THIRD DIVISION

COMMISSIONER OF INTERNAL REVENUE, Petitioner, - *versus* - **PHILIPPINE AIRLINES, INC.,** Respondent.	**G.R. No. 180066** Present: YNARES-SANTIAGO, *J.*, Chairperson, CHICO-NAZARIO, VELASCO, JR., NACHURA, and PERALTA, *JJ.* Promulgated: _______________________

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DECISION

CHICO-NAZARIO, *J.:*

Before this Court is a Petition for Review on *Certiorari*, under Rule 45 of the Revised Rules of Court, seeking the reversal and setting aside of the Decision[1] dated 9 August 2007 and Resolution[2] dated 11 October 2007 of the Court of Tax Appeals (CTA) *en banc* in CTA E.B. No. 246. The CTA *en banc* affirmed the Decision[3] dated 31 July 2006 of the CTA Second Division in C.T.A. Case No. 7010, ordering the cancellation and withdrawal of

Preliminary Assessment Notice (PAN) No. INC FY-3-31-01-000094 dated 3 September 2003 and Formal Letter of Demand dated 12 January 2004, issued by the Bureau of Internal Revenue (BIR) against respondent Philippine Airlines, Inc. (PAL), for the payment of Minimum Corporate Income Tax (MCIT) in the amount of ₱272,421,886.58.

There is no dispute as to the antecedent facts of this case.

PAL is a domestic corporation organized under the corporate laws of the Republic of the Philippines; declared the national flag carrier of the country; and the grantee under Presidential Decree No. 1590[4] of a franchise to establish, operate, and maintain transport services for the carriage of passengers, mail, and property by air, in and between any and all points and places throughout the Philippines, and between the Philippines and other countries.[5]

For its fiscal year ending 31 March 2001 (FY 2000-2001), PAL allegedly incurred zero taxable income,[6] which left it with unapplied creditable withholding tax[7] in the amount of ₱2,334,377.95. PAL did not pay any MCIT for the period.

In a letter dated 12 July 2002, addressed to petitioner Commissioner of Internal Revenue (CIR), PAL requested for the refund of its unapplied creditable withholding tax for FY 2000-2001. PAL attached to its letter the following: (1) Schedule of Creditable Tax Withheld at Source for FY 2000-2001; (2) Certificates of Creditable Taxes Withheld; and (3) Audited Financial Statements.

Acting on the aforementioned letter of PAL, the Large Taxpayers Audit and Investigation Division 1 (LTAID 1) of the BIR Large Taxpayers Service (LTS), issued on 16 August 2002, Tax Verification Notice No. 00201448, authorizing Revenue Officer Jacinto Cueto, Jr. (Cueto) to verify the supporting documents and pertinent records relative to the claim of PAL for refund of its unapplied creditable withholding tax for FY 2000-20001. In a letter dated 19 August 2003, LTAID 1 Chief Armit S. Linsangan invited PAL to an informal conference at the BIR National Office in Diliman, Quezon City, on 27 August

2003, at 10:00 a.m., to discuss the results of the investigation conducted by Revenue Officer Cueto, supervised by Revenue Officer Madelyn T. Sacluti.

BIR officers and PAL representatives attended the scheduled informal conference, during which the former relayed to the latter that the BIR was denying the claim for refund of PAL and, instead, was assessing PAL for deficiency MCIT for FY 2000-2001. The PAL representatives argued that PAL was not liable for MCIT under its franchise. The BIR officers then informed the PAL representatives that the matter would be referred to the BIR Legal Service for opinion.

The LTAID 1 issued, on 3 September 2003, PAN No. INC FY-3-31-01-000094, which was received by PAL on 23 October 2003. LTAID 1 assessed PAL for ₱262,474,732.54, representing deficiency MCIT for FY 2000-2001, plus interest and compromise penalty, computed as follows:

Sales/Revenues from Operation	₱ 38,798,721,685.00
Less: Cost of Services	30,316,679,013.00
Gross Income from Operation	8,482,042,672.00
Add: Non-operating income	465,111,368.00
Total Gross Income for MCIT purposes	9,947,154,040.00[8]
Rate of Tax	2%
Tax Due	178,943,080.80
Add: 20% interest (8-16-00 to 10-31-03)	83,506,651.74
Compromise Penalty	25,000.00
Total Amount Due	₱ 262,474,732.54[9]

PAL protested PAN No. INC FY-3-31-01-000094 through a letter dated 4 November 2003 to the BIR LTS.

On 12 January 2004, the LTAID 1 sent PAL a Formal Letter of Demand for deficiency MCIT for FY 2000-2001 in the amount of ₱271,421,88658, based on the following calculation:

Sales/Revenues from Operation		₱ 38,798,721,685.00
Less: Cost of Services		
Direct Costs -	₱ 30,749,761,017.00	

Less: Non-deductible interest expense	433,082,004.00	30,316,679,013.00
Gross Income from Operation		₱ 8,482,042,672.00
Add: Non-operating Income		465,111,368.00
Total Gross Income for MCIT purposes		₱ 9,947,154,040.00
MCIT tax due		₱ 178,943,080.80
Interest – 20% per annum – 7/16/01 to 02/15/04		92,453,805.78
Compromise Penalty		25,000.00
Total MCIT due and demandable		₱ 271,421,886.58[10]

PAL received the foregoing Formal Letter of Demand on 12 February 2004, prompting it to file with the BIR LTS a formal written protest dated 13 February 2004.

The BIR LTS rendered on 7 May 2004 its Final Decision on Disputed Assessment, which was received by PAL on 26 May 2004. Invoking Revenue Memorandum Circular (RMC) No. 66-2003, the BIR LTS denied with finality the protest of PAL and reiterated the request that PAL immediately pay its deficiency MCIT for FY 2000-2001, inclusive of penalties incident to delinquency.

PAL filed a Petition for Review with the CTA, which was docketed as C.T.A. Case No. 7010 and raffled to the CTA Second Division. The CTA Second Division promulgated its Decision on 31 July 2006, ruling in favor of PAL. The dispositive portion of the judgment of the CTA Second Division reads:

> **WHEREFORE**, premises considered, the instant Petition for Review is hereby **GRANTED**. Accordingly, Assessment Notice No. INC FY-3-31-01-000094 and Formal Letter of Demand for the payment of deficiency Minimum Corporate Income Tax in the amount of ₱272,421,886.58 are hereby **CANCELLED** and **WITHDRAWN**.[11]

In a Resolution dated 2 January 2007, the CTA Second Division denied the Motion for Reconsideration of the CIR.

It was then the turn of the CIR to file a Petition for Review with the CTA *en banc*, docketed as C.T.A. E.B. No. 246. The CTA *en banc* found that "the cited legal provisions

and jurisprudence are teeming with life with respect to the grant of tax exemption too vivid to pass unnoticed," and that "the Court in Division correctly ruled in favor of the respondent [PAL] granting its petition for the cancellation of Assessment Notice No. INC FY-3-31-01-000094 and Formal Letter of Demand for the deficiency MCIT in the amount of ₱272,421,886.58."[12] Consequently, the CTA *en banc* denied the Petition of the CIR for lack of merit. The CTA *en banc* likewise denied the Motion for Reconsideration of the CIR in a Resolution dated 11 October 2007.

Hence, the CIR comes before this Court via the instant Petition for Review on *Certiorari*, based on the grounds stated hereunder:

> THE COURT OF TAX APPEALS ERRED ON A QUESTION OF LAW IN ITS ASSAILED DECISION BECAUSE:
>
> (1) [PAL] CLEARLY OPTED TO BE COVERED BY THE INCOME TAX PROVISION OF THE NATIONAL INTERNAL REVENUE CODE OF 1997 (NIRC OF 1997). (sic) AS AMENDED; HENCE, IT IS COVERED BY THE MCIT PROVISION OF THE SAME CODE.
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> (2) THE MCIT DOES NOT BELONG TO THE CATEGORY OF "OTHER TAXES" WHICH WOULD ENABLE RESPONDENT TO AVAIL ITSELF OF THE "IN LIEU" (sic) OF ALL OTHER TAXES" CLAUSE UNDER SECTION 13 OF P.D. NO. 1590 ("CHARTER").
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> (3) THE MCIT PROVISION OF THE NIRC OF 1997 IS NOT AN AMENDMENT OF [PAL'S] CHARTER.
>
> (4) PAL IS NOT ONLY GIVEN THE PRIVILEGE TO CHOOSE BETWEEN WHAT WILL GIVE IT THE BENEFIT OF A LOWER TAX, BUT ALSO THE RESPONSIBILITY OF PAYING ITS SHARE OF THE TAX BURDEN, AS IS EVIDENT IN SECTION 22 OF RA NO. 9337.
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> (5) A CLAIM FOR EXEMPTION FROM TAXATION IS NEVER PRESUMED; [PAL] IS LIABLE FOR THE DEFICIENCY MCIT.[13]

There is only one vital issue that the Court must resolve in the Petition at bar, *i.e.*, whether PAL is liable for deficiency MCIT for FY 2000-2001.

The Court answers in the negative.

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 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.

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.

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.

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;[14] 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.[15]

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,[16] 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%).

x x x x

(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.*,[17] 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,[18] 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. [19] 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.*, [20] wherein it held that income tax on the passive income[21] 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.[22] 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.*,[23] 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.
>
> 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[24] 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.[25]

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.* –
>
> 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.

The CIR reasons that PAL was a government-owned and controlled corporation when Presidential Decree No. 1590, its franchise or charter, was issued in 1978. Since PAL was still operating under the very same charter when Republic Act No. 8424 took effect in 1998, then the latter can repeal or amend the former by virtue of Section 7(B).

The Court disagrees.

A brief recount of the history of PAL is in order. PAL was established as a private corporation under the general law of the Republic of the Philippines in February 1941. In **November 1977**, the government, through the Government Service Insurance System (GSIS), acquired the majority shares in PAL. PAL was privatized in **January 1992** when the local consortium PR Holdings acquired a 67% stake therein.[26]

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.

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."[27]

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.[28]

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*,[29] 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 laws, whereby due notice is a basic requirement (Sec. 1, Art. IV, Constitution; Art. 2, New Civil Code).

"In order that there shall be a just enforcement of rules and regulations, **in conformity with the basic element of due process, the following procedures are hereby prescribed** for the drafting, issuance and implementation of the said Revenue Tax Issuances:

"(1). 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.13

Nothing on record could tell us that it was either impossible or impracticable for the BIR to observe and comply with the above requirements before giving effect to its questioned circular. (Emphases ours.)

The Court, however, stops short of ruling on the validity of RMC No. 66-2003, for it is not among the issues raised in the instant Petition. It only wishes to stress the requirement of prior notice to PAL before RMC No. 66-2003 could have become effective. Only after RMC No. 66-2003 was issued on 14 October 2003 could PAL have been given notice of said circular, and only following such notice to PAL would RMC No. 66-2003 have taken effect. Given this sequence, it is not possible to say that RMC No. 66-2003 was already in effect and should have been strictly complied with by PAL for its fiscal year which ended on 31 March 2001.

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."[30] 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.[31] 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*[32]:

> 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. 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."** (Emphases ours.)

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; 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,[33] 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.

Not being liable for MCIT in FY 2000-2001, it necessarily follows that PAL need not apply for relief from said tax as the CIR maintains.

WHEREFORE, premises considered, the instant Petition for Review is hereby **DENIED**, and the Decision dated 9 August 2007 and Resolution dated 11 October 2007 of the Court of Tax Appeals *en banc* in CTA E.B. No. 246 is hereby **AFFIRMED**. No costs.

SO ORDERED.

MINITA V. CHICO-NAZARIO
Associate Justice

WE CONCUR:

CONSUELO YNARES-SANTIAGO
Associate Justice
Chairperson

RESBITERO J. VELASCO, JR.
Associate Justice

ANTONIO EDUARDO B. NACHURA
Associate Justice

DIOSDADO M. PERALTA
Associate Justice

A T T E S T A T I O N

I attest 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.

CONSUELO YNARES-SANTIAGO
Associate Justice
Chairperson, Third Division

C E R T I F I C A T I O N

Pursuant to Article VIII, Section 13 of the Constitution, and the Division Chairman's Attestation, 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.

REYNATO S. PUNO
Chief Justice

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[1] Penned by Associate Justice Erlinda P. Uy with Presiding Justice Ernesto D. Acosta and Associate Justices Juanito C. Castañeda, Jr., Lovell R. Bautista, Caesar A. Casanova, and Olga Palanca-Enriquez, concurring; *rollo*, pp. 43-56.

[2] Id. at 67-68.

[3] Penned by Associate Justice Juanito C. Castañeda with Associate Justices Erlinda P. Uy and Olga Palanca-Enriquez, concurring, id. at 70-90.

[4] An Act Granting a New Franchise to Philippine Airlines, Inc. to Establish, Operate, and Maintain Air-Transport Services in the Philippines and Other Countries.

[5] Section 1 of Presidential Decree No. 1590.

[6] According to the Annual Income Tax Return of PAL for the fiscal year in question, its allowable deductions exactly equalled its total gross income of ₱39,470,862,232.00, thus, leaving zero taxable income.

[7] Withheld at source, meaning, it was previously deducted and withheld by various withholding agents from the income payments made to PAL.

[8] Should be ₱8,947,154,040.00.

[9] *Rollo*, p. 105.

[10] Id. at 114.

[11] Id. at 89.

[12] Id. at 55.

[13] Id. at 17-18.

[14] As a general rule, there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including reasonable allowance for obsolescence) of property used in the trade or business. (Section 34(F)(1) of the NIRC of 1997)

[15] In general, losses shall be deducted from gross income in the same taxable year said losses were incurred. The recognized exception under Section 39(D) of the NIRC of 1997, allowing net capital loss carryover, may only be availed of by a taxpayer "other than a corporation."

[16] Prior to its amendment by Republic Act No. 9337, which was signed into law on 24 May 2005 and took effect on 1 July 2005.

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

[18] Section 34 of the NIRC of 1997 enumerates the allowable deductions, while Section 35 identifies the personal and additional exemptions.

[19] Section 27(E)(4) of the NIRC of 1997.

[20] Supra note 17at 98, 100.

[21] Passive income includes interest from deposits and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements and royalties [Section 27(D)(1) of the Tax Code of 1997]; capital gains from the sale of shares of stock not traded in the stock exchange [Section 27(D)(2); income derived under the Expanded Foreign Currency Deposit System [Section 27(D)(3)]; intercorporate dividends [Section 27(D)(4)]; and capital gains realized from sale, exchange or disposition of lands and/or buildings [Section 27(D)(5)].

[22] See *Carcar Electric and Ice Plant Co., Inc. v. Collector of Internal Revenue*, 100 Phil. 50, 54 (1956).

[23] Supra note 17 at 100-101.

[24] Article 4 of the Civil Code provides that "Laws shall have no retroactive effect, unless the contrary is provided."

[25] *Commissioner of Internal Revenue v. Central Luzon Drug Corporation*, G.R. No. 159647, 15 April 2005, 456 SCRA 414, 449.

[26] http://www.philippineairlines.com/about_pal/milestones/milestones.jsp

[27] Memorandum of the CIR, *rollo*, p. 264.

[28] *BPI Leasing Corporation v. Court of Appeals*, 461 Phil. 451, 460 (2003).

[29] 329 Phil. 987, 1007-1009 (1996).

[30] *Philippine Scout Veterans Security and Investigation Agency, Inc. v. National Labor Relations Commission*, 330 Phil. 665, 676 (1996).

[31] *Commissioner of Internal Revenue v. Philippine National Bank*, G.R. No. 161997, 25 October 2005, 474 SCRA 303, 320; *Commissioner of Internal Revenue v. Manila Mining Corporation*, G.R. No. 153204, 31 August 2005, 468 SCRA 571, 593-594.

[32] 338 Phil. 322, 330-331 (1997).

[33] Since it is readily apparent that the MCIT does not constitute the alternative franchise tax.