Incentivizing Investment: A Reinforcing Vision for Start-Ups and SMEs with Pro-Investor Taxation Policy Provisions

A Policy Research

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I. Introduction

A. Background

Investments

Investments are amongst the major drivers of economic growth in the Philippines, contributing significantly to the country's gross domestic product (GDP) and development in key industries of infrastructure, agriculture, manufacturing, and labor. Despite contracting 9.6% in 2020 from the impacts of the COVID-19 pandemic, the Philippine economy rebounded and expanded by 5.6% in 2021.[1] Investments further grew by 19% and accounted for 29.1% of the country's GDP in 2020.[2] In December 2022, investments comprised 21.5% of the Philippine Nominal GDP, compared to a ratio of 25.7 % in the previous quarter.[3]

There is no doubt that investments in the country have rapidly increased in recent years, with the government implementing a number of policies designed to attract foreign investors and encourage domestic investment. Departments such as the National Economic and Development Authority (**NEDA**) and the Philippine Board of Investments (**BOI**) have been working actively to promote the Philippines as a destination for investments, offering support and incentives to companies and businesses looking to invest in the country. In this regard, the government has turned its attention to the key contributors to the country's investment landscape—SMEs and start-ups.

The United Nations has identified the **micro, small and medium enterprises** (MSMEs) sector as vital to the inclusive recovery of the Philippine economy from the global pandemic. Small and medium enterprises (SMEs) make up 99.5% of all registered businesses in the Philippines and employ about 63% of the country's workforce.[4] Meanwhile, start-ups have been gaining traction in recent years, with the government implementing policies to support the growth of the sector by expanding access of companies to economic opportunities. Amongst these policies include the **Magna Carta**

[1] Asian Development Bank, "Philippines," accessed 2022, https://aric.adb.org/philippines.
[2] Ibid.
[3] CEIC Data, "Philippines - Investment (% of Nominal GDP)," accessed March 11, 2023, https://www.ceicdata.com/en/indicator/philippines/investment--nominal-gdp.
[4] United Nations Philippines, "MSME Sector: Key to COVID-19 Inclusive Recovery in the Philippines," accessed March 11, 2023, https://philippines.un.org/en/93680-msme-sector-key-covid-19-inclusive-recovery-ph#:~:text=in%20the%20Philippines.-MSMEs%20comprise%2099.5%25%20of%20business%20establishments%20in%20the%20Philippines%20and,Gross%20Domestic%20Product%20(GDP).

for Small Enterprises,[5] **Innovative Start-Up Act**,[6] **Go Negosyo Act**,[7] **Youth Entrepreneurship Ac**t,[8] and the **CREATE Act**—formerly CITIRA Act of 2021.[9]

Recently, the National Economic and Development Authority (NEDA) released its 2023-2028 Revitalization Plan[10] for the Philippine economy, which includes **plans for supporting micro, small and medium-sized enterprises and start-up**s. The government aims to facilitate business mentoring, training in entrepreneurship, linkages with startups and multinational corporations (MNCs), digitalization and innovation initiatives, incentivization, and easing of foreign equity restrictions. This outlines the administration's vision of achieving sustainable and inclusive economic growth through MSMEs, which now account for over 95 percent of the total number of establishments in the Philippines.[11]

The government anticipates that **enabling and improving access to financial capital, credit reporting systems, and insolvency regimes** to SMEs and start-ups, will strengthen the MSME ecosystem in the Philippines. While having a strong MSME ecosystem is seen to create more employment opportunities for Filipinos, allow more foreign participation, and attract more investments in these sectors.

In this regard, investments in small and medium-sized enterprises (SMEs) and start-ups are foreseen to be powerful catalysts for issues of labor unemployment and stunted economic development. By providing vital capital and resources, investors can expedite the expansion and optimization of these enterprises, resulting in improved productivity and profitability. This virtuous cycle of growth can unlock new opportunities for job seekers and generate higher incomes for workers. The potential for growth of SMEs and start-ups in the Philippines is promising, and investors play a crucial role in achieving this remarkable outcome.

However, the country may be missing out on key opportunities in attracting more investors. Unfortunately, the **current investment framework of the country may not be as appealing as expected**, for the reason that investments in SMEs and start-ups are subjected to a capital gains tax rate of 15%, dividend income tax rate of 10%, and interest income tax rate of 20%.[12] Combined, these standard tax percentages are high relative to the risk involved with investing in an early-stage company. Thus, existing taxation policies for investors in private companies in the Philippines, when compared with the

[5] Republic Act 6977: Magna Carta for Small Enterprises. Philippine Congress, 1991. Accessed March 11, 2023. http://www.chanrobles.com/republicactno6977.html
[6] Republic Act 11337: Innovative Startup Act. Philippine Congress, 2019. Accessed March 11, 2023. https://www.officialgazette.gov.ph/2019/04/26/republic-act-no-11337/
[7] Republic Act 10644: Go Negosyo Act. Philippine Congress, 2014. Accessed March 11, 2023. http://www.officialgazette.gov.ph/2014/06/17/republic-act-no-10644/
[8] Republic Act 10679: Youth Entrepreneurship Act. Philippine Congress, 2015. Accessed March 11, 2023. http://www.officialgazette.gov.ph/2015/11/03/republic-act-no-10679/
[9] Republic Act 11534: Corporate Recovery and Tax Incentives for Enterprises Act (CREATE Act). Philippine Congress, 2021. Accessed March 11, 2023.
[10] National Economic and Development Authority. (2021). Philippine Development Plan 2017-2022: Midterm Update. Chapter 9: Accelerating and Sustaining Inclusive Growth. Accessed March 11, 2023. https://pdp.neda.gov.ph/wp-content/uploads/2021/12/Chapter-09C.pdf
[11] Ibid.
[12] PwC. (2023). Philippines - Corporate - Income Determination. PwC Tax Summaries. https://taxsummaries.pwc.com/philippines/corporate/income-determination

tax policies and incentives of neighboring countries for investments in MSMEs, strike as **uninviting**—hindering the generous flow of foreign investment dollars into the economy. Furthermore, there is also **a significant lack of provisions on investor tax incentives in the recently enacted bills aimed at boosting the start-up and SME economic system in the Philippines**. In contrast to other countries whose policies and plans for the growth of SMEs and start-ups are underpinned by provisions providing tax incentives to its investors, the Philippines implements a rigid framework with the eligibility for tax benefits limited to foreign direct investors—*investors* in the sense that they invested by establishing or acquiring an SME or start-up business in the country.[13]

Small and medium-sized businesses and start-ups are now the backbone of the economy and have tremendous potential to further contribute to economic growth. However, this potential can only be fully realized if investors in the MSMEs sector are incentivized for allocating capital, which in turn maximizes mutual benefit and encourages a greater number of investors to confidently take risks in these growing industries.

In this regard, it is imperative for policymakers and stakeholders to acknowledge that bolstering SME and start-up environments has to be reinforced with tax incentivization of private equity investors such as in venture capital. The two aspects are closely intertwined and mutually support each other. **The recently enacted laws towards promotion of SMEs and start-ups have great potential, but they could be made better and more efficacious with investor tax incentivization as an inclusive policy provision.** With this, the country will not only fuel sustained economic growth in line with the NEDA's revitalization plan, but also close the gap between comparable policies in the region, equipping the Philippines with a competitive edge.

B. Significance of the Study

This research aims to evaluate the current investment climate for sectors of SMEs and start-ups in the Philippines, further aspiring to:

- Identify challenges that hinder investor participation in SMEs and start-ups, and assess impacts of tax policies on profitability and engagement;
- Review the efficacy and implications of existing policies and programs aimed at promoting investment in SMEs and start-ups in the Philippines;
- Analyze the current Philippine investment landscape, market trends, opportunities, and potential risks;
- Compare relevant policies providing tax incentives in developed and neighboring countries;
- Determine gaps in current Philippine policies designed to amplify SME and start-up sectors, in comparison to similar foreign policies;
- Propose policy provisions or recommendations that further improve current policies through incentivizing investment in SMEs and start-ups,

[13] Philippines, Fiscal Incentives Review Board. "Incentives Available." accessed March 11, 2023. https://firb.gov.ph/incentives-available/.

including but not limited to tax incentives, regulatory reforms, and capacity-building programs;
- Evaluate potential economic and social impact of the proposed policy recommendations using measurable outcomes, key performance indicators, progress-tracking, and qualitative analysis;

In summary, this research aims to provide evidence-based recommendations that can serve as a guide for policymakers, investors, and stakeholders in maximizing the potential of the SMEs and start-ups sector for inclusive and sustainable economic growth and development in the country, particularly through the amendment of current policies to include provisions on investor tax incentivization.

C. Scope of the policy research

The purview of this study entails a **brief evaluation of the economic impact of current Philippine SME and start-up incentivization and investment tax policies**, while focusing on the significant gaps and lack of efficacy namely in attracting foreign and domestic investors. The scope of this research also covers a **comparative analysis of policies implemented by different countries to incentivize investment in small and medium-sized enterprises and start-ups,** and the businesses themselves. Notably, this research intends to extract lessons in policymaking by placing particular focus on comparing tax incentive policies and programs instituted in Singapore—a country that has established itself as a leader in SME and start-up promotion.

However, it is imperative to recognize the **limitations of this research** which are namely, analyzing policies and programs implemented in other countries, identifying its strengths and policy outcomes, and prospective policy implications. Hence, policies may not be exactly appropriated to the unique political, economic, and social context of the Philippines. Furthermore, the research will only recommend select policies designed to incentivize investment in SMEs and start-ups, with an emphasis on the impact of these policies on investment attraction. This study will not delve on cultural and social factors that could potentially affect investment behavior or analyze macroeconomic policies and trade policies.

To ensure the preciseness of our data and analysis, **this research will only evaluate current relevant tax policies on incentivizing SMEs and start-ups,** and current tax policies for investments. implemented in the country. Despite these limitations, the researchers believe that the study will provide invaluable insights into the types of policies and programs that have proven to be successful in boosting SMEs and start-ups in foreign nations.

Part of the scope of this research is to demonstrate the vitality of tax incentivization for investments in SMEs and start-ups in boosting the sector, and shed light on the inseparability of the two concepts in bringing about economic growth.

In summary, this research encompasses a **detailed understanding of potential strategies**

that can be deployed to foster SME and start-up growth; sufficiently equipping policymakers and stakeholders in the Philippines with background essential to amending existing policies into more comprehensive, feasible, and effective laws capable of further stimulating investment in MSMEs and driving economic growth and development.

II. Overview of Tax Incentives in the Philippines

A. Definition of Terms

Start-Ups

Companies that are in the first stages of operations, centered on developing a unique product or service with the aim of growing the business into a large corporation. As defined by the Department of Trade and Industry, start-up companies are businesses that have innovative or scalable business models, and are less than 7 years old with a maximum number of 200 employees.[14]

MSMEs

Refers to micro, small and medium-sized enterprises that create jobs and promote innovation. They are companies that have fewer than a certain number of employees or a certain amount of annual revenue. Based on the Department of Trade and Industry, MSMEs are defined based on their assets and employment size. Microenterprises have assets worth up to Php 3 million and employ up to 9 people. Small enterprises have assets worth between PHP 3 million and Php 15 million and employ between 10 and 99 people. While medium-sized enterprises have assets ranging between Php 15 million to PHP 100 million and employ between 100 and 199 people.[15]

Tax Incentives

Special privileges granted by the government to eligible taxpayers to reduce their tax liabilities, or incentivize certain activities and behaviors. Tax incentives may come in the form of tax holidays, tax exemptions, tax breaks, tax credits, reduced tax rates, and other provisions.[16]

Tax Break

[14] "Definition of Start-up Enterprises," Department of Trade and Industry, accessed March 11, 2023, https://innovate.dti.gov.ph/programs/startups/#:~:text=Startups%20introduce%20innovative%20products%20and,entrepreneurial%20culture%20in%20the%20country.
[15] "The Importance of Micro, Small and Medium Enterprises (MSMEs)", Senate Economic Planning Office, 2012. https://legacy.senate.gov.ph/publications/AG%202012-03%20-%20MSME.pdf
[16] United Nations. (2018). "Tax Incentives and Economic Development". https://www.un.org/esa/ffd/wp-content/uploads/2018/02/tax-incentives_eng.pdf

A tax code provision that allows taxpayers to reduce their taxable income. Tax breaks are also interpreted as deductions in the amount of taxes that a person or entity owes to the government.[17]

Tax Deduction

Tax deductions are expenses that can be subtracted from a person's gross income to arrive at their taxable income. Certain expenses are covered under this provision such as business expenses, charitable donations, and medical expenses, among others.[18]

Tax Exemption

Another privilege granted by the government allowing certain types of income or transactions to be exempted from taxes. Tax exemption can also apply to individuals or businesses, and may be granted for various reasons such in support of certain industries, promotion of social welfare, or to encourage investments.[19]

Tax Credit

A tax credit is a dollar-for-dollar reduction in the amount of taxes owed based on certain expenditures or activities, and is granted to taxpayers who meet certain eligibility criteria such as employment of workers with disabilities or investment in renewable sources of energy.[20]

Investment Tax Credit

A form of tax incentive that provides credit against taxes owed for investments made in certain types of property or equipment, or specific sectors or industries.[21]

Accelerated Depreciation

A form of tax incentive that enables businesses to depreciate the value of their assets more rapidly than under standard depreciation schedules, resulting in a larger deduction in the early years of an asset's life and reduced tax liability.[22]

Government Grants

Government assistance in the form of transfer of resources to an entity in exchange for past or future compliance with operational conditions. Grants

[17] Investopedia (n.d.). “Tax Break.” Retrieved from: https://www.investopedia.com/terms/t/tax-break.asp
[18] Investopedia (n.d.). “Tax Deduction.” Retrieved from https://www.investopedia.com/terms/t/tax-deduction.asp
[19] Investopedia (n.d.). “Tax Exemption.” Retrieved from https://www.investopedia.com/terms/t/tax_exempt.asp
[20] Investopedia (n.d.). “Tax Credit.” Retrieved from https://www.investopedia.com/terms/t/taxcredit.asp
[21] Practical Law. (n.d.). Establishing a business in the Philippines: overview. Thomson Reuters. Retrieved March 14, 2023, from https://uk.practicallaw.thomsonreuters.com/1-517-6442?transitionType=Default&contextData=(sc.Default)&firstPage=true
[22] Investopedia (n.d.). “Accelerated Depreciation.” Retrieved from https://www.investopedia.com/terms/a/accelerateddepreciation.asp

typically cover a wide range of expenses, including research and development, marketing, and staffing.[23]

B. Types of Tax Incentives

The Philippines offers various tax incentives to businesses and investors to encourage economic development and growth. Here is a general **overview of tax incentives available in the country according to the Fiscal Incentives Review Board of the Department of Finance:**[24]

Income Tax Holiday

Permits businesses to enjoy a period of tax exemption from corporate income tax, local taxes, national taxes, and other fees depending on the location of the business and the type of activities it engages in.

a. Income tax holiday of 4 to 7 years depending on the location and industry
b. Additional income tax holiday of 3 years for businesses relocated from the National Capital Region
c. Additional income tax holiday of 2 years of businesses located in areas recovering from conflict or disaster

Special Tax Rate

An incentive that provides a lower tax rate for certain types of businesses or activities, such as offshore banking firms, export-oriented enterprises, and regional headquarters.

a. 5% special corporate income tax for 10 years for export enterprises

Enhanced Deductions

Various tax credits and deductions offered to eligible businesses for spending in research and development, training, and capital equipment investments.

a. Depreciation allowance (10% for buildings, 20% for machinery)
b. Labor expense (150%)
c. Research and development (200%)
d. Training expense (200%)
e. Domestic input expense (150%)
f. Power expense (150%)
g. Reinvestment allowance to the manufacturing industry (Up to 50%)
h. Enhanced NOLCO – losses during the first 3 years may be carried over

[23] Grant Thornton Global. (2021). IFRS - Government grants. Retrieved from https://www.grantthornton.global/en/insights/supporting-you-to-navigate-the-impact-of-covid-19/ifrs---government-grants/#:~:text=Definition%20of%20a%20government%20grant,operating%20activities%20of%20the%20entity.
[24] Philippines, Fiscal Incentives Review Board. "Incentives Available." accessed March 11, 2023. https://firb.gov.ph/incentives-available/.

within the next 5 consecutive years

Customs Duty Exemption

An incentive that allows businesses to import capital equipment, raw materials, and other goods without paying customs duties, given that such goods are used for eligible activities.

a. Duty exemption of up to 17 and 12 years for export and domestic enterprises from the date of registration, respectively, unless otherwise extended under the SIPP

Value-Added Tax (VAT) Zero Rating

An incentive permitting certain types of goods and services to be sold with a 0% VAT rate, reducing costs for businesses and consumers.

a. Rating of registered export enterprises of up to 17 years from the date of registration, unless otherwise extended under the SIPP

These incentives are meant to be granted directly to start-ups and SMEs businesses.

C. Current tax policies for SME and start-up investments in the Philippines

The Philippine government levies a variety of taxes on investors in start-ups and SMEs depending on the type of investment and the duration of the holding period.

For equity investments in start-ups and SMEs, investors may be subject to capital gains tax (**CGT**) and/or a documentary or stamp tax (**DST**). A CGT is a tax on gains from the sale or exchange of stocks or other securities, whereas a DST is a tax on the issuance of securities.[25] [26] The tax rate for CGT is **15% of the net capital gains**, while the DST rate is **Php 1.00 for every Php 200.00 of the par value of the shares issued,** with a maximum rate of Php 200.00 per share certificate.

Furthermore, investors in start-ups and SMEs may also be subject to **income tax on their investment returns.** Investors receiving dividends or interest income from investing in a start-up or SME will be subject to income tax on the amount received. The current tax rate for **dividend income is 10%**, while the tax rate for **interest income is 20%.**[27]

However, to stimulate investments in the country given the aforementioned policies, the Philippines offer tax incentives for eligible investors in start-ups and small and medium-sized enterprises (SMEs), given these businesses are registered with the Philippine Economic Zone Authority (PEZA).[28] Although, the provision can be

[25] Bureau of Internal Revenue. (n.d.). Capital Gains Tax. Retrieved March 11, 2023, from https://www.bir.gov.ph/index.php/tax-information/capital-gains-tax.html.
[26] Bureau of Internal Revenue. (n.d.). Documentary Stamp Tax. Retrieved March 11, 2023, from https://www.bir.gov.ph/index.php/tax-information/documentary-stamp-tax.html.
[27] PwC. (2023). Philippines - Corporate - Income Determination. PwC Tax Summaries. https://taxsummaries.pwc.com/philippines/corporate/income-determination
[28] "Incentives Available." Fiscal Incentives Review Board. Accessed March 12, 2023. https://firb.gov.ph/incentives-available/.

misleading since **PEZA only provides incentives to foreign direct investments such as through the acquisition of real estate and equipment procurement among others, and not to private equity investments.**

In recent years, the country has enacted several other policies aimed at amping up the start-up and SMEs sectors in the country.

Magna Carta for Small Enterprises

Also known as RA 6977, as amended by RA 8289 and RA 9501, defines a small enterprise as a company with assets of up to Php 50 million, excluding land and building. It also outlines the establishment of the Bureau of Small and Medium Enterprise Development (**BSMED**) and the National Council for Small and Medium Enterprise (**NCSME**), departments that are responsible for the implementation of programs and projects designed to promote and develop SMEs.

The law enabled the **Special Credit Facility for Small Enterprises**, providing credit assistance to SMEs through government financial institutions. SMEs are allowed a minimum loan of Php 5,000 to a maximum of Php 500,000. It also covers a **Priority Financing Program** (PFP) which provides access to credit for SMEs with a minimum loan of Php 500,000 up to Php 10 million. The act further incentivizes small enterprises to be entitled to tax exemptions, government procurement preferences, and priority access to government programs and services.[29]

Magna Carta for Micro, Small, and Medium Enterprises (MSMEs)

Also known as RA 9501,[30] this act amends RA 6977, redefining micro enterprises with total assets not exceeding Php 3 million and employing up to 9 workers; small enterprises with total assets of more than Php 3 million up to Php 15 million and employing 10 to 99 workers; while medium enterprises with total assets of more than Php 15 million up to Php 100 million and employing 100 to less than 200 workers. As part of the law, MSMEs are eligible to benefit from tax incentives, such as **exemptions from income tax for three years**, as well as **reductions in corporate income tax rates** for those who earn less than Php 3 million annually.

Although a more important provision of the law is perhaps the creation of the **Small Business Guarantee and Finance Corporation, also known as SB Corporation.** The government financial institution is charged with the responsibility of implementing comprehensive policies and programs to assist MSMEs in areas including, but not limited to finance and information services, training, and marketing. Its other functions include adopting development

[29] Republic Act 6977: Magna Carta for Small Enterprises. Philippine Congress, 1991. Accessed March 11, 2023. http://www.chanrobles.com/republicactno6977.html

[30] Republic Act No. 9501, An Act Providing for the Establishment of the Micro, Small and Medium Enterprise Development (MSMED) Council, and for Other Purposes, Philippine Government, https://www.officialgazette.gov.ph/2008/05/23/republic-act-no-9501/.

initiatives for globally competitive MSMEs, extending financial assistance and engaging in wholesale lending, guaranteeing loans obtained by qualified MSMEs, owning and disposing of real and personal property, receiving grants and donations, and investing in stocks, bonds, and other forms of indebtedness of the government and its agencies.

The Small Business Corporation (SB Corporation) will have an authorized capital stock of Ten billion pesos (P10,000,000,000.00), which will be divided into 80,000,000 common shares and 20,000,000 preferred shares with a par value of One hundred pesos (P100.00) per share. The initial capital of One billion pesos (P1,000,000,000.00) will be established from a pool of funds contributed by the Land Bank of the Philippines, the Development Bank of the Philippines, the Social Security System, and the Government Service Insurance System, with Two hundred million pesos (P200,000,000.00) each. Holders of preferred shares issued under Republic Act No. 6977 may convert their shares into common shares.

Additional equity funding will come from various sources, including trust placements of excess and unused funds of existing government agencies, official development assistance funds, subscriptions from government-owned or controlled corporations, and investments of private financial institutions and corporations. The SB Corporation will have a five-year grace period on dividend commitments, during which it may withhold all net income as retained earnings. After the grace period, it may only declare as dividend not more than thirty percent (30%) of its net income.

Innovative Start-Up Act

Officially known as RA 11337, the **law supports the establishment and growth of innovative start-ups in the country.** It defines an innovative startup as a corporation or partnership registered with the Securities and Exchange Commission (SEC) or the Department of Trade and Industry (DTI) that is engaged in the development of a new product, process, or service that is innovative, scalable, and has high potential for market growth and job creation. The law mandates the creation of a **Startup Grant Fund,** which will be administered by the Department of Science and Technology (**DOST**). The initial amount of the fund is Php 1 billion, which will be used to provide financial assistance to qualified startups.[31]

Startup Investment Development Plan

Under the act, a **Startup Investment Development Plan** was put in place in which the Department of Trade and Industry (**DTI**) works in coordination with the Department of Department of Information and Communications Technology (**DICT**), Department of Science and Technology **(DOST**), and Board of

[31] Republic Act 11337: Innovative Startup Act. Philippine Congress, 2019. Accessed March 11, 2023. https://www.officialgazette.gov.ph/2019/04/26/republic-act-no-11337/

Investments (**BOI**) to spearhead initiatives to develop the short, medium, and long-term strategies in spurring investment, and promote the growth and development of, startups and startup enablers in the Philippines.

Startup Venture Fund (SVF)

The **Startup Venture Fund (SVF)** was also created under the DTI, to be administered in coordination with the National Development Company (**NDC**). The purpose of the SVF is to match investments by selected investors in startups that are based in the Philippines, where the DTI and the NDC will jointly develop and issue appropriate rules and regulations for the selection of investors as well as the effective management and utilization of the fund.

Go Negosyo Act of 2014

Also known as RA 10644, the act has a budget of Php 1 billion and is designed to promote entrepreneurship for the creation of more job opportunities for Filipinos. The law mandated the **establishment of Negosyo Centers** which will serve as **one-stop-shops for entrepreneurs in terms of business registration assistance, business advisory services, and access to financing programs.** It is also tasked to map out all information and services essential to prospective entrepreneurs and prospective investors especially in key value chains and economic sub sectors within its jurisdiction.

This law also provides a **Start-Up Fund for MSMEs that was set up by the Department of Finance (DOF),** along with appropriate financing institutions to be sourced from the MSME Development Fund and the BMBE Fund. As specified in the MSMED Plan, the fund provides financing for the development and promotion of MSMEs in the priority sectors of the economy.[32]

Youth Entrepreneurship Act

Also known as RA 10679 aimed at promoting youth entrepreneurship by providing incentives and support for young entrepreneurs. **The law aims to promote youth entrepreneurship by providing the necessary support, resources, and training for young businesspeople to start and expand their enterprises.** This mandates the creation of **financing** programs, and **incentives** for banks and other financial institutions to **encourage them to lend to young entrepreneurs.**

There are also provisions in the law that mandate the establishment of **Youth Entrepreneurship Hubs** in various regions of the Philippines that will have the purpose of serving as incubation centers and co-working spaces for young entrepreneurs. In addition to allowing young entrepreneurs, including those who

[32] Republic Act 10644: Go Negosyo Act. Philippine Congress, 2014. Accessed March 11, 2023. http://www.officialgazette.gov.ph/2014/06/17/republic-act-no-10644/

are under the age of 30, to take advantage of tax breaks, exemptions, and other incentives, the law requires the allocation of PHP 100 million (about USD 2 million) for the various programs and initiatives under the Youth Entrepreneurship Act.[33]

CREATE Act—formerly CITIRA Act of 2021.

The "Corporate Recovery and Tax Incentives for Enterprises" (**CREATE**) Act, also known as Republic Act No. 11534, is a crucial component of the Comprehensive Tax Reform Program (CTR) and was previously a version of the Corporate Income Tax and Incentives Reform Act (CITIRA) bill.[34] The CREATE Act seeks to bolster businesses, particularly those organized as corporations, including One Person Corporations, to recover from the detrimental impact of the pandemic. The law does so by **lowering the corporate income tax rates** and providing other tax relief measures. The CREATE Act also aims to rationalize the grant of fiscal incentives to *targeted* investors, as the Philippines has been too generous in granting tax incentives to a few investors in perpetuity, without a regular and in-depth review of the costs and benefits.

In the provisions of the law, domestic corporations with net taxable income not exceeding Php 5 million and with total assets not exceeding Php 100 million are eligible for a reduced Regular Corporate Income Tax (RCIT) rate from 30% to 20%. All other domestic corporations and resident foreign corporations are eligible for a reduced RCIT rate from 30% to 25%. The CREATE Act has also reduced the Minimum Corporate Income Tax (MCIT) rate from 2% to 1% of gross income which is revenue less the cost of sales, effective July 1, 2020, to June 30, 2023. The MCIT is imposed if a corporation has negative taxable income or if the MCIT is higher than the 30% RCIT. The MCIT applies to the corporation on its fourth year of operation after the year of its BIR registration, and the excess of the MCIT over RCIT can be carried over to three (3) succeeding taxable years until the corporation becomes liable to pay RCIT.

In terms of incentives, the CREATE Act provides several key measures that rationalize the grant of fiscal incentives to targeted investors. Qualified export enterprises are entitled to a 4 to 7-year Income Tax Holiday (ITH) to be followed by 10 years of 5% Special Corporate Income Tax (SCIT) or Enhanced Deductions. Qualified domestic market enterprises are entitled to a 4 to 7-year ITH to be followed by 5 years of Enhanced Deductions. Additionally, registered enterprises are exempt from customs duty on importation of capital equipment, raw materials, spare parts, or accessories directly and exclusively used in the registered project or activity. VAT exemption on importation and VAT zero-rating on local purchases shall only apply to goods and services directly and exclusively used in the registered project or activity by a Registered Business Enterprise

[33] Republic Act 10679: Youth Entrepreneurship Act. Philippine Congress, 2015. Accessed March 11, 2023. http://www.officialgazette.gov.ph/2015/11/03/republic-act-no-10679/

[34] Republic Act 11534: Corporate Recovery and Tax Incentives for Enterprises Act (CREATE Act). Philippine Congress, 2021. Accessed March 11, 2023. http://www.officialgazette.gov.ph/2021/03/26/republic-act-no-11534/

(RBE).

However, one of the items vetoed by the President is the **removal of the extension of availment of tax incentives by existing RBEs. T**he President vetoed this item because it was said to be unfair to ordinary taxpayers and non incentivized enterprises. The President also stated that only new activities and projects deserve fresh incentives. Therefore, investments made before the effectiveness of CREATE may continue to avail of the incentives granted to them. RBEs granted only an ITH can continue to avail of the ITH for the remaining period of the ITH. RBEs granted an ITH + 5% Gross Income Tax (GIT) or currently enjoying 5% GIT are allowed to avail of the 5% GIT for ten years.

Investing in SB Corporation may provide tax incentives for investors under the CREATE (Corporate Recovery and Tax Incentives for Enterprises) Law. The law provides for a reduced corporate income tax rate of 20% for the first P5 million of taxable income, and 25% for the excess over P5 million for SMEs with a total assets of not more than P100 million and gross sales of not more than P100 million in the preceding year. The CREATE law also provides for a 5% tax on gross income earned (GIE) in lieu of all national and local taxes, including income tax, value-added tax, and local business tax, among others, for the first 10 years of operation for qualified new investors in certain priority sectors, including SMEs.

The tax incentive provisions in the law are expected to create a significant fiscal stimulus for businesses in line with the government's public policy objectives of promoting growth as a means to recover from post-pandemic economic uncertainty. According to the Department of Finance, the passage of the law was expected to result in a reduction of approximately Php 37 billion in government revenues in the latter half of 2021, and an estimated Php 476.8 billion in foregone government taxes in the next 5 years. Meanwhile, the House of Representatives estimates the government will lose Php 133 billion in revenue during the first year of its implementation. **In terms of standard valuation methods, the reduction in corporate income tax alone amounts to approximately P7.1 trillion in net present value**. On the other hand, **the law is projected to generate 1.1 to 1.4 million jobs over the next ten years, massively contributing to job creation, economic growth, and public welfare.**

III. Analysis of Tax Incentive Policies in the Country

A. Advantages

The extant tax incentives aimed at investments in start-ups and small and medium-sized enterprises (SMEs) in the Philippines are endowed with key advantages. Primarily, the **policy engenders lucidity and transparency on tax policies and rates applicable to**

investors in start-ups and SMEs, thereby empowering investors to make well-informed and judicious investment decisions. Furthermore, the differential tax rates and incentives accorded to equity investments, coupled with the PEZA incentives, serve to alleviate the tax burden on investors while simultaneously augmenting government revenue earmarked for critical public administration projects and infrastructure. Finally, the policy engenders a conducive environment for investing in nascent and evolving businesses while upholding a streamlined business regulatory framework under the Philippine Economic Zone Authority (PEZA).

In terms of the newly implemented policies for SMEs and start-ups, the policies serve to be beneficial by further incentivizing investments and boosting the MSME sector. Provides tax relief measures for businesses, particularly corporations, to recover from the pandemic's impact. Lowers corporate income tax rates, providing reduced Regular Corporate Income Tax rates for eligible domestic and foreign corporations. Rationalizes the grant of fiscal incentives to targeted investors, Rationalizes the grant of fiscal incentives to targeted investors, Rationalizes the grant of fiscal incentives to targeted investors, Estimated to generate 1.1 to 1.4 million jobs over the next ten years.

B. Disadvantages

In terms of the potential drawbacks of these policies, **the researchers understand that foregone losses in government revenue are translated into economic activity and growth in its backbone sectors.** Policymakers have extended their generosity to provide fiscal incentives to businesses across all sectors, particularly investors in SMEs and start-ups. However, the incentivization policies of the government are limited to foreign direct investments in SMEs and start-ups, such as those offered under the PEZA tax incentives. These incentives only apply to start-ups and SMEs registered under the PEZA and are limited to certain locations and business categories, rendering some investors unable to benefit from these advantages.

Meanwhile, the CREATE Act grants generous tax incentives for investors in SMEs and start-ups, but these fiscal incentives are only available to *targeted* investors. These targeted investors are *non-financial investors* or *foreign direct investors,* which invest through means other than stocks or financial instruments, such as building a business, buying property, exporting goods, initiating research projects, and providing skills or other resources. Private company investments in the SMEs and start-ups sector are not eligible for incentives under this act.

The tax rate for capital gains, dividends, and interest income at the standardized rates of 15%, 10%, and 20%, respectively, remains to be uniformly applied to investments in all forms of businesses. However, imposing the same rates on investments in SMEs and start-ups with considerably higher risks in contrast to stable multinational companies, could dampen investor interest in the sector as the overall return on investment is equally reduced.

This issue is of utmost importance as it provides options to businesses in the instance that government aid applications undergo lengthy processing periods, grant programs are not effectively implemented, or when federal institutions are unable to provide the necessary target financing to SMEs and start-ups. **Financial investors can play a crucial role in providing the much-needed capital to this sector,** allowing the businesses to grow and expand. Furthermore, the opportunity opens avenues for more Filipino investors to invest through purchase of shares in start-ups and SMEs.

Yet, despite the recent policies aimed at bolstering SMEs and start-ups, there appears to be **no provision for tax incentivization in private company investments, especially in the startup and SME sectors where it is most needed.** For the time being, the opportunities available for investors to invest in SMEs and startups will remain constrained, and a significant potential to enhance existing fiscal incentive policies remains to be overlooked.

IV. Comparison with Global Pro-Investor Policies

Presented below are summaries of incentivization policies implemented in various countries for investments in SMEs and start-ups, as well as the lessons in achieving optimal policy outcomes:

A. Jumpstart Our Business Startups (JOBS) 2012 of the United States

Law enacted to promote creation of job opportunities and establishment of small businesses by enabling SMEs and start-ups access to capital markets. new exemptions from SEC registration requirements for small companies seeking to raise capital. The act eased regulations for initial public offerings and reduced disclosure requirements which allowed emerging growth companies (ECGs) to raise funds through crowdfunding platforms and conduct general solicitation and advertising of private offerings to a wider pool of potential investors. The law also provided an enhanced regulatory framework for crowdfunding through the establishment of a new security type called "crowdfunding security".[35]

a. Allows crowdfunding for start-ups
b. Allows companies to have up to 2,000 shareholders without registering with the SEC
c. Allow companies to raise up to $50 million from the public through regulated offerings
d. Allows companies to confidentially file for IPOs
e. Provides a reduced regulatory burden for emerging growth companies

B. Seed Enterprise Investment Scheme (SEIS) 2012 of the United Kingdom

A government initiative launched to promote investment in early-stage and high-risk

[35] Jumpstart Our Business Startups (JOBS) Act, Pub. L. No. 112-106, 126 Stat. 306 (2012).

start-up companies through tax incentivization. The scheme set stringent criteria for eligibility which requires a business to be less than two years old, have less than £200,000 in gross assets, and employ fewer than 25 employees.[36] Since its inception, the initiative gained traction among start-ups, raising more than £1.4 billion in funding in over 2,000 businesses across the UK.[37]

The initiative, complementing the Enterprise Investment Scheme (EIS) and the Venture Capital Trusts (VCT), paved the way for the United Kingdom to rank as the second-best country in Europe for start-up businesses in 2020.[38] On top of that, private equity and venture capital-backed businesses delivered £102 billion of GDP in 2021, which is 5% of the GDP of the United Kingdom—further employing 1.9 million workers in the same year.[39]

a. Provides up to 50% income tax relief on investments up to £100,000 per year
b. Allows investors to defer capital gains tax on any gains invested in SEIS eligible companies
c. Provides exemption from capital gains tax on any profits made from the sale of SEIS eligible shares after 3 years
d. Investors can elect to have their SEIS investment treated as if it was made in the previous tax year, providing additional tax relief.
e. If the company fails, investors can claim loss relief against income tax at their highest marginal rate.

C. Start-up India 2016

A flagship initiative led by the Indian government to encourage entrepreneurship and boost employment through the support of startups. The program offers start-ups with access to funding, mentorship, network, a simplified regulatory process, reduced compliance burden, and a range of tax incentives. It also created a Rs 10,000 crore Funds of Funds which is approximately 1.4 billion USD aimed at investing in venture capital funds which in turn, invest in start-up companies.[40] Since its inception, the program has recognized 41,000 start-ups which have created 460,000 jobs and have raised a funding of over Rs 3,000 crore or 420 million USD.[41]

a. Provides reduced rate of taxation on profits
b. Provides a 3-year tax holiday for eligible start-ups
c. Provides a reduced patent filing fee for start-ups
d. Provides a fund of INR 10,000 crore to support start-ups over a 4-year period

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[36] Seed Enterprise Investment Scheme. (2011). About SEIS. Retrieved from https://www.seis.co.uk/about-seis
[37] St. James's Place. (n.d.). What is a Seed Enterprise Investment Scheme (SEIS) and how can you benefit from it? Retrieved from https://www.sjp.co.uk/news/what-is-a-seed-enterprise-investment-scheme-seis-and-how-can-you-benefit-from-it
[38] House of Commons Treasury Committee. (2020). Written evidence from the British Private Equity & Venture Capital Association (BVCA) (ECON0085). Retrieved from https://committees.parliament.uk/writtenevidence/111830/pdf/
[39] EY and BVCA. (2022). The Economic Contribution of British Private Equity and Venture Capital. Retrieved from https://www.bvca.co.uk/Portals/0/Documents/Research/2022%20Reports/EY-BVCA-Economic-Contribution-Report-2022.pdf
[40] Government of India. (2016). Startup India Action Plan. Retrieved from https://seedfund.startupindia.gov.in/about
[41] KPMG. (2021). Building a resilient start-up ecosystem. Retrieved from https://kpmg.com/xx/en/home/insights/2021/03/building-a-resilient-start-up-ecosystem.html

D. Early Stage Innovation Company (ESIC) 2016 of Australia

A government-backed initiative promoting investment in early-stage businesses through tax incentives to private individual investors in startups incorporated in Australia with expenses of less than $1 million.[42] Australia's start-up ecosystem massively boomed in the past decade, with just Melbourne and Sydney's startup ecosystem amounting to $10.5 billion and $24 billion respectively in 2021.[43] More impressively, in a span of 8 days, Australia's start-ups raised $1.6 billion in funding in the same year.[44]

a. Provides investors a non-refundable carry-forward tax offset of 20% of the amount invested
b. Provides a capital gains tax (CGT) exemption on the sale of ESIC shares for up to 10 years
c. Allows maximum amount invested in ESIC to $200,000 for sophisticated investors and $50,000 for non-sophisticated in a single income year
d. Allows maximum amount of $40,000 tax offset for sophisticated investors, otherwise a $10,000 tax offset claim

E. Small Business Innovation Research (SBIR) program 1982 of the United States

A competitive grant program to startups and small businesses for research and development (R&D) projects with commercial potential. The program is coordinated by the Small Business Administration (SBA) and funded by federal government agencies such as the National Science Foundation, the National Institutes of Health, and the Department of Defense.[45] The grant program is complemented by the Small Business Technology Transfer (STTR).[46]

a. Provides first phase of funding of up to $250,000 for proof of concept
b. Provides second phase of funding from $750,000 up to $1.972 million for prototype development
c. Opens businesses to commercialization without federal funding

F. Zukunftsfonds and Fondsstandortgesetz 2021 of Germany

The Fondsstandortgesetz is an amendment under the German Income Tax Act or Einkommensteuergesetz, incentivizing equity awards in SMEs and start-ups[47] to complement the Zukunftsfonds—an equity fund program also known as the German

[42] Standard Ledger. (n.d.). What is an ESIC, how do I become an ESIC, and what this means for startups raising capital. Retrieved from https://support.standardledger.co/knowledge/what-is-an-esic-how-do-i-become-an-esic-and-what-this-means-for-startups-raising-capital
[43] SmartCompany. (2022). Australia's funding boom: Startups' economic growth. Retrieved from https://www.smartcompany.com.au/startupsmart/venture-capital/australia-funding-boom-startups-economic-growth/
[44] SmartCompany. (2022). Aussie startups raise more than $1 billion in a week. Retrieved from https://www.smartcompany.com.au/startupsmart/analysis/aussie-startups-1-billion-week-funding-raise/
[45] Small Business Innovation Research (SBIR). Retrieved from https://www.sbir.gov/about
[46] Small Business Administration. (2020). SBIR/STTR Program Overview. Retrieved from https://www.sbir.gov/sites/default/files/SBA_SBIR_Overview_March2020.pdf
[47] Baker McKenzie. (2018). Germany incentivizes equity awards in start-ups. Retrieved from https://insightplus.bakermckenzie.com/bm/tax/germany-incentivizes-equity-awards-in-start-ups

Future Fund aimed at providing much-needed capital financing for high-growth start-ups to scale and expand globally.[48] Comprises a government-backed €10 billion fund called the "Future Fund". In just a year after its enactment, German start-ups have attracted high levels of investment amounting to over €30 billion.

The Future Fund is seen to further attract €60 billion in investment in the next few years.[49] Although more importantly, the Future Fund serves as the foothold for the Financing for the Future Act (**Zukunftsfinanzierungsgesetz**) that is set to be enacted in 2023.[50] The act is centered on providing efficient access to capital markets and equity funding to start-ups and SMEs, and includes a key provision to make investing more attractive from a tax perspective through incentivizing investment in shares.[51]

a. Provides €10 billion of federal funds and mobilizes €30 billion in venture capital for start-ups
b. Provides over €50 billion in venture capital for start-ups in the next few years together with private investors
c. Under the amended German Income Tax, provides for a temporary tax exemption of income from employment resulting from the transfer of shares to the employee at a price below the fair market value and
d. Provides income tax liability reduction by 20% to individuals investing in a qualified start-up, up to a maximum of €1 million per year
e. Provides individuals who sell shares held for at least one year an exemption of 60% of the capital gains from income tax

G. Investment Tax Credit of Canada

Amended provisions[52] from the general Investment Tax Credit policies of the government, including an initiative launched to encourage Canadian businesses to conduct research and development and promote innovation-driven economic progress among start-ups through tax incentivization.[53] Among these are the Accelerated Capital Cost Allowance (ACCA), Corporate Income Tax (CIT) cuts, and the Scientific Research and Experimental Development (SR&ED) Program. These policies are expected to reduce federal revenues by $53 million starting 2023.[54] But it is currently being reinforced by a proposed 2% tax on corporate stock buybacks, to encourage corporations to reinvest profits. The proposed tax rate is seen to generate an estimated $1.5 billion

[48] KfW. (2018). KfW Launches New EUR 200 Million Fund for Start-ups. Retrieved from https://www.kfw.de/About-KfW/Newsroom/Latest-News/Pressemitteilungen-Details_643072.html
[49] FedScoop. (2020). German government launches $1.2B fund to finance tech startups. Retrieved from https://fedscoop.com/german-government-launches-12b-fund-to-finance-tech-startups/
[50] Federal Ministry of Finance. (2021). Key points of the Financing for the Future Act. Retrieved from https://www.bundesfinanzministerium.de/Content/EN/Downloads/Financial-Markets/key-points-financing-for-the-future-act.pdf?__blob=publicationFile&v=2
[51] Ibid.
[52] Canada introduces investment tax credits for renewables. (2022, November 8). pv magazine. https://www.pv-magazine.com/2022/11/08/canada-introduces-investment-tax-credits-for-renewables/
[53] Scientific Research and Experimental Development (SR&ED) tax incentive program. (n.d.). PwC Canada. Retrieved March 16, 2023, from https://www.pwc.com/ca/en/services/tax/corporate-tax/sred.html
[54] Canada's Budget 2022: Taxes. (n.d.). Smart Prosperity Institute. Retrieved March 16, 2023, from https://institute.smartprosperity.ca/Budget2022Taxes

over the next five years.[55]

a. Provides a 50% corporate income tax cut for manufacturers of net-zero emission technologies
b. Provides 30% Canadian tax credit to investments in renewable energy generation and storage
c. Provides a a 15% non-refundable tax credit on qualified expenditures
d. Provides a refundable tax credit of up to 35% on eligible scientific research and experimental development (SR&ED) expenditures

H. Plan d'Epargne en Actions pour les Petites et Moyennes Entreprises (PEA-PME) 2014 of France

A government savings plan aimed at encouraging investment in SMEs and start-ups through tax incentivization of eligible investors. The plan has raised more than €700 million since its creation.[56] 5 years after its enactment, SMEs in France generated 55.8% of value added and 64.1% of employment, clashing by a hair with the EU averages of 56.4% and 66.6% respectively.[57] The report also states that the program has contributed to the creation of over 30,000 jobs in 4,000 supported SMEs.

a. Allows individual investment up to invest up to €225,000 in eligible
b. Provides dividends and capital gains tax exemption after a five-year holding period
c. Allows reduced rate of 22.5% before two years and 19% from two to five years for early withdrawals
d. Provides corporate tax credit reduction from 33.3% to 25%

I. Tax Deduction for Innovation (TDI) 2012 of the Netherlands

Another initiative designed to encourage innovation and active engagement in research and development (R&D) among Dutch companies.[58] Around 91% of R&D tax reliefs were claimed by SMEs in 2019. Netherlands has since been labeled to be a global leader in entrepreneurship with a "world-class" start-up ecosystem as Dutch start-ups founded between 2022 and 2030 are seen to contribute an estimated €250 billion to €400 billion market capitalization.[59]

a. Provides a tax deduction of up to 40% for SMEs for eligible research and development expenditures compared to large enterprises with 16%
b. Supports a separate tax incentive program called the Innovation Box, allowing companies to apply a reduced tax rate of 7% to profits from certain qualifying intellectual property and 9% corporate income tax from 25% over the profits

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[55] Valdmanis, R. (2022, November 3). Canada to set up tax credits for clean tech, launch growth fund. Reuters. https://www.reuters.com/business/cop/canada-set-up-tax-credits-clean-tech-launch-growth-fund-2022-11-03/
[56] Euronext. (2019). PEA-PME at a glance. Retrieved from https://www.euronext.com/sites/default/files/2019-04/pea-pme_at_a_glance_eng.pdf.
[57] French Craft Federation. (2022). The PEA-PME savings plan. Retrieved from https://infoartisanat.artisanat.fr/index.php?lvl=notice_display&id=37829.
[58] OECD. (2019). R&D tax incentive statistics in the Netherlands. Retrieved from https://www.oecd.org/sti/rd-tax-stats-netherlands.pdf.
[59] McKinsey & Company. (2017). Building a world-class Dutch start-up ecosystem. Retrieved from https://www.mckinsey.com/industries/technology-media-and-telecommunications/our-insights/building-a-world-class-dutch-start-up-ecosystem.

listed in the innovation box

c. Supports Venture Capital scheme which offers a tax break of up to 40% from taxable income from investments[60]

J. Angel Tax Credit of the United States

A tax incentive program administered at the state level with varying provisions by state. The program, with the goal of spurring innovation and creating more employment opportunities, provides tax credits to individuals and entities that invest in eligible early-stage companies or small businesses particularly developing new products or services in tech industries. to investors who invest in early-stage startups[61].

a. Provides a refundable tax credit in some states
b. Certain states such as Minnesota offers a tax credit of up to 25% of the amount invested capped at an annual maximum credit of $125,000 per investor
c. Provides a tax credit of up to 30% for investments in small businesses in designated rural or urban areas in certain states

K. Small Business Corporation Tax in South Korea

A tax incentive program targeted at supporting small and medium-sized enterprises (SMEs) in the country. Due to the complementing policies enacted, the total number of companies existing in Korea reached 6,644,000, with SMEs comprising 6,638,000. The successful growth in SMEs has resulted in the businesses accounting for 99.9% of all companies. Meanwhile, venture investment in 2020 recorded another all-time high of KRW 4.304.5 trillion, breaking the previous record of KRW 4.27 trillion in 2019 which were mainly put into investments in SMEs.[62]

a. Provides a reduced corporate income tax rate ranging from 10% to 17%, depending on the size and revenue of the business.
b. Supports relevant Angel Investment Tax Credit policy which provides individual investors in eligible SMEs a tax credit of up to 30% of their investment
c. Supports complementary Venture Investment Business Tax Credit policy which grants tax credit of up to 50% of an investment in eligible venture capital funds

L. Ökosoziales Steuerreformgesetz 2022 of Austria

Also known as the Eco-Social Tax Reform Act, this policy promotes investment in certain types of projects and assets, providing incentives to companies investing in new green technologies, infrastructure, and equipment.[63]

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[60] PwC. (n.d.). Netherlands - Tax credits and incentives. PwC's Global Tax Summaries. Retrieved March 13, 2023, from https://taxsummaries.pwc.com/netherlands/corporate/tax-credits-and-incentives
[61] Minnesota Department of Revenue. (n.d.). Angel investment tax credit. State of Minnesota. Retrieved March 13, 2023, from https://www.revenue.state.mn.us/angel-investment-tax-credit
[62] PwC. (2022). Taxes on corporate income in South Korea. Retrieved from https://taxsummaries.pwc.com/south-korea/corporate/taxes-on-corporate-income
[63] Orbatax. (2021). Austria enacts tax reforms, including investment incentives. Retrieved from https://www.orbitax.com/news/archive.php/Austria-Enacts-Tax-Reforms-Inc-49117

a. Provides a reduction in the corporate tax rate from 25% to 24% for 2023, and to 23% in 2024 with corresponding reductions in withholding income tax and real estate tax
b. Provides increased value threshold for the allowed write-off of low-value assets from €800 to €1,000
c. Provides reductions in individual income tax band rates and a reduction in the second band rate from 35% to 30%, with further reductions to 32.5% and a reduction in the third band rate from 42% to 40%

M. J-Startup Program 2018 of Japan

An initiative launched for the growth and development of high-potential start-ups in Japan in a bid to encourage innovation and entrepreneurship. This is through providing mentorship and networking, access to resources, marketing, and funding and investment opportunities. The program is overseen by the Ministry of Economy, Trade and Industry (METI), along with other government agencies such as the Japan External Trade Organization (JETRO) and the New Energy and Industrial Technology Development Organization (NEDO). It is also underpinned by various tax incentive policies.[64] As a result of these programs and policies, the start-up industry in Japan is nearing its "trillion-yen milestone", raising a record of JPY 877.4 billion in 2022, surpassing the previous record of JPY 850.8 billion set in 2021.[65]

a. Provides a tax credit rate of 20% or 30% for the total amount of R&D expenses for joint or contract research with universities and national research institutes
b. Provides capital investment tax cut of 15% to 25% special depreciation or 4% to 7% tax deduction on the acquisition value of specified business facilities
c. Provides reduced corporate tax rates of 9% for the first five years of operation, and 19% thereafter, of eligible start-ups from the standard corporate tax rate currently at 30%

N. Young Innovative Companies (YIC) 2012 program of Italy

A policy initiative supporting innovation among start-ups by providing access to financing, incentives, grants, and other forms of support.[66] It is underpinned by the Italian Start-Up Act of the same year.[67] The policies have encouraged early start-up growth in Italy, with over 10 000 registered startups operating in Italy in 2019.

a. Provides a 50% tax credit on research and development expenses and a 20% tax credit on investments made by private individuals
b. Provides a tax incentive of 20% fiscal deduction to equity investments up to a

[64] JETRO. (n.d.). Incentives and support programs in Japan. Retrieved from https://www.jetro.go.jp/en/invest/support_programs/incentive/#:~:text=Taxation%20measures%3A,special%20depreciation%2C%202%25%20tax%20deduction
[65] "Japan's startup funding 2022." Initial. Retrieved from https://initial.inc/articles/japan-startup-funding-2022-en
[66] "Report on Innovation Policy in the Western Balkans." Project FIRESPDF. Retrieved from https://projectfires.eu/wp-content/uploads/2017/09/D5-6-Deliverable_final.pdf
[67] "Executive Summary of the Digital Innovation Hub Mapping and Feasibility Study for the Western Balkans." Ministry of Economic Development Italy. Retrieved from https://www.mise.gov.it/images/stories/documenti/Executive%20summary%20ISA%2007_2019.pdf

maximum amount of € 1.8 million

c. Issues government-guaranteed bank loan fund to ensure up to 80 percent of the credit issued up to a total amount of € 2.5 million

O. Small Business Jobs Act 2010 of the United States

A policy with an incredible amount of provisions in the benefit of small businesses.[68] These include an extension of the Small Business Administration (SBA) recovery loan provision which has supported $30 billion in lending to over 70,000 small businesses. It also doubles the maximum loan size for the largest SBA programs from $2 million to $5 million, and provides a $30 billion small business lending fund in addition to the $15 billion in lending for innovative small businesses. Furthermore, the act includes a more important provision which includes eight new small business tax incentives which include the Qualified Small Business Stock (QSBS).

a. Provides a tax exclusion on capital gains on qualified stock for up to 100%
b. Increased expensing limit of $250,000 to $500,000
c. Provides an extension of 50% bonus depreciation
d. Allows carryback of tax credits offset for up to 5 years

V. Model Country

In view of the prevailing policy overviews, the researchers have determined it prudent to identify a country whose approach towards incentivizing investments in small and medium-sized enterprises (SMEs) and start-ups can serve as a beacon for the Philippines. With this in mind, the researchers have to select a prime candidate for emulation, a country with commendable strides in bolstering their SMEs and start-ups ecosystem.

Singapore stands out from this backdrop as a leading global hub for entrepreneurship and innovation. Its government has instituted a host of tax policies designed to incentivize investment in SMEs and start-ups, including tax exemptions and deductions, grants and loans, and angel investor networks. These measures have helped to attract a steady stream of domestic and foreign investment to the country, driving its impressive economic growth, rapid development, and modernization.

Hence, the researchers have decided to **choose Singapore as a model country** for the Philippines in enhancing the SMEs and start-ups sector. Singapore's tax incentives policies and initiatives, as enumerated below, show the potential to serve as valuable guideposts for Philippine policymakers and stakeholders seeking to stimulate investment and spur the growth of this critical sector.

A. **Startup SG Founder**

[68] "President Obama Signs Small Business Jobs Act: Learn What's in It." The White House, President Barack Obama. Retrieved from https://obamawhitehouse.archives.gov/blog/2010/09/27/president-obama-signs-small-business-jobs-act-learn-whats-it

A government-led initiative that provides support for first-time entrepreneurs, offering a range of benefits including access to mentorship, training, and funding.[69]

a. Equity financing of up to SGD 250,000 co-matching investment
b. Debt financing of up to SGD 500,000 co-sharing loan

B. **Enterprise Development Grant (EDG)**

A government-provided grant available to a wide range of industries particularly to help SMEs to grow and transform their businesses by funding projects that enhance the company's competitiveness.[70]

a. Up to 80% of qualifying project costs

C. **SGInnovate**

A government-owned organization that invests in and partners with deep technology startups, providing much needed funding, mentorship, and network support.[71]

a. Co-investment in early-stage deep tech startups in Singapore

D. **Tax Incentives for Start-Ups**

Tax incentives offered to start-ups that are engaged in innovation and research and development. In addition to tax deductions of up to 400% of qualifying R&D expenses, startups may also qualify for tax incentives such as the Pioneer Tax Incentive and the Development and Expansion Incentive.[72] [73]Here are some available incentives:

a. Tax Exemption Scheme for Start-ups (TESS)

   Eligible start-ups are exempt from paying taxes on the first SGD 100,000 of their chargeable income for the first three consecutive years of assessment. For the subsequent SGD 200,000 of chargeable income, a 50% exemption is given.

b. Productivity and Innovation Credit (PIC)

   Tax deductions or cash payouts to qualifying businesses that invest in productivity and innovation activities. Start-ups can become eligible for the scheme if they have made qualifying expenses in six areas: Research and Development, Automation Equipment, Training, Acquisition of Intellectual Property Rights,

[69] Infocomm Media Development Authority. (2022). Startup SG Founder. Retrieved from https://www.imda.gov.sg/disg/Programmes/2019/04/startup-sg-founder
[70] Enterprise Singapore. (n.d.). Enterprise Development Grant. Retrieved from https://www.enterprisesg.gov.sg/financial-assistance/grants/for-local-companies/enterprise-development-grant/overview
[71] SGInnovate. (n.d.). About Us. Retrieved from https://www.sginnovate.com/
[72] Asia Briefing. (2022). Tax Incentives for Businesses in Singapore. Retrieved from https://www.asiabriefing.com/countryguide/singapore/taxation-and-accounting/tax-incentives-for-businesses
[73] Acclime Singapore. (n.d.). Tax Incentives for Singapore Companies: A Guide. Retrieved from https://singapore.acclime.com/guides/tax-incentives/#:~:text=Tax%20Exemption%20Scheme%20for%20Startups,-The%20first%20type&text=If%20the%20startups%27%20first%20three,on%20the%20next%20SGD%20100%2C000.

Design, and Approved Software.

c. Equity Financing Incentive Scheme (EFIS)
Encourages start-ups to raise funds through equity financing, granting investors who provide funding to eligible start-ups a tax deduction of 250% on the amount of investment made.

d. Intellectual Property (IP) Development Incentive (IDI)

A tax incentive for businesses to develop and commercialize IP in Singapore, bestowing companies with a tax concession on their qualifying IP income.

e. Investment Allowance (IA)

A tax incentive that encourages businesses to invest in qualifying assets such as machinery and equipment through enabling tax allowance claim of up to 100% on the cost of qualifying assets.

f. Double Tax Deduction for Internationalization (DTDi)

A tax incentive with the goal of encouraging businesses expansion overseas by enabling a tax deduction claim for expenses incurred on qualifying activities that promote overseas expansion.

E. **Capital Gains Tax Exemption**

Offered capital gains tax exemption incentive for the disposal of shares in qualified companies granted to individuals who invest in approved start-ups

a. 0% tax on gains from sale of ordinary shares in a qualifying company, for the first three years from Year of Assessment 2020 to Year of Assessment 2025

F. **ACE Start-Up Grant**

Another government-led initiative that provides funding support, mentorship, and training programs to early-stage start-ups in Singapore.[74]

a. SGD 50,000 in equity co-investment from ACE Startups and partner investors

G. **SPRING SEEDS Capital**

Singapore's government-owned investment firm that provides equity financing to early-stage companies to accelerate their growth and scale.[75]

a. Up to SGD 250,000 co-matching grant for product development and market access

[74] "Tapping on Startup SG Founder Grant to Grow Your Startup." ACE. Retrieved from https://ace.org.sg/tapping-on-startup-sg-founder-grant-to-grow-your-startup/
[75] "Seeds Capital." Enterprise Singapore. Retrieved from https://www.enterprisesg.gov.sg/financial-assistance/investments/investments/seeds-capital/overview

VI. Recommendations for Tax Incentives Policy Reform

A. Recommendations

a. Capital Gains Tax Exemption

According to the Bureau of Internal Revenue (BIR), the capital gains tax rate is currently 15%. This policy proposes a **five-year period exemption from capital gains tax** to be provided to investors on the sale of shares in SMEs and start-ups. By doing so, investors would have the opportunity to buy and sell shares in these businesses without having to worry about additional tax burdens. The implementation of this policy anticipates the cost of the foregone tax revenue from exempting capital gains tax payments.

Considering the annual collection of individual capital gains tax released by the Bureau of Internal Revenue at Php 26.46 billion in 2021,[76] and the net placements in equity and investment of Non-Financial Corporations (NFCs) and Other Depository Corporations (ODCs) at Php 187.6 billion in 2019,[77] the country is seen to forego around Php 2.85 billion annually.

b. Dividend Income Tax Credit

It is also recommended that a tax credit be introduced for investors who receive dividend income from SMEs and start-ups. The tax credit should be equivalent to 20% of the dividend income received, up to a maximum of Php 500,000 ($10,000) per investor per year. The policy would substantially reduce tax burdens on investors and encourage reinvestment in these businesses. This policy would come at the expense of tax revenue estimated at around Php 1.6 billion per year, on account of Non-Financial Corporations (NFCs) and Other Depository Corporations (ODCs) at Php 187.6 billion in 2019 and Individual Income Tax collection in 2021 at Php 20.886 billion.

c. Interest Income Tax Exemption

A three-year tax exemption for interest income earned on loans to SMEs and start-ups is recommended to reduce the cost of borrowing for these businesses and incentivize investors to provide financing. Implementing this policy is projected to result in a loss of tax revenue amounting to approximately Php 3.74 billion per year, again given the Php 187.6 billion in net placements by Non-Financial Corporations (NFCs) and Other Depository Corporations (ODCs) in 2019, as well

[76] Bureau of Internal Revenue (2021). "BIR Annual Report 2021." Retrieved from https://www.bir.gov.ph/images/bir_files/annual_reports/annual_report_2021/BIR%20AR%202021.pdf
[77] Bangko Sentral ng Pilipinas (2019). "Philippine Flow of Funds Report 2019." Retrieved from https://www.bsp.gov.ph/Media_And_Research/Philippine%20Flow%20of%20Funds/FOFReport2019.pdf

as an the Php 20.886 billion in Individual Income Tax collection for 2021.

d. Platform-based Incentives

Introducing duly recognized platforms for investment allowing investors in SMEs and start-ups access to selected and limited investor tax incentives. The government can accomplish this by offering more options that extend beyond the traditional stock market exchanges, **such as equity crowdfunding,** which operates within federal regulatory frameworks while remaining to be a cutting-edge fintech platform. These would come at the expense of other percentage taxes amounting to Php 85.161 billion based on the 2021 collection of the Bureau of Internal Revenue, and would cost a foregone revenue of Php 1.2 billion.

B. Implications of Policies

The implications of these policies are clear, but in general, incentivizing investment in the economic growth engines of SMEs and start-ups can effectively contribute in addressing issues of unemployment and innovation stagnation in the country. **The projected cost (foregone tax revenue) of implementing these policies stands at around Php 10 billion per annum.** However, the potential benefits outweigh the cost, as providing tax incentives can become a long-term investment for the country in these sectors and industries. Through reduction or exemption in certain taxes, more domestic and foreign investors will be inclined to provide capital due to the appeal of a maximized return on investment.

The investors can then **reinvest their earnings** to other SMEs and start-ups to diversify their investments, further fueling the sector's growth. As a result, more and more investments will flow into SMEs and start-ups, allowing them to grow and expand more rapidly into becoming fully realized firms that can be subjected to standard corporate tax rates. In addition, **increased investments in SMEs and start-ups provides them with more resources and better capacity to compete with multinational companies,** thereby increasing market competition. Furthermore, the favorable tax incentive policies can also attract higher levels of investment and provide the Philippines with an edge in global investment competition, making it a preferable investment destination.

On the other hand, failing to provide such incentives could result in the Philippines losing to countries with better tax incentivization policies for investors, causing a significant stagnation in investment growth, ultimately leading to slow economic progress and inadequate job creation given the decline in economies around the world. **It is important to acknowledge that forgone tax revenue from providing tax incentivization to investors in the high potential sectors of SMEs and start-ups are translatable or convertible into cash flows of investments that significantly contribute to a country's Gross Domestic Product (GDP**). The loss may be a risky gamble, but it is a crucial and profitable one that has been trusted by various developed economies to yield absolute gains.

VIII. Evaluation

To measure the success of these policies, the government may track progress, efficacy, and profitability through the following:

A. **Key Performance Indicators (KPIs)**

a. **Annual no. of SMEs and start-ups established**
Measures the number of new SMEs and start-ups established in the Philippines annually from the date of implementation. An increase in the number of newly established SMEs and start-ups indicates that tax policies are effectively working at attracting investment and encouraging entrepreneurship.

b. **Amount of Investment Attracted by Businesses**

Measures the amount of investment into SMEs and start-ups in the Philippines per year from the date of inception. A higher level of investment threshold is an indication that the implemented tax policies appeal to investors and are effective in boosting economic activity.

c. **Number of People Employed**

Measures the number of people employed in SMEs and start-ups or the number of jobs created by these businesses from the date of enactment of provisions. An increase in the number of workers indicates higher employment rate and high efficacy of provisions in terms of job creation.

d. **Revenue Generated**

Measures the revenue growth or income generated throughout the year upon the enactment of the provisions. A higher revenue growth rate indicates successful policy implementation and positive effect of provisions on the incomes of SME and start-up businesses.

e. **Amount of Tax Claimed Under the Provision**

Measures losses and gains, with the cost of the tax incentives claimed being translated into a certain amount of investment attracted by the provision. number of investments. This can be achieved through the collaboration between government agencies and private sector stakeholders. Government agencies will primarily provide this valuable data on job creation, revenue growth, and investment, while the private sector can back this information with their respective data.

f. Level of Innovation

Considering the level of innovation demonstrated by SMEs and start-ups upon inception of provisions, such as their ability to develop new products or services that meet market demands. These innovation metrics, provided by government agencies and stakeholders include the number of patents filed or the development of new products. A higher level indicates that policies are working to spur innovation through allowing greater influx of funding to cause a significant impact on the growth potential of these businesses.

B. Progress Tracking

a. Data Collection from Government Agencies

Refers to valuable data provided or collected from government agencies and institutions such as recorded figures or methods to track key progress indicators accurately. These data include productivity reports, surveys, researches, statistics, global and regional economic trends, and other studies made by federal agencies on the sector and the investment environment.

b. Performance metric data from SMEs and start-ups

Refers to data collected by SMEs and start-ups, including performance metrics and feedback on the effectiveness of the policies to their businesses. The feedback provided shall help identify gaps and challenges that may hinder the growth of SMEs and start-ups, and may be useful in policymaking.

C. Qualitative Analysis

a. Surveys
Refer to surveys conducted on SME and start-up business owners, employees, investors in private companies, and other key stakeholders.

b. Interviews
Refer to interviews from SME or start-up business owners, private equity investors, venture capitalists, federal officials, financial institutions, key economic figures, and financial experts.

c. Case Studies
Refer to studies made on relevant market phenomena, the current business and investment environment, the start-up and SME ecosystem, as well as significant global events.

d. Stakeholder Feedback

Refers to opinions, comments, suggestions, and criticisms provided by individuals, academics, communities, advocacy groups, and regulators among others, with a vested interest in enhancing the sectors of SMEs and start-ups, attracting investments, and facilitating economic growth and development in the Philippines.

IX. Conclusion

There is a keen preference in the country for foreign direct investments in driving economic growth and actualizing development. However, current development frameworks are no longer viable, as dependence on foreign direct investment and specializing in export-led manufacturing have proven to be unsustainable in the long term.[78] Economic diversification has become the zeitgeist, and as such, the Philippines must explore options that do not rely on FDIs, but instead support its local small and medium sized enterprises (SMEs) and startups while adhering to the vision of the National Economic and Development Authority (NEDA).

The recent policies implemented are generally sound for SMEs and startups, but there is a significant lack of tax incentives for investors. Direct support for SMEs and start-ups have to be undergirded by incentivization of investments, as they are interrelated. Having these additional provisions would give start-ups and SMEs its much needed reinforcement.

Disclaimer: The figures provided above are projected estimates based on current data trends, which are added solely for informational purposes and to illustrate the potential policy implications. The data herein should not be relied upon as accurate representations of actual financial or economic data. Significant research is needed along with authentic data from financial institutions, economic experts, and government agencies prior to making any decisions based on this information. We waive all liability for any inaccuracies or omissions in the data presented here.

[78] Lowy Institute. "Does Southeast Asia Need a New Development Model?" accessed March 6, 2023, https://interactives.lowyinstitute.org/features/southeast-asia-economy/

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