

DoF expects appointments to Maharlika completed by Sept.

THE success of the Maharlika Investment Fund (MIF) will depend largely on the board of directors who will manage the fund, which the government hopes to appoint by September, Finance Secretary Benjamin E. Diokno said.

“The key to the success of this fund is to choose the (right) men and women... and the President recognizes that,” Mr. Diokno said in a television interview on ANC on Monday.

“We continue to receive applicants, names given to us, men and women. My timetable is that we should be able to appoint them before the end of September,” Mr. Diokno said.

“We have infrastructure projects which will give a return of about 20-25%. The decisions will be governed by the group composed of good men and women, and they will recommend to us the strategy and the projects that will be funded by Maharlika,” he added.

The MIF, recently signed into law, will be managed by the Maharlika Investment Corp. (MIC), led by a nine-member board.

In a brief, GlobalSource Partners noted the challenges that may arise in recruiting candidates for the board.

“Job one, finding credible highly regarded fund managers, chief executive officer, and board directors, will not be easy given the ambitious return and development objectives that its sponsors have publicized,” it said.

The MIC board will consist of the president and chief executive officer of the MIC, and the president and chief executive officer of the Land Bank of the Philippines and the Development Bank of the Philippines.

It will also have two regular directors and three independent directors from the private sector. The regular directors have a term of three years while the independent directors have a term of one year, but are eligible for reappointment provided their term does not exceed nine years.

The Secretary of Finance will chair the board in an ex-officio capacity.

Citigroup, Inc. Chief Executive Officer for the Philippines

Paul A. Favila said that the fund could bring in major investments if managed correctly.

“It does have the potential to actually facilitate investments. That’s what we obviously want for the country... we think it’s the opportune time to actually help bring in those investments. If the Maharlika fund does its job, then that should be good,” he told reporters on Monday.

Mr. Favila said the MIF is more of an infrastructure fund than a sovereign wealth fund.

GlobalSource said that the MIF needs “detailed mapping out to ensure that as a vehicle for bringing in private investment in strategic sectors; it should not be a source of unmanageable fiscal risks down the road.”

“They also need to find an institution builder that will define the rules, risk management principles, investment guidelines, and other governance guardrails of this new agency. It’s actually better if this is done separate from the investment mindset, so such

guardrails are shorn of agendas and biases,” it added.

Mr. Diokno said that the MIF will help unburden the budget from financing infrastructure projects and reduce the need to take on debt.

“The MIF creates additional funding for some 194 priority projects of this government, and that is worth about P8 trillion. Without the MIF, about 55% of that will be funded through official development assistance, around 10% through the budget, and around 30% will be through public-private partnerships,” he said.

“With the MIF, you open another area of financing. That’s the beauty of the MIF. We can accelerate the implementation of all these projects, which we need very badly,” he added.

Last week, President Ferdinand R. Marcos, Jr. signed Republic Act No. 11954, which creates the MIF. The fund is expected to be operational before the end of the year. — **Luisa Maria Jacinta C. Jocsón**

Diokno calls for simplified mining taxes to attract FDI

FINANCE Secretary Benjamin E. Diokno said Congress needs to promptly pass tax reform legislation for the mining industry, saying foreign investors are likely to find a simplified tax regime more attractive.

“With the expected congressional approval of a new tax system for mining, plus the roadshows being conducted abroad, there will be renewed interest in the (mining) industry,” he was quoted as saying in a statement issued by the Presidential Communications Office.

Mr. Diokno made the remarks in an interview with ABS-CBN News Channel.

Mr. Diokno said many potential investors from Canada have shown interest in the Philippine mining industry.

“They signified a lot of interest in our new economy and also given the new tax regime,” he said, citing the results of a recent roadshow in Canada.

The proposed new tax regime for the mining sector is “one of the priority measures of the Congress,” Mr. Diokno said, “and we expect it to be approved soon.”

He said the goal is to harmonize the tax treatment of mining that takes place in designated reservations with that of operations outside reservations.

“We will just have one tax. We will simplify the tax system and some royalties also. But we will try to make the tax system on mining competitive with other countries. That’s the gist of that proposal,” he added.

Economic managers have said that mining could be a key driver of the economic recovery.

The Chamber of Mines of the Philippines last year opposed a House of Representatives bill that sought to raise the effective tax rate on mining to 51% from 38% and impose a 5% royalty on the market value of gross output for large-scale mining operations.

Gerard H. Brimo, the chamber’s vice chairman, said earlier this month that the industry would prefer a margin-based royalty and windfall profits tax, noting the practice in many countries. — **Kyle Aristophere T. Atienza**

NGCP asks commission to approve two more AS contracts

THE National Grid Corp. of the Philippines (NGCP) said it asked its regulator to approve two more of its ancillary services (AS) agreements.

In separate filings, NGCP said it submitted applications to the Energy Regulatory Commission (ERC) to approve AS procurement agreements (ASPAs) it entered into with Universal Power Solutions, Inc. and Therma Marine, Inc.

Republic Act No. 9136 or the Electric Power Industry Reform Act (EPIRA) of 2001 requires the NGCP to “maintain the reliability, adequacy, security, stability and integrity of the nationwide electrical grid” in accordance with the Philippine Grid Code.

AS contracts are on call to be tapped when needed to augment the power supply, and are critical in ensuring the reliability of the transmission system.

EPIRA defines AS as “services that are necessary to support the transmission of capacity and energy from resources to loads while maintaining reliable operation of the transmission system in accordance with good utility practice and the Grid Code.”

Last week, the grid operator also said that it is asking the ERC to provisionally approve four other ASPAs.

Last month, the ERC said it is processing the approval of 36 ASPAs entered into by the NGCP. The contracts were signed according to the competitive selection process prescribed by the Department of Energy.

The ERC said that the grid operator issued notices of award for 36 ASPAs on April 18, of which 14 applications have been filed with the ERC and are awaiting hearing. — **Ashley Erika O. Jose**

Sugar planters want start of milling operations to return to August

SUGAR PLANTERS are asking the Sugar Regulatory Administration (SRA) to continue with the August timetable for starting milling season, claiming that delaying the start to September runs the risk of overripening the cane.

In a July 18 letter, the Sugar Council — composed of three planter federations — appealed to the SRA to continue starting milling operations in August, instead of reverting to the traditional start in September.

The letter was signed by the Confederation of Sugar Producers Associations, Inc. President Aurelio Gerardo J. Valderama, Jr., National Federation of Sugarcane Planters, Inc. President Enrique D.

Rojas, and Panay Federation of Sugarcane Farmers, Inc. President Danilo A. Abelita.

It was addressed to SRA Administrator Pablo Luis S. Azcona and planters’ representative to the SRA board David Andrew L. Sanson.

The sugar industry was instructed to start milling early last year due to the sugar shortage prevailing at the time, with mill output last year amounting to 432,345 tons.

Mr. Azcona has said that a September start will allow the cane additional time to mature, thereby improving sugar yields.

The sugar planters are pushing for an August start because the cane they planted last year after the milling season began in August is ripe for harvest.

“Consequently, the ratoon plants, estimated at 400,000 tons, are now mature, and delaying their harvest to September will cause them to become overripe, compromising purity and tonnage,” the Sugar Council said.

A ratoon is the sprout emerging from harvested cane.

The planters said delaying the start of milling this year may lower the weight and yield of the cane. They also cited the impact of Typhoon Dodong on output and the prospect of planters earning lower returns from their crop.

With the early start to milling last year, many sugar mills stopped operating in April, instead of the usual May or

June, leaving farmers “in dire need of fresh income.”

“Sugar farmers have already contracted cane cutters, and delaying milling to September will force them to financially support the workers or risk losing them,” the Sugar Council said.

It added that delaying milling to September will “create overwhelming demand” for farm workers and hauling services.

“Farmers are apprehensive that this unprecedented demand for farm labor and hauling services will give rise to unhealthy competition, thereby driving up their production costs,” it said. — **Sheldeen Joy Talavera**

OPINION

Application of arm’s-length principle in lease transactions

A lease is a contract whereby one of the parties (the lessor) binds himself to give to another (the lessee) the enjoyment or use of a thing for a certain price, and for a period that may be definite or indefinite. The lessor retains ownership of the asset during the term of the lease. For taxation purposes, a lease could be classified as an operating lease or a finance lease.

In business, commercial leases constitute a major area of consideration. Some businesses enter lease transactions to avoid committing too much capital in order to operate, especially start-ups, as well as the opportunity to use a facility or amenities at low cost. For some, the right physical location could provide them with an advantage for marketing, targeting customers, logistics, or an efficient value chain.

Lease transactions between related parties are common. How should related parties ensure that their lease transactions are arm’s length in nature?

ARM’S LENGTH PRINCIPLE IN LEASE

Lease transactions between related parties must adhere to the arm’s length principle. This means that the material and relevant terms and conditions of the lease, such as lease rate, payment terms, and escalation clause, among others, with a related party are comparable with those of an independent party.

APPLICATION OF ARM’S LENGTH PRINCIPLE IN LEASE

• *Comparable Uncontrolled Price (CUP) method*
One way of applying the arm’s length principle to leases is by using the CUP method. This method evaluates whether the lease rate charged by the lessor to its related party-lessee, as well as the terms and conditions of the lease, are at arm’s length by reference to the lease rate charged in a comparable uncontrolled transaction in comparable circumstances. This is the most direct way of ascertaining an arm’s-length lease rate but requires the highest degree of comparability of the terms and conditions of the lease with those of a related party-lessee and an independent party-lessee. In case of differences, reliable adjustments should be made to eliminate the material effects of such differences.

The CUP method is further broken down into internal and external.

The internal CUP compares the lease rate charged by the lessor to its related-party lessee with that of the lease rate charged by the same lessor to its independent-party lessee. For example, Lessor A charges a P1,000 per square meter lease to its independent-party lessee for office space. If Lessor A leases office

space comparable to its related-party lessee, the lease rate should ideally be comparable to the P1,000 per square meter.

Please note that in using internal CUP, it must be demonstrated that internal comparable is not transactions that were performed/entered solely to justify that the related party transactions are at arm’s length or to artificially create a comparable uncontrolled transaction that serves as a benchmark.

On the other hand, external CUP compares the lease rate with related-party lessee with that of the lease rates between two independent parties. For example, Lessor A has no lease transaction with an independent party. Assuming Lessor B charges P1,500 per square meter to Lessee C (both are independent parties). Then, the lease rate of Lessor A to its related-party lessee should ideally be comparable to the P1,500 per square meter.

Again, the CUP method requires the highest degree of comparability of lease terms and conditions. With that said, a comparability analysis must be performed first between the related and independent transactions. In performing this analysis, it is crucial to know the characteristics of the lease transaction. This is because differences in the terms and conditions might have a material influence on the lease rate.

Factors affecting the comparability could be qualitative and quantitative. For example, the classification of the property, whether residential, commercial, industrial, or agricultural, would affect the lease rate. Likewise, location matters most. Properties in prime locations would normally command higher lease rates than those in rural and undeveloped areas. The same is true in a commercial building depending on what floor you lease. Moreso, the lease term (i.e., short-term or long-term) would have an impact on the lease rate. Payment terms also play a factor, such that the longer the payment term, the higher the lease rate.

Other relevant factors are the party who pays for the taxes, insurance and maintenance, escalation clause, improvement and modifications, and purchase options, among others.

To reiterate, the CUP method is acceptable provided that reliable adjustments can be made to eliminate the several factors enumerated above that affect the lease rate.

• *Transactions Net Margin Method (TNMM)*
Instead of comparing the lease rate, TNMM uses the profit level indicator (PLI) to evaluate whether the lease transactions with related parties pass the arm’s-

length test. This method compares the net profit margins relative to an appropriate base such as costs, sales or assets attained by the lessor from a related-party transaction to those attained by the comparable independent lessors engaged in similar transactions.

The TNMM is based on the economic concept that similar firms operating in the same industry would tend to yield similar returns over time.

In our earlier example, instead of comparing the lease rate charged by Lessor A to its related party-lessee, TNMM will compare the net profit ratio using an appropriate base earned by Lessor A with that of the net profit ratio generated by independent comparable lessors, such that if Lessor A’s net profit ratio is comparable, then the lease transaction of Lessor A passes the arm’s-length principle.

The BIR has laid down the criteria in searching for comparable companies. The challenge in using TNMM is the capability and resources of the taxpayer to find reliable, comparable independent lessors.

When applying the TNMM, differences in the characteristics of lease transactions between related-party transactions and comparable companies generally do not have a material influence on the operating profit. A greater emphasis is placed on functional comparability than on the characteristics of lease transactions. In this regard, the factors affecting the lease rates discussed in the CUP method generally have no bearing on TNMM.

As such, the application of TNMM allows the use of broader comparable companies, as operating profits are less likely to be affected by differences in the terms and conditions of the lease and certain functions.

TAKEAWAY

Taxpayers seek the services of a professional real estate broker that would help them locate the best property and location and negotiate the best economic deal possible. But taxpayers should not forget that the best economic deal possible is one that complies with the arm’s-length principle.

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