REPUBLIC OF THE PHILIPPINES
Court of Tax Appeals
QUEZON CITY

EN BANC

AIR NEW ZEALAND,
Petitioner,

C.T.A. E.B. NO. 153
(C.T.A. CASE NO. 6761)

Present:

- versus -

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

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:

AUG 28 2006

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D E C I S I O N

UY, J.:

This is a Petition for Review before the Court of Tax Appeals *En Banc* filed on January 11, 2006 of the Decision promulgated on September 12, 2005 and the Resolution promulgated on December 16, 2005 rendered by the First Division of this Court pursuant to Section 11 of Republic Act No. 9282, the respective dispositive portions of which read as follows:

DECISION dated September 12, 2005: CTA CASE NO. 6761

> "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."[1]

RESOLUTION dated December 16, 2005: CTA CASE NO. 6761

"There being no new matter or argument advanced in the petitioner's Motion for Reconsideration which may compel this Court's First Division to reverse, modify or depart from the assailed decision, the same is hereby **DENIED** for lack of merit.

SO ORDERED."[2]

Culled from the assailed Decision, the established facts of the case are as follows:

Petitioner 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 having no landing rights in the Philippines. Consequently, it does not maintain flight operations to and from the Philippines.

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.

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.

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[1] Assailed Decision, Rollo, p.43.
[2] Assailed Resolution. Rollo, p.45

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. 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 1/2%, 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.

Unable to obtain an immediate relief from the respondent, petitioner filed before the First Division of this Court a Petition for Review on August 28, 2003 (docketed as C.T.A. Case No. 6761).

On September 12, 2005, the First Division of this Court rendered its assailed Decision denying the petition 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 is still liable to pay thirty two percent (32%) of its taxable income derived from its sales of passage documents here in the Philippines.

Likewise, finding no compelling reasons to either modify or alter the assailed Decision, the First Division of this Court denied petitioner's Motion for Reconsideration thereof in the assailed Resolution dated December 16, 2005.

Hence, this recourse before the Court *En Banc* praying that: (a) the Decision dated September 12, 2005 and the Resolution dated December 16, 2005 be reversed and set aside; (b) petitioner be declared as a non-resident foreign corporation and thus, not subject to the thirty two percent (32%) regular income tax on taxable income under Section 28(A)(1) of the NIRC of 1997; and (c) petitioner be declared as entitled to a refund or tax credit in the amount of P420,466.95 representing erroneously paid taxes on Gross Philippine Billings for taxable year 2001.

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 32% income tax imposed by Section 28(A)(1) of the 1997 NIRC.
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> 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.
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> III. Whether or not the Honorable Court erred in denying petitioner's claim for refund of erroneously paid tax on Gross Philippine Billings for taxable year 2001 despite finding that petitioner is not subject to 2 ½% tax on Gross Philippine Billings.
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> IV. 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."

In support of its Petition for Review, petitioner presents the following arguments:

a. "Petitioner, as an off-line international carrier, is not engaged in trade or business in the Philippines. Thus, it is not a resident foreign corporation subject to the 32% income tax imposed by Section 28(A)(1) of the 1997 NIRC on resident foreign corporations."

b. "Income taxation of international carriers is specifically covered by Section 28(A)(3) of the 1997 NIRC, imposing the 2 ½% tax on Gross Philippines Billings. Thus, it necessarily precludes the application of Section 28(A)(1) of the 1997 NIRC, which is a general provision of law imposing the 32% regular corporate income tax on resident foreign corporations."

c. "The RP-New Zealand Tax Treaty similarly precludes the application of Article 7 on Business Profits where income from Shipping and Air Transport is covered in Article 8 thereof."

d. "The denial of the instant claim for refund on the basis of the Honorable Court's determination that petitioner is subject to the 32% income tax has no legal basis and violates due process."

e. "The Honorable Court's Decision will result to an inequitable, absurd and unreasonable taxation among online and off-line international carriers."

No comment thereto was filed by the respondent within the extended period requested or until March 3, 2006. Hence, this decision

We find no merit in the petition.

A careful and closer look at the arguments set forth by the petitioner in the instant petition for review, and its annexes, would readily reveal that the grounds relied upon and the matters raised herein are mere restatements of petitioner's previous arguments raised before the First Division of this Court which had already been exhaustively discussed and passed upon by it in its assailed Decision and Resolution promulgated on September 12, 2005 and December 16, 2005, respectively.

Be that as it may, with the end view of further clarifying the decision of the First Division, We adopt its pronouncement 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 thirty two percent (32%) of its taxable income derived from its sales of passage documents here in the Philippines, quoted hereunder as follows:

> "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**,[3] 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**

[3] Affirmed in CTA EB No. 86, August 26, 2005.

> **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 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)[4]
>
> 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."[5]

As correctly pointed out by the First Division of this Court, the Supreme Court has already sustained the validity of the aforesaid finding in several cases.[6] As a matter of fact, it was clarified that the definition of gross

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[4] CTA Case No. 6572, December 22, 2004.
[5] Assailed Decision, Rollo, pp.40-41.
[6] Citing Commissioner of Internal Revenue vs. American Airlines, Inc. (180 SCRA 274), Commissioner of Internal Revenue vs. British Overseas Airways, Corp. (149 SCRA 395), and Commissioner of Internal Revenue vs. Japan Air Lines, Inc. (202 SCRA 450).

income "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".[7]

This Court has consistently ruled that even granting that a resident foreign corporation engaged in trade or business in the country is not liable to pay the Gross Philippine Billings Tax as provided in Section 28(A)(3)(a) of the NIRC of 1997, 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.[8]

Applying the aforementioned discussion in the case at bench, petitioner's appointment/designation of Aerotel as its agent in the Philippines, for the purpose of selling passage documents for compensation or commission, among others, on a regular basis contemplates its intention of continuity of commercial dealings in this country. Evidently, petitioner is engaged in business in the Philippines and it derives revenues from the conduct of its business activity regularly pursued in the Philippines.

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] Commissioner of Internal Revenue vs. British Overseas Airways, Corp., ibid.
[8] South African Airways vs. Commissioner of Internal Revenue, CTA EB No. 118 (CTA Case No. 6760), December 2, 2005; South African Airways vs. Commissioner of Internal Revenue, CTA Case No. 6656, May 10, 2006; and South African Airways vs. Commissioner of Internal Revenue, CTA Case No. 6759, May 3, 2006.

tax law and the income earned from its flight operations outside the Philippines is subject to an income tax rate of 32% under Section 28 of the NIRC of 1997, as amended.

Another point 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 First Division of this Court 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 taxable period 2001. Hence, said argument is likewise bereft of merit.

The rule in this jurisdiction to which our jurisprudence clung with unrelenting grasp 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".[9]

In the light of the foregoing discussions, the Court *En Banc* finds no reversible error committed by the First Division of this Court when it rendered its assailed Decision and Resolution dated September 12, 2005 and December 16, 2005, respectively.

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[9] 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]).

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