

2023 QUARTER 3

UPDATES

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LEGAL UPDATES

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Philippine Supreme Court rules that public utilities cannot treat corporate income taxes as operating expenses for purposes of computing rates chargeable to consumers

Introduction

In *Maynilad Water Services, Inc. v. National Water Resources Board*[1], the Supreme Court (SC) ruled that income tax paid by a public utility is inconsistent with the nature of operating expenses, which are limited to those expenses that contribute or are attributable to the production of income or revenue and redound to the benefit of consumers. Consequently, public utilities are prohibited from treating corporate income taxes as operating expenditures for purposes of computing rates chargeable to consumers. Thus, the SC declared that this prohibition applies to Maynilad and Manila Water since they are public utilities which regularly provide the public with clean and reasonably priced water, a business imbued with public interest. Even assuming that they are not public utilities, the SC went on and ruled that Maynilad and Manila Water cannot recover income taxes because they are not business taxes under Philippine law.

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Facts

Maynilad Water Services, Inc. (Maynilad) and Manila Water Company, Inc. (Manila Water) (collectively, the Concessionaires) separately entered into a Concession Agreement with Metropolitan Water and Sewerage Systems (MWSS) to regularly supply water to the public in the Service Area West and Service Area East, respectively. The Agreement allows the Concessionaires to recover, by way of tariff, items of expenditures, such as operating expenses and Philippine business taxes, among others.

In 2002, during the first-rate rebasing exercise to adjust the standard rates chargeable to consumers, the Concessionaires were allowed to recover corporate income taxes as these were considered as Philippine business taxes, and thus, part of the operating expenses that the Concessionaires may recover from consumers. However, in the same year, the case of *Republic v. Meralco*[2] was promulgated where the SC held that public utilities are prohibited from including income taxes as operating expense for purposes of computing the rates chargeable to consumers since income taxes are inconsistent with the nature of operating expenses which are those expenses "... reasonably incurred in connection with business operations to yield revenue or income."

Citing the case of *Meralco*, the MWSS issued a Notice of Extraordinary Price Adjustment to the Concessionaires. The Concessionaires disputed said Notice, resulting in



the creation of the Technical Working Group by the MWSS. The Technical Working Group concluded that the parties to the Agreement intended MWSS to remain as the public utility and for the Concessionaires to be its agents and contractors. Hence, the Concessionaires were again allowed to recover corporate income taxes by way of tariff for the second-rate rebasing exercise in 2007 since they were not considered public utilities.

In the third-rate rebasing exercise in 2013, the MWSS again took the position that the Concessionaires were prohibited from including their corporate income taxes as expenditures recoverable from consumers. This recommendation was adopted by the MWSS Board of Trustees.

Objecting to the denial of their petitions for tariff increase, Maynilad and Manila Water respectively submitted the dispute to arbitration where Maynilad obtained a favorable decision, while Manila Water did not. As a result, several petitions for certiorari were filed with the Supreme Court raising the common issue of whether the Concessionaires may recover corporate income taxes they paid as operating expenses during the life of the concession.



[1] G.R. Nos. 181764, 187380, 207444, 208207, 210147, 213227, 219362, and 239938, December 7, 2021.

[2] G.R. Nos. 141314 and 141369, November 15, 2002.



The SC explained that the Concessionaires are public utilities since they operate the waterworks and sewerage system and, in line with the ruling in *Tatad v. Garcia*[3], it is not the ownership, but the operation of the facilities used to provide the public service that vests the status as public utility. No legislative franchise is necessary for the Concessionaires to operate the facilities of MWSS and supply water in their respective areas since Republic Act No. 8041[4], Executive Order No. 286 (1995)[5] and Executive Order No. 311 (1996)[6] are the authorizations for them to operate the facilities of MWSS. These laws mandated the MWSS to involve the private sector in any or all of its segments, operations, and facilities. In addition, consistent with the SC's ruling in *Luzon Stevedoring Co., Inc. v. The Public Service Commission*[7], the mere fact that service is rendered only under a contract does not prevent a company from being a public utility. Thus, the Concessionaires are covered by the ruling in *Meralco* applicable to public utilities.

Even before the promulgation of the *Meralco* case in 2002, public utilities have been prohibited from passing on to consumers income taxes they paid as operating expenses. Under the 1985 State Audit Manual, the Commission on Audit considered income tax as a common disallowance because the privilege of earning income is enjoyed by the public utility, not the consumers. Thus, the tax on privilege should be shouldered by the public utility.

Further, while it is true that the Concessionaires are allowed to recover Philippine business taxes over the

Decision

The SC ruled in the negative and declared that the Concessionaires are public utilities covered by the ruling in *Meralco*, and even if they are not considered public utilities, the Concessionaires may not recover the corporate income taxes they paid since income taxes are not business taxes.

life of the concession, the SC held that income taxes are not business taxes. Income taxes are direct taxes that must be shouldered by the person directly liable for it, i.e., the income earner. They are excise taxes paid for by the person who enjoys the privilege to earn income and should be shouldered by the income earner who receives the benefit or protection of the State and cannot be unduly passed on to the consumers. On the other hand, business taxes are indirect taxes imposed upon goods before reaching the consumer who ultimately pays for it, not as a tax, but as part of the purchase price. They are initially shouldered by the producer but may be passed on to the consumer.

Notwithstanding the foregoing ruling, the SC declared that income taxes passed on to consumers may no longer be recovered as the right to refund had long prescribed since action to contest water rates may only be brought before the National Water Resources Board (the NWRB) within 30 days after effectivity of such rates. In this case, no such action was brought before the NWRB; thus, the NWRB cannot order a refund.

[3] G.R. No. 114222, April 6, 1995.

[4] National Water Crisis Act of 1995.

[5] Reorganizing the Metropolitan Waterworks and Sewerage System and the Local Water and Utilities Administration Pursuant to Republic Act No. 8041, otherwise known as the National Water Crisis Act of 1995.

[6] Encouraging Private Sector Participation in the Operations and Facilities of the Metropolitan Waterworks and Sewerage System.

[7] G.R. No. L-5458 September 16, 1953.

Comment

Public utilities may not pass on to consumers as operating expenses corporate income taxes they paid since income tax paid by a public utility is inconsistent with the nature of operating expenses. Further, the Maynilad case emphasized that income taxes and business taxes are mutually exclusive. While income taxes are direct taxes that must be paid by the entity directly liable for it, business taxes are indirect taxes where the liability to pay tax falls on one, but the burden may be shifted to another.

While this ruling may not be novel, Maynilad is relevant as it effectively stopped the long-standing practice of water concessionaires of passing on to consumers the corporate income taxes they paid as operating expenses, which as earlier stated, is highly inconsistent with the nature of operating expenses. Such practice has burdened the indefinite public who were made to shoulder the burden of paying for the income taxes of the water concessionaires. Therefore, public utilities should now be more cautious in only including expenses which are reasonably incurred in connection with business operations to yield revenue or income and redound to the benefit of consumers as part of their operating expenses.

Relevant to this ruling, it should be noted that Republic Act No. 11659 or “An Act Amending Commonwealth Act No. 146 otherwise known as the Public Service Act”, which took effect on April 9, 2022, limited the definition of public utilities only to the following sectors:

- 1) Distribution of Electricity;
- 2) Transmission of Electricity;
- 3) Petroleum and Petroleum Products Pipeline Transmission Systems;
- 4) Water Pipeline Distribution Systems and Wastewater Pipeline Systems, including sewerage pipeline systems;
- 5) Seaports; and
- 6) Public Utility Vehicles

The Implementing Rules and Regulations of Republic Act No. 11659 also took effect on April 4, 2023 which will facilitate the implementation of the Public Service Act, as amended, as it sets a clear distinction between the definition of public services and public utilities.

TAX UPDATES

By SyCip, Gorres, Velayo & Co. (SGV & Co.).



The BIR issued **RR No. 9-2023**, which prescribes the rules and regulations governing the imposition of **excise tax on perfumes and toilet waters** as provided under Section 150(b) of the National Internal Revenue Code (NIRC) of 1997, as amended. This regulation took effect immediately last August 4, 2023.

The BIR issued **RR No. 10-2023** to implement the extension on the period of availment of the Estate Tax Amnesty.

- Sections 2, 9, 13, and 16 of RR No. 6-2019, as amended by RR No. 17-2021, The extension covers the estate of decedents who died **on or before May 31, 2022**, with or without assessments duly issued, whose estate taxes have remained unpaid or have accrued as of May 31, 2022.
- The Estate Tax Amnesty Return (ETAR) (BIR Form No. 2118-EA) (Annex B) shall be filed and paid, either electronically or manually, by the executor or administrator, legal heirs, transferees or beneficiaries, who wish to avail of the Estate Tax Amnesty within **June 15, 2023 until June 14, 2025** with any AAB, through RCO of any RDO or authorized tax software provider as defined in RMO No. 8-2019.

BIR ISSUANCES REVENUE REGULATIONS (RR)

RR No. 8-2023 provides that the **signature of the senior citizen and/or PWD is not required** if the qualified purchase was made **online or through mobile applications**. The identification card number will suffice if the qualified purchase was made **online or through mobile applications**.

The regulation took effect fifteen (15) days after its publication in the Official Gazette or newspaper of general circulation. It was published in Manila Bulletin last July 31, 2023.

REVENUE MEMORANDUM ORDERS (RMO)

RMO No. 26-2023 issued on July 19, 2023 prescribes the policies, guidelines and procedures in the processing of request for corporate information, including beneficial ownership information, with the Securities and Exchange Commission (SEC).

The Data Sharing Agreement (DSA) allows the BIR to obtain information on corporations and other registered/licensed entities, including beneficial ownership information, from the SEC.



- Installment payment shall be allowed within two (2) years from the statutory date of its payment without civil penalty and interest.

This regulation take effect immediately after its publication in the Official Gazette or in a newspaper of general circulation. This was published in Manila Bulletin last September 12, 2023.

RR No. 11-2023 on issuance of Warrant of Garnishment (WGs) against the deposit of delinquent taxpayers

Traditionally, WGs are issued and served physically, or via constructive/substituted means, to the Bank Head Offices and Bank Branches within the locality of the delinquent taxpayer.

The BIR issued on 14 September 2023, Revenue Regulations (RR) No. 11-2023 dated 06 March 2023 to prescribe the **use of electronic mail (e-mail) and**

REVENUE MEMORANDUM **CIRCULARS (RMC)**

RMC No. 80-2023 dated August 9, 2023, provides clarification on the provisions of RR No. 3-2023 and certain issues and concerns pertaining to transactions with other entities granted with VAT zero-rate incentives on local purchases under special laws and international agreements.

The BIR issued **RMC No. 91-2023** to implement the amendment to Rule 18, Section 5 of the CREATE IRR. The amendment addresses the VAT related issues and concerns of RBEs particularly those registered prior to the CREATE Act.

BIR Memorandum dated August 2, 2023

BIR's OIC - Deputy Commissioner Operations Group issued the memorandum to reiterate to all RDO officers and personnel that **only the required**

electronic signature as additional mode of service of the WG. The WG shall be issued and electronically signed by the Regional Director concerned, Assistant Commissioner-Collection Service (CS), Assistant Commissioner-Large Taxpayer Service (LTS) and Chief Large Taxpayers Division Office (LTDOS) which shall be issued against the deposits of the delinquent taxpayer thru the BIR Office's official e-mail address.

The rest of the procedures are strictly laid down in the regulations.

The regulation took effect 15 days following its publication in the Official Gazette or in a newspaper of general circulation. It was published in Malaya on September 15, 2023.



documents listed in the Checklist of Documentary Requirements [CDR - Checklist of Documentary Requirements \(bir.gov.ph\)](http://bir.gov.ph) shall be requested for submission by taxpayers for the processing of their requested transactions in the RDO.

Requiring the submission of additional documents not listed in the CDR is a violation of Section 21(b) of Republic Act (RA) No. 11032 (Ease of Doing Business and Efficient Government Service Delivery Act of 2018).

COURT OF TAX APPEALS (CTA) DECISIONS



Commissioner of Internal Revenue vs. GB Global Expresz Inc. [CTA (En Banc) EB No. 2583, promulgated 22 June 2023]

The Tax Code, in giving the BIR authority to make arrests and seizures, simply recognized such agency as a law enforcement entity, similar to police officers. It did not envision the BIR to possess powers that violate the constitutional right against unreasonable searches and seizures and from the general rule of securing a search warrant from the court before making searches and seizures.

To avail of exceptional cases for warrantless searches, there should be a probable cause or personal knowledge of the facts and circumstances which would lead the CIR or his representative to reasonably conclude that an offense or infraction is committed under the Tax Code,

laws or rules or regulations administered by him, and that the objects sought in connection with such offenses or infraction are in the place sought to be searched.

The Mission Order is not equivalent to a valid search warrant issued by the court. A search warrant must have particularity on the subject matter to be seized.

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