December 2, 2019

BIR RULING NO. 723-19

Sec. 34 (F) (1), Tax Code; BIR Ruling No. 1017-18; BIR Ruling No. DA-217-06; BIR Ruling No. DA-122-97

FDC Misamis Power Corporation
PHIVIDEC Industrial Estate, Villanueva
Misamis Oriental 9002

Attention: *AAA*

Gentlemen :

This refers to your letter dated September 6, 2018 requesting for approval to change the accounting method of **FDC Misamis Power Corporation** (the "Company") from Straight Line Method to Units of Production Method.

As represented, the Company is a domestic corporation primarily engaged in the generation and sale of electricity with principal office address at PHIVIDEC Industrial Estate, Tambobong, Villanueva, Misamis Oriental. The Corporation was incorporated on November 16, 2009. It is duly registered with the Bureau of Internal Revenue with Tax Identification No. 000-000-000-00000.

The Company currently operates a 3x135 MW coal-fired power plant located in PHIVIDEC Industrial Estate in Misamis Oriental and produces electricity for subsequent sales to electric cooperatives or distribution utilities and commercial and industrial customers pursuant to a power purchase agreement. The Company is also registered with the Board of Investments.

The Company started commercial operations in October 2016 and has since used Straight Line Method of depreciation of its assets which include the three (3) units coal-fired power plant and related equipment completed during the following periods:

Unit 1 coal-fired power plant	10 August 2016
Unit 2 coal-fired power plant	31 August 2016
Unit 3 coal-fired power plant	15 October 2016

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The Company has recognized as part of its assets the cost of project development, engineering, construction, financing and other expenditures. Capitalization ceased when the power plant units were completed in 2016 and depreciation started in October 2016 for Units 1 and 2 and November 2016 for Unit 3 when the power plant assets were available for use and capable of operating in the manner intended by management.

The Company used Straight Line Method of depreciation during the initial year of operation because management estimated that the power plant will operate at full capacity and generate maximum output from the initial year of operation up to the end of the assets' useful life. However, due to unforeseen changes in market condition in Mindanao (*e.g.*, oversupply of electricity, increase competition and insufficient/unchanged demand), the Company was not able to fully contract its 405 MW capacity. Based on forecast, the Company will not be able to operate at full capacity until its 7th year of operation. This leads to the recognition of depreciation that does not match the current and expected usage of the power plant assets in terms of unit volume of output.

After consideration and review, the Company wishes to change the depreciation method of power plant related assets and equipment for both financial accounting and tax purposes to adopt a new depreciation method to take effect at the beginning of this taxable year, January 1, 2018.

The proposed change in depreciation is as follows:

Applicable Year	Units of Production Method (NEW)*	Straight Line Method (OLD)*	Difference
2018	668,179,069	1,124,285,548	456,106,479
2019	786,996,948	1,124,285,548	337,288,599
2020	938,469,164	1,124,285,548	185,816,383
2021	991,155,153	1,124,285,548	133,130,395
2022	1,070,184,135	1,124,285,548	54,101,413
2023	1,155,039,522	1,124,285,548	(30,753,974)
2024	1,202,730,890	1,124,285,548	(78,445,342)
2025	1,202,730,890	1,124,285,548	(78,445,342)
2026	1,198,155,225	1,120,071,443	(78,083,783)
2027	1,175,276,902	1,100,945,889	(74,331,013)
2028	1,175,276,902	1,100,945,889	(74,331,013)
2029	1,175,276,902	1,100,945,889	(74,331,013)
2030	1,175,276,902	1,100,945,889	(74,331,013)
2031	1,107,517,389	1,034,560,390	(72,956,999)
2032	768,719,827	733,272,357	(35,447,469)
2033	768,719,827	733,272,357	(35,447,469)
2034	768,719,827	733,272,357	(35,447,469)
2035	768,719,827	733,272,357	(35,447,469)

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2036	768,719,827	733,272,357	(35,447,469)
2037	768,719,827	733,272,357	(35,447,469)
2038	768,719,827	733,272,357	(35,447,469)
2039	768,719,827	733,272,357	(35,447,469)
2040	768,719,827	733,272,357	(35,447,469)
2041	765,563,452	730,292,863	(35,270,589)
2042	749,781,579	715,395,389	(34,386,190)
2043	749,781,579	715,395,389	(34,386,190)
2044	749,781,579	715,395,389	(34,386,190)
2045	749,781,579	715,395,389	(34,386,190)
2046	624,817,982	586,226,777	(38,591,205)
Total depreciation at the end of useful life	**26,330,252,183**	**26,330,252,183**	**-**

* *Depreciation applied per asset component in compliance with Philippine Accounting Standard 16, Property Plant and Equipment. Each asset component varies in useful life.*

Under the Units of Production Method, the asset is written off in line with its estimated total output. By relating depreciation to the proportion of productive capacity utilized to date, it reflects the fact that useful economic life of certain assets is more closely linked to its usage than to time. Management believes that the Units of Production Method will give fairer results and a more accurate estimation of usage.

In reply, please be informed that Section 34 (F) (1) of the Tax Code of 1997, as amended, states:

"(F) Depreciation.

(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 trade or business. . .*

(2) *Use of Certain Methods and Rates. — The term 'reasonable allowance' shall include, but not limited to, an allowance computed in accordance with 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);

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(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 No. 2, otherwise known as the Income Tax regulations, provides —

> *"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, 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. (Section 105, Revenue Regulations No. 2) [cited in BIR Ruling Nos. DA10-98 dated January 21, 1998, DA 267-98 dated June 24, 1998; DA413-04 dated July 30, 2004; and DA-217-06 dated April 7, 2006]*
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> xxx xxx xxx."

Depreciation is a cost allocation process that systematically and rationally allocates acquisition costs of operational assets to periods benefited by their use.

In view of the above representations, and the existing conditions in the operation of the power plant, FDC's request to change its method of computing the depreciation of its power plant related assets and equipment for both financial accounting and tax purposes from Straight Line Method to Units of Production Method effective January 1, 2018 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

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ruling shall be considered null and void.

Very truly yours,

(SGD.) CAESAR R. DULAY
Commissioner of Internal Revenue

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