‘Keen’ European interest in shipping after foreign ownership cap removed

By Alyssa Nicole O. Tan
Reporter

THE SHIPPING and telecommunications industry are likely to receive increased European investment following the passage of a law that removes the 40% foreign equity cap in various industries, according to the European Chamber of Commerce (ECCP).

Republic Act 11647, which amends the 85-year-old Public Service Act, now allows 100% foreign ownership in airports and airlines, subways and railways, telecommunications, domestic shipping, and tollways and expressways after these industries were excluded from the definition of public utility.

ECCP President Lars Wittig told *BusinessWorld* in a video call that "when it comes to shipping, we already know that the interest is keen, actually, I will say extreme."

Despite the "abnormally high" freight rates in the Philippines, Mr. Wittig said some of the largest international shipping companies still had access to domestic freight.

Freight charges have already gone up by an average of 25% this year, reflecting the impact of higher oil prices.

In the year to date, fuel prices have risen by a net P13.95 per liter for gasoline, P27.50 for diesel, and P20.80 for kerosene.

The presence of foreign companies here is a token of their enthusiasm, Mr. Wittig said, "because they had to go through a lot of challenges in order to get the advantages that they already had before the Public Service Act was signed."

This was possible because of their size, as well as decades of operations which allowed them to find ways to work around obstacles. However, Mr. Wittig said that it was still better to have an open market.

"We want everybody, without any limitation, to be able to do it, not just the biggest because they have the money to find a way," he said.

"It has to be equal, fair, even playing field for everybody — foreign and local alike, not just a few foreign and all the locals," he added.

Mr. Wittig said foreign interest in telecommunications was apparent from the 2018 bid to become the third player in the telecommunications industry.

Dito Telecommunity Corp., formerly known as Mindanao Islamic Telephone Company, Inc. (Mislatel), won after the two other contenders were disqualified. The consortium was granted a certificate of public convenience and necessity, as well as six radio frequency bands.

"There were multiple European telco providers that came here... but none of them won the tender, also because many of them didn't even submit their proposal. Why? Because of the 40% ownership cap," he said.

"Forty percent into something like telco is a massive investment, but it's not enough ownership to control your own destiny. And therefore, that was won by the Chinese," he added, referring to Dito's Chinese investor, China Telecom.

Now that the Public Service Act has been passed, European telecommunications companies have indicated renewed interest, he said.

"They are very eager to return now and give it another try, and they will be dead serious about it. I guarantee you," Mr. Wittig said..

"I also believe personally they will succeed in doing this," he added.

The law "basically eliminates the Chinese providers," Mr. Wittig said, referring to a provision that prohibits foreign state-owned enterprises from investing in any public service classified as a public utility or critical infrastructure.

"The Public Service Act, that which is really about national security, will allow the country to be equally safe in case of war," he added.

The Philippines, however, will have to ensure acceptable implementing rules and regulations are in place to make the most out of the newly passed law, he said.

"We need to advance the current movements in the legal system by changing the implementation of rules and regulations on foreign ownership," he said, noting that it is the country's constitution that "prevents foreign companies from eroding resources for their gain in the Philippines."


SINCERELY MEDIA-UNSPLASH

Onion crisis blamed on DA forecasting failures

THE ONION shortage has been blamed on the failure of the Department of Agriculture (DA) to adequately project supply and demand for the commodity, resulting in a delay in turning to imports.

Danilo V. Fausto, president of the Philippine Chamber of Agriculture and Food, Inc. (PCAFI), told reporters recently: "We failed to import, so that is why we are short of supply. Naturally, there was a transfer of leadership so maybe they did not notice that."

Mr. Fausto said that during holidays, demand spikes for many commodities, which should have been anticipated and planned for.

"During Christmas season the demand doubles, sometimes triples because of... celebrations and parties left and right. That's the time that you have to really prepare for, and you prepare for it for a year," he said.

Mr. Fausto said that this year, the shortage is estimated at about 40,000 to 50,000 metric tons. He added imports should have ordered in July and August to meet current demand.

"We did not import. Naturally, the supply is low and that is why the prices go up. There is no such thing as hoarding of onions," he said.

Mr. Fausto added that onions tend have a short shelf life. "if you keep onions in cold storage for long, you cannot sell it, simply because of the nature of the product."

The DA has cited hoarding as a possible cause for high prices.

Mr. Fausto also warned that "farmers are now planting onions because of the price, and it will take three months to harvest."

He expects a bumper harvest by April, which the government must prepare for with more cold storage.

"If the government will not put up (cold storage), by April we will be throwing onions away," Mr. Fausto said. — **Ashley Erika O. Jose**

Services, BPOs, semiconductors to remain growth drivers in 2023

THE SERVICES, business process outsourcing (BPO), semiconductor, and infrastructure industries are expected to be the growth drivers for the economy next year, analysts said.

"The crucial sector will be services. Digital technology has made it possible to realize economies of scale in services since face-to-face transactions are no longer necessary," Ateneo de Manila University Economics Professor Leonardo A. Lanzona said in an email.

"Trade in services especially with the numerous college graduates, is feasible as long as we improve our internet infrastructure. This can include professional services such as accountancy, advertising and computer services. Educational and health services may also be viable," he said.

"Services with the new technology can blur distinctions between sectors since services can enhance industry and agriculture by reducing transaction costs between buyers and sellers. We cannot ignore industry since this will absorb relatively unskilled labor," he added.

In the third quarter, services grew 9.1%, the most of any sector. It also had the biggest contribution to gross domestic product (GDP) growth.

Terry L. Ridon, a public investment analyst and convenor of think tank InfraWatch PH, said that the semiconductor and BPO industries are also key growth areas.

"The semiconductor and BPO sectors remain our best bet in driving high-value economic growth, and the Marcos government should find ways to further raise incentives and cut costs in these sectors," he said in an email.

"The country is at a good spot in developing the semiconductor business given the new chips ban on China. Government should be agile in convincing US chipmakers to transfer their factories here instead of our other ASEAN neighbors," he added.

Last year, the Semiconductor and Electronics Industries in the Philippines Foundation, Inc. (SEIPI) exceeded its 10% growth target. — **Luisa Maria Jacinta C. Jocson**

FULL STORY

Read the full story by scanning the QR code with your smartphone or by typing the link **<bit.ly/Services122722>**

PHL rated 17th in global manufacturing risk index

THE PHILIPPINES placed 17th out of 45 countries in Cushman and Wakefield's manufacturing risk index (MRI), indicating further room for improvement in making manufacturing more attractive to investors.

The ranking was the outcome of the firm's "baseline" scenario. The Philippines did much better in a scenario weighted towards cost (ninth) and much worse when risk was the main consideration (33rd).

The cost scenario scores countries higher for low operating costs, while the risk scenario favors countries presenting lower levels of economic and political risk.

"While the Philippines has continued to move up in the ranking of countries in the MRI index, there are several factors that will strengthen the attractiveness of the country as a manufacturing destination," Cushman and Wakefield said in a statement.

A year earlier, the Philippine ranking on the baseline scenario was 28th.

Cushman and Wakefield, a real estate services consultancy, said structural reform is needed to unlock the manufacturing industry.

"While the Philippines maintains strong and growing domestic consumer markets, the country is also beset by lack of qualified labor (i.e., new skills given advancements in technology), aging infrastructure networks and facilities, low commitment on renewable energy sources and still opaque level of business transparency," it added.

"Overall, the Philippines needs to clearly demonstrate its strength and arrest the weaknesses by dismantling the barriers that make it less competitive in any of the aforementioned factors," the firm said.

The MRI assesses the most suitable locations for global manufacturing among 45 countries in Europe, the Middle East and Africa (EMEA), the Americas and Asia-Pacific (APAC).

China placed first in all three scenarios, with half of the top 12 countries in the cost scenario being from the Asia-Pacific.

"Asian markets have dominated an annual study ranking top manufacturing destinations according to baseline, cost and risk scenarios, holding the most top quartile rankings of any region across each of the scenarios," Cushman and Wakefield said.

The report also noted that emerging Asia Pacific markets continue to benefit from expanding labor pools as unemployment rates continue to fall. — **Aaron Michael C. Sy**

OPINION

The concept of profit level indicator in TPD

LET'S TALK TAX
PAUL VINCES C. LEORNA

Another year is dawning, and the countdown has begun. As we take the first step in faith towards the new year, we hope everyone can reflect and truly say that it was indeed a year of intense growth. Since I am a believer that the new year is neither an end nor a beginning, I wish to take everyone back and to the Let's Talk Transfer Pricing (TP) articles that we published throughout the year so we may welcome 2023 with proper guidance.

To name a few, we started 2022 with our first article entitled "Are your related party transactions at arm's length?" followed by other monthly installments such as "Transfer pricing policies are a must-have," "How FAR are you in transfer pricing documentation?," "Fundamentals of entity characterization in TPD," "What's #TRENDING? Understanding and documenting industry analysis," and most recently "Understanding transfer pricing methodologies".

Before 2022 ends, our last Let's Talk TP article of the year deals with the concept of profit level indicator (PLI) in transfer pricing documentation (TPD) as discussed in Revenue Regulations (RR) No. 2-2013 and Revenue Audit Memorandum Order (RAMO) No. 1-2019.

WHAT IS PLI?

PLI is the ratio of net profit to an appropriate base (e.g., sales, costs incurred, assets employed). It measures the relationship between the net profit and the appropriate base.

Examples of PLI are return on sales (gross margin or operating margin), return on costs, and return on capital.

WHERE IS PLI USED IN TPD?

The discussion and selection of an appropriate PLI is presented in the "Application of the transfer pricing method" or "Benchmarking" section of the TPD.

In applying the transfer pricing method, consideration must be given to the choice of PLI. The use of an appropriate PLI ensures better accuracy in the determination of the arm's length price of a related party transaction.

The Resale Price Method (RPM), Cost Plus Method (CPM) and Transactional Net Margin Method (TNMM) are the transfer pricing methods that use PLI to determine whether the related party transaction involved is carried out at arm's length.

HOW DO WE SELECT AN APPROPRIATE PLI?

The selection of an appropriate PLI depends on the facts and circumstances of the related party transaction involved. Factors to consider include but are not limited to: (1) characterization of business; (2) availability of comparable data; and (3) the extent to which the PLI is likely to produce a reliable measure of arm's length profit.

In determining the numerator and denominator of the PLI, taxpayers should bear the following principles in mind: (a) only those items that are directly or indirectly related to the related party transaction involved and are of an operating nature should be considered; and (b) items that are not similar to the independent party transaction being compared should be excluded.

Further, the determination of the denominator used in PLI is done by considering the company's profit drivers and their independence from the denominator that is used. Other factors that need to be considered in selecting the PLI are the type of business and the availability of data.

WHAT ARE THE GENERALLY USED PLIS?

While PLI differs from case to case depending on the characterization of the business, among others, presented below are the generally used PLIs.

Business characterization is important because by determining the accurate characteristics of the entity's business, the expected level of price or return by the entity can be known and the selection of reliable comparable can be made.

TP Method	PLI	Formula	Business Character
RPM	Gross margin	Gross profit / sales	Distributor
CPM	Gross cost-plus margin	Gross profit / direct & indirect cost of production	Manufacturer
TNMM	Net mark up or full cost plus (return on total cost)	Operating profit / total cost	Manufacturer and service provider
TNMM	Operating Margin	Operating profit / net sales or net turnover	Manufacturer and distributor
TNMM	Return on Assets	Operating profit / operating assets	Manufacturer
TNMM	Return on Capital Employed	Operating profit / capital employed	Manufacturer

HOW IS PLI APPLIED?

A benchmarking study or comparable analysis is conducted to find comparable independent transactions or companies to verify the arm's length nature of the related party transactions under evaluation.

a. Search for comparable

In searching for comparable independent transactions or companies, it is advisable to consult commercial databases to generate reliable comparables. The data obtained from commercial database only leads you to a set of candidate comparables. Candidate comparables must be subjected to a manual selection process (i.e., General and Financial Review) mentioned in RAMO No. 1-2019 to be able to arrive at the final comparable.

a. Use of multi-year data

Then, the chosen appropriate PLI of the final comparable is computed. Multi-year PLI data (usually three years) rather than single-year data improves the reliability of the analysis. The inclusion of numerous years makes it easier to pinpoint variables that may have influenced or should have influenced transfer prices, like long-term arrangements and business or product life cycles, which may also need to be considered when determining comparability. Further, the use of multi-year data can help neutralize the impact of extreme data points, like abnormally high profits or abnormal losses, while at the same time ensuring that the arm's length range/ price is representative of the data points identified.

a. Use of interquartile range

In some cases, it will be possible to apply the arm's length principle to arrive at a single figure of PLI that is the most reliable to establish whether the conditions of a transaction are at arm's length. However, because transfer pricing is not an exact science, there will be many occasions when the application of the most appropriate method produces a range of figures all of which are equally reliable. This is often the case in practice where the comparable is extracted from a commercial database. In such cases, if the range includes many observations, statistical tools that account for a central tendency to narrow the range (e.g., the interquartile range or other percentiles) might help enhance the reliability of the analysis.

a. Benchmarking

The PLI of the tested party or related party transaction involved is compared with the interquartile range of PLIs of the comparable.

If the PLI of the tested party is within the arm's length range, the related party transaction is carried out at arm's length basis. Hence, no adjustments are likely to be made by the tax authority in case of audit.

However, if the PLI of the tested party falls outside the arm's length range, the tested party must be able to present justifiable commercial reasons that the conditions of the related party transaction satisfy the arm's length principle. If the tested party is unable to establish this fact, the related party transaction is deemed not to have been carried out at arm's length basis. Hence, the tax authority will make adjustments and determine the point within the arm's length range to which it will adjust the conditions of the related party transaction.

TAKEAWAY

Much like how life is about the choices we make and how the direction of our lives comes down to the choices we take, the use of an appropriate PLI grants taxpayers relief from questioning by tax authorities. Good life choices help us build healthy relationships and reliable PLI ensures better accuracy in the determination of the arm's length price of a controlled transaction. As we welcome the new year, may we all start doing our best to make decisions that matter, both in life and in choosing the appropriate PLI.

Happy new year and we hope everyone makes the conscious choice of staying tuned in for next month's Let's Talk TP article as we walk you through the remaining concepts of transfer pricing.

Let's Talk TP is an offshoot of Let's Talk Tax, 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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