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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EASTERN EXTENSION AUSTRALASIA
and CHINA TELEGRAPH COMPANY LTD.,
Petitioner,

- versus - C.T.A. CASE NO. 2498

THE COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

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D E C I S I O N

Petitioner, a foreign corporation wholly owned by British nationals, is engaged in international telecommunications. By a Royal Decree of the Spanish Government dated March 30, 1898, petitioner was given a concession for the construction, operation, and maintenance of submarine telegraph cable from Hongkong to Manila so that communication between the Philippines and the outside world was effected.

On June 21, 1952, long after the said concession had expired, Republic Act No. 808 was approved granting to petitioner herein a legislative franchise "to land, construct, maintain and operate at Manila in the Philippines a submarine telegraph cable connecting Manila with Hongkong". Section 8 thereof granted to petitioner a tax exemption from the payment of all taxes whether municipal, provincial, or national <u>except</u> a franchise tax of 5% on the gross earnings and the tax on its real property. Thus -

"SEC. 8. In consideration of the franchise and rights hereby granted, the Grantee shall <u>pay to the Republic of the Philippines during the life of this franchise, a tax of five per cent of the gross earnings derived by the Grantee from its operation under this franchise</u> and which originate in the Philippines. Such tax shall be due and payable annually, within ten (10) days after the audit and approval of the accounts as prescribed in section 7 of this Act, and <u>shall be in lieu of all taxes of any kind, nature or description, levied, established or collected by any municipal, provincial or Republic authority</u> except that the Grantee shall pay the tax on its real property in conformity with existing law." (emphasis supplied)

On July 17, 1967, Republic Act No. 5002 was approved amending Republic Act No. 808 by enlarging the scope of petitioner's franchise. Section 1 thereof provides as follows:

"SECTION 1. There is hereby granted to 'The Eastern Extension Australasia and China Telegraph Company, Ltd.' its successors and assigns, hereinafter referred to as the 'Grantee' a franchise to land, construct, maintain and operate telecommunication systems by cable, <u>or any other means now known to science or which in the future may be developed for the reception and transmission of messages between any point in the Philippines to points exterior thereto</u>, including airplanes, airships, or vessels even though such airplanes, airships or vessels may be located within territorial limits of the Philippines." (emphasis supplied)

On July 24, 1974, President Ferdinand E. Marcos promulgated Presidential Decree No. 489 authorizing the herein petitioner to transfer and assign the franchise granted to it under Republic Act No. 808, as amended by Republic Act No. 5002, to the Eastern Telecommunications Philippines, Inc.

On December 28, 1971, petitioner received from respondent Commissioner of Internal Revenue a letter of demand requiring the former to pay its income tax liabilities for the years 1965 to 1970 amounting to ₱7,122,571.61. More than a year later on, petitioner received on February 26, 1973 another letter from respondent requiring the former to pay its income tax liabilities for the years 1952 to 1971 amounting to ₱21,523,288.37, inclusive of surcharges, interests, and compromise penalties. Respondent's subsequent letter of demand modifies, increases, and supersedes the original income tax liabilities of petitioner.

In disregarding the validity and efficacy of the legislative franchise and the tax-exemption granted therein to petitioner, respondent Commissioner of Internal Revenue relied on the authority of the decision in the case of People vs. Quasha, June 12, 1952, (93 Phil. 338-339) and Article XIV, Section 8 of the Constitution then in force, which provides as follows:

> ART. XIV, Sec. 8. No franchise, certificate or any other forms of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or other entities organized under the laws of the Philippines sixty per centum of the capital of which is owned by citizens of the Philippines, nor shall such franchise, certificate or authorization be exclusive in character or for a longer period than fifty years. No franchise or right shall be granted to any individual, firm, or corporation, except under the condition that it shall be subject to amendment, alteration or repeal by the Congress when the public interest so requires.

The decision of respondent on the disputed income tax liabilities of petitioner amounting to ₱21,523,288.37 for the years 1952 to 1971, inclusive, was appealed to this

Court and assailed on the grounds, among others, that:

> 8. Petitioner is not liable for and is exempted from, among others, corporate income taxes because of said franchise and said income tax assessments are invalid, null and void and respondent exceeded his authority in issuing them.
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> 9. The government in enacting R. A. No. 808 and R. A. No. 5002 and in authorizing petitioner to operate and pay franchise taxes thereunder and in accepting those payments is in estoppel from questioning the validity of said R. A. Nos. 808 and 5002.
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> 12. Assuming the invalidity of said Acts and assuming petitioner's liability for corporate income taxes under the National Internal Revenue Code, then petitioner is not liable for franchise taxes and all the payments petitioner has made as franchise taxes in justice and equity are proper credits in favor of petitioner to serve as deductions for any income tax due. x x x x .
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> 13. Assuming again the invalidity of said Acts xx xx xx prescription has set in and is here set up as a defense for those periods beyond the 5-year period given for respondent to assess under Section 331 of the National Internal Revenue Code. xx xx . (Petition For Review, pp. 6 - 7)

The Court decided to avoid a tedious and prolonged litigation on the merits of this case involving the disputed income tax assessments covering a period of twenty (20) years. The Court, on its own volition, therefore, suggested to the opposing parties that they file their respective memorandum on the paramount and prejudicial issue of whether or not Republic Act No. 808, as amended by Republic Act No. 5002, is invalid, null and void, and violative of Article XIV, Section 8 of the 1935 Constitution of the Philippines then in force. Both parties agreed to the proposal.

The secondary and consequential issue that projects itself in the event that the legislative franchise of petitioner is declared unconstitutional is this: What is the effect on the declaration of nullity of petitioner's legislative franchise in relation to the disputed income tax assessment of ₱21,523,288.37 issued by the respondent Commissioner of Internal Revenue?

Deviating from the prejudicial and secondary issues stated above, respondent assailed and questioned the right of petitioner to maintain this suit in the Court of Tax Appeals because of the prohibition contained under Section 69 of the Corporation Law which provides as follows:

> SEC. 69. No foreign corporation or corporation formed, organized, or existing under any laws other than those of the Philippines shall be permitted to transact business in the Philippines or maintain by itself or assignee any suit for the recovery of any debt, claim or demand whatever, unless it shall have the license prescribed in the section immediately preceding. xx xx xx xx xx. (Section 69, Act No. 1459)

The foregoing provisions should be read in relation to Section 11 of Republic Act No. 1125 which provides that any person, association or corporation adversely affected by a decision or ruling of the Commissioner of Internal Revenue may file an appeal in the Court of Tax Appeals within 30 days after receipt of such decision or ruling. This Court exercises <u>exclusive appellate jurisdiction</u> to review by appeal the decisions of the Commissioner of Internal Revenue in cases involving disputed assessments of revenue taxes. (See Sec. 7, Rep. Act No. 1125)

The prohibition contained under Section 69 of the Corporation Law, <u>supra</u>, refers merely to the maintenance by any foreign unregistered corporation of any suit for the recovery of any debt, claim or demand whatever but it does not bar petitioner, a foreign corporation not registered with the Securities and Exchange Commission, from defending itself when sued because in essence and effect an appeal by a taxpayer to the Court of Tax Appeals is not an original action but a continuation of the proceeding began and instituted against it by the respondent Commissioner of Internal Revenue. Consequently, we find no valid justification to desist from taking cognizance of this appeal and resolving the controversial issues involved therein.

Petitioner contends that the legislative franchise granted to it under Republic Act No. 808, as amended by Republic Act No. 5002, is constitutional and therefore valid, operative and binding. In support of its contention, petitioner cited with emphasis and approval the opinion of the then Secretary of Justice, Hon. Roman Ozaeta, dated September 11, 1946, in his indorsement on the application of herein petitioner for the operation and maintenance of an overseas telecommunication system. The said official sustained the view that petitioner is a public utility corporation but it is not so within the purview of the Philippine Constitution because it is engaged in business exclusively interstate. Said opinion is reproduced hereunder:

> Being a telegraph company in the service of the general public, it must be admitted that the applicant is a public utility. Vide 52 Am. Jur. 38-39; C.J. 16; see, also page 6 of attached deed

> of concession granted by the Spanish Government in 1898.
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> Counsel for the applicant contends, however, that the term 'public utility' as used in the constitution has a special and restricted meaning, that is, that it should be construed in the light of section 16 of the Public Service Law which limits the term to those engaged in or operating within the Philippines, thus impliedly excluding those engaged in business exclusively interstate.
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> Concurring in the view thus stated, the undersigned is of the opinion that public utilities engaged exclusively in international commerce are beyond the purview of the constitutional provision in question. To hold otherwise would be to ascribe to the Constitutional Convention the intention of isolating the Philippines from the rest of the civilized world, as would - under the circumstances then and still prevailing - inevitably follow if all foreign public utilities engaged in international transportation and communication were to be banned from establishing terminals and offices in this jurisdiction. The disastrous consequences of such a policy are too obvious as to need further elaboration.
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> xx xx xx xx xx

Petitioner also contends that in passing House Bill 1099 which became Republic Act No. 808, Congress made the legislative determination that "petitioner is not a public utility doing business in the Philippines" because the bill is presented to enable petitioner to continue operating its expired concession. (Explanatory Note to the Bill). The said explanatory note found support in the opinion of the then Secretary of Justice Ricardo Nepomuceno, dated March 14, 1950, who said that: "I find nothing legally or constitutionally objectionable in the bill." Petitioner argued, therefore, that the legislative determination on the constitutionality of the franchise in question is conclusive and binding upon the courts.

Petitioner further contends that when Presidential Decree No. 489 was approved and promulgated by President Ferdinand Marcos on June 24, 1974 - transferring its franchise to Eastern Telecommunication Philippines, Inc., - the Chief Executive recognized and sanctioned the validity and constitutionality of petitioner's original franchise, as amended. Petitioner further argued, therefore, that to sustain respondent's arguments is for this Court to sustain the BIR's superiority over the President. Effectively, it will mean the invalidation of PD 489 in total disregard of the mandate and provisions of Section 3(2), Article XVII of the new Constitution.

All laws are presumed valid and constitutional unless the contrary is declared by at least ten justices of the Supreme Court. (See Sec. 2(2), Article X, New Constitution). This legal truism notwithstanding, I am of the persuasion that the operation by petitioner of the overseas telecommunication system is a "public utility" or a "public service" falling within the purview of the Public Service Law; and that the legislative franchise granted to petitioner under Republic Act No. 808, as amended, is unconstitutional and void.

Justice Secretary Ozaeta's opinion that petitioner would engage only in "an exclusive interstate business" and that the Public Service Law applies only to those "operating within the Philippines" presumably had in mind American decisions to the effect that American States have no power to regulate communication systems connecting them with other States, otherwise known as "interstate communication systems". These rulings were based on a provision of the Federal Constitution reserving to the Federal Government the power to regulate "interstate commerce". A critical and deeper analysis, however, of the said decisions will tend to support the view that the Philippine Government (the counterpart of the Federal Government) can regulate communication systems between the Philippines and foreign countries provided that the telecommunication equipment or apparatus are located in this country.

My stand is bolstered and strengthened by the strict interpretation that should be accorded to the provisions of Article XIV, Section 8, of the 1935 Constitution as enunciated by the Supreme Court in the case of Republic vs. Quasha, No. L-30299, Aug. 17, 1972, wherein it was held:

> The basis for the strict interpretation was given by former President of the University of the Philippines, Hon. Vicente G. Sinco (Congressional Record, House of Representatives, Volume 1, No. 26, page 561):
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> > "' It should be emphatically stated that the provisions of our Constitution which limit to Filipinos the rights to develop the natural resources and to operate the public utilities of the Philippines is one of the bulwarks of our national integrity. The Filipino people decided to include it in our Constitution in order that it may have the stability and permanency that its importance requires. It is written in our Constitution so that it may neither be the subject of barter nor be impaired

> in the give and take of politics. With our natural resources, our sources of power and energy, our public lands, and our public utilities, the material basis of the nation's existence, in the hands of aliens over whom the Philippine Government does not have complete control, the Filipinos may soon find themselves deprived of their patrimony and living as it were, in a house that no longer belongs to them.'"

Justice Secretary Ozaeta's opinion that the Philippines would be isolated from the rest of the world if the foreign public utilities were barred from operating in this country is, to my mind, devoid of any constitutional basis. Article XIV, Section 8 of the 1935 Philippine Constitution, does not totally ban or prohibit foreign investments in public utilities because in their capitalization foreign investors are entitled to a maximum of 40% thereof. The Secretary's opinion assumes that if alien operators of public utilities were asked to sell their controlling interests therein to Filipinos, they would pull out of the country rather than submit to the constitutional requirement limiting their investments to 40% of the total capital invested. The backlash feared by the Secretary of Justice is unjustified and illusory because foreign investors are more realistic and flexible than the way they are pictured to be. In fact, a Central Bank study shows that between February 1970 and June 30, 1975 foreign investments in public utilities operating in the Philippines amounted to 20.08 million in U. S. dollars. (The Tax Review, Vol. I, No. 4, December 1975).

Justice Secretary Ozaeta rendered the opinion that a telegraph company in the service of the general public like petitioner is a public utility. (52 Am. Jur. 38-39; 62 C. J. 16; see, also page 6 of attached deed of concession granted by the Spanish Government in 1898). This opinion disposes of the argument and pretension contained in the explanatory note to the bill which became Republic Act No. 808, that petitioner's operation is not a public utility. A "public utility" is synonymous with "public service". As a matter of fact, the Philippine Public Service Law (Comm. Act No. 146, as amended) was formerly known as the Public Utility Law (Acts 2203 and 2684).

Section 13(b) of the Public Service Act defines "public service" as "every person that now or hereafter may own, operate, manage, or control in the Philippines, for hire or compensation, with general or limited clientele, whether permanent, occasional or accidental, and done for general business purposes, any xx xx xx wire or wireless communication systems, wire or wireless broadcasting stations and other similar public services."

The term "communications system" is unqualified and no distinction is made in the law between "domestic communication" and "foreign communication" or a service connecting a point within the Philippines and any point outside of our country. It is my considered opinion, therefore, that the statutory definition is complied with provided that the receiving and transmitting stations of the telecommunication systems are located and operated in the"Philippines". This is so because, under their respective franchises, these telecommunication systems are subject to the jurisdiction of the Philippine Public Service Commission as to their rates; to Philippine taxes whether local, provincial, and national except when expressly exempted by law from the payment thereof; and to the control of the Secretary of Public Works and Communications as to the frequencies and wave lengths and the location of their stations. All the said statutory requirements are earmarks of the operation of petitioner's communication systems in the Philippines; otherwise, petitioner will become a supra-national public utility corporation which is operating under no flag at all.

When the Secretary of Justice concluded that petitioner is engaged exclusively in international commerce, it may be presumed that he had in mind foreign maritime and air transportation companies engaged in international commerce by transporting or moving persons, things and news or intelligence (1 Blanco, 643; Higginbotham v. Public Belt R. Com., 181, So. 65; Western U. Teleg. Co. v. Call Pub. Co., Neb. 326, 62 NW 506, 27 LRA 622). On the other hand, petitioner is engaged in overseas telecommunication business whose facilities therefor are permanently installed and operated in the Philippines. The difference lies in the mobility and/or permanence of their equipment. In the transportation business of foreign corporation, whether ships or airplanes, the means of transportation are mobile and their stay in the Philippines is transient while in petitioner's business the facilities therefor are permanently located and operated in this country. It is clear, therefore, that petitioner operates as a public utility in the Philippines within the purview of the Public Service Law.

It may be argued, however, that in the operation of petitioner's public utility business, the transmission of signals by wire, telegraph or telecommunication from the Philippines to a foreign country is not an operation within the Philippines. By the same token, the reception in the Philippines of the signals sent by cable, telegraph or telecommunication from said foreign country constitutes an operation within the Philippines. In whatever angle I view petitioner's activities under its legislative franchise, I am convinced that petitioner's public utility corporation is operating in the Philippines under the Public Service Law.

The Secretary of Justice stated that the constitutional provision in question "was obviously designed to afford needed protection to Filipino businessmen in their endeavor to compete with alien merchants, a purpose to disregard sound public policy must not be attributed to the framers of the Constitution, except upon the most cogent evidence." If we must speak of sound public policy on overseas communication, it is indispensable that this vital link of communication between the Philippines and the outside world should be under the control of Filipinos or by the Philippine Government because the interest in public utilities is not merely economic nationalism but more decisively the security and welfare of the State.

In the United States, the operation of overseas telecommunication is regulated by the Federal Communications Act, as amended, the purpose of which is "to maintain control of the United States over all channels of interstate and foreign radio transmission x x x" and which limits the issuance of licenses to engage in such business (Sec.310(a)). The restriction is readily understandable because of the sensitive and vital nature of the business. In fact, one of the first measures taken by the United States after the disastrous annihilation of the U. S. Naval Fleet at Pearl Harbor, Hawaii on December 7, 1941, was the taking over by the U. S. Armed Forces of all domestic and foreign communication facilities.

After stating the reasons justifying my firm stand against the constitutionality of Republic Act No. 808, as amended, the Supreme Court in the case of Francisca Serrano de Agbayani vs. Philippine National Bank, et al., No. L-23127, April 29, 1971, speaking thru Justice Enrique Fernando said: "A correct appreciation of the controlling doctrine as to the effect, if any, to be attached to a statute subsequently adjudged invalid, is decisive of this appeal x x." In declaring the moratorium under Executive Order No. 32 and Rep. Act No. 342 invalid and unconstitutional, our highest tribunal further said: " xx xx xx xx while a statute repugnancy to the fundamental law deprives it of its character as a juridical norm, its having been operative prior to its being nullified is a fact that is not devoid of legal consequences."

It devolves upon this Court, therefore, to determine and ascertain the legal consequences of respondent's assessment against petitioner for income tax liabilities amounting to ₱7,122,571.81, inclusive of 25% surcharges, interests and compromise penalty, covering the fiscal years 1965 to 1970 -- a period of five (5) years. The said income tax assessment was subsequently modified, increased and superseded by another income tax assessment in the aggregate amount of ₱21,523,288.37, inclusive of 50% surcharges, interests and compromise penalties covering the years 1952 to 1971 - a period of twenty (20) years.

The fantastic and fabulous income tax assessment of ₱21,523,288.37 issued by respondent against petitioner is without sufficient legal and valid justification under Sections 331 and 332(a) of the National Internal Revenue Code, in relation to Section 72 of the same code which read as follows:

> SEC. 331. Period of limitation upon assessment and collection. - Except as provided in the succeeding section, internal revenue taxes shall be assessed within five years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after expiration of such period. xx xx xx xx xx
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> SEC. 332. Exceptions as to period of limitation of assessment and collection of taxes. - (a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may

> be begun without assessment, at any time within ten years after the discovery of the falsity, fraud, or omission.
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> xx xx xx xx xx xx
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> SEC. 72. Surcharges for failure to render returns and for rendering false and fraudulent returns. - The Commissioner of Internal Revenue shall assess all income taxes. In case of willful neglect to file the return or list within the time prescribed by law, or in case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax or to the deficiency tax, in case any payment has been made on the basis of such return before the discovery of the falsity or fraud, a surcharge of fifty per centum of the amount of such tax or deficiency tax. xx xx xx xx

Respondent has neither denied nor assailed the fact that petitioner has invariably filed the corresponding franchise tax returns and paid the franchise taxes due thereon as required by Section 259 of the National Internal Revenue Code during the period under review. Under Section 331 of the Revenue Code, supra, internal revenue taxes shall be assessed by respondent within five (5) years after the taxpayer's return was filed. If petitioner's franchise tax returns filed with respondent's office were void by virtue of an invalid legislative franchise, respondent should have assessed petitioner for income taxes within a period of five (5) years after the due date for the filing of said returns. Respondent may, however, argue that under Section 332(a) of the Revenue Code, supra, petitioner's failure to file the income tax returns authorizes him to assess the income tax due from petitioner within ten years after the discovery of the falsity, fraud, or omission.

It is not denied that petitioner has failed to file any corporate income tax return for a period of twenty (20) years from 1952 to 1971, inclusive. Does this omission or failure to file the corresponding corporate income tax returns attributable to the fault of petitioner and motivated by a desire to defraud the government of the income taxes legally due to it at the time? The answer certainly should be in the negative because it was Congress which exempted petitioner from the payment of all taxes whether local, provincial or national, except franchise and real property taxes.

It is a cardinal rule in taxation and a settled jurisprudence that tax-fraud cannot be presumed. It is incumbent upon the tax collectors to prove the existance thereof by clear and convincing evidence amounting to more than mere preponderance of evidence.[1] On this point, respondent utterly and miserably failed even to indicate in his letters of demand or in any pleading filed in court that petitioner has willfully or intentionally evaded the payment of income taxes while its franchise was still in force and validly subsisting. In the circumstances, I hold that under Sections 331, 332(a) and 72 of the National

[1] Yutivo & Sons Hardware Co. v. C.T.A. and Collector of Internal Revenue, No. L-13203, Jan. 28, 1961, 1 SCRA 160.

Internal Revenue Code, respondent has only five (5) years within which to assess petitioner's income tax liabilities and that the 50% surcharges as fraud penalty imposed by respondent against the alleged income tax liabilities of petitioner is illegal and arbitrary.

Aside from the legal consequences mentioned above, there are two (2) valid grounds upon which respondent's income tax assessment of ₱21,523,288.37 may be wiped out and obliterated, namely: (1) The prevailing principle that the existence of a statute prior to its being adjudged void must have been in force and had to be complied with; and (2) The non-retroactive effect of rulings promulgated by the Commissioner of Internal Revenue as provided in Section 338-A of the National Internal Reve- Code which took effect on September 1, 1969.

For the sake of brevity, I will forego any discussion on the effect of Section 12, Article XVII of the New Constitution which recognizes as "legal, valid and binding all xx xx contracts entered into by the Government," xx xx in relation to the non-liability of petitioner from the payment of income tax.

FIRST GROUND

There are two schools of thought as to the force and effect of a statute which was subsequently adjudged by the court to be invalid and unconstitutional. The orthodox view held that an unconstitutional statute cannot be the source of any legal rights or duties. In brief, the statute is a mere scrap of paper. The prevailing and accepted doctrine however, is to the effect that the existence of a statute prior to its being adjudged void must have been in force and had to be complied with. Thus, in the case of Francisca Serrano de Agbayani vs. Philippine National Bank, et al., supra, the Supreme Court held:

> 1. The decision now on appeal reflects the orthodox view that an unconstitutional act, for that matter an executive order or a municipal ordinance likewise suffering from that infirmity, cannot be the source of any legal rights or duties. Nor can it justify any official act taken under it. Its repugnancy to the fundamental law once judicially declared results in its being to all intents and purposes a mere scrap of paper. As the new Civil Code puts it: "When the courts declare a law to be inconsistent with the Constitution, the former shall be void and the latter shall govern. Administrative or executive acts, orders and regulations shall be valid only when they are not contrary to the laws or the Constitution. It is understandable why it should be so, the Constitution being supreme and paramount. Any legislative or executive act contrary to its terms cannot survive.
>
> Such a view has support in logic and possesses the merit of simplicity. It may not however be sufficiently realistic. It does not admit of doubt that prior to the declaration of nullity such challenged legislative or executive act must have been in force and had to be complied with. This is so as until after the judiciary, in an appropriate case, declares its invalidity, it is entitled to obedience and respect. Parties may have acted under it and may have changed their positions. What could be more fitting than that in a subsequent litigation regard be had to what has been done while such legislative or executive act was in operation and presumed to be valid in all respects. It is now accepted as a doctrine that prior to its being nullified, its existence as a fact must be reckoned with. This is merely to reflect awareness that precisely because the judiciary is the governmental organ which has the final say on whether or not a legislative or executive measure is valid, a period of time may have elapsed before it can

exercise the power of judicial review that may lead to a declaration of nullity. It would be to deprive the law of its quality of fairness and justice then, if there be no recognition of what had transpired prior to such adjudication.

In the language of an American Supreme Court decision: "The actual existence of a statute, prior to such a determination [of unconstitutionality], is an operative fact and may have consequences which cannot justly be ignored. The past cannot always be erased by a new judicial declaration. The effect of the subsequent ruling as to the invalidity may have to be considered in various aspects, - with respect to particular relations, individual and corporate, and particular conduct, private and official." This language has been quoted with approval in a resolution in Araneta vs. Hill and the decision in Manila Motor Co., Inc. vs. Flores. An even more recent instance is the opinion of Justice Zaldivar speaking for the Court in Fernandez vs. Cuerva and Co.

2. xx xx xx. The legislature on the whole is not likely to allow an enactment suffering, to paraphrase Cardozo, from the infirmity of outrunning the bounds of reason and resulting in sheer oppression. It may be of course that if challenged, an adverse judgment could be the result, as its running counter to the Constitution could still be shown. In the meanwhile though, in the normal course of things, it has been acted upon by the public and accepted as valid. To ignore such a fact would indeed be the fruitful parent of injustice. Moreover, as its constitutionality is conditioned on its being fair or reasonable, which in turn is dependent on the actual situation, never static but subject to change, a measure valid when enacted may subsequently, due to altered circumstances, be stricken down. xx xx xx

There is all the more reason then to yield assent to the now prevailing principle that the existence of a statute or executive order prior to its being adjudged void is an operative fact to which legal consequences are attached.

xx xx xx xx

In line with the said ruling of the Supreme Court, I maintain that petitioner is only subject to the franchise tax imposed by Section 259 of the National Internal Revenue Code, infra, in relation to Section 8 of Republic Act No. 808, supra, covering the period from the year 1952, when petitioner's legislative franchise was granted, up to the time it is finally declared by the court to be invalid and unconstitutional. Consequently, respondent's income tax assessment of ₱21,523,288.37 against petitioner for the years 1952 to 1971, inclusive, issued on February 28, 1973, is without any legal force and effect.

SECOND GROUND

Section 338 of the National Internal Revenue Code authorizes the Secretary of Finance, upon the recommendation of the Commissioner of Internal Revenue, to promulgate all needful rules and regulations for the effective enforcement of the provisions of the same Code. One of these provisions relate to the franchise tax under Section 259 of the aforesaid Code which reads as follows:

> SEC. 259. Tax on franchises. - There shall be collected in respect to all franchises, upon the gross 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 charters of the grantees upon whom such franchises are conferred, whichever is higher, unless the provisions thereof preclude the imposition of a higher tax. For the purposes of facilitating the assessment of this tax, reports shall be made by the respective holders of the franchises in such form and at such times, as shall be required by the regulations of the Department of Finance.

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> The taxes, charges, and percentages on franchises, shall be assessed, collected by and paid to the Commissioner of Internal Revenue or any of his collection agents, any provision in the franchise to the contrary notwithstanding, and shall be due and payable as specified in the particular franchise, or, in case no time limit is specified therein, the provisions of Section one hundred eighty-three shall apply; and if such taxes, charges, and percentages remain unpaid on the date on which they must be paid, twenty-five per centum shall be added to the amount of such taxes, charges, and percentages, which increase shall form part of the tax. (As amended by Sec. 7, Republic Act No. 39; Sec. 1, Republic Act No. 418; and Sec. 53, Republic Act No. 6110.)

It can thus be seen from the said provisions that, for the purpose of facilitating the assessment of the franchise tax, the Secretary of Finance, upon the recommendation of respondent, may promulgate the implementing rules and regulations. It is to be noted that the said rules and regulations will merely implement the provisions of the franchise tax law. Any revocation, modification or reversal of the ruling or the franchise tax law itself by the respondent Commissioner of Internal Revenue shall not be given retroactive application. The mandatory requirement for the prospective operation of the new ruling is explicit under Section 338-A of the National Internal Revenue Code which provides as follows:

> SEC. 338-A. Non-retroactivity of rulings. - Any revocation, modification, or reversal of any of the rules and regulations promulgated in accordance with the preceding section or any of the rulings or circulars promulgated by the Commissioner of Internal Revenue shall not be given retroactive application if the revocation, modification, or reversal will be prejudicial to the

> taxpayers except in the following cases: (a) where the taxpayers deliberately misstates or omits material facts from his return or in any document required of him by the Bureau of Internal Revenue; (b) where the facts subsequently gathered by the Bureau of Internal Revenue are materially different from the facts on which the ruling is based; or (c) where the taxpayer acted in bad faith. (Inserted by Sec. 61, Republic Act No. 6110.)

On February 26, 1971, when respondent issued the final income tax assessment in question, Section 338-A of the National Internal Revenue Code was already operative and in force because the provisions thereof are contained in Section 61 of Republic Act No. 6110 which took effect on September 1, 1969.

Respondent's income tax assessment against petitioner for a period of twenty (20) years is tantamount to a revocation of the tax on franchise prescribed by Section 259 of the National Internal Revenue Code, _supra_, because the provisions thereof were disregarded in favor of Section 24 of the same Code which imposes the corporate income tax. In such a case, the revocation of the franchise tax law shall have _prospective application_ except in the following cases:

> (a) where the taxpayer deliberately misstates or omits material facts from his return or in any document required of him by the Bureau of Internal Revenue;
>
> (b) where the facts subsequently gathered by the Bureau of Internal Revenue are materially different from the facts on which the ruling is based; or
>
> (c) where the taxpayer acted in bad faith.

For obvious reasons, the facts and circumstances recited above are not present in the case at bar. Respondent's income tax assessments and letters of demand against petitioner are in the nature of rulings which in effect revoked the franchise tax law contained in Section 259 of the Tax Code. This conclusion is evidenced by the fact that in respondent's two (2) separate letters of demand against petitioner, the latter's payment of franchise taxes for a period of five (5) or twenty (20) years, respectively, were not deducted from the amount of income taxes assessed by respondent against petitioner. Consequently, respondent's final letter of demand against petitioner, dated February 28, 1973, cannot be given retroactive application.

WHEREFORE, the decision of the respondent Commissioner of Internal Revenue appealed from is reversed. Respondent's income tax assessment of P21,523,288.37 issued against petitioner is hereby cancelled and declared to be without any legal force and effect. No pronouncement as to costs.

SO ORDERED.

Quezon City, February 16, 1976.

ESTANISLAO R. ALVAREZ
Associate Judge

I concur solely in the result:

ROMAN M. UMALI
Presiding Judge

Associate Judge RAMON L. AVANCEÑA, who is on leave, took no part.