

LUALHATI v. MANILA ELECTRIC COMPANY (MERALCO)

G.R. No. 141369, 15 November 2002, Third Division (Puno, J.)

By its nature income tax payments of a public utility are not expenses which contribute to or are incurred in connection with the production of profit of a public utility. Income tax should be borne by the taxpayer alone as they are payments made in exchange for benefits received by the taxpayer from the State.

On December 23, 1993, MERALCO filed with the ERB an application for the revision of its rate schedules. The application reflected an average increase of 21 centavos per kilowatthour (kwh) in its distribution charge. The application also included a prayer for provisional approval of the increase pursuant to Section 16(c) of the Public Service Act and Section 8 of Executive Order No. 172.

On January 28, 1994, the ERB issued an Order granting a provisional increase of ₱0.184 per kwh, subject to the condition that if it is found after audit examination that MERALCO is entitled to a lesser increase, the excess shall be refunded or credited in favor of the customers. With the same order is a request to the Commission of Audit for an audit and examination of the books and records of account of MERALCO for a period of time (not less than 12 consecutive months).

On February 11, 1997, COA submitted its Audit Report which contained, among others, the recommendation not to include income taxes paid by MERALCO as part of its operating expenses for purposes of rate determination and the use of the net average investment method for the computation of the proportionate value of the properties used by MERALCO during the test year for the determination of the rate base.

ERB rendered its decision adopting the above recommendations and authorized MERALCO to implement a rate adjustment in the average amount of ₱0.017 per kwh, effective with respect to MERALCO's billing cycles beginning February 1994. The ERB further ordered that "the provisional relief in the amount of ₱0.184 per kilowatthour granted under the Board's Order dated January 28, 1994 is hereby superseded and modified and the excess average amount of ₱0.167 per kilowatthour starting with MERALCO's billing cycles beginning February 1994 until its billing cycles beginning February 1998, be refunded to MERALCO's customers or correspondingly credited in their favor for future consumption."

On appeal, the Court of Appeals set aside the ERB decision, hence this petition.

ISSUES:

1. Whether or not the income tax paid by MERALCO be treated as part of its operating expenses for the purpose of determining the amount of rate increase.
2. The method to be used in computing the rate base. (net average investment method vs. average investment method)

HELD:

The regulation of rates to be charged by public utilities is founded upon the police powers of the State and statutes prescribing rules for the control and regulation of public utilities are a valid exercise thereof. When private property is used for a public purpose and is affected with public interest, it ceases to be *juris privati* only and becomes subject to regulation. The regulation is to promote the common good. Submission to regulation may be withdrawn by the owner by discontinuing use; but as long as use of the property is continued, the same is subject to public regulation.

The ERB correctly ruled that income tax should not be included in the computation of operating expenses of a public utility. Income tax paid by a public utility is inconsistent with the nature of operating expenses. In general, operating expenses are those which are reasonably incurred in connection with business operations to yield revenue or income. They are items of expenses which contribute or are attributable to the production of income or revenue. Income tax, on the other hand, is imposed on an individual or entity as a form of excise tax or a tax on the privilege of earning income. Clearly, by its nature, income tax payments of a public utility are not expenses which contribute to or are incurred in connection with the production of profit of a public utility. Income tax should be borne by the taxpayer alone as they are payments made in exchange for benefits received by the taxpayer from the State. Accordingly, the burden of paying income tax should be Meralco's alone and should not be shifted to the consumers by including the same in the computation of its operating expenses. The principle behind the inclusion of operating expenses in the determination of a just and reasonable rate is to allow the public utility to recoup the reasonable amount of expenses it has incurred in connection with the services it provides. It does not give the public utility the license to indiscriminately charge any and all types of expenses incurred without regard to the nature thereof.

As to the contention of MERALCO in applying American case law allowing income tax as part of operating expenses (considering that the Public Service Act was patterned after Act 2306 of the Phil. Commission which in turn was borrowed from American State public utility laws); the Supreme Court held that the question of what constitutes a reasonable return for the public utility is necessarily determined and controlled by its peculiar environmental milieu. Aside from the financial condition of the public utility, there are other critical factors to consider for purposes of rate regulation. Among others, they are: particular reasons involved for the request of the rate increase, the quality of services rendered by the public utility, the existence of competition, the element of risk or hazard involved in the investment, the capacity of consumers, etc. Rate regulation is the art of reaching a result that is good for the public utility and is best for the public.

In the determination of the rate base, property used in the operation of the public utility must be subject to appraisal and evaluation to determine the fair value thereof entitled to a fair return. With respect to those properties which have not been used by the public utility for the entire duration of the test year, *i.e.*, the year subject to audit examination for rate-making purposes, a valuation method must be adopted to determine the proportionate value of the property.

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Under the “net average investment method,” properties and equipment used in the operation of a public utility are entitled to a return only on the actual number of months they are in service during the period. In contrast, the “average investment method” computes the proportionate value of the property by adding the value of the property at the beginning and at the end of the test year with the resulting sum divided by two. The reasonableness of net average investment method is borne by the records of the case. In its report, the COA explained that the computation of the proportionate value of the property and equipment in accordance with the actual number of months such property or equipment is in service for purposes of determining the rate base is favored, as against the trending method employed by MERALCO, “to reflect the real status of the property. By using the net average investment method, the ERB and the COA considered for determination of the rate base the value of properties and equipment used by MERALCO in proportion to the period that the same were actually used during the period in question. This treatment is consistent with the settled rule in rate regulation that the determination of the rate base of a public utility entitled to a return must be based on properties and equipment actually being used or are useful to the operations of the public utility.