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CREATE

Many countries around the world, including the Philippines, reverted back to lockdowns in order to arrest a new wave of coronavirus infections. Amid this ongoing crisis, major governments came up with their own stimulus programs while boosting healthcare spending and social services to help affected citizens. Last week, the Philippine government distributed short-term assistance (*ayuda*) to Filipinos. However, the government cannot continuously provide *ayuda* without compromising the country's fiscal position.

What may have been overshadowed by COVID-19 was the passage of the Corporate Recovery and Tax Incentives for Enterprises (CREATE) Act into law on March 27. CREATE is a major structural reform that upgrades the country's competitiveness as an investment destination. Its passage into law also comes as a timely economic stimulus and relief package for businesses. Over the long term, CREATE is expected to provide immense benefits to the economy.

Relief measures for the pandemic

To soften the impact of the pandemic on Filipinos, CREATE contains specific provisions that provide temporary relief for various firms and institutions. The tax rate for non-profit, proprietary educational institutions and hospitals has been cut from 10% to 1%, effective July 1, 2020 to June 30, 2023. The percentage tax for non-VAT taxpayers and minimum corporate income tax (previously at 3% and 2%, respectively) have likewise been reduced to 1%. And from January 1, 2021 to December 31, 2023, the sale and importation of pandemic-related goods are exempted from the 12% VAT. These include COVID-19 vaccines, equipment and materials for PPE production, as well as all prescription drugs, medical supplies, devices, and equipment used for COVID-19.

Largest fiscal stimulus for firms

The implementation of CREATE calls for a staggered cut to the corporate income tax rate from 30% to 25% by June 30, 2021. The corporate income tax rate for MSMEs (corporations with taxable income of P5m and below, and with total assets of not more than P100m) was likewise reduced from 30% to 20% by mid-year. Before CREATE, the country had a corporate income tax rate of 30%, the highest in the Asean region. A lower corporate tax rate would make our fiscal regime more competitive compared to our peers.

CREATE will be the largest fiscal stimulus for firms in recent memory. Cong. Joey Salceda, a key sponsor of CREATE, estimates the net present value (NPV) of the corporate tax cuts to be at P7.1 trillion. Finance Secretary Sonny Dominguez said, "In the long run, savings from the reduction in corporate income tax (CIT) rates will provide enterprises with more resources to re-invest in their businesses or expand their operations and thus create more jobs." The cut in corporate taxes will provide a significant and lasting boost to corporate earnings and make the Philippine market cheaper in valuation terms. Among listed companies, the primary beneficiary is the consumer sector, specifically retail companies which typically do not avail of incentives and have effective tax rates of close to 30%.

Rationalize fiscal incentives

Aside from lowering the corporate income tax rate, CREATE has standardized the framework for the granting of fiscal incentives to qualified business enterprises. The fiscal incentives will be targeted, performance-based, and time-bound. The granting of incentives will prioritize substantial investment activities, specifically those which can generate considerable employment or net exports, utilize modern technology, and promote market competitiveness. CREATE likewise contains transition or sunset provisions to soften the impact for businesses that are not qualified for incentives under the new regime. In all, the finalized framework addresses a key uncertainty pertaining to the country's fiscal incentives reform. The passage of CREATE will enable the country to attract much-needed foreign direct investments (FDIs) and allow investors to firm up their plans.

Laying the groundwork

CREATE follows the Tax Reform for Acceleration and Inclusion (TRAIN) in 2016. It is part of a multi-decade effort to overhaul and upgrade the country's fiscal regime. Due to the focus on COVID-19, we believe that investors may not be fully appreciating the structural benefits of CREATE. These include the significant boost to corporate earnings brought by lower taxes, stronger investment flows, and faster job creation for many years to come. CREATE will provide lasting benefits to the Philippine economy and lay the groundwork for long-term growth.

However, in the short term, the pressing concern is the ongoing pandemic and the recent surge in cases. Thus, it is imperative for the government to lead efforts in containing the new wave of infections and in sourcing a sufficient supply of vaccines for Filipinos. An adequate vaccination program is a prerequisite for a sustained reopening and recovery of the economy which would amplify the positive impact of CREATE.

Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit www.philequity.net to learn more about Philequity's managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 8250-8700 or email ask@philequity.net.