December 9, 2019

BIR RULING NO. 728-19

Sec. 34 (F), NIRC; Secs. 105 & 109, RR No. 2; BIR Ruling Nos. 144-13 & 144-97; & DA-638-07

Baniqued Layug & Bello
8/F Jollibee Center, San Miguel Avenue
Pasig City 1605

Attention: *AAA*
BBB

Gentlemen :

This refers to your letter dated September 25, 2017 requesting on behalf of your client, **Masinloc Power Partners Co., Ltd.** ("MPPCL") for confirmation of the proposed change in useful life of certain assets, for tax and financial accounting purposes beginning January 1, 2017, pursuant to Section 34 (F) (3) of the National Internal Revenue Code (NIRC) of 1997, as amended and Section 109 of Revenue Regulations No. 2.

As represented, MPPCL is a limited partnership established under Philippine laws to construct, develop, improve, operate, maintain, and hold power production and electric generating facilities in the Philippines. MPPCL's principal office is located at Masinloc Coal-Fired Thermal Power Plant, Brgy. Bani, Masinloc, Zambales.

MPPCL's fixed assets are composed of generation assets, buildings, vehicles, office furniture and equipment ("Subject Assets"). [1] The useful lives of the Subject Assets subject to depreciation are reviewed on a periodic basis.

Pursuant to MPPCL's fixed asset policy, a depreciation study is normally performed every three to five years, or as required by a rate-setting regulator. [2] The depreciation review is performed either by a third-party consultant or by internal subject matter experts if there is sufficient historic information in the fixed asset registers and there are depreciation studies from comparable plants that can be used as a benchmark.

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In connection with the fixed asset policy, MPPCL assessed the value of the Subject Assets based on experience as to actual wear and tear, frequency of replacement and/or maintenance, and the assessment of its technical/maintenance staff. Based on the outcome of the assessment of the useful life of the Subject Assets, it was concluded that it is necessary to change the current useful life of the Subject Assets to reflect the actual useful life. [3]

Accordingly, on July 24, 2017, the partners of MPPCL ("Partners") resolved to change the useful life of the Subject Assets in accordance with the findings of management. [4] The proposed change in useful life of the Subject Assets shall take effect on January 1, 2017.

In reply thereto, please be informed that Section 34 (F) (1) of the NIRC provides that 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. . . .

The term "reasonable allowance" 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. (Sec. 34 (F) (2), NIRC)

Corollarily, Section 34 (F) (3), *supra*, provides that —

"(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

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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 —

"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 instalment 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." (Emphasis supplied.)

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

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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.

It has been ruled that the remaining estimated useful life of the assets is determined as that period of time expressed in years that an asset is expected to perform in a satisfactory manner the function for which it was designed and built, assuming normal and reasonable maintenance. The estimates of remaining life for each item of property had been based, in a very large measure, upon the observed condition at the time of appraisal and condition of maintenance, and the consideration of normal rates of depreciation for the type of property.

In view of the foregoing, this Office hereby CONFIRMS the proposed change by MPPCL in useful life of Subject Assets, for both tax and financial accounting purposes beginning January 1, 2017, provided, however, that any prior period adjustments shall be subject to deficiency income tax, interest and penalties, if warranted.

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,

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

ATTACHMENT

Certification Executed by MPPCL Plant Manager

ANNEX A

Detailed List of Subject Assets of MPPCL

Footnotes

1. Detailed List of Subject Assets of MPPCL with Certification executed by MPPCL Plant Manager (Annex "A").

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2. Depreciation study of the assets involved entitled "AES Masinloc Composite Life Study" dated Sept. 30, 2016.
3. Certification dated September 25, 2017 issued by the Plant Manager of MPPCL as to the revised useful life of the Subject Assets.
4. Partner's Certificate dated July 24, 2017 certifying that the Partnership authorized the change of useful life of Subject Assets.

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