REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE
Quezon City

Secs. 106,108, & 114 (C), NIRC Sec. 4.114-2 (a), RR No. 16-2005 RA No. 9136
BIR Ruling No. 014-09 BIR Ruling No. 020-02
VAT-345-2022
JUN 30 2022

PALAWAN POWER GENERATION, INC.
NAPOCOR Compound
Brgy. Tiniguiban, Puerto Princesa City
Palawan

Attention: **<u>Ms. Ma. Theresia N. Delena</u>**
VP–Finance and Administration

Gentlemen:

This refers to your request for confirmation of the following:

1. The Missionary Electrification ("ME") Subsidy being disbursed by National Power Corporation ("NPC") to Palawan Power Generation, Inc. ("PPGI") from the Universal Charge for Missionary Electrification ("UCME") Fund pursuant to the Subsidy Agreements ("SAs") between PPGI, Palawan Electric Cooperative, Inc. ("PALECO"), and NPC executing Republic Act ("RA") No. 9136, otherwise known as the "Electric Power Industry Reform Act of 2001" or "EPIRA Law," as a result of its sale of electricity in an area that is not connected to the transmission system ("off-grid areas" or "missionary electrification areas") to PALECO is not subject to the twelve percent (12%) value added tax ("VAT"), and consequently the five percent (5%) Final Withholding VAT, in connection with Sections 106 and 108 of the National Internal Revenue Code of 1997, as amended ("Tax Code"); and

2. The ME Subsidy is not subject to VAT and as such, an acknowledgment receipt or non-VAT receipt or VAT-exempt receipt is proper, not being a sale of good or service contemplated under the existing laws, rules, and regulations on VAT.

Background

1. **PPGI** is a domestic corporation organized and existing under the laws of the Republic of the Philippines with principal place of business at NAPOCOR Compound, Brgy. Tiniguiban, Puerto Princesa City, Palawan. It is registered with the Securities and Exchange Commission (SEC) on July 11, 2007 with SEC Registration Number to establish, construct, develop,

operate, maintain and administer power plants, auxiliary plants, reservoirs, pipes transmission and distribution lines, power stations and substations and other works; to transmit, generate, supply, sell, whether in bulk or retail, such power to industrial users, distributors and other public utilities, electric cooperative and industrial consumers; to operate as a public utility in distributing, selling and supplying to the general public such power and electricity for their consumption.

2. **PALECO** is a non-stock, non-profit electric cooperative organized and existing by virtue of the provisions of Presidential Decree No. 269, as amended. It is duly registered with the Cooperative Development Authority under Registration No. with principal office address located at Tiniguiban, Puerto Princesa City, Palawan. It is a holder of Certificate of Franchise issued by the National Electrification Commission to operate as an electric distribution utility servicing its member-consumers within the Province of Palawan.

3. **NPC** is a government-owned-and-controlled corporation ("GOCC") created under Commonwealth Act No. 120 on November 3, 1936, as revised by RA No. 6395, as amended. It is mandated to energize far-flung, off-grid areas and islands in the Philippines by virtue of the EPIRA Law. It performs its missionary electrification function through the Small Power Utilities Group ("SPUG") and provides power generation and its associated power delivery systems in areas that are not connected to the transmission system. Its principal office is located in BIR Road corner Quezon Avenue, Diliman, 1100 Quezon City, Philippines.

4. The EPIRA Law signed on June 8, 2001 was enacted to institute reforms and provide framework for the restructuring of the electric power industry, including the privatization of the assets of NPC, the transition to the desired competitive structure, and the definition of the responsibilities of the various government agencies and private entities. Furthermore, the subject law prescribed UCME which institutionalized the provision of subsidies in areas not interconnected to the main grids or missionary areas. Section 34 of the EPIRA Law states that:

> "***Section 34. Universal Charge.*** - *Within one (1) year from the effectivity of this Act, a universal charge to be determined, fixed and approved by the ERC, shall be imposed on all electricity end-users for the following purposes:*
>
> *(a) Payment for the stranded debts and stranded contract costs of NPC and qualified distribution utilities resulting from the restructuring of the industry;*
> *(b) Missionary electrification;*
> *(c) The equalization of the taxes and royalties applied to indigenous on renewable sources of energy vis-à-vis imported energy fuels;*
> *(d) An environmental charge equivalent to one-fourth of one centavo per kilowatt-hour (P0.0025/kWh), which shall*

9K

VAT-345-2022

accrue to an environmental fund to be used solely for watershed rehabilitation and management. Said fund shall be managed by NPC under existing arrangements; and

(c) A charge to account for all forms of cross-subsidies for a period not exceeding three (3) years."

5. On June 2, 2004, Power One Corporation ("POC") entered into Electricity Supply Agreements ("ESAs") with PALECO for peak and reserve electricity supply which was amended on June 1, 2006, May 11, 2007, and August 1, 2007. The terms and conditions of the ESAs are as follows:

   i. PALECO has agreed to buy such electricity up to the plant production capacity and level of service provided in the agreement.
   ii. PALECO has agreed to buy such electricity without prejudice to PALECO's applicable agreement with NPC for a coordinated and systematic supply sharing and payment priorities acceptable to all parties.

6. On August 9, 2007, POC assigned all its rights, title, interests, and obligations in the ESAs to Palawan Power Generation, Inc. by virtue of an Assignment and Assumption Agreement. Upon assignment, the ESAs were approved by the Energy Regulatory Commission ("ERC") through its decisions in ERC Case No. 2007-143 RC dated May 21, 2008, and ERC Case No. 2007-144 RC dated July 7, 2008.

7. Subsequently, Subsidy Agreements were entered into by NPC, PALECO, and PPGI in November 2008 for the power plant in Puerto Princesa, Palawan and in February 2010 for the power plant in Narra, Palawan. These SAs were entered into by the above-parties in furtherance to the EPIRA Law.

8. By virtue of the subject SAs, the existence of the ESAs between PPGI, as the assignee, and PALECO was acknowledged to be in full force and effect. The SAs further recognized that NPC shall administer the disbursement of the subsidy, a portion of the True Cost of Generation Rate ("TCGR") for the electricity supplied by PPGI to PALECO in the form of a subsidy.

9. Per the SAs, the scope of the agreements between the signatories are as follows:

   > "By this Agreement, SUPPLIER (PPGI) shall take over the missionary electrification function of NPC-SPUG in mainland Palawan by supplying a guaranteed dependable capacity of up to 10,000 kW to OFFTAKER (PALECO) in accordance with the ESA between SUPPLIER and OFFTAKER. In consideration, SUPPLIER shall be entitled to receive OFFTAKER Fee from OFFTAKER in accordance with the ESA and should the TCGR be greater than the SAGR (Subsidized Approved Generation Rate), the Subsidy Fee from NPC-SPUG under the terms and subject to the conditions of this Agreement."

9r

AT -

JUN 30 2022

10. Based on the foregoing agreements, after supplying electricity, PPGI issues a Statement of Account ("SOA") in favor of PALECO for the Subsidized Approved Generation Rate ("SAGR") with the following breakdown:

Electricity in kWh	xxx
Multiply: SAGR Rate	xxx
SAGR	xxx
Add: 12% VAT	xxx
Total Amount Billed to PALECO	**xxx**

11. Upon payment by PALECO, PPGI issues a VAT official receipt in favor of the PALECO covering the SAGR as indicated in the SOA.

12. On the other hand, PPGI issues a Billing Statement in favor of NPC for the ME Subsidy amounting to the difference between TCGR and SAGR composing of the following:

Electricity Fee	xxx
Less: Non-VAT Sales	xxx
Amount Subject to VAT	xxx
Add: 12% VAT	xxx
Total Electricity Fee	xxx
Add: Fuel Reimbursement	xxx
TOTAL INVOICE AMOUNT	xxx
LESS: BILLED TO PALECO	xxx
ME Subsidy	**xxx**

13. The above Electricity Fee which is part of the ME Subsidy is both subjected to income tax and VAT in the books and tax returns of PPGI.

14. Before releasing the ME Subsidy by NPC as indicated in the SAs, the latter requires PPGI to issue a VAT official receipt. By reason of this requirement, the disbursement of the ME Subsidy is subject to the twelve percent (12%) VAT by NPC; and a five percent (5%) Final Withholding VAT is withheld by NPC on its disbursement to PPGI.

15. However, a perusal of the SAs between PPGI, PALECO, and NPC will show that there is no requirement to issue a VAT official receipt as a precondition for disbursement of the subsidy fee. The pertinent provisions for the billing of NPC under the SAs are as follows:

> "5. **Payment of Subsidy Fee**
>
> 5.1 **General.** For the supply of electricity from the Power Station during a Billing Month, SUPPLIER is entitled to receive payment equal to the Total Fee calculated using the Energy Fee Formula in the Ninth Schedule of the ESA. The terms and conditions for the SUPPLIER's right to receive the OFFTAKER Fee from OFFTAKER shall be governed by the ESA. Furthermore, should the

T-345-2022

TCGR be higher than the SAGR, the SUPPLIER shall be entitled to recover the difference therein from the ME Subsidy. In such cases, the Subsidy Fee shall be governed by the ESA and payment thereof shall be made in accordance with the procedure provided in this Section.

x x x x x x x x x

5.3. **Billing to NPC.** Within five (5) business days from the end of each Billing Month, SUPPLIER shall deliver to the appropriate NPC-SPUG Area Manager ("Area Manager"), the Subsidy Fee Invoice and its attached documents settling forth the amount of Subsidy Fee due from NPC-SPUG computed in accordance with Ninth Schedule of the ESA.

Within five (5) business days, the SUPPLIER shall forward the Subsidy Fee Invoice and its attached documents to NPC-SPUG.

The ME Subsidy Account Administrator shall, within ten (10) business days from receipt of the Subsidy Fee Invoice, issue a written notice to the SUPPLIER, confirming the Subsidy Fee Invoice or certain portions thereof. Should the confirmation be partial, the written notice shall indicate the portion that is disputed. Should the ME Subsidy Account Administrator fail to issue the written notice within ten (10) business days from the receipt of the Subsidy Fee Invoice, the Invoice shall be deemed confirmed. Within the same ten (10) day period, the ME Subsidy Account Administrator shall process the disbursement voucher ("DV") and endorse the same to the NPC Head Office for payment to SUPPLIER.

x x x x x x x x x

5.5. **Payments.** The amount stated in the DV under Section 5.3 above, shall be due and payable within fifteen (15) business days from issuance of the DV by the ME Subsidy Account Administrator, provided that the following terms shall be complied with at all times:

5.5.1 Manner of Payment. All sums indicated in the disbursement voucher shall be paid in Philippine Pesos.

5.5.2 Supplier Account. The payment to SUPPLIER shall be made through a bank-to-bank transfer to the SUPPLIER Account, maintained either at the

Landbank of the Philippines ("LBP") or the Philippine National Bank ("PNB"), with details indicated as required under Section 4.3.1(d) above.

5.5.3 No deduction. All payments shall be free and clear of any deductions, bank draft or deliver charges, set-offs, counterclaims, taxes or other similar fees and charges, except those which are required by law to be withheld by NPC.

5.5.4 Interest. All sums not paid within the period provided herein shall bear an interest at the rate of the 91-day T-Bill Rate prevailing as of the due date, from the date payment was due until payment is received by SUPPLIER."

In reply, please be informed that Section 114 (C) of the Tax Code reads:

*"**SEC. 114. Return and Payment of Value-Added Tax. –***

x x x   x x x   x x x

(C) Withholding of Value-added Tax. - The Government or any of its political subdivisions, instrumentalities or agencies, including government-owned or -controlled corporations (GOCCs) shall, before making payment on account of each purchase of goods and services which are subject to the value-added tax imposed in Sections 106 and 108 of this Code, deduct and withhold a final value-added tax at the rate of five percent (5%) of the gross payment thereof . . ."

In connection thereto, Section 106 of the Tax Code discusses when VAT may be imposed on sale of goods, while Section 108 of the same Tax Code discusses the circumstances when VAT may be imposed on sale of services, to wit:

*"**SEC. 106. Value-Added Tax on Sale of Goods or Properties. –***

(A) Rate and Base of Tax. - There shall be levied, assessed and collected on every sale, barter or exchange of goods or properties, value-added tax equivalent to twelve percent (12%) of the gross selling price or gross value in money of the goods or properties sold, bartered or exchanged, such tax to be paid by the seller or transferor."

*"**SEC. 108. Value-added Tax on Sale of Services and Use or Lease of Properties.***

(A) Rate and Base of Tax. - There shall be levied, assessed and collected, a value-added tax equivalent to twelve percent (12%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties.

VAT-345-2022

The phrase "sale or exchange of services" means the performance of all kinds of services in the Philippines for others for a fee, remuneration or consideration . . ."

Based on the foregoing provisions of the Tax Code, as amended, to be subjected to the twelve percent (12%) VAT, and consequently, to the five percent (5%) Final Withholding VAT the following must concur:

1. Purchase of goods and services should be subject to the VAT imposed in Sections 106 and 108 of the Tax Code; and

2. The payment is related to the purchase of goods and services by the government or any of its political subdivisions, instrumentalities or agencies, including GOCCs.

In the present case, the above-enumerated requisites are not present, to wit:

1. The grant of the ME subsidy from the UCME Fund being disbursed by NPC as the administrator of the disbursement of the fund is not a taxable income being a mere grant or gift of money in favor of PALECO as an incentive from the government.[1] Subsidy is not an income neither does it fall within the definition of income; it is a grant or gift of money from a government to a private company, organization, or charity to help it to function.[2]

2. There must be a sale, barter or exchange of goods or properties before any VAT may be levied.[3] In this case, the transaction between PPGI and NPC does not involve any sale of goods or services but a mere cash disbursement from the UCME Fund. PPGI did not render any form of service in favor of NPC neither did it sell goods in favor of the latter. PPGI performed services only in favor of PALECO for supplying electricity to PALECO, which was already subjected to VAT. Clearly, there is no sale, barter or exchange of goods or services in the subsidy given by NPC to PPGI.

3. NPC is a mere administrator of the disbursement of funds from the UCME pursuant to Section 70 of the EPIRA Law, as implemented by Section 2 (a) of the Implementing Rules and Regulations of the EPIRA Law. As such, it does not make any payment to PPGI. The receipt of the subsidy from NPC from the UCME Fund lacks the requirement of making payment on its own purchase of goods or services subject to VAT. Therefore, no payment was made by NPC on account of purchase of goods and services in favor of PPGI.

In BIR Ruling No. 020-02 dated May 13, 2002, this Office had occasion to rule that Universal Charge is not considered compensation for services or in the nature of income since it is earmarked by law or regulation for some reason other than the taxpayer.

---

[1] BIR Ruling No. 014-09 dated July 24, 2009
[2] BIR Ruling No. 014-09 dated July 24, 2009
[3] Commissioner of Internal Revenue v. Sony Philippines, G.R. No. 178697 dated November 17, 2010

VAT-

to wit:

> *"1. Collection of Universal Charge by distribution utilities is not part of their taxable revenues nor will it be part of their gross receipts for purposes of determining their franchise taxes. Likewise, the collection of Universal Charge by PSALM will not be considered as taxable income nor will it form part of its gross receipts for VAT purposes.*
>
> *The Universal Charge will be collected from all end-users by the distribution utilities. These charges will be remitted to PSALM and will be used exclusively for the liquidation of the stranded debts and stranded costs of NPC as well as qualified stranded contract costs of distribution utilities resulting from the restructuring of the industry. The EPIRA provides that the Universal Charge is a non-bypassable charge.*
>
> *Accordingly, since the Universal Charges to be collected by the distribution utilities do not belong to them and therefore, would not redound to their benefit, the same will not be considered in the nature of income. Neither will the same form part of the gross receipts of the distribution utilities for purposes of determining their franchise tax liability. Gross receipts of a taxpayer do not include monies or receipts entrusted to the taxpayer which do not belong to them and do not redound to the taxpayer's benefit; and it is not necessary that there must be a law or regulation which would exempt such monies and receipts within the meaning of gross receipts under the Tax Code. In another case, the Supreme Court ruled that* ***the gross receipts of a taxpayer should not include any money which although delivered to it has been especially earmarked by law or regulation for some reason other than the taxpayer****. However, we require that the Universal Charge appear as a separate item in the bill.*
>
> *x x x x x x x x x*
>
> *Neither can the Universal Charge be deemed part of the gross receipts of PSALM for VAT purposes. The term "gross receipts" means the total amount of money or its equivalent representing the contract price, compensation or service fee, including the amount charged for materials supplied with the services and deposits or advance payments actually or constructively received during the taxable quarter for the services performed or to be performed for another person.* ***The Universal Charge is not compensation for services*** *performed by PSALM. While it is authorized under the EPIRA to receive said charges, it is earmarked to be utilized for purposes mentioned in the immediately preceding paragraph."* (Emphasis supplied.)

Considering that the transaction between PPGI and NPC does not fall within the purview of the term gross income because it does not involve any sale of goods or services subject to the twelve percent (12%) VAT under Sections 106 and 108 of the Tax Code,

-345-2022
JUN 30 2022

and the disbursements of ME Subsidy by NPC to PPGI is not NPC's own purchase of goods or services because it is a mere administrator of the distribution of the missionary electrification fund, it follows that the ME Subsidy should not be subject to the VAT and that NPC is not required to withhold the five percent (5%) VAT thereon. Thus, PPGI shall have to issue a VAT-exempt receipt to NPC with respect to the ME Subsidy. In addition, PPGI should maintain subjecting the Electricity Fee, which is part of the ME Subsidy, to income tax and VAT.

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be ascertained that the facts are different, then this ruling shall be considered null and void.

Very truly yours,

CAESAR R. DULAY
Commissioner of Internal Revenue

052190

K-1