# ANNUAL SURVEY OF TAXATION

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INTERNAL REVENUE CODE:

*Income tax: Exemption of salaries of judges.*

The interaction of the different departments of government inevitably brings into play the doctrine of separation of powers. In the field of taxation, the old question of taxing the salaries of judicial officers was again raised in the case of *Endencia & Jugo vs. David.*[1] Not so long ago, the Supreme Court in the case of *Perfecto vs. Meer,*[2] held that despite the ruling of *O'Malley vs. Woodrough,*[3] the taxing of the salaries of judicial officers is a diminution of salary prohibited by the Constitution. That would have been the end of it, had not Congress enacted Republic Act No. 590, section 13 of which provides: "No salary whenever received by any public officer of the Republic of the Philippines shall be considered as exempt from the income tax, payment of which is hereby declared not to be a diminution of his compensation fixed by the Constitution or by law." As pointed out by the Solicitor General, it is apparent that that section is intended to be a Congressional rejection of the ruling in the case of *Perfecto vs. Meer.*

Republic Act No. 590, section 13, seeks to justify and legalize the collection of income tax on the salary of judicial officers. And the question is—Can Congress do that? The Supreme Court held that "under the separation of powers, only the judicial department can interpret the law and the Constitution. Section 13 of Republic Act No. 590 is an interpretation of Section 9, Article VIII of the Constitution, and is therefore a usurpation of judicial powers. If permitted it would cause confusion and instability in judicial processes and court decisions, because after final court determination of a case on judicial interpretation of the law or constitution, it can be undermined by legislative interpretation of the law or constitution." And turning its attention to the old question of whether taxing the salary is really a diminution within the meaning of the constitutional prohibition, the Court said that from the practical aspect, under the new practice of withholding tax from salary, the diminution becomes very apparent, more so than under the old system of giving the salary in full and making the official pay his income tax there-

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[1] G. R. Nos. L-6355 and 6356, Aug. 31, 1953.

[2] G. R. No. L-2348, Feb. 27, 1950.

[3] 307 U.S. 277.

from. The court further justified the exemption by saying that privileges in general and tax exemptions in particular are not unusual and exist in many forms and in favor of many officials and persons, natural or juridical. And in the case of judicial officers, the exemption is necessary to preserve the independence of the judiciary, not only of the Supreme Court, but also of all courts and also because of public policy and that as compared to the benefits, the amount which the government loses in income tax is negligible.

*Board of Tax Appeals; jurisdiction over decisions of Collector not exclusive.*

In the case of *University of Santo Tomas vs. Board of Tax Appeals* [4] the question was one of jurisdiction over appeals from the decisions of the Collector. Acting under Republic Act No. 422, the President of the Philippines issued Ex. Order No. 401-A, which Executive Order gives exclusive jurisdiction to the Board of Tax Appeals to decide all appeals from decisions of Collector in cases involving tax illegally collected; further prohibiting judicial action unless such appeal is first filed with B.T.A.; and provides for appeal to the Supreme Court from the rulings of the B.T.A. The purpose of said Republic Act was to effect reorganization of the different bureaus offices, agencies and instrumentalities of the executive branch of the government. The *University of Santo Tomas*, against whom P574, 811.43 was assessed as income tax for 1948-50, challenged the jurisdiction of the B.T.A. on the ground that Ex. Order No. 401-A deprives the Court of First Instance of its jurisdiction in cases involving recovery of taxes illegally collected, under sec. 306 of the Internal Revenue Code.

The Supreme Court held that the said executive Order deprives the CFI of its jurisdiction under the Internal Revenue Code, something which the President cannot do without encroaching upon the powers of Congress. Only Congress can deprive the CFI of its jurisdiction under the Internal Revenue Code over taxation cases, for under the Constitution [5] only Congress has the power to define, prescribe, and apportion the jurisdictions of the various courts. Ex. Order No. 401-A was declared null and void in so far as it interferes with the jurisdiction of CFI, but valid as to organization and functions of B.T.A.

The decision, however, declaring the Ex. Order null and void in so far as it interferes with the jurisdiction of the CFI and at the

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[4] G. R. No. L-5701, June 23, 1953.
[5] Art. VIII, Sec. 2.
[6] G. R. No. L-5157, April 27, 1953.

same time declaring it valid as to the organization and functions of the B.T.A., leaves much to be desired in term of clarity. It could mean that an ordinary action may be filed wilth the CFI after an adverse decision from the B.T.A. It could also mean that the taxpayer has a choice of action. He may directly bring the action to the CFI or to the B.T.A. and in the latter case, an appeal must be brought to the Supreme Court, the actions being exclusive of each other. The second interpretation seems more reasonable from policy considerations.

*Grantees of Legislative Franchise not subject to tax.*

The case of *Visayan Electric Co., vs. David* [6] is the latest reaffirmation of the holding in the case of *MRR vs. Rafferty,*[7] that a special law or charter cannot be amended, altered or replaced by a general law by implication. The plaintiff in this case is a sociedad anonima with principal office in Cebu City, whose business is to supply electric current. Under section 8 of Act No. 2499 (the franchise), the 2% tax therein imposed "shall be in lieu of all taxes at any time levied, established or collected by any authority whatever, now or in the future." But the Collector levied, assessed and collected from the plaintiff a five per cent tax on its gross earnings, on the ground that Sec. 259 of the Internal Revenue Code applies to all existing and future franchises, and should be deemed to have amended the charter or franchise. The court said that the principle involved is well-established in this jurisdiction, involving the ruling in the *MRR vs. Rafferty case* [8] and the recent *Philippine Railway vs. Collector case,*[9] where it was said that concessions and special laws approved and authorized by the legislature are of the nature of private contracts. And the reason why a general law cannot amend a special law is that the Legislature, in passing the special law, gave particular attention to the circumstances of a concrete case, which attention is not given in a general law, unless it manifests its intention to modify, alter or repal the special law. And while it is true that the franchise in question was granted under the condition that it may be altered, modified or repealed by the Legislature, such alteration, modification or repeal must be expressed, not merely deduced.

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[7] 40 J. F. 237. See also the case of *Philippine Railway Company vs. Collector,* G. R. No. L-3859, March 25, 1952.

[8] *Supra.*

[9] *Supra.* See also Annual Survey of Taxation, *Philippine Law Journal,* Vol. XXVIII, No. 1, page 70-71, February, 1953.

*Prescriptive period; Actions for recovery of internal revenue taxes prescribed in two years from payment.*

In the case of *P. J. Kiener Co., Ltd. vs. David,*[10] the controversy centered on the construction of Sec 306 of the Internal Revenue Code. Said section requires that a claim for refund first be filed with the Collector and at the same time makes it imperative that the suit in the CFI must be filed within two years from payment. Plaintiff contended that the two year period should not run during the pendency of the claim before the Collector. The Supreme Court, however, overruled such a contention and held that "all that the legislature intended in sec. 306 is that the Collector be given a chance to correct his error, if any before he is sued. His period of consideration was not intended to interrupt the two-year period, nor is the taxpayer prevented from bringing suit while the Collector is making his decision. The filing of claim with the Collector is intended as a notice or warning that unless tax is refunded, court action would follow." The taxpayer need not wait for the action by the Collector, if by so waiting, the two year period will lapse.

MUNICIPAL CORPORATIONS

*Power to tax Motor Vehicles void.*

In three cases,[11] the Supreme Court had occasion to declare Ordinance No. 3879 of the City of Manila null and void, as violative of the Motor Vehicles law and the rule of uniformity of taxation as ordained in the Constitution.

Ord. No. 3879 was purportedly an ordinance "levying a *property* tax on all motor vehicles operating within the city of Manila," and provides in its sec. 1 that the tax should be 1% ad valorem per annum, further that the proceeds shall accrue to the Street and Bridge Funds of the City and shall be expended exclusively for the repair, maintenance and improvement of its streets and bridges.

On the other hand, sec. 70(b) of the motor vehicles act provides that no fees may be exacted other than those therein provided, except *property* tax which may be imposed by a municipal corporation. Section 18(p) of Republic Act No. 409 confers upon the Municipal Board the power "to tax motor and other vehicles operating within the city of Manila the provision of any existing law to the contrary notwithstanding."

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[10] G. R. No. L-5163, April 22, 1953.

[11] *Association of Customs Brokers Inc. & G. Manlapit vs. Mun. Bd. et al.*, G. R. No. L-4376, May 22, 1953; *Phil. Motor Association et al. vs. Mun. Bd. et al.*, G. R. No. L-4442, May 22, 1953; *Borja vs. Manila*, G. R. No. L-6092, Dec. 24, 1953.

Simply stated, the question was whether the tax imposed was a property tax which the city may lawfully impose or an excise or license tax which the city cannot.

In the case first decided by the Supreme Court [12] the court held that it is a license tax saying that while as a rule, ad valorem tax is a property tax, the rule should not be taken in its absolute sense if the nature and purpose of the tax as gathered from the context show that it is in effect an excise tax." Quoting from the Corpus Juris,[13] "the character of tax as a property tax or a license or occupation tax must be determined by its incidents, and from the natural and legal effect of the language used in the act or ordinance, and not by the name by which it is described, or by the mode adopted in fixing the amount. If it is clearly a property tax, it will be so regarded, even though nominally and in form it is a license or occupation tax. On the other hand, if the tax is levied upon persons on account of their business, it will be construed as a license or occupation tax, even though graduated according to the property used in such business, or on the gross receipts of the business." The ordinance in question falls under the foregoing rule. While it is referred to as a property tax and it is fixed ad valorem, the court said that it cannot reject the idea that it is merely levied on motor vehicles operating within the city of Manila, with the main purpose of raising funds to be expended exclusively for the repairs and maintenance and improvement of the streets and bridges and the prohibition in the motor vehicles law is precisely to prevent the duplication in the imposition of fees for the same purpose.

The court also held that the ordinance infringes the rule of uniformity of taxation ordained in the Constitution because the tax is imposed only on the busses registered in Manila, while other busses contribute in no small degree to the deterioration of streets and public highways.

*Power to tax business establishments valid.*

While in this jurisdiction the power of a municipal corporation to extract fees must be expressly granted by the charter of statute and is not to be implied from the general power to license and regulate,[14] the grounds that may be offered to have the ordinance voided are many and varied. Thus in the case of *Uy Matiao & Co., Inc. vs. Cebu City*,[15] the plaintiff sought to have Ordinance No. 88, series

[12] *Asso. of Customs Brokers & Manlapit vs. Mun. Board, et al.*
[13] 37 C. J. 172.
[14] *Cu Unjieng vs. Patstone*, 42 Phil. 818, 862.
[15] G. R. No. L-4887, May 31, 1953.

of 1946 as amended by Ord. No. 46, series of 1947 voided of the following grounds: (1) the imposition is unauthorized; (2) it constitute specific tax prohibited by C.A. No. 472; (3) it contravenes national policy and C.A. 773, which accepted and approved the Ex. Agreement entered into by the U.S. President and the Philippine President, where it is provided that no export tax shall be imposed or collected by the Philippines on articles exported to the United States; (4) it denies equal protection; (5) it is unjust, unfair, discriminatory, oppressive, arbitrary and confiscatory; and (6) it deprives plaintiff of property without due process.

In reversing the decision of the lower court declaring the ordinances in question null and void, the Supreme Court held: (1) That Cebu is authorized to impose the tax (for the storage in wharehouses of copra and/or hemp, and/or for engaging in the buying and/or hemp in said city), under sec. 17 of C.A. No. 58 which gives the city the power to tax "establishments likely to endanger public safety or give rise to conflagrations or explosions; (2) That the tax is not a specific tax because it does not subject directly the goods to tax, but indirectly as an incident to the business to be taxed. It is a tax on the business of buying and selling or storing of copra; (3) That it is not a tax on export because it is imposed on all copra, whether for export or not; (4) That it does not deny equal protection because the tax as well as its exemptions applies equally to all persons, firms and corporations equally situated; (5) That the tax is not unfair, unjust, arbitrary and violative of uniformity of taxation merely because the basis of payment is not the value but the weight of the product. The tax becomes uniform by making weight as basis thereof. Fluctuation of prices does not make it uniform. P0.05 tax for 100 kilos or fraction thereof per month in not arbitrary but reasonable. The fact that the price of copra is going down and hemp is going up does not make the tax arbitrary; (6) That it does not deprive property without due process, because it is reasonable. Merchants can do business elsewhere.

*Power of Secretary of Finance over taxing power of Municipal Corporation.*

Section 4 of C.A. 472 provides: "The approval of the Secretary of Finance shall be secured: * * * (3) Whenever the municipal license tax on any business, occupation, or privilege the rate of which is not limited above is increased by more than fifty per cent." In the case of *Santos vs. Aquino et al.*,[16] the Supreme Court construed the above provision as impliedly granting to the Secretary the power

[16] G. R. No. L-5101, Nov. 28, 1953.

to reduce but not to increase the amount of the tax imposed by the ordinance. After implying the power to reduce, the Court said: "If the Congress has granted to the Secretary of Finance, the power to reduce taxes, there seems no congent reason for requiring the municipal council concerned to adopt another ordinance fixing the tax as reduced." It was the contention of the plaintiff in this case that as only municipal councils are authorized by law to adopt ordinances, after reduction by the Department of Finance, the municipal council should adopt another accepting or fixing the rate of tax as reduced. The Court said that this contention was without merit for the power and discretion exercised by the municipal council when it fixed the tax at a higher rate must be deemed to have been exercised by it when the Department of Finance reduced it to a lower rate. The greater includes the lesser. Furthermore, the adoption of another ordinance fixing the tax as reduced would be idle ceremony and waste of time.

Justice Reyes in his dissenting opinion said: "Under the Revised Administrative Code, legislative power of a municipality is lodged in the municipal council. While the exercise of that power is subject to a certain degree of supervisory control, under the principles of separation of powers, the veto power granted to the Secretary of Finance only authorizes that officer to approve or disapprove, and that it does not empower him to change, alter or modify the terms of the ordinance, for that would be investing an executive officer with legislative functions. The action of the Secretary can only be taken as a recommendation, so that the modified ordinance will have no effect until repassed."