WORLD BANK GROUP

CONFRONTING ILLICIT TOBACCO TRADE:

A GLOBAL REVIEW OF COUNTRY EXPERIENCES

PHILIPPINES: ADDRESSING THE ILLICIT FLOW OF TOBACCO PRODUCTS

TECHNICAL REPORT OF THE WORLD BANK GROUP GLOBAL TOBACCO CONTROL PROGRAM.

EDITOR:
SHEILA DUTTA

PHILIPPINES

17

PHILIPPINES:

Addressing the Illicit Flow of Tobacco Products

Kim Henares and Malou B. Recente[1]

Chapter Summary

The Philippines has recently made progress in addressing illicit tobacco trade, within an ambitious overall reconfiguration of the country's tobacco control efforts. The Philippines' widely discussed 2012 excise tax reform eliminated previous weaknesses in the excise tax structure on tobacco products. Earlier design flaws had limited the tax system's capacity to curb tobacco consumption and raise government revenues. These weaknesses had also complicated efforts to check illicit trade flows. The 2012 reform introduced broad changes, notably abolishing the previous multi-tiered classification of cigarettes based on net retail price. A single-tier cigarette excise tax structure is operational in the Philippines as of 2018. Philippine leaders have continued to raise tobacco tax rates and are weighing further increases to reach World Health Organization (WHO) recommended levels. These reforms set the context for the Philippines' action to control illicit tobacco flows.

The Bureau of Internal Revenue and the Bureau of Customs, the two major revenue-generating agencies of the Philippine government, are at the forefront of the fight against illicit tobacco. Both bureaus employ a wide range of enforcement tools, including the affixture of

[1] K. Henares (Former Commissioner, Bureau of Internal Revenue, Philippines) and M. Recente (Former Undersecretary, Department of Finance, Philippines)

revenue stamps, profiling, licensing, monitoring and surveillance of taxpayers and importers, use of x-ray machines and other technology, audit programs, and the imposition of stiff penalties for violators. The mechanisms deployed are aligned with the principles of the WHO Framework Convention on Tobacco Control and the Protocol to Eliminate Illicit Trade of Tobacco Products. Opportunities now exist to implement a tighter track-and-trace system involving reinforced collaboration between the two bureaus, other government agencies, and legitimate industry players.

Tax policy and enforcement mechanisms to combat illicit tobacco flows in the Philippines can be enhanced by (a) strengthening capacity, technology, and the use of data; (b) expanding partnerships with legitimate business; and (c) stronger coordination among enforcement agencies. Our findings support the following specific recommendations:

1. There should be stronger coordination between the Bureau of Internal Revenue and the Bureau of Customs, along with other law enforcement agencies and legitimate industry players, to better enforce the law regarding excise tax on cigarettes. Monitoring illicit tobacco products in the market and aggressively prosecuting violators are key parts of the agenda. Policy makers can boost results by creating a system wherein all regulatory agencies share a common database to monitor tobacco product flows.
2. International collaboration to curtail the illicit tobacco trade should be actively pursued within the ASEAN integration initiative and other forums. A priority aim for international collaboration would be ensuring that, in future, no cigarettes leave an exporting country without bearing the legal tax stamps of the importing country. To this end, customs authorities in exporting countries can and should share export documents with the importing countries. Region-wide collaboration in the use of revenue stamps and sharing of trade documents among governments of exporting and importing countries would go far in reducing illicit tobacco flows.
3. Government should resolve illicit tobacco cases quickly and ensure the enforcement of heavier penalties for violations.
4. The security features of tax stamps should be guarded and continuously updated to prevent counterfeiting.
5. Open data on tobacco trade and tax statistics are necessary to improve estimates of illicit trade and better evaluate tax and administrative measures used to control illicit tobacco.
6. Stronger capability-building programs for the Bureau of Internal Revenue and the Bureau of Customs should be prioritized. These should include training to sharpen analytical, profiling, and audit skills, and the use of technology.

1. Introduction

This chapter presents a case study on the Philippine experience in curtailing illicit tobacco flows. It discusses recent structural changes that corrected weaknesses in the country's tobacco tax structure. Administrative and enforcement measures are reviewed, including operational issues. The chapter details actual frontline interventions against illegal tobacco trading and analyzes how these came about through the joint efforts of the two agencies mainly responsible for controlling illicit tobacco in the Philippines: the Bureau of Internal Revenue (BIR) and Bureau of Customs (BOC). The concluding portions of the study formulate recommendations and identify areas for further progress for the BIR and BOC.

Methods and sources

In preparing the study, literature on tobacco taxation, curtailing illicit tobacco flows, and related topics were reviewed, as well as laws, rules, and regulations governing the implementation of excise taxes on tobacco products in the Philippines. Interviews were conducted with tax and customs administrators to determine specific processes in the implementation of tobacco excise taxes, including how controls and safeguards have been aligned to monitor the flow of tobacco products from manufacturers to final consumers. Data cited in this chapter, e.g., import data, volume of removals of tobacco products, and information on excise tax and total tax collections, are official data from the BIR and BOC. Other data such as smoking prevalence figures were drawn from the Global Adult Tobacco Surveys conducted in 2009 and 2015.

2. The Context of Action on Illicit Tobacco

2.1 The Philippines 2012 Excise Tax Reform

On December 19, 2012, the Philippine Congress enacted an ambitious reform law which restructured the excise tax system for cigarettes as well as alcohol products. This was Republic Act No. 10351,[2] which became effective in 2013. The reforms addressed many of the policy and implementation weaknesses found in the previous tax structure. The measures: (1) made the excise tax system more robust in generating revenues for government; (2) reduced cigarette consumption, fulfilling health objectives; and (3) helped reduce the illicit movement of tobacco that escapes taxation and other forms of government regulation.

RA 10351 abolished the multi-tiered classification of cigarettes based on net retail price, which had imposed different excise taxes on low-priced, medium-priced, and high-priced cigarettes. The new law reduced the previous four-tiered arrangement to a two-tiered structure from 2013 to 2017, then a unitary structure starting in 2018 (Table 1).

[2] "An Act Restructuring the Excise Tax on Alcohol and Tobacco Products by Amending Sections 141, 142, 143, 144, 145, 8, 131 and 288 of Republic Act No. 8424, otherwise known as the National Internal Revenue Code of 1997, as Amended by Republic Act No. 9334, and For Other Purposes."

Table 1. Comparative Tobacco Excise Tax Structure Before and After RA 10351

BEFORE RA 10351	TAX RATES IN 2012
Cigarettes packed by hand (in 30s)	Php 2.72/ pack
Cigarettes packed by machine (in 20s)	
Net retail price (NRP):	
Below Php 5.00	Php 2.72/pack
Php 5.00 but not over Php 6.50	Php 7.56/pack
Over Php 6.50 but not over Php 10.00	Php 12.00/pack
Over Php 10.00	Php 28.30/pack

AFTER RA 10351	TAX RATES PER RA 10351					
	2013	2014	2015	2016	2017	2018 AND THEREAFTER
Cigarettes packed by hand	Php 12.00	Php 15.00	Php 18.00	Php 21.00	Php 30.00	The specific tax rate shall be increased by 4%
Cigarettes packed by machine, where the NRP is:						The specific tax rate shall be increased by 4%
P11.50 and below	Php 12.00	Php 17.00	Php 21.00	Php 25.00	Php 30.00	
More than P11.50	Php 25.00	Php 27.00	Php 28.00	Php 29.00	Php 30.00	

What some had perceived as an "equity" feature of the previous system, subjecting low-priced cigarettes to low excise tax, had in reality became an invitation for manufacturers to misclassify higher-end cigarette brands as low-priced, low-tax brands as a means to evade taxes. This had made the work of tax administrators especially challenging. The Philippines Department of Finance (DOF) referred to the misclassification as a form of technical smuggling. The removal of the multi-tiered system and the imposition of a unitary tax of Php 30.00 under RA 10351 shut down these opportunities to cheat the system.

Along with the multi-tiered classification system, the previous excise tax structure had included other features that kept cigarette prices low, and which were addressed to an extent by RA 10351. A price classification freeze on numerous brands of cigarettes (indeed, 90 percent of all brands) meant that these products were taxed based on their prices prior to October 1996. On the other hand, all new brands introduced after October 1996 were taxed based on their current prices. This "legislative protection" spelled unfair competition and at the same time made cigarettes, on the whole, a relatively cheaper commodity than food, utilities, and education. This approach constrained the capacity of the new excise model to curtail consumption of a "sin product" (Sta. Ana and Latuja 2010).

2.2 Smoking Trends and Tobacco Tax Revenues in the Philippines

Smoking Trends. Various published studies have shown that smokers of any form of tobacco products have declined as a proportion of the Philippine population from 1989 up to the latest survey results in 2015. In 2009, 28.2 percent of the country's adult population (aged 15 and above) were reported to be tobacco smokers. This figure dropped to 22.7 percent in 2015. Some 22.7 percent of adults in urban areas are reported to be current tobacco smokers. The proportion is 25.3 percent in rural areas.

Daily smokers of any tobacco product represented 22.5 percent of the adult population in 2009, but this figure had shrunk to 18.7 percent in 2015. On the other hand, the GATS 2015 survey reported that daily smokers consumed 16.5 cigarettes per day on average in 2015, compared to 15.7 cigarettes per day in 2009. Considering all smokers (i.e., both daily and less frequent smokers), men (11.2 cigarettes per day) consume more cigarettes than women (8.6 cigarettes per day).

The government's anti-smoking campaign has had a striking effect on the attitudes and perceptions of the adult population regarding the effects of smoking. In the most recent surveys, about 95 percent considered smoking as a cause of serious illness, 93.5 percent believed that inhaling other people's smoke causes serious illness to non-smokers, and 97.2 percent of adults favored complete prohibition of smoking in indoor workplaces and public places.

The GATS 2015 results conveyed that more and more smokers made quit attempts (47.9 percent in 2009, rising to 52.2 percent in 2015), although the proportion of smokers who successfully quit remained almost unchanged from 2009 (4.5 percent) to 2015 (4.0 percent).

Table 2. Proportion of Tobacco Smokers Among Adult Population in the Philippines, Various Studies

YEAR	PREVALENCE	SOURCE
1989	58.6	Lung Center of the Philippines, DOH
1995	33.0	Social Weather Station Survey
1996	32.0	
1998	31.6	National Nutrition & Health Survey
2001	23.5	DOH - UPM Survey
2003	23.6	World Health Survey
2007	27.0	Social Weather Station Survey
2009	28.2	GATS, 2009
2015	22.7	GATS, 2015

Results of the Global Youth Tobacco Surveys in 2007 and 2015 indicate that 17.5 percent of Filipino youth surveyed in 2007 were cigarette smokers, but that by 2015 the proportion had dropped to 12 percent.

Table 2 indicates that the Philippines saw a remarkable decline in smoking prevalence from 1989 to 1995, then a more gradual decline until 2001, followed by rising prevalence in 2007-2009. A new, strong downtrend then emerged that, by 2015, had almost returned the country to its 2001 prevalence level. This pattern shows that the Philippines has the ability to cut smoking prevalence. That capacity, coupled with the robust public support for tobacco control described above, shows the country's potential to take the anti-tobacco fight much further.

Cigarette Consumption and Excise Tax Revenues. The 2012 excise tax reform altered cigarette consumption patterns but at the same time boosted government tax collections. Legal domestic sales of cigarettes in the Philippines dropped from 4.3 billion packs in 2013 to 3.1 billion packs in 2016, a 28.3 percent decline in four years. Annual domestic cigarette sales declined by 24 percent from 2013 to 2014 and by 18.4 percent from 2015 to 2016 (Table 3).

Table 3. Domestic Consumption of Cigarettes, Philippines, 2013 – 2016, in millions

YEAR	DOMESTIC CONSUMPTION, LOCALLY MANUFACTURED & IMPORTS		ANNUAL GROWTH RATE	INCREASE FROM 2013 – 2016
	PACKS	PIECES		
2013	4,339.4	86,787.95		
2014	3,295.9	65,918.4	-24.0%	
2015	3,812.8	76,256.8	15.7%	
2016	3,111.5	62,229.9	-18.4%	-28.3%

Source: Bureau of Internal Revenue

Despite this steep decline in sales, the Philippines' tobacco excise tax collection in 2016 had risen by approximately 289.6 percent over its 2009 level. Clearly, the drop in the volume of cigarettes sold during this period was not enough to negatively impact cigarette tax collection.

Excise Tax State of Play as of 2018. Republic Act (RA) No. 10963, otherwise known as the "Tax Reform for Acceleration and Inclusion (TRAIN)" Law, enacted on December 27, 2017, increased the unitary tax rates mandated by RA 10351. Effective on January 1, 2018, RA 10963 is set to increase tax rates by Php 2.50 four times from 2018 through the end of 2023, and then to apply an annual adjustment of 4 percent starting in 2024. While this is intended to make the excise taxes more revenue productive, the increments of tax increase still remain far below optimal levels that would sharply curb tobacco consumption.

Table 4. Excise Tax Rates under the TRAIN Law

BEFORE THE TRAIN LAW	UNDER THE TRAIN LAW
Effective January 1, 2017, unitary rate of Php 30.00 per pack (on cigarettes packed by hand and cigarettes packed by machine) January 1 to December 31, 2018 – Php 31.20 January 1 to December 31, 2019 – Php 32.45 January 1 to December 31, 2020 – Php 33.75 January 1 to December 31, 2021 – Php 35.10 January 1 to December 31, 2022 – Php 36.50 January 1 to December 31, 2023 – Php 37.96	January 1, 2018 to June 30, 2018 – Php 32.50 per pack July 1, 2018 to December 31, 2019 – Php 35.00 per pack January 1, 2020 to December 31, 2021 – Php 37.50 per pack January 1, 2022 to December 31, 2023 – Php 40.00 per pack
Tax shall continue increasing by 4% annually	Tax shall increase by 4% annually starting January 2024

According to the World Bank, citing studies from the World Health Organization, the tax per pack of cigarettes must be around 75 percent of the price in order to make a sharp dent in consumption (World Bank 2017). As of December 2017, the Php 30 excise tax represents some 40 percent of the retail price of a Php 75 pack of Marlboro cigarettes. At the new tax rate of Php 32.50/pack, clearly, the rate still does not approach the WHO-recommended level.

Will Tax Hikes Mean More Illicit Trade? Would higher excise taxes, resulting in higher-priced cigarettes, induce illicit tobacco flows? One of the risks of imposing higher taxes is that it provides a high economic return for evading taxes. Thus, there is a need to provide additional administrative and enforcement measures, strict implementation thereof, and aggressive criminal prosecution as a deterrent to the illicit tobacco trade, as tobacco tax hikes take effect.

3. Administrative Mechanisms to Control Illicit Tobacco Flows

3.1 At the Point of Taxation

The provisions of the Philippines' National Internal Revenue Code (NIRC) are sufficiently broad to encompass taxable events under the excise tax regime. Importation of tobacco products by duty-free shops, a huge loophole in the past, is no longer exempt from excise taxes. If exemption is requested, such as for direct export, an export bond and a transfer bond must be posted.

The Tax Code has been further clarified under several Revenue Regulations (RR) issued by the Bureau of Internal Revenue, in particular RR 3-2006, RR 3-2008, and RR 17-2012. These regulations stipulate that the excise tax on locally manufactured cigarettes shall be paid by the manufacturer or producer before removal of the cigarette product from the place of production. If the tobacco product is consumed within the premises of the tobacco producer, the tobacco producer becomes liable for the excise tax on said consumed tobacco. If the manufacturer removes the tobacco products from the place of production for purposes of exportation or sale to a tax-exempt entity (for example, foreign embassies) or international carriers, the manufacturer may pay the excise tax upon removal and claim excise tax credit or a refund later. Or the manufacturer may use the so-called product replenishment scheme provided under RR 3-2008, by applying previous excess excise tax payments to the current removals to cover current excise tax dues. Both schemes provide tightened controls. They require presentation of proofs, instead of simply granting outright exemption of a tobacco product once the taxpayer declares it to be for export or sale to a tax-exempt entity, a model prone to abuse and leakage.

Imported tobacco products are subject to excise taxes unless there is a qualification provided by law. A bond is also to be posted by the importer to guarantee payment of excise taxes. For imported manufactured cigarettes, the importer is liable for the excise tax. The importer prepays the tax upon acquiring revenue stamps from the BIR for affixture by the foreign supplier on the cigarettes being imported. If the specific tobacco product is imported on a smaller scale, for example semi-prepared tobacco to be used as raw material in producing twisted cigarettes, the excise tax is paid by the importer prior to release of the imported product.

If the imported semi-prepared tobacco product or imported stemmed tobacco leaves are to be directly exported or are to be used as an input in producing tobacco products for export, the importation is not excisable, but the importer posts an additional amount as bond equivalent to the excise tax that was not imposed. In addition to the export bond, a transfer bond is required if the exporter intends to transfer the good from the place of production to a bonded facility.

Importation of tobacco products by Duty-Free Philippines, Inc., and by duty-free shops in the country's special economic zones, along with other imports into these special economic zones or free ports, are no longer exempt but have become subject to excise taxes. They may be exempt from customs duties but are subject to the excise tax and the value-added tax (VAT).

Tobacco products imported into the Philippines for transshipment to a foreign country shall be subject to a bond equivalent to the amount of excise tax, VAT, and duties had the product been imported and sold on the domestic market. This is clarified under RR 17-2012. The bond serves as guarantee to the government that the imported products are to be directly exported to a foreign country and are not intended for sale in the local market.

3.2 Key Agencies and Regulatory Requirements in the Production or Importation of Tobacco Products

Several Philippines government agencies play roles in regulating the production or importation of tobacco products.

The **National Tobacco Administration (NTA**) issues an annual permit to import, export, or transship unmanufactured tobacco or manufactured tobacco, and an annual permit to manufacture tobacco products. The Import Commodity Clearance issued by NTA is a pre-requisite for the release of all importations of tobacco products, as well as tobacco-related equipment, supplies, raw materials, and ingredients.[3] It is listed among the documents to be submitted to the Bureau of Customs (BOC).

The legal basis of NTA is Executive Order No. 245, issued on July 24, 1987, which gave the NTA the power to regulate the tobacco industry. The agency has the primary mandate to set tobacco prices so as to guarantee tobacco farmers a minimum return of 25 percent on their investments. Floor prices have an indirect effect of dampening any plan to flood the market with cheap cigarettes. According to the NTA, the floor price considers prevailing market conditions such as production cost and a reasonable return to the farmer. Tobacco is the only product that is regulated in this manner.

The **Bureau of Internal Revenue** requires that producers, importers, and exporters of tobacco products register annually as taxpayers. An Authority to Release Imported Goods (or "ATRIG") is issued by the BIR prior to release of all imported excisable goods, including all tobacco products. This is a requirement every time an importation is made. Revenue Memorandum Order No. 35-2002 and Revenue Memorandum Order No. 35-2014 are the pertinent issuances, with the latter implementing the electronic ATRIG system, using the Philippine National Single Window (NSW) system at the Bureau of Customs. The importer files the eATRIG through the NSW system but still submits a hard copy and duly notarized application form to the Excise Large Taxpayers Regulatory Division of the BIR, which is the designated approving officer. Electronic filing has eliminated the falsified ATRIGs that were observed when these documents were manually filed and processed. The eATRIG system has allowed the "least manual intervention and personal representation of the importer or his representative."

One requirement for the approval of the eATRIG application is that the applicant must have a Permit to Operate as Importer of Excisable Articles. Likewise, applicants must be able to present their latest Annual Income Tax Return and Audited Financial Statements. If documentation is complete, an application can be approved on the next working day.

[3] "Provided under NTA Memorandum Circular 3-2004 issued on July 28, 2004.

The **Bureau of Customs** lists tobacco products as regulated imports. As such, the BOC requires the tobacco importer to submit the following clearances issued by other government regulatory agencies prior to release of any imported tobacco product:

1. ATRIG from the BIR
2. Authority to Import Leaf Tobacco and Tobacco Products or Import Commodity Clearance from the NTA
3. Sanitary and Phytosanitary Import Clearance from the Bureau of Plant Industry for importation of tobacco dust, stems, leaves, and other related materials.

Customs Memorandum Order (CMO) No. 9-2015, issued on April 10, 2015, lays down the strict enforcement of rules on regulated imports. Rules require that the importer or broker must be accredited with the BOC. In the process of accreditation, the importer or broker submits several documents including registrations or clearances secured from other government agencies, which the BOC uses for profiling. These include:

a. Latest General Information Sheet (if a corporation) or Registration with the Department of Trade and Industry (if a sole proprietor) or Articles of Partnership or Articles of Cooperation (if a cooperative)
b. Corporate Secretary Certificate (if a corporation) or Affidavit (if sole proprietor) or Partnership Resolution for designated signatories in the import entries
c. Original copy of the National Bureau of Investigation (NBI) Clearance of Applicant (issued within three months prior to the date of application)
d. Company Profile with pictures of office and warehouse premises with proper signage
e. Previous Certificate of Accreditation, if applicable
f. License / Permit / Accreditation from the concerned agency, when applicable, i.e., from NTA or BPI.

As part of data transparency, the customs website has a window on "tobacco importation" that shows the lists of tobacco importers and data on importation by port.

3.3 Submission of Manufacturer's or Importer's Sworn Statement

Under Revenue Regulations 17-2012, every manufacturer or producer or importer of an excisable product like cigarettes is required to submit a sworn statement as a supporting document to the application for initial registration of his product. An updated sworn statement is thereafter required to be submitted on or before the end of the months of June and December of every year. The following information must be contained in the manufacturer's or importer's sworn statement, as enumerated in the regulations:

- Name, address, Taxpayer Identification Number (TIN), and assessment number or control number of the manufacturer or importer assigned to him by the Excise Taxpayer Regulatory Division of the BIR
- Complete root name of the brand as well as the complete brand name with modifiers
- Complete specifications of the brand detailing the specific measurements, weights, manner of packaging, etc.
- Names of the regions where the brand is to be marketed
- Wholesale price per case, gross and net of VAT and excise tax
- Suggested retail price, gross and net of VAT and excise tax, per pack or per bottle
- Detailed production or importation costs and all other expenses incurred or to be incurred until the product is finally sold
- Applicable excise tax rate
- Corresponding excise and VAT.

If there is a change in the cost to manufacture, or a change in the actual selling price of the brand, the BIR requires that the sworn statement shall be updated and submitted five days before the removal of the product from the place of production or before release of the product from customs' custody.

The sworn statement is then verified by the BIR for accuracy and completeness. For instance, the BIR uses the reference books kept by the Bureau of Customs in determining the proper valuation of imports. If these are found to be erroneous or inaccurate, a revised sworn statement is required to be filed, and the taxpayer can be subject to corresponding penalties.

Section 13 of Revenue Regulations 17-2012 provides for the following penalties:

a. "Any manufacturer or importer who misdeclares or misrepresents in his or its sworn statement herein required any pertinent data or information shall, upon discovery, be penalized by a summary cancellation or withdrawal of his or its permit to engage in business as a manufacturer or importer of alcohol or tobacco products;

b. "Any corporation, association or partnership liable for any of the acts or omissions in violation of the Act and implemented by these Regulations shall be fined treble the aggregate amount of deficiency taxes, surcharges and interest which may be assessed pursuant to the provisions of the Act;

c. "Any person liable for any of the acts or omissions prohibited under the Act and implemented by these Regulations shall be criminally liable and penalized under Section 254 of the NIRC of 1997; and

d. "If the offender is not a citizen of the Philippines, he shall be deported immediately after serving the sentence, without further proceedings for deportation."

If the BIR finds out that there is an understatement of the suggested net retail price by as much as 15 percent, the manufacturer or importer shall be liable for additional excise tax equivalent to the tax due and difference between the understated net retail price and the actual net retail price, as provided for under Section 144 of the National Internal Revenue Code of 1997 as amended by Republic Act No. 10351.

From experience, the manufacturer's or importer's sworn statement is not misdeclared, because it is a sworn statement. If changes occur during the production process, for example regarding prices, these may be corrected through an amended statement submitted prior to release of the product from the warehouse.

The submission of the manufacturer's or importer's sworn statement is important for the following reasons:

1. To ensure that the government has a complete list of cigarette brands that are duly registered. Any brand that is not in the list provided by the manufacturer or importer is presumed to have been manufactured or imported illicitly, and it is presumed that no excise tax thereon has been paid;
2. To ensure that the brand is properly classified and the proper excise tax due thereon is collected under the multi-tier excise tax system;
3. As third-party information aiding in the collection of other taxes.

3.4 Affixture of Revenue Stamps on Cigarette Packs

Although the requirement to affix internal revenue stamps in the form of a bar code or fuson stamps has been mandated since 1997, this was actually implemented only in 2014. The BIR developed the Internal Revenue Stamp Integrated System (or "IRSIS") to implement the affixture of new internal revenue stamps on both imported and locally manufactured cigarettes, whether sold domestically or for export. Through the IRSIS, revenue stamps can be ordered, distributed, and monitored in real-time. The stamps have specific dimensions and different color designs. There are multi-layered security features, an IRSIS-assigned "Quick Reference Code," which is a two-dimensional bar code holding information about the revenue stamp, and a "Unique Identifier Code" which is a code or serial number referring to the revenue stamp.

The manufacturer or importer must enroll in the IRSIS. To order revenue stamps through the system, the taxpayer must have made his excise tax payment through the electronic Filing and Payment System (or "eFPS"). Under RR 7-2014, the price of a revenue stamp had been computed at Php 0.13 per piece. This has been adjusted to Php 0.15 per piece under RR 6-2017. Changes in the cost of raw materials and equipment incurred by APO Inc., the government agency mandated to print the revenue stamps and implement the IRSIS, caused an adjustment in the price by the BIR.

In 2016, BIR issued Revenue Memorandum Circular 51-2016 introducing the use of a Stamp Verifier app in verifying the authenticity of revenue stamps. The Stamp Verifier app is innovative and smart, as it uses modern technology as well as involving the cigarette user or smoker in identifying illegal cigarettes. This technology encourages consumers to download the mobile application and use it to check the validity of the revenue stamp affixed to the cigarette pack (either domestically manufactured or imported) that they are purchasing. The app will read the QR code, a two-dimensional code which is a security feature of the revenue stamp that contains information about the product. If the app shows a non-valid QR code, this would mean that the Unique Identifier Code (or UIC) for the cigarette pack is not in the database of UICs in the BIR, and one can conclude that the cigarette is counterfeit. BIR personnel received training in the use of the new technology.

Effective monitoring using mobile verification devices is, however, dependent on internet connection which could be weak in many areas. The BIR thus continues to conduct on-the-spot surveillance of production facilities as well as markets. Outstanding excise taxes are collected, in addition to penalties and sanctions, if discrepancies are detected during these surveillance activities.

RR 6-2017 mandates the affixture of new revenue stamps on all locally manufactured cigarettes starting on January 1, 2018, and on imported cigarettes starting on June 1, 2018. This is in line with the policy that security features of the revenue stamps should not be compromised and thus should be replaced every three years or sooner, if there is evidence of counterfeiting of stamps.

With the affixture of tax stamps, it has become easy for the BIR to determine whether the excise tax due on the cigarette pack has been properly paid or not. The BIR can easily confiscate cigarettes for which taxes were unpaid or erroneously paid, and assess the proper taxes due thereon. The tax stamps have greatly helped the government in conducting raids and bringing airtight cases against tax evaders.

The presence of revenue stamps on cigarette packs, to gauge implementation, was measured in a World Bank project in partnership with PREMISE. Simply described, the project identified sites nationwide and asked surveyors to collect evidence of revenue-stamp usage, such as pictures of stamps on cigarette packs bought by individuals from stores. The surveyors used mobile technology to send this data for analysis by PREMISE. Results of surveys conducted in the week of September 25, 2016, showed a high revenue stamp presence in several places, notably, Quezon and Pampanga with a 100 percent stamp usage rate, Bulacan with 98.7 percent, Laguna with 88.6 percent, and Metro Manila with 83 percent.[4] In addition to tax stamps presence, the project also tracked tobacco prices. However, this project has lapsed and the decision to continue the project has not been made by the BIR and the DOF.

[4] World Bank Philippines Sin Tax Dashboard, April 5, 2015 – September 25, 2016.

Notable in the BIR experience with the use of tax stamps is the success in engaging the public, especially young people who are comfortable with new technology, in the drive to detect illicit tobacco in the market. Another possible innovation is developing a website that could receive reports of illicit cigarettes from the public or consumers themselves.

The presence of a tax stamp on a pack of cigarettes is, in the first instance, a visual "proof" that tax must have been paid. The BIR has advised the BOC that cigarettes being imported without properly affixed stamps (for example, inside the clear plastic covering of the cigarette case and not outside the plastic cover) should immediately be confiscated. Determining whether the brand is fake, or the stamp is counterfeit, or the importer is unregistered all involve additional steps for the BIR and the BOC. Thus, both agencies should strengthen their track-and-trace capabilities, tighten their coordination, including linking up with relevant agencies and legitimate industry players, and continuously equip themselves with training and technology to go after illicit activities.

3.5 Other Administrative Monitoring Measures

All manufacturers and/or importers of cigarettes must be registered with the Bureau of Internal Revenue and are required to obtain permits from the Bureau for every sale, export, and import of their products. This rule also applies to suppliers of the following raw materials: tobacco leaves, tipping paper, filter rod, and cigarette papers. Cigarette manufacturers/importers are required to register themselves and obtain appropriate permits before they can operate. Necessary documents may include the Permit to Operate as Manufacturer of Cigarettes, Permit for a Storage Warehouse of Leaf Tobacco Within Factory Premises, Permit to Operate as a Dealer of Leaf Tobacco, and Permit for a Storage Warehouse of Cigarette Paper and Non-Tobacco Materials. Factories and warehouses relating to the manufacture and importation of cigarettes require the prior approval of the BIR. The taxpayer is required to provide a plot and plan of the premises which are in compliance with security measures that will ensure that the entry and exit points are limited in number and location and are specifically identified so that no raw materials and cigarettes can enter or exit without being observed by the Revenue Officer on Premises (ROOPs) assigned by the BIR.[5]

The BIR posts a number of ROOPs on the premises of each cigarette manufacturer/importer to ensure that the movement of cigarettes is not impeded, as a Withdrawal Certificate signed by the ROOPs is required for raw materials to enter and for cigarettes to be withdrawn from the facility. A cigarette manufacturer cannot transport cigarettes from its premises without the ROOPs issuing a Withdrawal Certificate, and this certificate can only be issued when the ROOPs is satisfied that the proper excise tax has been paid, and the tax stamp has been properly affixed. In theory, the facilities of each cigarette manufacturer need to be monitored 24 hours a day, seven days a week, since no cigarettes may be released without a withdrawal certificate. In practice, however, the surveillance is not strictly continuous, as the

[5] Revenue Memorandum Order 38-2003.

BIR personnel assigned as ROOPs are limited in number, and they follow standard working hours. The BIR relies on voluntary declarations by the taxpayer for withdrawals made outside working hours and without the ROOPs' presence. Declaration is subsequently verified during audit. Because ROOPs cannot be present 24/7, the BIR had planned to install close circuit television (CCTV) monitoring systems on all production and withdrawal points on the premises of the manufacturers, but this has yet to be implemented.[6] One issue that remains to be settled is responsibility for the maintenance and upkeep of the CCTVs.

The whole process of cigarette manufacturing is intended to be highly controlled. The design of packaging materials from the individual pack to the master cases requires BIR prior approval before it can be used. A graphic warning design on a cigarette pack that is not BIR-approved and is found in the market is already proof of illegal tobacco trade. Disposal of any raw materials or finished cigarettes requires prior approval from the BIR and may only be carried out when a BIR officer is present to witness the destruction.

As an additional monitoring measure, the tobacco industry is required to maintain an Official Registry Book, wherein daily transactions of receipts and removals of regulated raw materials, goods-in-process, and finished products must be entered and submitted to the BIR. All raw materials have a specific conversion rate to finished products. For a defined input quantity of tobacco leaves, cigarette paper, tipping paper, and filter rod, the conversion rate can be used to determine whether an appropriate quantity of cigarettes have been reported as manufactured and withdrawn. In 2013, the BIR developed the Electronic Official Registry Book (eORB) System, and on July 23, 2013, Revenue Memorandum Order No. 23-2013 mandated that the submission of the ORB be conducted electronically through the eORB mechanism.

Using the data submitted by taxpayers, the BIR can also conduct audits, assess possible reporting deficiencies, and/or order an inventory of raw materials, goods in process, and finished products to verify the accuracy and completeness of taxpayers' reports.

3.6 Profiling of Importers, Developing "Alert Orders," Use of X-Ray Machines, and Stiffer Penalties on Smuggling

The BOC employs several techniques to arm itself against smuggling activities. The information provided when the importer or customs broker applies for accreditation or permit to import goes to the Account Management Office of the BOC. The Account Management Office administers the Client Profile Registration System for importers and customs brokers, as mandated by Customs Memorandum Order No. 4-2014, and provides guidelines for risk profiling of importers and brokers. The BOC also inputs information on past importations, data from the exporting country, industry data, and information from other third-party sources.

[6] To further enhance the monitoring of the premises and the affixture of tax stamps on cigarettes packs, Section 14 of Revenue Regulation No. 7-2014 provided that the BIR shall study and cause the installation of CCTVs.

The Bureau issues so-called "alert orders" to effect apprehension of suspicious shipments coming into the country. Alert orders are formulated based on information coming from third-party sources and records obtaining from within the BOC itself. Outside sources include foreign customs authorities, Interpol, the business sector, or other government authorities. Again, the BOC relies on past records of importations and experience with the type of product being imported. For instance, if an importation deviates from the normal or average weight, volume, value, measurement, or tariff classification based on industry practice, this raises a red flag among customs operatives, and an alert order for an incoming shipment may be issued to the port collector.

The BOC has procured x-ray machines for key ports like the Port of Manila, Manila International Container Port, Port of Batangas, Subic Port, among others, which are mainly containerized ports. The proposal is to arm all containerized ports with x-ray machines and to consider doing this for non-containerized ports to strengthen border controls against illicit importations.

Under RA 10863, or the "Customs Modernization and Tariff Act (CMTA)," enacted on June 10, 2016, stiffer penalties and surcharges are now imposed for misdeclaration, misclassification, or undervaluation of importation and on unlawful importation or exportation of goods. The cost of committing these illegal acts should be greater than the reward, thus, the stiffer sanctions under the CMTA are long overdue. The surcharge for misdeclared, misclassified, or undervalued importation has risen from 100 percent to 250 percent of the taxes and duties due. If fraudulent intent has been established, the surcharge shall be equivalent to 500 percent. The good is also subject to seizure. Unlawful importation or exportation of goods subjects the person to imprisonment or a fine of up to Php 50 million, depending on the value of unlawful importation or exportation, but up to Php 200 million only. Beyond Php 200 million, the act is already deemed a heinous crime punishable with imprisonment of 20 to 40 years and a fine of not less than Php 50 million.

4. BIR and BOC Initiatives at Work in Recent Cases Against Illicit Tobacco Trade

Illicit tobacco trade activities were curtailed in three recent apprehensions carried out by teams from the BIR and BOC. Both bureaus have successfully harnessed modern technology and equipment, taxpayer profiling, and third-party information in their operations. A proposal has now been advanced to create a composite team and formalize coordination among the BIR, BOC, and DOF in addressing illicit tobacco trade. Other government agencies may also join the initiative, given the diverse and wide-ranging nature of illicit trade.

4.1 The Case of Mighty Corporation

The Mighty Corporation was a very large manufacturer and seller of cigarettes, cigars, and other tobacco products in the Philippines. The firm was also engaged in importing tobacco leaves, rolling paper, and acetate used in cigarette filters, as well as buying and selling machinery, equipment, and appliances used for making cigarettes and tobacco products.

The joint efforts of the BOC and BIR led to the filing of tax evasion charges against Mighty Corporation in 2017, as part of the revenue agencies' campaign against evasion, smuggling, and all forms of illicit trading.

Several raids of Mighty's warehouses confirmed that the company had stored master cases of cigarettes with false tax stamps in its facilities. The warehouses were allegedly owned by a local chief executive and had no business permit. With the use of the BIR Stamp Verifier, the BIR-BOC team proved that the cigarettes had received forged stamps. The BOC's Bureau Action Team Against Smugglers (BATAS) suspended the firm's import accreditation, which effectively prevented it from importing or sourcing raw materials outside the country for use in its production. A Php 38 billion tax evasion case was filed against the company. In September 2017, Japan Tobacco International (JTI) acquired Mighty Corporation's cigarette business, paving the way for settlement of the tax case. In October 2017, Mighty/JTI settled the case for Php 30.4 billion, of which Php 25 billion was paid to the government in settlement of Mighty's tax obligations, linked to three criminal cases for seized goods, assessment for open years with the BIR, and documentary stamp tax and withholding taxes payable. An additional Php 5.4 billion was paid as VAT on the deal.

4.2 Two Recent Apprehensions of Illicit Tobacco Imports by the BOC

In the first quarter of 2018, an intervention led by the BOC captured misdeclared cigarettes worth Php 8.2 million. The cigarettes came from China and were consigned to the firm Paragon Platinum International Trading Corporation (PPITC). They were hidden in container vans, and the importation was initially declared as brackets. Through the BOC profiling system, an alert order on the shipment was immediately issued by the Port of Manila. The shipment received a warrant of seizure and detention, and the importers face charges under Section 1400 of the Customs Modernization and Tariff Act (CMTA), which establishes sanctions for misdeclaration, misclassification, and undervaluation of goods.

A second interception, in April 2018, seized counterfeit cigarettes worth Php 18.5 million, again allegedly smuggled from China. The shipment was consigned to Marid Industrial Marketing and contained counterfeit cigarettes bearing the brands "Jackpot," "Fortune," "John," "Marvels," and "U2." The BOC reported that the shipment was declared as industrial artificial fur texture, but was intercepted when the container passed the x-ray machine, and the contents were found to be in boxes (as cigarette cartons are) instead of rolls (the typical format for industrial fur textures). Formal investigation is currently ongoing for both of these cases of intercepted illicit cigarettes.

5. Conclusion and Recommendations

The tax policy response and administrative mechanisms to combat illicit tobacco flows in the Philippines may be judged broadly sufficient and successful. They are aligned with the principles espoused under the Framework Convention for Tobacco Control, as well as the World Health Organization Protocol to Eliminate Illicit Trade in Tobacco Products. Nonetheless, these mechanisms can be further reinforced in a number of ways, through capacity, technology, and database build-up, partnerships with legitimate business, and stronger coordination among enforcement agencies. The analysis presented here also highlights the importance of international collaboration through the sharing of information and best practices among trading partners, especially at regional level. Together, these strategies may create a stronger track-and-trace system to combat and ultimately halt the illicit tobacco trade.

The evidence presented in this chapter supports the following recommendations:

1. There should be stronger coordination between the BIR and the BOC, along with other law enforcement agencies and legitimate industry players, to better enforce the law regarding excise tax on cigarettes. Monitoring illicit tobacco products in the market and aggressively prosecuting violators are key parts of the agenda. Policy makers can boost results by creating a system wherein all regulatory agencies share a common database to monitor tobacco product flows.
2. International collaboration to curtail the illicit tobacco trade should be actively pursued within the ASEAN integration initiative and other forums. A priority aim for international collaboration would be ensuring that, in future, no cigarettes leave an exporting country without bearing the legal tax stamps of the importing country. To this end, customs authorities in exporting countries can and should share export documents with the importing countries.
3. Government should resolve illicit tobacco cases quickly and ensure the enforcement of heavier penalties on violations.
4. The security features of tax stamps should be guarded and continuously updated to prevent counterfeiting.
5. Open data on tobacco trade and tax statistics are necessary to improve estimates of the extent of illicit trade and better evaluate the impact of tax and administrative mechanisms in controlling illicit tobacco.
6. Stronger capability-building programs for the BIR and BOC should be prioritized. These should include training to sharpen analytical, profiling, and audit skills, and the use of technology.

References:

Abola, V., Sy, D., Denniston, R., and Sy A. 2014. "Empirical Measurement of Illicit Tobacco Trade in the Philippines." *https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4737979/*

Chaloupka, F.J., Yurekli, A., Fong, G.T. 2012. "Tobacco Taxes as a Tobacco Control Strategy."*http://tobaccocontrol.bmj.com/content/tobaccocontrol/21/2/172.full.pdf*

Depasupil, W. "Mighty Corp. Import Accreditation Suspended," *Manila Times*. March 15, 2017.

GATS (Global Adult Tobacco Survey). 2015. Philippines country report. *http://www.doh.gov.ph/sites/default/files/publications/GATS-PHL2015-Executive_Summary.pdf*

GYTS (Global Youth Tobacco Survey). 2015. Philippines country report. *http://www.doh.gov.ph/sites/default/files/publications/FinalGYTS_CountryReport.pdf*

"Price increase will worsen the crisis of illegal cigarette trade," *The Sun Daily*. March 31, 2017.

Raj, A. "Government seen getting less tobacco revenue despite hefty duty hikes," *The Edge Malaysia*. July 20, 2016.

Santos, T. "BOC Seizes P8.98M Worth of Smuggled Cigarettes, Fireworks," *Philippine Daily Inquirer*. March 6, 2018.

Sta. Ana, F., and Latuja, J. 2010. Cigarette Affordability and the Impact of Tobacco Taxation on Health and Revenue. Action for Economic Reforms. *http://www.aer.ph/tobaccotax/wp-content/pdf/Cigarettes.pdf*

Surendran, S. " Malaysia's Taxation on Cigarettes Excessive," *The Edge Financial Daily*. May 11, 2017.

Tamayo, M.A. "Changes Under the Customs Modernization and Tariff Act: An Overview," *Business World*. June 20, 2016.

Unite, B. "Customs Creates Anti-Smuggling Task Force," *Manila Bulletin*. January 26, 2018.

WHO (World Health Organization). 2005. WHO Framework Convention on Tobacco Control. Geneva: WHO. *http://www.who.int/tobacco/framework/WHO_FCTC_english.pdf*

WHO (World Health Organization). 2013. Protocol to Eliminate Illicit Trade in Tobacco Products. Geneva: WHO. *http://apps.who.int/iris/bitstream/10665/80873/1/9789241505246_eng.pdf?ua=1&ua=1*

WHO (World Health Organization). 2015. WHO Report on the Global Tobacco Epidemic, 2015. Raising Taxes on Tobacco. Geneva: WHO. *http://apps.who.int/iris/bitstream/handle/10665/178574/9789240694606_eng.pdf?sequence=1*

World Bank Group. 2017. Tobacco Tax Reform at the Crossroads of Health and Development: A Multisectoral Perspective. Prepared by a team led by Patricio Marquez and Blanco Moreno-Dodson. *https://openknowledge.worldbank.org/bitstream/handle/10986/28494/119792-REVISED-v2-FINAL-WBG-TobaccoTaxReform-FullReport-web.pdf?sequence=1&isAllowed=y*

World Bank Philippines Sin Tax Dashboard, April 5, 2015 – September 25, 2016.

COVER QUOTE SOURCES

[i] WHO Framework Convention on Tobacco Control Press Release, June 28, 2018.
https://www.who.int/fctc/mediacentre/press-release/protocol-entering-into-force/en/

[ii] World Health Organization Press Release, July 19, 2017.
https://www.who.int/en/news-room/detail/19-07-2017-who-report-finds-dramatic-increase-in-life-saving-tobacco-control-policies-in-last-decade

[iii] Combatting illicit trade in tobacco products: Commissioner Andriukaitis' Statement on the EU's adoption of an EU-wide track and trace system. European Commission Press Release, December 15, 2017.
http://europa.eu/rapid/press-release_STATEMENT-17-5269_en.htm

[iv] How to design and enforce tobacco excises? International Monetary Fund, October 2016
https://www.imf.org/en/Publications/Fiscal-Affairs-Department-How-To-Notes/Issues/2016/12/31/How-to-Design-and-Enforce-Tobacco-Excises-44352

[v] World Bank Group: "Global Tobacco Control: A Development Priority for the World Bank Group", Preface of WHO Global Tobacco Report 2015.
http://www.who.int/tobacco/global_report/2015/timevansandworldbankforeword.pdf?ua=1

"To tackle illicit trade is to tackle accessibility and affordability of tobacco products, to be more effective on the control of the packaging and to reduce funding of transnational criminal activities whilst protecting the governmental revenues from tobacco taxation." [i]

– Dr. Vera Luiza da Costa e Silva
Head of the Secretariat of the WHO Framework Convention on Tobacco Control

"Governments around the world must waste no time in incorporating all the provisions of the WHO Framework Convention on Tobacco Control into their national tobacco control programmes and policies. They must also clamp down on the illicit tobacco trade, which is exacerbating the global tobacco epidemic and its related health and socio-economic consequences." [ii]

– Dr. Tedros Adhanom Ghebreyesus, Director-General
World Health Organization

"Tobacco still remains the biggest avoidable cause of premature death in the EU, and the illicit trade in tobacco facilitates access to cigarettes and other tobacco products, including for children and young adults. In addition, millions of euros in tax revenues are lost every year as a result of the illicit trade. [iii]

– Commissioner Vytenis Andriukaitis
Health and Food Safety / European Commission

"Given their light weight, small size, and high value, tobacco products are susceptible to fraud through illegal trade, production, and cultivation. . . Illegal trade is a context-specific activity that has various modus operandi and therefore requires multi-dimensional context-specific solutions." [vi]

– Patrick Petit (Senior Economist) & Janos Nagy (Senior Economist)
Fiscal Affairs Department / International Monetary Fund

"Effective tobacco tax regimens that make tobacco products unaffordable represent a 21st century intervention to tackle the growing burden of noncommunicable diseases. We are convinced that, working together with WHO and other partners in support of countries, we will be able to prevent the human tragedy of tobacco-related illness and death, and save countless lives each year." [v]

–Dr. Tim Evans (Senior Director) & Patricio V Márquez (Lead Public Health Specialist)
Health, Nutrition and Population Global Practice / World Bank Group