REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION
****

AIR CANADA,
Petitioner,

- versus -

C.T.A. CASE NO. 6572

Members:

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

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
DEC 2 2 2004
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DECISION

***BAUTISTA, L., J.*:**

This case seeks for the refund of alleged erroneously collected income tax covering the taxable period from the 3rd quarter of 2000 up to the 2nd quarter of 2002 in the total amount of **FIVE MILLION ONE HUNDRED EIGHTY FIVE THOUSAND SIX HUNDRED SEVENTY SIX PESOS AND 77/100 (P5,185,676.77)**.

The undisputed facts as culled from the records of the case are as follows:

Petitioner, Air Canada, a foreign corporation organized and existing under the laws of Canada, was granted an authority to operate as an off-line carrier by the Civil Aeronautics Board (CAB) subject to certain conditions, on April 24, 2000, with said authority to expire on April 24, 2005 *(Exhibit "I")*.

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On July 1, 1999, petitioner and Aerotel Ltd., Corporation, entered into a Passenger General Sales Agency Agreement, whereby Aerotel Ltd., Corporation was appointed as petitioner's Passenger General Sales Agent for the territory defined in the said Agreement *(Annex "B", Petition for Review).*

For the taxable quarters covering the 3rd Quarter of the taxable year 2000 up to the 2nd Quarter of the taxable year 2002, petitioner filed and paid its Quarterly and Annual Income Tax Returns, as follows:

Exhibit	Applicable Quarter/Year	Date Filed/Paid	Amount of Tax
"A" & "A-1"	3rd Qtr 2000	November 29, 2000	P 395,165.00
"B" & "B-1"	Annual ITR 2000	April 16, 2001	381,893.59
"C" & "C-1"	1st Qtr 2001	May 30, 2001	522,465.39
"D" & "D-1"	2nd Qtr 2001	August 29, 2001	1,033,423.34
"E" & "E-1"	3rd Qtr 2001	November 29, 2001	765,021.28
"F" & "F-1"	Annual ITR 2001	April 15, 2002	328,193.93
"G" & "G-1"	1st Qtr 2002	May 30, 2002	594,850.13
"H" & "H-1"	2nd Qtr 2002	August 29, 2002	1,164,664.11
TOTAL			**P 5,185,676.77**

On November 28, 2002, petitioner filed its administrative claim for refund with the Bureau of Internal Revenue in the total amount of FIVE MILLION ONE HUNDRED EIGHTY FIVE THOUSAND SIX HUNDRED SEVENTY SIX PESOS AND 77/100 (P5,185,676.77), allegedly representing erroneously paid income taxes from the 3rd quarter of 2000 up to the 2nd quarter of 2002 *(Exhibit K).*

With no response received from the Bureau of Internal Revenue and before it could be barred by prescription, petitioner deemed it proper to elevate its claim to this Court through this instant Petition for Review filed on November 29, 2002.

On February 4, 2003, respondent filed his Answer raising the following as his

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Special and Affirmative Defenses, to wit:

4. Petitioner's alleged claim for refund is subject to administrative examination/investigation by the respondent's Bureau;

5. Petitioner's claim for refund of alleged erroneously paid income tax (Gross Philippine Billings) has already prescribed;

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 period starting the 3rd quarter of 2000 and ending on the 2nd quarter of 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;

7. In fact Section 3 of Revenue Regulations No. 15-2002 cited in the petition has reservations when it 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.";

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;

9. Taxes paid and collected are presumed to have been paid in accordance with law, hence, not refundable;

10. In an action for tax refund/credit, the taxpayer has the burden to establish its right to 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.

This case was deemed submitted for decision on October 4, 2004 sans the Memorandum of the respondent.

The issues as stipulated by the parties are as follows:

1. Whether or not petitioner is subject to tax on its Gross Philippine Billings;

2. Whether or not petitioner is taxable as a non-resident foreign corporation doing business in the Philippines; and

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3. Whether or not petitioner is entitled to its claim for refund in the total amount of P5,185,676.77 pertaining to income tax paid for the 3rd Quarter of 2000 to the 2nd Quarter of 2002.

Considering that the first and third issues are interrelated, this Court shall discuss them jointly.

It is petitioner's argument that pursuant to the amended definition of Gross Philippine Billings under Section 28(A)(3)(a) of the 1997 Tax Code, for passenger revenue to form part of the Gross Philippine Billings, such revenues must be derived from the carriage of persons and cargo 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. As a consequence, there is no liability to pay the tax if the carriage of persons and cargo does not originate from the Philippines in a continuous and uninterrupted flight. This is regardless of whether the ticket or passage document is sold, issued or paid in the Philippines.

Petitioner further argues that under the definition of Gross Philippine Billings both in the 1993 and 1977 Tax Codes, the determinative factor in the imposition of the tax is the place where the passage documents are sold, and not where the carriage of the passengers or cargoes originate. Hence, in contrast to the amended definition of the term Gross Philippine Billings under the 1997 Tax Code, under the old definition, so long as the passage documents were sold in the Philippines, the gross revenue derived from the carriage of persons and cargoes regardless of where the carriage originates is subject to income tax. Petitioner maintains that it is a foreign corporation licensed to operate as an off-line carrier in the Philippines, without flight operations originating from and coming to the Philippines.

Thus, petitioner asserts that it is not subject to income tax on its Gross Philippine

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Billings nor to any income tax. It erroneously paid income tax in the amount of P5,185,676.77 representing the 1.5% of its total gross revenue for the 3rd quarter of taxable year 2000 up to the 2nd quarter of taxable year 2002 should therefore be refunded.

Section 28 (A)(3)(a) of the 1997 Tax Code defines "Gross Philippine Billings" in this manner, to wit:

> "**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 Billing 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 passengers 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 Billing." *(Emphasis and underscoring Ours)*

The Tax Code prior to the 1997 amendment, however, defined "Gross Philippine Billing in this wise:

> "**Gross Philippine Billings**" means gross revenue realized from **uplifts of passengers anywhere in the world** and **excess baggage, cargo and mail originating from the Philippines, covered by passage documents sold in the Philippines**: Provided, That documents sold outside the Philippines under a "prepaid ticket advice" scheme for passengers originating from the Philippines shall be considered as documents sold in the Philippines. Gross revenue from chartered flights originating in the Philippines shall likewise form part of the "Gross Philippine Billings" regardless of the place of sale or payment of the passage documents. For purposes of determining the taxability of revenue from chartered flights, the term "originating from the Philippines" shall include flights of passengers who stay in the Philippines for more than forty eight (48) hours prior to embarkation." *(Emphasis and underscoring supplied)*

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Based on the above provisions then, it 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, 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.

However, another question needs to be answered: Whether or not petitioner is liable to pay income tax based on its gross revenue from sales of its passenger tickets. Otherwise put, the parties jointly stipulated the issue of whether or not petitioner is taxable as a non-resident foreign corporation doing business in the Philippines.

It is petitioner's allegation that it does not maintain a branch, office, employee or personnel in the Philippines but is merely represented by an independent General Sales Agent. Petitioner further argues that under the RP-Canada Tax Treaty, petitioner may only be subjected to income tax if it maintains a "permanent establishment", pursuant to Article V of the said treaty, here in the Philippines.

We do not agree with petitioner.

Under Section 22 of the 1997 Tax Code, the term "resident foreign corporation"

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applies to a foreign corporation engaged in trade or business within the Philippines, while the term "non-resident foreign corporation" applies to a foreign corporation not engaged in trade or business within the Philippines. 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:

> " x x x 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."
> (Emphasis supplied)

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.

Evidently then, petitioner during the periods claimed, maintained a General Sales Agent in the Philippines, under a Passenger General Sales Agency Agreement. That

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sales agent's functions include, among others, solicitation, promotion and sale of petitioner's air passenger services, as well as, filing of all necessary tax returns and paying the tax thereon on its behalf *(Annex "B", Petition for Review)*. These activities are clearly in exercise of the functions which are normally incident to, and are in progressive pursuit of, the purpose and object of its organization as an international carrier. In fact, it can be said that the regular sale of tickets is an airline's main activity and is the very lifeblood of the airline business, the generation of ticket sales being its principal objective. There is no indicium of doubt then that petitioner is "engaged in" business in the Philippines through a local agent during the period covered by the claims. Accordingly, it is a resident foreign corporation subject to income tax.

Moreover, Revenue Regulations No. 6-78 had elaborated that the phrase "doing business in the Philippines" includes the "regular sale of tickets in the Philippines by off-line international airlines either by themselves or through their agents. In the case of off-line airlines, their general sales agents in the Philippines are constituted as withholding agents pursuant to section 50 of the NIRC." Consequently, it is even admitted by petitioner that it is its General Sales Agent which files and pays the necessary tax returns in its behalf.

It is noteworthy to stress that Section 28 (A) (1) of the 1997 Tax Code provides that resident foreign corporations shall be subject to an income tax equivalent to thirty-two (32) percent (32%) of their taxable income derived from sources within the Philippines. As defined by Section 32(A) of the 1997 Tax Code, gross income is "except when otherwise provided in this title, gross income means all income derived from whatever source, including (but not limited to) the following items: (1) compensation for services in whatever form paid, including, but not limited to, fees, salaries, wages,

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commissions, and similar items; (2) gross income derived from the conduct of trade or business or in the exercise of a profession x x x". By the very definition of the term "gross income" it is broad and comprehensive as to include proceeds from the sales of transport documents. The word "income from whatever source" discloses a legislative policy to include all income not expressly exempted within the class of taxable income under our laws. Income means "cash received or its equivalent"; it means something distinct from principal or capital. For, while capital is a fund, income is a flow. As used in our income tax law, "income" refers to the flow of wealth *(Commissioner of Internal Revenue vs. British Overseas Airways Corporation, 149 SCRA 395).*

Likewise, for a source of income to be considered as coming from the Philippines, it is sufficient that the income is derived from the activities within the Philippines. In the case of petitioner, the absence of flight operations within the Philippine territory cannot alter the fact that the income received was derived from the activities within the Philippines. "The test of taxability is the "source"; and the source of an income is that activity...which produced the income" *(Howden & Co., Ltd. vs. Commissioner of Internal Revenue, 13 SCRA 601).* The sale of tickets in the Philippines is the activity that produces the income. The tickets exchanged hands here and payments for fares were also made here in Philippine currency. The situs of the source of payments is the Philippines. The flow of wealth preceded from, and occurred within, Philippine territory, enjoying the protection accorded by the Philippine government. In consideration of such protection, the flow of wealth should share the burden of supporting the government." *(Commissioner of Internal Revenue vs British Overseas Airways Corporation, supra)*

Unquestionably, the ticket sales were sold here in the Philippines. Thus, the

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revenue received there from were also generated in the Philippines, as the business activities were regularly pursued in the Philippines.

In addition, under the RP-Canada Tax Treaty, more particularly Article V and Article VII, it is clear that petitioner's gross revenues are taxable in the Philippines. To quote the pertinent provisions of the tax treaty:

Article VII
Business Profits

1. The profits of an enterprise of a Contracting State shall be taxable only in that State **unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein**. If the enterprise carries on or has carried on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as are attributable to:

a. That permanent establishment;
b. Sales of goods or merchandise of the same or similar business activities of the same or similar kind as those affected, through that permanent establishment.

ARTICLE V
PERMANENT ESTABLISHMENT

1. For the purpose of this Convention, the term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on.

2. The term "permanent establishment" shall include especially:

a. a place of management
b. a branch
c. an office
d. a factory
e. a workshop
f. a mine, quarry, or other place of extraction of natural resources
g. a building or construction site or supervisory activities in connection therewith, where such activities continue for a period more than six months
h. an assembly or installation project which exists for more than three months
i. premises used as a sales outlet
j. a warehouse, in relation to a person providing storage facilities for others.

(Emphasis supplied)

By the very provisions of the said Tax Treaty, it is evident that petitioner is taxable on its gross revenues sourced within the Philippines. It bears emphasis that by

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the provisions itself, "an enterprise carrying on a business or enterprise in the Philippines through a permanent establishment" is subject to tax in the Philippines. Petitioner, by the appointment of the local General Sales Agent, in which petitioner uses its premises as an outlet where sales of tickets are made, petitioner is deemed to have had established a permanent establishment covered under the RP-Canada Tax Treaty. Petitioner cannot argue the fact that it maintains an agent responsible for the sales of tickets for its various flights.

Verily, petitioner is a resident foreign corporation subject to income tax here in the Philippines.

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

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Division of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Chairman, First Division
Presiding Justice

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