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

Sec. 43, NIRC
BIR Ruling No. 1017-18
[illegible]

Quiason Makalintal Barot Torres Ibarra Sison & Damaso
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1605 Ortigas Center, Pasig City

Attention: **Atty. Benedict R. Tugonon**
Atty. Antonio Gabriel L. Reyes

Gentlemen:

This refers to your letter dated June 6, 2017 requesting on behalf of your client, **ENERGY DEVELOPMENT CORPORATION ("EDC")** for approval on the changes in accounting method and estimate that EDC adopted beginning the effectivity of Republic Act No. 9513, otherwise known as Renewable Energy Law ("RE Law") on January 30, 2009, in accordance with the provisions of the RE Law, the Implementing Rules and Regulations of the RE Law ("IRR"), and the National Internal Revenue Code of 1997, as amended (Tax Code). Specifically, the changes in the accounting method and estimate adopted by EDC are on the following items:

1. Production Wells; and

2. Depreciation / Amortization Period for Tangible & Depreciable/Amortizable Assets.

As represented, EDC is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines. It is a power generating company and operates twelve (12) geothermal projects in five geothermal renewable energy service contract areas namely Leyte Geothermal Production Field, Southern Negros Geothermal Production Field, Bacman Geothermal Production Field, Mindanao Geothermal Production Field and Northern Negros Production Field. EDC and the government have previously entered into Geothermal Service Contract under Presidential Decree (P.D.) No. 1442 (the "GSCs"). With the effectivity of RE Law on January 30, 2009 which superseded P.D. No. 1442, the five (5) GSCs were converted to Geothermal Renewable Energy Service Contracts ("GRESCs") entered into with the Department of Energy ("DOE") pursuant to the RE Law.

The GRESCs generally provide that *"the RE Developer shall be liable each taxable year for Corporate Income Tax on its net taxable income from Geothermal Operations in accordance with the provisions of the Act and as determined under the provisions of the NIRC, as amended by RA 9337.* Meanwhile, the GSCs under PD No. 1442 generally provide under Section 8.2 that *"(t)he Contractor shall be liable each taxable year for Philippine income tax under the provisions of the National Internal Revenue Code and the Presidential Decree 1442".*

OLD ACCOUNTING AND TAX TREATMENT

1. Production Wells

Under the GSCs, cost of drilling wells, such as pipes, chemicals and various professional services, and borrowing costs were treated as outright recoverable cost.

Under the Leyte GSC, Southern Negros GSC, BacMan GSC executed on May 14, 1981, and October 16, 1981, respectively, the production wells were classified as part of intangible costs and recorded as outright expenses in the period the expenses were incurred. However, under the Northern Negros GSC and Mt. Apo GSC executed on March 24, 1994 and March 24, 1992, respectively, the production wells were considered as part of tangible assets depreciated over a period of ten (10) years.

2. Depreciation / Amortization Period for Tangible & Depreciable/Amortizable Assets

Under the GSCs, EDC recorded its tangible assets as depreciable assets and amortized over a period of ten (10) years beginning in the calendar year in which geothermal steam production starts or in the calendar year in which the costs are incurred, whichever is later, in accordance with the provisions of Article II (14) of the GSCs, to wit:

> *"The initial cost of all physical assets classified as depreciable, in accordance with generally accepted geothermal industry accounting principles, purchased, fabricated, constructed by and/ or the CONTRACTOR and used by the contractors in its operations shall include such costs as export broker's fee, purchasing agent's fees, transportation charges, loading and unloading fees, license fees associated with the procurement of materials and equipment, duties and custom fees, in transit losses not covered thru insurance and installation costs necessary to put the asset ready for use. The total cost shall be allocated to Operating Expenses over a ten (10) year period beginning in the calendar year which geothermal steam production starts or in the calendar year in which the costs are incurred, whichever is the later."*

CHANGES IN ACCOUNTING METHOD PURSUANT TO RE LAW AND THE GRESC

1. Production Wells

Under the GRESCs, production wells are classified as tangible investments/assets and are amortized or depreciated as part of Cost of Goods Sold *over the estimated useful life of the*

assets. The provision of Article III, (2) (i) of the GRESCs reads, to wit:

> *"i) Depreciation of Tangible Investment/ Assets*
>
> *The cost of physical assets classified as depreciable in accordance with generally accepted international geothermal industry as defined in Article II.2 incurred and purchased and/or fabricated by the RE DEVELOPER in its Geothermal Operations shall include such costs as export broker's fees, purchasing agent's fees, transportation charges, loading and unloading fees, license fees associated with the procurement of materials and equipment duties and customs fees, in-transit losses not recovered through insurance and installation costs necessary to put the asset ready for use. All tangible investments in the Contact Area acquired during the exploration, development/ commercial stage shall be allocated as part of Cost of Goods Sold over the estimated useful life of the asset. While tangible investments used in the exploration of additional wells shall be treated as Deferred Cost amortizable over the estimated useful life of the asset upon the start of commercial operations as mentioned in Article II.4a Tangible investments under this section include but are not limited to the costs of the following:*
>
> *i. Production wells*
> *ii. Well testing equipment*
> *iii. Fluid gathering equipment*
> *iv. Fluid separation equipment*
> *v. Power Plant and civil works (applicable for integrated geothermal generation*
> *vi. Pipelines*
> *vii. Laboratory equipment*
> *viii. Field survey equipment*
> *ix. Site Office furniture and fixtures / equipment*
> *x. Tools and equipment*
> *xi. Automotive equipment*
> *xii. Communication facilities*
> *xiii. Leasehold improvements with estimate classified useful life of over one (1) year*
> *xiv. Other capital expenditures classified as tangible investments following generally accepted geothermal industry accounting principles and practices."*

2. Depreciation/Amortization Period for Tangible & Depreciable/Amortizable Assets

Under the GRESCs, the tangible assets of EDC are depreciable and/or subject to amortization over the estimated useful life of the asset, pursuant to the aforequoted provision of the GRESCs.

Furthermore, tangible costs which include the Fluid Collection and Recycling System and other Capex are depreciated over the estimated economic useful life of the assets.

NEW ACCOUNTING AND TAX TREATMENT

To fully comply with the requirements of RE Law, and the National Internal Revenue Code of 1997, as amended, EDC intends to implement, among others, the following changes in its accounting method:

1. Production wells will be amortized over the estimated useful life of the assets; and
2. Tangible assets and leasehold improvements will be depreciated or amortized over the economic useful life of the assets.

The changes are pursuant to the RE Law which took effect on January 30, 2009 and the IRR which was signed on May 25, 2009. As a consequence of the new law, on October 23, 2009, EDC converted its existing GSCs into GRESCs which are consistent with the provisions of RE Law and the IRR.

In support of your request, you attached the following documents:

1. Amended Articles of Incorporation of EDC;
2. 2009 Audited Financial Statements of EDC – consolidated; and
3. 2008 Audited Financial Statements of EDC – parent only.

In reply, please be informed that the change of accounting method from one system to another is specifically allowed under the provision of Section 43 of the Tax Code which provides as follows:

> *"SEC. 43. General Rule. — The taxable income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner clearly reflects the income. . ."*

In relation thereto, pertinent portion of Section 167 of Revenue Regulations No. 2-40 provides:

> "Section 167. Methods of Accounting. - It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited for his purpose. . . . Any approved standard method of accounting which reflects taxpayer's income may be adopted. . ."

Likewise, Section 168 of the same Regulations prescribes that:

> "Section 168. Changes in accounting methods. — The true income, computed under the law, shall in all cases be entered in the return. If for any reason the basis of reporting income subject to tax is changed, the taxpayer shall

attach to his return a separate statement setting forth for the taxable year and for the preceding year the classes of items differently treated under the two systems, specifying in particular all amounts duplicated or entirely omitted as the result of such change.

A taxpayer who changes the method of accounting employed in keeping his book **shall**, before computing his income upon such new method for purposes of taxation, **secure the consent of the Commissioner of Internal Revenue**. For the purposes of this section, a change in the method of accounting employed in keeping books means any change in the accounting treatment of items of income or deductions, such as a change from cash receipts and disbursements method to the accrual method, or vice versa; a change involving the basis of valuation employed in the computation of inventories (see Sections 144 to 151 of these regulations); a change from the cash or accrual method to the long-term contract method, or vice versa; a change in the long term contract method from the percentage of completion basis to the completed contract basis, or vice versa (see Section 44 of these regulations) or a change involving the adoption of, or a change in the use of, any other specialized basis of computing net income such as the crop basis. Application for permission to change the method of accounting employed and the basis upon which the return is made shall be filed within 90 days after the beginning of the taxable year to be covered by the returns. The application shall be accompanied by a statement specifying all amounts which would be duplicated or entirely omitted as a result of the proposed change. Permission to change the method of accounting will not be granted unless the taxpayer and the Commissioner of Internal Revenue agree to the terms and conditions under which the change will be effected." *(Emphasis supplied)*

In the instant case, the change in method of accounting is pursuant to the RE Law and the IRR.

In view of the foregoing, the permission to change the method of accounting and estimate in accordance with R.A. No. 9513, the IRR and the Tax Code, is hereby granted.

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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