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. 6761

Members:

Acosta, *Chairman*,
Bautista, and
Casanova, *JJ.*

Promulgated:

SEP 12 2005 [signature]

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DECISION

ACOSTA, PJ.:

The instant petition is a claim for refund in the amount of FOUR HUNDRED TWENTY THOUSAND FOUR HUNDRED SIXTY SIX PESOS AND NINETY FIVE CENTAVOS (P420,466.95) alleged to have been erroneously paid as tax on Gross Philippine Billings for taxable year 2001.

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

Petitioner is a non-resident 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 having no landing rights in the Philippines. Consequently, it does not maintain flight operations to and from the Philippines (*Joint Stipulations of Facts and Issues, Paragraph 5, CTA Records, page 63*).

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Petitioner is likewise not licensed to do business in the Philippines inasmuch as it is not registered with the Securities and Exchange Commission (SEC) as a corporation, branch office or partnership (*Joint Stipulations of Facts and Issues, Paragraph 6, CTA Records, page 65*).

It, however, has a general sales agent in the Philippines, Aerotel Limited Corporation (Aerotel) which among others, sells passage documents for compensation or commission covering petitioner's off-line flights (*Joint Stipulations of Facts and Issues, Paragraph 7, CTA Records, page 65*).

During taxable year 2001, petitioner derived gross revenues in the amount of P28,031,130.00 from the sale in the Philippines through Aerotel, of passage documents for the carriage of passengers between ports or points outside the Philippines (*Exhibits "C", "D", "E", and "F"*). Thinking that its off-line flights, which are covered by passage documents sold in the Philippines by Aerotel, were subject to income tax on Gross Philippine Billings, petitioner paid tax at the reduced rate of 1 1/2% instead of 2 ½%, pursuant to Article 8(2) of the RP-New Zealand Tax Treaty or in the amount of P420,466.95.

On February 5, 2003, petitioner filed a formal claim for refund with respondent through Revenue District Office No. 47 of the Bureau of Internal Revenue (BIR), for the recovery of the subject amount of P420,466.95, representing erroneously paid tax on Gross Philippine Billings for taxable year 2001 (*Joint Stipulations of Facts and Issues, Paragraph 9*).

Up to the time of the filing of herein Petition for Review, respondent has not acted on petitioner's administrative claim for refund. Hence, on August 28, 2003, petitioner filed the instant petition.

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In his Answer filed on October 28, 2003, respondent asserted the following Special and Affirmative Defenses, to wit:

> "3. He reiterates and repleads the preceding paragraphs of this answer as part of his Special and Affirmative Defenses;
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> 4. Petitioner's alleged claim for refund is still subject to administrative routinary investigation/examination by the respondent's Bureau;
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> 5. Taxes paid and collected are presumed to have been made in accordance with law, hence, not refundable;
>
> 6. Petitioner failed to substantiate its claim for refund involving the amount of P420,466.95 as alleged erroneously paid Gross Philippine Billings Tax for taxable year 2001;
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> 7. Revenue Regulations No. 15-2002 dated May 30,2002 is not applicable to the issues involved in the instant case since it applies prospectively;
>
> 8. Petitioner being an off-line international airline and doing business in the Philippines by regularly selling tickets within the country through its sales agent, Aerotel Limited Corporation is subject to income tax based on Gross Philippine Billings (***BIR Ruling No. 269-89 dated December 27,1989***);
>
> 9. Petitioner's claim for refund covering the 1st quarter of 2001 has already prescribed;
>
> 10. It is incumbent upon petitioner to show that it has complied with the provisions under **Sections 204** in relation to **Section 230 (now 229) of the Tax Code**. Otherwise, its failure to prove the same is fatal to its claim for refund;
>
> 8. 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***)."

During the course of the trial, the parties decided to stipulate on the issues to be resolved by the court, namely:

1. Whether or not petitioner complied with the requirements under Section 204 and 229 of the National Internal Revenue Code of 1997 for the

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recovery of internal revenue taxes that have been erroneously, wrongfully, illegally or excessively assessed or collected.

2. Whether or not gross revenues derived by an off-line carrier 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 the off-line carrier's sales agent, are subject to the Gross Philippine Billings tax.

3. Whether or not Revenue Regulations No. 15-2002 dated May 30, 2002 alleged by petitioner as its basis for the claimed refund is applicable to the issues involved in the instant case.

4. Whether or not petitioner's judicial right to claim for refund for the 1st quarter of 2001 has already prescribed pursuant to Section 229 of the 1997 Tax Code.

5. Whether or not petitioner is entitled to the refund of erroneously paid tax on Gross Philippine Billings for taxable year 2001 in the amount of P420,466.95. (*Joint Stipulations of Facts and Issues, page 67, CTA Records*)

Inasmuch as the first and fourth issues are related, the same will be discussed jointly.

Sections 204 and 229 of the 1997 NIRC set forth the requirements for the recovery of internal revenue taxes that have been erroneously, wrongfully, illegally or excessively assessed or collected. And the said provisions provide that both the administrative and judicial claims for refund must be filed within two years from the date of payment of the tax alleged to have been erroneously, wrongfully, illegally or excessively assessed or collected.

Long-settled is the rule that for income taxes, the two-year prescriptive period laid down in Section 229 of the 1997 Tax Code is reckoned from the filing of the Annual Income Tax Return (**Philippine Bank of Communications vs. Commissioner of Internal Revenue,** *G.R. No. 112024, January 28, 1999*).

In the case before Us, the Annual Income Tax Return of petitioner for the taxable year 2001 was filed on April 15, 2002. This means that it had until April 15, 2004 to file a judicial claim for the refund of erroneously paid income tax on Gross Philippine Billings for the taxable year 2001. Accordingly, the petitioner filed both the administrative and judicial refund claims well-within the two-year period prescribed by law.

The three remaining issues which are likewise related will be jointly resolved.

Inasmuch as the focal point of contention is Section 28 (A)(3)(a) of the 1997 Tax Code, which provides for the tax on Gross Philippine Billings of international air carriers, the same is quoted hereunder for easy reference, to wit:

> "**SEC. 28. Rates of Income Tax on Foreign Corporations.**
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> "(A) Tax on Resident Foreign Corporations. — xxx
>
> "(3) International Carrier. — An international carrier doing business in the Philippines shall pay a tax of two and one-half percent (2 1/2%) 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 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."

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This Court declared in the recently promulgated case of **Air Canada vs. Commissioner of Internal Revenue**, *CTA Case No. 6572, December 22, 2004*, that:

> "xxx [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 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."**

Based on the foregoing it appears that the petitioner cannot be taxed on its Gross Philippine Billings. However, following the same ruling of this Court in the case of **Air Canada vs. Commissioner of Internal Revenue**, that while 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. We quote:

> "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:
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> ". . . **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."**
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> **"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**

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> **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.**" *(Emphasis 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 and it derives revenues from the conduct of its business activity regularly pursued within the Philippines. Hence, the 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 tax.

The High Tribunal on numerous occasions sustained the validity of the foregoing finding. Among these are the cases of **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 the Honorable Supreme Court 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. xxx The test of taxability is the 'source'; and the source of an income is that activity xxx 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."

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The High Court in the same case of Commissioner of Internal Revenue vs. British Overseas Airways Corporation, supra, explained further in this manner:

> "'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. xxx
>
> 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. xxx"

It has been consistently ruled that the source of income is the property, activity or service that produced the income and, in order that the source of income to be considered as coming from the Philippines, it is enough that the income is derived from activity within the Philippines **Commissioner of Internal Revenue vs. Japan Air Lines, Inc.** *202 SCRA 450*. Applying the said definition to the present case, proceeds from sales of passage documents by the petitioner are subject to income tax.

Lastly, **Revenue Regulations No. 15-2002**, dated May 30, 2002, whose **Section 3** provides in part that, "An offline airline having a branch or sales agent in the Philippines which sells passage documents for compensation or commission to cover off-line flights xxx is not considered engaged in the business as an international carrier in the Philippines and is, therefore, not subject to Gross Philippine Billings Tax xxx", which is alleged by petitioner as its basis for the claimed refund is not applicable to the issues involved in the instant case inasmuch as the transaction period covered by the refund claim is taxable period 2001, while the said regulation only became effective only on October 26, 2002. And based on the above-finding of this Court's First Division, even granting that petitioner is not liable to pay the Gross

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Philippine Billings Tax, it is still required to pay tax equal to 32% of its gross income received during the taxable year 2001 from all sources within the Philippines.

To recapitulate, the petitioner, as 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 Tax Code. However, 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.

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

SO ORDERED.

ERNESTO D. ACOSTA
Presiding Justice

We concur:

LOVELL R. BAUTISTA
Associate Justice

CAESAR A. CASANOVA
Associate Justice

CERTIFICATION

I hereby certify that the above decision was reached after due consultation with the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

ERNESTO D. ACOSTA
Presiding Justice

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