REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF FINANCE
BUREAU OF INTERNAL REVENUE

Quezon City

Section 119 of NIRC of 1997	PD 198	RR 16-05

Person to Contact: Chief, Law Division
Tel Nos. 926-55-36 / 927-09-63
#455-2017
9-25-2017

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Attention: Sylvette Y. Tankiang
Juanito L. Sañosa, Jr.
Kristin Charisse C. Siao
Joseph James K. Joaquino, Jr.

Gentlemen:

This refers to your letter dated January 8, 2016, requesting on behalf of your client, Metro Agoo Waterworks, Inc. ("MAWI", for brevity), for confirmation of your opinion that MAWI is not subject to two percent (2%) franchise tax on its gross receipts from water business but is subject to the 12% value-added tax (VAT).

It is represented that MAWI, with Tax Identification No.   , is a domestic corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines; that MAWI is a holder of a provincial franchise to Construct, Install, Operate and Maintain a Water Supply and Sewerage System in Agoo, Tubao and other Waterless Municipalities in the Second District of the Province of La Union granted under Ordinance No. 031-2012 issued by the provincial government of La Union ("Franchise", for brevity); and that the Franchise authorizes MAWI:

> "(a) To invest, acquire, own, lease, hold, sell, transfer, construct, develop, expand, modernize, administer, operate and maintain water-related and sewage-related assets including but not limited to water mains, tunnels, aqueducts, purification plants, pumping stations, pipes, conduits, reservoirs or dams, machineries and other waterworks on land owned or acquired or obtained by the grantee (MAWI) for said purposes;
>
> (b) To supply, sell, furnish such water to any person, corporation, or public or private concerns within the limits of the province of La Union, and to charge and collect a schedule for the use of said water, which schedule of prices and rates shall at all times be subject to regulation by

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the NWRB (National Water Resources Board), or any other government agency concerned thereon;

(c) To construct, develop, operate, maintain and provide bulk water supply services within the province of La Union and to charge and collect a schedule of prices and conventional rates for the availment of such services;

(d) To construct, maintain and operate such systems of sanitary sewers as may be necessary for the proper sanitation of the province of La Union, and to charge and collect a schedule of fees which shall at all times be subject to regulation by the government entity in charge of this activity;

(e) To purify the sources of water supply, the reservoirs and the dams, subject to the approval of the Department of Health and/or any other government agency concerned thereon, and to regulate the control and use, and prevent waste of water; and

(f) To construct, develop, maintain and operate such artesian wells and springs as may be needed in its operation within the province of La Union;"

On the basis of the foregoing representations, you now request for legal opinion on whether the gross receipts of MAWI is not subject to the 2% franchise tax imposed by Section 119 of the National Internal Revenue Code of 1997 ("NIRC"), as amended, but to the 12% VAT.

In reply, please be informed that Section 108 of the NIRC imposes 12% VAT on the gross receipts derived from the sale or exchange of services, including the use or lease of properties. The 12% VAT on sale of services applies to services of franchise grantees not covered by Section 119 of the NIRC, in accordance with Sections 4.108-2(14) and 4.108-3(h) of Revenue Regulations (RR) No. 16-05, as amended, to wit:

> *"SECTION 4.108-2. Meaning of "Sale or Exchange of Services". — The term "sale or exchange of services" means the performance of all kind of services in the Philippines for others for a fee, remuneration or consideration, whether in kind or in cash, including those performed or rendered by the following:*
>
> *xxx xxx xxxx"*
>
> *"14) franchise grantees of electric utilities, telephone and telegraph, radio and/or television broadcasting and all other franchise grantees, except franchise grantees of radio and/or television broadcasting whose annual gross receipts of the preceding year do not exceed Ten Million Pesos (P10,000,000.00), and franchise grantees of gas and water utilities;"*

> *"SECTION 4.108-3. Definitions and Specific Rules on Selected Services. —*
>
> *xxx xxx xxxx*
>
> *(h) Services of franchise grantees of telephone and telegraph, radio and/or television broadcasting, toll road operations and all other franchise grantees, except gas and water utilities, shall be subject to VAT in lieu of franchise tax, pursuant to Sec. 20 of RA No. 7716, as amended. However, franchise grantees of radio and/or television broadcasting whose annual gross receipts of the preceding year do not exceed Ten Million Pesos (P10,000,000.00) shall not be subject to VAT, but to the three percent (3%) franchise tax imposed under Sec. 119 of the Tax Code, subject to the optional registration provisions under Sec. 9.236-1(c) hereof.*
>
> *Likewise, franchise grantees of gas and water utilities shall be subject to two percent (2%) franchise tax on their gross receipts derived from the business **covered by the law granting the franchise** pursuant to Sec. 119 of the Tax Code.*
>
> *Gross receipts of all other franchisees, other than those covered by Sec. 119 of the Tax Code, regardless of how their franchises may have been granted, shall be subject to the 10% VAT imposed under Sec. 108 of the Tax Code. xxx"*

The determining factor of whether or not a water utility such as MAWI is subject to franchise tax under Section 119 of the NIRC is the governmental authority which granted its franchise. Section 119 of the NIRC requires that to be subject to the 2% franchise tax, gross receipts of a water utility must have been derived from business covered by the law granting the franchise. The said provision states:

> *"SECTION 119. Tax on Franchises. — Any provision of general or special law to the contrary notwithstanding, there shall be levied, assessed and collected in respect to all franchises on radio and/or television broadcasting companies whose annual gross receipts of the preceding year do not exceed Ten million pesos (P10,000,000), subject to Section 236 of this Code, a tax of three percent (3%) and on gas and water utilities, a tax of two percent (2%) on the gross receipts derived from the business covered by the **law granting the franchise**: Provided, however, That radio and television broadcasting companies referred to in this Section shall have an option to be registered as a value-added taxpayer and pay the tax due*

> *thereon: Provided, further, That once the option is exercised, said option shall be irrevocable."*

Clearly, the above provision refers to franchise tax imposed on the water utility business covered by a "law" granting the franchise. A law is national in character while an ordinance is a municipal regulation, which is local in character. A national law is a law that only Congress can pass while an ordinance is one that only legislative bodies of local governments, such as provinces, can pass.[1] In this case, MAWI's franchise was not granted by a law but by a provincial ordinance.

It is also noted that MAWI was not organized as a local water district ("LWD"). LWDs are considered Congressional franchisees, having been created pursuant to Section 6 of Presidential Decree (PD) 198, the source of authorization and power to form and maintain a local water district. Once formed, an LWD is subject to the provisions of PD 198 and not under the jurisdiction of any political subdivision.

An LWD is a water utility which is owned by the local government who transferred its water supply facilities to the LWD.[2] It is important to note that MAWI is not a LWD. It is a Local Water Utility ("LWU"), which is defined as "[a]ny district, city, municipality, province, investor-owned public utility or cooperative corporation which owns or operates a water system serving an urban center in the Philippines."[3] A LWU can be owned by a private corporation. As can be gleaned from the records, MAWI is a private corporation duly registered with the Securities and Exchange Regulations (SEC) with SEC Registration No. It is likewise shown that MAWI's franchise has been granted through a mere ordinance.

In view of the foregoing, we hold that MAWI is not subject to the franchise tax imposed under Section 119 of the NIRC, but it is subject to the 12% VAT under Section 108 of the same Code.

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be disclosed that the facts are different, then this ruling shall be considered null and void.

Very truly yours,

CAESAR R. DULAY
Commissioner of Internal Revenue

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1 Santiago v. COMELEC, G.R. No. 127325, 19 March 1997.
2 P.D. 198, Sec. 6.
3 P.D. 198, Sec. 3 (h)