EN BANC

[G.R. Nos. 65773-74. April 30, 1987.]

**COMMISSIONER OF INTERNAL REVENUE**, *petitioner*, ***vs.*** **BRITISH OVERSEAS AIRWAYS CORPORATION and COURT OF TAX APPEALS**, *respondents*.

*Quasha, Asperilla, Ancheta, Peña, Valmonte & Marcos* for respondent British Airways.

## D E C I S I O N

**MELENCIO-HERRERA**, *J*.:

Petitioner Commissioner of Internal Revenue (CIR) seeks a review on Certiorari of the joint Decision of the Court of Tax Appeals (CTA) in CTA Cases Nos. 2373 and 2561, dated 26 January 1983, which set aside petitioner's assessment of deficiency income taxes against respondent British Overseas Airways Corporation (BOAC) for the fiscal years 1959 to 1967, 1968-69 to 1970-71, respectively, as well as its Resolution of 18 November, 1983 denying reconsideration. cdphil

BOAC is a 100% British Government-owned corporation organized and existing under the laws of the United Kingdom. It is engaged in the international airline business and is a member-signatory of the Interline Air Transport Association (IATA). As such, it operates air transportation service and sells transportation tickets over the routes of the other airline members. During the periods covered by the disputed assessments, it is admitted that BOAC had no landing rights for traffic purposes in the Philippines, and was not granted a Certificate of public convenience and necessity to operate in the Philippines by the Civil Aeronautics Board (CAB), except for a nine-month period, partly in 1961 and partly in 1962, when it was granted a temporary landing permit by the CAB. Consequently, it did not carry passengers and/or cargo to or from the Philippines, although during the period covered by the assessments, it maintained a general sales agent in the Philippines —

Warner Barnes and Company, Ltd., and later Qantas Airways — which was responsible for selling BOAC tickets covering passengers and cargoes. [1(1)]

*G.R. No. 65773* (CTA Case No. 2373, the First Case)

On 7 May 1968, petitioner Commissioner of Internal Revenue (CIR, for brevity) assessed BOAC the aggregate amount of P2,498,358.56 for deficiency income taxes covering the years 1959 to 1963. This was protested by BOAC. Subsequent investigation resulted in the issuance of a new assessment, dated 16 January 1970 for the years 1959 to 1967 in the amount of P858,307.79. BOAC paid this new assessment under protest.

On 7 October 1970, BOAC filed a claim for refund of the amount of P858,307.79, which claim was denied by the CIR on 16 February 1972. But before said denial, BOAC had already filed a petition for review with the Tax Court on 27 January 1972, assailing the assessment and praying for the refund of the amount paid.

*G.R. No. 65774* (CTA Case No. 2561, the Second Case)

On 17 November 1971, BOAC was assessed deficiency income taxes, interests, and penalty for the fiscal years 1968/1969 to 1970-1971 in the aggregate amount of P549,327.43, and the additional amounts of P1,000.00 and P1,800.00 as compromise penalties for violation of Section 46 (requiring the filing of corporation returns) penalized under Section 74 of the National Internal Revenue Code (NIRC).

On 25 November 1971, BOAC requested that the assessment be countermanded and set aside. In a letter, dated 16 February 1972, however, the CIR not only denied the BOAC request for refund in the First Case but also re-issued in the Second Case the deficiency income tax assessment for P534,132.08 for the years 1969 to 1970-71 plus P1,000.00 as compromise penalty under Section 74 of the Tax Code. BOAC's request for reconsideration was denied by the CIR on 24 August 1973. This prompted BOAC to file the Second Case before the Tax Court praying that it be absolved of liability for deficiency income tax for the years 1969 to 1971.

This case was subsequently tried jointly with the First Case.

On 26 January 1983, the Tax Court rendered the assailed joint Decision reversing the CIR. The Tax Court held that the proceeds of sales of BOAC passage tickets in the Philippines by Warner Barnes and Company, Ltd., and later by Qantas Airways, during the period in question, do not constitute BOAC income from Philippine sources "since no service of carriage of passengers or freight was

performed by BOAC within the Philippines" and, therefore, said income is not subject to Philippine income tax. The CTA position was that income from transportation is income from services so that the place where services are rendered determines the source. Thus, in the dispositive portion of its Decision, the Tax Court ordered petitioner to credit BOAC with the sum of P858,307.79, and to cancel the deficiency income tax assessments against BOAC in the amount of P534,132.08 for the fiscal years 1968-69 to 1970-71.

Hence, this Petition for Review on Certiorari of the Decision of the Tax Court.

The Solicitor General, in representation of the CIR, has aptly defined the issues, thus:

> "1. Whether or not the revenue derived by private respondent British Overseas Airways Corporation (BOAC) from sales of tickets in the Philippines for air transportation, while having no landing rights here, constitute income of BOAC from Philippine sources, and, accordingly, taxable.
>
> "2. Whether or not during the fiscal years in question BOAC is a resident foreign corporation doing business in the Philippines or has an office or place of business in the Philippines.
>
> "3. In the alternative that private respondent may not be considered a resident foreign corporation but a non-resident foreign corporation, then it is liable to Philippine income tax at the rate of thirty-five per cent (35%) of its gross income received from all sources within the Philippines."

Under Section 20 of the 1977 Tax Code:

> "(h) the term 'resident foreign corporation' applies to a foreign corporation engaged in trade or business within the Philippines or having an office or place of business therein.
>
> "(i) The term 'non-resident foreign corporation' applies to a foreign corporation not engaged in trade or business within the Philippines and not having any office or place of business therein." LLpr

It is our considered opinion that BOAC is a resident foreign corporation. 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 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 gain or for the purpose and object of the business organization. [2] [(2)]"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.' [3(3)]

BOAC, during the periods covered by the subject-assessments, maintained a general sales agent in the Philippines. That general sales agent, from 1959 to 1971, "was engaged in (1) selling and issuing tickets; (2) breaking down the whole trip into series of trips — each trip in the series corresponding to a different airline company; (3) receiving the fare from the whole trip; and (4) consequently allocating to the various airline companies on the basis of their participation in the services rendered through the mode of interline settlement as prescribed by Article VI of the Resolution No. 850 of the IATA Agreement." [4] [(4)]Those 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. In fact, the regular sale of tickets, its main activity, is the very lifeblood of the airline business, the generation of sales being the paramount objective. There should be no doubt then that BOAC was "engaged in" business in the Philippines through a local agent during the period covered by the assessments. 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. [5(5)]

> "Sec. 24. Rates of tax on corporations. — . . .
>
> "(b) Tax on foreign corporations. — . . .
>
> "(2) Resident corporations. — A corporation organized, authorized, or existing under the laws of any foreign country, except a foreign life insurance company, engaged in trade or business within the Philippines, shall be taxable as provided in subsection (a) of this section upon the total net income received in the preceding taxable year from *all sources within the Philippines*. (Emphasis ours)

Next, we address ourselves to the issue of whether or not the revenue from sales of tickets by BOAC in the Philippines constitutes income from Philippine sources and, accordingly, taxable under our income tax laws.

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 whatev*er" (Sec. 29[3]; Emphasis supplied)

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 . . .; 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. 6(6)

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. 7(7)

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. 8(8) 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. 9(9)

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. 10(10)

BOAC, however, would impress upon this Court that income derived from transportation is income for services, with the result that the place where the services are rendered determines the source; and since BOAC's service of transportation is performed outside the Philippines, the income derived is from sources without the Philippines and, therefore, not taxable under our income tax laws. The Tax Court upholds that stand in the joint Decision under review.

The absence of flight operations to and from the Philippines is not determinative of the source of income or the situs of income taxation. Admittedly, BOAC was an off-line international airline at the time pertinent to this case. The test of taxability is the "source"; and the source of an income is that activity . . . which produced the income. 11 (11)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", 12 (12)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. 13(13)

It should be pointed out, however, that the assessments upheld herein apply only to the fiscal years covered by the questioned deficiency income tax assessments in these cases, or, from 1959 to 1967, 1968-69 to 1970-71. For, pursuant to Presidential Decree No. 69, promulgated on 24 November, 1972, international carriers are now taxed as follows:

> ". . . Provided, however, That international carriers shall pay a tax of 2-1/2 per cent on their gross Philippine billings." (Sec. 24[b] [2], Tax Code).

Presidential Decree No. 1355, promulgated on 21 April, 1978, provided a statutory definition of the term "gross Philippine billings," thus:

> ". . . 'Gross Philippine billings' includes gross revenue realized from

uplifts anywhere in the world by any international carrier doing business in the Philippines of passage documents sold therein, whether for passenger, excess baggage or mail, provided the cargo or mail originates from the Philippines. . . ."

The foregoing provision ensures that international airlines are taxed on their income from Philippine sources. The 2-1/2% tax on gross Philippine billings is an income tax. If it had been intended as an excise or percentage tax it would have been place under Title V of the Tax Code covering Taxes on Business.

Lastly, we find as untenable the BOAC argument that the dismissal for lack of merit by this Court of the appeal in JAL vs. Commissioner of Internal Revenue (G.R. No. L-30041) on February 3, 1969, is *res judicata* to the present case. The ruling by the Tax Court in that case was to the effect that the mere sale of tickets, unaccompanied by the physical act of carriage of transportation, does not render the taxpayer therein subject to the common carrier's tax. As elucidated by the Tax Court, however, the common carrier's tax is an excise tax, being a tax on the activity of transporting, conveying or removing passengers and cargo from one place to another. It purports to tax the business of transportation. [14](14) Being an excise tax, the same can be levied by the State only when the acts, privileges or businesses are done or performed within the jurisdiction of the Philippines. The subject matter of the case under consideration is income tax, a direct tax on the income of persons and other entities "of whatever kind and in whatever form derived from any source." Since the two cases treat of a different subject matter, the decision in one cannot be *res judicata* to the other.

WHEREFORE, the appealed joint Decision of the Court of Tax Appeals is hereby SET ASIDE. Private respondent, the British Overseas Airways Corporation (BOAC), is hereby ordered to pay the amount of P534,132.08 as deficiency income tax for the fiscal years 1968-69 to 1970-71 plus 5% surcharge, and 1% monthly interest from April 16, 1972 for a period not to exceed three (3) years in accordance with the Tax Code. The BOAC claim for refund in the amount of P858,307.79 is hereby denied. Without costs.

SO ORDERED.

*Paras, Gancayco, Padilla, Bidin, Sarmiento, Yap* and *Cortes, JJ*., concur.

*Fernan, J*., took no part, his brother-in-law being a member of the law firm representing private respondents.

# Separate Opinions

**TEEHANKEE**, *C .J .*, *concurring*:

I concur with the Court's majority judgment upholding the assessments of deficiency income taxes against respondent BOAC for the fiscal years 1959-1967, 1968-1969 to 1970-1971 and therefore setting aside the appealed joint decision of respondent Court of Tax Appeals. I just wish to point out that the conflict between the majority opinion penned by Mme. Justice Melencio-Herrera and the dissenting opinion penned by Mr. Justice Feliciano as to the proper characterization of the taxable income derived by respondent BOAC from the sales in the Philippines of tickets for BOAC flights as sold and issued by its general sales agent in the Philippines has become moot after November 24, 1972. Both opinions state that by amendment through P.D. No. 69, promulgated on November 24, 1972, of section 24(b) (2) of the Tax Code providing for the rate of income tax on foreign corporations, international carriers such as respondent BOAC, have since then been taxed at a reduced rate of 2-1/2% on their gross Philippine billings. There is, therefore, no longer any source of substantial conflict between the two opinions as to the present 2-1/2% tax on their gross Philippine billings charged against such international carriers as herein respondent foreign corporation. cdrep

**FELICIANO,** *J ., dissenting*:

With great respect and reluctance, I record my dissent from the opinion of Mme. Justice A.A. Melencio-Herrera speaking for the majority. In my opinion, the joint decision of the Court of Tax Appeals in CTA Cases Nos. 2373 and 2561, dated 26 January 1983, is correct and should be affirmed.

The fundamental issue raised in this petition for review is whether the British Overseas Airways Corporation (BOAC), a foreign airline company which does not maintain any flight operations 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. cdtai

1. The Solicitor General has defined as one of the issues in this case the

question of:

> "2. Whether or not during the fiscal years in question [1] (15)BOAC, [was] a resident foreign corporation doing business in the Philippines or [had] an office or place of business in the Philippines."

It is important to note at the outset that the answer to the above-quoted issue is *not* determinative of the liability of the BOAC to Philippine income taxation in respect of the income here involved. The liability of BOAC to Philippine income taxation in respect of such income depends, not on BOAC's status as a "resident foreign corporation" or alternatively, as a "non-resident foreign corporation," but rather on whether or not such income is derived from "sources within the Philippines."

A "*resident* foreign corporation" or a foreign corporation engaged in trade or business in the Philippines or having an office or place of business in the Philippines is subject to Philippine income taxation *only* in respect of income derived *from sources within the Philippines*. Section 24 (b) (2) of the National Internal Revenue Code ("Tax Code"), as amended by Republic Act No. 2343, approved 20 June 1959, as it existed up to 3 August 1969, read as follows:

> "(2) *Resident corporations.* — A foreign corporation engaged in trade or business within the Philippines (except foreign life insurance companies) shall be taxable as provided in subsection (a) of this section."

Section 24 (a) of the Tax Code in turn provides:

> *"Rate of tax on corporations*. — (a) *Tax on domestic corporations*. — . . . and a like tax shall be levied, collected, and paid annually upon the *total net income received* in the preeeding taxable year *from all sources within the Philippines* by every *corporation organized*, authorized, or existing *under the laws of any foreign country: . . . .*" (Emphasis supplied)

Republic Act No. 6110, which took effect on 4 August 1969, made this even clearer when it amended once more Section 24 (b) (2) of the Tax Code so as to read as follows:

> "(2) *Resident Corporations*. — A *corporation,* organized, authorized or *existing under the laws of any foreign country*, except foreign life insurance company, *engaged in trade or business within the Philippines*, shall be taxable as provided in subsection (a) of this section upon the *total net income received* in the preceding taxable year *from all sources within the Philippines*."

(Emphasis supplied)

Exactly the same rule is provided by Section 24 (b) (1) of the Tax Code upon *non-resident* foreign corporations. Section 24 (b) (1) as amended by Republic Act No. 3825 approved 22 June 1963, read as follows:

> "(b) *Tax on foreign corporations*. — (1) Non-resident corporations. — There shall be levied, collected and paid for each taxable year, in lieu of the tax imposed by the preceding paragraph upon the amount received by *every foreign corporation not engaged in trade or business within the Philippines, from all sources within the Philippines,* as interests, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinative annual or periodical gains, profits and incomes a tax equal to thirty per centum of such amount: provided, however, that premiums shall not include reinsurance premiums." 2(16)

Clearly, whether the foreign corporate taxpayer is doing business in the Philippines and therefore a resident foreign corporation, or not doing business in the Philippines and therefore a non-resident foreign corporation, it is liable to income tax only to the extent that it derives income from sources within the Philippines. The circumstance that a foreign corporation is resident in the Philippines yields no inference that all or any part of its income is Philippine source income. Similarly, the non-resident status of a foreign corporation does not imply that it has no Philippine source income. Conversely, the receipt of Philippine source income creates no presumption that the recipient foreign corporation is a resident of the Philippines. The critical issue, for present purposes, is therefore *whether or not BOAC is deriving income from sources within the Philippines*.

2. For purposes of income taxation, it is well to bear in mind that the "source of income" relates *not* to the *physical sourcing of a flow of money* or the *physical situs of payment* but rather to the "property, activity or service which produced the income." In *Howden and Co*., *Ltd*. *vs*. *Collector of Internal Revenue*, 3(17) the Court dealt with the issue of the applicable source rule relating to reinsurance premiums paid by a local insurance company to a foreign reinsurance company in respect of risks located in the Philippines. The Court said:

> "The source of an income is the property, activity or service that produced the income. The reinsurance premiums remitted to appellants by virtue of the reinsurance contracts, accordingly, had for their source the undertaking to indemnify Commonwealth Insurance Co. against liability. Said undertaking is the activity that produced the reinsurance premiums, and the same took place in the Philippines. — [T]he reinsured, the liabilities insured and

the risks originally underwritten by Commonwealth Insurance Co., upon which the reinsurance premiums and indemnity were based, were all situated in the Philippines. — " 4(18)

The Court may be seen to be saying that it is the *underlying prestation* which is properly regarded as the activity giving rise to the income that is sought to be taxed. In the *Howden* case, that underlying prestation was the *indemnification of the local insurance company*. Such indemnification could take place only in the Philippines where the risks were located and where payment from the foreign reinsurer (in case the casualty insured against occurs) would be received in Philippine pesos under the reinsurance contract. The Court held accordingly that the reinsurance premiums paid by the local insurance companies constituted Philippine source income of the foreign reinsurers.

The concept of "source of income" for purposes of income taxation originated in the United States income tax system. The phrase "sources within the United States" was first introduced into the U.S. tax system in 1916, and was subsequently embodied in the 1939 U.S. Tax Code. As is commonly known, our Tax Code (Commonwealth Act 466, as amended) was patterned after the 1939 U.S. Tax Code. It therefore seems useful to refer to a standard U.S. text on federal income taxation:

> "The Supreme Court has said, in a definition much quoted but often debated, that *income may be derived from three possible sources only*: (1) capital and/or (2) *labor* and/or (3) the *sale of capital assets*. While the three elements of this attempt at definition need not be accepted as all-inclusive, they serve as useful guides in any inquiry into whether a particular item is from 'sources within the United States' and suggest an investigation into the *nature and location of the activities or property which produce the income*. If the income is from labor (services) *the place where the labor is done* should be decisive; if it is done in this country, the income should be from 'sources within the United States.' If the income is from capital, the place where the capital is employed should be decisive; if it is employed in this country, the income should be from 'sources within the United States.' If the income is from the sale of capital assets, *the place where the sale is made* should be likewise decisive. *Much confusion will be avoided by regarding the term 'source' in this fundamental light. It is not a place*; *it is an activity or property. As such, it has a situs or location*; and if that situs or location is within the United States the resulting income is taxable to nonresident aliens and foreign corporations. The intention of Congress in the 1916 and subsequent statutes was to discard the 1909 and 1913 basis of taxing nonresident aliens and foreign corporations and *to make the test of taxability the 'source,' or situs of the activities or property which produce the income*. . . *Thus*, if income is to be taxed, the recipient

thereof must be resident within the jurisdiction, or *the property or activities out of which the income issues or is derived must be situated within the jurisdiction so that the source of the income may be said to have a situs in this country*. The underlying theory is that the consideration for taxation is *protection of life and property* and that the *income rightly to be levied upon* to defray the burdens of the United States Government *is that income which is created by activities and property protected by this Government or obtained by persons enjoying that protection*." 5(19)

3. We turn now to the question of what is the source of income rule applicable in the instant case. There are two possibly relevant source of income rules that must be confronted: (a) the source rule applicable in respect of *contracts of service*; and (b) the source rule applicable in respect of *sales of personal property*.

Where a contract for the rendition of service is involved, the applicable source rule may be simply stated as follows: the income is sourced in the place where the service contracted for is rendered. Section 37 (a) (3) of our Tax Code reads as follows:

"Section 37. Income from sources within the Philippines.

(a) Gross income from sources within the Philippines. — The following items of gross income shall be treated as gross income from sources within the Philippines:

xxx xxx xxx

(3) *Services*. — Compensation for labor or personal services *performed in the Philippines*; . . ." (Emphasis supplied)

Section 37 (c) (3) of the Tax Code, on the other hand, deals with income from sources without the Philippines in the following manner:

"(c) *Gross income from sources without the Philippines*. — The following items of gross income shall be treated as income from sources without the Philippines:

(3) Compensation for labor or personal services *performed without the Philippines; . . .* " (Emphasis supplied)

It should not be supposed that Section 37 (a) (3) and (c) (3) of the Tax Code apply only in respect of services rendered by individual natural persons; they also apply to services rendered by or through the medium of a juridical person. 6

(20)Further, a contract of carriage or of transportation is assimilated in our Tax Code and Revenue Regulations to a contract for services. Thus, Section 37 (e) of the Tax Code provides as follows:

> "(e) *Income from sources partly within and partly without the Philippines*. — Items of gross income, expenses, losses and deductions, other than those specified in subsections (a) and (c) of this section shall be allocated or apportioned to sources within or without the Philippines, under the rules and regulations prescribed by the Secretary of Finance. . . . Gains, profits, and *income from* (1) *transportation or other services rendered partly within and partly without the Philippines, or* (2) from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the Philippines, or produced (in whole or in part) by the taxpayer without and sold within the Philippines, shall be *treated as derived partly from sources within and partly from sources without the Philippines*. . . ." (Emphasis supplied)

It should be noted that the above underscored portion of Section 37 (e) was derived from the 1939 U.S. Tax Code which "was based upon a recognition that *transportation was a service and that the source of the income derived therefrom was to be treated as being the place where the service of transportation was rendered*." 7(21)

Section 37 (e) of the Tax Code quoted above carries a strong, well-nigh irresistible, implication that income derived from transportation or other services rendered entirely outside the Philippines must be treated as derived entirely from sources without the Philippines. This implication is reinforced by a consideration of certain provisions of Revenue Regulations No. 2 entitled "Income Tax Regulations," as amended, first promulgated by the Department of Finance on 10 February 1940. Section 155 of Revenue Regulations No. 2 (implementing Section 37 of the Tax Code) provides in part as follows:

> "Section 155. *Compensation for labor or personal services*. — Gross income from sources within the Philippines includes compensation for labor or personal services within the Philippines *regardless of the residence of the payor, of the place in which the contract for services was made, or of the place of payment* — " (Emphasis supplied)

Section 163 of Revenue Regulations No. 2 (still relating to Section 37 of the Tax Code) deals with a particular species of foreign transportation companies — i.e., foreign *steamship* companies deriving income from sources partly within and partly without the Philippines:

> "Section 163. *Foreign steamship companies*. — The returns of foreign steamship companies *whose vessels touch ports of the Philippines* should include as gross income, the total *receipts of all outgoing business* whether freight or passengers. With the gross income thus ascertained, the ratio existing between it and the gross income from all ports, both within and without the Philippines of all vessels, whether touching ports of the Philippines or not, should be determined as the basis upon which allowable deductions may be computed, — ." (Emphasis supplied)

Another type of utility or service enterprise is dealt with in Section 164 of Revenue Regulations No. 2 (again implementing Section 37 of the Tax Code) which provides as follows:

> "Section 164. Telegraph and cable services. — A foreign corporation carrying on the business of transmission of telegraph or cable messages between points in the Philippines and points outside the Philippines derives income partly from sources within and partly from sources without the Philippines.
>
> xxx xxx xxx (Emphasis supplied)

Once more, a very strong inference arises under Sections 163 and 164 of Revenue Regulations No. 2 that steamship and telegraph and cable services rendered *between points both outside the Philippines* give rise to income *wholly from sources outside the Philippines*, and therefore not subject to Philippine income taxation.

We turn to the "source of income" rules relating to the sale of personal property, upon the one hand, and to the *purchase and sale* of personal property, upon the other hand.

We consider first *sales* of personal property. Income from the sale of personal property by the producer or manufacturer of such personal property will be regarded as sourced *entirely within* or *entirely without* the Philippines or as sourced *partly within and partly without* the Philippines, depending upon two factors: (a) the place where the sale of such personal property occurs; and (b) the place where such personal property was produced or manufactured. If the personal property involved was both produced or manufactured and sold outside the Philippines, the income derived therefrom will be regarded as sourced entirely outside the Philippines. If, however, the sale took place within the Philippines, although the personal property had been produced outside the Philippines, or if the sale of the property takes place outside the Philippines and the personal property was produced in the Philippines, then, the income derived from the sale will be deemed partly as income sourced

within and partly as income sourced without the Philippines. In other words, the income (and the related expenses, losses and deductions) will be allocated between sources within and sources without the Philippines. Thus, Section 37 (e) of the Tax Code, although already quoted above, may be usefully quoted again:

> "(e) *Income from sources partly within and partly without the Philippines*. . . . Gains, profits and income from (1) transportation or other services rendered partly within and partly without the Philippines; or (2) *from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the Philippines, or produced (in whole or in part) by the taxpayer without and sold within the Philippines,* shall be treated as derived partly from sources within and partly from sources without the Philippines. . . ." (Emphasis supplied)

In contrast, income derived from the *purchase and sale* of personal property — i.e., trading — is, under the Tax Code, regarded as sourced *wholly* in the place *where the personal property is sold*. Section 37 (e) of the Tax Code provides in part as follows:

> "(e) Income from sources partly within and partly without the Philippines . . . Gains, profits and income derived from the *purchase of personal property within and its sale without the Philippines* or from the *purchase of personal property without and its sale within the Philippines*, shall be treated as *derived entirely from sources within the country in which sold.*" (Emphasis supplied)

Section 159 of Revenue Regulations No. 2 puts the applicable rule succinctly:

> "Section 159. *Sale of personal property. Income derived from the purchase and sale of personal property shall be treated as derived entirely from the country in which sold*. The word 'sold' includes 'exchange.' The 'country' in which 'sold' ordinarily means the place where the property is marketed. This Section does *not* apply to income from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the Philippines or produced (in whole or in part) by the taxpayer without and sold within the Philippines. (See Section 162 of these regulations). (Emphasis supplied)

4. It will be seen that the basic problem is one of characterization of the transactions entered into by BOAC in the Philippines. Those transactions may be characterized either as sales of personal property (i.e., *"sales of airline tickets*") or as *entering into a lease of services or a contract of service or carriage*. The applicable "source of income" rules differ depending upon which characterization is given to the

BOAC transactions.

The appropriate characterization, in my opinion, of the BOAC transactions is that of entering into contracts of service, i.e., carriage of passengers or cargo between points located outside the Philippines.

The phrase "sale of airline tickets," while widely used in popular parlance, does not appear to be correct as a matter of tax law. The airline ticket in and of itself has no monetary value, even as scrap paper. The value of the ticket lies wholly in the right acquired by the "purchaser" — the passenger — to demand a prestation from BOAC, which prestation consists of the carriage of the "purchaser" or passenger from one point to another outside the Philippines. The ticket is really the *evidence of the contract of carriage* entered into between BOAC and the passenger. The money paid by the passenger changes hands in the Philippines. But the passenger does not receive in the Philippines the consideration therefor — the service undertaken to be delivered by BOAC. The "purchase price of the airline ticket" is quite different from the purchase price of a physical good or commodity such as a pair of shoes or a refrigerator or an automobile; it is really the *compensation paid for the undertaking of BOAC* to transport the passenger or cargo outside the Philippines.

The characterization of the BOAC transactions either as sales of personal property or as purchases and sales of personal property, appear entirely inappropriate from another viewpoint. Consider first purchases and sales: is BOAC properly regarded as engaged in trading — in the purchase and sale of personal property? Certainly, BOAC was not purchasing tickets outside the Philippines and selling them in the Philippines. Consider next sales: can BOAC be regarded as "selling" personal property produced or manufactured by it? In a popular or journalistic sense, BOAC might be described as "selling" "a product" — its services. However, for the technical purposes of the law on income taxation, BOAC is in fact entering into contracts of service or carriage. The very existence of "source" rules" specifically and precisely applicable to the rendition of services must preclude the application here of "source rules" applying generally to sales, and purchases and sales, of personal property which can be invoked only by the grace of popular language. On a slightly more abstract level, BOAC's income is more appropriately characterized as derived from a "service", rather than from an "activity" (a broader term than service and including the activity of selling) or from the use of "property." Finally, it is well to recall that what is here involved is *income* taxation, and *not* a *sales* tax or an *excise* or *privilege* tax.

5. The taxation of international carriers is today effected under Section 24 (b) (2) of the Tax Code, as amended by Presidential Decree No. 69, promulgated on 24 November 1972 and by Presidential Decree No. 1355, promulgated on 21 April 1978,

in the following manner:

> "(2) *Resident corporations*. — A corporation organized, authorized, or existing under the laws of any foreign country, engaged in trade or business within the Philippines, shall be taxable as provided in subsection (a) of this section upon the total net income received in the preceding taxable year from all sources within the Philippines: *Provided, however, That international carriers shall pay a tax of two and one-half per cent on their gross Philippine billings.* 'Gross Philippine billings' includes gross revenue realized from uplifts anywhere in the world by any international carrier doing business in the Philippines of passage documents sold therein, whether for passenger, excess baggage or mail, provided the cargo or mail originates from the Philippines. The gross revenue realized from the said cargo or mail shall include the gross freight charge up to final destination. Gross revenues from chartered flights originating from the Philippines shall likewise form part of 'gross Philippine billings' regardless of the place of sale or payment of the passage documents. For purposes of determining the taxability of revenues from chartered flights, the term 'originating from the Philippines' shall include flight of passengers who stay in the Philippines for more than forty-eight (48) hours prior to embarkation." (Emphasis supplied)

Under the above-quoted proviso, international carriers issuing for compensation passage documentation in the Philippines for uplifts from any point in the world to any other point in the world, are not charged any Philippine *income* tax on their Philippine billings (i.e., billings in respect of passenger or cargo originating from the Philippines). Under this new approach, international carriers who service ports or points in the Philippines are treated in exactly the same way as international carriers not servicing any port or point in the Philippines. Thus, the source of income rule applicable, as above discussed, to transportation or other services rendered partly within and partly without the Philippines, or wholly without the Philippines, has been set aside. In place of Philippine income taxation, the Tax Code now imposes this 21/2 per cent tax computed on the basis of billings in respect of passengers and cargo originating from the Philippines regardless of where embarkation and debarkation would be taking place. This 2-1/2 per cent tax is effectively a tax on gross *receipts* or an excise or privilege tax and *not* a tax on *income*. Thereby, the Government has done away with the difficulties attending the allocation of income and related expenses, losses and deductions. Because taxes are the very lifeblood of government, the resulting potential "loss" or "gain" in the amount of taxes collectible by the state is sometimes, with varying degrees of consciousness, considered in choosing from among competing possible characterizations under or interpretations of tax statutes. It is hence perhaps useful to point out that the determination of the appropriate characterization here — that of contracts of air carriage rather than sales of airline

tickets — entails no down-the-road loss of income tax revenues to the Government. In lieu thereof, the Government takes in revenues generated by the 2-1/2 per cent tax on the gross Philippine billings or receipts of international carriers.

I would vote to affirm the decision of the Court of Tax Appeals.

*Narvasa, Gutierrez, Jr.* and *Cruz JJ.*, dissent.

### Footnotes

1. Partial Stipulation of Facts, Annex "E" and Annex "4", pp. 74-77 and 87-90, Rollo.
2. The Mentholatum Co., Inc., et al. vs. Anacleto Mangaliman, et al., 72 Phil. 524 (1941); Section 1, R.A. No. 5455.
3. Pacific Micronesian Line, Inc. vs. Del Rosario and Peligon, 96 Phil. 23, 30, citing Thompson on Corporations, Vol. 8, 3rd ed., pp. 844-847 and Fisher's Philippine Law of Stock Corporation, p. 415.
4. P. 11, BOAC Memorandum; p. 261, Rollo.
5. Section 24(b), (2), Tax Code, as amended by R.A. 6110, approved on 4 August 1969.
6. Madrigal and Paternol vs. Rafferty and Concepcion, 38 Phil. 414 (1918).
7. Memorandum for Petitioner, p. 22; p. 299, Rollo.
8. Mertens, Jr., Jacob, Law on Federal Income Taxation, Vol. 8, Section 45.27; cited in Howden & Co., Ltd. vs. Collector of Internal Revenue, 13 SCRA 601 (1965).
9. 14 Am Jur 2d 813.
10. British Trader's Insurance Co., Ltd. vs. Commissioner of Internal Revenue, 13 SCRA 719 (1965).
11. Howden & Co., Ltd. vs. Collector of Internal Revenue, 13 SCRA 601 (1965).
12. Partial Stipulation of Facts, paragraph 5, p. 89, Rollo.
13. Manila Gas Corporation vs. Collector of Internal Revenue, 62 Phil. 895 (1935).
14. Commissioner of Internal Revenue vs. U.S. Lines, Co., 5 SCRA 175 (1962).

**FELICIANO, J., dissenting:**

1. I.e., 1959-1969 and 1971.
2. Emphasis, Republic Act No. 6110 continued the above-quoted sub-paragraph, except that it raised the tax rate from 30% to 35%.
3. 13 SCRA 601 (1965).
4. 13 SCRA, at 604; emphasis supplied.
5. 8 Mertens, Law of Federal Income Taxation, Section 45.27 (1957); emphasis supplied; footnotes omitted.
6. Commissioner v. Hawaiian Philippine Co., 100 F. 2d 988, 991 (9th Cir. 1939), where the Court also observed that the sugar milling services rendered by the respondent were *not* any less in the nature of "personal" services merely because "they were performed, in part, through the use of machinery, or because of the magnitude of the taxpayers operations." *Id.*
7. 8 Mertens, *Id.*, Section 45.43, which goes on to state that: "It was the intention of

Congress under the 1921 law to place the taxation of transportation companies upon a sounder and more scientific basis (rather than the species of *franchise tax* previously imposed upon non-residents in general), and *so the principle was adopted of considering income derived from transportation to be income for services, with the result that the place where the services were rendered determined the source*. The result was income from sources partly within and partly without the United States." (*Id*.) (Emphasis supplied)

## Endnotes

**1 (Popup - Popup)**

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