Mindanao seen least affected by El Niño, NIA says

THE National Irrigation Administration (NIA) said on Monday that the priority areas for additional irrigation with the onset of the El Niño dry spell will be mostly in Luzon and the Visayas, leaving Mindanao largely unaffected.

At a Laging Handa briefing, NIA Acting Administrator Eduardo M. Gullen said: "As of now, there are only a few standing crops as everyone has already reaped but for the next (rainy-season) cropping, slight rainfall is expected because of El Niño," he said.

Citing the government weather service, known as PAGASA (Philippine Atmospheric, Geophysical and Astronomical Services Administration), he said irrigated land in Mindanao region are unlikely to be affected by El Niño.

Mr. Gullen said the augmentation of irrigation resources will include resort to a field-flooding technique that farmers can turn to to reduce overall water use.

He proposed the supply of additional inputs to farmers of high-value crops, in coordination with the Department of Agriculture, in areas that will have no access to water.

"*Ang isang* system *din ng* NIA *dyan ay magtanim ng* high yielding varieties like *mga* hybrid *kasi* times two *ang mga* output *diyan*, so *para ang kakulangan natin sa bigas* at least *mabigyan pa rin natin* (Another measure NIA recommends is the planting of high-yielding hybrid varieties, which can bring about double the usual output. Whatever shortage in rice production can thus be mitigated)," he said.

According to NIA, its coverage is 65.28% of the 3.12 million hectares of irrigable land, with 1 million hectares considered underdeveloped.

Last month, NIA partnered with the Public-Private Partnership (PPP) Center to fast-track irrigation projects.

The agency has identified 50 potential PPP projects that can generate seven potential revenue streams such as hydroelectric power, solar power, aquaculture, wind energy, bulk water supply, water treatment, and carbon credits. — **Sheldeen Joy Talavera**

VAT collections up 20% in 2022

THE Bureau of Internal Revenue (BIR) said on Monday that it collected P463 billion in value-added tax (VAT) in 2022, up 20%.

The BIR said in a statement that VAT accounted for 20% of all collections last year, adding that going forward, the shift to quarterly filing of VAT returns will afford taxpayers relief from the former system of monthly filing.

"The luxury of filing quarterly VAT returns, instead of monthly, carries with it the obligation of strict compliance. We will monitor all quarterly VAT returns. No extensions," BIR commissioner Romeo D. Lumagui, Jr. said.

Revenue Memorandum Circular No. 5 – 2023, removed the monthly requirement to file VAT Returns.

The BIR hopes to collect P2.6 trillion in revenue this year. If the target is achieved, it would represent an 11% rise against actual collections of P2.34 trillion in 2022.

The VAT filing deadline for the first quarter is April 25.

"VAT contributes heavily to the economy and to the prioritized projects of the government. Which is why we are encouraging everyone to report and pay the exact value-added tax amount on or before April 25, 2023," Mr. Lumagui said.

He added that the BIR had already issued reminders for the filing of VAT returns in January, in addition to the Tax Reform for Acceleration and Inclusion Law which mandates the simplification of VAT return filings and payments.

"We only wish to remind the public that we will not hesitate to impose penalties to individuals or companies that cannot file their VAT returns at the deadline," Mr. Lumagui said.

He warned against the practice of falsifying transactions to artificially lower taxable earnings.

Any individual or corporate taxpayer with any form of business with actual gross sales or receipts exceeding the P3 million threshold is required to file returns and pay VAT on a quarterly basis. — **Aaron Michael C. Sy**

Mineral processing, manufacturing investment expected from China

THE Department of Trade and Industry said it expects investment from China in the mineral processing and manufacturing industries, with Trade Secretary Alfredo E. Pascual planning to visit the Mainland later in the year.

"I am very optimistic of the interest of Chinese enterprises to invest in the Philippines. In fact, I am scheduling a visit to China sometime probably in the early third quarter towards the end of the second quarter," Mr. Pascual said in an interview with Market Edge.

Mr. Pascual said the government has also discussed mineral processing and manufacturing investment with potential US and European partners.

"We can talk about China investments in processing of minerals, which we are also discussing with some American and European companies," he said.

"I would like to be able to talk also to companies that are diversifying their (manufacturing) locations and we've been trying to catch some of them to locate in the Philippines," he added.

Mr. Pascual said the Philippines effectively enjoys free trade with China through the Regional Comprehensive Economic Partnership, whose participants include the Association of Southeast Asian Nations. — **Justine Irish D. Tabile**

Farmers lobby for P50-billion procurement budget for NFA

THE National Government needs a palay procurement budget of at least P50 billion to get through any shortages that may result from the El Niño dry spell, the farm industry said.

Danilo V. Fausto, president of the Philippine Chamber of Agriculture and Food, Inc. said in a Viber chat that "the government should provide additional funds for the National Food Authority (NFA), say P50 billion, to buy palay for buffer stocks. This (is equivalent to) an additional 50-day rice buffer."

"The only protection from El Niño vis-à-vis food supply is to have enough buffer for basic commodities," he added.

Federation of Free Farmers Chairman Raul Q. Montemayor said that the NFA must find ways to build up inventory for the July-September period — when rice production drops due to the rainy season — without resorting to imports.

He said via chat that "the government must also closely monitor imports because by this time, with the dry season harvest almost at an end, the only remaining source for supplemental stocks going into the lean months will be imports."

He added that the private sector should consider suspending their import activity with a projected increase in the international price of rice due to weather factors. — **Beatriz Marie D. Cruz**

Bill gives DoF Secretary full authority to amend LGU income brackets

A BILL has been filed in the Senate that will allow the reclassification of local government units (LGUs) by their income-generating activity every six years.

Senator Sherwin T. Gatchalian, the bill's author, said in a statement on Monday that periodic upgrades in income classification will help determine a municipality's capacity to carry out priority projects, and identify gaps in capacity that can be filled with assistance from the National Government.

Senate Bill No. 2067 gives the Secretary of Finance the authority to update the income ranges for each class of municipality.

The Philippines categorizes its municipalities into six income classes. First-class municipalities are those with income of at least P55 million. Sixth-class municipalities earn less than P15 million.

The bill also proposes automatic income reclassification of LGUs every two years with the release of the updated table of income classifications released by the Bureau of Local Government Finance, an arm of the Department of Finance.

The upgrade or downgrade decision will be governed by where the two-year average income posted by LGUs falls under the new classification brackets, according to the bill.

"In cases of unmanageable public sector deficit, the Secretary of Finance may retain the existing income classification or order its recomputation and revision," according to the bill.

The Secretary of Finance's current recommendatory authority to modify the income brackets for provinces, cities and municipalities derives from Executive Order No. 249, series of 1987.

The Justice department said in a 2012 legal opinion that the Secretary of Finance's power "only extends to recommending such appropriate changes or revision to the proper authority, the Philippine Congress." This was reaffirmed in a separate legal opinion in 2015.

"This bill will address the DoJ (Department of Justice) requirement of a Congressional action on LGU income reclassification," Mr. Gatchalian.

The House of Representatives approved on third reading a similar measure on March 14.

"By instituting the measure, we are also paving the way for local government personnel to receive any increase in their pay which they deserve. This also paves the way for LGUs to hire additional personnel in boosting their services to their constituents," he added. — **Beatriz Marie D. Cruz**

OPINION

Capitalizing the 4Cs of a TP benchmarking analysis

LET'S TALK TAX
SHEENA MARIE S. DAÑO

If transfer pricing documentation (TPD) were a movie, the benchmarking analysis would be the plot. A well-crafted plot bears weight on the quality of a movie as much as a well-prepared benchmarking analysis bears weight on the quality of a TPD.

Knowing that benchmarking analysis is a crucial part of any TPD, what does one need to consider to get the benchmarking analysis right and withstand the scrutiny of the Bureau of Internal Revenue (BIR)? Let's first start by understanding the nature and purpose of a benchmarking analysis.

WHAT IS BENCHMARKING ANALYSIS?

In simplest terms, benchmarking analysis is a method of determining whether related party transactions are undertaken at arm's length. It compares the controlled transaction of a related party with the transactions conducted by independent third parties based on a list of specified criteria, as provided in Revenue Memorandum Order No. 1-2019, following the transfer pricing guidelines laid out by the Organisation for Economic Co-operation and Development (OECD).

In searching for comparable independent third parties, there are the general review and financial review. A general review filters candidate companies based on the entity's status as active or dormant, corporate structure, availability of financial information, nature of business activity, independence, and consecutive losses, among others. A financial review, on the other hand, filters candidate companies based on level of revenue, level of research and development expenses, and level of intangible assets.

In a benchmarking analysis, the arm's length range, ideally the interquartile range, usually presents a range of arm's length profit or mark-up price from third-party comparable companies deemed to be similar or nearly similar to the related party in a controlled transaction.

PREPARING A RELIABLE BENCHMARKING ANALYSIS

Coming up with a reliable benchmarking analysis is not an exact science and requires a certain degree of professional judgement. The 4Cs presented as follows, detail the important guidelines in preparing a benchmarking analysis.

1. Capture the proper characterization of the related party involved in a controlled transaction

In reference to our previous article "Fundamentals of entity characterization in TPD," entity characterization is the result of analyzing the functions, assets, and risks involved in a controlled transaction. It identifies the type of entity of the related party with respect to the economic benefits and risks of the controlled transaction. For instance, if a company is engaged in the manufacturing of computer parts based on pre-agreed design and quantities solely for the related party, performing limited manufacturing functions puts the company in the category of contract manufacturer. To avoid distortion of arm's length range, it follows that the third-party companies to be selected as comparable companies are contract manufacturers.

By their very nature, controlled transactions have different characteristics which may lead to a difference in the market values. Such differences are to be accounted for and considered in analyzing the entity characterization of the related party.

2. Choose the most appropriate database, transfer pricing method and profit level indicator (PLI)

The process of screening, verifying, and selecting candidate comparable companies depends largely on the availability of a database wherein relevant data on such companies can be extracted. Electronic commercial databases, though sometimes costly, often provide a wide source of information. Other sources include but are not limited to databases from government or regulatory agencies (e.g., Securities and Exchange Commission, Department of Energy, Philippine Economic Zone Authority) and business organizations. Understanding the controlled transaction helps narrow down the type of database to be used. For instance, for leasing transactions, published rates from property managers could be appropriate.

With respect to transfer pricing method, no single method is preferred. Of the five transfer pricing methods and as discussed in our previous article "Understanding transfer pricing methodologies," the chosen method for benchmarking depends on what is to be benchmarked and how benchmarking is used. For instance, if the controlled transaction involves the sale of petroleum products like gasoline, diesel, and kerosene, the appropriate method could be the Comparable Uncontrolled Price (CUP) method wherein comparable data between controlled and uncontrolled transactions are required to be highly similar in order for prices to be considered comparable, using either external CUP (e.g., published prices of gasoline, diesel, and kerosene) or internal CUP (e.g., gasoline, diesel and kerosene prices offered to third party customers).

On the other hand, in our previous article "The concept of profit level indicator in TPD," the selection of an appropriate PLI depends on the facts and circumstances of the controlled transaction such as availability of comparable data and entity characterization. The Resale Price Method, Cost Plus Method and Transactional Net Margin Method (TNMM) use PLI to determine whether the related party transaction involved is carried out at arm's length. For instance, if the controlled transaction is the provision of back-office support services, under the TNMM, the appropriate PLI could be the net mark-up or full cost plus, which is computed as operating profit divided by the total costs, because costs are the relevant profit drivers and indicators of the value of the functions performed, assets used and risks assumed by the related party in a controlled transaction.

Determining the applicable database, transfer pricing methodology, and PLI helps in the process of streamlining the line-up of acceptable comparable companies.

3. Customize the benchmarking approach

There is no one-size-fits-all approach in a benchmarking analysis, notwithstanding that the related party in a controlled transaction operates within the same industry and economic conditions of the uncontrolled transaction. Fundamentally, in seeking the most appropriate comparable companies, a certain degree of adjustment is commonly considered. For instance, one-off transactions such as natural disaster damage costs and extraordinary legal costs, identified in the financial statements of the comparable companies and the related party in a controlled transaction, are excluded in the benchmarking analysis.

In addition, general and financial review criteria may also be adjusted. Typical examples include expanding the geographical location of the search criteria if there are no or limited local comparable companies, adjusting the revenue level in reference to the size of the related party in a controlled transaction, or adjusting the ownership independence criterion provided that the related party transactions of the candidate comparable company do not exceed 20% of the relevant threshold.

Any customization should best account for the facts and circumstances surrounding both the controlled and uncontrolled transactions. As such, understanding the transaction realities helps circumvent a biased approach on benchmarking analysis and yields a more reliable set of comparable companies.

4. Create a benchmarking analysis trail

Documenting the benchmarking process, from the results of each general and financial review criteria to the adjustments made in consideration of the peculiarities of the controlled and uncontrolled transactions, is crucial in providing transparent proof on how the benchmarking analysis is prepared. The extent of the details in the documentation will greatly depend on its relevance and significance. For instance, citing the business reason of out-of-range benchmarking results and providing a concise description of the primary business of the third-party comparable companies with respect to the controlled transaction adds credibility to the benchmarking analysis.

Not to mention, readily maintaining copies of supporting documents such as pricing agreements and audited financial statements of comparable companies would beef up the benchmarking analysis trail. For instance, notes to the financial statements could provide additional insight on the true nature of the company, impact of COVID-19, going concern matters, among others, and increase the reliability of the comparables.

WHAT ARE THE CHALLENGES IN BENCHMARKING ANALYSIS?

Considering that the methodology in creating a benchmarking analysis is neither universal nor linear by nature, the quality of the comparable companies may be open to interpretation and contention between the taxpayer and the BIR.

Some of the common challenges include the financial years of companies that will be compared with the related party in a controlled transaction, the lack of standardized hierarchy in adjusting general and financial review criteria, the lack of reliable comparable companies due to the absence or scarcity of data, and the selection of favorable third-party information as final comparable companies.

Proposed solutions to some of these challenges remain to be seen as the transfer pricing guidelines continue to be refined to adapt to the changing economic climate and technological capabilities.

HOW BENCHMARKING ANALYSIS IMPACTS BIR AUDITS

Benchmarking practice is not new for the BIR. Since 2006 through the issuance of Revenue Memorandum Order No. 4-2006, industry benchmarking or performance benchmarking have been part of the BIR Priority Programs, specifically to improve value-added tax and income tax collections.

Generally, a transfer pricing adjustment happens when the consideration for the sale of services/goods is less than the arm's length price, the consideration for the purchase of services/goods is higher than the arm's length price, or no consideration is charged to the related party for the supply of goods/services. A transfer pricing adjustment also occurs when the related party's benchmarking analysis yields disputable comparable companies, leading the BIR to identify its own set of comparable companies that will be tested against the related party in a controlled transaction.

Knowing that transfer pricing audits are inevitable as discussed in our previous article "BIR transfer pricing audits — the next wave?" a well-thought-out benchmarking analysis helps minimize the risk of transfer pricing adjustments, ultimately cementing the fact that the benchmarking analysis is the backbone of a transfer pricing documentation.

Continue to journey with us as we take a deeper appreciation of the fine points of the TPD in our upcoming articles.

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