REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE (CIR),
Petitioner,

- versus-

PHILIPPINE AIRLINES, INC.
Respondent,

CTA EB No. 605
(CTA Case No. 7669)

Present:

Acosta, *P.J.*
Castañeda,Jr.,
Bautista,
Uy,
Casanova,
Palanca-Enriquez,
Fabon-Victorino,
Mindaro-Grulla, and
Cotangco-Manalastas, *JJ.*

Promulgated:

SEP 13 2010 1:05 p.m.

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D E C I S I O N

COTANGCO-MANALASTAS, J.:

THE CASE

On appeal before the Court *En Banc* by way of Petition for Review[1] filed on March 25, 2010 by the Commissioner of Internal Revenue ("CIR"), pursuant to *Section 18 of Republic Act (R.A.) No. 1125, as amended by Section 11 of R.A. No. 9282, and Section 3(b), Rule 8 of the 2005 Revised Rules of the Court of Tax Appeals*

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[1] *Rollo*, CTA EB No. 605, pp. 1-39, with Annexes.

(RRCTA), are the Decision[2] and Resolution[3] promulgated on December 10, 2009 and March 11, 2010, respectively, by the former First Division of the Court of Tax Appeals. The dispositive portions of which read as follows:

Decision dated December 10, 2009:

> "**WHEREFORE**, the instant Petition for Review is hereby **GRANTED**. Accordingly, the Formal Letter of Demand dated February 8, 2007 and the Final Assessment Notice dated February 12, 2007 assessing petitioner for deficiency MCIT in the total amount of P65,544,153.43 are hereby **CANCELLED** and **SET ASIDE**.
>
> **SO ORDERED.**"

Resolution dated March 11, 2010:

> "**WHEREFORE**, for failure to present new arguments that will warrant the reversal or modification of the *Decision* dated December 10, 2009, respondent's *Motion for Reconsideration* is hereby **DENIED** for lack of merit.
>
> **SO ORDERED.**"

Petitioner CIR is praying that the afore-quoted Decision and Resolution be reversed and set aside and another one be rendered ordering respondent Philippine Airlines, Inc. ("PAL") to pay the amount of P65,544,153.43 as deficiency Income Tax for the fiscal year ending March 31, 2004, plus 25% surcharge and 20% annual interest for late payment from February 28, 2007 until fully paid pursuant to Sections 248 and 249 of the National Internal Revenue Code (NIRC) of 1997.

THE PARTIES

Petitioner is the Commissioner of the Bureau of Internal Revenue ("BIR"), which is the government agency in charge of the assessment and collection of all national internal revenue taxes, fees, and charges, including, among others, the two

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[2] *Rollo*, pp. 14-33, Annex "A"
[3] *Rollo*, pp. 34-36, Annex "B"

percent (2%) Minimum Corporate Income Tax (MCIT), imposed under Section 27(E) of the NIRC. He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

Respondent PAL is a domestic corporation organized in accordance with the laws of the Republic of the Philippines, with principal office at the 9th Floor, PAL Center, Legazpi St., Legazpi Village, Makati City.

THE FACTS

The facts, as found by the former First Division, are hereunder reproduced:

> Respondent [CIR, in CTA Case No. 7669], through the BIR's Large Taxpayer's Service, issued Letter of Authority LOA 2000-00096214 dated April 18, 2000 addressed to petitioner [PAL] and received by the latter on April 26, 2006; informing the petitioner that the Revenue Officers mentioned therein "are authorized to examine your books of accounts and other accounting records for all Internal Revenue Taxes (Except PT) – Claim for TCC/Refund for the period from FY ending March 31, 2004".
>
> On May 17, 2006, respondent issued a "Second Notice for Presentation and Submission of Documents and Records."
>
> On January 26, 2007, petitioner received a Preliminary Assessment Notice dated January 12, 2007 from the Officer-in-Charge (OIC) Assistant Commissioner of the BIR Large Taxpayers Service, informing petitioner that after audit investigation had been conducted on petitioner's internal revenue tax liabilities (except Percentage Taxes) for fiscal year ended March 31, 2004, pursuant to the above-mentioned Letter of Authority, there were found due from petitioner deficiency taxes, the details of which are as follows:

a.	INCOME TAX-MCIT	
	Deficiency Income Tax	P 40,740,189.10
	Add: 20% Interest (7/16/04 to 1/31/07)	20,738,430.51
	Compromise	25,000.00
	TOTAL AMOUNT DUE	P 61,503,619.61
b.	VALUE-ADDED TAX	
	Deficiency Value-Added Tax	P 408,470.45
	Add: 20% Interest (4/26/04 to 1/31/07)	226,057.62
	Compromise	16,000.00
	TOTAL AMOUNT DUE	P 650,528.07
c.	EXPANDED WITHHOLDING TAX	
	Deficiency Expanded Withholding Tax	P 856,832.50
	Add: 20% Interest (4/11/04 to 1/31/07)	481,234.69
	Compromise	20,000.00
	TOTAL AMOUNT DUE	P 1,358,067.19

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On February 1, 2007, petitioner filed a formal protest, dated February 1, 2007, against the afore-mentioned assessment, stating that under Section 13 of its franchise, Presidential Decree (P.D.) No. 1590, petitioner is liable only for the basic corporate income tax based on the annual net taxable income, or the 2% franchise tax based on gross revenue, whichever is lower, 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.

On February 20, 2007, petitioner received a Formal Letter of Demand from respondent dated February 8, 2007, demanding the payment of the total amount of P62,128,674.56; the details of which as shown in said letter are as follows:

INCOME TAX-MINIMUM CORPORATE INCOME TAX	
Deficiency Income Tax	P 40,740,189.10
Add: 20% Interest (7/16/04 to 2/28/07)	21,363,485.46
Compromise	25,000.00
TOTAL AMOUNT DUE	P 62,128,674.56

On March 12, 2007, petitioner filed its protest, dated February 28, 2007, reiterating its arguments contained in its protest-letter dated February 1, 2007 against respondent's Preliminary Assessment Notice.

On July 13, 2007, petitioner received a Final Decision on Disputed Assessment dated July 5, 2007, from the OIC Large Taxpayers Service of the BIR, Nestor S. Valeroso, informing petitioner that after evaluating its protest letter dated February 28, 2007 on the Formal Letter of Demand dated February 8, 2007 and Final Assessment Notice dated February 12, 2007 issued against petitioner, the said Large Taxpayers Service "still find due" from petitioner a deficiency income tax – MCIT pursuant to Section 27(E) of the NIRC, in the total amount of P65,544,153.43, computed as follows:

INCOME TAX-MINIMUM CORPORATE INCOME TAX	
Deficiency Income Tax	P 40,740,189.10
Add: 20% Interest (7/16/04 to 1/31/07)	24,778,964.33
Compromise	25,000.00
TOTAL AMOUNT DUE	P 65,544,153.43

Thus, on August 10, 2007, petitioner filed the instant Petition.

In his Answer filed on September 11, 2007, respondent counter-argued, among others, that: (a) petitioner is covered by Section 27(E) of the NIRC of 1997 and Revenue Regulations (R.R.) 9-98; (b) Revenue Memorandum Circular (RMC) No. 66-2003 dated October 14, 2003 clarified the taxability of petitioner for income tax purposes; and (c) petitioner may also be made liable for MCIT under Section 27(E), in relation to Sections 27(A) and 22(B) of the NIRC of 1997.

In a Resolution dated November 14, 2007, this Court approved the parties' Joint Stipulation of Facts and Issues filed on November 13, 2007, and both parties proceeded to present their respective evidence.

On December 23, 2008, this case was submitted for decision after the parties filed their respective Memorandum.

As stipulated by the parties, the following were the issues resolved by the Court *a quo*:

> "1. Whether or not petitioner is exempt by virtue of its franchise, Presidential Decree No. 1590, from the 2[%] Minimum Corporate Income Tax imposed by Section 27(E) of the NIRC, and therefore, not liable for the PHP65,544,153.43 deficiency MCIT assessment issued against it by respondent for the fiscal year ending March 31, 2001, and
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> 2. Whether or not Revenue Memorandum Circular No. 66-2003, dated October 14, 2003, on the subject 'Clarifying the Taxability of Philippine Airlines (PAL) for Income Tax Purposes as Well as Other Franchise Grantees Similarly Situated', is an unauthorized modification of Section 13 of PAL's franchise, P.D. No. 1590, in violation of Section 24 of said franchise."

After trial on the merits, the Court *a quo* handed a Decision[4] on December 10, 2009 granting the Petition for Review filed by PAL on August 10, 2007.

The Court *a quo* concluded that, after a conscientious study of Section 13 of P.D. 1590, in relation to Sections 27(A) and 27(E) of the NIRC of 1997, PAL cannot be subjected to MCIT. Appropriately, the Formal Letter of Demand and the Final Assessment Notice assessing petitioner for deficiency MCIT in the total amount of P65,544,153.43 were cancelled and set aside.

The assailed Decision heavily focused its discussions on the case of *Commissioner of Internal Revenue vs. Philippine Airlines, Inc.*[5] decided by the Supreme Court on July 7, 2009, which significantly dealt with similar issues as in this instant petition, and accorded great weight and credence to the provisions of Presidential Decree No. 1590, in relation to Sections 27(A) and 27(E) of the NIRC of 1997, and thus, declared: that PAL shall be governed by two fundamental rules, (1) PAL shall pay the Government either basic corporate income tax or franchise tax,

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[4] *Rollo*, pp. 14-33, Annex "A"
[5] G.R. No. 180066, July 7, 2009.

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whichever is lower; and (2) the tax paid by PAL shall, under either of these alternatives be in lieu of all other taxes, duties, royalties, registration, license, and other fees and charges, except only real property tax; that the arguments of CIR are contrary to the plain meaning and obvious intent of P.D. 1590; that, after a conscientious study of Section 13 of P.D. 1590 in relation to Sections 27(A) and 27(E) of the NIRC of 1997 , PAL cannot be subjected to MCIT for FY 2000-2001.

The Court *a quo* anchored the aforementioned conclusion on the following grounds, *viz*: that, as held by the Supreme Court in the case of *Commissioner of Internal Revenue vs. Philippine Airlines, Inc.*,[6] the **'basic corporate income tax'** cited in Section 13(a) of P.D. No. 1590 relates to the general rate of 35% as stipulated in Section 27(A) of the NIRC of 1997; that, as provided in P.D. 1590, the basic corporate income tax of PAL shall be based on its **annual net taxable income,** which is consistent with Section 27(A) of the NIRC of 1997 where it is provided that the rate of basic corporate income tax shall be imposed on the **taxable income**; that even if the basic corporate income tax and the MCIT are both income taxes under Section 27 of the NIRC of 1997, the two are distinct and separate taxes; that the evident intent of Section 13 of P.D. 1590 is to extend to PAL tax concessions not ordinarily available to other domestic corporations; the **'Substitution Theory'** of the CIR is untenable and has been rejected in *Commissioner of Internal Revenue vs. Philippine Airlines, Inc*; that P.D. 1590 explicitly allows PAL, in computing its basic corporate income tax, to carry over as deduction any net loss incurred in any year, up to five years following the year of such loss.

On January 12, 2010, the CIR filed a Motion for Reconsideration, which was denied by the Court *a quo* for failure to present new arguments that will warrant the reversal or modification of the assailed Decision dated December 10, 2009.

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[6] G.R. No. 160528, 9 October 2006, 504 SCRA 90, 100.

Hence, this Petition for Review.

THE ISSUE

The sole issue raised by CIR is WHETHER OR NOT THE SPECIAL FIRST DIVISION ERRED WHEN IT CANCELLED THE FINAL ASSESSMENT NOTICE DATED 12 FEBRUARY 2007 ASSESSING RESPONDENT FOR DEFICIENCY MCIT IN THE TOTAL AMOUNT OF P65,544,153.43 FOR THE FISCAL YEAR ENDING 31 MARCH 2004 BECAUSE REVENUE MEMORANDUM CIRCULAR NO. 66-2003 MERELY QUALIFIED THE TAXABILITY OF PETITIONER FOR INCOME TAX PURPOSES AS WELL AS OTHER FRANCHISE GRANTEES SIMILARLY SITUATED IS CONCERNED AND THE SAME DID NOT ALTER, MODIFY OR AMEND THE INTENT OF THE LAW INSOFAR AS THE IMPOSITION OF THE MCIT IS CONCERNED.

Records reveal that, the above issue raised by CIR, in fact, stemmed from the very crux of the controversy that this Court must resolve, and that is whether PAL is exempt, by virtue of its franchise, P.D. 1590, from the Minimum Corporate Income Tax of 2% of the gross income imposed by Section 27(E) of the NIRC for the fiscal year ending March 31, 2004.

Arguments of CIR

In this present Petition for Review, CIR maintains that respondent PAL is covered by Section 27(E) of the NIRC of 1997, which provides for the imposition of MCIT of two per cent (2%) of the gross income as of the end of the taxable year when MCIT is greater than the normal income tax under Section 27(A) of the NIRC of 1997 for the same taxable year, in view of the fact that the Amended Income Tax Return of respondent for fiscal year ended March 31, 2004 shows zero taxable income. Thus, PAL is liable for the computed deficiency MCIT of P65,544,153.43 for the fiscal year ending March 31, 2004.

Petitioner argues that Revenue Memorandum Circular No. 66-2003 (RMC) dated October 14, 2003 merely clarifies the taxability of respondent for income tax purposes as well as other franchise grantees similarly situated, and declared that it is the advent of the law or provision of law imposing the 2% MCIT which caused the modification of the corporate income taxation regime, RMC merely points out or clarifies the taxability of respondent for income tax purposes as well as other franchise grantees similarly situated. Relevant portion quoted by CIR are hereunder reproduced:

> "Given that PAL has been operating at a loss for many years, it is evident that in applying the provisions of Section 13 of said Charter for the computation of its tax liability, it chose to use the normal corporate income taxation under Section 27(A) of the Code as basis thereof in order to exempt itself from tax liability. This is without, however, considering the adjunct provision introduced by RA 8424 on the imposition of minimum corporate income tax (MCIT)."
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> "With the advent of such provision beginning January 1, 1998, it is certain that domestic corporations subject to normal income tax as well as those who chose to be subject thereto, such as PAL, are bound to pay income tax regardless of whether they are operating at a profit or loss."

Respondent asserts that the power to interpret the provisions of the Tax Code and other tax laws shall be under the exclusive and original jurisdiction of the Commissioner of Internal Revenue, subject to review by the Secretary of Finance (Section 4 of the NIRC of 1997).

The CIR posits that when an administrative agency renders an opinion by means of a circular or memorandum, it merely interprets a pre-existing law, and no publication is necessary for its validity. Moreover, CIR contends that, with the accumulation of experience and growth of specialized capabilities by the agency charged with implementing a particular statute, it is now a recognized principle that the construction given to a statute by an administrative agency charged with the interpretation and application of that statute should be accorded great weight by the courts, unless such construction is shown to be in sharp conflict with the statute.

Finally, CIR insists that assessments are *prima facie* presumed correct and made in good faith. In the absence of proof of any irregularities in the performance of official duties, an assessment will not be disturbed. Failure to present proof of error in the assessment will justify judicial affirmation of said assessment.

Arguments of PAL

In its Comment on Petition for Review filed on April 30, 2010, PAL submits that the Court *a quo* did not err when it cancelled the Final Assessment Notice of the petitioner assessing respondent for deficiency MCIT in the amount of P65,544,153.43 for the fiscal year ending March 31, 2004, for the reason that no less than the Supreme Court, in the case of *Commissioner of Internal Revenue vs. Philippine Airlines, Inc.*[7], has ruled that PAL cannot be subjected to MCIT.

PAL firmly clutches on to the ruling of the Supreme Court, in the above-cited case, that it is not covered by the provisions on MCIT of Sec. 27(E) of the NIRC of 1997. Section 13 of P.D. 1590 was not amended by R.A. 8424, the law which introduced the MCIT, and under said section PAL is subject only to the following taxes in lieu of all other taxes, *viz*:

1. (a) Basic corporate income tax based on respondent's annual net taxable income computed in accordance with the provisions of the NIRC, or

   (b) 2% franchise tax based on gross revenue, whichever of the two will result in a lower tax liability; and

2. Real Property Tax.

Moreover, respondent PAL argues that, under Revenue Regulations No. 9-98 implementing R.A. 8424, MCIT is imposed only on domestic and resident foreign

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[7] G.R. No. 180066, July 7, 2009

corporations liable to the tax under the regular income tax system. According to PAL, since its tax regime under its charter is clearly special and cannot fit into the regular or normal income tax system, it is therefore excepted from the coverage of MCIT, and, considering that Section 27(E) of the NIRC of 1997 is not applicable to PAL, with more reason that it cannot be made applicable by the so-called "clarificatory" RMC 66-2003.

For emphasis, respondent PAL quoted Section 24 of P.D. No. 1590, which provides that its franchise may only be modified, amended, or repealed expressly by a special law or decree that shall specifically modify, amend, or repeal its franchise or any section or provision thereof. PAL posits that, inasmuch as there is no provision in R.A. 8424 that dictates MCIT to be in addition to the taxes for which respondent is liable, and RMC No. 66-2003 is neither a special law nor a decree, by enforcing the same and assessing PAL the subject deficiency MCIT, petitioner has in effect made an unauthorized amendment of Section 13 of P.D. No. 1590 and is equivalent to a violation of Section 24 of P.D. 1590.

In response to petitioner's assertion concerning the weight and respect that should be accorded to CIR's construction of the provisions of the NIRC, respondent quoted in detail the Court *a quo's* view and the Supreme Court's declaration in *Commissioner of Internal Revenue vs. Philippine Airlines, Inc.*[8], both essentially provide that although the construction or interpretation placed upon a statute by the executive officer is entitled to great respect, the courts are not bound thereby if such construction is erroneous or is shown to be in conflict with the governing statute or Constitution or other laws.

[8] G.R. No. 180066, July 7, 2009

THE RULING OF THE COURT *EN BANC*

The Court *En Banc* finds no merit in the Petition for Review.

A perusal of the Petition reveals that petitioner's arguments brought for the consideration of this Court were intricately and appropriately passed upon and resolved in the assailed Decision and Resolution of the Court *a quo*.

Tax Liability of PAL under its franchise (Section 13, P.D. 1590)

The resolution of the issue herein is contingent on the interpretation of Section 13 of P.D. 1590, which states in clear and unequivocal terms that:

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

Plainly, three points are evident from this provision. As consideration for the franchise, PAL is liable to pay, *thus*:

1. Whichever of the two will result in a lower tax:

(a) Basic corporate income tax based on the grantee's annual net taxable income computed in accordance with the provisions of the NIRC;

(b) Franchise tax of two percent (2%) of the gross revenues derived by the grantee from all sources.

2. The above tax paid under either of the above alternatives shall be in lieu of all other taxes imposed by all government entities in the country;

3. Real Property tax.

The Supreme Court has already resolved that PAL is NOT Subject to MCIT (*Commissioner of Internal Revenue vs. Philippine Airlines, Inc.*)

In the assailed Decision, the Court *a quo* aptly pointed out that the main issue herein is not novel as the present case fits perfectly into the mold of *Commissioner of Internal Revenue vs. Philippine Airlines, Inc.*;[9] the settled issues therein are notably identical to the principal issue subject of this discourse. As in the instant case, therein petitioner CIR sought to hold respondent PAL liable for deficiency MCIT for FY 2000-2001, which claim was denied by the CTA Second Division, CTA *En Banc*, and ultimately by the Supreme Court.

To expel any uncertainty and to give full emphasis to the settled doctrine enunciated by the Supreme Court in the *Commissioner of Internal Revenue vs. Philippine Airlines, Inc.*[10] relative to PAL's tax liability, specifically for MCIT, the relevant points in the said Decision are reproduced hereunder:

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[9] G.R. No. 180066, July 7, 2009
[10] *Supra.*

1. A conscientious study of Section 13 of Presidential Decree No. 1590, in relation to Sections 27(A) and 27(E) of the NIRC of 1997, directed the Supreme Court to conclude that PAL cannot be subjected to MCIT.

> "According to the afore-quoted provisions [Sec. 13 of P.D.1590], the taxation of PAL, during the lifetime of its franchise, shall be governed by two fundamental rules, particularly: (1) PAL shall pay the Government either **basic corporate income tax** or **franchise tax**, whichever is lower; and (2) the tax paid by PAL, under either of these alternatives, shall be in lieu of all other taxes, duties, royalties, registration, license, and other fees and charges, except only real property tax."
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> xxx
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> "Hence, a domestic corporation must pay whichever is higher of: (1) the income tax under Section 27(A) of the NIRC of 1997, computed by applying the tax rate therein to the taxable income of the corporation; or (2) the MCIT under Section 27(E), also of the NIRC of 1997, equivalent to 2% of the gross income of the corporation. **Although this may be the general rule** in determining the income tax due from a domestic corporation under the NIRC of 1997, **it can only be applied to PAL to the extent allowed by the provisions in the franchise of PAL specifically governing its taxation.**"

2. The basic corporate income tax referred to in Section 13(a) of P.D. 1590 relates to the general rate of **35%** (now 30%, effective January 1, 2009) **of the taxable income** as stipulated in Section 27(A) of the NIRC. Sensibly, said definition effectively excludes liability for MCIT of **2% of the gross income**.

> *First*, Section 13(a) of Presidential Decree No. 1590 refers to **"basic corporate income tax."** In *Commissioner of Internal Revenue v. Philippine Airlines, Inc.*,[11] the Court already settled that the "basic corporate income tax," under Section 13(a) of Presidential Decree No. 1590, **relates to the general rate of 35% (reduced to 32% by the year 2000) as stipulated in Section 27(A) of the NIRC of 1997.**
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> Section 13(a) of Presidential Decree No. 1590 requires that the basic corporate income tax be computed in accordance with the NIRC. This means that PAL shall compute its basic corporate income tax using the rate and basis prescribed by the NIRC of 1997 for the said tax. **There is nothing in Section 13(a) of Presidential Decree No. 1590 to support the contention of the CIR that PAL is subject to the entire Title II of the NIRC of 1997,** entitled "Tax on Income."

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[11] G.R. No. 160528, 9 October 2006, 504 SCRA 90, 100.

3. In addition to the above argument, the basic corporate income tax referred to in Section 13(a) of P.D. 1590 shall be based on its **annual net taxable income,** whereas, the 2% MCIT referred to in Section 27(E) of the NIRC shall be based on the **gross income**. From this point alone, it can be fairly inferred that, the 2% MCIT is not one of those taxes, for which PAL is liable, contemplated under P.D. 1590, and it cannot in any way be crunched under one umbrella or be considered as falling under the term "basic corporate income tax" provided in Section 13(a) of PAL's franchise.

> "*Second,* Section 13(a) of Presidential Decree No. 1590 further provides that the **basic corporate income tax** of PAL shall be based on its **annual net taxable income**. This is consistent with Section 27(A) of the NIRC of 1997, which provides that the rate of basic corporate income tax, which is 32% beginning 1 January 2000, shall be imposed on the **taxable income** of the domestic corporation.
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> **Taxable income** is defined under Section 31 of the NIRC of 1997 as the **pertinent items of gross income specified in the said Code, less the deductions and/or personal and additional exemptions, if any, authorized for such types of income by the same Code or other special laws.** xxx
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> xxx
>
> In comparison, the **2% MCIT** under Section 27(E) of the NIRC of 1997 shall be based on the **gross income** of the domestic corporation. The Court notes that gross income, as the basis for MCIT, is given a special definition under Section 27(E)(4) of the NIRC of 1997, different from the general one under Section 34 of the same Code.
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> According to the last paragraph of Section 27(E)(4) of the NIRC of 1997, gross income of a domestic corporation engaged in the sale of service means **gross receipts, less sales returns, allowances, discounts and cost of services.** xxx
>
> In light of the foregoing, **there is an apparent distinction** under the NIRC of 1997 **between taxable income**, which is the basis for basic corporate income tax under Section 27(A); **and gross income**, which is the basis for the MCIT under Section 27(E). The two terms have their respective technical meanings, and cannot be used interchangeably. **The same reasons prevent this Court from declaring that the basic corporate income tax, for which PAL is liable under Section 13(a) of Presidential Decree No. 1590, also covers MCIT under Section 27(E) of the NIRC of 1997, since**

> **the basis for the first is the annual net taxable income, while the basis for the second is gross income.**"

4. Basic corporate income tax and the MCIT are distinct and separate taxes even if they are both considered as "income taxes"

> "*Third*, even if the basic corporate income tax and the MCIT are both income taxes under Section 27 of the NIRC of 1997, and one is paid in place of the other, the two are distinct and separate taxes.
>
> The Court again cites *Commissioner of Internal Revenue v. Philippine Airlines, Inc.*,[12] wherein it held that income tax on the passive income of a domestic corporation, under Section 27(D) of the NIRC of 1997, is different from the basic corporate income tax on the taxable income of a domestic corporation, imposed by Section 27(A), also of the NIRC of 1997. Section 13 of Presidential Decree No. 1590 gives PAL the option to pay basic corporate income tax or franchise tax, whichever is lower; and the tax so paid shall be in lieu of all other taxes, except real property tax. The income tax on the passive income of PAL falls within the category of "all other taxes" from which PAL is exempted, and which, if already collected, should be refunded to PAL.
>
> **The Court herein treats MCIT in much the same way**. Although both are income taxes, the MCIT is different from the basic corporate income tax, not just in the rates, but also in the bases for their computation. Not being covered by Section 13(a) of Presidential Decree No. 1590, which makes PAL liable only for basic corporate income tax, then MCIT is included in "all other taxes" from which PAL is exempted.
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> That, under general circumstances, the MCIT is paid in place of the basic corporate income tax, when the former is higher than the latter, does not mean that these two income taxes are one and the same. xxx
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> **Given the fundamental differences** between the basic corporate income tax and the MCIT, presented in the preceding discussion, **it is not baseless for this Court to rule that, pursuant to the franchise of PAL, said corporation is subject to the first tax, yet exempted from the second.**

5. The imposition of the MCIT on PAL cannot be done without contravening the evident intent of Section 13 of P.D. 1590.

> "*Fourth*, the evident intent of Section 13 of Presidential Decree No. 1590 is to extend to PAL tax concessions not ordinarily available to other domestic corporations. xxx

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[12] *Supra* note 11 at 98, 100.

> Section 13 of Presidential Decree No. 1520 is not unusual. A public utility is granted special tax treatment (including tax exceptions/exemptions) under its franchise, as an inducement for the acceptance of the franchise and the rendition of public service by the said public utility. xxx
>
> The imposition of MCIT on PAL, as the CIR insists, would result in a situation that contravenes the objective of Section 13 of Presidential Decree No. 1590. In effect, PAL would not just have two, but three tax alternatives, namely, the basic corporate income tax, MCIT, or franchise tax. **More troublesome is the fact that, as between the basic corporate income tax and the MCIT, PAL shall be made to pay whichever is higher, irrefragably, in violation of the avowed intention of Section 13 of Presidential Decree No. 1590 to make PAL pay for the lower amount of tax.**
>
> *And sixth*, Presidential Decree No. 1590 explicitly allows PAL, in computing its basic corporate income tax, to carry over as deduction any net loss incurred in any year, up to five years following the year of such loss. Therefore, Presidential Decree No. 1590 does not only consider the possibility that, at the end of a taxable period, PAL shall end up with **zero annual net taxable income** (when its deductions exactly equal its gross income), as what happened in the case at bar, but also the likelihood that PAL shall incur **net loss** (when its deductions exceed its gross income). **If PAL is subjected to MCIT, the provision in Presidential Decree No. 1590 on net loss carry-over will be rendered nugatory.** Net loss carry-over is material only in computing the annual net taxable income to be used as basis for the basic corporate income tax of PAL; but PAL will never be able to avail itself of the basic corporate income tax option when it is in a net loss position, because it will always then be compelled to pay the necessarily higher MCIT.

Section 27(E) of the NIRC of 1997 (2%MCIT) did not modify, amend or repeal P.D. 1590

Petitioner CIR claims that RMC No. 66-2003 did not alter, modify or amend the intent of the law insofar as the imposition of MCIT is concerned and that it merely clarifies the taxability of PAL for income tax purposes. CIR points the blame at the advent of R.A. 8424, which introduced the provision imposing the 2% MCIT, it argues that it is the said law that modified the corporate income taxation regime.

Contrary to CIR's claims, R.A. 8424, which introduced Section 27 (E) of the NIRC of 1997 pertaining to the imposition of 2% MCIT, did not modify, amend or repeal P.D. 1590. In the case of *Commissioner of Internal Revenue vs. Philippine Airlines, Inc.*,[13] the Supreme Court ruled in this wise:

Applying the rules of statutory construction, P.D. 1590, earlier special law, prevails over Section 27(E) of the NIRC of 1997, a later general law.

> "**Between Presidential Decree No. 1520 [1590]**, on one hand, which is a special law specifically governing the franchise of PAL, issued on 11 June 1978; **and the NIRC of 1997**, on the other, which is a general law on national internal revenue taxes, that took effect on 1 January 1998, **the former prevails**. The rule is that on a specific matter, the special law shall prevail over the general law, which shall be resorted to only to supply deficiencies in the former. In addition, where there are two statutes, the earlier special and the later general – the terms of the general broad enough to include the matter provided for in the special – the fact that one is special and the other is general creates a presumption that the special is to be considered as remaining an exception to the general, one as a general law of the land, the other as the law of a particular case. It is a canon of statutory construction that a later statute, general in its terms and not expressly repealing a prior special statute, will ordinarily not affect the special provisions of such earlier statute."

Section 24 of P.D. 1590 states that, the franchise or any portion thereof may only be modified, amended or repealed expressly by a special law or decree. No such special law or decree exists herein.

> "While Section 16 of Presidential Decree No. 1590 provides that the franchise is granted to PAL with the understanding that it shall be subject to amendment, alteration, or repeal by competent authority when the public interest so requires, Section 24 of the same Decree also states that the franchise or any portion thereof may only be modified, amended, or repealed expressly by a **special law or decree** that shall specifically modify, amend, or repeal said franchise or any portion thereof. No such special law or decree exists herein.
>
> The CIR cannot rely on Section 7(B) of Republic Act No. 8424, which amended the NIRC in 1997 and reads as follows:
>
>> Section 7. *Repealing Clauses.* –
>>
>> x x x x
>>
>> (B) The provisions of the National Internal Revenue Code, as amended, and all other laws, **including charters of government-owned or controlled corporations**, decrees, orders, or regulations or parts thereof, that are inconsistent with this Act are hereby repealed or amended accordingly.

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[13] *Supra* note 8.

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> It is true that when Presidential Decree No. 1590 was issued on **11 June 1978**, PAL was then a government-owned and controlled corporation; but when Republic Act No. 8424, amending the NIRC, took effect on **1 January 1998**, PAL was already a private corporation for six years. The repealing clause under Section 7(B) of Republic Act No. 8424 simply refers to charters of government-owned and controlled corporations, which would simply and plainly mean corporations under the ownership and control of the government **at the time of effectivity** of said statute. It is already a stretch for the Court to read into said provision charters, issued to what were then government-owned and controlled corporations that are now private, but still operating under the same charters.
>
> That the Legislature chose not to amend or repeal Presidential Decree No. 1590, even after PAL was privatized, reveals the intent of the Legislature to let PAL continue enjoying, as a private corporation, the very same rights and privileges under the terms and conditions stated in said charter. From the moment PAL was privatized, it had to be treated as a private corporation, and its charter became that of a private corporation. It would be completely illogical to say that PAL is a private corporation still operating under a charter of a government-owned and controlled corporation."

Courts are not bound by any construction/ interpretation of a statute which is erroneous or is clearly shown to be in conflict with the governing statute or the Constitution or other laws.

In the instant Petition, CIR reiterated that RMC No. 66-2003 dated October 14, 2003 merely clarifies the taxability of respondent PAL for income tax purposes.

Again, in the case of *Commissioner of Internal Revenue vs. Philippine Airlines, Inc.*,[14] the Supreme Court observed that RMC No. 66-2003 does more than just clarify a previous regulation and goes beyond mere internal administration. It effectively increases the tax burden of PAL and other taxpayers who are similarly situated, making them liable for a tax for which they were not liable before. Therefore, RMC No. 66-2003 cannot be given effect without previous notice or publication to those

[14] *Supra* note 8.

who will be affected thereby. In *Commissioner of Internal Revenue v. Court of Appeals*,[15] the Court ratiocinated that:

> "It should be understandable that when an administrative rule is merely interpretative in nature, its applicability needs nothing further than its bare issuance for it gives no real consequence more than what the law itself has already prescribed. **When, upon the other hand, the administrative rule goes beyond merely providing for the means that can facilitate or render least cumbersome the implementation of the law but substantially adds to or increases the burden of those governed, it behooves the agency to accord at least to those directly affected a chance to be heard, and thereafter to be duly informed, before that new issuance is given the force and effect of law.**
>
> A reading of RMC 37-93, particularly considering the circumstances under which it has been issued, convinces us that the circular cannot be viewed simply as a corrective measure (revoking in the process the previous holdings of past Commissioners) or merely as construing Section 142(c)(1) of the NIRC, as amended, but has, in fact and most importantly, been made in order to place "Hope Luxury," "Premium More" and "Champion" within the classification of locally manufactured cigarettes bearing foreign brands and to thereby have them covered by RA 7654. Specifically, the new law would have its amendatory provisions applied to locally manufactured cigarettes which at the time of its effectivity were not so classified as bearing foreign brands. Prior to the issuance of the questioned circular, "Hope Luxury," "Premium More," and "Champion" cigarettes were in the category of locally manufactured cigarettes not bearing foreign brand subject to 45% ad valorem tax. Hence, without RMC 37-93, the enactment of RA 7654, would have had no new tax rate consequence on private respondent's products. Evidently, in order to place "Hope Luxury," "Premium More," and "Champion" cigarettes within the scope of the amendatory law and subject them to an increased tax rate, the now disputed RMC 37-93 had to be issued. **In so doing, the BIR not simply interpreted the law; verily, it legislated under its quasi-legislative authority. The due observance of the requirements of notice, of hearing, and of publication should not have been then ignored.**
>
> Indeed, the BIR itself, in its **RMC 10-86**, has observed and provided:
>
> > "RMC NO. 10-86
> >
> > Effectivity of Internal Revenue Rules and Regulations "It has been observed that one of the problem areas bearing on compliance with Internal Revenue Tax rules and regulations is lack or insufficiency of due notice to the tax paying public. **Unless there is due notice, due compliance therewith may not be reasonably expected.** And most importantly, their strict enforcement could possibly suffer from legal infirmity in the light of the constitutional provision on 'due process of law' and the essence of the Civil Code provision concerning effectivity of

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[15] 329 Phil. 987, 1007-1009 (1996).

> laws, whereby due notice is a basic requirement (Sec. 1, Art. IV, Constitution; Art. 2, New Civil Code).
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> xxx
>
> "This Circular shall apply only to (a) Revenue Regulations; (b) Revenue Audit Memorandum Orders; and (c) **Revenue Memorandum Circulars** and Revenue Memorandum Orders bearing on internal revenue tax rules and regulations.
>
> "(2). Except when the law otherwise expressly provides, the aforesaid internal revenue tax issuances **shall not begin to be operative until after due notice thereof may be fairly presumed**.
>
> "Due notice of the said issuances may be fairly presumed only after the following procedures have been taken:
>
> "xxx xxx xxx "(5). Strict compliance with the foregoing procedures is enjoined.

As discussed by the Supreme Court, even conceding that the construction of a statute by the CIR is to be given great weight, the courts, which include the CTA, are not bound thereby if such construction is erroneous or is clearly shown to be in conflict with the governing statute or the Constitution or other laws. "It is the role of the Judiciary to refine and, when necessary, correct constitutional (and/or statutory) interpretation, in the context of the interactions of the three branches of the government."[16]

Moreover, in *Commissioner of Internal Revenue v. Court of Appeals*[17] the Supreme Court held that:

> "We disagree. Petitioner Commissioner of Internal Revenue erred in applying the principles of tax exemption without first applying the well-settled **doctrine of strict interpretation in the imposition of taxes. It is obviously both illogical and impractical to determine who are exempted without first determining who are covered by the aforesaid**

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[16] *Philippine Scout Veterans Security and Investigation Agency, Inc. v. National Labor Relations Commission*, 330 Phil. 665, 676 (1996).
[17] 338 Phil. 322, 330-331 (1997).

> **provision.** The Commissioner should have determined first if private respondent was covered by Section 205, applying the rule of strict interpretation of laws imposing taxes and other burdens on the populace, before asking Ateneo to prove its exemption therefrom. The Court takes this occasion to reiterate the hornbook doctrine in the interpretation of tax laws that "(a) statute will not be construed as imposing a tax unless it does so clearly, expressly, and unambiguously. x x x (A) tax cannot be imposed without clear and express words for that purpose. Accordingly, **the general rule of requiring adherence to the letter in construing statutes applies with peculiar strictness to tax laws and the provisions of a taxing act are not to be extended by implication." Parenthetically, in answering the question of who is subject to tax statutes, it is basic that "in case of doubt, such statutes are to be construed most strongly against the government and in favor of the subjects or citizens because burdens are not to be imposed nor presumed to be imposed beyond what statutes expressly and clearly import."**

While the Court *En Banc* recognizes the general rule that the grant of tax exemptions is strictly construed against the taxpayer and in favor of the taxing power, the doctrine of strict interpretation should equally be considered in every case, and in this instance, the latter doctrine properly comes into play. Under the said doctrine, the burden is upon the CIR to satisfactorily prove that the new MCIT provisions of the NIRC of 1997, clearly, expressly, and unambiguously extend and apply to PAL, despite the latter's existing tax exemption. To do this, the CIR must convince the Court that the MCIT is a basic corporate income tax, and is not covered by the "in lieu of all other taxes" clause of Presidential Decree No. 1590. Since the CIR failed in this regard, the Court is left with no choice but to consider the MCIT as one of "all other taxes," from which PAL is exempt under the explicit provisions of its charter.[18]

In 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.[19]

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[18] *Republic of the Philippines represented by the CIR vs. Philippine Airlines, Inc.*, G.R. No. 179800, February 4, 2010 citing *Commissioner of Internal Revenue vs. Philippine Airlines,* G.R. No. 160528, October 9, 2006, 504 SCRA 90.
[19] *Supra*

WHEREFORE, premises considered, the present Petition for Review is hereby **DISMISSED** for lack of merit.

The Decision[20] and Resolution[21] promulgated on December 10, 2009 and March 11, 2010, respectively, by the former First Division of the Court of Tax Appeals in CTA Case No. 7669 entitled Philippine Airlines, Inc. (PAL) vs. Commissioner of Internal Revenue are hereby **AFFIRMED** in *toto*.

SO ORDERED.

AMELIA R. COTANGCO- MANALASTAS
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

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

ESPERANZA R. FABON-VICTORINO
Associate Justice

CIELITO N. MINDARO-GRULLA
Associate Justice

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[20] *Rollo*, pp. 14-33, Annex "A"
[21] *Rollo*, pp. 34-36, Annex "B"

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the above Decision has been reached in consultation with the members of the Court *En Banc* before the case was assigned to the writer of the opinion of the Court.

ERNESTO D. ACOSTA
Presiding Justice