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TAX LAW FOR BUSINESS

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The proposed federal tax system and the problem of tax overlapping

A draft Constitution was submitted to the President on July 9, 2018, by the Consultative Committee constituted to review the 1987 Constitution. The main aim of the draft Constitution is to change the country's political system, from unitary to federal. This draft was approved by the President on July 10, 2018, and has since then been endorsed to Congress. Though the said draft still needs to go through other processes before approval, it gives us a glimpse of the tax system to be employed under the proposed federal system of government.

Under our current system of government, the power of taxation is exercised by the national government through Congress. Though local government units have the power to tax, such power is merely a delegated power to be exercised within the limitations imposed by law. This system follows the principle of preemption or exclusion, which means that local governments cannot impose a tax that is already levied by the national government. On the other hand, in a federal system, the power of taxation rests in the three levels of government, i.e., the federal, the state and the local governments. This means that each level of government can impose the same tax on the same taxpayer unless otherwise limited by the Constitution.

Taxation in a federal system presents a common pool problem. As the federal, state and local governments share the same tax base, the result can be overtaxation, analogous to overfishing in a shared body of water. Added to this is the problem of compliance: taxpayers will now have to go through various levels of regulations just to pay taxes. This results to overlap among the three

levels of government. To illustrate, in the United States, income tax is imposed by the federal, the state and local governments, and sales tax is imposed by the state government and, if delegated, the local governments. On this point, we ask: Does the draft Constitution address this foreseeable dilemma?

Under the draft Constitution, the envisioned “Federal Republic of the Philippines” shall consist of 18 federated regions. If there is no allocation of taxing power, then the proposed Federal Government, the proposed federated regions and the several local government units under the federated regions can impose similar taxes on the same taxpayer. To resolve this, the draft Constitution clearly delineates the power to tax between the proposed federal government and the federated regions. The draft Constitution gives the federal government the power to levy and collect all taxes, duties, fees and charges, except the power to tax granted to the Federated Regions. The draft Constitution then limits the federated regions’ power to tax to the following: (a) real property tax; (b) estate tax; (c) donor’s tax; (d) documentary stamp tax; (e) professional tax; (f) franchise tax; (g) games and amusement tax; (h) environmental tax, pollution tax and similar taxes; (i) road users tax; (j) vehicle-registration fees; (k) transport franchise fees; and (l) local taxes and other taxes that may be granted by federal law. To emphasize that no overlap occurs, the draft Constitution expressly states, “no double taxation shall be allowed.”

Thus, it can be readily seen that the allocation of the power to tax between the proposed federal government and the proposed federated regions bears a striking resemblance to the current setup between the national government and the local government units. Currently, the national government collects taxes under the National Internal Revenue Code and other national taxes, while local government units can only collect taxes delegated to it by Congress through the Local Government Code.

The change introduced by the draft Constitution is to shift certain national taxes, such as estate tax, donor’s tax, documentary stamp tax, road users tax and vehicle-registration fees to the proposed federated regions, and to give to the federated regions the power to impose local taxes, which is currently delegated to local government units. The proposed federal government retains the sole power to impose income taxes, value-added taxes, excise taxes, customs duties and other taxes to be passed by the proposed Federal Congress.

While the tax structure under the draft Constitution will minimize, if not avoid, the excessive tax burden that can result from multiple levels of taxation under a federal system, taxpayers will

inevitably be burdened by having to comply with another layer of rules set by the federated regions in addition to those set by the local governments. To resolve this, the proposed federated regions should pass uniform rules and procedures to govern taxpayer compliance.

Another inevitable outcome of the proposed tax structure is tax competition. Insofar as those taxes that they are allowed by the draft Constitution and by federal law to levy, federated regions will likely engage in a “race to the bottom” in terms of taxation and regulation to persuade taxpayers to move to their respective jurisdictions.

In a nutshell, the propriety of the shift to a federal system and the proposed tax structure is still a matter of debate. What is clear is that as the proposed draft goes through constitutional processes, it is the duty of every citizen to take part in this national debate. After all, the draft Constitution will still be presented to the people for ratification. In so doing, we, the people, will be deciding the future of our generation and generations to come. A participative and informed discussion on the draft Constitution is key in making an informed choice for the Philippines’s future.

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