For the past 30 years, the Bureau of Internal Revenue has undertaken several donor-funded reform efforts, most of which have failed. Until reforms are successfully put in place, taxpayers will continue to distrust, and likely work their way around, the system.

Photo by Mary Grace Mirandilla-Santos
Economic and social progress require a modicum of basic public goods that not only protect basic human rights but also make the lives of citizens progressively better. The provision of these public goods is the raison d’être of the entity we know as the state. The state’s power to tax, i.e., to collect revenues from its citizens, forcibly if need be, springs from the moral duty to provide those public goods. How well the state fulfills this function depends partly on the revenues generated by its revenue collection system. A well-functioning revenue collection system is a sine-qua-non for a well-functioning state.

The state’s moral right to resources privately owned by its citizens depends on how well these resources are deployed for the public interest. In economic efficiency terms, the resources collected by the revenue agencies are deployed by the state so that they collectively generate benefits in excess of the maximum that could be generated when such resources are deployed by their individual owners. That is the case, for example, of a public good such as a bridge or a roadway. The celebrated Samuelson theorem (1954) says that such public goods will be underprovided (i.e., fall below the Pareto optimum level) by voluntary contribution due to the self-regarding citizens’ disregard for the collective good. Indeed, if the Olsonian free riding (Olson, 1965) is taken into account, the situation becomes worse. Samuelson’s solution is a benevolent central planner armed with the power to tax who will adequately procure such goods. The biggest objection to the Samuelson theorem is the assumption of a benevolent central planner who is at once programmed to pursue the greatest good for the greatest number and is adequately competent to do so. Such a happy marriage of competence and benevolence seldom, if ever, exists in many less-developed countries (LDCs), where governments are more likely to be either (a) malevolent, if competent; (b) incompetent if benevolent; or (c) malevolent and incompetent. These combinations of qualities impact precisely the capacity of the state to turn tax revenues into public goods. Indeed, when the state is neither benevolent nor competent, the Samuelson under-provision thesis may reverse, i.e., private provision may do better (Fabella, 2009).

Whenever the public goods provided by the state consistently fall below the expected minimum, citizens can collectively resist the tax imposition,
That path being futile and being subject to collective action failure, latent individual resistance will surface as tax evasion. Once the state loses the moral right to collect taxes, it loses the first-party enforcement aspect of tax enforcement (that force of the law coming from the citizens’ sense of duty) and must raise its third party enforcement (involving detection and punishment) effort and budget for the same tax collection level. This is a scenario rife with the corruption of the revenue organs and agents. A self-perpetuating downward spiral of low revenues and more corruption is not far behind, unless the issues are quickly addressed.

The Bureau of Internal Revenue (BIR) of the Philippines has been facing the same self-feeding downward spiral. Collectors are traditionally paid very low wages relative to their responsibilities, from very low budgets, and are expected to collect from a very cynical public fully aware of government waste and graft. Collecting agents are therefore expected to be on the take, and honesty is not always a rational response. Thus develops a “lemons market”\(^1\) for talent in tax enforcement, where the bad commodities chase out the good ones. Meanwhile, taxpayers who collude with erring tax collectors end up paying less; and if in competitive business markets, they drive out rival and upright businessmen, creating another lemons market in the business sector. This collusive network forms the primary constituency of the internal revenue status quo. A system of favors and side-payments scales up the radius of this constituency to include strategic decision centers.

Once the feedback mechanism is in place, it is very difficult for well-meaning authorities to reverse it. The system will deploy any number of defensive maneuvers to preserve its privileges. Stemming the negative spiral has been the principal challenge of BIR reform initiatives over the years.

\(^1\) In Akerlof’s (1970) seminal paper, he used the automobiles market to illustrate how quality relates to uncertainty. In his example, Akerlof described how individuals buy a new automobile without knowing whether the car they buy will be good or bad (known in the US as lemons). Thus, “there is more incentive for sellers to market poor quality merchandise” and “there tends to be a reduction in the quality of goods and also in the size of the market”. For a detailed discussion, see Akerlof (1970).
BIR Reform Initiatives

In the last three decades, several reform efforts have been undertaken by the BIR, often with significant donor support. Some of these reforms have been outright failures. Even those that had some initial success have typically proven unsustainable. The following are nine major reform efforts that have been attempted in the last three decades:

4. The Comprehensive Tax Reform Program (1997)
5. Establishment of the Large Taxpayer Service (1999)

There are two general types of tax administrative reform initiatives: process and accountability. Many reforms focused on the procedures and systems, as well as training staff on reform management and on the various aspects of the tax process. The harvests from these reforms range from mixed to nil. Accountability reforms include reduced discretion of tax officials and increased accountability and transparency in the BIR (e.g., reforms in the audit process, performance management, and human resource management). These have failed outright, due to strong and overt opposition from BIR personnel, and at times, tacit opposition from top management. BIR tax effort performance in the last four decades is shown in Figure 1. Two episodes stand...
out as exceptions and are indicated by arrows representing the first two in the list, which will be discussed in depth.

Figure 8.1. BIR Tax Effort (1968-2008).
Source: Chua (2008).

At the outset, it is safe to observe that lack of sustained effort is partly to blame for the failures. A number of important reforms advocated by a new leadership were discarded or left to wither by the next leadership. Three examples of good reforms that have not been sustained in the past are: (1) the RATE Program of Commissioner Guillermo Parayno, which was, however, not given the same priority by his four immediate successors in the Arroyo administration; (2) the Revalida Program (or internal audit of tax examiners’ performance) of Commissioner Liwayway Vinzons-Chato, which was discontinued by her successors; and (3) Executive Order No. 114 (or EO 114), signed by President Arroyo but not implemented after the departure of Commissioner Rene Banex. More recently, the faster turnover of BIR commissioners and BIR officials assigned to the reform program has exacerbated this problem, giving rise to a large number of discontinued or failed reforms. Lack of high-level support and commitment appears to have been the main driver of the short-term nature of many reforms.

In the next sections we will focus on reform initiatives that have been relatively successful (the Plana reform and the 1986 Comprehensive Tax Reform and related tax administrative reforms), and instances where they have not succeeded as envisioned (the Tax Computerization Program, Large

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5 The nine BIR commissioners between 1998 and 2010 served an average of less than two years in office.
Cases of Relatives Success: Surge and Retreat

In the history of administrative reforms of the BIR, two episodes stand out as cases of relative success—relative, that is, to other BIR reform episodes, and successful in the sense that they led to sustained increase in tax revenues for at least five years. One was a series of accountability-enhancing measures adopted during Marcos’s martial law period. The BIR commissioner—with strong political backing from the martial law president and an astute reform management strategy—managed to oversee substantial improvements in revenue collection while making significant inroads into the web of corruption in the BIR. The other is a series of administrative reforms that accompanied a major overhaul of the tax system under the newly elected revolutionary government of Corazon Aquino.

Plana Reform (1975-1980)\(^6\)

The reforms under former BIR Commissioner Efren Plana are considered by observers to be the most successful administrative reforms in the history of the BIR. Appointed by President Marcos in September 1975, Commissioner Plana came into the BIR with an anti-corruption platform.\(^7\) Plana’s success in reforming the BIR was rooted in the unwavering support and the vast autonomy given to him by the former dictator to run the BIR with little political interference. Moreover, his reforms benefited from a public sector-wide anti-corruption drive that gave his reforms credibility. When he assumed office, Marcos had just conducted a public sector-wide performance audit and dismissed 2,000 government officials who failed it—including the minister of Public Works, the Customs commissioner, and the acting commissioner of

\(^{16}\) Robert Klitgaard (1988 and 2004) and Briones (1979) largely form the sources of this section. Also forming the basis were an interview with former Commissioner Plana and several interviews with former BIR officials under Plana. Klitgaard (2004) introduced Justice Plana as “the one who famously cleaned up the BIR more than two decades ago.”

\(^{17}\) Prior to his sudden appointment as BIR commissioner, Plana was associate justice of the Court of Appeals (1973-75). His other positions: deputy minister of justice (1972-73), deputy minister of National Defense (1970-72), and a director and chief legal counsel of the Board of Investments (BOI) (1968-70). While a complete outsider to BIR, Plana was well connected to the highest office and was fully supported by the most important members of the cabinet, namely, Finance Minister Cesar Virata and his former classmate, Defense Minister Juan Ponce Enrile.
the Commission on Audit. The BIR commissioner was also replaced. Plana’s spotless and distinguished record of public service made him highly credible. To combat corruption, Plana brought in third parties to the BIR, hired new blood, and deployed the media to publicize cases of BIR corruption.

Plana came into the BIR as the economy was recovering from previous crises. In 1975, the internal revenue tax effort had fallen to less than 6.4 percent of gross domestic product (GDP), more than one percentage point below the average of the previous two years, owing to a combination of a weak tax administration and slower economic growth, thanks to the 1973 oil price shock. Economic growth, which began to pick up in 1975, averaging six percent in the next five years, gave Plana room to collect more taxes. More importantly, the fiscal deficit was confined to less than two percent of GDP, relieving him of the pressure to collect. The importance of this cannot be overlooked.

Corruption was then already a serious problem in the BIR, and knowledgeable estimates put the amount of corruption at 10 to 20 percent of tax revenues (Briones, 1979). Taxpayer audits were riddled with extortion and bribe-taking. Grease money was the way to fast-track services in the BIR. Many sensitive positions were allegedly auctioned off to corrupt officials seeking lucrative rent-seeking opportunities. Corruption was systemic and payoffs reached top BIR officials and even the internal audit office. Public perception of the bureau was negative and staff morale was low (Klitgaard, 1988). BIR personnel were divided into the ins and the outs, or those who belonged to the “family,” and those who did not.

While Plana’s reform was carefully planned, Plana’s style also mattered. When he assumed office, he took time to learn the internal workings and dynamics of the BIR, consulting extensively with his senior staff and various stakeholders, such as field officials, rank-and-file staff, businessmen, other taxpayers, and officials of other government agencies. In order to gain their cooperation, he avoided the usual pitfall of assuming guilt a priori among the BIR veterans. Instead, he learned progressively who were possibly corrupt by asking bureau personnel who they believed were clean. More tellingly, he employed the services of investigators from the Department of Defense (DOD)

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8 Marcos fired the acting commissioner on Audit, believing that rampant corruption in government could not have happened without the connivance of the Commission on Audit.

9 Marcos’ own motive for the purge of the public sector of corrupt officials and his special attention on the BIR was understandable. Three years into the declaration of martial law, corruption was still rampant, his “new society” movement had not accomplished all it promised, and was thus losing credibility. Moreover, he needed to borrow from the World Bank and IMF to fund his massive infrastructure projects, one precondition for which was ensuring adequate revenues. Thus, BIR reform was an especially important initiative.

10 Civil society as a countervailing voice hardly existed during martial law.
to document the lifestyles of the top 125 employees of the BIR.\textsuperscript{11} He also used the media to publicize cases of BIR corruption, creating a highly effective form of non-judicial punishment (Klitgaard 1988). The press was then totally controlled.

To fight corruption, Plana limited discretion and increased transparency in the BIR. Old hands at the BIR had to adjust to his no-nonsense, professional, and strict manner of running the bureau.\textsuperscript{12} After ascertaining whom he could trust, he assigned these “clean” officials to special assignments, such as internal audits. He hired newly minted certified public accountants and had them work with “senior heroes” to review the work of tax examiners (Klitgaard, 2004). By doing so, he sent a strong signal to corrupt examiners that their work could be audited anytime. At the same time, he brought in the Commission on Audit (COA) to supplement the work of the internal audit office. To further limit the discretion of BIR employees and make the Tax Code simpler for taxpayers and tax examiners alike, he pushed for the simplification of the Tax Code, which led to the various amendments to the National Internal Revenue Code, all enacted by presidential decrees.

The reforms led to the longest sustained increase in internal revenue tax effort in decades. Tax effort rose from 6.4 percent of GDP during his first year in office in 1975 to 8.0 percent by the time he left the bureau in 1979. Growth in tax collection averaged 22 percent between 1976 and 1980 (with the highest collection growth recorded in 1978 at 30 percent, following amendments to the Tax Code in 1977).

The success of his reforms, however, depended so much on Plana’s leadership and the political support he personally enjoyed from both the president and some of the most influential members of the Cabinet. He fell short of engendering the institutionalization of his system, which began to sputter after five years of positive accomplishments. With Plana leaving the BIR in May 1980 to assume his post as deputy minister and acting minister of Finance, tax effort began to flag anew, along with the global slowdown in 1982. From eight percent of GDP in 1979, internal revenue tax effort fell to 7.7 percent the following year and reached 6.1 percent of GDP in 1983-1984 (the lowest since 1972). Tax compliance and administration also weakened—especially between 1983 and 1985—when the economy was in deep recession and the

\textsuperscript{11} According to Briones (1979), bureau personnel would refrain from naming corrupt officials (since members of the family were bound by loyalty) but were more open to naming who they thought were clean.

\textsuperscript{12} It was reported that Plana did not hesitate to publicly reprimand even the most senior officials in the bureau for poor performance. In one incident, an official suffered an apparent heart attack in his office allegedly after getting a serious scolding.
country became rife with rumors of corruption and waste in the highest level of political leadership. At the same time, President Marcos appeared to be shifting to using the BIR for extraneous ends. The BIR lost its moral stature.

**Comprehensive Tax Reform Program of 1986 and Related Tax Administrative Reforms**

In the wake of the fall of the Marcos dictatorship and of the worst recession in the country’s history, the newly inaugurated Aquino administration launched a comprehensive tax reform program. The reform was necessary, given the fall in the tax effort from 12.8 percent of GDP in 1979 to 10.7 percent of GDP in 1985 and the consolidated public sector deficit above six percent of GDP. Moreover, the debt crisis in the early 1980s had closed the international credit market to the Philippines. This left the new government with no recourse but to embark on a full reform of its tax system to be able to access concessional finance. It was primarily a tax policy reform and only secondarily a tax administration one.

Among the salient features of the reform were: (1) the shift from the dual personal income tax schedule system (one for compensation earners and another for business and professionals) to a unified schedule for personal income taxation; (2) the introduction of ceilings on allowable deductions (which, unfortunately, was not implemented due to the strong lobby from various professional groups); (3) the shift from a dual-rate system of 25 and 35 percent applicable to taxable income of corporations to a single rate of 35 percent; and (4) the introduction of the VAT. These sweeping tax policy reforms were enacted through executive orders, thanks to the fact that during this revolutionary period, the president enjoyed the power to issue executive orders with full force of legislation.

Administrative reforms—mostly piecemeal but high-impact in nature—followed to enable the BIR to implement the new policies and to prepare it for eventual modernization. In 1987, the Department of Finance (DOF) and its attached agencies, including the BIR, were restructured under EO 127. The BIR’s restructuring aimed to make its organization more responsive to the new tax system, improve taxpayer service, and increase efficiency. Tax collection was enhanced via (a) a credible one-time amnesty covering the years 1981 to 1985 (when compliance was the weakest), which resulted in ₱1 bil-

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13 This section draws partly from Diokno (2005).

14 The VAT replaced the previous sales tax system. All in all, the VAT replaced 66 various types of sales taxes. The adopted VAT was based on the consumption and destination principle with three effective rates: 10 percent, exempt, and zero-rated (primarily for exporters).
lion (0.2 percent of GDP) in additional tax collection in 1986, and (b) improvements in arrears management, which raised an additional P4.2 billion\(^{15}\) (0.6 percent of GDP) in 1987. The perception of reduced corruption (relative to the latter part of the martial law years) helped increase trust and tax compliance. Moreover, in the succeeding years, the bureau rationalized its audit process, significantly expanded the withholding tax system, and moved towards in-house computerization.\(^{16}\) Resistance was limited, as the reforms did not directly curtail the discretion and power of tax officials.

BIR’s administration reforms in the mid-eighties also benefited from the higher compensation of BIR staff. BIR staff remuneration had been increased in 1985 to about double the pay of other government agencies.\(^{17,18}\)

These reforms, together with the improving economic environment and a period of high growth in the mid-1990s, resulted in an unprecedented growth in the internal revenue tax effort from 7.3 percent of GDP in 1986 to 9.9 percent of GDP in 1992, and later, to a historic high of 13 percent of GDP in 1997—the total tax effort reached 17 percent of GDP in 1997. General tax compliance also improved. The number of tax filers doubled between 1986 and 1992 and continued to increase between 1992 and 1997 with the implementation of the tax identification number (TIN). Public perception of corruption also improved.

The successes of the tax reform of 1986 and complementary reforms by the administration were primarily driven by the imperative to put its fiscal house in order. President Aquino fully supported the reform, and a well-coordinated and highly competent economic team crafted the policies with little political and business interference. In tax administration, reform efforts, riding on the initial high credibility of the new government and the public perception of improving governance, were successful for a number of additional reasons, such as continuity of leadership at the BIR and the appointment of competent outsiders to head the bureau: Plana stayed for five years;

\(^{15}\) Foreign exchange rate was at P44 to US$ 1, as of December 2010. See http://www.xe.com/ for latest rates.

\(^{16}\) The information system of the BIR prior to 1991 was outsourced to the Revenue Information Systems Services, Inc. (RISSI). EO 468 abolished the RISSI and authorized BIR to establish an efficient computer and communications network system.

\(^{17}\) To incentivize the BIR to collect during the 1984-1985 recession, President Marcos granted all BIR personnel a package of benefits and incentives to improve professionalism and create a career system in the BIR (EO 1042). In particular, the BIR salary scale was upgraded to rectify the inequities in salaries and raise them to levels comparable with government financial institutions. This salary advantage, however, was removed with the passage of the Salary Standardization Law in 1988.

\(^{18}\) Commissioner Ruben Ancheta (1980-86) was well known (and well loved) in the BIR, not for his reforms, but for pushing for salary increase for BIR staff.
Commissioners Bienvenido Tan, Jr. (1986-1988) and Jose Ong (1989-1993) stayed in their posts long enough to personally oversee the reforms in the BIR. Moreover, there was also continuity in the second tier. Deputy Commissioners Victor Deoferio, Jr. and Eufracio Santos both served uninterrupted for almost eight years during the terms of the two commissioners.

**Why the Relative Success?**

The reasons why these initiatives made headway are important. Firstly, one cannot ignore the fact that they occurred under the watch of presidents with decree-making powers and who demonstrated the willingness to use those powers: President Marcos removed outright 2,000 officials who failed the government audit, while President Aquino replaced local officials en masse soon after assuming emergency powers. The Marcos regime also brought in freshly minted military officers into the BIR and other agencies and formed an investigative, monitoring body backed up by decree powers. These demonstrated—in no uncertain terms—the higher powers’ resolve, and it was not lost on anybody. The support of a higher power that was deemed ready and willing to deploy effective force to see its programs through was central.

The strength of the support and commitment of the higher authorities was manifested in the length of tenure of the commissioners appointed. In the case of Plana, there was an additional boost to the effort: the controlled press was used extensively in support of the reform effort.

Another favorable tailwind was that neither the political leadership nor its appointees were tainted by corruption. This gave the agency a moral ascendancy to collect taxes (in 1975, the Marcos regime had not yet shown its dark side, or at least, still enjoyed the benefit of the public’s doubt). When the leadership began to falter in the credibility dimension, these reforms also faltered.

The sad common observation is that these reform initiatives—while initially successful—were not sustained, and revenue performance began to retreat after peaking. The change in focal personnel and/or the change in the priorities and credibility of the higher leadership led to the erosion and eventual reversal of early gains.

**Cases of Partial and Outright Failure**

Other reforms have had less success or failed outright. In the period after the Marcos dictatorship and the Aquino revolutionary government, reforms that were carried out did not benefit from high levels of political will and posi-
tive circumstantial factors that made reforms easier to implement. In particular, the more frequent changes in leadership limited the sustainability of most reforms. As a result, most recent reforms have had little or no impact on tax effort.


In the 1990s, a major reform effort focused on computerizing the various tax processes and linking the regional and district offices to the national office via a network. In 1993, the Philippines, with funding from the World Bank, embarked on an ambitious US$63-million tax and customs computerization project—the largest agency modernization effort attempted by the government—after three years of preparation (World Bank, 2000). According to the project’s implementation completion report (ICR), “The project entailed changing manual, paper-based tax administration to computerized, paperless ones (sic), and training around 8,500 staff on the new systems.” The output, an integrated tax system (ITS), was judged by the IMF (1999) to be a “world-class tax system which many developed countries would benefit from.” A total of 14 modules representing the various tax processes were developed. Implementation, however, was limited to only a handful of modules, while other modules, which limited the discretion and power of tax officials, stalled and were apparently opposed. In addition, a network was set up to link 41 district offices, 19 regional offices, and three data centers with the main computers in the national office.

In many ways, the timing of the project was right. Tax effort had been on a general uptrend since 1986, aided by better tax policy and improved tax administration. From 10.8 percent of GDP in 1986, tax effort reached 15.6 percent of GDP in 1993 and continued to be responsive to growth.

The growing economy and high confidence in the new administration of President Ramos further fueled economic activity resulting in rapid growth of income and formal sector jobs, further increasing tax collection. A fiscal surplus (gross of privatization) was achieved in 1994—for the first time in history—and was maintained for the next three years. As such, there were no strong pressures to collect and meet revenue targets. Moreover, basic, fundamental reforms—such as the shift to the TIN and the expansion of the withholding tax system—were underway, ensuring an adequate revenue base. At the same time, the president appointed a competent new commissioner, Liwayway Chato, who would stay on as head of the BIR for the next five years. Prior to her appointment as commissioner, Chato, a private tax lawyer, headed a high-level team commissioned by Ramos to conduct a management and performance audit of the BIR.
The TCP moved smoothly, in general, throughout its implementation. In the BIR, continuity of leadership at the top and the second tier provided focus and adequate guidance. Although there were three deputy commissioners for information systems in succession, all three coordinated with one another, and the last deputy commissioner was with the project from its inception and had full ownership of the project. At the DOF level, Ramos’s second secretary of Finance, Roberto de Ocampo, stayed in office for four years, longer than any former Finance secretary since the time of Cesar Virata. After de Ocampo, three secretaries took office in succession, but this did not pose a problem, as the undersecretary for the Domestic Finance Group, Milwida Guevara, took the role as overseer of the project. However, the change in administration in 1998 threw in a change in leadership style and priorities; project momentum slowed, and some priorities were replaced.

Despite the favorable environment and commitment to the reform, project results were mixed. The ICR rated the project satisfactory in most aspects, such as development of the ITS, the setup of the Large Taxpayer Service (see discussion below), increasing the number of registered taxpayers, and improvements in the efficiency of tax administration in general. However, it was rated unsatisfactory in some aspects, such as audit and the inability to clearly demonstrate that computerization did indeed increase collections. Although all 14 modules were developed, only four “non-threatening” modules were institutionalized, while the rest were piloted but were eventually shelved. The ICR reported that, as of June 2000 (six months after the project closed), “Computerization has not yet had a significant impact on revenues. We expect the latter to happen once the ITS’s auditing capacities are fully used.”

However, the audit functions were never used after initial pilots due to resistance. According to the BIR’s version of the ICR:

ITS bases the selection of audit candidates principally on the completion of tax returns and the details of the account information form (AIF), a new tax form required from taxpayers. The poor taxpayer compliance on both returns and AIF made it impossible to use information from these forms as basis for audit selection. Because of this, the entire audit functionality was not implemented. On hindsight, it would still have been possible to implement at least the case monitoring, document tracking, and assessment issuance, which were also audit functionalities available from ITS.

What the BIR and World Bank ICRs did not say, however, was that several facets of the TCP were facing opposition, especially from field officials who feared that computerization was taking away too much of their power and discretion. As a result, field officials did not have the incentive to guide tax-
payers in filling out the forms properly and completely and in ensuring compliance with timely filing of forms. In addition, neither the BIR nor the DOF enforced the implementation of the Financial Link (FINLINK) functionality, which would have connected the BIR to other agencies to allow the collection of third-party data to feed into the audit system instead of relying on taxpayers’ returns.

Moreover, a very important management tool developed in the TCP—the National Office Management Information System (NOMIS)—was shelved after initial runs. The NOMIS intended to provide top management with quick summary and up-to-date tax statistics for planning and analysis, as well as a basis for allocation of collection goals and evaluating tax programs against agreed performance indicators. This system was equipped to provide management with taxpayer and industry profiles to aid the selection of taxpayers for audit or investigation. Chato’s successor, Beethoven Rualo, the second commissioner to have risen from the ranks, apparently had no interest in such a tool, which would curtail even the commissioner’s power of discretion.

Out of an ambitious system design, only a small subset of modules was fully implemented. Since the close of the project, only the front-end applications on bank interface, registration, transaction processing, and some back-end applications such as the returns compliance (stop-filer) application were implemented and institutionalized. The rest of the back-end modules, such as case monitoring, tax reconciliation, accountable forms, legal information, and audit, were not implemented. The technically sound reform foundered in the implementation stage, where it was rendered pro forma by opponents.

The impact of the TCP on revenue collection remains vague to this day. Towards the end of the project, many exogenous shocks entered the picture and significantly affected revenue collection. These factors were the Asian financial crisis, the 1997 CTRP (discussed below), and the 1998 and 2001 changes in administration. The DOF pushed several measures in taxation for personal income, value-added, and excise to offset the decline in revenues from import duties and fiscal incentives. Thus, the direct contribution of the TCP is hard to isolate.

The Comprehensive Tax Reform Program of 1997

In 1994, the government began work on a second comprehensive tax reform program, which became effective in 1997. The overarching goal of reform was to protect the tax effort from its imminent decline given falling import duties due to the trade liberalization, the large number of fiscal incentives that were enacted and approved between 1992 and 1996 to promote investments, and higher personal and additional exemptions for
individual taxpayers.

In particular, the reform aimed to (a) make the tax system broad-based, simple, and with reasonable tax rates; (b) minimize tax avoidance allowed by existing flaws and loopholes in the system; (c) encourage payment by increasing the exemption levels, lowering the tax rate, and simplifying procedures; and (d) rationalize the granting of tax incentives, which reached ₱32 billion in 1994 (Diokno, 2005).

Although desirable, there was no urgency to reform the Tax Code. While there was scope to improve the tax system—especially in the areas of corporate taxation and fiscal incentives—the rest of the tax system, though not perfect, was not in bad shape (as evidenced by the increase in tax effort, albeit slower). The tax system suffered more from administration problems than design problems. The economy was doing very well. Growth in 1996 reached 5.8 percent and was projected at 6 percent in 1997 (the start of financial crisis pushed down growth to 5.2 percent instead). The fiscal surplus was maintained between 1995 and 1997, and government debt stock was falling in real terms from over 70 to 55 percent of GDP between 1993 and 1997. In fact, the country was close to exiting the IMF program, and fixing remaining issues in the tax system was seen as one of the important requirements for that exit (Diokno, 2005).

The reforms to rationalize fiscal incentives were completely ignored by Congress. In fact, Congress passed 12 more laws granting fiscal incentives and higher exemptions. This, together with the non-indexation of excise taxes, contributed to the steady decline in the tax effort in the following decade. The result of the reform was the passage of 10 new tax measures having the effect of raising revenues and 28 tax measures having the opposite effect of giving away revenues through granting incentives and higher exemption (Diokno, 2005).

Unlike the 1986 reforms, revenue laws had to pass through Congress. As the proposals of the executive had to be approved by Congress, the passage of reform measures suffered significant delays, and many good provisions were watered down. Some laws even proved to be inferior to the laws they replaced. Congressmen, who were preparing for the 1998 general elections, had little interest in improving the tax system and were afraid to earn the ire

\footnote{In the cabinet, Secretaries Roberto de Ocampo, Cielito Habito, and Salvador Enriquez were major proponents of the reform. Finance Undersecretary Milwida Guevara led the technical panel. In addition, a presidential task force on tax and tariff reforms, chaired by the secretary of Finance and multi-sectoral in composition with representatives from the government, the private sector, and the academe, was created in 1994 (Diokno 2005).}
of big businesses, which generously contributed to their campaigns. In the Senate, Senator Juan Ponce Enrile, a foremost tax expert, was the champion.

The 1997 CTRP weakened, rather than strengthened, the Philippine tax system. In the years following the implementation of the CTRP, tax effort progressively fell in 2004 from a peak of 17 percent to 12.4 percent of GDP, the lowest since 1986 (BIR tax effort likewise fell from 13.1 to 9.8 percent of GDP). Tax effort was also pulled down by the twin Asian financial and El Niño crises in 1998.

Opposition also grew bolder after Chato’s departure. As a case in point, some features of the CTRP, such as the tax on fringe benefits and the minimum corporate income tax (MCIT), were not implemented by the BIR due to strong opposition by businesses. Moreover, the VAT on banks was also not implemented and “when finally implemented, was recalled, and then subsequently repealed.” (Diokno, 2005). The 1997 CTRP experience shows that tax policy reformers underestimated the power of bureaucratic and business opposition.

Establishment of the Large Taxpayer Office (LTO)

A sister reform to the TCP was the establishment of a Large Taxpayer Office in the BIR.20 To secure revenues coming from the largest taxpayers of the country, the BIR established the Large Taxpayer Service (LTS) in 1999. The LTS is a third-level office in the BIR headed by an assistant commissioner who reports directly to the commissioner. The LTS has its roots in the Large Taxpayer (LT) division (headed by a division chief), which existed between 1993 and 1999, and was limited to monitoring and receiving payments from large taxpayers. Other core functions (registration, assessment, and collection) were carried out by the respective revenue district offices having jurisdiction over the large taxpayers. The establishment of the LT division was one of the preconditions before the tax computerization loan could be approved in 1990. By contrast, the LTS is a one-stop shop.

The LTS was originally set up as an elite office composed of the best personnel in the BIR. To carry this out, LTS staff—examiners, in particular—were selected via a stringent recruitment process, which involved an interview with top management, a written exam, and a psychological exam. Successful applicants were then required to take core training (both formal and on-the-job) on the end-to-end audit process, including industry profiling and bench-

20 The country’s largest taxpayers normally contribute 50 to 80 percent of total tax revenues. The rationale for an LTO is to increase control over the largest part of the revenue flow. Countries that have successfully implemented LTOs have experienced improving tax compliance and higher tax revenues.
marking, international financial reporting standards, and the audit of complex industries such as banking and insurance. In the succeeding years, training in computerized audit tools became a standard requirement. Bonuses were given to both the office and to individual staff whenever the LTS exceeded its target.

Despite being a sterling idea, the LTS reform was not sustained in succeeding years. The increase in the number of large taxpayers under its purview, especially in the latter years, was not matched by a commensurate increase in the number, caliber, and capacity of LTS staff—in particular, examiners. Moreover, the original recruitment method was discontinued after the initial implementation, and the LTS training program lost steam following the budget cuts.

While the elite group of BIR examiners that was carefully selected in 1999 was given advanced and specialized training, the current roster of LTS examiners is undertrained and inadequate in number. Less than a quarter of the original high-caliber examiners have remained in the LTS.\(^{21}\) In mid-2007, a major reassignment of personnel led to the transfer of a significant number of original LTS examiners to the field and their replacement by examiners from the field with little or no LTS experience. At present, the auditing of more complex industries, such as banking and insurance, is a problem for the LTS.

Originally, the LTS covered 630 of the country’s largest taxpayers and accounted for 32 percent of the BIR’s tax collection. This was increased in 2000 to 938 taxpayers, when the excise tax service was merged with the LTS; to 1,306 taxpayers in 2002, covering more than 50 percent of total revenues; and finally to 1,587 taxpayers in 2006, accounting for about 65 percent of total revenues.\(^{22}\)

The transfer of large taxpayers to LTS has always been a sensitive issue. Regional directors and revenue district officers oppose the transfer, primarily because it significantly decreases their respective tax base, and hence collection, and in turn, opportunities for rent-seeking. This tussle between regional offices and the LTS intensified in 2007, when an additional 279 taxpayers were transferred from the regional offices to the LTS, raising the share of LTS collection to 65 percent. Something had got to give.

In 2007, Commissioner Lilian Hefti delisted almost 500 large taxpayers from the LTS, many of which were among the most compliant taxpayers. The delisting violated existing BIR policy to gradually increase the size of the LTS

\(^{21}\) Some of those who resigned found employment among large taxpayers.

\(^{22}\) The criteria for enlisting and delisting large taxpayers were not applied automatically and consistently.
The official reason for the transfer was to balance tax collection equally between the LTS and the regional offices (the regional offices were clearly unhappy with their small tax base).23 Among those delisted were the largest banks and insurance companies, which, by virtue of the complexity of their businesses should be placed in the LTS, and multinational companies, which were among the most highly compliant group of taxpayers. The delisting backfired as the BIR’s collection fell in the months after the delisting. The commissioner, realizing that her move could jeopardize collections further, declared her intention to return the delisted taxpayers if the fall in collection could be attributed to the delisting. She was soon replaced, however.

The new commissioner, Sixto Esquivias, declared at the start of his term his intention to return the delisted taxpayers and embark on a plan to strengthen the large taxpayer office. A plan was worked out on how to strengthen the LTS over the medium-term, with a timeline to gradually increase the capacity of the LTS and the number of taxpayers falling under it. The goal was to eventually increase the LTS’s share of collection from 50 percent after the delisting to 80 percent in three years. To improve the competence and integrity of staff in the LTS, the original selection process would be revived, and selected staff would be placed at higher salary grades and be given adequate training.

The LTS started as a good idea. However, it had to be implemented by a system that still has to overcome the opposition from within its own ranks, and so was neutralized to a large extent. This is a common fate of programs intended to reform an agency, but which have to be implemented by that very same agency. The story of the LTS continues.

The Bañez Reform Saga24

Rene Banez’s appointment as BIR commissioner came at a time when the anti-corruption momentum was high, and there was pressure from the people to run a clean government. Succeeding Estrada, who had been removed from office extra-constitutionally on account of corruption, President Arroyo publicly emphasized her personal interest in cleaning up the revenue agencies and proclaimed during her first state of the nation address (SONA) to Congress her intent to “make the BIR and Customs showcases in this fight against graft and corruption.” Upon assuming office, the president removed BIR Commissioner Dakila Fonacier, an appointee of Estrada who had just stayed for

23 The reasons for delisting were varied. One informant said the real reason was to “teach the taxpayers a lesson because they were hard headed.”

24 This section draws heavily from de Dios’s (2003) excellent account of the political economy of the Bañez reform.
Bañez assumed the Office of the BIR Commissioner in February 2001. He pushed for a three-pronged program of reform: (1) the reorganization of the BIR operations group into four taxpayer segments—large, non-large, government, and tax-exempt (embodied in EO 114). He also proposed the separation of the excise tax group from the large taxpayers; (2) outsourcing of non-core BIR activities; and, finally, (3) corporatization, the establishment of new accountability rules and performance contracting through the establishment of a new collection agency by an act of Congress (Internal Revenue Management Authority [IRMA]). He brought with him all the right ideas.

In May 2001, Bañez ordered the reshuffling of 10 revenue officials as part of the re-organization effort. This whipped up a storm of protest. Full-page ads began to appear in the dailies calling for the ouster of Bañez. A temporary restraining order (TRO) was secured, stopping the implementation of travel orders of revenue officials. The Philippine Association of Revenue District Officers (PARDO) filed a plunder case against Bañez before the Office of the Ombudsman. Twelve congressmen lent their voices to the opposition to the BIR commissioner. More tellingly, the revenue collection was reported to have fallen short by ₱6 billion. The squeeze had begun, but the real blow was still to come.

The IRMA Bill

Despite the ruckus caused by the reshuffle, Bañez persisted in pursuing the corporatization agenda. The IRMA bill was filed in August 2002. Explains Bañez (2009):

Under the IRMA, the tax agency would be supervised by a Revenue Board that would function like the independent policy-making Monetary Board of the Bangko Sentral ng Pilipinas (BSP). The Board would be chaired by the Finance secretary, and would have as members the budget and management and socioeconomic planning secretaries, the Securities and Exchange Commission (SEC) chief, and three private sector representatives.

The IRMA’s CEO would have a performance contract with the board, upon which his compensation would be based... a “new
BIR” that would have external accountability to the executive and legislative arms of government, as well as managerial flexibility.

IRMA was meant to replace the old BIR. IRMA would have had budget independence, greater autonomy, and would not have been hamstrung by civil service rules in the hiring and firing of front-line revenue officers. But all personnel of the BIR had to resign, or would have been considered to have done so, and had to reapply for positions in the new agency. This was the killer provision. EO 114, which was forged in an agreement with insiders, promised no de-hiring. As Bañez observed:

In the second week of August 2002, the workforce at the BIR denounced the proposed creation of the IRMA, particularly the provision that threatened the employees’ security of tenure. The said provision required that they apply anew for their positions, their acceptance or non-acceptance contingent on their qualifications.

The BIR Employees Association (BIREA) thereafter declared that the proposed abolition of the agency and its replacement by the IRMA was unconstitutional and violated civil service laws. BIREA referred to the measure, which was then pending in the House of Representatives, as “class legislation” because it singled out BIR employees for exclusion from civil service coverage.

The IRMA recruited the BIR rank-and-file to the anti-Bañez cause. It also gave the antis foot soldiers with which to mount protest marches. The BIREA was mobilized and held daily demonstrations. Members from the provinces were bused to the national office to reinforce the demonstrators from NCR offices. At one time, the “mob”—as described by onlookers and the press—went wild, banged the gates of the BIR, and pushed their way through the BIR's heavily guarded doors in an attempt to literally kick Bañez out of office.

Meanwhile, the revenue collection shortfall of PHP39 billion for the first half of 2002 put an even more negative light on the Bañez-BIR war. Bañez reported that this was a deliberate effort: “I strongly believe there are perpetrators who are out to sabotage the reforms by deliberately cutting back on collections during the first half of the year.”

In the weeks prior to Bañez’s resignation in August 2002, the BIR had come to a virtual standstill as many BIR officials refused to do their job. President Arroyo, who initially gave her full support to Bañez, wavered after seeing negative tax collection growth through the first half of 2002, and the national
government deficit exceeded five percent of GDP, the highest in decades. As de Dios (2003) explains the president’s attitude, “The need for a short-term solution to the deficit problem then appeared to overtake the longer-term strategy of placing revenue collection on a new footing, and a reversal was in the offing.” Other supporters in Congress and in the BIR also deserted Bañez.

Bañez resigned on August 19, 2002. IRMA languished and died in Congress. Even the EO 114 was opposed and fell victim to neglect. President Arroyo offered only token support, and the private sector was not eager to fight. Bañez, reflecting on the lack of private sector support, said, “I was actually waiting for signs, a show of support from other stakeholders, from the private sector, who, since time immemorial, had been asking for reforms.” In the end, Bañez was left to fend for himself. He became the latest victim of the powerful anti-reform network and a warning to others. The political hurdle proved too high for this well-meaning crusader.

Reasons for Failure

So why did the Bañez reform initiatives come to a different end than the Plana reforms? First, Plana was supported by a president with decree-making powers, i.e., effectively the EO was the law. Plana’s principal had demonstrated the will to use such power in other areas. Bañez was appointed and initially supported by a president who had to work with Congress. Plana had no such restrictions.

Secondly, their styles also differed. In his first speech as commissioner, Bañez told the BIR audience that he would “destroy the BIR and build a new one,” a remark that immediately earned the ire of many BIR officials. In sharp contrast, Plana avoided such incendiary language, and thus, slowly won the cooperation of BIR officials.

Thirdly, the macro-fiscal environment was very different. Between 1975 and 1980, during the term of Commissioner Plana, the country was growing at an average of 6 percent per year, and pressures to collect additional revenues were not as high. Bañez, on the other hand, was operating in a much weaker post-Asian Crisis economy and a weaker fiscal position. As such, it was imperative to meet collection targets to prevent the fiscal deficits from ballooning. This made support for radical reforms, which would have adverse short-term impact, more tenuous.

Fourth, the Bañez corporatization initiative embodied in the IRMA was far more radical than the Plana reforms. It exceeded the EO space and required an act of Congress. The decision to submit the IRMA to Congress after the strident
saber-rattling by PARDO stood the divide-and-conquer rule on its head: it recruited the BIR rank-and-file represented by BIREA into the opposition ranks. It also added a breach of trust dimension into the controversy, since IRMA controverted the no-dehiring promise of the original covenant EO 114. Suddenly, the advocates were fighting on more fronts than they could handle.

Some objective lessons can be learned from the Bañez experience. The first lesson is to exhaust the potential of the EOs and the powers of the chief executive. When the depth of the proposal extends beyond the purview of the EOs, the nature of the game radically changes, since the president has to play quid pro quo with Congress. When this is the case, the game must be played primarily by Malacañang (seat of power) not by the BIR commissioner. The second lesson is to deploy the divide-and-conquer rule: never make more enemies than necessary. Alienating the BIREA with IRMA, and threatening rank-and-file jobs even before the revenue officers reshuffle issue was settled, were tactical errors. Finally, the chief executive must realize that a proposal for meaningful reform of the BIR will run into the headwind of falling tax revenue as revenue collectors fight back. This latter must be part of the equation *ab initio*. As de Dios (2003) put it:

> It was ultimately a naïve belief that one could make a determined attempt to break the corruption cycle in the tax agencies, and at the same time, that one collected extraordinary revenues. It should instead have been expected that resistance to reform within the agency, particularly from insiders, but also from outside beneficiaries, would be put up, one of which might take the form of deliberate underperformance.

The Bañez reform program was rejected because it *misread the political environment and the limits it sets on the doable*. It advocated correct ideas of transparency and accountability, but its vehicle was overly radical for the political soil. The balance of forces permitted only evolutionary rather than revolutionary steps.

**Summary**

The story of the administrative reform initiatives in the BIR in the democratic era is a virtual litany of failures. These failed initiatives, nonetheless, are valuable sources of lessons for future advocacies. Since we cannot return to the era of the decree-making executive, reform advocates must become as politically savvy as their opponents. Internal resistance deploying a clever and well-funded use of the press and Congress, the use of the rank-and-file, the blocking moves using the courts of law, and most
importantly, the tax revenue squeeze have managed to cow higher authorities into largely letting the administrative status quo be. It is much easier to tweak the tax rates whenever a fiscal crisis looms. This is an interesting version of the Olson effect: a well-organized minority lords it over a diffuse majority. The minority here is represented by tax reform oppositors forcing government to raise assessments on the taxpaying majority to remedy fiscal imbalances. It is clear that future reform initiatives must carefully map the political terrain to avoid the tactical mistakes of past efforts. It seems clear that reform efforts must be planned and directed by and in Malacañang, outside the walls of the BIR itself.

References


