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PROPOSAL FOR A DEBIT TAX: AUTOMATIC RESPONSE TO FISCAL EMERGENCIES

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Abstract

Financial Transactions Taxes have gained popularity in Latin America during the 1980s and 1990s because these were able to generate large amounts of revenues during fiscal emergencies. This paper proposes a form of FTT called the Debit Tax that would be collected only when the deficit level reaches a certain trigger point: It is then automatically discontinued when the deficit figure goes below 3.5% of GDP. The advantage of this tax comes from its high yield (possibly up to .6% of GDP) despite a low tax rate of 1/5 of 1% based on transaction values.

In periods of fiscal distress, such as that currently experienced in the Philippines, the government will require more or higher levels of taxes to arrest the growth of deficits and debt. More and higher levels of taxes would impose a very heavy burden to large segments of the population, by and large making any incumbent administration highly unpopular.

A Light But High Yield Tax

There is one kind of tax that has a strong potential in generating huge amounts of new government revenues, but does not apparently represent a heavy burden to taxpayers. Latin American countries, including Argentina, Brazil, Colombia, Ecuador, Peru and Venezuela, have implemented variants of said tax since the late 1980s and have succeeded in collecting revenues between .29%-3.5% of GDP (*see Table 1*).

These taxes are seen in the form of the “Financial Transaction Tax” (FTT), which probably traces its roots to the traditional documentary stamp taxes. In current practice, it relates to the more modern

Table 1
Bank Debit Taxes in Latin America

Country	Year	Tax Rate	Gross Revenue	
			In % of GDP	In % of Tax Revenue
Argentina	1989	0.70	0.66	4.30
	1990	0.30	0.30	2.00
	1991	1.05 ^a	0.91	5.40
	1992	0.60 ^a	0.29	1.50
	2001	0.50	1.45	7.40
	2002	0.60	-	9.60
Brazil	1994	0.25	1.06	3.60
	1997	0.20	0.80	2.80
	1998	0.20	0.90	3.00
	1999	0.22 ^a	0.83	2.90
	2000	0.34 ^a	1.33	4.80
	2001	0.36 ^a	1.45	4.20
Colombia	2002	0.30	-	6.10
	1999	0.20	0.73	5.50
	2000	0.20	0.60	5.30
	2001	0.30	0.80	5.70
Ecuador	2002	-	-	5.30
	1999	1.00	3.50	26.70
	2000	0.80	2.33	17.10
Peru	1990	1.41 ^a	0.59	6.40
	1991	.81 ^a	0.46	5.00
Venezuela	1994	0.75	1.30	7.70
	1999	0.50	0.80	7.90
	2000	0.50	0.40	3.70
	2002	0.75	-	12.70

^a is average of rates, adjusted for the period during which the tax was in effect

Sources: Coelho, Ebrill and Summers (2001) and IMF staff estimates

Arbelaez, M., L. Burman and S. Zuluaga (2002)

Suescun (2004)

securities transfer tax, bank debit tax and the “Tobin tax”, named after the economist who proposed it to prevent speculation in capital markets.

The burden to taxpayers would be quite negligible when one considers that the tax rates commonly have been only from 1/5 of 1% up to 1.2% of the value of transactions or funds transferred. By contrast, ordinary documentary stamp taxes would range from 3%-10% of sales while the VAT rates are higher at 10%-14%.

Temporary Revenue Source

The significance of this tax is best presented by studying the Latin American experience. In the face of weak tax administration and harsh economic, financial and fiscal situation, these types of taxes may have presented the Latin American countries with a convenient tax handle because it takes advantage of financial institutions' sophisticated accounting systems, thus, simplifying tax collection.

The tax is viewed as a suitable short-term measure to raise needed revenues amid high budget deficits, economic contraction, hyperinflation and bailout of financial institutions. As such, financial transactions taxes have been used to improve the fiscal standing of said countries. These have also been a useful source of health, social welfare and calamity funds during conditions of fiscal distress. The tax has since become an important source of federal government tax revenues. In 2002, its share to total tax revenues registered 9.6% in Argentina, 6.1% in Brazil, 5.3% in Colombia, and 12.7% in Venezuela¹.

¹ Ecuador replaced its income tax for the bank debit tax from 1999 to 2000. Hence, this tax held a higher share to federal government tax revenues (26.7% in 1999 and 17.1% in 2000).

Adverse Effects

As with other cases of tax implementation, there are can be unintended results. The bank debit tax, for example, has caused financial disintermediation² in most of the Latin American economies. Argentina and Ecuador saw the movement of some of its bank accounts to offshore facilities to escape payments. Significant equity trading in Brazil and Venezuela appear to have moved from local bourses to foreign equity markets.

Interestingly, Argentina, Colombia and Peru experienced the phenomenon of multiple endorsements of check on transactions.

Designing the Debit Tax

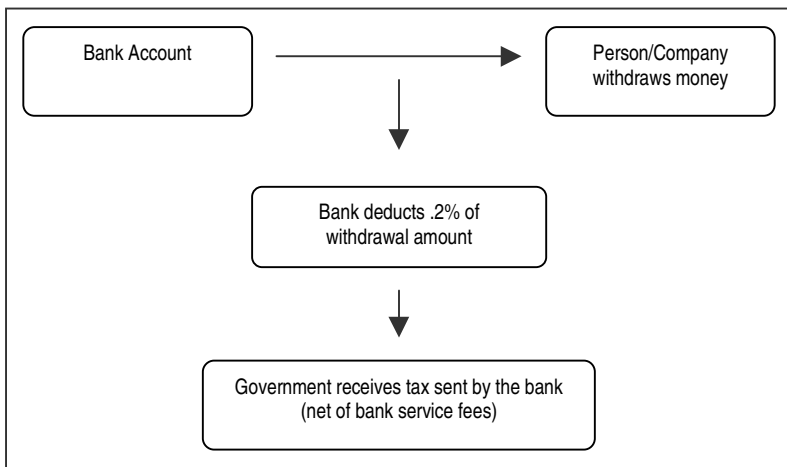
The Latin American countries have implemented variants of FTT on a time bound basis. They have also re-imposed it more than once to respond to expected fiscal problems. In the process, many features have been added to make the tax more efficient such as granting exemptions to the foreign exchange and financial markets, treasury and other government departments; and not allowing multiple check endorsements.

For the Philippines, it is proposed that the Debit Tax apply on bank withdrawals from checking, savings and term accounts. If a single rate of .2% is implemented, it could translate to only 20 centavos for every P100 transaction. In contrast, the EVAT would be P10-12 for end-user purchases of the same amount. The idea for a single rate is to promote administrative simplicity for the Debit Tax. Since the

² Defined as the removal of funds in a particular market (stock market, foreign exchange) and conducting of transactions in other ways to avoid the tax.

tax comes from debits in banking transactions, its collection is actually implemented by financial institutions- where accounting systems are well in place. Hence, the collection and administration is actually outsourced and the financial institutions would be compensated for their work (see *Figure 1*).

Figure 1
DBT Philippines



The proposal is different from other taxes because it will operate only under an automatic trigger mechanism based on a National Government deficit to GDP ratio. Policymakers could set the trigger at 3.5% NG Deficit of GDP ratio (see *Table 2 for deficit figures*). This means that if NG Deficit registers at 3% of GDP, the Debit Tax is not in effect. Correspondingly, when the deficit goes up to 3.6% of GDP, the tax should be automatically imposed for a period of at least 6 months.³

³ The 1986-2006 average of NG deficit is 2.49% of GDP. Its highest level in surplus was .96% (1994), and deficit 3.95% (2004).

Table 2
National Government Deficit, as % of GDP

Particulars	NG Deficit as % of GDP
1986-2006 Average	-2.49%
Highest Surplus, 1994	0.96%
Highest Deficit, 2002	-5.43%
2005 Program	-3.38%
2006 Projected	-2.08%

Source: BESF various years

Proposed Exemptions

A number of exemptions may be made based on the lessons learned from Latin America. For instance, Bank debits from the same account amounting to P5,000 and below in a given day would shield low income families from this tax. The exemption of long term loans from this tax would encourage greater real investment in the economy.

To continue encouraging financial deepening and capital market efficiency the following kinds of transactions may also be exempted:

- Transfers between accounts of the same person in the same financial institution
- Transactions with the central bank
- Inter-bank clearing and inter-bank transfers to ATM operations
- Stock market and government bonds transactions
- Foreign exchange market transactions

Some anti-tax avoidance measures may be embodied in the said proposal such as the prohibition of re-endorsement of checks if the tax applies only on final settlements. Otherwise, the tax should apply on each endorsement of a single check.

Expected Revenue Yields in the Philippines

The tax yield may be approximated using the value of cleared checks as a proxy variable. This is thought of as a conservative estimate because savings and term accounts are not included.

The value of cleared checks in 2004 amounted to P13.97 trillion. By multiplying this value to a .2% tax rate, the expected tax yield would be P27.95 billion (*see Table 3*). For the Jan-Oct 2005 period alone, the yield climbs up to P28.4 billion given the P14.2 Trillion total value of checks cleared,. In short, the estimated yields are very significant.

Table 3
Debit Tax Yield, (in billions)

Particulars	2003	2004	Jan-Oct 2005
Value of Cleared Checks	11,388.14	13,972.77	14,200.72
Potential Collection at .2% tax rate	22.78	27.95	28.40
as % of GDP	0.54%	0.58%	0.55%

Source: Philippine Clearinghouse Corporation

The prospect of higher revenues especially during conditions of fiscal distress will contribute to faster economic normalization. Investors would be encouraged and credit rating agencies may consider a better sovereign risk status for the country much sooner than the long wait for the approval of 12% VAT.

Relevant to the Philippines?

The history of the FTT in Latin America indicates that it has mostly been used as a temporary supplemental revenue source during fiscal emergencies, rather than as replacement for conventional

taxes. It was subsequently withdrawn within a few years as fiscal conditions stabilized.⁴

The Philippine economic experience over the past few decades has hemmed closely to its Latin American counterparts with its boom and bust cycles, chronic fiscal deficit scenarios, and a continuing enormous debt problem. The use of the proposed debit tax as a precautionary measure to aid fiscal stabilization is therefore essential. It is proposed that the said tax be introduced in the Philippines, which will automatically take effect only during the occurrence of a high deficit situation.

Perhaps the best time to introduce this tax is now⁵ because the prevailing situation will not yet trigger its use and therefore can not affect the electoral chances of those approving it. In future occurrences of fiscal distress, the tax will take effect minus the political costs to the incumbent administration and Congress.

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⁴ However, Brazil may have decided to make its current .34% FTT permanent.

⁵ As seen in Table 2, the NG deficit to GDP is programmed at 3.38% for 2005 and projected at 2.08% for 2006.