



Insight Briefing:

**Philippine Legislation in the Pipeline:
Can They "De-contract" the Economy?**

13 June 2020

Analysts predict that the Philippine economy may contract by as high as 9% in the second quarter of 2020. The country's financial managers and some policymakers are asking that Congress prioritize some key bills -- the *Corporate Recovery and Tax Incentives for Enterprises Act (CREATE)*, the *Digital Economy Taxation Act*, and *An Act Ensuring Philippine Financial Industry Resiliency Against the COVID-19 Pandemic* – in the hope that these measures can address the impact of the pandemic on business and the economy.

This briefing notes the status and highlights of these bills, as well as a look at a COVID relief measure for small and medium enterprises.

- A. [Corporate Recovery and Tax Incentives for Enterprises Act \(CREATE\)](#)¹
- B. [Digital Economy Taxation Act of 2020](#)²
- C. [Financial Institutions Strategic Transfer Act](#)³
- D. [Aid to Micro, Small, and Medium Enterprises](#)

¹ House Bill No. 4157 (http://www.congress.gov.ph/legisdocs/third_18/HBT4157.pdf; last accessed on June 12, 2020, 4 PM) was approved by the House of Representatives on September 13, 2019 and was transmitted on September 16, 2019 to the Senate. Senate Bill No. 1357 (<https://www.senate.gov.ph/lisdata/3236229216l.pdf>; last accessed on June 12, 2020, 4 PM), as of February 18, 2020, is “[p]ending Second Reading, Special Order.”

² House Bill No. 6765 (http://www.congress.gov.ph/legisdocs/basic_18/HB06765.pdf; last accessed on June 12, 2020, 4 PM), as of May 20, 2020, is “[p]ending with the Committee on Ways and Means.”

³ House Bill No. 6816 (http://www.congress.gov.ph/legisdocs/third_18/HBT6816.pdf; last accessed on June 12, 2020, 4 PM) was approved on June 2, 2020 by the House of Representatives on third and final reading, and was transmitted on June 3, 2020 to the Senate.

A. Can CREATE Create New Jobs, New Business, More Opportunities?

In response to the COVID-19 pandemic and as part of government's economic recovery program, the *Corporate Income Tax and Incentives Reform Act* (CITIRA) passed by the House of Representatives in September 2019 was repurposed into the *Corporate Recovery and Tax Incentives for Enterprises Act* (CREATE) in an effort to make it more relevant and responsive to the needs of businesses for the current situation. CREATE is now pending with the Senate Ways and Means committee as a substitute bill.

CREATE introduces the following changes to CITIRA:

1. an outright five percent (5%) reduction in the corporate income tax (CIT) rate starting July 2020, and a one percent (1%) point reduction from 2023 until the CIT rate reaches 20% in 2027 (The CITIRA proposed a gradual reduction of only one percent (1%) over 10 years starting in 2020 until 2029.);
2. an extension of the applicability of the net operating loss carryover (NOLCO) for losses incurred in 2020 by non-large taxpayers, from the current three (3) to five (5) years (The CITIRA did not amend the NOLCO provision.);
3. a lengthened maximum sunset period for registered business activities enjoying the 5% gross income earned (GIE) incentive under special laws, from two (2) to seven (7) years in the previous version, to four (4) to nine (9) years (The CITIRA had a shorter maximum sunset period.); and
4. a more flexible mechanism in granting fiscal and non-fiscal incentives by giving the President the power to grant "beefier" tax and non-tax incentives for investments, upon recommendation by the Fiscal Incentives Review Board. (The CITIRA did not provide such power to the President.)

Proponents hope that the redesigned CITIRA, now CREATE, will help revive the Philippine economy post-pandemic.

However, even as CREATE's 5% CIT reduction and other improved set of tax incentives are designed to stimulate the economy, they can also be revenue-eroding measures. Tax revenues foregone from the 5% percent point cut in CIT alone are estimated to be at P42 billion in 2020 and P625 billion more over the next five years. Given the significant amount of lost revenues by way of tax, the government is likely to turn to new sources to tax as it waits for tax reductions and incentive-giving to result in new investments and the building up of business.

B. Taxing the Digital Economy

With CREATE having a tax reduction effect, there is definitely interest in making up revenue loss in some way. On May 19, 2020, Representative Jose Maria Salceda filed House Bill (HB) No. 6765, dubbed as the "*Digital Economy Taxation Act of 2020*" or DETA, to help raise funds needed by the government for its COVID-19 response. HB No. 6765 has been pending with the Committee on Ways and Means since its filing, while the Department of Finance studies the said digital tax reform.

According to its proponents, DETA is estimated to generate P29.1 billion annually in incremental revenues by specifically subjecting to income tax and value-added tax (VAT) both local and cross-border digital transactions. DETA amends the following provisions of the Tax Code:

1. Section 57 (on withholding of tax at source), by making a “network orchestrator” -- a person who creates a network of accredited service providers and service consumers and acts as an intermediary -- a withholding tax agent of the income of its service providers;
2. Sections 105 and 108, by imposing VAT on services rendered electronically in the ordinary course of trade or business, such as digital advertising services, subscription-based services, and any other supply of services that can be delivered through an information infrastructure such as the Internet, either by a resident or nonresident person; and
3. Section 114 (on withholding of VAT). by making a network orchestrator or an electronic commerce platform a withholding agent of the VAT imposed in (2) above.

If DETA is passed, “network orchestrators” will be constituted as withholding agents and mandated to withhold income tax and VAT, as applicable, on fees earned by its accredited services providers.

Further, while the DETA did not amend the situs rules of the Tax Code, it requires nonresident network orchestrators or electronic commerce platforms, and nonresident suppliers of digital services, to be “domiciled” in the Philippines. They are allowed to render digital services in the Philippines only through a resident representative office or agent, presumably to make them easier to tax. This triggers legal issues outside of tax -- for example, would this result in nonresidents not just being made subject to this tax regime, but to other local laws, including those on nationality restrictions and on licensing? Such a result may make cross-border digital transactions untenable. Even as policymakers seek new streams of tax revenue, the idea is to keep the source of that revenue robust; creating regulatory uncertainty as a by-product of the proposed tax measure may have the opposite effect.

C. Banking on the Financial Institutions Strategic Transfer (FIST) Act

House Bill No. 6816, or “*An Act Ensuring Philippine Financial Industry Resiliency Against the COVID-19 Pandemic*,” seeks to assist banks and financial institutions (FIs) deal with the adverse effects of the COVID-19 pandemic by providing a legal framework for the full transfer of their bad loans and assets, allowing them to clean their books and re-channeling their resources to improve liquidity in the financial system.

The main mechanism under the bill is to allow for the establishment of special purpose corporations, known as Financial Institutions Strategic Transfer Corporations (FISTC), and the proposed law then provides tax and other incentives for the transfer of non-performing assets (NPAs) to and from these FISTCs.

The bill intends to repeal the *Special Purpose Vehicle Act of 2002*⁴ (SPV Act). The SPV Act was passed to help banks dispose of their NPAs in the aftermath of the Asian financial crisis by providing a legal framework for this purpose and granting fiscal incentives. However, banks have stopped setting up SPVs under the SPV Act because transactions are no longer entitled to incentives. The law provides limited periods for transfers to or by SPVs to qualify for incentives and these periods have now expired. The proposed measure is essentially the same as the SPV Act in terms of the creation and powers of the special purpose company, the conditions for the disposition of NPAs, and the incentives given at the various stages of the contemplated transactions. SPVs created under the SPV Act may avail of the incentives granted under the proposed law, subject to certain requirements.

The salient features of the proposed FIST Act include the following:

1. A FISTC must be a stock corporation with the power to invest in, or acquire NPAs of FIs and to engage third parties to manage, operate, collect and dispose of NPAs acquired from FIs, among other powers. It must be established within 24 months from the effectiveness of the regulations implementing the law or the applicable revenue regulations, whichever comes later. This period can be extended for another 24 months.
2. The transfer of NPAs from an FI to an FISTC, and from an FISTC to a third party, or a dation in payment by the borrower or by a third party in favor of an FI or an FISTC, is exempt from the following taxes, when applicable: (a) documentary stamp tax; (b) capital gains tax on the sale of certain capital assets, or creditable withholding tax on the income from the sale of ordinary assets; and (c) VAT.

These transfers are also subject to reduced fees on the following: (a) registration and transfer fees on the transfer of real estate mortgage and security interest to and from the FISTC; (b) filing fees for any foreclosure initiated by the FISTC in relation to any NPA acquired from an FI; and (c) land registration fees.

The incentives are time bound. For example, transfers of NPAs from FIs to an FISTC must be done within two years from effectiveness of the implementing regulations or the revenue regulations, whichever comes later, while transfers from a FISTC to third parties are given a five-year window from the acquisition of NPAs to dispose of the same with incentives. These periods may be extended for the same number of years.

3. The bill also gives tax exemptions and privileges to FISTCs, including exemption from income tax, documentary stamp tax, and mortgage registration fees on certain new loans. FISTCs are also exempt from documentary stamp tax in case of capital infusion to a borrower with non-performing loans.

As the bill mirrors the provisions of the SPV Act, it remains to be seen if this measure will be more effective than its predecessor in addressing the problems of the financial sector with non-performing assets. One provision of the bill that may provide relief to FIs and FISTCs is the prohibition on injunctive reliefs against certain transfers of assets involving FISTCs and participating FIs. This provision was not in the SPV Act.

⁴ Republic Act No. 9182.

Another factor that favors this new measure is that it will operate under a different insolvency regime, the *Financial Rehabilitation and Insolvency Act*, which allows more options for, and expedites, the rehabilitation of distressed companies. The SPV Act operated under the Insolvency Act, an archaic legal framework that was passed in 1909. The bill clarifies that non-Philippine nationals can participate in the foreclosure sale of real properties and possess the same for five years.

Similar to the SPV Act, the period to establish a FISTC and the incentives provided under the bill remain time-bound. FIs may see this as a negative feature of the law, given the slow judicial processes in the country and the various approval and regulatory requirements to set up and operate a FISTC and to transfer assets.

D. In the Meantime: Aid to Micro, Small, and Medium Enterprises

The government has put in place measures to aid micro, small and medium enterprises (MSMEs) in addressing the economic impact of COVID-19.

1. Under *Republic Act No. 11469*,⁵ or the *Bayanihan to Heal as One Act* (Bayanihan Act), MSMEs have been granted mandatory grace periods on the payment of loans falling due within the enhanced community quarantine (ECQ) period.⁶ In particular, the implementing rules of the Bayanihan Act provide that covered institutions shall not apply interest on interests, fees, and charges during the 30-day grace period to the future payments or amortizations of MSMEs.⁷
2. Under Memorandum Circular No. 20-12⁸ dated April 4, 2020 issued by the Department of Trade and Industry (DTI), MSMEs that temporarily ceased operations during the ECQ period have been given a minimum 30-day grace period on the payment of rent, without any interest, penalties, fees and charges.⁹ The benefit of the grace period was extended by the DTI to businesses that are not permitted to operate during ECQ, modified ECQ (MECQ) and general community quarantine (GCQ).¹⁰ The DTI also clarified that the mandatory grace period applies to rentals that became due during ECQ, MECQ and GCQ.¹¹

⁵ https://www.officialgazette.gov.ph/2020/03/24/republic-act-no-11469/#_blank; last accessed on June 13, 1 PM.

⁶ Republic Act No. 11469, Section 4(aa).

⁷ Implementing Rules and Regulations of Republic Act No. 11469, Section 3.02.

⁸ https://dtiwebfiles.s3-ap-southeast-1.amazonaws.com/COVID19Resources/COVID-19+Advisories/040420_MC2012.pdf; last accessed on June 13, 12:30 PM.

⁹ DTI Memorandum Circular No. 20-12 dated April 4, 2020, Section 3.2.

¹⁰ See DTI Memorandum Circular No. 20-29 dated June 2, 2020 (https://dtiwebfiles.s3-ap-southeast-1.amazonaws.com/COVID19Resources/COVID-19+Advisories/020620_MC2029.pdf); last accessed on June 13, 12:30 PM).

¹¹ See DTI Memorandum Circular No. 20-31 dated June 4, 2020 (https://dtiwebfiles.s3-ap-southeast-1.amazonaws.com/COVID19Resources/COVID-19+Advisories/060620_MC2031.pdf); last accessed on June 13, 12:30 PM.)

3. The government intends set up a PHP 1 billion Enterprise Rehabilitation Financing (ERF) Facility under the *Pondo sa Pagbabago at Pag-asenso (P3)*¹² for MSMEs, which shall be implemented after the community quarantine is lifted.¹³ Specifically --
 - a. The ERF loan fund will be available for micro and small enterprises with at least one year of continuous operation prior to March 2020, and whose businesses suffered drastic reduction in sales.
 - b. The loan amount will depend on an enterprise's asset size. An enterprise with an asset size of (i) not more than PHP 3 million will be allowed to borrow between PHP10,000 to PHP200,000, and (ii) not more than PHP 10 million will be allowed to borrow up to PHP500,000.
 - c. The loan shall be used to help stabilize or recover from losses, such as (i) updating loan amortizations of the business, (ii) inventory replacement for perishable stocks damaged, or (iii) restarting the business through a working capital replacement.
 - d. The interest rate shall be at 0.5% per month (discounted basis), with grace periods for payments until the economic crisis has abated.¹⁴
 - e. The ERF shall be run by the Small Business Corporation (SBC), which is a government financial institution under the DTI. The SBC was created through the *Magna Carta for MSMEs*¹⁵ and is primarily responsible for the implementation of comprehensive policies to aid MSMEs in all areas, including finance and information services, training and marketing.¹⁶

For more information about the matters covered by this briefing, please contact any the following:

Carina C. Laforteza
Partner
Head of the Tax Department
cclaforteza@syciplaw.com

Vicente D. Gerochi IV
Partner
Head of the Banking, Finance and Securities Department
vdgerochi@syciplaw.com

John Christian Joy C. Regalado
Partner
jcaregalado@syciplaw.com

Ma. Patricia B. Paz
Partner
mpbpaz@syciplaw.com

¹² P3 is a loan program wherein enterprises with an asset size not exceeding PHP 3 million may avail of loans without any service charge and with an interest of not exceeding 1.5% per annum;

<https://www.sbgfc.org.ph/programs-and-services/p3-program>; last accessed May 1, 2020, 8:26 PM

¹³ SB Corporation Opens P1B Loan Facility for MSMEs Affected by COVID 19;
<https://www.sbgfc.org.ph/news/sb-corporation-opens-p1b-loan-facility-msmes-affected-covid-19>; last accessed on April 30, 2020, 10:38 AM.

¹⁴ SB Corporation Opens P1B Loan Facility for MSMEs Affected by COVID 19;
<https://www.sbgfc.org.ph/news/sb-corporation-opens-p1b-loan-facility-msmes-affected-covid-19>; last accessed on April 30, 2020, 10:38 AM.

¹⁵ <https://www.officialgazette.gov.ph/2008/05/23/republic-act-no-9501/>; last accessed on June 13, 1 PM.

¹⁶ Magna Carta for MSMEs, Section 11.

Other bulletins and briefings

We have prepared COVID-19 related bulletins and briefings. The links to those materials are [here](#).

Please note that there are other issuances which are not covered by our bulletins and briefings. For more information about other regulations, please contact your account partner or sshg@syciplaw.com; info@syciplaw.com.

This briefing contains a summary of the legal issuances discussed above. It was prepared by SyCip Salazar Hernandez & Gatmaitan (SyCipLaw) to update its clients about recent legal developments.

This briefing is only a guide material and is circulated for information purposes only. SyCipLaw assumes no responsibility for the accuracy, completeness or timeliness of any information provided in this briefing. It does not constitute legal advice of SyCipLaw or establish any attorney-client relationship between SyCipLaw and the reader. It is not a substitute for legal counsel. Online readers should not act upon the information in this briefing without seeking professional counsel. For more specific, comprehensive and up-to-date information, or for help regarding particular factual situations, please seek the opinion of legal counsel licensed in your jurisdiction.

SyCipLaw may periodically add, change, improve or update the information in this briefing without notice.

Please check the official version of the issuances discussed in this briefing. There may be other relevant legal issuances not mentioned in this briefing, or there may be amendments or supplements to the legal issuances discussed here which are published after the circulation of this briefing.

No portion of this briefing may be emailed, forwarded, reposted, copied in different electronic devices, copied or posted online in any platform, copied or reproduced in books, pamphlets, outlines or notes, whether printed, mimeographed or typewritten, or copied in any other form, without the prior written consent of SyCipLaw.

SyCip Salazar Hernandez & Gatmaitan

SyCipLaw Center, 105 Paseo de Roxas
Makati City 1226, The Philippines
t: +632 8982 3500; +632 8982 3600; +632 8982 3700
f: +632 8817 3145; +632 8817 3896
e: sshg@syciplaw.com
www.syciplaw.com