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SECOND DIVISION

[G.R. No. 179259. September 25, 2013]

COMMISSIONER OF INTERNAL REVENUE, *petitioner, vs.* **PHILIPPINE AIRLINES, INC. (PAL),** *respondent.*

SYLLABUS

1. **TAXATION; NATIONAL INTERNAL REVENUE CODE (NIRC) OF 1997 IN RELATION TO PD 1590; FUNDAMENTAL RULES THAT GOVERN THE TAXATION OF PHILIPPINE AIRLINES, INC. (PAL).—** [D]uring the lifetime of the franchise of respondent, its taxation shall be strictly governed by two fundamental rules, to wit: (1) respondent shall pay the Government either the basic corporate income tax or franchise tax, whichever is lower; and (2) the tax paid by respondent, 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. Parenthetically, the basic corporate income tax of respondent shall be based on its annual net taxable income, computed in accordance with the NIRC of 1997, as amended. PD 1590 also explicitly authorizes respondent, 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. The franchise tax, on the other hand, shall be 2% of the gross revenues derived by respondent 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 respondent from its outgoing flights.

2. **ID.; ID.; ID.; PAL IS EXEMPT FROM THE MINIMUM CORPORATE INCOME TAX (MCIT) IMPOSED UNDER THE NIRC.—** Based on the x x x pronouncements [in *Commissioner of Internal Revenue vs. Philippine Airlines, Inc.*], it is clear that respondent is exempt from the MCIT imposed under Section 27(E) of the NIRC of 1997, as amended. Thus, respondent cannot

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be held liable for the assessed deficiency MCIT of ₱326,778,723.35 for fiscal year ending 31 March 2000.

3. ID.; ID.; ID.; ID.; WHAT EXEMPTS PAL FROM MCIT IS NOT THE FACT OF PAYMENT BUT THE EXERCISE OF ITS OPTION.— [A]s to petitioner's contention that respondent needs to actually pay a certain amount as basic corporate income tax or franchise tax before it can enjoy the tax exemption granted to it since it should retain the responsibility of paying its share of the tax burden, this Court has categorically ruled in the above-cited cases that it is not the fact of tax payment that exempts it, but the exercise of its option. Notably, in another case involving the same parties, the Court further expressed that a strict interpretation of the word "pay" in Section 13 of PD 1590 would effectively render nugatory the other rights categorically conferred upon the respondent by its franchise. Hence, there being no qualification to the exercise of its options under Section 13, then respondent is free to choose basic corporate income tax, even if it would have zero liability for the same in light of its net loss position for the taxable year. By way of reiteration, although it appears that respondent is not completely exempt from all forms of taxes under PD 1590 considering that Section 13 thereof requires it to pay, either the lower amount of the basic corporate income tax or franchise tax (which are both direct taxes), at its option, mere exercise of such option already relieves respondent of liability for all other taxes and/or duties, whether direct or indirect taxes. This is an expression of the same thought in Our ruling that, to repeat, it is not the fact of tax payment that exempts it, but the exercise of its option.

APPEARANCES OF COUNSEL

The Solicitor General for petitioner.

Jaclyn Marie S. Arellano Tan and *Oscar C. Yentanilla* for respondent.

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D E C I S I O N

PEREZ, *J.*:

Before the Court is a Petition for Review on *Certiorari* seeking to reverse and set aside the 19 July 2007 Decision[1] and 23 August 2007 Resolution[2] of the Court of Tax Appeals (CTA) *En Banc* in CTA EB No. 271 which affirmed the cancellation and withdrawal of Assessment Notice No. INC-FY-99-2000-000085 and Formal Letter of Demand for the payment by the respondent Philippine Airlines, Inc. (respondent), of deficiency Minimum Corporate Income Tax (MCIT) in the amount of ₱326,778,723.35, covering the fiscal year ending 31 March 2000.

The Facts

The factual antecedents of the case are undisputed:

Petitioner, the Commissioner of Internal Revenue, has the power to assess and collect national internal revenue taxes, fees, and charges, including the 2% per centum MCIT imposed under Section 27(E) of the National Internal Revenue Code (NIRC) of 1997, as amended. Respondent, on the other hand, is a domestic corporation duly organized and existing under and by virtue of the laws of the Philippines.

For the fiscal year that ended 31 March 2000, respondent filed on 17 July 2000 its Tentative Corporate Income Tax Return, reflecting a creditable tax withheld for the fourth quarter amounting to ₱524,957.00, and a zero taxable income for said year. Hence, respondent filed on 16 July 2001 a written claim for refund before the petitioner.

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[1] *Rollo*, pp. 43-62; Penned by Associate Justice Lovell R. Bautista with Presiding Justice Ernesto D. Acosta and Associate Justices Juanito C. Castañeda, Jr., Erlinda P. Uy and Olga Palanca-Enriquez concurring.

[2] *Id.* at 64-67.

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As a consequence thereof, respondent received on 10 September 2001 the Letter of Authority No. 200000002247 from the Bureau of Internal Revenue (BIR) Large Taxpayers Service, dated 3 September 2001, authorizing the revenue officers named therein to examine respondent's books of accounts and other accounting records for the purpose of evaluating respondent's "Claim for Refund on Creditable Withholding Tax – Income Tax" covering the fiscal year ending 31 March 2000.

Numerous correspondences between respondent and the Group Supervisor of the BIR Large Taxpayers Service, the revenue officers examining its accounting records, and the Chief of LT Audit & Investigation Division I of the BIR ensued, particularly as to the submission of various supporting documents and presentation of records.

On 16 July 2003, respondent received a "Summary of Creditable Withholding Tax at Source Certified by RAD Fiscal Year Ending March 31, 2000," together with a computation labelled "Compromise Penalties for Late Filing of Return." Likewise, on same date, respondent received a letter dated 8 July 2003 issued by the Chief of LT Audit & Investigation Division I, informing the former that the results of the investigation of its claim for refund on creditable withholding tax for fiscal year ending 31 March 2000 had already been submitted, and that an informal conference was set on 17 July 2003 to be held on the latter's office.

On 11 August 2003, respondent received from the same revenue officers a computation of their initial deficiency MCIT assessment in the amount of ₱537,477,867.64. Consequently, respondent received on 20 October 2003 a Preliminary Assessment Notice and Details of Assessment issued by the Large Taxpayers Service dated 22 September 2003, assessing respondent deficiency MCIT including interest, in the aggregate amount of ₱315,566,368.68. A written protest to said preliminary assessment was filed by respondent on 3 November 2003.

Thereafter, on 16 December 2003, respondent received a Formal Letter of Demand and Details of Assessment dated 1

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December 2003 from the Large Taxpayers Service demanding the payment of the total amount of ₱326,778,723.35, inclusive of interest, as contained in Assessment Notice No. INC-FY-99-2000-000085. In response thereto, respondent filed its formal written protest on 13 January 2004 reiterating the following defenses: (1) that it is exempt from, or is not subject to, the 2% MCIT by virtue of its charter, Presidential Decree No. (PD) 1590;[3] and (2) that the three-year period allowed by law for the BIR to assess deficiency internal revenue taxes for the taxable year ending 31 March 2000 had already lapsed on 15 July 2003.

Since no final action has been taken by petitioner on respondent's formal written protest, respondent filed a Petition for Review before the Second Division of the CTA on 4 August 2004 docketed as CTA Case No. 7029.

The Ruling of the CTA Second Division

In a Decision dated 22 August 2006,[4] the CTA Second Division granted respondent's petition and accordingly ordered for the cancellation and withdrawal of Assessment Notice No. INC-FY-99-2000-000085 and Formal Letter of Demand for the payment of deficiency MCIT in the amount of ₱326,778,723.35, covering the fiscal year ending 31 March 2000, issued against respondent.

The CTA Second Division made the following factual and legal findings, to wit:

(a) Section 13 of PD 1590 acquiring and limiting the extent of the tax liability of respondent under its franchise is coached in a clear, plain and unambiguous manner, and needs no further interpretation or construction;

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

[4] *Rollo*, pp. 69-90; Penned by Associate Justice Olga Palanca-Enriquez with Associate Justices Juanito C. Castañeda, Jr. and Erlinda P. Uy concurring.

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(b) Section 13 clearly provides that respondent is liable only for either the basic corporate income tax based on its annual net taxable income, or the 2% franchise tax based on gross revenue, whichever is lower;

(c) Respondent-grantee must only choose between the two alternatives mentioned in Section 13 in the payment of its tax liability to the government, and its choice must be that which will result in a lower tax liability;

(d) Since the income tax return of respondent reflected a zero taxable income for the fiscal year ending 31 March 2000, obviously being lower than the 2% franchise tax, its choice of the former is definitely a better alternative as basis for its tax liability to the government;[5]

(e) The basic corporate income tax mentioned in Section 13 of PD 1590 does not refer to the MCIT under Section 27(E) of the NIRC of 1997, as amended, but particularly to the applicable rate of 32% income tax under Section 27(A) of the same Code, on the taxable income of domestic corporations;

(f) The MCIT is regarded to belong to "other taxes" as it was not included in the choices provided by the franchise. To hold otherwise would be to give another option to respondent which is evidently not within the ambit of PD 1590;[6]

(g) The "in lieu of all other taxes" clause under Section 13 of respondent's legislative franchise exempts it from all taxes necessary in the conduct of its business covered by the franchise, except the tax on its real property for which respondent is expressly made payable;[7] and

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[5] *Id.* at 81-83.

[6] *Id.* at 88.

[7] *Id.* at 84.

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(h) The rationale or purpose for the exemption from all other taxes except the income tax and real property tax granted to respondent upon the payment of the basic corporate income tax or the 2% franchise tax is that such tax exemption is part of inducement for the acceptance of the franchise and the rendition of public service by the grantee.[8]

Simply put, it pronounced that the only qualification provided for in the law is the option given to respondent to choose between the taxes which will yield the lesser liability. Thus, if as a result of the exercise of the option, the respondent ends up without any tax liability, it should not be held liable for any other tax, such as the MCIT, except for real property tax.[9]

On 30 January 2007, the CTA Second Division denied petitioner's Motion for Reconsideration for lack of merit.[10]

Aggrieved, petitioner appealed to the CTA *En Banc* by filing a Petition for Review pursuant to Section 18 of Republic Act (RA) No. 9282 (should be RA No. 1125, as amended by RA No. 9282)[11] on 1 March 2007, docketed as CTA EB No. 271.[12]

The Ruling of the CTA En Banc

The CTA *En Banc* affirmed both the aforesaid Decision and Resolution rendered by the CTA Second Division in CTA

[8] *Id.* at 86.

[9] *Id.* at 86-87.

[10] *Id.* at 111-113.

[11] RA No. 1125, otherwise known as "An Act Creating the Court of Tax Appeals," as amended by RA No. 9282, also known as "An Act Expanding the Jurisdiction of the Court of Tax Appeals (CTA), Elevating its Rank to the Level of a Collegiate Court with Special Jurisdiction and Enlarging its Membership, Amending for the Purpose Certain Sections of Republic Act No. 1125, As Amended, Otherwise Known As the Law Creating the Court of Tax Appeals, and for Other Purposes", which took effect on 23 April 2004.

[12] *Rollo*, pp. 114-140.

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Case No. 7029, ruling that under Section 13 of PD 1590, respondent, as consideration for the franchise, is indeed granted the privilege to choose between two options in the payment of its tax liability to the government. Naturally, its choice will be that which will result in a lower tax liability since such choice is "in lieu of all other taxes" imposed by all government entities in the country.[13] The only exception is the real property tax.

The appellate court pointed out that even if respondent opted to be covered by the Income Tax provisions of the NIRC, it does not follow that it is covered by the MCIT provisions of the same Code. There is nothing in PD 1590 which obliges the respondent to pay other taxes, much less the MCIT, in case it suffers a net operating loss. Otherwise, it would negate the tax relief granted under Section 13 of its franchise and would render it useless. The tax relief allows respondent 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.[14]

Likewise, it elucidated that the MCIT is not the basic corporate income tax referred to in Section 13 of PD 1590. There is a distinction between the MCIT and the basic corporate income tax. The MCIT under Section 27(E)(1) of the NIRC of 1997, as amended, is imposed upon gross income; while the basic corporate income tax refers to the 32% income tax on the taxable income of domestic corporations under Section 27(A) of the same Code. In other words, the court *a quo* ruled that since the MCIT is imposed upon gross income, it cannot be made to apply to respondent by virtue of the express provision in its franchise that its basic corporate income tax shall be based on its annual net taxable income. Hence, it is in this sense that the MCIT qualifies as "other taxes" from which the respondent had been granted tax exemption by its franchise.[15]

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[13] *Id.* at 52; CTA *En Banc* Decision dated 19 July 2007.

[14] *Id*. at 54-55 citing *Commissioner of Internal Revenue v. Philippine Airlines, Inc*., 535 Phil. 95 (2006).

[15] *Rollo*, pp. 55-56.

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Moreover, the provision on MCIT, Section 27(E) of the NIRC of 1997, as amended, did not repeal respondent's franchise considering that it is a general law which cannot impliedly repeal, alter, or amend PD 1590, being a special law. Neither can Revenue Memorandum Circular (RMC) No. 66-2003 amend respondent's franchise as it is merely an administrative issuance.

Lastly, there is no provision in RA No. 8424[16] which provides and specifies that the MCIT shall be in addition to the taxes for which respondent is liable. To rule otherwise would be violative of Section 24 of PD 1590 which states that respondent's franchise may only be modified, amended, or repealed expressly by a special law or decree that shall specifically modify, amend or repeal the franchise or any section or provision thereof. Therefore, in the absence of a law expressly repealing PD 1590 at the time the subject assessment was issued and for the period covered by the assessment, respondent's tax exemption privilege under the "in lieu of all other taxes" clause of Section 13 thereof must be applied.

Upon denial of petitioner's Motion for Reconsideration of the 19 July 2007 Decision of the CTA *En Banc*, it filed this Petition for Review on *Certiorari* before this Court seeking the reversal of the aforementioned Decision and the 23 August 2007 Resolution[17] rendered in CTA EB No. 271.

The Issues

The issues submitted before this Court for consideration are as follows:

(1) Whether or not the CTA *En Banc* erred in holding that the MCIT is properly categorized as "other taxes" pursuant to respondent's charter; and

(2) Whether or not the CTA *En Banc* erred in ruling that respondent is not liable for the 2% MCIT deficiency for the fiscal year ending 31 March 2000.[18]

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[16] The Tax Reform Act of 1997, which took effect on 1 January 1998.

[17] *Rollo*, pp. 64-67.

[18] *Id.* at 19.

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The abovementioned issues may be consolidated and restated as follows: whether or not the CTA *En Banc* erred when it affirmed the cancellation of Assessment Notice No. INC-FY-99-2000-000085 and Formal Letter of Demand issued by petitioner against respondent for the payment of deficiency MCIT in the amount of ₱326,778,723.35, covering the fiscal year ending 31 March 2000.

In support thereof, petitioner submits the following arguments: (a) respondent clearly opted to be covered by the income tax provision of the NIRC of 1997, as amended; hence, it is covered by the MCIT provision of the same Code and liable to pay the same; (b) the MCIT does not belong to the category of "other taxes" which may enable respondent to avail of the "in lieu of all other taxes" clause under Section 13 of PD 1590 because it is a category of an income tax pursuant to Section 27(E)(1) of the NIRC of 1997, as amended; (c) the MCIT provision of the NIRC of 1997, as amended, is not an amendment of respondent's charter, but an amendment of the same Code. Hence, respondent's obligation to pay the MCIT is not the result of an implied amendment of PD 1590, but rather, the consequence of respondent's option of paying income tax rather than franchise tax; (d) respondent 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. Otherwise stated, it is the legislative intent to give respondent a privilege in the form of an option in paying its taxes which would result in paying a lower tax liability, but not in dispensing the sharing of a tax burden to which every taxpayer is obligated to bear; and (e) a claim for exemption from taxation is never presumed; thus, respondent is liable for the deficiency MCIT.

Respondent, in its Comment thereto, counters among others, that there is nothing in PD 1590 which obliges respondent to pay other taxes, much less the MCIT, in case it suffers a net operating loss. Since the MCIT is not the basic corporate income tax, nor the 2% franchise tax, nor the real property tax mentioned by Section 13 thereof, then it is but logical to conclude that the

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MCIT belongs to the category of "other taxes" for which respondent is not liable.

Our Ruling

Respondent's exemption from the MCIT is already a settled matter.

Section 27 of the NIRC of 1997, as amended, provides as follows:

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 law 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. (Emphasis supplied)

Based on the foregoing, a domestic corporation must pay whichever is the higher of: (1) the income tax under Section 27(A) of the NIRC of 1997, as amended, 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 same Code, equivalent to 2% of the gross income of the corporation. The Court would like to underscore that although this may be the

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general rule in determining the income tax due from a domestic corporation under the provisions of the NIRC of 1997, as amended, such rule can only be applied to respondent only as to the extent allowed by the provisions of its franchise.

Relevant thereto, PD 1590, the franchise of respondent, contains the following pertinent provisions governing its taxation:

> 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:
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> x x x x
>
> 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.

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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 fiscal 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 revenue"** is herein defined as the total gross income earned by the grantee; (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. (Emphasis supplied)

From the foregoing provisions, during the lifetime of the franchise of respondent, its taxation shall be strictly governed by two fundamental rules, to wit: (1) respondent shall pay the Government either the basic corporate income tax or franchise tax, whichever is lower; and (2) the tax paid by respondent, 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.

Parenthetically, the basic corporate income tax of respondent shall be based on its annual net taxable income, computed in accordance with the NIRC of 1997, as amended. PD 1590

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also explicitly authorizes respondent, in the computation of its basic corporate income tax, to: (1) depreciate its assets twice as fast the normal rate of depreciation;[19] 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.[20]

The franchise tax, on the other hand, shall be 2% of the gross revenues derived by respondent 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 respondent from its outgoing flights.[21]

Accordingly, considering the foregoing precepts, this Court had the opportunity to finally settle this matter and categorically enunciated in *Commissioner of Internal Revenue v. Philippine Airlines, Inc.*,[22] that respondent cannot be subjected to MCIT for the following reasons:

> *First*, Section 13(a) of [PD] 1590 refers to **"basic corporate income tax."** In *Commissioner of Internal Revenue v. Philippine Airlines, Inc.*,[23] the Court already settled that the "basic corporate income tax," under Section 13(a) of [PD] 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.

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

[20] 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, as amended, allowing net capital loss carryover, may only be availed of by a taxpayer "other than a corporation."

[21] *Commissioner of Internal Revenue v. Philippine Airlines, Inc.*, G.R. No. 180066, 7 July 2009, 592 SCRA 237, 250.

[22] *Id.* at 252-268.

[23] 535 Phil. 95 (2006).

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Section 13(a) of [PD] 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 [PD] 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. [PD] 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.

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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 [PD] 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.*,[24] 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 [PD] 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

[24] *Id*.

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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 [PD] 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 [PD] 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 [PD] 1520 (sic) is to extend to PAL tax concessions not ordinarily available to other domestic corporations. Section 13 of [PD] 1520 (sic) 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 [PD] 1520 (sic) 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 [PD] 1590. In effect, PAL would not just have two, but three tax alternatives, namely, the basic corporate income tax, MCIT, or

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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 [PD] 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 [PD] No. 1520 (sic), 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.*,[25] to wit:

> ***"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. It can reasonably

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[25] *Id*.

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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 theirs)

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 [PD] 1590 of PAL. PAL may no longer exercise its options or alternatives under Section 13 of [PD] 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, [PD] 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, [PD] 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 [PD] 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

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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 [PD] 1520 (sic).

Between [PD] 1520 (sic)**, 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.

x x x x

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 [PD] 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. (Emphasis supplied)

Based on the foregoing pronouncements, it is clear that respondent is exempt from the MCIT imposed under Section 27(E) of the NIRC of 1997, as amended. Thus, respondent cannot be held liable for the assessed deficiency MCIT of ₱326,778,723.35 for fiscal year ending 31 March 2000.

More importantly, as to petitioner's contention that respondent needs to actually pay a certain amount as basic corporate income tax or franchise tax before it can enjoy the tax exemption granted

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to it since it should retain the responsibility of paying its share of the tax burden, this Court has categorically ruled in the above-cited cases that it is not the fact of tax payment that exempts it, but the exercise of its option.

Notably, in another case involving the same parties,[26] the Court further expressed that a strict interpretation of the word "pay" in Section 13 of PD 1590 would effectively render nugatory the other rights categorically conferred upon the respondent by its franchise. Hence, there being no qualification to the exercise of its options under Section 13, then respondent is free to choose basic corporate income tax, even if it would have zero liability for the same in light of its net loss position for the taxable year.

By way of reiteration, although it appears that respondent is not completely exempt from all forms of taxes under PD 1590 considering that Section 13 thereof requires it to pay, either the lower amount of the basic corporate income tax or franchise tax (which are both direct taxes), at its option, mere exercise of such option already relieves respondent of liability for all other taxes and/or duties, whether direct or indirect taxes. This is an expression of the same thought in Our ruling that, to repeat, it is not the fact of tax payment that exempts it, but the exercise of its option.

All told, the CTA *En Banc* was correct in dismissing the petition in CTA EB No. 271, and affirming the CTA Second Division's Decision and Resolution dated 22 August 2006 and 30 January 2007, respectively, in CTA Case No. 7029.

WHEREFORE, the petition is **DENIED** for lack of merit. No costs.

SO ORDERED.

Carpio (Chairperson), del Castillo, Perlas-Bernabe, and *Leonen,*[*] *JJ.,* concur.

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[26] See *Commissioner of Internal Revenue v. Philippine Airlines, Inc.*, G.R. No. 180043, 14 July 2009, 592 SCRA 730, 740-741.

[*] Per Special Order No. 1560 dated 24 September 2013.