Republic of the Philippines
Supreme Court
Manila

SECOND DIVISION

AIR CANADA, Petitioner,	**G.R. No. 169507**
	Present:
-versus-	CARPIO, *J., Chairperson,* BRION, DEL CASTILLO, MENDOZA, and LEONEN, *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	**Promulgated:** 11 JAN 2016

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DECISION

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 1½% 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

[1] *Rollo*, pp. 9–40. The Petition was filed pursuant to Rule 45 of the Rules of Court.

[2] Id. at 57–72. The Decision was penned by Associate Justice Olga Palanca-Enriquez and concurred in by Presiding Justice Ernesto D. Acosta and Associate Justices Lovell R. Bautista, Erlinda P. Uy, and

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 ₱5,185,676.77,[10] detailed as follows:

Applicable Quarter[/]Year	**Date Filed/Paid**	**Amount of Tax**
3rd Qtr 2000	November 29, 2000	P 395,165.00
Annual ITR 2000	April 16, 2001	381,893.59
1st Qtr 2001	May 30, 2001	522,465.39
2nd Qtr 2001	August 29, 2001	1,033,423.34
3rd Qtr 2001	November 29, 2001	765,021.28
Annual ITR 2001	April 15, 2002	328,193.93
1st Qtr 2002	May 30, 2002	594,850.13
2nd 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 ₱5,185,676.77 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

Caesar A. Casanova. Associate Justice Juanito C. Castañeda, Jr. voluntarily inhibited himself.

3 Id. at 41–51. The Decision was penned by Associate Justice Lovell R. Bautista and concurred in by Presiding Justice Ernesto D. Acosta and Associate Justice Caesar A. Casanova.

4 Id. at 52–56. The Resolution was signed by Presiding Justice Ernesto D. Acosta and Associate Justices Lovell R. Bautista and Caesar A. Casanova.

5 Id. at 59, Court of Tax Appeals En Banc Decision.

6 Id. at 78, Civil Aeronautics Board Executive Director's Letter.

7 Id. at 300, Air Canada's Memorandum.

8 Id. at 118–140, Passenger General Sales Agency Agreement Between Air Canada and Aerotel Ltd., Corp.

9 Id. at 300, Air Canada's Memorandum.

10 Id. at 59–60, Court of Tax Appeals En Banc Decision.

11 Id.

12 Id. at 60.

13 Id. at 13, Petition.

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.* -
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> . . . .
>
> (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:
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> (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

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[14] Pres. Decree No. 1355 (1978), sec. 1 defines Gross Philippine Billings as: "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)

[15] *Rollo*, p. 60, Court of Tax Appeals En Banc Decision.

[16] Id. at 41, Court of Tax Appeals First Division Decision.

[17] Id. at 51.

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 Banc.[24] The appeal was docketed as CTA EB No. 86.[25]

In the Decision dated August 26, 2005, the Court of Tax Appeals En Banc 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 Banc 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:

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18 Id. at 47–48.
19 Id. at 51.
20 Id. at 50.
21 Id. at 51.
22 Id. at 53 and 56, Court of Tax Appeals First Division Resolution.
23 Id. at 54.
24 Id. at 16, Petition.
25 Id.
26 Id. at 71, Court of Tax Appeals En Banc Decision.
27 Id. at 67–68.
28 Id. at 71.
29 The Petition was received by the court on October 20, 2005. Respondent filed its Comment (Id. at 252–261) on August 6, 2007. Subsequently, pursuant to the court's Resolution (Id. at 282–283) dated November 28, 2007, petitioner filed its Memorandum (Id. at 284–328) on February 21, 2008 and respondent filed its Manifestation (Id. at 349–350) on January 5, 2009, stating that it is adopting its Comment as its Memorandum.

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 2½% 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 ₱5,185,676.77 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 1½% 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-

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30 Pursuant to Rep. Act No. 9337 (2005), the rate is reduced to 30% beginning January 1, 2009.
31 *Rollo*, pp. 22, Petition, and 307, Air Canada's Memorandum.
32 Id.
33 Id. at 28, Petition.
34 Id. at 23–24, Petition, and 315, Air Canada's Memorandum.

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) (1)"[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

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35 Id. at 319, Air Canada's Memorandum.
36 Id. at 28–29, Petition.
37 Id. at 29. According to Senator Juan Ponce Enrile, "the gross Philippine billings of international air carriers must refer to flown revenue because this is an income from services and this will make the determination of the tax base a lot easier by following the same rule in determining the liability of the carrier for common carrier's tax." (Minutes of the Bicameral Conference Committee on House Bill No. 9077 [Comprehensive Tax Reform Program], 10 October 1997, pp. 19–20).
38 Id.
39 Id. at 313, Air Canada's Memorandum.
40 Id. at 35, Petition.
41 Id. at 35, Petition, and 322, Air Canada's Memorandum.
42 Id. at 321, Air Canada's Memorandum.
43 Id. at 35, Petition.
44 Id. at 35–36, Petition, and 322–323, Air Canada's Memorandum.
45 Id. at 37, Petition, and 325, Air Canada's Memorandum.
46 Id. at 37, Petition, and 325–326, Air Canada's Memorandum.

business in the Philippines. Petitioner's total payment of ₱5,185,676.77 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 off-line 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 ₱5,185,676.77 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:

> **SEC. 28. Rates of Income Tax on Foreign Corporations. –**
>
> (A) *Tax on Resident Foreign Corporations*. -
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> > . . . .
> >
> > (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*

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[47] Id. at 256, Commissioner of Internal Revenue's Comment.
[48] 259 Phil. 757 (1989) [Per J. Regalado, Second Division].
[49] *Rollo*, p. 258, Commissioner of Internal Revenue's Comment.
[50] Id. at 257.
[51] Id. at 260.
[52] Id. at 260–261.

> *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)

Under the foregoing provision, the tax attaches only when the carriage of persons, excess baggage, cargo, and mail originated from the Philippines in a continuous and uninterrupted flight, regardless of where the passage documents were sold.

Not having flights to and from the Philippines, petitioner is clearly not liable for the Gross Philippine Billings tax.

II

Petitioner, an offline carrier, is a resident foreign corporation for income tax purposes. Petitioner falls within the definition of resident foreign corporation under Section 28(A)(1) of the 1997 National Internal Revenue Code, thus, it may be subject to 32%[53] tax on its taxable income:

> **SEC. 28. Rates of Income Tax on Foreign Corporations. -**
>
> (A) *Tax on Resident Foreign Corporations.* -
>
> (1) In General. - *Except as otherwise provided in this Code*, ***a corporation organized, authorized, or existing under the laws of any foreign country, engaged in trade or business within the Philippines, shall be subject to an income tax equivalent to thirty-five percent (35%) of the taxable income derived in the preceding taxable year from all sources within the Philippines***: Provided, That effective January 1, 1998, the rate of income tax shall be thirty-four percent (34%); effective January 1, 1999, the rate shall be thirty-three percent (33%); and effective January 1, 2000 and thereafter, the rate shall be thirty-two percent (32%[54]). (Emphasis supplied)

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[53] Pursuant to Rep. Act No. 9337 (2005), the rate is reduced to 30% beginning January 1, 2009.
[54] Pursuant to Rep. Act No. 9337 (2005), the rate is reduced to 30% beginning January 1, 2009.

The definition of "resident foreign corporation" has not substantially changed throughout the amendments of the National Internal Revenue Code. All versions refer to "a foreign corporation engaged in trade or business within the Philippines."

Commonwealth Act No. 466, known as the National Internal Revenue Code and approved on June 15, 1939, defined "resident foreign corporation" as applying to "a foreign corporation engaged in trade or business within the Philippines or having an office or place of business therein."[55]

Section 24(b)(2) of the National Internal Revenue Code, as amended by Republic Act No. 6110, approved on August 4, 1969, reads:

> 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.[56] (Emphasis supplied)

Presidential Decree No. 1158-A took effect on June 3, 1977 amending certain sections of the 1939 National Internal Revenue Code. Section 24(b)(2) on foreign resident corporations was amended, but it still provides that "[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[.]"[57]

As early as 1987, this court in *Commissioner of Internal Revenue v. British Overseas Airways Corporation*[58] declared British Overseas Airways Corporation, an international air carrier with no landing rights in the Philippines, as a resident foreign corporation engaged in business in the Philippines through its local sales agent that sold and issued tickets for the airline company.[59] This court discussed that:

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55 Com. Act No. 466 (1939), sec. 84(g).

56 *Commissioner of Internal Revenue v. British Overseas Airways Corporation*, 233 Phil. 406, 421 (1987) [Per J. Melencio-Herrera, En Banc], *citing* TAX CODE, sec. 24(b)(2), as amended by Rep. Act No. 6110 (1969).

57 Pres. Decree No. 1158-A (1977), sec. 1.

58 233 Phil. 406 (1987) [Per J. Melencio-Herrera, En Banc], *cited in Commissioner of Internal Revenue v. Air India*, 241 Phil. 689, 694–696 (1988) [Per J. Gancayco, First Division].

59 Id. at 420–421.

> 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***. "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.["]
>
> 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." 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.[60] (Emphasis supplied, citations omitted)

Republic Act No. 7042 or the Foreign Investments Act of 1991 also provides guidance with its definition of "doing business" with regard to foreign corporations. Section 3(d) of the law enumerates the activities that constitute doing business:

> d. ***the phrase "doing business" shall include*** soliciting orders, service contracts, opening offices, whether called "liaison" offices or branches; appointing representatives or distributors domiciled in the Philippines or who in any calendar year stay in the country for a period or periods totalling one hundred eighty (180) days or more; participating in the management, supervision or control of any domestic business, firm, entity or corporation in the Philippines; and ***any other act or acts that imply a continuity of commercial dealings or arrangements, and***

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[60] Id.

> ***contemplate 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 of the purpose and object of the business organization***: *Provided, however,* That the phrase "doing business" shall not be deemed to include mere investment as a shareholder by a foreign entity in domestic corporations duly registered to do business, and/or the exercise of rights as such investor; nor having a nominee director or officer to represent its interests in such corporation; nor appointing a representative or distributor domiciled in the Philippines which transacts business in its own name and for its own account[.][61] (Emphasis supplied)

While Section 3(d) above states that "appointing a representative or distributor domiciled in the Philippines which transacts business in its own name and for its own account" is not considered as "doing business," the Implementing Rules and Regulations of Republic Act No. 7042 clarifies that "doing business" includes "*appointing representatives or distributors,* ***operating under full control of the foreign corporation***, domiciled in the Philippines or who in any calendar year stay in the country for a period or periods totaling one hundred eighty (180) days or more[.]"[62]

An offline carrier is "any foreign air carrier not certificated by the [Civil Aeronautics] Board, but who maintains office or *who has designated or appointed agents or employees in the Philippines*, who sells or offers for sale any air transportation in behalf of said foreign air carrier and/or others, or negotiate for, or holds itself out by solicitation, advertisement, or otherwise sells, provides, furnishes, contracts, or arranges for such transportation."[63]

"Anyone desiring to engage in the activities of an off-line carrier [must] apply to the [Civil Aeronautics] Board for such authority."[64] Each offline carrier must file with the Civil Aeronautics Board a monthly report containing information on the tickets sold, such as the origin and destination of the passengers, carriers involved, and commissions received.[65]

Petitioner is undoubtedly "doing business" or "engaged in trade or business" in the Philippines.

Aerotel performs acts or works or exercises functions that are incidental and beneficial to the purpose of petitioner's business. The

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[61] Rep. Act No. 7042 (1991), sec 3(d).
[62] Implementing Rules and Regulations of Rep. Act No. 7042 (1991), sec 1(f).
[63] Civil Aeronautics Board Economic Regulation No. 4, chap. I, sec. 2(b).
[64] Civil Aeronautics Board Economic Regulation No. 4, chap. III, sec. 26.
[65] Civil Aeronautics Board Economic Regulation No. 4, chap. III, sec. 30.

activities of Aerotel bring direct receipts or profits to petitioner.[66] There is nothing on record to show that Aerotel solicited orders alone and for its own account and without interference from, let alone direction of, petitioner. On the contrary, Aerotel cannot "enter into any contract on behalf of [petitioner Air Canada] without the express written consent of [the latter,]"[67] and it must perform its functions according to the standards required by petitioner.[68] Through Aerotel, petitioner is able to engage in an economic activity in the Philippines.

Further, petitioner was issued by the Civil Aeronautics Board an authority to operate as an offline carrier in the Philippines for a period of five years, or from April 24, 2000 until April 24, 2005.[69]

Petitioner is, therefore, a resident foreign corporation that is taxable on its income derived from sources within the Philippines. Petitioner's income from sale of airline tickets, through Aerotel, is income realized from the pursuit of its business activities in the Philippines.

III

However, the application of the regular 32% tax rate under Section 28(A)(1) of the 1997 National Internal Revenue Code must consider the existence of an effective tax treaty between the Philippines and the home country of the foreign air carrier.

In the earlier case of *South African Airways v. Commissioner of Internal Revenue*,[70] this court held that Section 28(A)(3)(a) does not categorically exempt all international air carriers from the coverage of Section 28(A)(1). Thus, if Section 28(A)(3)(a) is applicable to a taxpayer, then the general rule under Section 28(A)(1) does not apply. If, however, Section 28(A)(3)(a) does not apply, an international air carrier would be liable for the tax under Section 28(A)(1).[71]

This court in *South African Airways* declared that the correct interpretation of these provisions is that: "international air carrier[s]

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66 *Cf. Cargill, Inc. v. Intra Strata Assurance Corporation*, 629 Phil. 320, 332 (2010) [Per J. Carpio, Second Division], *citing National Sugar Trading Corporation v. Court of Appeals*, 316 Phil. 562, 568–569 (1995) [Per J. Quiason, First Division].

67 *Rollo*, p. 122, Passenger General Sales Agency Agreement Between Air Canada and Aerotel Ltd., Corp.

68 Id. at 126.

69 Id. at 78, Civil Aeronautics Board Executive Director Guia Martinez's letter to Aerotel Limited Corporation.

70 626 Phil. 566 (2010) [Per J. Velasco, Jr., Third Division]. The case was also cited in *United Airlines, Inc. v. Commissioner of Internal Revenue*, 646 Phil. 184, 193 (2010) [Per J. Villarama, Jr., Third Division].

71 *South African Airways v. Commissioner of Internal Revenue*, 626 Phil. 566, 574–575 (2010) [Per J. Velasco, Jr., Third Division].

maintain[ing] flights to and from the Philippines . . . shall be taxed at the rate of 2½% of its Gross Philippine Billings[;] while international air carriers that do not have flights to and from the Philippines but nonetheless earn income from other activities in the country [like sale of airline tickets] will be taxed at the rate of 32% of such [taxable] income."[72]

In this case, there is a tax treaty that must be taken into consideration to determine the proper tax rate.

A tax treaty is an agreement entered into between sovereign states "for purposes of eliminating double taxation on income and capital, preventing fiscal evasion, promoting mutual trade and investment, and according fair and equitable tax treatment to foreign residents or nationals."[73] *Commissioner of Internal Revenue v. S.C. Johnson and Son, Inc.*[74] explained the purpose of a tax treaty:

> The purpose of these international agreements is to reconcile the national fiscal legislations of the contracting parties in order to help the taxpayer avoid simultaneous taxation in two different jurisdictions. More precisely, the tax conventions are drafted with a view towards the elimination of *international juridical double taxation*, which is defined as the imposition of comparable taxes in two or more states on the same taxpayer in respect of the same subject matter and for identical periods.
>
> The apparent rationale for doing away with double taxation is to encourage the free flow of goods and services and the movement of capital, technology and persons between countries, conditions deemed vital in creating robust and dynamic economies. Foreign investments will only thrive in a fairly predictable and reasonable international investment climate and the protection against double taxation is crucial in creating such a climate.[75] (Emphasis in the original, citations omitted)

Observance of any treaty obligation binding upon the government of the Philippines is anchored on the constitutional provision that the Philippines "adopts the generally accepted principles of international law as part of the law of the land[.]" [76] *Pacta sunt servanda* is a fundamental international law principle that requires agreeing parties to comply with their treaty obligations in good faith.[77]

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72 Id. at 575.

73 J. Paras, Dissenting Opinion in *Commissioner of Internal Revenue v. Procter & Gamble Philippine Manufacturing Corporation*, G.R. No. 66838, December 2, 1991, 204 SCRA 377, 411 [Per J. Feliciano, En Banc].

74 368 Phil. 388 (1999) [Per J. Gonzaga-Reyes, Third Division].

75 Id. at 404–405.

76 CONST., art. II, sec. 2.

77 *Tañada v. Angara*, 338 Phil. 546, 591–592 (1997) [Per J. Panganiban, En Banc]: "[W]hile sovereignty has traditionally been deemed absolute and all-encompassing on the domestic level, it is however subject to restrictions and limitations voluntarily agreed to by the Philippines, expressly or impliedly, as a member of the family of nations. Unquestionably, the Constitution did not envision a hermit-type

Hence, the application of the provisions of the National Internal Revenue Code must be subject to the provisions of tax treaties entered into by the Philippines with foreign countries.

In *Deutsche Bank AG Manila Branch v. Commissioner of Internal Revenue*,[78] this court stressed the binding effects of tax treaties. It dealt with the issue of "whether the failure to strictly comply with [Revenue Memorandum Order] RMO No. 1-2000[79] will deprive persons or corporations of the benefit of a tax treaty."[80] Upholding the tax treaty over the administrative issuance, this court reasoned thus:

> *Our Constitution provides for adherence to the general principles of international law as* ***part of the law of the land****. The time-honored international principle of pacta sunt servanda demands the performance in good faith of treaty obligations on the part of the states that enter into the agreement. Every treaty in force is binding upon the parties, and obligations under the treaty must be performed by them in good faith. More importantly,* ***treaties have the force and effect of law in this jurisdiction****.*
>
> Tax treaties are entered into "to reconcile the national fiscal legislations of the contracting parties and, in turn, help the taxpayer avoid simultaneous taxations in two different jurisdictions." *CIR v. S.C. Johnson and Son, Inc.* further clarifies that "tax conventions are drafted with a view towards the elimination of international juridical double taxation, which is defined as the imposition of comparable taxes in two or more states on the same taxpayer in respect of the same subject matter and for identical periods. The apparent rationale for doing away with double taxation is to encourage the free flow of goods and services and the movement of capital, technology and persons between countries, conditions deemed

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isolation of the country from the rest of the world. In its Declaration of Principles and State Policies, the Constitution "adopts the generally accepted principles of international law as part of the law of the land, and adheres to the policy of peace, equality, justice, freedom, cooperation and amity, with all nations." By the doctrine of incorporation, the country is bound by generally accepted principles of international law, which are considered to be automatically part of our own laws. One of the oldest and most fundamental rules in international law is *pacta sunt servanda* — international agreements must be performed in good faith. "A treaty engagement is not a mere moral obligation but creates a legally binding obligation on the parties. . . . A state which has contracted valid international obligations is bound to make in its legislations such modifications as may be necessary to ensure the fulfillment of the obligations undertaken." (Citations omitted)

78 G.R. No. 188550, August 28, 2013, 704 SCRA 216 [Per C.J. Sereno, First Division]. Also cited in *CBK Power Company Limited v. Commissioner of Internal Revenue*, G.R. Nos. 193383–84, January 14, 2015 <http://sc.judiciary.gov.ph/pdf/web/viewer.html?file=/jurisprudence/2015/january2015/193383-84.pdf> 7–8 [Per J. Perlas-Bernabe, First Division].

79 *Deutsche Bank AG Manila Branch v. Commissioner of Internal Revenue*, G.R. No. 188550, August 28, 2013, 704 SCRA 216, 223 [Per C.J. Sereno, First Division]. The Bureau of Internal Revenue "issued RMO No. 1-2000, which requires that any availment of the tax treaty relief must be preceded by an application with ITAD at least 15 days before the transaction. The Order was issued to streamline the processing of the application of tax treaty relief in order to improve efficiency and service to the taxpayers. Further, it also aims to prevent the consequences of an erroneous interpretation and/or application of the treaty provisions (*i.e.*, filing a claim for a tax refund/credit for the overpayment of taxes or for deficiency tax liabilities for underpayment)." (Citation omitted)

80 Id.

vital in creating robust and dynamic economies. Foreign investments will only thrive in a fairly predictable and reasonable international investment climate and the protection against double taxation is crucial in creating such a climate." Simply put, tax treaties are entered into to minimize, if not eliminate the harshness of international juridical double taxation, which is why they are also known as double tax treaty or double tax agreements.

"*A state that has contracted valid international obligations is bound to make in its legislations those modifications that may be necessary to ensure the fulfillment of the obligations undertaken." Thus, laws and issuances must ensure that the reliefs granted under tax treaties are accorded to the parties entitled thereto.* The BIR must not impose additional requirements that would negate the availment of the reliefs provided for under international agreements. More so, when the RP-Germany Tax Treaty does not provide for any pre-requisite for the availment of the benefits under said agreement.

. . . .

Bearing in mind the rationale of tax treaties, the period of application for the availment of tax treaty relief as required by RMO No. 1-2000 should not operate to divest entitlement to the relief as it would constitute a violation of the duty required by good faith in complying with a tax treaty. The denial of the availment of tax relief for the failure of a taxpayer to apply within the prescribed period under the administrative issuance would impair the value of the tax treaty. At most, the application for a tax treaty relief from the BIR should merely operate to confirm the entitlement of the taxpayer to the relief.

The obligation to comply with a tax treaty must take precedence over the objective of RMO No. 1-2000. Logically, noncompliance with tax treaties has negative implications on international relations, and unduly discourages foreign investors. While the consequences sought to be prevented by RMO No. 1-2000 involve an administrative procedure, these may be remedied through other system management processes, *e.g.*, the imposition of a fine or penalty. But we cannot totally deprive those who are entitled to the benefit of a treaty for failure to strictly comply with an administrative issuance requiring prior application for tax treaty relief.[81] (Emphasis supplied, citations omitted)

On March 11, 1976, the representatives[82] for the government of the Republic of the Philippines and for the government of Canada signed the Convention between the Philippines and Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (Republic of the Philippines-Canada Tax Treaty). This treaty entered into force on December 21, 1977.

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[81] Id. at 227–228.

[82] *Convention with Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, March 11, 1976 (1977) <http://www.bir.gov.ph/images/bir_files/international_tax_affairs/Canada%20treaty.pdf> (visited July 21, 2015). Cesar Virata signed for the government of the Republic of the Philippines, while Donald Jamieson signed for the government of Canada.

Article V[83] of the Republic of the Philippines-Canada Tax Treaty defines "permanent establishment" as a "fixed place of business in which the business of the enterprise is wholly or partly carried on."[84]

Even though there is no fixed place of business, an enterprise of a Contracting State is deemed to have a permanent establishment in the other Contracting State if under certain conditions there is a person acting for it.

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[83] Convention with Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, art. V provides:
Article V
Permanent Establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on.
2. The term "permanent establishment" shall include especially:
   a) a place of management;
   b) a branch;
   c) an office;
   d) a factory;
   e) a workshop;
   f) a mine, quarry or other place of extraction of natural resources;
   g) a building or construction site or supervisory activities in connection therewith, where such activities continue for a period more than six months;
   h) an assembly or installation project which exists for more than three months;
   i) premises used as a sales outlet;
   j) a warehouse, in relation to a person providing storage facilities for others.
3. The term "permanent establishment" shall not be deemed to include:
   a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
   b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
   c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
   d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information for the enterprise;
   e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the enterprise.
4. *A person acting in a Contracting State on behalf of an enterprise of the other Contracting State (other than an agent of independent status to whom paragraph 6 applies) shall be deemed to be a permanent establishment in the first-mentioned State if:*
   a) *he has and habitually exercises in that State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for that enterprise; or*
   b) he has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.
5. An insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other State if it collects premiums in the territory of that State or insures risks situated therein through an employee or through a representative who is not an agent of independent status within the meaning of paragraph 6.
6. *An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business.*
7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute for either company a permanent establishment of the other. (Emphasis supplied)

[84] Convention with Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, art. V(1).

Specifically, Article V(4) of the Republic of the Philippines-Canada Tax Treaty states that "[a] person acting in a Contracting State on behalf of an enterprise of the other Contracting State (other than an agent of independent status to whom paragraph 6 applies) shall be deemed to be a permanent establishment in the first-mentioned State if . . . he has and habitually exercises in that State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for that enterprise[.]" The provision seems to refer to one who would be considered an agent under Article 1868[85] of the Civil Code of the Philippines.

On the other hand, Article V(6) provides that "[a]n enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or ***any other agent of an independent status***, where such persons are acting in the ordinary course of their business."

Considering Article XV[86] of the same Treaty, which covers dependent personal services, the term "dependent" would imply a relationship between the principal and the agent that is akin to an employer-employee relationship.

Thus, an agent may be considered to be *dependent* on the principal where the latter exercises comprehensive control and detailed instructions

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[85] CIVIL CODE, art. 1868 provides:
Article 1868. By the contract of agency a person binds himself to render some service or to do something in representation or on behalf of another, with the consent or authority of the latter.

[86] Convention with Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, art. XV provides:
Article XV
Dependent Personal Services

1. Subject to the provisions of Articles XVI, XVIII and XIX, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.
2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if the recipient is present in the other Contracting State for a period or periods not exceeding in the aggregate 183 days in the calendar year concerned, and either
   a) the remuneration earned in the other Contracting State in the calendar year concerned does not exceed two thousand five hundred Canadian dollars ($2,500) or its equivalent in Philippine pesos or such other amount as may be specified and agreed in letters exchanged between the competent authorities of the Contracting States; or
   b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and such remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.
3. Notwithstanding the preceding provisions of this Article, remuneration in respect of employment as a member of the regular crew or complement of a ship or aircraft operated in international traffic by an enterprise of a Contracting State, shall be taxable only in that State.

over the means and results of the activities of the agent.[87]

Section 3 of Republic Act No. 776, as amended, also known as The Civil Aeronautics Act of the Philippines, defines a general sales agent as "a person, not a bonafide employee of an air carrier, who pursuant to an authority from an airline, by itself or through an agent, sells or offers for sale any air transportation, or negotiates for, or holds himself out by solicitation, advertisement or otherwise as one who sells, provides, furnishes, contracts or arranges for, such air transportation."[88] General sales agents and their property, property rights, equipment, facilities, and franchise are subject to the regulation and control of the Civil Aeronautics Board.[89] A permit or authorization issued by the Civil Aeronautics Board is required before a general sales agent may engage in such an activity.[90]

Through the appointment of Aerotel as its local sales agent, petitioner is deemed to have created a "permanent establishment" in the Philippines as defined under the Republic of the Philippines-Canada Tax Treaty.

Petitioner appointed Aerotel as its passenger general sales agent to perform the sale of transportation on petitioner and handle reservations, appointment, and supervision of International Air Transport Association-approved and petitioner-approved sales agents, including the following services:

> **ARTICLE 7**
> **GSA SERVICES**
>
> The GSA [Aerotel Ltd., Corp.] shall perform on behalf of AC [Air Canada] the following services:
>
> a) Be the fiduciary of AC and in such capacity act solely and entirely for the benefit of AC in every matter relating to this Agreement;

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87 Among the four elements of an employer-employee relationship (i.e., (i) the selection and engagement of the employee; (ii) the payment of wages; (iii) the power of dismissal; and (iv) the power of control of the employees conduct), the control test is regarded as the most important. Under this test, an employer-employee relationship exists if the employer has reserved the right to control the employee not only as to the result of the work done but also as to the means and methods by which the same is to be accomplished. *See Fuji Television Network, Inc. v. Espiritu*, G.R. Nos. 204944–45, December 3, 2014 <http://sc.judiciary.gov.ph/pdf/web/viewer.html?file=/jurisprudence/2014/december2014/204944-45.pdf> 19–20 [Per J. Leonen, Second Division]; *Royale Homes Marketing Corporation v. Alcantara*, G.R. No. 195190, July 28, 2014, 731 SCRA 147, 162 [Per J. Del Castillo, Second Division]; *Tongko v. The Manufacturers Life Insurance Co. (Phils.), Inc.*, 655 Phil. 384, 400–401 (2011) [Per J. Brion, En Banc]; *Sonza v. ABS-CBN Broadcasting Corporation*, G.R. No. 138051, June 10, 2004, 431 SCRA 583, 594–595 [Per J. Carpio, First Division]; *Dr. Sara v. Agarrado*, 248 Phil. 847, 851 (1988) [Per C.J. Fernan, Third Division], and *Investment Planning Corporation of the Philippines v. Social Security System*, 129 Phil. 143, 147 (1967) [Per J. Makalintal, En Banc], *cited in Insular Life Assurance Co., Ltd. v. National Labor Relations Commission*, 259 Phil. 65, 72 (1989) [Per J. Narvasa, First Division].

88 Rep. Act No. 776 (1952), sec. 1(jj), as amended by Pres. Decree No. 1462 (1978), sec. 1.

89 Rep. Act No. 776 (1952), sec. 10(A), as amended by Pres. Decree No. 1462 (1978), sec. 6.

90 Rep. Act No. 776 (1952), sec. 11, as amended by Pres. Decree No. 1462 (1978), sec. 7.

> . . . .
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> c) Promotion of passenger transportation on AC;
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> . . . .
>
> e) Without the need for endorsement by AC, arrange for the reissuance, in the Territory of the GSA [Philippines], of traffic documents issued by AC outside the said territory of the GSA [Philippines], as required by the passenger(s);
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> . . . .
>
> h) Distribution among passenger sales agents and display of timetables, fare sheets, tariffs and publicity material provided by AC in accordance with the reasonable requirements of AC;
>
> . . . .
>
> j) Distribution of official press releases provided by AC to media and reference of any press or public relations inquiries to AC;
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> . . . .
>
> o) Submission for AC's approval, of an annual written sales plan on or before a date to be determined by AC and in a form acceptable to AC;
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> . . . .
>
> q) Submission of proposals for AC's approval of passenger sales agent incentive plans at a reasonable time in advance of proposed implementation.
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> r) Provision of assistance on request, in its relations with Governmental and other authorities, offices and agencies in the Territory [Philippines].
>
> . . . .
>
> u) Follow AC guidelines for the handling of baggage claims and customer complaints and, unless otherwise stated in the guidelines, refer all such claims and complaints to AC.[91]

Under the terms of the Passenger General Sales Agency Agreement, Aerotel will "provide at its own expense and acceptable to [petitioner Air Canada], adequate and suitable premises, qualified staff, equipment, documentation, facilities and supervision and in consideration of the remuneration and expenses payable[,] [will] defray all costs and expenses of

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[91] *Rollo*, pp. 124–125, Passenger General Sales Agency Agreement Between Air Canada and Aerotel Ltd., Corp.

and incidental to the Agency."[92] "[I]t is the sole employer of its employees and . . . is responsible for [their] actions . . . or those of any subcontractor."[93] In remuneration for its services, Aerotel would be paid by petitioner a commission on sales of transportation plus override commission on flown revenues.[94] Aerotel would also be reimbursed "for all authorized expenses supported by original supplier invoices."[95]

Aerotel is required to keep "separate books and records of account, including supporting documents, regarding all transactions at, through or in any way connected with [petitioner Air Canada] business."[96]

"If representing more than one carrier, [Aerotel must] represent all carriers in an unbiased way."[97] Aerotel cannot "accept additional appointments as General Sales Agent of any other carrier without the prior written consent of [petitioner Air Canada]."[98]

The Passenger General Sales Agency Agreement "may be terminated by either party without cause upon [no] less than 60 days' prior notice in writing[.]"[99] In case of breach of any provisions of the Agreement, petitioner may require Aerotel "to cure the breach in 30 days failing which [petitioner Air Canada] may terminate [the] Agreement[.]"[100]

The following terms are indicative of Aerotel's dependent status:

First, Aerotel must give petitioner written notice "within 7 days of the date [it] acquires or takes control of another entity or merges with or is acquired or controlled by another person or entity[.]"[101] Except with the written consent of petitioner, Aerotel must not acquire a substantial interest in the ownership, management, or profits of a passenger sales agent affiliated with the International Air Transport Association or a non-affiliated passenger sales agent nor shall an affiliated passenger sales agent acquire a substantial interest in Aerotel as to influence its commercial policy and/or management decisions.[102] Aerotel must also provide petitioner "with a report on any interests held by [it], its owners, directors, officers, employees and their immediate families in companies and other entities in the aviation industry or . . . industries related to it[.]"[103] Petitioner may require that any

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92 Id. at 126.
93 Id. at 122.
94 Id. at 127.
95 Id. at 128.
96 Id. at 130.
97 Id. at 122.
98 Id.
99 Id. at 137.
100 Id.
101 Id. at 122.
102 Id. at 123.
103 Id.

interest be divested within a set period of time.[104]

Second, in carrying out the services, Aerotel cannot enter into any contract on behalf of petitioner without the express written consent of the latter;[105] it must act according to the standards required by petitioner;[106] "follow the terms and provisions of the [petitioner Air Canada] GSA Manual [and all] written instructions of [petitioner Air Canada;]"[107] and "[i]n the absence of an applicable provision in the Manual or instructions, [Aerotel must] carry out its functions in accordance with [its own] standard practices and procedures[.]"[108]

Third, Aerotel must only "issue traffic documents approved by [petitioner Air Canada] for all transportation over [its] services[.]"[109] All use of petitioner's name, logo, and marks must be with the written consent of petitioner and according to petitioner's corporate standards and guidelines set out in the Manual.[110]

Fourth, all claims, liabilities, fines, and expenses arising from or in connection with the transportation sold by Aerotel are for the account of petitioner, except in the case of negligence of Aerotel.[111]

Aerotel is a *dependent* agent of petitioner pursuant to the terms of the Passenger General Sales Agency Agreement executed between the parties. It has the authority or power to conclude contracts or bind petitioner to contracts entered into in the Philippines. A third-party liability on contracts of Aerotel is to petitioner as the principal, and not to Aerotel, and liability to such third party is enforceable against petitioner. While Aerotel maintains a certain independence and its activities may not be devoted wholly to petitioner, nonetheless, when representing petitioner pursuant to the Agreement, it must carry out its functions solely for the benefit of petitioner and according to the latter's Manual and written instructions. Aerotel is required to submit its annual sales plan for petitioner's approval.

In essence, Aerotel extends to the Philippines the transportation business of petitioner. It is a conduit or outlet through which petitioner's airline tickets are sold.[112]

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104 Id.
105 Id. at 122.
106 Id. at 126.
107 Id.
108 Id.
109 Id. at 129.
110 Id. at 131.
111 Id. at 132.
112 *Cf. Steelcase, Inc. v. Design International Selections, Inc.*, G.R. No. 171995, April 18, 2012, 670 SCRA 64 [Per J. Mendoza, Third Division]. This court held that "the appointment of a distributor in the Philippines is not sufficient to constitute 'doing business' unless it is under the full control of the foreign corporation. On the other hand, if the distributor is an independent entity which buys and

Under Article VII (*Business Profits*) of the Republic of the Philippines-Canada Tax Treaty, the "business profits" of an enterprise of a Contracting State is "taxable only in that State[,] unless the enterprise carries on business in the other Contracting State through a permanent establishment[.]"[113] Thus, income attributable to Aerotel or from business activities effected by petitioner through Aerotel may be taxed in the Philippines. However, pursuant to the last paragraph[114] of Article VII in relation to Article VIII[115] (*Shipping and Air Transport*) of the same Treaty,

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distributes products, other than those of the foreign corporation, for its own name and its own account, the latter cannot be considered to be doing business in the Philippines. It should be kept in mind that the determination of whether a foreign corporation is doing business in the Philippines must be judged in light of the attendant circumstances." (Id. at 74, citations omitted) This court found that Design International Selections, Inc. "was an independent contractor, distributing various products of Steelcase and of other companies, acting in its own name and for its own account." (Id. at 75) "As a result, Steelcase cannot be considered to be doing business in the Philippines by its act of appointing a distributor as it falls under one of the exceptions under R.A. No. 7042." (Id. at 77).

113 Convention with Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, art. VII provides:
Article VII
Business Profits
1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on or has carried on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to:
   a) that permanent establishment; or
   b) sales of goods or merchandise of the same or similar kind as those sold, or from other business activities of the same or similar kind as those affected, through that permanent establishment.
2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall be attributed to that permanent establishment profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.
3. In the determination of the profits of a permanent establishment, there shall be allowed those deductible expenses which are incurred for the purposes of the permanent establishment including executive and general administrative expenses, whether incurred in the State in which the permanent establishment is situated or elsewhere.
4. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.
5. For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.
6. Where profits include items of income which are dealt with separately in other Articles of this Convention, then, the provisions of those Articles shall not be affected by the provisions of this Article.

114 Convention with Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, art. VII, par. 6 provides:
6. Where profits include items of income which are dealt with separately in other Articles of this Convention, then, the provisions of those Articles shall not be affected by the provisions of this Article.

115 Convention with Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, art. VIII provides:
Article VIII
Shipping and Air Transport
1. Profits derived by an enterprise of a Contracting State from the operation of ships or aircraft shall be taxable only in that State.
2. Notwithstanding the provisions of paragraph 1, profits from sources within a Contracting State derived by an enterprise of the other Contracting State from the operation of ships or aircraft in international traffic may be taxed in the first-mentioned State but the tax so charged shall not exceed the lesser of

the tax imposed on income derived from the operation of ships or aircraft in international traffic should not exceed 1½% of gross revenues derived from Philippine sources.

IV

While petitioner is taxable as a resident foreign corporation under Section 28(A)(1) of the 1997 National Internal Revenue Code on its taxable income[116] from sale of airline tickets in the Philippines, *it could only be taxed at a maximum of 1½% of gross revenues,* pursuant to Article VIII of the Republic of the Philippines-Canada Tax Treaty that applies to petitioner as a "foreign corporation organized and existing under the laws of Canada[.]"[117]

Tax treaties form part of the law of the land,[118] and jurisprudence has applied the statutory construction principle that specific laws prevail over general ones.[119]

The Republic of the Philippines-Canada Tax Treaty was ratified on December 21, 1977 and became valid and effective on that date. On the other hand, the applicable provisions[120] relating to the taxability of resident foreign corporations and the rate of such tax found in the National Internal Revenue Code became effective on January 1, 1998.[121] Ordinarily, the later provision governs over the earlier one.[122] In this case, however, the provisions of the Republic of the Philippines-Canada Tax Treaty are more specific than the provisions found in the National Internal Revenue Code.

These rules of interpretation apply even though one of the sources is a treaty and not simply a statute.

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a) one and one-half per cent of the gross revenues derived from sources in that State; and
b) the lowest rate of Philippine tax imposed on such profits derived by an enterprise of a third State.

116 TAX CODE, sec. 31 provides:
SEC. 31. Taxable Income Defined. – The term 'taxable income' means the pertinent items of gross income specified in this Code, less the deductions and/or personal and additional exemptions, if any, authorized for such types of income by this Code or other special laws.

117 *Rollo*, p. 59, Court of Tax Appeals En Banc Decision.

118 CONST., art. II, sec. 2.

119 *Lex specialis derogat generali*; *See BAYAN (Bagong Alyansang Makabayan) v. Exec. Sec. Zamora*, 396 Phil. 623, 652 (2000) [Per J. Buena, En Banc], *citing Manila Railroad Co. v Collector of Customs*, 52 Phil. 950, 952 (1929) [Per J. Malcolm, En Banc] and *Leveriza v. Intermediate Appellate Court*, 241 Phil. 285, 299 (1988) [Per J. Bidin, Third Division], *cited in Republic v. Sandiganbayan, First Division*, 255 Phil. 71, 83–84 (1989) [Per J. Gutierrez, Jr., En Banc].

120 TAX CODE, sec. 28(A)(1), as amended by Rep. Act No. 9337 (2005), sec. 2.

121 *See* Bureau of Internal Revenue website <http://www.bir.gov.ph/index.php/tax-code.html> (visited July 21, 2015).

122 *See Herman v. Radio Corporation of the Philippines*, 50 Phil. 490, 498 (1927) [Per J. Street, En Banc] in that the later legislative expression prevails when two statutes apply.

Article VII, Section 21 of the Constitution provides:

> SECTION 21. No treaty or international agreement shall be valid and effective unless concurred in by at least two-thirds of all the Members of the Senate.

This provision states the second of two ways through which international obligations become binding. Article II, Section 2 of the Constitution deals with international obligations that are incorporated, while Article VII, Section 21 deals with international obligations that become binding through ratification.

"Valid and effective" means that treaty provisions that define rights and duties as well as definite prestations have effects equivalent to a statute. Thus, these specific treaty provisions may amend statutory provisions. Statutory provisions may also amend these types of treaty obligations.

We only deal here with bilateral treaty state obligations that are not international obligations *erga omnes*. We are also not required to rule in this case on the effect of international customary norms especially those with *jus cogens* character.

The second paragraph of Article VIII states that "profits from sources within a Contracting State derived by an enterprise of the other Contracting State from the operation of ships or aircraft in international traffic may be taxed in the first-mentioned State but the tax so charged *shall not exceed* the lesser of a) one and one-half per cent of the gross revenues derived from sources in that State; and b) the lowest rate of Philippine tax imposed on such profits derived by an enterprise of a third State."

The Agreement between the government of the Republic of the Philippines and the government of Canada on Air Transport, entered into on January 14, 1997, reiterates the effectivity of Article VIII of the Republic of the Philippines-Canada Tax Treaty:

> ARTICLE XVI
> (Taxation)
>
> The Contracting Parties shall act in accordance with the provisions of Article VIII of the Convention between the Philippines and Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at Manila on March 31, 1976 and entered into force on December 21, 1977, and any amendments thereto, in respect of the operation of aircraft in international traffic.[123]

[123] *Agreement Between the Government of Canada and the Government of the Republic of the Philippines on Air Transport,* Global Affairs Canada <http://www.treaty-accord.gc.ca/text-texte.aspx?id=100250>

Petitioner's income from sale of ticket for international carriage of passenger is income derived from international operation of aircraft. The sale of tickets is closely related to the international operation of aircraft that it is considered incidental thereto.

"[B]y reason of our bilateral negotiations with [Canada], we have agreed to have our right to tax limited to a certain extent[.]"[124] Thus, we are bound to extend to a Canadian air carrier doing business in the Philippines through a local sales agent the benefit of a lower tax equivalent to 1½% on business profits derived from sale of international air transportation.

V

Finally, we reject petitioner's contention that the Court of Tax Appeals erred in denying its claim for refund of erroneously paid Gross Philippine Billings tax on the ground that it is subject to income tax under Section 28(A)(1) of the National Internal Revenue Code because (a) it has not been assessed at all by the Bureau of Internal Revenue for any income tax liability;[125] and (b) internal revenue taxes cannot be the subject of set-off or compensation,[126] citing *Republic v. Mambulao Lumber Co., et al.*[127] and *Francia v. Intermediate Appellate Court*.[128]

In *SMI-ED Philippines Technology, Inc. v. Commissioner of Internal Revenue*,[129] we have ruled that "[i]n an action for the refund of taxes allegedly erroneously paid, the Court of Tax Appeals may determine whether there are taxes that should have been paid in lieu of the taxes paid."[130] The determination of the proper category of tax that should have been paid is incidental and necessary to resolve the issue of whether a refund should be granted.[131] Thus:

> Petitioner argued that the Court of Tax Appeals had no jurisdiction to subject it to 6% capital gains tax or other taxes at the first instance. The Court of Tax Appeals has no power to make an assessment.
>
> As earlier established, the Court of Tax Appeals has no assessment

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(visited July 21, 2015).

[124] *Marubeni Corporation v. Commissioner of Internal Revenue*, 258 Phil. 295, 306 (1989) [Per C.J. Fernan, Third Division].

[125] *Rollo*, pp. 325–326, Air Canada's Memorandum.

[126] Id. at 323–325.

[127] 114 Phil. 549, 554–555 (1962) [Per J. Barrera, En Banc].

[128] 245 Phil. 717, 722–723 (1988) [Per J. Gutierrez, Jr., Third Division].

[129] G.R. No. 175410, November 12, 2014 <http://sc.judiciary.gov.ph/pdf/web/viewer.html?file=/jurisprudence/2014/november2014/175410.pdf> [Per J. Leonen, Second Division].

[130] Id. at 1.

[131] Id.

> powers. In stating that petitioner's transactions are subject to capital gains tax, however, the Court of Tax Appeals was not making an assessment. It was merely determining the proper category of tax that petitioner should have paid, in view of its claim that it erroneously imposed upon itself and paid the 5% final tax imposed upon PEZA-registered enterprises.
>
> The determination of the proper category of tax that petitioner should have paid is an incidental matter necessary for the resolution of the principal issue, which is whether petitioner was entitled to a refund.
>
> The issue of petitioner's claim for tax refund is intertwined with the issue of the proper taxes that are due from petitioner. A claim for tax refund carries the assumption that the tax returns filed were correct. If the tax return filed was not proper, the correctness of the amount paid and, therefore, the claim for refund become questionable. In that case, the court must determine if a taxpayer claiming refund of erroneously paid taxes is more properly liable for taxes other than that paid.
>
> In *South African Airways v. Commissioner of Internal Revenue,* South African Airways claimed for refund of its erroneously paid 2½% taxes on its gross Philippine billings. This court did not immediately grant South African's claim for refund. This is because although this court found that South African Airways was not subject to the 2½% tax on its gross Philippine billings, this court also found that it was subject to 32% tax on its taxable income.
>
> In this case, petitioner's claim that it erroneously paid the 5% final tax is an admission that the quarterly tax return it filed in 2000 was improper. Hence, to determine if petitioner was entitled to the refund being claimed, the Court of Tax Appeals has the duty to determine if petitioner was indeed not liable for the 5% final tax and, instead, liable for taxes other than the 5% final tax. As in *South African Airways,* petitioner's request for refund can neither be granted nor denied outright without such determination.
>
> If the taxpayer is found liable for taxes other than the erroneously paid 5% final tax, the amount of the taxpayer's liability should be computed and deducted from the refundable amount.
>
> Any liability in excess of the refundable amount, however, may not be collected in a case involving solely the issue of the taxpayer's entitlement to refund. The question of tax deficiency is distinct and unrelated to the question of petitioner's entitlement to refund. Tax deficiencies should be subject to assessment procedures and the rules of prescription. The court cannot be expected to perform the BIR's duties whenever it fails to do so either through neglect or oversight. Neither can court processes be used as a tool to circumvent laws protecting the rights of taxpayers.[132]

Hence, the Court of Tax Appeals properly denied petitioner's claim for refund of allegedly erroneously paid tax on its Gross Philippine Billings, on the ground that it was liable instead for the regular 32% tax on its taxable income received from sources within the Philippines. Its determination of

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132 Id. at 9–10.

petitioner's liability for the 32% regular income tax was made merely for the purpose of ascertaining petitioner's entitlement to a tax refund and not for imposing any deficiency tax.

In this regard, the matter of set-off raised by petitioner is not an issue. Besides, the cases cited are based on different circumstances. In both cited cases,[133] the taxpayer claimed that his (its) tax liability was off-set by his (its) claim against the government.

Specifically, in *Republic v. Mambulao Lumber Co., et al.*, Mambulao Lumber contended that the amounts it paid to the government as reforestation charges from 1947 to 1956, not having been used in the reforestation of the area covered by its license, may be set off or applied to the payment of forest charges still due and owing from it.[134] Rejecting Mambulao's claim of legal compensation, this court ruled:

> [A]ppellant and appellee are not mutually creditors and debtors of each other. Consequently, the law on compensation is inapplicable. On this point, the trial court correctly observed:
>
> > Under Article 1278, NCC, compensation should take place when two persons in their own right are creditors and debtors of each other. *With respect to the forest charges which the defendant Mambulao Lumber Company has paid to the government, they are in the coffers of the government as taxes collected, and the government does not owe anything to defendant Mambulao Lumber Company. So, it is crystal clear that the Republic of the Philippines and the Mambulao Lumber Company are not creditors and debtors of each other, because compensation refers to mutual debts*. * * *.
>
> And the weight of authority is to the effect that internal revenue taxes, such as the forest charges in question, can not be the subject of set-off or compensation.
>
> > A claim for taxes is not such a debt, demand, contract or judgment as is allowed to be set-off under the statutes of set-off, which are construed uniformly, in the light of public policy, to exclude the remedy in an action or any indebtedness of the state or municipality to one who is liable to the state or municipality for taxes. Neither are they a proper subject of recoupment since they do not arise out of the contract or transaction sued on. * * *. (80 C.J.S.

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133 *Republic v. Mambulao Lumber Co., et al.*, 114 Phil. 549, 552 (1962) [Per J. Barrera, En Banc] and *Francia v. Intermediate Appellate Court*, 245 Phil. 717, 722 (1988) [Per J. Gutierrez, Jr., Third Division].

134 *Republic v. Mambulao Lumber Co., et al.*, 114 Phil. 549, 552 (1962) [Per J. Barrera, En Banc].

> 73–74.)
>
> The general rule, based on grounds of public policy is well-settled that no set-off is admissible against demands for taxes levied for general or local governmental purposes. The reason on which the general rule is based, is that taxes are not in the nature of contracts between the party and party but grow out of a duty to, and are the positive acts of the government, to the making and enforcing of which, the personal consent of individual taxpayers is not required. * * * If the taxpayer can properly refuse to pay his tax when called upon by the Collector, because he has a claim against the governmental body which is not included in the tax levy, it is plain that some legitimate and necessary expenditure must be curtailed. If the taxpayer's claim is disputed, the collection of the tax must await and abide the result of a lawsuit, and meanwhile the financial affairs of the government will be thrown into great confusion. (47 Am. Jur. 766–767.)[135] (Emphasis supplied)

In *Francia*, this court did not allow legal compensation since not all requisites of legal compensation provided under Article 1279 were present.[136] In that case, a portion of Francia's property in Pasay was expropriated by the national government,[137] which did not immediately pay Francia. In the meantime, he failed to pay the real property tax due on his remaining property to the local government of Pasay, which later on would auction the property on account of such delinquency.[138] He then moved to set aside the auction sale and argued, among others, that his real property tax delinquency was extinguished by legal compensation on account of his unpaid claim against the national government.[139] This court ruled against Francia:

> There is no legal basis for the contention. By legal compensation, obligations of persons, who in their own right are reciprocally debtors and creditors of each other, are extinguished (Art. 1278, Civil Code). The circumstances of the case do not satisfy the requirements provided by Article 1279, to wit:
>
> > (1) that each one of the obligors be bound principally and that he be at the same time a principal creditor of the other;
>
> x x x x x x x x x

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[135] Id. at 554–555.
[136] *Francia v. Intermediate Appellate Court*, 245 Phil. 717, 722 (1988) [Per J. Gutierrez, Jr., Third Division].
[137] Id. at 719.
[138] Id. at 720.
[139] Id. at 722.

> (3) that the two debts be due.
>
> x x x x x x x x x
>
> This principal contention of the petitioner has no merit. We have consistently ruled that there can be no off-setting of taxes against the claims that the taxpayer may have against the government. A person cannot refuse to pay a tax on the ground that the government owes him an amount equal to or greater than the tax being collected. The collection of a tax cannot await the results of a lawsuit against the government.
>
> . . . .
>
> There are other factors which compel us to rule against the petitioner. *The tax was due to the city government while the expropriation was effected by the national government.* Moreover, the amount of ₱4,116.00 paid by the national government for the 125 square meter portion of his lot was deposited with the Philippine National Bank long before the sale at public auction of his remaining property. Notice of the deposit dated September 28, 1977 was received by the petitioner on September 30, 1977. The petitioner admitted in his testimony that he knew about the ₱4,116.00 deposited with the bank but he did not withdraw it. It would have been an easy matter to withdraw ₱2,400.00 from the deposit so that he could pay the tax obligation thus aborting the sale at public auction.[140]

The ruling in *Francia* was applied to the subsequent cases of *Caltex Philippines, Inc. v. Commission on Audit*[141] and *Philex Mining Corporation v. Commissioner of Internal Revenue.*[142] In *Caltex*, this court reiterated:

> [A] taxpayer may not offset taxes due from the claims that he may have against the government. Taxes cannot be the subject of compensation because the government and taxpayer are not mutually creditors and debtors of each other and a claim for taxes is not such a debt, demand, contract or judgment as is allowed to be set-off.[143] (Citations omitted)

Philex Mining ruled that "[t]here is a material distinction between a tax and debt. Debts are due to the Government in its corporate capacity, while taxes are due to the Government in its sovereign capacity."[144] Rejecting Philex Mining's assertion that the imposition of surcharge and interest was unjustified because it had no obligation to pay the excise tax liabilities within the prescribed period since, after all, it still had pending claims for VAT input credit/refund with the Bureau of Internal Revenue, this

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[140] Id. at 722–723.

[141] G.R. No. 92585, May 8, 1992, 208 SCRA 726 [Per J. Davide, Jr., En Banc].

[142] 356 Phil. 189 (1998) [Per J. Romero, Third Division].

[143] *Caltex Philippines, Inc. v. Commission on Audit*, G.R. No. 92585, May 8, 1992, 208 SCRA 726, 756 [Per J. Davide, Jr., En Banc].

[144] *Philex Mining Corporation v. Commissioner of Internal Revenue*, 356 Phil. 189, 198 (1998) [Per J. Romero, Third Division], *citing Commissioner of Internal Revenue v. Palanca, Jr.*, 124 Phil. 1102, 1107 (1966) [Per J. Regala, En Banc].

court explained:

> To be sure, we cannot allow Philex to refuse the payment of its tax liabilities on the ground that it has a pending tax claim for refund or credit against the government which has not yet been granted. It must be noted that a distinguishing feature of a tax is that it is compulsory rather than a matter of bargain. Hence, a tax does not depend upon the consent of the taxpayer. If any tax payer can defer the payment of taxes by raising the defense that it still has a pending claim for refund or credit, this would adversely affect the government revenue system. A taxpayer cannot refuse to pay his taxes when they fall due simply because he has a claim against the government or that the collection of the tax is contingent on the result of the lawsuit it filed against the government. Moreover, Philex's theory that would automatically apply its VAT input credit/refund against its tax liabilities can easily give rise to confusion and abuse, depriving the government of authority over the manner by which taxpayers credit and offset their tax liabilities.[145] (Citations omitted)

In sum, the rulings in those cases were to the effect that the taxpayer cannot simply refuse to pay tax on the ground that the tax liabilities were off-set against any alleged claim the taxpayer may have against the government. Such would merely be in keeping with the basic policy on prompt collection of taxes as the lifeblood of the government.

Here, what is involved is a denial of a taxpayer's refund claim on account of the Court of Tax Appeals' finding of its liability for another tax in lieu of the Gross Philippine Billings tax that was allegedly erroneously paid.

Squarely applicable is *South African Airways* where this court rejected similar arguments on the denial of claim for tax refund:

> *Commissioner of Internal Revenue v. Court of Tax Appeals*, however, granted the offsetting of a tax refund with a tax deficiency in this wise:
>
> > Further, it is also worth noting that the Court of Tax Appeals erred in denying petitioner's supplemental motion for reconsideration alleging bringing to said court's attention the existence of the deficiency income and business tax assessment against Citytrust. The fact of such deficiency assessment is intimately related to and inextricably intertwined with the right of respondent bank to claim for a tax refund for the same year. To award such refund despite the existence of that deficiency assessment is an absurdity and a polarity in conceptual effects. Herein private respondent cannot be entitled to refund and at the same time be liable for a tax deficiency assessment for the same year.

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[145] Id. at 200.

The grant of a refund is founded on the assumption that the tax return is valid, that is, the facts stated therein are true and correct. The deficiency assessment, although not yet final, created a doubt as to and constitutes a challenge against the truth and accuracy of the facts stated in said return which, by itself and without unquestionable evidence, cannot be the basis for the grant of the refund.

Section 82, Chapter IX of the National Internal Revenue Code of 1977, which was the applicable law when the claim of Citytrust was filed, provides that "(w)hen an assessment is made in case of any list, statement, or return, which in the opinion of the Commissioner of Internal Revenue was false or fraudulent or contained any understatement or undervaluation, no tax collected under such assessment shall be recovered by any suits unless it is proved that the said list, statement, or return was not false nor fraudulent and did not contain any understatement or undervaluation; but this provision shall not apply to statements or returns made or to be made in good faith regarding annual depreciation of oil or gas wells and mines."

Moreover, to grant the refund without determination of the proper assessment and the tax due would inevitably result in multiplicity of proceedings or suits. If the deficiency assessment should subsequently be upheld, the Government will be forced to institute anew a proceeding for the recovery of erroneously refunded taxes which recourse must be filed within the prescriptive period of ten years after discovery of the falsity, fraud or omission in the false or fraudulent return involved. This would necessarily require and entail additional efforts and expenses on the part of the Government, impose a burden on and a drain of government funds, and impede or delay the collection of much-needed revenue for governmental operations.

Thus, to avoid multiplicity of suits and unnecessary difficulties or expenses, it is both logically necessary and legally appropriate that the issue of the deficiency tax assessment against Citytrust be resolved jointly with its claim for tax refund, to determine once and for all in a single proceeding the true and correct amount of tax due or refundable.

In fact, as the Court of Tax Appeals itself has heretofore conceded, it would be only just and fair that the taxpayer and the Government alike be given equal opportunities to avail of remedies under the law to defeat each other's claim and to determine all matters of dispute between them in one single case. It is important to note that in determining whether or not petitioner is entitled to the refund of the amount paid, it would [be] necessary to determine how much the Government is entitled to collect as taxes. This would necessarily include the determination

> of the correct liability of the taxpayer and, certainly, a determination of this case would constitute *res judicata* on both parties as to all the matters subject thereof or necessarily involved therein.
>
> Sec. 82, Chapter IX of the 1977 Tax Code is now Sec. 72, Chapter XI of the 1997 NIRC. The above pronouncements are, therefore, still applicable today.
>
> Here, petitioner's similar tax refund claim assumes that the tax return that it filed was correct. Given, however, the finding of the CTA that petitioner, although not liable under Sec. 28(A)(3)(a) of the 1997 NIRC, is liable under Sec. 28(A)(1), the correctness of the return filed by petitioner is now put in doubt. As such, we cannot grant the prayer for a refund.[146] (Emphasis supplied, citation omitted)

In the subsequent case of *United Airlines, Inc. v. Commissioner of Internal Revenue*,[147] this court upheld the denial of the claim for refund based on the Court of Tax Appeals' finding that the taxpayer had, through erroneous deductions on its gross income, underpaid its Gross Philippine Billing tax on cargo revenues for 1999, and the amount of underpayment was even greater than the refund sought for erroneously paid Gross Philippine Billings tax on passenger revenues for the same taxable period.[148]

In this case, the ₱5,185,676.77 Gross Philippine Billings tax paid by petitioner was computed at the rate of 1½% of its gross revenues amounting to ₱345,711,806.08[149] from the third quarter of 2000 to the second quarter of 2002. It is quite apparent that the tax imposable under Section 28(A)(1) of the 1997 National Internal Revenue Code [32% of taxable income, that is, gross income less deductions] will exceed the maximum ceiling of 1½% of gross revenues as decreed in Article VIII of the Republic of the Philippines-Canada Tax Treaty. Hence, no refund is forthcoming.

WHEREFORE, the Petition is **DENIED.** The Decision dated August 26, 2005 and Resolution dated April 8, 2005 of the Court of Tax Appeals En Banc are **AFFIRMED.**

SO ORDERED.

MARVIC M.V.F. LEONEN
Associate Justice

146 *South African Airways v. Commissioner of Internal Revenue*, 626 Phil. 566, 577 (2010) [Per J. Velasco, Jr., Third Division].
147 646 Phil. 184 (2010) [Per J. Villarama, Jr., Third Division].
148 Id. at 198–199.
149 *Rollo*, pp. 79–105, Air Canada's Quarterly and Annual Income Tax Returns.

WE CONCUR:

ANTONIO T. CARPIO
Associate Justice
Chairperson

ARTURO D. BRION
Associate Justice

MARIANO C. DEL CASTILLO
Associate Justice

JOSE CATRAL MENDOZA
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

ANTONIO T. CARPIO
Associate Justice
Chairperson

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution and the Division Chairperson's Attestation, I certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

MARIA LOURDES P. A. SERENO
Chief Justice