr>
</tbody>
</table>

DST = documentary stamp tax
TRAIN = Tax Reform for Acceleration and Inclusion
Source: Author’s compilation

Equities

Brokers and traders of equities may have cause to be discouraged by the new rates of taxes imposed on the trading of shares in the stock market. As pointed out earlier, the increase is as high as 20 percent, substantial in light of the taxes imposed by other ASEAN countries. In fact, most of our ASEAN neighbors do not impose a tax on the transfer of shares (Table 6). Indonesia is one exception, but its rate is but a small fraction of what the Philippines charges.

On sales of stocks, most ASEAN countries impose DST or its equivalent (Table 7). However, given the different tax bases of the Philippines and other ASEAN countries, a cost comparison is difficult to perform. If the tax base is the par value, the comparison would be easier, as par

Table 2. Taxes affecting the sale of shares of stock under TRAIN

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Table 3. DST on insurance under TRAIN

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<th>Old Rate</th>
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</tr>
</thead>
<tbody>
<tr>
<td>Life insurance</td>
<td>Premium charged</td>
<td>PHP 0.50 for every PHP 4.00 or fraction</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Amount of insurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preneed plan</td>
<td>On each specific amount or its fraction of the total value of the plan</td>
<td>PHP 0.50 for every PHP 500 or fraction</td>
<td></td>
</tr>
<tr>
<td>Certificate of damage</td>
<td>On each certificate</td>
<td>PHP 15.00</td>
<td>PHP 30.00</td>
</tr>
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value is fixed. Meanwhile, the market value of shares may go up and down and may even be below a share’s par value.

**Insurance**

Among the subsectors of the insurance industry, nonlife insurance was identified as the one heavily taxed. In fact, a significant portion of the cost of a nonlife insurance policy constitutes taxes imposed by the Philippine government.

While this may not be a friction cost to an investor, tax contributes to the high price of their product, which may inhibit the product’s growth in the market. The cost may drive down demand for nonlife insurance and discourage the entry of investors in this particular sector. In the long run, this may have an adverse impact on the liberalization thrust of the government.

Table 8 also reveals that the value-added tax (VAT) imposed by the Philippines is 71 percent higher than what is imposed by Thailand. Meanwhile, other jurisdictions do not impose VAT on nonlife insurance products.

The KII also revealed the private sector’s difficulty in entering into the crop insurance sector. Currently, the government is heavily involved in the said sector and the benefits are being poured into public institutions, such as the Philippine Crop Insurance Corporation (PCIC). Under Presidential Decree 1467, PCIC is exempt from taxes, which means PCIC would be able to provide services at lower costs.

A survey of taxes imposed by ASEAN countries also shows that life insurance is highly promoted in some jurisdictions. Moreover, insurance companies in certain jurisdictions enjoy reduced corporate income taxes. In Cambodia, for instance, life insurance companies are taxed at 5 percent on gross premiums (Jurado and Amurao 2015). In Singapore, while life insurance companies are taxed at 17 percent on their income like any other company, the policy holder enjoys the benefit of a tax rate on income of 10 percent (Jurado and Amurao 2015).
Meanwhile, the Philippines does not differentiate life insurance companies from any other firms and imposes a tax of 30 percent on their net taxable income.

Similar to the Philippines, other ASEAN countries also impose a standard corporate income tax on life insurance companies. However, the Philippine corporate income tax rate is the highest in the ASEAN region (Pabilona and Domo 2018). This means life insurance companies in the Philippines are subject to the highest income tax in ASEAN.

### Recommendations

This study recommends a careful analysis of the imposition of taxes on financial services to prevent unintended consequences. While taxes are meant to raise funds for the government to pump prime the economy, they may also serve as discouragement to investors and businesses. These investors and businesses may turn to the Philippines’ ASEAN neighbors instead, resulting in revenue losses from annual income taxes. The threshold for participants in the market should be determined to test their preference for Philippine financial services.

In certain respects, the comments expressed by certain sectors should be validated, as with the opposition to the increase in the stock transfer tax by players in the equities market. In the KIIIs, the taxes on the sale or transfer of shares of stock were cited as one of the reasons for the decline in the volume of stocks traded daily.

The same is true for the insurance sector, where its development and promotion are dampened by the...
concomitant taxes. Nevertheless, it is hard to assess the impact of taxes on insurance vis-a-vis the rates imposed by neighboring states since insurance is not as easily traded as equities and usually remains in its situs. What could be measured is demand for insurance products and investments by insurance companies.

Even removing the aspect of competition from the Philippines’ ASEAN neighbors in attracting investments, taxation should still be assessed in terms of improving the Philippine tax system. One aspect of which is the need to broaden the tax base (Pabilona and Domo 2018). If investors and businesses find taxes on transactions as burdensome costs and shun the Philippines for friendlier jurisdictions, then the tax base would not widen.

Tax rates under TRAIN have significantly increased. Such increases, particularly on DST, may be acceptable in single transactions. However, from the business standpoint, the cost of completing a transaction or delivering their service has already doubled. In wholesale investments, the increased costs accumulate, which may in turn reduce interest in the Philippines. In this regard, data on these sectors should be reviewed as soon as they become available.

In conclusion, what is apparent at the moment is that the increased taxes on the sale of equities contributed to the decline in the volume of trade. With ecommerce facilitating the transfer of funds in other markets, the effect on the Philippine equities market is immediately felt.

Meanwhile, on insurance, the taxes have increased the prices of insurance products. Whether such increases affected trade or entry into the Philippines, the data should be reviewed once they are consolidated. ☞

References