

SECOND DIVISION

[G.R. No. 169507, January 11, 2016]

**AIR CANADA, PETITIONER, VS. COMMISSIONER OF INTERNAL
REVENUE, RESPONDENT.**

D E C I S I O N

LEONEN, J.:

An offline international air carrier selling passage tickets in the Philippines, through a general sales agent, is a resident foreign corporation doing business in the Philippines. As such, it is taxable under Section 28(A)(1), and not Section 28(A)(3) of the 1997 National Internal Revenue Code, subject to any applicable tax treaty to which the Philippines is a signatory. Pursuant to Article 8 of the Republic of the Philippines-Canada Tax Treaty, Air Canada may only be imposed a maximum tax of 1 1/2% of its gross revenues earned from the sale of its tickets in the Philippines.

This is a Petition for Review^[1] appealing the August 26, 2005 Decision^[2] of the Court of Tax Appeals En Banc, which in turn affirmed the December 22, 2004 Decision^[3] and April 8, 2005 Resolution^[4] of the Court of Tax Appeals First Division denying Air Canada's claim for refund.

Air Canada is a "foreign corporation organized and existing under the laws of Canada[.]"^[5] On April 24, 2000, it was granted an authority to operate as an offline carrier by the Civil Aeronautics Board, subject to certain conditions, which authority would expire on April 24, 2005.^[6] "As an off-line carrier, [Air Canada] does not have flights originating from or coming to the Philippines [and does not] operate any airplane [in] the Philippines[.]"^[7]

On July 1, 1999, Air Canada engaged the services of Aerotel Ltd., Corp. (Aerotel) as its general sales agent in the Philippines.^[8] Aerotel "sells [Air Canada's] passage documents in the Philippines."^[9]

For the period ranging from the third quarter of 2000 to the second quarter of 2002, Air Canada, through Aerotel, filed quarterly and annual income tax returns and paid the income tax on Gross Philippine Billings in the total amount of P5,185,676.77,^[10] detailed as follows:

Applicable Quarter[/]Year	Date Filed/Paid	Amount of Tax
3 rd Qtr 2000	November 29,2000	P 395,165.00
Annual ITR 2000	April 16, 2001	381,893.59

1 st Qtr 2001	May 30, 2001	522,465.39
2 nd Qtr 2001	August 29, 2001	1,033,423.34
3 rd Qtr 2001	November 29, 2001	765,021.28
Annual ITR 2001	April 15, 2002	328,193.93
1 st Qtr 2002	May 30, 2002	594,850.13
2 nd Qtr 2002	August 29, 2002	1,164,664.11
TOTAL		P 5,185,676.77^[11]

On November 28, 2002, Air Canada filed a written claim for refund of alleged erroneously paid income taxes amounting to P5,185,676.77 before the Bureau of Internal Revenue,^[12] Revenue District Office No. 47-East Makati.^[13] It found basis from the revised definition^[14] of Gross Philippine Billings under Section 28(A)(3)(a) of the 1997 National Internal Revenue Code:

SEC. 28. Rates of Income Tax on Foreign Corporations. -

(A) *Tax on Resident Foreign Corporations. -*

. . . .

(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. (Emphasis supplied)

To prevent the running of the prescriptive period, Air Canada filed a Petition for Review before the Court of Tax Appeals on November 29, 2002.^[15] The case was docketed as C.T.A. Case No. 6572.^[16]

On December 22, 2004, the Court of Tax Appeals First Division rendered its Decision denying the Petition for Review and, hence, the claim for refund.^[17] It found that Air Canada was engaged in business in the Philippines through a local agent that sells airline tickets on its behalf. As such, it should be taxed as a resident foreign corporation at the regular rate of 32%.^[18] Further, according to the Court of Tax Appeals First Division, Air Canada was deemed to have established a "permanent

establishment"^[19] in the Philippines under Article V(2)(i) of the Republic of the Philippines-Canada Tax Treaty^[20] by the appointment of the local sales agent, "in which [the] petitioner uses its premises as an outlet where sales of [airline] tickets are made[.]"^[21]

Air Canada seasonably filed a Motion for Reconsideration, but the Motion was denied in the Court of Tax Appeals First Division's Resolution dated April 8, 2005 for lack of merit.^[22] The First Division held that while Air Canada was not liable for tax on its Gross Philippine Billings under Section 28(A)(3), it was nevertheless liable to pay the 32% corporate income tax on income derived from the sale of airline tickets within the Philippines pursuant to Section 28(A)(1).^[23]

On May 9, 2005, Air Canada appealed to the Court of Tax Appeals En Bane.^[24] The appeal was docketed as CTAEB No. 86.^[25]

In the Decision dated August 26, 2005, the Court of Tax Appeals En Bane affirmed the findings of the First Division.^[26] The En Banc ruled that Air Canada is subject to tax as a resident foreign corporation doing business in the Philippines since it sold airline tickets in the Philippines.^[27] The Court of Tax Appeals En Bane disposed thus:

WHEREFORE, premises considered, the instant petition is hereby **DENIED DUE COURSE**, and accordingly, **DISMISSED** for lack of merit.
^[28]

Hence, this Petition for Review^[29] was filed. The issues for our consideration are:

First, whether petitioner Air Canada, as an offline international carrier selling passage documents through a general sales agent in the Philippines, is-a resident foreign corporation within the meaning of Section 28(A)(1) of the 1997 National Internal Revenue Code;

Second, whether petitioner Air Canada is subject to the 21/2% tax on Gross Philippine Billings pursuant to Section 28(A)(3). If not, whether an offline international carrier selling passage documents through a general sales agent can be subject to the regular corporate income tax of 32%^[30] on taxable income pursuant to Section 28(A)(1);

Third, whether the Republic of the Philippines-Canada Tax Treaty applies, specifically:

- a. Whether the Republic of the Philippines-Canada Tax Treaty is enforceable;
- b. Whether the appointment of a local general sales agent in the Philippines falls under the definition of "permanent establishment" under Article V(2)(i) of the Republic of the Philippines-Canada Tax Treaty; and

Lastly, whether petitioner Air Canada is entitled to the refund of P5,185,676.77 pertaining allegedly to erroneously paid tax on Gross Philippine Billings from the third quarter of 2000 to the second quarter of 2002.

Petitioner claims that the general provision imposing the regular corporate income tax on resident foreign corporations provided under Section 28(A)(1) of the 1997 National Internal Revenue Code does not apply to "international carriers,"^[31] which are especially classified and taxed under Section 28(A)(3).^[32] It adds that the fact that it is no longer subject to Gross Philippine Billings tax as ruled in the assailed Court of Tax Appeals Decision "does not render it *ipso facto* subject to 32% income tax on taxable income as a resident foreign corporation."^[33] Petitioner argues that to impose the 32% regular corporate income tax on its income would violate the Philippine government's covenant under Article VIII of the Republic of the Philippines-Canada Tax Treaty not to impose a tax higher than 1 Vi% of the carrier's gross revenue derived from sources within the Philippines.^[34] It would also allegedly result in "inequitable tax treatment of on-line and off-line international air carriers[.]"^[35]

Also, petitioner states that the income it derived from the sale of airline tickets in the Philippines was income from services and not income from sales of personal property.^[36] Petitioner cites the deliberations of the Bicameral Conference Committee on House Bill No. 9077 (which eventually became the 1997 National Internal Revenue Code), particularly Senator Juan Ponce Enrile's statement,^[37] to reveal the "legislative intent to treat the revenue derived from air carriage as income from services, and that the carriage of passenger or cargo as the activity that generates the income."^[38] Accordingly, applying the principle on the situs of taxation in taxation of services, petitioner claims that its income derived "from services rendered outside the Philippines [was] not subject to Philippine income taxation."^[39]

Petitioner further contends that by the appointment of Aerotel as its general sales agent, petitioner cannot be considered to have a "permanent establishment"^[40] in the Philippines pursuant to Article V(6) of the Republic of the Philippines-Canada Tax Treaty.^[41] It points out that Aerotel is an "independent general sales agent that acts as such for ... other international airline companies in the ordinary course of its business."^[42] Aerotel sells passage tickets on behalf of petitioner and receives a commission for its services.^[43] Petitioner states that even the Bureau of Internal Revenue— through VAT Ruling No. 003-04 dated February 14, 2004—has conceded that an offline international air carrier, having no flight operations to and from the Philippines, is not deemed engaged in business in the Philippines by merely appointing a general sales agent.^[44] Finally, petitioner maintains that its "claim for refund of erroneously paid Gross Philippine Billings cannot be denied on the ground that [it] is subject to income tax under Section 28 (A) (I)"^[45] since it has not been assessed at all by the Bureau of Internal Revenue for any income tax liability.^[46]

On the other hand, respondent maintains that petitioner is subject to the 32% corporate income tax as a resident foreign corporation doing business in the Philippines. Petitioner's total payment of P5,185,676.77 allegedly shows that

petitioner was earning a sizable income from the sale of its plane tickets within the Philippines during the relevant period.^[47] Respondent further points out that this court in *Commissioner of Internal Revenue v. American Airlines, Inc.*,^[48] which in turn cited the cases involving the British Overseas Airways Corporation and Air India, had already settled that "foreign airline companies which sold tickets in the Philippines through their local agents . . . [are] considered resident foreign corporations engaged in trade or business in the country."^[49] It also cites Revenue Regulations No. 6-78 dated April 25, 1978, which defined the phrase "doing business in the Philippines" as including "regular sale of tickets in the Philippines by offline international airlines either by themselves or through their agents."^[50]

Respondent further contends that petitioner is not entitled to its claim for refund because the amount of P5,185,676.77 it paid as tax from the third quarter of 2000 to the second quarter of 2001 was still short of the 32% income tax due for the period.^[51] Petitioner cannot allegedly claim good faith in its failure to pay the right amount of tax since the National Internal Revenue Code became operative on January 1, 1998 and by 2000, petitioner should have already been aware of the implications of Section 28(A)(3) and the decided cases of this court's ruling on the taxability of offline international carriers selling passage tickets in the Philippines.^[52]

I

At the outset, we affirm the Court of Tax Appeals' ruling that petitioner, as an offline international carrier with no landing rights in the Philippines, is not liable to tax on Gross Philippine Billings under Section 28(A)(3) of the 1997 National Internal Revenue Code:

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(A) Tax on Resident Foreign Corporations. -

. . . .

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