Philexport pushing for review of road user's tax

By Justine Irish D. Tabile
Reporter

THE Philippine Exporters Confederation, Inc. (Philexport) said that the government should review proposals to impose a motor vehicle tax, and expressed doubt that such a tax will ultimately control vehicle numbers.

"It is not a problem for us if you tax the luxuries, even if that affects most businessmen; they are willing to do that," Philexport President Sergio R. Ortiz-Luis told reporters last week.

"However, I think they should first study the road user's tax. I think what they should find out first is why are the number of cars is growing," he said.

At his second State of the Nation Address, President Ferdinand R. Marcos, Jr. called for legislators to focus on tax measures, including a motor vehicle user's charge or road tax.

In July, the House ways and means committee approved amendments to the law regulating motor vehicle user's charges (MVUCs) which taxes all private, for-hire, and government-owned vehicles.

For-hire vehicles will receive a 50% discount on the MVUC, while motorcycles and tricycles are exempt. The revenue from the MVUC is expected to finance the public utility vehicle modernization program and the government's road infrastructure and safety programs.

According to Mr. Ortiz-Luis, many cars are now being parked on the roads, which he said was caused by temporary measures that were made permanent.

"Before, when you had one garage, you would only have one car. Now, you can see cars parked on the side of the roads," he said, blaming the number coding scheme that pushed motorists to buy more cars.

"(Number coding) was introduced as a temporary measure during the construction of the Metro Rail Transit but they made it a permanent measure. And because of that, people bought more cars. Now, if they have the money, they will buy," he added.

He said this is the reason why the car industry is growing continuously whatever the state of the economy.

"We still do not have a developed mass transportation system, which we should first fix. They said that the measure of being a developed country is when the rich people ride mass transit not when everyone is buying cars, even the poor," he said.

In July, the Philippine automotive industry saw a 33% year-on-year rise in sales to 37,086 units, the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI) and the Truck Manufacturers Association (TMA) reported.

For the first seven months of the year, CAMPI-TMA members sold 239,501 units, up 31.1%.

EPIRA changes should focus on tax — Congress think tank

PROPOSED amendments to the Electric Power Industry Reform Act (EPIRA) of 2001 should focus on rationalizing power taxes to lower electricity costs, according to a policy think tank attached to the House of Representatives.

"Since the burden of the taxes on the power sector and the concomitant higher electricity prices are ultimately borne by the consumer, it is imperative to revisit and rationalize all tax levies on the power sector," the Congressional Policy and Budget Research Department (CPBRD) said.

In its policy brief, "Continuing Reform in the Power Sector: Addressing energy insecurity and high prices," the CPBRD called for a review of the value-added tax (VAT) on systems losses, which it said cannot be classified as goods or services.

"Systems loss is part of one's electricity bill representing the cost of electricity lost during transmission, pilferage, and technical inefficiencies," it said.

The think tank also urged Congress to review other VAT charges on end-user electricity bills, like those on the subsidy to the lifeline rate, capital expenditure contribution, and National Grid Corp. of the Philippines (NGCP) franchise tax.

However, the CPBRD said legislators should consider potential revenue to be foregone in rationalizing taxes on the generation sector.

"Removing VAT on electricity will bring down electricity prices by 2%, but may result in a corresponding 3.4% reduction in government revenue, estimated at P212 billion," it said.

To lower power costs, the CPBRD also urged the government to amend the NGCP franchise to allow other private companies and the government to help build transmission infrastructure, strengthen energy governance, and prohibit cross-ownership.

It also called for the fast-tracking of exploration and development of indigenous energy sources, following the expected depletion of the Malampaya gas field by 2027, as well as to strengthen the Energy Virtual One-Stop Shop for energy projects and to include local government units.

Proposed amendments to EPIRA are currently with the House committee on energy. — **Beatriz Marie D. Cruz**

DoE sets Sept. 28 deadline for geothermal, hydro, wind bids

THE Department of Energy (DoE) said the new deadline to submit bids for the fourth round of the open and competitive selection process (OCSP-4) is Sept. 28, with the bids to be opened on the same day.

In an advisory, the DoE said it moved the deadline from Aug. 29. The fourth round will feature 19 sites on offer.

Energy Assistant Secretary Mylene C. Capongcol said the extension will "ensure the widest participation in the OCSP4" and provide enough time for prospective bidders to prepare and submit their proposals.

The DoE is offering three geothermal sites for development, with potential capacity of about 160 megawatts (MW).

The first site, with potential output of 100 MW, straddles the municipalities of Buguias, Benguet and Tinoc, Ifugao. A second site with potential output of 40 MW is in Mabini, Batangas. The third site with potential output of 20 MW straddles Pililla and Jala-Jala, Rizal, and Pangil and Pakil, Laguna.

The DoE has also identified 13 predetermined areas for hydropower projects with an overall capacity of 86.25 MW.

The proposed hydropower sites are located in Tinoc, Ifugao (5 MW); Alilem, Ilocos Sur (16.2 MW); San Remigio, Antique (4.2 MW); Libacao, Aklan (15 MW); Badian, Cebu (0.5 MW); two sites in Malaybalay, Bukidnon (4.5 and 5.65 MW); Dingalan, Aurora (1.0 MW); Surigao del Sur (16.3 MW); Digos City, Davao del Sur (4.0 MW); Manabo, Abra (7 MW); Naujan, Oriental, Mindoro (3.3 MW); and Calamba, Misamis Occidental (3.6 MW).

Wind sites on offer are in San Jose City, Nueva Ecija; Pantabangan, Nueva Ecija; and Bagac, Bataan. The target potential capacity has yet to be determined.

The deadline was first extended in a previous advisory in accordance with the memorandum circular issued by the Office of the President last week. The Palace had suspended work in government offices in Metro Manila for the opening ceremonies of the FIBA Basketball World Cup 2023.

"Bid proposals submitted prior to the issuance of this advisory may be retrieved by a prospective bidder for further enhancement and submitted on or before the deadline stated above," Ms. Capongcol said.

She also said the DoE will allow two authorized representatives per bidder — in possession of a board resolution or secretary's certificate — to attend in person or virtually during the opening of bids. — **Sheldeen Joy Talavera**

OPINION

The arm's length principle for retail companies

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

There are a variety of reasons why associated enterprises enter into commercial transactions with each other. The most common is the ease and speed of processing and delivery, since the setup allows the parties to bypass the common processes of doing business with a non-affiliate (e.g., supplier accreditation, credit investigation, etc.) due to the special relations between the affiliated companies.

One thing to consider in such arrangements is that transfer pricing rules dictate that transactions between or among affiliated entities observe the arm's length principle. This means that whatever price is charged for a similar good sold or service rendered to a related party must be comparable with that charged to an independent or unrelated party.

Sometimes, related party transactions are simple and straightforward arrangements, as is the case with the sale of products which are being offered for sale also to third-party buyers. One example might be a retailer who offers for sale the same pool of commodities to buyers, regardless of whether the latter are affiliates or not.

Hence, if the requirement under the arm's length principle is simply to ensure that a particular seller charges the same price for similar goods or services sold to unrelated and related buyers, are billing invoices and receipts showing the same prices sufficient evidence to prove that the transaction with related parties complies with the arm's length standard? The simple and perhaps immediate response to this question would be "yes," if we focus merely on the nature of the subject of the transaction. However, as is generally the case when determining prices for a particular commodity, there are a lot of factors to be considered which extend beyond the costs incurred in producing the good or providing the service to the end consumer.

This is where transfer pricing documentation (TPD) or transfer pricing policy come into the picture. A TPD supports the analysis performed on the surrounding factors that may impact the pricing of a specific transaction entered into between or among related parties. The analyses cover not only internal factors (e.g., functions performed, assets employed, risks assumed, etc.) but also external factors (e.g., economic and industry, regulatory environment, etc.) that usually affect pricing determination.

Going back to the case of retailers, how then is transfer pricing analysis or the arm's length principle applied on their related party transactions?

As mentioned earlier, a transaction involving the resale of goods, especially where the reseller does not perform any value-adding activity to the goods being offered for sale, may appear very straightforward. However, a careful examination of the factors surrounding the transaction must be made in order to determine an appropriate transfer pricing method that would identify the arm's length price.

The possible TP methods that can be applied in the case of retailers are the following:

COMPARABLE UNCONTROLLED PRICE (CUP) METHOD

The CUP method compares the price of the products sold by a retailer to the related party with the price of product sold to third-party buyers. This is the most direct way of ascertaining an arm's length price but requires the highest degree of comparability of the nature and characteristics of the product, terms and conditions of the transaction with related and third-party buyers. In case of differences, reliable adjustments should be made to eliminate the material effects of such differences.

The CUP method can be applied in two ways — internal and external CUP method.

The internal CUP compares the price of the product charged by the retailer to the related party buyer with the price charged by the same retailer to an independent party. For example, Retailer Corp. sells a specific type of multi-purpose tripod at P900 per unit. Buyers of Retailer Corp. are generally third-party end-consumers. However, in case a related party of Retailer Corp. procures the same multi-purpose tripod from Retailer Corp., the selling price should ideally be comparable to the price charged by Retailer Corp. to third-party buyers (i.e., P900 per unit).

Please note that in using internal CUP, it must be demonstrated that the internal comparables are 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 price of the product sold to a related party buyer with that of the price charged between two independent parties. For example, Distributor A supplies industrial cleansing liquid to retailers who are all affiliate entities. Distributor A does not supply to third-party retailers. Assuming Distributor B, a direct competitor of Distributor A, sells comparable cleansing liquid to non-affiliate retailers at P80 per kilo, then the price charged by Distributor A to its affiliate retailers should be comparable to the selling price of Distributor B to non-affiliate retailers, that is, P80 per kilo.

Again, the CUP method requires the highest degree of comparability of retail transactions with related and third-party buyers. 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 product characteristics, such as physical features and quality; whether the goods sold are compared at the same points in the supply or production chain; product differentiation is in the form of patented features such as trademarks, design, etc.; volume of sales if it has an effect on price; timing of sale if it is affected by seasonal fluctuations or other changes in market conditions; whether cost of transport, packaging, marketing, advertising, and warranty are included in the deal; whether the products are sold in places where the economic conditions are the same; and whether a business strategy is adopted in the controlled transaction that would produce material difference on the price of the controlled transaction as against the price in an uncontrolled transaction.

The above factors affecting the comparability could be qualitative or quantitative. For example, the products compared shall be of the same kind or model and of the same brand. Products that may appear identical physically but differ in terms of branding would have price variability. Of course, the more well-known the brand is, the higher the price. After-sales service must also be considered since a product sold with warranty that has extensive coverage or is provided for a longer period would normally call for a higher price than products sold without warranty, even if they are similar in nature or even in brand. Similar products sold on different occasions, such as regular sales or promotions, would also lead us to expect differences in pricing. The same is true when differing payment terms are applied, such as in the case of cash or deferred sale and installment sales, where the latter would normally entail higher pricing.

To reiterate, the CUP method is acceptable provided that reliable adjustments can be made to eliminate the factors enumerated above that affect the price of the product.

RESALE PRICE METHOD (RPM)

Another transfer pricing method that can be used in the case of retailers is the RPM. RPM is applied when a product that is purchased from a related party is resold to an independent party. The resale price method evaluates whether the amount charged in a controlled transaction is at arm's length by reference to the gross profit margin realized in uncontrolled transactions. RPM is most appropriate in a situation where the reseller adds relatively little value to the product.

To illustrate, say Retail Company sells hydraulic desks to non-affiliate buyers. The hydraulic desks are purchased by Retail Company from its affiliate, Manufacturing Company. Assuming the market price of a hydraulic desk with similar features or similar built as that sold by Retail Company is P20,000. In addition, hydraulic desk retailers in the market report a gross margin of 25%. The application of RPM is that the gross margin of independent retailers is P5,000 (P20,000 selling price multiplied by 25% gross margin). This means that the market cost of the product is P15,000 (P20,000 selling price minus P5,000 gross margin).

In the above illustration, the hydraulic desks must be sold by Manufacturing Company to Retail Company at a transfer price of P15,000.

TRANSACTIONAL NET MARGIN METHOD (TNMM)

As opposed to the CUP method and RPM which compare prices charged for comparable transactions, TNMM compares 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 entities involved in similar transactions. This method is based on the concept that similar firms operating in the same industry would tend to yield similar returns over time.

The advantage of TNMM is that it allows for differences in the characteristics of the products being sold or the terms and conditions surrounding the sale, which generally have no material influence on the net margin.

TNMM uses profit level indicators (PLI) in evaluating whether the transactions with related parties comply with the arm's length standard. In the case of retailers, which mostly do not perform any value-adding activities to the products they sell, the appropriate PLI is generally the operating margin. Operating margin is calculated by dividing a company's operating income (before interest and tax) by its net sales.

TAKEAWAY

Given the differing circumstances surrounding retail sales transactions, it is imperative that retailers who regularly transact with related party buyers are able to support their transfer prices by giving due consideration to all factors that may have an influence on their pricing. The best way to do that, of course, is to prepare and maintain TPD. Hopefully, more retailers with regular and material related party transactions will realize the importance of the TPD and consider it a necessary "add-to-cart" item.

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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