Republic of the Philippines
COURT OF TAX APPEALS
Quezon City

FIRST DIVISION
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STERLING TOBACCO CORPORATION.,
Petitioner,

-versus-

CTA Case No. 7112

Members:

ACOSTA, Chairperson
BAUTISTA, and
CASANOVA, JJ.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated:
JUL 04 2007 10:20 am

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DECISION

CASANOVA, J.:

This is a Petition for Review filed by herein petitioner, *STERLING TOBACCO CORPORATION*, seeking a refund in the amount of P2,827,932.07 allegedly representing excise taxes that were paid under protest by petitioner on its purchases of stemmed leaf tobacco for the year 1999.

THE FACTS

Petitioner is a domestic corporation duly organized and existing under the laws of the Philippines[1] with present address at PECABAR, Vernida Tower II,

[1] *1st Par. of Joint Stipulation of Facts ("JSF"), Rollo, pp. 123-125, duly approved by this Court in a Resolution dated August 22, 2005, Rollo, p. 127.*

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Alfredo St., Salcedo Village, Makati City.[2] It manufactures cigarette products such as Howling Coal, Sterling, Miller and Mint.[3]

Respondent is the duly appointed Commissioner of Internal Revenue vested by law to enforce and implement the provisions of the National Internal Revenue Code ("NIRC") or the 1997 Tax Code, as well as related statutes and their implementing rules and regulations, including *inter alia*, the power and authority to act and decide upon applications for refund of erroneously or illegally collected taxes, to issue deficiency tax assessments, evaluate and decide upon merits disputed assessments pursuant to law, with office address at BIR National Office Building, Diliman, Quezon City.

Petitioner received a Pre-Assessment Notice ("PAN")[4] dated December 9, 2002 from the Bureau of Internal Revenue ("BIR") which included among the taxes alleged to be due from petitioner, deficiency excise taxes for the taxable year 1999 in the total amount of P2,827,932.07, including increments thereto. The Details of Discrepancies[5] stated that "there were importations [made by the petitioner] of partially manufactured tobacco which were not subjected to excise tax[es] pursuant to the provisions of Section 140 of the NIRC, hence, assessed."[6]

On December 23, 2002, petitioner paid under protest the assessed excise tax liability, including penalties and interest, for a total amount of P2,827,932.07.[7]

On July 29, 2004, petitioner filed a claim for refund[8] before herein respondent Commissioner in order for it to recover the abovementioned amount paid. In its claim for refund, petitioner stated that according to the PAN, the excise taxes were due because the *stemmed leaf tobacco* imported by

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[2] *Par. 2.1 of Petition for Review, Rollo, pp. 1-20.*
[3] *Testimony of Mr. Harijani Martsiono, TSN, June 21, 2005, p. 8.*
[4] *Exhibit B, Rollo. pp. 145-147.*
[5] *Exhibit B-1, Rollo. pp. 148-149.*
[6] *2nd Par. Of Exhibit B-1, Ibid.*
[7] *Exhibits C (BIR Payment Form 0605) and D (Landbank- BIR Tax Payment Deposit Slip), Rollo. pp. 150-151.*
[8] *Exhibit A, Rollo. pp. 133-144.*

[petitioner] Sterling was allegedly *partially manufactured tobacco* that was taxable under Section 140 of the Tax Code. It further stated that the excise taxes were illegally collected by the BIR and erroneously paid by [petitioner] Sterling because: *(a)* the Tax Code has never imposed excise tax on transfers of stemmed leaf tobacco; *(b)* stemmed leaf tobacco is exempt from prepayment of excise tax if sold by one manufacturer to another; *(c)* R.R. [Revenue Regulation] No. 17-67, as interpreted by [the] Commissioner, exceeds limits on delegated legislative power; *(d)* R.R. No. V-39 does not mention stemmed leaf tobacco as among the imported tobacco products that are subject to excise tax; *(e)* Rules of Statutory Construction on tax exemptions [are] not applicable because no tax exemption was ever involved; *(f)* BIR's administrative practice for over half century supports non-taxability of stemmed leaf tobacco; and *(g)* BIR collected excise taxes on stemmed leaf tobacco not from their manufacturers but from manufacturers of cigars and cigarettes that were no longer in possession thereof.[9]

Receiving no response from respondent Commissioner, petitioner on December 20, 2004, filed this Petition for Review[10], asking this Court to rule in favor of its refund.

In his *Answer*[11] filed on March 17, 2005, the Commissioner of Internal Revenue alleged, *inter alia*, that petitioner's alleged claim for refund is subject to administrative investigation by the Bureau; that petitioner must prove that it paid excise tax on its purchases of stemmed leaf tobacco and such tax was erroneously or illegally collected as contemplated under Section 229 of the Tax Code; that the pertinent provision of law governing this issue is Section 137 (now Sec. 140) of the Tax Code which provides:

> "**Section 137 - Removal of Tobacco products without prepayment of tax.-** Products of tobacco entirely unfit for chewing or smoking may be removed free of tax for agricultural or

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[9] *Ibid.*
[10] *Rollo. pp. 1-20.*
[11] *Rollo. pp. 59-65.*

> industrial use, under such conditions as may be prescribed in the regulations of the Department of Finance. **Stemmed leaf tobacco**, fine-cuts shorts, the refuse of fine-cut chewing tobacco, scraps, cuttings, clippings, stems or midribs, and sweeping of tobacco **may be sold in bulk as raw material by one manufacturer directly to another, without payment of the tax under such conditions as may be prescribed in the regulations of the Department of Finance.**"(Emphasis supplied)

It can be seen that the tax-free sale of stemmed leaf tobacco is subject to conditions as may be prescribed in the regulations of the Department of Finance; that the conditions referred to in the above provision were provided by the Department of Finance in Revenue Regulations No. V-39 and Revenue Regulations No. 17-67, both issued to implement Section 137 of the Tax Code; that it is clear under Section 20 of R.R. No. V-39 that there is only one exemption from specific tax on the sale of stemmed leaf tobacco, that of sale by one L-7 directly to another L-7 and that this interpretation was upheld by the Supreme Court in the case of *Commissioner of Internal Revenue vs. La Campana Fabrica de Tabacos, Inc.* (G.R. No. 145275, November 15, 2001).

On April 5, 2005, petitioner filed its *Reply*[12] and averred therein, among others, that not only Section 140 of the NIRC is applicable in this case but also Section 144 of the same Code. It also attached therewith a Supreme Court Resolution[13] dated July 4, 2002 in the case of *Commissioner of Internal Revenue vs. La Suerte Cigar and Cigarette Factory* (G.R. No. 144942) which petitioner claimed is applicable in the instant case.

During trial, petitioner presented as its witness, Mr. Harijani Martsiono, petitioner's former Vice-President for Finance. On the other hand, respondent presented as his witness, Miss Dalisay C. Umbas, the Revenue Officer assigned to this case. Petitioner also submitted documentary evidence while respondent submitted the case for decision without presenting any documentary evidence.

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[12] *Rollo. pp. 68-73.*
[13] *Rollo. pp. 74-80.*

On January 29, 2007, petitioner filed its *Memorandum*[14]. Respondent did not file his Memorandum despite due notice. Hence, on February 13, 2007, this case was submitted for decision.[15]

The parties jointly stipulated the following issues for resolution of this Court:

1. Whether or not Section 20 (a) of R.R. No. V-39 limited the class of manufacturers whose sales of stemmed leaf tobacco were exempt from prepayment of specific tax.

2. Assuming for the sake of argument that the intention behind Section 3 of R.R. No. 17-67 was to limit the manufacturers that were exempt from prepayment of specific tax, would this have caused R.R. No. 17-67 to exceed on Constitutional grounds the allowable limits on the delegation of legislative power?

3. Did Section 2 (m) of R.R. No. 17-67, exceed on Constitutional grounds the allowable limits on the delegation of legislative power?

4. Whether or not Section 20 (a) of R.R. No. V-39 is applicable to Sterling's imports of stemmed leaf tobacco.

5. Whether or not Chapter V of R.R. No. V-39 is applicable to Sterling's imports of stemmed leaf tobacco.

6. Is the Commissioner's present interpretation of Sections 2 (m) (1) and 3 (h) of R.R. No. 17-67 proper?

7. Whether or not the rules on statutory construction on tax exemptions are applicable in this case.

8. Whether or not such tax was erroneously or illegally collected as contemplated under Section 229 of the Tax Code?

9. Whether or Sterling filed a claim for refund within the two (2) year period prescribed in Section 229 of the Tax Code?

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[14] *Rollo. pp. 198-212.*
[15] *Rollo. p. 216.*

Synthesizing the above cited contentions, there are only *two* pivotal issues this Court is tasked: *first*, the factual issue, whether or not the claim for refund was filed within the two (2) year period prescribed in Section 229 of the 1997 Tax Code and *second*, the legal issue, whether or not petitioner is liable for deficiency excise or specific tax on purchases of stemmed leaf tobacco from its foreign suppliers.

THE COURT'S RULING

Anent the *first* issue, which is factual, this Court rules in favor of petitioner.

Applicable in this case is Section 229 of the 1997 National Internal Revenue Code which reads as follows:

> **"Sec. 229. Recovery of Tax Erroneously or Illegally Collected —** No suit or proceeding shall be maintained in any court for the recovery of any national internal revenue tax hereafter alleged to have been *erroneously or illegally assessed or collected*, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessively or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Commissioner; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress.
>
> In any case, no such suit or proceeding shall be filed after the expiration of two (2) years from the date of payment of the tax or penalty regardless of any supervening cause that may arise after payment: *Provided, however*, That the Commissioner may, even without a written claim therefore, refund or credit any tax, where on the face of the return upon which payment was made, such payment appears clearly to have been erroneously paid."

Petitioner has complied with the two-(2) year requirement under Sec. 229 of NIRC by filing a claim for refund with the respondent on July 29, 2004[16] and

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[16] *Exhibit A-1, Rollo. p. 133.*

this petition on December 20, 2004[17] for its tax payment made on December 23, 2002.[18]

To prove payment, petitioner presented its BIR Payment Form 0605 and BIR Tax Payment Deposit Slip-Land Bank of the Philippines, both dated December 23, 2002 with the amount of P2,827,932.07.[19]

As to the *second* issue, which is the legal issue, *We* rule in favor of respondent Commissioner.

Central to the resolution of this issue is the application of two provisions of the NIRC, to wit, Section 140 of the 1997 NIRC (*formerly Section 137 of the Old Tax Code)* and Section 144 of the 1997 NIRC *(formerly Section 141 of the Old Tax Code)*, as well as two Revenue Regulations namely, RR No. 17-67 and RR No. V-39, particularly Section 20 (a) thereof.

Section 140 of the 1997 NIRC reads in part:

> "**SECTION 140. Removal of Tobacco Products Without Prepayment of Tax.** — Products of tobacco entirely unfit for chewing or smoking may be removed free of tax for agricultural or industrial use, under such conditions as may be prescribed in the rules and regulations prescribed by the Secretary of Finance. Stemmed leaf tobacco, fine-cut shorts, the refuse of fine-cut chewing tobacco, scraps, cuttings, clippings, stems or midribs, and sweepings of tobacco may be sold in bulk as raw material by one manufacturer directly to another without payment of the tax, under **such conditions as may be prescribed in the rules and regulations prescribed by the Secretary of Finance.**
>
> 'Stemmed leaf tobacco', as herein used, means leaf tobacco which has had the stem or midrib removed. The term does not include broken leaf tobacco." (Underscoring and emphasis *Ours*)

Moreover, Section 144 of the 1997 NIRC, reads:

[17] *Rollo. p. 1*
[18] *Exhibit C-2, Rollo. p. 150 and Exhibit D-1, Rollo. . 151..*
[19] *Ibid.*

"**SECTION 144. Tobacco Products.** — There shall be collected a tax of seventy-five centavos (P0.75) on each kilogram of the following products of tobacco:

(a) Tobacco twisted by hand or reduced into a condition to be consumed in any manner other than the ordinary mode of drying and curing;

(b) Tobacco prepared or **partially prepared** with or without the use of any machine or instruments or without being pressed or sweetened; and

(c) Fine-cut shorts and refuse, scraps, clippings, cuttings, stems and sweepings of tobacco.

Fine-cut shorts and refuse, scraps, clippings, cuttings, stems and sweepings of tobacco resulting from the handling or stripping of whole leaf tobacco may be transferred, disposed of, or otherwise sold, without prepayment of the excise tax herein provided for under **such conditions as may be prescribed in the rules and regulations promulgated by the Secretary of Finance**, upon recommendation of the Commissioner, if the same are to be exported or to be used in the manufacture of other tobacco products on which the excise tax will eventually be paid on the finished product.

On tobacco specially prepared for chewing so as to be unsuitable for use in any other manner, on each kilogram, Sixty centavos (P0.60)." (Emphasis supplied)

A careful reading of the abovementioned provisions show that a sale of stemmed leaf tobacco can be done without any pre-payment of tax. We must stress, however, that such sale is qualified by and is subject to "such **conditions** as may be prescribed in the regulations of the Secretary of Finance". Revenue Regulations Nos. V-39 and 17-67 provided the conditions. The Revenue Regulations were issued to elucidate and implement the foregoing provisions of the Tax Code. Therefore, said provisions of the Tax Code must be read and interpreted in accordance with said regulations. [*Compania General de Tabacos Filipinas vs. Hon. Court of Appeals and The Commissioner of Internal Revenue,* G.R. No. 147361, March 23, 2004]

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Section 20 (a) of R.R. No. V-39, which specifically lays the rules for tax exemption on tobacco products states:

> "**Section 20. Exemption from tax of tobacco products intended for agricultural or industrial purposes. —** (a) Sale of stemmed leaf tobacco, etc., by one factory to another. — **Subject to the limitations herein established,** products of tobacco entirely unfit for chewing or smoking may be removed free of tax for agricultural or industrial use; **and stemmed leaf tobacco**, fine-cut shorts, the refuse of fine-cut chewing tobacco, refuse, scraps, cuttings, clippings, and sweepings of tobacco may be sold in bulk as raw materials by one manufacturer directly to another without the prepayment of specific tax.
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> **Stemmed leaf tobacco**, fine-cut shorts, the refuse of fine-cut chewing tobacco, scraps, cuttings, clippings, and sweeping of leaf tobacco or partially manufactured tobacco or other refuse of tobacco **may be transferred from one factory to another under an official L-7 invoice on which shall be entered the exact weight of the tobacco at the time of its removal, and entry shall be made in the L-7 register in the place provided on the page of removals. Corresponding debit entry will be made in the L-7 register book of the factory receiving the tobacco under the heading "Refuse, etc., received from other factory", showing the date of receipt, assessment and invoice numbers, name and address of the consignor, form in which received, and the weight of tobacco.** This paragraph should not, however, be construed to permit the transfer of materials unsuitable for the manufacture of tobacco products from one factory to another."(Underscoring and emphasis *Ours*)

Section 20 (a) of R.R. No. V-39 must be construed in relation to Section 2 (m) (1) of R.R. No. 17-67 which classifies stemmed leaf tobacco as "partially manufactured tobacco", and Section 3 thereof which provides for the different designations for persons dealing with tobacco, to wit: L-3, L-4, L-6, L-7, etc. Also, Section 3 (h) of R.R. No. 17-67 describes an L-7 as a "manufacturer of tobacco products."[20]

[20] *Ibid.*

We quote the said Revenue Regulations:

"**RR No. 17-67** — Tobacco Regulations on Leaf, Scrap, other Partially Manufactured tobacco and other Tobacco Products, etc.

Section 2. Definition of terms.

xxx xxx xxx

(m) **"Partially manufactured tobacco"** — Includes:

(1) "stemmed leaf" — handstripped tobacco, clean, good, partially broken leaf only, free from mold and dust.

xxx xxx xxx

Section 3.

ADMINISTRATIVE DESIGNATION, SCHEDULES, PARAGRAPH AND ASSESSMENT NUMBER

(a) L-3 — Wholesale leaf tobacco dealer.

(b) L-3F — Wholesale leaf tobacco dealer. Issued only in favor of Farmer's Cooperative Marketing Association (FaCoMas) duly organized in accordance with law.

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(c) L-3R — Wholesale leaf tobacco dealers. Issued only in favor of persons or entities having fully equipped Redrying Plants.

(d) L-31/4 — Buyers for wholesale leaf tobacco dealers.

(e) L-4 — Wholesale leaf tobacco dealers. Issued only in favor of persons or entities having flue-curing barns, who may purchase or receive green Virginia Leaf Tobacco from bona fide tobacco planters only, or handle green leaf of their own production, which tobacco shall be sold or transferred only to holders of L-3 and L-3R permits after flue-curing the tobacco.

(f) L-5 — Tobacco planters selling to consumers part or the whole of their tobacco productions.

(g) L-6 — Wholesale leaf tobacco dealers who, is exclusively for export, except as otherwise provided for in these regulations, perform the following functions:

(1) handstripped and/or thresh whole leaf tobacco for themselves or for other L-6 or L-7 permittees;

(2) Re-process partially manufactured tobacco for themselves, or other L-6 or L-7 permittees;

(3) Sell their partially manufactured tobacco to other L-6 permittees.

(h) **L-7 — Manufacturers of tobacco products. [L-7 ¼ designates an auxiliary registered book (bale books), for manufacturers of tobacco products.]**

(i) B-14 — Wholesale leaf tobacco dealers (Privilege tax receipt)

(j) B-14(a) — Retail leaf tobacco dealers (Privilege tax receipt)"

As correctly pointed out by respondent Commissioner, the Supreme Court in the 2001 case of *Commissioner of Internal Revenue v. La Campana Fabrica de Tabacos, Inc.*[21] held that the following conditions must be met for stemmed leaf tobacco be transferred without prepayment of specific or excise tax, to wit:

(a) The transfer shall be made pursuant to an official L-7 invoice on which shall be entered the exact weight of the tobacco at the time of its removal;

(b) Entry shall be made in the L-7 register in the place provided on the page removals; and

(c) Corresponding debit entry shall be made in the L-7 register book of the factory receiving the tobacco under the heading "Refuse, etc., received from the other factory," showing the date of receipt, assessment and invoice numbers, name and

[21] *369 SCRA 118, November 15, 2001, G.R. No. 145275.*

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> address of the consignor, form in which received, and the weight of the tobacco.

From the foregoing, it is clear that an entity claiming exemption from specific tax under Section 140, must prove that both the **transferor** *and* the **transferee** are categorized as L-7 manufacturers since only an L-7 tobacco manufacturer has an L-7 invoice and an L-7 registry book.

As held by the Supreme Court in the aforementioned case of *La Campana*[22] and We quote:

> "Thus, under Sec. 3(h) of Revenue Regulations No. 17-67, L-7 refers to "Manufacturers of tobacco products." Hence, the **transferor** of the stemmed leaf tobacco must be an L-7 tobacco manufacturer. This is so because obviously only an L-7 tobacco manufacturer has an official L-7 invoice and an L-7 register and the **transferee** of the stemmed leaf tobacco must also be an L-7 tobacco manufacturer because, to repeat, only an L-7 tobacco manufacturer has an L-7 registry book." (Emphasis *Ours*)

In the case at bar, petitioner (the transferee), did not present before this Court, as its evidence, its L-7 license or permit. However, its witness, Mr. Harijani Martsiono, admitted the existence of the same.[23]

We noted that it is not disputed and petitioner even admitted in its Claim for Refund that the "stemmed leaf tobacco in question was imported by [petitioner] Sterling during the year 1999 **from foreign manufacturers of stemmed leaf tobacco** xxx[24]."

There is nothing in the records of this case which shows that such foreign suppliers are L-7 permittees.

Therefore, this Court finds that petitioner's purchases of stemmed leaf tobacco from its foreign suppliers (the transferors), are not exempted from specific or excise tax because foreign manufacturers of tobacco and tobacco

[22] *Ibid.*
[23] *Testimony of Mr. Harijani Martsiono, TSN, June 21, 2005, p. 9.*
[24] *6th Par. Petitioner's Claim for Refund. Rollo. p. 135.*

products who are not engaged in trade or business in the Philippines cannot obtain an L-7 classification.

In other words, both the **transferor** and the **transferee** failed to prove that they are L-7 permittees.

The Supreme Court in the case of *La Campana* enunciated the reason why only the transfer from one L-7 permittee to another L-7 permittee is exempted and *We* quote:

> "the exemption from specific tax of the sale of stemmed leaf tobacco as raw material by one L-7 directly to another L-7 **is because such stemmed leaf tobacco has been subjected to specific tax when an L-7 manufacturer purchased the same from wholesale leaf tobacco dealers designated under Section 3, Chapter I, Revenue Regulations No. 17-67 (supra) as L-3, L-3F, L-3R, L-4, or L-6, the latter being also a stripper of leaf tobacco**. These are the sources of stemmed leaf tobacco to be used as raw materials by an L-7 manufacturer which does not produce stemmed leaf tobacco. When an L-7 manufacturer sells the stemmed leaf tobacco purchased from the foregoing suppliers to another L-7 manufacturer as raw material, such sale is not subject to specific tax under Section 137 (now Section 140), as implemented by Section 20(a) of Revenue Regulations No. V 39."

Petitioner's arguments impugning the validity of Revenue Regulations Nos. V-39 and 17-67 deserve scant consideration because the High Tribunal upheld their validity and legality in the aforementioned *Compania General de Tabacos Filipinas* case as follows:

> "First, both regulations were issued pursuant to Section 245 (now Section 244) of the Tax Code. The authority of the Secretary of Finance, in conjunction with the Commissioner of Internal Revenue, to promulgate needful rules and regulations for the effective enforcement of internal revenue laws cannot be controverted. Such rules and regulations, as well as administrative opinions and rulings, ordinarily deserve to be given weight and respect by the courts. Second, our scrutiny of Revenue Regulations Nos. V-39 and 17-67 clearly shows that said regulations did not modify or deviate from the text of Sections 137 and 141 but merely implemented and clarified said two provisions by providing certain conditions under

which stemmed leaf tobacco may be exempted from prepayment of specific tax."

The above ruling was reiterated by the Supreme Court, specifically upholding the validity of Section 20 of Revenue Regulations No. V-39, in the latest case of *Commissioner of Internal Revenue vs. La Suerte Cigar and Cigarette Factory, Inc.* (G.R. No. 139803, September 2, 2005) to wit:

> "On respondent's contention that Section 20 of Revenue Regulation No. V-39 amounts to administrative legislation, this Court ruled in the same *Compania General de Tabacos de Filipinas* that Regulation No. V-39 does not modify or deviate from the text of Section 137 but merely implemented and clarified the said provision by providing certain conditions under which stemmed-leaf tobacco may be exempted from prepayment of specific taxes."

In sum, this Court rules that petitioner miserably failed to prove that it has complied with the tenet on the exemption provided for under Sections 140 and 144 of the 1997 NIRC, as well as the conditions set forth by Revenue Regulations V-39 and 17-67. Hence, petitioner's purchases of stemmed leaf tobacco were not exempted from excise tax. Consequently, the excise tax payment made by petitioner Sterling to respondent Commissioner in relation to such purchases was in order.

Well-settled is the rule that tax refunds are in the nature of tax exemptions and as such they are regarded as in derogation of sovereign authority and to be construed in *strictissimi juris* against the person or entity claiming it.[25]

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[25] *Commissioner of Internal Revenue vs. S.C. Johnson and Son, Inc., 309 SCRA 87; Commissioner of Internal Revenue vs. Tokyo Shipping Co., Ltd., 244 SCRA 332; and Commissioner of Customs vs. Court of Tax Appeals, 328 SCRA 822*

WHEREFORE, considering the above premises as well as the laws and jurisprudence cited, the Petition for Review is hereby **DENIED** for lack of merit.

SO ORDERED.

CAESAR A. CASANOVA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

LOVELL R. BAUTISTA
Associate Justice

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

ERNESTO D. ACOSTA
Presiding Justice
Chairperson, First Division