Republic of the Philippines
Supreme Court
Manila

EN BANC

SHELL PHILIPPINES EXPLORATION B.V. and CHEVRON MALAMPAYA LLC,
Petitioners,

G.R. No. 238846

- versus -

COMMISSION ON AUDIT,
Respondent.
x----------x

PNOC EXPLORATION CORPORATION,
Petitioner,

G.R. No. 238852

- versus -

COMMISSION ON AUDIT,
Respondent.
x----------x

THELMA M. CERDEÑA and NORA A. TUAZON,
Petitioners,

- versus -

COMMISSION ON AUDIT,
Respondent.

G.R. No. 238862

Present:

GESMUNDO, *C.J.*,
LEONEN,
CAGUIOA,
HERNANDO,*
LAZARO-JAVIER,**
INTING,
ZALAMEDA,
LOPEZ, M.,
GAERLAN,
ROSARIO,
LOPEZ, J.,
DIMAAMPAO,
MARQUEZ,
KHO, JR., and
SINGH, *JJ.*

Promulgated:

February 25, 2025

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DECISION

DIMAAMPAO, *J.*:

Impugned in these consolidated[1] Petitions for *Certiorari*[2] are Decision No. 2015-115[3] (assailed Decision) and Decision No. 2018-075[4] (challenged Resolution) of the Commission on Audit (COA), which affirmed Notice of

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* On official leave.

** No part.

1 *Rollo* (G.R. No. 238846), pp. 4817–4818; *rollo* (G.R. No. 238852), pp. 458–459; *rollo* (G.R. No. 238862), pp. 281–282.

2 *Rollo* (G.R. No. 238846), pp. 3–129; *rollo* (G.R. No. 238852), pp. 3–45; *rollo* (G.R. No. 238862), pp. 3–27.

3 *Rollo* (G.R. No. 238846), pp. 282–301; *rollo* (G.R. No. 238852), pp. 46–65; *rollo* (G.R. No. 238862), pp. 204–223. The April 6, 2015 Decision was signed by Commissioners Heidi L. Mendoza and Jose A. Fabia.

4 *Rollo* (G.R. No. 238846), pp. 306–337; *rollo* (G.R. No. 238852), pp. 66–97; *rollo* (G.R. No. 238862), pp. 28–59. The January 24, 2018 Resolution was signed by Commissioners Jose A. Fabia and Isabel D. Agito. Chairperson Michael G. Aguinaldo inhibited.

Charge No. 2010-01-151(09).[5] The crux of the controversy is the purported undercollection of the government's share in the Malampaya Natural Gas Project from 2002 to December 2009 amounting to PHP 53,140,304,739.86.

Antecedents

On December 11, 1990, the Government of the Republic of the Philippines, represented by then President Corazon C. Aquino, executed a Service Contract[6] with Occidental Philippines, Inc. and Shell Exploration B.V., the predecessors-in-interest of Shell Exploration B.V. (SPEX), PNOC Exploration Corporation (PNOC-EC), and Chevron Malampaya LLC (Chevron), collectively referred to as the Contractors. Dubbed as the Malampaya Natural Gas Project, this Service Contract was entered into pursuant to Presidential Decree No. 87,[7] which was promulgated to hasten the discovery and production of indigenous petroleum through the utilization of government and/or private resources, local and foreign.[8]

Under the Service Contract, the Contractors were responsible to execute all operations for searching and obtaining petroleum in the contract area. They were obliged to furnish the necessary technology and financing, including the required services for petroleum operations, and assume all exploration risks without being entitled to reimbursement even if no petroleum in commercial quantity is discovered and produced. The agreement was subject to the control and supervision of the then Office of Energy Affairs (now the Department of Energy [DOE]).[9]

Section 7.3 of the Service Contract provides that 60% of the net proceeds of the petroleum operations shall be remitted to the government. Section 7.4 allots to the Contractors the 40% retention fee of the net proceeds.[10]

Under Section 12(a) of Presidential Decree No. 87, the Contractors are exempted from payment of all taxes except income tax. However, Section 19 provides that the Contractors shall be liable each taxable year for the Philippine income tax on income derived from petroleum operations under its

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5 *Rollo* (G.R. No. 238846), pp. 418–419; *rollo* (G.R. No. 238852), pp. 129–130; *rollo* (G.R. No. 238862), pp. 129–130. The October 5, 2010 Notice of Charge (NC) No. 2010-01-151(09) was signed by Dolores T. Barraza, Supervising Auditor, Office of the Auditor, Department of Energy.

6 *Rollo* (G.R. No. 238846), pp. 216–254; *rollo* (G.R. No. 238852), pp. 1444-1482; *rollo* (G.R. No. 238862), pp. 60–98. Also referred to as Service Contract No. 38 or SC 38 in the proceedings below.

7 The Oil Exploration and Development Act of 1972.

8 *Rollo* (G.R. No. 238846), p. 283; *rollo* (G.R. No. 238852), p. 47; *rollo* (G.R. No. 238862), p. 205.

9 *Id.*

10 *Rollo* (G.R. No. 238846), pp. 237–238, 283; *rollo* (G.R. No. 238852), pp. 47, 1465–1466; *rollo* (G.R. No. 238862), pp. 81–82, 304.

Contract of Service, computed based on Sections 20 to 25 of the same law.[11]

The above Section 12(a) of Presidential Decree No. 87 is spelled out in Section 6.3 of the Service Contract:

> *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 or other consideration, the official receipts issued in the name of CONTRACTOR by any duly empowered Government authority, acknowledging the payment of said taxes.[12] (Emphasis supplied)

Quite palpably, the 60% Philippine government share in the net proceeds includes the corporate income taxes of the Contractors from the start of commercial operations of the Service Contract in 2002 up to 2009.[13]

During the conduct of a post-audit in 2004, DOE Supervising Auditor Dolores T. Barraza (Auditor Barraza) noted that the corporate income taxes of the Contractors were deducted from the government's share. Consequently, Audit Observation Memorandum No. 2004-006 was issued where Auditor Barraza highlighted that the inclusion of the corporate income taxes in the government's share from January 2002 to November 2003 resulted in the understatement of the government revenue worth PHP 2.63 billion.[14]

Auditor Barraza computed that the total under collection of the 60% government share from service income up to December 2009 totaled PHP 53,140,304,739.86.[15] As a result, she issued Notice of Charge No. 2010-01-151(09)[16] identifying the persons liable for the transaction, namely: 1) Thelma M. Cerdeña (Cerdeña), Chief of the DOE Compliance Division; 2) Nora A. Tuazon (Tuazon), Officer-in-Charge of the DOE Financial Services; and 3) the Contractors.

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11 *Rollo* (G.R. No. 238846), p. 283; *rollo* (G.R. No. 238852), p. 47; *rollo* (G.R. No. 238862), p. 205.

12 *Rollo* (G.R. No. 238846), p. 236; *rollo* (G.R. No. 238852), p. 1464; *rollo* (G.R. No. 238862), p. 80.

13 *Rollo* (G.R. No. 238846), p. 284; *rollo* (G.R. No. 238852), p. 48; *rollo* (G.R. No. 238862), p. 206.

14 *Id.*

15 *Rollo* (G.R. No. 238846), p. 285; *rollo* (G.R. No. 238852), p. 49; *rollo* (G.R. No. 238862), p. 207.

16 *Rollo* (G.R. No. 238846), pp. 418–419; *rollo* (G.R. No. 238852), pp. 129–130; *rollo* (G.R. No. 238862), pp. 129–130.

DOE, SPEX, PNOC-EC, and Chevron sought recourse before the COA, which denied their appeal.[17]

Unflustered, the Contractors, DOE, Cerdeña, and Tuazon, filed their Petitions for Review before COA Proper.[18]

In the assailed Decision, COA denied the Petitions for Review and declared that the income taxes of the Contractors should not have been part of the 60% government share. COA disputed the argument of the Contractors that the government assumed their income taxes due and demanded that they settle their back taxes under the Service Contract.[19]

DOE and the Contractors' bid for a reconsideration of the assailed Decision was denied in the challenged Resolution. Taking issue with the disposition, the Contractors, as well as Cerdeña and Tuazon are now before this Court via their respective Petitions for *Certiorari*. Essentially, they impute grave abuse of discretion amounting to lack or excess of jurisdiction on the part of COA in issuing the repugned Decision and Resolution.

However, during the pendency of the instant Petitions, the Office of the Solicitor General (OSG) informed the Court of two existing international arbitration cases related to the case at bar: *Shell Philippines Exploration B.V. v. The Republic of the Philippines*, docketed as ICSID Case No. ARB/16/22 pending before the International Centre for Settlement of Investment Disputes (ICSID), and *Shell Philippines Exploration B.V. (the Netherlands) and Chevron Malampaya LLC (USA) v. Government of the Republic of the Philippines*, docketed as ICC Case No. 21096/CYK/PTA pending before the International Chamber of Commerce (ICC).[20]

Moreover, OSG furnished the Court with the ICSID Decision on Provisional Measures[21] in ICSID Case No. ARB/16/22, which states, among others, that:

> (4) The [Republic of the Philippines] shall refrain from taking any steps to enforce any of the three Notices of Charge against [Shell Philippines Exploration B.V.] or to collect any sums due thereunder from [Shell Philippines Exploration B.V.] until this Tribunal shall have decided the

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17 *Rollo* (G.R. No. 238846), pp. 603–615; *rollo* (G.R. No. 238852), pp. 255–267; *rollo* (G.R. No. 238862), pp. 192–203. The August 22, 2011 NGS–Cluster B Decision No. 2011-009 was penned by Rizalina Q. Mutia, Director IV, COA National Government Sector, Cluster B – General Public Services II and Defense.

18 *Rollo* (G.R. No. 238846), p. 286; *rollo* (G.R. No. 238852), p. 50; *rollo* (G.R. No. 238862), p. 208.

19 *Rollo* (G.R. No. 238846), pp. 291–293; *rollo* (G.R. No. 238852), pp. 55–57; *rollo* (G.R. No. 238862), pp. 213–215.

20 *Rollo* (G.R. No. 238862), pp. 283–297.

21 *Rollo* (G.R. No. 238846), pp. 4834–4887; *rollo* (G.R. No. 238862), pp. 298–351. This August 29, 2017 Decision was signed by the President of the Tribunal V. V. Veeder, Arbitrator Horacio A. Grigera Naón, and Arbitrator Brigitte Stern.

> [Republic of the Philippines]'s jurisdictional objections identified in the Tribunals Procedural Order No[.] 3 of August 28, 2017 or further order[.][22]

On April 16, 2019, the ICC issued its Partial Final Award[23] in ICC Case No. 21096/CYK/PTA, which was followed by the release on December 16, 2019 of the Final Award[24] upholding the validity of the tax assumption mechanism in the Service Contract.

Commenting on all the Petitions, COA stood pat on its ruling, insisting that there was no provision in the law specifically providing that the income taxes of the Contractors would be part of the share of the Government.[25]

Issues

Stripped of unnecessary verbiage, the main queries brought to this Court for resolution are the following:

1. Does the Government's 60% share under Presidential Decree Nos. 87 and 1459 include the Contractors' income taxes?

2. Should the Contractors and petitioners Cerdeña and Tuazon be personally held liable for issuing the Notice of Charge?

On January 30, 2020, the OSG, acting on behalf of DOE, filed a Petition-in-Intervention[26] further fortifying its stance in the instant dispute between the Contractors and COA. The OSG stressed that Presidential Decree No. 87, Presidential Decree No. 1206[27] and Presidential Decree No. 1459[28] clearly provide that the Contractors' income taxes are included in the Government's 60% share in the net proceeds as stipulated in the Service Contract, and that tax assumption by the Government is permissible and not tantamount to a tax exemption.[29]

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22 *Rollo* (G.R. No. 238862), p. 350.

23 *Rollo* (G.R. No. 238846), pp. 5051–5135; *rollo* (G.R. No. 238852), pp. 601–685; *rollo* (G.R. No. 238862), pp. 492–577. The April 16, 2019 Partial Final Award was signed by the Arbitral Tribunal composed of Hon. L. Yves Fortier, QC, President; Sir David A. R. Williams, QC; and Chief Justice Reynato S. Puno (Ret.).

24 *Rollo* (G.R. No. 238846), pp. 5436–5478; *rollo* (G.R. No. 238852), pp. 979–1021; *rollo* (G.R. No. 238862), pp. 783–825.

25 *Rollo* (G.R. No. 238846), pp. 4945–5031; *rollo* (G.R. No. 238852), pp. 508–593; *rollo* (G.R. No. 238862), pp. 399–484.

26 *Rollo* (G.R. No. 238846), pp. 5817–5861; *rollo* (G.R. No. 238852), pp. 1346–1390; *rollo* (G.R. No. 238862), pp. 1150–1194.

27 Creating the Department of Energy (1977).

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

29 *See rollo* (G.R. No. 238846), pp. 5827–5839; *rollo* (G.R. No. 238852), pp. 1356–1368; *rollo* (G.R. No. 238862), pp. 1160–1172.

The Court's Ruling

The consolidated Petitions carry weight and conviction.

Courts consistently accord considerable deference to the factual findings of administrative bodies vested with expertise in their respective fields. Absent a showing of substantial evidence that such findings were premised on a misapprehension or misapplication of the evidence on record, they are deemed final, conclusive, and binding upon this Court.[30]

However, when there is a showing that COA has acted without, or in excess of jurisdiction, or with grave abuse of discretion amounting to lack or excess of jurisdiction, its findings may be set aside.[31] The Court has already discussed the scope of a *certiorari* proceeding when what is involved is a COA ruling—

> A Rule 65 petition is a unique and special rule because it commands limited review of the question raised. As an *extraordinary remedy*, its purpose is simply to keep the public respondent within the bounds of its jurisdiction or to relieve the petitioner from the public respondent's arbitrary acts. In this review, the Court is confined *solely* to questions of jurisdiction whenever a tribunal, board or officer exercising judicial or quasi-judicial function acts without jurisdiction or in excess of jurisdiction, or with grave abuse of discretion amounting to lack or excess of jurisdiction.
>
> The limitation of the Court's power of review over COA rulings merely complements its nature as an ***independent constitutional body*** that is tasked to safeguard the proper use of the government and, ultimately, the people's property by vesting it with power to (i) determine whether the government entities comply with the law and the rules in disbursing public funds; and (ii) disallow legal disbursements of these funds.[32] (Emphasis in the original)

The case at bench exemplifies the rare exception where the Court would overturn the factual and legal findings of COA.

The governing laws and Service Contract No. 38 expressly state that the Contractors' income taxes are included in the Government's share from the Malampaya Project's net proceeds

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30 *See Melloria v. Director Jimenez*, 944 Phil. 300, 307 (2023) [Per J. Dimaampao, *En Banc*].

31 *See National Power Corporation Board of Directors v. Commission on Audit*, 872 Phil. 671, 679 (2020) [Per J. Reyes, J., Jr., *En Banc*].

32 *Melloria v. Jimenez*, 944 Phil. 300, 308 (2023) [Per J. Dimaampao, *En Banc*]. (Citation omitted)

In the assailed Decision, COA found that there was no provision in the law which specifically provides that the income taxes of the Contractors should be part of the share of the Government.

This is a patent mistake committed by COA.
Section 18(b) of Presidential Decree No. 87 provides:

> SEC. 18. *Functions of the Petroleum Board.* — In accordance with the provisions and objectives of this Act, the Petroleum Board shall:
>
> . . . .
>
> (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-sphere 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 per cent of the difference between the gross income and the sum of operating expenses and Filipino participation incentive.* (Emphasis supplied)

So, too, Section 12(a)(i)(2) of Presidential Decree No. 1206 embodies the phrase "including all taxes paid by or on behalf of the contractor" in referring to the Government's annual net revenue or share:

> SEC.12. *Transferred Powers and Functions.* The following powers and functions are transferred as hereinafter indicated to the extent that they are not modified by any specific provision of this Decree:
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> ....
>
> (2) Enter into contracts herein authorized with such terms and conditions as may be appropriate under the circumstances: . . . 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 incentives*[.] (Emphasis supplied)

Section 1(a) of Presidential Decree No. 1459 invariably echoes the above provision, viz.:

> 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*[.] (Emphasis supplied)

All the above quoted laws governing oil exploration and development industry in the Philippines clearly and unambiguously state that the Government's share *includes* all taxes. As the word *include* means "to take in or comprise as a part of a whole or group" or "to contain between or within"[33] and leaves no room for any other interpretation, it becomes the duty of the Court to apply the law as it is worded.

"Under the [plainmeaning] rule or *verba legis*, wherever possible, the words used in the Constitution must be given their ordinary meaning except where technical terms are employed."[34] Here, the unequivocal language of Presidential Decree Nos. 87, 1206, and 1459 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, and *second*, the government assumes and pays the Contractors' income taxes.

The intent of Presidential Decree No. 87 is a predominant factor in its interpretation

Even assuming that an interpretation should be had, the intent of the law is the most dominant influence in its interpretation.[35] Along this vein, former Prime Minister Cesar Virata, former DOE Secretary Raphael Perpetuo Lotilla, and former DOE Undersecretary Rufino Bomasang all confirmed through their respective Judicial Affidavits and Witness Statements that the petroleum fiscal system established under Presidential Decree No. 87 provides for tax assumption:

> 165.1. Prime Minister Virata initiated the policy study conducted by the petroleum industry expert Mr. Walter Levy and developed the draft legislation that was eventually promulgated as PD 87. Prime Minister Virata confirmed that *the tax assumption system was intended to attract much needed foreign investments to the petroleum industry of the Philippines. It provides fiscal stability and enables foreign contractors to claim tax credits in their home jurisdictions*. This benefit is legal and recognized in the investors' home countries. For the home countries of Petitioners in particular, this is evident from the tax treaties of (i) the Republic of the Philippines and the United States and (ii) the Republic of the Philippines

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33 MERRIAM-WEBSTER DICTIONARY, "include," *available at* https://www.merriam-webster.com/dictionary/include (last accessed on October 9, 2024).

34 *Macalino v. Commission on Audit*, 949 Phil. 517, 521 (2023) [Per J. Marquez, *En Banc*].

35 *See Development Bank of the Phils. v. Commission on Audit*, 424 Phil. 411, 432 (2002) [Per J. Carpio, *En Banc*].

> and the Kingdom of Netherlands. In contrast, a mere tax exemption would not have given the same tax credit benefit.
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> 165.2. Secretary Lotilla further confirmed that *tax assumption is more favorable than tax exemption due to this tax credit benefit in the foreign investor's home jurisdiction.* From the standpoint of the Philippine Government, tax assumption has the *same financial consequence* as a tax exemption because *under both, the Government gets its full 60% share.* Hence, the tax assumption under PD 87 enables the Government to offer *additional incentives to foreign contractors* – in order *to attract the necessary investments – without any cost or negative financial impact to the Philippines.*
>
> 165.3. Undersecretary Bomasang said that throughout his 28 years of service as an energy official of the Government, the *tax assumption system was a key incentive highlighted to entice foreign investors and was consistently acknowledged by the Government as legal, valid, and binding.*[36] (Emphasis supplied)

Evidently, the intended scope and purpose of the law was to provide greater incentives to encourage private participation in the exploration and development of petroleum resources in the Philippines and attract foreign investors to take risks in the Philippine petroleum industry. Its key policy objective is to "hasten the discovery and production of indigenous petroleum through the utilization of government and/or private resources, local and foreign."[37] To achieve this, Presidential Decree No. 87 offered "more meaningful incentives to prospective service contractors,"[38] *one of which is the adoption of the tax assumption system.* Correspondingly, from both the letter of the law and the intent of its framers, a rejection of the tax assumption system has no leg to stand on.

The correct interpretation, therefore, taking into consideration all the provisions of Presidential Decree No. 87, as well as its intent, is that: (a) the Contractor is liable to pay income tax, *but* b) the Contractors' income tax forms part of or is counted in the Government's 60% share.

Tax assumption is not tax exemption

COA postulates that Section 6.3 of the Service Contract infringes upon the sovereign prerogative of the Government to impose tax or exempt a class from taxation and therefore the said provision is not valid and enforceable.[39]

The postulation is out on a limb.

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36 *Rollo* (G.R. No. 238846), pp. 62–63.

37 Presidential Decree No. 87 (1972), sec. 2.

38 2nd Whereas clause of Presidential Decree No. 87 (1972).

39 *Rollo* (G.R. No. 238846), p. 296; *rollo* (G.R. No. 238852), p. 60; *rollo* (G.R. No. 238862), p. 218.

Prefatorily, the word *exemption* is defined as "freedom from a duty, liability, or other requirement; an exception.[40] Exemption, being obnoxious to taxation, is not favored and never presumed; if at all, it must be categorically and unmistakably expressed in terms that admit of no doubt, yet such exempting provision must be interpreted in *strictissimi juris* against the taxpayer and liberally in favor of the taxing authority.[41] Even more crucially, the Constitution dictates that "[n]o law granting any tax exemption shall be passed without the concurrence of a majority of all the Members of the Congress."[42]

On the other hand, *assumption* is the "act of taking (esp. someone else's debt or other obligation) for or on oneself."[43] This means that the obligation or liability remains, although the same is merely passed on to a different person.[44]

From the foregoing perspective, it becomes quite clear that contrary to the standpoint of COA, the concept of an assumption is *distinct* and not synonymous to an exemption. Considering that Section 6.3 of the Service Contract is *not* in the nature of a tax exemption, it therefore does not infringe upon the sovereign prerogative of the Government, and the constitutional provisions on tax exemptions do not find application.

Upon this point, the case of *Republic v. City of Kidapawan*[45] is illuminating. The jugular issue of the controversy revolves around the purported exemption of Philippine National Oil Company-Energy Development Corporation (PNOC-EDC) from payment of real property taxes over the Mt. Apo Geothermal Reservation Area. Relatedly, the service contract entered into by the government and PNOC-EDC contained the similar provision in Section 6.3 of the subject Service Contract anent the payment of income taxes, viz.:

> 8.1 The GOVERNMENT shall assume and pay on behalf of CONTRACTOR all income taxes payable to the Republic of the Philippines based on income or profit derived from geothermal operations. It is understood, however, that such income tax payment shall come from the Government Share of sixty percent (60%) of the Net Value.[46]

The Court categorically held in *Kidapawan*:

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40 BLACK'S LAW DICTIONARY 717 (11th ed., 2019).

41 *See Commissioner of Internal Revenue v. Guerrero*, 128 Phil. 197, 201 (1967) [Per J. Fernando, *En Banc*].

42 CONST., art. VI, sec. 28(4).

43 BLACK'S LAW DICTIONARY 154 (11th ed., 2019).

44 *Mitsubishi Corporation-Manila Branch v. Commissioner of Internal Revenue*, 810 Phil. 16, 26 (2017) [Per J. Perlas-Bernabe, First Division].

45 513 Phil. 440 (2005) [Per J. Ynares-Santiago, First Division].

46 *Id.* at 449.

> Likewise, although it is the government which actually pays the income taxes, the contract nonetheless specifically provided that the payment is for and in behalf of PNOC-EDC and is chargeable against the 60% share of the government in the net profits derived by the PNOC-EDC arising from the geothermal operation. In reality, the PNOC-EDC is the actual payee while the government is only its agent in the payment of the income taxes. In fact, the official receipt is being issued in the name of PNOC-EDC.[47]

Evidently, it was decreed that "the exemption [from real property taxes] provided in the service contract cannot be given effect because the DOE, representing the government in the execution of the contract, has no authority to grant the same."[48] However, no such pronouncement was made with respect to the government's assumption of PNOC-EDC's *income* taxes.

It is likewise worthy to note that while the industry involved in the case at bench and in *Kidapawan* are distinct, it does not necessarily follow that the benefits which the respective contractors enjoy, such as tax assumption, must be construed differently. *Ubi lex non distinguit nec nos distinguere debemus*. When the law does not distinguish, we must not distinguish.

To illustrate further, in the case of *Mitsubishi Corp.-Manila Branch v. Commissioner of Internal Revenue*,[49] the Court ruled in favor of the private contractor's claim for tax refund by virtue of a "tax assumption" clause in an Exchange of Notes between Japan and the Philippines, which provides:

> 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.[50] (Emphasis and underscoring in the original]

The Court then distinguished *tax exemption* and *tax assumption*, ruling that the restrictions on *tax exemption* do not apply to *tax assumption*:

> 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*

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47 *Id.* at 450.
48 *Id.*
49 810 Phil. 16 (2017) [Per. J. Perlas-Bernabe, First Division].
50 *Id.* at 25–26.

> *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*.[51] (Emphasis supplied)

Consequently, the Court ruled in *Mitsubishi* that, pursuant to the tax assumption provision in the Exchange of Notes, the Philippine Government, through its executing agency, is responsible for paying any form of taxes 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 shall pay any and all forms of taxes that are directly imposable under the Contract*[.][52] (Emphasis supplied)

Ultimately, the Court concluded in *Mitsubishi* that the collection of taxes from entities otherwise enjoying the benefits of a tax assumption arrangement is erroneous and, thus, refundable.[53]

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*.

The Arbitral Awards upheld the validity of the tax assumption mechanism in the Service Contract

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51 *Id.* at 26.
52 *Id.* at 26–27.
53 *Id.* at 28.

"Arbitration agreements are *liberally* construed in favor of proceeding to arbitration."[54] Along this grain, Section XII of the Service Contract is clear and categorical—

SECTION XII
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 successor will be appointed in the same manner as the arbitrator whom he succeeds. Unless the Parties agree otherwise, the Philippines shall be the venue of the arbitration proceedings. The English language shall be the language used.

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.

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.[55] (Emphasis supplied)

As it happened, the Contractors lodged two separate cases for arbitration. The case before the ICSID is still pending. Meanwhile, on April 16, 2019, the ICC, in ICC Case No. 21096/CYK/PTA, issued its Partial Final Award, ruling in this wise:

203. Since Section 6.3 expressly requires the DOE to "assume and pay" the Contractor's income taxes, and Section 7.4 entitles the Contractor to 40% of Net Proceeds, the value of the Contractor's income taxes can only form part of the DOE's 60% share of Net Proceeds. There is no other way to read these provisions together and give them all meaning.

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[54] *Bases Conversion Dev't. Authority v. DMCI Proj. Developers, Inc.*, 776 Phil. 192, 205 (2016) [Per J. Leonen, Second Division].(Emphasis supplied)

[55] *Rollo* (G.R. No. 238846), pp. 243–244, *rollo* (G.R. No. 238852), pp. 1471–1472; *rollo* (G.R. No. 238862), pp. 87–88.

204. The Tribunal wishes to emphasize that this interpretation has been accepted by the DOE and the OSG, which have consistently maintained that "*the corporate income tax of the Contractor is a proper inclusion to and/or forms part of the sixty percent (60%) share of the Government citing Section 18(b) of [Presidential Decree No.] 87 and Section 6.3 of SC 38.*"

. . . .

206. This interpretation also comports with the implementing legislation which specifies that the Government's share of net proceeds "***including all taxes*** *paid by or on behalf of the contractor*" cannot be less than 60%.

. . . .

230. The Respondent contends that Section 6.3 of SC 38 infringes upon the sovereign prerogative of the Philippines [sic] government to impose tax or exempt a class from taxation, and accordingly, that this tax assumption provision is not valid and enforceable. The Respondent challenges the validity of Section 6.3 of SC 38 and not SC 38 as a whole.

231. The Tribunal disagrees with the Respondent.

232. Firstly, the tax pertaining to the Claimants' income derived from their petroleum operations is paid to the government of the Philippines, albeit by the DOE. As noted earlier, such payment is made by the DOE on behalf of the Claimants pursuant to Section 8.4 of SC 38. Section 8.4 provides that:

> *The Office of Energy Affairs, upon payment by it of Contractor's income taxes shall procure official receipts in the name of Contractor evidencing such payment. Each of the second parties, if more than (1) shall be subject to tax separately on its share of income and the office of Energy Affairs shall supply each with an individual receipt in its own name.*

233. There is no evidence on the record that the Claimants' income tax has not been paid to the national government by the DOE. Thus, there is no diminution of the government's 60% share.

234. Secondly, there is no evidence on the record that the applicable Presidential Decrees prohibit the practice of tax assumption when a particular agency of the government engages in business for profit.

235. Tax assumption is a form of tax avoidance which is allowed in the Philippines. As well put by a tax scholar: "*there is a distinction between tax avoidance and tax evasion. Tax avoidance is the use of legal means to prevent accrual of the tax or to reduce the tax that may accrue, while tax evasion is the use of fraudulent means to defeat the taxes that have accrued. Tax avoidance is legal while tax evasion is illegal and punishable by law.*"

236. In the case at hand, the tax assumption made by the DOE was done for a legitimate, not a fraudulent purpose, namely as an incentive for the Claimants to agree to explore oil and gas in the Philippines. The project enabled the government of the Philippines to earn billions of pesos.

237. As testified by Claimants' fact witnesses, this tax assumption incentive is usual in the oil and gas industry business. There is no public policy offended when an agency of the government adopts it as a business strategy especially when its overall effect is beneficient to the government.

238. Thirdly, in any event, the sovereign right of the government of the Philippines to tax is not at issue as, in fact, all the taxes due to the State have been paid.

239. Fourthly, the case at bar does not involve any tax exemption claim on the part of the Claimants but rather tax sharing, a legitimate business practice in the oil industry.

240. Finally, the Tribunal gives high persuasive effect to the positions of the different branches and agencies of the government of the Philippines that have recognized the legality of the tax assumption provision of Service Contract 38.

241. The DOE, which represent[s] the government of the Philippines in Service Contract 38, has been unwavering in its position supporting the Claimants. The Bureau of Internal Revenue in charge of collecting income tax due to the Government has not assailed said tax assumption as unlawful. Neither have the Department of Finance nor the Department of Justice. The Commission on Audit has audited the 60-40 division of profits between the parties based on the tax assumption provision. It was only in 2010 that the COA asserted the illegality of the tax assumption provision in Service Contract 38. The Office of the Solicitor General, the official counsel of the government of the Philippines, has refused to defend COA's position in the Supreme Court that the tax assumption provision violates the 60% share of the Government in Service Contract 38. President Rodrigo R. Duterte maintains that the Government should honour its commitment in Service Contract 38. Congress has not amended PD 87 and other related presidential decrees to accommodate the COA's new interpretation.

242. The consistency of these governmental opinions for the past thirty years support the Claimants' position that the tax assumption provision of Service Contract 38 is legally valid.

243. On the basis of the foregoing, the Tribunal finds that Section 6.3 of SC 38 is valid and enforceable under Philippine law.

. . . .

> 284. Having carefully considered the Parties' arguments in their written pleadings and oral submissions, and having deliberated, for the reasons stated above and as summarized in Section VI, the Tribunal unanimously:
>
> (a) Dismisses the Respondent's arbitrability objection;
>
> (b) Declares that the Philippine Income Taxes paid by or on behalf of the Claimants form part of the Respondent's sixty per cent (60%) share of the Net Proceeds from Petroleum Operations under the Service Contract;
>
> (c) Declares that Section 6.3 of the Service Contract which provides, inter alia, that the Respondent "shall assume and pay" all the Consortium's Income Taxes, is a valid and enforceable clause;
>
> (d) Declares that the Respondent has already received in full its 60% share of the Net Proceeds from 2002 until the conclusion of the Hearing in September 2018;
>
> (e) Declares that the Respondent has no right to demand or collect from the Claimants any additional amount for the period of 2002 until the conclusion of the Hearing in September 2018;
>
> (f) Directs the Respondent to comply with its obligations under the Service Contract;
>
> (g) All other claims are reserved for decision in a Final Award.[56] (Emphasis in the original)

Invariably, in the December 16, 2019 Final Award, the ICC Arbitral Tribunal reaffirmed the Partial Final Award and upheld the validity of the tax assumption mechanism in the Service Contract. Given that the policy of the state *favors arbitration*, the exhaustive contribution of foreign arbitral tribunals, such as the ICC, is invaluable in resolving the case at bench. Considering that the ICC made a categorical finding in favor of the Contractors, the Court must perforce respect to such finding.

Be that as it may, even in the absence of the arbitral award, the Court's independent analysis of the COA's disposition inevitably 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.

Cerdeña and Tuazon are likewise absolved from liability

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[56] *Rollo* (G.R. No. 238846), pp. 5115–5116, 5120–5122, and 5133–5134; *rollo* (G.R. No. 238852), pp. 665–666, 670–672, 683–684; *rollo* (G.R. No. 238862), pp. 557–558, 562–564, 575–576.

Considering that the Notice of Charge was issued by COA with grave abuse of discretion amounting to lack or excess of jurisdiction, a discussion on the liability of Cerdeña and Tuazon becomes superfluous. Similar to the Contractors, this Court absolves them from any liability under the Notice of Charge.

A final cadence. The Court is on all fours with COA to zealously ensure that the Government is never placed at a disadvantage and that it rightfully receives what is due it in all its transactions. Nevertheless, remaining bound by the Constitution and the laws of the land, the Government cannot be allowed to renege on its obligation, especially when such has been distinctly outlined in the contract it *freely* entered into and agreed to.

ACCORDINGLY, the consolidated Petitions for *Certiorari* are **GRANTED**. The April 6, 2015 Decision No. 2015-115 and the January 24, 2018 Decision No. 2018-075 of the Commission on Audit are **REVERSED** and **SET ASIDE**. The October 5, 2010 Notice of Charge No. 2010-01-151(09) is **LIFTED**.

SO ORDERED.

JAPAR B. DIMAAMPAO
Associate Justice

WE CONCUR:

ALEXANDER G. GESMUNDO
Chief Justice

See dissenting opinion

MARVIC M.V.F. LEONEN
Associate Justice

See Concurring Opinion

ALFREDO BENJAMIN S. CAGUIOA
Associate Justice

See concurring opinion

On official leave
RAMON PAUL L. HERNANDO
Associate Justice

No part
AMY C. LAZARO JAVIER
Associate Justice

HENRI JEAN PAUL B. INTING
Associate Justice

RODIL V. ZALAMEDA
Associate Justice

MARIVIC M.V.F. LEONEN
Associate Justice

SAMUEL H. GAERLAN
Associate Justice

RICARDO R. ROSARIO
Associate Justice

with separate concurring opinion

JHOSEP Y. LOPEZ
Associate Justice

JOSE MIDAS P. MARQUEZ
Associate Justice

ANTONIO T. KHO, JR.
Associate Justice

MARIA FILOMENA D. SINGH
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, I certify that the conclusions in the above Decision had been reached in consultation before the cases were assigned to the writer of the opinion of this Court.

ALEXANDER G. GESMUNDO
Chief Justice