November 21, 2019

BIR RULING NO. 694-19

Secs. 27 (A) & (C); 109 (1) (E); 119; BIR Ruling No. 179-12; BIR Ruling No. 182-16; BIR Ruling No. 1020-18

Primewater Infrastructure Corp.
2nd Floor Starmall Annex, Alabang-Zapote Road
Pamplona Tres, Las Piñas City

Attention: *AAA*

Gentlemen :

This refers to your letter dated January 17, 2018 requesting on behalf of Primewater Infrastructure Corp. (hereinafter referred to as the "Primewater"), for confirmation regarding the taxability of the parties to the joint venture between Primewater and the Tarlac City Water District ("TCWD") on their Joint Venture Agreement entered into on March 11, 2015.

It is represented that Primewater is a corporation duly organized and existing under the laws of the Philippines and registered with the Securities and Exchange Commission (SEC) on August 10, 2006 with SEC Company Reg. No. CS200610464. It is likewise registered with the BIR with Tax Identification Number (TIN) 000-000-000-000 as engaged in the business of collection, purification, distribution of water and other service activities. Its primary purpose, as amended, includes the following business activities, to wit:

> "To establish, construct, maintain, operate, manage or administer, conduct, supervise, expand, and rehabilitate waterworks system, sewerage and sanitation systems, waste water works, treatment facilities and services, specifically, with authority to own drilling rigs, machineries, pumps, tools, or apparatus necessary boring or otherwise sinking of walls for the production, storage, purification and distribution, supply and sale of potable water to domestic, commercial and industrial users in its service areas; the provision of sewerage and sanitation services; the maintenance, development, repair and upgrading of water and wastewater facilities including water supply, treatment, distribution of water, sewerage and sanitation, metering and leakage control, customer service and billing; the construction, acquisition by purchase or otherwise, maintenance and operation of all necessary and convenient buildings, structures, dams, reservoirs, conduits, aqueducts, tunnels,

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purification plants, water mains, pipes, valves, water tank and reservoirs, tank cars of all kinds and vehicles, pumping stations, machineries, sanitary sewer systems, sewage and septage treatment plants, lift stations and all other convenient necessary or incidental instrumentalities, other waterworks and the acquisition by purchase or otherwise, lease, occupation or use of land rights of way and easement therein, and such other activities incidental to the foregoing."

In pursuance of the aforesaid business purpose, Primewater is currently engaged in the operation and maintenance of water systems, as well as water supply distribution throughout the Philippines.

On the other hand, TCWD is a government owned and controlled corporation created pursuant to the provisions of Presidential Decree (PD) No. 198, as amended, and thus granted a special franchise by law to provide water supply service in Tarlac City, as evidenced by its Conditional Certificate of Conformance No. 014 issued by the Local Water Utilities Administration dated February 18, 1975.

TCWD is also registered with the BIR with TIN 000-000-000-000 as engaged in the business of collection, purification and distribution of water. It is not registered as a VAT taxpayer, and, as such, TCWD is liable for the monthly percentage taxes and quarterly percentage taxes, among others.

On March 11, 2015, Primewater and TCWD entered into a Joint Venture for the Financing, Development, Rehabilitation, Improvement, Expansion, Operation and Maintenance of the Water Supply System of Tarlac City (the "JVA") in accordance with the provisions of the 2013 NEDA Revised Guidelines and Procedures for Entering into Joint Venture (JV) Agreements Between Government and Private Entities (the "2013 Revised NEDA Guidelines").

Section 2.2.1 of the JVA states that the parties established an Unincorporated Joint Venture pursuant to the JV Guidelines to undertake the development of the JV Project. Each party shall use their respective business names for purposes of performing their respective functions as described in the said JVA.

Under the JVA, the general objective of the joint venture is to attain the highest possible level of water supply service for, as far as feasibly possible, 99% of total barangays in Tarlac City. On the other hand, the specific objectives of the Joint Venture Project, are as follows:

i. To develop new/additional sustainable water sources to meet long-term water demand;

ii. To reduce and maintain distribution losses (Non-Revenue Water) to internationally acceptable levels;

iii. To expand service coverage within the existing barangays utilizing and proving TCWD Facilities;

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iv. To expand service coverage to barangays not presently covered by TCWD;

v. To ensure uninterrupted 24-hour water supply to connected consumers;

vi. To ensure that water supplied to consumers comply with prevailing standards on drinking water quality set by PNSDW;

vii. To mitigate tariff impact to Consumers;

viii. To maintain good and harmonious relationship with water consumers at all times through their improved satisfaction level; and

ix. To protect the environment by ensuring and promoting responsible use of groundwater resources, ultimately shifting to surface water as a source of raw water and by providing for the sound of management of wastewater.

Primewater shall perform the following functions:

i. Finance, expand, rehabilitate, improve, operate, and maintain all water source facilities, wells, water treatment facilities, water storage facilities, pumping stations, water mains, pipes, fire hydrants, and other machineries and waterworks for the purpose of suppling water to the inhabitants of Tarlac City. As such, it will act as Facilities Operator and Asset Manager;

ii. PrimeWater shall have the authority to entertain complaints regarding water service to resolve said complaints. PrimeWater shall initiate and undertake all activities pertaining to customer relations such as information dissemination, public consultations, and the like;

iii. Bill and collect tariff from consumers within Tarlac City and for this purpose test, mount, dismount and remount water meters within its jurisdictions;

iv. Submit reports and remit revenue share to TCWD as agreed in the JV Agreement *(Secs. 2.2.8 and 4)*; and

v. Such other functions as may be required of PrimeWater as Operator of the Concession in the JV Area and in order to fulfill Primewater's Service Obligations.

From the above-quoted provisions of the JVA, Primewater is committed to rehabilitate, expand, improve, operate, and maintain the water supply system as well as to provide water supply services in Tarlac City. PrimeWater has also taken on the billing

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and collection functions for the joint venture, among others. Thus, water sales are billed and collected by and through Primewater.

Furthermore, Primewater is responsible for the taxes/charges on the operation of the Joint Venture. The JVA provide that:

> "**6.1.2. Taxes/Charges on the operation of the Joint Venture** —
>
> PRIMEWATER shall be responsible for all income and withholding taxes, customs and import duties, real property taxes on facilities used in the JV project, other local taxes, capital gains tax and other transfer taxes, value added tax and other forms of taxes and other charges arising from its operations of the Joint Venture."

Accordingly, it is your opinion that the 2% franchise tax under Section 119 of Republic Act (RA) No. 8424, as amended, is not applicable to Primewater's collections. Tax laws recognize the mutually-exclusive nature of VAT and other percentages taxes as enunciated in Section 109 (E) of RA No. 8424, as amended, and further amended by RA No. 10963, otherwise known as the Tax Reform for Acceleration and Inclusion (TRAIN).

Meanwhile, the TWCD, as a franchise grantee pursuant to the Presidential Decree No. 198, as amended, is liable for the 2% franchise taxes (a percentage tax) "on the gross receipts derived from the business covered by the law granting the franchise" under Section 119 of RA No. 8424, as amended.

In view of the above rationalization, you would like to request for a confirmation of your opinion that the revenues generated from the water sales as billed and collected by Primewater for and on behalf of the joint venture is subject only to the twelve percent (12%) VAT, but not to the two percent (2%) franchise tax under Section 119 of the National Internal Revenue Code of 1997, as amended. Meanwhile, the TCWD, as a franchise grantee pursuant to the Presidential Decree No. 198, as amended, is the one liable for the 2% franchise taxes (a percentage tax) on its gross revenues it will receive in the joint venture.

In support of your request, you submitted the following documents, to wit:

1. Annex "A1"-"A2" Primewater's Certificate of Incorporation
2. Annex "B" Primewater's BIR Certificate of Registration
3. Annex "C" Tarlac Water District's Certificate
4. Annex "D" Tarlac Water District's BIR Certificate of Registration
5. Annex "E" Joint Venture Agreement between Primewater & TWCD

In reply, please be informed as follows:

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1. As a local water district, the revenue share of TCWD from the unincorporated joint venture is exempt from the payment of income tax.

Section 27 (C) of the 1997 Tax Code, as amended by Republic Act (RA) No. 10026, and further amended by RA No. 10963, provides for the exemption of local water districts from income tax as follows:

> **"SEC. 27. Rates of Income Tax on Domestic Corporations.** —
>
> xxx xxx xxx
>
> **(C) Government-owned or -controlled Corporations, Agencies or Instrumentalities.** — The provisions of existing special or general laws to the contrary notwithstanding, all corporations, agencies, or instrumentalities owned or controlled by the Government, except the Government Service Insurance System (GSIS), the Social Security System (SSS), the Philippine Health Insurance Corporation (PHIC), and the local water districts (LWDs), shall pay such rate of tax upon their taxable income as are imposed by this Section upon corporations or associations engaged in a similar business, industry, or activity." (Underscoring supplied)

Based on the above-cited provision, a local water district is not liable to pay such rate of tax as imposed on other domestic corporations engaged in a similar business, industry or activity *(BIR Ruling No. 179-2012 dated March 14, 2012)*. Accordingly, TCWD, being a duly organized local water district per Conditional Certificate of Conformance No. 014 dated February 18, 1975 issued by the Local Water Utilities Administration, is not subject to income tax on its revenue share in the unincorporated joint venture with Primewater, as contained in Sections 2.2.8 and 4 of the JVA, and consequently to the 2% expanded withholding tax pursuant to Section 27 (C) of the 1997 Tax Code, as amended. *(BIR Ruling No. 1020-18 dated June 27, 2018)*

2. TCWD is not subject to VAT, but to the percentage tax.

Section 119 of the Tax Code of 1997, as amended, provides that —

> **"SEC. 119. Tax on Franchises.** — Any provision of general or special law to the contrary notwithstanding, there shall be levied, assessed and collected in respect to all franchises . . . and on gas and water utilities, a tax of two percent (2%) on the gross receipts derived from the business covered by the law granting the franchise: . . ."

Hence, while a local water district, like TCWD, is exempt from the corporate income tax of 30%, it is nevertheless subject to the 2% franchise tax as prescribed in Section 119 of the 1997 Tax Code, as amended, as there are no express provisions in RA No. 10026 and Revenue Memorandum Circular (RMC) No. 28-2010 exempting the local water districts from the said 2% franchise tax. *(BIR Ruling Nos. 179-2012 dated March 14, 2012 and 1020-18 dated June 27, 2018)*

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Moreover, Section 5.116 (A) (4) (b) of Revenue Regulations (RR) No. 2-98, as amended, provides —

"Sec. 5.116. Withholding of Percentage Tax. —

Bureaus, offices and instrumentalities of the government, including government-owned or controlled corporations as well as their subsidiaries, provinces, cities and municipalities making any money payment to private individuals, corporations, partnerships and/or associations are required to deduct and withhold the percentage taxes due from the payees on account of such money payments.

(A) Internal Revenue Taxes Required to be Withheld. — Percentage taxes on gross money payments to the following shall be subjected to withholding at the rates herein prescribed.

xxx xxx xxx

(4) Franchises. —

xxx xxx xxx

(b) On gross payments to franchisees on gas and water utilities. — Two percent (2%)

xxx xxx xxx"

Based on the above, gross money payments to TCWD by bureaus, offices and instrumentalities of the government, including government-owned or controlled corporations as well as their subsidiaries, provinces, cities and municipalities, is subject to the 2% franchise tax. The 2% franchise tax withheld from the gross payments to TCWD is a creditable percentage tax on the part of TCWD which can be applied against its franchise tax due pursuant to Section 4 of RR No. 4-2002.

In sum, this Office holds that TCWD is not subject to income tax, and consequently to the 2% expanded withholding tax on its revenue share from the unincorporated joint venture with Primewater, but the same is subject to the 2% franchise tax as imposed under Section 119 of the Tax Code of 1997, as amended, and to the 2% creditable percentage tax imposed under Section 5.116 (A) (4) (b) of RR No. 2-98, as amended, if payment is made by bureaus, offices and instrumentalities of the government, including government-owned or controlled corporations as well as their subsidiaries, provinces, cities and municipalities. *(BIR Ruling No. 182-16 dated May 16, 2016)*

3. The net income of Primewater from its revenue share derived from the unincorporated joint venture with TCWD is subject to corporate income tax of 30%.

Pursuant to Section 2.2.2 of the JVA, TCWD and Primewater shall use their

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respective business names for purposes of performing their respective functions as described in the JVA. PrimeWater has also taken on the billing and collection functions for the joint venture, among others. Thus, water sales are billed and collected by and through Primewater.

Under Section 27 (A) of the Tax Code of 1997, as amended, an income tax of 30% is imposed upon the taxable income derived by domestic corporations, while the term taxable income, pursuant to Section 31 of the same Code, refers to the pertinent items of gross income less deductions, if any, authorized for such types of income or other special laws. Consequently, for income tax purposes, the net income of Primewater from its revenue share derived from the unincorporated joint venture with TCWD is subject to the 30% corporate income tax.

4. Primewater's revenue derived from water sales is subject to the 12% VAT and not to the percentage tax under Section 119 of the Tax Code of 1997, as amended.

Under Section 108 (A) of the Tax Code of 1997, as amended, there shall be levied, assessed and collected, a value-added tax equivalent to 12% of gross receipts derived from the sale or exchange of services, including the use or lease of properties. Thus, the revenues generated from the water sales, as billed and collected by Primewater for and on behalf of the unincorporated joint venture is subject only to the twelve percent (12%) VAT, but not to the two percent (2%) franchise tax under Section 119 of the Tax Code of 1997, as amended.

Furthermore, as a VAT-registered corporate taxpayer, Primewater is allowed under the law to pass on the 12% output VAT on its water bill to its customers, and thereafter remit the net VAT payable after deducting the allowable input tax on its purchases of goods, services and capital expenditures, in accordance with Section 110 (A) (1) (2) and (B) of the Tax Code of 1997, as amended.

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be disclosed that the facts are different, then this ruling shall be considered null and void.

Very truly yours,

(SGD.) CAESAR R. DULAY
Commissioner of Internal Revenue

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