REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

AMERICAN AIRLINES, INC.,
Petitioner,

- versus - C.T.A. CASE NO. 3046

THE COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

x - - - - - - - - - - - - - - - x

4/16/84

D E C I S I O N

Petitioner American Airlines, Inc. appeals from the decision of respondent Commissioner of Internal Revenue denying its protest against a deficiency income tax assessment for 1974 in the total amount of ₱298,521.30, inclusive of interest and compromise penalty. The principal question raised in this case is whether or not petitioner is engaged in trade or business in the Philippines as an international carrier subject to income tax under Section 24(b)(2) of the National Internal Revenue Code, as amended by Presidential Decree No. 69.

The facts, which are not in dispute, as narrated by petitioner in his petition for review, admitted by respondent in his answer, and adopted by the parties in their respective memorandum, shows that petitioner, an airline company organized under the laws of the United States of America, is an off-line international airline with no flights originating from the Philippines. It is, however, duly licensed to establish a liaison office in the Philippines for passenger and freight information and reservation, and to render ticketing services. Sometime on August 8, 1979, petitioner received from respondent a letter of demand, with notice of assessment, dated July 31, 1979, requesting it to pay the amount of ₱298,521.30, representing deficiency income tax for 1974, inclusive of interest and compromise penalty, computed on the gross Philippine billings of ₱8,400,617.00 at 2½% income tax imposed under Section 24(b)(2) of the National Internal Revenue Code, as amended, as follows:

Gross Philippine billings per investigation	₱8,400,617.00
Income tax due thereon (2½%)	₱ 210,015.00
Add: 14% interest per annum from 4-16-75 to 7-31-79	88,206.30
Compromise, failure to file return and late payment of the tax	300.00
TOTAL AMOUNT DUE	₱ 298,521.30

On August 20, 1970, petitioner protested the assessment and requested that the same be withdrawn and cancelled.

On September 14, 1979, respondent denied petitioner's request and reiterated his demand for payment of the amount of ₱298,521.30. In the same letter, respondent informed petitioner that the denial was his final decision on the protest. Hence, this appeal.

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 even assuming petitioner is a non-resident foreign corporation, still, it is liable for the payment of Philippine income tax at the rate of thirty-five per cent (35%) of its gross income received from all sources within the Philippines (Sec. 24(b)(1), National Internal Revenue Code); that pursuant to the Foreign Business Regulations Act of 1968 (R.A. 5455), petitioner is engaged, or is doing business in the Philippines, as petitioner maintains an office in the Philippines, promotes goodwill and public relations, as well as distributes brochures, pamphlets and literature regarding its operations; and that the 2½% income tax in question was imposed on income received by petitioner from sources within the Philippines.

Against this backdrop, the question posed itself as to whether or not petitioner, during the year 1974 in question, was engaged in business in the Philippines.

The question is not new and respondent's position is not so different from the stand taken by a similarly situated petitioner in the recent case of the British Overseas Airways Corporation vs. Commissioner of Internal Revenue (CTA Cases Nos. 2373 & 2561), the factual setting of which is similar to the case at bar and where this Court in a decision promulgated on January 26, 1983 ruled to the effect that the selling of passage tickets of an international air carrier, as well as the maintenance of an office for promotion and information purposes, is not considered as engagement in business in the Philippines. Because the decision in the aforesaid cases disposed of the same defenses and contentions of respondent in this appeal, we will quote at length from said decision to wit:

For purposes of income taxation, the taxability of foreign corporations 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 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, is whether or not the proceeds of sales in the Philippines of BOAC passage tickets by the Warner Barnes & Co., Ltd., and later by the Qantas Airways during the period in question, and on which the assessments involved herein were based, constitute income of petitioner from the Philippine sources.

The controlling statute is Section 37 of the National Internal Revenue Code, the pertinent portions of which during the years in question, reads 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.
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> (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 BOAC passage tickets in the Philippines by the Warner Barnes & Co., Ltd., and later by the Qantas Airways 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 an 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. (Japan Air Lines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 2480, January 15, 1982.)

It seems already settled that such proceeds of sales of airline passage tickets in the Philippines of an international air carrier of passengers and/or freight are considered "compensation for labor or personal services performed in the Philippines", if the service of transportation is performed within the Philippines. (Japan Air Lines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 2480, January 15, 1982.) The important factor which determines the source of income, if from services, for purposes of income taxation, is the place where services are actually rendered. (Mertens, Law of Federal Taxation, Vol. 8, Chap. 45, p. 141.) Income derived from transportation is considered to be income from services, with the result that where the services are rendered determines the source. (Daiichi Chuo Kisen Kaisha vs. Commissioner of Internal Revenue, CTA Case No. 1277, May 31, 1969.)

However, it is an admitted fact that petitioner did not lift nor land passengers or cargo in the Philippines during the years in question. BOAC was without landing rights for traffic purposes in the Philippines as it was not granted by the then Civil Aeronautics Board (CAB) a certificate of public convenience and necessity to operate in the Philippines. Invariably, any leg or portion of the trips serviced by BOAC commenced outside the Philippines and terminated also outside the Philippines. It is thus clear beyond doubt that since no service of carriage of transportation of passengers or freight was performed by petitioner within the Philippines, the income derived by it from the sales of passage tickets in the Philippines for international air transportation service is not subject to Philippine income tax. Pursuant to Section 24(b)(1) of the Tax Code, as amended, a foreign corporation, whether resident or non-resident, is taxable only on income from "sources within the Philippines".

We see no significance therefore in the special affirmative defenses of respondent

> that petitioner is a resident foreign corporation liable to Philippine income tax on income from sources within the Philippines, considering that the travelled revenue derived by BOAC from sales of tickets in the Philippines for international air service is not income derived from sources within the Philippines. x x x. (Underlining supplied.)

Respondent also argued that pursuant to Foreign Business Regulations Act of 1968 (R.A. 5455), petitioner is engaged in or doing business in the Philippines, as petitioner maintains an office in the Philippines, promotes goodwill, and public relations, as well as distributes brochures, pamphlets and literature regarding its operation.

This argument calls to mind the decision of this Court in the case of Japan Air Lines vs. Commissioner of Internal Revenue, CTA Case No. 1634, November 29, 1968, on which an appeal by certiorari by respondent Commissioner of Internal Revenue was denied by the Supreme Court on February 3, 1969 in L-30041, and the factual setting of which is similar to the case at bar, to the effect that the acts of a foreign corporation in engaging in the business of international air carriage and of selling passage tickets in the Philippines through its agent; in maintaining of an office in the Philippines for promotion and information purposes; and the receipt of payments for passage tickets sold in the Philippines from passengers from the Philippines do not make such international air carrier engaged in business in the Philippines, resolves the identical problem now brought before us in this proceeding.

On the argument of respondent that as an international carrier, petitioner herein is now subject to income tax based on gross Philippine billings, suffice it to state that this Court in the case of Japan Air Lines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 2480, January 15, 1982, made this observation:

> 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, <u>international carriers are not taxable on their gross Philippine billings</u>. 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 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. 3355 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. (Underlining ours.)

We see no cogent reason to hold otherwise.

IN VIEW OF ALL THE FOREGOING, the appealed decision of the Commissioner of Internal Revenue should be, as it is hereby, reversed. Without pronouncement as to costs.

SO ORDERED.

Quezon City, Metro Manila, April 16, 1984.

CONSTANTE C. ROAQUIN
Associate Judge

WE CONCUR:

AMANTE FILLER
Presiding Judge

ALEX Z. REYES
Associate Judge