EN BANC

G.R. No. 238846 – SHELL PHILIPPINES EXPLORATION B.V. and CHEVRON MALAMPAYA LLC, Petitioners, **v. COMMISSION ON AUDIT,** Respondent.

G.R. No. 238852 – PNOC EXPLORATION CORPORATION, Petitioner, **v. COMMISSION ON AUDIT,** Respondent.

G.R. No. 238862 – THELMA M. CERDEÑA and NORA A. TUAZON, Petitioners, **v. COMMISSION ON AUDIT,** Respondent.

Promulgated:

February 25, 2025

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CONCURRING OPINION

CAGUIOA, *J.*:

The crux of the controversy stems from the alleged under collection of the government's 60% share in the Malampaya Natural Gas Project revenues amounting to PHP 53,140,304,739.86 from 2002 to 2009.

I concur with the ruling to grant the consolidated Petitions for *Certiorari*, reverse the Commission on Audit (COA) Decision No. 2015-115 dated April 6, 2015 (assailed Decision) and Decision No. 2018-075 dated January 24, 2018 (assailed Resolution), and lift the Notice of Charge No. 2010-01-151(09).

I write separately to emphasize that the tax assumption provision under Service Contract No. 38 is firmly rooted in the clear language of Presidential Decree No. 87,[1] otherwise known as the Oil Exploration and Development Act of 1972. The tax assumption mechanism is not only lawful but is also a cornerstone of the incentives designed to encourage private participation in the exploration and production of the nation's petroleum resources.

Brief review of the facts

To recall, the Government of the Republic of the Philippines, through the Department of Energy (DOE), entered into Service Contract No. 38 dated December 11, 1990 with Shell Philippines Exploration B.V. and Occidental Philippines, the predecessors-in-interest of Shell Exploration B.V. (SPEX), PNOC Exploration Corporation (PNOC-EC), and Chevron Malampaya LLC

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[1] Amending Presidential Decree No. 8 Issued on October 2, 1972, and Promulgating an Amended Act to Promote the Discovery and Production of Indigenous Petroleum and Appropriate Funds therefor.

(collectively, the contractors). Service Contract No. 38 was entered into pursuant to the provisions of Presidential Decree No. 87.

Under Service Contract No. 38, the contractors shall perform all petroleum operations and provide all necessary technology and finance, as well as the required services in connection therewith.[2] Moreover, under the terms of Service Contract No. 38, 60% of the net proceeds of the operation shall be remitted to the government,[3] while the contractors shall retain 40% as a service fee.[4] Part of the incentives extended to the contractors under Presidential Decree No. 87 is exemption from all other taxes except income tax, which was to be paid by the DOE on behalf of the contractors.[5] This exemption is also granted to the contractors under Section 6.2 (a) of Service Contract No. 38.

A 2004 post-audit revealed that the contractors' corporate income taxes had been deducted from the government's 60% share of net proceeds, resulting in an understatement of government revenue by PHP 53,140,304,739.86 from 2002 to December 2009. This led to the issuance of Notice of Charge No. 2010-01-151(09), holding petitioners Thelma M. Cerdeña and Nora A. Tuazon, both from the Financial Services of the DOE, along with the contractors, liable.[6]

The DOE and the contractors appealed, but COA National Government Sector Cluster B denied their appeal. The parties then filed Petitions for Review before COA Proper, asserting that under Section 6.3 of Service Contract No. 38, the government had assumed responsibility for the contractors' income tax obligations.[7]

In its assailed Decision and Resolution, COA denied the petitions and declared that the inclusion of the contractors' income taxes in the government's 60% share was improper and unsupported by law, prompting the filing of Petitions for *Certiorari* before the Court.[8]

In the interim, related disputes were brought to international arbitration. The International Centre for Settlement of Investment Disputes (ICSID) tribunal, in Case No. ARB/16/22, issued provisional measures enjoining the enforcement of the Notices of Charge during the proceedings, while the International Chamber of Commerce (ICC) Arbitral Tribunal upheld the validity of the tax assumption mechanism in Service Contract No. 38 in its Final Award issued in 2019.[9]

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2 *Rollo* (G.R. No. 238846), p. 520, Service Contract No. 38, sec. 6.1(a).
3 *Id.* at 528, Service Contract No. 38, sec. 7.3(a).
4 *Id.* at 529, Service Contract No. 38, sec. 7.4
5 Presidential Decree No. 87, secs. 12 & 18(b).
6 *Ponencia*, p. 4.
7 *Id.* at 4–5.
8 *Id.*
9 *Id.* at 6.

Before the Court, COA has steadfastly maintained its position, emphasizing that no specific provision of law explicitly authorizes the inclusion of the contractors' income taxes within the government's 60% share.

In ruling in favor of petitioners, the *ponencia* holds that both the text of Presidential Decree No. 87 and its legislative intent leave no doubt that the contractors remain liable for income tax, but such taxes are assumed by the government and included in its 60% share. The *ponencia* likewise applies the case of *Republic v. City of Kidapawan*,[10] where the Court upheld a tax assumption mechanism in a geothermal service contract between the government and PNOC-EDC, ruling that while the government assumed and paid PNOC-EDC's income taxes, these payments were charged against the government's 60% share of net proceeds. The Court emphasized that PNOC-EDC remained the actual taxpayer, with the government acting merely as its agent in the payment of income taxes, as evidenced by the issuance of official receipts in PNOC-EDC's name.[11]

As stated at the outset, I fully concur.

COA committed grave abuse of discretion in issuing the assailed Decision and Resolution, as the contractors' income taxes are included as part of the government's 60% share; tax assumption mechanism

COA as a constitutional office and guardian of public funds is endowed with the exclusive authority to determine and account government revenue and expenditures, and disallow irregular, unnecessary excessive use of government funds.[12] The case of *Metropolitan Waterworks and Sewerage System v. COA*[13] elucidated on this matter:

> [COA as a constitutional office] is endowed with enough latitude to determine, prevent and disallow irregular, unnecessary, excessive, extravagant, or unconscionable expenditures of government funds. **It has the power to ascertain whether public funds were utilized for the purpose for which they had been intended.** The 1987 Constitution has expressly made COA the guardian of public funds, vesting it with broad powers over all accounts pertaining to government revenue and expenditures and the uses of public funds and property, including the exclusive authority to define the scope of its audit and examination, establish the techniques and methods for such review, and promulgate

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10 513 Phil. 440 (2005) [Per J. Ynares-Santiago, First Division].

11 *Ponencia*, pp. 11–12.

12 *Philippine Health Insurance Corp. Regional Office-Caraga v. Commission on Audit*, 838 Phil. 600 (2018) [Per J. Tijam, *En Banc*].

13 821 Phil. 117 (2017) [Per J. Bersamin, *En Banc*].

> accounting and auditing rules and regulations.[14] (Emphasis supplied, citations omitted)

However, under Article IX-A, Section 7 of the 1987 Constitution, a decision, order, or ruling of COA may be brought to the Court on *certiorari*:

> . . . Unless otherwise provided by this Constitution or by law, any decision, order, or ruling of each Commission may be brought to the Supreme Court on *certiorari* by the aggrieved party within thirty days from receipt of a copy thereof.[15]

The Constitution limits the permissible scope of inquiry over judgments or resolutions of COA only to errors of jurisdiction or those rendered with grave abuse of discretion.[16] The Court explained this in *Veloso v. COA*:[17]

> It is the general policy of the Court to sustain the decisions of administrative authorities, especially one which is constitutionally-created not only on the basis of the doctrine of separation of powers but also for their presumed expertise in the laws they are entrusted to enforce. Findings of administrative agencies are accorded not only respect but also finality when the decision and order are not tainted with unfairness or arbitrariness that would amount to grave abuse of discretion. **It is only when the COA has acted without or in excess of jurisdiction, or with grave abuse of discretion amounting to lack or excess of jurisdiction, that this Court entertains a petition questioning its rulings.** There is grave abuse of discretion when there is an evasion of a positive duty or a virtual refusal to perform a duty enjoined by law or to act in contemplation of law as when the judgment rendered is not based on law and evidence but on caprice, whim and despotism.[18] (Emphasis supplied, citations omitted)

The present consolidated cases challenge COA's ruling, which held that the income taxes of the contractors should not have been part of the 60% government share and demanded that the contractors settle back taxes under Service Contract No. 38. In deciding the present consolidated cases, the Court is thus tasked to determine whether COA's ruling was tainted with grave abuse of discretion. This review entails interpreting the provisions of Presidential Decree No. 87, Presidential Decree No. 1206, and Presidential Decree No. 1459 in relation to Service Contract No. 38 and determining whether COA's ruling disregarded their explicit terms. As explained below, I agree with the *ponencia* that COA committed grave abuse of discretion in issuing the assailed Decision and Resolution and in affirming the Notice of Charge No. 2010-01-151(09).

Presidential Decree No. 87 was enacted to encourage private participation in the exploration and development of petroleum resources in the Philippines. Its overarching policy objective is to "hasten the discovery and

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14 *Id.* at 138.
15 *See also* RULES OF COURT, rule 64, sec. 2. Presidential Decree No. 1445, sec. 50.
16 *See Reblora v. Armed Forces of the Philippines*, 711 Phil. 401 (2013) [Per J. Perez, *En Banc*].
17 672 Phil. 419 (2011) [Per J. Peralta, *En Banc*].
18 *Id.* at 432.

production of indigenous petroleum through the utilization of government and/or private resources, local and foreign".[19] To achieve this, Presidential Decree No. 87 provided "more meaningful incentives to prospective service contractors."[20]

Among these incentives is an exemption from all taxes except income tax:

> Section. 12. *Privileges of contractor.* — The provisions of any law to the contrary notwithstanding, a contract executed under this Act may provide that the **contractor shall have the following privileges:**
>
> (a) **Exemption from all taxes except income tax.**[21] (Emphasis supplied)

Complementing the tax exemption privilege is the tax assumption mechanism and the government's guaranteed share of petroleum revenues under Section 18(b) of Presidential Decree No. 87:

> Section 18. *Functions of Petroleum Board.* — In accordance with the provisions and objectives of this Act, the Petroleum Board shall:
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> . . . .
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> (b) **Enter into contracts herein authorized with such terms and conditions as may be appropriate under the circumstances including the grant of special allowance**: *Provided, however*, That no depletion allowance shall be granted: *Provided, further*, That except as provided in Sections twenty-six and twenty-seven hereof, no contract in favor of one contractor and its affiliates shall cover less than fifty thousand nor more than seven hundred and fifty thousand hectares for on-shore areas, or less than eighty thousand nor more than one million five hundred thousand hectares for off-shore areas: *Provided, finally,* That **in no case shall the annual net revenue or share of the Government, including all taxes paid by or on behalf of the Contractor, be less than sixty percent of the difference between the gross income and the sum of operating expenses and Filipino participation incentive**[.][22] (Emphasis supplied)

The inclusion of taxes in the government's share is reinforced by subsequent legislation. Presidential Decree No. 1206,[23] which created the DOE, reiterates the government's guaranteed share in petroleum revenues in

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19 Presidential Decree No. 87, sec. 2.
20 Presidential Decree No. 87, Whereas Clause.
21 *Id.* at sec. 12(a).
22 *Id.* at sec. 18(b).
23 Creating the Department of Energy (1977).

Section 12(a)(i)(2) as "including all taxes paid by or on behalf of the contractor," thus:

> Section 12. *Transferred Powers and Functions.* — The following powers and functions are transferred as hereafter indicated to the extent that they are not modified by any specific provision of this Decree:
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> a. With reference to Section 11(a) above, the powers and functions transferred to the Bureau of Energy Development are:
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> i. The following powers and functions of the abolished Energy Development Board under Presidential Decree No. 87: *Provided*, That service contracts authorized under the said Decree, including the transfer or assignment of interest in said service contracts, shall require the approval of the Secretary:
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> . . . .
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> 2. **Enter into contracts herein authorized with such terms and conditions as may be appropriate under the circumstances**: *Provided, however,* That no depletion allowance shall be granted: *Provided, further*, That except as provided in Section 26 and 27 in favor of Presidential Decree No. 87, no contract in favor of one contractor and its affiliates shall cover less than fifty thousand hectares nor more than seven hundred and fifty thousand hectares for on-shore areas, or less than eighty thousand nor more than one million five hundred thousand hectares for off-shore areas: And, *Provided, finally*, That **in no case shall the annual net revenue or share of the government, including all taxes paid by or on behalf of the contractor,**

> **be less than sixty percent** of the difference between the gross income and the sum of operating expenses and Filipino participation incentive[.][24] (Emphasis supplied)

Similarly, Presidential Decree No. 1459,[25] which authorized the DOE to enter and conclude service contracts, reaffirms the government's minimum share in Section 1(a):

> Section 1. Any provision of law to the contrary notwithstanding, the Secretary of Energy is hereby authorized to enter into petroleum service contracts, or re-negotiate and modify existing ones, upon the approval of the President of the Philippines, subject to the following conditions:
>
> (a) **The share of the Government, including all taxes, shall not be less than sixty per cent** of the difference between the gross income and the sum of operating expenses and such allowances as the Secretary of Energy may deem proper to grant[.][26] (Emphasis supplied)

The above-mentioned provisions create a consistent legislative framework that guarantees the government its 60% share of the net proceeds from petroleum operations. The unequivocal language of these provisions underscores two key principles. *First*, the income taxes paid by or on behalf of the contractors are explicitly included in the government's guaranteed 60% share of the net proceeds from petroleum operations. *Second*, the government assumes and pays the contractors' income tax liabilities. This **tax assumption mechanism**, recognized in Presidential Decree No. 87, Presidential Decree No. 1206, and Presidential Decree No. 1459, is an integral part of the fiscal structure under Service Contract No. 38.

Service Contract No. 38 incorporates the fiscal terms set forth in Presidential Decree No. 87 and subsequent decrees. Section 6.3 of Service Contract No. 38 reads:

> 6.3 The OFFICE OF ENERGY AFFAIRS **shall assume and pay on behalf of CONTRACTOR and its parent company, on the first transaction in each instance where the tax is imposed, all income taxes payable to the Republic of the Philippines based on income and profits and, with respect to CONTRACTOR**, on the first transaction in each instance where the tax is imposed, all dividends, withholding taxes and other taxes imposed by the Government of the Philippines on the distribution of income and profits derived from Petroleum Operations to its parent company. The OFFICE OF ENERGY AFFAIRS shall promptly

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[24] Presidential Decree No. 1206, sec. 12(a)(i)(2).

[25] Authorizing the Secretary of Energy to Enter Into and Conclude Service Contracts, or Re-Negotiate and Modify Existing Contracts Subject to Certain Limitations (1978).

[26] Presidential Decree No. 1459, sec. 1(a).

> furnish to CONTRACTOR, without fee of other consideration, the official receipts issued in the name of CONTRACTOR by any duly empowered Government authority, acknowledging the payment of said taxes.[27] (Emphasis supplied)

The contractors' incentives or privileges under Presidential Decree No. 87, as also stated in Service Contract No. 38, include, among others, service fee of up to 40% of net production, exemption from all taxes except income tax, and income tax obligation paid out of government's share. Service Contract No. 38 stipulates the following:

1. a 60-40 production sharing scheme for the petroleum operations, where the government shall receive 60% of the net proceeds, while the contractors shall receive 40%;[28]

2. the contractors are exempt from all taxes except income tax;[29] and

3. the government, through the DOE, assumes and pays the contractors' income taxes.[30]

COA, however, contends that Presidential Decree No. 87 and Presidential Decree No. 1459 do not contain any clear and express provision stating that the contractors' income taxes are part of the government's share but, instead, explicitly provide that the contractors are subject to income tax.[31]

Indeed, it is not disputed that the contractors are subject to income taxes. The relevant tax provisions of Presidential Decree No. 87 state unequivocally that the contractors are liable for income taxes arising from their petroleum operations. Sections 12(a) and 19 of Presidential Decree No. 87 read:

> Section 12. *Privileges of contractor.* The provisions of any law to the contrary notwithstanding, a contract executed under this Act may provide that the contractor shall have the following privileges:
>
> (a) Exemption from all taxes **except income tax**.
>
> . . . .
>
> Section 19. *Imposition of tax.* — **The Contractor shall be liable each taxable year for Philippine income tax on income derived from its petroleum operations** under its contract of service, computed as provided in Section 20, through 25.[32] (Emphasis supplied)

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27 *Rollo* (G.R. No. 238846), p. 527, Service Contract No. 38, sec. 6.3.
28 *See id.* at 528–529, Service Contract No. 38, secs. 7.3 & 7.4.
29 *Id.* at 523, Service Contract No. 38, sec. 6.2(a).
30 *See id.* at 527, Service Contract No. 38, sec. 6.3.
31 *Rollo* (G.R. No. 238852), pp. 551–552, COA's Comment.
32 Presidential Decree No. 87, sec. 12(a) and 19.

Additionally, Section 24 of Presidential Decree No. 87 emphasizes that every party to a service contract is separately taxed on its share of taxable income:

> Section 24. *Return and payment of tax.* — **Every party to a service contract shall render to the Petroleum Board a return for each taxable year** in duplicate in such form and manner as provided by law setting forth its gross income and the deductions herein allowed. **The return shall be filed by the Petroleum Board with the Commissioner of Internal Revenue** or his [or her] deputies or other persons authorized by him [or her] to receive such return within the period specified in the National Internal Revenue Code and the Rules and Regulations promulgated thereunder. **Every party to a service contract shall be subject to tax separately on its share of taxable income arising from such contract.**[33] (Emphasis supplied)

COA's primary mistake is interpreting Section 12(a) of Presidential Decree No. 87, which states that the contractors are exempt from all taxes except income tax, in isolation. COA incorrectly concludes that this means the contractors must personally bear their income tax liabilities. However, this narrow interpretation disregards Section 18(b) of Presidential Decree No. 87, which states that the government's share includes all taxes paid by or on behalf of the contractors. A holistic reading of these provisions reveals the correct interpretation: the contractors remain legally liable for income tax, but once the government assumes and pays these taxes on their behalf, they are counted as part of the government's 60% share. If the contractor were entirely exempt from income tax, there would be no tax left for the government to pay on its behalf or to include as part of its share. COA's interpretation renders the phrase "including all taxes paid by or on behalf of the contractor" in Section 18(b) of Presidential Decree No. 87 meaningless and superfluous. Its narrow reading of Presidential Decree No. 87 is fundamentally flawed as it disregards the law in its entirety and isolates certain provisions without regard to the broader fiscal structure. It is a fundamental rule in statutory construction that the clauses, phrases, sections and provisions of a law be read as a whole; never as disjointed or truncated parts, for a law is enacted as a single entity and not by installment of paragraphs here and subsections there.[34]

Tax assumption arrangements like that in the case at bar are not novel. In *Mitsubishi Corp.-Manila Branch v. CIR*[35] (*Mitsubishi*), the Court explained that these arrangements allow the tax liability generally imposed on the statutory taxpayer to be passed on to a different person, such as the Philippine government or its implementing agency. This was a concession to Japanese suppliers, contractors, or consultants in consideration of the loan extended to the Philippine government. The tax assumption provision under the Exchange of Notes in *Mitsubishi* provides:

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33 *Id.* at sec. 24.

34 *Samar II Electric Cooperative, Inc. v. Quijano*, 550 Phil 523, 532 (2007) [Per J. Austria-Martinez, Third Division].

35 810 Phil 16 (2017) [Per J. Perlas-Bernabe, First Division].

Paragraph 5 (2) of the Exchange of Notes provides for a **tax assumption provision** whereby:

> (2) The **Government of the Republic of the Philippines will, *itself* or *through its executing agencies*** or instrumentalities, **assume all fiscal levies or taxes** imposed in the Republic of the Philippines on *Japanese firms and nationals operating as suppliers, contractors or consultants* on and/or in connection with *any income* that may accrue from the supply of products of Japan and services of Japanese nationals to be provided under the Loan.[36] (Emphasis in the original)

The Court then distinguished tax assumption from tax exemption in this wise:

> **To "assume" means "[t]o take on, become bound as another is bound, or put oneself in place of another as to an obligation or liability." This means that the obligation or liability remains, although the same is merely passed on to a different person. In this light, the concept of an assumption is therefore different from an exemption, the latter being the "[f]reedom from a duty, liability or other requirement" or "[a] privilege given to a judgment debtor by law, allowing the debtor to retain [a] certain property without liability." Thus, contrary to the CTA *En Banc*'s opinion, the constitutional provisions on tax exemptions would not apply.**[37] (Emphasis supplied, citations omitted)

In *Mitsubishi*, the Court decided that in line with the tax assumption provision under the Exchange of Notes, it is the Philippine Government, through its executing agency, which shall pay any form of taxes that are directly imposable under the Contract:

> As explicitly worded, the Philippine Government, through its executing agencies (*i.e.*, NPC in this case) particularly assumed "all fiscal levies or taxes imposed in the Republic of the Philippines on Japanese firms and nationals operating as suppliers, contractors or consultants on and/or in connection with any income that may accrue from the supply of products of Japan and services of Japanese nationals to be provided under the [OECF] Loan." **The Philippine Government's assumption of "all fiscal levies and taxes," which includes the subject taxes, is clearly a form of concession given to Japanese suppliers, contractors or consultants in consideration of the OECF Loan, which proceeds were used for the implementation of the Project.** As part of this, NPC entered into the June 21, 1991 Contract with Mitsubishi Corporation (*i.e.*, petitioner's head office in Japan) for the engineering, supply, construction, installation, testing, and commissioning of a steam generator, auxiliaries, and associated civil works for the Project, which foreign currency portion was funded by the OECF loans. **Thus, in line with the tax assumption provision under the Exchange of Notes, Article VIII (B) (1) of the Contract states that NPC**

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[36] *Id.* at 25–26.
[37] *Id.* at 26.

shall pay any and all forms of taxes that are directly imposable under the Contract:

> Article VIII (B) (1)
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> B. FOR ONSHORE PORTION.
>
> 1.) [The] CORPORATION **(NPC) shall**, subject to the provisions under the Contract [Document] on Taxes, **pay any and all forms of taxes** which are directly imposable under the Contract including VAT, that may be imposed by the Philippine Government, or any of its agencies and political subdivisions...
>
> This notwithstanding, petitioner included in its income tax due the amount of [PHP 44,288,712.00], representing income from the OECF-funded portion of the Project, and further remitted [PHP 8,324,100.00] as BPRT for branch profits remitted to its head office in Japan out of its income for the fiscal year that ended on March 31, 1998. These taxes clearly fall within the ambit of the tax assumption provision under the Exchange of Notes, which was further fleshed out in the Contract. **Hence, it is the Philippine Government, through the NPC, which should shoulder the payment of the same.**[38] (Emphasis supplied, citations omitted)

Thus, the Court in *Mitsubishi* recognized that the collection of taxes from entities otherwise enjoying the benefits of a tax assumption arrangement is erroneous and, thus, refundable:

> Therefore, considering that petitioner paid the subject taxes in the aggregate amount of [PHP 52,612,812.00], which it was not required to pay, the BIR erroneously collected such amount. Accordingly, petitioner is entitled to its refund.[39]

Similarly, under Service Contract No. 38, the contractors remain liable for income taxes, but the Philippine government assumes and pays these taxes as part of its share of net proceeds. The language of Section 6.3 of Service Contract No. 38 closely mirrors the tax assumption provision upheld in the Exchange of Notes in *Mitsubishi*. To restate, Section 6.3 of Service Contract No. 38 reads:

> 6.3 The OFFICE OF ENERGY AFFAIRS **shall assume and pay on behalf of CONTRACTOR and its parent company, on the first transaction in each instance where the tax is imposed, all income taxes payable to the Republic of the Philippines based on income and profits and, with respect to CONTRACTOR**, on the first transaction in each instance where the tax is imposed, all dividends, withholding taxes and other taxes imposed by the Government of the Philippines on the distribution of income and profits derived from Petroleum Operations to its parent company. The OFFICE OF ENERGY AFFAIRS shall promptly furnish to CONTRACTOR, without fee of other consideration, the official receipts issued in the name of CONTRACTOR by any duly empowered

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38 *Id.* at 26–27.

39 *Id.* at 28.

> Government authority, acknowledging the payment of said taxes.[40] (Emphasis supplied)

Both Section 6.3 of Service Contract No. 38 and paragraph 5(2) of the Exchange of Notes in *Mitsubishi* use the term "assume". The tax assumption mechanism under Section 6.3 of Service Contract No. 38 is entirely consistent with the ruling in *Mitsubishi*, where the government assumed tax obligations without granting any tax exemption.

However, COA argues that the tax assumption mechanism violates the government's 60% share of the net proceeds and effectively increases the contractors' share beyond the 40% limit. For COA, when the government pays the contractors' income taxes, the money representing tax payment is effectively added to the share of the contractors, and the effect is that the contractors are receiving more than their maximum 40% share.[41] Consequently, the tax assumption clause in Service Contract No. 38 resulted in the contractors being effectively exempt from income tax.[42]

COA's contention that income taxes included in the government's share constitute a tax exemption misunderstands the distinction between tax exemption and tax assumption. The essence of a tax exemption is the immunity or freedom from a charge or burden to which others are subjected. It is a waiver of the government's right to collect the amounts that would have been collectible under our tax laws. Thus, when the law speaks of a tax exemption, it should be understood as freedom from the imposition and payment of a particular tax.[43] Tax exemption requires congressional concurrence under Article VI, Section 28(4) of the 1987 Constitution. In contrast, tax assumption does not absolve the taxpayer of liability but merely shifts the responsibility for payment to another entity, in this case, the government.

Based on this premise, the mechanism under Service Contract No. 38 does not meet the criteria of a tax exemption, considering that the contractors are not immune from tax liability. The mechanism allows the government to assume and pay the contractors' income taxes on their behalf while ensuring that these payments form part of its 60% minimum share. **As long as the sum of the government's net share and the contractors' income tax liabilities amounts to at least 60% of the net proceeds, the fiscal arrangement complies with the explicit provisions of Presidential Decree No. 87.** In *Saguisag v. Ochoa*,[44] the Court also held that tax assumption is not equivalent to tax exemption:

> Finally, **petitioners allege that EDCA creates a tax exemption, which under the law must originate from Congress. This allegation ignores jurisprudence on the government's assumption of**

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40 *Rollo* (G.R. No. 238846), p. 527, Service Contract No. 38, sec. 6.3.
41 *See rollo* (G.R. No. 238852), pp. 554–555, COA's Comment.
42 *Id.* at 555–556, COA's Comment.
43 *Purisima v. Lazatin*, 801 Phil. 395, 424 (2016) [Per J. Brion, *En Banc*].
44 777 Phil. 280 (2016) [Per C.J. Sereno, *En Banc*].

> **tax liability. EDCA simply states that the taxes on the use of water, electricity, and public utilities are for the account of the Philippine Government. This provision creates a situation in which a contracting party assumes the tax liability of the other.** In *National Power Corporation v. Province of Quezon*, we distinguished between enforceable and unenforceable stipulations on the assumption of tax liability. Afterwards, we concluded that an enforceable assumption of tax liability requires the party assuming the liability to have actual interest in the property taxed. This rule applies to EDCA, since the Philippine Government stands to benefit not only from the structures to be built thereon or improved, but also from the joint training with U.S. forces, disaster preparation, and the preferential use of Philippine suppliers. **Hence, the provision on the assumption of tax liability does not constitute a tax exemption as petitioners have posited.**[45] (Emphasis supplied, citations omitted)

Essentially, COA seeks to remove income taxes from the computation of the government's share and reclassify these taxes as part of the contractors' share. This position is directly contrary to the explicit provisions of Presidential Decree No. 87, Presidential Decree No. 1206, and Presidential Decree No. 1459, all of which unequivocally state that the government's share includes "all taxes" paid by or on behalf of the contractor. Moreover, the inclusion of taxes as part of the government's 60% share reflects established practices in resource-sharing agreements and has been upheld by the Court in other contexts, such as mining agreements under the Philippine Mining Act of 1995. In *La Bugal-B'laan Tribal Association, Inc. v. Ramos*[46] (*La Bugal-B'laan*), the Court upheld a similar fiscal arrangement under the Financial or Technical Assistance Agreements (FTAAs). The Court noted that:

> The ***basic government share*** **is comprised of all direct taxes,** fees and royalties, as well as other payments made by the contractor during the term of the FTAA. **These are amounts paid directly to (i) the national government (through the Bureau of Internal Revenue,** Bureau of Customs, Mines & Geosciences Bureau and other national government agencies imposing taxes or fees), (ii) the local government units where the mining activity is conducted, and (iii) persons and communities directly affected by the mining project. The major taxes and other payments constituting the *basic government share* are enumerated below[.]
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> . . . .
>
> Apart from the basic share, an *additional government share* is also collected from the FTAA contractor in accordance with the second paragraph of Section 81 of [Republic Act No.] 7942, which provides that **the government share shall be comprised of, among other things, certain taxes, duties and fees.** The subject proviso reads:
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> > **"The Government share in a financial or technical assistance agreement shall consist of, among other things, the contractor's corporate income tax,** excise tax, special

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45 *Id.* at 481–482.

46 486 Phil. 754 (2004) [Per J. Panganiban, *En Banc*] (Resolution).

> allowance, withholding tax due from the contractor's foreign stockholders arising from dividend or interest payments to the said foreign stockholder in case of a foreign national, and all such other taxes, duties and fees as provided for under existing laws."[47] (Emphasis supplied, citation omitted)

Thus, *La Bugal-B'laan* affirmed that treating taxes as part of the government's share is a recognized and lawful practice in resource-sharing agreements. The arrangement in Presidential Decree No. 87 and Service Contract No. 38 mirrors the fiscal structure in *La Bugal-B'laan*, where taxes and other fiscal obligations are treated as integral components of the government's share.

By reducing the financial and administrative burdens on the contractors, the fiscal terms become more attractive to investors and encourage their participation in the high-risk and capital-intensive petroleum sector. This intent is further reinforced by the *ponencia*'s ruling, which highlights that Presidential Decree No. 87 was designed to attract foreign investment by adopting a tax assumption system as a key fiscal incentive. The tax assumption mechanism provides stability for foreign contractors and enables them to claim tax credits in their home jurisdictions, unlike a tax exemption.[48]

COA's finding that the government's share was diminished by the contractors' income tax payments arises from its failure to account for the taxes remitted to the Bureau of Internal Revenue (BIR). Again, the government's share, as defined by Presidential Decree. No. 87 and related laws, explicitly includes all taxes paid by or on behalf of the contractors. By disregarding the tax payments made to the BIR, COA artificially reduced the computed share of the government, leading to an incorrect conclusion that the contractors' taxes diminished the government's entitlement.

COA also appears to have narrowly interpreted "government" as used in Presidential Decree No. 87,[49] Presidential Decree No. 1206,[50] and Presidential Decree No. 1459[51] as referring solely to the amounts directly remitted to the DOE. This interpretation disregards the broader scope of the term, which necessarily includes payments made to other government entities, such as the BIR, in the form of taxes paid on behalf of the contractors. **The fiscal framework established by Presidential Decree No. 87 and implemented under Service Contract No. 38 envisions a unified government share, which comprises both remittances to the DOE and**

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47 *Id.* at 847–849.

48 *Ponencia*, pp. 10–11.

49 The relevant provision reads: "in no case shall the annual net revenue or share of the *Government*, including all taxes paid by or on behalf of the Contractor, be less than sixty percent[.]" (Emphasis supplied)

50 The relevant provision reads: "in no case shall the annual net revenue or share of the *government*, including all taxes paid by or on behalf of the contractor, be less than sixty percent[.]" (Emphasis supplied)

51 The relevant provision reads: "(a) The share of the *Government*, including all taxes, shall not be less than sixty per cent[.]" (Emphasis supplied)

taxes paid to the BIR on behalf of the contractors. In short, the combined proceeds received by both the DOE and the BIR must be recognized as fulfilling the government's 60% entitlement, as explicitly required by Presidential Decree No. 87, Presidential Decree No. 1206, and Presidential Decree No. 1459.

The ICC Arbitral Tribunal's recognition of the Court's jurisdiction

Section XII of Service Contract No. 38 provides for the consultation and arbitration:

> 12.1 **Disputes, if any, arising between the OFFICE OF ENERGY AFFAIRS and CONTRACTOR relating to this Contract or the interpretation and performance of any of the clauses of this Contract, and which cannot be settled amicably, shall be settled by arbitration.** The OFFICE OF ENERGY AFFAIRS on the one hand and CONTRACTOR on the other hand, shall each appoint one arbitrator within thirty (30) days after receipt of a written request of the other Party to do so, such arbitrator shall, at the request of the other Party, if the parties do not otherwise agree, be appointed by the President of the International Chamber of Commerce. If the first two arbitrators appointed as aforesaid fail to agree on a third within thirty (30) days following the appointment of the second arbitrator, the third arbitrator shall, if the Parties do not otherwise agree, be appointed, at the request of either Party, by the President of the International Chamber of Commerce. If an arbitrator fails or is unable to act, his [or her] successor will be appointed in the same manner as the arbitrator whom he [or she] succeeds. Unless the Parties agree otherwise, the Philippines shall be the venue of the arbitration proceedings. The English language shall be the language used.
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> 12. 2 **The decision of a majority of the arbitrators shall be final and binding upon the parties.** Judgment upon the award rendered may be entered in any court having jurisdiction or application may be made to such court for a judicial acceptance of the award and an order of enforcement, as the case may be.
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> 12. 3 Except as provided in this Section, arbitration shall be conducted in accordance with the Rules of Arbitration of the International Chamber of Commerce, then in effect.[52] (Emphasis supplied)

Pursuant to the foregoing arbitration provisions, the ICC Arbitral Tribunal issued a Partial Final Award on April 16, 2019, ruling that the Philippine income taxes paid by or on behalf of the contractors form part of the government's 60% share of the net proceeds from petroleum operations

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52 *Rollo* (G.R. No. 238846), pp. 534–535, Service Contract, sec. 12.

under Service Contract No. 38. The ICC Arbitral Tribunal also held that Section 6.3 of Service Contract No. 38, which provides, *inter alia*, that the government "shall assume and pay" all the contractors' income taxes, is a valid and enforceable clause. Subsequently, on December 16, 2019, the ICC Arbitral Tribunal issued a Final Award and upheld the validity of the tax assumption mechanism in Service Contract No. 38.

While the Arbitral Tribunal affirmed that the income taxes paid by or on behalf of the contractors form part of the government's 60% share, the *ponencia*'s resolution of the issues in these consolidated cases does not rely on the arbitral award but instead rests on an independent judicial review of COA's assailed Decision and Resolution. Recognizing its own jurisdictional limitations, the Arbitral Tribunal expressly declined to rule on whether COA has correctly exercised its mandate:

> . . . The Tribunal appreciates that the **decisions of the COA are only subject to review by the Supreme Court. The Tribunal wishes to [emphasize] that it is not deciding whether the COA has correctly exercised its constitutional mandate and indeed the Claimants have not asked the Tribunal to do so.** In this vein, the Claimants' request for relief is illustrative. The Claimants are seeking directions compelling the Respondent to comply with obligations under Service Contract 38. Such a direction is geared toward vindicating alleged contractual rights, not reviewing the Notices of Charge. The Tribunal is concerned only with Section 6.3 and whether the Respondent has breached that provision. The Tribunal accordingly finds that the Claimants' case does not involve constitutionality issues in this respect.[53]
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> . . . .
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> . . . The Tribunal stresses that in deciding the issue of the validity and enforceability of Section 6.3 of SC 38, **it has taken extreme care not to encroach on the jurisdiction of the Philippine Supreme Court as the exclusive arbiter of constitutional issues over cases in its jurisdiction.** The Tribunal also stresses that it does not seek to prevent the COA from discharging its audit duty under the 1987 Constitution of the Philippines.[54] (Emphasis supplied, citations omitted)

By these pronouncements, the Arbitral Tribunal itself confirmed that its Partial Final Award and Final Award do not and cannot override the Court's authority to review decisions of COA *via* Rule 64 petitions. While the *ponencia's* ruling aligns with the findings of the Arbitral Tribunal that the tax assumption mechanism under Service Contract No. 38 is valid, such ruling is not contingent on arbitration. Even absent the arbitral award, the Court's independent analysis of COA's ruling leads to the same conclusion—the tax assumption mechanism under Service Contract No. 38 is lawful and consistent with the legislative framework established by Presidential Decree Nos. 87, 1206, and 1459.

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53 Partial Final Award, pp. 46–47.

54 *Id.* at 69–70.

In sum, COA gravely abused its discretion in ruling that the tax assumption mechanism under Service Contract No. 38 was unlawful, as this system is explicitly authorized by Presidential Decree Nos. 87, 1206, and 1459 and forms an integral part of the government's 60% share in the net proceeds. Service Contract No. 38 grants no tax exemption. It merely provides for the assumption of tax liabilities by the government through its executing agency.

ACCORDINGLY, I vote to **GRANT** the consolidated Petitions for *Certiorari.*

ALFREDO BENJAMIN S. CAGUIOA
Associate Justice