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COURT OF TAX APPEALS
MANILA

Dec. 24, 1963

ESCUDERO ELECTRIC SERVICE
COMPANY,
Petitioner,

- versus -

C.T.A. CASE No. 1026

MELECIO R. DOMINGO, in his
capacity as Commissioner
of Internal Revenue,
Respondent.
x- - - - - - - - - - - - - - -x

D E C I S I O N

This is an appeal from the decision of the respondent holding the petitioner liable for the payment of the sum of ₱20,228.33 as deficiency franchise tax and surcharge covering the period from January 1, 1948 to June 30, 1959. Having failed to secure a reconsideration of said assessment, petitioner has instituted the present appeal.

The deficiency franchise tax and surcharge were assessed in connection with the operation of petitioner's electric plants in Candelaria, Quezon (formerly Tayabas) and in Calauan, Laguna. The franchise for the operation of the electric plant in Candelaria provides for the payment by the grantee of "uno por ciento de los ingresos brutos que obtenga por dicho privilegio durante los primeros veinte (20) años y el dos por ciento (2%) de los mismos ingresos durante los quince años restantes de la vigencia de este mismo privilegio." (Sec. 10, Resolution of the Mun. Council of Candelaria, June 7, 1928.) Said franchise does not contain any provision to the effect that payment of the tax provided therein shall be in lieu of all other taxes of any kind and nature, municipal, provincial or national.

In the case of the franchise for the operation of an electric plant in Calauan, no copy of said franchise was presented in evidence, all records concerning the same having been destroyed. It is presumed that during the period in question, the rate of tax provided in the franchise was 2% as this was the rate of tax being paid by petitioner. It is likewise presumed that said franchise does not contain any provision exempting petitioner from any and all taxes of any kind and nature, except the tax provided therein, because of Section 6 of Act No. 667, which provides:

> Tax exemption not conferable by local authorities.- There shall be no power on the part of the municipal council or the provincial board in the granting of franchise to contract for the exemption from taxation of the property of the grantee thereof, such exemption can only be granted by special act of the Commission.

Both franchises were granted pursuant to Act No. 667 which contains a reservation of the right of Congress to amend or repeal the same.

The following issues have been raised in the memorandum of counsel for petitioner: (1) whether or not the right of the Government to assess and collect the deficiency franchise tax and surcharge corresponding to the period from January 1, 1948 to September 30, 1955, has already prescribed; (2) whether the franchise tax payable by petitioner should be based on its gross earnings or on its actual gross receipts; (3) whether or not the amounts received by petitioner under its franchises in connection with transactions or services for the accommodation of its customers, from which it did not derive any gain or profit, are subject to the franchise tax; and (4) whether the franchise tax payable by petitioner is 2% of its gross receipts or gross earnings, as provided in its franchises, or 5% as provided in Section 259 of the Revenue Code.

As to the question of prescription, the decision appealed from states:

> Your contention that the assessment of the franchise tax for the period from January 1, 1948 to September 30, 1955 has already prescribed is without merit. Section 332 of the Tax Code provides for a ten year period from the discovery of the failure or omission of your client to include in its franchise tax returns its correct gross receipts, within which this office may assess the tax. It was only from the receipt of the audit report of the General Auditing Office dated July 20, 1955, that this Office became aware of the falsity in the returns of your client consist-

> ing of the underdeclaration of the gross receipts for the period from January 1, 1948 to December 31, 1954 and from the receipt of the audit report dated October 12, 1960, with respect to its underdeclarations of the gross earnings for the period from January 1, 1955 to June 30, 1959. The assessment of the deficiency franchise tax issued by this Office against your client on November 2, 1960 is within the ten year period provided for in Section 332 within which this Office may assess the tax and is, therefore, in order. (Exhs. D and 6, page 11, B.I.R. records.)

The answer to the petition for review filed by the Solicitor General in representation of respondent contains the following allegation:

> That petitioner failed to include in its franchise tax returns its correct gross receipts; hence, the respondent can assess the deficiency franchise tax within ten years from the discovery of the failure or omission, pursuant to Section 332(a) of the Tax Code.

And in the memorandum of counsel for the Government, it is alleged that the right to assess the deficiency franchise tax in question has not prescribed because the returns filed by petitioner were false so that the Government has 10 years from the date of discovery of the fraud.

> In the case at bar, the filing of false returns were discovered on October 12, 1960, (Exh. 1, pp. 1-3, BIR Rec.) when the Field Corporation Auditor of the General Auditing Office submitted his

> report on the deficiency franchise tax liability of petitioner. Therefore, the tax may be assessed at any time within ten (10) years from October 12, 1960 or on or before October 12, 1970. The assessment having been made on November 2, 1960 (Exh. 3, p. 5, BIR Rec.), it was issued well within the ten year period. (Page 5, Memorandum for Respondent.)

From the foregoing allegations, it is not clear what the position is of respondent with respect to the issue of prescription. At times, the claim is made that the Government has ten years from the date of the failure or omission to file returns within which the deficiency tax may be assessed, and this is apparently based on the failure to include certain items (underdeclared items) in petitioner's returns. At other times, it is alleged that the returns were false or fraudulent so that the Government has ten years from the date of discovery of the fraud within which to make the assessment. In the interest of justice, we will consider both questions.

There is no question that petitioner filed returns for purposes of the franchise tax. But if it is the position of respondent that with respect to certain items (uncollected gross earnings which it believed were not taxable until actually collected) not declared in its returns there was a failure or an omission to file returns, his position is untenable. The failure of a taxpayer to include certain items in his tax return, not due to willful omission or fraud, does not constitute a failure to file return with respect to the omitted items within the meaning of Section 332 of the Revenue Code. (Central Azucarera de Tarlac v. Coll., G.R. Nos. L-11760-61, July 31, 1958.)

The sole basis for respondent's opinion that petitioner's returns were false and fraudulent is that certain items of gross earnings were not included in the returns. The underdeclaration, according to the report of an auditor of the General Auditing Office, Exh. F, "was due to the fact that the company declared its gross receipts for franchise tax purposes on the cash instead of on the accrual basis." This is precisely one of the issues raised in this proceeding. From the evidence of record, we cannot perceive any element of fraud in the alleged underdeclarations.

Section 331 of the Revenue Code provides that internal revenue taxes may be assessed only within five years from the date the return was filed or was due, if the return is not otherwise fraudulent. There is no dispute that the deficiency franchise tax in this case covering the period from January 1, 1948 to September 30, 1955, was assessed beyond the five-year period. Therefore, the right of the Government to assess the same has already prescribed.

The second issue relates to the taxable base of the franchise tax payable by petitioner. It is contended that the tax should be applied to the actual gross receipts. On the other hand, respondent claims that the tax applies to the total gross earnings. It is now settled that in the cases of franchises granted by authority of the Philippine Bill of 1902 and the Jones Law, the franchise tax is imposed upon the "gross earnings" of the grantees. The Legislature was without power to tax less than the "gross earnings" of the grantees.]

> The acts of the Legislature granting the franchises should be construed so as not to contravene or violate the organic acts above mentioned (the Philippine Bill of 1902 and the Jones Law), for otherwise said legislative acts would be null and void or unconstitutional. The organic acts use the word "earnings." A person may have earned his salary but may not have collected it, or may be unable to collect it from an insolvent employer. A person cannot demand payment of his unpaid salary unless he has earned it. This would show that to collect is different from to earn. Consequently, the uncollected "gross receipts" which should be construed as meaning the same thing as "gross earnings" should be subject to the franchise tax. (The Phil. Long Distance Tel. Co. v. Coll. of Int. Rev., G.R. No. L-3222, Jan. 31, 1952.)

The decision of respondent on the taxability of petitioner's gross earnings being in order, the same must be sustained.

The third issue raised in the memorandum of counsel for petitioner reads as follows:

> Amounts received by petitioner from sales and services made or rendered to customers or other parties, out of which it does not derive any profit, gain or income, do not constitute part of its taxable gross receipts, for the transactions and services are only for accommodation purposes and the said amounts are mere returns of petitioner's capital.

This issue has not been raised in the petition for review. Neither was it raised nor considered in the administrative proceeding in the Bureau of Internal Revenue. We do not find it necessary to consider the same in this appeal.

Finally, petitioner claims that to require it to pay the franchise tax of 5% under Section 259 of the Revenue Code, instead of 2% under its franchises, would constitute an impairment of the obligation of contract in violation of the Constitution. In answer to this, it is enough to quote from the decision in Lealda Electric Co., Inc. v. Commissioner of Internal Revenue, G.R. No. L-16428, April 30, 1963, viz:

> Petitioner invokes our decision in Visayan Electric Company v. Saturnino David (49 O.G. No. 4, p. 1385) and Manila Railroad Company v. Rafferty (40 Phil. p. 224) mainly to the effect that special laws or charters may not be amended, altered or repealed, except by consent of all concerned, unless the right was expressly reserved. Said ruling is of no avail to petitioner for two reasons.

> Firstly, petitioner's charter (Art. 11, Act No. 2475) contains an express provision to the effect that the same may be altered or repealed by the Congress of the United States - now of the Philippines. And, as already stated heretofore, the rate of the franchise tax petitioner had been paying under the provisions of Section 10 of Act 3636 was expressly amended by Act No. 39.
>
> Secondly, the franchises involved in the cases relied upon by petitioner differ substantially from petitioner's franchise in that those of the Visayan Electric Company and of the Manila Railroad Company specifically provided that the franchise tax which the grantees were required to pay was to be "in lieu of all taxes of any kind levied, established, or collected by any authority whatsoever, now or in the future" (Charter of the Visayan Electric, Art. 8, Act 3499), and, in the case of the charter of the Manila Railroad Company, Section 1, Subsection 12 of Act 1510, "in lieu of all taxes of every name and nature - municipal, provincial or central." Petitioner's charter contains no such provision.

The decision in the Lealda case, cited above, applies with equal force to the instant case.

In resumé, we are of the opinion that the right of the Government to assess the deficiency franchise tax against petitioner covering the period from January 1, 1948 to September 30, 1955 has already prescribed. With respect to the deficiency franchise tax and surcharge covering the period from October 1, 1955 to June 30, 1959 in the sum of ₱15,772.91 (₱12,618.33 deficiency tax plus ₱3,154.58 as 25% surcharge), the decision of respondent is hereby affirmed.

DECISION -
CTA CASE No. 1026

IN VIEW OF THE FOREGOING, petitioner is hereby ordered to pay the sum of ₱15,772.91 within thirty days from the date this decision becomes final, without pronouncement as to costs.

SO ORDERED.

Manila, December 26, 1963.

ROMAN M. UMALI
Associate Judge

WE CONCUR:

MARIANO NABLE
Presiding Judge

AUGUSTO M. LUCIANO
Associate Judge