REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

SOUTH AFRICAN AIRWAYS, Petitioner,	**C.T.A. E.B. NO. 210** **(C.T.A. CASE NO. 6656)**
	Present:
- versus -	**ACOSTA,** *P.J.* **CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA,** *and* **PALANCA-ENRIQUEZ,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	**Promulgated:** JUL 19 2007

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DECISION

UY, J.:

This is a Petition for Review before the Court of Tax Appeals *En Banc* filed on September 15, 2006 under Republic Act No. 9282, seeking a review of the Decision and Resolution by the First Division of this Court (Court in Division) in CTA Case No. 6656, entitled "South African Airways vs. Commissioner of Internal Revenue", to wit:

1) Decision promulgated on May 10, 2006 denying herein petitioner's claim for refund or issuance of tax credit certificate in its favor in the amount of ONE MILLION SEVEN HUNDRED TWENTY SEVEN THOUSAND SEVEN HUNDRED SIXTY SIX and 38/100 PESOS (P1,727,766.38) representing erroneously paid tax on Gross Philippine Billings (GPB) for taxable year 2000; and

2) Resolution promulgated on August 11, 2006 denying herein petitioner's Motion for Reconsideration of the aforesaid Decision for lack of merit.

THE FACTS

The factual antecedents of the case are not in dispute.

Petitioner is a foreign corporation organized and existing under the laws of the Republic of South Africa with principal office at Airways Park, Jones Road, Johannesburg International Airport, South Africa. It is an off-line international air carrier having no landing rights in the Philippines, hence does not maintain flight operations to and from the Philippines. However, it maintains off-line flights for the carriage of passengers and cargo between ports or points outside the territorial jurisdiction of the Philippines. Petitioner has a general sales agent in the Philippines, Aerotel Limited Corporation, which, among others, sells passage documents for compensation or commission covering its off-line flights. Petitioner is not registered with the Securities and Exchange Commission as a corporation, branch office or partnership, and consequently, petitioner is not licensed to do business in the Philippines.

Respondent, on the other hand, is the duly appointed Commissioner of Internal Revenue who holds office at the 5th Floor of the BIR National Office Building, located at Agham Road, Diliman, Quezon City where he may be served with summons and other legal processes.

For taxable year 2000, petitioner filed through Aerotel separate quarterly and annual income tax returns for the carriage of passenger and cargo, detailed as follows:

	Period	Date Filed	2.5% Gross Philippine Billings	Exhibit
For Passenger	1ST Quarter	May 30, 2000	P 222,531.25	F
	2nd Quarter	August 29, 2000	424,046.95	G
	3rd Quarter	Nov. 29, 2000	422,466.00	H
	4th Quarter	April 16, 2000	453,182.91	J
Sub-total			P 1,522,227.11	
For Cargo	1ST Quarter	May 30, 2000	P 81,531.00	C
	2nd Quarter	August 29, 2000	50,169.65	D
	3rd Quarter	Nov. 29, 2000	36,383.74	E
	4th Quarter	April 16, 2000	37,454.88	I
Sub-total			P 205,539.27	
TOTAL			P 1,727,766.38	

On February 5, 2003, petitioner filed a formal claim for refund with Revenue District Office No. 47 of the Bureau of Internal Revenue for the recovery of the amount of P1,727,766.38 representing erroneously paid tax on Gross Philippine Billings for the taxable year 2000.

On April 14, 2003, petitioner filed a Petition for Review before this Court, docketed as C.T.A. Case No. 6656 due to alleged inaction of respondent on its claim.

On May 10, 2006, the Court in Division rendered its assailed Decision denying the petition for lack of merit. It ruled that petitioner, being a resident foreign corporation engaged in trade or business in the Philippines, is not liable to pay tax on Gross Philippine Billings as provided in Section

28(A)(3)(a) of the National Internal Revenue Code (NIRC) of 1997. However, it concluded by denying its claim for refund considering that petitioner is still liable to pay thirty two percent (32%) of its taxable income derived from its sales of passage documents here in the Philippines.

Likewise, finding no compelling reasons to either modify or alter the assailed Decision, the Court in Division denied petitioner's Motion for Reconsideration thereof in the assailed Resolution dated August 11, 2006.

Hence, this recourse before the Court *En Banc* praying that: (a) the Decision dated May 10, 2006 and the Resolution dated August 11, 2006 be reversed and set aside; (b) petitioner be declared as a non-resident foreign corporation and thus, not subject to the thirty two percent (32%) regular income tax on taxable income under Section 28(A)(1) of the NIRC of 1997; and (c) petitioner be declared as entitled to a refund or tax credit in the amount of P1,727,766.38 representing erroneously paid taxes on Gross Philippine Billings for taxable year 2000.

THE ISSUES

Petitioner submits the following issues for the resolution of the Court *En Banc*:

> "I. Whether or not petitioner, as an off-line international carrier selling passage documents through an independent sales agent in the Philippines, is engaged in trade or business in the Philippines subject to the 32% income tax imposed by Section 28(A)(1) of the 1997 NIRC.
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> II. Whether or not the income derived by petitioner from the sale of passage documents covering petitioner's off-line flights is Philippine-source income subject to Philippine income tax.

III. Whether or not the Honorable Court erred in denying petitioner's claim for refund of erroneously paid tax on Gross Philippine Billings for taxable year 2001 despite finding that petitioner is not subject to 2 ½% tax on Gross Philippine Billings.

IV. Whether or not petitioner is entitled to the refund of erroneously paid tax on Gross Philippine Billings for taxable year 2001 in the amount of P1,727,766.38."

In support of its Petition for Review, petitioner presents the following arguments:

a. "Petitioner, as an off-line international carrier, is not engaged in trade or business in the Philippines. Thus, it is not a resident foreign corporation subject to the 32% income tax imposed by Section 28(A) (1) of the 1997 NIRC on resident foreign corporations."

b. "Income taxation of international carriers is specifically covered by Section 28(A)(3) of the 1997 NIRC, imposing the 2 ½% tax on Gross Philippines Billings. Thus, it necessarily precludes the application of Section 28(A)(1) of the 1997 NIRC, which is a general provision of law imposing the 32% regular corporate income tax on resident foreign corporations."

c. "The denial of the instant claim for refund on the basis of the Honorable Court's determination that petitioner is subject to the 32% income tax has no legal basis and violates due process."

d. "The Honorable Court's Decision will result to an inequitable, absurd and unreasonable taxation among online and off-line international carriers."

Respondent filed its comment on October 16, 2006 and prayed for the denial of the present petition for being clearly bereft of merit and prayed that the Court issue an order declaring petitioner liable to the regular corporate tax rate of 32%. Accordingly, the case was deemed submitted for decision on October 31, 2006.

THE COURT EN BANC'S RULING

The petition is bereft of merit.

A careful and closer look at the arguments set forth by the petitioner in the instant petition for review would readily reveal that the grounds relied upon and the matters raised herein are mere restatements of petitioner's previous arguments raised before the Court in Division which had already been exhaustively discussed and passed upon by it in its assailed Decision and Resolution

Be that as it may, with the end view of further clarifying the decision of the Court in Division, We adhere to its findings on the focal issue as to whether or not petitioner is a resident foreign corporation engaged in trade or business in the country within the purview of our tax law and therefore subject to pay thirty two percent (32%) of its taxable income derived from its sales of passage documents here in the Philippines.

As correctly pointed out by the Court in Division, the Supreme Court has already sustained the validity of the aforesaid finding in several cases.[1] In the case of ***Commissioner of Internal Revenue vs. British Overseas Airways Corporation***,[2] the Supreme Court ruled:

> "The Tax Code defines 'gross income' thus:
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> 'Gross income' includes gains, profits, and income derived from salaries, wages or compensation for personal service of whatever kind and in whatever form paid, or from profession, vocations, trades, business, commerce, sales, or dealings in

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[1] Citing Commissioner of Internal Revenue vs. American Airlines, Inc. (180 SCRA 274 [1989]), Commissioner of Internal Revenue vs. British Overseas Airways, Corp. (149 SCRA 395 [1987]), and Commissioner of Internal Revenue vs. Japan Air Lines, Inc. (202 SCRA 450 [1991]).

[2] 149 SCRA 395 (1987).

property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interests, rents, dividends, securities, or the transactions of any business carried on for gain or profit, or gains, profits, and income derived from any source whatever' (Sec. 29[3]; Italics supplied)

The definition is broad and comprehensive to include proceeds from sales of transport documents. 'The words 'income from any source whatever' disclose a legislative policy to include all income not expressly exempted within the class of taxable income under our laws.' Income means 'cash received or its equivalent'; it is the amount of money coming to a person within a specific time x x x; it means something distinct from principal or capital. For, while capital is a fund, income is a flow. As used in our income tax law, 'income' refers to the flow of wealth.

The records show that the Philippine gross income of BOAC for the fiscal years 1968-69 to 1970-71 amounted to P10,428,368.00.

Did such 'flow of wealth' come from 'sources within the Philippines'?

The source of an income is the property, activity or service that produced the income. For the source of income to be considered as coming from the Philippines, it is sufficient that the income is derived from activity within the Philippines. In BOAC's case, the sale of tickets in the Philippines is the activity that produces the income. The tickets exchanged hands here and payments for fares were also made here in Philippine currency. The situs of the source of payments is the Philippines. The flow of wealth proceeded from, and occurred within, Philippine territory, enjoying the protection accorded by the Philippine government. In consideration of such protection, the flow of wealth should share the burden of supporting the government.

A transportation ticket is not a mere piece of paper. When issued by a common carrier, it constitutes the contract between the ticket-holder and the carrier. It gives rise to the obligation of the purchaser of the ticket to pay the fare and the corresponding obligation of the carrier to transport the passenger upon the terms and conditions set forth thereon. The ordinary ticket issued to members of the travelling public in general embraces within its terms all the elements to constitute it a valid contract, binding upon the parties entering into the relationship.

True, Section 37 (a) of the Tax Code, which enumerates items of gross income from sources within the Philippines, namely: (1) interest, (2) dividends, (3) service, (4) rentals and royalties, (5) sale of real property, and (6) sale of personal property, does not mention income from the sale of tickets for international transportation. However, that does not render it less an income from sources within the Philippines. Section 37, by its language, does not intend the enumeration to be exclusive. It merely directs that the types of income listed therein be treated as income from sources within the Philippines. A cursory reading of the section will show that it does not state that it is an all-inclusive enumeration, and that no other kind of income may be so considered."

In the more recent case of ***Commissioner of Internal Revenue vs. Baier-Nickel***,[3] the Supreme Court reiterated the ruling in ***Commissioner of Internal Revenue vs. British Overseas Airways Corporation***,[4] stating:

"In *Commissioner of Internal Revenue v. British Overseas Airways Corporation (BOAC)*, the issue was whether BOAC, a foreign airline company which does not maintain any flight to and from the Philippines is liable for Philippine income taxation in respect of sales of air tickets in the Philippines, through a general sales agent relating to the carriage of passengers and cargo between two points both outside the Philippines. Ruling in the affirmative, the Court applied the case of *Alexander Howden & Co., Ltd. v. Collector of Internal Revenue*, and reiterated the rule that the source of income is that 'activity' which produced the income. It was held that the 'sale of tickets' in the Philippines is the 'activity' that produced the income and therefore BOAC should pay income tax in the Philippines because it undertook an income producing activity in the country.

Both the petitioner and respondent cited the case of *Commissioner of Internal Revenue v. British Overseas Airways Corporation* in support of their arguments, but the correct interpretation of the said case favors the theory of respondent that it is the *situs* of the activity that determines whether such income is taxable in the Philippines. The conflict between the majority and the dissenting opinion in the said case has nothing to do with the underlying principle of the law on sourcing of

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[3] 500 SCRA 87 (2006).
[4] Supra.

> income. In fact, both applied the case of *Alexander Howden & Co., Ltd. v. Collector of Internal Revenue*. The divergence in opinion centered on whether the sale of tickets in the Philippines is to be construed as the 'activity' that produced the income, as viewed by the majority, or merely the physical source of income, as ratiocinated by Justice Florentino P. Feliciano in his dissent. The majority through Justice Ameurfina Melencio-Herrera, as *ponente*, interpreted the sale of tickets as a business activity that gave rise to the income of BOAC. Petitioner cannot therefore invoke said case to support its view that source of income is the physical source of the money earned. If such was the interpretation of the majority, the Court would have simply stated that source of income is not the business activity of BOAC but the place where the person or entity disbursing the income is located or where BOAC physically received the same. But such was not the import of the ruling of the Court. It even explained in detail the **business activity** undertaken by BOAC in the Philippines to pinpoint the taxable activity and to justify its conclusion that BOAC is subject to Philippine income taxation.
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> xxx xxx xxx."

Applying the afore-cited decisions of the Supreme Court in the case at bench, We affirm the Court in Division's ruling that the petitioner is a resident foreign corporation doing business in the Philippines and the income earned from its flight operations outside the Philippines is subject to an income tax rate of 32% under Section 28 of the NIRC of 1997, as amended.

Considering, therefore, that petitioner is a resident foreign corporation doing business in the Philippines, pursuant to Section 28(A)(1) of the NIRC of 1997, as amended, it shall be subject to an income tax equivalent to 32% of the taxable income derived from its sale of passage documents here in the Philippines. Having received income while engaged in business and utilizing the resources available to it within the Philippines, and considering that it is not a tax exempt corporation, petitioner cannot claim that it is not liable to the

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regular income tax of 32% of its taxable income here. It cannot escape tax liability from the clear provisions of the Philippine tax laws.

To reiterate, the absence of flight operations to and from the Philippines is not determinative of the source of income for purposes of ascertaining income tax liability. It is sufficient that the income is derived from activity within the Philippine territory. Therefore, petitioner is a resident foreign corporation doing business in the Philippines within the purview of our tax law and the income earned from its flight operations outside the Philippines is subject to an income tax rate of 32% under Section 28 of the NIRC of 1997, as amended.

Another issue worth mentioning is the matter raised by petitioner regarding the applicability of Revenue Regulations No. 15-2002 which does not consider an off-line airline having a branch office or sales agent in the Philippines selling passage documents, engaged in business as an international air carrier in the Philippines. This has already been properly addressed by the Court in Division in the assailed Decision where it ruled that the aforesaid regulation is not applicable in the instant case considering that the same only took effect on October 26, 2002 while the transaction covered by the present claim is taxable period 2000.

It is worthy to note that judicial decisions of the Supreme Court applying and interpreting the law shall form part of the legal system of the Philippines.[5] And it bears stressing that the BOAC decision has not been

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[5] Article 8, New Civil Code.

reversed nor modified by the Supreme Court and was again applied by the Supreme Court in the most recent case of ***Commissioner of Internal Revenue vs. Baier-Nickel***[6] promulgated on August 29, 2006.

The rule in this jurisdiction is that "[t]ax refunds are in the nature of tax exemptions. As such, they are regarded as in derogation of sovereign authority and to be construed *strictissimi juris* against the person claiming the exemption".[7]

In the light of the foregoing discussions, the Court *En Banc* finds no reversible error committed by the Court in Division when it rendered its assailed Decision and Resolution dated May 10, 2006 and August 11, 2006, respectively.

WHEREFORE, premises considered, the instant petition is hereby **DENIED** for lack of merit.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

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[6] Supra.
[7] Commissioner of Internal Revenue vs. Procter and Gamble Philippine Manufacturing Corporation (204 SCRA 377 [1991]) and Commissioner of Internal Revenue vs. S. C. Johnson & Son, Inc. (309 SCRA 87 [1999]).

(Inhibited)
JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

On Leave
CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

C E R T I F I C A T I O N

Pursuant to Section 13, Article VIII of the Constitution, it is hereby certified that the conclusions in the above decision were reached in consultation before the case was assigned to the writer of the opinion of the Court *En Banc*.

ERNESTO D. ACOSTA
Presiding Justice