Philequity Corner (January 22, 2018)
By Wilson Sy

Lower corporate taxes boost stocks

Last week, the Department of Finance (DoF) submitted the second package of the Duterte administration's comprehensive tax reform program to Congress. The second tranche of tax reform is envisioned to be revenue neutral as it will feature the lowering of corporate income taxes and the rationalization of fiscal incentives.

US market run-up due to lower corporate taxes

The DoF's push for lower corporate taxes follows the path paved by the US government. Optimism caused by the lowering of corporate taxes in the US has pushed the Dow and S&P 500 to record high after record high. The Dow is now up 7.6% while the S&P 500 has gained 6.4% since the US Senate passed an initial version of the tax plan on December 2. This move has sparked a global bull run and is one of the main reasons behind the strong performance of the PSEi (+9.5%) over the same period.

Trump's tax overhaul

The primary component of the Trump administration's tax overhaul is the lowering of the corporate income tax rate from 35% to 21%. The US tax reform also features a repatriation tax rate of 15.5% on accumulated offshore income which can be payable over eight years. These measures are expected to boost the competitiveness of US corporates and will result in increased hiring. These may also translate to higher wages and bonuses for American employees. In addition, the repatriation of offshore dollars means that US corporates will stand on massive cash piles that may be used for capital expenditures, M&As, share buybacks and dividends.

Rationalization of incentives to offset lower corporate taxes

Similar to the US, the Philippines will lower its corporate income tax rate from 30% to 25%. Since package two of tax reform is envisioned to be revenue neutral, the corporate income tax cuts will be compensated by the rationalization of fiscal incentives. According to Finance USec Karl Kedrick Chua, about P300b of government revenues are foregone due to VAT exemptions on certain imports, custom duty exemptions, income tax holidays and special rates. Package two therefore aims to plug leakages caused by income tax holidays and other incentives with no sunset provisions or time limits.

Performance-based, time-bound and transparent

In its statement, the DoF said that phase two of tax reform aims to "modernize incentives to make them performance-based, time-bound and transparent." This may also include the centralization of the granting of incentives under one institution to ensure proper monitoring and better transparency.

Improved competitiveness for Phl corporates

As we show in the table below, our country's corporate income tax rate of 30% is currently the highest in the region (along with India). It is also much higher than the average of 23% for Asia. This hinders the competitiveness of Philippine corporates compared to their Asian peers. Moreover, this dampens the attractiveness of the Philippines as an investment destination compared to other Asian countries with much lower corporate tax rates.

Corporate tax rates in Asia

Country	Rate
Philippines	*30%*
India	30%
China	25%
Indonesia	25%
Myanmar	25%
Japan	24%
Malaysia	24%
Korea	22%
Thailand	20%
Vietnam	20%
Hong Kong	17%
Singapore	17%
Average	23%

Source: Deloitte

Phl stocks to tread a path similar to US stocks

Philippine stocks, as a whole, will benefit from the lowering of corporate income taxes. The consumer retail sector stands as the clearest beneficiary of package two of tax reform. We thus expect the lowering of corporate taxes to further boost the performance of Philippine stocks, similar to what we are currently witnessing in the US (*A tale of two tax reforms*, December 4, 2017).

Consolidation will be healthy for PSEi

The PSEi has performed exceedingly well in the past two months because of the passage of TRAIN (*All aboard*, December 18, 2017) and a global bull market fueled by the implementation of tax reform in the US. The PSEi is now at 8,916 and is up 8% since the start of December. In this light, we believe that a consolidation will be healthy as this will allow the market to digest its gains.

Long-term trajectory is up

Despite the possibility of a correction or consolidation in the near-term, we maintain our key thesis that this bull market has further room to grow. We stated that this phase would be an earnings-driven bull market (*Let it go*, November 13, 2017) which will be supported by fiscal stimulus (*2017 – A record year for stocks*, January 1, 2018). Though there will be winners and losers from the implementation of reforms, lower corporate income taxes will have a positive impact on the long-term outlook for Philippine stocks.

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