REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

SOUTH AFRICAN AIRWAYS, *Petitioner,*	**C.T.A. EB NO. 211** **(C.T.A. CASE NO. 6759)**
	Present:
-versus-	ACOSTA, Presiding Justice, CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA, and PALANCA-ENRIQUEZ, JJ.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	**Promulgated:** JUN 0 7 2007

x -- x

DECISION

PALANCA-ENRIQUEZ, J.:

Another case involving the issue on whether or not the revenue derived by an international air carrier from sales of tickets in the Philippines for air transportation, while having no landing rights in the country, constitutes income of the said international air carrier from Philippine sources and accordingly, taxable under *Section 28 (A) (1)* of

189

the *National Internal Revenue Code of 1997* (hereafter "*NIRC of 1997*"), as amended, is presented before the Court.

THE CASE

This is a Petition for Review filed by South African Airways (hereafter "petitioner") under *Section 11 of Republic Act No. 9282 (An Act Expanding the Jurisdiction of the Court of Tax Appeals)*, in relation to *Rule 43* of the *1997 Rules of Civil Procedure, as amended*, which seeks the reversal of the Decision dated May 3, 2006 and Resolution dated August 11, 2006 rendered by the First Division of this Court in C.T.A. Case No. 6759. The respective dispositive portions of the Decision and Resolution read as follows:

> "**WHEREFORE**, premises considered, the Petition for Review is hereby **DENIED**.
>
> **SO ORDERED**."
>
> "**WHEREFORE,** premises considered, petitioner's Motion for Reconsideration is hereby **DENIED** for lack of merit.
>
> **SO ORDERED**."

THE FACTS

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

190

Petitioner is a nonresident 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 1627. 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, hence, 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.

Petitioner filed, through its sales agent, separate Quarterly Income Tax Returns for passenger and cargo during taxable year 2002 on the following dates:

PERIOD	DATE FILED	
	Passenger	Cargo
1st Quarter	5/30/2002	5/30/2002
2nd Quarter	8/29/2002	8/29/2002

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 P1,509,103.21 representing erroneously paid tax on Gross Philippine Billings for the first and second quarters of taxable year 2002.

In a letter dated July 4, 2003, respondent through the Regional Director of Revenue Region No. 8, denied petitioner's claim for refund, a copy of which was received by petitioner through its general sales agent, Aerotel Limited Corporation, on July 29, 2003.

On August 26, 2003, petitioner filed a Petition for Review before this Court, docketed as C.T.A. Case No. 6759.

In his Answer filed on October 13, 2003, respondent alleged, by way of special and affirmative defenses that the transaction periods mentioned in the petition are not covered within the effectivity of Revenue Regulations 15-2002 which took effect on October 26, 2002; that granting petitioner is not subject to tax on Gross Philippine Billings, then it is liable to pay the tax equal to 32% of its gross income received during the 1st and 2nd quarters of taxable year 2001 from all sources within the Philippines, pursuant to *Section 28 (B) (1) of the National Internal Revenue Code of 1997,* as a nonresident foreign corporation; and that taxes paid and collected are presumed to have been paid in accordance with law, hence, not refundable.

After trial on the merits, the First Division rendered the assailed Decision on May 3, 2006 denying the Petition for Review.

Not satisfied, petitioner filed a "Motion For Reconsideration", which was denied by the First Division in a Resolution dated August 11, 2006.

On September 15, 2006 petitioner filed the instant Petition for Review.

On October 5, 2006, We required respondent to file his comment on the petition, within ten (10) days from notice, which respondent failed to file.

Thereafter, on November 24, 2006, the parties were ordered to file their simultaneous memoranda, within fifteen (15) days from notice. Both parties having complied thereto, the case was deemed submitted for decision.

THE ISSUES

Petitioner raised the following issues for the Court *En Banc's* consideration:

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.

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 P1,509,103.21.

Decisive Issue

The decisive issue posed for resolution by the Court *En Banc* is whether or not the income derived by petitioner from the sales of passage documents in the Philippines for air transportation, while having no landing rights here, constitutes income of petitioner from Philippine sources, and accordingly, taxable.

THE COURT *EN BANC'S* RULING

The petition is bereft of merit.

There is nothing novel in this case, as the decisive issue raised herein had, in a number or so of cases, been previously ruled by the Supreme Court in the affirmative.

In the case of *Commissioner of Internal Revenue vs. British Overseas Airways Corporation (149 SCRA 395)*, the Supreme Court ruled:

"The Tax Code defines 'gross income' thus:

195

'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' (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,

196

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."

The Supreme Court reiterated the above ruling in the subsequent case of *Commissioner of Internal Revenue vs. Air India (157 SCRA 648)*, as follows:

"On the basis of the doctrine announced in *British Overseas Airways Corporation*, the revenue derived by the private respondent Air India from the sales of airplane tickets through its agent Philippine Air Lines, Inc., here in the Philippines, must be considered taxable income. As correctly assessed by the petitioner, such income is subject to a 2.5% tax pursuant to Presidential Decree No. 1355, amending Section 24(b)(2) of the tax code. The total Philippine billings of the private respondent for the taxable year in question amounts to P2,968,156.00. 2.5% of this amount or P74,203.90 constitutes the income tax due from the private respondent."

Then, in the case of *Commissioner of Internal Revenue vs. American Airlines, Inc. (180 SCRA 274)*, the Supreme Court adopted the same ruling and ruled:

"The controversy is now before this Court, elevated by petitioner on the issue of whether or not respondent American Airlines, Inc., which is an off-line international carrier without flight operations in this country but rendering ticketing services herein, is liable to pay the 2-1/2% tax on its gross Philippine billings pursuant to Section 24(b)(2), as amended, of the tax code.

We have already had the occasion to rule on this issue in two previous cases involving the British Overseas Airways Corporation and Air India, generated by similar factual backgrounds although of different taxable periods.

In said cases, foreign airline companies which sold tickets in the Philippines through their local agents, whether called liaison offices, agencies or branches, were considered resident foreign corporations engaged in trade or business in the country. 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.

It was likewise declared that for the source of income to be considered as coming from the Philippines, it is sufficient that the income is derived from activities within the country. In the case of these airline companies, the absence of flight operations within Philippine territory cannot alter the fact that the income was derived from activity within this jurisdiction for, as lucidly explained by Mme. Justice Melencio-Herrera in the *British Overseas Airways Corporation* case:

xxx xxx."

In the recent case of *Commissioner of Internal Revenue vs. Baier-Nickel (500 SCRA 87)*, the Supreme Court reiterated the ruling in *Commisisoner of Internal Revenue vs. British Airways Corporation, supra*, and ruled:

"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*

199

> *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 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. Thus-
>
> xxx xxx."

Pursuant to the aforecited decisions of the Supreme Court, We affirm the First Division's ruling that the petitioner is a resident foreign corporation doing business in the Philippines and the income earned from

200

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

As aptly ruled by the First Division:

> "In the instant case, petitioner's designation of Aerotel as its agent in the promotion and solicitation of the sale of airline tickets in the Philippines on a regular basis contemplates its intention of continuity of commercial dealings in this country. Clearly, petitioner is engaged in business in the Philippines and the revenues arising from the sale of airline tickets through petitioner's agent herein must be considered taxable income. The test of taxability is the 'source' and the source of an income is that activity which produced the income. The absence of flight operations to and from the Philippines is not the determinative of the source of income for purposes of ascertaining income tax liability. It is sufficient that the income is derived from

210

activity within the Philippine territory. Ineluctably, 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 1997 NIRC, as amended.

In fine, the petitioner, as 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 Tax Code. However, it is still liable to pay thirty two (32%) of its taxable income derived from its sales of passage documents here in the Philippines.

xxx xxx."

Pursuant to settled law and jurisprudence, and finding no reversible error in the assailed Decision dated May 3, 2006 and Resolution dated August 11, 2006, We affirm the First Division.

WHEREFORE, premises considered, the instant petition is hereby **DENIED DUE COURSE**, and accordingly, **DISMISSED** for lack of merit.

SO ORDERED.

OLGA PALANCA-ENRIQUEZ
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

202

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

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
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 above Decision has been reached in consultation with the members of the Court *En Banc* before the case was assigned to the writer of the opinion of the Court.

ERNESTO D. ACOSTA
Presiding Justice

203