Mid-December well-milled rice prices average P54.68 a kilo

THE national average retail price of well-milled rice in late December was P54.68 per kilogram (kg), according to the Philippine Statistics Authority (PSA).

Rice prices rose 0.97% during the Dec. 15 to 17 period, which the PSA calls the second phase of December, compared with prices between Dec. 1 and 5, or the first phase.

The PSA reported that Calabarzon (Cavite, Laguna, Batangas, Rizal and Quezon) posted the highest average retail price, with well milled rice selling for P58 per kg.

At the low end during the period was Ilocos Region with rice prices at P50.37 per kg.

It said regular-milled rice averaged P49.38 per kg, or 1.13% higher compared to the first phase.

Caraga region posted the highest average price at P50.64 per kg, while Western Visayas was lowest at P44.08 per kg.

The PSA reported that the national average retail price for refined sugar was P90.19 per kg.

For the second phase of December, prices in Eastern Visayas were the highest, with sugar hitting P102.92 per kg.

Prices in the Bangsamoro Autonomous Region in Muslim Mindanao were the lowest at P82.05 per kg.

Brown sugar averaged P79.52 per kg for the period.

The PSA reported that Calabarzon had the highest retail price for brown sugar at P88.86 per kg, while Zamboanga Peninsula posted the lowest at P71.87 per kg.

Pork *kasim* (shoulder) averaged P322.72 per kg. — **Adrian H. Halili**

Insurance program launched to cover 'strategic' gov't assets

THE Bureau of the Treasury (BTr) has launched the National Insurance Indemnity Program (NIIP) to provide cover for "strategically important" government assets, starting with school buildings, the Department of Finance said.

"I commend the BTr for successfully implementing the NIIP. Safeguarding our national assets is crucial to ensure the safety and readiness of the projects delivered by this administration for the Filipino people. This is just one of the many immediate actions we are taking to bolster our country's financial resilience. We are starting the year strong and well-prepared as we expect the realization of many more high-impact infrastructure projects under the leadership of President Ferdinand R. Marcos, Jr.," Finance Secretary Benjamin E. Diokno said in a statement on Monday.

The NIIP aims to assist the government in financing the recovery from unexpected losses due to disasters such as typhoons and earthquakes.

It also aims to ensure access to funding post-disaster for reconstruction.

The insurance was arranged by the Government Service Insurance System (GSIS), which took a portfolio approach to mitigate risk and maximize the available funding for premiums.

"I am excited to see this program finally come to fruition. This is just one of the many programs the BTr implements to enhance our resilience against disasters. Our vulnerability to natural disasters makes it imperative for us to act now and implement solutions that would help us become more resilient and recover faster," Monetary Board Member and former National Treasurer Rosalia V. de Leon said.

Ms. De Leon also led the development of the NIIP during her term as Treasurer.

"We are glad to start the year strong with one of our flagship programs — the NIIP, finally in place. The program will provide financial protection for our schools in the event of disasters. We are also grateful to the GSIS who continues to be our partner in finding appropriate solutions to protect government assets against unforeseen losses," BTr Officer-in-Charge Sharon P. Almanza said.

The 2024 pilot program of the NIIP covers 132,862 Department of Education school buildings nationwide.

The GSIS previously set aside P843.11 billion to provide fire, lightning, and natural catastrophe insurance cover for public school buildings for one year starting Jan. 1, 2024. — **Aaron Michael C. Sy**

National Gov't gross borrowing up 28.2% in Nov. as domestic debt surges

THE National Government's gross borrowing rose 28.2% year on year in November, as domestic debt continued to grow in the double digits.

The Bureau of the Treasury reported that gross borrowing rose to P125.462 billion in November from P97.865 billion a year earlier.

Gross domestic debt surged 59.4% to P121.020 billion in November. This accounted for 96.46% of total borrowing during the month.

Domestic debt consisted of P100 billion in fixed-rate Treasury bonds, P6.02 billion in Treasury bills, and P15 billion in tokenized bonds.

The Philippines issued P15 billion or $270 million in a maiden offering of tokenized bonds earlier in November.

Meanwhile, external debt dropped 80% to P4.44 billion, consisting of new project loans. There were no program loans and global bonds recorded for the month.

For the 11-month period, gross borrowing declined 0.14% to P2.101 trillion.

Domestic borrowings rose 1.9% to P1.64 trillion during the 11 months. This accounted for 78.1% of total borrowing for the period.

Fixed-rate Treasury bonds accounted for P1.155 trillion of domestic debt, followed by retail Treasury bonds (P252.091 billion), Treasury bills (P145.717 billion), retail onshore dollar bonds (P71.78 billion), and tokenized bonds.

Meanwhile, external debt as of November fell 6.6% to P460.756 billion.

This consisted of P187.573 billion in program loans, P163.607 billion in global bonds, and P109.573 billion in new project loans.

Rizal Commercial Banking Corp. Chief Economist Michael L. Ricafort said higher borrowing in November was due to elevated inflation, which increased government expenditure.

Headline inflation grew to 4.1% in November, falling from 4.9% in October and 8% in November 2022. This was the weakest inflation reading in 20 months, but it was still above the 2-4% target band for a 20th consecutive month.

Mr. Ricafort said that elevated interest rates also drove borrowing costs higher.

The Bangko Sentral ng Pilipinas (BSP) kept interest rates steady in November, after it delivered a 25-basis-point (bp) off-cycle rate hike in October. The benchmark interest rate stood at a 16-year high of 6.5%.

Since May 2022, the central bank has raised borrowing costs by a cumulative 450 bps.

Mr. Ricafort said easing inflation amid declining global crude oil prices would support possible local policy rate cuts this year, which could reduce debt servicing and temper additional government borrowings.

A *BusinessWorld* poll of 13 analysts last week yielded a median estimate of 4% for December inflation. This is also within the 3.6% to 4.4% forecast given by the BSP last week.

If realized, December would finally hit the BSP's 2-4% target range after 20 straight months of above-target inflation readings. It would also mark the slowest pace since the 3% in February 2022.

The Philippine Statistics Authority will release inflation data for December on Friday, Jan. 5.

This year, the National Government plans to borrow P2.207 trillion, consisting of P1.654 trillion from domestic sources and P553.5 billion from foreign creditors. — **Keisha B. Ta-asan**

OPINION

Transfer pricing considerations for intercompany loans

LET'S TALK TAX
PATRICK MANUEL R. OLARTE

As each delicate strand of Christmas light is taken down from the walls, each Christmas ornament is undecked from the halls, and each Christmas tree is carefully dismantled and boxed up, we officially bid a fond farewell to the 2023 holiday season. And as the final pages of the 2023 calendar turn, we find ourselves at a crossroads, reflecting on our experiences during the past year and eagerly anticipating the upcoming journey that awaits us in 2024.

Like the way families gather to celebrate and strengthen their bonds during the holidays, the advent of a new taxable year also brings the need for entities under the same corporate umbrella to collaborate and plan their business operations, organizational goals, and financing strategies ahead of the upcoming year. Perhaps an ever-present concern during such planning is the financial transaction requirements within a corporate group, including the appropriate interest rate and terms and conditions to be implemented to ensure that intercompany loans are negotiated at arm's length.

Worry not. The Bureau of Internal Revenue (BIR) issued Revenue Audit Memorandum Order (RAMO) No. 1-2019 which includes a chapter prescribing guidelines on testing the arm's length nature of interest payment transactions.

Further, the Organization for Economic Cooperation and Development (OECD) issued its final transfer pricing guidelines on financial transactions in February 2020. This marks the first time the OECD has laid out specific transfer pricing guidelines relating to intercompany financial transactions.

In this edition of Let's Talk TP, we discuss the key factors to consider in determining whether intercompany financial transactions are carried on at arm's length.

DELINEATION OF FINANCIAL TRANSACTIONS

Our previous article "The real deal: Delineating transactions in transfer pricing," discussed the concept of "substance over form" and how the economic and factual substance of transactions matter over their legal form in determining the arm's length price for controlled transactions between associated enterprises. This concept holds true when it comes to intercompany loans.

The RAMO and OECD guidelines highlighted that evaluating whether a financial transaction is carried out at arm's length does not only entail determining if the interest rate implemented is at arm's length. It also involves determining whether a prima facie loan can indeed be regarded as a debt transaction or if it can be construed as a contribution to equity. This will ultimately have tax consequences to the parties involved since the corresponding interest income or interest expense recognized may be partially or fully disallowed for taxation purposes if it can be determined that the debt transaction is, in essence, a capital contribution.

In one instance cited by the RAMO regarding the re-characterization of a financial transaction, an investment in a related party in the form of interest-bearing debt is not expected to be structured in the same way had it been conducted at arm's length given the economic circumstances of the lending company. In this case, it is appropriate for the transaction to be characterized according to its economic substance, and the loan may be treated as a capital subscription.

Now, it is critical to know the following economically relevant characteristics which are useful indicators in accurately delineating intercompany advancement of funds according to OECD: (a) presence or absence of a fixed repayment date; (b) obligation to pay interest; (c) right to enforce payment of principal and interest; (d) status of the funder in comparison to regular corporate creditors; (e) existence of financial covenants and security; (f) source of interest payments; (g) ability of the recipient of the funds to obtain loans from unrelated lending institutions; (h) the purpose of the loan and business strategy; and (i) the purported debtor's ability to repay on the due date or to seek a postponement.

The RAMO also defined the steps to be undertaken by the taxing authority in testing the nature of loan transactions which are performing analysis of the need for the debt, confirming that the loan actually occurred, testing the arm's length nature of the debt-to-equity ratio, testing interest rate of loans with affiliated parties, determination of arm's length price; and applying the corresponding adjustments.

INTEREST RATE BENCHMARKING ANALYSIS

The determination of the arm's length interest rate ultimately requires the identification of comparable transactions. In our previous articles, we discussed how the Comparable Uncontrolled Price method (CUP method) compares the price and conditions of products or services in a controlled transaction (i.e., between related parties) with those of an uncontrolled transaction (i.e., between unrelated parties). The OECD noted that the CUP method may be easier to apply to loan transactions than any other type of transactions due to the widespread existence of markets for borrowing and lending between independent borrowers and lenders. The arm's length interest rate for a tested loan can be benchmarked against publicly available data for other borrowers with the same credit rating for loans with sufficiently similar terms and conditions and other comparability factors.

According to the RAMO, testing the interest rate of intercompany loans involves the comparison of such rates with those commonly used by independent parties, which are usually calculated from a particular interest rate (i.e., BSP, LIBOR, SIBOR, USOR, or JISOR) plus a certain amount based on the credit rating of the borrower.

Based on the foregoing, the question now arises: Is it acceptable to merely use the interest rates published by Bangko Sentral ng Pilipinas (BSP) and other independent financial institutions as valid benchmark for interest rate of intercompany loans?

Note that the OECD emphasized several factors to consider in determining the appropriate comparable interest rates such as the similarity of the terms and conditions of the transaction, the credit rating of the borrower and other economic factors.

In fact, the OECD acknowledges that comparability adjustments may be required due to the varying features of debt instruments. Characteristics that usually increase the risk for the lender, such as long maturity dates, absence of security, subordination, or application of the loan to a risky project, will tend to increase the interest rate. Characteristics that limit the lender's risk, such as strong collateral, a high-quality guarantee, or restrictions on future behavior of the borrower, will tend to result in a lower interest rate.

Going back to the question, interest rates published by BSP, and other independent financial institutions can be used as benchmark but are subject to comparability adjustments as discussed by the OECD.

In case that there are no comparable uncontrolled transactions which could reasonably be used as benchmark, the OECD suggests that the cost of funds approach may serve an alternative to price intra-group loans. This approach considers the following borrowing costs borne by the lender when raising funds to be lent: (a) expenses incurred in arranging and servicing the loan; (b) a risk premium to account for the various economic factors inherent in the proposed loan; and (c) a profit margin, which will generally include the lender's incremental cost of the equity required to support the loan.

Keep in mind, however, that the cost of funds approach should be applied by considering the lender's cost of funds relative to other lenders operating in the market. Lenders cannot simply charge based on their cost of funds. It requires consideration of the options realistically available to the borrower as well. A borrowing entity would not execute a loan priced under the cost of funds approach if it could obtain the funding under better conditions by entering an alternative transaction.

The OECD also clarified that opinions issued by independent banks stating the interest rate the bank would apply were it to make a comparable loan to that particular entity are not sufficient evidence of an arm's length transaction. Such practice deviates from the arm's length approach to comparability since it is not based on the comparison of actual transactions.

DEBT CAPACITY ANALYSIS

In addition to delineating the transaction and determining the arm's length interest rate, it's also important to demonstrate that the borrower would have been able to raise a similar quantity of debt from independent lenders.

The creditworthiness of the borrower is one of the main factors independent moneylenders take into consideration when entering into a loan agreement. Even on a personal level, you wouldn't extend a loan to a person you know is not financially capable of paying you back or has a history of failing to meet payment obligations, wouldn't you? Thus, it is imperative to assess the credit quality of the borrower in a controlled transaction.

An independent lender will usually carry out a thorough credit assessment of the potential borrower to enable the lender to identify and evaluate the risks involved and to consider methods of monitoring and managing these risks. Such credit assessment includes understanding the structure and purpose of the loan, determining the source of repayments, and analyzing the borrower's cash flow forecasts and the strength of its balance sheet.

Remember, the ultimate objective of the arm's length principle is to ensure that a transaction is carried out as if it were entered into by independent parties. Hence, the related party lender is expected to perform a thorough credit assessment of the related party borrower, as if it were an independent financial institution.

TAKEAWAY

Holiday seasons may come and go, but as businesses continue to expand beyond global borders, the intricate webs of intra-group financial transactions are here to stay. And as we usher in a new taxable year, taxpayers must approach transfer pricing considerations on intercompany loans with a proactive mindset.

The RAMO and OECD provide detailed transfer pricing guidelines to ensure that financial transactions are carried out at arm's length. It is prudent that taxpayers prepare transfer pricing documentation containing the necessary information to establish that the terms and conditions of their intercompany loans are at arm's length. Although not yet prevalent in Philippine tax audits, transfer pricing issues relating to financial transactions are looming on the horizon and are something to watch out for in the future.

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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