REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

TOLEDO POWER COMPANY,
Petitioner,

- versus -

C.T.A. CASE NO. 5881

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
MAR 05 2002

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DECISION

This is a judicial appeal from the inaction of Respondent on Petitioner's administrative protest against the assessment for deficiency value-added tax in the amount of P95,097,140.76, inclusive of surcharge and interest, for the taxable year 1995.

Petitioner is a partnership duly registered with the Securities and Exchange Commission , engaged in the business of power generation, and with principal office at Sangi, Toledo City, Cebu.

On July 20, 1998, Petitioner received a formal assessment notice and demand letter both dated July 13, 1998 from the Bureau of Internal Revenue (BIR) alleging that it has deficiency value-added tax (VAT) for taxable year 1995 in the total amount of P95,097,140.76.

The alleged deficiency VAT assessment issued against Petitioner for taxable year 1995 was arrived at after subjecting all of Petitioner's sales of electricity generated from its Sangi Thermal Power Plant and Carmen Diesel Power Plant to the 10% VAT and deducting from the VAT computed the 2% franchise tax paid for said taxable year.

On August 18, 1998, Petitioner, through its external auditor, Sycip Gorres Velayo and Company, duly filed with the BIR an administrative protest against the subject VAT assessment.

On October 12, 1998, Petitioner through its external auditor, filed with the BIR a supplemental protest, reiterating its disagreement to the deficiency VAT assessment for taxable year 1995, submitting therewith relevant documents to support its position against the merit of the assessment.

To prove its claim, Petitioner submitted documents which were identified by its lone witness. However, this Court denied the admission of some of said documents, specifically the quarterly tax returns for the four quarters of 1995 (Exhibits A-2, A-6, A-9, A-13, A-17), the official receipts to prove payments of its franchise tax liabilities (Exhibits A, A-1, A-3, A-4, A-5, A-7, A-8, A-10, A-11, A-12, A-14, A-15, A-16, A-18) as well as the Power and Fuel Supply Agreement between NPC and ACMDC (Exhibit G) because they were not faithful copies of the documents contained in the BIR records. Likewise, this Court denied the admission of Exhibits E and E-1 (Certificates of Accreditation) for failure of the Petitioner to submit the original copies thereof (see Resolution promulgated on September 11, 2000, p. 183, CTA Records).

Respondent, for his part, offered the following Special and Affirmative Defenses, to wit:

a) Petitioner failed to submit all relevant documents in support of its protest. For instance, it did not submit any document showing that it is a duly accredited Private Sector Generation Facility (PSGF) as alleged in its protest. For its failure to submit all relevant documents, the assessment has become final.

b) In its protest, Petitioner did not question the assessment for failure to state the law on which it is made. Since it did not raise such issue in the administrative level, it cannot raise the same for the first time on appeal to this Honorable Court.

c) During the taxable year in question (1995), Petitioner was not a duly accredited PSGF. Hence, the BIR Rulings to the effect that PSGFs are subject to the 2% franchise tax and not to the 10% VAT are not applicable to the Petitioner.

d) During the taxable year in question (1995), while Petitioner sold electricity generated from the Sangi Thermal Power Plant and Carmen Diesel Plant, it was Atlas Consolidated Mining and Development Corporation who (sic) was duly accredited by the National Power Corporation to supply the latter electricity generated from said Plants. Since Petitioner did not have a contract with NPC, its sale of electricity from said plants should be considered as sale to ACMDC and not to NPC. Hence, the sale is subject to 10% VAT.

e) The assessment was issued in accordance with law and regulations.

f) All presumptions are in favor of the correctness of tax assessments.

Counsel for the Respondent further manifested that since the issues involved are purely legal, she has no evidence to present and submitted the case based on the pleadings and records of the case.

The issues to be resolved in this case are as follows:

1) Whether or not Petitioner was a duly accredited PSGF during the taxable year 1995;

2) Whether or not Petitioner's sale of electricity to NPC generated from Sangi Thermal Power Plant and Carmen Diesel Power plant are subject to 2% franchise tax and not 10% VAT; and

3) Whether or not the formal assessment notice and demand letter dated July 13, 1998 issued by the Respondent against Petitioner for deficiency VAT for the taxable year 1995 are void for failure to state the law and the facts on which the assessment was made.

It is the contention of the Respondent that Petitioner was not yet a duly accredited Private Sector Generating Facility (PSGF) during the taxable year in question inasmuch as the Certificates of Accreditation were issued by National Power Corporation (NPC) to Atlas Consolidated Mining Development Corporation (Atlas) while it was still the owner of the power plants. According to the Respondent, it is the owner or operator of the power plant that should be accredited as a PSGF and not the power plant itself which is an inanimate object having no legal personality.

On July 10, 1987, then President Corazon C. Aquino, issued Executive Order No. 215 allowing the private sectors to generate electricity. Relative thereto, the Department of Energy issued Energy Regulations No. 1-95 effective February 1, 1995 to implement the provisions of said law.

As evinced by the records of this case, Sangi Thermal Power Plant and Carmen Diesel Power Plant were formerly owned by Atlas. On February 8, 1993, NPC allegedly issued Certificates of Accreditation to Atlas Sangi Thermal Power Plant and Carmen

Diesel Power Plant. On July 9, 1994, Atlas and Petitioner herein executed a Deed of Assignment of Power Plants in Exchange for Partnership Interest (Exhibits C-C-5).

Petitioner counters that it is the facility or the power plant itself which is accredited as a PSGF quoting Section 3 of Energy Regulations 1-95 which defines PSGF and Private Sector Generator, *viz*:

> "h.1. '***Private Sector Generating Facility, (PSGF)***' means:
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> (1) any cogeneration facility meeting the minimum thermal efficiency standard set by the DOE for a cogeneration system, or
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> (2) any renewable resource power production facility, or
>
> (3) electric generating facility that shall use indigenous energy resources as its primary energy source, or
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> (4) any electricity generating facility, particularly a Block Power Production Facility, intended to sell all or the bulk of its power output grid, consistent with the development plans formulated by NAPOCOR and/or electric utilities, and approved by the DOE.
>
> i.1. '***Private Sector Generator'*** refers to the owner and/or operator of the accredited PSGF.

We agree with Petitioner's view that it is the PSGF or the power plant itself which is being accredited and not the owner as clearly indicated in the above-cited provision.

Respondent further claims that the transfer of ownership by Atlas of the power plants to the Petitioner on July 9, 1994, did not have the effect of transferring the former's accreditation to the latter because the transfer did not have the express consent of the NPC.

It is worth stressing that there is nothing in Executive Order No. 215 nor in its implementing regulations which requires that any transfer of ownership of the accredited power plant should be with the consent of the NPC or the Energy Industry Administration Bureau, as the case may be. Neither is it provided therein that a change of ownership of an accredited PSGF will result in the revocation of its accreditation. Section 8 of Article III of Energy Regulations 1-95 is hereunder quoted:

> "**Section 8.** *Revocation of Qualified Status.* The EIAB may revoke the qualified status of a PSGF which has been accredited under this Article if such facility fails to comply with the requirements of these Rules and Regulations, or any of the conditions contained in the Certificates of Accreditation, whether provisional or not, issued by the EIAB. The EIAB shall advise relevant parties of its decisions to revoke the qualified status of a PSGF citing the reasons for the revocation."

Thus, it can be noted that accreditation may be revoked if the facility fails to comply with the requirements of the rules or the conditions set forth in the Certificates of Accreditation. This goes without saying that it is really the facility itself which is being accredited and not the owner and/or operator thereof. Furthermore, there is no automatic revocation of accreditation as the EIAB is required first to notify the parties concerned. In reality, there is nothing in the above provision which prohibits the transfer of ownership of an accredited PSGF.

In sum, the change of ownership of Sangi and Carmen power plants from Atlas to Petitioner did not revoke the accreditation granted to the said power plants.

Granting that the Power and Fuel Supply Agreement between Atlas and NPC executed on April 8, 1993 (pp. 20-28, BIR records) provides that the rights and obligations of the parties are assignable and that neither of the parties may assign any rights or obligations without the express consent of the other, it was not stipulated therein that an assignment, transfer or conveyance of any right or obligation without consent would be void. As a matter of fact, it was so provided that neither party shall unreasonably withhold its consent to any such assignment and/or transfer. And no action was ever taken by the NPC to declare the Deed of Assignment between Atlas and Petitioner null and void.

In addition, on February 1, 1996, an Assignment Agreement was executed by and among Atlas, Petitioner and NPC to the effect that Atlas "assigns, transfers and conveys to Toledo absolutely all of its rights, benefits and interests, including the right pertaining to the accreditation of the Power Plants as a PSGF, in and to the full benefits, advantages, privileges and rights under the Power and Fuel Agreement shall hereafter accrue in favor of Toledo. NPC hereby consents to and Toledo hereby accepts the assignment, transfer and conveyance by Atlas of all the latter's rights, benefits and interests in and to the Power and Fuel Supply Agreement." Hence, whatever defect, if any, of the Deed of Assignment earlier accomplished is deemed cured by this Deed of Agreement. Moreover, prior to February 1, 1996, Petitioner had made substantial payments to NPC of the debts incurred by Atlas from the latter which Petitioner assumed as of July 27, 1994. In other words, even before the execution of the Assignment Agreement on February 1, 1996, NPC was already aware of the assignment of ownership to Petitioner from Atlas. And the acceptance of the payments of Atlas's debts is an implied consent of said transfer. Therefore, Petitioner was a duly accredited PSGF in 1995.

Although We have mentioned earlier that the Certificates of Accreditation issued by the NPC were denied admission for failure on the part of the Petitioner to present their original copies, We still find that Petitioner is an accredited PSGF in 1995. Records will reveal that Respondent never questioned the accreditation certificates issued by NPC. In fact, he admitted in his Answer that such certifications were issued in 1993 and that Atlas was duly accredited PSGF as of 1993. His only argument is that it was Atlas who was an accredited PSGF in 1995 and not the Petitioner. Considering that this matter has been exhaustively discussed above, We will now proceed to the second issue of whether or not Petitioner's sales of electricity in 1995 from its Sangi and Carmen power plants are subject to 2% franchise tax and not to 10% VAT.

The BIR had already resolved this issue in VAT Ruling No. 059-90 dated February 28, 1990 when it held that "inasmuch as PSGF are governed by laws applicable to electric utilities, then they are exempt from the payment of value-added tax on their sale of electricity pursuant to Section 103(j) of the Tax Code. However, as electric utilities granted authority by NPC or NEA, as the case may be, to own, operate and generate electricity, they are subject to the 2% franchise tax prescribed in Section 117 of the Tax Code. Likewise, they are subject to income tax." The BIR reiterated the same ruling in VAT Ruling No. 222-90 dated December 12, 1990.

Section 117 of the Tax Code, as amended, is hereby quoted for easy reference:

> **SEC. 117**. *Tax on franchises*. – Any provision of general or special law to the contrary notwithstanding, there shall be levied, assessed and collected in respect to all franchises, upon the gross receipts from the business covered by the law granting the franchise, a tax in accordance with the schedule prescribed hereunder.

(a) On electric utilities, city gas and water supplies ....Two (2) per cent

(b) On telephone and/or telegraph systems, radio broadcasting stations .... Three (3) per cent

(c) On other franchises .... Five (5) per cent

More importantly, in reply to Petitioner's request for confirmation of its opinion that the sale by Toledo Power Company of electricity generated from Sangi and Carmen power plants is subject to 2% franchise tax , the Assistant Commissioner for Legal Service, Alicia Clemeno, had this to say:

> "It is clear from the foregoing that private corporations, cooperatives and similar associations primarily engaged in the generation or sale of electric power which may own and operate qualified PSGFs are subject to taxes applicable to their operations as electric utilities. Since TPC is a partnership primarily engaged in electric power generation, it is subject to taxes applicable to electric utilities.
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> Accordingly, your opinion that the sale by TPC of electricity generated from its Sangi Thermal Power Plant and Carmen Diesel Power Plant is subject to 2% franchise tax under Section 117 of the Tax Code, as amended, is hereby confirmed" (DA 191-96, June 7, 1996, pp. 135-136, BIR records).

However, this ruling is being controverted by the Respondent on the ground that the Petitioner misrepresented its narration of facts for it "did not mention that the sale between ACDMC and Toledo Power Company in 1994 was without the express consent of NPC, in violation of the requirement under EO 215 and implementing rules. Thus, the transfer of ownership by ACMDC of the power plant to the Petitioner did not have the effect of transferring also ACMDC's PSGF accreditation. And, the BIR did not rule on this fact, because it was omitted in the narration of facts." Accordingly, he asserts that Petitioner is subject to 10% VAT and not to the 2% franchise tax.

Since the issue on accreditation has already been resolved, We need not elaborate. Suffice it to say that the sale by Petitioner of electricity in 1995 generated from its Sangi and Carmen power plants is subject to 2% franchise tax and not 10% VAT as ruled by the BIR in the aforementioned rulings.

Finally, We delve on the pivotal issue of whether or not the formal assessment notice and demand letter issued against Petitioner for deficiency VAT in 1995 is void for failure to state the law and facts on which the assessment was made.

Respondent insists that he complied with the requirements under Section 228 of the Tax Code that the taxpayer shall be informed of the law and the facts on which the assessment is made. He avers that in the pre-assessment notice dated February 12, 1998, Petitioner was informed of the result of review/audit conducted under Letter of Authority No. 91112 (p. 195, BIR records) which Petitioner refuted in a letter dated March 4, 1998 (pp. 197-204, BIR records, Annex B, Petition for Review).

For clarity, Section 228 is partly reproduced:

> **SEC. 228**. *Protesting of Assessment*. – When the Commissioner or his duly authorized representative finds that proper taxes should be assessed, he shall first notify the taxpayer of his findings: *Provided, however*, That a preassessment notice shall not be required in the following cases:
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> (a) When the finding for any deficiency tax is the result of mathematical error in the computation of the tax as appearing on the face of the return; or
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> (b) When a discrepancy has been determined between the tax withheld and the amount actually remitted by the withholding agent; or

(c) When a taxpayer who opted to claim a refund or tax credit of excess creditable withholding tax for a taxable period was determined to have carried over and automatically applied the same amount claimed against the estimated tax liabilities for the taxable quarter or quarters of the succeeding taxable year; or

(d) When the excise tax due on excisable articles has not been paid; or

(e) When an article locally purchased or imported by an exempt person, such as, but not limited to, vehicles, capital equipment, machineries and spare parts, has been sold, or traded or transferred to non-exempt persons.

The taxpayer shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.

Within a period to be prescribed by implementing rules and regulations, the taxpayer shall be required to respond to such notice. If the taxpayer fails to respond, the Commissioner or his duly authorized representative shall issue an assessment based on his findings.

Such assessment may be protested administratively by filing a request for reconsideration or reinvestigation within thirty (30) days from receipt of the assessment in such form and manner as may be prescribed by implementing rules and regulations. Within sixty (60) days from filing of the protest, all relevant supporting documents shall have been submitted; otherwise, the assessment shall become final. xxx

Prescinding from the above law, it is crystal clear that the notice being referred to and required to be first sent to the taxpayer is the preassessment notice. This is apparent from the subsequent sentence which enumerates of the exceptions when no preassessment notice is necessary. Further, the next two paragraphs also relate to the first paragraph of Section 228. Thus, what the law mandates of the Commissioner or his duly authorized representative, is to inform the taxpayer of the law and the facts on which the assessment is made. Undoubtedly, this refers to a preassessment notice because the third paragraph provides that if the taxpayer fails to respond to such notice, the Commissioner or his duly authorized representative shall issue an assessment based on the findings. At this point in time, no formal assessment notice has yet been issued by the Commissioner or his authorized representative for the taxpayer is given first the opportunity to answer the said preassessment notice. It must be observed that the law states that if the taxpayer fails to respond, then an assessment shall be issued based on the findings of the Commissioner or his authorized representative. The law this time refers to the formal assessment issued against the taxpayer. It can be remarked that this particular provision does not require that the taxpayer be informed of the law and the facts on which the assessment is made. The reason is simple, the taxpayer is already informed beforehand of the investigation or assessment being made.

The next paragraph provides that such assessment may be protested administratively by filing a request for reconsideration or reinvestigation. Meaning, an investigation has already been made by the Bureau. *A fortiori,* a preliminary or informal conference has already been conducted as is required by the Rules and Regulations. The taxpayer has been given the chance to respond to the preassessment notice. The point We are driving at is that the notice requirement where the taxpayer should be informed of the law and facts on which the assessment is made, actually refers to preassessment notice and not to the formal assessment. As early as the preassessment notice, the taxpayer is made aware of why and how the assessment is arrived at.

This is evidently true in the case at bar. The taxpayer was plainly informed of the law and the facts on which the assessment was made. Petitioner's letter to the Bureau dated August 14, 1998 (Annex B, Petition for Review) will speak for itself. We are not swayed by the allegation of Petitioner that it was not informed of how the assessment was arrived at. If said allegation bears a kernel of truth, how come it was able to intelligently argue its position or opposition to the assessment with the BIR? It must be emphasized that in its protest letter, Petitioner definitely explained how the BIR examiner arrived at the deficiency VAT assessment. The very existence of Petitioner's protest letter belied its averment that it was not informed of the law and the facts on which the assessment was made.

Be that as it may, We still hold that the formal assessment and demand letter are void not because Respondent failed to comply with the provisions of Section 228 of the Tax Code, but because Petitioner is liable to pay only the 2% franchise tax and not the 10% VAT.

Indeed, We denied the admission of the official receipts evidencing payments of the franchise tax for the period involved in this case. The monthly remittance returns to prove the filing of the same for the same period were likewise denied. Nevertheless, Respondent admitted that Petitioner paid the 2% franchise tax in 1995 (see Paragraph 4, Joint Stipulation of Facts). He never questioned the 2% franchise tax or the payment thereof for the taxable year 1995 by the Petitioner. It is noteworthy that in the formal assessment notice Respondent deducted the amount pertaining to the 2% franchise tax paid by the Petitioner for the period to come up with the deficiency VAT.

WHEREFORE, in view of all the foregoing, the assessment issued against Petitioner for the taxable year 1995 for deficiency VAT in the total amount of P95,097,140.76 is hereby **CANCELLED** and **SET ASIDE**. No costs.

SO ORDERED.

AMANCIO Q. SAGA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

JUANITO C. CASTAÑEDA, JR.
Associate Judge

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Judge