

15 June 2004

**LEGAL ADVISORY NO. 01**

**FOR : ALL ELECTRIC COOPERATIVES  
ALL OTHERS CONCERNED**

**SUBJECT : LOCAL TAX ADVISORY**

We are furnishing you for your reference, the following local tax advices:

1. Effect of the Supreme Court decision in G.R. No. 143076 dated June 10, 2003 (Philreca, ANECO, ILECO I and ISELCO I, petitioners vs. The Secretary, Department of Interior and Local Government, and The Secretary, Department of Finance, respondents).  
Petitioners, in this case, sought the annulment of Sections 193 and 234 of the Local Government Code as unconstitutional. For clarity, the two provisions in question are quoted in full as follows:

Sec. 193. *Withdrawal of Tax Exemption Privileges.* – Unless otherwise provided in this Code, tax exemptions or incentives granted to, or presently enjoyed by all persons, whether natural or juridical, including government-owned or controlled corporations, except local water districts, cooperatives duly registered under R.A. No. 6938, non-stock and non-profit hospitals and educational institutions, are hereby withdrawn upon the effectivity of this Code.

Sec. 234. *Exemption from Real Property Tax.* – The following are exempted from payment of the real property tax:

- a.) Real property owned by the Republic of the Philippines or any of its political subdivisions except when the beneficial use thereof has been granted, for consideration or otherwise, to a taxable person;
- b.) Charitable institutions, churches, parsonages or convents appurtenant thereto, mosques, nonprofit or religious cemeteries and all lands, buildings, and improvements actually, directly, and exclusively used for religious, charitable or educational purposes;
- c.) All machineries and equipment that are actually, directly and exclusively used by local water districts and government-owned or -controlled corporations engaged in the supply and distribution of water and/or generation and transmission of electric power;
- d.) All real property owned by duly registered cooperatives as provided for under R.A. 6938; and

e.) Machinery and equipment used for pollution control and environmental protection.

Except as provided herein, any exemption from payment of real property tax previously granted to, or presently enjoyed by, all persons, whether natural or juridical, including all government-owned or –controlled corporations are hereby withdrawn upon the effectivity of this Code.

The Supreme Court merely ruled that Section 193 and 234 of RA 7160 are not unconstitutional because they violate neither the Equal Protection Clause nor the Non-Impairment Clause of the Philippine Constitution.

As a result of this ruling of the Supreme Court, our electric cooperatives are excluded from that tax exemption benefits granted and/or retained under the two aforementioned Sections of RA 7160 for the benefit of CDA registered coops. It is important to note that this decision of the highest court neither touched nor ruled on other provisions of the Local Government Code that entitle the electric cooperative to certain specific tax exemption benefits by virtue of the EC's non-profit nature and/or government controlled status. For this reason, our ECs are entitled to the tax exemption and/or reduction benefits under Sections 137 in relation to Section 131(d) and 216 in relation to 218(d)

## 2. Local Franchise Tax on Businesses Enjoying a Franchise.

Section 137 of RA 7160, the relevant provision of law, provides:

*Sec. 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 a 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. In the case of a newly started business, the tax shall not exceed one-twentieth (1/20) of one percent (1%) of the capital investment. In the succeeding calendar year, regardless of when the business started to operate, the tax shall be based on the gross receipts for the preceding calendar year, or any fraction thereof, as provided herein.

By the wordings of this section, it is clear that only businesses enjoying a franchise are subject to local franchise tax. Section 137 of RA 7160 falls under Chapter 2 of Title One ( Local Government Taxation ) of Book II of the Local Government Code. And Section 131 of RA 7160 contains the definitions of the terms used in Title One of Book II. Such definitions include the definition of business to mean “trade or commercial activity regularly engaged in as a means of livelihood or with a view to profit”.

As stated in Sections 2 and 15 of PD 269, electric cooperatives registered with NEA are non-profit. Such statutory provisions on the non-profit nature of ECs finds realization in the fact that electricity rates of our ECs as approved by the

Energy Regulatory Board (now ERC) cover only costs of services. There is no provision or margin for profit whatsoever.

Hence, our ECs do not fall within the purview of businesses as defined in Title I Book II of RA 7160, and therefore, are not subject to the local franchise tax.

3. Real Property Tax

Section 216 of RA 7160 which provides for special classes of Real Properties is quoted in full as follows:

Sec. 216. *Special Classes of Real Property.* – All lands, buildings, and other improvements thereon actually, directly and exclusively used for hospitals, cultural, or scientific purposes, and those owned and used by local water districts, and government-owned or –controlled corporations rendering essential public services in the supply and distribution of water and/or generation and transmission of electric power shall be classified as special.

By virtue of the provisions of Presidential Decree No. 269 as amended by Sections 3, 5 and 6 of Presidential Decree No. 1645, electric cooperatives currently registered with NEA are government-controlled corporations. As such, their real properties fall under special classes which are entitled to an assessment level of only 10%. This is a lot lower than the 80% assessment level generally required for commercial and industrial properties. In the case of machineries and equipment that are actually, directly and exclusively used by the EC in the distribution of electricity and considered as real properties for local tax purposes, these shall be totally exempted from real property tax by virtue of Section 234 of the Local Government Code.



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