

## FIRST DIVISION

[ G.R. NO. 160528, October 09, 2006 ]

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

#### DECISION

#### **PANGANIBAN, CJ:**

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

#### The Case

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

"**WHEREFORE**, the petition is **GRANTED**, and [the] Commissioner of Internal Revenue is hereby directed to refund to the [respondent] the amount of P731,190.45 representing the 20% final withholding tax collected and deducted by depository banks on the petitioner's interest income or, in the alternative, to allow the [respondent] a tax credit for the same amount."<sup>[5]</sup>

#### The Facts

The CA narrates the facts thus:

"[Respondent] Philippine Airlines, Inc. (PAL) is a domestic corporation organized in accordance with the laws of the Republic of the Philippines, while [Petitioner] Commissioner of Internal Revenue (CIR) is in-charge of the assessment and collection of the 20% final tax on interest on Philippine currency bank deposits and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements, imposed on domestic corporation under Sec. 24 (e) (1) [now Sec. 27 (D) (1)] of the National Internal Revenue Code (NIRC).

"On November 5, 1997, [respondent's] AVP-Revenue Operations and Tax Services Officer, Atty. Edgardo P. Curbita, filed with the Office of the then Commissioner of Internal Revenue, Mdm. Liwayway Vinzons-Chato, a written request for refund of the amount of P2,241,527.22 which represents the total amount of 20% final withholding tax withheld from the [respondent] by various withholding agent banks, and which amount includes the 20% final withholding tax withheld by the United Coconut Planters Bank (UCPB) and Rizal Commercial Banking Corporation (RCBC) for the period starting March 1995 through February 1997.

"On December 4, 1997, the [respondent's] AVP-Revenue Operations and Tax Services Officer again filed with [petitioner] CIR another written request for refund of the amount of P1,048,047.23, representing the total amount of 20% final withholding tax withheld by various depository banks of the [respondent] which amount includes the 20% withholding tax withheld by the Philippine National Bank (PNB), Equitable Banking Corporation (EBC), and the Jade Progressive Savings & Mortgage Bank (JPSMB) for the period starting March 1995 through November 1997.

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

<b>Bank</b>	<b>Period Covered</b>	<b>Source</b>	<b>Amount</b>
UCPB	Jan. 9, 1997 - Feb. 21, 1997	Interest income on prime savings deposit	P60,328.38
		Interest income on government securities and/or commercial papers	<u>78,658.52</u> P131,986.65
RCBC	Jan. 6, 1997 - Feb. 28, 1997	Interest income on FBTB and Treasury Bills placements	47,763.55
PNB	Feb. 19, 1997 - Nov. 14, 1997	Interest income on PNBIG savings account	514,120.22
EBC	Jan. 3, 1997 - Feb. 28, 1997	Interest income on Treasury Bills placement	33,357.25
JPSMB	Jan. 1, 1997 - Feb. 28, 1997	Interest income on deposits	3,962.78

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

### **Ruling of the Court of Tax Appeals**

The CTA ruled that Respondent PAL was not entitled to the refund. Section 13 of Presidential Decree No. 1590, PAL's franchise,<sup>[7]</sup> allegedly gave respondent the

option to pay either its corporate income tax under the provisions of the NIRC or a franchise tax of two percent of its gross revenues. Payment of either tax would be in lieu of all "other taxes." Had respondent paid the two percent franchise tax, then the final withholding taxes would have been considered as "other taxes." Since it chose to pay its corporate income tax, payment of the final withholding tax is deemed part of this liability and therefore not refundable.<sup>[8]</sup>

### **Ruling of the Court of Appeals**

As stated earlier, the Court of Appeals reversed the Decision of the CTA. The CA held that PAL was bound to pay only the corporate income tax or the franchise tax. Section 13 of Presidential Decree No. 1590 exempts respondent from paying all other taxes, duties, royalties and other fees of any kind.<sup>[9]</sup> Respondent chose to pay its basic corporate income tax, which, after considering the factors allowed by law, resulted in a zero tax liability.<sup>[10]</sup> This zero tax liability should neither be taken against respondent nor deprive it of the exemption granted by the law.<sup>[11]</sup> Having chosen to pay its corporate income tax liability, respondent should now be exempt from paying all other taxes including the final withholding tax.

Hence, this Petition.<sup>[12]</sup>

### **The Issue**

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

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

### **The Court's Ruling**

The Petition has no merit.

### **Sole Issue:** **Tax Liability of PAL**

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

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

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

'(b)A franchise tax of two percent (2%) of the gross revenues derived by the grantee from all sources,

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

"The tax paid by the grantee under either of the above alternatives shall be in lieu of all other taxes, duties, royalties, registration, license, and other fees and charges of any kind, nature, or description, imposed, levied, established, assessed, or collected by any municipal, city, provincial, or national authority or government agency, now or in the future, x x x."<sup>[14]</sup>

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

### **Interpretation of PAL's Franchise**

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

On the other hand, the CTA held that the "in lieu of all other taxes" proviso implied the existence of something for which a substitution would be made.<sup>[16]</sup> Final withholding taxes come under basic corporate income tax liability; hence, payment of the latter cannot mean an exemption from the former. To be exempt from final withholding taxes, PAL should have paid the franchise tax of two percent, which would have been in lieu of all other taxes including the final withholding tax.

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

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

PAL availed itself of PD 1590, Section 13, Subsection (a), the crux of which hinged on the terms "basic corporate income tax" and "annual net taxable income." The applicable laws (PAL's franchise and the Tax Code) do not define the terms "basic corporate income tax."<sup>[19]</sup> On the other hand, "annual net taxable income" is computed in accordance with the provisions of the National Internal Revenue Code.

The statutory basis for the income tax on corporations is found in Sections 27 to 30 of the National Internal Revenue Code of 1997 under Chapter IV: "Tax on