REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE
National Office Building
Quezon City

Sec. 27(A) and Sec. 105 of the Tax Code of 1997, as amended; RR No. 16-2005, as amended
BIR Ruling No. 1211-2018
OT- 022 - 2024 APR 11 2024

LAYUG CELICIOUS-SY VILLAPANDO TAX LAW
Unit 503, The Linden Suites
37 San Miguel Avenue
Ortigas Center, Pasig City

Attention: **Laura Victoria Y. Layug**
Suzette A. Celious-Sy
Madeline L. Zialcita-Villapando

Gentlemen:

This refers to your request on behalf of your client, Air Liquide Philippines, Inc. (Air Liquide) for confirmation of your opinion that the termination fee to be received by Air Liquide from Pilipinas Shell Petroleum Corporation (Pilipinas Shell) on account of the termination of the Hydrogen Supply Agreement (Subject Agreement) previously entered into by the parties is subject to income tax and value-added tax (VAT).

It is represented that on July 12, 2019, Air Liquide and Pilipinas Shell entered into the Subject Agreement whereby Air Liquide agreed to process Pilipinas Shell's natural gas for a stipulated monthly fee for the next twenty (20) years. The Subject Agreement entailed the construction of a Hydrogen Manufacturing Unit and a Liquid Carbon Dioxide Plant by Air Liquide, customized specifically for Pilipinas Shell on the latter's refinery in Tabangao, Batangas. The construction of the Plants commenced in 2020 and was scheduled to be completed and operational in the first quarter of 2021. In August 2020, the Board of Directors of Pilipinas Shell decided to cease refinery operations and close the Tabangao Refinery. This closure meant that the Subject Agreement entered into by the parties will no longer be needed. On December 23, 2020, Air Liquide and Pilipinas Shell executed another agreement (Termination Agreement) whereby Pilipinas Shell agreed to pay Air Liquide a Termination Fee of the Subject Agreement amounting to Thirty-Six Million, Five Hundred Thousand US Dollars (36,500,000.00 USD) by way of On-Shore bank transfer converted from US Dollars to Philippine Peso with the latest reference exchange rate used by the Banko Sentral ng Pilipinas at the Invoicing Date (January 25, 2021 and January 25, 2022).

In reply, please be informed that Section 105 of the National Internal Revenue Code of 1997 (Tax Code), as amended, delineates the imposition of VAT only on sale, barter exchange, lease, rendering of service or importation of goods, *viz*:

> *"SEC. 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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> *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." (Emphasis and underscoring supplied)

In consonance thereto, Sections 4.105-1 and 4.105-2 of Revenue Regulations (RR) No. 16-2005, as amended, states that:

"SECTION 4.105-1. 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 VAT imposed in Secs. 106 to 108 of the Tax Code.*

xxx xxx xxx

'Person' refers to any individual, trust, estate, partnership, corporation, joint venture, cooperative or association.

'Taxable person' refers to any person liable for the payment of VAT, whether registered or registrable in accordance with Sec. 236 of the Tax Code.

xxx xxx xxx

"Taxable sale" refers to the sale, barter, exchange and/or lease of goods or properties, including transactions "deemed sale" and the performance of service for a consideration, whether in cash or in kind, all of which are subject to tax under Secs. 106 and 108 of the Tax Code.

SECTION 4.105-2. Nature and Characteristics of VAT. — ***VAT is a tax on consumption levied on the sale, barter, exchange or lease of goods or properties and services in the Philippines and on importation of goods into the Philippines.*** *The seller is the one statutorily liable for the payment of the tax but the amount of the 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 RA No. 9337. However, in the case of importation, the importer is the one liable for the VAT."* (Emphasis and underscoring supplied)

The above-quoted provisions are clear that VAT is levied to any individual, trust, estate, partnership, corporation, joint venture, cooperative or association on their sale, barter, exchange or lease of goods or properties and services in the Philippines and on the importation of goods into the Philippines.

The proceeds of the Termination Agreement in favor of Air Liquide, represents not only the indemnification from breach of contract perpetuated by Pilipinas Shell, but also a full compensation for costs, expenses and efforts as well as all other claims relative to the installation

of the Hydrogen Manufacturing Unit and the Liquid Carbon Dioxide Plant, including its obligation under the Subject Agreement and its early termination.

Therefore, the award of the Termination Fee is not only compensatory for the breach of the Subject Agreement, but at the same time, a settlement for an underlying payment for services rendered which payment has not yet been received. Ergo, the Termination Fee does not extricate from the purview of VAT as the same bears direct relevance to the taxpayer's course of trade or business.

In the same vein, the Termination Fee is subject to income tax, the same being compensation for the loss of anticipated profits. This is pursuant to Section 27 (A) of the Tax Code, as amended, which provides:

> *"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 twenty-five percent (25%) effective July 1, 2020 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."*

The phrase "from whatever source derived" indicates a legislative policy to include all income not expressly exempted within the class of taxable income under our laws. The term "income" has been variously interpreted to mean "cash received or its equivalent", "the amount of money coming to a person within a specific time" or "something distinct from principal or capital".[1]

The definition of income is broad enough to include the Termination Fee consequent to the breach of the Subject Agreement, hence, subject to regular income tax.

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,

ROMEO D. LUMAGUI, JR.
Commissioner of Internal Revenue

K-1-FFR

[1] CIR vs. Filinvest, G.R. No. 163653, July 19, 2011.