



Client Advisory Letter

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January 2019

At a glance

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clarifications on selected topics

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Does your contract manufacturing arrangement contain an embedded lease?

At a glance

PFRS/IFRS 16, 'Leases', will impact the accounting and financial reporting for companies in the pharmaceutical and life sciences (PLS) industry in many areas. This article highlights key considerations regarding the evaluation of contract manufacturing arrangements for potential embedded leases. The new leases standard requires lessees to record an asset and a liability on the balance sheet for nearly all leases. This requirement also applies to any leases embedded in other arrangements. To identify embedded leases, companies will need to consider arrangements not typically thought of as leases, including supply contracts, data center agreements, outsourcing contracts and contract manufacturing arrangements. This publication focuses on the latter as an example of an arrangement that might contain an embedded lease. Determining whether an arrangement contains an embedded lease often requires a detailed analysis that involves significant judgement.

What is the issue?

Contract manufacturing agreements can take many different forms. Generally, these agreements are structured such that a pharmaceutical company (Pharma) outsources the manufacturing of product to a contract manufacturing organization (CMO). The general rule under the new leases standard is that an arrangement contains a lease if (1) there is an explicitly or implicitly identified asset in the contract, and (2) the customer controls the identified asset over the period of use.

1. Identified asset

Contract manufacturing agreements could contain tangible assets that are explicitly specified in the contract. Examples might include machinery, production lines, and/or dedicated space in a facility. Even where no asset is explicitly specified in the contract, a tangible asset might be implicitly specified at the time when the asset (such as a machine or production line) is made available for use, provided that no alternative assets exist for the supplier to fulfil its obligations under the contract.

If an asset is explicitly or implicitly identified, the existence of substitution rights by the supplier will need to be evaluated. Where such rights are substantive, despite the existence of a specified asset, the customer would not have the right to use an identified asset, and thus a lease would not exist. A supplier's right to substitute an asset is considered substantive only if both of the following conditions exist: (1) the supplier has the practical ability to substitute alternative assets throughout the period of use; and (2) the supplier would benefit economically from the exercise of its right to substitute the asset. This assessment is completed at inception of the arrangement based on facts and circumstances that exist as of that date.

The following factors are examples that might indicate that an arrangement does not contain a substantive substitution right and therefore includes the use of an identified asset:

- The contractual arrangement prevents the CMO from substituting the identified asset.
- The contractual arrangement allows the CMO to substitute the identified asset; however, Pharma designed aspects of the production line, which is highly specialized for Pharma's product.
- Alternative machines or production lines are not readily available to the supplier, or cannot be sourced by another entity in a reasonable period of time and without incurring costs that exceed the related benefits from substitution.
- The costs to relocate the manufacturing process to a different production line or machine exceed the related benefits. This might particularly be the case, for example, where the manufacturing process is highly specialized, complicated, or temperature controlled. Pharma should carefully assess each contract manufacturing agreement for these and similar terms. A supplier's ability to use alternative assets temporarily, while they repair or upgrade a production line, does not represent a substantive substitution right.

Where Pharma is unable to readily determine if there is a substantive substitution right, it is presumed that no substitution right exists.

2. Right to control the use of an identified asset over the period of use

If Pharma concludes that the arrangement implicitly or explicitly identifies an asset, it must then evaluate whether it controls the use of that asset throughout the period of use. Pharma should assess whether, throughout the period of use, it has (1) the right to obtain substantially all of the economic benefits from use of the identified assets, and (2) the right to direct the use of the identified asset. Both criteria must be met for the arrangement to contain a lease. The following are among the factors that should be considered to determine whether Pharma controls the asset:

- The frequency and timing of purchase orders generated. Where this substantially determines whether and when the related machine or production line produces output, this might indicate that the customer (that is, Pharma) effectively has the right to direct the use of the related identified assets.
- Pharma's role in the operating decisions. If Pharma can dictate specific operating instructions or must approve operating decisions, that might be an indicator that the customer has the right to direct the use of the asset.
- Whether the CMO has the right and ability to sell the product to another customer. If the CMO can sell the product to anyone other than Pharma (for example, to a collaborative partner), that might be an indicator that the CMO (and not Pharma) has the right to direct the use of the asset.

Example #1:

Facts: Customer A enters into an arrangement with a CMO to produce medical equipment and disposables ('the Products') that customer A then sells to outside customers. The CMO has multiple production lines that it uses to fulfil orders for multiple customers. The arrangement allows the CMO to choose the production line used to fulfil customer A's orders. Even after the production of the Products commences on a product line, CMO can easily change to a different production line, with minimal transfer costs, because other production lines are available. Customer A submits legally binding purchase orders quarterly to the CMO, and it is contractually required to provide an annual non-binding production forecast. The Products are generic, and can easily be stored, and the CMO has full discretion over the operating process, including the selection of materials to use in production.

Question: Does this arrangement contain a lease?

Discussion: This arrangement is not likely to contain a lease under PFRS/IFRS 16. While the use of an asset (that is, the production line) is implicit in the contract, there is likely no identified asset, because substantive substitution rights exist (assuming that the CMO can benefit from substitution). Even if there was no substantive substitution, there is likely not a lease, because the CMO has the right to change the operating process and decide when the output is produced.

Example #2:

Facts: Assume the same facts as in Example#1, except that there is a dedicated production line for the Products, the CMO is contractually unable to use any other production line, the Products are highly specialized, and purchase orders are very frequent and effectively determine whether, when and how much output is produced. In addition, key operating decisions are standardized, and any changes in operating procedures are subject to approval by customer A.

Question: Does this arrangement contain a lease?

Discussion: This arrangement is likely to contain a lease under PFRS/IFRS 16. An identified asset is explicit in the contract (that is, the production line), and there are no substitution rights. There is a dedicated production line, and customer A appears to effectively control the decision-making rights over the use of the production line, because customer A's purchase orders effectively determine whether, when and how much output is produced by the dedicated production line. The CMO does not have the right to change the operating instructions, including types of materials/components, overall production process, and other decisions related to the output, without prior authorization by customer A. Customer A also has substantially all of the economic benefits from use of the production line.

Lease arrangements that contain variable payments

Once a lease has been identified (including embedded leases), the accounting is impacted by whether the payments are fixed or variable. Fixed payments required under the lease can come in many forms, such as fixed annual payments or fixed monthly payments to guarantee capacity (often described as 'capacity fees' in lease arrangements). Companies will need to carefully review their lease agreements to ensure that all fixed payments have been identified. Variable lease payments are payments made by a lessee to a lessor for the right to use an underlying asset that vary because of changes in facts or circumstances occurring after the commencement date, other than the passage of time.

Any payments that vary based on an index or a rate should initially be measured using the index or rate at the commencement date. Other variable lease payments will not impact the initial accounting for a lease (unless those payments are in-substance fixed lease payments), meaning that they are not included in the value of the initial lease liability and right-of-use (ROU) asset recorded at inception of a lease.

components from non-lease components and, instead, to treat the entire drug product cost as lease expense as the drug is produced / delivered.

Example #3

Facts: Pharma enters into a two-year contract manufacturing agreement with Supplier, a CMO, to manufacture drug product. Pharma has concluded that it has an embedded lease for the production line. Pharma pays Supplier a fee for each batch of drug product produced. The contract specifies the minimum monthly volume of the drug product that is contractually required to be purchased by Pharma. The specified volume cannot be changed by Pharma during the term of the arrangement.

Question: How should Pharma account for this embedded lease under PFRS/IFRS 16?

Discussion: Pharma is required to purchase minimum volumes throughout the two-year period of use. As a result, although the total consideration is variable, the minimum volumes establish a fixed minimum consideration. First (assuming that Pharma has not elected to account for non-lease components as part of the lease component), Pharma should allocate the fixed consideration between the leased production line (lease component) and drug product (non-lease component), based on their relative stand-alone price at lease commencement. Then, Pharma would record an ROU asset and a lease liability on its balance sheet at the present value of the amount allocated to the lease.

Example #4

Facts: Assume the same facts as in Example #3, except that the contract contains no minimum monthly volume.

Question: How should Pharma account for this embedded lease under PFRS/IFRS 16?

Discussion: While this contract manufacturing agreement contains an embedded lease, the consideration is 100% variable. Because variable consideration is excluded from the value of the initial ROU asset and lease liability, there would be no initial lease liability for this agreement. Instead, Pharma would record variable lease expense for the embedded lease component over the two-year period. Under the new leases standard, Pharma can elect not to separate lease

Taxes, compliance matters, assessments, and refunds

Hidden treasures

Willfulness may be proven by educational level and ability to understand

An individual taxpayer sold gold and silver to the BSP from 2005 to 2009. However, he did not declare these sales in his ITRs.

Accordingly, the BIR filed a criminal case against him for failing to supply correct and accurate information in his ITRs. The CTA found the taxpayer guilty, sentencing him to imprisonment and payment of fines, and ordering him to pay deficiency income taxes and penalties totaling approximately PH₱12.2bn.

The conviction was based on the following:

- Certified List of Gold Transactions prepared by the BSP
- BSP Letters of Delivery and Sales
- A finding of willful failure to supply correct and accurate information given that the taxpayer is highly educated and testified that he can read and understand everything regarding the ITRs that were prepared by his accountant
- Admission by the taxpayer that he was aware that all income is subject to income tax and that he had an obligation to keep records and receipts of all business transactions

(CTA Crim. Case Nos. O-287 to O-291, promulgated 17 January 2019)

Glossary

BIR – Bureau of Internal Revenue
BSP – Bangko Sentral ng Pilipinas
CIR – Commissioner of Internal Revenue
CTA – Court of Tax Appeals
EWT – Expanded Withholding Tax
FDDA – Final Decision on Disputed Assessment
ITR – Income Tax Return
RR – Revenue Regulations

Missed opportunities

Disallowance of expenses despite payment of deficiency withholding taxes

After receiving the FDDA on 23 September 2014, the taxpayer filed a request for reconsideration with the CIR. The latter's decision was received by the taxpayer on 24 February 2015.

On 19 March 2015, the taxpayer paid the deficiency EWT assessment in the FDDA. In light of the EWT payment, the taxpayer sought the cancellation of the related deficiency income tax assessment, invoking Section 2.58.5(C) of RR No. 2-1998 which allows the deduction of expenses if the withholding tax is paid at the time of the investigation or reinvestigation/reconsideration.

The CTA upheld the income tax assessment because the EWT was paid on 19 March 2015, after the taxpayer received the CIR's decision on the request for reconsideration of the FDDA. Therefore, the payment was not considered made during the investigation or reinvestigation/reconsideration.

(CTA Case No. 9016, promulgated 8 January 2019)

Out of time

30-day period to appeal is tolled by a request for reconsideration

When an administrative protest is denied by the duly authorized representative of the CIR, the taxpayer may, within 30 days from receipt of the denial, either file an appeal with the CTA or file a request for reconsideration with the CIR.

Accordingly, if the taxpayer received the FDDA on 12 November 2015, it generally has until 12 December 2015 to file an appeal with the CTA. However, if the taxpayer files a request for reconsideration of the FDDA with the CIR, it has 30 days from receipt of the denial of the CIR to file an appeal with the CTA.

(CTA Case No. 9301, promulgated 4 January 2019)

You've got mail

Proper service of assessment notices

The FAN/FLD should be served to the taxpayer either by registered mail or by personal delivery. Service through electronic mail (email) is not allowed and violates the right of the taxpayer to due process.

(CTA EB No. 1714, promulgated 4 January 2019)

Life support

Non-submission of supporting documents within 60 days from filing of protest

The Tax Code requires that all relevant supporting documents be submitted by the taxpayer within sixty (60) days from the filing of its administrative protest. Otherwise, the assessment becomes final.

However, if there is a showing that relevant supporting documents were attached to the administrative protest, the subsequent non-submission of supporting documents within the 60-day period will not render the assessment final. In this relation, the term 'relevant supporting documents' refer to those documents necessary to support the protest, as determined by the taxpayer and not by the BIR.

(CTA EB No. 1714, promulgated 4 January 2019)

Final analysis

When the 5-year prescriptive period for the right to collect taxes is tolled

The five-year prescriptive period for the BIR's right to collect starts with the date of issuance of the FAN/FLD which is the date when the FAN/FLD is released, mailed or sent to the taxpayer. It is not the date of receipt by the taxpayer.

However, the above prescriptive period is tolled when the taxpayer files a request for reinvestigation of the FAN/FLD - not when a request for reconsideration is instead filed. In determining whether a protest letter is a request for reinvestigation or for reconsideration, the words used by the taxpayer, the tenor of its request, and the type of documents presented may be analyzed by the CTA.

Hence, if documents submitted with a protest letter partake the nature of additional evidence that could not have been passed upon by the BIR examiners during their investigation and re-examination of taxpayer records, the protest letter will be considered a request for reinvestigation. In such case, the prescriptive period to collect is tolled.

(CTA EB No. 1678 & 1680, promulgated 3 January 2019)

A chemical reaction

Importations of alkylate are subject to excise taxes

The Tax Code imposes excise taxes on the importation of naphtha, regular gasoline and other similar products of distillation. According to the CTA, imported alkylate is a product of distillation, hence, subject to excise tax. Although alkylate is not directly produced through distillation (but by alkylation), the olefins and isobutane utilized during alkylation are products of distillation.

(CTA Case Nos. 8914 & 8981, promulgated 18 December 2018)

Glossary

BIR – Bureau of Internal Revenue
CTA – Court of Tax Appeals
FAN – Final Assessment Notice
FLD – Formal Letter of Demand

Ordinary people

ADB's Filipino employees are subject to income tax

According to the CTA, Filipino employees of the ADB are subject to income taxes for the following reasons:

1. The legislature intended to tax the salaries of Filipino employees as provided in the ADB Charter, ADB Headquarters Agreement and Tax Code.
2. The RTC decision that nullified the provision of RMC No. 31-2013 exempting only non-Filipino employees from income tax is not a binding precedent. Further, said RTC decision appears infirm because the CTA has exclusive jurisdiction to rule on the validity of administrative issuances of the CIR.
3. The RMC No. 31-2013 is merely an interpretative rule and does not impose additional tax burdens not found in law.
4. Prior prolonged practice of not collecting income taxes from Filipino ADB employees does not ripen into validity. Hence, the government is not estopped from correcting erroneous non-collection.

(CTA EB No. 1674, promulgated 6 December 2018)

Glossary

ADB – Asian Development Bank
BIR – Bureau of Internal Revenue
CIR – Commissioner of Internal Revenue
CTA – Court of Tax Appeals
FAN – Final Assessment Notice
RMC – Revenue Memorandum Circular
RTC – Regional Trial Court
VAT – Value-Added Tax

Loose authority

Applying the doctrine of apparent authority

A domestic corporation seeks to invalidate the FAN because it never issued a Secretary's Certificate or Board Resolution authorizing a natural person to represent it before the BIR for purposes of the tax investigation.

The CTA upheld the validity of the FAN. Citing a Supreme Court decision, the CTA applied the doctrine of apparent authority whereby the board of directors may validly delegate authority to natural persons impliedly or by acquiescence in the general course of business. Thus, the authority of a corporate officer or agent may either be actual or apparent.

Based on the evidence presented, the internal accountants of the domestic corporation who represented the latter before the BIR were deemed to have apparent authority.

(CTA Case No. 9331, promulgated 11 December 2018)

The cure

Implementing the VAT exemption of certain drugs and medicines

The BIR issued regulations implementing the VAT exemption of sales of drugs and medicines prescribed for diabetes, high cholesterol and hypertension. Here are the salient features of these regulations:

- VAT exemption applies to sales by manufacturers, distributors, wholesalers and retailers of drugs prescribed for the treatment and/or prevention of diabetes, high cholesterol and hypertension.
- VAT exemption does not apply to importations.
- The VAT exemption is effective starting 1 January 2019.
- The Food and Drug Administration will identify and publish a List of VAT-exempt Diabetes, High Cholesterol and Hypertension Drugs which will be posted by the BIR through an RMC.
- Only those drugs and medicines included in the above List are VAT-exempt.
- The word "VAT-exempt" should be prominently indicated in the invoices issued for the sales of VAT-exempt drugs and medicines.

(Revenue Regulations No. 25-2018, published 28 December 2018)

Electric dreams

Excise tax exemption of purely electric or hybrid vehicles

Purely electric vehicles (EVs) are exempt from the excise tax on automobiles. On the other hand, hybrid electric vehicles (HEVs) are subject to fifty percent (50%) of applicable excise tax rates on automobiles.

Prior to removal from the manufacturing plant or customs custody, the BIR, in determining qualification for excise tax exemption, shall require the manufacturer, assembler or importer to submit a certified true copy of the COC issued by the DENR-EMB (for HEVs) or a Certificate of Non-Coverage (for EVs).

(Revenue Regulations No. 24-2018, published 30 November 2018)

Advancement in delay

Amending the Exchange of Information Regulations

Taxpayers who are subjects of a foreign tax authority's request for exchange of information held by financial institutions shall be duly notified in writing:

1. In general - within sixty (60) days after the transmittal of all information by the financial institution to the requesting foreign tax authority; or
2. In cases where notification will likely undermine the success of the investigation of the requesting foreign tax authority and the latter requested deferment of notification – only after receiving communication from the requesting foreign tax authority that the investigation has already attained finality.

(Revenue Regulations No. 22-2018, published 19 October 2018)

Getting started

Clarifying the start of the 90-day period to process VAT refund claims

The 90-day period for the processing of VAT refund applications, in relation to the VAT zero-rated sales of goods, property and services and for attributable input VAT, starts from the date when the application was filed up to the date when the refund is released.

For purposes of counting the 90-day period, the application is considered filed when the supporting official receipts or invoices have been submitted.

(Revenue Regulations No. 26-2018, published 1 January 2019)

Coals of fire

Clarifying the payment of excise taxes on domestic coal

The excise tax on coal is a tax levied on the product. Generally, the coal producer is liable for the excise tax. However, if the excise tax is unpaid and possession of the coal has already been transferred to a buyer/possessor, the latter can be held liable for the unpaid excise tax.

Accordingly, when the coal is removed from the place of production without the payment of excise tax, the coal producer shall be a designated collecting agent of the excise tax due from the buyer-possessor and shall be required as follows:

- To remit the excise tax using BIR Form No. 2200M to be filed via eFPS – reflecting the coal producer's name and TIN
- Simultaneous with the filing of BIR Form No. 2200M, to submit to the BIR via email an alphabetical list of first buyers/possessors with respective TINs, volume of coal sold and excise tax collected
- To submit the above alphabetical list to the BIR via email on a monthly basis starting January 2019
- To reflect the excise tax separately in the invoice

The deadline for filing and payment of the excise tax is on or before the 10th day following the close of the month.

(Revenue Memorandum Circular Nos. 6-2019, issued 17 January 2019 & 105-2018, issued 19 December 2018)

Glossary

BIR – Bureau of Internal Revenue

COC – Certificate of Conformity

DENR – Department of Environment and Natural Resources

eFPS – Electronic Filing and Payment System

EMB – Environment Management Bureau

TIN – Taxpayer Identification Number

VAT – Value-Added Tax

High maintenance

List of VAT-exempt Diabetes, High Cholesterol and Hypertension Drugs

The BIR has disseminated the FDA-prepared List of VAT-exempt Diabetes, High Cholesterol and Hypertension Drugs updated as of 3 January 2018.

(Revenue Memorandum Circular No. 4-2019, issued 15 January 2019)

Joint effort

Implementing guidelines for the VAT-exempt sale of certain drugs

The DOH, DOF, FDA and BIR issued a Joint Administrative Order containing the implementing guidelines for the VAT exemption of the sale of diabetes, high cholesterol and hypertension drugs. Among others, the guidelines mandate the specific roles of the DOH, DOF, FDA and BIR.

The guidelines shall take effect on 1 January 2019 after complete publication in at least one newspaper of general circulation.

(Revenue Memorandum Circular No. 2-2019, issued 10 January 2019)

Across the deadline

Further extending the deadline for processing VAT refund/credit claims

The concerned BIR offices have until 29 March 2019 to act on all VAT refund/credit claims that were filed before the effectivity of RMC No. 54-2014.

(Revenue Memorandum Circular No. 102-2018, issued 11 December 2018)

Trust fund

Setting aside a portion of VAT collections to cover VAT refunds

The BIR published the Joint Circular of the DOF, DBM, BTr, BIR, BOC and COA with respect to the payment of VAT refund claims.

The Joint Circular provides for the following:

- Five percent (5%) of total VAT collections by the BIR and BOC from the immediately preceding year shall be treated as trust receipts to cover the payment of VAT refund claims
- The following VAT refunds are covered:
 1. VAT refunds issued by the BIR pursuant to Section 112 of the Tax Code
 2. Import VAT refunds issued by the BOC pursuant to Section 112 of the Tax Code
 3. VAT drawback on importations issued by the BOC and One-Stop Shop Inter-Agency Tax Credit and Duty Drawback Center
- Procedures for the transfer to the Trust Receipt Account
- Guidelines for the withdrawal of deposits from the BTr
- Duties and responsibilities of the BIR, BOC, BTr, DBM and DOF

The Joint Circular shall be published in the Official Gazette and in at least two (2) newspapers of general circulation prior to its effectivity on 1 January 2019.

(Revenue Memorandum Circular No. 3-2019, issued 10 January 2019)

Glossary

BIR – Bureau of Internal Revenue

BOC – Bureau of Customs

BTr – Bureau of Treasury

COA – Commission on Audit

DBM – Department of Budget and Management

DOF – Department of Finance

DOH – Department of Health

FDA – Food and Drug Administration

RMC – Revenue Memorandum Circular

VAT – Value-Added Tax

Clearing the air

Clarifying issues regarding the PERA Act of 2008

The BIR has issued clarificatory questions and answers (Q&As) in relation to the rules, guidelines and procedures in implementing the PERA Act of 2008. The Q&As touch on the following:

- FBT exemption of the qualified employer's contribution
- Employer's non-entitlement to the 5% tax credit
- Early withdrawal of PERA contribution
- Substituted filing
- Entitlement of overseas Filipinos to TCCs
- Stock transaction tax

(Revenue Memorandum Circular No. 99-2018, issued 7 December 2018)

Third person

Certification of developers of filing and/or payment solutions

To encourage taxpayers to use the eBIRForms, the BIR allows the use of tax filing and/or payment solutions developed by tax software providers (TSPs). However, these solutions should be tested and certified by the BIR.

Accordingly, TSPs may access the Electronic Tax Software Provider Certification (eTSPCert) System in www.bir.gov.ph for the facilitation of the certifications of their tax filing and/or payment solutions.

(Revenue Memorandum Circular No. 98-2018, issued 5 December 2018)

Up for renewal

Policies and guidelines in the re-accreditation of printers of receipts/invoices

The BIR issued guidelines, policies and procedures for the renewal of the accreditation of printers of principal/supplementary receipts/invoices. Among others, they provide for:

- 5-year validity period of the accreditation
- Start date of application for renewal
- Ocular inspection
- Roles and responsibilities of the printer and concerned BIR offices
- Checklist of requirements
- Pro-forma documents

(Revenue Memorandum Order No. 6-2019, issued 15 January 2019)

Glossary

BIR – Bureau of Internal Revenue

FBT – Fringe Benefits Tax

PERA – Personal Equity and Retirement Account

TCC – Tax Credit Certificates

Latest on regulatory landscape

Working from home

Enacting the Telecommuting Act

The President approved the Telecommuting Act which allows private sector employers to offer a telecommuting program to employees wherein the latter are allowed to work from an alternative workplace with the use of telecommunications and/or computer technologies.

Here are some of the features of the Telecommuting Act:

- The telecommuting program may be offered on a voluntary basis and shall be subject to mutually agreed terms and conditions.
- Employers shall ensure the fair treatment of telecommuting employees.
- Employers shall be responsible for data protection.
- The employer and telecommuting employee are responsible administering the arrangement.
- The DOLE shall establish and maintain telecommuting pilot programs.

The implementing rules and regulations shall be issued by the Secretary of Labor and Employment within sixty (60) days from effectivity of the Telecommuting Act.

(Republic Act No. 11165, published 11 January 2019)

Alien arrival

Admission and stay of foreign nationals in the SBFZ as temporary visitors

The President made the following amendments to the guidelines for uncomplicated access of foreign nationals to areas within the SBFZ:

- Upon arrival, foreign nationals who are not 'restricted' should provide, among others, their confirmed onward flight or marine vessel tickets.
- Foreign nationals entering the SBFZ may depart from the Philippines through Subic Bay Piers and Wharves.

(Executive Order No. 72 dated 18 December 2018)

For good measure

Filing of 2019 Annual Financial Statements and General Information Sheet

The SEC adopted measures to maintain an organized and orderly filing of the AFS and GIS. The measures include:

- A number coding schedule (based on the last digit of the SEC registration/license number) for AFS filings of entities whose fiscal year ends in 31 December 2018
- Acceptance of late filings and imposition of penalties
- Requirement of stamp of receipt by the BIR or AABs
- Reminder of the deadline for GIS filing
- Venue of direct filing of the AFS and GIS
- Procedures for filing via SEC Express Nationwide Submission, and via courier or regular mail

(SEC Memorandum Circular No. 1-2019 dated 10 January 2019)

Glossary

AAB – Authorized Agent Bank
AFS – Audited Financial Statements
DOLE – Department of Labor and Employment
GIS – General Information Sheet
SBFZ – Subic Bay Freeport Zone
SEC – Securities and Exchange Commission

Approved for adoption

Recently approved accounting standards and interpretations

The SEC approved the adoption of recently approved accounting standards and interpretations as part of its rules and regulations on financial reporting.

The accounting standards pertain to prepayment features with negative compensation, long-term interest in associates and joint ventures, materiality judgments and real estate industries.

On the other hand, the accounting interpretations pertain to capitalization of operating lease cost, accounting for collector's items, accounting for common areas of condominium corporations, related parties, financial instruments, accounting for reciprocal holdings in associates and joint ventures, accounting for lease-related payments and subsequent treatment of equity component arising from intercompany loans.

(SEC Memorandum Circular No. 13-2018 dated 15 October 2018)

The cable problem

Whether a post-production facility is engaged in mass media activities

A post-production facility engaged in the editing and packaging of imported cable television content (television programs) for re-export to overseas clients (regional distributors) will not constitute mass media, which is a nationalized activity, if said cable content will not be distributed in the Philippines.

(SEC-OGC Opinion No. 18-22 dated 28 November 2018)

Room for doubt

How to determine the nationality of a corporation

The franchise for the operation of a public utility such as telecommunications is limited to Filipino citizens or domestic corporations at least sixty percent (60%) of whose capital is owned by Filipino citizens.

In determining the nationality of a corporation, there are two acknowledged tests, the Control Test and the Grandfather Rule.

According to the SEC, the Grandfather Rule is only applicable when the 60%-40% Filipino-foreign equity ownership is in doubt.

Doubt arises:

- When the investing corporation has less than 60% Filipino stockholdings and the investee corporation has either 60%-40% Filipino-foreign ownership ratio or has 59% or less Filipino shareholdings.
- When there are various indicia that the beneficial ownership and control of the corporation do not, in fact, reside in Filipino shareholders but in foreign stakeholders.

(SEC-OGC Opinion No. 18-24 dated 20 December 2018)

You got served

Determining the nationality of a corporation engaged in the restaurant business

Under the Retail Trade and Liberalization Act, enterprises engaged in retail trade with paid-up capital of less than US\$2.5m are exclusively reserved for Filipino citizens and corporations wholly-owned by Filipino citizens.

In determining whether a domestic corporation engaged in a restaurant business is 100%-owned by Filipino citizens and/or corporations 100%-owned by Filipino citizens, the Control Test does not apply. Therefore, if a corporate stockholder is 60% owned by Filipino citizens and 40% is foreign-owned, the domestic corporation violates the nationality restriction.

(SEC-OGC Opinion No. 18-20 dated 21 November 2018)

Draw the line

Distinguishing advertising from mass media activities

Corporations engaged in advertising and mass media activities have the following nationality restrictions:

Advertising	At least 70% of capital must be owned by Filipino citizens
Mass media	100% of capital must be owned by Filipino citizens

Glossary

SEC – Securities and Exchange Commission

OGC – Office of the General Counsel

In order for an online or mobile app platform operator not to be deemed engaged in advertising activities:

1. It should not write or prepare commercial messages or materials for the products of third party clients to be posted in their platform or mobile app.
2. It should not select for or advise third party clients what medium to use in disseminating the advertising material or commercial messages.

On the other hand, in order for an online or mobile app platform operator not to be deemed engaged in mass media activities:

1. There should not be a pervasive or indiscriminate display to the general public of any advertisements on products or services being offered by the third party clients or even on the platform or mobile app itself.
2. Only the following information may be made available in the app, website or platform:
 - a. enumeration of the services offered by the platform itself
 - b. instruction on how to use the platform
 - c. enumeration of third party partners limited to the name or logo
 - d. any information on the platform required to be displayed by law or regulations
3. The disclosure of the products or services offered by third party clients is only for the purpose of completing the transaction enabled by the app, website or platform.

(SEC-OGC Opinion No. 18-21 dated 28 November 2018)

Raising the bar

Minimum wage rates have been increased in MIMAROPA

The Regional Tripartite Wages and Productivity Board – MIMAROPA Region increased the daily minimum wage of private sector minimum wage workers in MIMAROPA as follows:

Sector/ Industry	Minimum Wage	Basic Wage Increase	New Minimum Wage Rates
All Sectors			
Establishments with 10 workers and above	PHP300	PHP 20	PHP 320
Establishments with less than 10 workers	PHP271	PHP12	PHP283

On 1 February 2019, the daily minimum wage of workers in establishments with less than 10 workers shall be increased by PHP11 from PHP283 to PHP294.

The above daily wage rates shall take effect fifteen (15) days after publication of the subject Wage Order in a newspaper of general circulation.

(Wage Order No. RB-MIMAROPA-09 dated 09 October 2018)

Delayed

Deferring the implementation of IFRS 17

The Insurance Commissioner deferred the implementation of IFRS 17 for life and non-life insurance industries to 1 January 2023. Pre-need companies, HMOs and MBAs are required to comply with the current accounting standards until required by the IC to comply with IFRS 17.

Nevertheless, regulated entities which are willing and ready to comply with IFRS 17 may already implement the same.

(IC Circular Letter No. 2018-69 dated 28 December 2018)

Glossary

IFRS – International Financial Reporting Standards

HMO – Health Maintenance Organization

MBA – Mutual Benefit Association

MIMAROPA – Mindoro Marinduque Romblon Palawan

Making the rules

Financial reporting of health maintenance organizations

The IC issued rules and regulations regarding the issuance of a Standard Chart of Accounts and application of Philippine Financial Reporting Standards with respect to HMOs.

(IC Circular Letter No. 2018-68 dated 28 December 2018)

One fine day

Fines for breach of tariff rates

The Insurance Commissioner promulgated the Guidelines in the Imposition of Fines for Breach of Tariff Rates ("Guidelines"), addressed to all non-life insurance companies doing business in the Philippines and all licensed insurance agents.

The Guidelines also define an 'offense', and provide how a breach and 'intervention' is determined.

(IC Circular Letter No. 2018-67 dated 28 December 2018)

As simple as that

Facilitating the release of life insurance policy proceeds

The presentation of proof of payment of transfer taxes and required taxes are no longer required before life insurance policy proceeds are released by the insurer.

Accordingly, insurers are required to immediately release life insurance policy proceeds to the beneficiaries within sixty (60) days after presentation of the claim and filing of the proof of death of the insured.

(IC Circular Letter No. 2018-63 dated 11 December 2018)

Glossary

BSP – Bangko Sentral ng Pilipinas

EC – Employees Compensation

IC – Insurance Commission

PFRS – Philippine Financial Reporting Standards

SBL – Loan Limit to a Single Borrower

SSS – Social Security System

One from the heart

Increasing the benefits of EC disability and death pensioners

All EC disability and death pensioners are informed of the following benefits:

1. Additional benefit of ~~PHP~~1,500 for EC permanent disability and EC death pensioners effective 1 January 2017, including 13th month; and
2. Carer's monthly allowance granted to all EC permanent disability pensioners is increased from ~~PHP~~575 to ~~PHP~~1,000 effective 19 May 2018.

(SSS Circular No. 2018-023 dated 30 October 2018)

Single bells

Amendments to the SBL applicable to non-stock savings and loan associations

The Monetary Board amended the Manual of Regulations for Non-Bank Financial Institutions on the SBL for non-stock savings and loan associations.

The amendments specifically refer to the following:

- Policy on loan limit to a single borrower
- Loan limit to a single borrower or SBL
- SBL guidelines

(BSP Circular No. 1026-2018 dated 6 December 2018)

The guidance of reason

Amending the appendices and provisions of PFRS 9 guidelines

Further to the guidelines governing the adoption of PFRS 9 – Financial Instruments, the Monetary Board amended certain appendices of the Manual of Regulations for Banks and provisions of the Manual of Regulations for Non-Bank Financial Institutions.

(BSP Circular No. 1023-2018 dated 4 December 2018)

Meet us

Pampanga students get new chairs



The students of Archbishop Emilio Cinense Memorial Integrated School (AECMIS) are happy to receive their Seat of Hope chairs. In the background are Board of trustees and volunteers of Isla Lipana & Co. Foundation, staff members of HOPE in a bottle, the Principal and teachers of the beneficiary school.

Isla Lipana & Co. Foundation turned over 100 chairs to a public school in San Fernando, Pampanga. This latest donation brings the total to over 5,200 chairs that the Foundation has given so far to selected schools nationwide.

Archbishop Emilio Cinense Memorial Integrated School is the 38th school to receive the chairs under the Foundation's Seat of Hope (SOH) program. Foundation trustees Wilfredo Madarang, Jr. and Melissa Ramos signed the deed of donation.

The Foundation responded to a request by Hope in a Bottle Foundation, following the latter's sponsorship of the construction of the school's three-classroom building. Hope in a Bottle Foundation is a developmental social enterprise (DSE) that won the grand prize in the 2017 DSE Awards.

SOH is a flagship program of the Isla Lipana & Co. Foundation, the corporate responsibility arm of Isla Lipana & Co./PwC Philippines. The program aims to address the shortage of quality school chairs in public elementary and high schools nationwide, especially in calamity-stricken areas.



L-R: HOPE's Program Officer for Education Joie Balong, Isla Lipana & Co. Foundation, Inc. Trustees Melissa Ramos and Wilfredo Madarang, Jr. and AECMIS Principal Felisa Cabaobas and Grade 3 Class Adviser Catherine Balagtas sign the deed of donation for 100 Seat of Hope chairs.



The students with their brand-new Seat of Hope chairs.

PwC PH co-launches real estate report with ULI



ULI, represented by Raymond P. Rufino (ULI Global Trustee, at far left) and Carlos "Charlie" Rufino (Chair of Governance, ULI Philippines, at far right), thanks its panelists.

Urban Land Institute Philippines (ULI) and PwC Philippines co-presented the Manila launch of the Emerging Trends in Real Estate® Asia Pacific Report 2019 at Conrad Manila on 16 January 2019. An expert panel of industry leaders had an exchange their insights and own personal perspectives on the report.

Emerging Trends in Real Estate® is an annual series of trends and forecast publications that reflect the views of leading real estate executives in three regions — Americas, Europe, and Asia Pacific. Undertaken jointly with PwC and ULI, the report provides an outlook on real estate investment and development trends.

Deals & Corporate Finance Director Raoul Villegas represented PwC Philippines in the panel, which was moderated by Rick Santos (Chairman, Santos Knight Frank). Co-panelists were Hannah Yulo (Chief Investment Officer, Doubledragon Properties Corp.), Eduardo Francisco (President, BDO Capital Investment Corp.), and Augusto D. Bengzon (Chief Finance Officer, Chief Compliance Officer, and Treasurer, Ayala Land, Inc.).

Alex gives tax updates, reminders to CPAs



PwC Philippines Chairman and Senior Partner Alex Cabrera delivered his talk on tax updates in the "Tax Updates and Year-End Tax Reminders" seminar organized by the PICPA-Philippine Institute of Certified Public Accountants on 30 January 2019.

PICPA's Committee on Legislation and Taxation, chaired by Jose S. Tayag, Jr., sponsored the event that was held at the Palawan Ballroom of EDSA Shangri-La Hotel, Mandaluyong City.

Alex is joined by other resource speakers from the accountancy and government sectors.

Talk to us

For further discussion on the contents of this issue of the **Client Advisory Letter**, please contact any of our partners.

For tax and related regulatory matters



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