COMMENT

THROUGH THE EYE OF THE JUDICIAL NEEDLE: FINDING NON-TRADITIONAL EXCEPTIONS TO SECTION 218*

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"The power to tax is not the power to destroy while this court sits."[1]

Taxes are said to be the price we pay for a civilized society.[2] The moment the symbiotic relationship between taxpayers and government turns parasitic, however, must a taxpayer play the part of the lamb led to the slaughter and be sacrificed at the altar of practical considerations? We submit that he may yet find succor in the courts' august halls.

I. LEGISLATIVE HISTORY OF SECTION 218 OF THE NATIONAL INTERNAL REVENUE CODE

The Philippine legal regime governing remedial and taxation law was derived from American sources.[3] Philippine remedial law was substantially derived from the Code of Civil Procedure of the State of California and the Federal Rules of Civil Procedure of the United States.[4] As for taxation, the original internal revenue law was Act No. 1189, patterned after the Internal Revenue Law then in force in the United States; the Act of Congress of July

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1 Graves v. New York, 306 U.S. 466 (1938).

2 Commissioner v. Algue, G.R. No. 28896, 158 SCRA 9, Feb. 17, 1988.

3 Campos Rueda Corp. v. Sta. Cruz Timber Co., Inc., No. 6884, 98 Phil. 627, 630, Mar. 21, 1956; Madrigal v. Rafferty, No. 12287, 38 Phil 414, 423, Aug. 7, 1918; El Oriente, Fabrica De Tabacos, Inc. v. Collector of Internal Revenue, No. 34774, 56 Phil. 147, 151, Sep. 21, 1931.

4 Garcia v. David, No. 45454, 67 Phil. 279, 283, Apr. 12, 1939; MANUEL MORAN, COMMENTS ON THE RULES OF COURT (1980).

13, 1866,[5] as amended by the Act of June 6, 1872.[6] Its section 52 expressly prohibited the issuance of injunctions against the collection of taxes.[7]

This prohibition was subsequently incorporated in the Internal Revenue Law of 1914 and the Revised Administrative Code enacted by the Philippine Commission:

> SECTION 139. Injunction not Available to Restrain Collection of Tax. – No court shall have authority to grant an injunction to restrain the collection of any internal-revenue tax.
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> SECTION 140. Recovery of Tax Paid Under Protest. – When the validity of any tax is questioned, or its amount disputed, or other question raised as to liability therefor, the person against whom or against whose property the same is sought to be enforced shall pay the tax under instant protest, or upon protest within ten days, and shall thereupon request the decision of the Collector of Internal Revenue. ...[8]
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> SECTION 1578. Injunction not available to restrain collection of tax. – No court shall have authority to grant an injunction to restrain the collection of any internal-revenue tax.[9]

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[5] Yee Poco & Co., Inc. v. Posadas, No. 43142, 64 Phil. 640, 654, Aug. 26,1937, *citing* 14 Stat. at L., ch. 184, at 152. Sarasola v. Trinidad, No. 14595, 40 Phil. 252, 256, Oct. 11, 1919, *citing* 14 Stat. at L., 475; sec. 32"4, U.S. Rev. Stat.

[6] Yee Poco, 64 Phil. at 654, *citing* 17 Stat. at L., ch. 315, at 257; Sarasola v. Trinidad, No. 14595, 40 Phil. 252, Oct. 11, 1919, *citing* 14 Stat. at L., 475; sec. 32"4, U.S. Rev. Stat.

[7] "No suit shall be maintained in any court for the recovery of any internal-revenue tax alleged to be excessive or collected without authority or of any sum alleged to be excessive or in any manner wrongfully collected, unless protest against such tax was made at the time of the payment thereof or within ten days thereafter nor until appeal shall have been duly made to the Collector of Internal Revenue and his decision has been had thereon: *Provided*, That if such decision is delayed six months from the date of appeal then the suit may be brought without first having the decision of the Collector of Internal Revenue: And *provided further*, That no suit shall be maintained in any court for such recovery unless the same is brought within two years next after the cause of action accrued: And *provided further*, That no courts shall have authority to grant an injunction restraining the collection of any taxes imposed by virtue of the provisions of this Act, but the remedy of the taxpayer who claims that he is unjustly assessed or taxed shall be by payment under protest of the sum claimed, from him by the Collector of Internal Revenue and by action to recover back the sum claimed to have been illegally collected."

[8] Act No. 2339, §§139-40 (1914).

[9] Act No. 2711, § 1578 (1917).

Substantially similar provisions were incorporated in the National Internal Revenue Codes of 1939, 1977, and 1997.[10] Given this history, an examination of the American experience lends insights into the prohibition.

III. AMERICAN PRECEDENTS ON THE ISSUANCE OF WRITS OF INJUNCTION AGAINST THE COLLECTION OF TAXES

A. EXCEPTIONS TO THE INJUNCTION BAR RULE

Although the prohibition was once considered absolute, a large number of American courts have since repudiated this doctrine and it is now common practice for courts of equity to exercise jurisdiction to enjoin the collection of a tax in certain limited cases.[11]

It is presumed that the prohibition is a proper and constitutional exercise of legislative power if some other adequate remedy remains open to the taxpayer.[12] Thus, where the available remedy is inadequate and the facts fall within a recognized area of equity jurisdiction, the courts may intervene. This is in line with the rule that a statute is construed in a manner that will avoid conflict with the Constitution.[13] Indeed, a number of American authorities assert that injunction lies despite statutory prohibitions:

> [T]his court likewise recognizes the rule that, in cases where complainant shows that in addition to the illegality of an exaction in the guise of a tax there exist special and extraordinary circumstances sufficient to bring the case within some acknowledged head of equity jurisprudence, a suit may be maintained to enjoin the collector.
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> It has never held the rule to be absolute, but has repeatedly indicated that extraordinary and exceptional circumstances render its provisions inapplicable.[14]

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[10] Com. Act No. 466 (1936); Pres. Decree No. 1158 (1977); Rep. Act No. 8424 (1997).

[11] 72 AM JUR 2D, §1115 (1974), *citing, e.g.,* Minturn v. Hays, 2 Cal. 590. The discussion that follows is drawn largely from 47B C.J.S. Internal Revenue §§ 774-76, Taxation § 804 (2004).

[12] Eddy v. Lee Twp., 73 Mich. 123, 40 N.W. 792 (1888); Black v. Geissler, 58 Okla. 335, 159 Pac. 1124 (1916); Raleigh & G.R. Co. v. Lewis, 99 N.C. 62, 5 S.E. 82 (1888); 72 Am Jur 2d, State and Local Taxation §1115 (1974); 77 A.L.R. 629, 630 (1932).

[13] 2A SUTHERLAND STATUTORY CONSTRUCTION, § 45:11 (6th ed.), *citing* American Federation of Labor and Congress of Indus. Organizations v. Kahn, 618 F.2d 784 (1979); AGPALO, *supra* note 14, at 266-69.

[14] Miller v. Standard Nut Margarine Co., 284 U.S. 498 (1932).

> . . .
> [T]his statute, which provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court," has been regarded in various cases as merely declaratory of the prior rule that courts of equity will not restrain the collection of a tax upon the sole ground of its illegality."[15]

The "exceptional circumstances" requirement is interrelated with the basis for equity jurisdiction. Thus, the test is whether the remedy at law is as complete, practical, and efficient.[16]

After the United States Internal Revenue Code was amended, American jurisprudence has held that courts will not issue a *writ* of injunction to restrain the collection of tax unless the tax is be illegal and there are extraordinary circumstances.[17] Invalidity alone does not justify injunction.[18] One case, for example, found that beyond such invalidity, its imposition would have destroyed the taxpayer's business, and that the Commissioner and some courts had ruled the plaintiff's product, and identical products produced by other manufacturers who were not being called upon to pay the tax, were not subject to it.[19]

In most cases where injunctions were permitted, the tax involved was in fact a penalty.[20] Where a true tax is involved, the circumstances involved must be shown as so special and extraordinary that an injunction would be justified.[21] American courts have formulated a two-pronged test.[22] First, the injury feared must be irreparable.[23] Second, it must be clear that the government cannot prevail even when the facts and law are examined in the light most favorable to it.[24]

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[15] Miller, 284 U.S. 498 (1932).

[16] Reider v. Rogan, 12 F.Supp. 307 (1935); Union Pacific Railroad Co. v. Weld County, 247 U.S. 282 (1918); Fredenberg v. Whitney, 240 F. 819 (1917).

[17] Mensik v. Long, 261 F.2d 45 (1958); Smith v. Flinn, 261 F.2d 781 (1958). The discussion that follows is drawn largely from 14 MERTENS, THE LAW OF FEDERAL INCOME TAXATION, § 49E.47 (2004).

[18] Voss v. Hinds, 208 F.2d 912 (1954).

[19] Miller, 284 U.S. 498.

[20] Mellon v. Mertz, 82 F.2d 872 (1936); Schenley Distillers, Inc. v. Bingler, 145 F.Supp. 517 (1956).

[21] Enochs v. Williams Packing & Navigation Co., Inc., 370 U.S. 1 (1962); Baker v. Dist. Dir. of Internal Revenue, 348 F.Supp. 524 (1972).

[22] Enochs, 370 U.S. 1; Starr v. Salemi, 329 F.Supp. 1150 (1971).

[23] Enochs, 370 U.S. 1.

[24] 14 MERTENS, *supra* note 25, §49E.47.

However, irreparable injury *per se* has been deemed insufficient to justify injunction. An injury is considered irreparable if it is of such constant and frequent recurrence that no fair or reasonable redress can be had therefore in a court of law or where there is no standard by which their amount can be measured with reasonable accuracy, that is, it is not susceptible of mathematical computation.[25] It is emphasized that the applicant must prove extraordinary circumstances exist in his case, such as his possible ruin.[26] Thus, in some extreme cases, taxpayers established their poverty to the point that the tax would be a cruel and unusual hardship. Courts have drawn distinctions between deprivation of necessities, which would result in failure to support one's family, and protection from monetary harm compensable at a later date.[27]

Although such cases were decided after the repeal of the American prohibition, it is submitted that these precedents remain useful to a discussion of the Philippine counterpart.

B. PROCEDURAL REQUIREMENTS FOR AN INJUNCTION

American courts have applied the general procedural rules for injunctions to proceedings to enjoin tax collection. These are summarized:

a. Real parties in interest

1) All persons who are materially interested in the outcome of the suit, or who will be affected by the decree, should be made parties, either as plaintiffs or defendants;[28]

2) Plaintiff must show that he has such right, title, and interest in the proceeds of the tax, the collection of which he seeks to enjoin, as would result in specific injury to him if he pays the tax;[29]

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[25] Phil. Virginia Tobacco Administration v. De los Angeles, G.R. 27829, 164 SCRA 543, Aug. 19, 1988, *citing* Ollundorff v. Abrahanson, No. 13228, 38 Phil. 585, September 13, 1918.

[26] 108 A.L.R. 205 [Injunction, § 142] (1937); Larabee Flour Mills v. Nee, 11 F.Supp. 132 (1935).

[27] McFarland v. U.S., 52 AFTR 1584; Long v. United States, 148 F.Supp. 758 (1957); Williams Packing & Navigation Co., Inc. v. Enochs, 176 F.Supp. 168 (1959); Jensen v. Comm'r, 835 F.2d 196 (1987).

[28] United States v. Doyal, 462 F.2d 1357 (1972); Yannicelli v. Nash, 354 F.Supp. 143 (1973).

[29] Morris v. United States, 813 F.2d 343 (1987); Meridian Grain & Elevator Co. v. Fly, 12 F.Supp. 64 (1935); Wicomico County Comm'rs v. Bancroft, 135 F. 977 (1905).

3) If the tax is actually borne by others, such others are the real parties in interest, and they and not the complainant must bring the action;[30] and

4) In accordance with general rules, proper parties may be allowed to intervene.[31]

b. Manner of making allegations in pleadings

1) In a proceeding to enjoin the collection of a tax, the complaint must present a statement of facts which, if true, would entitle plaintiff to the relief sought;[32]
2) The complaint must allege facts that show that there is an illegal exaction in the guise of a tax;[33]
3) that there are unusual and extraordinary circumstances bringing the case within the limited exceptions to the prohibition of the statute against suits to restrain the collection of taxes;[34] and
4) Subject to the ordinary rules of pleading in injunction suits generally, the petition or complaint must state a good cause of action,[35] and must plead facts, allowing the court to draw the legal conclusions therefrom.[36]

c. Evidentiary requirements; Burden of proof

1) In an action to enjoin the collection of a tax, the burden is on plaintiff to prove all the essential allegations of his complaint;[37]
2) A taxpayer has the burden of proof to show that he falls within the exceptions to the statutory prohibition against suits to restrain the collection of a tax;[38]
3) A party who seeks the return of property wrongfully levied upon by the Internal Revenue Service retains the ultimate burden of proof in its attempt to persuade the court that the government

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[30] Meridian Grain, 12 F.Supp. 64.

[31] St. Louis Southwestern Ry. Co. v. Yates, 23 F.2d 283 (1927).

[32] Singleton v. Mathis, 284 F.2d 616 (1960); Hubbard Inv. Co. v. Brast, 59 F.2d 709 (1932).

[33] Bennett v. United States Dir. of Internal Revenue, 468 F.2d 584 (1972).

[34] Jensen v. Internal Revenue Service, 835 F.2d 196 (1987); Vorachek v. United States, 337 F.2d 797 (1964).

[35] Ken Realty Co. v. Johnson, 46 F.Supp. 408 (1942).

[36] Ray v. Armstrong, 140 Ky. 800, 131 S.W. 1039 (1910).

[37] Schildcrout v. McKeever, 580 F.2d 994 (1978).

[38] Thornton v. United States, 493 F.2d 164 (1974); Dietrich v. Alexander, 427 F.Supp. 135 (1977).

action should be overturned.[39] However, the burden is on the IRS to justify the extraordinary action of connecting an ostensible third party's property to a particular delinquent taxpayer;[40]

4) In a proceeding to enjoin the collection of a tax, plaintiff must prove his allegations by at least a preponderance of the evidence;[41]
5) The ordinary rules of evidence in suits for injunctions apply to injunction suits to restrain assessments, as, for example, the rules regulating the presumptions[42] and burden of proof,[43] and its weight and sufficiency;[44] and
6) Moreover, pursuant to general rules, issues outside the scope of the case as presented by the pleadings are not before the court for determination[45] and every fact put into issue in the injunction proceeding must be proved.[46]

d. Time to sue

1) In accordance with the general rules governing suits for injunctions, suits to enjoin tax assessments must be seasonably begun,[47] since a court of equity will enjoin assessments only where the injured person has been diligent in his or her own protection.[48]

Again, however, there are substantial differences in the requirements for a *writ* of injunction in an ordinary civil action and one to enjoin the collection of a tax,[49] and the latter are stricter.

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[39] Security Counselors, Inc. v. United States, 860 F.2d 867 (1988); Valley Finance, Inc. v. United States, 629 F.2d 162 (1980).

[40] 47B C.J.S. Internal Revenue § 778.

[41] Marlin, Inc. v. Indiana Dept. of Internal Revenue, 512 N.E.2d 475 (1986); Follum v. United States, 81 A.F.T.R. 2d 98-2008 (1998); Red Star Yeast & Products Co. v. La Budde, 83 F.2d 394; Patrick v. United States, 524 F.2d 1109 (1975).

[42] Pardee v. Schuylkill County, 276 Pa. 246, 120 A. 139 (1923).

[43] Hale v. Jefferson County, 39 Mont. 137, 101 P. 973 (1909).

[44] Tacoma Ry. & Power Co. v. Pierce County, 193 F. 90 (1910).

[45] Western Union Telegraph Co. v. Wilcox, 85 F.2d 352 (1936).

[46] 84 C.J.S. Taxation § 804.

[47] Owens-Illinois, Inc. v. Little Cypress-Mauriceville Independent School Dist., 481 S.W.2d 477 (1972).

[48] Sanitary District of Chicago v. Young, 285 Ill. 351, 120 N.E. 818 (1918).

[49] *See* RULES OF COURT, Rule 58, §§ 3, 5.

Regarding the doctrine of exhaustion of administrative remedies, the Philippine Supreme Court has summarized the exceptions:

> (1) when there is a violation of due process, (2) when the issue involved is purely a legal question, (3) when the administrative action is patently illegal amounting to lack or excess of jurisdiction, (4) when there is estoppel on the part of the administrative agency concerned, (5) when there is irreparable injury, (6) when the respondent is a department secretary whose acts as an alter ego of the President bears the implied and assumed approval of the latter, (7) when to require exhaustion of administrative remedies would be unreasonable, (8) when it would amount to a nullification of a claim, (9) when the subject matter is a private land in land case proceedings, (10) when the rule does not provide a plain, speedy and adequate remedy, and (11) when there are circumstances indicating the urgency of judicial intervention.[50]

Regarding the doctrine of state immunity from suit, it is well-settled that an action to enjoin the act of a public officer is not a suit against the State for the reason that it does not compel it to take affirmative action, such as the appropriation of the needed amount, to satisfy the judgment.[51] Thus, the doctrine does not apply.

IV. THE PHILIPPINE REGIME GOVERNING INJUNCTIONS AGAINST COLLECTION OF TAXES

Section 218 of the National Internal Revenue Code states:

> No court shall have the authority to grant an injunction to restrain the collection of any national internal revenue tax, fee or charge imposed by this Code.[52]

The only exception is found in the Court of Tax Appeals ("CTA") charter:

> SECTION 11. *Who may appeal; effect of appeal.* – Any person association or corporation adversely affected by a decision or ruling of the Collector of Internal Revenue, the Collector of Customs or any provincial or city Board of Assessment Appeals may file an appeal in the Court of Tax Appeals within thirty days after the receipt of such decision or ruling.

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[50] Paat v. Court of Appeals, G.R. 111107, 266 SCRA 167, 176-77, Jan. 10, 1997.
[51] Sanders v. Veridiano, G.R. No. 46930, 162 SCRA 88, Jun. 10, 1988.
[52] Rep. Act No. 8424, § 218 (1997).

> No appeal taken by the Court of Appeals from the decision of the Collector of Internal Revenue or the Collector of Customs shall suspend the payment, levy, distraint, and or sale of any property of the taxpayer for the satisfaction of his tax liability as provided by existing law; *Provided, however*, That when in the opinion of the Court the collection by the Bureau of Internal Revenue or the Commissioner of Customs may jeopardize the interest of the Government and/or the taxpayer the Court at any stage of the proceeding may suspend the said collection and require the taxpayer either to deposit the amount claimed or to file a surety bond for not more than double the amount with the Court....[53]

Aggrieved taxpayers may appeal a final assessment made by the Commissioner of Internal Revenue or his agents to the CTA and apply for an injunction at this level after depositing the amount claimed or filing a surety bond.[54] However, this is hardly a swift remedy. Prior to an appeal, a taxpayer must first administratively protest against a formal letter of demand and assessment notice within thirty days from receipt. If this is denied, he may appeal to the CTA. However, the Commissioner is given 180 days from submission to act on the protest, and the taxpayer may only make the appeal after the lapse of this 180-day period.[55] Moreover, Bureau Revenue Regulations prescribe that no action shall be taken on the issues a taxpayer disputes until he has paid the deficiency taxes pertaining to undisputed issues:

> 3.1.5 Disputed Assessment. – The taxpayer or his duly authorized representative may protest administratively against the aforesaid formal letter of demand and assessment notice within thirty (30) days from date of receipt thereof. If there are several issues involved in the formal letter of demand and assessment notice but the taxpayer only disputes or protests against the validity of some of the issues raised, the taxpayer shall be required to pay the deficiency tax or taxes attributable to the undisputed issues, in which case, a collection letter shall be issued to the taxpayer calling for payment of the said deficiency tax, inclusive of the applicable surcharge and/or interest. No action shall be taken on the taxpayer's disputed issues until the taxpayer has paid the deficiency tax or taxes attributable to the said undisputed issues. The prescriptive period for assessment or collection of the tax or taxes attributable to the disputed issues shall be suspended.[56]

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[53] Rep. Act No. 1125, § 11 (1954).

[54] Comm'r of Customs v. Alikpala, 32542, 36 SCRA 208, 216, Nov. 26, 1970.

[55] Rep. Act No. 8424, § 228 (1997).

[56] Rev. Regs. No. 12-99, § 3.1.5 (1999).

In certain situations, the administrative remedies provided may be inadequate. For example, a taxpayer may have paid his obligations but be unable to maintain an administrative protest. Assume that *Corporation X* is in the process of expanding its business operations and has used up its excess cash as well as its lines of credit, secured and unsecured, for this purpose. As a result, it only has enough funds for working capital requirements. Being the diligent taxpayer, it pays taxes to an authorized agent bank of the Bureau of Internal Revenue (BIR) before the date required by law. However, the last amount it paid is subsequently misappropriated by BIR employees. As BIR records show that it failed to pay the taxes due, the Bureau issues a formal assessment notice outlining demanding the immediate payment of outstanding tax liabilities amounting to PHP100,000,000.00.

Under current Revenue Regulations,[57] the Bureau will not take action on *Corporation X's* motion for reconsideration or reinvestigation unless the latter first pays the alleged deficiency. However, it is unable to comply with this requirement due to its current state of liquidity. Undeniably, the corporation is effectively deprived of its remedy. This result is arguably exceptional enough to justify relief, and it is submitted that the statutory prohibition must be interpreted accordingly.

Notably, the Philippine Supreme Court has had occasion to pass upon similar arguments in *Sarasola v. Trinidad*:[58]

> The broad principle is that every taxpayer has a right to a remedy for any actual wrong he may have suffered in the collection of taxes. Usually a party will find a plain and sufficient remedy for the injuries complained of, or threatened, in the courts of law; in such instances, equity will not take jurisdiction. "Presumptively," Judge Cooley says, "the remedy at law is adequate." ... An exceptional circumstance which serves to take cases out of the general rule comes under the head of irreparable injury. In a decision of the United States Supreme Court in which this was explained it was remarked that there can be no case of equitable cognizance "where there is a plain and adequate remedy at law. And except where the special circumstances which we have mentioned exist, the party of whom an illegal tax is collected has ordinarily ample remedy, either by action against the officer making the collection or the body to whom the tax is paid." Accordingly, it was held that since the plaintiff had his action after the tax was paid "against the officer or the city to recover back the money," a bill in equity to restrain the collection of a tax would not be sustained. If the

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[57] § 3.1.5.

[58] No. 14595, 40 Phil 252, October 11, 1919.

> ground alleged is alone that the tax was illegal, this is not sufficient for the maintenance of an injunction. (internal citations omitted).[59]

This excerpt confirms that the Court recognizes exceptions based on irreparable injury and exceptional circumstances. This conforms to the views in American authorities, as earlier presented.

It is public knowledge that the Philippine government is currently on the brink of a fiscal crisis. Nevertheless, the direst of circumstances should never sanction the oppression of innocents or the emasculation of basic constitutional rights so dearly held by society. It is submitted that a rational compromise between legal and practical considerations may be adopted under our present legal regime on taxation. The extraordinary but not insurmountable bar of exceptional circumstances protects the State from frivolous and vexatious suits for injunction, but allows the taxpayer an avenue for relief in the cases where such is justified.

It is hoped that this humble opinion leads to a reexamination of the injunction bar rule and a more equitable application of the law.

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[59] *Id.* at 256