REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

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DAVAO CITY WATER DISTRICT,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 7522

Members:

ACOSTA, *Chairperson*
BAUTISTA, and
CASANOVA, *JJ.*

Promulgated:

OCT 01 2009; 9:00am

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DECISION

BAUTISTA, *J.*:

The instant Petition for Review seeks the refund of the amount of **THIRTY ONE MILLION ONE HUNDRED NINETEEN THOUSAND FIVE HUNDRED FORTY SEVEN AND 21/100 PESOS (P31,119,547.21)**, allegedly representing franchise taxes paid by petitioner during taxable years 2000, 2001, 2002, 2005, and 2006.

Davao City Water District (Petitioner) is a government-owned and controlled corporation created and organized by virtue of Presidential Decree (P.D.) No. 198, as amended. Petitioner is primarily engaged in the production and supply of potable water to the constituents of Davao City since 1973 up to the present. It came into being through the passage of Davao City Ordinance No. 707 dated November 1, 1973, and

Davao City Council Resolution No. 1283 dated February 13, 1974. Petitioner's office is located at Kilometer 5, J.P. Laurel Avenue, Bajada, Davao City.[1]

Respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR) empowered to perform the duties of his office, including among others, the duty to decide, approve, and grant refunds or tax credits of erroneously or excessively paid taxes. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

Respondent issued Revenue Regulations No. 17-03 on March 21, 2003 and Revenue Regulations No. 6-01 on July 31, 2001, mandating the top 10,000 corporations and government agencies to withhold franchise tax and other taxes from public utilities. Pursuant to the said issuances, a customer withholding tax system emerged, whereby the top 10,000 corporations and government agencies are withholding the franchise tax equivalent to two percent (2%) of their water bills.[2]

On September 4, 2006, respondent received petitioner's "Petition"[3] dated August 28, 2006, demanding the refund of franchise taxes paid in the total amount of P31,132,989.59.

Respondent has yet to act upon the said Petition; thus, prompting petitioner to file the present Petition for Review on September 25, 2006.

In his Answer[4] filed on November 20, 2006, respondent interposed the following defenses:

"4. Petitioner must prove that it paid the franchise taxes so alleged;

5. Petitioner must prove that it is exempt from the franchise tax;

[1] Par. 1, Facts, Joint-Stipulation of Facts and Issues (JSFI), docket, p. 235
[2] Pars. 6 and 7, Facts, JSFI, docket, p. 236
[3] Annex "YYY", Petition for Review, docket, pp. 106-123
[4] Docket, pp. 175-182

6. Petitioner must show that it has complied with the provisions of Section 204 (C) and 229 of the 1997 Tax Code on the prescriptive period for claiming tax refund/credit;

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7. Petitioner's contention that Local Water Districts (LWDs) are not liable for the franchise tax has no leg to stand on. By applying to operate as LWDs under PD No. 198, petitioner in effect applied for a franchise. This is precisely the rationale of the law expressly providing LWDs exemption from franchise tax. This is stated in Section 45 the said law as follows:

> '**Section 45.** *Exemption from Taxes.* - A district shall (1) be exempt from paying income taxes, and (2) shall be exempt from the payment of (a) all National Government, local government and municipal taxes and fees, **including any franchise**, filing, recordation, license or permit fees or **taxes and fees,** charges or costs involved in any court of administrative proceeding in which it may be a party and (b) all duties and imposts on imported machinery, equipment and materials required for its operations.' (emphasis supplied)

It naturally follows that an exemption assumes the fact that absent such exemption, the person would be subject to the indicated tax. It would be ridiculous for the law to explicitly provide a franchise tax exemption to a person not ordinarily subject to the franchise tax. Otherwise stated, it would be absurd to exempt a person if he were not subject to the tax in the first place;

8. Furthermore, PD 198 also accords protection by providing that they be the only franchise established and operating within the district. In Section 46, the said law reads as follows:

> **Section 46.** *Exclusive Franchise.* – **No franchise shall be granted to any other person or agency for domestic water service within the district** or any portion thereof unless and except to the extent that the board of directors of said district consents thereto by resolution duly adopted.' (emphasis supplied)

It is obvious that the law assumes that the existing LWD is considered a franchisee when it states 'any other person or agency';

9. Subsequently, Republic Act No. 7109 was passed into law and made effective on August 13, 1991. Under the said law, the tax exemption privileges provided for LWDs, including franchise taxes, were declared to exist only for a limited period. Specifically, only for a period of five (5) years from the effectivity of the Act, or up to 13 August 1996;

10. Upon the expiration of the said five year period, LWDs such as petitioner, became liable for the franchise tax under Section 119 of the 1997 Tax Code which taxes water utilities as follows:

> '**Sec. 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 does not exceed Ten million pesos (P10,000.00), subject to Section 236 of this Code, a tax of three percent (3%) and on electric, 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, it shall not be revoked.' (emphasis supplied)

11. The law is very clear and categorical. It declares water utilities subject to the franchise tax. Thus all the other arguments of petitioner that the said law imposes the tax only on private corporations, or that it is a 'Government Instrumentality', or that there is the matter of economics to be considered, or that they are part of 'Government', are all self-serving arguments which are not in the law. Not even a hint of these arguments can be derived from the clear and concise provision.

12. Finally, while petitioner is correct that there is a legal maxim that grants a measure of liberality in construing exemptions in favor of government agencies and instrumentalities, there is no license to apply such principle indiscriminately. First this is the necessity of a law granting an exemption from the tax and there is a conflict in interpretation either strictly against, or liberally in favor of the government instrumentality. This circumstance is unavailing here. What is present is a law clearly imposing the franchise tax on water utilities without any qualifications;

13. Second, the said legal maxim is only applicable in cases where the only effect is the reduction of intra-government fund transfers. There are no exchange or transfers funds herein. Petitioner is a self-sufficient, profitable corporation which does not remit funds or dividends to the Government or vice-versa. The fact that it is a claim for refund produces the only practical effect of a liberal construction, that is, the reduction of revenues to the Government. This is prohibited. Therefore, the legal principle cited by petitioner is inapplicable herein. As enshrined in jurisprudence:

> 'True, it is a recognized principle that the rule on *strictissimi juris* does not apply in the case of exemptions in favor of a government political subdivision or instrumentality, the rationale for which has been identified as follows:
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> 'The basis for applying the rule of strict construction to statutory provisions granting tax exemptions or deductions, even more obvious than with reference to the affirmative or levying provisions of tax statutes, is to minimize differential treatment and foster impartiality, fairness, and equality of treatment among tax payers.
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> ***The reason for the rule does not apply in the case of exemptions running to the benefit of the government itself or its agencies. In such case the practical effect of an exemption is merely to reduce the amount of money that has to be handled by government in the course of its operations. For these reasons, provisions granting exemptions to government agencies may be construed liberally, in favor of non tax liability of such agencies.'*** (Emphasis supplied; italics in the original)
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> However, the foregoing finds no application to the present case.
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> First, xxx
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> Second, as noted above, the liberal construction of tax exemptions in favor of the government is premised on their resulting only in a reduction in infra-governmental fund transfers, **but not government revenue**.[5]" (emphasis supplied)

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[5] John Hay vs. Lim, G.R. No. 119775, March 29, 2005

14. Furthermore, in an action for refund the burden of proof is on the taxpayer to establish its right to refund and failure to sustain the burden is fatal to the claim for refund/credit. This is because exemptions from taxation are highly disfavored in law and he who claims exemption must be able to justify his claim by the clearest grant of organic or statutory law. An exemption from the common burden cannot be permitted to exist upon vague implications (Asiatic Petroleum Co. {P.I.} v. Llanes, 49 Phil. 466 cited in Collector of internal Revenue v. manila Jockey Club, Inc. 98 Phil. 670);

15. Claims for refund are construed strictly against the claimant for the same partake the nature of exemption from taxation."

In the Additional Joint-Stipulation of Facts[6] dated November 17, 2007, the parties agreed to dispense with the presentation of witnesses and documentary evidence to prove the fact of petitioner's payment to respondent of its franchise taxes in the amount of P30,156,126.94, covering the years 2000, 2001, 2002, 2005, and 2006, as manifested in the following documents:

a. BIR Certification dated February 28, 2007 issued by Zenaida D. Ganata, OIC-Revenue Accounting Division of BIR Quezon City, attesting to petitioner's payment of P18,160,408.69 for years 2005 and 2006; and

b. BIR Certification dated March 7, 2007 issued by Dir. Marcelinda Omila-Yap, Regional Director of BIR Revenue Region No. 19, attesting to petitioner's tax payments in the amount of P11,995,718.25 covering the years 2000, 2001, and 2002.

After trial on the merits, the case was submitted for decision on October 7, 2008, taking into consideration petitioner's Memorandum posted on August 15, 2008, sans respondent's Memorandum.[7]

The parties stipulated the following issues[8] for this Court's resolution:

"1. Whether or not petitioner has paid the alleged amount of franchise tax sought to be refunded.

[6] Docket, pp. 290-291
[7] Docket, p. 398
[8] Docket, pp. 236-237

2. Whether or not the alleged franchise tax payments were erroneously made.

3. Whether or not petitioner is liable to franchise tax under Section 119 of the Tax Code.

4. Whether or not this action for refund has prescribed under Section 229 of the Tax Code."

The issue of whether or not petitioner is liable for franchise tax under Section 119 of the National Internal Revenue Code (NIRC) of 1997 shall be discussed first.

A "franchise", as defined in the case of **National Power Corporation vs. City of Cabanatuan**[9], is a privilege conferred by government authority, which does not belong to citizens of the country generally as a matter of common right. In its specific sense, a franchise may refer to:

1. General or primary franchise — relates to the right to exist as a corporation, by virtue of a duly approved articles of incorporation, or a charter pursuant to a special law creating the corporation. The right under a primary or general franchise is vested in individuals who compose the corporation and not in the corporation itself.

2. Special or secondary franchise — refers to the right or privileges conferred upon an existing corporation such as the right to use the streets of a municipality to lay pipes of tracks, erect poles or string wires. The rights under a secondary or special franchise are vested in the corporation and may ordinarily be conveyed or mortgaged under a general power granted to a corporation to dispose of its property, except such special or secondary franchises as are charged with a public use.

The latter is also the type of franchise where the franchise tax provided under Section 119 of the NIRC of 1997 is imposed and to which petitioner allegedly is liable. Section 119 of the NIRC of 1997 states as follows:

> "**SEC. 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

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[9] G.R. No. 149110, April 9, 2003

"SECTION 3. *Period and Conditions of Exemptions.* — **The tax exemption privileges provided for in Sections 1 and 2 to all water districts shall be enjoyed only for a period of five (5) years from the effectivity of this Act:** *Provided*, That the water districts shall adopt internal control reforms that would bring about their economic and financial viability: *Provided, further*, That, for a water district to be entitled to the tax exemption, its appropriation for personal services, as well as for travel, transportation or representation expenses and purchase of motor vehicles, shall not be increased by more than twenty-five percent (25%) a year during the period of exemption." (*Emphasis supplied*)

The said law was approved and took effect on August 14, 1991. Counting five years from the effectivity of said Republic Act, local water districts, like herein petitioner, had until August 13, 1996 to enjoy their exemption from the taxes mentioned in Section 45 of P.D. No. 198. Thereafter, all LWDs became liable to income, franchise, and real property taxes, as well as duties and taxes on imported machinery, equipment and materials required for its operations.

The franchise tax imposed under Section 119 of the NIRC of 1997 is clearly applicable to local water districts created as water utilities; hence, petitioner's payment of franchise tax under Section 119 of the NIRC of 1997 was correct.

As to whether or not petitioner paid its franchise taxes to respondent, this issue had already been settled. The fact of said payments was already duly stipulated by the parties and attested to by officers of the BIR, as indicated in BIR Certifications dated February 28, 2007[11] and March 7, 2007[12]; stating petitioner's payments amounting to P18,160,408.69 and P11,995,718.25, respectively.

Since petitioner is liable for franchise tax under Section 119 of the NIRC of 1997, then its payments to respondent were not erroneously made. Consequently, its claim

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[11] Annex "AAAA", Additional Joint-Stipulation of Facts, docket, pp. 292-293
[12] Annex "BBBB", Additional Joint-Stipulation of Facts, docket, p. 294

> preceding year does not exceed Ten million pesos (P10,000,000), subject to Section 236 of this Code, a tax of three percent (3%) and on electric, 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, it shall not be revoked.
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> The grantee shall file the return with, and pay the tax due thereon to the Commissioner or his duly authorized representative, in accordance with the provisions of Section 128 of this Code, and the return shall be subject to audit by the Bureau of Internal Revenue, any provision of any existing law to the contrary notwithstanding."

Petitioner argues that it is not among those water utilities mentioned in Section 119 of the NIRC of 1997 that are liable to pay franchise tax. Petitioner supports this argument by stating that it is a government-owned or controlled corporation (GOCC), and the imposition of franchise tax was intended for private persons or corporations who were granted a franchise (*i.e.*, a right or a privilege affecting public interest). Since petitioner is a GOCC and it forms part of the government, then it should not be held liable for a franchise tax under Section 119 of the NIRC of 1997.

Respondent counters that the law specifically subjects water utility companies, such as herein petitioner, to franchise tax. The benefit of exemption to all taxes, provided for in Section 45 of P.D. No. 198, granted to local water utilities was for a limited period only due to the passage of Republic Act (R.A.) No. 7109; which effectively limited the exemption only for a period of five years or until August 13, 1996.

The Court agrees with respondent.

The Supreme Court explained the nature or legal personality of local water districts (LWDs), such as herein petitioner, in the case of **Feliciano vs. Commission on Audit, *et al.***[10] in the following manner:

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[10] G.R. No. 147402, January 14, 2004

"LWDs exist by virtue of PD 198, which constitutes their special charter. Since under the Constitution only government-owned or controlled corporations may have special charters, LWDs can validly exist only if they are government-owned or controlled. To claim that LWDs are private corporations with a special charter is to admit that their existence is constitutionally infirm.

Unlike private corporations, which derive their legal existence and power from the Corporation Code, LWDs derive their legal existence and power from PD 198. xxx

Clearly, LWDs exist as corporations only by virtue of PD 198, which **expressly confers on LWDs corporate powers**. Section 6 of PD 198 provides that LWDs 'shall exercise the powers, rights and privileges given to private corporations under existing laws.' Without PD 198, LWDs would have no corporate powers. Thus, PD 198 constitutes the special enabling charter of LWDs. The ineluctable conclusion is that LWDs are government-owned and controlled corporations with a special charter."

P.D. No. 198, as mentioned above, granted LWDs, like herein petitioner, the franchise to operate as a water utility and the corresponding tax exemption privileges, to wit:

"**Section 45.** *Exemption from Taxes.* - A district shall (1) be exempt from paying income taxes, and (2) shall be exempt from the payment of (a) all National Government, local government and municipal taxes and fees, including **any franchise**, filing, recordation, license or permit fees or taxes and fees, charges or costs involved in any court of administrative proceeding in which it may be a party and (b) all duties and imposts on imported machinery, equipment and materials required for its operations." (*Emphasis supplied*)

Based on the foregoing, LWDs are exempted from the following taxes: (1) income taxes; (2) all National Government, local government, and municipal taxes and fees; and (3) all duties and imposts on imported machinery, equipment and materials required for its operations.

After the passage of R.A. No. 7109, otherwise known as "An Act Granting Tax Exemption Privileges to Local Water Districts," such tax exemption privileges however were limited for a period of five years, thus:

for refund cannot be granted. Accordingly, the resolution of the other issues is no longer necessary.

WHEREFORE, premises considered, the instant Petition for Review is hereby **DENIED** for lack of merit.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

ERNESTO D. ACOSTA
Presiding Justice
Chairperson, First Division