REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PHILIPPINE POWER & DEVELOPMENT CO., INC.,
Petitioner,

- versus - C.T.A. CASE NO. 1152

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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D E C I S I O N

This is an appeal from a decision of respondent holding petitioner liable for the sum of ₱141,469.40 as deficiency franchise tax for the taxable period from October 1, 1955 to June 30, 1960, plus the sum of ₱39,930.76, representing franchise tax erroneously credited to petitioner, or a total amount of ₱181,300.16.

Petitioner, a corporation duly organized and existing under the laws of the Philippines, is engaged in the business of supplying electric light, heat and power in the municipalities of Bay, Calamba, Lilio, Los Baños, Magdalena, Majayjay, Nagcarlan, Pila, Rizal, and Sta. Cruz, all in the Province of Laguna, and in the municipalities of Sto. Tomas and Tanauan, in the Province of Batangas, pursuant to the municipal franchises granted under Act No. 667 of the Philippine Commission. The said municipal franchises, follow a standard form or pattern and contain similar provisions.

Paragraphs 10 and 13, of Resolution No. 81, dated October 21, 1929, of the Municipal Council

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of Bay, Laguna, one of the franchise involved herein, provide in part:

> "Par. 10. x x x The said grantee, in consideration of the franchise hereby granted, shall pay quarterly into the Provincial Treasury of Laguna, one percentum of the gross earnings, obtained thru this privilege during the first twenty years (20) and two percentum during the remaining fifteen (15) years of the life of said franchise." (Exhibit "A-1", p. 61, C.T.A. records.)
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> "Par. 13. This franchise is granted with the understanding and upon the condition that it shall be subject to amendment, alteration or repeal by the Congress of the United States as provided in section 28 of the Act of Congress approved August 29, 1916, entitled 'AN ACT TO DECLARE THE PURPOSE OF THE PEOPLE OF THE UNITED STATES AS TO FUTURE POLITICAL STATES OF THE PEOPLE OF THE PHILIPPINE ISLANDS, AND TO PROVIDE A MORE AUTONOMOUS GOVERNMENT FOR THOSE ISLANDS' and that it shall be subject moreover to the provisions of Act No. 3108 as amended. x x x" (Par. 13, Exhibit "A", p. 62 C.T.A. records.)

In the light of the decision of the Supreme Court in the cases entitled Hoa Hin Co., Inc. vs. Saturnino David and Hoa Hin Co., Inc. vs. Blaquera, G.R. Nos. L-9616 and L-11783, May 25, 1959, the field corporation auditor of the General Auditing Office made a recomputation of the franchise tax liability of petitioner based on the gross earnings of its operation, which recomputation is contained in a report submitted to the Auditor General. In a letter dated November 15, 1960, the Auditor General furnished respondent with said audit report, which reads:

> "Pursuant to the provisions of Section 259 of the Tax Code, as amended, the utility had been paying its franchise tax at the rate of 5% on its gross receipts up to March 31, 1955. By virtue of the letter of the Collector of Internal Revenue dated April 4, 1955, the utility's franchise tax rate was declared to be 2% and not 5% in conformity with its franchise authorized under Act 667, as amended. Following the ruling of the Collector of Internal Revenue, our audit report dated May 18, 1955 was based on the tax rate of 2%. Accordingly, the utility requested the refund of its tax overpayment for the first quarter of 1953 and for the period from July 1, 1953 to March 31, 1955, in its letters dated March 18, 1955 and July 18, 1955, and the Collector of Internal Revenue in its letter dated June 15 and July 12, 1955, granted a tax credit in the amount of ₱30,178.28 and ₱9,652.48 or a total amount of ₱39,830.76 for the said periods. Since April 1, 1955, therefore, the utility had been paying franchise tax at the rate of 2%."

On the basis of said audit report, respondent, on November 29, 1960, assessed and demanded from petitioner the total amount of ₱201,627.21, representing deficiency franchise tax for the period from January 1, 1947 to June 30, 1960, inclusive of the 25% surcharge and the amount of ₱39,830.76 alleged to have been erroneously credited in favor of petitioner. This assessment was received by petitioner on December 19, 1960. In a letter, dated January 5, 1961, petitioner protested and requested the cancellation and withdrawal thereof. This request was partially granted in a revised assessment, dated October 18, 1961, reducing the original assessment of ₱201,627.21 to ₱181,300.16 by eliminating therefrom the alleged deficiency corresponding to the period beyond five years from the date of the original assessment, that is, the period from January 1, 1947 to September 30, 1955, and limiting the assessment to the period from October 1, 1955 to June 30, 1960.

This revised assessment is itemized as follows:

Total gross receipts per audit...	₱3,733,619.69	
5% tax due thereon..	186,680.98	
Less: Amount paid...	73,505.46	
Balance	113,175.52	
Add: 25% surcharge..	28,293.88	₱141,469.40
Tax erroneously credited		39,830.76
Total amount due		₱181,300.16

The issues raised for our consideration are:

1. Whether or not respondent has jurisdiction, power and authority to assess and collect the franchise tax in question;

2. Whether the correct rate of franchise tax payable by petitioner is the 2% prescribed in its municipal franchises or the 5% provided for in Section 259 of the Tax Code, as amended;

3. Whether or not petitioner is liable for the 25% surcharge on the alleged deficiency franchise tax;

4. Whether or not respondent can recover the amount of ₱39,830.76 alleged to have been erroneously credited to the petitioner for the period from January 1, 1953 to March 31,1955; and

5. Whether or not the income of the employees' retirement fund, the interest on savings account, the gain in the sale of fixed assets and cars, and the proceeds on sales of materials and supplies form part of the gross receipts subject to franchise tax.

On the first issue, petitioner contends that the powers and duties of the Commissioner of Internal Revenue comprehend only "the collection of all _national_ internal revenue taxes, fees and charges, and the enforcement of all forfeitures, penalties, and fines in connection therewith", and do not include the collection of franchise tax under Act No. 667, as amended, which by the terms of the municipal franchises is paid by the grantee to the Provincial Treasurer, who acts, not as deputy of the respondent, but solely in behalf of and for the benefit of the local governments (Par. 1, p. 4, Petitioner's Memorandum). In short, petitioner claims that the franchise tax in question is a municipal tax, not an internal revenue tax, and therefore, respondent has no power and authority to assess and collect the same.

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This contention is untenable. Sections 3 and 18 of the Tax Code respectively provide:

> "SEC. 3. Powers and duties of Bureau.- The powers and duties of the Bureau of Internal Revenue shall comprehend the collection of all national internal revenue taxes, fees and charges, and the enforcement of all forfeitures, penalties, and fines connected therewith. Said Bureau shall also give effect to and administer the supervisory and police power conferred to it by this Code or other laws". (Underscoring ours.)

> "SEC. 18. Sources of revenue.- The following taxes, fees, and charges are deemed to be national internal revenue taxes:
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> x x x x x
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> (g) Miscellaneous taxes, fees and charges, namely, taxes on banks, and insurance companies, franchises taxes, taxes on amusements, charges on forest products, fees for sealing weights and measures, firearms license fees, radio registration fees, tobacco inspection fees, and water rentals". (Underlining ours.)

It will be noted that in the above enumerated sources of revenue, franchise taxes are deemed to be national internal revenue taxes. And before its amendment by Section 5 of Republic Act No. 2655, Section 6 of the Tax Code designated provincial and city treasurers as deputies of the Commissioner of Internal Revenue in the collection of national internal revenues, of which franchise tax is one. But with the said amendment: "Any and all references in the National Internal Revenue Code to the provincial and city treasurers and their deputies, their functions and duties in connection with internal revenue shall x x x be deemed to refer to the collection agents of the Bureau of Internal Revenue." From these provisions, it is clear that respondent Commissioner of Internal Revenue is empowered or authorized to assess and collect franchise taxes due under Act No. 667.

Petitioner's claim that it is liable only for 2% franchise tax is likewise without merit. Nowhere in the franchises of petitioner can be found a provision to the effect that the franchise tax prescribed therein "shall be in lieu of all other taxes." Inasmuch as said franchises do not preclude the imposition of a higher franchise tax, petitioner-grantee is subject to the 5% franchise tax provided in Section 259 of the Tax Code, as amended, and not to the lower rate of franchise tax prescribed in the franchises in question. This doctrine has been consistently upheld in previous cases involving franchises of similar nature (Balanga Power Plant Co., Inc. vs. Commissioner of Internal Revenue, G. R. No. L-20499, June 30, 1965; Lealda Electric Co., Inc. vs. Commissioner of Internal Revenue, G. R. No. L-16428, April 30, 1963; Hoa Hin Co., Inc. vs. David etc. and Hoa Hin Co., Inc. vs. Blaquera etc., G. R. Nos. L-9616 and 11783, May 25, 1959; also, Imus Electric Co., Inc. vs. Commissioner of Internal Revenue, C.T.A. Case No. 1144, December 16, 1963; Escudero Electric Service Co. vs. Melecio R. Domingo etc., C.T.A. Case No. 1026, December 26, 1963; and Guagua Electric Plant Co., Inc. vs. Commissioner of Internal Revenue, C.T.A. Case No. 1175, August 29, 1964). More so, because each franchise was granted with the express "understanding and upon the condition that it shall be subject to amendment, alteration or repeal by the Congress of the United States", now (the Congress of the Philippines).

And having accepted said franchises subject to the afore-mentioned terms and conditions, petitioner cannot now assert that the imposition and collection of the higher rate of 5% is in violation of the non-impairment clause of our constitution (Lealda Electric Co., Inc. vs. Commissioner of Internal Revenue, supra; Balanga Power Plant Co., Inc. vs. Commissioner of Internal Revenue, supra).

On the third issue, petitioner contends that he is not liable for the sum of ₱28,293.88, representing the 25% surcharge, for the reason that the failure to pay the 5% franchise tax was due to respondent's letters, dated June 15, 1955 and July 13, 1955, respectively, which led him to believe that the correct rate of percentage tax due was only 2%, and in consequence of which it was granted a tax credit of ₱39,830.76, or the difference between the 5% prescribed in Section 259 of the Tax Code and the 2% provided in its franchises.

This contention is well taken. Having acted in good faith and having been misled by the respondent, it would not be fair and equitable to impose upon the petitioner the 25% surcharge. In the case of Ilagan Electric & Ice Plant, Inc. vs. the Commissioner of Internal Revenue, C.T.A. Case No. 1178, May 18, 1964, this Court held:

> "It is undisputed that petitioner paid the 2% franchise tax in accordance with the view of respondent's deputy that the former was liable only for the 2% franchise tax. It may, therefore, be said that the failure to pay the correct amount of tax is clearly and directly attributable to the mistaken view of respondent's deputy regarding the rate of tax applicable to petitioner's gross receipts. In paying 2% franchise tax, petitioner was acting in good faith. Having thus acted, it would not be just to penalize petitioner with 25% surcharge for falling into the error to which it has been led by respondent's deputy. (See Connell Bros. Co. [Phil.] vs. Collector of Internal Revenue, G. R. No. L-15470, December 26, 1963.)"

The defense of prescription interposed by petitioner against the collection and/or recovery of the sum of ₱39,830.76, which was credited as overpayment, is well taken. It is the rule that where deficiencies in taxes arise as a result of erroneous refunds made by respondent, he may make a new or deficiency assessment against the taxpayer if the statute of limitations has not yet set in (Ilagan Electric & Ice Plant, Inc. vs. Commissioner of Internal Revenue, supra, citing May R. Millez, 19 TC 395; Carl H. Thorsell, 13 TC 909; Rothensies v. Electric Storage Battery Co., 329 U. S. 296; Southern Maryland Agricultural Fair Association vs. Comr. of Int. Rev., 40 BTA 549, 554). In the case at bar, petitioner paid franchise tax and was granted a tax credit in the total amount of ₱39,830.76 for the period from the first quarter of 1953 to the first quarter of 1955. From this, we can reasonably assume that quarterly returns were seasonably filed for that period. Consequently, the right of respondent to assess the amount of ₱39,830.76 is limited to five (5) years from the filing of the returns (See Section 331 of the Tax Code). And it appearing that the assessment in question was made only on November 29, 1960 and received by petitioner on December 19, 1960, it is obvious that the assessment was made beyond five (5) years from the filing of the last return for the first quarter of 1955. Hence, the right of respondent to collect the amount of ₱39,830.76 has prescribed.

But respondent contends that the government is not assessing the deficiency franchise tax, but is recovering tax erroneously credited, and, therefore, Section 331 of the Tax Code does not apply. In this connection, it must be stated that respondent, himself, has termed the assessments in question, which include the amount of ₱39,830.76, as deficiency. Moreover, if we were to agree to respondent's contention, then this Court is not the proper forum for recovering the amount allegedly credited as tax (Guagua Electric Plant Co., Inc. vs. Commissioner of Internal Revenue, supra.).

Petitioner admits its franchise tax liability on the income of ₱7,033.57 it derived from rental of poles, rental of bulbs, jobbing, and adjustment of accounts receivable. But, it is contesting the imposition of franchise tax on the interest income on its savings account, earning of the employees' retirement fund, profits in the sales of fixed assets, interest in the sale of cars, and proceeds of sales of materials and supplies, which amounted to ₱57,321.34, on the ground that these items were not obtained thru the franchise granted to petitioner.

The interest income on petitioner's savings accounts is subject to franchise tax for the reason that it represents profit made in the course of regular transactions, in connection with petitioner's franchise (Philippine Long Distance Telephone Co. vs. Collector, 90 Phil. 674). Similarly, the other contested items, consisting of earning of employees'

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retirement fund, profits in the sales of fixed assets, interest in the sale of cars, and proceeds of sales of materials and supplies, are earnings or profits incidental to and necessarily connected with the operation of its franchises, hence, includible in its taxable gross earnings.

WHEREFORE, the assessment appealed from is hereby modified. Petitioner is hereby ordered to pay respondent Commissioner, within 30 days from the date this decision becomes final, deficiency franchise tax for the period from October 1, 1955 to June 30, 1960 in the amount of ₱113,175.52. If the said amount is not paid within 30 days from the date this decision becomes final, the same shall be subject to the surcharge of 25% for delinquency pursuant to Section 259 of the Revenue Code.

SO ORDERED.

Quezon City, October 31, 1965.

ROMAN M. UMALI
Associate Judge

I CONCUR:

ALEJANDRO B. AFURONG
Associate Judge

Presiding Judge TEOFILO D. REYES, SR.
concurs and dissents in a
separate opinion.

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CONCURRING AND DISSENTING OPINION

I concur with the majority opinion except on the question of the (a) interest income on the savings account, (b) the earning of the Employees' Retirement Fund, (c) the profits in the sales of fixed assets, (d) the interest in the sale of cars, and (e) the proceeds of sales of materials and supplies. I do not believe that these items are subject to franchise tax. The pertinent provisions of law in this case are the following:

> "Par. 10. x x x The said grantee, in consideration of the francise hereby granted, shall pay quarterly into the Provincial Treasurer of Laguna, one _per_ _centum_ of the gross earnings, _obtained thru this privilege_ during the first twenty years (20) and two _per_ _centum_ during the remaining fifteen (15) years of the life of said franchise." (Resolution No. 81, dated October 21, 1929, of the Municipal Council of Bay, Laguna, Exh. "A-1," p. 61, C.T.A. Records). Underlining supplied.

> "Sec. 259. _Tax on corporate franchises_. - There shall be collected in respect to all existing and future franchises, upon the _gross earnings or receipts from the business covered by the law granting the franchise_ a tax of five _per_ _centum_ or such taxes, charges, and percentages as are specified in the special

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charters of the grantees upon whom such franchises are conferred, whichever is higher, unless the provisions thereof preclude the imposition of a higher tax. x x x. (National Internal Revenue Code). Underlining supplied.

To my mind, it is clear that what is intended to be covered by the franchise tax is gross earnings or receipts obtained thru the exercise of the privilege or the business covered by the law granting the franchise. The privilege or business covered by petitioner's municipal franchises is limited to the maintenance and operation of electric light, heat and power. Clearly, it is the gross earnings or receipts from such operation that must be considered in the computation of the franchise tax, and not the non-operating revenues. Therefore, interest on the savings account, earnings of the Employees' Retirement Fund, profits on the sale of fixed assets, interest in the sale of cars, and the sales of materials and supplies are certainly not earnings or receipts obtained thru the exercise of petitioner's corporate franchises, nor are they necessary in carrying out the public service to which petitioner is bound to render under the terms and conditions of the franchise. They should not therefore be considered in the computation of the franchise tax.

A franchise tax is essentially an imposition for the privilege granted by the corporate franchise. Thus, it has been defined as:

> "A 'franchise tax' is not a tax on property of corporation, but is imposed on corporation for privilege of carrying on its business and exercising corporate franchise granted by state. City of Chicago v. Chicago Ry. Co., 245 lll. App. 473." (Underlining supplied).
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> "A franchise tax is a tax imposed directly on the corporation, and not on

its capital stock, its property, the shares of the stockholders, or the dividends or profits accruing. Worth v. Petersburg R. R. Co., 89 N. C. 301, 305."

"'Franchise Tax' is tax imposed on corporation for privilege of being corporation, or of doing business in corporate capacity. Pacific Co. v. Johnson (Cal.) 298 P. 489, 492.

"A 'franchise tax' is a tax on the privilege of doing business under corporate organization. State v. Clement Nat. Bank, 78 A. 944, 949, 84 Vt. 167, Ann.Cas.1912D, 22."

(Words & Phrases, Vol. 17, pp. 510, 511)

Moreover, in accordance with the science of accounting, in so far as petitioner's business is concerned, these incomes are classified as non-operating or extraneous incomes and are thusly treated in the profit and loss statement. They are not added to the gross income arising from the operation of electric light, heat and power because they are not receipts or earnings from such operation.

To consider them as part of the gross receipts or earnings for franchise tax purposes would be to make the phrase "gross earnings, obtained thru this privilege" meaningless. They may be subject to other taxes, such as sales tax in the case of proceeds of sales of materials and supplies, but certainly not to franchise tax.

In view of the foregoing, I vote for the modification of the decision appealed from in the sense that petitioner is liable only for deficiency franchise tax in the amount of ₱110,609.46, itemized as follows:

Total gross receipts per audit		₱3,733.619.69
Less:		
Interest from Savings Account -	₱6,126.44	

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Interest earned by employees retirement fund	₱34,219.37	
Gains on sales of fixed assets	9,704.30	
Interest on balances of company financed cars..	597.60	
Proceeds of sales of materials and supplies	673.63	
Total		51,221.34

Gross receipts subject to franchise tax	₱3,682,298.35
5% tax due thereon	₱ 184,114.92
Less: Amount paid	73,505.46
Amount due	₱ 110,609.46

plus the delinquency penalty provided for in Section 259 of the National Internal Revenue Code, in case of non-payment within 30 days from the date this decision becomes final.

TEOFILO D. REYES, SR.
Presiding Judge

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