REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

AIR CANADA, *Petitioner,*	**C.T.A. E.B. NO. 86 (C.T.A. CASE NO. 6572)**
	Present:
-versus-	ACOSTA, Presiding Justice, CASTAÑEDA, JR., BAUTISTA, UY, CASANOVA, and PALANCA-ENRIQUEZ, JJ.
COMMISISONER OF INTERNAL REVENUE, *Respondent.*	**Promulgated:** AUG 2 6 2005

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DECISION

PALANCA-ENRIQUEZ, J.:

Legal Principle Involved:

An international airline which has appointed a ticket sales agent in the Philippines and which allocates fares received to various airlines on the basis of their participation in the services rendered, although it does not operate any airplane in the Philippines, is a resident foreign corporation subject to tax on income received from Philippine sources.

The Case

This is a Petition For Review filed by Air Canada (hereafter "petitioner") under *Section 11 of Republic Act No. 9282 (An Act Expanding the Jurisdiction of the Court of Tax Appeals)*, in relation to *Rule 43 of the 1997 Rules of Civil procedure, as amended*, which seeks the reversal of the Decision dated December 22, 2004 issued by the First Division of this Court in C.T.A Case No. 6572. The assailed Decision was disposed as follows:

> "WHEREFORE, premises considered, the Petition For Review is hereby DENIED.
>
> SO ORDERED."

and the Resolution dated April 8, 2005 denying the Motion For Reconsideration, the dispositive portion of which reads as follows:

> "WHEREFORE, in view of the foregoing, petitioner's Motion For Reconsideration is hereby DENIED. This Court's Decision of December 22, 2004 is hereby AFFIRMED in all respects.
>
> SO ORDERED."

THE FACTS

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

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

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

Exhibit	Applicable Quarter Year	Date Filed/Paid	Amount of Tax
"A" & "A-1"	3rd Qtr 2000	November 29, 2000	P 395,165.00
"B" & "B-1"	Annual ITR 2000	April 16, 2001	381,893.59

"C" & "C-1"	1st Qtr 2001	May 30, 2001	522,465.39
"D" & "D-1"	2nd Qtr 2001	August 29, 2001	1,033,423.34
"E" & E-1"	3rd Qtr 2001	November 29, 2001	765,021.28
"F" & "F-1"	Annual ITR 2001	April 15, 2002	328,193.93
"G" & "G-1"	1st Qtr 2002	May 30, 2002	594,850.13
"H" & "H-1"	2nd Qtr 2002	August 29, 2002	1,164,664.11
TOTAL			**P 5,185,676.77**

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

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

After trial on the merits, the First Division rendered its assailed Decision on December 22, 2004 in the terms earlier set forth.

Not satisfied, petitioner filed a "Motion For Reconsideration", which was denied by the First Division in a Resolution dated April 8, 2005.

ISSUES

Hence, this Petition For Review raising the following issues:

I

THE HONORABLE COURT ERRED IN HOLDING THAT PETITIONER IS A RESIDENT FOREIGN CORPORATION SUBJECT TO 32% INCOME TAX ON TAXABLE INCOME UNDER SECTION 28(A)(1) OF THE 1997 TAX CODE.

II

THE HONORABLE COURT ERRED IN FINDING THAT PETITIONER MAINTAINED A PERMANENT ESTABLISHMENT IN THE PHILIPPINES PURSUANT TO ARTCILE V (2)(I) OF THE RP-CANADA TAX TREATY BY THE APPOINTMENT OF A LOCAL GENERAL SALES AGENT IN THE PHILIPPINES.

III

THE HONORABLE COURT ERRED IN DENYING THE PETITIONER'S CLAIM FOR REFUND OF ERRONEOUSLY PAID INCOME TAX ON GROSS PHILIPPINE BILLINGS BASED ON ITS FINDING THAT PETITIONER IS A RESIDENT FOREIGN CORPORATION SUBJECT TO 32% INCOME TAX ON

TAXABLE INCOME UNDER SECTION 28(A)(1) OF THE 1997 TAX CODE.

On May 20, 2005, We required respondent to file comment on the petition, within ten (10) days from notice, and also ordered petitioner to submit the Board Resolution and/or Secretary's Certificate authorizing Ms. Divina S. Abad Santos to sign the verification and certification against forum shopping, within five (5) days from receipt thereof. On June 3, 2005, petitioner filed its "Compliance" with the Resolution dated May 20, 2005.

Despite the thirty (30) days extension from May 26, 2005 or until June 27, 2005 granted to the respondent within which to file Comment, to date he has failed to file the same.

THE COURT EN BANC'S RULING

The petition has no merit.

The principal issue raised in this Petition is whether or not the revenue derived by an international air carrier from sales of tickets in the Philippines for air transportation, while having no landing rights in the country, constitutes income of said international air carrier from

Philippine source, and accordingly, taxable under *Section 24(b)(2) of the National Revenue Code* (hereafter NIRC").

This issue has already been laid to rest in a number of cases by the Supreme Court, one of which is the landmark case of *Commissioner of Internal Revenue v. British Overseas Airways Corporation, 149 SCRA 395,* where it categorically ruled that such revenue constitutes taxable income.

Petitioner's contention that the revenue derived by it from its sales of tickets in the Philippines on its off-line flights through its local General Sales Agent cannot be subject to income tax because the same is not sourced within the Philippines cannot be sustained.

In the aforesaid landmark case of *Commissioner of Internal Revenue v. British Overseas Airways Corporation, supra*, the Supreme Court ruled:

"The Tax Code defines "gross income' thus:

> " '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.* x x x.

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.

The records show that the Philippines 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

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> wealth should share the burden of supporting the government.
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> 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 traveling public in general embraces within its terms all the elements to constitute it a valid contract, binding upon the parties entering into the relationship.
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> 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 intent 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."

The above ruling was adopted in toto in the subsequent case of *Commissioner of Internal Revenue vs. Air India and the Court of Appeals, 157 SCRA 648*, holding that the revenue derived from its sales of airplane tickets through its agent Philippine Air Lines, Inc., here in the

Philippines must be considered taxable income, and in the case of *Commissioner of Internal Revenue vs. American Airlines, Inc. and the Court of Appeals, 180 SCRA 276*, it was likewise declared that for the source of income to be considered as coming from the Philippines it is sufficient that the income is derived from activities with in this country regardless of the absence of flight operations within the Philippine territory (Commissioner of Internal Revenue vs. Japan Air Lines, Inc. and the Court of Tax Appeals, 202 SCRA 451).

Verily, petitioner is a resident foreign corporation under *Section 22 of the NIRC of 1997,* which states:

"SEC. 22. Definitions. – When used in this Title:

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> (H) the term 'resident foreign corporation' applies to a foreign corporation engaged in trade or business within the Philippines.
>
> (I) the term 'non resident foreign corporation' applies to a foreign corporation not engaged in trade or business within the Philippines."

There are no specific criteria as to what constitutes "doing" or "engaging in" or "transacting" business. Each case must be judged in

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the light of the prevailing environmental circumstances. The term implies a 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 gains or for the purpose and object of the business organization (*The Mentholatum Co., Inc. vs. Anacleto Mangaliman, et al., 72 Phil. 524*). In order that a foreign corporation may be regarded as doing business within a state, 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 (*Commissioner of Internal Revenue vs. British Overseas Airways Corporation, supra*).

Petitioner, during the periods claimed, constituted and maintained Aerotel as its General Sales Agent in the Philippines, under a Passenger General Sales Agency Agreement. The General Sales Agent was engaged, among others, in selling and issuing petitioner's air passenger services, as well as, filing of all necessary tax returns and paying the tax thereon in its behalf. These activities were 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 air carrier. There is no doubt that petitioner was "engaged in" business in the Philippines during the period covered by the claim. Accordingly, it is a resident foreign corporation subject to tax upon its total net income received in the preceding taxable year from all sources within the Philippines (*Section 28 (A)(1) of the NIRC of 1997, as amended*).

Considering therefore that petitioner is a resident foreign corporation doing business in the Philippines, pursuant to *Section 28(A)(1) of the NIRC of 1997, as amended*, it shall be subject to an income tax equivalent to 32% of the taxable income derived from its sale of passage documents here in the Philippines. Having received income while engaged in business and utilizing the resources available to it within the Philippines, and considering that it is not a tax exempt corporation, petitioner cannot claim that it is not liable to the regular income tax of 32% of its taxable income here. It cannot escape tax liability from the clear provisions of the law.

We therefore find no reason to overturn the factual findings of the First Division of this Court, which in fine states:

> "In addition, under the RP-Canada Tax Treaty, more particularly Article V and Article VII, it is clear that petitioner's gross revenues are taxable in the Philippines. To quote the pertinent provisions of the tax treaty:
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> **Article VII**
> **Business Profits**
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> 1. The profits of an enterprise of a Contracting State shall be taxable only in that State **unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein**. If the enterprise carries on or has carried on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as are attributable to:
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> a. That permanent establishment;
> b. Sales of goods or merchandise of the same or similar activities of the same or similar kind as those affected, through that permanent establishment.
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> **Article V**
> **PERMANENT ESTABLISHMENT**
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> 1. For the purpose of this Convention, the term 'permanent establishment' means a fixed place of business in which the business of the enterprise is wholly or partly carried.
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> 2. The term 'permanent establishment' shall include especially:

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

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

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

In sum, all of petitioner's assigned errors failed in the light of jurisprudence and law.

WHEREFORE, premises considered, the instant petition is hereby **DENIED DUE COURSE**, and accordingly, **DISMISSED** for lack of merit.

SO ORDERED.

OLGA PALANCA-ENRIQUEZ
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

(Voluntarily inhibited himself)
JUANITO C. CASTAÑEDA, JR.
Associate Justice

LOVELL R. BAUTISTA
Associate Justice

ERLINDA P. UY
Associate Justice

CAESAR A. CASANOVA
Associate Justice

C E R T I F I C A T I O N

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.

ERNESTO D. ACOSTA
Presiding Justice