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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

REPUBLIC FLOUR MILLS, INC.,
Petitioner,

- versus -

C.T.A.
CASE NO. 1151

THE COMMISSIONER OF INTERNAL
REVENUE,
Respondent.

Ave. 12/60

x - - - - - - - - - - - - - - x

D E C I S I O N

Petitioner appeals from the decision of respondent holding it liable for the sum of ₱27,723.85 as deficiency sales tax and surcharge for the year 1959.

The parties have stipulated on the facts, the pertinent portions of which are the following:

> "3. That Petitioner is engaged in the manufacture of flour. The raw materials which are utilized in the manufacture of Petitioner's flour are either purchased locally, or, if not available locally, like the wheat grain, are imported by Petitioner from abroad, principally the United States;
>
> "4. That Petitioner is tax-exempt in respect of the manufacture of wheat flour under Republic Act No. 901. Because of its tax-exemption, Petitioner was totally exempt from payment of the advance sales tax on its wheat importations as well as from payment of the manufacturer's tax on the sale of its flour in the year 1958. Copy of letter of the Secretary of Finance, dated February 11, 1957, granting Petitioner tax-exemption has been attached as Annex "A" of the Petition for Review;
>
> "5. That on January 1, 1959, Petitioner had a ₱1,486,616.41 surplus of wheat grain from the previous year. Petitioner milled the surplus on or after January 1, 1959 and subsequently sold the flour during the same year;

Sgd. Pitero

"6. That commencing on January 1, 1959, Petitioner became liable to 10% of the 7% manufacturer's tax on the sale of its flour. In that year, Petitioner paid a tax of ₱37,-276.55 on its total sales of ₱21,011,818.17;

"7. That in computing the sales tax for the year 1959, Petitioner deducted from gross selling price of flour the cost of wheat grain which it had imported tax-free in the year 1958. Petitioner's computation is shown on the statement prepared by its accountants, copy of which has been attached as Annex "B" of the Petition for Review;

"8. That on March 28, 1961, after a routine investigation of Petitioner's books of account, Respondent addressed to Petitioner the following letter:

x x x x x

"11. That on May 21, 1962, respondent issued a revised letter of demand against petitioner increasing the deficiency sales tax liability of the latter from ₱23,170.17 to ₱27,723.85, computed as follows:

x x x x x

"12. That the legal issue is whether or not the cost of raw materials imported tax-free in the year 1958 which raw materials were utilized in the year 1959 for the manufacture of flour sold in 1959, is deductible from gross sales in the year 1959;

"13. If the legal question before this Honorable Court should be resolved in the affirmative, Petitioner's tax liability shall be ₱3,288.16, computed as follows:

Net sales	₱ 21,011,181.17
Deduct: Cost of raw materials used for flour (including tax-free raw materials) . .	15,310,806.74
Taxable gross sales	₱ 5,701,011.43
7% tax thereon	399,070.80
10% of said tax	39,907.08
Less: Amount of tax paid	37,276.55
Deficiency sales tax	₱ 2,630.53
Plus 25% surcharge	657.63
TOTAL AMOUNT PAYABLE	₱ 3,288.16

"14. On the other hand, if the question is resolved in the negative, Petitioner's tax liability shall be ₱24,587.98, computed as follows:

Net sales		₱ 21,011,818.17
Deduct: Cost of raw materials used for flour	₱15,310,806.74	
Less: Cost of tax-free raw materials . .	2,434,264.24	
		₱ 12,876,542.50
Taxable gross sales		8,135,275.67
7% tax thereon		569,469.30
10% of said tax		56,946.93
Less amount paid		37,276.55
Deficiency sales tax due		₱ 19,670.38
Plus 25% surcharge		4,917.60
TOTAL AMOUNT DUE & COLLECTIBLE. . .		₱ 24,587.98"

The only question involved in this case is whether or not the cost of raw materials imported tax-free in the year 1958, which were utilized in the year 1959 for the manufacture of flour sold in 1959, is deductible from the gross sales in the year 1959.

Petitioner seeks to justify the deduction of the cost of the wheat grain from the gross selling price of flour on the theory that its tax exemption is equivalent to a payment of the advance sales tax on the wheat grain used in the manufacture of flour. In support of this theory, it invokes Sec. 186-A of the Revenue Code, which authorizes the deduction of the value of a tax-free product used in the manufacture of an article from the value of such finished article. It is also suggested that the wheat grain, which was imported tax-free in 1958, did not lose its tax-exempt character merely because it was used in 1959, the year the taxability of petitioner's produce or manufacture commenced.

We do not subscribe to petitioner's view that tax exemption is equivalent to a tax payment. The Supreme Court, in the case of Tan Chiu vs. Commissioner, L-15008, January 28, 1961, denied the deductibility of the cost of cotton knitted materials (raw materials) used in the manufacture of undershirts (finished articles) from the gross selling price of the finished articles because no sales tax was paid on the raw materials which were bought from a tax-exempt industry. (See also Pacific Oxygen & Acetylene Co. v. Comm., L-17708, April 30, 1965.) The fact, therefore, that the raw materials were tax-exempt does not mean payment of the tax so as to preclude its taxability. A clear indication that exemption of raw materials from the payment of tax is not considered payment therefor is the incorporation of Section 186-A, which expressly allows the deduction of the value of tax-exempt raw materials from the gross selling price of the finished articles.

We now come to the question of whether or not petitioner comes within the purview of Section 186-A of the Revenue Code, which provides as follows:

> "SEC. 186-A. Whenever a tax-free product is utilized in the manufacture or production of any article, in the determination of the value of such finished article, the value of such tax-free product shall be deducted." (Underlining supplied)

Congress passed laws (Republic Acts Nos. 35 and 901) exempting new and necessary industries from the payment of taxes. However, Section 186 of the Revenue Code does not allow the deduction of the cost of raw materials bought from new and necessary industries from that of the finished articles if the sales tax on the raw materials has not been previously paid (Tan Chiu vs. Commissioner, supra). Thus, Section 186-A was added to the Revenue Code to allow the deduction of the cost of raw materials bought from new and necessary industries which were utilized in the manufacture of another article. And since petitioner imported the wheat grain in question, it cannot justify the deduction of its cost from the value of the flour on the provisions of Section 186-A of the Revenue Code. The "tax-free product" mentioned in the said Section 186-A refers to a product or raw material bought from tax-exempt new and necessary industries. Moreover, to sustain the view of petitioner would extend the full tax exemption on the flour beyond December 31, 1958, contrary to the time limit set forth in the certificate of exemption granted to petitioner.

The Bureau of Internal Revenue in implementing Section 5, Republic Act No. 2025 (now Sec. 186-A, Revenue Code), issued General Circular No. V-251 dated July 15, 1957 (Phil. Tax Journal, Vol. 2, p. 605) which reads:

> "Deductibility of cost of tax-exempt raw materials from the gross selling price of manufactured articles. - Section 186-A is a new section. The 'tax-free product' mentioned in this new section has reference to raw materials purchased from tax-exempt industries. Before its enactment, the cost of raw materials purchased from tax-exempt industries is not, for purposes of the sales tax, deductible from the gross selling price of the articles manufactured therefrom. By virtue of its enactment, the cost of said raw materials is now deductible.
>
> "In applying the provisions of this new section, the cost of raw materials purchased from tax-exempt industries prior to June 22, 1957 shall not be allowed as a deduction although they are or may be used after said date. In

> other words, only the cost of such raw materials purchased on or after June 22, 1957 shall be deductible."

We do not think that the above-mentioned circular is contrary to Section 186-A of the Revenue Code, as contended by petitioner. The construction of a statute placed by the department whose duty it is to carry it into execution is entitled to great weight (Regalado v. Yulo, 61 Phil. 173). And it is a cardinal rule in taxation that "exemptions from taxation are highly disfavored in law, and he who claims exemption must be able to justify his claim by the clearest grant of organic or statute law. An exemption from the common burden cannot be permitted to exist upon vague implications" (Col.. v. Manila Jockey Club, L-8755, March 23, 1956; House v. Posadas, 53 Phil. 338; Asiatic Petroleum v. Llanes, 49 Phil. 466). Petitioner failed to justify its claim for tax exemption and, therefore, the cost of tax-exempt surplus wheat grain imported in the year 1958 but utilized in 1959 cannot be deducted from its gross selling price in 1959.

IN VIEW OF ALL THE FOREGOING, petitioner is hereby ordered to pay respondent the sum of P24,-587.98, as deficiency sales tax and surcharge for the year 1959. With costs against petitioner.

SO ORDERED.

Quezon City, December 12, 1965.

TEOFILO D. REYES, SR.
Presiding Judge

WE CONCUR:

ROMAN M. UMALI
Associate Judge

ALEJANDRO B. AFURONG
Associate Judge