ISSUE BRIEF

TAX JUSTICE ISSUES IN THE PHILIPPINES' INVESTMENT AND TRADE AGREEMENTS

Tax regimes are commonly seen as separate from investments and trade regimes, with no substantive linkages in between. As well, investments and free trade agreements (FTAs), whether bilateral, regional or multilateral, appear to be only marginally connected with tax matters.

We contend, however, that while investment and trade agreements may not directly contain provisions on tax, they hold important implications for resource mobilization, specifically taxation. Tax matters are inextricably linked with investments and trade concerns especially at a time of increasing cross-border trade and market integration. Under neoliberal economic globalization, tax and trade rules work to mutually reinforce each other to achieve common goals of removing barriers to the expansion of markets.

THE PHILIPPINES' TRADE AND INVESTMENTS CONTEXT

In the 80s, the Philippines entered into a period of structural adjustment, distinct from past efforts by the marked shift it brought to trade and investments policy. Through successive trade liberalization packages up to the mid-90s, the government steadily pared down protective tariff barriers and foreign exchange controls and withdrew interventions in capital markets (Aldaba). Foreign financing included the Structural Adjustment Loans of the World Bank, which came with the commitment of the Philippine government to lowering tariffs, liberalizing import restrictions, following a flexible exchange rate policy and restructuring industries to complement the overarching thrust of export orientation (Montes).

The Philippines took another step further in opening its markets by acceding to the World Trade Organization (WTO) in 1995, following successive waves of Tariff Reform Programs in the 80s and early 90s. In compliance with WTO rules, it lifted restrictions and duties on a number of agricultural, industrial and information technology products.

It was also during this period that changes in investment policy were instituted. One of these, the passage of the framework Omnibus Investments Code of 1987 added more incentives and made processes and requirements easier for availing of the same. As of 2010, there were reportedly 140 laws extending various types of fiscal incentives to different investment categories. These include laws establishing special economic zones and freeports where income tax holidays of 4-10 years, tax credits, tax and duty exemptions are granted on income, importation of raw materials, imported capital equipment and the like.●

CURRENT TRADE COMMITMENTS

Then as now, the Philippines continues to pursue a trade liberalization agenda and to give premium to attracting foreign investments. This has entailed to a significant degree, entering into regional trade agreements (RTAs) as part of the Association of Southeast Asian Nations (ASEAN). Altogether, the Philippines is involved in 10 free trade agreements, of which three are under negotiations (ADB). The trend is reflective of a context where mega-regional trade agreements are on the rise.

By 2010, the Philippines had already removed duties on 99 per cent of products in the Inclusion List of the Common Effective Preferential Tariff (CEPT) scheme[1] of the ASEAN Free Trade Area (AFTA) (Parcon-Santos). The terms of the agreement stipulate reducing tariffs on agriculture products to 5% in 2015, with only rice having a 35% tariff. Another study reported in 2010, the decline in the weighted average of tariffs in agriculture from 24% to just 12%; and in manufacturing, from a weighted

1 The CEPT-AFTA has further been reinforced with the adoption of the ASEAN Trade in Goods Agreement (ATIGA), an even more comprehensive and legally binding mechanism signed in 2009. ASEAN RTA partners include Australia, New Zealand, China (on services), India, Japan and Korea.

average of 32% to 6% (Briones).

In 2008, the Philippines entered into its first bilateral FTA -- the Japan-Philippines Economic Partnership Agreement (JPEPA). JPEPA targets that by 2018, tariffs are eliminated on 95% of Philippine exports to Japan, and completely removed for 90% of Japanese products. ●

INVESTMENT TRENDS, TAX IMPLICATIONS

In terms of investments, the Philippines has negotiated 38 Bilateral Investment Treaties (BITs) over the last two decades, almost all of which are in force. Many of these BITs are with investment-sending countries such as France, Australia, Canada, Germany, Italy and other rich, developed countries, thus putting in question the claim of reciprocal investments protection and promotion.

As with BITs in general, the Philippines' treaties differ in form but share elements commonly seen in as important to investors. Relevant to public revenues are provisions on national treatment and Most Favored National clauses that afford equal treatment with other investors, whether foreign or domestic.

The Philippines-Canada BIT, for example, stipulates in Article II that investors shall be allowed to establish their businesses in the contracting state "on a basis no less favourable" than that which in similar circumstances it allows its own investors or prospective investors or those of a third state. In addition, there is a distinct Most Favored Nation Treatment provision (Article III) spelling out the scope of such treatment to cover the management, use, enjoyment or disposal of investments or returns (Agreement between the Government of Canada and the Government of the Republic of the Philippines for the Promotion and Reciprocal Protection of Investments).

It is important to note that the RP-Canada BIT, while explicitly stating that it does not apply to taxation, fully defers to the RP-Canada Double Taxation Avoidance Agreement (DTAA) that has been in effect since 1977. Article XII provides further that where there are issues of conflict, the tax treaty shall prevail; further, the Party that breaches the tax treaty is open to liability as well of breaching the BIT.

Since DTAs typically contain national treatment and MFN clauses as well, the lowest rates can be claimed by any other tax treaty partner who can invoke non-discrimination. Canada currently enjoys a 15% corporate income tax (CIT) rate, lower by half than the regular rate, under the DTA with the Philippines. Germany, however, was able to negotiate for as low as a 10% CIT in the Philippine-Germany DTA. As per the terms of the DTA between the Philippines and Canada, and the ASEAN DTA, there is no bar to Canada claiming the lower rate.

The Philippines – Germany BIT similarly states that contracting parties mutually commit to treat investors no less favourably than the treatment accorded to investors of other states with regard "management, maintenance, use, enjoyment or disposal of their investments...." (Article 3, Treatment) (Agreement between the Federal Republic of Germany and the Republic of the Philippines for the Promotion and Reciprocal Protection of Investments)

Moreover, while the treaty states that parties are not obliged to extend to each other the benefits arising from international agreements (e.g., tax treaties), it expounds that

> *[i]f the legislation of either Contacting State or obligations under international law..contain a regulation,..., entitling investors of the other Contracting State to a treatment more favourable than is provided for by this Agreement, such regulation shall to the extent that it is more favorable prevail over this Agreement....(Ibid.)* ●

SOME IMPACTS AND CONSEQUENCES

EROSION OF PUBLIC REVENUES

Developing countries typically rely on trade-related tariffs and taxes to finance an average of 30 per cent of their budgets. Income from trade taxes represents an average of one-third of total tax revenue in developing countries.

The last two FTAs that came into force in 2010 – with Australia and New Zealand, and with India – was estimated by government to lead to public revenue losses of PhP9 billion or US$195.65 (US$1=PhP46). Finance officials, however, claimed "quick compensation" through the increased traffic in goods (ASEAN Affairs). This is bound to increase considering that tariff reduction of up to 96% is targeted by the FTA with Australia and New Zealand by 2020. (As of 2015, only 67% of Australia's exports to the region were reported as tariff-free.) The FTA with India on the other hand will abolish export and import duties on 4,000 products by 2016.

The Philippines in particular reported a decline in taxes on international trade as a share of total revenues from 21.5% in 2010 to 19% in 2012 (World Bank). But despite these revenue losse, there have been increasing calls to reduce the country's 30% Corporate Income Tax-- the highest among the ASEAN countries – as a way to draw in more investors (Mir). The Philippine Senate's own research office raised some important questions:

First, can we afford to lose revenue given that we have been in fact operating on budgetary deficit, which in 2013 was pegged at ₱238 billion? Second, how far more can we stretch government finances given that the post-typhoon Yolanda rehabilitation efforts require at least ₱361 billion? This amount almost eclipses the ₱363 billion the BIR collected from corporate income tax in 2012. (Ibid.)

UNMET BASIC NEEDS AND CONTINUED DEPENDENCE ON BORROWINGS

An oft-cited reason for low public services budgets and poor delivery is the lack of funds, which also lays the basis for government to go into privatization, depend on aid, resort to increased borrowings, and adopt more broad-based, regressive tax measures.

The Philippines' budget for education, for example, has continuously declined, from a high of 30.78% of the national budget in the 50s to less 14.97% as of 2013. Education spending from the post-Marcos years up to the present is yet to reach the 6% of GNP UNESCO Delors standard (Freedom

from Debt Coalition). Health costs are still largely out-of-pocket (57% of expenditures in 2007), and expenditures have persisted until the present below the World Health Organization (WHO) recommendation of 5% share of GDP. More than 50% of public hospitals as of 2009 were characterized as "comparable only to infirmaries" and there were only 1.04 beds per 1,000 population against WHO's standard of 20 (Department of Health). The maternal mortality rate slightly rose to 163 per 100,000-population, thus missing the MDG target of 52 by a wide margin (Department of Health).

VULNERABILITY TO DANGEROUS LEGAL PRECEDENTS IN ARBITRATION

Showing the capacity of BITs to impinge on national tax laws is the case of Vodafone International Holdings BV, which initiated in 2012 arbitration proceedings under the India-Netherlands Bilateral Investment Treaty. Vodafone wanted the Indian government to drop or amend a tax bill allowing Indian tax authorities to reopen tax cases from 1962, citing this as a violation of the government's obligations under the BIT. The Indian government stood to gain Rs11,000 crore ($2.2 billion) in taxes for Vodafone's $11.2 billion acquisition of mobile operator Hutchison Essar in 2007 (Singh).

The Vodafone case is only one example of the many instances of investor-state dispute settlement, illustrating how BITS contravene the well-established view that conflicts over tax issues, which are within the sovereign right of states, should be under the jurisdiction of states rather than international arbitral courts. In this manner, the tax carve-out clauses in BITs and FTAs can very well encroach on basic elements of sovereignty, such as taxation and law-making. At the same time, investors are able to exempt themselves from international standards and norms including core human rights treaties, which countries as states parties may have translated into jurisprudence applied in national courts.

Suits filed against countries have reportedly increased to an average of one case per week and that damages awarded have grown so massive as to be considered as assets or loan collaterals by investment funds. It is feared that "[a]s the claims made by companies get bigger, it seems increasingly likely that the massive financial risks associated with investor-state arbitration will effectively grant foreign investors a veto over government decisions" (Provost and Kennard).●

CONCLUSIONS

It is clear that BITS and FTAs contribute to the factors that lead to the erosion of public revenues and impede domestic resource mobilization. Developing countries like the Philippines can ill afford revenue losses in the face of long unmet needs for essential social services that are critical to enjoying a secure, healthy and decent life. It is crucial to examine these instruments for their revenue-erosion dimensions especially in the face of the country's needs for sustainable development and the particular risks it faces at a time of increasingly destructive climate change.

At the same time, attention must be paid to the fiscal consequences of this decline in domestic resources. Will it lead to more borrowings? Will it bring about higher regressive taxes? It is significant to note that loan mechanisms have been made available by international financial institutions for countries to be able to borrow from an existing facility, or augment an already outstanding loan, with the purpose of financing fiscal revenue lost through trade liberalisation.

Finally, the increasing use of investor-state dispute settlement that has come with the proliferation of these instruments renders developing countries even more vulnerable to further revenue losses. In addition to requiring huge resources, they have shown to be lacking in accountability and transparency, and devoid of concern for domestic conditions and development needs.●