REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

COMMISSIONER OF INTERNAL REVENUE, Petitioner,	C.T.A. E.B. NO. 221 (C.T.A. CASE NO. 6735)
	Present:
- versus -	ACOSTA, *P.J.* CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA, *and* PALANCA-ENRIQUEZ, *JJ.*
PHILIPPINE AIRLINES, INC. (PAL), Respondent.	Promulgated: AUG 0 9 2007

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DECISION

UY, J.:

This is a Petition for Review before the Court of Tax Appeals *En Banc* filed on November 17, 2006 under Republic Act No. 9282, seeking a review of the Decision and Resolution by the First Division of this Court (Court in Division) in CTA Case No. 6735, entitled "Philippine Airlines, Inc. (PAL) vs. Commissioner of Internal Revenue", to wit:

1) Decision promulgated on June 14, 2006 granting herein respondent's claim for refund in the aggregate amount of P126,243.80 representing erroneously collected ten percent (10%) Overseas Communications Tax for the period April to December 2001; and

2) Resolution promulgated on October 17, 2006 denying herein petitioner's Motion for Reconsideration of the aforesaid Decision.

THE FACTS

The factual antecedents of the case are undisputed.

Petitioner is the duly appointed Commissioner of Internal Revenue who is in charge with the duty to assess and collect all national internal revenue taxes, fees, and charges, including the ten percent (10%) tax on overseas dispatch, message or conversation originating from the Philippines, imposed by Section 120 of the National Internal Revenue Code (NIRC) of 1997 with principal office at the Bureau of Internal Revenue National Office Building, Agham Road, Diliman, Quezon City. Respondent is a domestic corporation organized in accordance with the laws of the Republic of the Philippines with principal office address at the 9th Floor, PAL Center, Legaspi St., Legaspi Village, Makati City.

For the period January to December 2001, the Philippine Long Distance Telephone Company (PLDT) collected from respondent ten percent (10%) Overseas Communications Tax (OCT) on the latter's overseas telephone calls in the total amount of P202,471.18, summarized as follows:

PERIOD	AMOUNT
January to March 2001	P 75,332.26
April to June 2001	50,271.43
July to September 2001	43,313.96
October to December 2001	33,553.53
Total	P202,471.18

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Believing that it is exempted from the ten percent (10%) OCT under Section 13 of its franchise, Presidential Decree No. 1590 (P.D. 1590), and with the BIR Ruling No. 97-94 dated April 13, 1994, respondent filed an administrative claim for refund with petitioner for the erroneously paid OCT in the amount of P202,471.18.

Unable to obtain any relief from petitioner, respondent filed before the Court in Division a Petition for Review on July 24, 2003 (docketed as C.T.A. Case No. 6735) seeking only for a refund of the amount of P127,138.92 allegedly representing erroneously collected 10% OCT by PLDT for the second, third and fourth quarters of the taxable year 2001 or covering the amounts collected from April to December 2001.

On June 14, 2006, the Court in Division rendered its assailed Decision granting respondent's petition, and accordingly, ordered petitioner to refund the substantiated amount of P126,243.80 representing erroneously collected ten percent (10%) OCT for the period April to December 2001.

Not satisfied, petitioner filed a Motion for Reconsideration of the said Decision on June 28, 2006.

Finding no compelling reason to either modify or alter the assailed Decision, the Court in Division denied petitioner's motion thereof in a Resolution dated October 17, 2006.

Hence, this recourse before the Court *En Banc* praying that the assailed Decision and Resolution dated June 14, 2006 and October 17, 2006, respectively, be reversed and set aside.

In support of his Petition for Review, petitioner submits that respondent is not entitled to the subject refund based on the ground that the Court in Division erred in holding that the phrase "in lieu of all other taxes" does not contemplate the fulfillment of a condition before the exemption from all other taxes may be applied.

On December 4, 2006, the Court *En Banc* issued a Resolution ordering respondent to comment thereto. Thus, on December 22, 2006, respondent timely filed through registered mail his "Comment on Petitioner's Petition for Review" and duly received by this Court on January 4, 2007.

The Court *En Banc* gave due course to the present petition and required the parties to submit their respective memoranda in a Resolution dated January 23, 2007. Petitioner filed his Memorandum on March 1, 2007 while respondent also filed its Memorandum through registered mail on the same date and duly received by this Court on March 8, 2007. Thereafter, this case was deemed submitted for decision on March 15, 2007.

THE ISSUE

The sole issue being raised by petitioner in the instant petition for review is "[w]hether or not respondent is entitled to the refund in the amount of P126,243.80 allegedly representing erroneously collected 10% overseas communications tax for the period April to December 2001".

THE COURT EN BANC'S RULING

This Court finds no merit in the petition.

The resolution of the instant case hinges on the interpretation of Section 13 of PAL's franchise (P.D. 1590), which states in part:

> "SEC. 13. In consideration of the franchise and rights hereby granted, the grantee shall pay to the Philippine Government during the life of this franchise whichever of subsections (a) and (b) hereunder will result in a lower tax:
>
> > (a) The basic corporate income tax based on the grantee's annual net taxable income computed in accordance with the provisions of the National Internal Revenue Code; or
> >
> > (b) A franchise tax of two percent (2%) of the gross revenues derived by the grantee from all sources, without distinction as to transport or non-transport operations; provided, that with respect to international air-transport service, only the gross passenger, mail, and freight revenues from its outgoing flights shall be subject to this tax.
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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
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> The grantee, shall, however, pay the tax on its real property in conformity with existing law.
>
> **For purposes of computing the basic corporate income tax as provided herein, the grantee is authorized**:
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> a. To depreciate its assets to the extent of not more than twice as fast the normal rate of depreciation; and
>
> **b. To carry over as a deduction from taxable income any net loss incurred in any year up to five years following the year of such loss**." *(Underscoring Ours)*

The abovequoted Section 13 of P.D. 1590 acquiring and limiting the extent of the tax liability of the respondent under its franchise is coached in a clear, plain and unambiguous manner, and needs no further interpretation or construction. Consequently, two points are evident from this provision. *First*, as consideration for its franchise, PAL is liable to pay either: (a) its basic corporate income tax based on its net taxable income, as computed under the National Internal Revenue Code; or (b) a franchise tax of two percent based on its gross revenues, *whichever is lower*. *Second*, the tax paid is "in lieu of all other taxes" imposed by all government entities in the country.[1]

The respondent-grantee must choose between the two (2) aforementioned alternatives in the payment of its tax liability to the government and its choice must be that which will result in a lower tax liability. Payment, when made, shall be in lieu of all other taxes. The "in lieu of all other taxes" clause of Section 13 of P.D. 1590 exempts it from all taxes necessary in the conduct of its business covered by the franchise, except the tax on its real property for which PAL is expressly made liable.

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

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[1] Commissioner of Internal Revenue vs. Philippine Airlines Inc., 504 SCRA 90 (2006).

In the case at bench, the Court in Division found that respondent opted to pay corporate income tax when it filed its Annual Income Tax Returns for the fiscal years ending in March 31, 2001 and March 31, 2002.[2] Therefore, using the provisions of the NIRC of 1997 in computing its basic corporate income tax, it resulted in zero or nil tax liabilities as it was in a net loss position. Clearly, respondent has exercised its option under Subsection (a) that resulted to a zero tax liability. Zero tax liability is obviously lower than the two percent (2%) franchise tax; hence, respondent chose a better alternative in availing of the basic corporate income tax as basis for its tax liability to the government. Consequently, it can now claim the exemptions granted to it by its franchise with regard to the "in lieu of all other taxes" clause.

The "in lieu of all other taxes" proviso in the franchises of numerous grantees which has been the subject of many controversies has been consistently upheld by no less than the Supreme Court. Considerably, in the case of ***Province of Misamis Oriental vs. Cagayan Electric Power and Light Company, Inc.***,[3] the Supreme Court cited several instances where validity and effectivity of the "in lieu of all other taxes" provision found in various franchise of different entities were previously upheld, to wit:

> "In an earlier case, the phrase 'shall be in lieu of all taxes and at any time levied, established by, or collected by any authority' found in the franchise of the Visayan Electric Company was held to exempt the company from payment of the 5% tax on corporate franchise provided in Section 259 of the

[2] Exhibits "K" and "L".
[3] 181 SCRA 38 (1990).

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

In relation to this, petitioner contends that the "in lieu of all other taxes" clause cannot be made to benefit respondent as there was no actual payment made for either the basic corporate income tax or the two percent (2%) franchise tax.

As correctly pointed out by the Court in Division, respondent's franchise does not provide that only upon actual payment of the income tax or the franchise tax would it be entitled to the exemption.

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

Hence, this Court concludes that no "actual" payment is necessary before respondent may avail of the exemption. It must simply choose between the two aforesaid alternatives and such choice must be that whichever will result in a lower tax liability.

Significantly, in the recent case of ***Commissioner of Internal Revenue vs. Philippine Airlines, Inc.***,[4] the Supreme Court clarified the correct interpretation of Section 13 of respondent's franchise, to quote:

> "<u>Substitution Theory of the CIR Untenable</u>
>
> A careful reading of Section 13 rebuts the argument of the CIR that the 'in lieu of all other taxes' proviso is a mere incentive that applies only when PAL actually pays something. It is clear that PD 1590 intended to give respondent the option to avail itself of Subsection (a) or (b) as consideration for its franchise. Either option excludes the payment of other taxes

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[4] Supra.

> and dues imposed or collected by the national or the local government. PAL has the option to choose the alternative that results in lower taxes. **It is not the fact of tax payment that exempts it, but the exercise of its option**." *(Emphasis Ours)*

Likewise, We adopt the reasoning of the Court of Appeals in ***Philippine Airlines, Inc. vs. Honorable Court of Tax Appeals and the Commissioner of Internal Revenue***.[5] Thus,

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

Prescinding from the above ruling, the ten percent (10%) OCT was treated as "other taxes" because the respondent-grantee availed of the basic corporate income tax as basis for its tax liability pursuant to Section 13(a) of P.D. 1590.

Conclusively, it is evident that respondent PAL in the instant case could still avail of the exemption granted to it by its franchise even if it did not pay any tax for the fiscal years covering the period where the OCT sought to be refunded accumulated.

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[5] CA-G.R. SP No. 67970, September 30, 2003.

With all the foregoing, the facts and the applicable laws and jurisprudence, and contrary to petitioner's argument, respondent has sufficiently discharged its burden of proving its entitlement to the refund sought for.

This Court is not unaware of the principle that the burden of proof is upon him who claims the exemptions in his favor and he must be able to justify his claim by the clearest grant of the organic or statute law.[6] This is consistent with the well-established principle that tax refunds are in the nature of a tax exemption and should be construed strictissimi juris against the taxpayer.[7]

However, as earlier pointed out, We are convinced that respondent was able to establish its claim for refund in the amount of P126,243.80 representing erroneously collected ten percent (10%) OCT for the period April to December 2001 based on the evidence presented and the factual and legal findings of the Court in Division.

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

SO ORDERED.

ERLINDA P. UY
Associate Justice

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[6] China Banking Corporation vs. Court of Appeals, 403 SCRA 634 (2003).
[7] Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc. and Court of Appeals, 309 SCRA 87(1999); Commissioner of Internal Revenue vs. Tokyo Shipping Co., Ltd., 244 SCRA 332 (1995); Commissioner of Internal Revenue vs. Procter and Gamble Philippine Manufacturing Corporation and the Court of Tax Appeals, 204 SCRA 377 (1991).

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Justice