REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

SPECIAL THIRD DIVISION

SAN ROQUE POWER CORPORATION, *Petitioner,*	**CTA Case No. 11118**
- versus -	Members: **REYES-FAJARDO,** *Chairperson, and* **ANGELES,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	Promulgated: JUL 16 2026 4:20 p.m.

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DECISION

REYES-FAJARDO, *J.*:

This Petition for Review filed on March 31, 2023, by San Roque Power Corporation seeks to cancel and set aside alleged deficiency value-added tax (VAT), final withholding tax (FWT), and final withholding VAT assessments for fiscal year (FY) ending March 31, 2020, in the amount of ₱212,476,688.89.[1]

FACTS

Petitioner San Roque Power Corporation is a corporation organized and existing under the laws of the Republic of the Philippines, with principal office address at Barangay San Roque, Municipality of San Manuel 2438, Pangasinan, Philippines. It is a registered taxpayer with Taxpayer Identification No. 005-017-501-0000.[2]

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1 Statement of the Case, Pre-Trial Order dated February 2, 2024, Docket - Vol. I, p. 267.

2 Par. 1, Summary of Admitted Facts, Joint Stipulation of Facts and Issues (JSFI), Docket - Vol. I, p. 250.

Respondent is the head of the Bureau of Internal Revenue (BIR), the government agency officially responsible for the assessment and collection of all national internal revenue taxes, fees, and charges.[3]

On November 15, 2021, petitioner received an undated Preliminary Assessment Notice (PAN), containing proposed deficiency income tax, VAT on ancillary services, VAT on unaccounted source of cash, expanded withholding tax (EWT), FWT, final withholding VAT, fringe benefits tax (FBT), documentary stamp tax (DST), and administrative penalties, in the total amount of ₱211,566,497.86, inclusive of interest and penalties, for taxable year 2020.[4]

On November 29, 2021, petitioner filed its Reply to the PAN.[5]

On March 21, 2022, petitioner received the Formal Letter of Demand/Final Assessment Notice (FLD/FAN) dated March 17, 2022, with the Details of Discrepancies, which found petitioner liable for alleged deficiency income tax, VAT on ancillary services, VAT on unaccounted source of cash, EWT, FWT, final withholding VAT, FBT, and DST in the total amount of ₱208,059,827.70, inclusive of interest and penalties, for taxable year 2020. In addition, a compromise penalty of ₱215,000.00 was imposed.[6]

On April 20, 2022, petitioner filed its Protest to FAN with Request for Reinvestigation, accompanied by supporting documents.[7]

On June 17, 2022, petitioner filed its Supplemental Protest Against the FAN and submitted additional supporting documents.[8]

On March 3, 2023, petitioner received the Final Decision on Disputed Assessment (FDDA) issued by respondent. The FDDA upheld deficiency tax assessments against petitioner for ₱214,066,997.53, inclusive of interest and penalties.[9]

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3 Par. 2, Summary of Admitted Facts, JSFI, Docket - Vol. I, p. 250.
4 Par. 6, Summary of Admitted Facts, JSFI, Docket - Vol. I, p. 251.
5 Par. 7, Summary of Admitted Facts, JSFI, Docket - Vol. I, p. 251.
6 Par. 8, Summary of Admitted Facts, JSFI, Docket - Vol. I, pp. 251 to 252.
7 Par. 11, Stipulated Facts, JSFI, Docket - Vol. I, p. 252.
8 Par. 12, Stipulated Facts, JSFI, Docket - Vol. I, p. 252; Exhibit "P-17," Docket - Vol. II, p. 849 to Docket - Vol. III, p. 1097.
9 Par. 9, Summary of Admitted Facts, JSFI, Docket - Vol. I, p. 252; Exhibit "P-18," Docket - Vol. III, pp. 1098 to 1113.

On March 7, 2023, petitioner paid the deficiency income tax, VAT on unaccounted source of cash, and EWT in the total amount of ₱1,610,719.07, inclusive of interest and penalties as of March 7, 2023,[10] and submitted the proof thereof to respondent on March 8, 2023.[11] Thus, only the VAT, FWT, and final withholding VAT assessments remain in dispute.

On March 31, 2023, petitioner filed its Petition for Review.[12]

On July 4, 2023, respondent posted his Answer.[13]

On November 21, 2023, the Pre-Trial Conference was set and held.[14]

On December 20, 2023, the parties submitted their Joint Stipulation of Facts and Issues,[15] which was admitted and approved by the Court by Resolution dated January 11, 2024. The Pre-Trial Order dated February 2, 2024, was then issued.[16]

Trial ensued.

Petitioner presented: (1) Ms. Lalaine A. Estayo,[17] petitioner's Assistant Manager; (2) Mr. Rubentheo P. Cuta,[18] petitioner's Operations Manager; and (3) Atty. Jose M. Layug, Jr. (Atty. Layug Jr.),[19] petitioner's expert witness.

On June 28, 2024, Petitioner filed its Formal Offer of Evidence,[20] with respondent's Comment filed on July 8, 2024.[21]

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10 Par. 10, Summary of Admitted Facts, JSFI, Docket - Vol. I, p. 252.
11 Par. 13, Stipulated Facts, JSFI, Docket - Vol. I, p. 252.
12 Docket - Vol. I, pp. 6 to 59.
13 Docket - Vol. I, pp. 153 to 166.
14 Minute Resolution dated August 24, 2023, Docket - Vol. I, pp. 176 to 177; Minutes of the hearing held on, and Order dated, November 21, 2023, Docket - Vol. I, p. 234 and 238 to 240.
15 Docket - Vol. I, pp. 250 to 263.
16 Docket - Vol. I, pp. 267 to 277.
17 Exhibits "P-39" and "P-43," Docket - Vol. I, pp. 78 to 110 and pp. 291 to 297; Minutes of the hearing held on, and Order dated, April 11, 2024, Docket - Vol. I, pp. 302 to 303.
18 Exhibit "P-40," Docket - Vol. I, pp. 111 to 121; Minutes of the hearing held on, and Order dated, April 11, 2024, Docket - Vol. I, pp. 302 to 303.
19 Exhibits "P-41," Docket - Vol. I, pp. 122 to 140; Minutes of the hearing held on, and Order dated, June 13, 2024, Docket - Vol. I, pp. 330 to 332.
20 Docket - Vol. I, pp. 334 to 357.
21 Docket - Vol. IV, pp. 1887 to 1889.

By Resolution dated October 10, 2024,[22] the Court admitted all of petitioner's offered exhibits.

Respondent presented Revenue Officer (RO) Bacolor D. Yambing.[23]

On November 27, 2024, respondent filed its Formal Offer of Evidence,[24] with petitioner's Comment filed on December 16, 2024.[25]

By Resolution dated May 14, 2023,[26] the Court admitted all of respondent's offered exhibits.

On June 18, 2025, respondent's[27] and petitioner's[28] Memoranda were both posted.

On July 18, 2025, the case was submitted for decision.[29]

ISSUE

Is petitioner liable for alleged deficiency VAT on ancillary services, FWT, and final withholding VAT (inclusive of interest and penalties) for taxable year 2020 in the amount of PhP212,476,688.89?[30]

ARGUMENTS

Petitioner contends that the PAN, FLD/FAN, and FDDA are void for offending its right to due process, as respondent failed to consider its defenses to the PAN and FLD/FAN. It asserts that respondent erroneously assessed VAT on its Ancillary Services Procurement Agreement (ASPA). Further, it argues that the services rendered under its Operation & Maintenance Consulting Agreement (Offshore) (OMCA) shall not be subject to FWT and final withholding VAT assessment.

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22 Docket - Vol. IV, pp. 1899 to 1900.
23 Exhibit "R-13," Docket - Vol. I, pp. 225 to 233; Minutes of the hearing held on, and Order dated, November 14, 2024, Docket - Vol. IV, pp. 1901 to 1903.
24 Docket - Vol. IV, pp. 1906 to 1912.
25 Docket - Vol. IV, pp. 1916 to 1926.
26 Docket - Vol. IV, pp. 1945 to 1946.
27 Docket - Vol. IV, pp. 1949 to 1967.
28 Docket - Vol. IV, pp. 1971 to 2023.
29 Minute Resolution dated July 18, 2025, Docket - Vol. IV, p. 2028.
30 See Stipulated Issue, JSFI, Docket - Vol. I, pp. 252 to 253.

Respondent counters that there was no denial of petitioner's right to due process. He maintains that petitioner is liable for the remaining deficiency tax assessments.

RULING

We grant the Petition.

Foremost. We are vested with jurisdiction over the instant case.

Section 7, in relation to Section 11 of Republic Act (RA) No. 1125, as amended by RA No. 9282,[31] pertinently provides:

> Sec. 7. Jurisdiction. — The CTA shall exercise:
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> a. **Exclusive appellate jurisdiction to review by appeal**, as herein provided:
>
> 1. **Decisions of the Commissioner of Internal Revenue in cases involving disputed assessments**, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue;
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> ...
>
> SEC. 11. Who May Appeal; Mode of Appeal; Effect of Appeal. — **Any party adversely affected by a decision, ruling or inaction of the Commissioner of Internal Revenue, . . . may file an appeal with the CTA within thirty (30) days after the receipt of such decision** or ruling or after the expiration of the period fixed by law for action as referred to in Section 7(a)(2) herein.[32]

Indeed, a party aggrieved by the decision of respondent or his duly authorized representative on a disputed assessment may seek recourse before the CTA in Division, within thirty (30) days from receipt thereof. This matches with the period to appeal endowed to the taxpayer, in impugning respondent or his duly authorized

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31 An Act Expanding the Jurisdiction of the Court of Tax Appeals, Elevating Its Rank to the Level of a Collegiate Court with Special Jurisdiction and Enlarging its Membership, Amending for the Purpose Certain Sections or Republic Act No. 1125, as amended, otherwise known as the Law Creating the Court of Tax Appeals, and for Other Purposes, March 30, 2004.

32 Emphasis ours.

representative's decision on disputed assessment, under Section 228 of the NIRC of 1997 (NIRC), as amended:

> Section 228. Protesting of Assessment. –
> ...
>
> **If the protest is denied in whole or in part**, or is not acted upon within one hundred eighty (180) days from submission of documents, **the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision**, or from the lapse of the one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable.[33]

Here, petitioner received respondent's FDDA on March 3, 2023.[34] Counting thirty (30) days from said date, petitioner had until April 3, 2023 to appeal before the Court. Timely enough, on March 31, 2023, petitioner filed the Petition for Review,[35] thus clothing Us with jurisdiction over CTA Case No. 11118.

Next. Respondent duly observed petitioner's right to due process for VAT, FWT, and final withholding VAT assessments.

Section 228 of the NIRC, as amended, ordains:

> SEC. 228. *Protesting of Assessment.* – ...
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> ...
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> **The taxpayers shall be informed in writing of the law and the facts on which the assessment is made; otherwise, the assessment shall be void.**
>
> ...[36]

This statutory mandate reflects the principles of administrative due process enunciated in *Ang Tibay v. Court of Industrial Relations (Ang Tibay)*.[37] It decreed that: *one,* the administrative tribunal or body must consider the evidence presented; and *two,* the administrative tribunal's decision is rendered in a manner that the parties may know the various issues involved and the reasons for the decision.

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[33] Emphasis ours.
[34] *Supra* at note 9.
[35] *Supra* at note 12.
[36] Emphasis ours.
[37] G.R. No. L-46496, February 27, 1940.

These two (2) components of administrative due process in *Ang Tibay* were applied in *Commissioner of Internal Revenue v. Avon Products Manufacturing, Inc. (Avon).*[38] There, Avon Products Manufacturing, Inc. (APMI) advanced before the BIR, its defenses on the initial findings of the examining revenue officers, informal conference, PAN, and FAN. However, the BIR failed to give explanation or discussion on APMI's defenses in various segments of the assessment process. *Avon* decreed that the BIR scorned APMI's right to due process:

> The facts demonstrate that Avon was deprived of due process. It was not fully apprised of the legal and factual bases of the assessments issued against it. **The Details of Discrepancy attached to the Preliminary Assessment Notice, as well as the Formal Letter of Demand with the Final Assessment Notices, did not even comment or address the defenses and documents submitted by Avon. Thus, Avon was left unaware on how the Commissioner or her authorized representatives appreciated the explanations or defenses raised in connection with the assessments.** There was clear inaction of the Commissioner at every stage of the proceedings.
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> ...
>
> **It is true that the Commissioner is not obliged to accept the taxpayer's explanations, as explained by the Court of Tax Appeals. However, when he or she rejects these explanations, he or she must give some reason for doing so. He or she must give the particular facts upon which his or her conclusions are based, and those facts must appear in the record.**
>
> Indeed, the Commissioner's inaction and omission to give due consideration to the arguments and evidence submitted before her by Avon are deplorable transgressions of Avon's right to due process. **The right to be heard, which includes the right to present evidence, is meaningless if the Commissioner can simply ignore the evidence without reason.**[39]

Commissioner of Internal Revenue v. Unioil Corporation (Unioil)[40] condensed *Avon* by instructing that the "CIR, in exercising its power to assess and collect taxes if these are owed, ought to give due consideration to the arguments and evidence submitted by the affected party."

Here, respondent adhered to the teachings of *Avon* and *Unioil.*

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[38] G.R. Nos. 201398-99, October 3, 2018.
[39] Emphasis ours.
[40] G.R. No. 204405, August 4, 2021.

While the amounts in respondent's FLD[41] are substantially the same as the PAN,[42] save for interest, We found that respondent addressed petitioner's arguments in its Reply to the PAN as indicated in the Details of Discrepancies[43] attached to the FLD, *viz.*:

> In the protest to the PAN, SRPC claimed that the ancillary service income without energy dispatched is subject to 0% VAT since the language in Section 108 (B) (7) of the NIRC of 1997, as amended is plain, clear and unambiguous. The sales of power that is generated through renewable sources of energy such as hydropower, is subject to zero percent (0%) VAT rate, *whether or not there is 'actual generation of power'*. In other words, SRPC would have us believe that it is not subject to VAT for the payments received from NGCP for the periods during which the latter did not receive power as consideration therefor.
>
> This Office agrees with the contention of SRPC that the language in Section 108 (B) (7) of the NIRC of 1997, as amended is plain, clear, and unambiguous. According to the Oxford dictionary, to 'generate' means to 'produce'. It must be given its literal meaning and must be applied without further interpretation. SRPC cannot interpret the law to state that the sale of power that is generated through renewable sources of energy such as hydropower, is subject to zero percent (0%) VAT rate, *whether or not there is 'actual generation of power'* because this would run counter to the spirit and intent of the law.
>
> ...
>
> After thorough evaluation and consideration, SRPC was not able to adduce sufficient evidence necessary to overcome the assessment. Thus, the deficiency tax assessment is sustained in its entirety since the ancillary service income without energy dispatched is subject to 12% VAT pursuant to Section 108(A) of the NIRC, as amended.
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> ...
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> In the protest to the PAN, SRPC claimed that the operation and maintenance contract between KEPCO and SRPC is an offshore contract. All services rendered by KEPCO to SRPC during the period were performed outside of Philippines. Further, KEPCO, as a non-resident foreign corporation not engaged in trade or business in the Philippines cannot be compelled to implement/adopt the BIRs invoicing requirement.
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> In reply, Section 50 of the NIRC, as amended, empowers the Commissioner of Internal Revenue (CIR) to rectify abnormalities

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41 Exhibit "P-15," Docket - Vol. II, at pp. 669 to 670.
42 Exhibit "P-13," Docket - Vol. II, pp. 543 to 553.
43 Exhibit "P-15," Docket - Vol. II, at pp. 675 to 677.

> and distortions in income/deductions brought about by common control through the adoption of standards considered fair, reasonable or at arm's length, the pertinent portion of which provides that:
>
>> *'In the case of two or more organizations, trades or businesses, (whether or not incorporated and whether or not organized in the Philippines) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organization, trade, or business, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades or business.'*
>
> In this particular situation, although SRPC cannot compel KEPCO to comply with the BIR's invoicing requirements to document the payments made to KEPCO, the *arm's length principle* requires any transaction with a related party to be made under comparable conditions and circumstances as a transaction with an independent party. Hence, the proper document to support the payments made should not be an internal invoice which is considered as self-serving evidence but rather the official receipt or any official document being used in the country of origin of KEPCO. Thus, the deficiency final withholding tax assessment is sustained in its entirety.

The same holds for the FDDA. Respondent considered and addressed petitioner's arguments in its Protest in the Results of Reinvestigation,[44] sufficiently informing petitioner of the reasons for his conclusion.

What *Avon* proscribes is inaction. Here, there was no such inaction. Petitioner was neither left unheard nor ignored. *Ergo*, its right to due process for the subject deficiency tax assessments was fully observed.

Ultimately. While due process was observed as regards the deficiency VAT, FWT, and final withholding VAT assessments, petitioner nonetheless bears no liability therefor.

Our findings on each item of deficiency tax assessment, and corresponding justifications therefor, shall proceed in *seriatim*.

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[44] Exhibit "P-18," Docket - Vol. II, at pp. 1102 to 1106.

Petitioner is not liable for VAT on its ancillary service income.

Respondent found that petitioner derived gross receipts of ₱1,152,371,809.78 from ancillary services rendered to the National Grid Corporation of the Philippines (NGCP) under the ASPA, broken down as follows:

Period	Customer Name	SOA	Date	Official Receipt		Ancillary Service Income
				Number	Date	
Jan. 26 - Feb. 25, 2019	NGCP	30000112[45]	Feb. 28, 2019	20000061[46]	Apr. 30, 2019	₱100,248.36
Jan. 26 - Feb. 25, 2019	NGCP	30000119[47]	Mar. 29, 2019	20000061[48]	Apr. 30, 2019	108,897,723.62
Mar. 26 - Apr. 25, 2019	NGCP	30000125[49]	Apr. 30, 2019	20000065[50]	May 31, 2019	103,950,547.77
Apr. 26 - May 25, 2019	NGCP	30000132[51]	May 31, 2019	20000070[52]	June 28, 2019	130,491,058.40
Apr. 26 - May 25, 2019	NGCP	30000132[53]	May 31, 2019	20000073[54]	July 31, 2019	41,711.52
May 26 - June 25,2019	NGCP	30000137[55]	June 28, 2019	20000073[56]	July 31, 2019	115,214,108.31
June 26 - July 25, 2019	NGCP	30000142[57]	July 31, 2019	20000077[58]	Aug. 30. 2019	120,228,147.21
June 26 - July 25, 2019	NGCP	30000142[59]	July 31, 2019	20000080[60]	Sept. 30, 2019	90,245.98
July 26 - Aug. 25, 2019	NGCP	30000147[61]	Aug. 30, 2019	20000080[62]	Sept. 30, 2019	114,062,098.21
Aug. 26 - Sept. 25, 2019	NGCP	30000153[63]	Sept. 30, 2019	20000083[64]	Oct. 31, 2019	133,145,406.10
Sept. 26 - Oct. 25, 2019	NGCP	30000158[65]	Oct. 31, 2019	20000086[66]	Nov. 29, 2019	170,326,164.24
Oct. 26 - Nov. 25, 2019	NGCP	30000164[67]	Nov. 30, 2019	20000090[68]	Dec. 27, 2019	51,720,772.94
Nov. 26 - Dec. 25, 2019	NGCP	30000171[69]	Dec. 31, 2019	20000095[70]	Jan. 31, 2020	62,243,087.76
Dec. 26 - Jan. 25, 2020	NGCP	30000176[71]	Jan. 31, 2020	20000098[72]	Feb. 28, 2020	41,860,489.36
					TOTAL	**₱1,152,371,809.78**

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45 BIR Records (Exhibit "R-12"), p. 458.
46 BIR Records (Exhibit "R-12"), p. 510.
47 BIR Records – Docket 1 (Exhibit "R-12"), p. 458.
48 BIR Records – Docket 1 (Exhibit "R-12"), p. 510.
49 BIR Records – Docket 1 (Exhibit "R-12"), p. 452.
50 BIR Records – Docket 1 (Exhibit "R-12"), p. 506.
51 BIR Records – Docket 1 (Exhibit "R-12"), p. 445.
52 BIR Records – Docket 1 (Exhibit "R-12"), p. 501.
53 BIR Records – Docket 1 (Exhibit "R-12"), p. 445.
54 BIR Records – Docket 1 (Exhibit "R-12"), p. 498.
55 BIR Records – Docket 1 (Exhibit "R-12"), p. 440.
56 BIR Records – Docket 1 (Exhibit "R-12"), p. 498.
57 BIR Records – Docket 1 (Exhibit "R-12"), p. 435.
58 BIR Records – Docket 1 (Exhibit "R-12"), p. 494.
59 BIR Records – Docket 1 (Exhibit "R-12"), p. 435.
60 BIR Records – Docket 1 (Exhibit "R-12"), p. 491.
61 BIR Records – Docket 1 (Exhibit "R-12"), p. 430.
62 BIR Records – Docket 1 (Exhibit "R-12"), p. 491.
63 BIR Records – Docket 1 (Exhibit "R-12"), p. 424.
64 BIR Records – Docket 1 (Exhibit "R-12"), p. 488.
65 BIR Records – Docket 1 (Exhibit "R-12"), p. 419.
66 BIR Records – Docket 1 (Exhibit "R-12"), p. 485.
67 BIR Records – Docket 1 (Exhibit "R-12"), p. 413.
68 BIR Records – Docket 1 (Exhibit "R-12"), p. 481.
69 BIR Records – Docket 1 (Exhibit "R-12"), p. 406.
70 BIR Records – Docket 1 (Exhibit "R-12"), p. 476.
71 BIR Records – Docket 1 (Exhibit "R-12"), p. 401.
72 BIR Records – Docket 1 (Exhibit "R-12"), p. 473.

Petitioner submits that the income from the sale of ancillary services under the ASPA is a sale of power generated through renewable sources of energy, which is subject to zero percent (0%) VAT, as contemplated under Section 108(B)(7) of the NIRC, as amended.[73]

On the contrary, respondent asserts that the ancillary service fees paid by NGCP are subject to the regular 12% VAT under Section 108(A) of the NIRC, as amended. He posits that these fees are derived from ancillary services without energy generation and, therefore, did not constitute power generated through renewable energy sources as contemplated under Section 108(B)(7) of the NIRC, as amended.

Petitioner is correct.

Section 108(B)(7) of the NIRC, as amended, provides that the sale of power generated through renewable sources of energy is among the transactions subject to zero percent (0%) VAT, *viz.*:

> SEC. 108. *Value-added Tax on Sale of Services and Use or Lease of Properties.* – …
>
> (B) *Transactions Subject to Zero Percent (0%) Rate.* – The following services performed in the Philippines by **VAT-registered persons shall be subject to zero percent (0%) rate:** …
>
> (7) **Sale of power or fuel generated through renewable sources of energy** such as, but not limited to, biomass, solar, wind, **hydropower**, geothermal, ocean energy, and other emerging energy sources using technologies such as fuel cells and hydrogen fuels.[74]

To determine whether petitioner's sale of ancillary services to NGCP falls within the foregoing provision, the nature of ancillary services must first be considered.

Section 4(b) of the Electric Power Industry Reform Act of 2001[75] defines ancillary services as "those services necessary to support the transmission of capacity and energy from resources to loads while

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[73] Par. II, Grounds to Reverse the Assailed Decision, Memorandum for Petitioner, Docket – Vol. IV, p. 1979.
[74] Emphasis ours.
[75] Republic Act No. 9136 June 8, 2001.

maintaining reliable operation of the transmission system in accordance with good utility practice and the Grid Code…"

Consistent therewith, the Philippine Grid Code[76] identifies ancillary services as "support services such as Primary Reserve, Secondary Reserve, Tertiary Reserve, Reactive Power Support, and Black Start Capability which are necessary to support the transmission capacity and energy that are essential in maintaining power quality and the reliability of the Grid."

From this, ancillary services are classified and defined as:

> 1. Primary Reserve (*Contingency Reserve*) - Synchronized generating capacity that is allocated to stabilize the system Frequency and to cover the loss or failure of a Synchronized Generating Unit or a transmission line or the power import from a single circuit interconnection.[77]
>
> 2. Secondary Reserve (*Regulating Reserve*) - Synchronized generating capacity that is allocated to restore the system Frequency from the quasi-steady state value as established by the Primary Responses of Generating Units to the nominal Frequency of 60 Hz.[78]
>
> 3. Tertiary Reserve (*Dispatchable Reserve*) - The capacity which can be connected (automatically or manually) under Tertiary Control, in order to provide an adequate Secondary Reserve.[79]
>
> 4. Reactive Power Support - The capability of a Generating Unit to supply or absorb Reactive Power beyond the ranges prescribed under GCR 4.4.2.1.3.[80]
>
> 5. Black Start Capability - The ability of a Generating Unit to go from a shutdown condition to an operating condition, within a specified period of time, without feedback power from the Grid and to start delivering power to the sections of the Grid and provide power to other Generating Plants and other critical loads.[81]

By way of illustration, Primary Reserve or Contingency Reserve, comes into play when a generating unit or transmission line suddenly fails and the grid immediately loses part of its power

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76 Energy Regulatory Commission Resolution No. 22, Series of 2016, October 5, 2016.
77 *Ibid.*
78 *Ibid.*
79 *Ibid.*
80 *Ibid.*
81 *Ibid.*

supply.[82] In such a case, the Primary Reserve is at once tapped to supply the missing power, stabilize the system frequency, and prevent a wider power interruption.

On the other hand, Secondary Reserve or Regulating Reserve, operates during normal system conditions when electricity demand and generator output naturally rise or fall from time to time. These small fluctuations create temporary imbalances between supply and demand, causing minor deviations in system frequency.[83] The Regulating Reserve is then used to correct these imbalances and restore the system frequency to the nominal level of 60 Hz, thereby maintaining the quality and reliability of the grid.

Atty. Layug Jr., petitioner's expert witness in energy law and the Philippine power industry, confirmed that treating the sale of power as both the sale of energy and generating capacity is an industry practice, *viz.*: [84]

> Q13: Why do you say that the industry practice also supports your conclusion?
>
> A13: In the energy sector, it is an established industry practice for power purchase agreements, power supply agreements, energy conversion agreements and similar agreements involving the sale of power to include both a sale of energy and a sale of capacity. Under power industry practice, the term "power" means (i) energy, in KWh or MWh, and (ii) capacity or demand, in KW or MW and, hence, sale of power covers both sale of energy and sale of capacity. Also, sale of energy requires actual generation and delivery of electricity or energy while sale of capacity requires the seller to make available the capacity of a generating plant without necessarily requiring actual generation and delivery of energy.

From this backdrop, it may be gleaned that while ancillary services are characterized as support services, it shows that they actually consist of power reserves through generating capacity available to the transmission system.

Accordingly, the sale of power is not confined to the sale of electricity actually dispatched. It also includes the sale of generating capacity, which may be purchased even without the actual delivery of energy. To exclude generating capacity derived from the same

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82 Exhibit "P-21," Docket - Vol. III, p. 1207.
83 Exhibit "P-21," Docket - Vol. III, p. 1207.
84 Exhibit "P-41," Docket - Vol. I, pp. 122 to 140.

renewable source, would unduly restrict the statutory grant of VAT zero-rating pursuant to State's policy to "increase the utilization of renewable energy…by providing fiscal and nonfiscal incentives."[85]

This conclusion is reinforced by RR No. 16-2005,[86] which implements provisions of Section 108(B)(7) of the NIRC, by including related ancillary services in the gross receipts of generation companies and subjecting the sale of power generated through renewable sources to zero percent (0%) VAT, thus:

> SEC. 4.108-3. Definitions and Specific Rules on Selected Services.— …
>
> (f) Sale of electricity by generation, transmission, and distribution companies shall be subject to 10% VAT on their **gross receipts; Provided, that sale of power or fuel generated through renewable sources of energy** such as, but not limited to, biomass, solar, wind, **hydropower**, geothermal, ocean energy, and other emerging energy sources using technologies such as fuel cells and hydrogen fuels **shall be subject to 0% VAT.**
>
> …
>
> "Gross Receipts" under this Subsection (f) shall refer to the following:
>
> (a) Total amount charged by generation companies for the sale of electricity and **related ancillary services**; and/or
>
> …
>
> SEC. 4.108-5. Zero-Rated Sale of Services.— …
>
> (b) Transactions Subject to Zero Percent (0%) VAT Rate.— The following services performed in the Philippines by a VAT-registered person **shall be subject to zero percent (0%) VAT rate:**…
>
> (7) **Sale of power or fuel generated through renewable sources of energy** such as, but not limited to, biomass, solar, wind, **hydropower**, geothermal and steam, ocean energy, and other emerging sources using technologies such as fuel cells and hydrogen fuels; Provided, however, that zero-rating shall apply strictly to the sale of power or fuel generated through renewable sources of energy, and shall not extend to the sale of services

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85 Whereas Clause. Republic Act No. 9513, Renewable Energy Act of 2008, December 16, 2008.

86 Consolidated Value-Added Tax Regulations of 2005, September 1, 2005.

> related to the maintenance or operation of plants generating said power.[87]

In passing, upon the effectivity of the TRAIN Law, RR Nos. 13-2018[88] and 26-2018[89] amended the regular VAT rate applicable to the sale of electricity to 12% but retained the zero-rating of power generated through renewable sources and the definition of gross receipts.

Hence, RR No. 16-2005, as amended, treats related ancillary services as part of the sale of power by generation companies. *A fortiori*, ancillary service fees from the sale of hydroelectric generating capacity are subject to zero percent (0%) VAT under Section 108(B)(7) of the NIRC, as amended.

Here, records show that: (1) petitioner is a generation company primarily engaged in the business of generation of electricity or power generation and provision of ancillary services;[90] (2) petitioner is registered with the BOI as an operator of a hydroelectric power generating plant with capacity of 345 MW;[91](3) petitioner and NGCP entered into an ASPA on November 1, 2017 for the provision of Ancillary Services;[92] approved by the Energy Regulatory Commission,[93] and through thereof (4) petitioner generated gross receipts from the sale of ancillary services to NGCP amounting ₱1,152,371,809.78.

In fine, applying the above disquisitions, petitioner sufficiently established that, in TY 2020, it sold ancillary services to NGCP, consisting of power capacity or reserves generated solely from hydropower. Accordingly, such sales are subject to zero percent (0%) VAT.

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87 Emphasis ours.
88 Regulations Implementing the VAT Provisions under the RA No. 10963, Further Amending RR No. 16-2005, as Amended, March 15, 2018.
89 Amends Certain Provisions of RR No. 13-2018 to Implement the 90-Day Processing of Claim for VAT Refund under Section 112 (C) of the Tax Code of 1997, as Amended by Republic Act (R.A.) No. 10963, Otherwise Known as the Tax Reform for Acceleration and Inclusion or TRAIN, December 21, 2018.
90 Exhibit "P-1," Docket - Vol. I, pp. 361 to 405.
91 Exhibit "P-4," Docket - Vol. I, pp. 425 to 428.
92 Exhibit "P-20," Docket - Vol. III, pp. 1134 to 1201.
93 Exhibit "P-21," Docket - Vol. III, pp. 1202 to 1219.

Petitioner's OMCA transactions are not subject to FWT.

Respondent found that petitioner paid ₱51,994,611.14 to Kansai Electric Power Co., Inc. (KEPCO), a Japan-incorporated non-resident foreign corporation[94] and related party, under OMCA dated April 1, 2015.[95]

According to respondent, petitioner submitted only email correspondence, KEPCO's internal invoices, and bank remittance receipts, but no official receipts pertaining to said services. For this reason, respondent subjected petitioner's payments to FWT under Sections 28(B) and 57(A) of the NIRC, as amended.[96]

Petitioner retorts that the services rendered under the OMCA were performed outside the Philippines. As such, the income derived therefrom is not considered Philippine-sourced income and is therefore not subject to withholding tax.

Petitioner is again correct.

Section 57(A) of the NIRC, as amended, enjoins income-payors to withhold final income taxes on, among others, income of NRFCs taxed under, *inter alia,* Section 28(B)(1) of the same Code:

> **Section 57.** *Withholding of Tax at Source.* -
>
> ...
>
> (A) *Withholding of Final Tax on Certain Incomes.* - Subject to rules and regulations the Secretary of Finance may promulgate, upon the recommendation of the Commissioner, requiring the filing of income tax return by certain income payees, the tax imposed or prescribed by Sections 24(B)(1), 24(B)(2), 24(C), 24(D)(1); 25(A)(2), 25(A)(3), 25(B), 25(C), 25(D), 25(E), 27(D)(!), 27(D)(2), 27(D)(3), 27(D)(5), 28 (A)(4), 28(A)(5), 28(A)(7)(a), 28(A)(7)(b), 28(A)(7)(c), **28(B)(1)**, 28(B)(2), 28(B)(3), 28(B)(4), 28(B)(5)(a), 28(B)(5)(b), 28(B)(5)(c); 33; and 282 of this Code on specified items of income shall be withheld by payor-corporation and/or person and paid in the same manner and subject to the same conditions as provided in Section 58 of this Code.

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94 Exhibit "P-23," Docket - Vol. I, at pp. 1347 to 1361.
95 Exhibit "P-15," Docket - Vol. II, at pp. 676 to 677.
96 Exhibit "P-18," Docket - Vol. III, at pp. 1105 to 1106.

Section 28(B)(1)[97] of the NIRC, as amended, imposes income taxes on income or gains of NRFCs derived from sources within the Philippines. Likewise, Section 23(F) of the same Code states that "[a] foreign corporation, whether engaged or not in trade or business in the Philippines, is taxable only on income derived from sources within the Philippines."

There is no denying that the income earned by KEPCO was derived from its rendition of services to petitioner under the OMCA. Thus, for said service income to be taxable, it must be derived from sources within the Philippines.

The service income earned by KEPCO was derived from sources **outside** the Philippines; thus, KEPCO is not subject to income tax under Section 28(B)(1) of the NIRC, as amended. For this reason, petitioner's obligation to withhold final income taxes thereon under Section 57(A) of the same Code did *not* arise.

We explain.

Section 42(A)(3) and (C)(3) of the NIRC, as amended, is plain in that the place of performance of service is determinative of the source of service income. If the services were performed in the Philippines, the income generated therefrom are derived from sources within the Philippines. In reverse, if the services were performed **outside** the Philippines, the income generated therefrom are derived from sources **outside** the Philippines. Thus:

> Sec. 42. Income from Sources Within the Philippines. –
>
> (A) Gross Income From Sources Within the Philippines. – The following items of gross income shall be treated as gross income from sources within the Philippines: …

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[97] SEC. 28. *Rates of Income Tax on Foreign Corporations.* –

…

(B) *Tax on Nonresident Foreign Corporation.* –

…

(1) *In General.* - Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-five percent (35%) of the gross income received during each taxable year **from all sources within the Philippines**, such as interests, dividends, rents, royalties, salaries, premiums (except reinsurance premiums), annuities, emoluments or other fixed or determinable annual, periodic or casual gains, profits and income, and capital gains, except capital gains subject to tax under subparagraph 5(c): Provided, That effective January 1, 2009, the rate of income tax shall be thirty percent (30%). Emphases ours.

> **(3) Services. - Compensation for labor or personal services performed in the Philippines; ...**
>
> ...
>
> (C) Gross Income From Sources Without the Philippines. - The following items of gross income shall be treated as income from sources without the Philippines:
>
> ...
>
> **(3) Compensation for labor or personal services performed without the Philippines.**

Our immediately preceding remarks find succor in the pronouncement in *Commissioner of Internal Revenue v. Baier-Nickel:*[98]

> The important factor therefore which determines the source of income of personal services is not the residence of the payor, or the place where the contract for service is entered into, or the place of payment, **but the place where the services were actually rendered.**
>
> ...
>
> The Court reiterates the rule that "source of income" relates to the property, activity or service that produced the income. With respect to rendition of labor or personal service, as in the instant case, it is the place where the labor or service was performed that determines the source of the income. There is therefore no merit in petitioner's interpretation which equates source of income in labor or personal service with the residence of the payor or the place of payment of the income.[99]

Here, petitioner was able to show that the services were rendered by KEPCO outside the Philippines as indicated in its OMCA dated April 1, 2015:[100]

> **4. SITUS**
>
> Consultant shall render all services **outside the Philippines and no personnel or employee of Consultant will go to the Philippines to provide the Services**.[101]

The OMCA is plain and simple. All of KEPCO's services to petitioner are performed outside the Philippines. Too, none of

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[98] G.R. No. 153793 August 29, 2006.
[99] Emphasis ours.
[100] Exhibit "P-24," Docket - Vol. III, at p. 1369. OMCA for brevity.
[101] Emphasis Ours.

KEPCO's employees or personnel would go to the Philippines in the performance of services. It means that the service income of KEPCO resulting from the performance thereof is derived from sources **outside** the Philippines.

In fact, respondent acknowledged through the Certificate of Entitlement to Treaty Benefit[102] that services performed by KEPCO was rendered outside the Philippines and therefore exempt from income tax:

> In this case, (KEPCO) **does not have a fixed place of business in the Philippines, and did not furnish consultancy or supervisory services in the Philippines** in connection with a contract for a building, construction or Installation project, through its employees or other personnel, for a period aggregating more than six months within any twelve-month period. In fact, the **services were rendered and will be rendered outside the Philippines** based on Section 4 (Situs) of the Offshore Operation and Maintenance Consulting Agreement.
>
> Accordingly, the income derived by (KEPCO) from the services it rendered to San Roque is **exempt from income tax.**[103]

In *fine,* the service income earned by KEPCO was derived from sources **outside** the Philippines. Being so, it is not subject to income tax under Section 28(B)(1) of the NIRC, as amended. *A fortiori,* petitioner's obligation to withhold final income taxes thereon under Section 57(A) of the same Code did *not* arise. For this reason, the nullification of the 2020 deficiency FWT assessment slapped against petitioner on said service income is warranted.

Petitioner's OMCA transactions are not subject to final withholding VAT.

Respondent faults petitioner in its failure to withhold final VAT on the service fees earned by KEPCO by virtue of the latter's OMCA with petitioner. According to respondent, petitioner's obligation to withhold final VAT is sanctioned by Section 4.114(A)(3) of RR No. 2-98.[104]

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102 Exhibit "P-31," Docket - Vol. IV, pp. 1735 to 1737.
103 Emphasis ours.
104 Exhibit "P-18," Docket - Vol. III, at p. 1106.

Petitioner argues that the services rendered under the OMCA were performed outside the Philippines by a non-resident foreign corporation, thus, such services should not be subject to final withholding VAT.

Petitioner is, for the third time, correct.

The VAT system generally uses the destination principle as a basis for the jurisdictional reach of the tax.[105] Under the Destination Principle, goods and services are taxed only in the country where these are consumed.[106] Specifically, the place of consumption of services is the place *where* these services were performed or rendered. *Commissioner of Internal Revenue v. American Express International, Inc. (Philippine Branch) (Amex)*[107] is explicit:

> VAT is a tax on consumption "expressed as a percentage of the value added to goods or services" purchased by the producer or taxpayer. As an indirect tax on services, its main object is the transaction itself or, more concretely, the performance of all kinds of services conducted in the course of trade or business in the Philippines. These services must be regularly conducted in this country; undertaken in "pursuit of a commercial or an economic activity;" for a valuable consideration; and not exempt under the Tax Code, other special laws, or any international agreement.
>
> ...
>
> Consumption is "the use of a thing in a way that thereby exhausts it." **Applied to services, the term means the performance or "successful completion of a contractual duty, usually resulting in the performer's release from any past or future liability...**"[108]

With the foregoing discourse as fulcrum, Section 105 and 108 of the NIRC, as amended, subjects to VAT the all kinds of services **performed in the Philippines** for a fee. In the opposite, services **performed outside** the Philippines should be free of VAT. Thus:

> Section 105. Persons Liable. – Any person who, in the course of trade or business, sells barters, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 106 to 108 of this Code.

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105 *Commissioner of Internal Revenue v. Placer Dome Technical Services (Phils.), Inc.*, G.R. No. 164365, June 8, 2007.

106 *Commissioner of Internal Revenue v. Filminera Resources Corporation*, G.R. No. 236325, September 16, 2020.

107 G.R. No. 152609, June 29, 2005.

108 Emphasis ours. Citations omitted.

> The value-added tax is an indirect tax and the amount of tax may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services. This rule shall likewise apply to existing contracts of sale or lease of goods, properties or services at the time of the effectivity of Republic Act No. 7716.
>
> 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 nonstock, 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.
>
> The rule of regularity, to the contrary notwithstanding, services as defined in this Code rendered in the Philippines by non-resident foreign persons shall be considered as being in the course of trade or business.
>
> . . .
>
> 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 ten percent (10%) of gross receipts derived from the sale or exchange of services, including the use or lease of properties: Provided, That the President, upon the recommendation of the Secretary of Finance, shall, effective January 1, 2006, raise the rate of value-added tax to twelve percent (12%), after any of the following conditions has been satisfied:
>
> 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 ...

Significantly, the duty of a withholding agent, like petitioner, to withhold final VAT referred to in Sections 105 and 108(A) of the NIRC, as amended, would only come into play when the services rendered by non-residents, such as KEPCO, were performed in the Philippines. Inversely, such duty does not arise when the services of the non-resident were performed outside the Philippines. Section 4.114-2(b) of RR No. 16-2005 confirmed:

> SECTION 4.114-2. Withholding of VAT on Government Money Payments and Payments to Non-Residents. — ...

> (b) The government or any of its political subdivisions, instrumentalities or agencies, including GOCCs, as well as **private corporations**, individuals, estates and trusts, whether large or non-large taxpayers, **shall withhold ten percent (10%) [now 12%] VAT with respect to the following payments**:
>
> (1) Lease or use of properties or property rights owned by non-residents;
> (2) Services rendered to local insurance companies, with respect to reinsurance premiums payable to non-residents; and
> (3) **Other services rendered in the Philippines by non-residents.**

Adverting to Our earlier discourse, the OMCA specifically stipulated that all the services rendered by KEPCO to petitioner are performed outside the Philippines.[109] Such contract also states that none of KEPCO's employees or personnel would go to the Philippines in the performance of services.[110] Simply put, KEPCO's services were performed outside the Philippines; thus, should *not* be subjected to VAT under Section 105, in relation to Section 108(A) of the NIRC, as amended. In view thereof, petitioner's duty to withhold final VAT thereon, likewise, did *not* arise. On this account, respondent's 2020 deficiency final withholding VAT emanating therefrom should be cancelled.

Parenthetically, with KEPCO's performance of services abroad, said services was *not* done in the course of trade or business, to be saddled with VAT. The last paragraph of Section 105 of the NIRC, as amended, reads:

> The rule of regularity, to the contrary notwithstanding, **services** as defined in this Code **rendered in the Philippines by nonresident foreign persons shall be considered as being rendered in the course of trade or business**.

Here, KEPCO is an NRFC, and the OMCA specifically stipulated that all services thereunder would be rendered outside the Philippines. Hence, the statutory requisite for VAT purposes treating KEPCO's services as rendered in the course of trade or business in the Philippines is therefore absent. This gives Us added justification to blot out respondent's 2020 deficiency final withholding VAT.

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109 *Supra* at note 101.
110 *Ibid.*

Petitioner is not liable to pay compromise penalties.

Respondent meted compromise penalties on the following alleged violations by petitioner,[111] to wit:

For failure to file and/or pay VAT at time or times required by law or regulation	₱35,000.00
For failure to withhold or remit Final Withholding Tax at the time or times required by law or regulation	25,000.00
For failure to withhold or remit Final Withholding VAT at the time or times required by law or regulation	25,000.00
TOTAL	**₱85,000.00**

A compromise is, by its nature, mutual in essence.[112] It implies agreement. One party cannot impose it upon the other.[113] Considering that there is no indication that petitioner consented to the subject compromise penalty, the said amount cannot be sustained.

WHEREFORE, the Petition for Review filed on March 31, 2023, by petitioner San Roque Power Corporation, is **GRANTED.** Accordingly, respondent's deficiency VAT, final withholding tax, and final withholding VAT assessments, inclusive of interest and penalties against petitioner for fiscal year ending March 31, 2020, in the total amount of ₱212,476,688.89 are **CANCELLED AND SET ASIDE.**

Respondent, his representatives, agents, or other persons acting in his behalf are **ENJOINED** from implementing the collection of VAT, final withholding tax, and final withholding VAT assessments, inclusive of interest and penalties against petitioner for fiscal year ending March 31, 2020, in the total amount of ₱212,476,688.89.

SO ORDERED.

Marian Ivy F. Reyes-Fajardo
MARIAN IVY F. REYES-FAJARDO
Associate Justice

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[111] Exhibit "P-18," Docket - Vol. III, at p. 1108.
[112] Refer to *Vda. De San Agustin v. Commissioner of Internal Revenue*, G.R. No. 138485, September 10, 2001.
[113] *Commissioner of Internal Revenue vs. Abad, et al.*, G.R. No. L-19627, June 27, 1968.

I CONCUR:

HENRY S. ANGELES
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

Marian Ivy F. Reyes-Fajardo
MARIAN IVY F. REYES-FAJARDO
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

MA. BELEN M. RINGPIS-LIBAN
Presiding Justice