REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

CITY OF ZAMBOANGA, represented
by HON. JOAQUIN F. ENRIQUEZ,
Jr., Mayor, City of Zamboanga,
Petitioner,

- versus - C.T.A. CASE No. 2192

THE COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

x- - - - - - - - - - - - - - - - -x

June 11/73

D E C I S I O N

This is an appeal of petitioner City of Zamboanga from a decision of respondent Commissioner of Internal Revenue, dated July 6, 1970, holding the former liable for percentage and fixed taxes for the period from May 16, 1965 to June 30, 1969.

It appears that petitioner is a municipal corporation created under Commonwealth Act No. 39, otherwise known as the Charter of the City of Zamboanga. Among the powers and duties granted by said Charter to its City Council is -

> To provide for the maintenance of waterworks for the purpose of supplying water to the inhabitants of the city, and for the purification of the source of supply and the places through which the same passes, and to regulate the consumption and use of the water; to fix and provide for the collection of rents or fees therefor; and to regulate the construction, repair, and use of hydrants, pumps, cisterns, and reservoirs.

Sometime in October, 1969, the Zamboanga City Waterworks System, which was owned and operated by petitioner, was assessed by the Bureau of Internal Revenue for percentage and fixed taxes for the period from May 16, 1965 to June 30, 1969, computed as follows:

Gross receipts from sales of water from May 16, 1965 to June 30, 1969	₱930,376.03
3% tax due thereon	₱ 27,911.28
25% surcharge - late payment ..	6,977.82
Total percentage taxes & penalties	₱ 34,889.10

Fixed taxes:	
1965	₱ 20.00
1966	20.00
1967	20.00
1968	20.00
1969 (Jan. 1 - June 30)	10.00
Total fixed taxes due	₱ 90.00

The assessment was protested by petitioner thru the Mayor of Zamboanga City on the ground, among others, that the operation of the Zamboanga City Waterworks System was in compliance with its governmental function of supplying water to its inhabitants and to prevent fire, and that the fact that it derived income therefrom should not be taken as basis for determining the character of the waterworks. On July 6, 1970, petitioner's protest was denied by respondent Commissioner of Internal Revenue. Hence, this appeal.

The sole issue presented for determination is whether or not petitioner City of Zamboanga is liable for the fixed and percentage taxes in question.

Respondent urges that a municipal corporation, like the City of Zamboanga, has a two-fold character, one of which is public or governmental and the other, private or proprietary. In its governmental or public character, a municipal corporation acts as a political subdivision of the state for the purpose of performing governmental functions and is not subject to tax, but in its private or proprietary capacity, it is endowed with the attributes and distinctive legal rights of a private corporation, hence subject to tax. Petitioner's waterworks system which collects fees from the inhabitants for its use falls under the proprietary functions of a municipal corporation and is thus subject to the fixed and percentages taxes in question since the City's charter does not provide for a tax exemption.

Respondent further urges that at any rate Section 1 of Republic Act No. 104 provides that -

> All corporations, agencies or instrumentalities owned or controlled by the Government shall pay such duties, taxes, fees and other charges upon their transaction, business, industry, sale or income as are imposed by law upon individuals, associations or corporations engaged in any taxable business, industry, or activity, x x x

and petitioner is liable for the tax in question under said law.

Petitioner, on the other hand, contends that the operation of its waterworks system is provided by its charter and although the charter does not provide for a tax exemption for the percentage and fixed taxes in question, the exemption arises from the mere fact that the same is partly designed for protection against fire which is a governmental function.

We can not agree with respondent that petitioner is subject to tax under Republic Act No. 104. This law was intended by Congress to apply to corporations or agencies owned or controlled by the Government to promote certain aspects of the economic life of our people and are thus engaged in business or industry for profit in competition with private enterprises; they perform no governmental function. The law was not meant to cover agencies and instrumentalities through which the functions of government are exercised as an attribute of sovereignty, like municipal corporations. These entities are not merely agencies owned or controlled by the Government; they are part and parcel of the Government. As aptly said in Opinion No. 67, s. 1948, of the Secretary of Justice:

> Republic Act No. 104 was intended by Congress to apply to corporations or agencies owned or controlled by the Government engaged in business or industry for profit in competition with private enterprises. The Explanatory

Note to Bill No. 817, which became Republic Act No. 104, after noting that "under existing laws corporations owned or controlled by the government, like the National Development Company, the National Trading Corporation, the National Coconut Corporation, the National Cooperatives Administration and other instrumentalities of the government to promote certain economic objectives are exempt from the payment of internal revenue taxes and customs duties," declares that "it is the right of the public to know whether these corporations are efficiently and economically operated and the only way to gauge their activities is to require them to pay taxes."

The exemption in favor of the corporations, continues the Explanatory Note, has placed "business and industries operated by private concerns and individuals which pay taxes and duties at an entirely disadvantageous position. For this reason, the attached bill seeks to levy on all government-owned or controlled corporations the same taxes, duties, fees and charges that are paid by private individuals and concerns.

That only corporations or agencies owned or controlled by the Government engaged in business or industry for profit were intended to be covered by Republic Act No. 104 is likewise shown by records of the proceedings of the Congress of the Philippines. Representative Formilleza, who sponsored the bill, explained on the floor of the House of Representatives that "the purpose [of the bill] is to require these government owned or controlled corporations to reduce their expenditures to recover the taxes that are lost to the Government as a result of this tax immunity in favor of these government-owned corporations; and third, in order to place them on an equal footing, on a level with private initiative in order not to discourage entirely private initiative by giving exemption to government enterprises."

The liability of petitioner for the tax in question rests on grounds other than the provision of Republic Act No. 104.

Municipal corporations in the Philippines have both governmental and corporate or business functions (Mendoza vs. De Leon, et al., 33 Phil. 508). The rule of taxation, recognizing this dual character or two-fold functions of municipal corporations, exempts them from taxes in their governmental functions but subjects them thereto in their corporate or business functions (United States vs. Baltimore & Ohio R. Co., 21 L. Ed. 597; South Carolina vs. United States, 50 L. Ed. 261). And good authorities are to the effect that the operation of a waterworks system for the purpose of supplying or furnishing water to the inhabitants of a city or municipality for a price or consideration or for domestic or commercial purposes, is a private or proprietary function of a municipal corporation; hence, subject to tax (Lehigh Valley R. Co. vs. Jersey City, 138 A. 467, 468; Eastern Illinois State Normal School vs. City of Charleston, 111 N. E. 573).

> Such contracts are not made by the municipal corporation by virtue of its powers of local sovereignty, but in its capacity of a private corporation. The supply of gaslight is no more a duty of sovereignty than the supply of water. Both these objects may be accomplished through the agency of individuals or private

corporations, and in very many instances they are accomplished by those means. If this power is granted to a borough or a city, it is a special private franchise, made as well for the private emolument and advantage of the city as for the public good. The whole investment is the private property of the city, as much so as the lands and houses belonging to it. Blending the two powers in one grant does not destroy the clear and well-settled distinction, and the process of separation is not rendered impossible by the confusion. In separating them, regard must be had to the object of the legislature in conferring them. If granted for public purposes exclusively, they belong to the corporate body in its public, political or municipal character. But if the grant was for purposes of private advantage and emolument, though the public may derive a common benefit therefrom, the corporation quoad hoc is to be regarded as a private company. It stands on the same footing as would any individual or body of persons upon whom the like special franchises had been conferred. (South Carolina vs. United States, supra.)

The appellees say it is not applicable to them because they are not persons engaged in the business of distributing, supplying, furnishing, or selling water, gas, or electricity; that their business is that of government and that the sale of water, gas, or electricity is but incidental thereto; further, that "business" ordinarily means a trade or occupation carried on for profit, while the sale of water, gas, or electricity by them is neither attended with profits nor conducted for that purpose, and that they act in such sales in their governmental and not proprietary capacity.

The use of the term "person" in statutory enactments has been held to include municipalities . . . We are unable to

> concur in the argument of the appellees that cities selling water, gas, or electricity for private consumption cannot be said to be engaged in the business of such selling. A municipal corporation selling gas, water, or electricity for private consumption does so in its proprietary rather than governmental capacity. Such is in nowise to be considered the exercise of sovereignty. No distinction is to be drawn between such business of selling when indulged by a municipality and when engaged in by a private corporation. x x x.
>
> Municipalities are created primarily for the exercise of such powers of sovereignty as the General Assembly bestow upon them, and the production of water, gas, or electricity for all municipal purposes is within the scope of governmental function, but when a municipality goes into the business of furnishing water for sale through contracts made between it and the consumer, which contract the consumer has an option to make or not, as he pleases, such municipality does so not in the capacity of sovereignty but in a private capacity. x x x. (Chicago vs. Ames, 109 A. L. R. 1509; citing Ohio vs. Helvering, 78 L. Ed. 1307.)

For the taxability of municipal corporations in its corporate or business function, it makes no difference then if the tax statutes do not specify municipal corporations as taxable; if a municipal corporation is not exempted, either expressly or impliedly, the same will be treated as a private person, individual or corporation subject to tax (Chicago vs. Ames, <u>supra</u>).

We note that Section 29(b)(7)(B) of the National Internal Revenue Code expressly exempts from income tax "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" while on the other hand the same code offers no exemption to said entities with respect to the percentage tax in question. Neither is there any grant of exemption in the charter of the petitioner and our attention has not been called to any such grant elsewhere.

That petitioner's waterworks system is also used for protection against fire, which is concededly a governmental function, can in nowise affect the result of this appeal. The production of water for all municipal purposes is within the scope of governmental function, but when a municipality goes further and enters in the business of furnishing water to the general public for a fee, such municipality does so not in the exercise of sovereignty but in a private capacity. The business of selling to private consumers is not less a business conducted at a profit just because of the fact that the city applies such profit to defray what would otherwise be a cost of government in securing the city's needed water (Chicago vs. Ames, *supra*). Taxwise, the blending of governmental and private functions in petitioner's waterworks system does not render inoperative the consequences of the distinctive nature of each function (South Carolina vs. United States, *supra*).

WHEREFORE, the appealed decision is hereby affirmed, without pronouncement as to costs.

SO ORDERED.

Quezon City, June 11, 1973.

RAMON L. AVANCEÑA
Associate Judge

WE CONCUR:

ROMAN M. UMALI
Presiding Judge

ESTANISLAO R. ALVAREZ
Associate Judge