

THIRD DIVISION

[G.R. No. 180066, July 07, 2009]

COMMISSIONER OF INTERNAL REVENUE, PETITIONER, VS. PHILIPPINE AIRLINES, INC., RESPONDENT.

D E C I S I O N

CHICO-NAZARIO, J.:

Before this Court is a Petition for Review on *Certiorari*, under Rule 45 of the Revised Rules of Court, seeking the reversal and setting aside of the Decision^[1] dated 9 August 2007 and Resolution^[2] dated 11 October 2007 of the Court of Tax Appeals (CTA) *en banc* in CTA E.B. No. 246. The CTA *en banc* affirmed the Decision^[3] dated 31 July 2006 of the CTA Second Division in C.T.A. Case No. 7010, ordering the cancellation and withdrawal of Preliminary Assessment Notice (PAN) No. INC FY-3-31-01-000094 dated 3 September 2003 and Formal Letter of Demand dated 12 January 2004, issued by the Bureau of Internal Revenue (BIR) against respondent Philippine Airlines, Inc. (PAL), for the payment of Minimum Corporate Income Tax (MCIT) in the amount of P272,421,886.58.

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

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

For its fiscal year ending 31 March 2001 (FY 2000-2001), PAL allegedly incurred zero taxable income,^[6] which left it with unapplied creditable withholding tax^[7] in the amount of P2,334,377.95. PAL did not pay any MCIT for the period.

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

Acting on the aforementioned letter of PAL, the Large Taxpayers Audit and Investigation Division 1 (LTAID 1) of the BIR Large Taxpayers Service (LTS), issued on 16 August 2002, Tax Verification Notice No. 00201448, authorizing Revenue Officer Jacinto Cueto, Jr. (Cueto) to verify the supporting documents and pertinent records relative to the claim of PAL for refund of its unapplied creditable withholding tax for FY 2000-2001. In a letter dated 19 August 2003, LTAID 1 Chief Armit S. Linsangan invited PAL to an informal conference at the BIR National Office in Diliman, Quezon City, on 27 August 2003, at 10:00 a.m., to discuss the results of the investigation conducted by Revenue Officer Cueto, supervised by Revenue Officer Madelyn T. Sacluti.

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

The LTAID 1 issued, on 3 September 2003, PAN No. INC FY-3-31-01-000094, which was received by PAL on 23 October 2003. LTAID 1 assessed PAL for P262,474,732.54, representing deficiency MCIT for FY 2000-2001, plus interest and compromise penalty, computed as follows:

Sales/Revenues from Operation	P 38,798,721,685.00
Less: Cost of Services	30,316,679,013.00
Gross Income from Operation	8,482,042,672.00
Add: Non-operating income	465,111,368.00
Total Gross Income for MCIT purposes	9,947,154,040.00 ^[8]

Rate of Tax	2%
Tax Due	178,943,080.80
Add: 20% interest (8-16-00 to 10-31-03)	83,506,651.74
Compromise Penalty	25,000.00
Total Amount Due	P 262,474,732.54 ^[9]

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

On 12 January 2004, the LTAID 1 sent PAL a Formal Letter of Demand for deficiency MCIT for FY 2000-2001 in the amount of P271,421,886.58, based on the following calculation:

Sales/Revenues from Operation		P 38,798,721,685.00
Less: Cost of Services		
Direct Costs -	P 30,749,761,017.00	
Less: Non-deductible interest expense	433,082,004.00	30,316,679,013.00
Gross Income from Operation		P 8,482,042,672.00
Add: Non-operating Income		465,111,368.00
Total Gross Income for MCIT purposes		P 9,947,154,040.00
MCIT tax due		P 178,943,080.80
Interest - 20% per annum - 7/16/01 to 02/15/04		92,453,805.78
Compromise Penalty		25,000.00
Total MCIT due and demandable		P 271,421,886.58 ^[10]

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

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

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

WHEREFORE, premises considered, the instant Petition for Review is hereby **GRANTED**. Accordingly, Assessment Notice No. INC FY-3-31-01-000094 and Formal Letter of Demand for the payment of deficiency Minimum Corporate Income Tax in the amount of P272,421,886.58 are hereby **CANCELLED** and **WITHDRAWN**.^[11]

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

It was then the turn of the CIR to file a Petition for Review with the CTA *en banc*, docketed as C.T.A. E.B. No. 246. The CTA *en banc* found that "the cited legal provisions and jurisprudence are teeming with life with respect to the grant of tax exemption too vivid to pass unnoticed," and that "the Court in Division correctly ruled in favor of the respondent [PAL] granting its petition for the cancellation of Assessment Notice No. INC FY-3-31-01-000094 and Formal Letter of Demand for the deficiency MCIT in the amount of P272,421,886.58."^[12] Consequently, the CTA *en banc* denied the Petition of the CIR for lack of merit. The CTA *en banc* likewise denied the Motion for Reconsideration of the CIR in a Resolution dated 11 October 2007.

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

THE COURT OF TAX APPEALS ERRED ON A QUESTION OF LAW IN ITS ASSAILED DECISION BECAUSE:

(1) [PAL] CLEARLY OPTED TO BE COVERED BY THE INCOME TAX PROVISION OF THE NATIONAL INTERNAL REVENUE CODE OF 1997 (NIRC OF 1997). (sic) AS AMENDED; HENCE, IT IS COVERED BY THE MCIT PROVISION OF THE SAME CODE.

(2) THE MCIT DOES NOT BELONG TO THE CATEGORY OF "OTHER TAXES" WHICH WOULD ENABLE RESPONDENT TO AVAIL ITSELF OF THE "IN LIEU" (sic) OF ALL OTHER TAXES" CLAUSE UNDER SECTION 13 OF P.D. NO. 1590 ("CHARTER").

(3) THE MCIT PROVISION OF THE NIRC OF 1997 IS NOT AN AMENDMENT OF [PAL'S] CHARTER.

(4) PAL IS NOT ONLY GIVEN THE PRIVILEGE TO CHOOSE BETWEEN WHAT WILL GIVE IT THE BENEFIT OF A LOWER TAX, BUT ALSO THE RESPONSIBILITY OF PAYING ITS SHARE OF THE TAX BURDEN, AS IS EVIDENT IN SECTION 22 OF RA NO. 9337.

(5) A CLAIM FOR EXEMPTION FROM TAXATION IS NEVER PRESUMED; [PAL] IS LIABLE FOR THE DEFICIENCY MCIT.^[13]

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

The Court answers in the negative.

Presidential Decree No. 1590, the franchise of PAL, contains provisions specifically governing the taxation of said corporation, to wit:

Section 13. In consideration of the franchise and rights hereby granted, the grantee shall pay to the Philippine Government during the life of this franchise **whichever of subsections (a) and (b) hereunder will result in a lower tax:**

(a) The **basic corporate income tax** based on the **grantee's annual net taxable income** computed in accordance with the provisions of the National Internal Revenue Code; or

(b) A **franchise tax** of two per cent (2%) of the gross revenues derived by the grantee from all sources, without distinction as to transport or nontransport operations; provided, that with respect to international air-transport service, only the gross passenger, mail, and freight revenues from its outgoing flights shall be subject to this tax.

The tax paid by the grantee under either of the above alternatives shall be **in lieu of all other** taxes, duties, royalties, registration, license, and other fees and charges of any kind, nature, or description, imposed, levied, established, assessed, or collected by any municipal, city, provincial, or national authority or government agency, now or in the future, including but not limited to the following:

1. All taxes, duties, charges, royalties, or fees due on local purchases by the grantee of aviation gas, fuel, and oil, whether refined or in crude form, and whether such taxes, duties, charges, royalties, or fees are directly due from or imposable upon the purchaser or the seller, producer, manufacturer, or importer of said petroleum products but are billed or passed on to the grantee either as part of the price or cost thereof or by mutual agreement or other arrangement; provided, that all such purchases by, sales or deliveries of aviation gas, fuel, and oil to the grantee shall be for exclusive use in its transport and nontransport operations and other activities incidental thereto;
2. All taxes, including compensating taxes, duties, charges, royalties, or fees due on all importations by the grantee of aircraft, engines, equipment, machinery, spare parts, accessories, commissary and catering supplies, aviation gas, fuel, and oil, whether refined or in crude form and other articles, supplies, or materials; provided, that such articles or supplies or materials are imported for the use of the grantee in its transport and nontransport operations and other activities incidental thereto and are not locally available in reasonable quantity, quality, or price;
3. All taxes on lease rentals, interest, fees, and other charges payable to lessors, whether foreign or domestic, of aircraft, engines, equipment, machinery, spare parts, and other property rented, leased, or chartered by the grantee where the payment of such taxes is assumed by the grantee;

4. All taxes on interest, fees, and other charges on foreign loans obtained and other obligations incurred by the grantee where the payment of such taxes is assumed by the grantee;
5. All taxes, fees, and other charges on the registration, licensing, acquisition, and transfer of aircraft, equipment, motor vehicles, and all other personal and real property of the grantee; and
6. The corporate development tax under Presidential Decree No. 1158-A.

The grantee, shall, however, pay the **tax on its real property** in conformity with existing law.

For purposes of **computing the basic corporate income tax** as provided herein, the grantee is authorized:

- (a) To **depreciate** its assets to the extent of not more than **twice as fast** the normal rate of depreciation; and
- (b) To **carry over** as a deduction from taxable income any **net loss** incurred in any year up to five years following the year of such loss.

Section 14. The grantee shall pay either the franchise tax or the basic corporate income tax on quarterly basis to the Commissioner of Internal Revenue. Within sixty (60) days after the end of each of the first three quarters of the taxable calendar or fiscal year, the quarterly franchise or income-tax return shall be filed and payment of either the franchise or income tax shall be made by the grantee.

A final or an adjustment return covering the operation of the grantee for the preceding calendar or fiscal year shall be filed on or before the fifteenth day of the fourth month following the close of the calendar or fiscal year. The amount of the final franchise or income tax to be paid by the grantee shall be the balance of the total franchise or income tax shown in the final or adjustment return after deducting therefrom the total quarterly franchise or income taxes already paid during the preceding first three quarters of the same taxable year.

Any excess of the total quarterly payments over the actual annual franchise of income tax due as shown in the final or adjustment franchise or income-tax return shall either be refunded to the grantee or credited against the grantee's quarterly franchise or income-tax liability for the succeeding taxable year or years at the option of the grantee.

The term "**gross revenues**" is herein defined as the total gross income earned by the grantee from; (a) transport, nontransport, and other services; (b) earnings realized from investments in money-market placements, bank deposits, investments in shares of stock and other securities, and other investments; (c) total gains net of total losses realized from the disposition of assets and foreign-exchange transactions; and (d) gross income from other sources. (Emphases ours.)

According to the afore-quoted provisions, the taxation of PAL, during the lifetime of its franchise, shall be governed by two fundamental rules, particularly: (1) PAL shall pay the Government either basic corporate income tax or franchise tax, whichever is lower; and (2) the tax paid by PAL, under either of these alternatives, shall be in lieu of all other taxes, duties, royalties, registration, license, and other fees and charges, except only real property tax.

The basic corporate income tax of PAL shall be based on its annual net taxable income, computed in accordance with the National Internal Revenue Code (NIRC). Presidential Decree No. 1590 also explicitly authorizes PAL, in the computation of its basic corporate income tax, to (1) depreciate its assets twice as fast the normal rate of depreciation;^[14] and (2) carry over as a deduction from taxable income any net loss incurred in any year up to five years following the year of such loss.^[15]

Franchise tax, on the other hand, shall be two per cent (2%) of the gross revenues derived by PAL from all sources, whether transport or nontransport operations. However, with respect to international air-transport service, the franchise tax shall only be imposed on the gross passenger, mail, and freight revenues of PAL from its outgoing flights.

In its income tax return for FY 2000-2001, filed with the BIR, PAL reported no net taxable income for the period, resulting in zero basic corporate income tax, which would necessarily be lower than any franchise tax due from PAL for the same period.

The CIR, though, assessed PAL for MCIT for FY 2000-2001. It is the position of the CIR that the MCIT is income tax for which PAL is liable. The CIR reasons that Section 13(a) of Presidential Decree No. 1590 provides that the corporate income tax of PAL shall be computed in accordance with the NIRC. And, since the NIRC of 1997

imposes MCIT, and PAL has not applied for relief from the said tax, then PAL is subject to the same.

The Court is not persuaded. The arguments of the CIR are contrary to the plain meaning and obvious intent of Presidential Decree No. 1590, the franchise of PAL.

Income tax on domestic corporations is covered by Section 27 of the NIRC of 1997,^[16] pertinent provisions of which are reproduced below for easy reference:

SEC. 27. Rates of Income Tax on Domestic Corporations. -

(A) *In General* - Except as otherwise provided in this Code, an income tax of **thirty-five percent (35%)** is hereby imposed upon the **taxable income** derived during each taxable year from all sources within and without the Philippines by every corporation, as defined in Section 22(B) of this Code and taxable under this Title as a corporation, organized in, or existing under the laws of the Philippines: *Provided*, That effective January 1, 1998, the rate of income tax shall be thirty-four percent (34%); effective January 1, 1999, the rate shall be thirty-three percent (33%); and effective January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%).

x x x x

(E) Minimum Corporate Income Tax on Domestic Corporations. -

(1) *Imposition of Tax.* - A minimum corporate income tax of **two percent (2%) of the gross income** as of the end of the taxable year, as defined herein, is hereby imposed on a corporation taxable under this Title, beginning on the fourth taxable year immediately following the year in which such corporation commenced its business operations, when the minimum income tax is greater than the tax computed under Subsection (A) of this Section for the taxable year.

Hence, a domestic corporation must pay whichever is higher of: (1) the income tax under Section 27(A) of the NIRC of 1997, computed by applying the tax rate therein to the taxable income of the corporation; or (2) the MCIT under Section 27(E), also of the NIRC of 1997, equivalent to 2% of the gross income of the corporation. Although this may be the general rule in determining the income tax due from a domestic corporation under the NIRC of 1997, it can only be applied to PAL to the extent allowed by the provisions in the franchise of PAL specifically governing its taxation.

After a conscientious study of Section 13 of Presidential Decree No. 1590, in relation to Sections 27(A) and 27(E) of the NIRC of 1997, the Court, like the CTA *en banc* and Second Division, concludes that PAL cannot be subjected to MCIT for FY 2000-2001.

First, Section 13(a) of Presidential Decree No. 1590 refers to "**basic corporate income tax.**" In *Commissioner of Internal Revenue v. Philippine Airlines, Inc.*,^[17] the Court already settled that the "basic corporate income tax," under Section 13(a) of Presidential Decree No. 1590, relates to the general rate of 35% (reduced to 32% by the year 2000) as stipulated in Section 27(A) of the NIRC of 1997.

Section 13(a) of Presidential Decree No. 1590 requires that the basic corporate income tax be computed in accordance with the NIRC. This means that PAL shall compute its basic corporate income tax using the rate and basis prescribed by the NIRC of 1997 for the said tax. There is nothing in Section 13(a) of Presidential Decree No. 1590 to support the contention of the CIR that PAL is subject to the entire Title II of the NIRC of 1997, entitled "Tax on Income."

Second, Section 13(a) of Presidential Decree No. 1590 further provides that the basic corporate income tax of PAL shall be based on its **annual net taxable income**. This is consistent with Section 27(A) of the NIRC of 1997, which provides that the rate of basic corporate income tax, which is 32% beginning 1 January 2000, shall be imposed on the **taxable income** of the domestic corporation.

Taxable income is defined under Section 31 of the NIRC of 1997 as the **pertinent items of gross income specified in the said Code, less the deductions and/or personal and additional exemptions, if any, authorized for such types of income by the same Code or other special laws.** The gross income, referred to in Section 31, is described in Section 32 of the NIRC of 1997 as income from whatever source, including compensation for services; the conduct of trade or business or the exercise of profession; dealings in property; interests; rents; royalties; dividends; annuities; prizes and winnings; pensions; and a partner's distributive share in the net income of a general professional partnership.

Pursuant to the NIRC of 1997, the taxable income of a domestic corporation may be arrived at by subtracting from gross income deductions authorized, not just by the NIRC of 1997,^[18] but also by special laws. Presidential Decree No. 1590 may be considered as one of such special laws authorizing PAL, in computing its annual net taxable income, on which its basic corporate income tax shall be based, to deduct from its gross