



TAX LAW FOR BUSINESS
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Taxing Off-Line Carriers

Would it be better for airline carriers to go on-line? It seems that off-line carriers are required to pay much higher tax than on-line carriers, anyway.

The 1997 Tax Code provides for the imposition of 2 ½% income tax on Gross Philippine Billings (GPB) of international air carriers doing business in the Philippines. However, not all international carriers are subject to GPB tax under the current regulations.

Under Section 28 of the 1997 Tax Code as implemented by Revenue Regulations (RR) No. 15-02 (May 30, 2002), off-line carriers are expressly exempted from the tax on international air carriers. Section 2(a) of RR 15-02 defines an off-line carrier as any international air carrier with no flight operations to and from the Philippines. On-line carriers, on the other hand, are international air carriers with flight operations to and from the Philippines.

Revenue Regulations No. 15-02 went one step further by stating that an off-line carrier having a branch office or a sales agent in the Philippines which sells passage documents for compensation or commission to cover off-line flights of its principal or head office, or for other airlines covering flights originating from Philippine ports or off-line flights, is not considered engaged in business as an international air carrier in the Philippines and is, therefore, not subject to tax on GPB nor to the 3% common carrier's tax.

Effect on Prior Supreme Court Rulings

Under the 1977 Tax Code, the coverage of the GPB tax on international carriers was more comprehensive. This law contemplated to tax all transactions of an international carrier, including flown revenue from tickets sold in the Philippines even in the absence of flight operations within Philippine territory, because it then covered all uplifts of passengers anywhere in the world. The validity of this law has never been questioned.

It will be noted that under the regime of the 1977 Tax Code, the Philippine Supreme Court (SC) promulgated a decision on December 19, 1989, confirming the validity of an assessment made by the Bureau of Internal Revenue (BIR) which treated an offline carrier as a “resident foreign corporation engaged in business in the Philippines and deriving income from Philippine sources” (*Commissioner of Internal Revenue vs. American Airlines, Inc*, G.R. No. 67938, December 19, 1989). The Court reiterated previous rulings on the same issue (i.e., *British Overseas Airways Corporation* and *Air India* cases) when it stated that foreign airline companies which sold tickets in the Philippines through their local agents, whether called liaison offices, agencies or branches, were considered resident foreign corporations engaged in trade or business in the country. This ruling was promulgated prior to the effectivity of the 1997 Tax Code (i.e., January 1, 1998) and Revenue Regulations No. 15-02 (May 30, 2002).

In contrast, the current Section 28 of the 1997 Tax Code expressly limits the coverage of the law to uplifts originating from the Philippines in a continuous and uninterrupted flight. Its implementing regulations further provides that an off-line carrier which sells passage documents to cover off-line flights of its principal or head office or for other airlines is not considered engaged in business as an international air carrier.

Based on the foregoing, it would seem that the enactment of Section 28 of the 1997 Tax Code and Revenue Regulations No. 15-02 has already superseded the Court ruling on *American Airlines* which subjects an offline carrier to income tax as a resident foreign corporation engaged in business in the Philippines and deriving income from Philippine sources.

The Court of Tax Appeals in citing the American Airlines and British Overseas Airways Corporation decisions, had recently ruled in several cases (involving taxable years 2000 onwards, which are clearly within the coverage of the 1997 Tax Code) that the absence of flight operations to and from the Philippines is not determinative of the source of the income or the *situs* of income taxation. Since passage documents are sold in the Philippines through the sales agents, the off-line carrier derives revenues from the conduct of its business activity regularly pursued within the Philippines. Accordingly, the Tax Court considered an off-line carrier that sells passage documents in the Philippines a resident foreign corporation engaged in trade or business in the country.

The law defines a "foreign corporation" as one which is formed, organized or existing under laws other than those of the Philippines; and a "resident foreign corporation" is one which engaged in trade or business within the Philippines.

Accordingly, if the pronouncements of the Tax Court were taken in conjunction with the Tax Treaty definition of "permanent establishment" (a fixed place of business through which a resident of a Contracting State engages in trade or business), this would mean that off-line carriers have a taxable presence, in the Philippines through their sales agents.

With these recent decisions by the Tax Court, an off-line carrier may be considered a resident foreign corporation subject to 35% corporate income tax, while an on-line carrier is only subject to a much lower rate of 2 ½% income tax on GPB, pursuant to Section 28 of the 1997 Tax Code.