REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

PROCTER & GAMBLE PHILIPPINE MANUFACTURING CORPORATION,
Petitioner,

- versus -

C.T.A. CASE NO. 2723

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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

7/31/90

D E C I S I O N

In this appeal, petitioner seeks the review of the decision of respondent dated August 7, 1965 denying the protest against the assessment of deficiency manufacturer's sales tax and surcharge for the years 1962 to 1966.

It appears that petitioner is a domestic corporation engaged, among others, in the manufacture of vegetable lard, margarine, edible cooking oil, soap, toothpaste, etc.

On the basis of the report and recommendation and suppletory memorandum of the revenue examiners, and having determined that petitioner wilfully failed to pay the correct sales taxes as manufacturer for the years 1962 to 1963, and the failure to pay the correct sales taxes on taxable

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sales for 1964, 1965 and 1966 in violation of Sections 183 and 186, penalized under Section 209, respectively, all of the Tax Code, respondent issued a letter dated August 21, 1970 assessing and demanding from petitioner the aggregate amount of P18,401,232.09, inclusive of surcharges for the said years. (Exhs. A & 3, pp. 272-273, BIR rec.)

In a letter dated December 8, 1970, petitioner protested the assessment on grounds showing lack of factual and legal basis. (Exhs. G & 4, pp. 292-333, BIR rec.)

In a letter dated August 7, 1975, respondent rendered his final decision on the disputed assessment denying the protest and reiterating the demand for the amount of P18,401,232.09. (Exhs. J & 5, pp. 343-353, BIR rec.)

Hence, this appeal.

The issues for resolution in this controversy are as follows:

1. Whether or not cooking oil is legally subject to the 7% sales tax;

2. Whether or not the disallowance of the market value of crude coconut oil deducted in computing the taxable sales of manufactured soap, lard, margarine, etc. is justified;

3. Whether or not the disallowance of the cost of certain imported raw materials not covered by official

receipts evidencing payment of advance sales tax has legal and factual basis;

4. Whether or not the disallowance of the cost of certain raw materials not forming part of the finished products is justified;

5. Whether or not the disallowance of the cost of certain raw materials not taxed under Sections 186 and 189 of the Tax Code is proper;

6. Whether or not petitioner has complied with the requirement of separate billing of sales tax in the issuance of the invoices to its customers;

7. Whether or not petitioner underdeclared its sales of cooking oil for the years in question;

8. Whether or not the right to assess deficiency sales tax for the years 1962 to August 31, 1965 has already prescribed; and

9. Whether or not the imposition of the 50% surcharge is justified in this case.

Set forth are the discussions of the above issues.

1. Tax on cooking oil -

Petitioner contends that cooking oil is subject only to the millers tax of 2% under Section 189 of the Tax Code since the law imposes said tax on coconut oil, among other products without distinction and subjecting cooking oil to the 7% sales tax is unjustified.

Respondent on the other hand, asserts that the coconut oil subject to the 2% millers tax refers to the product of coconut oil mills operators where copra is a by-product disposable as such and does not include cooking oil being a manufactured product which has undergone chemical or physical process before it becomes marketable, thus, subject to 7% sales tax under Section 186 of the Tax Code.

The issue is not new. The question has already been resolved in the case of Procter & Gamble Philippine Manufacturing Corporation vs. The Commissioner of Internal Revenue, C.T.A. Case No. 2740, September 30, 1985, where respondent withdrew the assessment for deficiency sales tax on cooking oil in view of BIR Ruling No. 203-000-00-098-83 dated June 8, 1983, holding that proprietors or operators of coconut oil mills are subject to the millers tax of 2% and not to the 7% sales tax assessed against petitioner. In a more recent case, this Court conformed to the said ruling as the law clearly imposes the 2% millers tax on all coconut oil manufactured or processed or milled by proprietors or operators of oil mills without distinction, it is enough that what is produced is coconut oil; and considering that the above ruling is a contemporaneous and practical interpretation of Section 189 of the Tax Code relative to coconut oil, it should be respected and not to be disturbed except for cogent reasons unless contrary to the statute or exceeding departmental authority and they are binding upon the Commissioner and taxpayer alike. (Please see Philippine Refining Company, Inc. vs. Commissioner of Internal Revenue, C.T.A. Cases Nos. 3148 & 3499.)

2. <u>Disallowance of the market value of coconut oil used in the manufacture of the finished products</u> -

Respondent disallowed the value of crude coconut oil used in the manufacture of soap, lard, margarine, toothpaste, etc. on the ground that said crude oil is not within the purview of Section 189 of the Tax Code and payment of the 2% millers tax is erroneous. Thus, respondent argued that said crude oil had not been covered by purchase invoice or invoices because petitioner itself is the miller and owner. And, considering that the manufacture of petitioner's products is a continuing process, there was no actual removal. In other words, the value of crude coconut oil used had not been duly established as there was not actual removal thereof within the contemplation of the law.

We find the arguments of respondent unfounded. The fact that petitioner is the miller and owner, and because the manufacture of finished products is a continuing process, do not signify that there was no removal of the coconut crude oil for the accrual of the tax under Section 189 of the Tax Code is not dependent on the actual sale of the products.

As ruled by the Supreme Court in an analogous case:

> x x x The text of Section 189 of the Revenue Code indicates that actual sale of the product is not essential to the accrual of the tax since the tax is based on the actual selling price or market value of these articles at the time they leave the factory or mill warehouse without taking into account the reason why the article is withdrawn. The fact that the distillery and the sugar mill are in the same compound, does not prove that they are not independent units. It is not contended that all the sugar produced by the mill is converted into alcohol; and the manufacture of alcohol from sugar is clearly distinct from the processing of sugar cane into sugar. Since manufacture of alcohol does not have to be the manufacture of the sugar, taxwise the routing of sugar and molasses to the distillery is as much a withdrawal of sugar from the central as a removal thereof for the purpose of selling it. (Collector of Internal Revenue vs. Central Azucarera de Tarlac, G.R. No. L-11760, July 31, 1958.)

Moreover, the Supreme Court in the latest decision involving the same issue under consideration, held:

> The attempt of the respondent Court to distinguish between a manufacturer and purchaser of coconut oil and to discriminate against the former is unwarranted and unreasonable. To deny to the petitioner the right to deduct the 2% miller's tax enjoyed by the other soap,

> lard, and margarine manufacturers who, unlike petitioner buy, instead of produce, their raw materials would discourage the establishment of integrated or self-sufficient industries. The State would be regressing from, instead of progressing toward, the national goal of self-sufficiency.
>
> It is no argument for disallowing, for purposes of the sales tax, the deduction of the 2% miller's tax as part of the "total cost" of the coconut oil used in the manufacture of lard, soap, and margarine, that the manufacturer (herein petitioner) would enjoy a "double advantage" because it may also deduct the 2% miller's tax from its gross income for purposes of income tax. Although the petitioner denies that it deducted said miller's tax from its gross income for income tax purposes, the point is, even if it did deduct the 2% tax, the "double advantage" reaped by it would be its just reward for having integrated its industry." (Procter & Gamble Philippine Manufacturing Corporation vs. The Commissioner of Internal Revenue and the Court of Tax Appeals, G.R. No. L-33425, January 20, 1989.)

We see no cogent reason to deviate from the above precedents.

3. Disallowance of the cost of certain imported raw materials without advance sales tax receipts -

Respondent disallowed as deduction the cost of certain imported raw materials mainly on the ground that payments of the advance sales tax thereon were not duly covered by official receipts. According to respondent's examiners, the fact that they came into possession of a confidential letter Exhibit

10, which appears to be an instruction on "how much of the sales should be reduced for imported tide for sales tax purposes" made them more certain that no advance sales tax payments were ever made on these raw materials.

Petitioner on the other hand, asserts that there is no legal or factual basis for the disallowance of the cost of said raw materials. In support of this assertion, petitioner presented witness Celia Garcia who testified as follows:

Q. On this issue of alleged missing advance sales tax receipt.

I believe that BIR records has listing of all shipments or importations where advance sales tax receipts could not be produced.

First of all, what records were presented to the BIR from which they obtained this listing of alleged missing tax receipts on importations?

A. From our importation documents. Voluminous importation were examined by them.

Q. What does these importation documents contain?

A. They contain all data being required.

Q. Are they in separate folders?

A. Yes.

Q. Letter of Credit?

A. Yes.

Q. Declaration with the formal entry?

A. Yes.

Q. Is it a fact or is it true that the amount for which you cannot produce allegedly the advance sales tax receipts is that total alleged by the BIR?

A. No.
How could we possibly make importation without allegedly paying sales tax? We could not bring them out of the Customs.

Q. You have importation allegedly not covered by official receipts and they disallowed the total amount of -

For the year 1963 - P988,028.79
For the year 1964 - P6,076,020.89
For the year 1965 - P6,600,805.40

These figures come up to?

A. Almost thirteen million.

Q. What can you say about this fantastic amount which you allegedly failed to pay AST?

A. As I mentioned before, I don't believe a big firm as Procter & Gamble PMC could possibly bring in these materials without paying advance sales tax.

Q. Were you able to locate these alleged missing receipts?

A. Yes.

Q. Do you have those official receipts available?

A. Yes, in fact, there was an arrangement made with the BIR. We will confine the presentation of official receipts on those a hundred thousand and above.

Q. When you say a hundred thousand and above, is it AST or amount of importation?

A. Mark up landed cost.

Q. So that the sales tax would be 7%?

A. Yes.

Q. Per particular shipment?

A. Yes.

Q. Did you present copies of official receipts to the BIR?

A. Yes, the total items which were selected totals 59 shipments. Out of the total 59 shipments, we were able to present to the BIR 43 official receipts.

Now, on the remaining items because we were not able to secure true copies from the Bureau of Customs, because of their topsy-turvy records, what we did was to present the cancelled checks of such shipment.

Q. Are these documents available in the next hearing?

A. Yes.

Q. I understand that copies were given to BIR examiners as secondary evidence. Do you feel that they made use of the official receipts given to them?

A. I really do not think they did.

Q. Please scrutinize the records and see if they attached those?

A. No. They are all working papers.

(Please see t.s.n., pp. 25-28, July 1, 1980.)

Witness further testified on the disallowance of something not claimed as deduction, errors in the computation by the examiners, duplication of disallowance, illogical presumption which remains uncontroverted.

On the basis of the unrefuted testimony of petitioner's witness and the evidence presented (Exhs. CCC-DDDD, inclusive), which show that petitioner paid the advance sales tax on the raw materials, we are convinced that the disallowance of the cost of raw materials is baseless and unjustified.

4. Disallowance of certain raw materials not forming part of the finished products -

Respondent disallowed as deduction the cost of certain imported raw materials on which the 7% sales tax had been paid for the years under review on the ground that said materials are supplies and mere agents of production or do not go into the composition of the finished products. Otherwise stated, disallowance of said materials not forming part of the finished products is justified.

We disagree with respondent.

The controlling provision of Section 186 of the Tax Code, as amended by Republic Act No. 6110, in part pertinent, states:

> x x x That where the articles subject to tax under this section are manufactured out of materials likewise subject to tax under this section and section one hundred and eighty-nine, the total cost of such materials, as duly established, shall be deductible from the gross selling price or gross value in money of such manufactured articles.

Under the foregoing provision, it is not necessary for the raw materials to become part of the finished products to be deductible. To our mind, it is enough that the said materials which had been subjected to the 7% sales tax were used in the manufacture of the finished products otherwise the interpretation would defeat the very purpose of said law, to wit:

> x x x that the purpose of Section 186 of the Internal Revenue code authorizing the deduction of the costs of materials manufactured from the gross selling price, is to avoid or prevent double taxation; that the purpose of the law is to prevent a second assessment of the percentage tax on materials that went into the production of the manufactured articles x x x. (Tan Chiu vs. Coll. of Internal Revenue, 110 Phil. 910.)

5. <u>Disallowance of cost of certain raw materials not taxed under Section 186 or 189 of the Tax Code</u> -

Respondent disallowed the cost of certain raw materials basically for the reason that petitioner's suppliers have been paying the 3% contractor's tax under Section 191 and were no longer enjoying exemption under Republic Act No. 901. He argued that since said raw materials were not taxed under Section 186 and 189, the deduction of the cost thereof is not in order.

We find respondent stand untenable in the light of our decision in Procter & Gamble Philippine Manufacturing Corporation vs. The Commissioner of Internal Revenue, C.T.A. Case No. 2740, supra, where the deductibility of raw materials has been succinctly disposed of as follows:

> Even assuming arguendo but without deciding it that only 3% tax was paid by the suppliers as alleged by respondent, there is no valid reason why petitioner should be precluded from deducting the cost of raw materials considering that the suppliers are manufacturers and not contractors; and, that if any error was ever committed, it is an error on the part of the suppliers who should be truly taxed as manufacturers of the raw materials they supplied to petitioner. As such, the suppliers should be made to pay the 7% sales tax, instead of prejudicing an innocent purchaser.

6. Re: Separate billings of tax -

Before proceeding with our discussion of this issue, it must be pointed out that respondent also raises the issue of whether or not for purposes of computing the 7% sales tax, the 2% miller's tax should be considered as part of the total cost of coconut oil deductible from the gross sales of the manufactured products. A careful review of the records, however, reveals that the controversy relates to the separate billing or shifted tax sales as indicated in the examiners' worksheets. (Please see Exhs. 29 & 30, pp. 2 & 3, BIR rec.) Hence, we zeroed in on this issue of whether or not petitioner has complied with the requirement of separate billing of sales tax in the issuance of invoices to its customers.

Petitioner assails the inclusion of the amounts representing the 7% sales tax as part of the gross selling price in computing the tax under Section 186 of the Tax Code claiming that the sales invoices clearly indicate the amount of sales tax included in the total amount payable by the customers, thereby complying with the rule on separate billings. Respondent on the other hand, maintains that said amount should be included in the gross sales because the sales invoices issued by petitioner contained a column "amount sales tax included" indicating non-compliance with the rule of separate billings invoking the Supreme Court's decision in the case of Connel Bros. Co., Phil. vs. Collector of Internal Revenue, L-15470, Dec. 26, 1963, 9 SCRA 735, which states that "unless billed to the purchaser as separate items in the invoices, the amounts intended to cover the sales tax shall be considered as part of the gross selling price of the articles sold and deductions thereof will not be allowed".

Again, we disagree with the assertion of respondent. This Court has already passed upon this question on separate billings in the case of Procter & Gamble Philippine Manufacturing Corporation, C.T.A. Case No. s2740, supra, which held in part pertinent, thus:

> x x x With respect to the ground advanced by respondent's letter of denial subject of this appeal, witness Araceli Garcia testified to the effect that since 1962, petitioner corporation had been billing the tax separately to its customers (pp. 4, 7, t.s.n., April 5, 1977) and that since that time on there was no other examiner who had raised this question. At the hearing of October 6, 1978, (p. 46, CTA rec.) witness presented samples of sales invoices for the year in question and official receipts evidencing payments made by customers. A perusal of Exhs. "Q", "R" and "S" (pp. 117-119, CTA rec.), said invoices will indicate that there are three columns therein, namely: "Unit price sales tax incl.", "Amount Sales Tax included" and "Sales Tax". Under the second money column of "Exh. Q", appears the product of quantity multiplied by unit price for each item, e.g., "Tide 60", etc. For each item, the sales tax is recorded under the third money column. Thus for the second item, "Tide 288" shows a unit price of P24.95", the amount sales tax included or

P823.35", and sales tax of "P22.44" under the column "sales tax". The customer is appraised of the unit price and total amount of each item, and tax on such amount but at the end of the invoice the following information appears:

Unit Price Sales Tax Included	Amount Sales Tax Included	Sales Tax
End of Invoice Gross	P2,559.50	P53.58
2% discount	51.19	
N e t	P2,508.31	

From the information gathered from the invoices, the customer is appraised of the details by item and by totals. The customer is appraised too of the sales tax being shifted to them. This manner of separate billing the sales tax is in accord with the Connel Bros. case, *supra.*

We find no valid and cogent reason to modify or depart from the conclusion reached in the above cited case and the same should resolve the similar question now before us in this appeal.

7. Re: Underdeclaration of sales of cooking oil -

For the reason that respondent's examiners were in possession of Exhibit 10 which in their opinion is a secret instruction to petitioner's employees to reduce the sales of imported tide for sales tax purposes and believing that this was a pattern of deliberate intent to defraud the Government of sales tax, respondent justifies the use of the inventory method of examination. Thus, using said method and availing of the excerpts of tin plate data from Court records in C.T.A. Cases Nos. 1568 and 1740, usage factor, plant inventories, summary of sales of cooking oil and price lists, respondent came out with the findings that petitioner has understated the sales of cooking oil in the amount of P1,985,668.07.

Petitioner however, disagree with the findings of fraud for lack of legal and factual basis, and through its witness explains that the alleged secret instruction is nothing more than a precaution against double taxation. (Please see t.s.n., pp. 17-19, July 1, 1980 and t.s.n., pp. 12-14, August 4, 1982.) It also assails the use of the inventory method of investigation invoking the doctrine laid down by the Supreme Court in the case of Collector of Internal Revenue vs. Alberto D. Benipayo, G.R. No. L-13656, January 31, 1963, 4 SCRA 182, which states:

> x x x assessment should not be based on mere presumptions no matter how reasonable or logical said presumption may be x x x. In order to stand the test of judicial scrutiny, the assessment must be based on actual facts. The presumption cannot be made to rest on another presumption. x x x.

And more, petitioner pointed out to some inherent defects in the method used, like: lack of beginning and ending inventories of copra, crude coconut oil and other materials used in the manufacture of cooking oil; failure to consider purchases of copra and crude oil from other millers; failure to take into account short deliveries of tin plates; and failure to consider that some tin plates were used in some products other than cooking oil.

After careful study of the respective position of the parties and on the basis of the uncontroverted testimony of petitioner's witness, precedent and reasons, we feel compelled to subscribe to petitioner's position as to the non-existence of fraud. Hence, we find no underdeclaration of sales of cooking oil.

8. Re: Prescription of the right to assess -

Petitioner invariably contends that the deficiency sales tax assessment for the years 1962 to 1965 has already prescribed because the assessment was issued beyond the 5-year period pursuant to the provisions of Section 331 of the Tax Code. Respondent however, asserts that while the letter of demand was admittedly issued beyond the five year period, the applicable provision is Section 319 (now Section 269) which grants him a period of 10 years within which to assess revenue taxes from discovery of fraud, since petitioner deliberately and substantially underdeclared its sales of cooking oil during the period in question and made improper deductions for materials clearly not deductible.

The argument of respondent does not appear plausible under the circumstances obtaining in this case as found earlier and it is hardly necessary to reiterate our findings in the preceding issue discussed above, wherein we subscribed to the position of petitioner. On the allegation that petitioner made improper deductions from supplies clearly not deductible, suffice it to say that we have also disposed of earlier the issue adverse to respondent in the light of our decision in C.T.A. Case No. 2740, supra.

In fine, there being no sufficient evidence to establish deliberate intent on the part of petitioner to defraud the Government of sales tax for the period in question and respondent's failure to prove his allegations that would place his case within the exception of Section 331 of the Tax Code, his position on this issue becomes less tenable. Ergo, we find and so hold that respondent's right to assess is already time barred.

With the above conclusion, the issue as to whether or not the imposition of the 50% fraud penalty becomes moot and academic.

WHEREFORE, the decision appealed from is hereby reversed and set aside. No pronouncement as to costs.

SO ORDERED.

Quezon City, Metro Manila, July 31, 1990.

ALEX Z. REYES
Associate Judge

WE CONCUR:

AMANTE FILLER
Presiding Judge

CONSTANTE C. ROAQUIN
Associate Judge

C E R T I F I C A T I O N

I hereby certify that this decision was reached after due consultation among the members of the Court of Tax Appeals in accordance with Section 13, Article VIII of the Constitution.

AMANTE FILLER
Presiding Judge
Court of Tax Appeals