REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

JAPAN AIR LINES, INC.,
Petitioner

- versus -

C.T.A. CASE NO. 2480

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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1/15/82

D E C I S I O N

Petitioner Japan Air Lines, Inc. appeals from a decision of respondent Commissioner of Internal Revenue denying its protest against a deficiency income tax assessment for the years 1959, 1960, 1961, 1962 and 1963 in the total amount of ₱2,099,687.52, inclusive of 50% surcharge and interest, plus compromise penalty of ₱1,500.00 as penalty of ₱300.00 per year from 1959 to 1963 for failure to keep books of accounts in the Philippines. The basic question presented in this appeal is whether or not the proceeds of sales in the Philippines of petitioner's international air line passage tickets during the years in question, on which the deficiency income tax assessment was based after deduction of sales returns and commissions, constituted income of petitioner from sources within the Philippines subject to income tax.

Appropriate to mention here, at the outset, is CTA Case No. 1634, Japan Air Lines vs. Commissioner of Internal Revenue, involving the same parties. In this CTA Case No. 1634, this Court was asked to say whether during the period from January, 1959 to September, 1964, which is within the period covered in the instant case, the Japan Air Lines was engaged in business as a common carrier in the Philippines subject to the 2% percentage tax imposed by Section 192 (now Section 207) of the National Internal Revenue Code. Answering the query in the negative, this Court ruled that the mere sale in the Philippines of airline passage tickets of a non-resident foreign international air transportation company by a local airline, unaccompanied by physical act of carriage or transportation is not considered engaged in business in the Philippines subject to the 2% common carrier's tax. Since CTA Case No. 1634 and CTA Case No. 2480 involve the same parties and cover the same activities done or transacted under the same factual setting during the same period, they may be considered as companion cases dealing on the same proceedings, the business tax aspect having been treated in CTA Case No. 1634 and the income tax angle in the instant appeal.

There is no controversy as to the facts of the case. As narrated in the amended decision in CTA Case No. 1634 (Exh. "F"):

> "Petitioner, Japan Air Lines (or JAL for short), is a foreign corporation engaged in the business of international air carriage. JAL did not have planes that lifted or landed passengers and cargo in the Philippines during the period under review. It had not been granted by the Civil Aeronautics Board (CAB) a certificate of public convenience and necessity to operate here (Exh. A, p. 19, CTA rec.). However, on two occasions, JAL's planes landed here on chartered flights - one on September 23-26, 1963 carrying the Prime Minister of Japan on a state visit and the other a small plane, Beechcraft, that came here on January 14-17, 1964 (see pp. 24-25, t.s.n.; Exhs. B, B-1 & B-2, pp. 20-22, CTA rec.). In November, 1967 its application to operate in the Philippines was finally approved by the CAB (see Petitioner's Reply Memo.)
>
> "Since mid-July, 1957, JAL had maintained an office at the Filipinas Hotel, Roxas Boulevard, Manila. Said office did not sell tickets but was maintained merely for the promotion of the company's public relations and to hand out brochures, literature and other information playing up the attractions of Japan as a tourist spot and the services enjoyed in JAL planes (Exh. I, p. 54, BIR rec.).
>
> "On July 17, 1957, JAL constituted the Philippine Air Lines (PAL for short) its general sales agent in the Philippines (Exh. E, pp. 51-57, CTA rec.;

pp. 12 & 21, t.s.n.). As an agent, PAL, among other things, sold for and in behalf of JAL, plane tickets and reservations for cargo spaces which were used by the passengers or customers on the facilities of JAL. Although PAL was the exclusive general sales agent in the Philippines, sales of JAL tickets were done also by travel agencies but all such sales were under the direct supervision of PAL which was responsible to JAL for the settlement, accounting and liquidation of said sales.

"For the period from January, 1959 to September 1964, PAL paid, for and in behalf of JAL, 2% common carrier's tax based on the 'on line' portion of the fares on the tickets sold by PAL on behalf of JAL. The 'on line' portion refers to the fares corresponding to the leg carried on a JAL plane (Exh. 1, pp. 1-3, BIR rec.; pp. 17-19, t.s.n.)".

On June 2, 1972, petitioner received deficiency income tax assessment notices and a demand letter, all dated February 28, 1972, for a total amount of ₱2,099,687.52 inclusive of 50% surcharge and interest, for years 1959 through 1963, computed as follows:

	1959	1960	1961
Net income per investigation	₱472,025.16	₱476,671.48	₱734,812.77
Tax due thereon	₱133,608.00	₱135,001.00	₱212,444.00
Add: 50% surch.	66,804.00	67,500.50	106,222.00
1/2% mo.int. (3 yrs.)	24,049.44	24,300.18	38,239.92
Total due	₱224,461.44	₱226,801.68	₱356,905.92

	1962	1963	S U M M A R Y
Net income per investigation	₱1,065,641.63	₱1,550,230.48	₱224,461.44
Tax due thereon	₱ 311,692.00	₱ 457,069.00	226,801.68
Add: 50% surch.	155,846.00	228,534.50	356,905.92
1/2% mo.int.			523,642.56
(3 yrs.)	56,104.56	82,272.42	767,875.92
Total due	₱ 523,642.56	₱ 767,875.92	₱2,099,687.52
Compromise			1,500.00

On June 19, 1972, petitioner contested said assessments on the main ground that as a nonresident foreign corporation, it was taxable only on income derived from Philippine sources as determined under Section 37 of the Tax Code, and there being no such income during the period in question, it was not liable for the deficiency income tax liabilities assessed. However, on January 17, 1973, petitioner received the final decision of respondent dated December 21, 1972, denying the aforementioned protest, and reiterating the demand for payment of the sum of ₱2,099,687.52.

Hence the present appeal filed on February 14, 1973.

As special and affirmative defenses, respondent, among others, alleges in his answer to the petition for review:

That during the period in question, petitioner was engaged in business in the Philippines and it derived income from sources within the Philippines;

That petitioner is a resident foreign corporation liable to the payment of income tax on income from all sources within the Philippines (Sec. 24(b) (2) National Internal Revenue Code);

That in the alternative that petitioner may not be considered a resident foreign corporation but a non-resident foreign corporation, still it is liable to the payment of Philippine income tax at the rate of thirty-five percent (35%) of its gross income received from all sources within the Philippines (Sec. 24(b)(1) National Internal Revenue Code);

That the income tax in question was imposed on income received by petitioner from sources within the Philippines.

As elucidated in the decision of respondent appealed from (Exh. "C"; Exh. "3", p. 76, BIR records; Annex "B", petition for review) and reiterated in respondent's memorandum (p. 128, CTA records), petitioner Japan Air Lines was, during the years involved, a foreign corporation engaged in business in the Philippines by its acts of -

(1) Selling passage tickets in the Philippines through its agent the Philippine Air Lines;

(2) Maintaining an office in the Philippines even if only for promotion and information purposes; and

(3) Receiving payments for passage tickets a. sold in the Philippines, b. in Philippine currency, and c. from passengers coming or originating from the Philippines.

Admittedly, the deficiency income tax under consideration and the 50% surcharge amounting to a total of ₱1,874,715.00, exclusive of interest, was based on the proceeds of sales in the Philippines of petitioner's airline passage tickets by its local agent, the Philippine Airlines. (Exh. "D", pp. 22-24, BIR records.)

Was petitioner during the years in question engaged in business in the Philippines?

Respondent's position is not in any way different from the stand taken by him in CTA Case No. 1634, Japan Air Lines vs. Commissioner of Internal Revenue, supra, the factual setting of which is, as stated earlier, exactly on all four with the case at bar, and where this Court ruled that the selling of passage tickets of petitioner in the Philippines by the Philippine Air Lines, as well as the maintenance of an office for promotion and information purposes, was not considered engaged in business in the Philippines. Because the amended decision in the said case, the petition for review on certiorari of which was denied for lack of merit by the Supreme Court in L-30041, February 3, 1969, disposed of the same defenses and contentions of respondent in this appeal, we will quote at length from said amended decision.

> Petitioner contends that its activity or business as a common carrier was confined outside the Philippines and as such it was not liable for common carrier's tax. Respondent, however, counters that petitioner was engaged in the business of common carrier in the Philippines through its agent, the Philippine Air Lines.
>
> In the light of the additional evidence it now appears that, for its survival and proper regulation, the airline industry has formed an organization known as the International Air Transport Association (IATA for short). IATA has promulgated agreements and resolutions to implement the practices of the industry which become binding upon all its members once approved by their respective government. In the Philippines, they are submitted to the Civil Aeronautics Board for approval. Some of these agreements or resolutions are the Traffic Conference Resolutions (Exh. M) and the Interline Agreements (Exh. S). For the administration of air traffic, IATA has divided the world into three traffic conference areas; actions of each traffic conference are done in the form of resolutions known as Traffic Conference Resolutions. JAL and PAL belong to Traffic Conference No. 3 (see Exh. T-2; pp. 182-184, t.s.n.).
>
> With respect to the activity of carrying passengers and cargo, there has evolved in the airline business,

primarily for the convenience of passengers, the practice of honoring tickets issued by other airlines. This means that a passenger buying a ticket from one particular airline could be accepted as a passenger in the planes of other airlines by simply using the ticket of the issuing airline (Exhs. F, R-2-a, N-2-b & Q-1). This practice is governed by a binding agreement among IATA airline members, designated as Traffic Conference Resolution No. 850, otherwise known as the Interline Traffic Agreement (Exhs. M-3 & S-5; pp. 171-181, t.s.n.). The airline which carries a passenger holding ticket of another airline is designated as the "carrying airline", while the airline to which the ticket belongs is known as the "issuing airline" (Exhs.L to L-6-a & M-3; pp. 188-189, t.s.n.).

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As stated earlier JAL did not have planes that lifted or landed passengers and cargo in this country. It however maintained an office in Manila for the promotion of the company's public relations and to hand out brochures, literatures and other informations playing up the attractions of Japan as a tourist spot and the services enjoyed in JAL planes. JAL dit not sell tickets in said office. Instead, taking advantage of the IATA agreements, on July 17, 1957, JAL constituted the Philippine Air Lines (PAL for short) its general sales agent in the Philippines (Exh. E, pp. 51-57, CTA rec.; pp. 12 & 21, t.s.n.). As an agent, PAL, among other things, sells for and in behalf of JAL, plane tickets and reservations for cargo spaces which are used by the passengers or customers on the facilities of JAL. Although PAL was the exclusive general sales agent in the Philippines, sale of JAL tickets was done also by travel agencies but all such sales were under the direct supervision of PAL which was responsible to JAL for the settlement, accounting and liquidation of said sales. As general sales agent, PAL issued JAL tickets in which case JAL was the issuing airline. When PAL carried the passenger in its leg of the flight from the Philippines to the country where JAL planes took over, it became the carrying airline for said leg. In this connection, PAL, like other airlines, performed dual functions: (a) the activity of selling transportation of other airlines and (b) the activity of transporting in its own planes passengers and cargo from one place to another. One deals with the sale of tickets and travel documents, for and in behalf of other airlines, and the other deals with the physical act of transporting passengers and cargo from one place to another by means of aircraft (pp. 228-238, t.s.n.).

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The practice of, and arrangement between, JAL and PAL is well exemplified in the situation represented by Exhibit F. The passenger, Ong Sin, bought a JAL ticket from a PAL office in Manila bound for Seoul via Taipeh and Tokyo. From Manila to Taipeh, the first leg, he was lifted by a PAL plane under the JAL ticket. In Taipeh, a JAL plane took over and carried him to Tokyo, Seoul and then back to Tokyo under the same JAL ticket. The situation created by the JAL ticket aforesaid may be stated this wise: When Passenger Ong Sin boarded the PAL plane in Manila, bearing a JAL ticket, his contract of transportation was with PAL, the "carrying-airline", up to the end of the first leg of the flight - Taipeh. From Taipeh, where JAL plane took over, his contract of transportation was transferred to JAL, the new carrying airline, and also up to the particular line of the flight - Tokyo. The clear intent of the arrangement is to save the passenger the trouble of purchasing tickets at the point of departure of every leg of the entire trip. Under this set-up the conclusion is obvious that JAL did not engage in the business of a carrier in the Philippines either directly or with the intervention of another carrier that may be considered its extension.

The practice in the airline industry on the apportionment of commissions between the issuing and the carrying airline reflects the foregoing legal relationship between them. In the sale of tickets for and in behalf of JAL, PAL is entitled to two commissions, namely: (a) 7% sales commission if it itself sold the ticket, based on the fare for the whole ticket; and (b) 3% overriding commission, based on the "on-line" portion or legs actually carried by JAL planes. In turn, JAL for issuing the ticket and giving business to PAL, gets the 7% interline commission, based on the fare pertaining to those legs actually carried by PAL (Exhs. E, N to N-2-b, O to O-5, U & V; pp. 63-64, 127-137 & 146-156, t.s.n.). The issuing airline obviously acts as a mere sales agent of tickets for the leg covered by the plane of the carrying airline which is the sole carrier.

We find no merit in respondent's contention that international air transportation companies should be considered engaged in business wherever they derive fares or freight and are taxable as carrier in said place, that is, for purposes of taxation the situs is said place.

It is to be admitted that CTA Case No. 1634 involves business tax, while the case at bar covers income tax. Nonetheless, the ruling enunciated therein that petitioner was not engaged in business in the Philippines during the years under review by its acts of (a) selling passage tickets in the Philippines through the Philippine Air Lines; (b) the maintenance of an office in the Philippines for promotion and information purposes; and (c) the receipt of payments for passage tickets sold in the Philippines from passengers from the Philippines resolves the identical problem brought before us in this proceeding.

For purposes of income taxation, the taxability of foreign corporations, including an international air carrier of passengers and freight like petitioner herein, at the time material to this case, whether engaged in trade or business in the Philippines or not engaged in trade or business here depends, however, on whether the income is derived from sources within the Philippines. (Sec. 24, National Internal Revenue Code; Secs. 16 & 60, Rev. Reg. No. 2.) While a foreign corporation doing business in the Philippines is taxable on income solely from sources within the Philippines, it is permitted to claim deductions from gross income but only to the extent connected with income earned in the Philippines. (Secs. 24(b)(2) and 37, National Internal Revenue Code.) On the other hand, a foreign corporation not doing business in the Philippines is taxable on income "from all sources within the Philippines, as interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical or casual gains, profits and income and capital gains." (Sec. 24(b)(1), National Internal Revenue Code.)

The decisive question, therefore, as posed by petitioner, is whether or not the proceeds of sales in the Philippines of Japan Air Lines passage tickets by the Philippine Air Lines during the period in question, and on which the assessment was based (after deducting sales returns and PAL's commissions) constituted income of petitioner from Philippine source.

The controlling statute is Section 37 of the National Internal Revenue Code, the pertinent portions of which during the years in question, read as follows:

> SEC. 37. Income from sources within the Philippines - (a) Gross income from sources within the Philippines. - The following items of gross

income shall be treated as gross income from sources within the Philippines:

(1) Interest.- Interest derived from sources within the Philippines, and interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise;

(2) Dividends.- The amount received as dividends

(A) From a domestic corporation;

(B) From a foreign corporation unless less than fifty per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the Philippines as determined under the provisions of this section; but only in an amount which bears the same ratio to such dividends as the gross income of the corporation for such period derived from sources within the Philippines bears to its gross income from all sources;

(3) Services.- Compensation for labor or personal services performed in the Philippines;

(4) Rentals and royalties.- Rentals and royalties from property located in the Philippines or from any interest in such property, including rentals or royalties for the use of or for the privilege of using in the Philippines patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchise, and other like property;

(5) Sale of real property.- Gains, profits and income from the sale of

> real property located in the Philippines; and
>
> (6) Sale of personal property.- Gains, profits, and income from the sale of personal property, as determined in subsection (e) of this section.
>
> (b) Net income from sources in the Philippines.- From the items of gross income specified in subsection (a) of this section there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the Philippines.

Adverting to the terms of the law, it is quite apparent that the proceeds of sales of Japan Air Lines passage tickets in the Philippines by the Philippine Air Lines during the period in question could not be considered as interest, dividends or rentals and royalties derived from sources within the Philippines. There is patently the absence of analogy or similarity between interest, dividends, rentals or royalties and proceeds of sales of airline passage tickets. And by no stretch of the imagination could such proceeds of sales of airline passage tickets be compared to income "from the sale of personal property produced (in whole or in part)" by petitioner and sold within the Philippines so as to be treated as income derived partly from sources within and partly from sources without the Philippines under Section 37(e) of the then in force National Internal Revenue Code.

As an international air carrier of passengers and freight, perhaps, such proceeds of sale of airline passage tickets in the Philippines may be classified as "compensation for labor or personal services performed in the Philippines"; that is, compensation for service of carriage of passengers and freight performed within the Philippines. However, it is an admitted fact and confirmed by this Court in its amended decision in CTA Case No. 1634, Japan Air Lines vs. Commissioner of Internal Revenue, that petitioner did not lift nor land passengers or cargo in the Philippines during the years in question. Invariably, any leg or portion of the trips serviced by the Japan Air Lines commenced <u>outside</u> the Philippines and terminated also <u>outside</u> of the Philippines. To reiterate:

> "We find no merit in respondent's contention that international air transportation companies should be considered engaged in business wherever they derive fares or freight and are taxable as carrier in said place, that is, for purposes of taxation the situs is said place." (Japan Air Lines vs. Commissioner of Internal Revenue, CTA Case No. 1634.)

At this juncture, it may be stated that under the present law as introduced by Presidential Decree No. 69, effective January 1, 1973; amplified by Presidential Decree No. 1355, approved April 21, 1978; and incorporated in Section 24(b)(2) of the 1977 National Internal Revenue Code, international carriers are now taxable on their gross Philippine billings. The term "gross Philippine billings" includes gross revenue realized from uplifts anywhere in the world by any international carrier doing business in the Philippines of passage documents sold therein, whether for passenger, excess baggage or mail, provided the cargo or mail originates from the Philippines. The gross revenue realized from the said cargo or mail includes the gross freight charge up to final destination. Like other statutes, however, tax laws operate prospectively, whether they enact, amend or repeal, unless the legislative intent to give retrospective effect is expressly declared or may clearly be implied from the language used. (Lorenzo vs. Posadas, 64 Phil. 353; Commissioner of Internal Revenue vs. Filipinas Cia de Seguros, 107 Phil. 1055; Cebu Portland Cement Company vs. Collector of Internal Revenue, L-20563, October 29, 1968, 25 SCRA 789.) And there is nothing in Presidential Decree No. 69, Presidential Decree No. 1355 or the 1977 National Internal Revenue Code which provides expressly or from which it can necessarily be implied that Section 24(b)(2) thereof should be given retroactive effect.

Not much need be said on respondent's point that when the Philippine Air Lines (PAL) lifted a passenger from the Philippines on a Japan Air Lines passage ticket, it acted as "agent" or "sub-contractor" for petitioner Japan Air Lines. In its amended decision in CTA Case No. 1634, as quoted lengthily above, this Court disposed of the same charge and contention in clear and unequivocal terms in the following wise:

> "x x x. When PAL carried the passenger in its leg of the flight from the Philippines to the country where JAL planes took over, it became the carrying airline for said leg. In this connection, PAL, like other airlines, performed dual functions: (a) the activity of selling transportation of other airlines and (b) the activity of transporting in its own planes passengers and cargo from one place to another. One deals with the sale of tickets and travel documents, for and in behalf of other airlines, and the other deals with the physical act of transporting passengers and cargo from one place to another by means of aircraft." (pp. 9-10; emphasis supplied.)

" x x x

"x x x. It now appears that PAL acted merely as a sales agent when it issued JAL tickets and that <u>when it carried passengers with JAL ticket on its leg of the trip, it acted as principal with sole responsibility for the trip and not as agent carrier of JAL.</u> x x x." (pp. 11-12, emphasis supplied.)

Respondent would however unwrap a theory that the airline passage ticket purchased in the Philippines is a complete written contract between petitioner and the passenger since it has all the elements of a complete contract, i.e., consent; cause or consideration which is the full or entire fare paid by the passenger; and object which is the transportation of the passenger to the place of destination via the routes of other airlines as stated in the ticket. The consideration of the contract between petitioner and its patron being entire and single, the said contract then could not be held to be divisible, irrespective of the division of the obligation to be performed by several successive carriers. Respondent would thus consider the service of petitioner a continuous one originating from the Philippines to the passenger's final destination without service interruption. (pp. 130-131, CTA records.)

Respondent's position again calls to mind CTA Case No. 1634, where this Court in its amended decision, answering the same argument and contention, unambiguously disposed of this question in the following words:

> "The practice of, and arrangement between, JAL and PAL is well exemplified in the situation represented by Exhibit F. The passenger, Ong Sin, bought a JAL ticket from a PAL office in Manila bound for Seoul via Taipeh and Tokyo. From Manila to Taipeh, the first leg, he was lifted by a PAL plane under the JAL ticket. In Taipeh, a JAL plane took over and carried him to Tokyo, Seoul and then back to Tokyo under the same JAL ticket. The situation created by the JAL ticket aforesaid may be stated this wise: When Passenger Ong Sin boarded the PAL plane in Manila, bearing a JAL ticket, his contract of transportation was with PAL, the 'carrying airline', up to the end of the first leg of the flight - Taipeh. From Taipeh, where JAL plane took over, his contract of transportation was transferred to JAL, the new carrying airline, and also up to the particular line of the flight - Tokyo. The clear intent of the arrangement is to save the passenger the trouble of purchasing tickets at the point of departure of every leg of the entire trip. Under this set-up the conclusion is obvious that JAL did not engage in the business of a carrier in the Philippines either directly or with the intervention of another carrier that may be considered its extension." (pp. 12-13, Amended Decision, Japan Air Lines vs. Commissioner of Internal Revenue, supra.)

We find no cogent reason to modify, much less depart from, the conclusion reached in CTA Case

No. 1634, as expressed in the amended decision of this Court there, the petition for review on certiorari thereof filed by respondent, as stated earlier, was denied by the Supreme Court for lack of merit. The same should therefore resolve the identical problem now again brought before us in this proceeding.

Nevertheless, respondent would attempt to draw support from Section 37(e) of the then in force National Internal Revenue Code which considers income from transportation or other services rendered partly within and partly without the Philippines as income derived from sources partly within and partly without the Philippines. Pursuant to Section 152 of Revenue Regulations No. 2, taxable income from sources within the Philippines includes that derived in full from sources within the Philippines and that portion of the income which is derived partly from sources within and partly from sources without the Philippines which is allocated or apportioned to sources within the Philippines. Since income from the business of transportation service rendered between the Philippines and points outside the Philippines is considered income derived partly from within and partly from without the Philippines under Section 37(e) of the Tax Code, respondent would thus treat revenue derived by petitioner from sales of passage tickets in the Philippines for international air transportation service as income derived from sources partly within and partly without the Philippines. (pp. 133-135, CTA records.)

The argument misses the point. In its textual completeness, the applicable statute provides: "Gains, profits, and income from (1) transportation or other services rendered partly within and partly without the Philippines, x x x x shall be treated as derived partly from sources within and partly from sources without the Philippines." It deals centrally on transportation service rendered partly within and partly without the Philippines. A foreign transportation company derives income partly from sources within and partly from sources without the Philippines if it is carrying on a business of transportation service between points in the Philippines and outside the Philippines. (N.V. Reederiz "Amsterdam" and Royal Interocean Lines vs. Commissioner of Internal Revenue, CTA Case No. 1996, December 1, 1976; Procter & Gamble

Philippine Manufacturing Corporation vs. Commissioner of Internal Revenue, CTA Case No. 2437, January 4, 1977; see also Vol. 3, 1965, Federal Taxes, par. 16,381.) Since respondent had admitted - a fact confirmed by this Court in its amended decision in CTA Case No. 1634 - that petitioner did not have planes that lifted or landed passengers and cargo in the Philippines during the period under review as the Japan Air Lines had not yet been granted by the Civil Aeronautics Board a certificate of public convenience and necessity to operate in the Philippines, petitioner could not have carried on a business of transportation service between points in the Philippines and outside the Philippines. Under the circumstances, petitioner during the period under review did not render, or could not have rendered, transportation service partly within and partly without the Philippines in order to derive income partly from sources within and partly from sources without the Philippines under Section 37(e) of the Tax Code.

Moreover, Section 37(e) provides that in the case of gross income derived from sources partly within and partly without the Philippines, the net income should first be computed by deducting the expenses, losses, or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some items or class of gross income. The portion of such net income attributable to sources within the Philippines may then be determined by processes or formulas of general apportionment prescribed by the Secretary (now Minister) of Finance. As stated earlier, the deficiency income tax assessment under review was based solely on the proceeds of sales of Japan Air Lines passage tickets in the Philippines, which respondent considered income derived in full from sources within the Philippines after deducting sales returns and commissions of the Philippine Air Lines. The fact that the deficiency income tax assessment was based solely on income which respondent considered derived from Philippine sources computed after subtracting deductions to the extent connected with income earned in the Philippines and not on income derived by petitioner from sources partly within and partly without the Philippines determined by the formula of general apportionment prescribed in Section 163 of Revenue Regulations No. 2 in effect negates respondent's allegation that the revenue derived by petitioner from sales of passage tickets in the Philippines is income derived from sources partly within and partly without the Philippines under Section 37(e) of the Tax Code.

The net result is that the deficiency income tax assessment in question cannot be sustained. The decision of respondent Commissioner of Internal Revenue dated December 21, 1972 holding petitioner Japan Air Lines liable for the payment of the amounts of ₱224,461.44, ₱226,801.68, ₱356,905.92, ₱523,642.56 and ₱767,875.92 or a total of ₱2,099,687.52 as deficiency income tax, inclusive of surcharge and [illegible] for the years 1959, 1960, 1961, 1962 and 1963, plus the sum of ₱1,500.00 as compromise penalty, or ₱300.00 per year from 1959 to 1963, for violation of the bookkeeping regulations is therefore of no legal effect. With this conclusion, it becomes unnecessary to pass upon the issue whether or not the assessment for 1963 has been barred by prescription or the question whether or not the 50% surcharge or compromise penalty may be properly imposed.

WHEREFORE, the decision appealed from should be as it is hereby reversed.

SO ORDERED.

Quezon City, Metro Manila, January 15, 1982.

Amante Filler

AMANTE FILLER
Presiding Judge

WE CONCUR:

CONSTANTE C. ROAQUIN
Associate Judge

ALEX Z. REYES
Associate Judge