REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

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UNITED AIRLINES, INC.,
Petitioner,

C.T.A. CASE NO. 6641

Members:

- versus -

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

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

FEB 22 2007

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DECISION

CASANOVA, C., J.:

Before Us is a Petition for Review under Section 7 of Republic Act No. 1125, as amended by Republic Act No. 9282, seeking a refund of alleged erroneously paid tax on Gross Philippine Billings for the taxable years 2000 and 2001 in the total amount of P10,783,619.23.

Petitioner is a foreign corporation organized and existing under the laws of the State of Delaware, United States of America. It is engaged in the business of international air transport and is duly licensed to operate as an off-line carrier in the Philippines.

Respondent is the Commissioner of Internal Revenue who is empowered to perform the duties of his office, including, among others, the duty to act on and approve claims for refund or tax credit as provided by law. He holds office at the Bureau of Internal Revenue ("BIR") National Office Building, Diliman, Quezon City.

By virtue of Securities and Exchange Commission ("SEC") Registration No. 1094 dated June 7, 1984, petitioner was licensed to establish and operate a branch in the Philippines and to "open an office as an off-line carrier".[1] On June 2, 1986, such SEC License was amended, allowing petitioner now to act as "an on-line carrier of persons, property and mail between the United States and the Philippines".[2]

In a letter dated January 23, 1998, petitioner informed the Civil Aeronautics Board ("CAB") that it was discontinuing its passenger flights to and from Manila after February 20, 1998 but will continue its thrice weekly freighter (cargo) flights to Osaka and the U.S. as previously approved by the CAB.[3]

On April 1, 1998, petitioner appointed Aerotel Ltd. Corp ("Aerotel") as its General Sales Agent ("GSA") in the Philippines for both passenger and cargo operations,[4] which appointment was renewed on April 1, 2000 and May 1, 2000, respectively.[5] Aerotel is an independent GSA acting as such for several international airline companies. It is duly authorized by the CAB to act as a GSA on behalf of petitioner.[6] As a GSA, Aerotel's functions include solicitation, promotion and sale of petitioner's air passenger and cargo transportation services. And its responsibilities include filing of all the necessary tax returns and paying the taxes due thereon on behalf of petitioner.

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[1] Annex A, Petition for Review [*Off-line carrier is an international air carrier having no flight operations to and from the Philippines, Revenue Regulations No. 15-02*].
[2] Annex B, Petition for Review [*On-line carrier is an international air carrier having or maintaining flight operations to and from the Philippines, Revenue Regulations No. 15-02*].
[3] Exhibit G.
[4] Annexes F & G, Petition for Review.
[5] Exhibits E & F.
[6] Exhibit I.

On March 19, 2001, petitioner obtained an Amended SEC License No. 1094, amending its purpose from "*providing to the travel and related industries a computerized reservation and ticketing service called "Apollo Services," which performs flight, hotel and rental car reservation and ticket issuance functions, subject to the same terms and conditions imposed in its Certificate of Authority Nos. 1472 and 1690*" to "to act as an off-line carrier in the Republic of the Philippines".[7]

Although it allegedly ceased its passenger ad cargo flights to and from the Philippines effective February 21, 1998 and January 31, 2001, respectively, petitioner through Aerotel, allegedly continued to pay 1.5%[8] income tax on revenues from tickets/passage documents sold in the Philippines covering passenger/cargo flights originating outside of the Philippines.

For taxable years 2000 and 2001, petitioner through Aerotel, duly filed its Quarterly Income Tax Returns and Annual Income Tax Returns and paid the corresponding income taxes due thereon.[9]

In its 2000 Annual Income Tax Return filed on April 6, 2001,[10] petitioner reflected an amount of P1,365,067,866.43 Gross Philippine Billings (GPB) with the related 1.5% GPB tax due of P20,476,018.00 which was partially offset against the creditable taxes withheld of P26,809.60 and quarterly payments for the first three quarters in the amount

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[7] CTA Records, p. 57.

[8] Pursuant to Article 9(1) of the Convention on the Avoidance of Double Taxation and the Prevention of Fiscal Evasion between the Republic of the Philippines and the United States ("RP-US Tax Treaty") which provides:

> "Article 9. Shipping and air transport.- 1) Notwithstanding any other provision of this Convention, 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 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-
>
> a) one and one-half percent of the gross revenues derived from sources in that State; and
>
> b) the lowest rate of Philippine tax that may be imposed on profits of the same kind under similar circumstances by a resident of a third State."

[9] Exhibits A, A-1, B, B-1, C, C-1, D, D-1, K, K-1, L, L-1, M, M-1, N & N-1.

[10] Exhibit A.

P15,766,045.92. The remaining income tax due of P4,683,162.48 was paid by petitioner on the same date of April 6, 2001.[11]

In its 2001 Annual Income Tax Return filed on February 22, 2002,[12] petitioner's declared GPB amounted to P390,560,599.68 with the related 1.5% GPB tax due of P5,858,409.00 which was partially applied against the first three (3) quarterly payments of P4,660,155.32 and the balance of P1,198,253.68 was paid by petitioner on the same date of February 22, 2002.[13]

Pursuant to Section 28(A)(3)(a) of the National Internal Revenue Code ("NIRC") of 1997, as amended, in relation to Article 4(7)[14] of the Convention Between the Government of the Republic of the Philippines and the Government of the United States of America with Respect to Income Taxes (RP-US Tax Treaty), petitioner filed with the BIR and administrative claim for refund on April 12, 2002[15] pertaining to income taxes paid on gross passenger and cargo revenues for taxable years 1999 to 2001 in the sum of P15,916,680.69, broken down as follows:

Period Covered	Passenger Revenue (Php)	Income Tax Paid on Passenger Revenue (Php)
1st quarter of 1999	65,536,459.00	983,046.90
2nd quarter of 1999	119,727,482.73	1,795,912.24
3rd quarter of 1999	85,836,895.44	1,287,553.43
4th quarter of 1999	64,153,377.15	962,300.66
TOTAL		**5,028,813.23**

Period Covered	Passenger Revenue (Php)	Income Tax Paid on Passenger Revenue (Php)
1st quarter of 2000	45,808,764.91	687,131.47
2nd quarter of 2000	137,745,402.99	2,066,181.05
3rd quarter of 2000	84,793,471.82	1,271,912.08
4th quarter of 2000	66,882,913.926	1,003,243.71
TOTAL		**5,028,458.31**

[11] Exhibit A-1.
[12] Exhibit K.
[13] Exhibit K-1.
[14] Article 4(7) of the RP-US Tax Treaty provides: "*Gross revenues from the operation of ships in international traffic shall be treated as from sources within the Contracting State to the extent they are derived from international traffic originating in that State.*"
[15] Exhibit J.

Period Covered	Passenger Revenue (Php)	Income Tax Paid on Passenger Revenue (Php)
1st quarter of 2001	74,317,918.70	1,114,768.78
2nd quarter of 2001	124,726,618.42	1,870,899.28
3rd quarter of 2001	104,749,278.74	1,571,239.18
4th quarter of 2001	79,883,578.52	1,198,253.68
TOTAL		**5,755,160.92**

The claim for refund on all four (4) quarters of taxable year 1999 in the amount of P5,028,813.23 is the subject claim in a separate case docketed as *United Airlines, Inc., vs. Commissioner of Internal Revenue, CTA Case No. 6449*.[16]

Due to respondent's inaction on petitioner's claim for refund in the amount of P10,783,619.23, petitioner filed a Petition for Review before this Court on April 4, 2003.

On May 6, 2003, the respondent filed his Answer, raising the following Special and Affirmative Defenses:

> "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 routinary investigation/examination by the Bureau;
>
> 6. The amount of P10,783,619.23 being claimed by petitioner as alleged erroneously collected income taxes on Gross Philippine Billings for the taxable years 2000 and 2001 was not properly documented;
>
> 7. 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;
>
> 8. Petitioner must show that it has complied with the provisions of Sections 204(C) and 229 of the Tax Code on the prescriptive period for claiming tax refund/credit;
>
> 9. Claims for refund are construed strictly against the claimant for the same partake the nature of exemption from taxation (*Commissioner of Internal Revenue vs. Ledesma, 31 SCRA 95)* and as such, they are looked upon with disfavor (*Western Minolco Corp. vs. Commissioner of Internal Revenue, 124 SCRA 1211)."*

Upon submission of the parties' respective memoranda, the case was submitted for decision per this Court's Resolution dated April 12, 2006.

[16] See Decision promulgated on May 18, 2006.

The parties in this case have stipulated on the following issues for the resolution of this Court:

"The main issue to be resolved is whether or not petitioner is entitled to a refund of income tax erroneously or illegally collected in the amount of ₱10,783,619.23 in the taxable years 2000 and 2001. To resolve the foregoing issue, the following issues need to be addressed:

(a) Whether or not petitioner has actually paid the amount of income tax subject of the claim for refund covering the taxable years 2000 and 2001; and

(b) Whether or not petitioner has complied with the provisions of Sections 204 (C) and the 229 of the 1997 National Internal Revenue Code. *[sic]*

(c) Whether or not the income generated by the petitioner during the periods on *[sic]* issue upon which petitioner paid income tax subject of the instant claim was from sale of passage documents in the Philippine covering flights outside the Philippines."

Compliance with the two (2)-year prescriptive period provided in Sections 204 (C) and 299 of the National Internal Revenue Code of 1997, as amended.

Sections 204 (C) and 229 of the National Internal Revenue Code of 1997, provide as follows:

"SEC. 204. *Authority of the Commissioner to Compromise, Abate and Refund or Credit Taxes. – The Commissioner may-*

x x x

(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: *Provided, however,* That a return filed showing an overpayment shall be considered as a written claim for credit or refund."

"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 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: *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."

In ***ACCRA Investment Corporation vs. Court of Appeals, the Commissioner of Internal Revenue and the Court of Tax Appeals,***[17] the Supreme Court ruled that there is a need to file a return first before a claim for refund can prosper and that a claim for refund commences to run, at the earliest, on the date of the filing of the adjusted final tax return. In another case,[18] it has been settled that the taxpayer may file a claim for refund or credit with the Commissioner of Internal Revenue, within two (2) years after payment of tax, before any suit in the Court of Tax Appeals is commenced. The two (2)-year prescriptive period provided should be computed from the time of filing the Adjustment Return and the final payment of the tax for the year.

In this case, the subject claim of petitioner covers alleged erroneously paid 1.5% income tax on Gross Philippine Billings for taxable years 2000 and 2001 for which petitioner has filed its annual income tax returns on April 6, 2001[19] and February 22, 2002,[20] respectively. Counting from these dates, both the administrative claim filed on April 12, 2002 and this Petition for Review filed on April 4, 2003 were timely made.

<u>Petitioner's liability or non-liability for Gross Philippine Billings under Article 28(3)(a) of the National Internal Revenue Code of 1997, as amended.</u>

Being inter-related, issues (a) and (c) will be discussed jointly.

[17] 204 SCRA 957 (1991).
[18] Philippine Bank of Communications vs. Commissioner of Internal Revenue, 302 SCRA 241 (1999).
[19] Exhibit A.
[20] Exhibit K.

Through the machine validated returns and official receipts issued by the Land Bank of the Philippines,[21] petitioner has sufficiently proven that for taxable years 2000 and 2001, it paid the amounts of P20,476,018.00 and P5,858,409.00 representing 1.5% income tax on GPB in the amounts of P1,365,067,866.43 and P390,560,599.68, respectively.

As verified by the commissioned auditing firm, Punongbayan and Araullo, from petitioner's Schedule of Quarterly Gross Revenues attached to its Quarterly Income Tax Return/Final Adjustment Returns, the total GPB tax payment for the year 2000 in the amount of P20,476,018.00 comprised of the GPB tax paid of P5,028,458.31 on declared Passenger Revenues of P335,230,554.00 and GPB tax paid of P15,447,559.69 on reported Cargo Revenues of P1,029,837,313.00,[22] as shown below:

Quarter	Passenger Revenues	Cargo Revenues	Total Revenues
1st	P 45,808,765.00	P 208,559,491.00	P 254,368,256.00
2nd	137,745,403.00	255,555,581.00	393,300,984.00
3rd	84,793,472.00	319,369,794.00	404,163,266.00
4th	66,882,914.00	246,352,447.00	313,235,361.00
Total Revenues	**P 335,230,554.00**	**P 1,029,837,313.00**	**P1,365,067,867.00**
1.5% GPB Tax Paid	**P 5,028,458.31**	**P 15,447,559.69**	**P 20,476,018.00**

Likewise, for the year 2001, petitioner's total GPB tax payment of P5,858,409.00 consisted of GPB tax paid of P4,580,300.00 on reported Passenger Revenues of P305,353,362.00 and GPB tax paid of P1,278,109.00 on reported Cargo Revenues of P85,207,238.00, as follows:[23]

Quarter	Passenger Revenues	Cargo Revenues	Total Revenues
1st	P 61,792,324.00	P 19,408,800.00	P 81,201,124.00
2nd	108,394,474.00	16,332,144.00	124,726,618.00
3rd	77,103,458.00	27,645,821.00	104,749,279.00
4th	58,063,106.00	21,820,473.00	79,883,579.00
Total Revenues	**P 305,353,362.00**	**P 85,207,238.00**	**P 390,560,600.00**
1.5% GPB Tax Paid	**P 4,580,300.43**	**P 1,278,108.57**	**P 5,858,409.00**

[21] Exhibits A, A-1, B, B-1, C, C-1, D, D-1, K, K-1, L, L-1, M, M-1, N, & N-1.
[22] CTA Records, p. 299.
[23] CTA Records, p. 328.

However, of the total GPB tax payment of P5,858,409.00 for taxable year 2001, only the amount of P5,755,161.00 is being claimed by petitioner.

Respondent admits that petitioner ceased to be an on-line carrier of passengers in the Philippines starting February 21, 1998 as evidenced by petitioner's letter to the office of the Civil Aeronautics Board dated January 23, 1998.[24] Thus, according to respondent, all income reported by petitioner in its income tax returns after this period is obviously income from sale of passenger tickets the uplifts of which did not originate from the Philippines, which under Section 28 (A)(3)(a) of the NIRC of 1997 is not subject to GPB tax.

Nevertheless, respondent maintains that petitioner is not entitled to the entire claim of P5,028,458.31 for the year 2000. Based on the examiner's audit of cargo sales reports from both International Air Transport Association and Non- International Air Transport Association agencies, it was determined that there were discrepancies from petitioner's reported revenues as against the summary of gross revenues coming from the cargo manifest. These adjustments reduced the claim in the amount of P2,462,817.73 and the remaining allowable refundable amount is established to be only P2,565,640.58[25], computed as follows:

Gross Philippine Billing Tax-Passenger			Php	5,028,458.31
Cargo Revenue	US$	39,936,268.08		
Less: Freight Adjustments		13,489,667.44		
Net Revenue Per Investigation	US$	26,446,600.64		
Cargo Revenue Per Return		23,327,782.00		
Discrepancy	US$	3,118,818.64		
Peso Equivalent	Php	164,187,848.52		
Tax Rate		1.5%		
Tax Due			Php	2,462,817.73
Refundable Amount			Php	2,565,640.58

This Court agrees with respondent. Considering that petitioner did not provide any explanation or supporting documents to account for the discrepancy found by the revenue

[24] Exhibit G.
[25] Page 415, Records; pp. 1482-1483 & 1456-1464, BIR Records.

examiner, only the amount of P2,565,640.58 appears to have been erroneously paid by petitioner for the year 2000.

As regards petitioner's claim of P5,755,160.92 covering the year 2001, the respondent's examiner recommended for the disallowance of the amount of P1,174,886.96 representing GPB tax paid on cargo revenues on the ground that petitioner was not able to prove its allegation that it was not an on-line carrier or cargoes. A copy of the General Sales Agency Agreement allegedly states that petitioner is an on-line carrier of cargoes. Further, notification to and from the CAB Board on the cessation of the cargo flights was absent. Accordingly, petitioner's refundable claim for taxable year 2001 as found by the revenue examiner amounts only to P4,580,296.67 representing GPB tax paid on passenger revenues from tickets sold in the Philippines, covering flights originating outside of the Philippines, as computed below:

Gross Passenger Revenue (in Peso)		P 305,350,224.82
Cargo Revenue		85,206,893.57
Total Amount of Revenue per Return		P 390,557,118.39
Multiplied by Tax Rate		1.5%
Tax Due		P 5,858,356.78
Tax Paid Per Returns Filed		
1st Quarter	P 1,218,017.00	
2nd Quarter	1,870,890.21	
3rd Quarter	1,571,239.18	
Final Return	1,198,253.68	P 5,858,400.07
Less: Tax on Cargo Revenue for January		103,216.44
Total Income Tax Claimed for Refund		P 5,755,183.63
Less: Tax on Cargo Revenue Not Allowed For Refund		1,174,886.96
Total Claim to be Allowed as Refund		P 4,580,296.67

This Court disagrees. As can be seen from the Certification issued by the Civil Aeronautics Board on September 6, 2004,[26] petitioner discontinued its freighter (cargo) operations effective December 24, 2000. Consequently, all cargo revenues reported by petitioner for taxable year 2001 were derived from flights originating outside of the Philippines and the corresponding GPB tax paid thereon was erroneous.

[26] Page 333, Records.

In fine, petitioner was able to establish that it had erroneously paid the amounts of P2,565,640.58 and P5,755,160.92 representing Gross Philippine Billings for taxable years 2000 and 2001, respectively.

Section 28(A)(3)(a) of the 1997 National Internal Revenue Code, (NIRC) as amended, reads:

> (3) *International Carrier.* – An international carrier doing business in the Philippines shall pay a tax of two and one-half percent (2 ½%) 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 person, 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 the Gross Philippine Billings.' *(Underscoring supplied)*

Under the foregoing definition, for passenger and cargo revenues to form part of Gross Philippine Billings, such revenues must be derived from the carriage of persons and the carriage of cargo originating from the Philippines in a continuous and uninterrupted flight. This rule applies irrespective of the place of sale or issue and the place of payment of the tickets or passage documents.

Moreover, in the case of ***South African Airways vs. Commissioner of Internal Revenue, C.T.A. EB No. 118,***[27] the Court *En Banc* citing the case of *Air Canada vs. Commissioner of Internal Revenue,*[28] already ruled that an international carrier like herein petitioner, cannot be taxed on its Gross Philippine Billings. To quote:

> "[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

[27] (Case No. 6760), December 2, 2005.
[28] (CTA Case No. 6572), December 22, 2004, CTA E.B. No. 86, August 26, 2005.

> 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)*

Hence, in the case at bench, it is very clear that petitioner's cannot be made liable to pay the income tax on Gross Philippine Billings since its carriage of persons, excess baggage, cargo and mail does not originate from the Philippines in a continuous and uninterrupted flight.

Petitioner's liability for income tax on its gross revenue from sale of its passage documents through a duly appointed General Sales agent, Aerotel in this case.

Although petitioner is not liable for Gross Philippine Billings under Section 28(A)(3) of the 1997 NIRC, it does not follow however, that it is not liable for the payment of income tax at all.

It is without contest that petitioner is duly licensed to engage in trade or business in the Philippines as an off-line carrier. As such, it is considered as a resident foreign corporation subject to tax upon its total income received in the preceding taxable year from all sources within the Philippines. Moreover, petitioner's appointment, since 1998, of a General Sales Agent in the person of Aerotel whose functions include the solicitation, promotion and sale of petitioner's air passenger and cargo services, verily shows the manifest intent of petitioner to continue its commercial dealings within the Philippines with the end in view of gaining profit therefrom. It matters not that petitioner has ceased its passenger and cargo flights originating from the Philippines. Aerotel, its GSA, still continued to sell petitioner's passenger and cargo tickets in the Philippines which were serviced by petitioner's airplanes beginning on transshipment outside the Philippines and on flight legs that originated elsewhere. In other words, the absence of flight operations to and from the Philippines is not determinative of the source of income or the *situs* of income taxation.[29] Gain/profits derived from the act of selling petitioner's passage tickets constitute income that is accordingly taxable under our income tax laws. Therefore, its income from all sources within the Philippines is undoubtedly subject to tax at the rate of 32% corporate income tax under Section 28(A)(1)of the 1997 Tax Code.

The Tax Code defines "gross income" as one which 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, vocation, trades, business, commerce, sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in any 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.

As enunciated in ***Commissioner of Internal Revenue vs. British Overseas Airways Corporation and Court of Tax Appeals,***[30] the foregoing 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. Income means 'cash received or its equivalent'; it is the amount of money coming to a person within a specific time xxx; 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." And "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 income is derived from activity within the Philippines."

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[29] Commissioner of Internal Revenue vs. British Overseas Airways Corporation and Court of Tax Appeals, 149 SCRA 395 (1978).
[30] *Ibid.*

Petitioner's sale of tickets through its local agent is the activity that produced the income. Indubitably, the passage tickets were sold in the Philippines. This is the place where the tickets exchanged hands and the place where payments for such fares where made. Consequently, the *situs* of the source of payment is in the Philippines. The "flow of wealth" proceeded from and occurred within the Philippine territory and this income enjoyed the protection accorded by the Government of the Republic of the Philippines; it is but proper that having enjoyed such protection, the flow of wealth should share the burden of what we all pay for a civilized society.

Thus, while petitioner, as a resident foreign corporation engaged in trade or business in the Philippines, is not liable to pay tax on its Gross Philippine Billings as provided in Section 28(A)(3)(a) of the Tax Code, it is nonetheless liable to pay corporate income tax on its taxable income derived from its sale of passage documents here in the Philippines.

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 of its gross revenues derived from sources within the Philippines arising from the "operation of ships in international traffic" as provided in Article 9(1)(A) of the RP-US Tax Treaty,[31] *viz:*

"Article 9
Shipping and air transport

1) Notwithstanding any other provision of this Convention, 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 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 -

   a) one and one-half per cent of the gross revenues derived from sources in that State; and

   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.

[31] Convention on the Avoidance of Double Taxation and the Prevention of Fiscal Evasion Between the Republic of the Philippines and the United States.

xxx xxx xxx"

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,[32] 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 xxx". 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.

Simply put, profits derived by a resident of one 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.

It is important to note that the RP-US Tax Treaty does not mention of Gross Philippine Billings but of whatever profits derived by a resident of one of the Contracting States from sources within the other Contracting States. And as already discussed above, "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 the other Contracting State from the operation of ships in international traffic".

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[32] Article 2(1)(h), The term *international traffic* means any transport by a ship or aircraft operated by a resident of one of the Contracting States except where such is confined solely to places within the Contracting State.

The RP-US Tax Treaty is just one of a number of bilateral treaties which the Philippines has entered into for the avoidance of double taxation.[33] The purpose of these international agreements is to reconcile the national fiscal legislations of the contracting parties in order to help the taxpayer avoid simultaneous taxation in two different jurisdictions. More precisely, the tax conventions are drafted with a view towards the elimination of *international juridical double taxation,* which is defined as the imposition of comparable taxes in two or more states on the same taxpayer in respect of the same subject matter and for identical periods. The apparent rationale for doing away with double taxation is to encourage the free flow of goods and services and the movement of capital, technology and persons between countries, conditions deemed vital in creating robust and dynamic economies. Foreign investments will only thrive in a fairly predictable and reasonable international investment climate and the protection against double taxation is crucial in creating such a climate.[34]

In sum, petitioner is not liable for income tax at the rate of 32% as generally imposed on resident foreign corporations by the National Internal Revenue Code of 1997 but for the lower rate of 1½% pursuant to RP-US Tax Treaty on the profits it derived from sources within the Philippines. Inasmuch as the petitioner paid its income tax liabilities for taxable years 2000 and 2001 at the rate of 1½% of gross revenue, the payment is correct. Hence, no refundable amount is due.

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

SO ORDERED.

CAESAR A. CASANOVA
Associate Justice

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[33] As of June 29, 1997, the following countries have entered into tax treaties with the Philippines for the avoidance of double taxation: Denmark, Singapore, Canada, France, United Kingdom, Pakistan, Australia, Japan, Belgium, New Zealand, Finland, Indonesia, Austria, United States of America, Thailand, Germany, Malaysia, Korea, Sweden, Italy, Netherlands, Brazil, Spain, India and Israel.
[34] Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc. and Court of Appeals, 309 SCRA 87 (1999).

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

LOVELL R. BAUTISTA
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