REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

FIRST DIVISION

THE PROVINCIAL TREASURER OF LEYTE (formerly represented by LORETO BALLAIS and presently by RODOLFO P. BADIABLE, ICO-Provincial Treasurer),
Petitioner-Appellee,

- versus -

NATIONAL POWER CORPORATION
Respondent-Appellant.

CTA AC No. 64
(Civil Case No. 2005-11-124, Regional Trial Court, 8th Judicial Region, Branch 6, Tacloban City, Leyte)

Members:

ACOSTA, *Chairperson*
UY, *and*
FABON-VICTORINO, *JJ.*

Promulgated:
OCT 11 2011 ; 3:38 pm

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DECISION

UY, J.:

This is an appeal pursuant to Section 7(a)(3) of Republic Act (R.A.) No. 9282 in relation to Rule 42 of the 1997 Rules on Civil Procedure[1] assailing the Decision of the Regional Trial Court (RTC), Branch 6, 8th Judicial Region, Tacloban City dated December 21, 2009 in Civil Case No. 2005-11-124 entitled "*National Power Corporation, Appellant, vs. The Provincial Treasurer of Leyte, rep. by Loreto Ballais, Appellee*". The dispositive portion of the assailed Decision reads:

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[1] Rule 8, Section 4 (a), Revised Rules of the Court of Tax Appeals which pertinently provides that: "An appeal from a decision or ruling x x x of the Regional Trial Court in the exercise of their original jurisdiction, shall be taken to the Court by filing before it a petition for review as provided in Rule 42 of the Rules of Court. The Court in Division shall act on the appeal."

"**WHEREFORE**, premises considered, Appellants' Appeal is hereby **GRANTED**.

The Letter/Decision of the Provincial Treasurer of Leyte, issued on September 19, 2005, is hereby declared **NULL** and **VOID**, and therefore, **SET ASIDE.**

The National Power Corporation is **NOT LIABLE** for the payment of Franchise Tax assessed under the Notice of Assessment and Demand for Payment, dated July 22, 2005, issued by the Provincial Treasurer of Leyte.

SO ORDERED."

THE FACTS

The significant factual antecedents as culled from the records of this case are as follows:

Petitioner-appellee, the Provincial Treasurer of Leyte (to be referred to as the Provincial Treasurer), is an officer of the Province of Leyte, a local government unit, and is responsible for the collection of the Province's local taxes, including but not limited to, franchise tax.

Respondent-appellant, National Power Corporation (to be referred to as NPC) is a government-owned and controlled corporation organized pursuant to Republic Act (R.A.) No. 6395, as amended, engaged in the generation and transmission of electricity. It maintains a geothermal power plant within the territorial jurisdiction of the Province of Leyte.

NPC received on July 19, 2005 a "Notice of Assessment and Demand for Payment" dated July 11, 2005[2] from the Provincial Treasurer . In the said Notice of Assessment, NPC was assessed for franchise tax in the amount of

[2] Annex "A", Docket, p. 78

P70,999,230.00, inclusive of surcharges and interest, covering the period from 2000 to 2004 for its operation of Tongonan Geothermal Power Plant. Petitioner sent another "Notice of Assessment and Demand for Payment" dated July 22, 2005[3], which NPC received on July 28, 2005, assessing and demanding payment of franchise tax in the amount P43,327,580.43 for the period of 2001 to 2004.

NPC refused to heed the demand of petitioner, arguing that it is exempt from franchise tax imposed under Section 137 of the Local Government Code (LGC) of 1991 since it is not enjoying a franchise in view of R.A. No. 9136, known as the Electric Power Industry Reform Act (EPIRA), which provides that a franchise is not required for any person or entity engaged in power generation and supply of electricity.

On September 15, 2005, the Provincial Treasurer issued the "2nd Notice of Assessment and Demand for Payment" reiterating its demand for immediate payment of the assessed franchise tax.[4] Subsequently, NPC was declared delinquent in the payment of the said franchise tax per "Certificate of Delinquency" dated November 10, 2005.[5]

On November 29, 2005, NPC filed an "Appeal (With Prayer for Issuance of Temporary Restraining Order/Preliminary Injunction)" before Branch 6, RTC of Tacloban City praying that: (1) A Temporary Restraining Order/Preliminary Injunction be issued enjoining the Provincial treasurer from seizing, levying or selling the Tongonan Geothermal Plant; (2) The decision of

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[3] Annex "D-1", Docket, p. 81
[4] Annex "F", Docket, p. 87
[5] Annex "G", Docket, pp. 89

the Provincial Treasurer of Leyte dated September 19, 2005 be NULLIFIED AND SET ASIDE; (3) Subsequently, NPC be declared NOT LIABLE for payment of Franchise Tax assessed under the Notice of Assessment and Demand for Payment dated July 22, 2005 from the period 2001 to 2004. [6]

In response to the summons issued by the RTC,[7] the Provincial Treasurer filed his Answer on April 28, 2006, praying for the dismissal of the appeal and that the Province of Leyte be declared as entitled to collect the local franchise tax.[8]

During the pre-trial conference held on November 9, 2007 at the RTC, the parties agreed that the issues involved are purely questions of law, and in view thereof, the court *a quo* directed the parties to submit their respective memorandum in support of the summary judgment.[9]

After the parties filed their respective Memorandum,[10] the RTC rendered the assailed Decision[11] on December 21, 2009, granting the appeal and declaring respondent not liable to pay the assessed franchise tax. It stated that the EPIRA clearly provides for the withdrawal of the requirement for the procurement of a franchise for NPC, and without a franchise, it cannot be held liable to pay the franchise tax. It likewise ruled that petitioner's reliance on *National Power Corporation vs. City of Cabanatuan*[12] *(Cabanatuan case)* is misplaced because that case was instituted before the enactment of

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[6] Docket, pp. 91-103.
[7] RTC Records, p. 27.
[8] RTC Records, pp. 45-64.
[9] RTC Records, p. 129.
[10] RTC Records, pp. 151 and 177.
[11] Docket, pp. 36-42; RTC Records, pp. 184-190.
[12] G.R. No. 149110, April 9, 2003.

the EPIRA. In that case, NPC still has a franchise, a government corporation, and a "power generating and distribution agency"; while in the appealed case, NPC is already divested of its franchise and had already been transformed into a mere power generating agency.

Aggrieved, the Provincial Treasurer filed the instant Petition for Review on March 8, 2010[13], ascribing the following errors allegedly committed by the court *a quo*:

> "1. With all due and insurmountable respect, the Regional Trial Court committed reversible error in holding that, because the National Power Corporation is no longer required to secure a franchise, it follows that it is no longer liable for the payment of franchise tax.
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> 2. With all due and insurmountable respect, the Regional Trial Court committed reversible error in holding that, the enactment of the EPIRA LAW makes the Cabanatuan Doctrine inapplicable in the issue of whether or not NPC is liable to pay franchise tax."

After NPC filed its Comment[14] on August 4, 2010, the Petition for Review was given due course in a Resolution[15] dated August 17, 2010. In the same Resolution, the Court ordered the parties to file their respective Memorandum.

The Provincial Treasurer posted a "Manifestation in Lieu of Memorandum" on November 2, 2010, manifesting that the instant Petition is comprehensive and inclusive of all the arguments to merit the grant of his prayer[16] (which was noted by this Court in the Order dated November 17,

[13] Docket, pp. 17-34.
[14] Docket, pp. 161-170.
[15] Docket, p. 174.
[16] Docket, pp. 195-198.

2010)[17], while respondent filed its "Memorandum" on November 18, 2010.[18] Thereafter, this case was submitted for decision on April 12, 2011.[19]

PETITIONER-APPELLEE'S ARGUMENTS

The Provincial Treasurer argues that NPC is a "business enjoying franchise" liable to franchise tax because it completely satisfies the requirements laid down in the *National Power Corporation v. City of Cabanatuan*[20] *(Cabanatuan case)*, namely, that it has a secondary or special franchise, and that it is exercising its rights or privileges under this franchise within the territory of the Province of Leyte. He contends that the ruling in the *Cabanatuan case* is applicable in view of the fact that the said ruling was reiterated in 2006 in the case of *National Power Corporation vs. Province of Isabela*[21] *(Isabela case)*, five years after the effectivity of the EPIRA. Accordingly, if the intention of the Supreme Court was to make the doctrine in the *Cabanatuan case* inapplicable by reason of the passage of the EPIRA, it should have been expressly done in the *Isabela case*.

He asserts that what is mentioned under the EPIRA is not a local franchise but a national franchise. These two kinds of franchises are separate and distinct from each other as the former is covered under the LGC. Reference is made to the records of the deliberations of the drafters of the LGC as bereft of any indication that the existence of a national franchise is

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[17] Docket, p. 200.
[18] Docket, pp. 201-213.
[19] Docket, p. 237.
[20] G.R. No. 149110, April 9, 2003
[21] G.R. No. 165827, June 16, 2006.

intended to be made a condition *sine qua non* for the applicability of local franchise tax. It is his opinion that the local franchise tax can be collected independent of the existence of a national franchise.

Allegedly, the EPIRA simply provides that "power generation shall not be considered a public utility" and that "any person or entity engaged in power generation" shall not be required to secure a national franchise, and that it does not provide that any one of the four sectors of the electric power industry, namely: generation, transmission, distribution, and supply, is exempt or not liable from the payment of local franchise tax. Allegedly, any doubt as to the liability to pay franchise tax should be resolved in favor of the local government unit as mandated in Section 5(a) of the LGC and pursuant to the direct-authority principle stated in the Constitution.

Finally, the Provincial Treasurer stresses the rule that tax exemptions are highly disfavored and construed *strictissimi juris* against the taxpayer and liberally in favor of the taxing power, and that the burden of proof rests upon the party claiming exemption.

RESPONDENT-APPELLANT'S COUNTER-ARGUMENTS

NPC counter-argues that franchise tax may only be imposed on a "business enjoying a franchise" and considering that under the EPIRA its transmission function has been transferred to the National Transmission Corporation (TRANSCO) and it is now transformed into a mere power generation company which is not required to secure a franchise, it is not liable to pay franchise tax.

NPC points out that the rulings in the *Cabanatuan and Isabela cases* cannot be applied in the instant case because those cases involve franchise taxes which became due to the local government unit concerned prior to the effectivity of the EPIRA; and that the issue of exemption from payment of franchise tax under the EPIRA was not discussed in the said cases of *Cabanatuan and Isabela*. Lastly, NPC asserts that while taxes are the lifeblood of the government, the imposition thereof must not be done arbitrarily and that a taxpayer should not be rendered helpless in the face of an apparent illegal act.

THE ISSUE

> "Whether or not respondent is liable to pay the assessed franchise tax imposed under Section 137 of the LGC by virtue of the effectivity of the EPIRA."

THE COURT'S RULING

The power of the province to impose a franchise tax is sanctioned by Section 137 of the LGC, which provides:

> "SECTION 137. *Franchise Tax.* — Notwithstanding any exemption granted by any law or other special law, the province may impose a tax on businesses enjoying a franchise, at the rate not exceeding fifty percent (50%) of one percent (1%) of the gross annual receipts for the preceding calendar year based on the incoming receipt, or realized, within its territorial jurisdiction."

Based from the foregoing provision of the LGC, a province may impose a franchise tax on "business enjoying a franchise", as correctly argued by respondent. In line with this, it is settled that a taxpayer may be covered by this imposition when the two requisites are present:

(1) [it] has a "franchise" in the sense of a secondary or special franchise; and

(2) it is exercising its rights or privileges under this franchise within the territory of the local government concerned.[22]

As stated earlier, the Provincial Treasurer believes that the foregoing requisites are present in this case; hence, NPC is liable to pay the assessed franchise tax. The appealed Decision of the court *a quo*, however, ruled that NPC is not liable for franchise tax because the EPIRA clearly provides for the withdrawal of the requirement for the procurement of a franchise for NPC, and without a franchise, it cannot be held liable to pay the franchise tax. The court *a quo*, therefore, has sustained the stand of NPC that under the EPIRA, it is now transformed into a mere power generation company not required to secure a franchise because its transmission function was already transferred to TRANSCO.

The court *a quo* failed to consider the fact that the EPIRA took effect only on June 26, 2001. It likewise failed to observe that under paragraph 2 of Section 8 of the EPIRA, it is provided that the transmission and subtransmission facilities of NPC and all other assets related to transmission operations, including the nationwide franchise of NPC for the operation of the transmission system and the grid shall be transferred to TRANSCO within six (6) months from the effectivity of the said law. Certainly, NPC not only performed its generation function in the year 2001 (which period is also being assessed of franchise tax), but also its transmission function since the transfer

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[22] *National Power Corporation vs. The Provincial Government of Bukidnon and Luis L. Oro, in his capacity as Provincial Treasurer of Bukidnon*, CTA AC No. 57, August 10, 2010 and Amended Decision dated December 13, 2010.

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of its transmission facilities to TRANSCO happened only in the latter part of the year, at the time of the effectivity of the EPIRA.

It must be noted that even during the effectivity of the EPIRA, NPC may still be held liable for the assessed franchise tax covering the period from 2002 to 2004 because it cannot be considered as exclusively operating as a generation company.

In the case of *National Power Corporation vs. The Provincial Government of Bukidnon and Luis L. Oro*, in his capacity as Provincial Treasurer of Bukidnon[23], the Court of Tax Appeals' Special Second Division had an occasion to make the following extensive discussion:

> "We look into the pertinent provisions of RA No. 9136, to wit:
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> '**Section 5. Organization**. – The electric power industry shall be divided into four (4) sectors, namely: generation; transmission; distribution and supply.'
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> '**Section 6. Generation Sector**. – Generation of electric power shall be competitive and open.
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> xxx xxx xxx
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> Any law to the contrary notwithstanding, power generation shall not be considered a public utility operation. For this purpose, any person or entity engaged or which shall engage in power generation and supply of electricity shall not be required to secure a local or national franchise.'
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> '**Section 8. Creation of the National Transmission Company**. – There is hereby created a National Transmission Corporation, hereinafter referred to as TRANSCO, which shall

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[23] *Supra.*

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> assume the electrical transmission function of the National Power Corporation, and have the powers and functions hereinafter granted. The TRANSCO shall assume the authority and responsibility of NPC for the planning, construction and centralized operation and maintenance of its high voltage transmission facilities, including grid interconnections and ancillary services.'

Although Section 8 of the EPIRA Law provides that TRANSCO shall assume the electrical transmission function of the NPC, We do not agree with petitioner that its remaining business activity is the generation of power, which allegedly does not require national or local franchise pursuant to Section 6 of the EPIRA law. In fact, this assertion is belied in the ruling of the Supreme Court in the case of ***National Power Corporation vs. City of Cabanatuan***, which also involves herein petitioner, wherein the High Court ruled that:

> 'As its secondary franchise, Commonwealth Act No. 120, as amended, vests the petitioner the following powers which are not available to ordinary corporations, *viz.*:
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> xxx xxx xxx
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> (e) To conduct investigations and surveys for the development of water power in any part of the Philippines;
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> (f) To take water from any public stream, river, creek, lake, spring or waterfall in the Philippines, for the purposes specified in this Act; to intercept and divert the flow of waters from lands of riparian owners and from persons owning or interested in waters which are or may be necessary for said purposes, upon payment of just compensation therefor; to alter, straighten, obstruct or increase the flow of water in streams or water channels intersecting or connecting therewith or contiguous to its works or any part thereof: Provided, That just compensation shall be paid to any person or persons whose property is directly or indirectly, adversely affected or damaged thereby;

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(g) To construct, operate and maintain power plants, auxiliary plants, dams, reservoirs, pipes, mains, transmission lines, power stations and substations, and other works for the purpose of developing hydraulic power from any river, creek, lake, spring and waterfall in the Philippines and supplying such power to the inhabitants thereof; to acquire, construct, install, maintain, operate, and improve gas, oil, or steam engines, and/or other prime movers, generators and machinery in plants and/or auxiliary plants for the production of electric power; to establish, develop, operate, maintain and administer power and lighting systems for the transmission and utilization of its power generation; to sell electric power in bulk to (1) industrial enterprises, (2) city, municipal or provincial systems and other government institutions, (3) electric cooperatives, (4) franchise holders, and (5) real estate subdivisions...;

(h) To acquire, promote, hold, transfer, sell, lease, rent, mortgage, encumber and otherwise dispose of property incident to, or necessary, convenient or proper to carry out the purposes for which the Corporation was created: Provided, That in case a right of way is necessary for its transmission lines, easement of right of way shall only be sought: Provided, however, That in case the property itself shall be acquired by purchase, the cost thereof shall be the fair market value at the time of the taking of such property;

(i) To construct works across, or otherwise, any stream, watercourse, canal, ditch, flume, street, avenue, highway or railway of private and public ownership, as the location of said works may require...;

(j) To exercise the right of eminent domain for the purpose of this Act in the manner provided by law for instituting condemnation

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proceedings by the national, provincial and municipal governments;

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(m) To cooperate with, and to coordinate its operations with those of the National Electrification Administration and public service entities;

(n) To exercise complete jurisdiction and control over watersheds surrounding the reservoirs of plants and/or projects constructed or proposed to be constructed by the Corporation. Upon determination by the Corporation of the areas required for watersheds for a specific project, the Bureau of Forestry, the Reforestation Administration and the Bureau of Lands shall, upon written advice by the Corporation, forthwith surrender jurisdiction to the Corporation of all areas embraced within the watersheds, subject to existing private rights, the needs of waterworks systems, and the requirements of domestic water supply;

(o) In the prosecution and maintenance of its projects, the Corporation shall adopt measures to prevent environmental pollution and promote the conservation, development and maximum utilization of natural resources...'

Apparently, petitioner failed to appreciate the fact that its existence is not based on pure power generation and electrical transmission. The above-enumerated powers of petitioner, by virtue of its secondary franchise, have not been entirely divested to TRANSCO. Moreover, We note that petitioner has not specifically pointed out which of the said powers mentioned in its special franchise under RA No. 6395 have been impliedly repealed and withdrawn by the EPIRA Law.

Additionally, Section 2 (a) of Part I, Rule 3 of the 'Rules and Regulations Implementing RA 9136' categorically provides:

'RULE 3. RESPONSIBILITIES OF THE DOE, ERC, NPC, NEA AND PSALM

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Section 2. Responsibilities of the NPC. –

(a) Pursuant to Section 70 of the Act, ***notwithstanding the divestment and/or Privatization of NPC assets***, IPP contract and spun-off corporations, ***NPC shall remain as a National Government-owned and controlled corporation to perform the missionary electrification function through the Small Power Utilities Group (SPUG) and shall be responsible for providing power generation and its associated power delivery systems in areas that are not connected to the transmission system.*** The missionary electrification function shall be funded from the revenues from sales in missionary areas and from the Universal Charge to be collected from all electricity End-users as determined by the ERC.' *(Emphasis supplied)*

In this connection thereto, Rule 4 (a) of the same implementing rules and regulations provides:

'RULE 4. DEFINITION OF TERMS

As used in these Rules, the following terms shall have the following respective meanings:

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ddd) '***Missionary Electrification***' refers to the provision of basic electricity service in Unviable Areas with the ultimate aim of bringing the operations in these areas to viability levels;'

Pursuant to the above-cited provisions, petitioner shall remain to be a National Government-owned and controlled corporation to perform the missionary electrification function through the Small Power Utilities Group (SPUG) and shall be responsible for providing power generation and its associated

> power delivery systems in areas that are not connected to the transmission system. Therefore, even with the passage of the EPIRA law, petitioner cannot be considered to be exclusively operating as a generation company."

Based on the above-quoted ruling of the Court, it is clear that respondent's existence is not based on pure power generation and electrical transmission since its Charter has vested it with certain powers, which are not available to ordinary corporations. Even though NPC's franchise has been modified by virtue of the transfer of its electric transmission function to TRANSCO; it may still be held liable for the subject franchise tax since the law has given it a missionary electrification function. It is possible that this function may have been exercised by NPC in the Province of Leyte during the period in question.

The Court, however, could not determine whether NPC has exercised its rights or privileges under its franchise, including the missionary electrification function, within the territory of the Province of Leyte during the subject period. The records of the case show that the RTC decided the case by summary judgment in view of the fact that both parties believed that the issue involved in the case is purely a question of law. Consequently, the issue of whether respondent performed its function/powers, including the missionary electrification function, in the Province of Leyte was not ventilated.

Hence, We have no other recourse but to remand the case to the court *a quo* for further proceedings subject to and in accordance with the pronouncements in this Decision.

WHEREFORE, the instant Petition for Review is hereby **GRANTED**. Accordingly, the assailed decision of the RTC, Branch 6 of Tacloban City is hereby **REVERSED** and **SET ASIDE**. The records of this case are hereby **REMANDED** to the court *a quo* for further proceedings in accordance with the pronouncements in this Decision.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

ESPERANZA R. FABON-VICTORINO
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.

ERNESTO D. ACOSTA
Presiding Justice