REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

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SOUTH AFRICAN AIRWAYS,
Petitioner,

C.T.A. CASE NO. 6759

Members:

- versus -

ACOSTA, *Chairman*
BAUTISTA, and
CASANOVA, *JJ.*

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
MAY 03 2006

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DECISION

ACOSTA, E., PJ.:

Before Us is a Petition for Review under Section 11 of Republic Act No. 1125, as amended by Republic Act No. 9282, seeking a refund of alleged erroneously paid tax on Gross Philippine Billings for the first and second quarters of taxable year 2002 in the amount of One Million Five Hundred Nine Thousand One Hundred Three Pesos and 21/100 (P1,509,103.21).

(19)

South African Airways ("petitioner") is a corporation duly organized and existing under the laws of Republic of 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, thus, does not maintain flight operations to and from the Philippines. Moreover, petitioner is not registered with the Securities Exchange Commission as a corporation, branch office or partnership, hence, it is not licensed to do business in the Philippines.[1]

The respondent on the other hand, is the Commissioner of Internal Revenue who is empowered, among others, to decide on disputed assessments, grant refunds of internal revenue taxes, fees or other charges and penalties under the 1997 National Internal Revenue Code ("NIRC"), as amended, or other related laws, with office address at the 5th Floor BIR National Office Building, Agham Road, Diliman, Quezon City.

As an off-line international air carrier, petitioner transports passengers and cargo between ports or points outside the territorial jurisdiction of the Republic of the Philippines. It maintains the services of a general sales agent in the Philippines, Aerotel Limited Corporation ("Aerotel"), which, among others, sells passage documents for compensation or commission covering its off-line flights.[2]

On May 30, 2002 and August 29, 2002, Aerotel, for and in behalf of petitioner, filed separate Quarterly Income Tax Returns for income accruing from the carriage of cargo and passenger covering the first and second quarters, respectively, of taxable year 2002, detailed as follows:

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[1] Joint Stipulation of Facts, pars. 1, 4 & 5
[2] *Ibid.*, par. 7

Quarterly ITR	Period	Date Filed	Gross Billings	Tax Due	Exhibit
For Passenger	1st Quarter	May 30, 2002	P28,125,502.59	P703,137.56	E
	2nd Quarter	Aug. 29, 2002	26,752,967.19	668,824.18	F
For Cargo	1st Quarter	May 30, 2002	3,347,625.34	83,690.63	C
	2nd Quarter	Aug. 29, 2002	2,138,033.43	53,450.84	D
	Sub Total			P 137,141.47	
TOTAL				P1,509,103.21	

Aerotel paid the above taxes due for and in behalf of petitioner.[3]

On February 5, 2003, petitioner filed a formal claim for refund before the Bureau of Internal Revenue ("BIR") District Office No. 47, for the recovery of the alleged erroneously tax paid on Gross Philippine Billings in the amount of P1,509,103.21 for the first and second quarters of taxable year 2002. In a letter dated July 4, 2003, respondent, through the Acting Regional Director of Revenue Region No. 8, Anselmo G. Adriano, denied petitioner's claim for refund.[4]

Hence, this petition filed on August 26, 2003.

On October 13, 2003, the respondent filed through registered mail, his Answer, raising the following Special and Affirmative Defenses:

> ***"5. The transaction periods mentioned in the petition are not covered within the effectivity of the Revenue Regulations 15-2002 which became effective October 26, 2002.***
>
> ***6. Granting that petitioner is not subject to the tax on Gross Philippine Billings, then it is liable to pay the tax equal to 32% of its gross income received during the first and second quarter of tax year 2001 from all sources within the Philippines pursuant to Section 28 (B) (1) of the National Internal Revenue Code 1997 as a Non-Resident Foreign Corporation.***
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> ***7. In fact Section 3 of Revenue Regulations No. 15-2002 cited in the petition has reservations when its states that "(T)his provision is without prejudice to classifying such taxpayer under a different category pursuant to a separate provision of the same Code";***

[3] Exhibits H, J, L, N in relation to Exhibit G, I, K and M; Exhibit U
[4] Stipulation of Facts, pars. 9 & 10

> ***8. When the law is clear and unambiguous it leaves no room for interpretation and must be applied according to its plain meaning, resort therefore to the legislative intent, much more interpretation of the statement of a senator in the bicameral conference is unnecessary;***
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> ***9. Taxes paid and collected are presumed to have been paid in accordance with law, hence, not refundable;***
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> ***10. In an action for tax refund/credit, the taxpayer has the burden to establish its right to a refund, and failure to sustain the burden is fatal to the claim for refund;***
>
> ***11. Well-established is the rule that refunds/tax credits are construed strictly against the taxpayer as they partake the nature of exemption from tax."[5]***

The parties in this case have stipulated on the following issues for the resolution of this Court:

> "1. Whether or not petitioner complied with the requirements under Section 204 and 229 of the National Internal Revenue Code of 1997 for the recovery of internal revenue taxes that have been erroneously, wrongfully, illegally or excessively assessed or collected;
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> 2. Whether or not gross revenues derived by an off-line carrier from the carriage of passengers and cargo between ports or points outside the territorial jurisdiction of the Philippines, through the sale of passage documents in the Philippines by the off-line carrier's sales agent, are subject to the Gross Philippine Billings Tax; and
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> 3. Whether or not petitioner is entitled to the refund of erroneously paid tax on Gross Philippine Billings for the first and second quarters of taxable year 2002 in the amount of P1,509,103.21."[6]

The first issue is resolved in the affirmative.

As culled from the records of this case, petitioner's administrative claim for refund filed on February 5, 2003[7] and the present Petition for Review filed on August 26, 2003 are well within the two-year prescriptive period allowed by law reckoned from the filing of petitioner's quarterly income tax returns for the first and second quarters of 2002 on May 30, 2002 and August 29, 2002, respectively.[8]

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[5] **Rollo, pages 37-38**
[6] **Rollo, page 60**
[7] Stipulation of Facts, par. 9
[8] Exhibits C, D, E & F

Anent the second issue, petitioner alleges that it is not liable to the 2½% tax on Gross Philippine Billings, since it is imposed only on gross revenues derived from the carriage of persons, excess baggage, cargo and mail originating from the Philippines in a continuous and uninterrupted flight. Foreign airline companies without flights from or passing through any point in the Philippines such as the petitioner, are not subject to 2½% tax on Gross Philippine Billings. Thus, petitioner is entitled to the refund of erroneously tax paid on Gross Philippine Billings in the amount of P1,509,103.21.

Petitioner further contends that assuming *arguendo* that it is deemed doing business in the Philippines, the revenues accruing from the sale of passage documents for the carriage of passengers and cargo within ports or points outside the Philippines are not considered income from Philippine source. Hence, it is not subject to income tax.

Respondent however counters, among others, that the transaction periods in the petition are not covered within the effectivity of the Revenue Regulations No. 15-2002 which became effective only on October 26, 2002; and even granting that petitioner is not subject to the tax on Gross Philippine Billings, still, it is liable to pay the tax equal to 32% of its gross income received during the first and second quarters of taxable year 2002 from all sources within the Philippines pursuant to Section 28 (B)(1) of the National Internal Revenue Code of 1997 as a non-resident foreign corporation.

As regards petitioner's argument, Section 3 of Revenue Regulations No. 15-2002, dated May 30, 2002, 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 . . . is not considered engaged in the business as an international carrier in the Philippines and is, therefore, not subject to Gross

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Philippine Billings Tax . . ." is not applicable in the instant case because said regulations only became effective on October 26, 2002 while the transactions covered by the present claim are the first and second quarters of taxable period 2002.

The NIRC imposes 2½% tax on Gross Philippine Billings on revenues derived by an international air carrier doing business in the Philippines. "Gross Philippine Billings" refers to 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.[9] Otherwise stated, the crucial factor in ascertaining the tax on Gross Philippine Billings is the place where the carriage of passengers and cargo originated and not where the tickets were sold.

Petitioner's absence of flight operations to and from the Philippines is bolstered by the fact it was not conferred any landing rights here,[10] therefore, its gross revenues derived from the carriage of persons and goods are not within the purview of Gross Philippine Billings. It follows that petitioner is not liable to pay 2½% tax on its Gross Philippine Billings.

In the case of ***South African Airways vs. Commissioner of Internal Revenue, CTA EB No. 118 (CTA Case No. 6760), December 2, 2005***, the Court *En Banc* held that petitioner South African Airways cannot be taxed on its Gross Philippine Billings, to wit:

> "[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

[9] Section 28 (A) (3)(a) of the 1997 National Internal Revenue Code
[10] Stipulation of Facts, par. 4

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> 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."[11]

However, despite the above ruling that petitioner, being an off-line international carrier without flights originating from the Philippines, cannot be taxed on its Gross Philippine Billings, still, it is not entitled to the claim for refund as it is liable to pay 32% income tax as a resident foreign corporation.

In the same case of ***South African Airways vs. Commissioner of Internal Revenue,*** *supra,* the Court *En Banc,*[12] elucidated that while petitioner is not liable to pay on Gross Philippine Billings, it is still required to pay income tax on its gross revenue from the sales of its passage documents. To quote:

> "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 case of Air Canada vs. Commissioner of Internal Revenue, that while petitioner is not liable to pay tax on Gross Philippine Billings, it is still liable to pay income tax on its gross revenue from the sales of its passage documents. We quote:
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> > "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

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[11] The same stand was reiterated by the Court in the case of **Air New Zealand vs. Commissioner of Internal Revenue, CTA Case No. 6761, promulgated on September 12, 2005**, citing as basis the case of Air Canada vs. Commissioner of Internal Revenue, CTA Case No. 6572, December 22, 2004.

[12] Citing the case of Air Canada vs. Commissioner of Internal Revenue, CTA Case No. 6572, December 22, 2004, affirmed in CTA EB No. 86, August 26, 2005

> progressive prosecution of commercial gain or for the purpose and object of the business organization."
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> "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."

The absence of flight operations to and from the Philippines is not determinative of the source of income or the situs of income taxation. Petitioner admitted that 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. Hence, 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.

The High Tribunal on numerous occasions sustained the validity of the foregoing 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 Honorable Supreme Court explained 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. . . . The test of taxability is the 'source'; and the source of an income is that activity . . . 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."

The High Court in the same case of Commissioner of Internal Revenue vs. British Overseas Airways Corporation, *supra*, explained 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.
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> 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. . . ."

> It has been consistently ruled 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 said definition to the present case, proceeds from sales of passage documents by the petitioner are subject to income tax.

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.[13] 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 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.

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[13] Howden and Company, Ltd. vs. Commissioner of Internal Revenue, 13 SCRA 601

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 percent (32%) of its taxable income derived from its sales of passage documents here in the Philippines.

WHEREFORE, premises considered, The Petition for Review is hereby ***DENIED.***

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

(On Leave)
CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 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's Division.

ERNESTO D. ACOSTA
Presiding Justice
Chairman, First Division