LANDBANK exploring financing deal for New Clark City gov't facilities

THE Land Bank of the Philippines (LANDBANK) and the New Clark Government Center Corp. (NGCC) are exploring a financing deal to support the construction of new government buildings in New Clark City in Tarlac.

LANDBANK said that NGCC is sounding out institutions willing to support the MTD Group's upcoming projects, which include facilities for the National Bureau of Investigation.

NGCC is a special-purpose company created for the development of New Clark City. The company is an arm of the MTD Group.

In a statement, the state-run bank said that this initiative would "support the National Government's plan to decongest Metro Manila."

Since 2015, LANDBANK has helped finance the MTD Group's infrastructure projects in Central Luzon.

These include the Palayan Government Center and Business Hub in Nueva Ecija, and the Bataan Government Center and Central Business Hub in Bataan.

The project in Nueva Ecija includes a five-storey government building for national and regional government offices, two six-storey buildings for business process outsourcing offices and commercial areas, and a six-storey business hotel with an adjoining two-storey commercial and retail complex.

Meanwhile, the project in Bataan serves as a one-stop shop for various government services, providing greater convenience to the constituents of the province. — **Luisa Maria Jacinta C. Jocson**

Investigation looms after six power plants declare outages

THE Department of Energy (DoE) called on the Energy Regulatory Commission to investigate the forced outages or limited production at six power plants which caused yellow alerts, and, briefly, a red alert, to be raised over the Luzon grid on Monday.

On Monday, the National Grid Corp. of the Philippines (NGCP) twice placed the Luzon grid on yellow alert after outages removed 2,648 megawatts (MW) worth of supply from the grid.

The DoE said that power plants that went on forced outages were Calaca 2 and Sta. Rita Module 20 in Batangas; GNPower Mariveles 1 in Bataan; Sual 1 in Pangasinan; Masinloc 3 in Zambales; and San Buenaventura in Quezon.

"We anticipate that the Energy Regulatory Commission will also look into the root of this to prevent similar occurrence," the DoE said in a statement.

In an advisory, the NGCP declared a yellow alert for the 10 a.m. to 5 p.m. period and again for the 6 p.m. to 9 p.m. period. The grid operator said that the capacity available on Monday was 11,750 MW, against peak demand of about 10,437 MW.

The NGCP initially declared a red alert for the 5 p.m. to 6 p.m. period but withdrew it at 11:30 a.m. after Sual 1 and Masinloc 3 came back online.

Yellow alerts are declared when supply available to the grid falls below a designated safety threshold. If the supply-demand balance deteriorates to below an adequate supply of power, a red alert is declared, warning consumers of rolling brownouts.

"We assure the public that there appears to be no fuel constraints. Some of these generating plants are on forced outage caused by power plant tripping," Energy Secretary Raphael P.M. Lotilla said.

Manila Electric Co. (Meralco) said it put interruptible load program (ILP) participants on standby for possible activation after the NGCP alert.

ILP participants are large power users that have their own generating facilities. These entities stop drawing power from the grid for a time, tapping their own power plants for their needs, reducing the overall load on the grid.

"As of 11:30 a.m., we had 346.40 MW of committed de-loading capacity under the ILP," Meralco said in a statement.

Meralco said that it currently monitoring the situation and is ready to implement manual load dropping or rotating power interruptions if instructed by NGCP. — **Ashley Erika O. Jose**

Romualdez files bill creating sovereign wealth fund

SPEAKER Ferdinand Martin G. Romualdez has filed a bill that, if passed, would create a sovereign wealth fund to be seeded by the major pension funds and government banks.

House Bill 6398, filed on Monday, seeks to establish the so-called Maharlika Investments Fund (MIF), which will "optimize investment allocation" by the Government Service Insurance System, Social Security System, Land Bank of the Philippines, and Development Bank of the Philippines.

The MIF will also ensure that "resources are efficiently channeled to investments that will provide the most value not only to the participating GFIs (government financial institutions), but also to the country."

Mr. Romualdez described the MIF as a "sovereign wealth fund," which is typically funded by a government's oil or other commodity export revenue or excess foreign exchange reserves.

He said the MIF's investment allocation policy will seek to align itself with President Ferdinand R. Marcos, Jr.'s Agenda for Prosperity and the eight-point socioeconomic roadmap.

Mr. Romualdez cited as a model the Indonesian fund, which invested in airports, supply chains, logistics, digital infrastructure, the green economy, healthcare services, the financial sector, technology, and tourism.

"The MIF will have a governing board, composed of nominees of contributing GFIs, which would be in charge of managing the fund. It will also have two independent directors."

Mr. Romualdez said that the MIF will adhere to the Santiago Principles, a list of best practices for sovereign wealth funds.

Co-authors of the bill are Majority Leader Manuel Jose M. Dalipe, Senior Deputy Majority Leader Ferdinand Alexander A. Marcos, Marikina Rep. Stella Luz A. Quimbo, and Tingog Party-list Representatives Yedda Marie K. Romualdez and Jude A. Acidre. — **Alyssa Nicole O. Tan**

Tablet demand drops as physical classes resume

THE return of face-to-face classes dampened demand for tablets in the Philippines in the third quarter, according to the International Data Corp. (IDC).

"The Philippines tablet market declined 11.6% quarter on quarter in the third quarter, and was almost flat compared to last year," the market intelligence company said in a report issued on Nov. 27.

The education market has been the primary driver of tablet sales in the Philippines since schools resorted to blended learning during the pandemic.

"But (the sale of tablets for school use) declined by 47.8% quarter on quarter and 42.4% year on year as more schools, both public and private, returned to physical classes as part of the Department of Education's expansion of face-to-face classes," IDC Philippines Market Analyst Angela Jenny V. Medez noted.

With public schools reverting to physical classes beginning November, and the looming global economic slowdown, the IDC expects the tablet market to decline in 2023.

"Even though more Chinese vendors have turned up in the tablet space and sparked competition, we don't expect them to offset the slowdown of the overall tablet market," Ms. Medez added.

The top five tablet brands in the Philippines in the third quarter were Samsung with a 43.5% market share, realme (13.9%), Cherry Mobile (11.2%), Huawei (8.6%), and Lenovo (6.4%).

Samsung "more than doubled its shipments compared to the previous quarter and grew 37.7% year on year," the IDC said.

"This was driven by its top-selling Galaxy Tab A7 Lite model that accounted for almost 80% of its shipments," it added.

The market intelligence company previously reported that smartphone shipments to the Philippines also fell in the third quarter as a result of inflation and recent typhoons.

Smartphone shipments declined by 8% quarter on quarter and 6.8% year on year, with 3.9 million units shipping in the third quarter, the IDC said.

Recent typhoons and inflation hurt both consumers and vendors, according to the market intelligence company.

"Vendors took a more conservative approach by clearing inventories, maintaining prices of existing models, and sustaining momentum by bringing in more affordable smartphones," Ms. Medez noted.

Inflation accelerated to 7.7% in October, the highest in nearly 14 years. — **Arjay L. Balinbin**

ADB touts microfinance role in building resilience vs climate change

MICROFINANCE institutions (MFIs) should be tapped in helping build resilience against climate change, especially for poorer and more vulnerable communities, according to the Asian Development Bank (ADB).

"Economic development supporting small- and medium-sized enterprises contributes to the resilience of the poor and vulnerable, including in urban areas," the ADB said in a report.

"Building resilience against the impacts of climate change and geophysical shocks is critical for economic development and poverty reduction," it added.

The world faces increasing flooding events; more frequent and longer heat waves; and stronger tropical cyclones, the ADB said.

The world's extremely poor population is expected to rise to 132 million by 2030 due to the pandemic and climate change, according to the report. — **Luisa Maria Jacinta C. Jocson**

FULL STORY

Read the full story by scanning the QR code with your smartphone <bit.ly/ADB112922>

OPINION

Understanding transfer pricing methodologies

LET'S TALK TAX
ARIANNE CYRIL L. MANDAC-VILLARAMA

In our previous articles on transfer pricing (TP), we have discussed the functions, assets, and risks (FAR) analysis, entity characterization, and industry analysis. This time, we will talk about the different transfer pricing methodologies.

The Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines provide five methodologies that are widely used and accepted by almost all tax authorities in determining transfer prices. These include three traditional transaction methods — comparable uncontrolled price (CUP) method, resale price method (RPM), and cost-plus method (CPM); and two transactional profit methods — transactional net margin method (TNMM) and profit split method (PSM).

These have been adopted by the Bureau of Internal Revenue (BIR). To better understand them, we will discuss broadly each of the five TP methods with some sample illustrations.

1. CUP METHOD

The CUP method compares the price and conditions of products or services in a controlled transaction (i.e., between related parties) with those of an uncontrolled transaction (i.e., between unrelated parties). In applying the CUP method, comparable data between controlled and uncontrolled transactions are required which must be highly similar in order for prices to be considered comparable.

Since this method compares extremely similar products or services, it is considered the most effective and most reliable way of determining the arm's-length price for controlled transactions. However, due to the high standards of comparability required in applying the CUP method, it is usually a challenge to identify a transaction that is appropriately comparable to the controlled transaction.

The CUP method can be applied in two ways — the internal CUP and external CUP. Internal CUP is applicable in case the company transacts comparable transactions with related and unrelated parties. On the other hand, external CUP uses comparable data of transactions entered into between two unrelated third parties. Between the two, external CUP is more difficult to apply due to the usual lack of publicly available data on comparable third-party transactions.

Below is an example of how the internal CUP method is applied.

Company A, which is engaged in the lease of commercial space, needs to determine how much rent it should charge Company B, an affiliate, for the lease of a commercial unit in one of the buildings owned by the former. Let's say Company A leases some commercial space in the same building to third-party lessees. In applying internal CUP, Company A must ascertain that all lease arrangements made with the third-party lessees are sufficiently comparable with the terms and conditions of the lease to Company B (e.g., leased area, payment terms, liability provisions, etc.) in order for Company A to apply the same rent charged to independent third-party lessees to Company B."

2. RPM

RPM evaluates whether the amount charged in a controlled transaction is at arm's length by reference to the gross margin realized in a comparable uncontrolled transaction. It uses the selling price of a product or service, or the resale price, from which an appropriate gross profit is subtracted.

The usefulness of this method largely depends on how much added value or alteration the reseller has performed on the product before it is resold, or the time that has lapsed between purchase and onward sale. The greater the value added by the reseller, to the extent that market conditions might have changed before it is resold, the more difficult to use RPM to arrive at the arm's length price.

Example:

Company C is a distributor of an energy drink manufactured by its parent company in Thailand. The product is being resold by Company C to consumers at P34 per 350ml bottle. Assuming comparable independent distributors earn margins of 5%, the arm's length transfer price that the parent company may charge Company C is computed below.

Resale price/	
Third-party sale price	P 34.00
Less: Resale price margin — 5%	1.70
Transfer price	P 32.30

3. CPM

Under CPM, the arm's length price is arrived at by adding an appropriate gross profit to the overall cost (direct and indirect) of producing the goods or services involved in the controlled transaction. This method calls for a very high level of similarity in the functions being performed by the comparable companies. Therefore, if the comparison is not apples-to-apples, the results will not be reliable. As is the case for all transactional methods, the challenge in using CPM is the availability of comparable data and consistency in the accounting methods.

Here is an example of the application of CPM.

Company D provides engineering design services to its Japan-based parent company which is in the construction industry. In determining the appropriate markup (gross cost plus) for the services provided to the Japan affiliate, Company D may use the markup applied for its similar comparable transactions with third parties, provided the costs incurred are substantially the same for both services provided. If no comparable third-party transactions of Company D are available, then independent companies engaged in similar activity with Company D can be identified and can apply those comparable companies' markup to the transactions with the Japan-based related party.

4. TNMM

Instead of testing and comparing the transfer price, TNMM compares the net margins, relative to an appropriate base such as costs, sales, or assets, attained by an entity from a controlled transaction as against those attained by comparable independent companies involved in similar transactions such that if the level of net margin of the related party is comparable with those independent companies, then the transfer price is carried at arm's length.

This method is based on the concept that similar firms operating in the same industry would tend to yield similar returns over time. TNMM is the most broadly applicable transfer pricing methodology and commonly used due to its fairly easy implementation which only requires financial data.

Below is an illustration of TNMM.

Company E is a Philippine subsidiary of a US business process outsourcing (BPO) company. The parent company engages Company E to provide BPO services to its clients.

To determine how much profit Company E should earn for its BPO operations, comparable companies engaged in the same business activity in the Philippines are identified. Using the independent comparable companies' profit margins before tax, a range of profit margins is computed which can be referred to as the arm's length range of net profit. As such, Company E may then charge service fees to the parent company allowing Company E to earn a level of net profit within the arm's length range.

5. PSM

Affiliated entities normally enter into closely interrelated transactions, so that they cannot be observed independently from each other. This typically is the case when unique intangibles are involved or where multiple controlled transactions happen at the same time.

Normally, the affiliated entities would agree to split the profits. Thus, in the profit split method, the operating profits or losses from controlled transactions are allocated in proportion to the relative contributions made by each party in creating the combined profits or losses. The terms and conditions of interconnected related party transactions are evaluated to determine how profits would be divided in case similar transactions are entered into between unrelated parties.

Below is an example of the application of profit split method.

Company F is an Australia-based intangible holding company that provides patents to a related manufacturing Company G in Malaysia. Company G sells its entire production to a related marketing company H. Assuming there are no significant marketing intangibles (trademarks, etc.), the determination of arm's length price for royalties to be charged by Company F to Company G would be as follows:

1. Determine the optimum profits that should be earned by Company G on the basis of the profits of comparable companies (i.e., engaged in manufacturing).

2. Determine the optimum profits that should be earned by Company H on the basis of the profits of comparable companies (i.e., engaged in marketing).

3. Aggregate the entire actual profits of the group (F, G, and H).

4. From such aggregate profits, the optimum profits attributable to activities of Company G and H as determined in the previous steps are deducted.

5. The balance profits would be the value of intangibles held by F and would indicate the optimum level of royalty to be paid by G.

TAKEAWAY

The Philippine transfer pricing rules do not prefer any particular methodology. The tax authority only requires that the method used provides the most reliable measure of an arm's length result. It is, therefore, crucial in preparing transfer pricing documentation that taxpayers are well informed of the different methodologies and on how and when they are applicable in order to arrive at justifiable transfer prices that comply with the arm's length principle.

Stay tuned for our next month's article as we continue to take you through the other components of transfer pricing documentation.

Let's Talk Tax is a weekly newspaper column of P&A Grant Thornton that aims to keep the public informed of various developments in taxation. This article is not intended to be a substitute for competent professional advice.

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