

## Transfer pricing consideration in BIR's new audit selection process

The Bureau of Internal Revenue (BIR) entered 2026 with an important shift in identifying taxpayers that will undergo tax audits. Revenue Memorandum Order (RMO) No. 12026 outlines a system-assisted, risk-based selection framework that relies on analytics and selection criteria to determine entities most likely to present tax compliance risks. Notably, the framework integrates transfer pricing (TP) considerations into the selection process. This reflects the BIR's continued focus on related-party transactions.

In our previous article "Actual TP Audit: What the BIR Flags and Key Takeaways," we highlighted how the BIR examined and challenged the transfer pricing of the taxpayer's related-party transactions. The inclusion of TP-related indicators under RMO No. 1-2026 suggests that this type of review will now become more routine and systematically applied in the BIR's audit process.

This article examines the TP-related audit triggers outlined in RMO No. 1-2026. Understanding these considerations is crucial for taxpayers, as these will serve as early warning signs of potential BIR audit.

### SIGNIFICANT INCREASE IN EXEMPT/ZERO-RATED SALES

One relevant trigger identified in RMO No. 12026 is a substantial increase in zero-rated or exempt sales or revenue. A significant increase in such sales may draw the attention of tax authorities because these transactions directly reduce the taxpayer's effective tax burden and, in many cases, the government's tax base. Zero-rated sales allow recovery of input VAT, while exempt sales eliminate output VAT altogether. When these sales grow materially, particularly in cross-border or related-party transactions, tax authorities may perceive a heightened risk that the structure is being used to achieve tax efficiencies rather than reflecting ordinary commercial activity.

From a transfer pricing perspective, a sharp increase in exempt or zero-rated sales often coincides with expanded inter-company transactions, such as the provision of services to foreign affiliates. This can raise concerns that profits are being shifted out of the jurisdiction through non-arm's length pricing, for example by limiting the local entity to routine, cost-plus returns regardless of the value of functions performed. Tax authorities may therefore scrutinize whether the pricing of these transactions appropriately reflects the economic contributions, assets, and risks assumed by the taxpayer.

Another common red flag arises when growth in zero-rated or exempt revenue is not accompanied by a corresponding improvement in profitability or is inconsistent with industry benchmarks. If revenue increases substantially, but margins remain low or decline, tax authorities may question whether the taxpayer is being adequately compensated under arm's-length conditions. Such inconsistencies can suggest that transfer prices have been influenced by VAT or tax considerations rather than by market-based outcomes.

Finally, significant increases in exempt or zero-rated sales often trigger broader audits, particularly where VAT refund or credit claims are involved. These audits frequently expand beyond indirect taxes to include a review of inter-company agreements, functional characterization, and transfer pricing documentation. As a result, even commercially-driven increases in exempt or zero-rated sales can become a transfer pricing red flag if they are not clearly supported by robust documentation, sound economic analysis, and alignment between contractual terms and actual operations.

### INCOME TAX DUE OF LESS THAN 2% OF GROSS SALES

Another important selection factor concerns taxpayers that report very low effective income tax rates, specifically when the tax due is less than 2% of gross revenue.

An income tax due that is consistently below 2% of gross sales or revenue is commonly treated by the BIR as a preliminary risk indicator for audit selection, particularly in transfer pricing cases. While tax laws do not prescribe a minimum income tax ratio, this metric is frequently used by the BIR as a practical screening tool to identify entities whose reported profitability appears low relative to their scale of operations. From an enforcement standpoint, a low income tax-to-revenue ratio suggests a potential erosion of the domestic tax base, warranting closer examination.

From a transfer pricing perspective, this red flag is especially pronounced where the taxpayer is engaged in related-party transactions, such as inter-company services, royalties, or management fees. The BIR may question whether the Philippine entity is being compensated at arm's length, particularly if it is characterized as a routine service provider earning only modest mark-ups despite performing substantive functions or supporting core group operations. A tax outcome showing income tax due of less than 2% of gross revenue may indicate that profits are being shifted to related parties abroad through pricing mechanisms that do not reflect economic reality.

The risk is further heightened when the low income tax ratio is inconsistent with industry benchmarks or the taxpayer's historical performance. In BIR transfer pricing audits, examiners often compare the taxpayer's profit margins against those of comparable independent companies or against prior years before changes in inter-company arrangements. If similarly situated companies earn materially higher margins, or if

profitability declined following a restructuring or expansion of related party transactions, the BIR may infer that transfer prices were adjusted in a manner that suppresses taxable income in the Philippines.

Ultimately, an income tax due of less than 2% of gross sales does not automatically mean non-compliance. However, in Philippine practice, it significantly increases the likelihood of a transfer pricing audit, particularly when combined with recurring losses, growing related party expenses, or limited economic substance. Taxpayers in this position are therefore expected to maintain robust transfer pricing documentation, clearly demonstrate their functional profile, and show that their pricing outcomes are consistent with arm's-length principles. Absent such support, a low income tax ratio may be viewed by the BIR not as a commercial result, but as a signal of potential transfer pricing exposure.

### SUBSTANTIAL REVENUE BUT REPORTING NET LOSSES

RMO No. 12026 also flags taxpayers that report significant revenue while consistently reporting net losses. Entities categorized as limited-risk service providers, distributors, or manufacturers typically earn positive returns under normal commercial conditions. While temporary losses may be reasonable due to market conditions, strategic shifts, or operational inefficiencies, the BIR transfer pricing guidelines provide that independent parties would not accept long-term losses without corresponding commercial justification.

Repeated or unexplained losses may indicate potential mispricing, such as under-remuneration for services rendered to affiliates, excessive deductions, or disproportionate allocations of global costs to the Philippine entity.

### SUBSTANTIAL REVENUE FROM RELATED PARTIES

Entities whose revenue comes almost entirely from related parties are also expected to face heightened scrutiny under the new RMO. These are typically captive service centers or global business service hubs whose pricing structures are internally set by group policy rather than by market forces.

The BIR evaluates whether the functional profile of such entities aligns with their reported results, whether inter-company agreements accurately describe actual operations, and whether margins fall within arm's length. RR No. 22013 places the burden of proof on the taxpayer to demonstrate arm's-length outcomes. Inconsistencies between TP documentation, agreements, and tax filings often serve as clear red flags and can lead to substantial adjustments.

### SHARED EXPENSES AND OTHER INTERRELATED CHARGES

Shared expenses and inter-company cross-charges remain one of the BIR's most scrutinized areas, particularly where taxpayers are unable to support the economic rationale or allocation basis of charges relating to regional management, IT services, marketing intangibles, brand fees, treasury functions, or global insurance arrangements. Revenue Audit Memorandum Order (RAMO) No. 12019 identified these areas as high-priority audit subjects.

The BIR evaluates whether these charges pass the benefit test and whether cost allocations reflect economic reality. Taxpayers unable to provide documentation such as cost pool breakdowns, allocation keys, or proof of benefit may face significant adjustments.

### THE IMPORTANCE OF TP DOCUMENTATION

TP documentation remains the taxpayer's strongest safeguard. Without contemporaneous TP documentation, the BIR may rely on internal comparables, industry-based profit indicators to determine tax base. A consistent TP policy, aligned across agreements, functional analyses, and financial statements, is essential in mitigating audit risk.

### KEY TAKEAWAY

For business leaders, the BIR's audit selection framework as outlined in RMO No. 12026 underscores the need to view transfer pricing as an enterprise-level risk rather than a purely technical compliance matter. Indicators such as substantial revenue coupled with net losses, income tax due that is disproportionately low relative to gross revenue, heavy reliance on related-party income, and the presence of shared expenses or inter-company charges are now central to the BIR's data-driven risk assessment. While these factors do not automatically imply non-compliance, they require active oversight to ensure that pricing outcomes are aligned with the company's functional profile and commercial reality. In this environment, business leaders are expected to proactively assess transfer pricing exposure, ensure consistency between financial results and transfer pricing policies, and strengthen documentation and internal controls to manage audit risk and support informed, defensible tax positions.

*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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# Auctions set for Naga, Ormoc, Tacloban, Kalibo airport dev't projects

THE Department of Transportation (DoTr) said it is inviting bidders for airport upgrade and development projects for Naga City, Ormoc, Tacloban, and Kalibo airports, with the contracts valued at a combined P1.65 billion.

In a bid notice on Monday, the DoTr said it is inviting interested parties to develop the P431.33-million New Naga Airport.

It said the winning contractor for the New Naga Airport Development project will have 270 calendar days, inclusive of pre-determined unworkable days, to complete the project.

Qualified bidders must have completed a similar project within the last

10 years from the date of submission of the bid, it said.

The DoTr also issued a bid invitation for the P419.92-million Ormoc Airport development project, which will cover airside civil works and runway improvements. The winning contractor will have 360 days to complete the contract.

Also issued were bid notices for the P611.10-million Tacloban Airport and the P189.64-million Kalibo International Airport development projects.

The contract for Tacloban includes construction and upgrade of airside facilities, with the winning bidder given 390 days to complete the project.

The Kalibo project covers landslide site development, the DoTr said, with the winning contractor given 240 days to finish the project.

The DoTr said bidders will have until March 16 to submit bids for the projects.

The DoTr's airport upgrade program is focused on improving many provincial airports to accommodate at least narrowbody jets to handle the growing passenger capacities. The capacity to handle Boeing 737 or Airbus A320 aircraft — the most prevalent single-aisle jet models — also suggests upgrades to attract direct international flights. — **Ashley Erika O. Jose**

## Maharlika Investment Corp. appoints chief investment and operating officer

MAHALIKA INVESTMENT Corp. (MIC) said it appointed Kheed Nielsen Ng as its chief investment and operating officer.

"As MIC increases its investment activity, ensuring clear leadership, accountability, and authority within the investment function is critical to delivering on MIC's mandate and meeting stakeholder expectations," MIC President and Chief Executive Officer Rafael D. Consing said in a statement on Monday.

"With a proven track record of managing and scaling wealth on a global stage, Mr. Ng possesses the strategic foresight and technical depth essential to driving MIC's investment mandate forward," he added.

Mr. Ng first joined the MIC as vice-president of the investment management group. His new posts were confirmed during the MIC's board meeting on Feb. 12.

He will now serve as MIC's principal technical authority on investment strategy and portfolio management, as well as serve as a key adviser to the board.



KHEED NIELSEN NG

"His position entails full oversight of the Investment Management Group, including investment strategy formulation, portfolio construction and asset allocation, risk management integration, performance evaluation, and alignment with global sovereign wealth fund governance standards," MIC said.

Mr. Ng previously held senior investment roles at Canada Pension Plan Investments and Morningside Capital.

He also has been an investment banker and private equity investor, with professional experience in North America, Europe, and Asia.

"Over the course of his career, he has evaluated investments across a wide range of industries and overseen the deployment of approximately \$2 billion in capital," MIC said. — **Justine Irish D. Tabile**

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