

SECOND DIVISION

[G.R. No. 167260, February 27, 2009]

**THE CITY OF ILOILO, MR. ROMEO V. MANIKAN, IN HIS CAPACITY
AS THE TREASURER OF ILOILO CITY, PETITIONERS, VS. SMART
COMMUNICATIONS, INC. (SMART), RESPONDENT.**

D E C I S I O N

BRION, J.:

Before this Court is the appeal by *certiorari* filed by the City of Iloilo (*petitioner*) under Rule 45 of the Rules of Court seeking to set aside the decision of the Regional Trial Court (*RTC*) of Iloilo City, Branch 28, which declared that respondent SMART Communications, Inc. (*SMART*) is exempt from the payment of local franchise and business taxes.

BACKGROUND FACTS

The facts of the case are not in dispute. SMART received a letter of assessment dated February 12, 2002 from petitioner requiring it to pay deficiency local franchise and business taxes (in the amount of P764,545.29, plus interests and surcharges) which it incurred for the years 1997 to 2001. SMART protested the assessment by sending a letter dated February 15, 2002 to the City Treasurer. It claimed exemption from payment of local franchise and business taxes based on Section 9 of its legislative franchise under Republic Act (*R.A.*) No. 7294 (*SMART's franchise*). Under SMART's franchise, it was required to pay a franchise tax equivalent to 3% of all gross receipts, which amount shall be in lieu of all taxes. SMART contends that the "in lieu of all taxes" clause covers local franchise and business taxes.

SMART similarly invoked R.A. No. 7925 or the Public Telecommunications Policy Act (*Public Telecoms Act*) whose Section 23 declares that any existing privilege, incentive, advantage, or exemption granted under existing franchises shall *ipso facto* become part of previously granted-telecommunications franchise. SMART contends that by virtue of Section 23, tax exemptions granted by the legislature to other holders of telecommunications franchise may be extended to and availed of by SMART.

Through a letter dated April 4, 2002, petitioner denied SMART's protest, citing the failure of SMART to comply with Section 252 of R.A. No. 7160 or the Local Government Code (*LGC*) before filing the protest against the assessment. Section 252 of the LGC requires payment of the tax before any protest against the tax assessment can be made.

SMART objected to the petitioner's denial of its protest by instituting a case against petitioner before the RTC of Iloilo City.^[1] The trial court ruled in favour of SMART and declared the telecommunications firm exempt from the payment of local

franchise and business taxes;^[2] it agreed with SMART's claim of exemption under Section 9 of its franchise and Section 23 of the Public Telecoms Act.^[3]

From this judgment, petitioner files this petition for review on *certiorari* raising the sole issue of whether SMART is exempt from the payment of local franchise and business taxes.

THE COURT'S RULING

SMART relies on two provisions of law to support its claim for tax exemption: Section 9 of SMART's franchise and Section 23 of the Public Telecoms Act. After a review of pertinent laws and jurisprudence - particularly of *SMART Communications, Inc. v. City of Davao*,^[4] a case which, except for the respondent, involves the same set of facts and issues - we find SMART's claim for exemption to be unfounded. Consequently, we find the petition meritorious.

The basic principle in the construction of laws granting tax exemptions has been very stable. As early as 1916, in the case of *Government of the Philippine Islands v. Monte de Piedad*,^[5] this Court has declared that he who claims an exemption from his share of the common burden of taxation must justify his claim by showing that the Legislature intended to exempt him by words too plain to be beyond doubt or mistake. This doctrine was repeated in the 1926 case of *Asiatic Petroleum v. Llanes*,^[6] as well as in the case of *Borja v. Commissioner of Internal Revenue (CIR)*^[7] decided in 1961. Citing American jurisprudence, the Court stated in *E. Rodriguez, Inc. v. CIR*:^[8]

The right of taxation is inherent in the State. It is a prerogative essential to the perpetuity of the government; and he who claims an exemption from the common burden, must justify his claim by the clearest grant of organic or statute law xxx When exemption is claimed, it must be shown indubitably to exist. At the outset, every presumption is against it. A well-founded doubt is fatal to the claim; it is only when the terms of the concession are too explicit to admit fairly of any other construction that the proposition can be supported.

In the recent case of *Digital Telecommunications, Inc. v. City Government of Batangas, et al.*,^[9] we adhered to the same principle when we said:

A tax exemption cannot arise from vague inference...Tax exemptions must be clear and unequivocal. A taxpayer claiming a tax exemption must point to a specific provision of law conferring on the taxpayer, in clear and plain terms, exemption from a common burden. Any doubt whether a tax exemption exists is resolved against the taxpayer.

The burden therefore is on SMART to prove that, based on its franchise and the Public Telecoms Act, it is entitled to exemption from the local franchise and business taxes being collected by the petitioner.

Claim for Exemption under SMART's franchise

Section 9 of SMART's franchise states:

Section 9. *Tax provisions.* -- The grantee, its successors or assigns shall be liable to pay the same taxes on their real estate buildings and personal property, exclusive of this franchise, as other persons or corporations which are now or hereafter may be required by law to pay. In addition thereto, **the grantee, its successors or assigns shall pay a franchise tax equivalent to three percent (3%) of all gross receipts of the business transacted under this franchise by the grantee, its successors or assigns and the said percentage shall be in lieu of all taxes on this franchise or earnings thereof:** *Provided,* That the grantee, its successors or assigns shall continue to be liable for income taxes payable under Title II of the National Internal Revenue Code pursuant to Section 2 of Executive Order No. 72 unless the latter enactment is amended or repealed, in which case the amendment or repeal shall be applicable thereto.

The grantee shall file the return with and pay the tax due thereon to the Commissioner of Internal Revenue or his duly authorized representative in accordance with the National Internal Revenue Code and the return shall be subject to audit by the Bureau of Internal Revenue. [Emphasis supplied.]

The petitioner posits that SMART's claim for exemption under its franchise is not equivocal enough to prevail over the specific grant of power to local government units to exact taxes from businesses operating within its territorial jurisdiction under Section 137 in relation to Section 151 of the LGC. More importantly, it claimed that exemptions from taxation have already been removed by Section 193 of the LGC:

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, except local water districts, cooperatives duly registered under RA No. 6938, non-stock and non-profit hospitals and educational institutions, **are hereby withdrawn upon the effectivity of this Code.** [Emphasis supplied.]

The petitioner argues, too, that SMART's claim for exemption from taxes under Section 9 of its franchise is not couched in plain and unequivocal language such that it restored the withdrawal of tax exemptions under Section 193 above. It claims that "if Congress intended that the tax exemption privileges withdrawn by Section 193 of RA 7160 [LGC] were to be restored in respondent's [SMART's] franchise, it would have so expressly provided therein and not merely [restored the exemption] by the simple expedient of including the 'in lieu of all taxes' provision in said franchise."

[10]

We have indeed ruled that by virtue of Section 193 of the LGC, all tax exemption privileges then enjoyed by all persons, save those expressly mentioned, have been withdrawn effective January 1, 1992 - the date of effectivity of the LGC.^[11] The first clause of Section 137 of the LGC states the same rule.^[12] However, the withdrawal of exemptions, whether under Section 193 or 137 of the LGC, pertains only to those already existing when the LGC was enacted. The intention of the legislature was to remove all tax exemptions or incentives granted *prior* to the LGC.^[13] As SMART's franchise was made effective on March 27, 1992 - after the effectivity of the LGC -

Section 193 will therefore not apply in this case.

But while Section 193 of the LGC will not affect the claimed tax exemption under SMART's franchise, we fail to find a categorical and encompassing grant of tax exemption to SMART covering exemption from *both* national and local taxes:

R.A. No. 7294 does not expressly provide what kind of taxes SMART is exempted from. It is not clear whether the "in lieu of all taxes" provision in the franchise of SMART would include exemption from local or national taxation. **What is clear is that SMART shall pay franchise tax equivalent to three percent (3%) of all gross receipts of the business transacted under its franchise. But whether the franchise tax exemption would include exemption from exactions by both the local and the national government is not unequivocal.**

The uncertainty in the "in lieu of all taxes" clause in R.A. No. 7294 on whether SMART is exempted from both local and national franchise tax must be construed strictly against SMART which claims the exemption. [Emphasis supplied.]^[14]

Justice Carpio, in his Separate Opinion in *PLDT v. City of Davao*,^[15] explains why:

The proviso in the first paragraph of Section 9 of Smart's franchise states that the grantee shall "continue to be liable for income taxes payable under Title II of the National Internal Revenue Code." Also, the second paragraph of Section 9 speaks of tax returns filed and taxes paid to the "Commissioner of Internal Revenue or his duly authorized representative in accordance with the National Internal Revenue Code." Moreover, the same paragraph declares that the tax returns "shall be subject to audit by the Bureau of Internal Revenue." Nothing is mentioned in Section 9 about local taxes. The clear intent is for the "in lieu of all taxes" clause to apply only to taxes under the National Internal Revenue Code and not to local taxes.

Nonetheless, even if Section 9 of SMART's franchise can be construed as covering local taxes as well, reliance thereon would now be unavailing. The "in lieu of all taxes" clause basically exempts SMART from paying all other kinds of taxes for as long as it pays the 3% franchise tax; it is the franchise tax that shall be in lieu of all taxes, and not any other form of tax.^[16] Franchise taxes on telecommunications companies, however, have been abolished by R.A. No. 7716 or the Expanded Value-Added Tax Law (*E-VAT Law*), which was enacted by Congress on January 1, 1996.^[17] To replace the franchise tax, the E-VAT Law imposed a 10%^[18] value-added tax on telecommunications companies under Section 108 of the National Internal Revenue Code.^[19] The "in lieu of all taxes" clause in the legislative franchise of SMART has thus become *functus officio*, made inoperative for lack of a franchise tax.^[20]

SMART's claim for exemption from local business and franchise taxes based on Section 9 of its franchise is therefore unfounded.

Claim for Exemption Under Public Telecoms Act