***Haggling for a handful of vegetables*: with very limited budget for food, housewives have to make the most painful choices at the vegetable stand.**

The Extremely Vicious, Atrocious, Tyrannical E-VAT

■ By **Roel A. Andag***

THE controversial Expanded-Value-Added Tax (E-VAT) Act of 2005, which President Gloria Macapagal-Arroyo signed into law, will torment the poor. But the president looks at it the opposite way. Calling it "the capstone" of her administration's fiscal reform program, she hopes that the tax measure will address the fiscal crisis. To a lot of Filipinos, however, E-VAT is the *eject button* that could expel the President into ignominy.

Strategic Forecasting, a Texas, USA-based think tank that predicted Estrada's ouster, sees the E-VAT as a likely cause of President Arroyo's expulsion from Malacañang. The Supreme Court had saved the presidency when it issued a Temporary Restraining Order on 1 July 2005 – E-VAT's first day of implementation—in effect, securing the presidential *eject button* from being pushed.

A grumbling stomach and spiraling prices of food items are not the best of companions.

Crisis mode

It was in August 2004 when 11 professors at the University of the Philippines School of Economics confirmed a lingering suspicion – that the country is in fiscal crisis, as demonstrated by the ballooning government budget deficit. The two major causes: 1) declining revenues because of flaws in the tax structure, bureaucratic corruption, and tax evasion, and 2) huge losses incurred by government-managed corporations and the national government's policy of assuming their debts.

President Arroyo quickly admitted the findings of the 11 UP professors as true and implemented their recommendations, including the creation of new taxes and raising the levels of existing ones. Like a mantra, the president repeatedly declared that annual revenues and savings of PhP180 billion are needed to contain the budget deficit. Of the total amount, PhP80 billion will come from eight tax measures and PhP100 billion from administrative measures. So far, Congress has passed three of the eight tax measures: the Sin Taxes on Alcohol and Tobacco, the Lateral Attrition Law, and E-VAT Act of 2005.

Mother of all taxes

President Arroyo signed into law on May 24, 2005 Republic Act 9337, which among others:

THE Supreme Court upheld the constitutionality of the expanded value-added tax law in its decision on September 1.

But the high court ruling has not lifted the Temporary Restraining Order (TRO) it issued on July 1 against E-VAT implementation.

The TRO will be forfeited as soon as the court rules on any motion for reconsideration that might be filed by any of the petitioners or if they fail to appeal within 15 days upon receipt of the SC decision.

The Supreme Court halted E-VAT collection on July 1, its first day of implementation, upon the petition of opposition lawmakers.

The petitioners alleged that the E-VAT law was unconstitutional because it allowed the president to raise taxes, a power exclusive only to Congress.

"Budget meals" that can be grabbed from any fast-food outlet are way beyond the budget of most Filipinos.

• Retains the original VAT at 10 percent but gives the President a standby authority to raise it to 12 percent on January 1, 2006 if requisite conditions are met;

• Raises corporate tax from 32 percent to 35 percent until December 31, 2008, to be reduced to 30 percent thereafter;

• Limits input VAT at 70 percent during a transitory period spanning July-December 2005;

• Lifts exemptions of electricity and petroleum products like gasoline and diesel; and

• Repeals the income tax exemption of PAGCOR, doctors, artists and lawyers.

E-VAT is called "mother of all taxes" because of its enormous revenue generation potential. The Department of Finance (DOF) calculates that this year alone, the cancellation of exemptions will rake in anywhere from P28 billion to P35 billion – already constituting 44 percent of the PhP80 billion that Malacañang wants to collect annually through eight tax measures. If President Arroyo uses her standby authority next year, E-VAT will generate P105 billion in 2006 alone. Government intends to use 70 percent of E-VAT proceeds to address the deficit, while the rest will go to budgetary support.

With this development, the Philippines is expected to finally experience a balanced budget in 2010 or, by DOF's reckoning, in 2008. Government posted a deficit of P187 billion in 2004, but expects to narrow the budget chasm with the help of E-VAT to P160 billion this year and to P100 billion in 2006. As a magical, albeit bitter, pill, E-VAT will rescue a country that has been experiencing budget deficits for 11 of the last 15 years.

By President Arroyo's admission, the 12 percent VAT is a bitter pill. And that pill costs a family a monthly additional expense of anything between P65.22 (DOF estimate) to P123.90 (Bayan Muna computation).

Days before July 1, 2005 – R.A. 9337's opening salvo – the DOF put out a full-page newspaper advertisement glorifying E-VAT. In it, DOF reported that 86 percent of government revenues get spent on debt servicing. DOF also enumerated E-VAT exemptions: rice, fresh vegetables, meat and fish; books, newspapers and magazines; purchase of low-cost housing, rent for a house below P10,000; and goods sold by merchants whose annual income do not exceed P1.5 million. Displayed successively for several days in major newspapers, the advertisement was clearly an appeal for public support to make it hurdle its introduction as a full-blown policy.

VAT's wrong with that?

By President Arroyo's admission, the 12 percent VAT is a bitter pill. And that pill costs a family a monthly additional expense of anything between P65.22 (DOF estimate) to P123.90 (Bayan Muna computation). It obliterates the recent P25-increase that raised the daily minimum wage to P275. Ibon calculated that in May 2005 the daily cost of living for a family of six living in the National Capital Region stood at P618. A family with a sole breadwinner will have to literally pinch every penny.

Even prior to the 12 percent VAT, prices of electricity and fuel – now VAT-covered – will have been hiked starting July 1 this year. Being major manufacturing inputs, rising prices of electricity and gasoline will impact on the prices of basic commodities. Estimates put fuel price increases to as high as 22 percent. Even pre-R.A. 9337, a P2-increase in the minimum fare of jeepneys had already been imposed to cope with rising oil prices in the world market.

Government asserts that high-end consumers will feel VAT's impact more because it is a consumption-based tax. It ignores, however, the fact that the rich has the ability to pay. The shrinking income of a poor family forces it to slash further its survival-level spending on food, health care and utilities.

Electrocution by taxation

Electricity in the country is already expensive because of purchasing power adjustment or PPA – the result of onerous contracts between government and independent power producers – that bloats power rates. Covering electricity under VAT worsens the situation.

Both versions of the House and Senate VAT bills contained a "no pass-through" provision that would have prevented electric companies from charging the 10 percent VAT on consumers. The provision, however, got deleted during the bicameral conferences. Quoted by a newspaper, Congressman Jesli Lapus, who headed the House panel in the bicameral committee, explained the deletion by saying that "the bicameral conferees doubted that electric and oil companies can really be compelled to pay the VAT" – an admission of government's fundamental lack of political will in implementing laws.

The 199-member Associa-tion of Philippine Electric

Cooperatives says that an average household serviced by electric cooperatives pays P4-P8.59 for every kilowatt-hour. A 10-12 percent VAT will raise it to P9.45/kwh. Charging the second-highest electricity rates in Asia next to Japan, E-VAT steals money from consumers while chasing away investors.

Corporate squeeze

Objections of the business sector go beyond the 35 percent business tax. Where the old VAT law allowed firms to avail of 100 percent input tax credit, Section 8 of R.A. 9337 caps that privilege at 70 percent during a transitory period spanning July-December 2005. Full availment of input tax credits will be restored thereafter. Input tax is the accumulated amount of VAT that a VAT-registered firm pays VAT-registered suppliers when purchasing goods or services that are priced inclusive of the 10 percent VAT. Input tax credits are deducted from the firm's gross tax liability or output VAT.

Business groups aver that the input tax cap would bloat the cost of doing business. To offset this cost, businesses will be forced to raise prices. Some may even be constrained to close shop altogether, thus worsening unemployment. They say the input tax cap encourages tax evasion as it drives manufacturers to resort to the informal sector where tax laws do not apply. The business lobby clamored that 90 percent is a more acceptable compromise. It has been reported that drafters of R.A. 9337's Implementing Rules and Regulations (IRR) obligingly found a way to retain 100 percent input credit contrary to the law.

Unhappy New Year

Nowhere has the new law demonstrated its contentiousness more intensely than in the bicameral committee where differences in legislative bills are ironed out to produce a unified result. The primary contention was that the bill authored by the Lower House wanted VAT's outright increase to 12 percent while the one endorsed by the Senate proposed the retention of the 10 percent VAT in conjunction with the cancellation of exemptions. Malacañang favored the House version. Insistent on each of their versions, the Lower House and Senate contingencies deadlocked.

Government warned that the stalemate was making investors jittery. Basing on E-VAT's computed potential annual revenue intake, the DOF quantified the anxiety: the delay in the enactment was costing government some P167 million to P222 million in lost daily revenues.

To break the impasse, Senator Ralph Recto suggested granting President Arroyo a standby authority to raise VAT from 10 percent to 12 percent by January 1, 2006, if either of these conditions is met: (a) if VAT collections exceed 2.8 percent of the gross domestic product (GDP) of the previous year, or (b) if the budget deficit exceeds 1.5 percent of GDP of the previous year. The proposal is now law. Probability of 'compliance' with precondition (b) appears very high.

Despite initial preference for the automatic 12 percent E-VAT, the Recto solution nonetheless filled President Arroyo with glee, prompting her to announce shortly after the ratification of R.A. 9337 that she will exercise the standby authority "with prudence and decisiveness." But the opposition raised to the Supreme Court the question on the constitutionality of such authority as it allegedly usurps Congress' power to modify tax rates. The 1987 Constitution empowers the President to modify only tariff rates, export and import quotas, and other duties.

President Arroyo's standby authority is curtailed until the High Court makes a ruling. If said power is cleared of legal infirmities, the fireworks of New Year '06 will signal gloom.

Spiraling prices of basic food items endanger the Filipinos' right to food.
PJR/LITO OCAMPO

Free fall

BIR defines VAT as "an indirect tax that can be passed on to the buyer." Thus, the same product increases its price by 10 percent (and soon 12 percent) every time it is sold and resold. No matter if no value was added to the product by any of the resellers. Being indirect in nature, VAT is shifted from buyer to buyer, making the end-user ultimately pay for all the accumulated VAT and markups that occurred at every transaction. For instance, A sells for P100 (VAT-inclusive) plus markup, a ream of paper to B. B sells the paper to C at P110 (accumulated VAT-inclusive) plus markup. C sells it to D, the end user, at P121 (accumulated VAT-inclusive) plus accumulated markups. A, B and C each compensates for their respective VAT costs through a recovery mechanism called input tax. The end-user bears the burden of all the tax incidences and markups along the chain.

The Association of Philippine Electric Cooperatives calls VAT a "triple tax whammy" as each of the three components of the power industry – generation, transmission, and distribution – will each charge 10 percent VAT. Ultimately, a consumer will be paying 30 percent.

The poor are precariously suspended in this VAT trapeze. Anticipating their inevitable fall, government has insisted that there are 'safety nets' being spread underneath to soften the crash. But the nets are not yet in place. At best, they are mere filaments whose interweaves are still being studied. 'Safety nets' to be implemented are: reduction of duties on petroleum products and removal of duties for liquefied petroleum gas and diesel; rigorous implementation and perhaps expansion of lifeline rates – discounts given to those consuming 100 kwh or less electricity per month; penalty for those who take undue advantage of R.A. 9337 and the rising oil prices in the world market; promotion of energy conservation; monitoring of pump prices and crackdown on smuggling of petroleum products.

In the end, as Congressman and presidential economic adviser Joey Sarte Salceda puts it, the VAT affliction can be "cured by progressive public expenditures on health and education and more efficiently targeted at the poor." He concedes that VAT will hurt the poor but reasons out that a fiscal crisis will hurt them more.

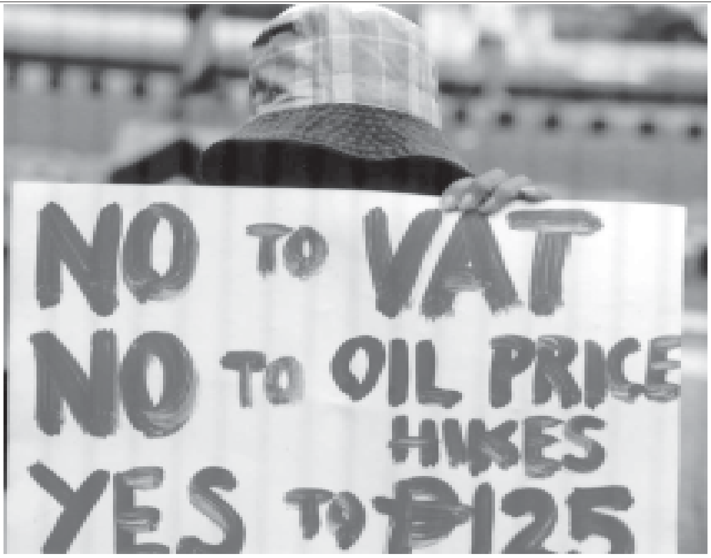
It remains to be seen if these assurances will be able to absorb VAT's inflationary impact once the law is fully implemented.

IneVATable?

Is the mother of all taxes really the ultimate choice? No. There are other options that are more publicly palatable and powerful when fully implemented.

1. Improve tax efficiency. VAT collection efficiency is estimated at 70 percent, meaning 30 percent slips through government's porous tax dragnet. The National Tax Research Center says that government lost an average of P30.7 billion annually from 1999-2002. For the period, average potential annual VAT collection was P111 billion, but actual collection averaged at only P80 billion. Underdeclaration and excessive claims of input VAT credits caused this persistent hemorrhage. The DOF says government lost P144 billion from VAT leakages in 2003 alone. Government collected only P135 billion from the expected P279 billion. The BIR admits that in 2004, only 39,833 out of 451,309 companies paid corporate income taxes totaling P100.8 billion.

2. Institutionalize tax education. The BIR is now employing a name-and-shame gimmick that has so far entrapped delinquent celebrities in its early stages. It is laudable that BIR is embarking on an aggressive tax education campaign – done way before R.A. 9337 – starting with actors and actresses. With voluntary compliance accounting for 98 percent of tax collections and only 2 percent from audit activity, it pays to help taxpayers demystify the nuances of taxation. Again, R.A. 9337 would have been unnecessary if this was done



A minimum-wage earner's wish list. PJR/LITO OCAMPO

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earlier. R.A. 9337 allocates P15 million for the BIR's public information and education program.

3. Curb tax corruption. Aside from pocketing tax monies collected, some collectors have been reported to accept bribes from tax evaders. BIR and DTI should also strictly monitor the issuance of receipts by companies and professionals. In a national pre-R.A. 9337 survey, the Social Weather Station (SWS) found out that most respondents said they would favor additional taxes as long as government uses the proceeds efficiently and addresses corruption effectively. With corruption devouring up to 20 percent of the country's annual national budget, it is difficult to convince taxpayers that their taxes will indeed redound to better roads and bridges, better-equipped public schools and hospitals, and more efficient government services. As a disincentive to compliance, corruption instead encourages taxpayers to resort to tax evasion and avoidance.

4. Slash pork barrel. The UP 11 estimates that halving pork barrel allocations could have led to annual savings of P10.7 billion. Scrap the corruption-laden discretionary fund altogether and the country gets double that amount. But only a leader with a spine of steel will hazard a resultant political isolation.

5. Rationalize salaries of GOCC officials and employees. Being exempted from the Salary Standardization Law, officials and employees of government-owned and -controlled corporations (GOCCs) receive astronomical salaries. Government Service Insurance System President Winston Garcia used to receive P200,000 per month before he volunteered to have it cut. Garcia's total annual salary could easily finance the construction of at least four classrooms. A lot of savings will be realized if the salaries and benefits of officials and employees of the existing 1,126 GOCCs and their subsidiaries are kept on a par with what other government employees receive. Losing GOCCs should also be abolished to avoid further indebtedness.

Add to these the potential administrative savings to be realized from curing government's debt reflex and through calibrated liposuctions that will siphon bureaucratic fat and transform government from an obese and lethargic monster to a lean and responsive organism.

The hero of July

People woke up to a rude surprise on July 1, 2005. Increased toll rates, airfare and fuel prices sarcastically greeted the transport industry and the riding public. The Supreme Court saved the day when, acting on a petition filed by the opposition to question the constitutionality of President Arroyo's standby authority, voted 13-2 in issuing a temporary restraining order (TRO) to stop E-VAT implementation until all legal issues hounding the law are settled. The E-VAT train was derailed even before it could warm up its engine, on the day of its maiden trip no less.

Forecasting monthly revenue losses of P4 million to P5 million due to the TRO, the administration reflexively served notice that the Solicitor General will file a motion for reconsideration.

To President Arroyo, the TRO has two sides: on the one hand, it is a major setback on her economic agenda. On the other hand, it is a political lifeline that temporarily holds back public disenchantment. Confronted with mounting political seismic waves that can yank her out of the presidential palace, the President's priority is to ensure her personal political survival than to ensure national economic sustenance.

It is becoming clearer that the poor are not the only ones destined to fall into the E-VAT abyss. Pres. Arroyo may even go down first as Stratfor prophesied. It boldly predicts that by becoming a protest centerpiece, E-VAT will ignite an organized widespread indignation that the *juetenggate* and *Gloriagate* scandals failed to bring about.

The Supreme Court ruling may worsen the fiscal crisis but it definitely saves President Arroyo's political career. At least for now. The posturing of the administration that it will question the wisdom of the High Court may be choreographed bravado at this point. The TRO is manna from on high.

Footnotes

* The author is the Program Director for Advocacy, Research & Communications of the National Secretariat for Social Action-Justice & Peace.