REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

March 22, 2012

REVENUE MEMORANDUM CIRCULAR NO. 11-2012

SUBJECT : Tax Consequences of Power Sector Assets and Liabilities Management Corporation (PSALM) transactions.

TO : All Revenue Officials and Employees and Others Concerned

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This Circular is issued to clarify the tax consequences of the various transactions of the Power Sector Assets and Liabilities Management Corporation (PSALM).

BACKGROUND

In anticipation of the impending power crisis and to sustain the Philippines' emerging economy, the Philippine Government moved for the privatization of the electric power industry. This privatization program was embodied in Republic Act (RA) No. 9136, known as the Electric Power Industry Reform Act of 2001 or "EPIRA".

The objectives of the EPIRA are to ensure quality, reliable, secure and affordable electric power supply; to promote a regime of free and fair competition; to enhance the inflow of private capital and broaden the ownership base of the power generation, transmission and distribution sectors; and to provide for an orderly and transparent privatization of the assets and liabilities of the National Power Corporation (NPC).

Pursuant to Section 49 of the EPIRA, the PSALM was created as a government-owned and controlled corporation and is mandated to take ownership of all the existing generation assets, independent power producer (IPP) contracts, real estate and all other disposable assets, and to assume all liabilities and obligations of NPC.

The proceeds from the privatization of NPC assets will be utilized by PSALM to liquidate debts of NPC that PSALM has assumed. Upon expiration of its term of existence of twenty five (25) years, all assets held by PSALM, including all the moneys and properties belonging to it, and all its liabilities outstanding shall revert to and be assumed by the National Government.

TAX CONSEQUENCES

I. On the Sale of the NPC Generation Assets and other Real Properties in view of the Privatization

1. No income and withholding taxes are due from the sale of the NPC generation assets and other real properties to winning bidders;

2. The sale by PSALM of the NPC generation assets and other real properties to winning bidders, is subject to Value-Added Tax (VAT);

3. The sale by PSALM of the NPC generation assets and other real properties is subject to Documentary Stamp Tax; and

4. The rental income of PSALM from the NPC generation assets and other real properties, prior to its sale to winning bidders, is subject to income tax and VAT.

DISCUSSION

1. No income and withholding taxes are due from the sale of the NPC generation assets and other real properties to winning bidders.

Pursuant to Section 50 of the EPIRA, PSALM shall primarily manage the orderly sale, disposition and privatization of NPC generation assets and other real properties with the objective of liquidating all NPC financial obligations, stranded contract costs and stranded debts in an optimal manner.

PSALM shall take over the existing generation assets and other real properties and liabilities of NPC. The transfer of such obligations is by operation of law. In this particular instance, the transfer of the loans is actually a transfer of such loans from one government vehicle (that is, NPC) to another (that is, PSALM) both of which share the same objective and governmental purpose of ensuring supply of electricity to the country.

The value of the NPC liabilities assumed by PSALM, which includes stranded debts[1] and stranded contract costs[2] of NPC, exceeds the value of the NPC assets that were transferred to it. In fact, since the estimated proceeds from the sale of the NPC transferred assets would not be sufficient to liquidate NPC's outstanding obligations, imposition of Universal Charge has been necessary and was provided for under the EPIRA. Under Section 34(a) of the EPIRA, a Universal Charge to be determined, fixed and approved by the Energy Regulatory Commission (ERC), shall be imposed on all electricity end-users.

One of the purposes of the imposition of the Universal Charge is to pay the stranded debts and stranded contract costs of NPC and qualified distribution utilities. Thus, the PSALM was tasked to calculate the amount of stranded debts and stranded contract costs of NPC which shall form the basis for ERC in the determination of the Universal Charge.[3] For purpose of administration of the proceeds from the Universal Charge, PSALM shall create a Special Trust Fund which shall be disbursed only for the purposes specified under the EPIRA in an open and transparent manner.

The value to be generated from the sale of the NPC generation assets and other real properties must be maximized since the proceeds from its privatization will be utilized by PSALM to liquidate debts of NPC, and any deficiency thereof will be borne by the National Government while any excess thereof shall also accrue to the National Government.

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[1] "Stranded contract costs of NPC or distribution utility" refer to the excess of the contracted cost of electricity under eligible contracts over the actual selling price of such contracts in the market. Such contracts shall have been accredited by the DOE or NPC and approved by the ERB as of the effectivity of this Act. [Section 4(pp) of the EPIRA]

[2] "Stranded Debts of NPC" refer to any unpaid financial obligations of NPC which have not been liquidated by the proceeds from sales and privatization of NPC assets [Section 4(qq) of the EPIRA]

[3] Section 51(c) of the EPIRA

The NPC generation assets and other real properties are tangible assets with definite book values for NPC and PSALM. The book values of the NPC's tangible assets, which are pre-computed and available during the transfer by NPC to PSALM, are substantially minimal compared with the large amount of the estimated total liabilities of NPC. Hence, the estimated pre-computed proceeds from the sale of the tangible assets are significantly insufficient to pay the estimated total liabilities of NPC. Considering that the estimated proceeds from the sale of NPC generating assets and other real properties cannot be reasonably expected to exceed the estimated NPC liabilities, PSALM will not derive gain from the disposal of these tangible assets.

Moreover, proceeds from sale of generating assets and other real properties does not accrue to PSALM but to the National Government. However, the same is earmarked for a particular purpose, as said proceeds are set aside in a special account for payments of NPC's liabilities, as mandated by the EPIRA.

The EPIRA, particularly Section 50 thereof, provides that the proceeds from the sale of the NPC generation assets and other real properties and all its liabilities outstanding upon the expiration of its term of existence shall revert to and be assumed by the **National Government**, to wit:

> "Sec. 50. *Purpose and Objective, Domicile and Term of Existence.* - The principal purpose of the Corporation is to manage the orderly sale, disposition, and privatization of NPC generation assets, real estate and other disposable assets, and IPP contracts with the objective of liquidating all NPC financial obligations and stranded contract costs in an optimal manner.
>
> The Corporation shall have its principal office and place of business within Metro Manila.
>
> The Corporation shall exist for a period of twenty five (25) years from the effectivity of this Act, unless otherwise provided by law, and all assets held by it, all moneys and properties belonging to it, and all its liabilities outstanding upon the expiration of its term of existence **shall revert to and be assumed by the National Government.**" (emphasis supplied)

It clear from the foregoing that PSALM, the principal purpose of which is to manage the orderly sale, disposition, and privatization of NPC generation assets and other real properties, with the objective of liquidating all NPC financial obligations and stranded contract costs in an optimal manner[4], *will not derive gain from the said sale of the NPC generation assets and other real properties*.

Accordingly, no income tax and consequently withholding tax is due from PSALM on its sale of the NPC generation assets and other real properties.

2. The sale by PSALM of the NPC generation assets and other real properties to winning bidders, is subject to Value-Added Tax (VAT);

Pursuant to Section 105 of the Tax Code, any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties shall be subject to VAT. The Tax Code of 1997 defines the phrase *"in the course of trade or business"* as 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 enactment of RA 9337[5] on July 1, 2005 placed the electric power industry in the VAT System. Particularly, the amendment included the sale of electricity by generation companies, transmission and distributions companies, to sales subject to VAT, to wit:

> " **SEC. 6.** Section 108 of the same Code, as amended, is hereby further amended to read as follows:
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> SEC. 108. *Value-added Tax on Sale of Services and Use or Lease of Properties.* -
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> xxx xxx xxx
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> "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,

[4] Section 50 of the EPIRA

[5] Otherwise known as the "E-VAT Law", AN ACT AMENDING SECTIONS 27, 28, 34, 106, 107, 108, 109, 110, 111, 112, 113, 114, 116, 117, 119, 121, 148, 151, 236, 237 AND 288 OF THE NATIONAL INTERNAL REVENUE CODE OF 1997, AS AMENDED, AND FOR OTHER PURPOSES

including those performed or rendered by construction and service contractors; stock, real estate, commercial, customs and immigration brokers; lessors of property, whether personal or real; warehousing services; lessors or distributors of cinematographic films; persons engaged in milling, processing, manufacturing or repacking goods for others; proprietors, operators or keepers of hotels, motels, rest-houses, pension houses, inns, resorts; proprietors or operators of restaurants, refreshment parlors, cafes and other eating places, including clubs and caterers; dealers in securities; lending investors; transportation contractors on their transport of goods or cargoes, including persons who transport goods or cargoes for hire and other domestic common carriers by land relative to their transport of goods or cargoes; common carriers by air and sea relative to their transport of passengers, goods or cargoes from one place in the Philippines to another place in the Philippines; **<u>sales of electricity by generation companies, transmission, and distribution companies</u>**; **xxx**" (emphasis supplied)

Moreover, Revenue Regulations (RR) No. 16-2005 was accordingly amended by RR 04-2007 and subjected the sale of real properties not primarily held for sale or for lease, <u>but used in business</u>, to VAT, to wit:

"**SEC. 4.109-1.** ***VAT-Exempt Transactions***.-

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(B) Exempt transactions . – Subject to the provisions of Sec. 4.109-2 hereof, the following transactions shall be exempt from VAT:

xxx xxx xxx

(p) The following sales of real properties are exempt from VAT, namely:

(1) Sale of real properties not primarily held for sale to customers or held for lease in the ordinary course of trade or business.

<u>However, even if the real property is not primarily held for sale to customers or held for lease in the ordinary course of trade or business but the same is used in the trade or business of the seller, the sale thereof shall be subject to VAT being a transaction incidental to the taxpayer's main business.</u>

xxx xxx xxx" (emphasis supplied)

Considering that the sale of electricity is now subject to VAT, the real properties sold by PSALM are regarded as real properties *used in the trade or business.* While it is clear under the Tax Code of 1997 that such sale is not subject to income tax, there is no provision under the same Code that exempts it from VAT nor subject it to VAT at zero rate. Sec. 106 of the Tax Code of 1997 imposes VAT on “all kinds of goods and properties” sold in the Philippines, with the term “goods and properties” given an all-encompassing meaning by Congress. Thus, any goods and properties sold should be deemed included unless some provisions of law especially exclude it. The sale of the generation assets, real properties and other disposable assets by PSALM are no different from the goods and properties provided under Section 106 of the Tax Code of 1997.

It is to be noted, however, that the VAT imposed on the sale of the transferred assets may be utilized by the buyer as creditable input VAT.

3. The sale by PSALM of the NPC generation assets and other real properties is subject to Documentary Stamp Tax (DST)

Pursuant to Section 196 of the Tax Code of 1997, the sale of real properties by PSALM will be subject to DST at the rate of P15.00 for every P1,000 based on the consideration contracted to be paid for such realty or its fair market value determined in accordance with Section 6(E) thereof, whichever is higher. When one of the contracting parties is the Government, the tax to be imposed shall be based on the actual consideration subject to the proviso that, where one party to the transaction is exempt, the other party shall pay the tax. (Section 173 of the Tax Code of 1997).

Accordingly, the sale of the NPC generation assets and other real properties by PSALM pursuant to the privatization will be subject to DST based on the fair market value or the actual consideration that PSALM will receive, whichever is higher.

4. The rental income of PSALM from the NPC generation assets and other real properties, prior to its sale to winning bidders, is subject to income tax and VAT

After the transfer of the NPC generation assets and other real properties to PSALM but prior to the privatization, PSALM enters into contracts of lease with private entities where the subject of the lease are the NPC generation assets and other real properties transferred to PSALM. The income received by PSALM from the lease is subject to corporate income tax provided under Section 27(A) of the Tax Code of 1997, to wit:

> " SEC. 27. Rates of Income tax on Domestic Corporations. -
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> (A) In General. - Except as otherwise provided in this Code, an income tax of thirty-five percent (35%) is hereby imposed upon the taxable income derived during each taxable year from all sources within and without the Philippines by every corporation, as defined in Section 22(B) of this Code and taxable under this Title as a corporation, organized in, or existing under the laws of the Philippines: *Provided*, That effective January 1, 2009, the rate of income tax shall be thirty percent (30%).

The principal purpose for the creation of PSALM is to manage the orderly sale, disposition, and privatization of NPC transferred assets in order to liquidate NPC's liabilities. Although PSALM generates revenues from leasing of the NPC transferred assets and other assets, such revenues are merely incidental to the mandate of PSALM to dispose such assets.

Thus, while no income tax is due on PSALM on its mandate to sell the NPC generation assets and other real properties to winning bidders, revenues derived by PSALM from its leasing activities are nevertheless subject to income tax.

Moreover, gross receipts of PSALM from the lease of NPC transferred assets and other assets are deemed in the ordinary course of trade or business, hence, subject to VAT under the Tax Code of 1997.

II. On the Operation of the Generation Facilities

<u>Income and Withholding Tax</u>

Prior to the privatization of the transferred assets, PSALM shall administer and operate such assets. Until these assets are privatized, PSALM will be selling electric power from the transferred generation assets and thus, under the IRR of the EPIRA, PSALM will be considered a generation company with respect to its sale of generated electric power.

Currently, government-owned and/or controlled corporations (GOCCs) are now subject to income tax pursuant to Section 27 (C) of the Tax Code[6] except for the

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[6] "SEC. 27. Rates of Income Tax on Domestic Corporations. —

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(C) Government-owned or -Controlled Corporations, Agencies or Instrumentalities. — The provisions of existing special or general laws to the contrary notwithstanding, all corporations, agencies, or instrumentalities owned or controlled by the Government, except the Government Service Insurance System (GSIS), the Social four (4) government corporations specifically enumerated therein. PSALM is not one of the exempt GOCCs under the said provision of the Tax Code of 1997.

The operation by PSALM of the NPC assets transferred to it is not its principal purpose but only incidental to its mandate to privatize the generating plants of NPC in order to avoid a massive interruption in the supply of electricity. In this regard, any income derived therefrom is subject to income tax imposed under Section 27(A) and (E) of the Tax Code of 1997.

Value- Added Tax

Since the sale of the electricity and sale of service by PSALM are deemed made in the course of its business, the same is subject to VAT under Section 108 of the Tax Code of 1997 (as amended by RA 9337).

However, pursuant to Section 108(B)(7) of the Tax Code of 1997, as amended by RA 9337, sale of power generated though renewable sources of energy is subject to VAT at zero percent. The pertinent provision of Section 108 (B)(7) of the Tax Code of 1997 provides:

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

Security System (SSS), the Philippine Health Insurance Corporation (PHIC) and the Philippine Charity Sweepstakes Office (PCSO), shall pay such rate of tax upon their taxable income as are imposed by this Section upon corporations or associations engaged in a similar business, industry, or activity."

III. Miscellaneous Activities

Other income/receipts derived by PSALM from miscellaneous activities such as forfeiture of performance bonds, interest income from persons other than the winning bidders, and from other activities not related with its mandate are subject to all applicable taxes under the Tax Code of 1997.

IV. Repealing Clause

The Supreme Court, in the case of *Emilio Y. Hilado vs. The Collector of Internal Revenue and the Court of Tax Appeals*[7], held:

> "With regard to the contention that General Circular No. V-139 cannot be given retroactive effect because that would affect and obliterate the vested right acquired by *Petitioner* under the previous circular, suffice it to say that **General Circular No. V-123, having been issued on a wrong construction of the law, cannot give rise to a vested right that can be invoked by a taxpayer. The reason is obvious: <u>a vested right cannot spring from a wrong interpretation</u>**. This is too clear to require elaboration.
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> "It seems too clear for serious argument that an administrative officer cannot change a law enacted by Congress. **A regulation that is merely an interpretation of the statute when once determined to have been erroneous becomes <u>nullity</u>. An erroneous construction of the law by the Treasury Department or the collector of internal revenue <u>does not preclude or estop the government from collecting a tax which is legally due</u>**." (Ben Stocker, et al., 12 B. T. A., 1351.)"
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> "Art. 2254. — No vested or acquired right can arise from acts or omissions which are against the law or which infringe upon the rights of others." (Article 2254, New Civil Code.)

Accordingly, all other existing BIR rulings and revenue issuances inconsistent with the provisions of this Revenue Memorandum Circular are of no force and effect.

All concerned are hereby enjoined to be guided accordingly and to give this Circular as wide publicity as possible.

(Original Signed)
KIM S. JACINTO-HENARES
Commissioner of Internal Revenue

[7] G.R. No. L-9408, October 31, 1956