Supreme Court E-Library

deemed as outright admissions by them that the same is public land. They are now estopped from claiming otherwise.

WHEREFORE, the decision appealed from, the remaining effective portion of which declares private respondents Del Rosarios as riparian owners of the dried-up portion of Estero Calubcub, is hereby *REVERSED* and *SET ASIDE*.

SO ORDERED.

Melencio-Herrera (Chairman), Paras, Padilla, and *Sarmiento, JJ*., concur.

FIRST DIVISION

[G.R. No. L-44007. March 20, 1991]

THE COMMISSIONER OF INTERNAL REVENUE, *petitioner*, *vs*. **COURT OF TAX APPEALS, EASTERN EXTENSION AUSTRALASIA AND CHINA TELEGRAPH COMPANY, LTD.,** *respondents*.

SYLLABUS

1. POLITICAL LAW; CONSTITUTIONAL LAW; JUDICIAL INQUIRY; REQUISITES; CITED.— Although We sustain the respondent tax court's finding that the constitutional issue was squarely raised by the parties, We find merit with the contention of the petitioner that it is not necessary for the disposition of this case. The fact that constitutional question was properly raised by a party is not alone sufficient for the respondent court to pass upon the issue of constitutionality. This is supported by recent Supreme Court rulings which oblige every court to approach a constitutional question with grave care and considerable caution. Thus: "It is a well-settled rule that no constitutional question will be heard and resolved unless the following requisites of a judicial inquiry are present:

Supreme Court E-Library

(1) the existence of an appropriate case; (2) an interest personal and substantial by the party raising the constitutional question; (3) the plea that the function be exercised at the earliest opportunity; and (4) the necessity that the constitutional question be passed upon in order to decide the case."

2. **ID.; ID.; ID.; ID.; REQUISITE THAT "THE NECESSITY THAT THE CONSTITUTIONAL QUESTION BE PASSED UPON IN ORDER TO DECIDE THE CASE," ABSENT IN CASE AT BAR; THIS COURT GIVES HIGH RESPECT FOR ACTS OF OTHER DEPARTMENTS OF THE GOVERNMENT AND AS MUCH AS POSSIBLE, AVOIDS DECIDING THE CONSTITUTIONAL QUESTION.—** Undoubtedly, the last criterion is not present. This case can be resolved based on the other available grounds obtaining in this case. Respondent court should have avoided the issue and instead maintained the presumption of constitutionality. A law is supposed to have been carefully studied and determined to be constitutional before it was finally enacted by Congress and approved by the Chief Executive. Accordingly, this Court gives high respect for the acts of the other departments of the government and, as much as possible, avoids deciding the constitutional question.

3. **ID.; LEGISLATIVE DEPARTMENT; LEGISLATIVE FRANCHISE; PARTAKES THE NATURE OF A CONTRACT; FRANCHISE, CONSTRUED.—** A legislative franchise partakes of the nature of a contract. Franchises spring from contracts between the sovereign power and private citizens made upon valuable considerations, for purposes of individual advantage as well as public benefit. It is generally considered that the obligation resting upon the grantee to comply with the terms and conditions of the grant constitutes a sufficient consideration. It can also be said that the benefit to the community may constitute the sole consideration for the grant of a franchise by the state. Such being the case, the franchise is the law between the parties and they are bound by the terms thereof.

4. **REMEDIAL LAW; EVIDENCE; PRESUMPTIONS; PRESUMPTION IS THAT SPECIAL STATUTES ARE EXEMPTIONS TO THE GENERAL LAW BECAUSE THEY PERTAIN TO A SPECIAL CHARTER GRANTED TO MEET A PARTICULAR SET OF CONDITIONS AND CIRCUMSTANCES.—** Petitioner, being a government agency,

Supreme Court E-Library

is also bound by the terms of the franchise. It cannot declare the franchise as "ineffective and unenforceable" merely by stating that the private respondent failed to comply with the requirements of the general statutes which are not mentioned in R.A. No. 808. To allow petitioner's claim would be to defy and ignore the superiority of a legislative franchise granted by a special enactment over a mere authorization or permit granted in accordance with the provisions of laws of general application. Republic Act No. 808 as amended by Republic Act No. 5002, is a special law applicable only to the respondent corporation, while the Public Service Act and the Corporation Law are general statutes. The presumption is that special statutes are exemptions to the general law because they pertain to special charter granted to meet a particular set of conditions and circumstances.

5. **ID.; SPECIAL CIVIL ACTIONS; *CERTIORARI*; WHEN ACT OF A COURT OR TRIBUNAL CONSIDERED AS COMMITTED IN GRAVE ABUSE OF DISCRETION.—** An act of a court or tribunal may only be considered as committed in grave abuse of discretion when the same was performed in a capricious and whimsical exercise of judgment which is equivalent to lack of jurisdiction. The abuse of discretion must be so patent and gross as to amount to an evasion of positive duty enjoined by law, or to act at all in contemplation of law, as where the power is exercised in an arbitrary and despotic manner by reason of passion or personal hostility.

6. **TAXATION; NATIONAL INTERNAL REVENUE CODE; TAX ASSESSMENT; INTERNAL REVENUE TAXES SHALL BE ASSESSED WITHIN FIVE YEARS AFTER THE TAXPAYER'S RETURN WAS FILED.—** This Court finds that respondent tax court erred in declaring that the assessment was issued beyond the period prescribed by law. The National Internal Revenue Code then in force provides: "Section 331 (now Section 203). *Period of Limitation Upon Assessment and Collection*. — Except as provided in the succeeding section, internal revenue taxes shall be assessed within five years (now 3 years) after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after expiration of such period. x x x It is clear from the foregoing provision that internal revenue taxes shall be assessed within five (5) years after the taxpayer's return was filed. It is, however, undisputed

Supreme Court E-Library

that petitioner has failed to file any corporate income tax return for a period of twenty (20) years from 1952 to 1971. With this, petitioner argued that under Section 332 (a) (now Section 223 [a]) of the Revenue Code, private respondent's failure to file the income tax returns authorizes him to assess the income tax due from the private respondent *within ten years after* the discovery of the falsity, fraud, or omission.

7. **ID.; ID.; ID.; CAN ONLY STAND VALID INSOFAR AS THE ASSESSMENT IS FOR INCOME DERIVED FROM SERVICES WITHIN THE PHILIPPINES AND WHICH IS BEYOND THE SCOPE OF R.A. NO. 808.—** The omission was discovered only in 1971 upon investigation conducted by petitioner's examiners. Accordingly, petitioner has ten (10) years from 1971 or until 1981 within which to assess respondent corporation. The assessment on the deficiency income tax against private respondent in the amount of ₱21,523,288.37 was issued on February 28, 1973 which is well within the period prescribed by law. But while it is true that the assessment is within the prescribed period, it does not necessarily follow that it is a valid assessment in its entirety. We have already ruled that Republic Act No. 808 is an operative act. Because of this, private respondent is exempted from the payment of all taxes whether local, provincial or national, except franchise and real property taxes. It goes without saying that the assessment cannot be held valid against the income derived from private respondent's operation authorized by the franchise. It can only stand valid insofar as the assessment is for income derived from services within the Philippines and which is beyond the scope of R.A. No. 808.

8. **ID.; ID.; ID.; ASSESSMENT IN CASE AT BAR TREATED AS AN ORDINARY ASSESSMENT FOR THE PAYMENT OF TAXES, LIKE ANY OTHER ASSESSMENT ISSUED AGAINST ANY PERSON OR ENTITY, HOLDING A LEGISLATIVE FRANCHISE.—** Contrary to the Court of Tax Appeals ruling, We believe that the assessment against the petitioner cannot be likened to a revocation of the tax on franchise prescribed in Section 259. Firstly, a ruling by a Commissioner cannot revoke a provision of the National Internal Revenue Code, a substantive law. Secondly, the provision above stated contemplates of a revocation, modification or reversal of any of the rules and regulations promulgated for the

Supreme Court E-Library

enforcement of the provisions of the tax code but not a revocation, modification or reversal of the tax code's provision itself. The reason why the Commissioner issued the assailed assessment of ₱21,523,288.37 was not because he wanted to revoke, expressly or implicitly, Section 259 of the Tax Code, but because the Commissioner believed that private respondent is liable for corporate income tax by virtue of an inoperative franchise. Hence, the said assessment should not be regarded as a ruling contemplated under Section 338-A. It should be treated as an ordinary assessment for the payment of taxes, like any other assessment issued against any person or entity, holding a legislative franchise and is exempted from the payment of certain national and local taxes, including corporate income tax but, nevertheless, found to be liable to pay the latter due to its earnings derived from sources within the Philippines but beyond the scope of the franchise.

APPEARANCES OF COUNSEL

Sycip, Salazar, Feliciano, Hernandez & Castillo for private respondent.

D E C I S I O N

MEDIALDEA, *J.*:

The petitioner Commissioner of Internal Revenue challenges the decision of the respondent Court of Tax Appeals dated February 18, 1976 in CTA Case No. 2498 entitled "*Eastern Extension Australasia and China Telegraph Co. Ltd. v. The Commissioner of Internal Revenue*." The dispositive portion of said decision reads as follows:

"WHEREFORE, the decision of the respondent Commissioner of Internal Revenue appealed from is reversed. Respondent's income tax assessment of ₱21,523,288.37 issued against the petitioner is hereby cancelled and declared to be without any legal force and effect. No pronouncement as to costs.

"SO ORDERED." (*Rollo*, p. 71)

Supreme Court E-Library

Petitioner also seeks annulment of the Resolution dated June 18, 1976 denying the motion for reconsideration of the above-mentioned decision, the dispositive portion of which reads:

"WHEREFORE, finding Respondent's Motion for Reconsideration dated March 26, 1976 to be without sufficient legal and valid justification, the same has to be, as it is hereby, DENIED.

"SO ORDERED." (*Rollo*, p. 99)

From the records, the antecedents facts of the case are as follows:

Private respondent, Eastern Extension Australasia and China Telegraph Co., Ltd. is a foreign corporation, organized and existing under the laws of Great Britain and is engaged in international telecommunications. By a Royal Decree of the Spanish Government dated March 30, 1898, petitioner was given a concession for the construction, operation and maintenance of submarine telegraph cable from Hongkong to Manila.

On June 21, 1952, when the concession expired, Republic Act No. 808 was approved granting to respondent corporation a legislative franchise "to land, construct, maintain and operate at Manila in the Philippines a submarine telegraph cable connecting Manila with Hongkong." Section 8 thereof granted to the Corporation a tax exemption from the payment of all taxes whether municipal, provincial, or national except a franchise tax of 5% on the gross earnings and the tax on its real property. Thus —

"SEC. 8. In consideration of the franchise and rights hereby granted, the Grantee shall pay to the Republic of the Philippines during the life of this franchise a tax of five percent of the gross earnings derived by the grantee from its operation under this franchise and which originate in the Philippines. Such tax shall be due and payable annually, within ten (10) days after the audit and approval of the accounts as prescribed in Section seven of this Act, and *shall be in lieu of all taxes of any kind, nature or description, levied, established or collected by any municipal, provincial or Republic Authority except that the Grantee shall pay the tax on its real property in conformity with existing law*." (italics supplied) (*Rollo*, p. 180)

Supreme Court E-Library

On May 2, 1967, Republic Act No. 808 was amended by Republic Act No. 5002 by enlarging the scope of the franchise granting respondent corporation a franchise to land, construct, maintain and operate telecommunications by cable or other means known to science or which in the future may be developed for the transmission of messages between any point in the Philippines to points exterior thereto.

Respondent corporation, pursuant to the provisions of Section 8 of Republic Act No. 808 which was not amended by Republic Act No. 5002, had duly reported its gross Philippine earnings and paid the corresponding franchise tax thereon beginning the year 1952 to the General Auditing office.

The controversy commenced on November 25, 1971 when petitioner assessed private respondent in the amount of ₱7,122,571.61, representing private respondent's deficiency income tax, inclusive of surcharges, interests and penalties thereon for the years 1965 to 1970. It is obvious that petitioner made its assessment in view of its belief that respondent corporation's franchise under Republic Act No. 808, later amended by Republic Act No. 5002 is inoperative for failure of the latter to conform with the constitutional requirement that it be organized under Philippine laws with 60% of its capital owned by Filipinos. The provision of Section 8, Art. XIV of the 1935 Constitution provides as follows:

"ART. XIV. Sec. 8. — No franchise, certificate or any other forms of authorization for the operation of a public utility shall be granted except to citizen of the Philippines or to corporations or other entities organized under the laws of the Philippines sixty per centum of the capital of which is owned by citizens of the Philippines, nor shall such franchise, certificate or authorization be exclusive in character or for a longer period than fifty years. No franchise or right shall be granted to any individual, firm, or corporation, except under the condition that it shall be subject to amendment, alteration or repeal by the Congress when the public interest so requires." (*Rollo*, p. 58)

Petitioner contends that since private respondent is 100% owned by British citizens, it is illegally operating its business

Supreme Court E-Library

in the Philippines it being a fact that private respondent is engaged in the operation of a public utility. Private respondent through counsel questioned and disputed this assessment by means of two letters dated 17 and 18 January 1972. The letter questioned petitioner's authority to assess income taxes against private respondent pointing out the franchise and its exclusive tax feature. It contends further that the assessment is incorrect and without basis and that prescription had set in on part of the assessment assuming that the assessment is valid.

Petitioner in a letter dated February 28, 1973, rejected the private respondent's position and declared that the Office of the Commissioner finds no reason to withdraw much more cancel its assessment and even reassessed the private respondent not only from 1965 to 1970 but from 1952 to 1971 in the aggregate amount of ₱21,523,288.37 representing deficiency income taxes, inclusive of surcharges, interests and compromise penalties.

On March 13, 1973, private respondent filed with the respondent Court of Tax Appeals a petition for review contesting the legality of the assessment dated February 28, 1973 with prayer for a restraining order directing the Commissioner of Internal Revenue to desist from enforcing and collecting the same.

In the meanwhile, President Ferdinand E. Marcos promulgated on July 24, 1974 Presidential Decree No. 489 authorizing the herein respondent corporation to transfer and assign the franchise granted to it under Republic Act No. 808 as amended by Republic Act No. 5002, to the Eastern Telecommunications Philippines, Inc. Thereabout, respondent corporation transferred its franchise to Eastern Telecommunications, Inc. a duly organized corporation existing under the laws of the Philippines with at least 60% of its capital owned by Filipino citizens.

On February 18, 1976, public respondent rendered the assailed decision. While holding the franchise as unconstitutional, public respondent declared the petitioner's assessment as cancelled and without any legal force and effect, the "*ratio decidendi*" being that the assessment was made beyond the prescribed

Supreme Court E-Library

period required by the Tax Code; and that the assessment which is tantamount to a revocation of the Tax on Franchise under Section 259 (now Sec. 117) of the Tax Code cannot be given retroactive effect pursuant to the provisions of Section 338-A (now Section 246) of the same code. Unable to obtain a reconsideration from the said decision, this petition for renew is now before Us raising the following issues:

I — Whether or not the constitutionality of the legislative franchise granted to the respondent Corporation should have been passed upon by the respondent Court when it was not an issue raised in the pleadings;

II — Whether or not the provision in the franchise requiring the payment of only 5% of gross receipts in lieu of any and all taxes is unenforceable and without effect, considering that the franchise is inoperative for failure of the respondent Corporation to comply with the requirements of the Constitution, the Corporation Law and the Public Service Act.

III — Whether or not the respondent Court acted in excess of its jurisdiction in declaring the assessment in question as "fantastic and fabulous" considering that there had been no trial on the merits of this case.

IV — Whether or not the assessment was issued within the period prescribed by law.

V — Whether or not petitioner's assessment against respondent Corporation is in the nature of a ruling within the purview of Section 338-A of the National Internal Revenue Code. (pp. 11-12, *Rollo*)

It has been the persistent contention of the petitioner that the constitutionality of R.A. No. 808 was never raised as an issue by either party. Moreover, petitioner argued that said issue was not necessary in the resolution of this case. On the other hand, both public and respondent corporation maintained that the issue was properly raised during the trial. Respondent tax court, in its resolution dated June 18, 1976 stated as follows:

Supreme Court E-Library

"The constitutionality of the legislative franchise granted to petitioner (now private respondent) under Republic Act No. 808, as amended, is not only an indispensable issue in this case but a prejudicial question to be resolved by the Court. We will first begin with the BIR Records. In their memorandum to the Commissioner of Internal Revenue dated November 2, 1972, the Investigating Revenue Examiners reported, among others, as follows:

'x x x x x x x x x

'9. *That the Court of Tax Appeals has previously decided on an issue of constitutionality* in the case of *Jose Ma. Espino v. Commissioner of Internal Revenue*, CTA No. 1532 March 31, 1969.' (Italics supplied; p. 308, BIR Records)

'In the statement of Mrs. Librada R. Natividad, Chief, Litigation Division of the BIR, dated October 5, 1973, she stated, among others, as follows:

"*Observations and Recommendations*:

"1. That Eastern is operating illegally because:

"(a) Eastern was not organized under Philippine law and/or licensed to do business in the Philippines;

"(b) That it is wholly owned by British;

"(c) It is engaged in the business of public utility; and

"(d) *That Republic Act No. 808 is unconstitutional*. (Italics supplied, p. 448, BIR records)

"Even before this case was elevated to the Court of Tax Appeals, the investigating Revenue Examiners and the Chief of the Litigation Division, BIR, were already certain that the only way to negate and counteract the broad legislative grant of tax-exemption to petitioner (private respondent) from the payment of any municipal, provincial, and national tax under Section 8 of Republic Act No. 808 was to impugn and consider petitioner's legislative franchise invalid and/or unconstitutional; otherwise, respondent's income tax assessment against petitioner will have no solid and justifiable legal basis to stand on. (*Rollo*, pp. 83-85)

x x x x x x x x x

"It has been said that a review and analysis of the transcript of stenographic notes taken during the hearing on January 16, 1965

Supreme Court E-Library

failed to show that the issue of constitutionality of petitioner's legislative franchise was ever raised by respondent. It is to be noted, however, that before the formal hearing of this case on the date above-mentioned, a pre-trial conference was held in the private chamber of the undersigned Judge where Attys. Manuel Tomacruz and Cirilo Francisco where then and there present. At the suggestion of the Court, both counsel agreed that the prejudicial issue of whether or not petitioner's legislative franchise is valid and constitutional should be resolved first." (*Rollo*, pp. 88-89)

Although We sustain the respondent tax court's finding that the constitutioned issue was squarely raised by the parties, We find merit with the contention of the petitioner that it is not necessary for the disposition of this case. The fact that constitutional question was properly raised by a party is not alone sufficient for the respondent court to pass upon the issue of constitutionality. This is supported by recent Supreme Court rulings which oblige every court to approach a constitutional question with grave care and considerable caution. Thus:

"It is a well-settled rule that no constitutional question will be heard and resolved unless the following requisites of a judicial inquiry are present: (1) the existence of an appropriate case; (2) an interest personal and substantial by the party raising the constitutional question; (3) the plea that the function be exercised at the earliest opportunity; and (4) the necessity that the constitutional question be passed upon in order to decide the case" (*People v. Vera,* 65 Phil. 56 [1937]; *Dumlao v. COMELEC*, 95 SCRA 400 [1980] *National Economic Protectionism Association v. Ongpin*, 171 SCRA 657 [1989]).

Undoubtedly, the last criterion is not present. This case can be resolved based on the other available grounds obtaining in this case. Respondent court should have avoided the issue and instead maintained the presumption of constitutionality. A law is supposed to have been carefully studied and determined to be constitutional before it was finally enacted by Congress and approved by the Chief Executive. Accordingly, this Court gives high respect for the acts of the other departments of the government and, as much as possible, avoids deciding the constitutional question.

Supreme Court E-Library

The evidence demonstrate quite clearly the logic of the above ruling. Republic Act No. 808 was enacted in 1952 and it was amended in 1967 by Republic Act No. 5002. These Acts conferred the said franchise to the private respondent for the operation of an international telecommunications system during the effectivity of the 1935 Constitution. This is a persuasive indication that Congress excluded the operation of international telecommunication from the coverage of the constitutional prohibition. The deliberations in Congress, as extensively quoted in respondent's brief, indubitably show that a legislative franchise was granted to said private respondent on the premise that its operations were merely that of an international airline, establishing merely a terminal or station in the Philippines. As such, it is the opinion of Congress "that a company which operates only a cable station or a terminal in the Philippines, does not and cannot fall under that provision of the Constitution that confines the granting of franchises, permits and other certificates to Filipino citizens and Filipino corporations" (Respondent's Brief, p. 38; *Rollo*, p. 231).

It is rather unusual that in the case at bar, petitioner is the one seeking the annulment of the respondent tax court's decision declaring R.A. No. 808 unconstitutional. It's argument is premised on the fact that despite the validity of Republic Act No. 808, respondent corporation cannot avail of the tax exemption granted therein because of its failure to comply with the requirements of Section 8, Article XIV of the 1935 Constitution, the Public Service and the Corporation Law, which formed part and should be read into Republic Act No. 808. Respondent corporation, according to petitioner, should have:

1) restructured its equity by transferring at least 60 *per centum* of its capital to citizens of the Philippines;

2) obtained the certificate of convenience and public necessity required by Section 15 of the Public Service Law; and

3) secured a license as required by Sections 68 and 69 of the Philippine Corporation Law.

Supreme Court E-Library

In resolving this issue, this Court adverted to the terms and conditions set forth in the said legislative franchise. Thus:

"x x x x x x x x x

"Sec. 7. The Grantee shall keep a separate account of the gross earnings from submarine telegraph cable messages originating in the Philippines, and shall furnish to the General Auditing Office, or its successor a copy of such account not later than the thirty-first day of January of each year for the preceding year. For the purpose of auditing accounts so rendered, all of the books and accounts of the Grantee, or duplicates thereof, so far as they relate to submarine telegraph cable messages originating in the Philippines, shall be kept in the Philippines, and shall be subject to the official inspection of the Auditor General or his authorized representatives, and the audit and approval of such accounts shall be final and conclusive evidence as to the amount of said gross earnings, except that the Grantee shall have the right to appeal to the courts of the Philippines, under the terms and conditions provided in the laws of the Philippines.

"Sec. 8. In consideration of the franchise and rights hereby granted, the Grantee shall pay to the Republic of the Philippines during the life of this franchise a tax of five per cent of the gross earnings derived by the Grantee from its operation under this franchise and which originate in the Philippines. Such tax shall be due and payable annually, within ten (10) days after the audit and approval of the accounts as prescribed in section seven of this Act, and shall be in lieu of all taxes of any kind, nature and description, levied, established or collected by any municipal, provincial or Republic authority except that the Grantee shall pay the tax of its real property in conformity with existing law.

"Sec. 9. The grantee shall hold the national, provincial and municipal governments of the Philippines, harmless from all claims, accounts, demands, or actions arising out of accidents or injuries, whether to property or to persons, caused by the construction or operation of the cable and station for transmission and reception of submarine telegraph cable messages of the Grantee.

"Sec. 10. The Grantee shall be subject to the Corporation laws of the Philippines now existing or hereafter enacted.

"Sec. 11. It shall be unlawful for the Grantee to use, employ, or contract for the labor of persons held in involuntary servitude.

Supreme Court E-Library

"Sec. 12. The franchise hereby granted shall be subject to amendment, alteration, or repeal by the Congress of the Philippines, and the rights to use and occupy public property and places hereby granted shall revert to the Government, upon the termination of this franchise, by such repeal, or by forfeiture or expiration in due course.

"Unless earlier terminated by any such repeal or forfeiture, or extended, the franchise and rights hereby granted shall terminate by expiration of time fifty years after the date of the acceptance of this Act by the Grantee.

"Sec. 13. As a condition of the granting of this franchise the Grantee shall execute a bond in favor of the Government of the Philippines, in the sum of fifty thousand pesos; in a form and with sureties satisfactory to the Secretary of Public Works and Communications, conditioned upon the faithful performance of the Grantee's obligations hereunder during the first three years of the life of this franchise. If after three years from date of acceptance of this franchise, the Grantee shall have fulfilled said obligation, or so soon thereafter as the Grantee shall have fulfilled the same, the bond aforesaid shall be cancelled by the Secretary of Public Works and Communications.

"Sec. 14. Acceptance of this franchise shall be given in writing within six months after approval of this Act. When so accepted by the Grantee and upon the approval of the bond aforesaid by the Secretary of Public Works and Communications, the Grantee shall be empowered to exercise the privileges granted hereby.

"Sec. 15. The Grantee shall not lease, transfer, grant the usufruct of, sell or assign this franchise nor the rights and privileges acquired thereunder to any person, firm, company, corporation or other commercial or legal entity, nor merge with any other company or corporation organized for the same purpose, without the approval of the Philippine Congress first had. Any corporation to which this franchise may be sold, transferred, or assigned shall be subject to the corporation laws of the Philippines now existing or hereafter enacted, and any person, firm, company, corporation or other commercial or legal entity to which this franchise is sold transferred, or assigned shall be subject to all the conditions, terms, restrictions and limitations of this franchise as fully and completely and to the same extent as if the franchise had been originally granted to the said person, firm, company, corporation or other commercial or legal entity." (*Rollo*, pp. 179-182).

Supreme Court E-Library

Undisputedly, respondent corporation duly complied with all the foregoing conditions. It accepted in writing the franchise within the requisite period and filed the required bond. The Secretary of Public Works and Communications in turn approved and accepted the bond. Respondent corporation further complied with the tax requirement by paying to the Republic of the Philippines a tax of five per cent of the gross earnings from Philippine operations regularly since its creation.

A legislative franchise partakes of the nature of a contract. In the case of the *Province of Misamis Oriental v. Cagayan Electric Power and Light Company, Inc*., (G.R. No. L-45355, January 12, 1990, 181 SCRA 38), We stated:

"So was the exemption upheld in favor of the Carcar Electric and Ice Plant Company when it was required to pay the corporate franchise tax under Section 259 of the Internal Revenue Code, as amended by R.A. No. 39 (*Carcar Electric and Ice Plant v. Collector of Internal Revenue*, 53 O.G. [No. 4] 1068). This Court pointed out that such exemption is part of the inducement for the acceptance of the franchise and the rendition of public service by the grantee. *As a charter is in the nature of a private contract*, the imposition of another franchise tax on the corporation by the local authority would constitute an impairment of the contract between the government and the Corporation (Italics supplied).

Franchises spring from contracts between the sovereign power and private citizens made upon valuable considerations, for purposes of individual advantage as well as public benefit. It is generally considered that the obligation resting upon the grantee to comply with the terms and conditions of the grant constitutes a sufficient consideration. It can also be said that the benefit to the community may constitute the sole consideration for the grant of a franchise by the state. Such being the case, the franchise is the law between the parties and they are bound by the terms thereof.

Petitioner, being a government agency, is also bound by the terms of the franchise. It cannot declare the franchise as "ineffective and unenforceable" merely by stating that the private respondent failed to comply with the requirements of the general

Supreme Court E-Library

statutes which are not mentioned in R.A. No. 808. To allow petitioner's claim would be to defy and ignore the superiority of a legislative franchise granted by a special enactment over a mere authorization or permit granted in accordance with the provisions of laws of general application. Republic Act No. 808 as amended by Republic Act No. 5002, is a special law applicable only to the respondent corporation, while the Public Service Act and the Corporation Law are general statutes. The presumption is that special statutes are exemptions to the general law because they pertain to special charter granted to meet a particular set of conditions and circumstances (*Province of Misamis Oriental v. Cagayan Electric Power and Light Company, Inc*., *supra*).

In the same vein, We cannot accept petitioner's claim that the franchise is "inoperative and unenforceable" due to the failure of the respondent Corporation to comply with the constitutional requirement. Under Section 15 of the same act, the respondent corporation is expressly prohibited from leasing, transferring, selling or assigning the franchise thus granted to it, without the approval of the Philippine Congress being previously obtained. Presidential Decree No. 489 which authorized respondent Corporation to transfer to another corporation its franchise was issued only on June 24, 1974. Consequently, respondent corporation cannot be faulted in not restructuring its equity to conform with the constitutional requirement of 60% Filipino ownership in view of its limited right to transfer its property. Why then should the private respondent be at the receiving end or the "horses to be beaten" for its inability to comply with the "60% Filipino ownership" when the franchise itself prohibited it from doing so. This Court is not prepared to punish the respondent corporation which remained firm in not violating its franchise.

Petitioner claims that the respondent court had no basis in declaring the assessment as "fantastic and fabulous" considering that there was no trial on the merits - thereby implying grave abuse of discretion. In justifying its position, petitioner argued:

Supreme Court E-Library

"x x x Had there been such a hearing petitioner could have presented the examiners who conducted the examination of the book of accounts and accounting records of respondent Corporation. And they would have testified on all of the facts that they were able to gather in the course of their examination x x x Without their testimonies, there is really no way of ascertaining whether or not the assessment or the deficiency income tax on respondent Corporation is "fantastic and fabulous' x x x." (Brief for the Petitioner, pp. 34-35, *Rollo*, p. 222)

The main thrust of petitioner's argument in this regard is directed to the propriety of the respondent court's pronouncement that the assessment is "fantastic and fabulous." The pertinent portion of the said decision reads:

"The *fantastic and fabulous* income tax assessment of ₱21,523,288.37 issued by respondent (herein petitioner) against petitioner (herein private respondent) is without sufficient legal and valid justification under Sections 331 and 332(a) of the National Internal Revenue Code, in relation to Section 72 of the same Code which reads as follows:

x x x x x x x x x

(*Rollo*, p. 65) (words in parenthesis supplied)

Petitioner displayed a crude attempt to impress upon this Court that respondent tax court made a grave error and abused its discretion in declaring the assessment "fantastic and fabulous." While such phrase is an "*obiter dictum*," petitioner capitalized on it in assailing the decision as having been rendered with grave abuse of discretion. Assuming that the same was really made without basis, considering that there was really no trial on the merits of the case, as the respondent court decided to avoid a tedious and prolonged litigation involving the disputed income tax assessments, and limited its consideration only on the validity or constitutionality of the franchise, does it constitute grave abuse of discretion which amounts to lack of jurisdiction?

The answer is in the negative. An act of a court or tribunal may only be considered as committed in grave abuse of discretion when the same was performed in a capricious and whimsical

Supreme Court E-Library

exercise of judgment which is equivalent to lack of jurisdiction. The abuse of discretion must be so patent and gross as to amount to an evasion of positive duty enjoined by law, or to act at all in contemplation of law, as where the power is exercised in an arbitrary and despotic manner by reason of passion or personal hostility (*Butuan Bay Wood Export Corp. v. CA*, G.R. No. L-45473, April 28, 1980, 97 SCRA 297; *Litton Mills, Inc. v. Galleon Traders*, *Inc*., G.R. No. L-40867, July 26, 1988, 163, SCRA 489).

The phrase "fantastic and fabulous" is a collateral matter and is not substantially material to the instant case because, as already stated above, the court did not proceed with the merits of the case or did not deal with the factual issue to prove or disprove the figures or amount of the assailed assessment. This case will necessarily be decided upon with this Court simply disregarding the said phrase and by so doing, this Court perceives no substantial change in the respondent Court's assailed decision.

As regards the fourth assigned error, this Court finds that respondent tax court erred in declaring that the assessment was issued beyond the period prescribed by law. The National Internal Revenue Code then in force provides:

"Section 331 (now Section 203). *Period of Limitation Upon Assessment and Collection*. — Except as provided in the succeeding section, internal revenue taxes shall be assessed within five years (now 3 years) after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after expiration of such period. x x x

It is clear from the foregoing provision that internal revenue taxes shall be assessed within five (5) years after the taxpayer's return was filed. It is, however, undisputed that petitioner has failed to file any corporate income tax return for a period of twenty (20) years from 1952 to 1971. With this, petitioner argued that under Section 332 (a) (now Section 223 [a]) of the Revenue Code, private respondent's failure to file the income tax returns authorizes him to assess the income tax due from the private respondent *within ten years after* the discovery of the falsity,

Supreme Court E-Library

fraud, or omission. Petitioner relied on Section 332 (now Section 223) of the same Code:

"SEC. 332 (now Section 223). — *Exceptions as to period of limitation of assessment and collection of taxes*.

(a) In the case of a false or fraudulent return with intent to evade tax or of a *failure to file a return*, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud or omission." (italics supplied)

The omission was discovered only in 1971 upon investigation conducted by petitioner's examiners. Accordingly, petitioner has ten (10) years from 1971 or until 1981 within which to assess respondent corporation. The assessment on the deficiency income tax against private respondent in the amount of ₱21,523,288.37 was issued on February 28, 1973 which is well within the period prescribed by law.

But while it is true that the assessment is within the prescribed period, it does not necessarily follow that it is a valid assessment in its entirety. We have already ruled that Republic Act No. 808 is an operative act. Because of this, private respondent is exempted from the payment of all taxes whether local, provincial or national, except franchise and real property taxes. It goes without saying that the assessment cannot be held valid against the income derived from private respondent's operation authorized by the franchise. It can only stand valid insofar as the assessment is for income derived from services within the Philippines and which is beyond the scope of R.A. 808.

For example, private respondent should be held liable to pay the taxes on its income derived from the managerial services it rendered to other corporations, like the Oceanic Wireless, Inc., a domestic corporation; and the income derived from rentals on a leased portion of its building. Private respondent may not escape payment of these taxes by claiming tax exemption in view of the provision of R.A. 808. To hold otherwise would open the gate to rampant *tax evasion*.

Supreme Court E-Library

Lastly, We find that respondent tax court erred in declaring that the assessment for deficiency income tax against respondent corporation is in the nature of a ruling within the purview of Section 338-A of the tax code.

The Court of Tax Appeals' decision stated:

"Section 338 (now Section 246) of the National Internal Revenue Code authorizes the Secretary of Finance, upon the recommendation of the Commissioner of Internal Revenue, to promulgate all needful rules and regulations for the effective enforcement of the provisions of the same code. One of these provisions relate to the franchise tax under Section 259 of the aforesaid Code which reads as follows:

> 'Sec. 259 (now Sec. 117). Tax on franchises. — There shall be collected in respect to all franchises, upon the gross receipts from the business covered by the law granting the franchise, a tax of five *per centum* or such taxes, charges, and percentages as are specified in the special charters of the grantees upon whom such franchises are conferred, whichever is higher, unless the provisions thereof preclude the imposition of a higher tax. For the purposes of facilitating the assessment of this tax, reports shall be made by the respective holders of the franchises in such form and at such times, as shall be required by the regulations of the Department of Finance.
>
> 'The taxes, charges and percentages on franchises, shall be assessed, collected by and paid to the Commissioner of Internal Revenue or any of his collection agents, any provision in the franchise to the contrary notwithstanding, and shall be due and payable as specified in the particular franchise, or, in case no time limit is specified therein, the provisions of Section one hundred eighty three shall apply; and if such taxes, charges, and percentages remain unpaid on the date on which they must be paid, twenty-five *per centum* shall be added to the amount of such taxes, charges, and percentages, which increase shall form part of the tax. (As amended by Sec. 7, Republic Act No. 39; Sec. 1, Republic Act No. 418; and Sec. 53, Republic Act No. 6110).'"

"It can thus be seen from the said provisions that for the purpose of facilitating the assessment of the franchise tax, the Secretary of Finance, upon the recommendation of respondent, may promulgate

Supreme Court E-Library

the implementing rules and regulations. It is to be noted that the said rules and regulations will merely implement the provisions of the franchise tax law. Any revocation, modification or reversal of the ruling or the franchise tax law itself by the respondent Commissioner of Internal Revenue *shall not be given retroactive application*. The mandatory requirement for the prospective operation of the new ruling is explicit under Section 338-A (now Section 246) of the National Internal Revenue Code which provides as follows:

> 'Sec. 338-A. (Section 246). *Non-retroactivity of rulings*. — Any revocation, modification or reversal of any of the rules and regulations promulgated in accordance with the preceding section or any of the rulings or circulars promulgated by the Commissioner of Internal Revenue shall not be given retroactive application if the revocation, modification or reversal will be prejudicial to the taxpayers except in the following cases; (a) where the taxpayers deliberately misstates or omits material facts from his return or in any document required of him by the Bureau of Internal Revenue; (b) where the facts subsequently gathered by the Bureau of Internal Revenue are materially different from the facts on which the ruling is based; or (c) where the taxpayer acted in bad faith. (inserted by Sec. 61, Republic Act No. 6110).
>
> x x x x x x x x x.
>
> 'Respondent's income tax assessment against petitioner for a period of twenty (20) years is tantamount to a revocation of the tax on franchise prescribed by Section 259 of the National Internal Revenue Code, *supra*, because the provisions thereof were disregarded in favor of Section 24 of the same code which imposes the corporate income tax. In such a case, the revocation of the franchise tax law shall have prospective operation except in the following cases:
>
> x x x x x x x x x.'" (*Rollo*, pp. 69-71)
>
> (Words in parenthesis supplied)

Contrary to the Court of Tax Appeals ruling, We believe that the assessment against the petitioner cannot be likened to a revocation of the tax on franchise prescribed in Section 259. Firstly, a ruling by a Commissioner cannot revoke a provision of the National Internal Revenue Code, a substantive law. Secondly, the provision above stated contemplates of a revocation,

Supreme Court E-Library

modification or reversal of any of the rules and regulations promulgated for the enforcement of the provisions of the tax code but not a revocation, modification or reversal of the tax code's provision itself. The reason why the Commissioner issued the assailed assessment of ₱21,523,288.37 was not because he wanted to revoke, expressly or implicitly, Section 259 of the Tax Code, but because the Commissioner believed that private respondent is liable for corporate income tax by virtue of an inoperative franchise. Hence, the said assessment should not be regarded as a ruling contemplated under Section 338-A. It should be treated as an ordinary assessment for the payment of taxes, like any other assessment issued against any person or entity, holding a legislative franchise and is exempted from the payment of certain national and local taxes, including corporate income tax but, nevertheless, found to be liable to pay the latter due to its earnings derived from sources within the Philippines but beyond the scope of the franchise.

ACCORDINGLY, the decision of the Court of Tax Appeals is hereby modified, as follows:

1. Republic Act No. 808 is presumed to be an operative act and the decision of the respondent tax court declaring the same to be unconstitutional is hereby SET ASIDE;
2. the provision in the franchise requiring the payment of 5% of gross receipts as franchise tax in lieu of any and all taxes is enforceable and operative;
3. the assailed assessment was issued within the period prescribed by law;
4. the assailed assessment is not in the nature of a ruling within the purview of Section 338-A of the National Internal Revenue Code; and
5. the decision of the respondent tax court declaring the Commissioner's assessment cancelled and without any legal force and effect is hereby SET ASIDE. A remand of this case to respondent Court of Tax Appeals is ordered for trial on the merits to determine the income tax liability of the private respondent corresponding to its income beyond the scope of Republic Act No. 808.

Supreme Court E-Library

The decision of the Court of Tax Appeals is AFFIRMED in all other respects.

SO ORDERED.

Narvasa, Cruz, and *Griño-Aquino, JJ.*, concur.

Gancayco, J., on leave.

SECOND DIVISION

[G.R. No. 75801. March 20, 1991]

DEVELOPMENT BANK OF THE PHILIPPINES, *petitioner*, *vs*. **THE MINISTER OF LABOR and SAMAHANG PAGKAKAISANG MANGGAGAWA SA RMC-GATCORD,** *respondents*.

SYLLABUS

1. LABOR AND SOCIAL LEGISLATION; LABOR STANDARDS; WORKER'S RIGHT OF PREFERENCE UNDER ARTICLE 110 OF THE CODE; MAY NOT BE INVOKED IN THE ABSENCE OF A FORMAL DECLARATION OF BANKRUPTCY OR JUDICIAL LIQUIDATION ORDER. — The pivotal issue in this case is whether or not a writ of garnishment may be issued against the proceeds of RMC's properties foreclosed by DBP and sold to Rosario Textile Mills, by the application of the worker's right of preference under Article 110 of the Labor Code. Because of its impact on the entire system of credit, Article 110 of the Labor Code cannot be viewed in isolation of, and must always be reckoned with the provisions of the Civil Code on concurrence and preference of credits (*DBP v. NLRC, et al., supra*), thus, it may not be invoked by employees of RMC, like private respondent-Samahan herein, in the absence of a formal declaration of bankruptcy or judicial liquidation order.