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THIRD DIVISION

[G.R. No. 131359. May 5, 1999]

MANILA ELECTRIC COMPANY, *petitioner, vs.* **PROVINCE OF LAGUNA and BENITO R. BALAZO, in his capacity as Provincial Treasurer of Laguna,** *respondents.*

SYNOPSIS

Certain municipalities of the province of Laguna issued resolution through their respective municipal councils granting franchise in favor of petitioner Manila Electric Company (MERALCO) for the supply of electric light, heat and power within the concerned areas. On 12 September 1991, Republic Act No. 7160, otherwise known as the "Local Government Code of 1991," was enacted to take effect on 01 January 1992 enjoining local government units to create their own sources of revenue and to levy taxes, fees and charges, subject to the limitations expressed therein, consistent with the basic policy of local autonomy. Pursuant to the provisions of the Code, franchise tax ordinance was enacted. On the basis of this ordinance, respondent Provincial Treasurer sent a demand letter to MERALCO for the corresponding tax payment. MERALCO paid the tax under protest. A formal claim for refund was thereafter sent by MERALCO to the Provincial Treasurer of Laguna claiming that the franchise tax it had paid and continued to pay to the National Government pursuant to P.D. 551 already included the franchise tax imposed by the Provincial Tax Ordinance. The claim for refund of petitioner was denied. In denying the claim, respondents relied on a more recent law, *i.e.*, Republic Act No. 7160 or the Local Government Code of 1991, than the old decree invoked by petitioner. Petitioner MERALCO filed with the Regional Trial Court of Sta. Cruz, Laguna, a complaint for refund. The trial court dismissed the complaint. In the instant petition, MERALCO assailed the trial court's ruling contending that the franchise tax ordinance is violative of the non-impairment clause of the Constitution.

The petition was dismissed by the Supreme Court. Truly, tax exemptions of this kind may not be revoked without impairing the obligations of contracts. These contractual tax exemptions,

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however, are not to be confused with tax exemptions granted under franchises. A franchise partakes of the nature of a grant which is beyond the purview of the non-impairment clause of the Constitution. While the Court has referred to tax exemptions contained in special franchises as being in the nature of *contracts* and a part of the inducement for carrying on the franchise, these exemptions are far from being strictly contractual in nature.

SYLLABUS

1. **POLITICAL LAW; LOCAL GOVERNMENT UNITS; POWER TO TAX; DEEMED TO EXIST ALTHOUGH CONGRESS MAY PROVIDE STATUTORY LIMITATIONS AND GUIDELINES; RATIONALE.** — Prefatorily, it might be well to recall that local governments do not have the *inherent* power to tax except to the extent that such power might be *delegated* to them either by the basic law or by statute. Presently, under Article X of the 1987 Constitution, a general delegation of that power has been given in favor of local government units. The 1987 Constitution has a counterpart provision in the 1973 Constitution, which did come out with a similar delegation of revenue making powers to local governments. Under the regime of the 1935 Constitution no similar delegation of tax powers was provided, and local government units instead derived their tax powers under a limited statutory authority. Whereas, then, the delegation of tax powers granted at that time by statute to local governments was confined and defined (outside of which the power was deemed withheld), the present constitutional rule (starting with the 1973 Constitution), however, would broadly confer such tax powers subject only to specific exceptions that the law might prescribe. Under the now prevailing *Constitution*, where there is neither a grant nor a prohibition by *statute*, the tax power must be deemed to exist although Congress may provide statutory limitations and guidelines. The basic *rationale* for the current rule is to safeguard the viability and self-sufficiency of local government units by directly granting them general and broad tax powers. Nevertheless, the fundamental law did not intend the delegation to be absolute and unconditional; the constitutional objective obviously is to ensure that, while the local government units are being strengthened and made more autonomous, the legislature must still see to it that (a) the taxpayer will not be over-burdened or

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saddled with multiple and unreasonable impositions; (b) each local government unit will have its fair share of available resources, (c) the resources of the national government will not be unduly disturbed; and (d) local taxation will be fair, uniform, and just.

2. **ID.; ID.; ID.; CONTRACTUAL TAX EXEMPTIONS; DISTINGUISHED FROM TAX EXEMPTIONS GRANTED UNDER FRANCHISES; CASE AT BAR.** — *The Court has viewed its previous rulings as laying stress more on the legislative intent of the amendatory law — whether the tax exemption privilege is to be withdrawn or not — rather than on whether the law can withdraw, without violating the Constitution, the tax exemption or not.* While the Court has, not too infrequently, referred to tax exemptions contained in special franchises as being in the nature of *contracts* and a part of the inducement for carrying on the franchise, these exemptions, nevertheless, are far from being strictly contractual in nature. *Contactual tax exemptions, in the real sense of the term and where the non-impairment clause of the Constitution can rightly be invoked, are those agreed to by the taxing authority in contracts, such as those contained in government bonds or debentures, lawfully entered into by them under enabling laws in which the government, acting in its private capacity, sheds its cloak of authority and waives its governmental immunity.* Truly, tax exemptions of this kind may not be revoked without impairing the obligations of contracts. These contractual tax exemptions, however, are not to be confused with tax exemptions granted under franchises. A franchise partakes the nature of a grant which is beyond the purview of the non-impairment clause of the Constitution. Indeed, Article XII, Section 11, of the 1987 Constitution, like its precursor provisions in the 1935 and the 1973 Constitutions, is explicit that no franchise for the operation of a public utility shall be granted except under the condition that such privilege shall be subject to amendment, alteration or repeal by Congress as and when the common good so requires.

APPEARANCES OF COUNSEL

Quiason, Makalintal, Barot, Torres and Ibarra for petitioner.

The Provincial Legal Officer for respondents.

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DECISION

VITUG, *J.*:

On various dates, certain municipalities of the Province of Laguna, including, Biñan, Sta. Rosa, San Pedro, Luisiana, Calauan and Cabuyao, by virtue of existing laws then in effect, issued resolutions through their respective municipal councils granting franchise in favor of petitioner Manila Electric Company ("MERALCO") for the supply of electric light, heat and power within their concerned areas. On 19 January 1983, MERALCO was likewise granted a franchise by the National Electrification Administration to operate an electric light and power service in the Municipality of Calamba, Laguna.

On 12 September 1991, Republic Act No. 7160, otherwise known as the "Local Government Code of 1991," was enacted to take effect on 01 January 1992 enjoining local government units to create their own sources of revenue and to levy taxes, fees and charges, subject to the limitations expressed therein, consistent with the basic policy of local autonomy. Pursuant to the provisions of the Code, respondent province enacted Laguna Provincial Ordinance No. 01-92, effective 01 January 1993, providing, in part, as follows:

> "Sec. 2.09. Franchise Tax. — There is hereby imposed a tax on businesses enjoying a franchise, at a rate of fifty percent (50%) of one percent (1%) of the gross annual receipts, which shall include both cash sales and sales on account realized during the preceding calendar year within this province, including the territorial limits on any city located in the province."[1]

On the basis of the above ordinance, respondent Provincial Treasurer sent a demand letter to MERALCO for the corresponding tax payment. Petitioner MERALCO paid the tax, which then amounted to ₱19,520,628.42, under protest. A formal claim for refund was thereafter sent by MERALCO to

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[1] *Rollo*, p. 27.

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the Provincial Treasurer of Laguna claiming that the franchise tax it had paid and continued to pay to the National Government pursuant to P.D. 551 already included the franchise tax imposed by the Provincial Tax Ordinance. MERALCO contended that the imposition of a franchise tax under Section 2.09 of Laguna Provincial Ordinance No. 01-92, insofar as it concerned MERALCO, contravened the provisions of Section 1 of P.D. 551 which read:

"Any provision of law or local ordinance to the contrary notwithstanding, the franchise tax payable by all grantees of franchises to generate, distribute and sell electric current for light, heat and power shall be two per cent (2%) of their gross receipts received from the sale of electric current and from transactions incident to the generation, distribution and sale of electric current.

"Such franchise tax shall be payable to the Commissioner of Internal Revenue or his duly authorized representative on or before the twentieth day of the month following the end of each calendar quarter or month, as may be provided in the respective franchise or pertinent municipal regulation and shall, any provision of the Local Tax Code or any other law to the contrary notwithstanding, be in lieu of all taxes and assessments of whatever nature imposed by any national or local authority on earnings, receipts, income and privilege of generation, distribution and sale of electric current."

On 28 August 1995, the claim for refund of petitioner was denied in a letter signed by Governor Jose D. Lina. In denying the claim, respondents relied on a more recent law, *i.e.,* Republic Act No. 7160 or the Local Government Code of 1991, than the old decree invoked by petitioner.

On 14 February 1996, petitioner MERALCO filed with the Regional Trial Court of Sta. Cruz, Laguna, a complaint for refund, with a prayer for the issuance of a writ of preliminary injunction and/or temporary restraining order, against the Province of Laguna and also Benito R. Balazo in his capacity as the Provincial Treasurer of Laguna. Aside from the amount of ₱19,520,628.42 for which petitioner MERALCO had priorly made a formal request for refund, petitioner thereafter likewise made additional payments under protest on various dates totaling ₱27,669,566.91.

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The trial court, in its assailed decision of 30 September 1997, dismissed the complaint and concluded:

"WHEREFORE, IN THE LIGHT OF ALL THE FOREGOING CONSIDERATIONS, JUDGMENT is hereby rendered in favor of the defendants and against the plaintiff, by:

"1. Ordering the dismissal of the Complaint; and

"2. Declaring Laguna Provincial Tax Ordinance No. 01-92 as valid, binding, reasonable and enforceable."[2]

In the instant petition, MERALCO assails the above ruling and brings up the following issues; *viz*:

"1. Whether the imposition of a franchise tax under Section 2.09 of Laguna Provincial Ordinance No. 01-92, *insofar as petitioner is concerned,* is violative of the non-impairment clause of the Constitution and Section 1 of Presidential Decree No. 551.

"2. Whether Republic Act. No. 7160, otherwise known as the Local Government Code of 1991, has repealed, amended or modified Presidential Decree No. 551.

"3. Whether the doctrine of exhaustion of administrative remedies is applicable in this case."[3]

The petition lacks merit.

Prefatorily, it might be well to recall that local governments do not have the *inherent* power to tax[4] except to the extent that such power might be *delegated* to them either by the basic law or by statute. Presently, under Article X of the 1987 Constitution, a general delegation of that power has been given in favor of local government units. Thus:

"Sec. 3. The Congress shall enact a local government code which shall provide for a more responsive and accountable local government structure instituted through a system of decentralization with effective

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[2] *Rollo*, p. 31.

[3] *Rollo*, p. 113.

[4] *Basco vs. PAGCOR,* 197 SCRA 52.

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mechanisms of recall, initiative, and referendum, allocate among the different local government units their powers, responsibilities, and resources, and provide for the qualifications, election, appointment and removal, term, salaries, powers and functions, and duties of local officials, and all other matters relating to the organization and operation of the local units.

"x x x x x x x x x

"Sec. 5. Each local government unit shall have the power to create its own sources of revenues and to levy taxes, fees, and charges subject to such guidelines and limitations as the Congress may provide, consistent with the basic policy of local autonomy. Such taxes, fees, and charges shall accrue exclusively to the local governments."

The 1987 Constitution has a counterpart provision in the 1973 Constitution which did come out with a similar delegation of revenue making powers to local governments.[5]

Under the regime of the 1935 Constitution no similar delegation of tax powers was provided, and local government units instead derived their tax powers under a limited statutory authority. Whereas, then, the delegation of tax powers granted at that time by statute to local governments was confined and defined (outside of which the power was deemed withheld), the present constitutional rule (starting with the 1973 Constitution), however, would broadly confer such tax powers subject only to specific exceptions that the law might prescribe.

Under the now prevailing *Constitution*, where there is neither a grant nor a prohibition by *statute*, the tax power must be deemed to exist although Congress may provide statutory limitations and guidelines. The basic *rationale* for the current rule is to safeguard the viability and self-sufficiency of local government units by directly granting them general and broad tax powers. Nevertheless, the fundamental law did not intend the delegation to be absolute and unconditional; the constitutional objective obviously is to ensure that, while the local government units are being strengthened and made more autonomous,[6] the

[5] Art XI, 1973 Constitution.

[6] See Sec. 25, Art. II and Sec. 2, Art. X.

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legislature must still see to it that (a) the taxpayer will not be over-burdened or saddled with multiple and unreasonable impositions; (b) each local government unit will have its fair share of available resources; (c) the resources of the national government will not be unduly disturbed; and (d) local taxation will be fair, uniform, and just.

The Local Government Code of 1991 has incorporated and adopted, by and large, the provisions of the now repealed Local Tax Code, which had been in effect since 01 July 1973, promulgated into law by Presidential Decree No. 231[7] pursuant to the then provisions of Section 2, Article XI, of the 1973 Constitution. The 1991 Code explicitly authorizes provincial governments, notwithstanding "*any exemption granted by any law or other special law, x x x (to) impose a tax on businesses enjoying a franchise.* Section 137 thereof 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. (*Italics* supplied for emphasis)"

Indicative of the legislative intent to carry out the Constitutional mandate of vesting broad tax powers to local government units, the Local Government Code has effectively withdrawn, under Section 193 thereof, tax exemptions or incentives theretofore enjoyed by certain entities. This law states:

"Section 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,

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[7] Later amended by PD 426.

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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*. (*Italics* supplied for emphasis)

The Code, in addition, contains a *general* repealing clause in its Section 534; thus:

"Section 534. *Repealing Clause.* — x x x.

"(f) *All general and special laws*, acts, city charters, decrees, executive orders, proclamations and administrative regulations, or part or parts thereof which are inconsistent with any of the provisions of this Code are hereby repealed or modified accordingly. (*Italics* supplied for emphasis)"[8]

To exemplify, in *Mactan Cebu International Airport Authority vs. Marcos*,[9] the Court upheld the withdrawal of the real estate tax exemption previously enjoyed by Mactan Cebu International Airport Authority. The Court ratiocinated:

"x x x These policy considerations are consistent with the State policy to ensure autonomy to local governments and the objective of the LGC that they enjoy genuine and meaningful local autonomy to enable them to attain their fullest development as self-reliant communities and make them effective partners in the attainment of national goals. The power to tax is the most effective instrument to raise needed revenues to finance and support myriad activities of local government units for the delivery of basic services essential to the promotion of the general welfare and the enhancement of peace, progress, and prosperity of the people. It may also be relevant to recall that the original reasons for the withdrawal of tax exemption privileges granted to government-owned and controlled corporations and all other units of government were that such privilege resulted in serious tax base erosion and distortions in the tax treatment of similarly situated enterprises, and there was a need for these entities to share in the requirements of development, fiscal or otherwise, by paying the taxes and other charges due from them."[10]

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[8] *Rollo*, pp. 28-29.

[9] 261 SCRA 667.

[10] At p. 690.

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Petitioner in its complaint before the Regional Trial Court cited the ruling of this Court in Province of *Misamis Oriental vs. Cagayan Electric Power and Light Company, Inc.*;[11] thus:

"In an earlier case, the phrase 'shall be in lieu of all taxes and at any time levied, established by, or collected by any authority' found in the franchise of the Visayan Electric Company was held to exempt the company from payment of the 5% tax on corporate franchise provided in Section 259 of the Internal Revenue Code (*Visayan Electric Co. vs. David*, 49 O.G. [No. 4] 1385).

"Similarly, we ruled that the provision: 'shall be in lieu of all taxes of every name and nature' in the franchise of the Manila Railroad (Subsection 12, Section 1, Act No. 1510) exempts the Manila Railroad from payment of internal revenue tax for its importations of coal and oil under Act No. 2432 and the Amendatory Acts of the Philippine Legislature (*Manila Railroad vs. Rafferty*, 40 Phil. 224).

"The same phrase found in the franchise of the Philippine Railway Co. (Sec. 13, Act No. 1497) justified the exemption of the Philippine Railway Company from payment of the tax on its corporate franchise under Section 259 of the Internal Revenue Code, as amended by R.A. No. 39 (*Philippine Railway Co. vs. Collector of Internal Revenue*, 91 Phil. 35).

"Those magic words, 'shall be in lieu of all taxes' also excused the Cotabato Light and Ice Plant Company from the payment of the tax imposed by Ordinance No. 7 of the City of Cotabato (*Cotabato Light and Power Co. vs. City of Cotabato*, 32 SCRA 231).

"So was the exemption upheld in favor of the Carcar Electric and Ice Plant Company when it was required to pay the corporate franchise tax under Section 259 of the Internal Revenue Code, as amended by R.A. No. 39 (*Carcar Electric & Ice Plant vs. Collector of Internal Revenue*, 53 O.G. [No. 4] 1068). This Court pointed out that such exemption is part of the inducement for the acceptance of the franchise and the rendition of public service by the grantee."[12]

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[11] 181 SCRA 38, citing *Carcar Electric & Ice Plant vs. Collector of Internal Revenue*, 56 O.G. (No. 4) 1068.

[12] At pp. 42-43.

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In the recent case of the *City Government of San Pablo, etc., et al. vs. Hon. Bienvenido V. Reyes, et al.*,[13] the Court has held that the phrase *in lieu of all taxes* "have to give way to the peremptory language of the Local Government Code specifically providing for the withdrawal of such exemptions, privileges," and that "upon the effectivity of the Local Government Code all exemptions except only as provided therein can no longer be invoked by MERALCO to disclaim liability for the local tax." *In fine, the Court has viewed its previous rulings as laying stress more on the legislative intent of the amendatory law — whether the tax exemption privilege is to be withdrawn or not — rather than on whether the law can withdraw, without violating the Constitution, the tax exemption or not.*

While the Court has, not too infrequently, referred to tax exemptions contained in special franchises as being in the nature of *contracts* and a part of the inducement for carrying on the franchise, these exemptions, nevertheless, are far from being strictly contractual in nature. *Contractual tax exemptions, in the real sense of the term and where the non-impairment clause of the Constitution can rightly be invoked, are those agreed to by the taxing authority in contracts, such as those contained in government bonds or debentures, lawfully entered into by them under enabling laws in which the government, acting in its private capacity, sheds its cloak of authority and waives its governmental immunity.* Truly, tax exemptions of this kind may not be revoked without impairing the obligations of contracts.[14] These contractual tax exemptions, however, are not to be confused with tax exemptions granted under franchises. A franchise partakes the nature of a grant which is beyond the purview of the non-impairment clause of the Constitution.[15] Indeed, Article XII, Section 11, of the 1987

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[13] G.R. No. 127708, 25 March 1999.

[14] See *Casanovas vs. Hord,* 8 Phil. 125.

[15] See *Cagayan Electric Co. vs. Commissioner*, G.R. No. L-601026, 25 September 1985, but see *Prov. of Misamis Oriental vs. Cagayan Electric*, 181 SCRA 38, reiterated in *Comm. vs. CTA,* 195 SCRA 445.

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Constitution, like its precursor provisions in the 1935 and the 1973 Constitutions, is explicit that no franchise for the operation of a public utility shall be granted except under the condition that such privilege shall be subject to amendment, alteration or repeal by Congress as and when the common good so requires.

WHEREFORE, the instant petition is hereby DISMISSED. No costs.

SO ORDERED.

Romero, Panganiban, Purisima, and *Gonzaga-Reyes, JJ.,* concur.

THIRD DIVISION

[G.R. No. 132607. May 5, 1999]

CEBU SHIPYARD AND ENGINEERING WORKS, INC., *petitioner, vs.* **WILLIAM LINES, INC. and PRUDENTIAL GUARANTEE and ASSURANCE COMPANY, INC.,** *respondents.*

SYNOPSIS

Private respondent William Lines, Inc. was the owner of M/V Manila City, a luxury passenger-cargo vessel, which caught fire and sank while undergoing dry-docking and repairs within the premises of petitioner Cebu Shipyard and Engineering Works, Inc. (CSEW) on February 16, 1991. The subject vessel was insured with private respondent Prudential Guarantee and Assurance Company, Inc. for ₱45 million. William Lines, Inc. sued CSEW for damages and impleaded Prudential as co-plaintiff, after the latter had paid William Lines, Inc. the value of the hull and machinery insurance on the M/V Manila City. As a result of such payment Prudential was subrogated to the claim of ₱45 million, representing the value of the said insurance it