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

Secs. 30, 33(A), 105, 237, Tax Code of 1997, as amended
BIR Ruling No. 113-82 BIR Ruling No. 020-02 VAT Ruling No. 073-99
[illegible]
[illegible]

INDEPENDENT ELECTRICITY MARKET OPERATOR
9th Floor Robinson Equitable Tower, ADB Avenue
Ortigas Center, Pasig City

Attention: **Richard J. Nethercott**
President and CEO

Gentlemen:

This refers to your letter requesting, on behalf of **Independent Electricty Market Operator (IEMOP)**[1], for confirmation of the following:

1. The tax implications of the funds received by IEMOP for its own account and for remittance to other entities;
2. The withholding tax implication of income payments made by IEMOP;
3. The liability of IEMOP, as employer, to fringe benefits tax; and
4. The value-added tax (VAT) implications of the receipt of funds by IEMOP, as operator of the **Wholesale Electricity Spot Market (WESM).**

Background of WESM

WESM is defined as the electricity market established by the Department of Energy (DOE) under Republic Act (RA) No. 9136, otherwise known as the "Electric Power Industry Reform Act of 2001", or EPIRA Law, which states:

> *"Sec. 30. Wholesale Electricity Spot Market.- Within one (1) year from the effectivity of this Act, the DOE shall establish a wholesale electricity spot market composed of the wholesale electricity spot market participants. The market shall provide the mechanism for identifying and setting the price of actual variations from the quantities transacted under contracts between sellers and purchasers of electricity.*

[1] Previously, the Philippine Electricity Market Corporation or PEMC handled the market operations of the Wholesale Electricity Spot Market or WESM. This market operations function has been transferred to IEMOP on September 26, 2018. Thus, references to PEMC with respect to its previous market operations functions shall also refer to IEMOP in this Ruling.

> *Jointly with the electric power industry participants, <u>the DOE shall formulate the datailed rules for the wholesale electricity spot market</u>. Said rules shall provide the mechanism for determining the price of electricity not covered by bilateral contracts between sellers and purchasers of electricity users. The price determination methodology contained in said rules shall be subject to the approval of the ERC. Said rules shall also reflect accepted economic principles and provide a level playing field to all electric power industry participants. The rules shall provide, among others, procedures for:*
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> *x x x x x x x x x*
>
> *(c) Administering the market, including criteria for admission to and termination from the market which includes security of performance bond requirements, voting rights of the participants, surveillance and assurance of compliance of the participants with the rules and <u>the formation of the wholesale electricity spot market governing body;</u>*" (Underscoring supplied)

The objectives of WESM are to establish a competitive, efficient, transparent and reliable market for electricity where:

1. A level playing field exists among WESM participants;
2. Trading of electricity is facilitated among WESM participants within the spot market;
3. Third parties are granted access to the power system in accordance with the Act (EPIRA Law);
4. Prices are governed as far as practicable by commerccial and market forces; and
5. Efficiency is encouraged.

The idea is that all the output from generators would be centrally coordinated within the market and the buyers of bulk electricity would have to compete for a share in the electricity pool provided therein. Electricity is a peculiar commodity which cannot be stored and must be available on demand. Its flow is determined by the laws of physics and it is thus not possible to trace its flow. Because of the nature of the product and the pooling system within WESM, it is impossible for any particular sale of energy by one participant to be traced through a particular purchaser. This necessarily makes trading within the market an anonymous transaction as it is impossible to make a physical matching of the generator to its consumer.

The market participants - generating companies, customers, market operator, system operator, network service provider, ancillary services provider and metering service provider must register with the IEMOP in order to participate in the market.

Background of the Philippine Electricity Market Corporation (PEMC)

Tasked under the EPIRA Law to establish the WESM, the DOE together with the electric industry participants formulated the WESM Rules and constituted the Autonomous Group Market Operator (AGMO) which "shall undertake the preparatory work and initial operation of the WESM for a period of 12 months from the spot market commencement date, initially under the administrative supervision of the National Transmission Corporation (TRANSCO)." This AGMO constituted by the DOE is PEMC.

PEMC was organized and established under the Corporation Code of the Philippines (Batas Pambansa [BP] No. 68) as a non-stock, non-profit corporation whose primary purpose is as follows:

> "Manage, govern and administer an efficient, competitive, transparent and reliable market for the wholesale and purchase of electricity and ancillary services in the Philippines (the Wholesale Electricity Spot Market or "WESM") in accordance with Republic Act (RA) No. 9136 (EPIRA), the rules promulgated to govern the operation of the WESM (the "WESM Rules"), including their respective amendments and such other laws, rules and regulations which may be enacted hereafter that shall govern the WESM."

Furthermore, as a non-stock non-profit corporation, it is explicitly stated in Article 10 of PEMC's Articles of Incorporation that "no part of the income which the Corporation may obtain as in incident to its operation shall be distributed as dividends to its members, directors or officers subject to the provisions of the Corporation Code on dissolution. Any fund obtained by the Corporation as a result of its operation, whenever necessary or proper shall be used for the furtherance of the purposes enumerated in Article Second, subject to the provision of Title XI of the Corporation Code."

It must be emphasized that by administering WESM, PEMC does not thereby become a buyer or seller of electricity through the market. In other words, since PEMC merely operates, manages, and administers the market, PEMC will not buy nor sell electricity for its own account.

Thus, for a period of one (1) year from the spot market commencement date, the market operator which is responsible for the operation thereof is PEMC. This market operations function has been transferred to IEMOP on September 26, 2018.

Transaction Flow

Under the current setup, a typical supply transaction within WESM is outlined as follows:

1. A Generator submits an offer to supply electricity to the market and/or a Customer submits a demand bid to purchase electricity from the market;
2. IEMOP sends an electronic confirmation of receipt and acceptance of the offer or bid;
3. IEMOP matches supply with demand for that particular trading interval;

4. IEMOP submits the dispatch schedule to the System Operator (SO);
5. The SO implements the dispatch schedule, which means to say that the electricity purchased by the Customer through the market is delivered to identified points of supply by way of the network;
6. IEMOP implements the settlement process by which the amounts due to IEMOP from every Market Participant and the amounts due from IEMOP to every Market Participant are paid out.

The various funds received or handled by IEMOP in the operation of the spot market may be categorized as either for its own account, or on behalf of the other entities, viz:

Type of Fund	**For the Account of**
1. Registration Fees	- IEMOP
2. Metering Fees	- IEMOP
3. Billing and Settlement Fees	- IEMOP
4. Administration Fees	- IEMOP
5. Costs	- IEMOP
6. Other Service Fees	- IEMOP
7. Special Assessments	- IEMOP
8. Funds from Contributions, Donations	- IEMOP
9. Energy Fee	- Generator
10. Ancillary Services Fee	- Ancillary Service Provider
11. Transmission Tariff	- Network Service Provider

Funds Received by IEMOP for its own account

The EPIRA Law provides:

> *"The cost of administering and operating the wholesale spot market shall be recovered by the market operator through a charge imposed to all market members: Provided, that such charge shall be filed with and approved by the ERC."*

The law mandates the Market Operator (MO) to recover its costs for administering and operating the market. This is based on the logical presumption that the MO will not have any other source of funds except these charges on its members and thus, for its survival, and in order to continue administering and operating the market, the MO must be able to cover its costs.

Thus, in compliance with the EPIRA Law and WESM Rules, the IEMOP, as the MO, shall charge the members of the market ("Market Fees") which include:

1. *Registration fees*, comprising of annual fee payable by each WESM Member for the category or categories in which they are registered; the registration fee is intended to defray the cost of the IEMOP in the registration process, which includes expenses for evaluation of the

participant and its technical facilities to determine its qualifications to participate in WESM as well as expenses for training, digital certificates, the production of information materials and other related expenses;

2. *Metering Fees*, to recover the IEMOP's budgeted revenue requirements for providing the billing and settlements services provided to the Members;

3. *Billing and Settlement Fees*, to recover the IEMOP's budgeted revenue requirements for providing the billing and settlements service provided to the Members;

4. *Administration Fees*, to recover the remainder of the IEMOP's budgeted revenue requirements not covered by the membership fees, membership dues, metering and Billing and Settlement Fees;

5. Costs reasonably incurred by the Board and the Committees and working groups that the Board may create under the By-laws and the WESM rules; and

6. Other Service Fees which the Board may impose such as Reserve Cost Recovery Charges and information dissemination charges.

The Market Fees are intended to defray the costs that will be incurred by the MO in administering and operating the market. Therefore, the Market Fees charged by IEMOP as administrator and operator of WESM are based on budgeted requirements.

In the fulfillment of its primary purpose of managing, administering and governing the market, IEMOP may in some instances realize Net Settlement Surplus which is the amount remaining after all the market transactions have been accounted for. Because the energy price charged from a Customer takes into account system losses and the additional costs arising from line congestion, the amount paid by a Customer would typically be higher than that which the IEMOP pays the Generator. Such Net Settlement Surplus may be utilized by IEMOP to: 1) fund deficits, 2) flowed back to Market Participants, 3) to establish and support the market for Financial Transmission Rights. In all instances, it shall be clearly accounted for and taken into account when setting the allowable charges under any regulatory instruments applying to IEMOP.

Funds Received by IEMOP for other Entities

Since the electricity supplied within the market is "pooled" together and centrally coordinated, it is not possible to trace which Generator produced the electricity consumed by a particular Customer. The amounts due from each Customer to the Generators could only be coursed through the market.

IEMOP performs the function of settling the amounts payable by or to any Market Participant and in the course thereof, receives various funds actually meant for other participants in the market.

In view of the foregoing, you now request for confirmation of the following opinions:

1. The Market Fees/Net Settlement Surplus/Membership Dues and Fees received by IEMOP for its own account, are not subject to corporate income tax and consequently, exempt from withholding tax;

2. The income of IEMOP from its properties and for activities conducted for profit is subject to income tax and consequently, to withholding tax;

3. The payments received by IEMOP as operator of the market, but which are earmarked for other entities, are not part of IEMOP's gross income, and consequently, are not subject to income tax in the hands of IEMOP;

4. IEMOP, as income payer, is constituted as withholding agent which shall be liable to withhold the appropriate withholding tax on its income payments as prescribed in Revenue Regulations (RR) No. 2-98, as amended;

5. IEMOP shall be designated as a withholding tax agent for WESM transactions and shall be responsible for withholding and remitting withholding taxes and issuing the requisite withholding tax certificates.

6. IEMOP, as employer is subject to final tax imposed on the grossed-up monetary value of fringe benefit furnished to its employees, except rank and file employees;

7. All funds received by IEMOP for its own account as a result of its administration and operation of WESM, and which funds are held in trust for and on behalf of the WESM members, are not subject to VAT;

8. All funds received by IEMOP as MO, but which are intended, and actually earmarked, for other entities, are not included in IEMOP's gross receipt, hence not subject to VAT in the hands of IEMOP;

9. Transactions for the supply of energy and ancillary services made through the WESM shall be exempt from the requirements of Section 237 of the National Internal Revenue Code of 1997 (Tax Code), as amended, subject to adequate procedures and documentation;

10. IEMOP may be passed on with VAT by its suppliers of goods and services, and may be liable for VAT on its importations, which shall form part of its cost of goods and services purchased.

11. The use of a generation mix ratio (GMR), calculated as the ratio of the Total VATable (12%) Spot Market Sales over the Total Spot Market Sales, will

properly account for the zero-rated sales of generation companies generating power from renewable energy (RE) resources.

12. The transfer of market infrastucture, other personal and real properties, cash and PSALM loan and loan repayment funds from PEMC to IEMOP is not subject to income tax, VAT, documentary stamp tax (DST), and donor's tax.

In reply, please be infomed as follows:

INCOME TAX

1. ***Market Fees/Net Settlement Surplus/ Membership Dues and Fees***

There is no doubt that WESM is the market where trading of electricity will be made and PEMC, now IEMOP, was set up by the DOE, along with other electric industry participants, as the AGMO which, pursuant to the EPIRA Law, is to undertake preparatory work and initial operation of the WESM for twelve (12) months from the spot market commencement date. As such, IEMOP was organized for the purpose of managing, governing and administering an efficient, competitive, transparent and reliable market for the wholesale purchase of electricity in the Philippines.

IEMOP, which is organized as a non-stock, non profit corporation, claims that it should be treated as a business league under Section 30 (F) of the Tax Code, as amended. The pertinent provision states:

> *"Sec. 30. Exemption from Tax on Corporation. The following organizations shall not be taxed under this Title in respect to income received by them as such.*
>
> *x x x x x x x x x*
>
> *(F) Business league, chamber of commerce, or board of trade, not organized for profit and no part of the net income of which inures to the benefit of any private stockholder or individual;"*

Section 31 of RR No. 02-40, however, defines a "business league" as follows:

> "SECTION 31. Business leagues. --- A business league is an association of persons having some common business interest, which limits its activities to work for such common interest and does not engage in a regular business of a kind ordinarily carried on for profit. Its work need not be similar to that of a chamber of commerce or board of trade. If it engages in a regular business of a kind ordinarily carried on for profit, the fact that the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not ground for exemption. An association engaged in furnishing information to prospective investors, to enable them to make sound

> investments, is not exempt, since its members have no common business interest, even though all of its income is devoted to the purpose stated. xxx xxx xxx." (Underscoring supplied)"

From the definition of a "business league", IEMOP, as the market operator of WESM, cannot qualify as such considering the nature and purposes of its incorporation. The various market participants, although registered as members of WESM, cannot be said to be of common business interest with IEMOP since the reason for their membership is to enable them to participate in the trading and not to further IEMOP's purposes. Moreover, its activity as a market operator of WESM, for which it receives market/service fees from its trading participants for the availment of its services, is a regular business of a kind ordinarily carried on for profit. It is similar to other online platforms whose income for the provision of online services are ordinarily subject to applicable taxes under the Tax Code.

In BIR *Ruling No. 113-82 dated April 15, 1982*, upon the request for exemption from income tax by then Manila Stock Exchange, which was organized as a non-stock non-profit corporation, the BIR opined that:

> "It has been held that if the organization's primary purpose is to provide services or facilities for transaction business to individuals or a limited class, it is not an exempt business league. Thus a stock or commodity exchange is not a business league. [34 Am. Jur.2d p. 687 (1976 ed)]
>
> In review thereof, the Manila Stock Exchange, cannot be considered an exempt business league within the purview of Section 27(f) of the Tax Code. Consequently, it should file an income tax return and pay income tax on its net income"

Based on the foregoing, IEMOP cannot be considered an exempt business league as construed by Section 30 of the Tax Code, as amended. Accordingly, IEMOP is subject to corporate income tax under Section 27 of the Tax Code, as amended, and consequently to witholding tax pursuant to Section 57 of the same Tax Code.

On the issue of whether or not Market Fees/Net Settlement Surplus/Membership fees received by IEMOP are subject to income tax, it is a principle of taxation that income, in the broad sense, means all wealth which flows into the taxpayer other than mere return of capital.[2]

Under WESM Rules, Market Fees[3] are imposed by IEMOP such that -

> "The cost of administering and operating the WESM shall be recovered by the Market Operator through a charge imposed on all WESM Members or WESM transactions, provided that such charge shall be filed by the market operator with the ERC for approval."[4]

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[2] Section 36, RR No. 02-40
[3] 2.10, WESM Rules
[4] 2.10.1, WESM Rules

> "In developing the structure and level of market fees, the market operator shall take into consideration the manner in which it intends to charge each category of WESM members, and whether that charging proposal is reasonable given the relative involvement of each category of WESM member in the spot market."[5]

Market fees is a collective term that includes registration fees, metering fees, billing and settlement fees, administration fees and other costs, as represented. In short, this is the amount paid for by the WESM members for its administration and operation.

On the other hand, "Net Settlement Surplus" is defined in WESM Rules as "the settlement surplus remaining after all market transaction have been accounted for, including the assignment of transmission line rentals to the Network Service Providers. This remainder is assumed to be attributable to economic rentals arising from other binding constraints".

> "3.14.16 of the WESM Rules provides for the treatment of Remaining Settlement Surplus as follows:
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> 3.13.16.1 If the transactions required by clauses 3.13.144 and 3.13.155, in aggregate, result in a surplus or deficit remaining, this will be known as the net settlement surplus.
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> 3.13.16.2 The net settlement surplus:
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> (a) May be retained by the Market Operator, or paid to the System Operator, according to a formula to be developed by the Market Operator subject to approval of the PEM Board; and
>
> (b) Shall be clearly accounted for and taken into account when setting the allowable charges under any regulatory instruments applying to the Market Operator and the System Operator."

Considering that these monies flow into IEMOP as part of its operations, benefiting the corporation and having the discretion on how to apply the net settlement surplus, they shall be part of the corporation's gross income subject to income tax.

2. Income of IEMOP from its properties and for activities conducted for profit is subject to income tax

As previously discussed, IEMOP does not qualify as a tax-exempt organization under Section 30 of the Tax Code, as amended. Hence, its income derived from any of its properties, real or personal or from any of its activities conducted for profit regardless of the disposition made of such income shall be subject to tax imposed under the Tax Code, as amended. Moreover, its interest income derived from Philippine currency bank deposits and yield or any

[5] 2.10.2.2 WESM Rules

other monetary benefits from deposit substitute instruments are subject to the 20% final witholding tax pursuant to Section 27(D)(1), in relation to Section 57(A), both of the Tax Code, as amended.

3. The payments received by IEMOP which are earmarked for other entities are not part of IEMOP's gross income

As represented, IEMOP receives various funds either for its own account or on behalf of other entities such as energy fee, ancillary services fee and transmission tariff.

In *BIR Ruling No. 020-02 dated May 13, 2002* issued to the Power Sector Assets & Liabilities Management Corporation (PSALM) confirming the latter's opinion that collection of universal charge will not be considered as taxable income, this Office ruled that:

> "On the other hand, the Universal Charge received by PSALM will not be in the nature of income as defined in Sec. 32(A) of the Tax Code of 1997, which includes gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce, sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rents, dividends, securities, or transactions or any business carried on for gain or profits, and income derived from any source whatever. Income, in a broad sense, means all wealth that flows into the taxpayer other than as a mere return of capital. (Section 36, Revenue Regulations No. 2, otherwise known as the Income Tax Regulations). The Universal Charge is not a flow of wealth to PSALM as it would not accrue to its benefit but would be remitted to the Special Trust Fund, as provided under the EPIRA."

IEMOP's receipt of the energy fee for the Generator, ancillary services fee for the Ancillary Service Provider and transmission tariff for the Network Service Provider, will not redound to the benefit of IEMOP, but are earmarked and actually remitted to the said participants in the market and therefore, not in the nature of income, nor a flow of wealth to IEMOP.

Therefore, the payments received by IEMOP as operator of the market, but which are earmarked for other entities, are not part of IEMOP's gross income, and consequently, are not subject to income tax in the hands of IEMOP.

4. IEMOP, as income payer, is constituted as withholding agent

IEMOP is required to impose withholding taxes on certain income payments made by it pursuant to Sections 2.57 of RR No. 2-98, as amended.

IEMOP, as employer is constituted as withholding agent of the government when its employees receive compensation income subject to the withholding tax under Section 79(A), Chapter XIII, Title II of the Tax Code, as amended, as implemented by RR No. 2-98, as amended, or if it makes income payments to individuals or corporations subject to the expanded withholding tax provided for in Section 57(B) of the Tax Code, as amended, also as implemended by RR No. 2-98, as amended.

5. ***The Customer/Buyer shall be the withholding tax agent for energy sold and paid through the WESM, while both the Customer/Buyer and Generator/Seller shall be the withholding tax agents for the Market Fees collected by IEMOP.***

Considering that electricity is of the nature of "fungible" goods, defined as "*(g)oods which are identical with others of the same nature, such as grain and oil; a product which has no important characteristics that identify it as coming from a particular supplier.*"[6], and considering further the gross pool nature of the WESM as a market, it will be impossible for a WESM electricity customer to identify the electricity it purchased as coming from a particular WESM electricity seller.

Since the MO has a view of all the electricity generated for sale and by which company, as well as all the customers and their particular purchases, the role of the MO is therefore key in matching the transactions, as only the MO knows who the actual customers and sellers are.

Thus, after the sale of energy, the MO prepares a "transaction summary of energy sold" and provides copies of the "settlement statements of energy sold (broken down by customer)" to the Generators/Sellers and the "settlement statements of energy purchased (broken down by seller)" to the Customers/Buyers.

The Customer/Buyer can then proceed to remit payment, net of withholding taxes, for the purchase of energy, through the MO's payment facility using the "settlement statements" as bases. The MO payment facility then proceeds to transmit payment to the Generator/Seller upon the MO's payment instructions. The Generator/Seller then issues the Official Receipts under the names of the Customers/Buyers based on the settlement statements and payments/remittances made by the MO payment facility. The Customer/Buyer in turn issues the BIR Form No. 2307[7] to the Generators/Sellers. The Customers/Buyers shall then remit to the BIR the taxes withheld from the payments for electricity purchased through the WESM. This arrangement shall ensure that the withholding taxes are properly withheld and remitted, and the Generators/Sellers in the WESM are properly credited with the taxes withheld.

On the other hand, both the Generator/Seller and the Customer/Buyer are designated as withholding tax agents for the market fees charged by and paid to IMEOP. IEMOP bills the Generator/Seller and the Customer/Buyer for the corresponding market fees. The Customer/Buyer pays IEMOP the market fees net of withholding tax and shall remit the withholding tax to the BIR. Prior to remitting the amount on the sale of electricity to the

[6] Black's Law Dictionary, Sixth Edition.
[7] Certificate of Creditable Tax Withheld at Source.

Generator/Seller, IEMOP shall deduct and keep its market fees net of withholding tax and remit the amount, together with the withholding tax on the market fees, to the Generator/Seller. The Generator/Seller then shall remit the withholding tax on the market fees to the BIR. Both the Generator/Seller and the Customer/Buyer shall issue BIR Form No. 2307 to the MO for the taxes they withheld on the payment of Market Fees.

In cases where an aggregator buys electricity from a seller in WESM through a generation company, two separate transactions shall be considered, to wit: (1) the sale from the seller to the generation company; and (2) the sale from the generation company to the aggregator. In such cases, the generation company shall be the designated withholding tax agent for the sale transaction between the seller and the generation company, while the aggregator shall be the designated withholding tax agent for the transaction between the generation company and the aggregator.

6. IEMOP, as employer, is subject to final tax imposed on fringe benefits furnished to its employees

Section 33(A) of the Tax Code, as amended by RA No. 10963, provides for the special treatment of fringe benefits, to wit:

"SEC. 33. Special Treatment of Fringe Benefit. -

(A) Imposition of Tax. – Effective January 1, 2018 and onwards, a final tax of thirty-five percent (35%) is hereby imposed on the grossed-up monetary value of fringe benefit furnished or granted to the employee (except rank and file employees defined herein) by the employer, whether an individual or a corporation (unless the fringe benefit is required by the nature of, or necessary to the trade, business or profession of the employer, or when the fringe benefit is for the convenience or advantage of the employer). The tax herein imposed is payable by the employer which tax shall be paid in the same manner as provided for under Section 57 (A) of this Code. The grossed-up monetary value of the fringe benefit shall be determined by dividing the actual monetary value of the fringe benefit by sixty-five percent (65%) effective January 1, 1998; sixty-seven percent (67%) effective January 1, 1999; and sixty-eight percent (68%) effective January 1, 2000 and thereafter: Provided, however, That fringe benefit furnished to employees and taxable under Subsections (B), (C), (D) and (E) of Section 25 shall be taxed at the applicable rates imposed thereat: Provided, further, That the grossed -up monetary value of the fringe benefit shall be determined by dividing the actual monetary value of the fringe benefit by the difference between one hundred percent (100%) and the applicable rates of income tax under Subsections (B), (C), (D), and (E) of Section 25."

Hence, if IEMOP furnishes or grants any goods, service, or benefit in cash or in kind to its employees, except rank and file, it is subject to a final tax of 35%[8] of the grossed-up monetary value of the fringe benefit. However, if benefit furnished or granted is required by the nature or, or necessary to the conduct of business of IEMOP's activities, or when the fringe benefit is for the convenience or advantage of IEMOP as employer, it is not subject to said tax.

Membership fees, dues and other expenses borne by the employer for the employee in social and athletic clubs or other similar organizations are fringe benefits under Section 33(B)(6) of the Tax Code, as amended.[9]

However, transportation and representation allowances that are fixed in amounts and are regularly received by the employees as part of their monthly compensation income shall not be treated as taxable fringe benefits but the same shall be treated as allowances which shall form part of their taxable compensation income subject to income tax and consequently to the withholding tax prescribed under Section 79 of the Tax Code, as amended.[10]

VALUE ADDED TAX

Section 105 of the Tax Code, as amended, provides for the persons liable for VAT, to wit:

> *"SEC. 105 Persons Liable. - Any person who, in the course of his trade or business, sells,barters, exchanges or leases goods or properties, or renders services, and any person who imports goods, shall be liable to value-added tax (VAT) imposed in Sections. 106 to 108 of this Code."*
>
> *xxx xxx xxx*
>
> *The phrase "**in the course of trade or business**" means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto, by any person regardless of whether or not the person engaged therein is a non-stock, nonprofit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests), or government entity."*

In the case of ***Commissioner of Internal Revenue vs. Court of Appeals and Commonwealth Management and Services Corporation***[11], the Supreme Court held that even a non-stock, non-profit organization or government entity is liable to pay VAT on the sale of goods or services, thus:

> *"Contrary to COMASERCO's contention the above provision clarifies that even a non-stock, non-profit organization or government*

[8] The rate was increased from 32% to 35% effective January1, 2018 by RA No. 10963
[9] BIR Ruling No. 025-2001 dated June 13, 2001.
[10] Ibid.
[11] G.R No. 125355, March 30, 2000

entity, is liable to pay VAT on the sale of goods or services. VAT is a tax on transactions, imposed at every stage of the distribution process on the sale, barter, exchange of goods or property, and on the performance of services, even in the absence of profit attributable thereto. The term "in the course of trade or business" requires the regular conduct or pursuit of commercial or an economic activity, regardless or whether or not the entity is profit-oriented.

The definition of the term "in the course of trade or business" incorporated in the present law applies to all transactions even to those made prior to its enactment. Executive Order No. 273 stated that any person who, in the course of trade or business, sells, barters or exchanges goods and services, was already liable to pay VAT. The present law merely stresses that even a nonstock, nonprofit organization or government entity is liable to pay VAT for the sale of goods and services.

Sec. 108 of the National Internal Revenue Code of 1997 defines the phrase "sale of services" as the "performance of all kinds of services for others for a fee, remuneration or consideration." It includes "the supply of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking or project."

On February 5, 1998, the Commissioner of Internal Revenue issued BIR Ruling No. 010-98 emphasizing that a domestic corporation that provided technical, research, management and technical assistance to its affiliated companies and received payments on a reimburesment-of-cost basis, without any intention of realizing profit, was subject to VAT on services rendered. In fact, even if such corporation was organized without any intention of realizing profit, any income or profit generated by the entity in the conduct of its activities was subject to income tax.

Hence, it is immaterial whether the primary purpose of a corporation indicates tha it receives payments for services rendered to its affiliates on a reimbursement-of-cost basis only, without realizing profit, for purposes of determining liability for VAT on services rendered. As long as the entity provides service for a fee, remuneration or consideration, then the srvice rendered is subject to VAT.

At any rate, it is a rule that because taxes are the lifeblood of the nation, statutes that allow exemptions are construed strictly against the grantee and liberally in favor of the government. Otherwise stated, any exemption from the payment of a tax must be clearly stated in the language of the law; it cannot be merely implied therefrom. In the case of VAT, Section 109, Republic Act 8424 clearly enumerates the

> *transactions exempted from VAT. The services rendered by COMASERCO do not fall within the exemptions.*
>
> *Both the Commissioner of Internal Revenue and the Court of Tax Appeals correctly ruled that the services rendered by COMASERCO to Philamlife and its affiliates are subject to VAT. As pointed out by the Commissioner, the performance of all kinds of services for others for a fee, remuneration or consideration is considered as a sale of services subject to VAT. As the government agency charged with the enforcement of the law, the opinion of the Commissioner of Internal Revenue, in the absence of any showing that it is plainly wrong, is entitled to great weight. Also, it has been the long standing policy and practice of this Court to respect the conclusions of quasi-judicial agencies, such as the Court of Tax Appeals which, by the nature of its functions, is dedicated exclusively to the study and consideration of tax cases and has necessarily developed an expertise on the subject, unless there has been an abuse or improvident exercise of its authority.*
>
> *There is no merit to respondent's contention that the Court of Tax Appeals' decision in CA-G.R. No. 34042, declaring the COMASERCO as not engaged in business and not liable for the payment of fixed and percentage taxes, binds petitioner. The issue in CA-G.R. No. 34042 is different from the present case, which involves COMASERCO's liability for VAT. As heretofore stated, every person who sells, barters, or exchanges goods and services, in the course of trade or business, as defined by law, is subject to VAT.*" (Underscoring supplied)

With the foregoing in mind, we rule as follows:

1. All the funds received by IEMOP for its own account as a result of its administration and operation of WESM are subject to VAT

Section 30 of EPIRA Law provides that the cost of administering and operating the wholesale spot market shall be recovered by the market operator (IEMOP) through a charge imposed to all market members.

Pursuant thereto, IEMOP charges several fees collectively referred to as "Market Fees" the components of which are the following: registration fees, metering fee, billing and settlement fees, administration fees, costs reasonably incurred by its Board and the committees and working groups that the Board appoints under WESM Rules as well as other service fees.

In the same vein as in the above-cited jurisprudence, it has been settled that for as long as the entity provides service for a fee, remuneration or consideration, the service rendered is subject to VAT. In upholding the assessment of the BIR, the Supreme Court held that it is immaterial whether the primary purpose of a corporation indicates that it receives payments for services rendered to its affiliates on a reimbursement-in-cost basis only, without realizing profit, for purposes of determining liability for VAT on services rendered. For as long as the entity provides service for a fee, remuneration or consideration, then the service rendered is subject to VAT.

Hence, considering that IEMOP performs services as market operator of WESM and for which the market participants and members are charged market fees collected by IEMOP, said fees/payments, shall be subject to VAT, notwithstanding its status as a non-stock, non-profit organization.

Registration or membership fees of the market participants, however, are exempt from VAT since these comprise fees intended to defray cost of registration and expenses incidental thereto.[12]

2. Funds received by IEMOP intended and actually earmarked for other entities are not included as part of IEMOP's gross receipts

Section 108 (A) of the Tax Code, as amended, states that:

"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.

xxx xxx xxx

*The term "**gross receipts**" means the total amount of money or its equivalent representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits and advanced payments actually or constructively received during the taxable quarter for the services performed or to be performed for another person, excluding value-added tax."*

In relation thereto, Section 11 of RR No. 04-2007[13] dated February 7, 2007 provides viz:

"SECTION 11. Gross Receipts. – Sec. 4.108-4 of RR No. 16-2005 is hereby amended to read as follows:

SEC. 4.108-4. *Definition of Gross Receipts.* 'Gross receipts' refers to the total amount of money or its equivalent

[12] BIR Ruling No. DA-(VAT-013) 275-08) dated October 5, 2008

[13] Amending Certain Provisions of Revenue Regulations No. 16-2005, As Amended, Otherwise Known as the Consolidated Value-Added Tax Regulations of 2005

> representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits applied as payments actually or constructively received during the taxable period for the services performed or to be performed for another person, excluding the VAT, ***except those amounts earmarked for payment to unrelated third (3rd) party or received as reimbursement for advance payment on behalf of another which do not redound to the benefit of the payor.***
>
> *A payment is a payment to a third (3rd) party if the same is made to settle an obligation of another person, e.g., customer or client, to the said third party, which obligation is evidenced by the sales invoice/official receipt issued by said third party to the obligor/debtor (e.g., customer or client of the payor of the obligation).*" (Emphasis and underscoring supplied)

In the case of ***Commissioner of Internal Revenue vs. Tours Specialists, Inc.***[14], the Supreme Court declared that:

> "*Gross receipts subject to tax under the Tax Code, as amended,* ***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, as amended.*" (Emphasis and underscoring supplied)

Under the above-quoted provision, in relation to the said decision of the Supreme Court, it is clear that gross receipts do not include monies or receipts entrusted to the taxpayer and those amounts earmarked for payment to unrelated third (3rd) party or received as reimbursement for advance payment on behalf of another which do not redound to the benefit of the payor. Therefore, the energy fee for the Generator, ancillary services fee for the Ancillary Service Provider, and transmission tariff for the Network Service Provider, which will not redound to the benefit of IEMOP, but are only earmarked and actually remitted to the said participants in the market, should not be included as part of IEMOP's gross receipts.

3. Transactions for the supply of energy and ancillary services made through the WESM shall be subject to the requirements of Section 237 of the Tax Code

Section 237 of the Tax Code, as amended, provides:

[14] G.R. No. 66416 dated March 21, 1990 citing the case of Commissioner of Internal Revenue vs. Manila Jockey Club, Inc., 108 Phil. 882

"Section 237. Issuance of Receipts or Sales or Commercial Invoices. –

(A) Issuance. - All persons subject to an internal revenue tax shall, at the point of each sale and transfer of merchandise or for services rendered valued at One hundred pesos(P100)[15] *or more, issue duly registered receipts or sale or commercial invoices, showing the date of transaction, quantity, unit cost and description of merchandise or nature of service: Provided, however, That where the receipt is issued to cover payment made as rentals, commisisions, compensations or fees, receipts or invoices shall be issued which shall show the name, business style, if any, and address of the purchaser, customer or client: Provided, further, That where the purchaser is a VAT-registered person, in addition to the information herein required, the invoice or receipt shall further show the Taxpayer Identification Number (TIN) of the purchaser.*

Within five (5) years from the effectivity of this Act and upon the establishment of a system capable of storing and processing the required data, the Bureau shall require taxpayers engaged in the export of goods and services, taxpayers engaged in e-commerce, and taxpayers under the jurisdiction of the Large Taxpayers Service to issue electronic receipts or sales or commercial invoices in lieu of manual receipts or sales or commercial invoices, subject to the rules and regulations to be issued by the Secretary of Finance upon recommendation of the Commissioner and after a public hearing shall have been held for this purpose: Provided, That taxpayers not covered by the mandate of this provision may issue electronic receipts or sales or commercial invoices, in lieu of manual receipts, and sales and commercial invoices.

The original of each receipt or invoice shall be issued to the purchaser, customer or client at the time the transaction is effected, who, if engaged in business or in the exercise of profession, shall keep and preserve the same in his place of business for a period of three (3) years from the close of the taxable year in which such invoice or receipt was issued, while the duplicate shall be kept and preserved by the issuer, also in his place of business, for a like period: Provided, That in case of electronic receipts or sales or commercial invoices, the digital records of the same shall be kept by the purchaser, customer or client and the issuer for the same period above stated.

The Commissioner may, in meritorious cases, exempt any person subject to internal revenue tax from compliance with the provisions of this Section."

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[15] RA 10963 increased the amount of sales requiring issuance of duly registered receipts or invoice from ₱25.00 to ₱100.00

As defined in RR No. 12-98, the term "receipt(s)" means a written admission or acknowledgment of the fact of payment in money or other settlement between seller and buyer of goods, debtor or creditor, or persons rendering services and client or customers. Apparently, it is not merely an evidence of sale but necessarily an evidence of payment. This is obvious from the provisions of Section 237 to the effect that the issuance of an invoice is required the moment there is already a sale or transaction of merchandise or services rendered.

As already established, WESM is the market where the participants buy and sell their commodity which is electricity. Essentially, it is the market that receives the demand and matches the supply of electricity in accordance thereto since there is neither a specific customer from the point of view of the generators nor a specific generator from the point of view of the customers. Thus, in the sale of electricity by the Generators traded through WESM, the Generators cannot issue official receipts in the name of the particular buyer of electricity but can only bill/charge IEMOP for the value of the electricity supplied by it upon trading in the market.

Inasmuch as receipts are not only pieces of evidence of sale but also proof of payment by the customers and end-users, the Generator/Seller and the MO cannot be exempted from issuing official receipts under Section 237 of the Tax Code, as amended, for the supply of electricity and ancillary services provided to the customers, as well as for the market fees it collects from trading participants.

Revenue Memorandum Circular (RMC) No. 61-2005[16] was issued to clarify certain BIR issuances affecting generation, transmission, and distribution companies as well as electric cooperatives as defined in RA No. 9136 (EPIRA Law) subject to the VAT as well as their suppliers and customers. In the main, the RMC states that generation, transmission, and distribution companies as well as electric cooperatives shall be subject to VAT on their sale of electricity pursuant to the provisions of Section 108, in relation to Section 109, of the Tax Code, as amended.

It is argued that for uniformity of treatment, IEMOP should be treated in the same manner as that of the Distribution Utilities (DUs) which is a pass-through entity with respect to sale of electricity.

We disagree. IEMOP, as market operator, is not in the same category as the DUs or even similarly situated taking into account its role in the flow of transactions purchasing electricity which are not necessarily end-users.

As previously mentioned, the MO prepares the transaction summary of energy sold and provides copies of the settlement statements of energy sold (broken down by customer) to the Generators/Sellers and the settlement statements of energy purchased (broken down by seller) to the Customers/Buyers. The Customers/Buyers can then proceed to remit payments through the MO payment facility using the "settlement statements" as bases. The MO payment facility then proceeds to transmit payments to Generators/Sellers. The Generators/Sellers, then issue

[16] Clarifying the VAT Provisions of R.A. 9337 Applicable to the Power Industry

the Official Receipts under the names of the Customers/Buyers based on the settlement statements from the MO and the payments/remittances made by the MO payment facility.

The MO, on the other hand, issues the official receipts to the Generators/Sellers and the Customers/Buyers for the income payments the MO receives on its own account (e.g., Market Fees).

The sale of electricity covered by bilateral agreements and settled outside WESM shall be governed by existing rules and regulations regarding invoicing requirements.

For situations where an Aggregator buys electricity from a seller in WESM through a generation company, two separate transactions shall be considered. Thus, two separate Official Receipts shall be issued – one from the WESM Seller to the Generation Company as Customer/Buyer, and another from the Generation Company to the Aggregator.

4. *IEMOP is not exempt from pass-on VAT on its purchase of goods and services*

The VAT is a tax on the person who sells, barters, exchanges, leases goods or properties, renders services, and on any person who imports goods pursuant to Section 105 of the Tax Code, as amended. It should be noted that VAT is an indirect tax payable by the seller and not by the purchaser of goods.

However, being an indirect tax, it can be shifted or passed on to the buyer/purchaser, transferee or lessee of the goods, properties or services. Once shifted to the buyer/customer as an addition to the cost of goods or services sold, it is no longer a tax but an additional cost which the buyer/customer has to pay in order to obtain the goods or services.[17]

Since there is no showing that IEMOP is exempt from indirect tax under any existing law, its purchases of goods, properties or services from VAT registered entities are subject to the 12% VAT, which can be passed on to it by the seller as an indirect tax and shall form part of the invoice price thereof.[18]

5. *The use of the GMR to account for the zero-rated sales is proper*

The GMR calculated as follows is proper and acceptable to account for the VAT zero-rated sales of generation companies generating power from renewable energy (RE) resources, to wit:

$$\text{GMR} = \frac{\text{Total 12\% VATable Spot Market Sales}}{\text{Total Spot Market Sales}}$$

[17] VAT Ruling No. 073-99 dated July 27, 1999
[18] BIR Ruling No. DA No. 454-03 dated December 5, 2003.

6. The transfer of assets and liabilities from PEMC to IEMOP is not subject to income tax, VAT, DST, and donor's tax

Regarding the transfer of market infrastucture, other personal and real properties, cash and PSALM loan and loan repayment funds from PEMC to IEMOP, *BIR Ruling No. 020-02 dated May 13, 2002* issued to PSALM states:

> "In this case, the transfer of NPC's generation assets and liabilities to PSALM, as well as of the transmission and subtransmission assets and systems to TRANSCO, all of which are government-owned and -controlled corporations is mandated by law. There is no positive offer to sell and buy the aforesaid NPC properties. Moreover, consideration, which should be the prime reason for the transfer of abovementioned assets, is not availing to the parties in the transfer of the aforementioned NPC assets. Although it has been stated earlier, it should bear stressing that this is a transaction between and among government-owned and -controlled corporations pursuant to a law calling for the reorganization of NPC's assets.
>
> Consideration is defined as the inducement to a contract. It is the reason or material cause of a contract. It is some right, interest, profit, or benefit accruing to one party. (Black's Law Dictionary, 6th Edition)
>
> In the case of PSALM, its assumption of NPC's liabilities is mandated by law. Normally, the transfer of property by a person (transferor) to another person (transferee) in exchange for the assumption by said person of the transferor's liability will be considered a sale, where the assumption of liability constitutes a consideration for the assets. The gain, if any, from the transfer is the difference between the higher of the consideration received or zonal value, if applicable, and the value of the assets given up. The amount of the liabilities transferred is treated as part of the consideration.
>
> Likewise, the taking of title over the assets of NPC by PSALM for the purpose of selling or disposing them, is consistent with the guidelines set under the EPIRA. Unlike in an ordinary business transaction, PSALM, as the entity assuming the obligation, does not exercise any discretion whether to accept the assets and liabilities to be transferred nor does it play any role in the determination of the amount of the liabilities that it will assume." (Underscoring supplied)

In this case, the transfer of assets and liabilities from PEMC to IEMOP was pursuant to the EPIRA Law, specifically RA No. 9136, thus, there is no consideration in the transfer of assets and liabilities. Therefore, such transfer is not subject to income tax or to the creditable withholding tax/capital gains tax. In the same manner, since the transfer is not a transaction contemplated under Sections 196 and 198 of the Tax Code, as amended, the transfer is not subject to documentary stamp tax (DST) under the said Sections. The notarial certification is, however, subject to DST under Section 188 of the Tax Code, as amended.

Moreover, the transfer of assets and liabilities from PEMC to IEMOP is not subject to VAT. In the case of *PSALM vs. Commissioner of Internal Revenue*[19] the Supreme Court held:

> "xx xx xx Under the EPIRA law, the ownership of these power plants was transferred to PSALM for sale, disposition, and privatization in order to liquidate all NPC financial obligations. Unlike the Mindanao II case, the power plants in this case were not previously used in PSALM's business. The power plants, which were previously owned by NPC were transferred to PSALM for the specific purpose of privatizing such assets. The sale of the power plants cannot be considered as an incidental transaction made in the course of NPC's or PSALM's business. Therefore, the sale of the power plants should not be subject to VAT."

In the instant case, there was an express mandate by the EPIRA Law to transfer the assets and liabilities from PEMC to IEMOP, as follows:

> "SEC. 30. *Wholesale Electricity Spot Market*. – <u>Within one (1) year from the effectivity of this Act, the DOE shall establish a wholesale electricity spot market composed of the wholesale electricity spot market participants</u>. The market shall provide the mechanism for identifying and setting the price of actual variations from the quantities transacted under contracts between sellers and purchasers of electricity.
>
> xxx xxx xxx
>
> The wholesale electricity spot market shall be implemented by a market operator in accordance with the wholesale electricity spot market rules. The market operator shall be an autonomous group, to be constituted by DOE, with equitable representation from electric power industry participants, initially under the administrative supervision of the TRANSCO. The market operator shall undertake the preparatory work and initial operation of the wholesale electricity spot market. <u>Not later than one (1) year after the implementation of the wholesale electricity spot market, an independent entity shall be formed and the functions, assets and liabilities of the market operator shall be transferred to such entity with the joint endorsement of the DOE and the electric power industry participants. Thereafter, the administrative supervision of the TRANSCO over such entity shall cease</u>. (Underscoring supplied)

There was no sale, barter, exchange, or lease of goods or properties in the course of trade or business that would make the transfer come under the purview of Section 105 of the Tax Code, as amended. Thus, such transfer of assets and liabiltiies is not subject to VAT.

[19] G.R. No. 198146, August 8, 2017.

Likewise, since the transfer was mandated by the EPIRA Law, there was no donative intent on the part of the transferor (PEMC). Neither did the transferee (IEMOP) exercise any discretion on whether to accept the assets and liabilities to be transferred, nor did IEMOP play any role in the determination of the amount of the liabilities that it will assume. Thus, such transfer of assets and liabilities is not subject to donor's tax.

7. ***The electricity purchased by Renewable Energy (RE) Developers through WESM, if any, that is subsequently sold in WESM shall be generally subject to VAT***

While the sale of power or fuel generated through renewable sources of energy is subejct to zero percent (0%) VAT under Section 108(B)(7) of the Tax Code, power supply that is purchased through WESM by RE Developers and subsequently sold therein shall not be entitled to the zero percent (0%) VAT unless it can be ascertained that the same is generated from a renewable source of energy as required under the Tax Code.

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

Very truly yours,

Caesar Dulay

CAESAR R. DULAY
Commissioner of Internal Revenue

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