Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

En Banc

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

- versus -

PHILIPPINE AIRLINES, INC. (PAL),
Respondent.

E.B. CASE NO. 273
(CTA Case No. 6962)

Present:

ACOSTA, PJ,
CASTAÑEDA, JR.,
BAUTISTA,
UY,
CASANOVA, *and*
PALANCA-ENRIQUEZ, JJ.

Promulgated:
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DECISION

CASANOVA, J.:

This is an appeal[1] before the CTA Court *En Banc* filed on March 14, 2007 by herein petitioner, Commissioner of Internal Revenue ("Commissioner"), from the Decision[2] of the CTA *Second Division* dated November 13, 2006 and Resolution[3] dated February 7, 2007 in CTA Case No. 6962 entitled ***"Philippine Airlines, Inc. vs. Commissioner of Internal Revenue"*** . The assailed Decision granted Philippine Airlines' ("PAL") claim for refund. Thus, the

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[1] *Petition for Review, EB Rollo. pp. 8-18.*
[2] *Division Rollo. pp. 216-228.*
[3] *Division Rollo. pp. 250-252.*

Commissioner was ordered to refund PAL the amount of P93,424.67 representing Overseas Communications Tax ("OCT"). The Resolution denied the Commissioner's Motion for Partial Reconsideration.

THE FACTS

The facts of the case, as culled from the records, are as follows:

PAL is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines. It is engaged in the air transportation business with principal address at the 9th Floor, PAL Center, Legaspi Village, Makati City.

The Commissioner of Internal Revenue is the duly authorized government official empowered, among others, to refund erroneously collected taxes under the 1997 National Internal Revenue Code ("NIRC"), as amended, with office address at the BIR National Office Building, Agham Road, Diliman, Quezon City.

To meet the exigencies of its daily business operations, PAL availed the communication services of Philippine Long Distance Company ("PLDT"). For the period January 1, 2002 to December 31, 2002, PAL allegedly paid PLDT the 10% OCT in the amount of P134,431.95 on its overseas telephone calls.

On February 24, 2004, PAL, through its AVP-Financial Planning and Analysis Ma. Stella L. Diaz, filed with the Commissioner a claim for refund in the amount of P134,431.95 representing the total amount of 10% OCT paid to PLDT from January to December 2002 citing as legal bases Section 13 of Presidential Decree (P.D.) No. 1590 and BIR Ruling No. 97-94 dated April 13, 1994.[4]

Due to the Commissioner's inaction on its claim for refund, PAL appealed before the CTA on April 22, 2004. The case was raffled to the *Second Division* of this Court.

In Answer to the Petition, the Commissioner alleged, *inter-alia,* that: (a) PAL's claim for refund is subject to administrative routinary investigation or

[4] *Exhibit A*

examination by the BIR; (b) the amount of P134,431.95 being claimed by PAL representing 10% OCT for the period January to December 2002 is not properly documented; (c) PAL must show that it has complied with the prescriptive period in claiming for a refund or tax credit under Sections 204(C) and 229 of the 1997 NIRC, as amended; and (d) in an action for refund, the burden of proof is on the taxpayer to establish its right to refund, and failure to sustain the burden is fatal to the claim for refund or credit because claims for refund are construed strictly against the claimant for the same partake of the nature of exemption from taxation.[5]

The parties jointly stipulated on the following issues for the *Second Division's* resolution:

> "1. Whether or not petitioner is exempt from the 10% overseas communications tax under its franchise, PD 1590, and therefore, entitled to the refund of the 10% overseas communications tax prayed for;
>
> 2. Whether or not the amount of P134,431.95 being claimed by petitioner as allegedly representing 10% overseas communications tax erroneously collected from PAL by PLDT and remitted to the BIR for the period of January to December 2002, is properly documented; and
>
> 3. Whether or not petitioner complied with the provisions of Sections 204(C) and 229 of the Tax Code on the prescriptive period for claiming tax refund/credit."[6]

According to PAL, the 10% OCT that was collected by PLDT from it for the period January to December 2002 was covered by two (2) annual corporate income tax returns, namely: (i) the tax return for the fiscal year ending March 31, 2002 [which covers the first three (3) months of 2002] and (ii) the income tax return for the fiscal year ending March 31, 2003 [which covers the last nine

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5 *Division Rollo, pp. 43-44.*
6 *Division Rollo, p. 63.*

(9) months of 2002). For both fiscal years, **PAL opted to pay its basic corporate income**. However, as reflected in its income tax returns for fiscal years 2002 and 2003, PAL incurred negative taxable income of P844,734,355.00[7] and P911,552,157.00,[8] respectively. Consequently, it did not pay any income tax for the same fiscal years. PAL did not pay either the two percent (2%) franchise tax on its gross revenues as the latter tax would result in a higher tax liability.

PAL argues that in opting for zero basic corporate income tax which is lower than the 2% franchise tax, PAL complied with the "in lieu of all other taxes" clause of P.D No. 1590. Thus, it is no longer liable for all other taxes of any kind nature, or description including the 10% OCT and the erroneous payments thereof entitles it to a refund pursuant to its franchise.

But the Commissioner disagrees. He maintains that Section 120 of the 1997 NIRC, as amended, imposes 10% OCT on overseas dispatch, message or conversion originating from the Philippines which include PLDT communication services, to wit:

> **"SEC. 120 Tax on Overseas Dispatch, Message or Conversion originating from the Philippines**.-
>
> (A) Persons Liable. – There shall be collected upon every overseas dispatch, message or conversion transmitted from the Philippines by telephone, telegraph, telewriter exchange, wireless and other communication equipment service, a tax of ten percent (10%) on the amount paid for such services. The tax imposed in this Section shall be payable by the person paying for the services rendered and shall be paid to the person rendering the services who is required to collect and pay the tax within twenty (20) days after the end of each quarter."

After trial on the merits and upon consideration of PAL's as well as the Commissioner's arguments and evidence, the *Second Division* rendered the assailed Decision on November 13, 2006. The assailed Decision ruled that PAL is

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[7] *Exhibit E-2*
[8] *Exhibit F-2*

not required to pay the 10% OCT, therefore entitled to refund the same, because of the "in lieu of all other taxes" provision under Section 13 of P.D. 1590[9]. The *Second Division* relied on the ruling of the Court of Appeals in the case of ***Philippine Airlines (PAL) vs. Honorable Court of Tax Appeals and The Commissioner of Internal Revenue***[10]. It emphasized that the law simply states that PAL, in order for it to be exempt from taxes, must only choose between the two alternatives under Section 13 of P.D. 1590, that is to pay *whichever is lower* between (a) the basic corporate income tax or (b) 2% franchise tax. It further ruled that PAL, in this case, chose to pay the basic corporate income tax from January to December 2002 and not the 2% franchise tax, but since it incurred zero tax liability, no payment is needed in order for it to avail of the "in lieu of all other taxes" provision. Hence, it ruled that PAL is not liable to pay the P134,431.95 representing the 10% OCT. Consequently, the *Second Division* granted PAL's claim for refund of its OCT in the reduced amount of P93,424.67 from the original claim of P134,431.95. The amounts of P2,424.16 and P38,583.12 were disallowed due to non-verification and prescription, respectively.

On November 24, 2006, the Commissioner filed his Motion for Partial Reconsideration[11] claiming that the Court of Appeals' decision relied upon by the *Second Division* in its Decision is not yet a doctrine and can only be raised to the status of a doctrine upon affirmation by the Supreme Court. He further stated that PAL, in order for it to be not liable for other taxes, in this case the 10% OCT, should first pay the 2% franchise tax since it did not pay any amount as its basic corporate income tax. On February 7, 2007, the *Second Division* denied the abovementioned motion for lack of merit.

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[9] *An Act Granting a New Franchise to Philippine Airlines, Inc. to Establish, Operate, and Maintain Air-Transport Services in the Philippines and Between the Philippines and Other Countries, enacted on June 11, 1978.*
[10] *CA-G.R. SP No. 67970, September 30, 2003.*
[11] *Division Rollo, pp. 229-234.*

Hence, on March 14, 2007, the Commissioner filed this Petition for Review.

The petition raised the following sole issue:

WHETHER OR NOT RESPONDENT IS ENTITLED TO THE REFUND IN THE AMOUNT OF P93,424.67 REPRESENTING OVERSEAS COMMUNICATIONS TAX ALLEGEDLY PAID FOR THE PERIOD JANUARY TO DECEMBER 2002.

The Commissioner relied on the following ground:

THE PHRASE "IN LIEU OF ALL OTHER TAXES" CONTEMPLATES THE FULFILLMENT OF A CONDITION BEFORE THE EXEMPTION FROM ALL OTHER TAXES MAY BE APPLIED.

THE COURT EN BANC'S RULING

The Commissioner in this petition reiterated that since the ruling of the Court of Appeals carry only a persuasive effect, he maintains his position that Section 13 of P.D. 1590 contemplates the fulfillment of a condition before the exemption from all other taxes may be applied, that is PAL must either pay the basic corporate income tax or the 2% franchise tax. He further argued that since PAL did not pay any amount of tax for either of the two options, PAL's claim for refund must fail.

We find no merit in the petition.

A franchise is a legislative grant to operate a public utility. Like those of any other statute, the ambiguous provisions of a franchise should be construed in accordance with the intent of the legislature. In the present case, P.D. 1590 granted PAL an option to pay the lower of two alternatives: (a) "the basic corporate income tax based on PAL's annual net taxable income computed in accordance with the provisions of the National Internal Revenue Code" or (b) "a franchise tax of two percent (2%) of gross revenues." Availment of either of these two alternatives shall exempt the airline from the payment of "all other taxes," including the 10% Overseas Communications Tax.

The resolution of the instant case hinges on the interpretation of Section 13 of PAL's franchise, which states in part:

> "SEC. 13. In consideration of the franchise and rights hereby granted, the grantee **shall pay to the Philippine Government during the life of this franchise whichever of subsections (a) and (b) hereunder will result in a lower tax**:
>
> '(a) The basic corporate income tax based on the grantee's annual net taxable income computed in accordance with the provisions of the National Internal Revenue Code; or
>
> '(b) A franchise tax of two percent (2%) of the gross revenues derived by the grantee from all sources, without distinction as to transport or non-transport operations; provided, that with respect to international air-transport service, only the gross passenger, mail, and freight revenues from its outgoing flights shall be subject to this tax.'
>
> "The tax paid by the grantee under either of the above alternatives **shall be in lieu of all other taxes**, duties, royalties, registration, license, and other fees and charges **of any kind, nature, or description, imposed, levied, established, assessed, or collected by any** municipal, city, provincial, or **national authority or government agency, now or in the future**, x x x."[12]

Two points are evident from this provision. *First*, as consideration for the franchise, PAL is liable to pay either a) its basic corporate income tax based on its net taxable income, as computed under the National Internal Revenue Code; or b) a franchise tax of two percent (2%) based on its gross revenues, *whichever*

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[12] *Presidential Decree No. 1590 (1978), Sec. 13.(Emphasis and underscoring Ours).*

is lower. *Second,* the tax paid is "in lieu of all other taxes" imposed by all government entities in the country.

It is not disputed that PAL chose the *first option*. The only problem is that, if PAL chose the first option and it incurred negative taxable income and consequently did not pay any income tax neither did it pay the 2% franchise tax, will it still be liable to the 10% OCT?

The Court *En Banc* rules in the negative.

Note that the tax liability of PAL under the option it chose is to be "*computed* in accordance with the provisions of the National Internal Revenue Code".

According to the 1997 National Internal Revenue Code, *taxable income* means the pertinent items of **gross income** specified in this Code, **less the deductions and/or personal and additional exemptions**, if any, authorized for these types of income.[13]

Under Section 32 of the 1997 NIRC, *gross income* means income derived from whatever source, including compensation for services; the conduct of trade or business or the exercise of a profession; dealings in property; interests; rents; royalties; dividends; annuities; prizes and winnings; pensions; and a partner's distributive share in the net income of a general professional partnership.

Section 34 of the 1997 NIRC enumerates the allowable deductions and Section 35 thereof gives the personal and additional exemptions.

Under the *first option* of Section 13 of P.D. 1590, the basis for the tax rate is PAL's annual **net taxable income**, which (as earlier discussed) is computed by subtracting allowable deductions and exemptions from gross income. **By basing the tax rate on the annual net taxable income, PD 1590 necessarily recognized the situation in which taxable income may result in a negative amount and thus translate into a zero tax liability.**

[13] *Section 31 of the 1997 NIRC.*

When PAL operates at a loss (as in the instant case), no taxes are due; in this instance, it has a lower tax liability than that provided by the *second option.*

The *Second Division* correctly ruled that the **operative act** in order to avail of exemption from all other taxes under the "in lieu of all other taxes" clause of its Charter **is the actual exercise by PAL of the option to avail either the basic corporate income tax or the 2% franchise tax** and no actual payment is required.

Therefore, PAL is not liable to the 10% OCT. Accordingly, the refund, as granted by the *Second Division,* in the amount of P93,424.67, is correct.

The above discussion is in accordance with the latest ruling laid down by the Supreme Court in the case of *Commissioner of Internal Revenue vs. Philippine Airlines, Inc.* (G.R. No. 160528) promulgated last October 9, 2006 as penned by then Chief Justice Artemio V. Panganiban.

The Supreme Court upheld the decision of the Court of Appeals[14] which was used by the *Second Division* of this Court as one of its bases in ruling against the Commissioner in the assailed Decision.

The High Tribunal's ruling in the abovementioned case is the doctrine applicable here.

To reiterate the Supreme Court's explanation in ruling in favor of PAL, *We* quote:

> "The fallacy of the (CIR's) Commissioner's argument is evident from the fact that the payment of a measly sum of one peso would suffice to exempt PAL from other taxes, whereas a zero liability arising from its losses would not. **There is no substantial distinction between a zero tax and a one-peso tax liability.**[15]

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[14] *CA-GR SP No. 67970, September 30, 2003.*

[15] *Emphasis and underscoring Ours.*

Determining whether this tax exemption is wise or advantageous is outside the realm of judicial power. This matter is addressed to the sound discretion of the lawmaking department of government."

Therefore, considering the aforementioned discussions and considering further that the Supreme Court has already promulgated the latest jurisprudence that is applicable in the instant case, the *Second Division's* assailed Decision and Resolution dated November 13, 2006 and February 7, 2007, respectively, are hereby AFFIRMED.

WHEREFORE, the instant Petition for Review is hereby **DENIED DUE COURSE** and **DISMISSED** for lack of merit. Accordingly, the Commissioner of Internal Revenue is hereby **ORDERED** to **REFUND** in favor of PAL the amount of P93,424.67 representing Overseas Communication Tax paid for the period January to December 2002.

SO ORDERED.

CAESAR A. CASANOVA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above decision were reached in consultation before the case was assigned to the writer of the opinion of the Court.

ERNESTO D. ACOSTA
Presiding Justice