EV industry group seeks exemption from Customs import assessment

THE Electric Vehicle Association of the Philippines (EVAP) said it requested an exemption for its members from going through the Bureau of Customs' (BoC) Import Assessment System.

"This initiative aims to streamline the clearance process, making it more efficient for EVAP members. Subject to the usual post-clearance audit process," EVAP said in a statement.

The Import Assessment System typically applies to vehicle imports, but EVAP is applying for pre-approval, the organization's chairman Rommel T. Juan said in an e-mail.

On Saturday, the electric vehicle (EV) organization met with the BoC to address and clarify policies concerning the importation of electric vehicles.

"The meeting was pivotal in ensuring a seamless and efficient process for importing electric vehicles into the Philippines," the EV association said.

The BoC was represented by Assistant Commissioner Vincent Philip C. Maronilla.

"The BoC is in the midst of overcoming these initial challenges, as the EV industry is rapidly expanding, thanks to the recent implementation of Electric Vehicle Industry Development Act (EVIDA) law," Mr. Maronilla said in a statement.

Under the revised implementing rules and regulations of EVIDA, corporate and government vehicle fleets have been set a 5% EV quota and are also required to set aside dedicated EV parking slots and install charging stations.

"This collaboration aims to pave the way for a smoother and more efficient importation process for electric vehicles, ensuring that this transformative industry continues to flourish in the Philippines," Mr. Juan added.

In May, EVAP expressed its support for the removal of import tariffs on two-wheeled electric vehicles.

It said that the removal of tariffs for two-wheelers will help the Philippines achieve its goal of reducing greenhouse gas emissions and improving air quality. — **Justine Irish D. Tabile**

PPP bill approved on 3rd reading

THE SENATE on Monday approved on third and final reading a priority bill that seeks to streamline the framework for public-private partnerships (PPPs) and to address bottlenecks in pursuing these ventures.

In a 20-0-0 vote, legislators approved Senate Bill No. 2233 or the proposed PPP Act, which seeks to amend the Build-Operate-Transfer Law to attract more investment and boost the government's infrastructure program.

The bill also seeks to establish a PPP Governing Board, which will oversee policy related to PPPs.

The board will be headed by the National Economic and Development Authority Secretary, with the Finance Secretary as vice-chair.

The Commission on Audit will also be tasked to issue guidelines on auditing PPP projects.

The House of Representatives approved its version of the bill on third reading in December.

As of Sept. 1, there were 104 PPP projects in the pipeline at an estimated cost of P2.521 trillion. Some 180 projects are being implemented worth P2.639 trillion, according to the Department of Finance.

"We are confident that through this measure, the identified bottlenecks and challenges in the PPP process will be effectively addressed, further fostering a more competitive and enabling environment for PPPs," PPP Center of the Philippines Executive Director Maria Cynthia C. Hernandez said in a statement, commenting on the Senate's approval.

She added that the proposed law will also help generate more jobs in the infrastructure industry and attract more private investment.

Senators on Monday also approved another priority bill of President Ferdinand R. Marcos, Jr. that seeks to ease the process of paying taxes, with the goal of boosting compliance with tax obligations.

Senate Bill No. 2224, written by Senator Sherwin T. Gatchalian, will allow taxpayers to file returns and pay their taxes through electronic channels or authorized agent banks.

"We aim to simplify the process of paying taxes in the hope of enhancing tax compliance and strengthening taxpayers' rights," Mr. Gatchalian said last month.

At the same plenary hearing, a priority bill that aims to protect online consumers with stricter digital commerce regulations was also approved on final reading.

Senate Bill No. 1846, or the Internet Transactions Act of 2022 written by Sen. Mark A. Villar, will classify entities involved in e-commerce as businesses operating within the country, making them subject to domestic law.

The House of Representatives approved its version of the bill on third and final reading last December. In June, the President certified the measure as urgent, citing the need to improve the regulation of e-commerce transactions and upgrade consumer protections.

"It will address the pressing need to ensure that Filipinos can harness the benefits of the digital world without compromising their privacy and security," Mr. Villar said last month in a statement detailing the measure. — **John Victor D. Ordoñez**

PCCI to help encourage greater use of FTAs

THE Philippine Chamber of Commerce and Industry (PCCI) said it entered into a partnership with the Department of Trade and Industry (DTI) to promote greater use of free trade agreements (FTAs).

On Monday, PCCI and DTI signed a memorandum of understanding (MoU) to promote the Regional Comprehensive Economic Partnership and other free trade and preferential trade agreements, which is expected to help businesses and industry associations rise their participation in global value chains.

"The MoU is intended to create a strategic and institutional partnership between the government and the business community to capitalize on these agreements," the PCCI said in an advisory.

Under the MoU, the two parties will conduct trade education and mentorship programs, establish trade assistance centers or help desks in key regions and provinces, provide networking and linkage opportunities, and share resources.

The partnership also gives the PCCI access to DTI data and DTI assistance in PCCI collaboration with other government instrumentalities.

The PCCI agreed to promote FTAs within its membership and identify industry associations to serve as pilot participants for international trade assistance centers. — **Justine Irish D. Tabile**

Palay farmgate price up 8.6% in July; unmilled rice costliest in Central Visayas

THE average farmgate price of palay, or unmilled rice, rose 8.6% year on year in July to P19.38 per kilogram, according to the Philippine Statistics Authority (PSA).

"Similar to the previous month, all regions, except Eastern Visayas, continued to record positive year-on-year growth rates in the average farmgate prices of palay in July 2023," the PSA said in a report.

The highest farmgate price was recorded in the Central Visayas at P22 per kilo, 19.95% higher from a year earlier.

This was followed by Central Luzon with average palay prices hitting P21.04 per kilo, up 22.5% from a year earlier, the highest growth rate registered for the month.

The Ilocos region averaged P20.23 per kilo, up 5.9% year on year. July palay prices were flat from a month earlier.

The lowest farmgate price was in Caraga, where palay fetched P17.36 per kilo, up 12.3% from a year earlier.

Eastern Visayas recorded a year-on-year decline of 4%, with palay prices averaging P17.47 per kilo.

On a month-on-month basis, the PSA said that the average farmgate price rose 0.8% from June.

"Nine regions recorded increases in the average farmgate prices of palay, while six regions posted decreases during the month," it added.

The PSA said that Central Visayas reported the highest month-on-month rise at 10.7%, while Caraga saw a 5% decline. — **Adrian H. Halili**

OPINION

Transfer pricing rules for manufacturers

LET'S TALK TAX
CHRISTIAN DERICK D. VILLAFRANCA

Foreign investors consider the Philippines a preferred destination in Southeast Asia for offshore manufacturing due to low labor costs, the large and young labor pool, high English proficiency, and fiscal incentives, to name a few.

Most manufacturers, if not all, are part of a multinational company (MNC). Hence, related party transactions are common within the group.

THE MANUFACTURING VALUE CHAIN AND PROPER ALLOCATION OF PROFITS

Porter's value chain model recognizes two types of activity: primary and secondary. Primary activities are core functions for the enterprise, creating and delivering products and services for customers. This includes inbound logistics, operations, outbound logistics, marketing and sales, and service.

Secondary activities, on the other hand, support the primary activities; these activities often play a more significant role in the success of the primary activities. This includes procurement, human resources, technology, and infrastructure.

For an MNC engaged in manufacturing and selling products, having a well-planned value chain can help in achieving its goals by identifying business activities that can create value and a competitive advantage for the business. Creating separate entities to perform each function in the value chain can help optimize activities to maximize output and minimize organizational expenses. This strategy was adopted decades ago and has proven to be a success.

For instance, ABC Group, which sells electronic devices globally, may set up a research and development subsidiary, a manufacturing subsidiary, a logistics subsidiary, and a sales and marketing subsidiary. In practice, these subsidiaries are established in different jurisdictions for various commercial reasons.

In this set-up, transfer pricing (TP) issues usually arise, particularly on the question of whether each entity in the group is commensurately compensated depending on the functions performed, assets employed, and risks borne in the value chain. Because these entities are usually established in separate jurisdictions with different income tax rules, MNCs typically minimize their tax payments by setting up transfer prices in such a manner as to earn more profits from low-tax jurisdictions instead of high-tax jurisdictions, while maintaining the desired groupwide profits.

This is where the arm's length principle (ALP) comes in. As a rule, the level of profit derived by an entity should be directly correlated to the functions performed, the assets used, and the risks assumed.

ARM'S LENGTH PRINCIPLE IN MANUFACTURING

TP rules provide that transactions between related parties must adhere to the ALP, which means that transactions with a related party should be made under comparable conditions and circumstances as transactions with an independent party, or the conditions of the commercial and financial relations between the independent parties are ordinarily determined by external market forces.

To determine the ideal transfer price or the appropriate level of profit for manufacturing companies, proper characterization of the entity is fundamental. For TP purposes, a manufacturing company is characterized as either a toll manufacturer, contract manufacturer, licensed manufacturer, or entrepreneur/full-fledged manufacturer.

A toll manufacturer processes the raw materials supplied by the principal into finished or semi-finished products based on the principal's specifications, formula, and quantity. This entity performs very limited functions, does not own manufacturing intangibles, and bears limited risks.

A contract manufacturer produces goods for a principal generally based on pre-agreed quantities and schedules. The principal guarantees the purchase of goods for the quantity agreed. This entity generally performs moderate functions, with limited manufacturing intangibles, and shoulders limited risks.

A licensed manufacturer is akin to an entrepreneur/full-fledged manufacturer, except that it does not own the manufacturing intangibles used to produce the products nor perform any research and development (R&D) functions.

Lastly, an entrepreneur/full-fledged manufacturer has a high functional profile. It undertakes manufacturing functions for its own sales, and performs significant functions in the value chain (e.g., R&D, sales, production, after-sales, logistics, and marketing). In addition, it bears significant risks such as product liability, warranty, capacity utilization, market, price, etc., and receives all residual profits or losses from the value chain.

Functional analysis is performed to accurately identify the characteristics of the entity. By knowing the characteristics, the level of the risks borne and profit proportional to the risks can be predicted. Let's consider a contract or toll manufacturer that only carries out production as ordered by a related party, without performing functions such as operational strategy setting, product R&D, and sales. Such a company is expected to maintain a consistent level of profitability. Should the manufacturer suffer from losses, it must prove that these losses are not a result of its transactions with a related party.

APPLICATION OF ALP IN MANUFACTURING

Below are the TP methodologies that manufacturing companies can use to measure the transfer price or level of profits.

Comparative Uncontrolled Price (CUP) method

This method compares the price that a manufacturer charges its related party (controlled transaction) with the price charged to an unrelated party (uncontrolled). This method requires the highest degree of similarity (i.e., type of product, volume of transactions, geographical market, period of transactions, terms of agreement, FAR analysis, specific features, etc.).

If the manufacturer sells to both related and unrelated parties where the product and other terms are comparable, internal CUP may be used. To illustrate, Mfg. Corp., a manufacturer of semiconductors, sells its products primarily to third-party customers at P10,000 per unit. If Mfg. Corp. sells comparable products to related parties with comparable terms and conditions, ideally, the price should also be P10,000.

On the other hand, external CUP may also be used by comparing the selling price charged to the related party with that of the selling price between two independent parties. Say, Mfg. Corp., a company that manufactures plastic molds, sells its products solely to related parties. If one of its competitors also manufactures and sells comparable plastic molds to third-party customers and charges P11,000 per piece, then Mfg. Corp. should ideally charge P11,000 per piece to its related parties, provided that the terms and conditions are also comparable.

Again, the CUP method requires the highest degree of comparability of the manufactured product as well as the terms and conditions of the transactions. With that said, a comparability analysis must be performed first between the related and independent transactions. If material differences exist such as quality of the products, credit terms, transport terms, etc., which affect the price, reliable adjustments should be made to eliminate the differences.

Cost Plus Method (CPM)

CPM compares the gross profit mark-up on the costs incurred by the manufacturer with the gross profit realized by the same manufacturer (internal CPM) or comparable independent manufacturers (external CPM) in uncontrolled transactions.

For instance, Mfg. Corp. manufactures packaging materials. The total cost of goods manufactured is P100 per unit. Mfg. Corp. bills third-party customers at a 40% mark-up on the cost of goods manufactured, or P140 per unit. If Mfg. Corp. sells comparable products to related parties, ideally, the price should also be P140 per unit.

On the other hand, if there are independent and comparable manufacturing companies whose gross profit mark-up is 50%, then Mfg. Corp. should ideally charge its related parties a 50% mark-up on costs of goods manufactured.

In using CPM, companies should bear in mind there may be substantial variance in the classification and accounting treatment of items of expenses as either cost of goods manufactured or operating expenditure among different manufacturing companies. Hence, these differences should be taken into consideration.

The Transactional Net Margin Method (TNMM)

TNMM compares the profit level indicator (PLI), net profit relative to an appropriate base (e.g., cost, sales, assets), realized by the manufacturing company from controlled transactions with the same PLI realized by independent and comparable manufacturing companies.

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

As compared to other TP methods, TNMM allows for some degree of tolerance in minor differences between the functions and products of the comparable manufacturing companies and the taxpayer. Hence, the total profits of the companies can be tested even if there are some minor differences in the products and functions.

Takeaway

A Bible verse says, "Whoever sows sparingly will also reap sparingly, and whoever sows generously will also reap generously." The same is true in applying the ALP in manufacturing companies — the more functions performed, assets employed, and risk borne, the higher benefits, and rewards that it should reap.

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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