REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

EN BANC

SOUTH AFRICAN AIRWAYS,
Petitioner,

-versus-

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. EB No. 118
(C.T.A. Case No. 6760)

Present:

Acosta, *P.J.*
Castañeda, Jr.,
Bautista,
Uy,
Casanova, and
Palanca-Enriquez, *JJ.*

Promulgated:

DEC 0 2 2005

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D E C I S I O N

ACOSTA, P.J.:

This is a Petition for Review seeking the reversal and setting aside of the Decision of this Court's First Division dated June 9, 2005, denying petitioner's claim for refund of alleged erroneously paid tax on Gross Philippine Billings for the taxable year 2001 and the subsequent Resolution dated September 6, 2005, denying the Motion for Reconsideration.

The antecedent facts as culled from the records are as follows:

Petitioner is a non-resident 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 1672. It is an off-line international air carrier having no landing rights in the Philippines. Consequently, it does not maintain flight operations to and from the Philippines. Petitioner instead maintains off-line flights for the carriage of passengers and cargo between ports or points outside the territorial jurisdiction of the Philippines.

Petitioner is likewise not licensed to do business in the Philippines inasmuch as it is not registered with the Securities and Exchange Commission (SEC) as a corporation, branch office or partnership. It, however, has a general sales agent in the Philippines, Aerotel Limited Corporation (Aerotel) which among others, sells passage documents for compensation or commission covering petitioner's off-line flights.

On February 5, 2003, petitioner filed a formal claim for refund with respondent through Revenue District Office No. 47 of the Bureau of Internal Revenue (BIR), for the recovery of the subject amount of P2,690,049.81 representing erroneously paid tax on Gross Philippine Billings for taxable year 2001. However, for failure of respondent to act on petitioner's claim for refund, herein petitioner sought relief from this Court's First Division.

In its Decision dated June 9, 2005, the CTA First Division dismissed the petition for lack of merit. On July 8, 2005, petitioner filed a Motion for Reconsideration which was likewise denied via a Resolution dated September 6, 2005.

Hence, on October 17, 2005 petitioner filed this Petition for Review raising the following issues:

1. 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.

2. 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.

3. 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.

4. 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 P2,690,049.81.

Inasmuch as the crux of the controversy is **Section 28 (A)(3)(a) of the 1997 Tax Code**, which provides for the tax on Gross Philippine Billings of international air carriers, the same is quoted hereunder for easy reference, to wit:

> "**SEC. 28. Rates of Income Tax on Foreign Corporations.**
>
> "(A) Tax on Resident Foreign Corporations. — xxx
>
> "(3) International Carrier. — An international carrier doing business in the Philippines shall pay a tax of two and one-half percent (2 1/2%) on its 'Gross Philippine Billings' as defined hereunder:
>
> "(a) International Air Carrier. — 'Gross Philippine Billings' refers to the amount of gross revenue derived from carriage of persons, excess baggage, cargo and mail originating from the Philippines in a continuous and uninterrupted flight, irrespective of the place of sale or issue and the place of payment of the ticket or passage document: Provided, That tickets revalidated, exchanged and/or indorsed to another international airline form part of the Gross Philippine Billings if the passenger boards a plane in a port or point in the Philippines: Provided, further, That for a flight which originates from the Philippines, but transshipment of passenger takes place at any port outside the Philippines on another airline, only the aliquot portion of the cost of the ticket corresponding to the leg flown from the Philippines to the point of transshipment shall form part of Gross Philippine Billings."

This Court applied and explained the above-quoted provision in the recently promulgated case of **Air Canada vs. Commissioner of Internal Revenue**, *CTA Case No. 6572, December 22, 2004*, in this manner, thus:

> "xxx [I]t is evident that the definition of "Gross Philippine Billings" under Section 28(A)(3)(a) of the 1997 Tax Code covers the gross revenue derived from the carriage of persons, excess baggage, cargo and mail "originating from the Philippines in a continuous and uninterrupted flight" irrespective of the place or sale or issue and the

> place of payment of the ticket or passage document. "To originate" would mean "to cause the beginning of; to start (a person or thing) on a course or journey; to begin, start" (Webster's Third New International Dictionary). In other words, the flights carrying the passengers must have originated or started from the Philippines. **Verily, petitioner, being an off-line international carrier, as authorized to operate by the Civil Aeronautics Board (Exhibit "I") and having no flights originating from the Philippines in a continuous and uninterrupted flight, cannot be taxed pursuant to Section 28(A)(3)(a) of the 1997 Tax Code, that is, based on their Gross Philippine Billings."** *(Emphasis supplied)*

Based on the foregoing it appears that the petitioner cannot be taxed on its Gross Philippine Billings. However, following the same ruling of this Court in the said case of **Air Canada vs. Commissioner of Internal Revenue**, supra, and the finding of the CTA First Division in the subject Decision, that while petitioner is not liable to pay tax on Gross Philippine Billings, it is still required to pay income tax on its gross revenue from the sales of its passage documents. We quote:

> "However, with regard to the term "doing" or "engaged in" business, there is no fixed or specific criterion as what constitutes "doing" or "'engaging" in business. In the case of **The Mentholatum Co., Inc., et al. vs. Mangiliman, et al.**, *72 PHIL 524*, the Honorable Supreme Court had thoroughly and clearly explained the term in this way:
>
> ". . . **There is no specific criterion as to what constitutes "doing" or "engaging in" or "transacting" business**. Each case must be judged in the light of its peculiar environmental circumstances. **The term implies continuity of commercial dealings and arrangements, and contemplates, to that extent, the performance of acts or works or the exercise of some of the functions normally incident to, and in progressive prosecution of commercial gain or for the purpose and object of the business organization."**
>
> **"In order that a foreign corporation may be regarded as doing business, there must be continuity of conduct and intention to establish a continuous business, such as the appointment of a local agent, and not one of a temporary character. In other words, a foreign airline company selling tickets in the Philippines through their local agents, whether liaison offices, agencies or branches, as in the case at bar, shall be considered as resident foreign corporation engaged in trade or business in that country for such activities show continuity of commercial dealings or arrangements and**

> **performance of acts or works or the exercise of some functions normally incident to and in progressive prosecution of commercial gain or for the purpose and object of the business organization.**" *(Emphasis supplied)*

The petitioner is a resident foreign corporation engaged in trade or business in the country within the purview of our tax law and must be subject to tax. It sells passage documents in the Philippines through its sales agent Aerotel and it derives revenues from the conduct of its business activity regularly pursued within the Philippines. The absence of flight operations to and from the Philippines is not determinative of the source of income or the *situs* of income taxation.

The Honorable Supreme Court in some of its landmark decisions affirmed the validity of the afore-mentioned finding. Among these are the cases of **Commissioner of Internal Revenue vs. American Airlines, Inc.**, *180 SCRA 274* and **Commissioner of Internal Revenue vs. British Overseas Airways, Corp.**, *149 SCRA 395*, where the High Tribunal clarified that:

> "**The absence of flight operations to and from the Philippines is not determinative of the source of income or the situs of income taxation. xxx The test of taxability is the 'source'; and the source of an income is that activity xxx which produced the income.** Unquestionably, the passage documentations in these cases were sold in the Philippines and the revenue therefrom was derived from a business activity regularly pursued within the Philippines. **And even if the BOAC tickets sold covered the 'transport of passengers and cargo to and from foreign cities', it cannot alter the fact that income from the sale of tickets was derived from the Philippines.** The word 'source' conveys one essential idea that of origin, and the origin of the income herein is the Philippines." (*Emphasis supplied*)

The High Court in the same case of **Commissioner of Internal Revenue vs. British Overseas Airways Corporation**, supra, expounded further in this manner:

> "'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 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. xxx
>
> **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.** xxx" (*Emphasis supplied*)

Long-established is the principle that the source of income is the property, activity or service that produced the income and, in order that the source of income to be considered as coming from the Philippines, it is enough that the income is derived from activity within the Philippines (**Commissioner of Internal Revenue vs. Japan Air Lines, Inc.** *202 SCRA 450*). Applying the foregoing definition to the present case, proceeds from sales of passage documents by the petitioner are clearly subject to income tax.

Finally, the contention of petitioner that **Section 3 of Revenue Regulations No. 15-2002** dated May 30, 2002, which provides in part that, "An offline airline having a branch or sales agent in the Philippines which sells passage documents for compensation or commission to cover off-line flights xxx is not considered engaged in the business as an international carrier in the Philippines and is, therefore, not subject to Gross Philippine Billings Tax xxx", justifies the grant of its refund claim is misplaced. It must be pointed out that the transaction period covered by the refund claim is taxable period 2001, while the said regulation only became effective on October 26, 2002. Assuming *arguendo* that petitioner is not covered by the Gross Philippine Billings Tax, it is still liable to pay tax equal to 32% of its gross income derived or received during the taxable year 2001 from all sources within the Philippines.

To reiterate, the petitioner, as resident foreign corporation engaged in trade or business in the Philippines, is not taxable on its Gross Philippine Billings as provided in Section 28(A)(3)(a) of the Tax Code. However, it is still liable to pay thirty two percent (32%) of its taxable income derived from its sales of passage documents here in the Philippines.

WHEREFORE, finding no reversible error in the assailed Decision promulgated on June 9, 2005 and Resolution dated September 6, 2005, the instant Petition for Review is hereby **DISMISSED** for lack of merit.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

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

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

CERTIFICATION

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