REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

****

AIR NEW ZEALAND,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. CASE NO. 6657

Members:

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

Promulgated:
JUL 1 1 2006

x - x

DECISION

BAUTISTA, L., J.:

This case seeks the refund of allegedly erroneously paid taxes on Gross Philippine Billings covering the taxable year 2000 in the amount of **EIGHT HUNDRED SEVENTY TWO THOUSAND FOUR HUNDRED FORTY SEVEN AND 66/100 PESOS (P872,447.66).**

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

Petitioner, Air New Zealand, is a 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. It is an off-line international air carrier with no landing rights in the Philippines, nor is it registered with the Securities and Exchange Commission as a corporation, branch office or partnership.[1] However, it maintains a general sales agent here in the Philippines which sells passage documents covering its off-line flights.

On the other hand, respondent is the duly appointed Commissioner of Internal Revenue charged with the duties of assessing, collecting as well as refunding internal revenue taxes, among others, with office at the 5th Floor of the BIR National Office Building located at Agham Road, Diliman, Quezon City.

For the taxable year 2000, petitioner filed, through its general sales agent, Quarterly Income Tax Returns and paid taxes on Gross Philippine Billings at the reduced rate of 1 ½% pursuant to Article 8(2) of the RP-New Zealand Tax Treaty, as follows:

PERIOD	AMOUNT PAID	DATE FILED
1st Quarter	P 260,364.00	5/30/2000
2nd Quarter	217,924.79	8/29/2000
3rd Quarter	119,671.00	11/29/2000
4th Quarter	274,487.87	4/16/2001
Total	P 872,447.66	

On the ground that it is not liable to income tax on Gross Philippine Billings, petitioner filed with the respondent on February 5, 2003, through Revenue District Office No. 47, a formal claim for refund for the recovery of the amount of P872,447.66 allegedly representing the erroneously paid taxes on Gross Philippine Billings for the taxable year 2000.

With no immediate response received from the respondent 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 on April 14, 2003.

On June 4, 2003, respondent filed his Answer raising the following as his Special and Affirmative Defenses:

[1] par. 2, Joint Stipulation of Facts & Issues

4. He reiterates and repleads the preceding paragraphs of this Answer as part of his Special and Affirmative Defenses;

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

6. It was held in the leading case of Commissioner of Internal Revenue vs. British Overseas Airways Corp., et al., 149 SCRA 395, that:

> *"The source of an income is the property, activity or service that produced the income. For the 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 xxx" (emphasis supplied)*

The British Overseas Airways Corp. (BOAC), Air India, American Airlines and Japan Airlines in the cases of Commissioner v. BOAC, 149 SCRA 395, Commissioner v. Air India, 157 SCRA 648, Commissioner v. American Airlines, 180 SCRA 274 and Commissioner v. Japan Airlines, 202 SCRA 450 had no landing rights – but sold tickets – in the Philippines. In these cases, the Supreme Court held:

> *"The absence of flight operations to and from the Philippines is not determinative of the source of income or the situs of income taxation x x x. The test of taxability is the "source", and the source of an income is that activity x x x 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. In BOAC case, BOAC tickets sold covered the transport of passengers and cargo to and from foreign cities. And even so, it cannot alter the fact that income from the sale of tickets was derived from the Philippines. Hence, the aforementioned foreign airline companies were held liable for the two and one-half per cent (2 ½%) Gross Philippine Billings.

In the case at bar, petitioner admitted that it is an off-line international air carrier having no landing rights in the Philippines, hence, does not maintain flight operations to and from the Philippines. Further, it is admitted that petitioner derived gross revenues 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 petitioner's sales agents (par. 4 & 7, page 2 of Petition for Review).

The instant case is analogous to the cases of British Overseas Airways Corp. (BOAC), Air India, American Airlines and Japan Air Lines. Hence, it is submitted that petitioner is liable to the two and one-half per cent (2 ½%) Gross Philippine Billings Tax under Section 28 (A)(3)(a) of the Tax Code, as amended.

7. Petitioner anchored its claim for tax refund on the provision of Revenue Regulations No. 15-2002 dated May 30, 2002, particularly Section 3 thereof, which provides that:

> "Sec. 3. Foreign Airline Companies Without Flights Starting from or Passing Through any Point in the Philippines. - An off-line airline having a branch or 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 the Philippine ports of 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 per cent (3%) common carrier's tax under Section 118 (A) of the same Code."

Assuming arguendo, that the provisions of Revenue Regulations No. 15-2002, particularly Section 3 thereof, on the exemption from the Gross Philippine Billings Tax as provided for in Section 28 (A)(3)(a) of foreign airline companies without flight starting from or passing through any point in the Philippines applies to the petitioner, the same provision for exemption does not apply to the instant case in view of the non-retroactivity of rules and regulations. It is worthy of emphasis that said revenue regulations was issued in 2002 only and its REPEALING AND EFFECTIVITY CLAUSES provide that:

> "SEC 11. REPEALING CLAUSE. - The provisions of these regulations expressly amend Revenue Regulations No. 6-66 as well as all other existing rules and regulations which are inconsistent herewith."
>
> Revenue Regulations No. 6-66 dated December 1, 1966 provides the Regulations for Percentage Tax Purposes on International Air Transport Services. Sections 1 (b) and 2(a) thereof provides:
>
> > "Section 1. Definition: When used in these regulations. –
> >
> > (b) The term "off-line airline" means an airline having no flight operations to and from the Philippines;"
> >
> > "Section 2. International airline companies without flights starting from or passing through any point in the Philippines. –
> >
> > (a) An off-line international airline having a branch office or a sales agent in the Philippines which sells ticket for compensation or commission to cover off-line flights of its principal foreign airline or for other airlines, is not considered engaged in business as a common carrier in the Philippines, and therefore, not subject to common carriers fixed and percentage taxes provided for in Sections 182 and 192 of the tax Code." (emphasis supplied)

2dd

"SEC. 12. EFFECTIVITY CLAUSE. - These Regulations shall take effect fifteen (15) days after publication in the Official Gazette or any newspaper of general circulation, whichever comes first".

Further, Section 246 of the Tax Code provides:

"Sec. 246. Non-retroactivity of Rulings. - Any revocation, modification or reversal of any of the rules and regulations promulgated in accordance with the preceding section or any of the rulings or circulars promulgated by the Commissioner shall not be given retroactive application xxx"

8. Further, the last sentence of Section 3 of Revenue Regulations 15-2003 provides that "this provision is without prejudice to classifying such taxpayer under a different category pursuant to a separate provision of the same Code;

Assuming arguendo that petitioner is not liable for the Gross Philippine Billings Tax as provided for in Section 28 (A)(3)(a) of the Code, the revenues derived by the petitioner, a non-resident foreign corporation organized and existing under the laws of New Zealand (par. 1, page 1 of Petition for Review), in the year 2000 covering gross revenues 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 petitioner's sales agents in the amount of P58,163,177.00, is subject to the 32% Final Gross Income Tax under Section 28 (B)(1) of the Tax Code, as amended. It provides that:

"Section 28. Rates of Income Tax on Foreign Corporations. –

(A) Tax on Resident Foreign Corporation. –
(B) Tax on Non-Resident Foreign Corporation

(1) In General - Except as otherwise provided in this Code, a foreign corporation not engaged in trade or business in the Philippines shall pay a tax equal to thirty-five percent (35%) of the gross income received during each taxable year from all sources within the Philippines, xxx and effective January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%). (emphasis supplied)

It must be observed that for Philippine tax purposes, the kind of tax imposed is sometimes a crucial factor in determining whether the situs of taxation is in a particular taxing jurisdiction or not. In the case of BOAC, while it was held that said airline is taxable on the income realized, at the same time, the Court observed that the airline would not be subject to any business tax inasmuch as the absence of any landing rights would mean that it is not engaged in the exercise of any privilege which could be subject to the business or privilege tax (Commissioner v. BOAC, supra).

Hence, in the case at bar, if this Honorable Court would hold that petitioner is not liable for Gross Philippine Billings Tax provided for in Section 28 (A)(3)(a) of the Code, it is submitted that petitioner, as a non-resident foreign corporation, is liable for a higher income tax rate of 32% under Section 28 (B)(1) of the Tax Code, as amended.

In any case, the petitioner is not entitled to any tax refund but may even be liable for a deficiency income tax for the difference between the 32% and the 2 ½% tax rates as previously discussed.

9. To support its claim, it is imperative for petitioner to prove that petitioner's administrative and judicial claims for tax refund of the alleged erroneously paid tax on Gross Philippine Billings for the taxable year 2000 was filed within two (2) years from the date of payment of the tax regardless of any supervening cause that may arise after payment in accordance with Sections 204 (C) and 229 of the Tax Code, as amended;

10. Furthermore, in an action for refund the burden of proof is on the taxpayer to establish its right to refund and failure to sustain the burden is fatal to the claim for refund/credit. This is so because exemptions from taxation are highly disfavored in law and he who claims exemption must be able to justify his claim by the clearest grant of organic or statutory law. An exemption from common burden cannot be permitted to exist upon vague implications. (Asiatic Petroleum Co. [P.I.] v. Llanes, 49 Phil 466 cited in Collector of Internal Revenue v. Manila Jockey Club, Inc., 98 Phil 670); and

11. Claims for refund are construed strictly against the claimant for the same partake the nature of exemption from tax.

This case was submitted for decision on December 21, 2005 after both parties have filed their respective memoranda.

The issues as stipulated by the parties are as follows:

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 income tax on Gross Philippine Billings from the gross revenues derived by petitioner for the taxable year 2000 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 petitioner's general sales agents;

3. Assuming that petitioner is not liable for income tax on Gross Philippine Billings, whether or not petitioner has paid the amount of P872,447.66 to the Bureau of Internal Revenue;

366

4. Whether or not petitioner is entitled to refund in the amount of P872,447.66 allegedly representing paid tax on Gross Philippine Billings for the taxable year 2000; and

5. Assuming *arguendo* that petitioner is not liable for the 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 rate of 32% under Section 28 (B)(1) of the same Code.

As regards the first issue raised, long-settled is the rule that for income taxes, the two-year prescriptive period laid down in Section 229 of the National Internal Revenue Code of 1997 is reckoned from the filing of the Adjustment Return and final payment of the tax for the year *(Philippine Bank of Communications vs. Commissioner of Internal Revenue, G.R. No. 112024, January 28, 1999).*

In the case before this Court, the Annual Income Tax Return of petitioner for the taxable year 2000 was filed on April 14, 2001. Thus, petitioner had until April 15, 2003 within which to file a claim for refund of its alleged erroneously paid income tax on gross Philippine Billings for the taxable year 2000. Petitioner filed its administrative claim for refund on February 5, 2003 and the judicial claim on April 14, 2003. Both claims were filed well within the two-year period prescribed by law.

Considering that the other remaining issues are interrelated, this Court deems it proper to 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. Accordingly, 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. Therefore, petitioner asserts that it is not subject to income tax on its Gross Philippine Billings nor to any income tax. Apparently, its erroneously paid income tax on Gross Philippine Billings in the amount of P872,447.66 representing 1 ½% of its total gross revenue for the taxable year 2000 should be refunded. Further, the fact that petitioner has a general sales agent in the Philippines for the purpose of selling passage documents covering its off-line flights will not prejudice the present claim pursuant to Section 3 of Revenue Regulations No. 15-2002.

Anent petitioner's argument that having a general sales agent in the Philippines for the purpose of selling passage documents covering its off-line flights does not affect its claim because Section 3 of Revenue Regulations No. 15-2002 clearly provides that having a sales agent in the Philippines which sells passage documents for compensation or commission to cover off-line flights of its principal "is not considered engaged in business as an international air carrier in the Philippines and is, therefore, not subject to Gross Philippine Billings Tax", the same is not applicable in this instant case inasmuch as Revenue Regulations No. 15-2002 became effective only on October 26, 2002, while the instant claim covered the taxable year 2000.

As to the issue of whether petitioner is subject to tax on Gross Philippine Billings, We rule in favor of the petitioner.

Section 28 (A)(3)(a) of the 1997 Tax Code imposes 2½% tax on Gross Philippine Billings on revenues derived by international air carriers:

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

3(1D

> 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." (Emphasis supplied)

"Gross Philippine Billings" as above defined 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. Moreover, in the case of ***South African Airways vs. Commissioner of Internal Revenue, C.T.A. EB No. 118 (Case No. 6760), December 2, 2005,*** the Court *En Banc* already ruled that an international air carrier like herein petitioner, cannot be taxed on its Gross Philippine Billings. To quote:

> "xxx 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."** *(Emphasis Ours)*

Notwithstanding the foregoing ruling that 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. In the same case of *South African Airways*, the Court *En Banc* had this to say:

309

> "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 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." *(Italics supplied)*

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 Limited Corporation, and that it derives revenues from the conduct of its business activity regularly pursued within the Philippines. Hence, 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.

Petitioner, during the taxable year 2000, maintained a General Sales Agent in the Philippines, under a Marketing Representation Agreement. The sales agent's functions include, among others, solicitation, promotion and sale of petitioner's air passenger services. 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 claim. Accordingly, it is considered a resident foreign corporation subject to income tax.

The Supreme Court had on numerous occasions, sustained the validity of the foregoing findings *(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 it 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."

In this regard, petitioner is still required to pay a tax equal to 32% of its gross income received during the taxable year 2000 from all sources within the Philippines. Unquestionably, the ticket sales were executed here in the Philippines, thus, the revenue received therefrom were also generated in the Philippines, as the business activities were regularly pursued in the Philippines.

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 percent (32%) of their taxable income derived from sources within the Philippines, and as defined by Section 32 (A) of the 1997 Tax Code, gross income "except when otherwise provided in this title, means all income derived from whatever source, including (but not

381

limited to) the following items: (1) compensation for services in whatever form paid, including, but not limited to, fees, salaries, wages, 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 enough 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)*

Finally, 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)*

To reiterate, 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

312

Section 28(A)(3)(a) of the Tax Code. Nevertheless, 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.

IN VIEW OF ALL THE FOREGOING, the subject Petition for Review is hereby **DENIED** for lack of merit.

SO ORDERED.

LOVELL R. BAUTISTA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding 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
Chairperson, First Division

213