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FIRST DIVISION

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COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

- versus -

PHILIPPINE AIRLINES, INC.,
Respondent.

G.R. No. 160528

Present:

PANGANIBAN, *CJ,* Chairperson,
YNARES-SANTIAGO,
AUSTRIA-MARTINEZ,
CALLEJO, SR., and
CHICO-NAZARIO, *JJ*

Promulgated:
October 9, 2006

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DECISION

PANGANIBAN, *CJ:*

A franchise is a legislative grant to operate a public utility. Like those of any other statute, the ambiguous provisions of a franchise should be construed in accordance with the intent of the legislature. In the present case, Presidential Decree 1590 granted Philippine Airlines an option to pay the lower of two alternatives: (a) “the basic corporate income tax based on PAL’s annual net taxable income computed in accordance with the provisions of the National Internal Revenue Code” or (b) “a franchise tax of two percent of gross revenues.” Availment of either of these two alternatives shall exempt the airline from the payment of “all other taxes,” including the 20 percent final withholding tax on bank deposits.

The Case

Before us is a Petition for Review[1] under Rule 45 of the Rules of Court, challenging the September 30, 2003 Decision[2] of the Court of Appeals (CA) in CA-GR SP No. 67970. The CA reversed the June 13, 2001 Decision[3] and the November 13, 2001 Resolution[4] of the Court of Tax Appeals (CTA) in CTA Case No. 5824. The assailed CA Decision disposed as follows:

> "**WHEREFORE**, the petition is **GRANTED**, and [the] Commissioner of Internal Revenue is hereby directed to refund to the [respondent] the amount of ₱731,190.45 representing the 20% final withholding tax collected and deducted by depository banks on the petitioner's interest income or, in the alternative, to allow the [respondent] a tax credit for the same amount."[5]

The Facts

The CA narrates the facts thus:

> "[Respondent] Philippine Airlines, Inc. (PAL) is a domestic corporation organized in accordance with the laws of the Republic of the Philippines, while [Petitioner] Commissioner of Internal Revenue (CIR) is in-charge of the assessment and collection of the 20% final tax on interest on Philippine currency bank deposits and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements, imposed on domestic corporation under Sec. 24 (e) (1) [now Sec. 27 (D) (1)] of the National Internal Revenue Code (NIRC).
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> "On November 5, 1997, [respondent's] AVP-Revenue Operations and Tax Services Officer, Atty. Edgardo P. Curbita, filed with the Office of the then Commissioner of Internal Revenue, Mdm. Liwayway Vinzons-Chato, a written request for refund of the amount of ₱2,241,527.22 which represents the total amount of 20% final withholding tax

withheld from the [respondent] by various withholding agent banks, and which amount includes the 20% final withholding tax withheld by the United Coconut Planters Bank (UCPB) and Rizal Commercial Banking Corporation (RCBC) for the period starting March 1995 through February 1997.

"On December 4, 1997, the [respondent's] AVP-Revenue Operations and Tax Services Officer again filed with [petitioner] CIR another written request for refund of the amount of ₱1,048,047.23, representing the total amount of 20% final withholding tax withheld by various depository banks of the [respondent] which amount includes the 20% withholding tax withheld by the Philippine National Bank (PNB), Equitable Banking Corporation (EBC), and the Jade Progressive Savings & Mortgage Bank (JPSMB) for the period starting March 1995 through November 1997.

"The amounts, subject of this petition, and which represent the 20% final withholding tax allegedly erroneously withheld and remitted to the BIR by the aforesaid banks may be summarized as follows:

Bank	Period Covered	Source		Amount
UCPB	Jan. 9, 1997 – Feb. 21, 1997	Interest income on prime savings deposit	₱60,328.38	
		Interest income on government securities and/or commercial papers	78,658.52	₱131,986.65
RCBC	Jan. 6, 1997 – Feb. 28, 1997	Interest income on FBTB and Treasury Bills placements		47,763.55
PNB	Feb. 19, 1997 – Nov. 14, 1997	Interest income on PNBIG savings account		514,120.22
EBC	Jan. 3, 1997 – Feb. 28, 1997	Interest income on Treasury Bills placement		33,357.25
JPSMB	Jan. 1, 1997 – Feb. 28, 1997	Interest income on deposits		3,962.78

"[Petitioner] CIR failed to act on the [respondent's] request for refund; thus, a petition was filed before the CTA on April 23, 1999."[6]

Ruling of the Court of Tax Appeals

The CTA ruled that Respondent PAL was not entitled to the refund. Section 13 of Presidential Decree No. 1590, PAL's franchise,[7] allegedly gave respondent the option to pay either its corporate income tax under the provisions of the NIRC or a franchise tax of two percent of its gross revenues. Payment of either tax would be in lieu of all "other taxes." Had respondent paid the two percent franchise tax, then the final withholding taxes would have been considered as "other taxes." Since it chose to pay its corporate income tax, payment of the final withholding tax is deemed part of this liability and therefore not refundable.[8]

Ruling of the Court of Appeals

As stated earlier, the Court of Appeals reversed the Decision of the CTA. The CA held that PAL was bound to pay only the corporate income tax or the franchise tax. Section 13 of Presidential Decree No. 1590 exempts respondent from paying all other taxes, duties, royalties and other fees of any kind.[9] Respondent chose to pay its basic corporate income tax, which,

after considering the factors allowed by law, resulted in a zero tax liability.[10] This zero tax liability should neither be taken against respondent nor deprive it of the exemption granted by the law.[11] Having chosen to pay its corporate income tax liability, respondent should now be exempt from paying all other taxes including the final withholding tax.

Hence, this Petition.[12]

The Issue

The sole issue raised by petitioner is stated in this wise:

> "The Court of Appeals erred on a question of law ruling that the 'in lieu of all other taxes' provision in Section 13 of PD No. 1590 applies even if there were in fact no taxes paid under any of subsections (A) and (B) of the said decree."[13]

The Court's Ruling

The Petition has no merit.

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Sole Issue:
Tax Liability of PAL

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The resolution of the instant case hinges on the interpretation of Section 13 of PAL's franchise, which states in part:

> "SEC. 13. In consideration of the franchise and rights hereby granted, the grantee shall pay to the Philippine Government during the life of this franchise whichever of subsections (a) and (b) hereunder will result in a lower tax:
>
> '(a) The basic corporate income tax based on the grantee's annual net taxable income computed in accordance with the provisions of the National Internal Revenue Code; or
>
> '(b) A franchise tax of two percent (2%) of the gross revenues derived by the

> grantee from all sources, without distinction as to transport or non-transport operations; provided, that with respect to international air-transport service, only the gross passenger, mail, and freight revenues from its outgoing flights shall be subject to this tax.'

"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, x x x."[14]

Two points are evident from this provision. *First*, as consideration for the franchise, PAL is liable to pay either a) its basic corporate income tax based on its net taxable income, as computed under the National Internal Revenue Code; or b) a franchise tax of two percent based on its gross revenues, *whichever is lower*. *Second,* the tax paid is "in lieu of all other taxes" imposed by all government entities in the country.

Interpretation of PAL's Franchise

According to the CA and PAL, the "other taxes in lieu of all other taxes" proviso includes final withholding taxes.[15] When respondent availed itself of the basic corporate income tax as its chosen tax liability, it became exempt from final withholding taxes.

On the other hand, the CTA held that the "in lieu of all other taxes" proviso implied the existence of something for which a substitution would be made.[16] Final withholding taxes come under

basic corporate income tax liability; hence, payment of the latter cannot mean an exemption from the former. To be exempt from final withholding taxes, PAL should have paid the franchise tax of two percent, which would have been in lieu of all other taxes including the

final withholding tax.

The CIR argues that the "in lieu of all other taxes" proviso is a mere incentive that applies only when PAL actually pays something; that is, either the basic corporate income tax or the franchise tax.[17] Because of the zero tax liability of respondent under the basic corporate income tax system, it was not eligible for exemption from other taxes.[18]

Construing Subsection (a)
of Section 13 of PD 1590
Vis-à-vis the Corporate Income Tax

PAL availed itself of PD 1590, Section 13, Subsection (a), the crux of which hinged on the terms "basic corporate income tax" and "annual net taxable income." The applicable laws (PAL's

franchise and the Tax Code) do not define the terms "basic corporate income tax."[19] On the other hand, "annual net taxable income" is computed in accordance with the provisions of the National Internal Revenue Code.

The statutory basis for the income tax on corporations is found in Sections 27 to 30 of the National Internal Revenue Code of 1997 under Chapter IV: "Tax on Corporations." Section 27 enumerates the rate of income tax on domestic corporations; Section 28, the rates for foreign corporations; Section 29, the taxes on improperly accumulated earnings; and Section 30, the corporations exempt from tax.

Being a domestic corporation, PAL is subject to Section 27, which reads as follows:

> "Section 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, x x x, organized in, or existing under the laws of the Philippines x x x."[20]

The NIRC also imposes final taxes on certain passive incomes, as follows: 1) **20 percent on the interests on currency bank deposits, other monetary benefits from deposit substitutes, trust funds and similar arrangements, and royalties derived from sources within the Philippines;**[21] 2) 5 percent and 10 percent on the net capital gains realized from the sale of shares of stock in a domestic corporation not traded in the stock exchange;[22] 3) 10 percent on income derived by a depositary bank under the expanded foreign currency deposit system;[23] and 4) 6 percent on the gain presumed to be realized on the sale or disposition of lands and buildings treated as capital assets.[24] These final taxes are withheld at source.[25]

A corporate income tax liability, therefore, has two components: the general rate of 35 percent, which is not disputed; and the specific final rates for certain passive incomes. PAL's request for a refund in the present case pertains to the passive income on bank deposits, which is subject to the specific final tax of 20 percent.[26]

Computation of Taxable Income Under the Tax Code

Note that the tax liability of PAL under the option it chose (Item "a" of Section 13 of PD 1590) is to be "*computed* in accordance with the provisions of the National Internal Revenue Code," as follows:

> "(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[.]"

Taxable income means the pertinent items of gross income specified in the Tax Code, less the deductions and/or personal and additional exemptions, if any, authorized for these types of income.[27] Under Section 32 of the Tax Code, *gross income* means income derived from whatever source, including compensation for services; the conduct of trade or business or the exercise of a 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. Section 34 enumerates the allowable deductions; Section 35, personal and additional exemptions.

The definition of gross income is broad enough to include all passive incomes subject to specific rates or final taxes. However, since these passive incomes are already subject to different rates and taxed finally at source, *they are no longer included in the computation of gross income, which determines taxable income.*

Basic Corporate Income Tax Based on Annual Net Taxable Income

To repeat, the pertinent provision in the case at bar reads: "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." The Court has already illustrated that, under the Tax Code, "taxable income" does not include passive income subjected to final withholding taxes. Clearly, then, the "basic corporate income tax" identified in Section 13 (a) of the franchise relates to the general rate of 35 percent as stipulated in Section 27 of the Tax Code. The final 20 percent taxes disputed in the present case are not covered under Section 13 (a) of PAL's franchise; thus, a refund is in order.

"Substitution Theory" of the CIR Untenable

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.[28] 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 instance, 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.

The Court is bound to effectuate the lawmakers' intent, which is the controlling factor in interpreting a statute.[29] Significantly, this Court has held that the soul of the law is intent:

> "The intent of a statute is the law. If a statute is valid it is to have effect according to the purpose and intent of the lawmaker. The intent is the vital part, the essence of the law, and the primary rule of construction is to ascertain and give effect to the intent. The intention of the legislature in enacting a law is the law itself, and must be enforced when ascertained, although it may not be consistent with the strict letter of the statute. Courts

will not follow the letter of a statute when it leads away from the true intent and purpose of the legislature and to conclusions inconsistent with the general purpose of the act. Intent is the spirit which gives life to a legislative enactment. In construing statutes the proper course is to start out and follow the true intent of the legislature and to adopt that sense which harmonizes best with the context and promotes in the fullest manner the apparent policy and objects of the legislature."[30]

While the Court recognizes the general rule that the grant of tax exemptions is strictly construed against the taxpayer and in favor of the taxing power,[31] Section 13 of the franchise of respondent leaves no room for interpretation. Its franchise exempts it from paying any tax other than the option it chooses: either the "basic corporate income tax" or the two percent gross revenue tax.

Determining whether this tax exemption is wise or advantageous is outside the realm of judicial power. This matter is addressed to the sound discretion of the lawmaking department of government.

WHEREFORE, the Petition is ***DENIED***. No pronouncement as to costs.

SO ORDERED.

ARTEMIO V. PANGANIBAN
Chief Justice
Chairperson, First Division

W E C O N C U R:

CONSUELO YNARES-SANTIAGO MA. ALICIA AUSTRIA-MARTINEZ
Associate Justice Associate Justice

ROMEO J. CALLEJO, SR. **MINITA V. CHICO-NAZARIO**
Associate Justice Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution, I certify 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.

ARTEMIO V. PANGANIBA N
Chief Justice

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[1] *Rollo*, pp. 8-23.

[2] Id. at 25-33. Sixth Division. Penned by Justice Delilah Vidallon-Magtolis (Division chair), with the concurrence of Justices Jose L. Sabio, Jr. and Hakim S. Abdulwahid.

[3] Id. at 34-41. Penned by Presiding Judge (now Presiding Justice) Ernesto D. Acosta and concurred in by Associate Judge Amancio Q. Saga.

[4] Id. at 42.

[5] Id. at 33.

[6] Assailed CA Decision, pp. 1-3; *rollo*, pp. 25-27.

[7] An Act Granting a New Franchise to Philippine Airlines, Inc. to Establish, Operate, and Maintain Air-Transport Services in the Philippines and Between the Philippines and Other Countries, enacted on June 11, 1978.

[8] CTA Decision, p. 7; *rollo,* p. 40.

[9] Assailed CA Decision, p. 8; *rollo*, p. 32.

[10] Id.

[11] Id.

[12] This Petition was deemed submitted for decision on December 7, 2004, upon this Court's receipt of petitioner's Memorandum, prepared by the Office of the Solicitor General and signed by Assistant Solicitor General Renan E. Ramos and Associate Solicitor Catherine Joy R. Mallari. Respondent's Memorandum, signed by Attys. Eduardo R. Ceniza, Nelson M. Reyes and Oscar C. Ventanilla Jr., was received by this Court on October 29, 2004.

[13] Petitioner's Memorandum, p. 5; *rollo,* p. 238. (Uppercase in the original.)

[14] Presidential Decree No. 1590 (1978), Sec. 13.

[15] Assailed CA Decision, p. 8; *rollo*, p. 32; Respondent's Memorandum, p. 9, *rollo*, p. 115.

[16] CTA Decision, p. 7; *rollo*, p. 40.

[17] Petitioner's Memorandum, pp. 8-9; *rollo*, pp. 241-242.

[18] Id.

[19] There is no dispute that respondent availed itself of paragraph (a) of Section 13 of its franchise. See also Assailed CA Decision, p. 3; *rollo*, p. 27.

[20] Under the same section, the tax rate was lowered by one percent yearly until January 1, 2000. Under Republic Act No. 9337 (approved on May 24, 2005), the tax rate was returned to 35 percent. (Italics in the original)

[21] TAX CODE, Sec. 27(D)(1). The provision notes that the final tax on interest income derived from a depositary bank under the foreign currency is 7½ percent.

[22] TAX CODE, Sec. 27(D)(2). Five percent is imposed on amounts not over Php100,000; 10 percent, on amounts exceeding Php100,000.

[23] TAX CODE, Sec. 27(D)(3).

[24] TAX CODE, Sec. 27(D)(5).

[25] TAX CODE. Sec. 57.

[26] *See* the emphasized portion in the preceding paragraph.

[27] TAX CODE, Sec. 31.

[28] The first paragraph of Presidential Decree No. 1590 reads:

> "WHEREAS, the ownership, control and management of Philippine Airlines, our national flag carrier, have been reacquired by the Government;"

[29] *Inding v. Sandiganbayan,* 434 SCRA 388, July 14, 2004; *National Tobacco Administration v. Commission on Audit,* 370 Phil. 793, August 5, 1999.

[30] *Philippine National Bank v. Office of the President,* 322 Phil. 6, 14, January 18, 1996, per Panganiban, *J.* (later *CJ*); *Ongsiako v. Gamboa,* 86 Phil. 50, 57, April 8, 1950, per Torres, *J.*; *Torres v. Limjap,* 56 Phil. 141, 145-146, September 21, 1931, per Johnson, *J.* (all citing SUTHERLAND, STATUTORY CONSTRUCTION, Vol. II, pp. 693-695).

[31] F. HORACK, SUTHERLAND STATUTORY CONSTRUCTION, VOL. III, 217-218 (1943).