REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

AIR NEW ZEALAND,
Petitioner,

- versus -

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

C.T.A. E.B. NO. 313
(C.T.A. CASE NO. 6949)

Present:

ACOSTA, *P.J.*
CASTAÑEDA, JR.,
BAUTISTA,
UY,
CASANOVA, *and*
PALANCA-ENRIQUEZ, *JJ.*

Promulgated:

JAN 3 0 2008 1:10 p.m.

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DECISION

UY, J.:

This is a Petition for Review before the Court of Tax Appeals *En Banc* filed on September 26, 2007 seeking a review of the Decision and Resolution dated June 19, 2007 and September 5, 2007, respectively, rendered by the First Division of this Court[1] (Court in Division) in C. T. A. Case No. 6949 entitled "Air New Zealand, petitioner, vs. Commissioner of Internal Revenue, respondent", pursuant to Section 18 of Republic Act No. 1125, as amended by Republic Act No. 9282. The dispositive portions of which read as follows:

[1] Ponencia of Presiding Justice Ernesto D. Acosta and concurred by Associate Justice Lovell R. Bautista and Associate Justice Caesar A. Casanova.

<u>Decision in CTA Case No. 6949 promulgated on June 19, 2007</u>:

"In conclusion, the petitioner as resident foreign corporation engaged in trade or business in the Philippines on account of its sale of passage documents here in the Philippines, is not taxable on its Gross Philippine Billings as provided in Section 28(A)(3)(a) of the NIRC. However, it is still liable for income tax not at the rate of 32% as generally imposed on resident foreign corporations, but at the lower rate of 1 ½% pursuant to the RP-New Zealand Tax Treaty on the profits derived from sources within the Philippines. Since petitioner already paid its income tax liabilities for taxable year 2002 at the rate of 1 ½% of gross income, the payment is correct and therefore no refundable amount is due.

WHEREFORE, the instant Petition for Review is hereby **DISMISSED** for lack of merit.

SO ORDERED."

<u>Resolution denying petitioner's Motion for Reconsideration promulgated on September 5, 2007</u>:

"**IN VIEW OF THE FOREGOING**, petitioner's Motion for Reconsideration is hereby **DENIED** for lack of merit.

SO ORDERED."

THE FACTS

As found by the Court in Division, these are the undisputed facts of the case:

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. As an off-line international air carrier having no landing rights in the Philippines, petitioner does not maintain flight operations to and from the Philippines. Likewise, it is not registered with the Securities and Exchange Commission as

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a corporation, branch office or partnership, and, consequently, is not licensed to do business in the Philippines.

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

Petitioner filed, through Aerotel, its Quarterly Income Tax Returns for the First and Second Quarters of taxable year 2002 and paid the amount due thereon as follows:

Period	Date Filed & Paid	Amount Paid
1st Quarter	May 30, 2002	P137,144.00
2nd Quarter	August 29, 2002	P120,554.00
		P257,698.00

On February 5, 2003, petitioner filed a formal claim for refund with the respondent Commissioner of Internal Revenue, through Revenue District Office No. 47 of the Bureau of Internal Revenue, for the recovery of the amount of P257,698.00 allegedly representing erroneously paid tax on Gross Philippine Billings for the First and Second Quarters of taxable year 2002.

In a letter dated March 9, 2004, respondent, through the Regional Director of Revenue Region No. 8, categorically denied petitioner's claim for refund, which was received by petitioner, through Aerotel, on March 19, 2004.

On April 16, 2004, petitioner filed a Petition for Review before the Court in Division, docketed as C.T.A. Case No. 6949, seeking the cancellation of respondent's final decision on the denial of its claim for refund.

On June 19, 2007, the Court in Division rendered a decision denying petitioner's claim for refund for lack of merit. It ruled that petitioner, being a resident foreign corporation engaged in trade or business in the Philippines, is not liable to pay tax on Gross Philippine Billings as provided in Section 28(A)(3)(a) of the National Internal Revenue Code (NIRC) of 1997. However, it concluded by denying its claim for refund considering that petitioner it is still liable for income tax not at the rate of 32% as generally imposed on resident foreign corporations, but at the lower rate of 1 ½% pursuant to the RP-New Zealand Tax Treaty on the profits derived from sources within the Philippines.

On July 13, 2007, petitioner filed its Motion for Reconsideration seeking reconsideration of the aforesaid Decision. Subsequently, the Court in Division denied the said motion for lack of merit in its Resolution dated September 5, 2007.[2]

Hence, this recourse before the Court *En Banc* praying that: (a) the Decision dated June 19, 2007 and the Resolution dated September 5, 2007 be reversed and set aside; (b) petitioner be declared as a non-resident foreign corporation and thus, not subject to either the thirty two percent (32%) regular income tax on taxable income under Section 28(A)(1) of the NIRC of 1997 or the 1 ½% tax pursuant to the RP-New Zealand Tax Treaty; (c) the income derived by petitioner from the sale of passage documents covering its off-line flights in not Philippine-source income and, consequently, not subject to Philippine income tax; and (d) petitioner be declared as entitled to a refund or tax credit in the amount of P257,698.00 representing erroneously paid tax on Gross Philippine Billings for the First and Second Quarters of taxable year 2002.

[2] Docket, pp. 60-65.

Accordingly, for failure of respondent to file his comment within the period prescribed by this Court, the case was deemed submitted for decision on December 5, 2007.

Hence, this Decision.

THE ISSUES

Petitioner submits the following issues for the resolution of the Court *En Banc*:

I. Whether or not petitioner, as an off-line international carrier selling passage documents through an independent sales agent in the Philippines, is engaged in trade or business in the Philippines subject to the corporate income tax on resident foreign corporations, either at 32% under Section 28(A)(1) of the NIRC of 1997 or at 1 ½% under the RP-New Zealand Tax Treaty;

II. Whether or not the income derived by petitioner from the sale of passage documents covering petitioner's off-line flights is Philippine-source income subject to Philippine income tax; and

III. Whether or not petitioner is entitled to the refund or tax credit of erroneously paid tax on Gross Philippine Billings for the First and Second Quarters of taxable year 2002 in the amount of P257,698.00.

THE COURT EN BANC'S RULING

The petition is bereft of merit.

A careful and closer look at the arguments set forth by the petitioner in the instant petition for review would readily reveal that the grounds relied upon and the matters raised herein are mere restatements of petitioner's previous arguments raised before the Court in Division which had already been exhaustively discussed and passed upon by it in its assailed Decision and Resolution.

Be that as it may, with the end view of further clarifying the decision of the Court in Division, We adhere to its findings on the focal issue as to whether or not petitioner is a resident foreign corporation engaged in trade or business in the country within the purview of our tax law and therefore subject to pay its income derived from its sales of passage documents here in the Philippines.

No other than the Highest Court of the land sustained the validity of the aforesaid finding in several cases.[3] In the case of ***Commissioner of Internal Revenue vs. British Overseas Airways Corporation***,[4] the Supreme Court pronounced as follows:

> "The Tax Code defines 'gross income' thus:
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> 'Gross income' includes gains, profits, and income derived from salaries, wages or compensation for personal service of whatever kind and in whatever form paid, or from profession, vocations, trades, business, commerce, sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interests, rents, dividends, securities, or the transactions of any business carried on for gain or profit, or gains, profits, and income derived from any source whatever' (Sec. 29[3]; Italics supplied)
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> The definition is broad and comprehensive to include proceeds from sales of transport documents. 'The words 'income from any source whatever' disclose a legislative policy to include all income not expressly exempted within the class of taxable income under our laws.' Income means 'cash received or its equivalent'; it is the amount of money coming to a person within a specific time x x x; 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.

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[3] Commissioner of Internal Revenue vs. American Airlines, Inc. (180 SCRA 274 [1989]), Commissioner of Internal Revenue vs. British Overseas Airways, Corp. (149 SCRA 395 [1987]), and Commissioner of Internal Revenue vs. Japan Air Lines, Inc. (202 SCRA 450 [1991]).

[4] 149 SCRA 395 (1987).

The records show that the Philippine gross income of BOAC for the fiscal years 1968-69 to 1970-71 amounted to P10,428,368.00.

Did such 'flow of wealth' come from 'sources within the Philippines'?

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. In BOAC's case, 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 proceeded 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.

A transportation ticket is not a mere piece of paper. When issued by a common carrier, it constitutes the contract between the ticket-holder and the carrier. It gives rise to the obligation of the purchaser of the ticket to pay the fare and the corresponding obligation of the carrier to transport the passenger upon the terms and conditions set forth thereon. The ordinary ticket issued to members of the travelling public in general embraces within its terms all the elements to constitute it a valid contract, binding upon the parties entering into the relationship.

True, Section 37 (a) of the Tax Code, which enumerates items of gross income from sources within the Philippines, namely: (1) interest, (2) dividends, (3) service, (4) rentals and royalties, (5) sale of real property, and (6) sale of personal property, does not mention income from the sale of tickets for international transportation. However, that does not render it less an income from sources within the Philippines. Section 37, by its language, does not intend the enumeration to be exclusive. It merely directs that the types of income listed therein be treated as income from sources within the Philippines. A cursory reading of the section will show that it does not state that it is an all-inclusive enumeration, and that no other kind of income may be so considered."

Moreover, in ***Commissioner of Internal Revenue vs. Baier-Nickel***,[5] the Supreme Court reiterated the ruling in ***Commissioner of Internal Revenue vs. British Overseas Airways Corporation***,[6] stating:

> "In *Commissioner of Internal Revenue v. British Overseas Airways Corporation (BOAC)*, the issue was whether BOAC, a foreign airline company which does not maintain any flight to and from the Philippines is liable for Philippine income taxation in respect of sales of air tickets in the Philippines, through a general sales agent relating to the carriage of passengers and cargo between two points both outside the Philippines. Ruling in the affirmative, the Court applied the case of *Alexander Howden & Co., Ltd. v. Collector of Internal Revenue*, and reiterated the rule that the source of income is that 'activity' which produced the income. It was held that the 'sale of tickets' in the Philippines is the 'activity' that produced the income and therefore BOAC should pay income tax in the Philippines because it undertook an income producing activity in the country.
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> Both the petitioner and respondent cited the case of *Commissioner of Internal Revenue v. British Overseas Airways Corporation* in support of their arguments, but the correct interpretation of the said case favors the theory of respondent that it is the *situs* of the activity that determines whether such income is taxable in the Philippines. The conflict between the majority and the dissenting opinion in the said case has nothing to do with the underlying principle of the law on sourcing of income. In fact, both applied the case of *Alexander Howden & Co., Ltd. v. Collector of Internal Revenue*. The divergence in opinion centered on whether the sale of tickets in the Philippines is to be construed as the 'activity' that produced the income, as viewed by the majority, or merely the physical source of income, as ratiocinated by Justice Florentino P. Feliciano in his dissent. The majority through Justice Ameurfina Melencio-Herrera, as *ponente*, interpreted the sale of tickets as a business activity that gave rise to the income of BOAC. Petitioner cannot therefore invoke said case to support its view that source of income is the physical source of the money earned. If such was the interpretation of the majority, the Court would have simply stated that source of income is not the business activity of BOAC but the place where the person or entity disbursing the income is located or where BOAC physically received the same. But such was not the import of the ruling of the Court. It even

[5] 500 SCRA 87 (2006).
[6] Supra.

> explained in detail the **business activity** undertaken by BOAC in the Philippines to pinpoint the taxable activity and to justify its conclusion that BOAC is subject to Philippine income taxation.
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> xxx xxx xxx."

Applying the afore-cited decisions of the Supreme Court in the case at bench, We affirm the Court in Division's ruling that since petitioner admitted that it sells passage documents in the Philippines through its sales agent, Aerotel, and that it derives revenues from the conduct of its business activity regularly pursued within the Philippines, petitioner is a resident foreign corporation engaged in trade or business in the Philippines and must be subject to income tax.

Considering, therefore, that petitioner is a resident foreign corporation doing business in the Philippines, and applying Article 8(2) of the RP-New Zealand Tax Treaty,[7] it shall be subject to an income tax equivalent to 1 ½% on the profits derived from sources within the Philippines. Since, as found by the Court in Division, petitioner already paid its income tax liabilities for taxable year 2002 at the rate of 1 ½% of its gross income, the payment is correct and therefore no refundable amount is due. It cannot escape tax liability from the clear provisions of the Philippine tax laws.

To reiterate, the absence of flight operations to and from the Philippines is not determinative of the source of income for purposes of ascertaining income tax liability. It is sufficient that the income is derived from activity within the Philippine territory. Therefore, petitioner is a resident foreign corporation doing business in the Philippines within the purview of our

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[7] The Court in Division applied, by analogy, the case of United Airlines, Inc. vs. Commissioner of Internal Revenue, CTA Case No. 6641 promulgated on February 22, 2007.

tax law and the income earned from its flight operations outside the Philippines is subject to income tax.

Another issue worth mentioning is the matter raised by petitioner regarding the applicability of Revenue Regulations No. 15-2002 which does not consider an off-line airline having a branch office or sales agent in the Philippines selling passage documents, engaged in business as an international air carrier in the Philippines. This has already been properly addressed by the Court in Division in the assailed Decision where it ruled that the aforesaid regulation is not applicable in the instant case considering that the same only took effect on October 26, 2002 while the transaction covered by the present claim is the First and Second Quarters of taxable period 2002.

It is worthy to note that judicial decisions of the Supreme Court applying and interpreting the law shall form part of the legal system of the Philippines.[8] And it bears stressing that the BOAC decision has not been reversed nor modified by the Supreme Court and was again applied by the Supreme Court in the recent case of ***Commissioner of Internal Revenue vs. Baier-Nickel***[9] promulgated on August 29, 2006.

The rule in this jurisdiction is that "[t]ax refunds are in the nature of tax exemptions. As such, they are regarded as in derogation of sovereign authority and to be construed *strictissimi juris* against the person claiming the exemption".[10]

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[8] Article 8, New Civil Code.
[9] Supra.
[10] Commissioner of Internal Revenue vs. Procter and Gamble Philippine Manufacturing Corporation (204 SCRA 377 [1991]) and Commissioner of Internal Revenue vs. S. C. Johnson & Son, Inc. (309 SCRA 87 [1999]).

In the light of the foregoing discussions, the Court *En Banc* finds no reversible error committed by the Court in Division when it rendered its assailed Decision and Resolution dated June 19, 2007 and September 5, 2006, respectively.

WHEREFORE, premises considered, the instant petition is hereby **DENIED** for lack of merit.

SO ORDERED.

ERLINDA P. UY
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

(Inhibited)
JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

OLGA PALANCA-ENRIQUEZ
Associate Justice

CERTIFICATION

Pursuant to Section 13, Article VIII 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 *En Banc*.

ERNESTO D. ACOSTA
Presiding Justice