

**PHILIPPINE-AUSTRALIA
LAND ADMINISTRATION AND MANAGEMENT
PROJECT**

FEES AND FINANCE POLICY STUDY

**REPORT ON FINANCE AND FEES
ON REAL PROPERTY**

JULY 29, 2002

REPORT A3



This report is a result of technical assistance managed by Land Equity International to the Government of Philippines. The TA was funded by AusAID and the views expressed in this work do not necessarily represent the views of the Commonwealth of Australia.

FEES AND FINANCE POLICY STUDY: REPORT ON TAXES AND FEES ON REAL PROPERTY

TABLE OF CONTENTS

	Page
Executive Summary	i
1.0 Introduction	1
2.0 Structure of Taxes and Fees Currently Applied to Land in the Philippines	3
2.1 National Taxes and Fees	4
2.2 Local Government Taxes and Fees	12
2.3 Issues Concerning the Structure and Performance of Taxes and Fees	17
3.0 Costs of Collecting Land Taxes and Fees and Operating the Land Administration System	30
3.1 Costs Incurred by National Government	30
3.2 Expenditures on Land Administration and Taxation by Local Governments	31
4.0 Economic Impacts of Taxes and Fees: Key Issues	33
4.1 Constraints to Participation in Formal Land Markets	33
4.2 Constraints to Revenue-Generating Capacity of the Formal Land Administration System	39
5.0 Options for Restructuring Taxes and Fees	44
6.0 Recommendations	50
7.0 Time-Bound Implementation Plan	52
References	54
ANNEXES	
A. National Collection Services	

- B. Data from Metro Manila Assessors on Transactions Fees and Taxes
- C. Excerpts from June Draft Report on Fees and Finance
- D. National Tax Research Center's Remarks about the Study's Recommendations

FEES AND FINANCE POLICY STUDY
REPORT ON TAXES AND FEES ON
LAND OWNERSHIP, USE AND TRANSACTIONS

Executive Summary

Background and Objectives

This study was conducted as part of the Philippines-Australia Land Administration and Management Project (PA-LAMP), which is providing technical assistance to the Land Administration and Management Project. It is one of four policy studies funded by AusAID, the other three being policy studies of institutional arrangements, land laws, and land valuation. The findings and recommendations of all four studies will be drawn together in an Integration Report for presentation to the Government of the Philippines (GOP) in mid-August 2002.

The objectives of the Fees and Finance policy study are to:

:

- document the entire range of taxes, fees and charges imposed on real property ownership, use and transactions and government's cost in collecting and administering them;
- conduct broad consultation with stakeholders to identify current problems, obstacles to reform and possible solutions;
- investigate the extent to which the current fees and taxes on real property ownership and transfers affect the willingness of citizens to participate in the formal land administration system, i.e. to improve the efficiency of land markets, and also to optimize the revenue-generating capacity of the formal land administration system;
- identify options for modification of the system to improve its performance;
- make recommendations for policy reform and legislative changes based on the options;
- outline a time-bound action plan for implementation of the recommendations.

The sponsoring government agency is the Department of Finance (DOF), which is the principal actor in raising revenue on real property ownership, use and transactions both directly, through the Bureau of Internal Revenue (BIR) and indirectly, through the oversight of local government units (LGUs) by the Bureau of Local Government Finance (BLGF). The study team was hosted by the DOF's National Tax Research Center (NTRC), whose staff collaborated closely with the team's members at all stages of the study.

In order to document all taxes, fees and charges, there were consultations with other national government agencies (NGAs), including:

- the Department of Environment and Natural Resources (DENR), including its components, the Land Management Bureau (LMB), the Land Management Sectors (LMS) of the decentralized offices of DENR, the Environment Management Bureau

(EMB), the Forest Management Bureau (FMB), and the Mines and Geosciences Bureau (MGB).

- the Land Registration Authority (LRA) and Registers of Deeds (ROD) under the Department of Justice (DOJ);
- the Department of Agrarian Reform (DAR);
- the National Economic and Development Authority (NEDA).

Contacts were also made with Local Government Units (LGUs) in Metro Manila and Leyte, and with the two Prototype Implementation Offices (PIOs) developing the pilot tests of land titling and registration procedures in Quezon City and Tacloban, Leyte. Meetings, discussions and workshops were held with numerous stakeholders throughout the study period.

Existing Structure of Taxes, Fees and Charges (Section 2)

The study discovered that data on land administration-related revenues and expenditures of national and local governments are not readily available. The primary reasons for this are:

- most available data are for internal agency purposes rather than for the purpose of informing other parts of government or the public and therefore is difficult to use;
- heretofore the government has not considered land administration to be a separable, identifiable system, and except for LRA the various components of land administration are subsumed into agencies which do not sufficiently distinguish them from their other activities;
- data on some taxes, like Documentary Stamp Tax, are not disaggregated by type of document, at least by the BIR headquarters;
- decentralized agencies like the RODs, the LMSs, and the LGUs do not report many elements of their activities to their supervisory NGAs in a useful manner, and the latter see little reason to collect the information in the first place.
- different sources report different values for the same item; this is especially true for expenditures of the land administration agencies.

Because of these problems, many of the figures reported in the study are informed estimates rather than hard numbers. A summary of the revenues generated by the principal government units is given in Table 2.1. The BIR and LGUs clearly predominate, with each collecting nearly half. LRA and DENR collect smaller amounts as fees for services.

Table 2.1: Total Collections Related to Land Administration (CY 2000)

Agency	All Collections	Percent
BIR	14,444,000,000	45.37
LGUs	15,708,000,000	49.34
LRA	1,080,000,000	3.39
DENR	605,000,000	1.90
Total	31,837,000,000	100.00

* Including some Income Tax and Value Added Tax identifiably generated from real property activity

The principal BIR revenues stem from Income Tax on real property income (46%), Capital Gains Tax (CGT: 24%) and Documentary Stamp Tax (DST: 8%) on real property transactions, Value Added Tax (VAT) on the activities of real estate professionals (18%), and a smaller amount from Estate and Donor's Taxes (3% total). All of these taxes together represented 4% of BIR's total collections in 2000.

LGUs derive nearly all their real property-related income (94%) from the Real Property Tax (RPT), including the Special Education Fund (SEF) tax, with the Transfer Tax yielding 6%. Together, these taxes represented 11% of the total resources available to LGUs and about one-third of their locally-generated resources.

Issues internal to the revenue generation process that are identified by the study include:

- The declining collections of and number of transactions taxed by the CGT;
- The contrast between CGT performance and that of the local government's Transfer Tax, whose base has not declined (except in 1998, probably due to the Asian crisis);
- Estate and Donor's taxes are a minor source of revenue, and the fairly generous exemptions mean that they do not have an impact on very many taxpayers;
- The high cost of transactions;
- Fees and charges imposed by the land administration agencies are not a large percentage of the cost of transactions;
- Conversely, CGT and DST together constitute the largest element of the cost of transactions.
- RPT and SEF collections are well below potential because of low valuations, poor incentives to collect on the part of municipalities (because of the large IRA and because they must share RPT revenues with provinces) and delinquencies on the part of taxpayers;

Costs of Revenue Collection and Land Administration (Section 3)

The costs of the land administration system and of the generation of revenue by its component agencies have proven difficult to quantify for the reasons given at the start of the previous section. The methods used by the study team to separate out land administration-related costs vary by agency as a function of what data are available. The principal findings are that:

- BIR appears to be reasonably efficient at raising revenues on real property transfers;
- LRA appears to make a substantial surplus on the fees it charges in spite of their modest level;
- DENR's fees are generally too low to achieve cost recovery;
- LGUs have high costs of revenue generation, especially because of the large number of employees in municipal assessor's and treasurer's offices.

Issues (Section 4)

The study finds that real property markets are not contributing as much as they should to national economic development. While there are no data enabling direct study of the operation of real property markets, partial, anecdotal, and indirect methods all point in

the same direction: growth in real property-related economic activities is slower than the national average. The analysis indicates that the national taxes on real property transactions – Capital Gains Tax (CGT) and Documentary Stamp Tax (DST) – are the principal financial cause, compounding the constraints imposed on formal real property markets by low and inequitable property valuation, legal inconsistencies, institutional complexity, and opportunities for inappropriate practices. The two taxes total 7.5 per cent of the value of the transaction; LGUs add another 0.5 per cent in the form of a Transfer Tax.

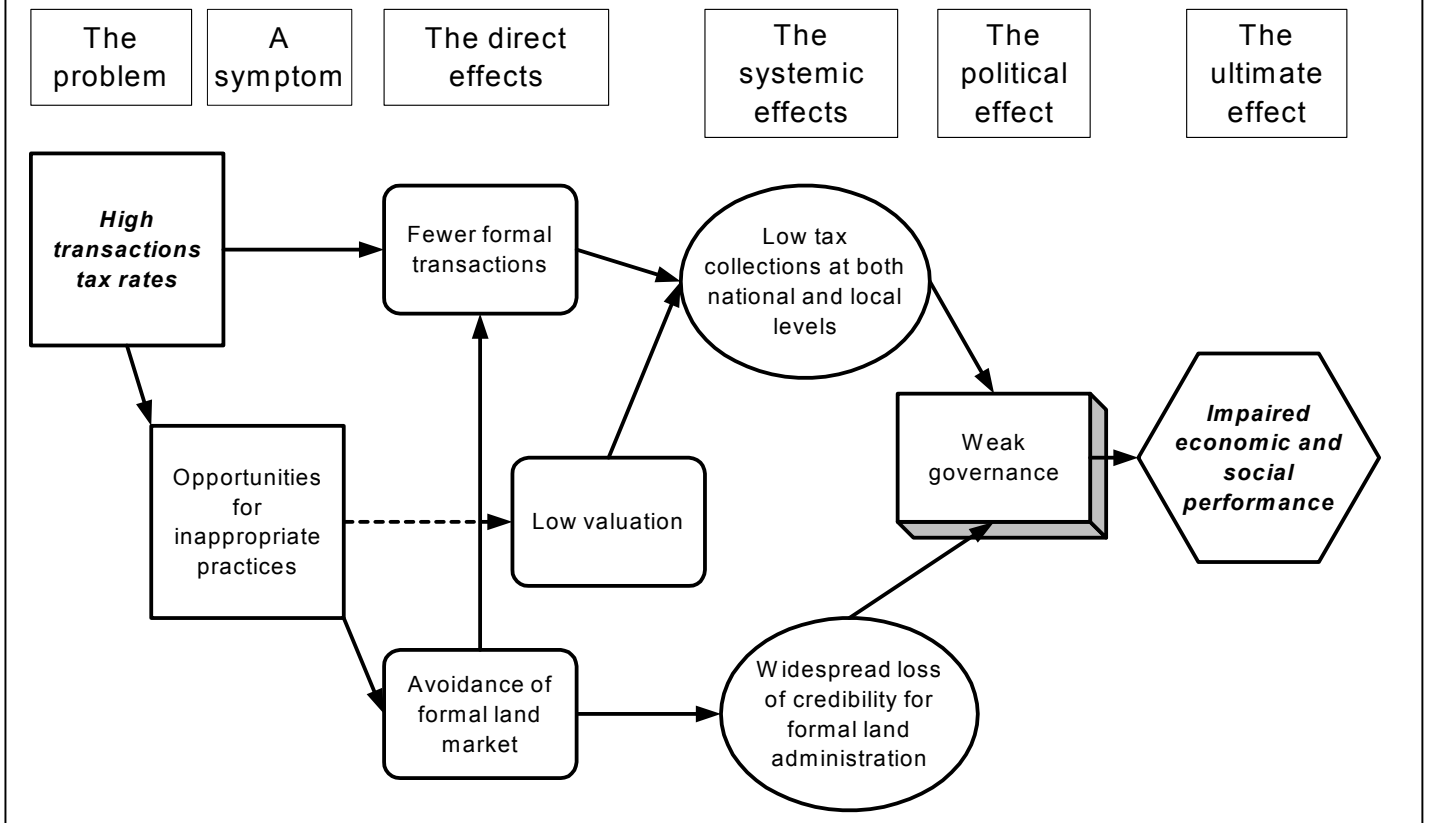
Figure 4.1 illustrates the mechanism by which high transactions taxes impede the economic development of the Philippines. High tax rates:

- discourage formal transactions because buyers and sellers find it harder to agree on a selling price
- provide opportunities for officials within the land administration system to engage in inappropriate practices;
- make sellers and buyers seek nonformal ways of transacting to avoid the taxes and inappropriate practices, thereby reducing the number of formal transactions even further; and
- put pressure on the valuation system to reduce the assessed value of property to compensate for the high tax rates.

These direct effects compromise the land administration system by: 1) reducing its ability to generate tax revenue and 2) reducing its credibility with the population. Both of these “systemic” effects impair the ability of both national and local governments to fulfill their roles as supporters of social and economic development.

Transactions taxes are not the only problem with the structure and operation of the tax and fees system. Many others, especially concerning LGUs, are caused by the overly prescriptive and constraining provisions of the Local Government Code (LGC). These make LGUs passive recipients of Internal Revenue Allotment (IRA), and render them unable to adjust the levels and targets of local taxation to meet local needs. This is ironic given the “Declaration of Policy” in Sec. 2 of the LGC, which promotes the autonomy and accountability of LGUs. In addition, weaknesses in appraisal and tax collection, the overhang of real property tax delinquency, and lack of implementation of the idle lands tax are pointed out as important to the future revenue-generating ability of local governments.

Figure 4.1: The Effects of High Transactions Taxes



Options for Reform (Section 5)

Based on its analysis of the current structure of fees and taxes, the study concludes that taxes on transactions should be reduced both in number and in rate. Further, it identifies the relative responsibility of national and local governments for the regulation of real property ownership and transactions as the principal policy decision to be made. The options for reform are:

1. Minimize responsibility at the national level by eliminating national taxes on real property transactions and transferring more taxing authority on real property ownership and transactions to LGUs.
2. Maintain the current balance between national and local government responsibilities, making small changes to the current structure of taxation.
3. Maximize responsibility for taxes in relation to real property at the national level.

Specific contents of the three options are shown in Table 5.1.

TABLE 5.1: OPTIONS FOR RESTRUCTURING TAXES ON REAL PROPERTY OWNERSHIP AND TRANSACTIONS

Taxes	Option 1 Maximize LG U responsibility	Option 2 Maintain current balance	Option 3 Maximize national level responsibility
Capital Gains Tax	Exempt real property transactions	Reduce rate substantially for real property transactions	Reduce rate somewhat for real property transactions
Documentary Stamp Tax	Exempt real property transactions	Retain at current rate	Retain at current rate
Transfer Tax	Retain; perhaps increase rate	Retain at current rate	Abolish; replace by IRA increase
Real Property Tax and Special Educational Fund	increase rate for provinces to same as for cities	Retain at current rates	Eliminate SEF

The study simulates the financial impact of transactions tax reductions under several sets of assumptions about the new rates, the increase in transactions they cause, and improvements in valuation and tax collection efficiency. If there are no changes in these factors, the result is a decrease in total revenues under all three options, but if they do change, even modestly, revenues rise strongly in Options 1 and 2. Option 3 shows a reduction in total revenues, highlighting the fact that real property taxes are more responsive than transactions taxes to changes in rates at their current levels.

Recommendations (Section 6)

Common to all the options are the following recommendations about fees and finance:

1. eliminate the requirement that delinquent real property taxes be paid prior to registration of transfers, replacing it with a lien attached to the Certificate of Title.
2. retain Estate and Donor's Taxes at current levels, as they have no significant impact on the great majority of the population and provide a small measure of equity.
3. increase all land administration fees that currently do not recover operating costs (except those for mass titling under CARP, DENR, and urban antipoverty programs).
4. enable more flexibility in changing local government tax and fee rates and revenue distribution formulas.
5. when revenues have risen sufficiently to make LGUs more self-reliant, retain all RPT revenue in the community in which it is raised, i.e. the municipality or city.
6. when revenues have risen sufficiently to make LGUs more self-reliant, reformulate IRA, linking it to some measure of LGUs' fiscal performance.
7. develop transparent and equitable procedures to enable LGUs to seize real property for nonpayment of RPTs
8. eliminate the opportunity for owners to redeem a property after it has been auctioned by a LGU for nonpayment of delinquent taxes.
9. experiment with the imposition of the Idle Lands Tax in a LAMP pilot area.
10. Institute monitoring procedures to enable LAMP and its partner government agencies to acquire information on transactions and financial data more readily and timely.

Option 1, "Maximize LGU responsibility," is the preferred option, and the one which would do the most to approach the LGC's "Declaration of Policy." The core idea of Option 1 is to remove the national government from the real property market by vesting all power to tax ownership and transfers in LGUs. The net result would be to reduce the tax rate on transactions from 8.5%-8.75% to 1-1.5%, while increasing the annual charges on real property ownership in the provinces. Under reasonable assumptions, this would lead to an increase in LGU revenues that would more than compensate for national government revenue losses, and the difference could be made up via IRA reduction.

The justification of this recommendation is that the listed advantages:

- greatly reduced transactions costs
- fewer requirements for registration of transactions
- increase of locally-generated LGU revenue
- increase in responsibility and accountability of LGUs
- reduction of paperwork for BIR

outweigh the disadvantages:

- loss of revenue for BIR

- reduction in national-level information about transactions
- reduction of IRA receipts by LGUs

by more than is the case with the other options. Specifically, two of the disadvantages (BIR revenue loss and reduction of IRA) cancel themselves out at the national level, and the national-level information about transactions is in any case fragmentary at best.

This is an ambitious program with a significant shift in the relative taxing powers of national and local governments. It will probably not be accomplished overnight. In the interim, while the legislative process is taking its course, a series of administrative changes, detailed in the “time-bound action plan” in Section 7 can be made, consensus can be built, and alternative solutions to issues like delinquent real property taxes and the idle lands tax can be studied.

Time-bound Action Plan (Section 7)

A series of administrative and legislative actions are proposed to bring most recommendations into effect by the end of 2003 and the rest by 2005.

1.0 Introduction

This study was conducted as part of the Philippines-Australia Land Administration and Management Project (PA-LAMP), which is providing technical assistance to the Land Administration and Management Project (LAMP). It is one of four policy studies funded by AusAID, the other three being policy studies of institutional arrangements, land laws, and land valuation. The findings and recommendations of all four studies will be drawn together in an Integration Report for presentation to the Government of the Philippines (GOP) in mid-August 2002.

The purpose of this study is to assess the financial aspects of the Philippine system of land administration and management, including taxes and fees relating to ownership, use, and transactions in real property, and the government's costs of generating that revenue. Its approach is based on the AusAID goal "to assist the GOP to improve the effectiveness, transparency and efficiency of land administration and the resultant flow of social and economic benefits in the Philippines." [AusAID PDD: 24] The key elements of the LAMP are to bring people and their real property into the formal system through land titling, and to keep them in by facilitating transactions in an efficient land registration process. This report focuses on the ways in which the current structure of taxes and fees affects the efforts of the LAMP.

The objectives of this study are to:

- document the entire range of taxes, fees and charges imposed on real property ownership, use and transactions;
- document the costs of the national and local government in collecting and administering the taxes, fees and charges;
- conduct broad consultation with stakeholders to identify current problems, obstacles to reform and possible solutions;
- investigate the extent to which the current fees and taxes on real property ownership and transfers affect the willingness of citizens to participate in the formal land administration system, i.e. to improve the efficiency of land markets;
- investigate the extent to which the current fees and taxes on real property ownership and transfers optimize the revenue-generating capacity of the formal land administration system;
- identify options for modification of the system to improve its performance if the investigation under the preceding two objectives finds that the current system is not optimal;
- make recommendations for policy reform and legislative changes based on the options.

The sponsoring government agency is the Department of Finance (DOF), which is the principal actor in raising revenue on real property ownership, use and transactions both directly, through the Bureau of Internal Revenue (BIR) and indirectly, through the oversight of local government units (LGUs) by the Bureau of Local Government Finance (BLGF). The study team was hosted by the DOF's National Tax Research Center (NTRC), whose staff collaborated closely with the team's members at all stages of the study.

In order to document all taxes, fees and charges, there were consultations with other national government agencies (NGAs), including:

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- the Land Registration Authority (LRA) and Registers of Deeds (ROD) under the Department of Justice (DOJ);
- the Department of Agrarian Reform (DAR);
- the National Economic and Development Authority (NEDA).

Contacts were also made with Local Government Units (LGUs) in Metro Manila and Leyte, and with the two Prototype Implementation Offices (PIOs) developing the pilot tests of land titling and registration procedures in Quezon City and Tacloban. Meetings, discussions and workshops were held with numerous stakeholders throughout the study period.

Section 2 details the structure of taxes and fees currently applied by land administration agencies; Section 3 estimates the cost of tax and fee collection; Section 4 outlines the key issues that arise from the economic analysis of tax structure and performance; Section 5 discusses possible policy options to make the system more responsive to the social and economic needs of the nation and does preliminary calculations of the revenue implications of the options; Section 6 is the study team's recommendations of which option to adopt and which policy and legislative changes to make; and Section 7 is a time-bound action plan for implementing the recommendations.

2.0 Structure of Taxes and Fees Currently Applied to Land in the Philippines

Responsibility for land taxation in the Philippines is shared between the national and local governments. The division of taxing authority is based on the desire for efficiency in collection, in order to improve government performance and ultimately the economy. However, despite the best intentions, revenues are well below potential, and the land market is not contributing as much as it should to sustainable, equitable economic development. This suggests a need to rethink the tax structure so that landowners play more dynamic and productive roles in the land market and the government raises more revenues.

This section is a review of the current structure of land taxes and fees. It starts with an overview of the aggregate revenues on real property ownership and transfers, and subsequently gives details of each type of taxes and fees, the revenue they generate, the issues involved in their collection, and their direct impact on stakeholders.

Revenue Collection – In Calendar Year (CY) 2000, the GOP collected P514,762 million in tax and non-tax revenues, and LGUs collected P49,078 million.¹ Real property-related revenues of the GOP were P16,129 million and those of LGUs P15,708 million. Real property-related revenues represent 3.1% of GOP revenues and 32.0% of LGU revenues.

Overall, for CY 2000, P31,837 million in land-related taxes and fees were collected (see Table 2.1), 50.7 per cent of which were national revenues and 49.3 percent were LGUs' revenues. The four government units collecting virtually all the taxes and fees are DENR, LRA, BIR and LGUs.

Table 2.1: Total Collection of Taxes and Fees Related to Land Administration, pesos (CY 2000)

Agency	All Collections	Percentage of Total
NGAs		
BIR	14,444,000,000	45.4
LRA	1,080,000,000	3.4
DENR	605,000,000	1.9
Total GOP	16,129,000,000	50.7
LGUs	15,708,000,000	49.3
Total	31,837,000,000	100.00

BIR is different from the other three because it is a pure revenue-generating agency rather than a participant in the land administration system per se. LRA is the only "pure" land administration agency; for DENR and LGUs land administration is one component of a wide array of responsibilities.

The taxes are meant to finance the operations of government in general, whereas the fees and charges are intended recover the government's costs in providing

1. This figure excludes intergovernmental transfers from GOP to LGUs.

services to landowners under the land administration program. A more detailed presentation of the current structure of land taxes and fees is discussed below.

2.1 National Taxes and Fees

An inventory of national land taxes and fees by collecting agency is given in Annex A. The BIR is the only NGA collecting taxes. Land-related fees and charges however, are imposed and collected by other NGAs such as the offices under the DENR and the LRA of the DOJ. Some characteristics of the national taxes and fees are presented in Table 2.2.

A. BIR

The BIR collects four major taxes that are related to land transfers: (a) Capital Gains Tax (CGT), (b) Estate Tax (ET), (c) Donor's Tax (DT) and (d) Documentary Stamp Tax (DST). It also collects Income Tax on income of real property professionals and others participating in land markets as a business, Value Added Tax (VAT) on certain real property sales, and a minor amount in certification fees.

Capital Gains Tax

Individual taxpayers must pay 6% CGT on the value of the sale, exchange or disposition of real properties classified as capital assets. The rate was increased from 5% by the enactment of Republic Act (R.A.) No. 8424, which became effective on January 1, 1998. The same law subjected to the 6% capital gains tax the gains derived by corporations on the sale, exchange or disposition of their lands and or building that are not actually used in the business of a corporation and are treated as capital assets.

CGT collections from 1995 to 2000 are presented in Table 2.3. It can be seen that, partly due to the downturn in the property market in 1998 as a result of the Asian financial crisis, collections declined by 30% in 1998, 16% in 1999, and 6% in 2000.

In 1997 the tax base was 104,080 million, but this declined in 2000 to 57,650 million, of which a component (property sold by corporations) had not been included in the 1997 tax base. Therefore there has been a near halving of the tax base over the period, and revenue in 2000 was two-thirds what it was in 1997. The declines in CGT collections and tax base will be analyzed in Section 2.3, below.

Table 2.2: Some Characteristics of BIR Taxes and Fees (As of CY 2000)

Tax	Rate	Base	Surcharge & Penalties	No. of Returns CY 2000	Average Tax Per Return CY 2000	Average Base Value CY 2000
Capital Gains Tax	6%	Gross Selling Price or BIR valuation or LGU valuation, whichever is highest	25% for each violation and 50% of tax or deficiency tax	122,378	28,200	469,768
Estate Tax	0-200,000 Exempt, 200,000-500,000: 5%, over 200,000; 500,000-2,000,000: 15,000 + 8% over 500,000; 2-5,000,000: 135,000 + 11% over 2,000,000; 5-10,000,000: 465,000 + 15% over 5,000,000; over 10,000,000: 1,215,000 + 20% over 10,000,000	Fair market value (BIR or LGU) of net estate at the time of incidence of death	25% for each violation and 50% of tax or deficiency tax	22,070	11,962	439,240
Donor's Tax	0 -100,000 Exempt; 100,000-200,000: 2% over 100,000; 200,000-500,000: 2,000 + 4% over 200,000; 500,000-1,000,000: 14,000 + 6% over 500,000; 1-3,000,000: 44,000 + 8% over 1,000,000; 3-5,000,000 = 204,000 + 10% over 3,000,000; 5-10,000,000 =404,000 + 12% over 5,000,000; over 10,000,000: 1,004,000 + 15% over 10,000,000	Sum of net gifts during the calendar year. Fair market value of gifts (LGU or BIR valuation) less allowable deductions.	25% for each violation and 50% of tax or deficiency tax	16,694	9,344	383,600
Documentary Stamp Tax	(a) Leases, etc. - First 2,000 = 3 pesos and then for every 1,000 or fractional part thereof for each year of the term of the contract or agreement = 1 peso (b) Mortgages, etc. First 5,000 = 20 pesos and then on each 5,000 or fractional part thereof in excess of 5,000 = 10 pesos (c) Deeds of sale, etc. = 1.5%;	(a) consideration (b) amount secured (c) consideration or fair market value, whichever is higher (If government is a party, basis shall be the consideration)	25% for each violation and 50% of tax or deficiency tax	(a) unknown (b) 120,481 (estimate) (c) 122,338 (estimate)	(a) unknown (b) 830 (estimate) (c) 7,046 (estimate)	(a) unknown (b) 412,077 (estimate) (c) 469,768 (estimate)
Value-Added Tax	10%	Gross receipts or sales		Unknown	Unknown	Unknown
Excise Tax on Mineral Products	2%	actual market value of the annual gross output at the time of removal		Unknown	Unknown	Unknown
Income Tax (land transactions Only)	Domestic corporations: 32%	Taxable income, i.e. gross income less deductions and exclusions		Unknown	Unknown	Unknown
Certification Fees	Pesos: 25.00	Per Page		400,000	25	no base

**Table 2.3: Capital Gains Tax Collections 1995 – 2000
(P Million)**

Year	Collection	Tax base*	Annual % Change
1995	4,992	99,854	
1996	4,174	83,490	-16%
1997	5,204	104,088	25%
1998	4,387	73,120	-30%
1999	3,696	61,615	-16%
2000	3,459	57,663	-6%

Source: BIR Annual Reports

* "Tax base is the implied total value of transactions subject to the tax.

Estate Tax

Estate tax is paid on the net value of assets transferred via inheritance. In a survey of Revenue District Offices (RDOs) in Quezon City and Manila City it was established that 95% of the value of 'estates' is real property. This percentage has been used to enable the collection of estate tax on real property specifically, shown in Table 2.4.

**Table 2.4: Estate Tax Collections, CYs 1995 – 2000
(P Million)**

Year	Collection	Annual % change
1995	272	
1996	398	46%
1997	650	63%
1998	262	(-60%)
1999	375	29%
2000	264	(-30%)

Source: BIR Annual Reports

Net estate is determined by subtracting the total amount of allowable deductions² from the total fair market value of the gross estate. Given the level of deductions allowable, estate tax will not affect the poorer socio-economic groups within the community. Therefore it cannot be regarded as an impediment to the objectives of LAMP.

From 1995 to 2000 there has been a decline in the amount of tax collected, which would indicate that there has been no real increase in the tax base due to increases in real property valuations. However, it should also be noted that this tax is unpredictable, as evidenced by its erratic behavior over the six-year period.

Donor's Tax

Donor's tax is imposed on the gratuitous transfer of property between two or more persons who are living at the time of the transfer. In a survey of RDOs in Quezon City and Manila City it was established that virtually all donations are real property and therefore no adjustments in figures were necessary.

2. These include, most importantly, a standard deduction of P1,000,000, funeral expenses up to P200,000; medical expenses during the last year of the decedent's life; the net share of the surviving spouse; and the fair market value of the decedent's family home up to a maximum of P1,000,000.

**Table 2.5: Donor's Tax Collections, CYs 1995 – 2000
(P Million)**

Year	Collections	% change
1995	129	
1996	148	15%
1997	210	42%
1998	134	-36%
1999	123	-8%
2000	156	27%

Source: BIR Annual Reports

The taxable base is the fair market value of the total net gifts made by a donor during the calendar year, excluding those made to charities and related organizations. The rates are low by world standards, and the P100,000 exemption means that this tax will not affect the poorer socio-economic groups within the community..

The tax collected, shown in Table 2.5, reflects the pattern of other national government taxes with a rise in the mid-1990s, a fall in 1998, and some recovery in 1999-2000.

Both Estate and Donor's taxes, which collectively are referred to by BIR as the 'transfer taxes' are minor revenue raisers for the GOP. The ratio of these transfer taxes to total tax revenue is only 0.18 per cent.

Documentary Stamp Tax

The DST is considered one of the most reliable taxes because it is easy to collect and enforce. This is because a corresponding DST is paid each time financial documents like securities are transferred. Failure to attach the stamp will render the documents unacceptable in third party transactions and cannot be used as evidence in court. Total DST collections are given in Table 2.6.

**Table 2.6: Documentary Stamp Tax Collections, CYs 1995 – 2000
(P Million)**

Year	Collection	% Change
1995	12,034	-
1996	12,399	15%
1997	14,292	15%
1998	16,477	16%
1999	15,680	-18%
2000	15,540	-1%

Source: BIR Annual Reports

Current BIR reporting makes it impossible to determine the exact share of real property-related collections of DST. The following estimates have been made for 2000:

- Section 196, for deeds of sale and other conveyances of real property, uses the same tax base as CGT plus CGT-exempt cases (those where VAT is

involved), and therefore can be calculated by taking the tax rate, 1.5% and applying it to the derived tax base, as follows:

CGT: P3,451 million divided by 6% = P57,516 million

VAT: P1,002 million divided by 10% = P10,020 million.

The tax base in total would be approximately P67,500 million.

DST would amount to approximately P1,000 million at the rate of 1.5%.

- Section 195, for mortgages, presents an added problem because it is not possible to get information on the percentage of CGT-related transactions which are financed via mortgage. The following assumptions are made:
 1. the CGT tax base of P57,516 million is understated in comparison to the "real" consideration (see Section 2.3, below), and presumably "real" consideration is reflected in the mortgages and therefore in the amount of DST.
 2. conservatively, "real" consideration could be at least 30% higher (based on pure speculation). Therefore consideration is closer to P75,000 millions.
 3. mortgages will relate to two thirds of consideration (based on pure speculation).
 4. therefore the appropriate base to use in calculation is P50,000 million which would result in DST of P100 million at the tax rate of 0.2 per cent after the first P5,000.

Under Section 194, the only tax base that can be calculated relates to VAT on the lease of real property, which totals P1,665 million. This translates into a tax base of P16,650 million; applying the Section 194 tax rate (0.1%) DST is estimated at P17 million.

Total DST relating to real property is therefore estimated at P1,117 million or approximately 7% of total DST in 2000. This percentage would have changed over time because of the changes that have occurred in the Section 196 tax rate over time.

Value Added Tax

The VAT is a business tax imposed and collected from the seller in the course of trade or business on every sale of properties (real or personal), lease of goods or properties (real or personal) or vendors of services. It is an indirect tax, thus it can be passed on to the buyer.

VAT is charged on three different types of land-related transactions:

- Buying and selling of property as a business (this group is exempt from CGT);
- The income of real property market professionals such as brokers, lawyers, banks etc. The VAT collected on these two types is estimated to total P1,002 million.
- Leasing of property; collections are P1,665 million.

related activities. The bulk of collections, 63.7 per cent, was collected by the LRA; the DENR collected 35.7 percent.

E.O No. 197, dated January 2000 , authorized the increase by at least twenty-five per cent in the fees and charges of all departments, bureaus, commissions, offices, etc. of the GOP, but it has not been implemented⁵.

**Table 2.8: Fees and Charges Collected by National Agencies, CY 2000
(P Million)**

Collecting Entity	Collections	Percent
BIR	10	0.59%
LRA	1,080	63.7%
DENR*	605	35.7%
Total	1,695	100%

*Includes collections of LMS of P33 M (LMS), P13 M (FMS) and P2 M (EMB) based on estimates from a 10% sample of all CENROs, PENROs and DENR-ROs in the Philippines.

BIR Fees

BIR imposes fees to recoup costs of services for issuance of certifications of different documents (e.g. obtaining information re: zonal values of real properties, or establishing that no zonal value exists on a property). The rate is P25.00 per page. People applying for these services include property owners, brokers, taxpayers, appraisers, and others. An estimated total of P10 million has been collected, which is 0.60 per cent of total fees and charges.

LRA Fees and Charges

Fees and charges⁶ of the LRA in CY 2000 registered a total of P1,080 million paid by landowners to:

- Clerk of Court 0.5 million
- Administrator 1.3 million
- Register of Deeds 1,078.0 million

LRA's collection represents 63.7 per cent of the total fees and charges of the GOP. The ROD collects the bulk of these fees, most of which are very minimal, to recover costs of the certificate of registration and other forms and services.

DENR Fees and Charges

Investigations in the LAMP pilot areas reveal anecdotally that despite the minimal rates of DENR charges⁷, poor landowners find it difficult to raise the money to pay them. This is primarily, however, because there are hidden costs that go along with the formal ones. An anecdotal example is that of an applicant who approached a

5. A Task Force on the Revision of Fees and Charges was created under A.O. No. 255 issued in 1996 and charged with the synchronization of the accounting and reporting of collections of fees and charges and the monitoring of their revisions. LRA has made proposals to increase fees by 100-300% It was estimated that the increased fees and charges will yield some P2,450 Million in revenues.

6. refer to Annex C, pp. 37 and 53 for specific rates and service performance

7. see Annex C, pp 53-59 on the specifics of DENR fees and charges.

CENRO office in Region XI and had his application for a patent accepted by the OIC but was told that his records were in Manila and that someone would have to go to Manila and collect them. This would involve a return airfare of P8,250. When the records were recovered the applicant was told that there were some errors in the survey plans and another survey would have to be carried out, the cost of which was P5,000. Once the survey was done the applicant was told that the signing authority needed a P5,000 facilitation fee and so the story continued; estimated costs for facilitation could be between P20,000 and P30,000. This illustrates that it is not the formal costs that are a barrier but the informal costs, which are required to get action, in addition to existing bureaucratic procedures.

2.2 Local Government Taxes and Fees

A review of the LGU revenue structure shows that real property taxes are a major source of locally-generated revenue, along with business taxes. The Local Government Code (LGC, R.A. 7160, effective January 1, 1992) has attempted to give LGUs greater autonomy in mobilizing resources and in allocating them to meet local needs. Among other things, the LGC expanded the tax base of LGUs. Second, it increased the maximum allowable rates at which most local taxes may be levied, although it effectively reduced the assessment levels for purposes of real property taxation for residential land, all types of buildings, and all types of machinery. Third, it markedly liberalized the scope for LGU credit financing, and fourth, repealed some of the statutory requirements that limited the latitude of LGUs in allocating their budgets.

A. Local Government Taxes

Real Property Tax

Real properties are the most stable tax base of LGUs. There are four taxes on real property: basic Real Property Tax (RPT), Additional RPT for the Special Education Fund (SEF), Idle Land Tax, and Special Levy (see Table 2.9). The taxable base of the real property taxes is the assessed value, which is the product of the fair market value and the assessment level, a percentage of fair market value established by the LGC. The tax rates and levels embodied in the code are ceilings, except for the SEF,⁸ and local governments are empowered to adopt the maximum or lower rates.⁸ Assessment of property is based on the actual use of the property regardless of its location.

8. According to National Tax Research Center (NTRC) inquiries, virtually all, if not all, LGUs use the maximum rates of tax and maximum assessment levels.

Table 2.9: Taxes on Real Property, Tax Base and Tax Rates

Real Property Taxes	Tax Base	Tax Rates in Provinces	Tax Rates in Cities and MM Municipalities
Basic RPT	Actual use; assessed value	Not exceeding 1%	Not exceeding 2%
Additional RPT for SEF	Actual use; assessed value	1%	1%
Idle Land Tax	Actual use; assessed value	Not exceeding 5%	Not exceeding 5%
Special Levy on Land benefited by local public works	Actual use; assessed value	Not exceeding 60% of the actual cost of the projects and improvements	Not exceeding 60% of the actual cost of the projects and improvements

Source: Local Government Code, Book 2, Title 2.

Tax Base and Tax Rate

The rate of the basic RPT is 1% for provinces and 2% for cities and Metro Manila municipalities, but no floor or maximum rate is set. The rate of the idle land tax was raised from at most 2% to not more than 5%. The additional RPT for SEF tax remains at a rate of 1%. The proceeds of the additional 1% RPT for SEF accrue exclusively to the respective Local School Boards. Nationally, about 10 per cent of real properties are exempted from paying RPTs.

Valuation of Real Property

Real property is appraised by the LGU assessor at Fair Market Value (FMV), for land, buildings, and machinery separately. The LGC sets out “assessment levels” as a percentage of FMV (see Table 2.10 for the schedule of maximum assessment levels). The local sanggunian can opt to adopt them or lower levels. Local assessors are required to make a general revision of real property assessment every three years but in practice it is done less frequently. This is compounded by the fact that sanggunians frequently refuse to accept the new schedules of FMV, implying that the tax base for the RPTs is increasingly undervalued.

RPT Performance – Incentives to collect the tax is weak. Collection is a responsibility of the municipalities but the municipalities are required to share the revenue with the provinces and the barangays. Of the basic tax revenues collected, the municipality is required to deliver 35 percent to the province and 25 percent to its component barangays. It keeps only 40% for itself. Yet the municipalities bear most of the cost of administration and collection (Loehr and Manasan, 1999).

Table 2.11 shows total collections and taxable assessed value from 1996 to 2000. Unlike the national transactions taxes, RPT collections have increased every year. The only indication of possible problems is that since 1997, collections have risen more slowly than assessed value.

Table 2.10: Assessment Levels Applied to Fair Market Value

a) Lands		b) Buildings and other structures		
	Assessment Level		Valued at:	Assessment Level
Residential	20%	1) Residential	not over P175,000	0%
Agricultural	40%		175-300,000	10%
Commercial	50%		300-500,000	20%
Industrial	50%		500-750,000	25%
Mineral	50%		750-1,000,000	30%
Timberland	20%		1-2,000,000	35%
			2-5,000,000	40%
			5-10,000,000	50%
c) Machinery			over 10,000,000	60%
Agricultural	40%			
Residential	50%			
Commercial	80%	2) Agricultural	not over P300,000	25%
Industrial	50%		300-500,000	30%
			500-750,000	35%
			750-1,000,000	40%
d) Special Classes				
(assessment levels for all lands, buildings, machinery, and other improvements)			1-2,000,000	45%
			over 2,000,000	50%
Cultural	15%	3) Commercial/ Industrial	not over P300,000	30%
Scientific	15%		300-500,000	35%
Hospital	15%		500-750,000	40%
Local Water Districts	10%		750-1,000,000	50%
			1-2,000,000	60%
			2-5,000,000	70%
Government-owned or controlled corporations engaged in the supply and distribution of water and/or generation and transmission of electric power: 10%			5-10,000,000	75%
			over 10,000,000	80%
		4) Timberland	not over P300,000	45%
			300-500,000	50%
			500-750,000	55%
			750-1,000,000	60%
			1-2,000,000	65%
			over 2,000,000	70%

Source: Local Government Code, Sec. 218.

Table 2.12 gives a regional breakdown of RPT collection in CY 2000. The striking features of this table are:

- the low share of RPTs in total revenues of LGUs
- the dominance of Metro Manila in total collections,
- the low efficiency of collection in all regions,
- the very low collection totals in most regions,

Further discussion of the issues involved with RPTs is found in Section 2.3.

Table 2.11: RPT + SEF Collections and Tax Base, 1995 – 2000
(P Million)

Year	Actual Collection	Annual % Change	Taxable Assessed Value	Annual % Change
1995	6,987		470,373	
1996	8,445	21%	548,964	18%
1997	10,377	23%	656,661	18%
1998	11,358	9%	777,249	19%
1999	12,841	13%	891,230	15%
2000	14,702	14%	1,057,151	19%

Source: BLGF

Table 2.12: Local Government Revenues by Region, CY 2000

Region		(P million)		RPTs as % of Total LGU revenues	Regional share of total RPTs collected	Collection efficiency* (1999)
		Total Revenues	Real Property Tax Collections ⁹			
NCR	Metro Manila	25,834	7,532	29.2%	48.5%	55.3%
I	Ilocos	6,760	363	5.4%	2.3%	50.9%
CAR	Cordillera	3,597	169	4.7%	1.1%	48.8%
II	Cagayan Valley	5,518	135	2.4%	0.9%	32.1%
III	Central Luzon	11,476	1,256	10.9%	8.1%	60.0%
IV	Southern Tagalog	20,858	3,011	14.4%	19.4%	55.6%
V	Bicol	6,314	215	3.4%	1.4%	36.9%
VI	W. Visayas	10,380	683	6.6%	4.4%	44.7%
VII	C. Visayas	10,020	736	7.3%	4.7%	57.7%
VIII	E. Visayas	6,346	175	2.8%	1.1%	41.5%
IX	W. Mindanao	4,813	100	2.1%	0.6%	39.7%
X	N. Mindanao	5,316	317	6.0%	2.0%	70.1%
XI	S. Mindanao	8,993	538	6.0%	3.5%	47.5%
XII	C. Mindanao	4,397	180	4.1%	1.2%	49.7%
XIII	Caraga	4,300	126	2.9%	0.8%	48.8%
ARMM	Autonomous Region	3,127	10	0.3%	0.06%	20.0%
	TOTAL	138,049	15,544	11.3%	100.0%	54.1%
	Total less NCR	112,215	8,012	7.1%	51.5%	52.4%
	Total less NCR + IV	91,357	5,001	5.5%	32.2%	50.7%

* Defined as actual collections as a percentage of the "target" established by BLGF.

Source: BLGF and COA

Transfer Tax

The province may impose a tax on the sale, donation, barter, or on any other mode of transferring ownership or title of real property at the rate of not more than one-half of one per cent (up to three-fourths of one per cent in cities and Metro Manila municipalities) of the total consideration involved in the acquisition of the property or of the fair market value in case the monetary consideration involved in the transfer is not substantial, whichever is higher. The sale, transfer or other disposition of real

9. The difference between this total and the RPT+SEF total for 2000 in Table 2.11 is due to the fact that penalties on payment of back taxes are included in Table 2.12 and not in Table 2.11.

property pursuant to the Comprehensive Agrarian Reform Law (CARL) is exempt from this tax.

Table 2.13 shows that collections during CYs 1995 to 2000 increased annually except in 1998 when they dropped by 19% with the adjustment in tax base. However, the succeeding years showed an increase. The discordance between the increase in Transfer Tax collections and decrease in those of CGT will be discussed in Section 2.3.

Table 2.13: LGUs Transfer Tax Collection 1995 – 2000¹⁰
(P Million)

Year	Collection	Tax Base (a)	Tax Base (b)	Annual % Change
1995	680	136,000	100,338	-
1996	823	164,760	121,438	21%
1997	875	175,000	129,111	6%
1998	710	142,140	104,764	-19%
1999	821	164,320	121,143	16%
2000	975	195,180	143,867	19%

Source: BLGF

Other Local Taxes

Idle Lands Tax

A province or city, or municipality within the Metropolitan Manila Area, may levy an annual tax on idle lands at the rate not exceeding 5% of the assessed value of the property, which shall be in addition to the basic real property tax. While this tax is part of the ordinances of many LGUs, it apparently has never been implemented.

Special Levy

A province, city or municipality may impose a special levy on the lands comprised within its territorial jurisdiction specially benefited by public works projects or improvements funded by the local government unit concerned. Limited to 60% cost recovery. In CY 2000, P8 million was collected.

B. Local Fees and Charges

Certification fees

For administrative work in relation to supplied certified copies of documents and certifications, minimal service fees are imposed per page or per certification issued. In CY 2000 about P23 million was collected.

10. Tax base (a) assumes that all LGUs taxed transfers at a rate of 0.5%. Tax Base (b) assumes that cities and MM municipalities tax them at 0.75%. In CY 2000, cities and MM municipalities accounted for 79% of transfers, and that proportion was also assumed for earlier years. To corroborate, it was established by survey that Metro Manila alone accounts for approximately 60% of transfers.

**Table 2.14: Summary of LGU Land-Related Revenues, CY 2000
(P million)**

Tax or Fee	Revenue
Basic Real Property Tax + SEF*	14,702
Transfer Tax	975
Special levy	8
Certification fees	23
TOTAL	15,708
REVENUE FROM ALL SOURCES	138,000

* Penalties on back taxes not included.

2.3 Issues Concerning the Structure and Performance of Taxes and Fees

1. The Erosion of the Tax Base of CGT

The CGT tax base, calculated by dividing collections by the tax rate (5% until 1997, 6% thereafter) (see Table 2.15) is only a fraction of what it was, particularly after 1997. The transfer tax base of LGUs, on the other hand, increased every year except 1998. Compared to either of the transfer tax base variants, there has been a significant decrease in the proportion of formal transactions (here defined to mean those on which transfer tax is due) that also pay CGT. The two tax bases are not exactly the same, as is discussed below, but they should follow similar trends.

**Table 2.15: Comparison of CGT Tax Base to Transfer Tax Base
(P Million)**

Year	Tax Base CGT	Tax Base Transfer Tax (a)*	Tax Base Transfer Tax (b)	CGT as % Transfer Tax (a)	CGT as % Transfer Tax (b)
1995	99,854	136,000	100,338	73%	100%
1996	83,490	164,760	121,438	51%	69%
1997	104,088	175,000	129,111	59%	81%
1998	73,120	142,140	104,764	51%	70%
1999	61,615	164,320	121,143	37%	51%
2000	57,663	195,180	143,867	29%	40%

* see footnote to Table 2.13 for an explanation of the two tax bases.

The CGT tax base is reduced by exemptions relating to principal residence, transactions involving entities in the business of buying and selling real property, and transfers covered by Estate and Donor's Taxes, whereas none of these is exempted from the transfer tax. Only if all of these exempted categories have increased dramatically as a share of formal transactions would the different trends in the tax bases be explicable.

The analysis of adjustments in the CGT base to make it more comparable to the Transfer Tax base in the June draft report that is excerpted in Annex C of this report was done only for 2000; similar adjustments would have to be made for 1995-99 if

trends were to be made clear. Still, it is useful to repeat part of that analysis, and apply Transfer Tax base (b) to it¹¹:

- Principal residence exemptions are rarely given due to administrative problems¹² and therefore would not materially affect the tax base.
- VAT for sale of real property is recorded in BIR's Comparative Report of Collections for 2000 as 1,002 millions. Allowing for no deductions, this would involve a maximum adjustment to the CGT tax base of P10,000 million.
- Estate tax relating to real property is P264 million; using the average tax rate derived at 2.7% (in lowest range of exemption of P200,000 plus 5% between P200,000 and P500,000 and therefore results in conservative bias) plus allowing for all 22,000 returns to take full advantage of P1,000,000 in standard deductions, the tax base derived is P38,000 million plus P8,000 million to take advantage of P1,000,000 principal residence exemption.
- Donor's tax relating to real property which is P156 million and average tax rate derived at 2.4% which results in tax base of P7,000 million.

Total adjustment would be in the vicinity of P55,000 million. Therefore the 2000 tax base for CGT could be estimated at approximately P140,000 million and CGT at P8,400 million. At this level CGT collection relative to DST collection would return to the mid-1990's level (13% versus 12% which reflects the increase in CGT tax rate). The CGT tax base, at this new level, would be 72% of LGUs tax base.

That analysis was done assuming Transfer Tax base (a). Using base (b), the numbers are smaller but still significant: the 2000 tax base for CGT would be approximately P90,000 million, so that CGT would be P5,400 million, P2,000 million more than was actually collected. The CGT tax base would have been 63% of that of the Transfer Tax.

2. The High Cost of Transactions

Transactions costs are high. Beyond the private-sector costs of surveyor, lawyer, real estate broker and notary public, government taxes and fees account for a large percentage of the value of the transaction. Table 2.16 shows a breakdown of the public sector costs for four transactions leading to the issuance of a Transfer Certificate of Title of different values, ranging from P174,000¹³ to P50,000,000, assuming honest declaration of the selling price. Because most of the taxes are ad valorem, the total costs are essentially proportional to the value of consideration, at 8.2% to 8.5%. Registration fees are regressive, declining by more than half as a percentage of consideration from the lowest to the highest value. The table shows

11. For further analysis of the CGT tax base problem, see Annex C, pp. 17-22.

12. The principal problem is that the tax must be paid at the time of transfer; BIR then places the funds in an escrow account until until the seller returns with proof that he or she has purchased a new principal residence.

13. This is a typical value of consideration declared at the ROD upon application for a TCT; perhaps coincidentally, it is P1,000 below the value at which residential buildings are exempt from RPTs.

Table 2.16: Costs of Transactions: Government Taxes and Fees

	Frequently Declared at ROD	% of Total	Average CGT Transaction	% of Total	Middle Class House 3,000,000	% of Total	Developer Transaction 50,000,000	% of Total
Consideration	174,000		470,000					
BIR								
Capital Gains Tax @ 6%	10,440		28,200		180,000		3,000,000	
Documentary Stamp Tax on sale @ 1.5%	2,610		7,050		45,000		750,000	
[Documentary Stamp Tax on mortgage]	358		950		6,010		100,010	
Total BIR (not including DST on mortgage)	13,050	87.8%	35,250	89.4%	225,000	91.0%	3,750,000	91.2%
LGU								
LGU Transfer Tax @ 0.5%	870		2,350		15,000		250,000	
LGU certification fee	30		30		30		30	
Total LGU	900	6.1%	2,380	6.0%	15,030	6.1%	250,030	6.1%
Register of Deeds								
Entry (assuming four required on average)	60		60		60		60	
Annotation (assuming mortgage involved)	60		60		60		60	
Certified copy of the Court order	15		15		15		15	
Issuance of transfer certificate of title	30		30		30		30	
Registration fees	728		1,638		7,098		112,848	
Certified copy of the document	15		15		15		15	
total RoD	908	6.1%	1,818	4.6%	7,278	2.9%	113,028	2.7%
Overall total -- government taxes and fees	14,858	100.0%	39,448	100.0%	247,308	100.0%	4,113,058	100.0%
Taxes and fees: percentage of consideration	8.5%		8.4%		8.2%		8.2%	
RoD fees: percentage of consideration	0.52%		0.39%		0.24%		0.23%	

clearly the predominance of BIR taxes in the total, about 90 per cent. This is an unacceptably high level of costs, and surely contributes to the weakness of the formal land market.¹⁴

3. The Weak Performance of Real Property Taxes

Incentives to collect RPTs are weak. Collection is a responsibility of the municipalities but the municipalities are required to share the revenue with the provinces and the barangays. Of the basic tax revenues collected, the municipality is required to deliver 35 percent to the province and 25 percent to the barangays. It keeps only 40% to itself. Yet, the municipalities bear most of the cost of administration and collection (Loehr and Manasan, 1999).

RPT delinquencies are a great problem. Manasan and Loehr state that despite sufficient powers under the LGC to enforce collection from delinquent accounts, the collection rate has rarely exceeded 60 percent during the period 1983 - 1997. Worse, the collection efficiency for the RPT declined from 56.7 percent in the pre-LGC regime to 53.8 percent in the post-LGC regime. Moreover, it is also shown that the RPT collection efficiency in both provinces and cities deteriorated, with the former suffering a bigger drop than the latter. Therefore, the RPT has not been as effective as it should be in bringing taxation to the level where local land administration services are found. This is indicative of an underdeveloped real property taxation system.

With the poor performance of RPT, including the failure of LGUs to generate a majority of their own revenues, it was concluded that the degree of fiscal decentralization declined with the implementation of the LGC. When measured by the Financial Autonomy Ratio (FAR), the FAR dropped from 51.6 percent in the pre-Code period to 36.7 percent in the post-Code period¹⁵. It is apparent that local revenue generation, of which the RPT is a main component, is lagging revenue generated through the IRA.

Clearly there has been a decline in collection efficiency. However the degree of the decline has no real lasting significance, as collections generally are poor. They reflect the fact that just over 50% of the community bears the burden of the tax. It has been suggested that the recent decline in the collection rate is due to a political seasonality factor, namely with an election due there is a community expectation that an amnesty may be given to back taxes, in part or full. The consequences therefore are: (a) revenue is foregone; and (b) back taxes accumulate at a rapid rate creating impediments for transfers in the formal market.

14. There are also private costs of transactions: fees paid to surveyors, lawyers, real estate brokers, and notaries public. The only private cost that is mandatory is the notarization of the signatures of the buyer and seller on the Deed of Sale or other conveyance. Lawyers charge on the order of 1% for transactions valued over P1 million, and 1.5-2% for lower-valued transactions, including notarial fees. Real estate brokers charge 5% on small transactions and as low as 3% on large ones. No data on the costs of private surveyors were readily available; any duly registered property would not have to be surveyed because the ROD would provide the buyer with adequate security.

15 Financial Autonomy Ratio (FAR) is computed as the ratio of locally raised revenues to local expenditures. It provides an indication of local government independence from central government funding.

As a source of revenue to LGUs the RPT suffers from important problems such as:

1. Out-of-date property assessments. Manasan (1998) shows that cities' RPT systems have not been able to capture the positive effects on land values that urbanization normally entails. Other jurisdictions have not re-assessed properties inline with current market values.
2. Only a partial inventory of real property. Some unrecorded property may be owned by local elites who want their holdings "off the record".
3. Confused titles among property owners and border disputes among provinces and municipalities.
4. Antiquated administrative tools.
5. Tax amnesties, occasionally decreed by provincial governors may encourage non-compliance
6. High collection costs due in part to small property size, low tax per property and difficult topography. Manasan (1995) examined a set of 14 provinces and found that in 11 of them the cost of collection exceeded the revenue collected
7. Incentive problems
(Loehr and Manasan, 1999)

Some key issues found in many researches may be summarized as they affect LGUs' revenue performance on land tax and fees, to wit:

- Inadequacy of own-sourced revenue renders the LGUs dependent on transfers from the national government through the IRA. Bird (1995:2) referred to this as the problem of vertical imbalance. Very few LGUs have exploited their own sources of revenues. Yet, all face budget constraints. In order to maintain allocative efficiency, LGUs should not normally be "bailed out" by the National Government when spending exceeds revenue.
- Absence of the "correspondence principle", that is, LGUs do not connect land taxpayers in particular and the service they receive. Real Property taxes should be able to connect local economic activity to local services well (Manasan, 1999).
- Collection efficiency is very low. Rarely does an LGU collect even half of the collectible revenues. The cost of collection exceeds the revenue collected, which implies that the RPT is a burden rather than a source of revenue. Over the years, collection efficiencies generally improved but cost of collection did not. (Loehr and Manasan, 1999)

A study of the Asian Development Bank in 1999¹⁶ attempted to gather revenue issues of LGUs, summarized as follows:

16. ADB, *Strengthening Public Finance and Planning of Local Government Units*, Technical Assistance No. 3145 – PHI, 1999. The study among others recommended for the establishment of an LGU-Development fund that would, in the short term parallel functionally with the MDFO with the former providing in the budget a block grant that would serve as an equalization fund particularly for resource poor LGUs. Access by LGU, however, would be subject to a Governance Performance Criteria. The fund is intended to eliminate gradually the LGUs' dependence from the IRA but in the long term, as the LGUs would have build better revenue performance (among others) the MDFO will be transformed into a Municipal Development Bank that would address LGUs financing needs. Included in the recommendation is the establishment of a valuation entity to provide support services for determining creditworthiness of LGUs. The ultimate goal of the

- Disparity in national revenue sharing schemes
- Disparity in the IRA share
- Continued reliance on the IRA
- Low collection efficiency
- Inadequacies of the Municipal Development Fund (Inaccessibility, lending and credit)
- Poor fiscal and budget planning
- Poor expenditures management practices
- Inadequacies in local development planning
- Lack of management system for the operation of economic enterprises e.g. cemetery, slaughterhouse, public markets, etc.
- Traditional functional organization for fiscal management
- Low capability level.

There are also significant numbers of properties exempt from payment of RPTs. They include those owned by the GOP (except when beneficially used by a taxable person); various charitable organizations such as the low-cost housing program, church groups, NGO's and People's Organizations; various utilities and environmental agencies; and registered cooperatives. The total of exempt properties is substantial, as is shown below.

Taxable Assessed Value =	P1,057,152 million with	20.7 million Real Property Units
<u>Exempt Assessed Value =</u>	<u>P130,946 million with</u>	<u>1.7 million Real Property Units</u>
Total Assessed Value =	P1,188,099 million with	22.4 million Real Property Units

Properties with 11% of assessed value are exempt. In addition, there are groups that receive preferential assessments levels - e.g. cultural, scientific, hospitals have an assessment level of 15% and local water districts, government owned water/electricity supply units have 10% residential homes with Market Value of P175,000 and below assessed at 0% level and therefore not required to pay RPTs.

Overall, The real property tax was intended to become the main source of own revenue for the LGU but it has not turned out to be (Loehr and Manasan, 1999).

4. Valuation Issues in Land Administration and Taxation

The various land administration and taxation agencies use different valuation rules to establish the basis for taxes and fees. Some examples from the June draft report, excerpts from which are attached as Annex C, are given in this section.

The understatement of the gross selling price to minimize the payment of the registration fee, which is based on consideration only, encourages practices that lead to payment of lower charges. An example cited at Manila City Register of Deeds had a condominium unit with a consideration of 600,000 where as the LGU valuation was 2,200,000 and the BIR zonal value was 2,600,000. In such a case nearly 5,000 pesos was 'saved' because of the understatement.

recommendation was to strengthen LGUs' capability in financing at the same time maximizing real property taxes.

Further, the estimated average valuation for LGUs transfer tax is P407,000 whereas the average consideration given to LRA for calculation of their registration fees is P174,000 (fees = 728 fees). The difference in fees = 1,419 - 728 = 689 pesos. It is this group that puts the 'package' together including the consideration to be used for LRA purpose.

National Government loses revenue from CGT if documented selling price is understated, as the practice tends to be lower than the valuation. And, if valuation is understated the revenue loss corresponds at least half of fair market value.

Expectedly, the government gains revenues from fees and other charges but it could also loss revenues if transactions are based on false data (e.g. low gross selling price, if rates used are outdated e.g. Clerk of the Court is using pre 1993 rates for filing an application/petition), and if fees collected from land transactions are not formally reported.

5. Specific Analysis of LRA Proposals for Fee Increases

LRA has recently made two proposals for increases in its registration fees. The analysis from the draft report excerpted in Annex C is presented here.

LRA's current proposal for an increase in rates of 100% or 300% assumes that this has to do with recouping of costs relating to a new computerized records system. This is still pending with the DOJ. This means that both the 100% proposal (earlier made) which would add an estimated 1,100 Millions in revenues and the 300% proposal which would mean 3 times the 1,100 Millions, would be contradictory to a strategy aimed at encouraging buyers/sellers to utilize the formal process. If rates increased by 300% there would be significant implications for land administration as an entity – that is, it would demonstrate a lack of commitment to what is being proposed, namely a consolidated strategy aimed at improving the land titling and land registration system in the Philippines. Although E.O 197 provides for at least 25 percent increase in fees and charges but the proposed 300 percent could be unattractive to landowners. Given the CPI figures below the defendable increase would be limited to 50%.

Consumer Price Index (CPI) and Inflation rate,
1994 = 100

<u>Year</u>	<u>CPI</u>	<u>Growth rate</u>
1994	100	8.3%
1995	108	8.0%
1996	117.8	9.1%
1997	124.7	5.9%
1998	136.9	9.8%
1999	146.0	6.6%
2000	152.3	4.3%

It is considered that the same proposed level of income could be raised if buyers/sellers were having the fee based on a more realistic consideration. An initial step in achieving that objective would be to realize that the stated consideration is erroneous and therefore base the registration fee on LGU or BIR valuation. This would go a long way to increasing the revenues to the stated levels. To simply double fees will be to penalize those taxpayers who do the right thing and state the correct consideration as opposed to those who halve the consideration and therefore halve the fee due. Also it is considered that increased revenue should result from

increased use of the formal market process. Higher fees would discourage this and therefore may not result in the anticipated gains.

Any increase in fees by the LRA together with its current Special Fund on a 20% share of its total fees collection have to be looked at carefully within the context of the entire land administration system. The LRA should serve as a cost recovery agency.

To this should be added the recommendation to adjust the registration fees on TCTs so that their progressivity, or at least neutrality, with respect to value of consideration is guaranteed. This could be done either by converting them to an ad valorem rate or by enabling the top fee increment to adjust with inflation.

6. Impact of Land Taxes and Fees on Stakeholders

The investigation on the foregoing structure of taxes and fees applied in land titling, registration and transactions showed the following indicative impact:

Since the rise to 6% in 1998 of the CGT, tax avoidance or minimization appears to have increased substantially. Taxpayers are simply not willing to pay this tax, and thereby do not formalize their transactions. Their dissatisfaction in fact lost money on the transaction. Taxpayers would be more satisfied with a conventional CGT as they would not then be liable for such a tax. As a result, taxpayers would have the tendency to understate the selling price, particularly if they have already lost money on the transaction and want to minimize their tax liabilities.

In areas where there are security problems (e.g. where there are informal settlers) landowners are looking to sell their properties at low prices but the burden of CGT discourages them from doing so. It is the buyer that often assumes the burden of CGT and therefore depresses land market activity. As a result, the income of private surveyors, banks, credit agencies, real estate agents, brokers and others who depend on the land market for their livelihood is lessened by a high CGT. Government then loses additional revenue through VAT and Income Tax.

In the case of squatters, if they form an association and buy the land from the owner via the Community Mortgage Program (CMP), they are exempted from the CGT but subject to Documentary Stamp Tax based on actual consideration of sale or under Section 6(E) whichever is higher.

The lowering of the schedule of estate and donor's tax rates as well as the standard deduction of one million pesos and family home deduction with a maximum of one million pesos (estate) has resulted in recent lower collections from this source. Donors can manipulate the tax to their advantage in the following ways: (a) inflate the price of the donation to the Government or to charity so that they can claim a tax advantage; (b) donate the property in effect to themselves by the setting up of a foundation; and (c) donate a portion of the land to the government or other organization with a view to improving the value of the remaining portion of the property. Moreover, corporate or individual taxpayer service providers pay value added tax but invariably pass on the burden of the tax to their clients/customers.

Property owners are the driving influence in the LGUs political arena and the group most affected by real property taxes, namely through the Real Property Tax and

Special Education Fund tax. They are keen to see taxes kept as low as possible and are mostly likely to complain if they believe there is inequity. As a consequence there is constant pressure on assessors to record low market values against properties. Ironically this group is the biggest abuser of the tax system, as many fail to pay taxes when due.

Sellers and Buyers want low fees to encourage activity within the land market. Fees imposed could either reduce the buyer's ability to pay a higher price or a contractual arrangement whereby the seller meets all associated transaction fees. However LRA fees are quite low at present and would have little impact on sellers' decision to participate in either the formal or informal market. LRA's proposal to increase fees by 300% would change this. On the other hand, buyers could pay the fees and therefore bear the burden.

It is the buyer who often assumes the burden of transfer taxes and other administrative costs incurred by the seller. Therefore the higher transfer costs in terms of taxes and fees the less likely is the buyer to want to purchase or alternatively deal in the formal market. Back taxes would be the buyer's biggest burden, as these no doubt are passed on to the buyer, if not in total, in part.

Potential sellers will oppose any increases in transfer taxes and associated administrative fees as they adversely affect the market. As transfer fees are based on the consideration or LGU determined market value, this group has a vested interest in keeping 'fair market' values low. However, individuals are not 'repeat' short-term sellers and normally would be unaware of these charges until they enter the property market. Sellers would encourage transactions through the informal market as they can only benefit from such a process. That is, they are more likely to gain a higher price for their property and are not burdened by 'lack of security' considerations. This group would see back taxes as a significant impediment to the selling process, particularly if the sale has to go through the formal process.

Corporate sellers pay transfer taxes and incur annotation/certification and copying fees. They are more likely to be involved on a regular basis than individuals and certainly would have more political influence. This group would oppose increases in charges as a matter of course. Also, in general, the sums involved in corporate transactions would be higher than those of individuals and therefore their costs would be substantial. However it is less likely that this group would be transacting business through the informal market.¹⁷

Non-government entities such as private surveyors, lawyers, banks, credit agencies, real estate agents, brokers and others who depend on the land market for their livelihood want fees and charges to be as low as possible to help stimulate activity within the land market because their income is dependent on such activity. They would encourage practices that lead to lower charges payable. This would include

17. This group was also heavily involved in real property development and market speculation in the boom years of the mid-1990s. The collapse of property prices after 1998, with consequent need for distress sales of property by overextended banks, developers and speculators, has meant that actual selling price or consideration may be lower than either BIR or LGU valuation, so that one of the latter two will be used as the tax base for CGT and DST. This makes the transactions tax burden even higher than the nominal rate.

reporting considerations lower than actuality and having valuations set at well below market price. This group would also have to play an active part in the informal market and one of the ways in which the informal market can be discouraged would be to penalize this group in some manner.

GOP Although allocations to LGUs are fixed by law, the failure of LGUs to collect taxes and fees due to them places pressure on the National Government to maintain the current allocation percentages when funds could perhaps be put to better use. Therefore when LGU revenue from transfer taxes is forgone because of low valuations, or if Real Property Tax is not collected, it is the National Government that ultimately bears the burden.

In 2000 revenue for LGUs was derived from:

- 11% (15,500 millions out of 138,000 millions) real property tax
- 19% from other local sources
- 5% from other sources
- 65% from Internal Revenue Allotment

Also, expenditure by LGUs has increased more than the CPI through the years 1996 to 2000. CPI movement has been 30% while revenue (expenditure) has increased nearly 70%.

Since the distribution to LGUs by the IRA is linked to a percentage entitlement rather than identified needs, it means that as the government improves revenue collection in other areas the LGUs benefit through no extra effort on their part. In fact the more they get from IRA the more likely they are to be less active in revenue collection in relation to real property tax. It allows them to claim a political advantage by not imposing higher local taxes. However all that is happening is that the burden is being transferred to the national government. Therefore the National Government is interested in reforms that increase revenue from real property taxes.

LGUs directly benefit from the collection of taxes and recovery of costs. However, with reference to the previous discussion about GOP, it can be seen that taxes on land ownership, use and transfers only constitute a small proportion of LGUs total revenue and since they are politically sensitive, the notion of rigorously pursuing local taxes is not embraced enthusiastically by most LGUs.

There are, however, two separate issues for these LGUs in relation to local property taxes: (1) Determining how much to collect and (2) Collecting what is owed. The current situation is inequitable. Just over half the taxpayers contribute to general revenue via RPTs (assuming that the nonpayers have the same property values as the payers). If all due taxes were collected, tax rates could be reduced or alternatively more funds would be available to provide the community with a better services.

It should be noted that the LGUs have no reason to see their delinquencies pool shrink. That is, they do not 'write off' back taxes, preferring instead to keep them on the 'books' until such time as the property is sold. Therefore, there is a need to provide LGUs with incentive to remove back taxes from their 'books' if a strategy to

minimize back taxes is adopted. Back taxes are seen as one of the major impediments to the formal market.

Local School Boards are the hardest hit by non-collection of property tax for SEF as they derive funds from this source and are not compensated from IRA. The SEF is automatically released to the school boards, divided equally between the province and municipalities, in the case of provinces. The proceeds are allocated to the following as determined and approved by the local school board:

- Operation and maintenance of public schools
- Construction and repair of school buildings, facilities and equipment
- Educational research
- Purchase of books and periodicals
- Sports development

The need is critical because the GOP education budget includes very little for these items

Political parties and elected representatives would like to be seen as reducing taxes to bolster political advantage. They would support the idea of reducing tax rates, removing back taxes and encouraging the promotion of the formal market to improve land ownership security with a view to using it for loan purposes (and hence improvements).

Influential groups Well-known, large landowning families who have derived their wealth, status and power from previous grants of land and who have consolidated this power through the political process pose as a strong political force that is keen to influence any decisions affecting land administration. This group undoubtedly exploits the current system and therefore would oppose extensive change. It is unknown whether they pay land taxes at the level that they should, but they are likely to be powerful opponents to any move to improve collection or raise rates.

Informal settlers who claim formal ownership, are reluctant to pay the LRA fees, together with back taxes. This is a barrier to the issuance of a Certificate of Title. That is, this group may be satisfied with just the tax declaration as their claim to ownership.

While this group would tend to be less likely to pay real property tax and engage in the informal market it is also true that they would be affected by the accumulation of back taxes against properties that at some stage in the future they may want to lay more formal claim to.

It is known that informal settlers trade their 'right to claim' parcels. Therefore in an informal market involving verifiable claims to ownership it would appear that there is also a market relating to 'possible future claims'. This practice, of course, is detrimental to the process of official land titling.

Therefore, this group, for a multitude of reasons, may wish to see the status quo maintained - the current vagaries of the system might help them.

7. Impact on Land Markets

a. formal land markets

The economic issues of how real property-related taxes and fees affect the land market are given in Section 4 of this report. In this section the issues dealing with the market impact of tax administration are reproduced and edited from the June draft report.

- People are confused at being taxed at two different levels, national and local, for the same transaction.
- Different rules apply to the two transfer taxes: CGT grants exemptions to principal residence (although this is rarely claimed) and other categories of property, whereas local transfer tax does not.¹⁸
- the requirement to pay back taxes and the LGUs' transfer tax are impediments to the registration of title.
- the distribution of lands under the CARP adversely affects RPT collection because the landowners refuse to pay the tax once their land has been targeted.
- back taxes depress the land market, as they create an additional burden on buyers and sellers.
- National Government is losing substantial revenue by having the taxation base for registration fees as the consideration only. In the case of these fees the taxpayer grossly understates the consideration.
- The inadequacy of the current tax base has resulted to an even less collection. This is due to valuation systems that are seriously flawed in both theory and application
- Political improprieties and the existence of facilitation fees ensure values that do not represent fair market value.

Ironically, this breakdown in the determination of the tax base should have more to do with lost revenue than it does the registration of land transactions but the rates, per se, imply high transactions costs. Therefore taxpayers seek to avoid the costs.

b. informal land markets

This section summarizes the points made in Annex C, p. 65.

- Back taxes help create the informal market as buyers/sellers seek to avoid the burden that is built up over time. This indicates need to prevent back taxes accumulating to the extent they do and this can be achieved by:
 - Improved collections
 - Removing penalties as a means of encouraging payment
 - Prescription period for remedies for the collection of RPT as provided by the Local Government Code should be implemented.
- A major problem is Section 255 of Local Government Code: "Interests on Unpaid Real Property Tax," which sets the interest rate at 2% per month for the 36 months following the due date. If this is applied cumulatively, which it is in many cases, it has the affect of doubling the debt of the taxpayer.

18. It is fortunate that LGUs do not give exemptions from transfer tax, because it can thereby permit them to monitor changes in ownership; hence it is a measure to enforce the Real Property Tax.

- Back taxes identified in the last six years were shown to have accumulated to 41,000 millions (or 28,000 millions if BLGF figures used). This amount would be doubled because of penalties.

3.0 Costs of Collecting Land Taxes and Fees and Operating the Land Administration System

3.1 Costs Incurred by National Government

As stated in the previous section, GOP and LGU accounting and reporting systems make it difficult to separate the financial flows attributable to land administration from those of other parts of the government's activities. With that caveat, the best estimates possible are presented in this section.

A. BIR

BIR does not itemize the costs of collecting each of its taxes. One must therefore use partial or indirect methods to estimate them. A partial method is to study the structure of a sample of RDOs, assess the amount of work time and other expenses devoted to land-related taxation, and then try to scale up to the entire agency. Table 3.1 shows the results of this, based on information received from the Quezon City RDO. The result is an estimate of P61 million, or approximately 1.8 per cent of BIR's total expenditures.

**Table 3.1: BIR Land-Related Revenues and Cost Estimates, CY 2000
(P Million)**

Tax	Revenue	Expenditure to collect tax
Capital Gains Tax	3,459	28
Estate Tax	264	2
Donor's Tax	156	1
Documentary Stamp	1,117	8
Value Added Tax	2,667	21
Excise Tax	64	1
Income Tax	6,700	unknown
Certification Fees	10	minimal
Income from Forfeited Properties	17	minimal
TOTAL	14, 454	61
BIR Totals	360,802	3,438

Source: BIR Annual Report, CY 2000, information from Quezon City RDO

The other method is to look at overall costs and revenues of BIR and to make the assumption that the collection of land-related revenues has proportionate costs. Table 3.2 presents these results. Land-related revenues and numbers of tax returns filed are roughly equal shares of BIR totals. If costs are proportional to revenues, land-related costs would be approximately P137 million; if they are proportional to the number of returns, they would amount to about P123 million.

The indirect measures are about twice as large as the partial measure. All three, however, are very small in comparison to revenues, between one-half and one per cent, suggesting that BIR is an efficient generator of revenues for the GOP.

Table 3.2: BIR Revenues and Numbers of Tax Returns, CY 2000
(P Million)

	Total	Land-related	Percentage Land-Related
Revenues	360,802	14,444	4.00%
Number of returns*	9,018,751	322,284	3.57%
Expenditures	3,438		
proportional to revenues		137.2	
proportional to number of returns		122.8	

* number of returns for CGT, DST on CGT transactions, Estate and Donor's Taxes only

B. Other GOP Agencies

The costs of the other GOP land administration agencies are in theory easier to obtain. It should be noted, however, that it is not possible to separate their costs of revenue generation from those of service provision. But since they are essentially service providers whose fees and charges are intended to cover all or a share of their costs, this is not a serious problem. The available information is shown in Table 3.3.

Table 3.3: Revenues, Expenditures and Services of GOP Agencies, CY 2000
(P million)

Agency	Bureau	Revenues	Expenditures	Number of Services
LRA		1,080	595	
DENR	LMB	18.7	55	27,865
	LMS	48		668,231
	FMB	176.2	60.8	
	EMB	4.0		
	MGB	353	443	

3.2 Expenditures on Land Administration and Taxation by LGUs

As is true for the GOP agencies, LGUs do not categorize their expenditures in a way that would enable simple extraction of the costs of land administration and taxation. Table 3.4 shows the expenditure categories that most likely contain some elements of land administration. One can safely say that land administration and taxation comprise

Table 3.4: Expenditures of LGUs: CY 2000
(P million)

Total Expenditures	129,156	
General Public Services	55,352	42.86%
Administrative Services	1,307	1.01%
Treasury Services	4,767	3.69%
Assessment of Real Property	2,237	1.73%
Land Registration Services	39	0.03%

Source: BILG and COA

100% of Assessment of Real Property and Land Registration Services, but without detailed studies of the Administrative and Treasury Services there is no possibility of accurately calculating the share of their expenditures that is attributable to land administration and taxation. Two possible assumptions for estimating the share of Treasury Services is to calculate the proportion of land-related revenues in total revenues, or total locally-generated revenues. The former share is 11.3%, and the latter is 46.4%.¹⁹ Unfortunately this difference is too great to make estimates with any confidence. This study therefore relies on the estimates of the study presented in Annex C, shown in Table 3.5, below.

LGU expenditure for land administration and revenue collection varies considerably by type of local government. Metro Manila, which has over half the RPT revenue, expenditures are less than 4% of revenues, whereas they are 27% for the cities and 58% for provinces. If the provinces applied the same tax rate as the other two, the expenditure ratio would be 39%, that is, closer to the non-Metro Manila cities.

Table 3.5: RPT Revenue/Collection Expenditure Breakdown for Year 2000
(P Million)

Area	Revenue	Total Expenditure	Direct wages	MOOE	Capital Outlay	Total Expenditure as % of Revenue
Total	14,702	3,730	3,170	485	75	25.4%
Metro Manila	7,321	258	220	33	5	3.5%
Cities	2,628	707	600	92	15	26.9%
Provinces	4,754	2,765	2,350	360	55	58.2%

If the Special Education Fund tax were to be repealed, as one of the Options for tax reform in Section 5 of this report proposes, it would not be economically viable to retain the basic RPT in the provinces, either. In other words, if collection costs would not decrease with the elimination of SEF, provincial and municipal LGUs would lose money on collection.²⁰

19. The truth is probably somewhere in between. It is certainly easier for Treasurers to raise the revenues coming from IRA and the other intergovernmental transfers than to raise local revenues, but the administration of the transfer payments is not costless.

20. Of course many LGUs are already spending more on collection than they receive in revenues; these numbers are averages. Since every LGU must have an assessor's office and must run it, those LGUs collecting no real property taxes now (such as those in all ARMM provinces except one) are clearly making a loss.

4.0 Economic Impacts of Taxes and Fees: Key Issues

This section focuses on the two issues that most centrally affect the ability of the land administration system to contribute to sustainable, equitable economic growth: the effects of taxes and fees on real property market participation, and the revenue-generating potential of the current tax and fee structure. Previous sections of this report have identified the high rates of taxes on real property transactions as the principal financial constraint. This section discusses the ways they have this effect.

Figure 4.1 illustrates the mechanisms. High tax rates:

- discourage formal transactions because buyers and sellers find it harder to agree on a selling price;
- provide opportunities for officials within the land administration system to engage in inappropriate practices;
- make sellers and buyers seek nonformal ways of transacting to avoid the taxes and inappropriate practices, thereby reducing the number of formal transactions even further; and
- put pressure on the valuation system to reduce the assessed value of property to compensate for the high tax rates.

These direct effects compromise the land administration system by: 1) reducing its ability to generate tax revenue and 2) reducing its credibility with the population. Both of these “systemic” effects impair the ability of both national and local governments to fulfill their roles as supporters of social and economic development.

4.1 Constraints to Participation in Formal Land Markets

4.1.1 Current status of formal land markets

It is difficult to analyze systematically the extent to which taxes and fees discourage buyers and sellers of real property from formalizing their transactions. This is also the case for the institutional and legal problems of land administration described in the other policy studies. There are no reliable statistics on the overall activity of real property markets, even in relatively prosperous urban areas, and there has been no in-depth research on the question.

- There is no private real property information system such as a Multiple Listing Service.
- Government sources have incomplete and/or inaccurate data:
 - The Register of Deeds, which in most countries is an accurate source of information on the volume and value of transactions, cannot serve that function in the Philippines because an unknown proportion of transactions are registered (368,000 Transfer Certificates of Title issued in 2000);
 - Capital Gains Tax and Documentary Stamp Tax are paid on an unknown percentage of transactions (122,378 in 2000);
 - The records of LGU treasurers, who collect the Transfer Tax and charge certification fees on transactions, are of poor quality, as a survey of Metro Manila treasurer’s offices undertaken by the present study’s team discovered (see Annex B). There is no reporting of the number of transactions to BLGF.

Therefore the only ways to describe real property market activity are incomplete, anecdotal or indirect.

One “incomplete” approach is to study changes over time in CGT collections and number of returns filed. As Table 4.1 shows, both CGT collections and the number of returns rose from 1991 to 1995-1997, and both have fallen since then. The same is true of the number of Transfer Certificates of Title (TCT) issued by the RODs.²¹ This corresponds with the generally-accepted view that real property markets have been depressed since the Asian financial crisis. The trends probably reflect reality, but there is no way to know whether they are quantitatively accurate, because there is a missing variable: the percentage of transactions on which CGT is paid.

Anecdotes are numerous and are reported in the other policy studies as well as the LAMP Social Assessment. They can be summarized as illustrating the strong disincentives to participation in the formal market generated by bureaucratic procedures on one hand and – at least in the case of informal settlers – by the existence of alternative, informal, guarantors of tenure security (who may be partly responsible for some of the destruction of Registries of Deeds, according to some anecdotes). The Social Assessment also points out widespread ignorance in rural areas about the procedures that must be followed in order to formalize transactions. But knowledge of how to proceed may be equally discouraging: an examination of the steps required for registration of an ownership transfer will reveal the manifold opportunities for ‘facilitation fees’ to reduce the time required to complete a formal transaction.

One indirect method is an analysis of the contribution of real property to national income: if it grows more rapidly than average, it is helping the nation’s growth rate; if more slowly, it is hindering the growth rate. The National Accounts statistics show that real property-related sectors²² have grown less rapidly than the overall economy since 1990; this was as true prior to the Asian financial crisis as subsequently. As shown in Table 4.2, real GDP grew 32.5% over the decade, or nearly 3 per cent per year. Real property-related sectors, except for Finance (only a fraction of which is directly tied to real property), grew between 16 and 21%, or between 1.5 and 2 per cent per year. This is unusual in developing countries, where housing and industrial and commercial real property are generally income-elastic.²³ The result of this sluggishness is that real property values are not rising as fast as they should, thereby reducing the growth of the tax base for GOP and LGU taxation.

All three approaches indicate that real property markets are not fulfilling their roles of supporting sustainable, equitable economic development.

21. The ratio of CGT returns to TCTs has showed an irregular pattern, but is lower in the late 1990’s than earlier

22. “Real property-related” is defined here as the contribution to GDP of improvements (e.g. construction, including such things as irrigation infrastructure), plus value added in finance and real estate (the latter essentially the value of leases), plus the imputed rental value of owner-occupied dwellings. Formally it should be defined as the contribution of the land and improvements to economic growth, but the information necessary to calculate this is not available.

23. Income elasticity is defined as the percentage change in something, such as expenditure on real property, for a one per cent change in income.

Figure 4.1: The Effects of High Transactions Taxes

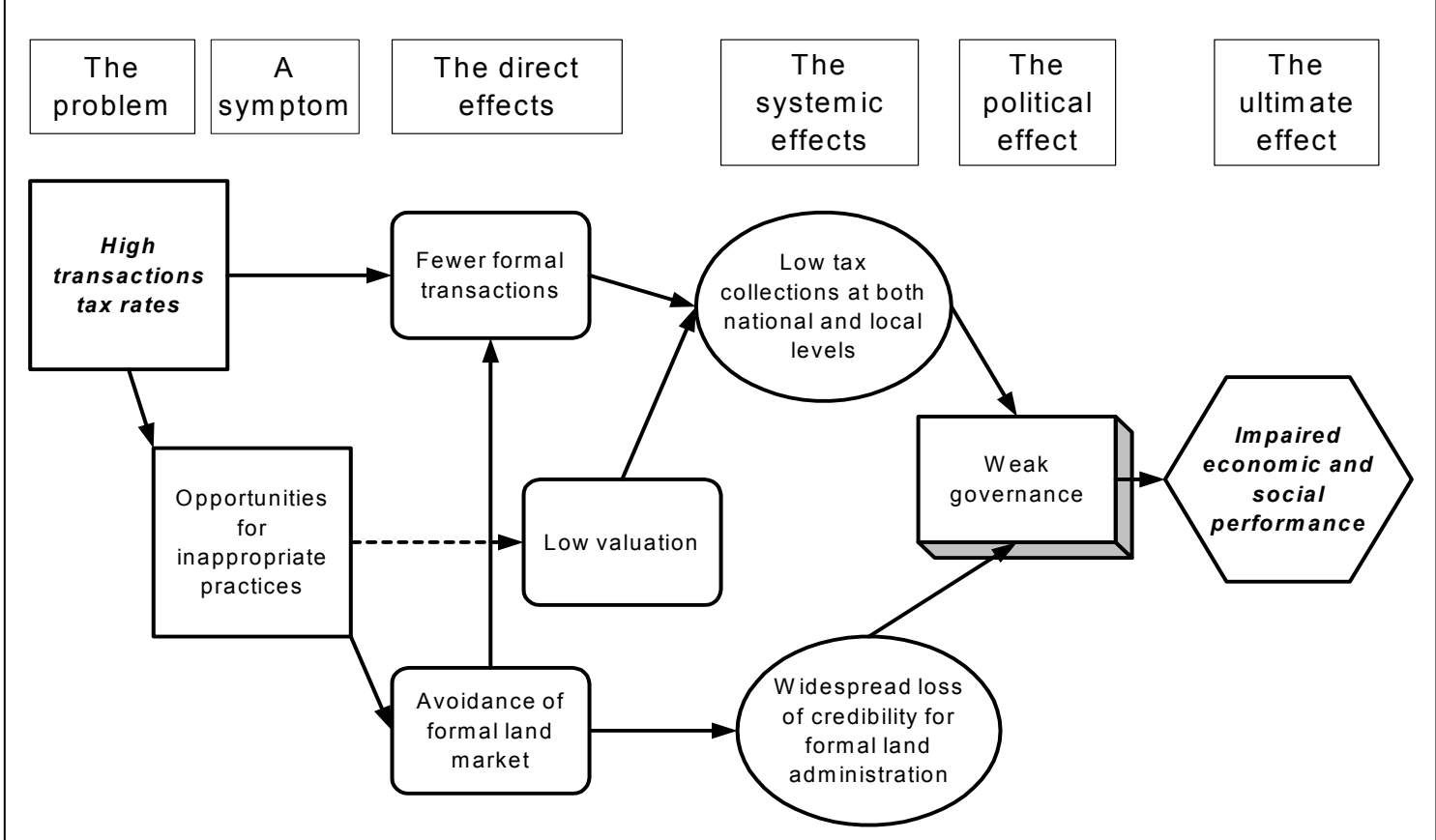


Table 4.1 Performance of the Capital Gains Tax, 1990-2000

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
CGT collections P millions	1,056	1,127	1,506	2,068	3,070	4,993	4,174	5,204	4,387	3,696	3,451
CGT returns filed	n.a.	133,087	145,788	154,646	159,141	148,856	156,238	151,265	136,327	133,211	122,378
CGT per return (P)	--	8,468	10,330	13,372	19,291	33,542	26,716	34,403	32,180	27,745	28,200
Deflators*											
Real estate	1.000	1.178	1.284	1.382	1.507	1.630	1.767	1.857	2.023	2.164	2.255
Ownership of Dwellings	1.000	1.183	1.385	1.557	1.760	1.963	2.180	2.396	2.632	2.850	2.965
Real value deflated by:											
Real estate	1,056	957	1,173	1,497	2,037	3,063	2,362	2,802	2,169	1,708	1,531
Ownership of Dwellings	1,056	953	1,087	1,328	1,745	2,544	1,915	2,172	1,667	1,297	1,164
Real value per return deflated by:											
Real estate	--	7,191	8,043	9,678	12,799	20,577	15,118	18,527	15,909	12,824	12,507
Ownership of Dwellings	--	7,159	7,458	8,587	10,963	17,088	12,255	14,360	12,225	9,736	9,509
Number of Transfer Certificates of Title Issued	n.a.	347,609	374,364	452,359	526,583	462,869	575,385	559,744	482,949	387,372	368,068
Ratio of CGT returns to TCTs	--	38.3%	38.9%	34.2%	30.2%	32.2%	27.2%	27.0%	28.2%	34.4%	33.2%

* Deflators are from National Accounts

Sources: BIR Annual Reports, Philippine Statistical Yearbook 2001, LRA unpublished data

Table 4.2: Real Property-Related Activity in Gross Domestic Product

	P million in constant prices of 1985			Percentage change from:		
	1990	1995	2000	1990-2000	1990-1995	1995-2000
GDP	720,690	802,224	954,962	32.5%	11.3%	19.0%
Construction	41,858	44,492	48,851	16.7%	6.3%	9.8%
Finance	29,968	33,852	46,717	55.9%	13.0%	38.0%
Real Estate	7,897	9,003	9,378	18.8%	14.0%	4.2%
Ownership of Dwellings	32,249	34,762	38,960	20.8%	7.8%	12.1%
Total of real property-related GDP	111,972	122,109	143,906	28.5%	9.1%	17.9%
excluding Finance	82,004	88,257	97,189	18.5%	7.6%	10.1%
Property-related share of GDP	15.5%	15.2%	15.1%			
excluding Finance	11.4%	11.0%	10.2%			

Source: *Philippine Statistical Yearbook*, 2001.

4.1.2. Taxes and Fees in the Land Market

Monetary transactions costs are significant. The national CGT and DST amount to 7.5% of the selling price, BIR or LGU appraised value, whichever is highest. To that is added the provincial or city transfer tax (0.5%, which cities may increase by 50%, to 0.75%), plus a small certification fee and the fees required for registration at the ROD; see the discussion in Section 2.3. Furthermore, in order to register the property and obtain a TCT, the buyer must obtain confirmation from the LGU treasurer that all real property taxes due have been paid in full. The fees, as is argued in Section 2, above, are quite modest. Given the valuation practices discussed in the Valuation policy study, the true tax burden in most cases is probably significantly less.²⁴

On the other hand, it can be argued that the high tax rates are a principal cause of the difficulties facing the valuation system. Assessors, zonal appraisers, and LGU officials surely recognize the potential political impact of adjusting to true market values, and might hesitate to do so even if they could. Buyers and sellers are more willing to pay 'facilitation fees' in the context of negotiations with the assessor or in order to avoid site inspection by the BIR.

4.2. Constraints to Revenue-Generating Capacity of the Formal Land Administration System

24. In certain segments of the real property market the opposite may be the case. Developers whose construction was halted during or after the Asian financial crisis may wish to sell at a loss, and banks that have foreclosed on nonperforming loans may wish to liquidate their assets, at considerably less than fair market value. If the actual selling price is below the zonal valuation, transactions taxes become an even greater percentage of the value of the property, thereby discouraging sellers from agreeing to sell. In other words, there is no longer a "willing buyer – willing seller" situation which is the conceptual prerequisite for the use of the actual selling price to determine fair market value.

Figure 4.1 also shows the mechanism by which the high transactions taxes can reduce tax collections. All three “direct effects,” low valuations, low numbers of formal transactions, and informal transactions, contribute. Thus, for example, the increase in CGT from 5% to 6% via R.A. 8424 in 1998 may have given transactors an additional incentive to pursue lower valuations or move to informality, and may have contributed to the depressed real property market already buffeted by the Asian financial crisis. Unfortunately, however, because of the near coincidence of R.A. 8424 and the crisis, it is impossible to disentangle their two effects. In any case, it is ironic that the high tax rates on transactions may contribute to the inability of LGUs to establish an accurate valuation base for RPTs. In other words, high transactions tax rates lead to low collections not only of transactions taxes, but also of local taxes on real property ownership. Together with the restrictive fiscal provisions of the Local Government Code described below, national tax policy renders LGUs relatively helpless to improve their revenue generation ability.

Analysis of the performance of the principal taxes on real property ownership and transfers shows that they are not uniform in their ability to respond to changes in the economy. Given the lack of disaggregated data on DST applied to real property transactions and the modest rate of the Transfer Tax, attention is focused on real property taxes, the principal tax on ownership, and the capital gains tax, the principal tax on transactions.

The two measures²⁵ shown in Table 4.3 demonstrate that RPTs have had more stability over the 1990s than has the CGT. The latter expanded rapidly in the first half of the decade, with extremely high buoyancy and a steeply rising share of GDP,²⁶ but thereafter buoyancy turned negative and the share of GDP fell back to its 1990 level by 2000. It should also be noted that the decline in CGT collections took place in a period when the components of GDP related to real property were rising, albeit more slowly than GDP as a whole (see Table 4.2). After a promising few years of growth, the CGT is losing much of its relevance as a source of national government revenue while, if our analysis is correct, retaining its negative effects on land markets. In 2000 it represented less than one per cent of the BIR collections of P360 billion.

Real property taxes, on the other hand, have had a buoyancy consistently greater than 1.0, i.e. collections rose faster than GDP, and thus their share of GDP rose consistently as well. It is interesting to note that RPTs have attained a share of GDP last seen in the 1970s, which Tan (1992: p. 23) recommended as a short-term target for collection by LGUs.

25. Buoyancy is defined as the percentage change in tax collections for a one per cent change in GDP; it is akin to the income elasticity defined above. But fiscal economists term this “buoyancy,” reserving the term “elasticity” for a measure corrected for intervening changes in the tax base (such as the CGT rate increase of 1998).

26. There is no clear explanation for the size of the increase in CGT collections. As Table 4.1 shows, the number of transactions rose, but not sharply. There were no important changes in BIR or other land administration agency procedures during the period, and while the economy was booming after 1992 real estate growth was not disproportional (see Table 4.2).

Table 4.3 Performance of Principal Taxes on Real Property

Buoyancy			Share of GDP		
Interval	RPTs	CGT	Year	RPTs	CGT
1990-2000	1.695	1.098	1990	0.30%	0.10%
1990-1995	1.481	4.846	1995	0.37%	0.26%
1990-1997	1.738	3.136	1996	0.39%	0.19%
1995-2000	1.507	-0.421	1997	0.43%	0.21%
1997-2000	1.155	-0.933	1998	0.43%	0.16%
			1999	0.43%	0.12%
			2000	0.45%	0.10%

In spite of the RPTs' fairly robust performance, there remain several issues regarding LGUs' financial capabilities:

1. the appraisal and collection system;
2. the problem of back taxes, both the requirement that all back and current RPTs must be paid prior to registering a transaction and the difficulties imposed by the LGC on the sale of real property seized for nonpayment of RPTs;
3. the specification of rates for RPT and SEF;
4. the structure of assessment levels;
5. the sharing of revenues among levels of local government;
6. the tax on idle lands;
7. the IRA and its effects on LGU tax effort;
8. the prescriptive nature of the Local Government Code's tax provisions.

1. The appraisal and collection system is universally recognized to be technically weak, politicized, and corrupt. Improvement on those dimensions, via training, professionalization of the assessors, and removal of their negotiating authority – as recommended in the valuation policy study – would clearly add to the revenue potential of LGUs while increasing equity and efficiency of the system.

2. BLGF estimates that delinquent RPTs total P7-11 billion per year. These are a liability rather than an asset (as accountants consider them) both for the formal land market and for LGU governance. Regarding the land market, the requirement that all back and currently-due RPTs be paid before a transaction can be registered in the ROD and a Transfer Certificate of Title issued is a serious barrier to formality. Given the periodic RPT amnesties (in 1975 and 1986, plus many by individual LGUs) and other forms of alleviating pressure on people to pay, as well as the reluctance of LGUs to seize real property for nonpayment of taxes, this requirement is a strong inducement to non-registration and hence informality of transactions. The Departments of Justice and Finance are pursuing a solution to this problem.

Concerning governance, the LGC obliges LGU treasurers to issue a notice of delinquency when the RPTs are unpaid, and thereafter to advertise the property for sale or auction. Treasurers are subject to administrative or judicial sanctions, including dismissal, for failure to do so. Yet very few LGUs take advantage of this approach to resolve the issue of back taxes, and therefore most LGU treasurers are violating the LGC (Sec. 259). The LGC complicates their duty by allowing owners to redeem the property within one year following the sale (Sec. 261). This undoubtedly decreases the interest of potential buyers, who would not wish to go through the

process only to lose the property shortly after having bought it. This is yet a good example of internal contradictions in legislation that make enforcement difficult, if not impossible.

3. The LGC fixes a maximum rate of 1% for the basic RPT in provinces, and 2% in cities and Metro Manila municipalities. It is not clear why the provinces are discriminated against in this way, nor why all LGUs should not be free to set their own rates as a function of their budgetary needs on one hand and political realities on the other. Similarly, the fixed 1% rate for SEF limits communities' abilities to contribute more to the education of their children than the national average of about P350 per student per year.²⁷ On the other hand, there is no minimum rate for either tax, presumably permitting more prosperous LGUs, or LGUs whose IRA allocation is large relative to their needs, to set lower rates. This inequity is presumably unintentional. Further, these constraints encourage municipalities to politicize the schedules of fair market values that form the basis for RPTs, thereby lowering confidence in governments.

4. Tan (1992: pp 7-9) terms the structure of assessment levels inequitable and inefficient. Referring to the wide range of percentages of assessed value that are applied to different categories of real property, she says: "As a whole the incentive effects of the RPT schedule run counter to the key development objectives of the government which are to stimulate productive investments in all sectors of production, preserve our forests and encourage their socially optimal use. Instead, the RPT structure seems to encourage large real estate holdings and investments in residential improvement." (p. 9). That structure, which is shown in Table 2.14, is also excessively detailed for buildings and other structures, with tiny distinctions in assessment levels among different classes of fair market value. The buildings schedule also suffers from "bracket creep," the increase in levels as fair market value increases over time due to inflation, so that everyone's assessment level will go up over time (except for the "special classes"). The problem with including the schedules in the LGC is that amendments will be necessary if any changes are to be made; it would have been better to specify them in an Administrative Order which could have been more easily modified if problems were identified.

Also, it appears from the BLGF and LGU data that the RPT on Machineries is very irregularly collected and hence inequitable. For example in NCR, two cities, Makati and Las Piñas, and one municipality, San Juan, there was no machineries assessed value in 2000. At the micro level, in one barangay in Sta. Rosa, Laguna which had over 1,300 buildings and about 4,000 land parcels, there were four machineries listed, one of which was exempt.²⁸ Only in about half the barangays in Sta. Rosa were any machineries assessed. The logic of assessing them is unclear, since they are also taxed indirectly via VAT on the services they provide. Overall, machineries are a small proportion of assessed value and probably a high share of appraisal costs, so exempting them from RPT would not be very costly to LGUs in terms of revenue and would save a good deal of the assessors' time. In some provinces,

27. based on an enrollment of 19 million in preschool, elementary and secondary schools and SEF collections of about P7 billion. The SEF accounts for less than 5 per cent of the cost of P-10 education.

28. information gathered by the National Land Valuation Adviser in a visit to Sta. Rosa Assessor's office.

however, machinery assessed value is quite high, usually because of major industries such as oil refineries, so LGUs would be reluctant to quit taxing them. Perhaps the best way of dealing with this issue is to take administrative action to inform LGUs that they may choose not to appraise and tax machineries if they feel that it would not be worth their while.

5. The basic RPT is distributed among levels of government by formulas shown in Table 4.4. This enables the different LGUs to provide services in their areas of responsibility, but the formulas reduce their flexibility to establish budgets that reflect their particular conditions, and reduce responsibility and accountability. The system common in the USA, where counties, cities and towns, as well as special districts like technical colleges, establish their own tax rates based on their own budgetary decisions, would be more desirable because it would give greater ability and responsibility to each LGU to determine its own budget and to be more directly accountable to its citizens. This would take time to implement, as LGUs have not thus far had to spend much time or effort worrying about the revenue side of their budgets. An alternative approach, that would ensure that municipalities have more responsibility toward their constituents, is to eliminate the province's share of RPTs, and readjust the IRA and possibly the division of responsibilities, between them and municipalities so that RPT revenues stay "at home," where their use will be more obvious. Municipalities could be advised (not required) to specify what use they were making of RPT revenues; this could increase support for, or reduce resistance to, this type of tax. This could be phased in over a number of years.

Table 4.4: Disposition of Basic RPT Proceeds*

Provinces	Share	Cities	Share	Metro Manila Authority**	Share
Province	35%	City	70%	Metro Manila Authority	35%
Municipality	40%	Barangay***	30%	Municipality	35%
Barangay	25%			Barangay***	30%

Source: LGC, sec. 271.

* the SEF is distributed 50% to the provincial school board and 50% to the municipal school board in the case of provinces

** municipalities

*** 50% to the barangay where the property is located and 50% shared equally among barangays

6. The Idle Lands Tax of up to 5% is to be applied at the discretion of LGUs to discourage land speculation and to induce landowners, especially large estate-owners, to put their land into productive use. It has not yet been implemented in any LGU.²⁹ That fact says quite a bit about the local political power of landowners everywhere in the Philippines. One real difficulty in implementing it should be noted, however: the lack of complete clarity in the definition of idle lands in the LGC. It would be an interesting challenge for the LAM program to work with one of the LGUs in a LAMP pilot area, first to inventory idle lands and then to experiment with imposing a modest tax, perhaps 1-2%, to see what happens.

7. The preceding three issues with the structure of RPTs pale in comparison to the most severe compromise to the ability of LGUs to exercise some independent decision-making and budgeting: the Internal Revenue Allotment (IRA). The LGC (sec. 284) prescribes that 40% of all proceeds of national internal revenue taxes³⁰

29. As of early July there are unconfirmed reports that Marikina has begun to assess this tax.

30. "based on the collection of the third fiscal year preceding the current fiscal year"

shall be transferred to LGUs. The distribution formula is predictably complex: 23% to provinces, 23% to cities, 34% to municipalities, and 20% to barangays. Among provinces, cities and municipalities IRA is shared based on population (50%), land area (25%), and equal sharing (25%).

In recent years the IRA has comprised nearly two-thirds of LGU revenues on average, and much more for rural and poor areas; by contrast the RPTs generate about 11% of revenues on average (see Table 4.5). The extreme example of dependence is ARMM, with 96.4% of its revenues coming from IRA.

Table 4.5: Local Government Resources (Revenues),

		CY 2000, by Region (P million)			Percentage of LGU Resources		RPTs as % of as- sessed value
Region		Total Resources	RPTs	IRA	RPTs	IRA	
NCR	Metro Manila	25,834	7,532	6,780	29.2%	26.2%	1.48%
I	Ilocos	6,760	363	4,990	5.4%	73.8%	1.37%
CAR	Cordillera	3,597	169	2,982	4.7%	82.9%	1.64%
II	Cagayan Valley	5,518	135	4,656	2.4%	84.4%	0.90%
III	Central Luzon	11,476	1,256	7,476	10.9%	65.1%	1.81%
IV	Southern Tagalog	20,858	3,011	12,789	14.4%	61.3%	1.05%
V	Bicol	6,314	215	5,333	3.4%	84.5%	0.91%
VI	W. Visayas	10,380	683	7,617	6.6%	73.4%	1.11%
VII	C. Visayas	10,020	736	6,358	7.3%	63.5%	1.49%
VIII	E. Visayas	6,346	175	5,573	2.8%	87.8%	0.91%
IX	W. Mindanao	4,813	100	3,999	2.1%	83.1%	1.02%
X	N. Mindanao	5,316	317	4,141	6.0%	77.9%	1.47%
XI	S. Mindanao	8,993	538	6,323	6.0%	70.3%	1.23%
XII	C. Mindanao	4,397	180	3,401	4.1%	77.3%	0.77%
XIII	Caraga	4,300	126	3,541	2.9%	82.3%	0.90%
ARMM	Autonomous Region	3,127	10	3,014	0.3%	96.4%	0.38%
	TOTAL	138,049	15,544	88,973	11.3%	64.5%	1.31%
	Total less NCR	112,215	8,012	82,193	7.1%	73.2%	1.18%
	Total less NCR+IV	91,357	5,001	69,404	5.5%	76.0%	1.28%

Source:BLGF and COA

In only 3 regions do RPTs amount to as much as 10% of LGU resources; only in NCR do RPTs produce more than IRA; and NCR plus Region IV, with less than 30% of the country's population, together account for more than two-thirds of RPT collections. This means that most LGU officials do not have to make politically risky efforts to raise revenue locally, and the last two columns of Table 4.5 show that they do not. In no region does RPT collection approach the potential of between 2 and 3 per cent,³¹ and except for Region X all regions have collection efficiencies below 70 per cent. The political consequence is that the community's residents do not have a personal stake in seeing how "their" money is spent by their local government.

31. the exact percentage depends on the proportion of assessed value in cities vs. that in provinces. In Region III, the region that comes the closest to reaching its potential, cities have about 30% of the assessed value so the potential collection rate would be 2.3%.

9. The “Declaration of Policy” in Sec.2 of the LGC states that

... the territorial and political subdivisions of the State shall enjoy genuine and meaningful local autonomy to enable them to attain their fullest development as self-reliant communities and make them more effective partners in the attainment of national goals. Toward this end, the State shall provide for a more responsive and accountable local government structure instituted through a system of decentralization whereby local government units shall be given more powers, authority, responsibilities, and resources.

This is a laudable policy, but it is unattainable under the current LGC. The LGC’s tax provisions make a mockery of decentralization. They prescribe so many aspects of the revenue side of LGU finances³² that local governments have little room to maneuver – other than reduce tax rates or their collection effort. Both of these are easy for them to do because of IRA, and doing them presumably maintains their popularity.

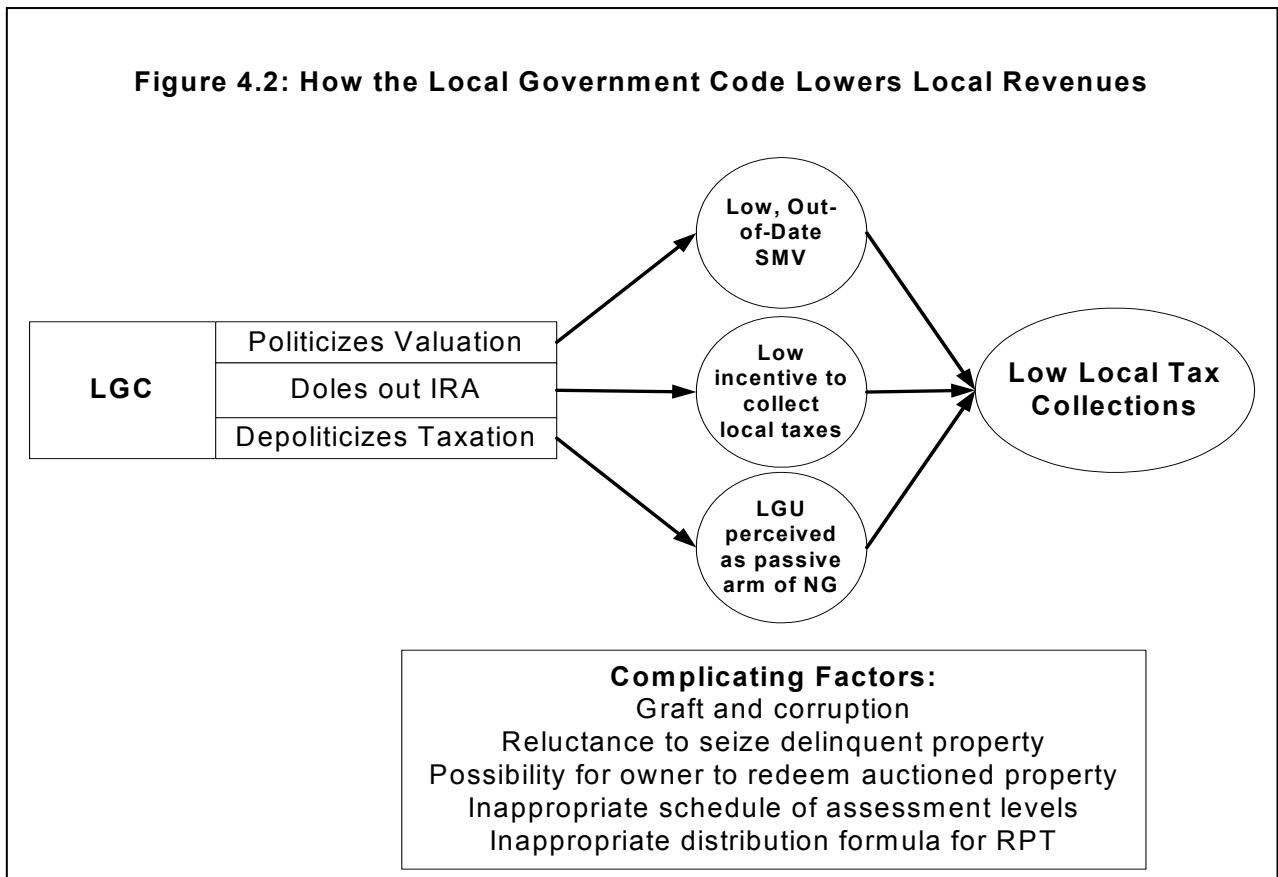


Figure 4.2 summarizes the problems with LGC provisions on local taxation. It politicizes valuation, which should be a dispassionate technical function. It depoliticizes taxation, whereas taxation is the ultimate political issue because it determines the distribution of income between government and the people. Finally, it creates disincentives for tax collection by distributing IRA automatically; LGUs’ performance has no effect on how much they receive.

32. The same is true for the expenditure side, but that subject is beyond the purview of this report.

5.0 Options for Restructuring Taxes and Fees

The most important principle to establish in deciding how to repair the financial aspects of the land administration system is the relative responsibilities of national and local governments to impose taxes on transactions and ownership of real property. At present, their functions overlap; they confuse market participants and provide excessive opportunities for informal taxation. The options presented here attempt to clarify the situation for the four principal revenue sources: CGT, DST, local Transfer Tax, and RPTs.³³

The Options:

1. Maximize responsibility at the local level by transferring all taxing authority on real property ownership and transactions to LGUs, eliminating the two major taxes on transactions.
2. Maintain the current balance between national and local government responsibilities. Make small changes to the overall current taxation structure, primarily by reducing the CGT rate
3. Increase responsibility for taxes in relation to real property at the national level, by eliminating the local Transfer Tax and reducing real property taxes by abolishing the SEF.

The major changes that would be necessary under the three options are shown in Table 5.1. All would require legislation.

Table 5.1: Options For Restructuring Taxes On Real Property Ownership And Transactions

Taxes	Option 1 Maximize LG U responsibility	Option 2 Maintain current balance	Option 3 Maximize national level responsibility
Capital Gains Tax	Exempt real property transactions	Reduce rate substantially for real property transactions	Reduce rate somewhat for real property transactions
Documentary Stamp Tax	Exempt real property transactions	Retain at current rate	Retain at current rate
Transfer Tax	Retain; perhaps increase rate	Retain at current rate	Abolish; replace by IRA increase
Real Property Tax and SEF	increase rate for provinces to same as for cities	Retain at current rates	Eliminate SEF

The details of each option are given below, along with their direct advantages and disadvantages. In other words, nothing is assumed here (but will be subsequently) about their induced effects on land markets, valuation, and tax collection.

33. Even though Income Tax and VAT comprise nearly 60% of BIR land-related revenues, they are applied to all income and therefore do not discriminate against land ownership, use or transactions.

5.1 Option 1: Maximize LGU Responsibility

This option would simplify the tax system on real property ownership and transactions by exempting transactions from the two national taxes, CGT and DST. Provincial LGUs would be permitted to tax real property ownership at the same rate as cities.³⁴ Given the elimination of CGT and DST, it would be feasible to increase the rate of Transfer Tax, and perhaps renaming it Documentary Stamp Tax if appropriate.

Advantages:

- greatly reduced transactions costs
- fewer requirements for registration of transactions (elimination of requirement to pay CGT and DST prior to registration)
- increase of locally-generated LGU revenue
- increase in responsibility and accountability of LGUs
- reduction of paperwork for BIR (250-300,000 fewer forms for CGT and DST)

Disadvantages:

- loss of revenue for BIR³⁵
- reduction in national-level information about transactions
- reduction of IRA receipts by LGUs

5.2 Option 2: Maintain Current Balance³⁶

This option would recognize the legitimate interests of both national and local governments in the regulation of real property markets and the generation of revenues from transactions and ownership. The sole change would be a reduction in the CGT rate to lower transactions costs.

Advantages:

- reduced transactions costs

Disadvantages

- loss of revenue for BIR

5.3 Option 3: Maximize National Level Responsibility

This option would simplify the tax system on real property ownership and transactions, making clearer the pre-eminent role of national government in land management and LGU finance in general. The CGT rate would be reduced somewhat to encourage transactions. The Transfer Tax on real property sales would be abolished to reduce transaction costs and paperwork. Also, given its small share in the total financing of elementary and secondary education, SEF could be

34. Raising the rate of RPT for provinces would also alleviate the high ratio of collection costs to revenues which was noted in Section 3.

35. There is a possible further loss in revenue if corporations would convert ordinary assets to capital assets in order to avoid taxation. This could be handled by removing the distinction between the two.

36. In both this Option and Option 3, it would be essential that the requirement to pay taxes prior to registration be eliminated (see common recommendation 7)

abolished and be replaced by a special IRA earmarked to education operations and maintenance costs.

Advantages:

- somewhat reduced transactions costs
- fewer requirements for registration of transactions
- reduction in paperwork for LGU officials
- reduction of tax-related political pressure on LGU officials
- increase in IRA receipts by LGUs

Disadvantages:

- some loss of revenue for BIR
- reduction of locally-generated LGU revenues
- reduction in responsibility and accountability of LGUs

5.4 Revenue Implications of Tax Rate Changes

Table 5.2 illustrates a possible schedule of rates for the four major taxes: CGT, DST, Transfer Tax and RPTs, under the three options. The revenue implications of each of the options are calculated under the assumptions that:

1. collection efficiency and assessment rates remain the same as currently;
2. there is no change in the number of formal transactions following reduction in transactions costs;
3. LGUs change their RPT rates proportionally to the change in the legal maxima.

With the rates given in the table, the revenue implications of all three options are negative, "other things being equal," i.e. if the assumptions given above are correct.³⁷ Table 5.2 also indicates the increase in collection efficiency, number of transactions, or assessed value that would be required to achieve overall revenue neutrality (3.1%, 11.1%, and 39.4% for Options 1, 2 and 3, respectively), and the IRA change that would be required to achieve revenue neutrality for LGUs (- P3,687 million, 0, and + P7,060 million, respectively). This implies a reduction in Option 1 since LGU revenues would rise, no change in Option 2, and an increase in Option 3.

To complete the financial analysis of the options, one can relax the assumptions to simulate the expected impact on transactions, collections and valuation. Purely for illustration, the modest predicted responses are:

- Formal transactions rise as a function of the reduction in transactions costs, by 25% for Option 1, 15% for Option 2, and 10% for Option 3.
- Valuation improvement raises assessed value by 25%. Valuation will affect both transactions taxes and RPTs.
- RPT collection efficiency rises by 10%.

37. There is an oversimplification in the tables. Changes in national government revenues are shared with LGUs since the latter receive 40% of internal revenue (lagged three years). Thus, while it is true that national revenues will bear the entire burden in the first years after tax reductions, LGUs will bear some of it in the future.

The combination of these factors raises the total value of transactions by 56.25% in Option 1, 43.75% in Option 2, and 37.5% in Option 3. In all options, total assessed value of real property rises by 37.5%.

The results are shown in Table 5.3. Every option sees a considerable improvement, with the best results naturally occurring in Option 1 because of the larger predicted increase in the number of transactions, although Option 2 is close behind. In Options 1 and 2, national revenues would be lower than currently, but in Option 3 they would be higher in spite of the lower CGT rate. Conversely, LGUs would see increased revenues in the first two options and decreased revenues in the third. IRA could be the balancing item to ensure that neither national nor LGU revenues would be lower than before the changes.

A second scenario can be instructive as well. One can assume that transactions will rise by the same amount in all three options, which would be the case if transactions costs now are only marginally above what people can tolerate so that reducing them even slightly, as in Option 3, would induce a strong response. This will also indicate the sensitivity of the exercise to the size of the hypothesized changes. Table 5.4 shows that when transactions are assumed to increase by 15% across the board, the decrease in revenues in Option 1 (from Transfer Tax) and the increase in revenues in Option 3 (from CGT and DST) as compared to those in Table 5.3 are quite modest, less than P250 million. Table 5.5 summarizes the changes in revenues of the three scenarios.

It must be re-emphasized that these results are completely hypothetical. The only facts are the current rates and revenues. Still, they show that relatively modest rearrangements in tax rates and responsibilities may have big payoffs.

Table 5.2: Revenue Implications of the Options: Illustrative Calculations Assuming no Change in Transactions, Valuation and Collection

	Current maximum tax rates	proposed new tax rates			2000 receipts		(P millions)		Option 1		Option 2		Option 3	
		option 1	option 2	option 3	National	LGUs	National	LGUs	National	LGUs	National	LGUs	National	LGUs
Capital Gains Tax	6.0%	0.0%	2.0%	4.0%	3,459		0		1,153		2,306			
Documentary Stamp Tax	1.5%	0.0%	1.5%	1.5%	865 *		0		865		865			
Transfer Tax:						975		1,950		975		0		
provinces	0.5%	1.0%	0.5%	0.0%	208		417		208		0			
cities & MM municipalities	0.75%	1.5%	0.75%	0.0%	767		1,533		767		0			
Real Property Tax and SEF:						15,544		18,256		15,544		9,459		
provinces	2.0%	3.0%	2.0%	1.0%	5,424		8,136		5,424		2,712			
cities & MM municipalities	3.0%	3.0%	3.0%	2.0%	10,120		10,120		10,120		6,747			
Total/Change from current system for each level of government					4,324	16,519	-4,324	3,687	-2,306	0	-1,153	-7,060		
Total/Net change in tax collections					20,843		-637		-2,306		-8,213			

Overall revenue neutrality would require a valuation or collection increase of:

Revenue neutrality for LGUs would require an IRA change of:

3.1%	11.1%	39.4%
-3,687	0	7,060

* on transactions on which CGT is collected

Table 5.3: Revenue Implications of the Options: Illustrative Calculations Assuming Change in Transactions, Valuation and Collection
(differentiated changes in the number of transactions)

	Current maximum tax rates	proposed new tax rates			2000 receipts		(P millions)		Option 1		Option 2		Option 3	
		option 1	option 2	option 3	National	LGUs	National	LGUs	National	LGUs	National	LGUs	National	LGUs
Capital Gains Tax	6.0%	0.0%	2.0%	4.0%	3,459		0		1,657		3,171			
Documentary Stamp Tax	1.5%	0.0%	1.5%	1.5%	865 *		0		1,243		1,709			
Transfer Tax						975		3,047		1,401		0		
provinces	0.5%	1.0%	0.5%	0.0%	208		651		299		0			
cities & MM municipalities	0.75%	1.5%	0.75%	0.0%	767		2,396		1,102		0			
Real Property Tax and SEF						15,544		25,102		21,373		13,006		
provinces	2.0%	3.0%	2.0%	1.0%	5,424		11,187		7,458		3,729			
cities & MM municipalities	3.0%	3.0%	3.0%	2.0%	10,120		13,915		13,915		9,276			
Total/Change from current system for each level of government					4,324	16,519	-4,324	11,630	-1,423	6,255	556	-3,513		
Total/Net change in tax collections					20,843		7,306		4,832		-2,957			
Increase due to effects of tax changes							7,943		7,138		5,256			

Table 5.4: Revenue Implications of the Options: Illustrative Calculations Assuming Change in Transactions, Valuation and Collection
(uniform changes in the number of transactions)

	Current				(P millions)							
	maximum tax rates	proposed new tax rates			2000 receipts		Option 1		Option 2		Option 3	
		option 1	option 2	option 3	National	LGUs	National	LGUs	National	LGUs	National	LGUs
Capital Gains Tax	6.0%	0.0%	2.0%	4.0%	3,459		0		1,657		3,315	
Documentary Stamp Tax	1.5%	0.0%	1.5%	1.5%	865 *		0		1,243		1,787	
Transfer Tax						975		2,803		1,401	0	
provinces	0.5%	1.0%	0.5%	0.0%		208		599		299	0	
cities & MM municipalities	0.75%	1.5%	0.75%	0.0%		767		2,204		1,102	0	
Real Property Tax and SEF						15,544		25,102		21,373	13,006	
provinces	2.0%	3.0%	2.0%	1.0%		5,424		11,187		7,458	3,729	
cities & MM municipalities	3.0%	3.0%	3.0%	2.0%		10,120		13,915		13,915	10,276	
Total/Change from current system for each level of government					4,324	16,519	-4,324	11,386	-1,423	6,256	778	-2,851
Total/Net change in tax collections					20,843		7,062		4,832		-2,735	
Increase due to effects of tax changes							7,699		7,138		5,478	

Table 5.5: Summary of Revenue Changes due to Tax Rate Changes

Scenario	(P Million)								
	Option 1 revenue change			Option 2 revenue change			Option 3 revenue change		
	GOP	LGUs	Total	GOP	LGUs	Total	GOP	LGUs	Total
No change	-4,324	+3,687	-637	-2,306	0	-2,306	-1,153	-7,060	-8,213
Differentiated change	-4,324	+11,630	+7,306	-1,423	+6,255	+4,832	+556	-3,513	-2,957
Uniform change	-4,324	+11,386	+7,062	-1,423	+6,256	+4,832	+778	-3,513	-2,735

note: there is no difference between the two change scenarios in Option 2 because the uniform change in transactions is that of Option 2, and there is no change in LGU revenue in Option 3 because LGUs have no transaction taxes in both cases.

6.0 Recommendations

Common to all the options are the following recommendations about fees and finance:

1. eliminate the requirement that delinquent real property taxes be paid prior to registration of transfers, replacing it with a lien attached to the Certificate of Title.
2. retain Estate and Donor's Taxes at current levels, as they have no significant impact on the great majority of the population and they provide a small measure of equity. However, the requirement that the taxes be paid prior to registering the transfer should be eliminated.
3. increase all land administration fees that currently do not recover operating costs (except those for mass titling under CARP, DENR, and urban antipoverty programs) in a manner that allows them to respond flexibly to changes in costs due to inflation or to changes in efficiency of processing. Also ensure that the relatively large ones are not regressive, as are LRA's fees for registration.
4. enable more flexibility in changing local government tax and fee rates and revenue distribution formulas by removing the schedules from the LGC and placing them in separate regulations.
5. when revenues have risen sufficiently to make LGUs more self-reliant, retain all RPT revenue in the community in which it is raised, i.e. the municipality or city (including the barangays, who could retain their current share), rather than being shared with the province. This would mean modifying the LGC to make RPT a municipal tax, and reviewing the division of responsibilities between provinces and municipalities. Compensate provinces with IRA, if the following provision is adopted. Consider combining RPT and SEF rather than specifying their separate allocation.
6. when revenues have risen sufficiently to make LGUs more self-reliant, reformulate IRA, linking it to LGUs' collection efficiency,³⁸ either of RPTs alone or of all local revenue sources, or to some other performance measure; increase provinces' share if the previous provision is adopted; and permit IRA to decline as a share of LGU revenue in the long run as LGUs' ability to collect local revenues increases.
7. develop transparent and equitable procedures to enable LGUs to seize real property for nonpayment of RPTs without political consequences and with some prospect of attracting buyers; alternatively, enforce the provision obliging LGU treasurers to seize the properties.
8. eliminate the opportunity for owners to redeem a property after it has been auctioned by a LGU for nonpayment of delinquent taxes.
9. experiment with the imposition of the Idle Lands Tax in a LAMP pilot area.
10. Institute monitoring procedures to enable LAMP and its partner government agencies to acquire information on transactions and financial data more readily and timely.

Option 1, "Maximize LGU responsibility," is the preferred option, the most sustainable in the long term, and the one which would do the most to approach the LGC's "Declaration of Policy." The core idea of Option 1 is to remove the national

38. Given the highly uneven tax bases of LGUs, taxable capacity, as measured by per capita income or some other indicator, should also be part of the IRA distribution formula.

government from the real property market by vesting all power to tax ownership and transfers in LGUs. The net result would be to reduce the tax rate on transactions from 8%-8.25% to 1-1.5%, while increasing the annual charges on real property ownership in the provinces. Under reasonable assumptions, this would lead to an increase in LGU revenues that would more than compensate for national government revenue losses.

The justification of this recommendation is that the listed advantages:

- greatly reduced transactions costs
- fewer requirements for registration of transactions (elimination of requirement to pay CGT and DST prior to registration because transactions would be exempt)
- increase of locally-generated LGU revenue
- increase in responsibility and accountability of LGUs
- reduction of paperwork for BIR (250-300,000 fewer forms for CGT and DST)

outweigh the disadvantages:

- loss of revenue for BIR
- reduction in national-level information about transactions
- reduction of IRA receipts by LGUs

by more than is the case with the other options.

This is an ambitious program with a significant shift in the taxing powers of national and local governments and, consequently, fundamental political issues. It will probably not be accomplished overnight. In the interim, while the legislative process is taking its course, a series of administrative changes, detailed in the “time-bound action plan” in Section 7, can be made; consensus can be built; and alternative solutions to issues like delinquent real property taxes and the idle lands tax can be studied.

The National Tax Research Center’s support for and comments on the principal elements of this set of recommendations is illustrated in Annex D.³⁹

39. This edition of the report takes many of these comments into account.

7.0 Time-Bound Implementation Plan

By March 31, 2003

Reach consensus with all stakeholders on which of the options to pursue.

Institute monitoring procedures to enable LAMP and its partner government agencies to acquire information on transactions and revenue and expenditure data more readily and timely. – DOF, LRA, DENR

Draft a schedule of fees and charges that achieve cost recovery – DENR, LRA/ROD, BLGF (with LGUs)

By June 30, 2003

Administrative Tasks

Develop transparent and equitable procedures to enable LGUs to seize real property for nonpayment of RPTs without political consequences and to attract buyers, or alternatively enforce the provision obliging LGU treasurers to seize the properties. – BLGF, DOJ

Conduct the proposed Idle Lands Tax experiment – LAMP PIO1, Leyte LGUs

Incorporate changes in administrative regulations of LRA and DENR to:

- increase all land administration and management fees that currently do not recover operating costs, in a manner that allows them to respond flexibly to changes in costs due to inflation or to changes in efficiency of processing. Also ensure that they are not regressive, as LRA's fees for registration and issuance of a TCT are currently.

Legislative Tasks

Draft amendments to the National Internal Revenue Code and other relevant laws to:

- exempt real property transactions from CGT and DST in the case of Option 1, or reduce CGT rates in the cases of Options 2 and 3.

Draft amendments to the Local Government Code to:

- increase RPT and Transfer Tax rates in the case of Option 1, or eliminate SEF and the Transfer Tax in the case of Option 3.
- alternatively for Option 1, eliminate the maximum rates on RPT and SEF.
- enable more flexibility in changing tax and fee rates and revenue distribution formulas by removing the schedules from the LGC and placing them in separate regulations.
- eliminate the possibility that owners of real property with delinquent RPTs can redeem their property after it has been sold.

By October 31, 2003

Ensure the passage of all legislative and administrative changes by engaging all stakeholders in persuading Congress, the Departments, LGUs, and the Administration to accept their necessity.

Report on the Idle Land Tax experiment and, if it proves successful, make recommendations for nationwide implementation.

By June 30, 2005

Draft amendments to the Local Government Code to:

- retain all RPT revenue in the community in which it is raised, i.e. the municipality or city, rather than municipality revenue being shared with the province.
- assign basic RPT and SEF as municipal and city rather than provincial taxes.
- reformulate IRA, linking it to LGUs' collection efficiency, either of RPTs alone or of all local revenue sources, or by some other performance measures; increase provinces' share if the previous provision is adopted; and permit IRA to decline as a share of LGU resources in the long run if LGUs' ability to collect local revenues increases substantially.

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Annex A National Collection Services

Collecting Agencies		Collection Services	
Department	Bureaus/Service	Taxes and tax-like fees	Fees and Charges
Department of Finance	<i>Bureau of Internal Revenue</i>	Capital Gains Tax Estate Tax Donor's Tax Documentary Stamp Tax Value-Added Tax Excise Tax (mineral products) Income Tax Income from Forfeited Properties	Certification Fees
Department of Justice	<i>Land Registration Authority</i>		Filing/Application fee Petition fee Certification fee Plans Consultations Entry fee TCT Issuance & Additional TCT Annotation Fee Verification Fee Registration Fees
Department of Environment and natural Resources	<i>Land Management Bureau</i>		Lease/Sale of Patrimonial Properties of the State Various Minor Fees Free Patent Application Miscellaneous Sales Patent Miscellaneous lease Application Revocable Permit Application Occupation Fee Cadastral cost Interest Certification Fee Protest Fee Inspection Fee Affidavit Fee Technical Description Fees Execution Fee Survey Authority Fee Agricultural Sales application Sales of Public Lands Others
	<i>Forest Management Bureau</i>	Forest Charges (TS) *	Tallying Fee Certification Fee (PAWB) Application Fee Registration Fee Oath Fee CLO Fee Permit Fee Reforestation Cost Inspection Fee License Fee Penalty Inventory
	<i>Mines and Geosciences Bureau</i>	Royalties from Mineral Reservations Explored*	
Department of Agriculture	<i>Bureau of Soils</i>		Application Fee (Reclassify Agricultural Land to Residential Land)
Department of Agrarian Reform	<i>Department of Agrarian Reform</i>		Conversion Certificate Fee

* BIR determined that minor collections of royalties and other tax-like charges are better handled by appropriate agencies. MOA between MGB and BIR executed.

Annex B Data from Metro Manila Assessors on Transactions Fees and Taxes

City/ Municipality	Certification Fee			Transfer tax			Real Property Tax Delinquency as % of Assessed Value	
	amount collected	% on real property	fee per certifi-cate implied no. of transfers	amount collected	average collected	implied no. of transfers		
	(P)		(P)	(P)	(P)			
Las Pinas	717,800	100	100	7,178	24,121,493	7,000	3,446	2.71%
San Juan	50,000	100	30	1,667	8,778,267	17,000	516	n.a.
Paranaque	8,000	100	12	667	35,408,180	2,500	14,163	1.32%
Pasay City	108,000	100	20	5,400	86,791,186	27,500	3,156	1.76%
Caloocan	172,890	60	10	10,373	9,433,259	7,500	1,258	1.82%
Valenzuela City	n.a.	n.a.	n.a.	--	10,868,878	n.a.	--	0.06%
Marikina	24,000	100	20	1,200	6,519,402	n.a.	--	2.65%
Makati	101,575	99	25	4,022	118,920,129	54,055	2,200	0.03%
Mandaluyong	57,000	100	10	5,700	24,015,455	n.a.	--	0.11%
Mutinlupa	86,484	96	10	8,302	4,505,683	5,000	901	n.a.
Pasig City	11,110	19	10	211	44,839,425	177,231	253	0.07%
Malabon City	476,818	100	0.5	953,636	1,252,432	n.a.	--	n.a.
Taguig	n.a.	n.a.	n.a.	--	18,419,166	13,261	1,389	n.a.

Source: PA-LAMP survey of municipal and city assessors in Metro Manila

The calculation of the implied number of transfers is simply the amount collected divided by the average fee or tax collected (times the percentage on real property for the certification fee).

The PA-LAMP survey of municipal and city treasurers in Metro Manila asked respondents to furnish information including the amount collected, and the average collected per transaction for the Certification Fee and the Transfer Tax. The table shows all their responses. It was hoped that one could deduce the number of transactions by dividing the amount collected by the average collected; having two independent ways to calculate the number was meant to increase confidence. In fact, as can be seen, the two never come close to corresponding. The data for amount collected were exact to the centavo in most cases, so it is clearly the estimate of average collected per transaction that is wrong. But some of the numbers for amount collected are also out of line, especially in Las Piñas and Malabon City. This is a symptom of the financial dysfunction of LGUs. The conclusion that can be drawn from this table is that the records of the LGUs are insufficient to provide a source of reliable information for assessment of land market activity. In no city does the information on certification fees and transfer tax yield similar numbers of transfers.

Annex C: Excerpts from First Report on Fees and Finance (June 2002)

From Pages 17-22

In the following table the results for the LGUs transfer tax is shown.

Apart from the obvious question as to why there is such a marked difference in the tax bases, the trend of each tax base is what is reviewed first. It shows a 29% increase when comparing 1997 to 1995 as against 4% for the CGT. These are the years prior to the downturn. In 1998 while the CGT tax base falls 30% the LGU tax base falls only 19%. It then climbs 16% and 19% respectively in 1999 and 2000 while CGT continues to decline by 16% and 6% respectively.

LGUs Transfer Tax Collection, 1995 - 2000 (millions)

Year	Collection	Tax Base	% Change
1995	680	136,000	-
1996	823	164,760	21%
1997	875	175,000	6%
1998	710	142,140	(-19%)
1999	821	164,320	16%
2000	975	195,180	19%

In the table below the tax base of the CGT is compared to the tax base of the LGUs' transfer tax and it can be seen that is only a fraction of what it was, particularly after 1998.

Comparison CGT tax base versus LGUs tax base (millions)

Year	Tax Base CGT	Tax Base LGUs	CGT/LGU (%)
1995	99,854	136,000	73%
1996	83,490	164,760	51%
1997	104,088	175,000	59%
1998	73,120	142,140	51%
1999	61,615	164,320	37%
2000	57,663	195,180	29%

While the two tax bases are not exactly the same (CGT tax base is reduced by exemptions relating to principal residence, transactions involving entities in the business of buying and selling real property and transfers covered by Estate tax and Donor's tax) they are certainly good indicators for each other.

As can be seen the CGT tax base is currently half what it was relative to the transfer tax base. Historically the CGT tax base has been significantly below that of the transfer tax and while there are factors which explain this (refer immediately above) there is also a countering aspect, namely it is generally accepted that the BIR zonal valuation (used in CGT calculations) is higher than its LGUs counterpart (used in Transfer Tax calculations). This was certainly true during the mid 1990's and data for 1995 in the table support this.

However the relationship changed in 1996 when there was a significant decline in CGT and while an increase in CGT the following year saw the relationship move up to 59% (compared to 73% in 1995) it declined thereafter – particularly following the rate increase in 1998. The figures indicate it is at least half what it should be based on its historical relationship to the transfer tax.

This deterioration is also supported by reference to both the Documentary Stamp Tax Collections and statistics from the Lands Registration Authority.

**DST Collection, 1995 - 2000
(millions)**

Year	Collection	% Change
1995	12,034	-
1996	12,399	15%
1997	14,292	15%
1998	16,477	16%
1999	15,680	(-18)%
2000	15,540	(-1)%

DST collections shown here include all documentary stamp duty collected, not just that relating to real property. However the activity trend is similar to the transfer tax (shown previously) and Lands Registration Authority (next table).

There was growth through 1996 and 1997 and a significant decline in one year only, in this case in 1999 as opposed to 1998. The collections in 2000 are higher than was the case for the years 1995 to 1997 which is not the case for CGT.

Further, in 1995 DST on CGT transactions accounted for 1,500 millions of the 12,034 millions, i.e. more than 12%. However in 2000, DST on CGT transactions accounted for 865 millions of the 15,540 millions (due allowance has been made for change in CGT tax rate and no significant changes to DST) i.e. less than 6%.

As was the case with the LGUs transfer tax the relationships between CGT and DST appears to indicate at least a doubling of CGT is required to restore historical relativity.

Also in 2000 the VAT for sale of real property is given at 1,002 millions which translates to a tax base of 10,002 millions. If this tax base is added to the tax base for CGT, namely 3,451 millions divided by 6% = 57,500 million we have a total property tax base (i.e. CGT + CGT exempt properties) of approximately 67,500. Applying 1.5% DST rate to this results in 1,012 millions DST payable or 6.5% of total DST.

If a breakdown of DST was available it would be possible to determine the extent of CGT or VAT relating to real property that is being lost. This exercise is to be carried out through June – that is, it is proposed to collect all necessary data for the month of June in relation to real property to allow for cross checking and estimation of ‘lost’ revenue.

Deeds Registered, 1995 - 2000

Year	Collection	% Change
1995	2.03	-
1996	2.20	8%
1997	2.17	(-1%)
1998	1.86	(-14%)
1999	1.94	4%
2000	1.95	1%

The above data indicates that while there was a decline in activity in 1998, that decline did not continue through 1999 and 2000. (It should be noted that deeds registered as shown in the table consists of documents registered under titled lands, unregistered land, chattel mortgage law and free of charge. It has been assumed that the profile has not changed significantly throughout the period and therefore the activity analysis as it relates to real property is indicative of the situation).

Notwithstanding the above analysis which would indicate that the level of CGT in 2000 should have been doubled, from 3.45 billions to 7 billions it is further contended that the appropriate tax base should have been in the vicinity of 140,000 millions which would have resulted in CGT of over 8 billions. The rationale for this is as follows:

LGUs tax base in 2000 = 195,000 millions which resulted in a recorded transfer tax collected of 975 millions.

The question is then, how does the CGT tax base differ? The answer relates to:

- Principal residence exemption
- Exemption where an entity is involved in the buying and selling of property as a business and is therefore subject to VAT.
- Estate transfer resulting in payment of estate tax
- Donor's tax resulting in payment of donor's tax

Therefore the 195,000 millions LGUs tax base can be converted to CGT tax base by deducting the following:

- Principal residence exemption is rarely given due to administrative problems and therefore would not materially affect the tax base.
- VAT for sale of real property is recorded in BIR's Comparative Report of Collections for 2000 as 1,002 millions. Allowing for no deductions this would involve a maximum adjustment to the CGT tax base of 10,000 millions.
- Estate tax relating to real property = 264 millions and using average derived tax of rate 2.7% (in lowest range of exemption of 200,000 plus 5% between 200,000 and 500,000 and therefore results in conservative bias) + allowing for all 22,000 returns to take full advantage of 1,000,000 in standard deductions tax base derived is 38,000 millions + 8,000 to take advantage of 1,000,000 principal residence exemption.
- Donor's tax relating to real property = 156 millions and average tax rate has been derived at 2.4% which results in tax base of 7,000 millions.

Total adjustment would be in vicinity of 55,000 millions.

Therefore 2000 tax base for CGT estimated at approximately 140,000 millions and CGT at 8,400 millions. At this level CGT collection relative to DST collection would return to mid 1990's level (13% versus 12% which reflects the increase in CGT tax rate). The CGT tax base, at this new level, would be 72% of LGUs tax base which compares to 73% in 1995.

Conclusion

- The collection of 3.45 billions in Capital Gain Tax in 2000 does not appear to be at a level in keeping with reasonable expectation. The increase in the tax rate from 5% to 6% appears to have triggered widespread avoidance of this tax.

Additional issues

The taxation base for CGT is the highest value of the following:

- Gross Selling Price
- BIR zonal valuation
- LGU valuation

Gross Selling Price is not used as the consideration figure submitted by taxpayers and recorded on documentation is well below that of either valuation. This is a feature of CGT forms submitted as taxpayers seek to minimize tax in relation to BIR's Capital Gains Tax and Documentary Stamp Duty, and also LRA's land registration fees.

Therefore the tax is dependent on the valuation of BIR or LGU.

BIR zonal valuation relates only to land. Therefore when an improvement is involved the BIR examiner has to make reference to the LGU valuation for the improvement to determine the appropriate tax base. As a result assessment for CGT becomes improvement as per LGUs' tax declaration + the higher of the BIR land valuation or the LGUs land valuation.

In the context of CGT the valuation is supposed to be a proxy for the wrongly reported consideration. That is, in a perfect world this transaction tax (remembering it is not related to capital gains) should be based on the consideration.

Is either valuation a proxy for the consideration?

The simple answer is no.

At best the valuation represents 50% of the current market selling price and therefore all transactions that are currently being processed are attracting half the CGT they should.

This means that in 2000, notwithstanding the problems mentioned so far, CGT should have been 7 billions instead of the 3.5 billions reported. Carrying this further it means the potential 8 billions it should have been if there had not been tax avoidance or poor collection (as argued in this report) could have in fact been 16 billions. However this figure would have been dependant on the current CGT rate of 6% being applied to an appropriate tax base. The reality was just under 3.5 billions was collected.

What contributed to the existence of the poor tax base?

Political interference saw valuations maintained at unacceptably low levels. The BIR zonal valuation was introduced to combat the low valuations set by LGUs. It was however only useful for the land component. This meant it was only addressing half the problem (According to LGU records on assessed values for 2000 only 46% of their valuations related to the land component).

Apart from this aspect, the values used by the BIR were not updated as they should have been (see table below):

Survey of the number of Revenue District Offices (RDOs) whose schedules of Zonal Values took effect from 1993 to 2002

Year when valuation was revised (approved)	Number of RDO's	Cumulative %
2002	5	100%
2001	0	96%
2000	8	96%
1999	0	88%
1998	22	88%
1997	26	69%
1996	28	46%
1995	17	22%
1994	7	7%
1993	1	1%

While the above table shows when the current schedule took effect it does not indicate when the valuation was determined.

In the current year 46% of BIR zonal valuations in use can be dated back to at least 1996, and nearly all of them are at least four years or more old. Even assuming that they did reflect current prices at the time of introduction, which is extremely unlikely, it is certain they do not reflect current market prices now.

Also, as stated previously, land is only half the story. The existence of the current BIR valuation system is confusing to say the least and would only be contributing to procedural delay rather than providing the CGT with an appropriate taxation base.

As for the LGUs valuation that suffers a similar fate in terms of being updated. Since 1991 there has only been two general revisions and, again, because of political pressure at the municipality level it is doubtful that the fair market value determined ever approached anything like the real current market value.

Indicative evidence to support the above comes from a numbers of sources:

- From a list of 100 properties (land only) (Annex D) with known appraisal values (the properties were on the market and minimum sale prices had been set). Primarily the properties were in Manila and had a total sales value of 1 billion pesos. They were compared to valuations using BIR zonal values and conservatively selling prices were double those provided by the valuations.
- From a workshop conducted in Leyte with municipality assessors it was the collective opinion that current market prices were more than double those of the valuations used by the assessors to determine assessed values. Further the difference was most marked where improvements were involved.
- From discussions with government personnel over a four months period in Manila and with others, including the LAMP Policy Adviser for the Valuations study, there can be little doubt that neither the BIR valuation or the LGUs valuation provide an appropriate tax base for CGT.

Conclusion

The valuation systems used as a proxy for the consideration for CGT do not result in the maximization of revenue for the national government.

However, the valuation systems do contribute to the perception that there are high transfer costs involved with land – namely 6% CGT whereas in reality this is more likely to be 3%.

From pp. 27-28

(6) EXCISE TAX ON MINERAL PRODUCTS are an ad valorem tax based on the actual market value of the annual gross output at the time of removal.

In general, excise tax based on weight, volume capacity or any other physical unit of measurement is referred to as a 'specific tax' and if based on selling price or other specified value is referred to as 'ad valorem' tax. The excise tax shall be in addition to VAT.

Basis = Mineral products, based on the actual market value of the annual gross output at the time of removal multiplied by 2% (except for indigenous petroleum, based on the fair international market price = 3%).

In 2000:

Excise tax for Mineral products is given at 64 millions.

Conclusion

The Mines and Geosciences Bureau (MGB) of the Department of Natural Resources and Environment (DENR) estimated gross production value of minerals for the year 2000 and using the 2% excise rate calculated the excise tax to be 492 millions.

This compares with the reported figure of 64 millions.

The discrepancy is indicative of the revenue which is foregone by the national government in relation to land administration. However, in the Mineral Industry, as in other areas of the community, there is a perception that taxation is too high – this will be related to the number of taxes that are levied both at national and local government level and the rates rather than the total revenue collected.

(7) INCOME TAX FROM INCOME DERIVED FROM LAND TRANSACTIONS

Income can be grouped into three categories:

- Compensation income (e.g. salaries and wages etc)
- Business income and income from profession
- Passive income and other sources

Basis = Taxable income multiplied by approximately 32% (in simple terms).

It is not possible to derive the income tax for all persons involved in the land market as the data is not available.

However from the top 7,000 corporations business profiles for 2000 it is possible to derive an income tax figure for those businesses involved in “real estate buying, selling, renting, leasing and operating of self-owned/leased apartment buildings, non-residential and dwellings”. (This group would make up most of the VAT group identified previously).

The tax for this group = 6,700 millions.

(Note: VAT of 2,665 millions was identified previously as being connected with real property and with income tax being three times that of VAT the tax figures are compatible).

(8) CERTIFICATION FEES are fees collected from the certification of different documents. (e. g. obtaining information re: (a) zonal values of real properties or (b) establishing that no zonal value exists on a property).

Charge is 25 pesos per certified page.

People applying for these services include property owners, brokers, taxpayers, appraisers.

In 2000

Total revenue is given as 10 millions.

(9) INCOME FROM FORFEITED PROPERTIES

In 2000

Total revenue is given as 17 millions

From pp. 53-59 Land Registration Authority

(a) Taxes/fees and activity

In 2000

Fees payable to Clerk of Court:

- Filing an application/petition = 15,924 services at 20 pesos per services
- Certifications = 14,155 at 15 pesos per service

Fees payable to Sheriff:

- Posting of notices – not collected
- Serving notices – not collected

Fees payable to Administrator:

- Sub division plans for approval = 2,667 at 36 pesos per plan
- Consultas = 214 at 60 pesos per consultas
- Certifications = 79,245 certifications at 15 pesos each
- Inspection of lands - no activity
- Field work of subdivision survey – no activity

Fees Payable to Register of Deeds:

- Entry in primary entry book = Titled 997,241; Unregistered 95,555; Mortgages 398,195; at 15 pesos per entry
- Annotation = 647,928 at 60 pesos
- Issuance of transfer certificate of title = 380,016 at 30 pesos per title
- Registration = 1,092,796 at an average rate of 728 pesos based on average value of 174,000 pesos
- Certifications = 13,979,301 at 15 pesos

Original Certificate of Title - Judicial process DOJ charges	Filing an application with the Court (pesos)	20
	Certified copy of correctness of plans	15
	Issuance of certificate of title	30
	Registration fees of average consideration (174,000)	728
	Certified copy of the document	15

Original Certificate of Title - LRA Administrative process	Sub division plans for approval (Pesos)	36
	Posting of notices	9
	Certified copy of the Court order	15
	Issuance of certificate of title	30
	Registration fees of average consideration (174,000)	728
	Certified copy of the document	15

Transfer Certificate of Title - LRA process	Entry (assuming four required on average) (Pesos)	60
	Annotation (assuming mortgage involved)	60
	Certified copy of the Court order	15
	Issuance of transfer certificate of title	30

	Registration fees of average consideration (174,000)	728
	Certified copy of the document	15

(b) Impact on stakeholders

Sellers

Have the documents required by the buyer for LRA. Want low fees to encourage activity within the land market. Also net proceeds can be affected by LRA fees either in terms of reducing the buyer's ability to pay a higher price or a contractual arrangement whereby the seller meets all associated transaction fees.

However LRA fees are quite low at present and would have little impact on sellers' decision to participate in either the formal or informal market.

LRA's proposal to increase fees by 300% would change this.

Buyers

Pay the fees and therefore bear the burden - however can be view as a joint responsibility with seller (see above). Regardless, they want low fees.

Non-government entities: Private surveyors, banks, credit agencies, real estate agents, brokers and others who depend on the land market for their livelihood.

They want charges to be as low as possible to help stimulate activity within the land market because their income is dependent on such activity.

They encourage practices that lead to lower charges payable - for example, the under statement of the gross selling price to minimize the payment of the registration fee which is based on the consideration only. (An example cited at Manila City Register of Deeds had a condominium unit with a consideration of 600,000 where as the LGU valuation was 2,200,000 and the BIR zonal value was 2,600,000. In such a case nearly 5,000 pesos was 'saved' because of the understatement).

Further, the estimated average valuation for LGUs transfer tax is 407,000 whereas the average consideration given to LRA for calculation of their registration fees is 174,000 (fees = 728 fees). The difference in fees = $1,419 - 728 = 689$ pesos. It is this group that puts the 'package' together - including the consideration to be used for LRA purpose. They need to be penalized for their complicity.

Others: Informal settlers, Projects, such as the low cost housing program, that currently are given incentives in the form of exemptions, Church groups, NGO's and People's Organizations.

For informal settlers who claim formal ownership, LRA fees, together with back taxes, can be a barrier to the finalization of the process through the issuance of an original certificate of title. That is, this group may be satisfied with the Patent or Certificate of Land Ownerships; others are content to have just the tax declaration as their claim to ownership.

National Government:

- Gains revenue from fees.
- Loses revenue if transactions are based on false data - for example, low gross selling price.
- Loses revenue if Agency is charging clients based on out dated rates. For example the office of the Clerk of the Court is using pre 1993 rates for filing an application/petition.
- Loses revenue if Agency rates are out of date - Current rates based on LRA circular 61 which is dated November 4, 1993.
- Loses revenue if transactions are not formally reported.

Currently the LRA has a proposal pending for an increase in rates of 100% or 300% (the initial proposal submitted by the LRA to Department of Justice (DOJ) was for a 100% across the board increase. However that ‘proposal’ has been ‘lost’ by DOJ and now there is a proposal that fees be increased by 300% - one assumes this has to do with recouping costs relating to new computerized records system).

As this would involve no real increase in expenditure the 100% proposal would add 1,100 millions in revenue (and the 300% proposal three times this amount). However this would be contrary to a strategy aimed at encouraging buyers/sellers to utilize the formal process.

If rates increased by 300% there would be significant implications for land administration as an entity – that is, it would demonstrate a lack of commitment to what is being proposed, namely a consolidated strategy aimed at improving the land titling and land registration system in the Philippines.

Given the CPI figures below the defensible increase would be limited to 50%.

Consumer Price Index (CPI) and Inflation rate, base year 1994 = 100

<u>Year</u>	<u>CPI</u>	<u>Growth rate</u>
1994	100	8.3%
1995	108	8.0%
1996	117.8	9.1%
1997	124.7	5.9%
1998	136.9	9.8%
1999	146.0	6.6%
2000	152.3	4.3%

It is considered that the same proposed level of income could be raised if buyers/sellers were having the fee based on a more realistic consideration.

An initial step in achieving that objective would be to realize that the stated consideration is erroneous and therefore base the registration fee on LGU or BIR valuation. This would go a long way to increasing the revenues to the stated levels. To simply double fees will be to penalize those taxpayers who do the right thing and state the correct consideration as opposed to those who halve the consideration and therefore halve the fee due.

Also it is considered that increased revenue should result from increased use of the formal market process. Higher fees would discourage this and therefore may not result in the anticipated gains.

Any increase in fees by the LRA has to be looked at carefully within the context of the entire land administration system.

LRA

LRA has a 'Special Fund' that is dependent on a 20% share of its total fees collection. Therefore the greater the fees collected the greater is the funds available to LRA through its Special Fund. This Fund can be used for capital items.

It is considered that this "Special Fund" should not exist as such preferential sourcing of funds cannot be justified.

Department of Environment and Natural Resources

(a) Fees and activity

LMB

Should not have any fees but did collect the following in 2000:

Fee	Number of Services	Average fee
Field inspection	138	200
Copy of plans	25,804	5.5
Survey services	50	160
Public land application fees	552	52
Transfer fee	7	100
Protest, appeals, petitions	41	50
Records certification	873	10
Surveying instruments	400	100

FMB

Covered under LMS as LMB should have been, and is (Revenue for forest charges was highlighted in revenue section and is not included here).

EMB

Fee	Number of Services	Fee
Application for Environmentally Critical Certificate	569	3,000 or 6,000
Application for Certificate of Non Coverage	205	600
Post ECC Services	731	500 or 1,200
Other Services	12	25 or 50

MGB

Minor fees and charges relating to: Mining rights, mining investigation, lease of drilling equipment, other services, fire assays, marine geophysical investigations. (Revenue for mining tax was highlighted in revenue section and is not included here).

Details not shown as operating income only totals 8 millions.

LMS

Fee	Number of Services	Average fee
LMB:		
Free Patent application	46,700	38
Miscellaneous sales application	7,544	1,158
Miscellaneous lease application	620	2,638
Revocable Permit application	3,100	50
Occupation Fee	1,386	3,532
Cadastral Cost	13,340	237
Interest	28,680	62
Certification fee	28,400	127 (mode =25)
Protest fee	21,933	60
Inspection fee	23,998	154
Affidavit fee	1,887	8
Technical Description fee	122,791	15
Execution fee	n/a	n/a
Survey Authority	n/a	n/a
Agricultural Sales application	n/a	n/a
Sale of public land	n/a	n/a
Other	n/a	n/a
FMS		
Tallying fee	143,000	5
Certification Fee (Operation PAWB)	64,077	55
Application Fee	65,626	55
Registration Fee	3,831	415
Oath fee	51,700	30
CLO fee	580	50
Permit Fee (Operation PAWB)	12,943	49
Forest Charges (Technical Services)	n/a	n/a
Refo cost	n/a	n/a
Inspection fee	1,790	422
License fee	n/a	n/a
Penalty	n/a	n/a

Inventory	n/a	n/a
EMB		
Certification	21,300	49
Permit	3,005	199

BS from Department of Agriculture

Fee	Number of services	Average fee
Certification	342	1,961

(b) Impact on Stakeholders

Applicants

Pay fees.

However it is the informal fees that are the real problem.

Example given involved an applicant who approached a CENRO office in Region X1 and had his application accepted by the OIC but was told that his records were in Manila and that someone would have to go to Manila and collect them. This would involve a return airfare of 8,250 pesos. When the records were recovered the applicant was told that there were some errors in the survey plans and another survey would have to be carried out, the cost of which was 5,000 pesos. Once the survey was done the applicant was told that the signing authority needed a 5,000 pesos facilitation fee and so the story continued - estimated costs for facilitation could be between 20,000 and 30,000 pesos.

This illustrates that it is **not the formal costs** that are a barrier **but the informal costs** which relate to facilitation - that is, to facilitate the actual length of time it is going to take an applicant to get appropriate action.

From p. 37 Land Registration Authority (LRA)

LRA is located within the Department of Justice.
The following revenue was raised by LRA in 2000

Total revenue:	1,080 millions
Total expenditure	<u>518 millions</u>
Net	562 millions

Although it only charges fees the LRA is in reality a revenue raiser - see Annex B re: Background information on the cost recovery policy of the Government.

Specifically:

- Payable to Clerk of Court 0.5 millions
- Payable to Administrator 1.3 millions
- Payable to Register of Deeds 1,078.0 millions

In detail:

- Payable to Clerk of Court
 - Filing applications/petitions 318,480
 - Certifications 212,330
- Payable to Administrator
 - Plans 96,012
 - Consultations 12,840
 - Certifications (TDs, plans etc) 1,188,676
 - Other income 107,421
- Payable to Register of Deeds
 - Documents Registered (Entry)
 - 1. PD 1529 (Act 496) 14,958,615
 - 2. PD 1529 (Act 3344) 1,433,325
 - 3. PD 1529 (Act 1508) 5,972,925
 - TOTAL = 22,364,865
 - Titles issues
 - 1. TCTs issued 11,290,080
 - 2. Additional 55,200
 - TOTAL = 11,345,280
 - Annotations 38,875,680
 - Certifications/verifications 209,689,526
 - Registration fees(sales/mortgages) 795,411,914

From p. 65ff: Informal market

- Back taxes help create the informal market as buyers/sellers seek to avoid the burden that is built up over time. Therefore need to prevent back taxes accumulating to the extent they do and this can be achieved by:
 - Improved collections
 - Removing penalties as a means of encouraging payment
 - Prescription period for remedies for the collection of RPT as provided by the Local Government Code should be implemented.
- Major problem here is Section 255 of Local Government Code which states: "Interests on Unpaid Real property Tax - In case of failure to pay the basic real property tax or any other tax levied under this title upon the expiration of the periods as provided in Section 250, or when due, as the case may be, shall subject the taxpayer to the payment of interest at the rate of 2% per month on the unpaid amount or a fraction thereof, until the delinquent tax shall have been fully paid. Provided, however, that in no case shall the total interest on the unpaid tax or portion thereof exceed 36 months."
If this is applied cumulatively, which it is in many cases, it has the affect of doubling the debt of the taxpayer.
- Back taxes identified in the last six years were shown to have accumulated to 41,000 millions (or 28,000 millions if BLGF figures used). This amount would be doubled because of penalties.
- Clearly it is back taxes that are a problem for transfers, as opposed to say the transfer tax.
- Collection efficiency should have been higher and penalties lower and then significant debt would not have been created.

Workshop with LGUs in the Province of Leyte:

Factors related to the informal market: (1) high BIR taxes and fees, (2) DAR rules and regulations related to issuance of clearance and certification, (3) Long administrative processes, (4) no 'technical' knowledge, (5) voluminous documentary fees in formal form section, (6) properties erroneously declared to another person or adjacent property owner, (5) failure to update general inventory of property by assessors.

Solutions given as: (1) lower rates of taxes and fees,(2) disregard laws on tenancy, (3) shorten processes (4) public assistant officer to conduct training (6) concerned agency to re correct their relocation survey (7) provide additional personnel

Institutional issues

- Relationship between National Government level and LGUs has to be reviewed.
 - To correct inequitable and poor valuations used in determining the taxation base for RP and SEF taxes
 - To address the unacceptable level of collections which places a greater burden on National level revenues than there should be.
- National level funding should be based on identified need rather than automatic entitlement. The LGUs are progressively becoming more dependent on the National Government as a source of funds. As a first step there should be some demarcation of funds attributable to

specified LGUs activities i.e. National Governments should fund certain activities and the RPT others.

(The law provides that 20% of IRA shall be utilized for local development projects which generally is circumvented by LGU's enabling them to use the funds for other purposes which are not really developmental by nature).

- Linkages with LGU's and agencies such as the Registry of Deeds, DAR and DENR (LMB) are not well established. Procedures need to be in place to ensure a common data base.

Legal issues

- Local Government Code is not being adhered to which is contributing to the poor situation re: collections.
- The code needs to be amended to reflect a simplified approach in relation to determination of the assessment base, penalties, collections, provision of appropriate information to BLGF and other organizations such as ROD.
- Many Local tax ordinances are not consistent with the provision of the LGC and some are still based on former law.

Cost recovery

- In line with the 'user pay' principle, fees relating to annotation/certification/ copying should ensure all costs are recovered. If this is not the case then all local government taxpayers are subsidizing the group who utilizes these services.

Exemptions

- Review required of exemptions and rates of assessment including the zero assessment level of residential houses with market value of P 175,000 and below (note: land component is still assessed).

The power of LGU's to condone or reduce RPT is limited to taxes and interest on property for the succeeding year or years subject to the recommendation of the LDCC. The power to condone or reduce tax for any year is vested in the President.

Back taxes

- Collections are a problem.
- Penalties are a needless burden.
- Current level of delinquencies must be identified and 'written off'. It is money that will never be collected.
- Trouble with amnesty it encourages taxpayers to wait until the next one. This may be one of the reasons why collections % is going down.

Collections

- Collections are poor. Assessed values have gone up just under 19% each year while collections' %'s has declined. There is a definite causal relationship which needs to be considered further.

Workshops with LGUs in the province of LEYTE:

Major problems in RPT collection: (1) Lack of tax enforcement in consonance with mandate of law, (2) addresses of owners not known, (3) lack of incentives, (4) inadequate coordination

Solutions given as: (1) strict law implementation, (2) seek barangay assistance, (3) give incentives to collectors, (4) improve support and coordinating mechanisms.

Annex D: NTRC Remarks on Study Options and Recommendations

POLICY OPTIONS	JUSTIFICATIONS	REMARKS
<p>Maximize LGU responsibility in the taxation of real property ownership and transactions</p>	<ul style="list-style-type: none"> ● will improve efficiency (fewer requirements for registration and property owners will only deal with LGUs) ● will reduce transaction costs ● will increase LGU revenue ● will make LGUs more responsible and accountable ● will reduce BIR costs <p>Note: The disadvantages are:</p> <ul style="list-style-type: none"> ◆ loss of revenue for BIR ◆ reduction in national level information on property transactions 	<ul style="list-style-type: none"> ▪ this policy direction seems to be the most rational although it will mean a radical shift in the thinking of the parties involved ▪ it would almost surely result to displacement of people (BIR) ▪ there may be need to review the balancing of revenue powers and consequent responsibilities between NG and LGUs (devolution/decentralization and local autonomy)

POLICY OPTIONS	JUSTIFICATIONS	REMARKS
<p><i>Policy Changes at the National Level</i></p> <ol style="list-style-type: none"> 1. Exempt real property transactions from CGT and DST 2. Retain estate and donor's taxes at current levels but eliminate the requirement that these be paid first prior to registering the transfer 3. Increase all land administration fees that currently do not recover operating costs (except those under CARP and urban poverty programs) 	<ul style="list-style-type: none"> • will reduce transaction costs • will encourage property owners to formalize their transactions • will strengthen cost-recovery principle and increase government revenue 	<ul style="list-style-type: none"> ▪ revenue loss will be about P3.5 billion ▪ there could be a potential additional revenue loss from those who would convert their ordinary assets to capital assets to avoid the tax ▪ the original concept of taxing capital gains as income will be lost ▪ BIR will lose an effective tool of tax enforcement ▪ there is a very large room for simplifying the fee structure and improving progressivity ▪ with simple and transparent system, there can be better compliance and less room for "facilitation fees"

POLICY OPTIONS	JUSTIFICATIONS	REMARKS
<p><i>Policy Changes at the LGU Level</i></p> <p>1. Retain RPT revenue at the municipality/city level; abolish share of provinces</p> <p>2. Increase local transfer tax</p> <p>3. Reduce IRA and link it to collection performance</p>	<ul style="list-style-type: none"> ● to improve transparency and accountability ● to compensate for the abolition of CGT ● to improve LGU collection efficiency and make them more self-reliant 	<ul style="list-style-type: none"> ▪ may necessitate reallocation of responsibilities between provinces and municipalities/cities ▪ provincial share from RPT is about P1.4 billion a year ▪ lost revenue can be recovered from IRA ▪ simulations on the revenue impact are critical to determine the rate of increase; minimum objective should be revenue neutrality ▪ simulations should also consider updating of property values ▪ with NG losing some revenue (60% of CGT and DST) there is really a need to reduce IRA just to maintain the existing balance between NG and LGUs

POLICY OPTIONS	JUSTIFICATIONS	REMARKS
<p>4. Increase flexibility of LGUs by removing from LGC tax and fee rates and revenue distribution formulas</p> <p>5. Eliminate the requirement that back taxes (RPT) be paid prior to registration of transactions</p>	<ul style="list-style-type: none"> ● to strengthen LGU autonomy ● will remove a major impediment in the official titling/registration of land transactions 	<ul style="list-style-type: none"> ▪ LGUs have been so used to receiving IRA without doing anything that it may be difficult to sell the idea of a performance-based IRA ▪ proposal can be double-edged; at the hands of responsible local officials, it can promote efficiency and accountability but with irresponsible officials, it can be abused ▪ LGUs will lose one tool for improving their collections ▪ given a very low RPT collection efficiency (just over 50% nationwide), the proposal can worsen the situation ▪ there is a need to clean the data on delinquencies (it is doubtful if LGUs implement the 5-year prescriptive period for collecting RPT)

POLICY OPTIONS	JUSTIFICATIONS	REMARKS
<p>6. Remove machineries as part of the tax base of RPT</p> <p>7. Enforce remedies to address RPT delinquency</p> <p>8. Experiment with the imposition of the idle lands tax in a LAMP pilot area</p>	<ul style="list-style-type: none"> ● to simplify the system since anyway, it is not consistently enforced by all LGUs ● to improve collections ● to prove that the concept can really work out 	<ul style="list-style-type: none"> ▪ with varying interpretations on what “machineries” are, it can only be a source of inequity and possibly, corruption ▪ strict enforcement of the rules can only give the signal that government is serious in its business ▪ will remove that “tax amnesty” mindset among taxpayers which has greatly undermined confidence in the system ▪ there is no information that an LGU has collected this tax although it has been in the books since the 70’s (PD 464)