REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

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AIR NEW ZEALAND,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 6949

Members:

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

Promulgated:
JUN 19 2007 ; 1:25 pm

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DECISION

ACOSTA, P.J.:

The instant petition is a claim for refund in the total amount of P257,698.00 representing alleged erroneously paid taxes on Gross Philippine Billings of petitioner for the First and Second Quarters of taxable year 2002.

Air New Zealand (Petitioner) is a non-resident foreign corporation organized and existing under the laws of New Zealand with principal office at ANZ Level 21, Quay Tower, 29 Customs Street, West Auckland I, New Zealand. As an off-line international air carrier having no landing rights in the Philippines, petitioner does not maintain flight operations to and from the Philippines. Likewise, it is not registered with the Securities and Exchange

Commission as a corporation, branch office or partnership, and, consequently, is not licensed to do business in the Philippines.[1]

Petitioner, though, has a general sales agent in the Philippines, Aerotel Limited Corporation (Aerotel), which, among others, sells passage documents for compensation or commission covering off-line flights of petitioner.[2]

Petitioner filed, through Aerotel, its Quarterly Income Tax Returns for the First and Second Quarters of taxable year 2002 and paid the amount due thereon as follows[3]:

Period	Date Filed & Paid	Amount Paid
1st Quarter	May 30, 2002	P 137,144.00[4]
2nd Quarter	August 29, 2002	P 120,554.00[5]
		P 257,698.00

On February 5, 2003, petitioner filed a formal claim for refund with the Commissioner of Internal Revenue (respondent), through Revenue District Office No. 47 of the Bureau of Internal Revenue, for the recovery of the amount of P257,698.00 allegedly representing erroneously paid tax on Gross Philippine Billings for the First and Second Quarters of taxable year 2002.[6]

In a letter dated March 9, 2004, respondent, through the Regional Director of Revenue Region No. 8, categorically denied petitioner's claim for refund, which was received by petitioner, through Aerotel, on March 19, 2004.[7]

Hence, the instant petition filed on April 16, 2004.

Instead of filing an Answer, respondent filed a Motion to Dismiss alleging that petitioner has no capacity to sue. The same, however, was denied by this Court via Resolution dated February 10, 2005 on the ground that petitioner has complied with Section 4 of the Rules of Court and the averments in the Petition for Review sufficiently showed that

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[1] Paragraphs 1, 3, & 4, Joint Stipulation of Facts and Issues, Records, p. 61
[2] Paragraph 5, Joint Stipulation of Facts and Issues, p. 62
[3] Paragraph 6, Joint Stipulation of Facts and Issues, p. 62
[4] Exhibit "C"
[5] Exhibit "D"
[6] Paragraph 7, Joint Stipulation of Facts and Issues, Records, p. 62; Annex "D" of Petition for Review, Records, p. 15
[7] Paragraph 8, Joint Stipulation of Facts and Issues, Records, p. 62; Annex "E" of Petition for Review, Records, p. 20

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petitioner is not suffering from any disqualification affecting its capacity to bring suit. Thereafter the trial ensued.

The case was submitted for decision on November 22, 2006.

Both parties submit the following issues for the Court's resolution:

1. Whether or not petitioner complied with the requirements under Sections 204 and 229 of the National Internal Revenue Code of 1997 (NIRC) for the recovery of internal revenue taxes that have been erroneously, wrongfully, illegally or excessively assessed or collected.

2. Whether or not gross revenues derived by an off-line carrier from the carriage of passengers 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 income tax on Gross Philippine Billings.

3. Whether or not Revenue Regulations No. 15-2002 dated May 30, 2002 alleged by petitioner as its basis for the claimed refund is applicable to the issues involved in the instant case.

4. Whether or not petitioner's claim for refund in the sum of P257,698.00 as alleged erroneously paid income tax on Gross Philippine Billings for the 1st and 2nd quarters of taxable year 2002 was duly substantiated.

5. Whether or not petitioner is entitled to the refund of erroneously paid tax on Gross Philippine Billings for the 1st and 2nd quarters of taxable year 2002 in the amount of P257,698.00.

Anent the first issue, the Court rules in the affirmative. The conditions for claiming refunds of taxes erroneously or illegally paid are provided in Sections 204 (C) and 229 of the National Internal Revenue Code of 1997 (NIRC) as follows:

> "**Section 204.** *Authority of the Commissioner to Compromise, Abate and Refund or Credit Taxes.* — The Commissioner may —
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> x x x
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> (C) Credit or refund taxes erroneously or illegally received or penalties imposed without authority, refund the value of internal revenue stamps when they are returned in good condition by the purchaser, and, in his discretion, redeem or change unused stamps that have been rendered unfit for use and refund their value upon proof of destruction. **No credit or refund of taxes or penalties shall be allowed unless the taxpayer**

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> **files in writing with the Commissioner a claim for credit or refund within two (2) years after the payment of the tax or penalty**: *Provided, however,* That a return filed showing an overpayment shall be considered as a written claim for credit or refund.
>
> x x x" (*Underscoring supplied*)
>
> "**Section 229.** *Recovery of Tax Erroneously or Illegally Collected.* — No suit or proceeding shall be maintained in any court for the recovery of any national internal revenue tax hereafter alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessively or in any manner wrongfully collected, **until a claim for refund or credit has been duly filed with the Commissioner**; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress.
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> **In any case, no such suit or proceeding shall be filed after the expiration of two (2) years from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment**: *Provided, however,* That the Commissioner may, even without a written claim therefor, refund or credit any tax, where on the face of the return upon which payment was made, such payment appears clearly to have been erroneously paid." (*Emphasis supplied)*

In the instant case, petitioner's administrative claim for refund filed on February 5, 2003 and Petition for Review filed on April 16, 2004 were 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]

Considering that the second, third, fourth, and fifth issues are related, these issues shall be discussed jointly.

Petitioner argues that it is not liable to the 2½% tax on Gross Philippine Billings on the following grounds:

First, it is imposed only on gross revenues derived from the carriage of persons, excess baggage, cargo and mail which originate from the Philippines in a continuous and uninterrupted flight. Such tax, therefore, does not apply to off-line flights carried out or

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[8] Exhibits "C", "D" and Annex "D" of Petition for Review.

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maintained by an international air carrier (such as petitioner) between ports or points outside the territorial jurisdiction of the Philippines, without touching a port or point situated in the Philippines.

Second, Revenue Regulations No. 15-02 applies to its case; the pertinent provision of which is quoted hereunder for ready reference, to wit:

> "**Section 3.** *Foreign Airline Companies Without Flights Starting From Or Passing Through Any Point In The Philippines.* — An off-line airline having a branch office or a sales agent in the Philippines which sells passage documents for compensation or commission to cover off-line flights of its principal or head office, or for other airlines covering flights originating from Philippine ports or off-line flights, is not considered engaged in business as an international air carrier in the Philippines and is, therefore, not subject to Gross Philippine Billings Tax provided for in Section 28(A)(3)(a) of the Code nor to the three percent (3%) common carrier's tax under Section 118(A) of the same Code. This provision is without prejudice to classifying such taxpayer under a different category pursuant to a separate provision of the same Code."

Such regulation is consistent and in harmony with Section 28 of the NIRC and has the force and effect of law.

Third, the determining factor of the income tax on Gross Philippine Billings of international air carriers is the place where the carriage of passengers originated and not where the tickets are sold.

Fourth, the mere fact that petitioner has a general sales agent in the Philippines does not render it "engaged in business in the Philippines" as an international air carrier subject to tax on Gross Philippine Billings. Assuming *arguendo* that petitioner is engaged in business in the Philippines, the revenues it derives from the sale of passage documents for the carriage of passengers within ports or points outside the Philippines are not considered Philippine-sourced income.

Thus, petitioner claims entitlement to the refund of erroneously paid tax on Gross Philippine Billings in the amount of P257,698.00.

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At this juncture, Section 28 (A)(3)(a) of the NIRC is hereunder quoted inasmuch as its proper interpretation is the crux of the controversy, thus:

> "**Section 28.** *Rates of Income Tax on Foreign Corporations.—*
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> (A) Tax on Resident Foreign Corporations.—
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> x x x
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> (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:
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> (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.
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> x x x"

Based on the foregoing, petitioner is not liable for the tax on Gross Philippine Billings because it does not maintain flight operations to and from the Philippines, as bolstered by the fact it was not conferred any landing rights here. For passenger and cargo revenues to form part of Gross Philippine Billings, such revenues must be derived from the carriage of persons and/or cargo originating from the Philippines in a continuous and uninterrupted flight. This is supported by the case of *South African Airways vs. Commissioner of Internal Revenue*[9] wherein the Court *En* Banc, citing the case of *Air Canada vs. Commissioner of*

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[9] CTA EB No. 118 (C.T.A. Case No. 6760) dated December 02, 2005

Internal Revenue,[10] ruled that an international carrier cannot be taxed on its Gross Philippine Billings in this wise:

> "[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 of 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*)

Notwithstanding that petitioner is not liable to pay tax on Gross Philippine Billings, it is still liable to pay corporate income tax on its gross revenue from the sales of its passage documents in the Philippines. Still in the case of *South African Airways vs. Commissioner of Internal Revenue*[11], the Court *En Banc*, quoting the ruling of this Court in the case of *Air Canada vs. Commissioner of Internal Revenue,*[12] had this to say:

> "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:
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>> '. . . 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.'

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[10] CTA EB No. 86 (CTA Case No. 6572) dated December 22, 2004
[11] *Supra*
[12] CTA Case No. 6572 dated December 22, 2004

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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."

Since petitioner admitted that it sells passage documents in the Philippines through its sales agent, Aerotel, and that it derives revenues from the conduct of its business activity regularly pursued within the Philippines, 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 income tax.

The Supreme Court in several of its landmark decisions corroborates the validity of the afore-mentioned finding. Among these are the cases of *Commissioner of Internal Revenue vs. British Overseas Airways, Corp.*[13] and *Commissioner of Internal Revenue vs. American Airlines, Inc.,*[14] where the Supreme Court clarified in the earlier cited case 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 . . . 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."

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[13] 149 SCRA 395
[14] 180 SCRA 274

The High Tribunal in the same case of *Commissioner of Internal Revenue vs. British Overseas Airways Corporation*[15] 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. (*Citation omitted*)
>
> *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.* x x x" (*Emphasis supplied*)

Clearly, 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.[16] Accordingly, proceeds from sales of passage documents by the petitioner are subject to income tax.

In order to resolve the issue that Revenue Regulations No. 15-2002 justifies the grant of petitioner's refund claim, this Court points out that the transaction period covered by the refund claim is the First and Second Quarters of taxable period 2002, while the said regulation only became effective on October 26, 2002. And as earlier settled, even though petitioner is not covered by the Gross Philippine Billings Tax, it is still liable to pay income tax on its taxable income derived or received from the sale of its passage documents in the Philippines during the taxable year 2002.

Now that petitioner's liability for corporate income tax on its taxable income has been established, the question to be resolved is the rate of income tax to be imposed thereon.

[15] *supra*
[16] *Commissioner of Internal Revenue vs. Japan Air Lines, Inc.* (202 SCRA 450)

For the first time, this Court answered that question in *United Airlines, Inc. vs. Commissioner of Internal Revenue*[17] in this wise:

> "Generally, under Section 28(A)(1) of the 1997 Tax Code, a resident foreign corporation like herein petitioner, shall be subject to 32% corporate income tax. However, with the existence of a tax treaty between the Philippines and the United States, petitioner is liable only to 1½% tax on its gross revenues derived from sources within the Philippines arising from the "operation of ships or in international traffic" as provided in Article 9(1)(A) of the RP-US Tax Treaty, *viz:*
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> "Article 9
> Shipping and air transport
>
> 1) Notwithstanding any other provision of this Convention, <u>profits derived by a resident of one of the Contracting States from sources within the other Contracting State from the operation of ships in international traffic</u> may be taxed by both Contracting States; however, the tax imposed by the other Contracting State may be as much as, but shall not exceed, the lesser of –
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>   a) one and one-half per cent of the gross revenues derived from sources in that State; and
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>   b) the lowest rate of Philippine tax that may be imposed on profit of the same kind under similar circumstances by a resident of a third State.
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> xxx xxx xxx"
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> Based on the foregoing, the state of residence and the state of source are both permitted to tax profits derived by corporations engaged in shipping and air transport in the operation of its ship and/or air transport in international traffic, with a restraint on the tax that may be collected by the state of source. The restraint here being, instead of holding petitioner liable to pay corporate income tax at the rate of 32%, it is liable only to the extent of 1½% of the gross revenues derived from sources in this State. This is due to the fact that a closer look at the RP-US Tax Treaty shows that the tax rates fixed by Article 9 are the maximum rates as reflected in the phrase "shall not exceed, the lesser of x x x." This means that any tax imposable by the contracting states concerned, with respect only to the operation of ships or air transport in international traffic, should not exceed the 1½% limitation and that said rate would apply only if the tax imposed by our laws exceed the same.

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[17] CTA Case No. 6641, dated February 22, 2007

> Simply put, profits derived by a resident of one of the Contracting States from operation of ships/air transport in international traffic shall be taxable at the rate of whatever is lesser between 1½% of the gross revenues and the lowest rate of the Philippine tax on profits of the same kind by a resident of a third State."

Though the tax treaty involved in the above-quoted case pertains to that of the treaty between the Philippines and the United States of America, the ruling therein nevertheless applies by analogy to the instant case due to the similarity of provisions contained therein with that of the RP-New Zealand Tax Treaty. Article 8(2) of the RP-New Zealand Treaty provides:

> **"ARTICLE 8**
>
> **SHIPPING AND AIR TRANSPORT**
>
> 1. Profits derived by an enterprise of a Contracting State from the operation in international traffic of ships or aircraft shall be taxable in that State.
>
> 2. Notwithstanding the provisions of paragraph 1, profits from sources within a Contracting State derived by an enterprise of the other Contracting State from the operation of ships or aircraft in international traffic may be taxed in the first-mentioned State **but the tax so charged shall not exceed one and one-half percent of the gross revenues derived from sources in that State**. x x x. (*Emphasis supplied*)"

Though the RP-New Zealand Tax Treaty does not mention Gross Philippine Billings, it does mention "profits derived by an enterprise of a Contracting State from the operation in international traffic of ships or aircraft." As earlier discussed, "gross income" includes gains, profits and income derived from whatever source. In the present case, the activity that produced income, *i.e.*, petitioner's sale of tickets through its local agent, was conducted in the Philippines. Hence, the same should be considered as taxable income within the Philippines as this income easily falls under the phrase "sources within a Contracting State derived by an enterprise of the other Contracting State from the operation of ships or aircraft in international traffic."

In conclusion, the petitioner, as resident foreign corporation engaged in trade or business in the Philippines on account of its sale of passage documents here in the Philippines, is not taxable on its Gross Philippine Billings as provided in Section 28(A)(3)(a) of the NIRC. However, it is still liable for income tax not at the rate of 32% as generally imposed on resident foreign corporations, but at the lower rate of 1½% pursuant to the RP-New Zealand Tax Treaty on the profits derived from sources within the Philippines. Since petitioner already paid its income tax liabilities for taxable year 2002 at the rate of 1½% of gross income, the payment is correct and therefore no refundable amount is due.

WHEREFORE, the instant Petition for Review is hereby **DISMISSED** for lack of merit.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

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