**REPUBLIC OF THE PHILIPPINES**
**COURT OF TAX APPEALS**
**QUEZON CITY**

# FIRST DIVISION

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| **PHILIPPINE AIRLINES, INC. (PAL),** Petitioner, | **C.T.A. CASE NO. 7669** |
| | Members: |
| - versus - | **ACOSTA,** *Chairperson* **BAUTISTA,** and **CASANOVA,** *JJ.* |
| **COMMISSIONER OF INTERNAL REVENUE,** Respondent. | **Promulgated:** DEC 10 2009; 10:30am |

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# DECISION

**BAUTISTA, *J.*:**

This Petition for Review seeks the cancellation of respondent's tax assessment against petitioner in the total amount of P65,544,153.43, allegedly representing petitioner's deficiency Minimum Corporate Income Tax (MCIT) inclusive of penalty and interest for fiscal year ending March 31, 2004.

As stipulated by the parties, the facts of the case are as follows:[1]

Philippine Airlines, Inc. (Petitioner) 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.

Respondent 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 the two percent (2%) MCIT,

[1] Joint Stipulation of Facts and Issues, docket, pp. 122-126.

imposed under Section 27(E) of the National Internal Revenue Code (NIRC). He holds office at the BIR National Office Building, Agham Road, Diliman, Quezon City.

Respondent, through the BIR's Large Taxpayers Service, issued Letter of Authority LOA 2000-00096214 dated April 18, 2000, addressed to petitioner and received by the latter on April 26, 2006; informing 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, 20004".

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

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|---|---|
| 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

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|---|---|
| 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 |

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[2] 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.[3]

As stipulated by the parties, the issues for this Court's resolution are as follows:[4]

> "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

[2] Docket, p. 131.
[3] Docket, p. 210.
[4] Docket, p. 126.

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."

At this juncture, it must be pointed out that the above issues are not novel, considering they were already settled by the Supreme Court in **Commissioner of Internal Revenue vs. Philippine Airlines, Inc.**[5] The pertinent portions of the said Decision are quoted hereunder for ready reference, to wit:

"Presidential Decree No. 1590, the franchise of PAL, contains provisions specifically governing the taxation of said corporation, to wit:

Section 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 per cent (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.

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:

1. All taxes, duties, charges, royalties, or fees due on local purchases by the grantee of aviation gas, fuel, and oil, whether refined or in crude form, and whether such

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

taxes, duties, charges, royalties, or fees are directly due from or imposable upon the purchaser or the seller, producer, manufacturer, or importer of said petroleum products but are billed or passed on to the grantee either as part of the price or cost thereof or by mutual agreement or other arrangement; provided, that all such purchases by, sales or deliveries of aviation gas, fuel, and oil to the grantee shall be for exclusive use in its transport and nontransport operations and other activities incidental thereto;

2. All taxes, including compensating taxes, duties, charges, royalties, or fees due on all importations by the grantee of aircraft, engines, equipment, machinery, spare parts, accessories, commissary and catering supplies, aviation gas, fuel, and oil, whether refined or in crude form and other articles, supplies, or materials; provided, that such articles or supplies or materials are imported for the use of the grantee in its transport and nontransport operations and other activities incidental thereto and are not locally available in reasonable quantity, quality, or price;

3. All taxes on lease rentals, interest, fees, and other charges payable to lessors, whether foreign or domestic, of aircraft, engines, equipment, machinery, spare parts, and other property rented, leased, or chartered by the grantee where the payment of such taxes is assumed by the grantee;

4. All taxes on interest, fees, and other charges on foreign loans obtained and other obligations incurred by the grantee where the payment of such taxes is assumed by the grantee;

5. All taxes, fees, and other charges on the registration, licensing, acquisition, and transfer of aircraft, equipment, motor vehicles, and all other personal and real property of the grantee; and

6. The corporate development tax under Presidential Decree No. 1158-A.

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:

(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.
>
> **Section 14.** The grantee shall pay either the franchise tax or the basic corporate income tax on quarterly basis to the Commissioner of Internal Revenue. Within sixty (60) days after the end of each of the first three quarters of the taxable calendar or fiscal year, the quarterly franchise or income-tax return shall be filed and payment of either the franchise or income tax shall be made by the grantee.
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> A final or an adjustment return covering the operation of the grantee for the preceding calendar or fiscal year shall be filed on or before the fifteenth day of the fourth month following the close of the calendar or fiscal year. The amount of the final franchise or income tax to be paid by the grantee shall be the balance of the total franchise or income tax shown in the final or adjustment return after deducting therefrom the total quarterly franchise or income taxes already paid during the preceding first three quarters of the same taxable year.
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> Any excess of the total quarterly payments over the actual annual franchise of income tax due as shown in the final or adjustment franchise or income-tax return shall either be refunded to the grantee or credited against the grantee's quarterly franchise or income-tax liability for the succeeding taxable year or years at the option of the grantee.
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> The term '**gross revenues**' is herein defined as the total gross income earned by the grantee from; (a) transport, nontransport, and other services; (b) earnings realized from investments in money-market placements, bank deposits, investments in shares of stock and other securities, and other investments; (c) total gains net of total losses realized from the disposition of assets and foreign-exchange transactions; and (d) gross income from other sources. (Emphases ours.)

According to the afore-quoted provisions, 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.

The basic corporate income tax of PAL shall be based on its annual net taxable income, computed in accordance with the National Internal Revenue Code (NIRC). Presidential Decree No. 1590 also explicitly authorizes PAL, in the computation of its basic corporate income tax, to (1) depreciate its assets twice as fast the normal rate of depreciation; and (2) 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.

Franchise tax, on the other hand, shall be two per cent (2%) of the gross revenues derived by PAL from all sources, whether transport or nontransport operations. However, with respect to international air-transport service, the franchise tax shall only be imposed on the gross passenger, mail, and freight revenues of PAL from its outgoing flights.

In its income tax return for FY 2000-2001, filed with the BIR, PAL reported no net taxable income for the period, resulting in zero basic corporate income tax, which would necessarily be lower than any franchise tax due from PAL for the same period.

**The CIR, though, assessed PAL for MCIT for FY 2000-2001. It is the position of the CIR that the MCIT is income tax for which PAL is liable. The CIR reasons that Section 13 (a) of Presidential Decree No. 1590 provides that the corporate income tax of PAL shall be computed in accordance with the NIRC. And, since the NIRC of 1997 imposes MCIT, and PAL has not applied for relief from the said tax, then PAL is subject to the same.**

**The Court is not persuaded. The arguments of the CIR are contrary to the plain meaning and obvious intent of Presidential Decree No. 1590, the franchise of PAL.**

Income tax on domestic corporations is covered by Section 27 of the NIRC of 1997, pertinent provisions of which are reproduced below for easy reference:

> SEC. 27. *Rates of Income Tax on Domestic Corporations.* —
>
> (A) *In General* — Except as otherwise provided in this Code, an income tax of **thirty-five percent (35%)** is hereby imposed upon the **taxable income** derived during each taxable year from all sources within and without the Philippines by every corporation, as defined in Section 22(B) of this Code and taxable under this Title as a corporation, organized in, or existing under the laws of the Philippines: *Provided*, That effective January 1, 1998, the rate of income tax shall be thirty-four percent (34%); effective January 1, 1999, the rate shall be thirty-three percent (33%); and effective January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%).

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(E) *Minimum Corporate Income Tax on Domestic Corporations.* —

(1) *Imposition of Tax.* — A minimum corporate income tax of **two percent (2%) of the gross income** as of the end of the taxable year, as defined herein, is hereby imposed on a corporation taxable under this Title, beginning on the fourth taxable year immediately following the year in which such corporation commenced its business operations, when the minimum income tax is greater than the tax computed under Subsection (A) of this Section for the taxable year.

**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.**

**After 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, the Court, like the CTA *en banc* and Second Division, concludes that PAL cannot be subjected to MCIT for FY 2000-2001.**

*First*, Section 13 (a) of Presidential Decree No. 1590 refers to **'basic corporate income tax.'** In *Commissioner of Internal Revenue v. Philippine Airlines, Inc.*, 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.

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'.

*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.

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**. The gross income, referred to in Section 31, is described in Section 32 of the NIRC of 1997 as income from whatever source, including compensation for services; the conduct of trade or business or the exercise of profession; dealings in property; interests; rents; royalties; dividends; annuities; prizes and winnings; pensions; and a partner's distributive share in the net income of a general professional partnership.

Pursuant to the NIRC of 1997, the taxable income of a domestic corporation may be arrived at by subtracting from gross income deductions authorized, not just by the NIRC of 1997, but also by special laws. Presidential Decree No. 1590 may be considered as one of such special laws authorizing PAL, in computing its annual net taxable income, on which its basic corporate income tax shall be based, to deduct from its gross income the following: (1) depreciation of assets at twice the normal rate; and (2) net loss carry-over up to five years following the year of such loss.

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.

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**. 'Cost of services' refers to all **direct costs and expenses** necessarily incurred to provide the services required by the customers and clients including (a) salaries and employee benefits of personnel, consultants, and specialists directly rendering the service; and (b) cost of facilities directly utilized in providing the service, such as depreciation or rental of equipment used and cost of supplies. Noticeably, inclusions in and exclusions/deductions from gross income for MCIT purposes are limited to those directly arising from the conduct of the taxpayer's business. It is, thus, more limited than the gross income used in the computation of basic corporate income tax.

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.

*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.*, 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.**

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. The said taxes are merely paid in the alternative, giving the Government the opportunity to collect the higher amount between the two. The situation is not much different from Section 13 of Presidential Decree No. 1590, which reversely allows PAL to pay, whichever is lower of the basic corporate income tax or the franchise tax. It does not make the basic corporate income tax indistinguishable from the franchise tax.

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.

*Fourth*, the evident intent of Section 13 of Presidential Decree No. 1520 is to extend to PAL tax concessions not ordinarily available to other domestic corporations. Section 13 of Presidential Decree No. 1520 permits

PAL to pay **whichever is lower of** the basic corporate income tax or the franchise tax; and the tax so paid shall be **in lieu of all other taxes**, except only real property tax. Hence, under its franchise, PAL is to pay the least amount of tax possible.

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. In this case, in addition to being a public utility providing air-transport service, PAL is also the official flag carrier of the country.

**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.**

*Fifth*, the CIR posits that PAL may not invoke in the instant case the 'in lieu of all other taxes' clause in Section 13 of Presidential Decree No. 1520, if it did not pay anything at all as basic corporate income tax or franchise tax. As a result, PAL should be made liable for 'other taxes' such as MCIT. This line of reasoning has been dubbed as the Substitution Theory, and this is not the first time the CIR raised the same. The Court already rejected the Substitution Theory in *Commissioner of Internal Revenue v. Philippine Airlines, Inc.*, to wit:

> ***'Substitution Theory' of the CIR Untenable***
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> **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 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.**

> Under Subsection (a), the basis for the tax rate is respondent's annual net taxable income, which (as earlier discussed) is computed by subtracting allowable deductions and exemptions from gross income. By basing the tax rate on the annual net taxable income, PD 1590 necessarily recognized the situation in which taxable income may result in a negative amount and thus translate into a zero tax liability.
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> Notably, PAL was owned and operated by the government at the time the franchise was last amended. It can reasonably be contemplated that PD 1590 sought to assist the finances of the government corporation in the form of lower taxes: When respondent operates at a loss (as in the instant case), no taxes are due; in this instances, it has a lower tax liability than that provided by Subsection (b).
>
> **The fallacy of the CIR's argument is evident from the fact that the payment of a measly sum of one peso would suffice to exempt PAL from other taxes, whereas a zero liability arising from its losses would not. There is no substantial distinction between a zero tax and a one-peso tax liability.** (Emphasis ours.)

Based on the same ratiocination, the Court finds the Substitution Theory unacceptable in the present Petition.

The CIR alludes as well to Republic Act No. 9337, for reasons similar to those behind the Substitution Theory. Section 22 of Republic Act No. 9337, more popularly known as the Expanded Value Added Tax (E-VAT) Law, abolished the franchise tax imposed by the charters of particularly identified public utilities, including Presidential Decree No. 1590 of PAL. PAL may no longer exercise its options or alternatives under Section 13 of Presidential Decree No. 1590, and is now liable for both corporate income tax and the 12% VAT on its sale of services. The CIR alleges that Republic Act No. 9337 reveals the intention of the Legislature to make PAL share the tax burden of other domestic corporations.

The CIR seems to lose sight of the fact that the Petition at bar involves the liability of PAL for MCIT for the fiscal year ending **31 March 2001**. Republic Act No. 9337, which took effect on **1 July 2005**, cannot be applied retroactively and any amendment introduced by said statute affecting the taxation of PAL is immaterial in the present case.

***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.**

**Consequently, the insistence of the CIR to subject PAL to MCIT cannot be done without contravening Presidential Decree No. 1520.**

Between Presidential Decree No. 1520, 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.

Neither can it be said that the NIRC of 1997 repealed or amended Presidential Decree No. 1590.

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.* —

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(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." (*Emphases supplied*)

As regards the second issue, pertaining to the questioned validity of RMC No. 66-2003, the Supreme Court had the following to say:

"The alternative argument of the CIR — that the imposition of the MCIT is pursuant to the amendment of the NIRC, and not of Presidential Decree No. 1590 — is just as specious. As has already been settled by this Court, the basic corporate income tax under Section 13(a) of Presidential Decree No. 1590 relates to the general tax rate under Section 27(A) of the NIRC of 1997, which is 32% by the year 2000, imposed on taxable income. Thus, only provisions of the NIRC of 1997 necessary for the computation of the basic corporate income tax apply to PAL. And even though Republic Act No. 8424 amended the NIRC by introducing the MCIT, in what is now Section 27(E) of the said Code, this amendment is actually irrelevant and should not affect the taxation of PAL, since the MCIT is clearly distinct from the basic corporate income tax referred to in Section 13(a) of Presidential Decree No. 1590, and from which PAL is consequently exempt under the 'in lieu of all other taxes' clause of its charter.

The CIR calls the attention of the Court to RMC No. 66-2003, on 'Clarifying the Taxability of Philippine Airlines (PAL) for Income Tax Purposes As Well As Other Franchise Grantees Similarly Situated.' According to RMC No. 66-2003:

Section 27(E) of the Code, as implemented by Revenue Regulations No. 9-98, provides that MCIT of two percent (2%) of the gross income as of the end of the taxable year (whether calendar or fiscal year, depending on the accounting period employed) is imposed upon any domestic corporation beginning the 4th taxable year immediately following the taxable year in which such corporation commenced its business operations. The MCIT shall be imposed whenever such corporation has zero or negative taxable income or whenever the amount of MCIT is greater than the normal income tax due from such corporation.

> 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 choose to be subject thereto, such as PAL, are bound to pay income tax regardless of whether they are operating at a profit or loss.
>
> Thus, in case of operating loss, PAL may either opt to subject itself to minimum corporate income tax or to the 2% franchise tax, whichever is lower. On the other hand, if PAL is operating at a profit, the income tax liability shall be the lower amount between:
>
> (1) normal income tax or MCIT whichever is higher; and
> (2) 2% franchise tax.

The CIR attempts to sway this Court to adopt RMC No. 66-2003 since the '[c]onstruction by an executive branch of government of a particular law although not binding upon the courts must be given weight as the construction comes from the branch of the government called upon to implement the law.'

But the Court is unconvinced.

It is significant to note that RMC No. 66-2003 was issued only on 14 October 2003, more than two years after FY 2000-2001 of PAL ended on 31 March 2001. This violates the well-entrenched principle that statutes, including administrative rules and regulations, operate prospectively only, unless the legislative intent to the contrary is manifest by express terms or by necessary implication.

**Moreover, despite the claims of the CIR that RMC No. 66-2003 is just a clarificatory and internal issuance, the Court observes 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 who will be affected thereby.** In *Commissioner of Internal Revenue v. Court of Appeals*, 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.**
>
> xxx xxx xxx

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.' It is furthermore the rule of long standing that this Court will not set aside lightly the conclusions reached by the CTA which, by the very nature of its functions, is dedicated exclusively to the resolution of tax problems and has, accordingly, developed an expertise on the subject, unless there has been an abuse or improvident exercise of authority. In the Petition at bar, the CTA *en banc* and in division both adjudged that PAL is not liable for MCIT under Presidential Decree No. 1590, and this Court has no sufficient basis to reverse them

As to the assertions of the CIR that exemption from tax is not presumed, and the one claiming it must be able to show that it indubitably exists, the Court recalls its pronouncements in *Commissioner of Internal Revenue v. Court of Appeals*:

> 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 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. . . . (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.**' (Emphases ours.)"[6]

Moreover, this Court's First Division had already ruled in **Philippine Airlines, Inc. (PAL) vs. Commissioner of Internal Revenue**[7] that RMC 66-2003 cannot amend the franchise of petitioner since it is merely an administrative issuance. The significant parts of the said Decision state:

> "As previously discussed, Section 27(E) of the NIRC of 1997 did not modify, amend or repeal P.D. No. 1590, a fortiori, **RMC No. 66-2003 cannot amend PAL's franchise. A scrutiny of the provisions of RMC No. 66-2003 shows that even if PAL suffers losses in its business operations, it is still liable to pay the 2% MCIT based on its gross income. Clearly, this is contrary to the intention of Section 13 of P.D. 1590 allowing petitioner to choose the income tax option that will result to a lesser tax liability as an incentive for undertaking a line of business impressed with public service. It went beyond interpreting the law it seeks to implement.** 'Although it is widely accepted that the interpretation placed upon a statute by the executive officers, whose duty is to enforce it, is entitled to great respect by the courts, this interpretation is not conclusive and will have to be ignored if judicially found to be erroneous and clearly absurd or improper. **An administrative issuance that overrides the law it merely seeks to interpret, instead of remaining consistent and in harmony with it, will not be countenanced by this Court.' It is only the legislature that has the prerogative to alter or modify the terms of any previously granted franchise.**"(*Emphasis supplied*)

In closing, the Court quotes the declaration of the High Tribunal in the case of **Commissioner of Internal Revenue vs. Philippine Airlines, Inc.**[8], to wit

> "For two decades following the grant of its franchise by Presidential Decree No. 1590 in 1978, PAL was only being held liable for the basic corporate income tax or franchise tax, whichever was lower;

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[6] Commissioner of Internal Revenue vs. Philippine Airlines, Inc., *supra.*

[7] C.T.A. Case No. 7840, August 27, 2009, citing Commissioner of Internal Revenue vs. Philippine Airlines, Inc. (PAL), C.T.A. EB No. 271, July 19, 2003.

[8] *Supra.*

and its payment of either tax was in lieu of all other taxes, except real property tax, in accordance with the plain language of Section 13 of the charter of PAL. Therefore, the exemption of PAL from 'all other taxes' was not just a presumption, but a previously established, accepted, and respected fact, even for the BIR.

The MCIT was a new tax introduced by Republic Act No. 8424. Under the doctrine of strict interpretation, the burden is upon the CIR to primarily 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."

**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**.

**LOVELL R. BAUTISTA**
Associate Justice

WE CONCUR:

**ERNESTO D. ACOSTA**
Presiding Justice

**CAESAR A. CASANOVA**
Associate Justice

# CERTIFICATION

Pursuant to Article VIII, Section 13 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's Division.

**ERNESTO D. ACOSTA**
Presiding Justice
Chairpersonon, First Division