

THIRD DIVISION

[G.R. No. 155491, September 16, 2008]

SMART COMMUNICATIONS, INC., PETITIONER, VS. THE CITY OF DAVAO, REPRESENTED HEREIN BY ITS MAYOR HON. RODRIGO R. DUTERTE, AND THE SANGGUNIAN PANLUNGSOD OF DAVAO CITY, RESPONDENTS.

DECISION

NACHURA, J.:

This is a petition for review on *certiorari* under Rule 45 of the Rules of Court filed by Smart Communications, Inc. (Smart) against the City of Davao, represented by its Mayor, Hon. Rodrigo R. Duterte, and the Sangguniang Panlungsod of Davao City, to annul the Decision^[1] dated July 19, 2002 of the Regional Trial Court (RTC) and its Order^[2] dated September 26, 2002 in Sp. Civil Case No. 28,976-2002.

The Facts

On February 18, 2002, Smart filed a special civil action for declaratory relief^[3] under Rule 63 of the Rules of Court, for the ascertainment of its rights and obligations under the Tax Code of the City of Davao,^[4] particularly Section 1, Article 10 thereof, the pertinent portion of which reads:

Notwithstanding any exemption granted by any law or other special law, there is hereby imposed a tax on businesses enjoying a franchise, at a rate of seventy-five percent (75%) of one percent (1%) of the gross annual receipts for the preceding calendar year based on the income or receipts realized within the territorial jurisdiction of Davao City.

Smart contends that its telecenter in Davao City is exempt from payment of franchise tax to the City, on the following grounds: (a) the issuance of its franchise under Republic Act (R.A.) No. 7294^[5] subsequent to R.A. No. 7160 shows the clear legislative intent to exempt it from the provisions of R.A. 7160;^[6] (b) Section 137 of R.A. No. 7160 can only apply to exemptions already existing at the time of its effectivity and not to future exemptions; (c) the power of the City of Davao to impose a franchise tax is subject to statutory limitations such as the "*in lieu of all taxes*" clause found in Section 9 of R.A. No. 7294; and (d) the imposition of franchise tax by the City of Davao would amount to a violation of the constitutional provision against impairment of contracts.^[7]

On March 2, 2002, respondents filed their Answer^[8] in which they contested the tax exemption claimed by Smart. They invoked the power granted by the Constitution to local government units to create their own sources of revenue.^[9]

On May 17, 2002, a pre-trial conference was held. Inasmuch as only legal issues were involved in the case, the RTC issued an order requiring the parties to submit their respective memoranda and, thereafter, the case would be deemed submitted for resolution.^[10]

On July 19, 2002, the RTC rendered its Decision^[11] denying the petition. The trial court noted that the ambiguity of the "*in lieu of all taxes*" provision in R.A. No. 7294, on whether it covers both national and local taxes, must be resolved against the taxpayer.^[12] The RTC ratiocinated that tax exemptions are construed in *strictissimi juris* against the taxpayer and liberally in favor of the taxing authority and, thus, those who assert a tax exemption must justify it with words too plain to be mistaken and too categorical not to be misinterpreted.^[13] On the issue of violation of the non-impairment clause of the Constitution, the trial court cited *Mactan Cebu International Airport Authority v. Marcos*,^[14] and declared that the city's power to tax is based not merely on a valid delegation of legislative power but on the direct authority granted to it by the fundamental law. It added that while such power may be subject to restrictions or conditions imposed by Congress, any such legislated limitation must be consistent with the basic policy of local autonomy.^[15]

Smart filed a motion for reconsideration which was denied by the trial court in an Order^[16] dated September 26, 2002.

Thus, the instant case.

Smart assigns the following errors:

[a.] THE LOWER COURT ERRED IN NOT HOLDING THAT UNDER PETITIONER'S FRANCHISE (REPUBLIC ACT NO. 7294), WHICH CONTAINS THE "IN LIEU OF ALL TAXES" CLAUSE, AND WHICH IS A SPECIAL LAW ENACTED SUBSEQUENT TO THE LOCAL GOVERNMENT CODE, NO FRANCHISE TAX MAY BE IMPOSED ON PETITIONER BY RESPONDENT CITY.

[b.] THE LOWER COURT ERRED IN HOLDING THAT PETITIONER'S FRANCHISE IS A GENERAL LAW AND DID NOT REPEAL RELEVANT PROVISIONS REGARDING FRANCHISE TAX OF THE LOCAL GOVERNMENT CODE, WHICH ACCORDING TO THE COURT IS A SPECIAL LAW.

[c.] THE LOWER COURT ERRED IN NOT HOLDING THAT SECTION 137 OF THE LOCAL GOVERNMENT CODE, WHICH, IN RELATION TO SECTION 151 THEREOF, ALLOWS RESPONDENT CITY TO IMPOSE THE FRANCHISE TAX, AND SECTION 193 OF THE CODE, WHICH PROVIDES FOR WITHDRAWAL OF TAX EXEMPTION PRIVILEGES, ARE NOT APPLICABLE TO THIS CASE.

[d.] THE LOWER COURT ERRED IN NOT HOLDING THAT SECTIONS 137 AND 193 OF THE LOCAL GOVERNMENT CODE REFER ONLY TO EXEMPTIONS ALREADY EXISTING AT THE TIME OF ITS ENACTMENT BUT NOT TO FUTURE EXEMPTIONS.

[e.] THE LOWER COURT ERRED IN APPLYING THE RULE OF STATUTORY

CONSTRUCTION THAT TAX EXEMPTIONS ARE CONSTRUED STRICTLY AGAINST THE TAXPAYER.

[f.] THE LOWER COURT ERRED IN NOT HOLDING THAT PETITIONER'S FRANCHISE (REPUBLIC ACT NO. 7294) HAS BEEN AMENDED AND EXPANDED BY SECTION 23 OF REPUBLIC ACT NO. 7925, "THE PUBLIC TELECOMMUNICATIONS POLICY ACT," TAKING INTO ACCOUNT THE FRANCHISE OF GLOBE TELECOM, INC. (GLOBE) (REPUBLIC ACT NO. 7229), WHICH ARE SPECIAL PROVISIONS AND WERE ENACTED SUBSEQUENT TO THE LOCAL GOVERNMENT CODE, THEREBY PROVIDING AN ADDITIONAL GROUND WHY NO FRANCHISE TAX MAY BE IMPOSED ON PETITIONER BY RESPONDENT CITY.

[g.] THE LOWER COURT ERRED IN DISREGARDING THE RULING OF THE DEPARTMENT OF FINANCE, THROUGH ITS BUREAU OF LOCAL GOVERNMENT FINANCE, THAT PETITIONER IS EXEMPT FROM THE PAYMENT OF THE FRANCHISE TAX IMPOSABLE BY LOCAL GOVERNMENT UNITS UNDER THE LOCAL GOVERNMENT CODE.

[h.] THE LOWER COURT ERRED IN NOT HOLDING THAT THE IMPOSITION OF THE LOCAL FRANCHISE TAX ON PETITIONER WOULD VIOLATE THE CONSTITUTIONAL PROHIBITION AGAINST IMPAIRMENT OF CONTRACTS.

[i.] THE LOWER COURT ERRED IN DENYING THE PETITION BELOW.^[17]

The Issue

In sum, the pivotal issue in this case is whether Smart is liable to pay the franchise tax imposed by the City of Davao.

The Ruling of the Court

We rule in the affirmative.

I. Prospective Effect of R.A. No. 7160

On March 27, 1992, Smart's legislative franchise (R.A. No. 7294) took effect. Section 9 thereof, quoted hereunder, is at the heart of the present controversy:

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.)

Smart alleges that the "in lieu of all taxes" clause in Section 9 of its franchise exempts it from all taxes, both local and national, except the national franchise tax (now VAT), income tax, and real property tax.^[18]

On January 1, 1992, two months ahead of Smart's franchise, the Local Government Code (R.A. No. 7160) took effect. Section 137, in relation to Section 151 of R.A. No. 7160, allowed the imposition of franchise tax by the local government units; while Section 193 thereof provided for the withdrawal of tax exemption privileges granted prior to the issuance of R.A. No. 7160 except for those expressly mentioned therein, viz.:

Section 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 the 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 thereon, as provided herein.

Section 151. *Scope of Taxing Powers.* -- Except as otherwise provided in this Code, the city may levy the taxes, fees, and charges which the province or municipality may impose: Provided, however, That the taxes, fees and charges levied and collected by highly urbanized and independent component cities shall accrue to them and distributed in accordance with the provisions of this Code.

The rates of taxes that the city may levy may exceed the maximum rates allowed for the province or municipality by not more than fifty percent (50%) except the rates of professional and amusement taxes.

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.)

Smart argues that it is not covered by Section 137, in relation to Section 151 of R.A. No. 7160, because its franchise was granted after the effectivity of the said law. We agree with Smart's contention on this matter. The withdrawal of tax exemptions or incentives provided in R.A. No. 7160 can only affect those franchises granted prior to the effectivity of the law. The intention of the legislature to remove all tax exemptions or incentives granted prior to the said law is evident in the language of Section 193 of R.A. No. 7160. No interpretation is necessary.

II. The "in lieu of all taxes" Clause in R.A. No. 7294

The "in lieu of all taxes" clause in Smart's franchise is put in issue before the Court. In order to ascertain its meaning, consistent with fundamentals of statutory construction, all the words in the statute must be considered. The grant of tax exemption by R.A. No. 7294 is not to be interpreted from a consideration of a single portion or of isolated words or clauses, but from a general view of the act as a whole. Every part of the statute must be construed with reference to the context.
[19]

Smart is of the view that the only taxes it may be made to bear under its franchise are the national franchise tax (now VAT), income tax, and real property tax.^[20] It claims exemption from the local franchise tax because the "in lieu of taxes" clause in its franchise does not distinguish between national and local taxes.^[21]

We pay heed that R.A. No. 7294 is not definite in granting exemption to Smart from local taxation. Section 9 of R.A. No. 7294 imposes on Smart a franchise tax equivalent to three percent (3%) of all gross receipts of the business transacted under the franchise and the said percentage shall be in lieu of all taxes on the franchise or earnings thereof. 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. Smart has the burden of proving that, aside from the imposed 3% franchise tax, Congress intended it to be exempt from all kinds of franchise taxes - whether local or national. However, Smart failed in this regard.

Tax exemptions are never presumed and are strictly construed against the taxpayer and liberally in favor of the taxing authority.^[22] They can only be given force when the grant is clear and categorical.^[23] The surrender of the power to tax, when claimed, must be clearly shown by a language that will admit of no reasonable construction consistent with the reservation of the power. If the intention of the legislature is open to doubt, then the intention of the legislature must be resolved in favor of the State.^[24]

In this case, the doubt must be resolved in favor of the City of Davao. The "in lieu of