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SO ORDERED.

Carpio,[*] *Corona (Chairperson), Velasco, Jr.,* and *Nachura, JJ.,* concur.

THIRD DIVISION

[G.R. No. 179800. February 4, 2010]

REPUBLIC OF THE PHILIPPINES represented by the COMMISSIONER OF INTERNAL REVENUE, *petitioner, vs.* **PHILIPPINE AIRLINES, INC. (PAL),** *respondent.*

SYLLABUS

1. TAXATION; TAX EXEMPTION; 2% FRANCHISE TAX IN LIEU OF OTHER TAXES; CONSTRUED. — Deciding in favor of therein respondent PAL, this Court enunciated: 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. x x x 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**

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[*] Designated to sit as an additional member in lieu of Associate Justice Jose C. Mendoza per Special Order No. 818 dated January 18, 2010.

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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. x x x 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." It is clear from the foregoing that this Court had already settled the issue of whether or not there was a need for the actual payment of tax, either the basic corporate income tax or the 2% franchise tax, before therein respondent PAL could avail itself of the "in lieu of all other taxes" provision under its Charter. This Court finds no cogent reason to deviate from the ruling in the said case. This Court reiterates the pronouncement of the CTA that under the first option of Sec. 13 of P.D. No. 1590, the basis for the tax rate is PAL's annual net taxable income. By basing the tax rate on the annual net taxable income, P.D. No. 1590 necessarily recognized the situation in which taxable income may result in a negative amount and, thus, translate into a zero tax liability. In this scenario, respondent PAL operates at a loss and no taxes are due. Consequently, the first option entails a lower tax liability than the second option.

2. ID.; ID.; THE MATTER IS ADDRESSED TO THE SOUND DISCRETION OF THE LAWMAKING DEPARTMENT OF GOVERNMENT; APPLICATION IN CASE AT BAR. — Petitioner contends that since P.D. No. 1590 does not provide for an exemption from the payment of taxes, any claim of exemption from the payment thereof must be strictly construed against the taxpayer. Said position is, however, dispelled by *Commissioner of Internal Revenue v. Philippine Airlines,* where this Court ruled: 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, **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. Given the foregoing, and the fact that the 10% OCT properly falls within the purview of the "all other taxes" *proviso* in P.D. No. 1590, this Court holds that respondent PAL is exempt from the 10% OCT and, therefore, entitled to the refund requested.

APPEARANCES OF COUNSEL

The Solicitor General for petitioner.
Oscar C. Ventanilla, Jr. for respondent.

D E C I S I O N

PERALTA, *J.*:

Before this Court is a Petition for Review on *Certiorari*,[1] under Rule 45 of the Revised Rules of Court, seeking to set aside the August 9, 2007 Decision[2] and September 17, 2007 Resolution[3] of the Court of Tax Appeals (CTA) *En Banc*, in E.B. Case No. 273 (CTA Case No. 6962).

The facts, as culled from the record by the CTA *En Banc*:

[Respondent Philippine Airlines] (PAL) is a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines. It is engaged in the air transportation business with principal address at the 9th Floor, PAL Center, Legaspi Village, Makati City.

[Petitioner] Commissioner of Internal Revenue [CIR] is the duly authorized government official empowered, among others, to refund

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[1] *Rollo*, pp. 13-33.

[2] Penned by Associate Justice Caesar A. Casanova with Presiding Justice Ernesto D. Acosta and Associate Justices Juanito C. Castaneda, Jr., Lovell R. Bautista, Erlinda P. Uy, and Olga Palanca-Enriquez concurring; *id.* at 35-45.

[3] *Id.* at 47-49.

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erroneously collected taxes under the 1997 National Internal Revenue Code (NIRC), as amended, with office address at the BIR National Office Building, Agham Road, Diliman, Quezon City.

To meet the exigencies of its daily business operations, [respondent] PAL availed [of] the communication services of the Philippine Long Distance Company (PLDT). For the period January 1, 2002 to December 31, 2002, PAL allegedly paid PLDT the 10% [Overseas Communications Tax] OCT in the amount of ₱134,431.95 on its overseas telephone calls.

On February 24, 2004, [respondent] PAL, through its AVP-Financial Planning and Analysis Ma. Stella L. Diaz, filed with the Commissioner a claim for refund in the amount of ₱134,431.95 representing the total amount of 10% OCT paid to PLDT from January to December 2002 citing as legal bases Section 13 of Presidential Decree (P.D.) No. 1590[4] and BIR Ruling No. 97-94 dated April 13, 1994.

Due to the Commissioner's inaction on its claim for refund, PAL appealed before the CTA on April 22, 2004. The case was raffled to the Second Division of the CTA.[5]

Respondent PAL argued that since it incurred negative taxable income[6] for fiscal years 2002 and 2003 and opted for zero basic corporate income tax, which was lower than the 2% franchise tax, respondent PAL had complied with the "in lieu of all other taxes" clause of Presidential Decree (P.D.) No. 1590.[7] Thus, it was no longer liable for all other taxes of any kind, nature, or description, including the 10% OCT, and the erroneous payments thereof entitled it to a refund pursuant to its franchise.[8]

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[4] 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.

[5] CTA *En Banc* Decision, p. 2; *rollo,* p. 36.

[6] "As reflected in its income tax returns for fiscal years 2002 and 2003, respondent incurred a negative taxable income of ₱844,734,355.00 and ₱911,552,157.00 respectively"; *rollo*, p. 17.

[7] *Supra* note 5, at 38.

[8] *Id.*

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Petitioner CIR disagreed. It maintained that Section 120 of the 1997 NIRC, as amended, imposes 10% OCT on overseas dispatch, message or conversion originating from the Philippines, which includes PLDT communication services. It further stated that respondent PAL, in order for it to be not liable for other taxes, in this case the 10% OCT, should pay the 2% franchise tax, since it did not pay any amount as its basic corporate income tax.[9]

Ruling of CTA Second Division

The CTA Second Division rendered a Decision dated November 13, 2006, and ruled that respondent PAL was not required to pay the 10% OCT and, therefore, was not entitled to the refund, based on the "in lieu of all taxes" provision under Sec. 13 of P.D. No. 1590, respondent PAL's franchise.

The Second Division granted respondent PAL's claim for a refund of the OCT, albeit in the reduced amount of ₱93,424.67.[10] The amounts of ₱2,424.16 and ₱38,583.12 were disallowed due to non-verification and prescription, respectively.[11]

The Second Division reasoned that since respondent PAL chose to pay the basic corporate income tax for January to December 2002, and given that for the same period respondent PAL incurred zero tax liability, it was not required to pay the 2% franchise tax before it could avail itself of the "in lieu of all taxes" provision under Sec. 13 of P.D. No. 1590.[12] It emphasized that the law simply states that PAL, in order for it to be exempt from taxes, must only choose between two alternatives under Sec. 13 of P.D. No. 1590, namely: (1) the basic corporate income tax or (2) the 2% franchise tax.[13] And, having chosen

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[9] *Id.* at 39.

[10] *Id.*

[11] *Id.*

[12] CTA Second Division Decision, *rollo* p. 56.

[13] *Supra* note 5, at 39.

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the first option, respondent PAL was under no obligation to pay the 2% franchise tax in order to avail itself of the exemption.

Petitioner CIR filed a Motion for Partial Reconsideration of the Decision of the CTA Second Division. However, the same was denied on February 7, 2007. Consequently, petitioner CIR filed a Petition for Review with the CTA *En Banc.*

Ruling of the CTA *En Banc*

The CTA *En Banc* upheld the Decision of the CTA Second Division and pointed out that since respondent PAL chose the first option, even if it incurred negative taxable income and consequently did not pay any income tax, it could still avail itself of the exemption, and could not be held liable for the 10% OCT.[14] The **operative act,** in order for it to avail itself of exemption from all other taxes under the "in lieu of all other taxes" clause of its Charter, **is actual exercise by respondent PAL of the option to avail itself either of the basic corporate income tax or the 2% franchise tax,** and no actual payment is required.[15]

Hence, the Commissioner of Internal Revenue, through the Office of the Solicitor General, filed before this Court a Petition for Review on *certiorari* under Rule 45 of the Rules of Court assailing the CTA *En Banc* Decision dated August 9, 2007.

Issue

The sole issue for consideration before this Court, as stated in the present petition, is:

WHETHER OR NOT RESPONDENT IS EXEMPT FROM THE PAYMENT OF THE 10% OVERSEAS COMMUNICATIONS TAX UNDER ITS FRANCHISE, PD 1590, AND THEREFORE, ENTITLED TO THE REFUND PRAYED FOR.[16]

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[14] *Id.* at 42.

[15] *Id.* at 43.

[16] Petitioner's Petition, *rollo* p. 21.

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The Court's Ruling

The petition is without merit.

Sec. 13 of P.D. No. 1590 states that:

> 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 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:
>
> x x x x x x x x x

Petitioner firmly contends that the law uses the mandatory terms "shall pay… whichever… will result in a lower tax"; and while these words clearly envision the payment of a lower tax, petitioner asserts that they mandate payment, nonetheless. Hence, petitioner argues that since respondent PAL has not paid taxes during the fiscal years subject of the refund, respondent PAL cannot claim exemption from paying other taxes under the "in lieu of all taxes" provision.

Petitioner's contention does not hold water.

It is worthy to note that the sole issue raised by petitioner in this case has already been settled in a similar case entitled

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Commissioner of Internal Revenue v. Philippine Airlines,[17] penned by then Chief Justice Artemio Panganiban. This was the same case upon which the CTA *En Banc* Decision was based.

In said case, therein respondent PAL also sought the refund of the amount of ₱2,241,527.22, which represented the total amount of 20% final withholding tax withheld by various withholding agent banks for the period starting March 1995 through February 1997.[18] Therein respondent PAL's request for a refund was also based on the "in lieu of all taxes" provision found under Sec. 13 of P.D. 1590.

Therein petitioner CIR argued that the "in lieu of all other taxes" *proviso* was a mere incentive that applied only when therein respondent PAL *actually paid something* (emphasis supplied), that is, either the basic corporate income tax or the franchise tax.[19] Because of the zero tax liability of respondent under the basic corporate income tax system, it was not eligible for exemption from other taxes.[20]

Deciding in favor of therein respondent PAL, this Court enunciated:

> 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.
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> x x x x x x x x x

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

[18] *Id.* at 93.

[19] *Id.* at 97.

[20] *Id.*

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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**. (Emphasis and underscoring supplied).

x x x x x x x x x

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."[21]

It is clear from the foregoing that this Court had already settled the issue of whether or not there was a need for the actual payment of tax, either the basic corporate income tax or the 2% franchise tax, before therein respondent PAL could avail itself of the "in lieu of all other taxes" provision under its Charter. This Court finds no cogent reason to deviate from the ruling in the said case.

This Court reiterates the pronouncement of the CTA that under the first option of Sec. 13 of P.D. No. 1590, the basis for the tax rate is PAL's annual net taxable income. By basing the tax rate on the annual net taxable income, P.D. No. 1590 necessarily recognized the situation in which taxable income may result in a negative amount and, thus, translate into a zero tax liability.[22] In this scenario, respondent PAL operates at a loss and no taxes are due. Consequently, the first option entails a lower tax liability than the second option.

Lastly, petitioner contends that since P.D. No. 1590 does not provide for an exemption from the payment of taxes, any

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[21] *Id.* at 100-101.

[22] *Supra* note 5, at 42.

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claim of exemption from the payment thereof must be strictly construed against the taxpayer.[23] Said position is, however, dispelled by *Commissioner of Internal Revenue v. Philippine Airlines,* where this Court ruled:

> 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, **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.[24]

Given the foregoing, and the fact that the 10% OCT properly falls within the purview of the "all other taxes" *proviso* in P.D. No. 1590, this Court holds that respondent PAL is exempt from the 10% OCT and, therefore, entitled to the refund requested.

WHEREFORE, premises considered, the petition is *DENIED*. The August 9, 2007 Decision and September 17, 2007 Resolution of the Court of Tax Appeals *En Banc*, in E.B. Case No. 273 (CTA Case No. 6962), are hereby *AFFIRMED*.

SO ORDERED.

Carpio,[*] *Corona (Chairperson), Velasco, Jr.,* and *Nachura, JJ.,* concur.

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[23] *Rollo*, p. 25.

[24] *Supra* note 17, at 102.

[*] Designated to sit as an additional member in lieu of Associate Justice Jose C. Mendoza per Special Order No. 818 dated January 18, 2010.