Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

FIRST DIVISION

DAVAO CITY WATER DISTRICT,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CTA Case No. 8979
For: Refund

Members:
DEL ROSARIO, P.J., *Chairperson*
UY, and
MINDARO-GRULLA, JJ.

Promulgated:
SEP 05 2017, 3:40pm

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DECISION

MINDARO-GRULLA, J.:

Before this Court is a Petition for Review filed by registered mail on January 21, 2015 by Davao City Water District as petitioner against the Commissioner of Internal Revenue as respondent, before the Court in Division, pursuant to Section 7(a)(2) of Republic Act (RA) No. 1125, An Act Creating the Court of Tax Appeals, as amended[1], as well as Rule 4, Section 3(a)(2), in relation to Rule 8, Section 4(a) of the Revised Rules of the Court of Tax Appeals (RRCTA)[2], as amended.

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[1] Sec. 7. *Jurisdiction.* – The CTA shall exercise:

(a) Exclusive appellate jurisdiction to review by appeal, as herein provided:

x x x x x x

(2) Inaction by the Commissioner of Internal Revenue in cases involving disputed assessments, refunds or internal revenue taxes, fees of other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue, where the National Internal Revenue Code provides a specific period for action, in which case the inaction shall be deemed a denial;

x x x x x x

[2] Rule 4, Sec. 3. *Cases within the jurisdiction of the Court in Division.* – The Court in Division shall exercise:

Petitioner prays that an order be made directing the Commissioner of Internal Revenue to refund the franchise tax payments made by it and those paid on its behalf in the amount of Twenty-Four Million Eight Hundred Twenty-Four Thousand Five Pesos and 45/100 (₱24,824,005.45).

Petitioner Davao City Water District is a government-owned water utility created and organized under and by virtue of Presidential Decree (PD) No. 198, Davao City Ordinance No. 707 dated November 1, 1973, and Davao City Council Resolution No. 1283 dated February 13, 1975 with Tax Identification No. 000-261-243. It is a public utility engaged in the production and supply of potable water to the entire City of Davao since 1973. Petitioner holds office at Km. 5, J.P. Laurel Avenue, Bajada, Davao City.[3]

(a) Exclusive original over or appellate jurisdiction to review by appeal the following:

x x x x x x

(2) Inaction by the Commissioner of Internal Revenue in cases involving disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties in relation thereto, or other matters arising under the National Internal Revenue Code or other laws administered by the Bureau of Internal Revenue, where the National Internal Revenue Code or other applicable law provides a specific period for action: *Provided,* that in case of disputed assessments, the inaction of the Commissioner of Internal Revenue within the one hundred eighty day-period under Section 228 of the National Internal Revenue Code shall be deemed a denial for purposes of allowing the taxpayer to appeal his case to the Court and does not necessarily constitute a formal decision of the Commissioner of Internal Revenue on the tax case; *Provided, further,* that should the taxpayer opt to await the final decision of the Commissioner of Internal Revenue on the disputed assessments beyond the one hundred eighty day-period abovementioned, the taxpayer may appeal such final decision to the Court under Section 3(a), Rule 8 of these Rules;

x x x x x x

Rule 8. Sec. 4. *Where to appeal; mode of appeal.-*

(a) An appeal from a decision or ruling or the inaction of the Commissioner of Internal Revenue on disputed assessments or claim for refund of internal revenue taxes erroneously or illegally collected, the decision or ruling of the Commissioner of Customs, the Secretary of Finance, the Secretary of Trade & Industry, the Secretary of Agriculture, and 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.

x x x x x x

[3] Petitioner's Memorandum, Docket, p. 1397.

On the other hand, respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR) who has the power to decide disputed assessments, refunds of internal revenue taxes, fees or other charges, penalties imposed in relation thereto or other matters arising under the National Internal Revenue Code (NIRC) or other laws or portions thereof administered by the BIR. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

On August 8, 2014, petitioner filed its Petition for Franchise Tax Refund for the year 2012 before respondent.[4]

Since the claim was not acted upon by respondent, petitioner filed the instant Petition for Review[5] on January 21, 2015. Respondent filed his Answer[6] thereto via registered mail on April 28, 2015 and received by the Court on May 7, 2015.

The case was set for pre-trial conference on July 14, 2015.[7] Petitioner filed its Pre-Trial Brief[8] by registered mail on July 1, 2015 and received by the Court on July 9, 2015; while respondent submitted his Pre-Trial Brief[9] on July 6, 2015.

The parties filed their Joint Stipulation of Facts and Issue[10] on September 18, 2015, which was adopted by the Court in the Pre-Trial Order[11] dated October 19, 2015.

During trial, the following witnesses testified for petitioner: (1) Mr. Siegfred G. Medina[12]; (2) Ms. Annabelle I. Opamin[13]; (3) Mr. Hilton Hussain[14]; and (4) Mr. Edwin V. Regalado[15].

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[4] Exhibits "P-3" and "P-7".
[5] Docket, pp. 24-44.
[6] Docket, pp. 133-144.
[7] Resolution dated May 7, 2015, Docket, p. 148.
[8] Pre-Trial Brief for Petitioner, Docket, pp. 160-165.
[9] Respondent's Pre-Trial Brief, Docket, pp 155-158.
[10] Docket, pp. 274-278.
[11] Docket, pp. 284-290.
[12] Minutes of the Hearing dated November 12, 2015, Docket, pp. 305-307.
[13] Minutes of the Hearing dated December 1, 2015, Docket, pp. 340-342.
[14] *Id.*
[15] Minutes of the Hearing dated May 17, 2016, Docket, pp. 1342-1344.

Petitioner likewise formally offered its evidence on May 30, 2016.[16] In a Resolution[17] dated August 1, 2016, the Court admitted Exhibits "P-1", "P-1-A", "P-2", "P-3", "P-3-A", "P-4", "P-4-A", "P-5", "P-6", "P-7", "P-8", "P-10", "P-10-A", "P-11", "P-12", "P-13", "P-14", "P-15", "P-15-A", "P-16", "P-16-A", "P-17", "P-17-A", "P-18", "P-18-A", and "P-19" to "P-774", as petitioner's evidence. However, the Court denied the admission of Exhibit "P-9" for petitioner's failure to present the original for comparison.

Petitioner offered the following documentary exhibits, to wit:

Exhibit:	Description:
P-1	Judicial Affidavit of Engr. Edwin V. Regalado executed on August 19, 2015
P-1-A	Signature of Engr. Edwin V. Regalado above his name appearing in Page 4 of the Judicial Affidavit
P-2	Certification dated January 13, 2014 certifying the issuance of DCWD Board Resolution No. 13-241, issued on July 5, 2013
P-3	Claim/Petition for Franchise Tax Refund on Franchise Tax Payment for the Year 2012 dated July 24, 2014
P-3-A	Signature of Engr. Edwin V. Regalado above his name appearing in Page 12 of the Claim/Petition for Franchise Tax Refund
P-4	Judicial Affidavit of Siegfred G. Medina executed on August 19, 2015
P-4-a	Signature of Siegfred G. Medina above his name appearing in Page 4 of the Judicial Affidavit
P-5	Affidavit of Service and Filing executed by Siegfred G. Medina on August 8, 2014
P-6	Return Card with stamp "Received" by the CIR
P-7	Letter dated July 15, 2015 signed by Siegfred G. Medina
P-8	Certification dated August 3, 2015 signed by Gloria L. Japitana
P-10	Judicial Affidavit of Hilton P. Husain, CPA executed on August 19, 2015
P-10-A	Signature of Hilton P. Husain above his name appearing in Page 4 of the Judicial Affidavit
P-11	Certification dated July 17, 2014

[16] Formal Offer of Exhibits, Docket, pp. 1355-1368.
[17] Docket, pp. 1380-1381.

P-12	DCWD Disbursement Voucher No. 232168 dated January 18, 2013 amounting to Php24,247,224.60 indicating BIR as payee
P-13	Land Bank of the Philippine Confirmation Receipt with No. 0001212013133816207 0 dated January 21, 2013
P-14	BIR Monthly Percentage Tax Return (Form No. 2551 M)
P-15	Supplement to the Judicial Affidavit of Hilton P. Husain, CPA, executed on October 19, 2015
P-15-A	Signature of Hilton P. Husain, CPA above his name appearing in Page 3 of the Supplement to the Judicial Affidavit
P-16	Judicial Affidavit of Annabelle I. Opamin (For Commissioning) executed on November 20, 2015
P-16-A	Signature of Annabelle I. Opamin above her name appearing in Page 5 of the Judicial Affidavit
P-17	Judicial Affidavit of Annabelle I. Opamin (For ICPA Report) executed on March 2, 2016
P-17-A	Signature of Annabelle I. Opamin above her name appearing in Page 10 of the Judicial Affidavit
P-18	ICPA Report of Annabelle I. Opamin dated January 8, 2016
P-18-A	Signature of Annabelle I. Opamin above her name appearing in Page 2 of ICPA Report
P-19 to P-774	Creditable Withholding Tax Certificates of Philippine Ports Authority and other customers of the petitioners duly appointed as withholding agents of the BIR who have done the withholding franchise tax assessed on the petitioner

On the other hand, respondent's counsel manifested that there is no report of investigation.[18] Moreover, respondent manifested that he has no witness to present.[19]

As directed by the Court, respondent submitted his Memorandum[20] on August 15, 2016, while petitioner filed its Memorandum[21] via registered mail on September 23, 2016 and received by the Court on October 5, 2016.

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[18] Minutes of the Hearing dated August 20, 2015.
[19] Transcript of Stenographic Notes (TSN), May 17, 2016, p. 10.
[20] Memorandum, Docket, pp. 1382-1393.
[21] Petitioner's Memorandum, Docket, pp. 1395-1415.

Hence, on October 13, 2016, the Court deemed the case submitted for decision.[22]

The parties submitted the following issue[23] for this Court's disposition:

> "Whether petitioner is entitled to a refund or tax credit of franchise tax paid in the amount of Php24,824,005.45 for taxable year 2012."

Petitioner insists that it cannot be a franchisee under the fundamental law of the land, and thus, cannot be subject to franchise tax. Moreover, it claims that a franchise is not necessary for petitioner to operate as a water utility.[24]

It avers that it is a public utility owned by the government of the Philippines. Since it forms part of the government machinery, it should not be subject to franchise tax.[25]

On the other hand, respondent asserts that petitioner, as a Local Water District, is liable for the payment of franchise tax. Respondent adds that upon the enactment of Republic Act (RA) No. 7109, the exemption privilege granted to Local Water Districts was limited to a period of five (5) years. Respondent also avers that it is clear that a franchise tax is imposed on water utilities by virtue of Section 119 of the National Internal Revenue Code of 1997, as amended.[26]

Moreover, respondent argues that in case of a 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.[27]

In the case of *National Power Corporation vs. City of Cabanatuan*[28], the Supreme Court defined the term "franchise" as a

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[22] Resolution dated October 13, 2016, Docket, p. 1418.
[23] Issue, Pre-Trial Order, Docket, p. 285.
[24] Petitioner's Memorandum, Docket, pp. 1402-1410.
[25] *Id.*
[26] Memorandum, Docket, pp. 1383-1387.
[27] Memorandum, Docket, pp. 1388-1392.
[28] G.R. No. 149110, April 9, 2003.

privilege conferred by government authority, which does not belong to citizens of the country generally as a matter of common right.

Section 119 of the NIRC of 1997, as amended, provides when franchise tax is imposable, to wit:

> "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 (P10,000,000), 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, it shall not be revoked.
>
> 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."

In the case of *Mendoza vs. Commission on Audit*[29], citing *Feliciano vs. Commission on Audit, et al.*[30], the High Tribunal explained that Local Water Districts are government-owned or controlled corporations (GOCCs). The pertinent portion of the decision are quoted hereunder:

> "In *Feliciano v. Commission on Audit*, this Court reiterated that local water districts are government-owned

[29] G.R. No. 195395, September 10, 2013.
[30] G.R. No. 147402, January 14, 2004.

or controlled corporations existing pursuant to Presidential Decree No. 198, thus:

> **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. Sections 6 and 25 of PD 198 provide:
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>> Section 6. Formation of District. – **This Act is the source of authorization and power to form and maintain a district. For purposes of this Act, a district shall be considered as a quasi-public corporation performing public service and supplying public wants. As such, a district shall exercise the powers, rights and privileges given to private corporations under existing laws, in addition to the powers granted in, and subject to such restrictions imposed, under this Act.**
>>
>> x x x x
>
> 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.** (Emphasis supplied)

Water utilities are not covered by Republic Act No. 10149, otherwise known as the 'GOCC Governance Act of 2011.' This recognizes that despite being government-owned or controlled corporations, water utilities are governed by a special law, that is, Presidential Decree No. 198 or the 'Provincial Water Utilities Act of 1973.'"

From the foregoing, it can be seen that PD No. 198 granted LWDs, such as petitioner, the franchise to operate as a water utility, with corresponding tax exemption privileges. According to Section 45 of PD No. 198, LWDs are exempted from income taxes, all National Government, local government, and municipal taxes and fees, and all duties and imposts on machinery, equipment, and materials required for its operations. Section 45 of PD No. 198 provides:

"SEC. 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)*

However, upon the enactment of RA No. 7109, or "An Act Granting Tax Exemption Privileges to Local Water Districts" on August 14, 1991, such tax exemption privileges were limited for a period of five (5) years. Section 3 of RA No. 7109 provides:

"SEC. 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)*

Considering that RA No. 7109 was approved and took effect on August 14, 1991, Local Water Districts, including herein petitioner, had five (5) years from such date, or until August 13, 1996 to enjoy their exemption from the taxes mentioned above. Thereafter, all LWDs became liable to the afore-mentioned taxes.

As a water utility, the franchise tax imposed under Section 119 of the NIRC of 1997, as amended, is clearly applicable to petitioner. Therefore, its payment of franchise tax was correct. As a result, the claim for refund cannot be granted.

It is noteworthy that the issue in this case is not novel. In an earlier case entitled *Davao City Water District vs. Commissioner of Internal Revenue*[31], involving the same parties and issues as in the present case, the Court of Tax Appeals First Division denied therein petitioner's claim for refund on the ground that Local Water Districts are liable for franchise tax under Section 119 of the NIRC of 1997, as amended. The significant parts of the decision are hereunder quoted:

"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:

[31] CTA Case No. 7522, October 1, 2009.

> '**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:

> '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." *(Emphases supplied)*

WHEREFORE, premises considered, the instant Petition for Review filed by Davao City Water District is **DENIED** for lack of merit.

SO ORDERED.

Cielito N. Mindaro-Grulla
CIELITO N. MINDARO-GRULLA
Associate Justice

WE CONCUR:

ROMAN G. DEL ROSARIO
Presiding Justice

ERLINDA P. UY
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.

ROMAN G. DEL ROSARIO
Presiding Justice
Chairperson, 1st Division