Republic of the Philippines
Supreme Court
Manila

**FIRST DIVISION**

**COMMISSIONER OF INTERNAL REVENUE,**
Petitioner,

- versus -

**PILIPINAS SHELL PETROLEUM CORPORATION,**
Respondent.

**G.R. No. 188497**

Present:

SERENO, *C.J.*,
*Chairperson*,
LEONARDO-DE CASTRO,
BERSAMIN,
VILLARAMA, JR., and
REYES, *JJ.*

Promulgated:

FEB 19 2014

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## RESOLUTION

**VILLARAMA, JR., *J.*:**

For resolution are the Motion for Reconsideration dated May 22, 2012 and Supplemental Motion for Reconsideration dated December 12, 2012 filed by Pilipinas Shell Petroleum Corporation (respondent). As directed, the Solicitor General on behalf of petitioner Commissioner of Internal Revenue filed their Comment, to which respondent filed its Reply.

In our Decision promulgated on April 25, 2012, we ruled that the Court of Tax Appeals (CTA) erred in granting respondent's claim for tax refund because the latter failed to establish a tax exemption in its favor under Section 135(a) of the National Internal Revenue Code of 1997 (NIRC).

> WHEREFORE, the petition for review on certiorari is GRANTED. The Decision dated March 25, 2009 and Resolution dated June 24, 2009 of the Court of Tax Appeals *En Banc* in CTA EB No. 415 are hereby REVERSED and SET ASIDE. The claims for tax refund or credit filed by respondent Pilipinas Shell Petroleum Corporation are DENIED for lack of basis.
>
> No pronouncement as to costs.

SO ORDERED.[1]

Respondent argues that a plain reading of Section 135 of the NIRC reveals that it is the petroleum products sold to international carriers which are exempt from excise tax for which reason no excise taxes are deemed to have been due in the first place. It points out that excise tax being an indirect tax, Section 135 in relation to Section 148 should be interpreted as referring to a tax exemption from the point of production and removal from the place of production considering that it is only at that point that an excise tax is imposed. The situation is unlike the value-added tax (VAT) which is imposed at every point of turnover – from production to wholesale, to retail and to end-consumer. Respondent thus concludes that exemption could only refer to the imposition of the tax on the statutory seller, in this case the respondent. This is because when a tax paid by the statutory seller is passed on to the buyer it is no longer in the nature of a tax but an added cost to the purchase price of the product sold.

Respondent also contends that our ruling that Section 135 only prohibits local petroleum manufacturers like respondent from shifting the burden of excise tax to international carriers has adverse economic impact as it severely curtails the domestic oil industry. Requiring local petroleum manufacturers to absorb the tax burden in the sale of its products to international carriers is contrary to the State's policy of "protecting gasoline dealers and distributors from unfair and onerous trade conditions," and places them at a competitive disadvantage since foreign oil producers, particularly those whose governments with which we have entered into bilateral service agreements, are not subject to excise tax for the same transaction. Respondent fears this could lead to cessation of supply of petroleum products to international carriers, retrenchment of employees of domestic manufacturers/producers to prevent further losses, or worse, shutting down of their production of jet A-1 fuel and aviation gas due to unprofitability of sustaining operations. Under this scenario, participation of Filipino capital, management and labor in the domestic oil industry is effectively diminished.

Lastly, respondent asserts that the imposition by the Philippine Government of excise tax on petroleum products sold to international carriers is in violation of the Chicago Convention on International Aviation ("Chicago Convention") to which it is a signatory, as well as other international agreements (the Republic of the Philippines' air transport agreements with the United States of America, Netherlands, Belgium and Japan).

In his Comment, the Solicitor General underscores the statutory basis of this Court's ruling that the exemption under Section 135 does not attach to

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[1] *Commissioner of Internal Revenue v. Pilipinas Shell Petroleum Corporation*, G.R. No. 188497, April 25, 2012, 671 SCRA 241, 264.

the products. Citing *Exxonmobil Petroleum & Chemical Holdings, Inc.-Philippine Branch v. Commissioner of Internal Revenue*,[2] which held that the excise tax, when passed on to the purchaser, becomes part of the purchase price, the Solicitor General claims this refutes respondent's theory that the exemption attaches to the petroleum product itself and not to the purchaser for it would have been erroneous for the seller to pay the excise tax and inequitable to pass it on to the purchaser if the excise tax exemption attaches to the product.

As to respondent's reliance in the cases of *Silkair (Singapore) Pte. Ltd. v. Commissioner of Internal Revenue*[3] and *Exxonmobil Petroleum & Chemical Holdings, Inc.-Philippine Branch v. Commissioner of Internal Revenue*,[4] the Solicitor General points out that there was no pronouncement in these cases that petroleum manufacturers selling petroleum products to international carriers are exempt from paying excise taxes. In fact, *Exxonmobil* even cited the case of *Philippine Acetylene Co, Inc. v. Commissioner of Internal Revenue*.[5] Further, the ruling in *Maceda v. Macaraig, Jr*.[6] which confirms that Section 135 does not intend to exempt manufacturers or producers of petroleum products from the payment of excise tax.

The Court will now address the principal arguments proffered by respondent: (1) Section 135 intended the tax exemption to apply to petroleum products at the point of production; (2) *Philippine Acetylene Co., Inc. v. Commissioner of Internal Revenue* and *Maceda v. Macaraig, Jr.* are inapplicable in the light of previous rulings of the Bureau of Internal Revenue (BIR) and the CTA that the excise tax on petroleum products sold to international carriers for use or consumption outside the Philippines attaches to the article when sold to said international carriers, as it is the article which is exempt from the tax, not the international carrier; and (3) the Decision of this Court will not only have adverse impact on the domestic oil industry but is also in violation of international agreements on aviation.

Under Section 129 of the NIRC, excise taxes are those applied to goods manufactured or produced in the Philippines for domestic sale or consumption or for any other disposition and to things imported. Excise taxes as used in our Tax Code fall under two types – (1) *specific tax* which is based on weight or volume capacity and other physical unit of measurement, and (2) *ad valorem tax* which is based on selling price or other specified value of the goods. Aviation fuel is subject to specific tax under Section 148 (g) which attaches to said product "as soon as they are in existence as such."

On this point, the clarification made by our esteemed colleague,

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2 G.R. No. 180909, January 19, 2011, 640 SCRA 203.
3 G.R. No. 166482, January 25, 2012, 664 SCRA 33.
4 Supra note 2.
5 No. L-19707, August 17, 1967, 20 SCRA 1056.
6 G.R. No. 88291, June 8, 1993, 223 SCRA 217.

Associate Justice Lucas P. Bersamin regarding the traditional meaning of excise tax adopted in our Decision, is well-taken.

The transformation undergone by the term "excise tax" from its traditional concept up to its current definition in our Tax Code was explained in the case of *Petron Corporation v. Tiangco*,[7] as follows:

> Admittedly, the proffered definition of an excise tax as "a tax upon the performance, carrying on, or exercise of some right, privilege, activity, calling or occupation" derives from the compendium *American Jurisprudence,* popularly referred to as *Am Jur* and has been cited in previous decisions of this Court, including those cited by Petron itself. Such a definition would not have been inconsistent with previous incarnations of our Tax Code, such as the NIRC of 1939, as amended, or the NIRC of 1977 because in those laws the term "excise tax" was not used at all. In contrast, the nomenclature used in those prior laws in referring to taxes imposed on specific articles was "specific tax." Yet beginning with the National Internal Revenue Code of 1986, as amended, the term "excise taxes" was used and defined as applicable "to goods manufactured or produced in the Philippines… and to things imported." This definition was carried over into the present NIRC of 1997. Further, these two latest codes categorize two different kinds of excise taxes: "specific tax" which is imposed and based on weight or volume capacity or any other physical unit of measurement; and "*ad valorem* tax" which is imposed and based on the selling price or other specified value of the goods. In other words, **the meaning of "excise tax" has undergone a transformation, morphing from the *Am Jur* definition to its current signification which is a tax on certain specified goods or articles.**
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> The change in perspective brought forth by the use of the term "excise tax" in a different connotation was not lost on the departed author Jose Nolledo as he accorded divergent treatments in his 1973 and 1994 commentaries on our tax laws. Writing in 1973, and essentially alluding to the *Am Jur* definition of "excise tax," Nolledo observed:
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> > Are specific taxes, taxes on property or excise taxes –
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> > > In the case of *Meralco v. Trinidad* ([G.R.] 16738, 1925) it was held that specific taxes are property taxes, a ruling which seems to be erroneous. Specific taxes are truly excise taxes for the fact that the value of the property taxed is taken into account will not change the nature of the tax. It is correct to say that specific taxes are taxes on the privilege to import, manufacture and remove from storage certain articles specified by law.
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> In contrast, after the tax code was amended to classify specific taxes as a subset of excise taxes, Nolledo, in his 1994 commentaries, wrote:
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> > 1. *Excise taxes*, as used in the Tax Code, refers to taxes applicable to certain specified goods or articles manufactured or produced in the Philippines for domestic sale or consumption or for any other disposition and to

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[7] G.R. No. 158881, April 16, 2008, 551 SCRA 484.

> things imported into the Philippines. They are either *specific* or *ad valorem*.
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> 2. *Nature of excise taxes.* – They are imposed directly on certain specified goods. (*infra*) They are, therefore, taxes on property. (see Medina vs. City of Baguio, 91 Phil. 854.)
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> A tax is not excise where it does not subject directly the produce or goods to tax but indirectly as an incident to, or in connection with, the business to be taxed.

In their 2004 commentaries, De Leon and De Leon restate the *Am Jur* definition of excise tax, and observe that the term is "synonymous with 'privilege tax' and [both terms] are often used interchangeably." At the same time, they offer a caveat that "[e]xcise tax, as [defined by *Am Jur*], is not to be confused with excise tax imposed [by the NIRC] on certain specified articles manufactured or produced in, or imported into, the Philippines, 'for domestic sale or consumption or for any other disposition.'"

**It is evident that *Am Jur* aside, the current definition of an excise tax is that of a tax levied on a specific article, rather than one "upon the performance, carrying on, or the exercise of an activity."** This current definition was already in place when the Code was enacted in 1991, and we can only presume that it was what the Congress had intended as it specified that local government units could not impose "excise taxes on articles enumerated under the [NIRC]." This prohibition must pertain to the same kind of excise taxes as imposed by the NIRC, and not those previously defined "excise taxes" which were not integrated or denominated as such in our present tax law.[8] (Emphasis supplied.)

That excise tax as presently understood is a tax on property has no bearing at all on the issue of respondent's entitlement to refund. Nor does the nature of excise tax as an indirect tax supports respondent's postulation that the *tax exemption* provided in Sec. 135 attaches to the petroleum products themselves and consequently the domestic petroleum manufacturer is not liable for the payment of excise tax *at the point of production.* As already discussed in our Decision, to which Justice Bersamin concurs, "the accrual and payment of the excise tax on the goods enumerated under Title VI of the NIRC prior to their removal at the place of production are absolute and admit of no exception." This also underscores the fact that the exemption from payment of excise tax is conferred on international carriers who purchased the petroleum products of respondent.

On the basis of *Philippine Acetylene*, we held that a tax exemption being enjoyed by the buyer cannot be the basis of a claim for tax exemption by the manufacturer or seller of the goods for any tax due to it as the manufacturer or seller. The excise tax imposed on petroleum products under Section 148 is the direct liability of the manufacturer who cannot thus invoke the excise tax exemption granted to its buyers who are international

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[8] Id. at 492-493.

carriers. And following our pronouncement in *Maceda v. Macarig, Jr.* we further ruled that Section 135(a) should be construed as prohibiting the shifting of the burden of the excise tax to the international carriers who buy petroleum products from the local manufacturers. Said international carriers are thus allowed to purchase the petroleum products without the excise tax component which otherwise would have been added to the cost or price fixed by the local manufacturers or distributors/sellers.

Excise tax on aviation fuel used for international flights is practically nil as most countries are signatories to the 1944 Chicago Convention on International Aviation (Chicago Convention). Article 24[9] of the Convention has been interpreted to prohibit taxation of aircraft fuel consumed for international transport. Taxation of international air travel is presently at such low level that there has been an intensified debate on whether these should be increased to "finance development rather than simply to augment national tax revenue" considering the "cross-border environmental damage" caused by aircraft emissions that contribute to global warming, not to mention noise pollution and congestion at airports).[10] Mutual exemptions given under bilateral air service agreements are seen as main legal obstacles to the imposition of indirect taxes on aviation fuel. In response to present realities, the International Civil Aviation Organization (ICAO) has adopted policies on charges and emission-related taxes and charges.[11]

Section 135(a) of the NIRC and earlier amendments to the Tax Code represent our Governments' compliance with the Chicago Convention, its subsequent resolutions/annexes, and the air transport agreements entered into by the Philippine Government with various countries. The rationale for exemption of fuel from national and local taxes was expressed by ICAO as follows:

> ...The Council in 1951 adopted a Resolution and Recommendation on the taxation of fuel, a Resolution on the taxation of income and of aircraft, and a Resolution on taxes related to the sale or use of international air transport (cf. Doc 7145) which were further amended and amplified by the policy statements in Doc 8632 published in 1966. The Resolutions and Recommendation concerned were designed **to recognize the uniqueness of civil aviation and the need to accord tax exempt status to certain aspects of the operations of international air transport and were adopted because multiple taxation on the aircraft, fuel, technical supplies and the income of international air transport, as well as taxes**

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[9] Art. 24. Customs Duty

(a) Aircraft on a flight to, from, or across the territory of another contracting State shall be admitted temporarily free of duty, subject to the customs regulations of the State. Fuel, lubricating oils, spare parts, regular equipment and aircraft stores on board an aircraft of a contracting State, on arrival in the territory of another contracting State and retained on board on leaving the territory of that State shall be exempt from customs duty, inspection fees or similar national or local duties and charges. This exemption shall not apply to any quantities or articles unloaded, except in accordance with the customs regulations of the State, which may require that they shall be kept under customs supervision.

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[10] See "*Indirect Taxes on International Aviation"* by Michael Keen and Jon Strand, IMF Working Paper published in May 2006, sourced from Internet - *http://www.imf.org/external/pubs/ft/wp/2006/wp06124.pdf*

[11] Set out in the *Statements by the Council to Contracting States for Airports and Air Navigation Services* (Doc 9082) and Council Resolution on environmental charges adopted in December 1996.

> **on its sale and use, were considered as major obstacles to the further development of international air transport.** Non-observance of the principle of reciprocal exemption envisaged in these policies was also seen as risking retaliatory action with adverse repercussions on international air transport which plays a major role in the development and expansion of international trade and travel.[12]

In the 6th Meeting of the Worldwide Air Transport Conference (ATCONF) held on March 18-22, 2013 at Montreal, among matters agreed upon was that "the proliferation of various taxes and duties on *air transport* could have negative impact on the sustainable development of air transport and on consumers." Confirming that ICAO's policies on taxation remain valid, the Conference recommended that "ICAO promote more vigorously its policies and with industry stakeholders to develop analysis and guidance to States on the impact of taxes and other levies on air transport."[13] Even as said conference was being held, on March 7, 2013, President Benigno Aquino III has signed into law Republic Act (R.A.) No. 10378[14] granting tax incentives to foreign carriers which include exemption from the 12% value-added tax (VAT) and 2.5% gross Philippine billings tax (GPBT). GPBT is a form of income tax applied to international airlines or shipping companies. The law, based on reciprocal grant of similar tax exemptions to Philippine carriers, is expected to increase foreign tourist arrivals in the country.

Indeed, the avowed purpose of a tax exemption is always "some public benefit or interest, which the law-making body considers sufficient to offset the monetary loss entailed in the grant of the exemption."[15] The exemption from excise tax of aviation fuel purchased by international carriers for consumption outside the Philippines fulfills a treaty obligation pursuant to which our Government supports the promotion and expansion of international travel through avoidance of multiple taxation and ensuring the viability and safety of international air travel. In recent years, developing economies such as ours focused more serious attention to significant gains for business and tourism sectors as well. Even without such recent incidental benefit, States had long accepted the need for international cooperation in maintaining a capital intensive, labor intensive and fuel intensive airline industry, and recognized the major role of international air transport in the development of international trade and travel.

Under the basic international law principle of *pacta sunt servanda*, we have the duty to fulfill our treaty obligations in good faith. This entails

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12 *ICAO's Policies on Taxation in the Field of International Air Transport* (Document 8632-C/968), Introduction, Second Edition, January 1994. Sourced from Internet - http://www.icao.int/publications/Documents/8632_2ed_en.pdf

13 *Outcome of the Sixth Worldwide Air Transport Conference,* Item 2.6, accessed at - http://www.icao.int/Meetings/a38/Documents/WP/wp056_rev1_en.pdf

14 AN ACT RECOGNIZING THE PRINCIPLE OF RECIPROCITY AS BASIS FOR THE GRANT OF INCOME TAX EXEMPTIONS TO INTERNATIONAL CARRIERS AND RATIONALIZING OTHER TAXES IMPOSED THEREON BY AMENDING SECTIONS 28(A)(3)(a), 109, 118 AND 236 OF THE NATIONAL REVENUE CODE (NIRC), AS AMENDED, AND FOR OTHER PURPOSES (Approved on

15 *Commissioner of Internal Revenue, et al. v. Botelho Shipping Corp., et al.,* 126 Phil. 846, 851.

harmonization of national legislation with treaty provisions. In this case, Sec. 135(a) of the NIRC embodies our compliance with our undertakings under the Chicago Convention and various bilateral air service agreements not to impose excise tax on aviation fuel purchased by international carriers from domestic manufacturers or suppliers. In our Decision in this case, we interpreted Section 135 (a) as prohibiting domestic manufacturer or producer to pass on to international carriers the excise tax it had paid on petroleum products upon their removal from the place of production, pursuant to Article 148 and pertinent BIR regulations. Ruling on respondent's claim for tax refund of such paid excise taxes on petroleum products sold to tax-exempt international carriers, we found no basis in the Tax Code and jurisprudence to grant the refund of an "erroneously or illegally paid" tax.

Justice Bersamin argues that "(T)he shifting of the tax burden by manufacturers-sellers is a business prerogative resulting from the collective impact of market forces," and that it is "erroneous to construe Section 135(a) only as a prohibition against the shifting by the manufacturers-sellers of petroleum products of the tax burden to international carriers, for such construction will deprive the manufacturers-sellers of their business prerogative to determine the prices at which they can sell their products."

We maintain that Section 135 (a), in fulfillment of international agreement and practice to exempt aviation fuel from excise tax and other impositions, prohibits the passing of the excise tax to international carriers who buys petroleum products from local manufacturers/sellers such as respondent. However, we agree that there is a need to reexamine the *effect* of denying the domestic manufacturers/sellers' claim for refund of the excise taxes they already paid on petroleum products sold to international carriers, and its serious implications on our Government's commitment to the goals and objectives of the Chicago Convention.

The Chicago Convention, which established the legal framework for international civil aviation, did not deal comprehensively with tax matters. Article 24 (a) of the Convention simply provides that fuel and lubricating oils on board an aircraft of a Contracting State, on arrival in the territory of another Contracting State and retained on board on leaving the territory of that State, shall be exempt from customs duty, inspection fees or similar national or local duties and charges. Subsequently, the exemption of airlines from national taxes and customs duties on spare parts and fuel has become a standard element of bilateral air service agreements (ASAs) between individual countries.

The importance of exemption from aviation fuel tax was underscored in the following observation made by a British author[16] in a paper assessing the debate on using tax to control aviation emissions and the obstacles to introducing excise duty on aviation fuel, thus:

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[16] Antony Seely, *Taxing Aviation Fuel* (Standard Note SN00523, last updated 02 October 2012), House of Commons Library, accessed at *ww,parliament.uk/briefing-paper/SN00523.pdf*

> Without any international agreement on taxing fuel, it is highly likely that moves to impose duty on international flights, either at a domestic or European level, would encourage 'tankering': carriers filling their aircraft as full as possible whenever they landed outside the EU to avoid paying tax. Clearly this would be entirely counterproductive. Aircraft would be travelling further than necessary to fill up in low-tax jurisdictions; in addition they would be burning up more fuel when carrying the extra weight of a full fuel tank.

With the prospect of declining sales of aviation jet fuel sales to international carriers on account of major domestic oil companies' unwillingness to shoulder the burden of excise tax, or of petroleum products being sold to said carriers by local manufacturers or sellers at still high prices , the practice of "tankering" would not be discouraged. This scenario does not augur well for the Philippines' growing economy and the booming tourism industry. Worse, our Government would be risking retaliatory action under several bilateral agreements with various countries. Evidently, construction of the tax exemption provision in question should give primary consideration to its broad implications on our commitment under international agreements.

In view of the foregoing reasons, we find merit in respondent's motion for reconsideration. We therefore hold that respondent, as the statutory taxpayer who is directly liable to pay the excise tax on its petroleum products, is entitled to a refund or credit of the excise taxes it paid for petroleum products sold to international carriers, the latter having been granted exemption from the payment of said excise tax under Sec. 135 (a) of the NIRC.

**WHEREFORE,** the Court hereby resolves to:

(1) **GRANT** the original and supplemental motions for reconsideration filed by respondent Pilipinas Shell Petroleum Corporation; and

(2) **AFFIRM** the Decision dated March 25, 2009 and Resolution dated June 24, 2009 of the Court of Tax Appeals *En Banc* in CTA EB No. 415; and **DIRECT** petitioner Commissioner of Internal Revenue to refund or to issue a tax credit certificate to Pilipinas Shell Petroleum Corporation in the amount of ₱95,014,283.00 representing the excise taxes it paid on petroleum products sold to international carriers from October 2001 to June 2002.

**SO ORDERED.**

**MARTIN S. VILLARAMA, JR.**
Associate Justice

WE CONCUR:

**MARIA LOURDES P. A. SERENO**
Chief Justice
*Chairperson*

I concur but joins the opinion of J. Bersamin that the excise tax exemption applies to the product sold to international carriers, and not to the latter.
Teresita Leonardo de Castro

**TERESITA J. LEONARDO-DE CASTRO**
Associate Justice

Please see Separate Opinion

**LUCAS P. BERSAMIN**
Associate Justice

**BIENVENIDO L. REYES**
Associate Justice

## CERTIFICATION

Pursuant to Section 13, Article VIII of the 1987 Constitution, I certify that the conclusions in the above Resolution had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

**MARIA LOURDES P. A. SERENO**
Chief Justice