REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE, Petitioner,	**C.T.A. E.B. NO. 246 (C.T.A. CASE NO. 7010)**
	Present:
- versus -	**ACOSTA,** *P.J.* **CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA,** *and* **PALANCA-ENRIQUEZ,** *JJ.*
PHILIPPINE AIRLINES, INC. (PAL), Respondent.	**Promulgated:** AUG 09 2007

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DECISION

UY, J.:

This is a Petition for Review before the Court of Tax Appeals *En Banc* filed on February 7, 2007 pursuant to Section 18 of Republic Act No. 9282, seeking a review of the Decision and Resolution dated July 31, 2006 and January 2, 2007, respectively, rendered by the Second Division of this Court (Court in Division) in CTA Case No. 7010, entitled "Philippine Airlines, Inc. (PAL) vs. Commissioner of Internal Revenue". The dispositive portions of which read as follows:

Decision promulgated on July 31, 2006:

"**WHEREFORE**, premises considered, the instant Petition for Review is hereby **GRANTED**. Accordingly, Assessment Notice No. INC FY-3-31-01-000094 and Formal Letter of Demand for the payment of deficiency Minimum Corporate Income Tax in the amount of P272,421,886.58 are hereby **CANCELLED** and **WITHDRAWN.**

SO ORDERED."

Resolution promulgated on January 2, 2007:

"**WHEREFORE**, finding no cogent reason to reverse or modify the assailed Decision of July 31, 2006, this Court **RESOLVES** to **DENY** respondent's Motion for Reconsideration.

SO ORDERED."

THE FACTS

The factual antecedents of the case are not in dispute.

Petitioner is the duly appointed Commissioner of Internal Revenue charged with the duty to assess and collect all national internal revenue taxes, fees, and charges, among others, with principal office at the Bureau of Internal Revenue (BIR) National Office Building, Agham Road, Diliman, Quezon City. Respondent is a domestic corporation organized in accordance with the laws of the Republic of the Philippines with principal office address at the 9th Floor, PAL Center, Legaspi St., Legaspi Village, Makati City.

Respondent incurred a zero taxable income for fiscal year ending March 31, 2001 but had unapplied excess creditable withholding taxes. It did not pay the minimum corporate income tax (MCIT) for the same fiscal year.

On July 16, 2002, respondent filed with the office of the petitioner a claim for refund of the unapplied expanded creditable withholding tax of P2,334,377.95 for fiscal year 2000-2001. Attached thereto were the (1) Schedule of Creditable Tax Withheld at Source for fiscal year 2000-2001; (2)

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Certificates of Creditable Taxes Withheld; and (3) Audited Financial Statements.

Petitioner thereafter acted on respondent's claim for refund and conducted an investigation based on the documents submitted by the latter. Subsequently, an informal conference was held on August 27, 2003 informing respondent that its claim for refund was being denied and instead was being assessed of a deficiency MCIT.

Thereafter, on October 23, 2003, respondent received a Preliminary Assessment Notice (PAN) dated September 3, 2003 and Details of Discrepancies issued by the Large Taxpayers Service assessing petitioner the amount of P262,474,732.54 representing deficiency minimum corporate income tax including interest and compromise penalty.

On November 5, 2003, respondent filed a written protest against the PAN.

On February 12, 2004, respondent received from petitioner Assessment Notice No. INC FY-3-31-01-000094, Formal Letter of Demand and Details of Discrepancies for the payment of P272,421,886.58.

On February 23, 2004, respondent filed a formal written protest to the Final Assessment Notice and Formal Letter of Demand.

On May 26, 2004, respondent received from Deputy Commissioner Estelita C. Aguirre, OIC of the Large Taxpayers Service of the BIR, the Final Decision on Disputed Assessment denying respondent's protest and demanding immediate payment of the deficiency MCIT.

Hence, respondent filed before the Court in Division a Petition for Review on June 22, 2004 (docketed as C.T.A. Case No. 7010).

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On July 31, 2006, the Court in Division rendered its assailed Decision granting respondent's petition therein, and accordingly, Assessment Notice No. INC FY-3-31-01-000094 and Formal Letter of Demand for the payment of deficiency MCIT in the amount of P272,421,886.58 are cancelled and withdrawn.

Not satisfied, petitioner filed a Motion for Reconsideration of the said Decision on August 24, 2006.

Finding no compelling reason to either modify or alter the assailed Decision, the Court in Division denied petitioner's motion thereof in a Resolution dated January 2, 2007.

Hence, this recourse before the Court *En Banc* praying that the assailed Decision dated July 31, 2006 and the assailed Resolution dated January 2, 2007 be reversed and set aside.

In support of his Petition for Review, petitioner submits that respondent should pay the amount of P271,421,886.58 (sic) for the fiscal year ending March 31, 2001 as deficiency MCIT, inclusive of increments, plus twenty five percent (25%) surcharge for late payment and twenty percent (20%) annual interest, based on the following grounds: (a) "Respondent clearly *opted* to be covered by the Income Tax provision of the National Internal Revenue Code of 1997 (NIRC of 1997), as amended; hence, covered by the MCIT provisions of the same Code"; (b) "MCIT does *not* belong to the category of 'other taxes' which may enable respondent to avail of the 'in lieu of all other taxes' clause under Section 13 of P.D. No. 1590 ('Charter')"; (c) "The MCIT provision of the NIRC of 1997 is not an amendment of respondent's Charter"; (d) "Respondent is not only given the

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privilege to choose between what will give it the benefit of a lower tax, but also the responsibility to pay its share of tax burden. Such is evident in the wordings of Section 22 of RA No. 9337"; and (e) "Claim for exemption from taxation is never presumed. Respondent is liable for the deficiency MCIT".

On March 1, 2007, the Court *En Banc* issued a Resolution ordering respondent to comment thereto. Thus, on March 19, 2007 respondent timely filed through registered mail its "Comment on Petition for Review" and duly received by this Court on March 26, 2007.

Thereafter, this case was deemed submitted for decision on April 25, 2007.

THE ISSUES

Petitioner raised the following issues for the Court *En Banc*'s consideration, to wit:

> "1. Whether or not the Honorable Division erred in holding that MCIT is properly categorized as 'other taxes' pursuant to respondent's Charter;
>
> 2. Whether or not the Honorable Division erred in ruling that respondent is not liable for the deficiency 2% MCIT for the fiscal year ending 31 March 2001."

THE COURT EN BANC'S RULING

The petition is bereft of merit.

Considering that the issues raised are purely legal in nature and are at the same time interrelated, this Court deems it apropos to discuss them jointly for convenience and brevity.

The crux of the controversy in the instant case is the interpretation of Section 13 of PAL's franchise (P.D. 1590), quoted hereunder as follows:

"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, including but not limited to the following:

x x x

The grantee, shall, however, pay the tax on its real property in conformity with existing law.

For purposes of computing the basic corporate income tax as provided herein, the grantee is authorized:

a. To depreciate its assets to the extent of not more than twice as fast the normal rate of depreciation; and

b. To carry over as a deduction from taxable income any net loss incurred in any year up to five years following the year of such loss."

The abovequoted provision of P.D. 1590, which acquired and limited the extent of the tax liability of the respondent under its franchise, is coached

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in a clear, plain and unambiguous manner. It needs no further interpretation or construction. Consequently, two points are evident from this provision. *First*, as consideration for its 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 based on its gross revenues, *whichever is lower*. *Second,* the tax paid is "in lieu of all other taxes" imposed by all government entities in the country.[1]

Time and again, We have emphasized that respondent-grantee must choose between the two aforementioned alternatives in the payment of its tax liability to the government and its choice must be that which will result in a lower tax liability. Payment, when made, shall be in lieu of all other taxes. The "in lieu of all other taxes" clause of Section 13 of respondent's legislative franchise exempts PAL from all taxes necessary in the conduct of its business covered by the franchise, except the tax on its real property for which PAL is expressly made liable.

In the case at bench, the Court in Division found that respondent opted to pay corporate income tax when it filed its Annual Income Tax Return[2] and Amended Corporate Income Tax Returns for the fiscal year ending in March 31, 2001. Thus, using the provisions of the NIRC in computing its basic corporate income tax, it resulted in zero or nil tax liabilities as it was in a net loss position. Clearly, respondent has exercised its option under Subsection (a) and, after computations, resulted to a zero tax

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[1] Commissioner of Internal Revenue vs. Philippine Airlines Inc., 504 SCRA 90 (2006).
[2] Exhibit "D-5".

liability. Zero tax liability is obviously lower than the two percent (2%) franchise tax; hence, respondent chose a better alternative in availing of the basic corporate income tax as basis for its tax liability to the government. Nevertheless, petitioner assessed respondent for deficiency MCIT for the same fiscal year.

The basis for the tax rate pursuant to Subsection (a) of the abovequoted provision is respondent's annual net taxable income, which is computed by subtracting allowable deductions and exemptions from gross income. By doing this, P.D. 1590 apparently recognizes the situation in which taxable income may result in a negative amount and thus resulting into a zero tax liability.

However, We agree with the Court in Division that the basic corporate income tax mentioned in Section 13 of P.D. 1590 does not refer to MCIT under Section 27(E) of the NIRC of 1997, as amended. Rather, it particularly refers to the applicable rate of thirty five percent (35%) income tax pursuant to Section 27(A) of the same Code, on the taxable income of domestic corporations, such as respondent. The tax base thereof, as expressly specified in the aforequoted section of respondent's franchise is its *annual net taxable income*. This was already clarified by no less than the Highest Court in ***Commissioner of Internal Revenue vs. Philippine Airlines, Inc.***,[3] which states in part:

> "<u>Basic Corporate Income Tax Based on Annual Net Taxable Income</u>
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> To repeat, the pertinent provision in the case at bar reads: 'basic corporate income tax based on the grantee's

[3] Supra.

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> annual net taxable income computed in accordance with the provisions of the National Internal Revenue Code.' The Court has already illustrated that, under the Tax Code, 'taxable income' does not include passive income subjected to final withholding taxes. **Clearly, then, the 'basic corporate income tax' identified in Section 13 (a) of the franchise relates to the general rate of 35 percent as stipulated in Section 27 of the Tax Code**. xxx" *(Emphasis Ours)*

Conversely, under Section 27(E)(1) of the NIRC of 1997, as amended, the MCIT is imposed on the gross income of a corporation. There is a clear difference between the two terms. The regular or corporate income tax is a tax on net profits while the MCIT, on the other hand, is in effect, a tax on gross profits.[4] Therefore, the MCIT as it is imposed on the gross income of a corporation cannot be made to apply to herein respondent by virtue of the express provision of its franchise that its basic corporate income tax shall be based on its annual net taxable income. Thus, being a different specie from the required tax payable by petitioner established under its franchise, the MCIT qualifies as "other taxes" from which petitioner had been granted tax exemption.

Corollary, the "in lieu of all other taxes" proviso in the franchises of numerous grantees which has been the subject of many controversies has been consistently upheld by no less than the Supreme Court. In the case of ***Province of Misamis Oriental vs. Cagayan Electric Power and Light Company, Inc.***,[5] it cited several instances where validity and effectivity of the "in lieu of all taxes" provision found in various franchise of different entities were previously upheld, to wit:

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[4] The National Internal Revenue Code, Annotated, 8th Ed., Hector S. De Leon and Hector M. De Leon, Jr., p. 184 (2003).
[5] 181 SCRA 38, (1990).

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> "In an earlier case, the phrase 'shall be in lieu of all taxes and at any time levied, established by, or collected by any authority' found in the franchise of the Visayan Electric Company was held to exempt the company from payment of the 5% tax on corporate franchise provided in Section 259 of the Internal Revenue Code (Visayan Electric Co. vs. David, 49 O.G. [No.4] 1385).
>
> Similarly, we ruled that the provision: 'shall be in lieu of all taxes of every name and nature' in the franchise of the Manila Railroad (Subsection 12, Section 1, Act No. 1510) exempts the Manila Railroad vs. Rafferty, 40 Phil. 224).
>
> The same phrase found in the franchise of the Philippine railway Co. (Sec. 13, Act No. 1497) justified the exemption of the Philippine Railway Company from payment of the tax on its corporate franchise under Section 259 of the Internal Revenue Code, as amended by R.A. No. 39 (Philippine Railway Co. vs. Collector of Internal Revenue, 91 Phil. 35).
>
> Those magic words: 'shall be in lieu of all taxes' also excused the Cotabato Light and Ice Plant Company from the payment of the tax imposed by Ordinance No. 7 of the City of Cotabato (Cotabato Light and Power Co. vs. City of Cotabato, 32 SCRA 231).
>
> So was the exemption upheld in favor of the Carcar Electric and Ice Plant Company when it was required to pay the corporate franchise tax under Section 259 of the Internal Revenue Code as amended by R.A. No. 39 (Carcar Electric and Ice Plant Company vs. Collector of Internal Revenue, 53 O.G. [No.4} 1068). This Court pointed out that such exemption is part of the inducement for the acceptance of the franchise and the rendition of public service by the grantee. As a charter is in the nature of a private contract, the imposition of another franchise tax on the corporation by the local authority would constitute an impairment of the contract between the government and the corporation."

Clearly, the framers of P.D. 1590 recognize the scenario of PAL possibly incurring a net loss in its operations. As a matter of fact, for purposes of computing the basic corporate income tax, the same law allows PAL to: (a) depreciate its assets to the extent of not more than twice as fast the normal rate of depreciation; and (b) carry over as a deduction from taxable income any net loss incurred in any year up to five (5) years following the year of such loss. In the event that no basic corporate income tax is due (i.e. when PAL sustains a net loss), PAL is not liable for any other tax except for real properties, pursuant to the phrase "in lieu of all other taxes". Clearly, it cannot be compelled to pay any tax (such as the 2% franchise tax) when its operations result to a net loss, in particular, the MCIT.

Significantly, in the same case,[6] the Supreme Court made definite the correct interpretation of Section 13 of respondent's franchise, to quote:

> "Substitution Theory of the CIR Untenable
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> A careful reading of Section 13 rebuts the argument of the CIR that the 'in lieu of all other taxes' proviso is a mere incentive that applies only when PAL actually pays something. It is clear that PD 1590 intended to give respondent the option to avail itself of Subsection (a) or (b) as consideration for its franchise. **Either option excludes the payment of other taxes and dues imposed or collected by the national or the local government.** PAL has the option to choose the alternative that results in lower taxes. It is not the fact of tax payment that exempts it, but the exercise of its option.
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> Under Subsection (a), the basis for the tax rate is respondent'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." *(Emphasis and underscoring Ours)*

Lastly, We agree with the rationalization expressed by the Court of Appeals in ***Philippine Airlines, Inc. vs. Honorable Court of Tax Appeals and the Commissioner of Internal Revenue***.[7] Thus,

> "Moreover, the law does not say that to avail of the exemption from payment of all other taxes, there must be, after

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[6] Commissioner of Internal Revenue vs. Philippine Airlines, Inc., supra.
[7] CA-G.R. SP No. 67970, September 30, 2003.

> the computation, a tax due coupled with an 'actual' payment thereof. The law simply states that the petitioner-grantee must choose between the two alternatives and such choice must be that whichever will result in a lower tax liability. **Any tax paid under either of the two alternatives shall exempt the petitioner-grantee from the payment of the other taxes as the said tax payment is considered by law 'in lieu of all other taxes'.** In this case, as earlier stated, the petitioner availed of the right and privilege granted to it by law by opting to choose the basic corporate income tax as basis for its tax liability, which however, after considering the factors allowed by law, resulted in a zero tax liability. Such zero tax liability as a result of the exercise of its lawful privilege should not be taken against the petitioner nor deprive it of availment of the exemption granted by the law." *(Emphasis Ours)*

Prescinding from the above ruling, the MCIT was treated as "other taxes" because the respondent-grantee availed of the basic corporate income tax as basis for its tax liability pursuant to Section 13(a) of P.D. 1590.

The justification for the exemption from all other taxes except the income tax and real property tax granted to respondent upon the payment of the basic corporate income tax or the two percent (2%) franchise tax is that such exemption is part of the inducement for the acceptance of the franchise and the rendition of public service by the grantee. Nothing is said about inapplicability of the exemption from "other taxes" if respondent, choosing the payment of corporate income tax, does not pay income tax at all. If the lawmakers intended to provide for such a condition, then they would have included such a provision. More importantly, if We were to impose the MCIT against respondent, this would effectively negate the rationale of the law, by stripping PAL of the right given to it by virtue of its franchise to avail of tax incentives, such as the "in lieu of all other taxes" clause.

It bears stressing that the intent of the law must always be upheld. The Court is bound to effectuate the lawmaker's intent, which is the controlling factor in interpreting a statute.[8] 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 the Government.[9]

In sum, in the case at bench, all the cited legal provisions and jurisprudence are teeming with life with respect to the grant of tax exemption, too vivid to pass unnoticed.

In view of the foregoing, the Court in Division correctly ruled in favor of the respondent granting its petition for the cancellation and withdrawal of Assessment Notice No. INC FY-3-31-01-000094 and Formal Letter of Demand for the deficiency MCIT in the amount of P272,421,886.58.

WHEREFORE, premises considered, the instant petition is hereby **DENIED** for lack of merit.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

[8] Inding vs. Sadiganbayan, 434 SCRA 388 (2004).
[9] Commissioner of Internal Revenue vs. Philippine Airlines Inc., supra.

Juanito C. Castañeda, Jr.
JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

C E R T I F I C A T I O N

Pursuant to Section 13, Article VIII 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 *En Banc*.

ERNESTO D. ACOSTA
Presiding Justice

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