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. 6656

Members:

\- versus -

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

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
MAY 10 2006

x - x

DECISION

ACOSTA, E., PJ.:

This case involves a claim for refund of alleged erroneously paid tax on Gross Philippine Billings in the amount of One Million Seven Hundred Twenty-Seven Thousand Seven Hundred Sixty-Six Pesos and Thirty-Eight Centavos (P1,727,766.38) for the taxable year 2000.

The facts as revealed by the records of the case are as follows:

Petitioner is a foreign corporation organized and existing under the laws of the Republic of South Africa with principal office at Airways Park, Jones Road, Johannesburg

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International Airport, South Africa.[1] It is an off-line international air carrier having no landing rights in the Philippines.[2] Thus, it does not maintain flight operations to and from the Philippines. Moreover, petitioner 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.[3]

Petitioner has a general sales agent in the Philippines, Aerotel Limited Corporation (*Aerotel, for brevity*), that, among others, sells passage documents for compensation or commission covering off-line flights of petitioner.[4]

For the taxable year 2000, petitioner filed, through Aerotel, separate quarterly and annual income tax returns for carriage of cargo and passengers, detailed as follows:

	Period	Date Filed	2.5% Gross Philippine Billings	Exhibit
For Passenger	1st Quarter	May 30, 2000	P 222,531.25	F
	2nd Quarter	Aug. 29, 2000	424,046.95	G
	3rd Quarter	Nov. 29, 2000	422,466.00	H
	4th Quarter	April 16, 2000	453,182.91	J
Sub- total			**P 1,522,227.11**	
	1ST Quarter	May 30, 2000	P 81,531.00	C
For Cargo	2ND Quarter	Aug. 29, 2000	50,169.65	D
	3RD Quarter	Nov. 29, 2000	36,383.74	E
	4th Quarter	April 16, 2000	37,454.88	I
Sub-Total			**P 205,539.27**	
TOTAL			**P 1,727,766.38**	

On February 5, 2003, petitioner filed a formal claim for refund with respondent through Revenue District Office No. 47 of the Bureau of Internal Revenue (*BIR, for brevity*), for the recovery of the alleged erroneously paid tax on the Gross Philippine Billings for the taxable year 2000 in the amount of P1,727,766.38.

[1] Exhibit V
[2] Exhibits W & X
[3] par. 2, Stipulation of Facts, Records, page 105
[4] (*Exhibits U and U-1*).

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On April 14, 2003, petitioner filed the instant petition due to alleged inaction of the respondent on its claim.

The parties, in their Joint Stipulation of Facts and Issues,[5] agreed on the following issues to be resolved by this Court:

1. Whether or not petitioner has complied with the provisions of Sections 204 (C) and 229 of the Tax Code on the prescriptive period for filing administrative and judicial claims for tax refund;

2. Whether or not petitioner is liable for 2.5% income tax on Gross Philippine Billings Tax from gross revenues derived by the petitioner for taxable year 2000 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 petitioner's general sales agent;

3. Assuming that petitioner is not liable for 2.5% income tax on Gross Philippine Billings, whether or not petitioner has paid the amount of P1,727,766.38 to the Bureau of Internal Revenue;

4. Whether or not petitioner is entitled to a refund in the amount of P1,727,766.38 allegedly representing erroneously paid tax on Gross Philippine Billings for the taxable year 2000; and

5. Assuming *arguendo* that petitioner is not liable for the 2.5% income tax on Gross Philippine Billings under Section 28(A)(3)(a) of the Tax Code, as amended, whether or not petitioner, as a non-resident foreign corporation, is liable for a higher income tax of 32% under Section 28(B)(1) of the same Code.

Anent the first issue, the National Internal Revenue Code of 1997 provides:

> SEC. 204. *Authority of the Commissioner to Compromise, Abate and Refund or Credit Taxes.* — The Commissioner may —
>
> xxx xxx xxx
>
> (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 files in writing with the Commissioner a claim for credit or refund within two (2) years after the payment of the tax or penalty: xxx
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> SEC. 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

[5] Filed on October 29, 2003

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> 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.
>
> 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: xxx

Based on the foregoing and the evidence presented in this case, petitioner's administrative claim for refund filed on February 5, 2003[6] and the judicial claim filed on April 14, 2003 fall within the two-year prescriptive period allowed by law reckoned from the filing of petitioner's income tax returns on April 16, 2001.[7]

Likewise, records show that petitioner paid to the BIR the amount of P1,727,766.38 as 2.5% tax on its Gross Philippine Billings, as follows:[8]

	Period	2.5% Gross Philippine Billings	Exhibit
For Passenger	1st Quarter	P 222,531.25	F, F-1, F-2
	2nd Quarter	424,046.95	G, G-1, G-2
	3rd Quarter	422,466.00	H, H-2, H-2
	4th Quarter	453,182.91	J, J-1, J-2
Sub- total		**P 1,522,227.11**	
	1ST Quarter	P 81,531.00	C, C-1, C-2
For Cargo	2ND Quarter	50,169.65	D, D-1, D-2
	3RD Quarter	36,383.74	E, E-1, E-2
	4th Quarter	37,454.88	I, I-1, I-2
Sub-Total		**P 205,539.27**	
TOTAL		**P 1,727,766.38**	

We will now proceed to the remaining issues of whether petitioner is liable for 2.5% tax on Gross Philippine Billings and whether it is entitled to the claimed of erroneously paid tax on Gross Philippine Billings for the taxable year 2000 amounting to P1,727,766.38.

Petitioner argues that it is not liable to pay the 2.5% tax on Gross Philippine Billings because the same is imposed only on gross revenues derived from the carriage of persons,

[6] Par. 4, Stipulation of Facts, Records, page 106
[7] Exhibit I & J
[8] See also Exhibit L

excess baggage, cargo and mail that originate from the Philippines in a continuous and uninterrupted flight pursuant to Section 28(A)(3)(a) of the NIRC as implemented by Revenue Regulations No. 15-2002. The determining factor in imposing tax on Gross Philippine Billings on international air carriers is the place where the carriage of passengers and cargo originated and not the place of sale of tickets. The mere fact that it has a general sales agent in the Philippines does not render petitioner as "engaged in business in the Philippines". Also, petitioner does not derive Philippine source income, hence, it is not subject to tax.

On the other hand, respondent maintains, among others, that petitioner is liable to pay the 2.5% tax on Gross Philippine Billings for the subject period in accordance with the ruling of the Supreme Court in the case of Commissioner of Internal Revenue vs. British overseas Airways Corporation, *et al.*[9], wherein the source of an income is the property, activity, or service that produced the income. For source of income to be considered as coming from the Philippines, it is sufficient that the source of income is derived from activity within the Philippines.

Further, Revenue Regulations No. 15-2002 dated May 30, 2002 is not applicable in the instant case since it was issued only in 2002. And even assuming that petitioner is not subject to 2.5% tax on Gross Philippine Billings, it is subject to the 32% final gross income tax under Section 28(B)(1) of the 1997 NIRC.

The contention of petitioner that Section 3 of Revenue Regulation No. 15-2002 dated May 30, 2002, which provides in part that, "An offline airline having a branch or sales agent in the Philippines which sells passage documents for compensation or commission to cover off-line flights xxx is not considered engaged in the business as an international carrier in the Philippines and is, therefore, not subject to Gross Philippine Billings Tax xxx", justifies the grant of its refund claim is misplaced. It must be pointed out that the transaction period

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[9] 149 SCRA 395 [1997]

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covered by the present claim is taxable year 2000, while the said regulations only became effective on October 26, 2002.

Section 28 (A)(3)(a) of the National Internal Revenue Code of 1997 imposes 2.5% tax on Gross Philippine Billings on revenues derived by an international air carrier. To quote:

> SEC. 28. *Rates of Income Tax on Foreign Corporations.* -
>
> (A) *Tax on Resident Foreign Corporations.* —
>
> xxx xxx xxx
>
> (3) *International Carrier.* — An international carrier doing business in the Philippines shall pay a tax of two and one-half percent (2½%) on its *'Gross Philippine Billings'* as defined hereunder:
>
> (a) *International Air Carrier.* — *'Gross Philippine Billings'* refers to the amount of gross revenue derived from carriage of persons, excess baggage, cargo and mail originating from the Philippines in a continuous and uninterrupted flight, irrespective of the place of sale or issue and the place of payment of the ticket or passage document: *Provided*, That tickets revalidated, exchanged and/or indorsed to another international airline form part of the Gross Philippine Billings if the passenger boards a plane in a port or point in the Philippines: *Provided, further*, That for a flight which originates from the Philippines, but transshipment of passenger takes place at any port outside the Philippines on another airline, only the aliquot portion of the cost of the ticket corresponding to the leg flown from the Philippines to the point of transshipment shall form part of Gross Philippine Billings.

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 therein 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 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, <u>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</u>."[10] *(Underscoring supplied)*

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[10] 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.

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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*,[11] 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:
>
>> "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."
>>
>> "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." *(Underscoring supplied)*

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[11] 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

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.
>
> 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. *(Underscoring Ours)*

In the case at bar, 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 it derives revenues from the conduct of its business activity regularly pursued in the Philippines. 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. Therefore, petitioner is a resident foreign corporation doing business in the Philippines within the purview of our tax law 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 sum, the petitioner, as a 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 in the Philippines.

WHEREFORE, premises considered, petitioner's claim for refund is hereby **DENIED** for lack of merit.

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

WE CONCUR:

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

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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
Chairperson, First Division

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