



Greg Navarro

A matter of principle

OBG talks to Greg Navarro, Managing Partner and CEO, Punongbayan & Araullo

How do tax rates in the Philippines compare to other regional investment destinations? What is being done to reduce bureaucracy?

NAVARRO: From the beginning of 2009, following legislation passed in 2005, the country's corporate income tax rate will be reduced to 30%: lower than those of Laos (35%) and Vietnam (32%) and on a par with Indonesia and Thailand. Another income tax amendment in 2008 allowed corporate taxpayers to choose the scheme that would yield lower taxable income by offering an optional standard deduction at 40% of gross income in lieu of the itemised list of allowable expenses.

The government is addressing the Philippines' poor ranking in terms of efficiency and the incidence of corruption. It has instituted many reforms and has encouraged the participation of the private sector in the fight against corruption. For instance, measures are being implemented to streamline procedures and minimise the contact between taxpayers and tax authorities through technological enhancements. The e-commerce law has allowed greater transparency in government procurement. There are bills pending in Congress that are designed to give more teeth to efforts to combat corruption. The creation of a public company oversight board is in the offing and there is increased awareness about the problems associated with corruption and tax evasion. These partnerships will be successful because they reach out to civil society itself and in doing so address the problem at its roots.

How will recent changes in Philippine accounting standards affect private enterprises?

NAVARRO: The Philippines' transition to international accounting standards, begun in 2005, has amplified the need to harmonise the provisions of the Philippine tax code with financial reporting standards. In general, revenues and expenses, for purposes of income taxation, are determined based on the accounting method employed by the taxpayer. However, the tax laws also provide that if there are accounting rules contrary to

those provided for tax purposes, the tax rules should still prevail. The adoption of the new accounting standards has significantly widened the differences between financial reporting and tax reporting.

Aside from being difficult and prone to errors, reconciliation of the differences could also be costly in terms of time, manpower and technology. As a consequence, the risk of exposure to deficiency taxes when the tax rules and the reconciliations are not correctly applied has become very real to large numbers of taxpayers. This situation can then become a breeding ground for tax evasion and corruption in the tax administration and collection system.

What changes can be made to harmonise financial reporting and tax reporting?

NAVARRO: Punongbayan & Araullo has invested in studying these differences and publishing guidelines on how our clients can adapt. The results are summarised in a new publication: "New Accounting Standards and Income Tax Reporting, A Study of Differences". Harmonisation will entail a period of adjustment and some initial difficulty, but I believe this will eventually benefit both the government and the taxpayer in terms of ease in compliance and administration.

Further fine-tuning of the definition used for cost of sales and cost of goods sold could be a critical area, considering that the Philippines imposes a 2% minimum corporate income tax (MCIT) on gross income, and that a newly institutionalised law simplified optional standard deduction for corporations. Cost of sales should ideally be an accounting concept and should therefore follow accounting principles.

After the legislation of the MCIT, certain definitions of costs and expenses were incorporated into tax laws. Tax authorities went further by providing limitations on a per-industry basis, making tax rules look arbitrary. International accounting standards are generally seen to be more principles-based, and tax rules and regulations should also be based on fair and equitable principles.