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

Sec. 34 (F), NIRC of 1997, as amended
BIR Ruling No. 1315-18
CT - 241 - 2021
JUL 12 2021

SyCip Gorres Velayo & Co.
6760 Ayala Avenue
1226 Makati City

Attention: **Atty. Jonald R. Vergara**
Principal, Business Tax Services

Gentlemen:

This refers to your letter dated March 27, 2019 requesting on behalf of your client, **Cavitex Infrastructure Corp.** ("CIC") for authority to:

1. Change its Method of computing depreciation for Segment 1 (R-1 Expressway) Project from Double Declining Balance Method to the Units-of-Production Method; and,

2. Change its Method of computing depreciation for Segment 4 (R-1 Expressway Extension) Project from Straight Line Method to the Units-of-Production Method effective January 1, 2019.

As represented, CIC, formerly known as UEM-MARA Philippines Corporation, is a domestic corporation incorporated on October 9, 1995 for the primary purpose of undertaking the design, construction and financing of the Manila-Cavite Toll Expressway Project ("MCTEP" or the "Project") in accordance with the terms of the concession granted by the Republic of the Philippines, and to receive all revenues arising from the operation thereof. On December 15, 1999, Cavitex Holdings, Inc. (CHI) acquired full ownership over CIC from its original shareholders. On January 2, 2013, Metro Pacific Tollways Corporation (MPTC) acquired control over CIC from CHI through Management Letter-Agreement.

CIC was originally organized to represent United Engineers (Malaysia) Berhad (UEM) and Majlis Amanah Rakyat (MARA), which entered into a Joint Venture Agreement (JVA) with the Philippine Reclamation Authority (PRA, formerly Public Estates Authority or PEA) for the development of the Project which consists of R-1 Expressway, C-5 Link Expressway, and R-1 Expressway Extension.

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On July 26, 1996, the Republic of the Philippines (acting through the Toll Regulatory Board [TRB]), PRA and CIC then entered into a Toll Operations Agreement (TOA) to expand the scope and toll collection period of the Toll Operation Certificate of PRA and amplify the terms and conditions which are necessary to ensure the financial viability of the project. Under the TOA, PRA shall be responsible for the operation and maintenance of the expressway, while CIC is responsible for the design and construction, and financing of the expressways.

The Project is divided into segments which are briefly defined as follows:

- **Segment 1** refers to the R-1 Expressway. It consists of existing tollroad facility which is also known as Coastal Road. The expressway is 6.45 kilometers long and stretches from Seaside Drive in Parañaque to Zapote in Las Piñas City. CIC commenced the rehabilitation of the R-1 Expressway in November 1996 and completed the works in May 1998. The TRB issued a notice authorizing the start of toll collection for R-1 Expressway on May 24, 1998.

- **Segment 2 and 3** are subdivisions of the C-5 Link Expressway which is a proposed spur of R1 Expressway. The Segment 2 will run from R1 Interchange to Sucat Road, while Segment 3 will extend from Sucat Road to Skyway System and connect with C5. The entire C5 Link Expressway would be approximately 7.6 kilometers in length.

- **Segment 4 and 5**, on the other hand are subdivisions of the R-1 Expressway Extension. Segment 4 starts at the southern terminus of R1 Zapote and ends in Kawit, Cavite, and is about 7 kilometers long. On April 29, 2011, the TRB has issued a Notice to Start Collection for Segment 4 – R-1 Expressway Extension effective May 1, 2011. On the other hand, Segment 5 is the future continuation of Segment 4 which is planned to run from Kawit to Noveleta, Cavite with approximate length of 4.2 kilometers.

CIC accounts for its concession arrangement under the intangible asset model. It initially recognized the service concession asset (SCA) at the fair value of construction services. Following the initial recognition, the SCA is carried at cost, which includes capitalized borrowing costs less accumulated amortization and any impairment losses. CIC used an estimated useful life of 35 years from the last operation date, which is the date on which all segments of each expressway shall have commenced operation or from October 1, 1998, whichever is earlier.

For financial reporting purposes, the SCA is amortized using the output/unit of production (UOP) basis. For tax purposes, however, CIC amortizes the SCA as follows:

Segment 1 (R1 Expressway)	Double Declining Balance Method
Segment 4 (R1 Expressway Extension)	Straight Line Method

In 2014, Parsons Brinckerhoff, an independent engineering consultant, conducted a traffic study and submitted a report (the "Study") to CIC. The Study shows, among others, an increase in the expected growth in traffic, as compared to the originally forecasted average growth of 3% per year from 2010 to 2030. For Segment 1, the traffic growth will be sustained to 3.7% annually for the ten (10)-year period starting 2019. For similar period, Segment 4 traffic will be about 8.9% annually. The combined traffic of Segments 1 and 4 will grow annually by 5.2% also for ten (10) years starting 2019.

Upon consideration of the updated traffic projections and review of the practice of some toll road operators/concessionaires in Asia and Europe, CIC considered a change in depreciation Method from Double Declining Method and Straight Line Method for the R-1 Expressway and R-1 Expressway Extension, respectively, of CIC to Output/Units of Production Method which account for around 98% of the net book value of the service concession agreement.

The Output/Units of Production Method is considered to be more reasonable since the usage of the road in terms of actual traffic volume is more reflective of the reduction in its value rather than mere passage of time which is the presumption of the Straight Line Method and Double Declining Balance Method.

In reply thereto, please be informed that Section 34 (F) (1) & (2) of the National Internal Revenue Code of 1997, as amended (Tax Code), provides, viz.:

> *"Section 34 (F)(1). — 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.*
>
> *x x x x x x x x x*
>
> *Section 34 (F)(2). — 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 34 (F) (3), supra, provides —

> *"(3) Agreement as to Useful Life on which Depreciation Rate is Based. — Where under rules and regulations prescribed by the Secretary of Finance, upon recommendation of the Commissioner, the taxpayer and the Commissioner have entered into an agreement in writing specifically dealing with the useful life and rate of depreciation of any property, the rate so agreed upon shall be binding on both the taxpayer and the National Government in the*

absence of facts and circumstances not taken into consideration during the adoption of such agreement. The responsibility of establishing the existence of such facts and circumstances shall rest with the party initiating the modification. Any change in the agreed rate and useful life of the depreciable property as specified in the agreement shall not be effective for taxable years prior to the taxable year in which notice in writing by certified mail or registered mail is served by the party initiating such change to the other party to the agreement.

Provided, however, That where the taxpayer has adopted such useful life and depreciation rate for any depreciable asset and claimed the depreciation expenses as deduction from his gross income, without any written objection on the part of the Commissioner or his duly authorized representative, the aforesaid useful life and depreciation rate so adopted by the taxpayer for the aforesaid depreciable asset shall be considered binding for purposes of this Subsection."

Moreover, Section 105 of Revenue Regulations No. 2, otherwise known as the "Income Tax Regulations" reads:

"Section 105. Depreciation. — A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income. For convenience, such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such 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, at the end of the useful life of the property in business, equal the basis of the property. Due regard must also be given to expenditures for current upkeep."

Furthermore, Section 109 of said Regulations No. 2 likewise reads:

"SEC. 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 annual installments or in accordance with any other recognized trade practice, 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 the useful life as originally estimated under all the then known facts, the portion of the cost or 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."

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Based on the foregoing, the taxpayer and the Commissioner may agree on the estimated useful life and rate of depreciation of any property. The rate so agreed upon shall be binding on both the taxpayer and the BIR. However, if it develops that the useful life of the property originally estimated under previous factual conditions is no longer reasonable, the law allows the taxpayer to lengthen or shorten the useful life of the property in the light of prevailing factual considerations.

Inasmuch as the change in CIC's accounting method is considered to be more reasonable given the current conditions of Segment 1 (R-1 Expressway) and Segment 4 (R-1 Expressway Extension), and taking into account the traffic projections as indicated in the Study, CIC is hereby granted permission to change its Method of computing the depreciation/amortization of the service concession asset as follows:

Service Concession Asset	**Previous Method of Depreciation**	**New Method of Deperciation**
Segment 1	Double Declining Balance Method	Units-of-Production Method
Segment 4	Straight Line Method	

effective January 1, 2019, pursuant to the provisions of Section 34 (F) of the 1997 Tax Code, as amended, in relation to Section 109 of RR No. 2 provided that such method is the best accounting practice applicable to CIC's trade, and provided further that such method will clearly reflect the correct income of the company.

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.

Sincerely yours,

CAESAR R. DULAY
Commissioner of Internal Revenue

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