REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Quezon City

Sec. 34 (F) (1) Tax Code of 1997, as amended
BIR Ruling No. 723-2019
OT- 215-2022
MAY 11 2022

WARRENSBURG MANUFACTURING, INC.
10th Avenue, Free Port Area of Bataan
Mariveles, Bataan

Attention: **Francis S. Lim**
President

Gentlemen:

This refers to your letter requesting for a change on the method of computing the depreciation of Warrensburg Manufacturing, Inc. ("Warrensburg")'s manufacturing plant related assets and equipment from Straight Line Method to Units of Production Method effective January 1, 2022.

It is represented that Warrensburg is a corporation duly organized and existing under the laws of the Philippines. Its primary purpose is to engage in the general business of manufacturing, feed processing, livestock farming, agricultural farming and other relevant business, such as but not limited to manufacture, produce, fabricate, convert, store, import, export or otherwise acquire and deal in oils, feeds, acids, alkalies, salts, pigments, by products or products resulting from the processing of the foregoing and all land, building, articles, plants, factories, equipment, appliances, machineries or materials necessary or useful in connection therewith; to purchase, maintain, acquire, research, construct, hold, lease, operate and use land, building, machineries, plants, factories, equipment, pipes, appliances including, but not limited to shares of stock or securities engaged in the business set forth hereinabove.

Warrensburg primarily adopted the straight-line method for depreciating its Property Plant and Equipment ("PPE") for both financial accounting and tax purposes when it started its commercial operations. Warrensburg classifies its PPE into the following categories:

- Buildings (depreciating over 40 years);
- Machinery and Equipment (depreciating over 20 years);
- Transportation equipment (depreciating over 7 years);
- Office furniture and equipment (depreciating over 5 years); and
- Leasehold improvements (depreciating over 10 years).

Warrensburg adopted the straight line method on the premise that the manufacturing plant will operate at full capacity and would generate maximum output from the initial year of operations up to the end of the assets' useful life. However, due to unforeseen changes in market condition, Warrensburg was not able to fully utilize the plant capacity. This resulted

in depreciations that do not match with the expected usage of the manufacturing plant assets in terms of unit volume output.

After consideration and review, Warrensburg wishes to change the depreciation method of the manufacturing plant related assets and equipment into the Units of Production Method beginning taxable year January 1, 2022.

Under the Units of Production Method, the assets are written off in line with its estimated total output. Thus, beginning taxable year 2022, the manufacturing plant is expected to run for at least one week every quarter or equivalent to 8.2% of its capacity. By relating depreciation to the proportion of productive capacity utilized to date, it reflects the fact that useful economic life of certain assets are more closely linked to its usage than to time. Warrensburg's management believes that the Units of Production Method will give fairer results and more accurate estimation of usage.

In reply, please be informed that depreciation is the gradual diminution in the useful value of tangible property resulting from wear and tear and normal obsolescence. It commences with the acquisition of the property and its owner is not bound to see his property gradually waste, without making provision out of earnings for its replacement. It is entitled to see that from earnings the value of the property invested is kept unimpaired, so that at the end of any given term of years, the original investment remains as it was in the beginning.[1]

Section 34 (F) (1) of the National Internal Revenue Code (Tax Code) of 1997, as amended, permits the taxpayer to recover gradually his capital investment in wasting assets free from income tax, *viz*:

> *"SEC. 34. Deductions from Gross Income. – Except for taxpayers earning compensation income arising from personal services rendered under an employer-employee relationship where no deductions shall be allowed under this Section, in computing taxable income subject to income tax under Sections 24(A); 25(A); 26; 27(A), (B), and (C); and 28(A)(1), there shall be allowed the following deductions from gross income:*
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> *xxx xxx xxx*
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> *(F) Depreciation. –*
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> *(1) General Rule. – There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including reasonable allowance for obsolescence) of property used in the trade or business. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust, the allowable deduction shall be apportioned between the income beneficiaries and the trustees in accordance with the pertinent*

[1] Basilan Estates, Inc. vs. Commissioner of Internal Revenue, G.R. No. L-22492, September 5, 1967

provisions of the instrument creating the trust, or in the absence of such provisions, on the basis of the trust income allowable to each.

(2) Use of Certain Methods and Rates. - The term 'reasonable allowance' as used in the preceding paragraph shall include, but not limited to, an allowance computed in accordance with rules and regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner, under any of the following methods:

(a) The straight-line method;

(b) Declining-balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in Subsection (F) (1);

(c) The sum-of-the-years-digit method; and

(d) Any other method which may be prescribed by the Secretary of Finance upon recommendation of the Commissioner."

Corollarily, Section 109 of Revenue Regulations (RR) No. 2, otherwise known as the "*Income Tax Regulations*" provides for methods of deduction from gross income for depreciation but limits the recovery to the capital invested in the asset being depreciated:

"Section 109. Method of computing depreciation allowance. — The capital sum to be replaced should be charged off over the useful life of the property, either in equal installment or in accordance with any other recognized trade practices, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. While the burden of proof must rest upon the taxpayer to sustain the deductions taken by him, such deductions must not be disallowed unless shown by clear and convincing evidence to be unreasonable. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made. If it develops that the useful life of the property will be longer or shorter than useful life as originally estimated under all the then known facts, the portion of the cost of other basis of the property not already provided for through depreciation allowances should be spread over the remaining useful life of the property as re-estimated in the light of the subsequent facts, and depreciation deductions taken accordingly."

The proper allowance for depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonable consistent plan whereby the aggregate of the amount so set aside, plus the salvage value, will,

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at the end of the useful life of the property in business, equal the basis of the property. Due regard must be given to expenditures for current upkeep.[2]

In view of the foregoing, Warrensburg's request to change its method of computing the depreciation of its manufacturing plant, related assets and equipment for both financial accounting and tax purposes from Straight Line Method to Units of Production Method effective January 1, 2022 is hereby granted pursuant to the provisions of Section 34 (F) (1) of the Tax Code of 1997, as amended.

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

Very truly yours,

CAESAR R. DULAY
Commissioner of Internal Revenue

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By:

MARISSA O. CABREROS
Deputy Commissioner
Legal Group
Officer-in-Charge

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[2] Section 105 of RR No. 2