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

Secs. 27(C); 32(B)(7); 236; 238; RR 18-2012
BIR Ruling No.369-11 BIR Ruling No. 239-14 BIR Ruling No. 471-18
OT- 0659-2020
DEC 09 2020

DEPARTMENT OF FINANCE
BUREAU OF LOCAL GOVERNMENT FINANCE
8th Floor, EDPC Building, BSP Complex
Roxas Boulevard, 1004 Manila

Attention: **Mr. Niño Raymond B. Alvina**
Executive Director

Gentlemen:

This refers to your letter dated September 24, 2020, requesting for clarification regarding the imposition of income tax on local government units (LGUs) engaged in the operation of local economic enterprises, pursuant to Section 22(d) of Republic Act (RA) No. 7160 or the Local Government Code (LGC) of 1991.

Background:

The Municipal Mayor of the Municipality of Baao, Camarines Sur, relayed in his letter addressed to the Bureau of Local Government Finance of the Department of Finance dated February 10, 2020 that the BIR Revenue District Office (RDO) No. 66, Iriga City, requested for the payment of income taxes from the market rental fees being paid to the said LGU in view of the alleged proprietary business operated by the Municipality of Baao. The OIC-Revenue District Officer of RDO No. 66 expressed in her letter to the Municipal Mayor of Baao dated December 26, 2019 that the tax exemption privilege granted to LGUs only include the income derived from public utilities or from the exercise of any essential government function accruing to the government by virtue of Section 32 (B)(7) of the National Internal Revenue Code (NIRC) of 1997, as amended, thus, the liability of the said municipality to pay the taxes due from its proprietary functions.

In reply, please be informed that Section 27(C) of the NIRC, as amended by Republic Act (R.A.) No. 10963, provides:

"**SEC. 27. Rates of Income Tax on Domestic Corporations. —**

xxx xxx xxx

(C) Government-owned or Controlled Corporations, Agencies or Instrumentalities. — The provisions of existing special or general laws to the contrary notwithstanding, all corporations, agencies, or instrumentalities owned or controlled by the Government, except the Government Service Insurance System (GSIS), the Social Security System (SSS), the Philippine Health Insurance

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Corporation (PHIC), and the local water districts shall pay such rate of tax upon their taxable income as are imposed by this Section upon corporations or associations engaged in a similar business, industry, or activity."

On the other hand, Section 32 (B) (7) (b) of the NIRC, as amended, likewise provides, viz.:

"**SEC. 32. Gross Income. —**

xxx xxx xxx

(B) Exclusions from Gross Income. — The following items shall not be included in gross income and shall be exempt from taxation under this Title:

xxx xxx xxx

(7) Miscellaneous Items.

(b) Income Derived by the Government or its Political Subdivisions. — Income derived from any public utility or from the exercise of any essential governmental function accruing to the Government of the Philippines or to any political subdivision thereof."

Under Sec. 27(C) of the NIRC, government-owned or controlled corporations, agencies or instrumentalities of the government are no longer exempt from taxation and shall be liable to pay such rate of tax upon their taxable income as are imposed upon corporations or associations engaged in similar business, industry or activity, except the GSIS, SSS, PHIC, and Local Water Districts. While on the other hand, Section 32 (B) (7) (b) of the NIRC, as amended, excludes from the gross income and exempts from income tax, the income derived from the discharge of any essential governmental functions accruing to the Government of the Philippines or to any of its political subdivisions. It is necessary then to determine whether or not the income from market rental fees received by the Municipality of Baao, Camarines Sur was derived in the performance of its essential governmental function.

There is no hard and fast rule for purposes of determining the true nature of an undertaking or function of a provincial, city, or a municipal corporation (LGUs). The surrounding circumstances of a particular case are to be considered and would be decisive. "The basic element, however beneficial to the public the undertaking may be, is that it is governmental in essence, otherwise, the function becomes private or proprietary in character" *(Torio vs. Fontanilla, 85 SCRA 602 (1978))*. It has been established though that an instrumentality of the government which acts for the purpose of accomplishing government policies and objectives and extending essential services to the people performs governmental and not proprietary functions *(Peoples' Homesite and Housing Corporation vs. Court of Industrial Relations, 150 SCRA 296, 310 (1987)) (BIR Ruling No. 369-11 dated October 5, 2011)*

In *Angat River Irrigation System, et al. vs. Angat River Workers' Union, et al., 102 Phil. 789, 796-797 (1957)*, the Supreme Court made a distinction between acts in the performance of a government function and those in the performance of a corporate or proprietary function and held that:

"As ordinarily constituted, municipal corporations (and this may be said of the National Government) have dual character, the one governmental, legislative, or public; the other, proprietary or private. In their public capacity, a responsibility exists in the performance of acts for the public benefit, and in this respect, they are merely a part of the machinery of government of the sovereignty creating them, and

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the authority of the state is supreme. But in their PROPRIETARY or private character their powers are supposed to be conferred not from considerations of state, but for the private advantage of the particular corporation as a distinct legal personality (Bouvier's Law Dictionary, 3rd revision, vol. II, p. 2270).

In its governmental or public character, the corporation is made by the state one of its instruments, or the local depository of certain limited and prescribed political powers, to be exercised for the public good in behalf of the state rather than for itself. But in its proprietary or private character, the theory is that the powers were supposed not to be conferred primarily or chiefly from considerations connected with the government of the state at large, but for the private advantage of the compact community which is incorporated as a distinct legal personality or corporate individual; and as to such powers, and to property acquired and contracts made thereunder, the corporation is frequently regarded as having the rights and obligations of a private rather than those of a public corporation. *(Trenton vs. New Jersey, 262 US 182, 67 L Ed. 937, 29 ALR 1471)*

The governmental functions of a municipal corporation or a local government unit are those conferred or imposed upon it as a local agency, to be exercised not only in the interest of its inhabitants, but also in the advancement of the public good and welfare as affecting the public generally *(37 Am. Jur. 727)*.

The distinction between acts in the performance of a governmental function and those in the performance of a corporate or proprietary function is that in the case of the former, the municipal corporation is executing a legislative mandate with respect to a public duty generally, while in the other, it is exercising its private rights as a corporate body. *(Loeb vs. Jacksonville, 101 Fla. 429, 69 ALR 459)*"

Furthermore, RR No. 18-2012 dated December 28, 2012 defines government proprietary function, as follows:

> "x x x when a public corporation or a local government unit acts in its proprietary character, it is regarded as having the rights and obligations of a private corporation. For government entities to be taxable, the following requisites must concur: <u>(1) the government entity concerned must not be performing an essential governmental function; and (2) it must be engaged in similar business, industry, or activity as performed by other ordinary taxable corporations</u>. All income realized from or received in the exercise of its proprietary functions shall be subject to income tax and business taxes in the same manner as other private corporations similarly situated. All income realized from or received in the exercise of its proprietary functions shall be subject to income tax and business taxes in the same manner as other private corporations similarly situated." (Underscoring supplied)

In *BIR Ruling No. 369-11 dated October 5, 2011*, it has been established that provincial, city and municipal governments are liable to income tax in the performance of their corporate or proprietary functions since the tax exemption privileges, including preferential tax treatment of all government units, *i.e.*, the National Government, its agencies and political subdivisions, as well as government-owned or controlled corporations were withdrawn by Presidential Decree (PD) No. 1931 (1984) and Executive Order No. 93 (1987).

It is to be noted that governmental functions are those pertaining to the administration of government, and as such, are treated as absolute obligation on the part of the state to perform, while proprietary functions are those that are undertaken only by way of advancing the general interest of society, and merely optional on the government.

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From the foregoing, this Office is of the opinion that the Municipality of Baao, Camarines Sur, in leasing out its property (market spaces) and receiving rental fees thereof, acted in its proprietary or private character since no governmental or public policy of the state was involved. As a corporation, the Municipality of Baao, Camarines Sur enjoys full autonomy in the exercise of its economic enterprises, subject to the limitations provided in the Local Government Code of 1991 and other applicable laws *(Local Government Code, Sec. 22 (d))*. When a public corporation or a local government unit acts in its proprietary character, it is regarded as having the rights and obligations of a private corporation. Therefore, the income from market rental fees will not fall under the exclusions from gross income under Section 32(B)(7) of the NIRC, as amended, and shall be subject to income tax in the same manner as other private corporations similarly situated *(Sison vs. Ancheta, 130 SCRA 654, 664 (1984)). (BIR Ruling Nos. 239-2014 dated June 25, 2014 and 471-2018 dated March 13, 2018)*

Time and again, this Office has established that provincial, city and municipal governments are liable for income tax in the performance of their corporate or proprietary functions because the tax exemption privileges, including preferential tax treatment of all government units, *i.e.*, the National Government, its agencies and political subdivisions as well as government-owned or controlled corporations, were withdrawn by Presidential Decree No. 1931 (1984) and Executive Order No. 93 (1987). There is no reason to depart from these rulings. *(BIR Ruling No. 369-2011 dated October 5, 2011)*

Finally, the Municipality of Baao, Camarines Sur shall apply for an Authority to Print (ATP) in the printing of their receipts or invoices and pay the Annual Registration Fee, pursuant to Sections 238 and 236, respectively, of the NIRC, as amended, and implemented by RR No. 18-2012 dated October 22, 2012.

Please be guided accordingly.

Very truly yours,

CAESAR R. DULAY
Commissioner of Internal Revenue

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