

Philippines issues guidelines for transfer pricing audits

EY Tax News Update: Global Edition

EY's Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration [here](#).

Also available is our [EY Global Tax Alert Library](#) on ey.com.

Executive Summary

The Philippine Bureau of Internal Revenue (BIR) issued Revenue Audit Memorandum Order No. 1-2019 (the Transfer Pricing (TP) Audit Guidelines),¹ which provides standardized audit procedures and techniques applicable to taxpayers with related-party and/or intracompany transactions.

This Alert summarizes the key aspects of the TP Audit Guidelines.

Detailed discussion

Background

Related-party transactions subject to TP audits include both cross-border and domestic transactions, including intracompany transactions, which occur when a firm has activities subject to different tax regimes² that may be abused to minimize tax liabilities by misallocating revenues and costs.

The TP Audit Guidelines apply to the following transactions:

- ▶ Controlled transactions between related/associated parties, when at least one party is subject to tax in the Philippines, including sale, purchase, transfer and utilization of tangible and intangible assets, provision of intra-group services, interest payments and capitalization.

- ▶ Transactions between permanent establishments (PEs) and their head offices or other related branches.³

The TP Audit Guidelines also cover business restructuring within a multinational group and cost contribution arrangements.

General audit procedure

A TP audit tests the arm's-length nature of intercompany transactions by applying the transfer pricing method under the best method concept – the method that produces the most reliable result under the facts and circumstances.

The BIR TP audit procedure consists of three phases: preparation; implementation; and reporting.

The preparation phase begins with the gathering of information on the taxpayer's related party transactions, related parties, and the taxpayer's selected TP method. Documents that may be requested for the audit will include annual income tax returns, audited financial statements, tax treaty relief applications/rulings, prior year audit reports, TP policy and TP documentation. The taxpayer may also be required to submit, within five working days from receipt of notice, information/evidence of segmented financial statements, supply chain management analysis, functional, asset and risk analysis, and comparability analysis.⁴

The implementation phase includes the characterization of the taxpayer's business, selection of the appropriate TP method,⁵ and application of the arm's-length principle.

If a price in a controlled transaction is not at arm's length, the revenue officer may make an adjustment to reflect an arm's-length price or interest rate.

Revenue officers are required to issue a written report after the audit has been concluded. The revenue officer should meet with the taxpayer to discuss the audit findings on all issues prior to finalizing the report.

Implications

It is expected that the BIR will aggressively conduct TP audits, identify issues and impose assessments to taxpayers with related-party and/or intracompany transactions. The outcomes of any transfer pricing audit may have significant financial impacts. Accordingly, it is recommended that taxpayers review their current TP documentation to assess if additional steps should be taken to reduce TP audit risks.

The TP Audit Guidelines are applicable to the audit/investigation of tax returns upon approval.

Endnotes

1. The TP Audit Guidelines were dated 20 August 2019.
2. For example, taxpayers granted income tax holidays, 5% gross income tax, and regular corporate tax.
3. Under the TP Audit Guidelines, a PE will be treated as a separate and distinct enterprise from its head office or other related branches/subsidiaries for tax purposes.
4. Information/evidence includes details of related party transactions; segmented financial statements; supply chain management analysis; function, assets and risk analysis; characteristics of business; and comparability analysis.
5. As identified in the Philippine Transfer Pricing Guidelines (Revenue Regulations No. 2-2013).

For additional information with respect to this Alert, please contact the following:

Ernst & Young Philippines (SGV & Co.), Makati City

- ▶ Fabian Delos Santos fabian.k.delos.santos@ph.ey.com
- ▶ Fidela T. Isip-Reyes fidela.t.isip-reyes@ph.ey.com
- ▶ Reynante Marcelo reynante.m.marcelo@ph.ey.com

Ernst & Young LLP (United States), Philippine Tax Desk, New York

- ▶ Betheena Dizon betheena.c.dizon1@ey.com
- ▶ Michelle Arias michelle.arias@ey.com

Ernst & Young LLP (United States), Asia Pacific Business Group, New York

- ▶ Chris Finnerty chris.finnerty1@ey.com
- ▶ Kaz Parsch kazuyo.parsch@ey.com
- ▶ Bee-Khun Yap bee-khun.yap@ey.com

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Transfer Pricing Group

© 2019 EYGM Limited.
All Rights Reserved.

EYG no. 001192-19Gbl

1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com