REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

CONTINENTAL LEAF TOBACCO (PHILS.) INC.,
Petitioner,

- versus -

C.T.A. CASE NO. 4961 and 4992

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Promulgated: JAN 20 1999

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DECISION

This refers to two (2) separate Petitions for Review filed by the herein Respondent on February 24, 1993 and May 26, 1993. In the first, CTA case No. 4961, the Petitioner seeks the cancellation of the assessment made by the Respondent ordering the former to pay specific tax in the amount of P4,381,494.26, including increments, covering the period from July 1, 1989 to July 17, 1991 and in the second, CTA Case No. 4992, the refund of the amount of P1,046,850.00 representing alleged erroneously or illegally collected specific tax on the sales of stemmed-leaf tobacco by the Petitioner covering the period May 28, 1991 to March 1992. These cases are consolidated for they involve the same issues.

The antecedent facts giving rise to the controversy at bar are as follows:

Petitioner is a corporation engaged in the manufacture of tobacco by removing the stems from whole leaf tobacco and selling partially manufactured tobacco in bulk to other tobacco manufacturers, in particular, manufacturers of cigarettes which the latter use as raw materials in the production and manufacture of cigars and cigarettes.

On June 24, 1992, Petitioner received an Assessment Notice from the Bureau of Internal Revenue for deficiency specific tax covering the period from July 1989 to July 1991 amounting to P4,381,492.26. Instead of paying the said amount, Petitioner, through its counsel, filed a protest on July 16, 1992 with the Assistant Commissioner for Collection invoking Section 137 of the Tax Code which allegedly allows the local sale and purchase of stemmed-leaf tobacco from one manufacturer to another without payment of specific tax. The Commissioner denied the protest on January 26, 1993 contending that, in previous similar cases, the BIR had maintained that sales of partially manufactured tobacco, more particularly stemmed-leaf tobacco, are subject to tax under paragraph (b) of Section 141 of the Tax Code. Thus, a Petition for Review was thereafter filed with this Court on February 24, 1993.

While waiting for Our decision in CTA Case No. 4961, Petitioner again, this time involving specific taxes on the same transactions amounting to P1,046,850.00 covering the period from May 28, 1991 to March 1992, filed a judicial claim for refund on May 26, 1993 with this Court lest it be barred by the mandatory two-year prescriptive period.

Traversing Petitioner's contentions, Respondent in his answer pointed out, among others, the following Special and Affirmative Defenses, to wit:

> "6. All presumptions are in favor of the correctness of tax assessments (CIR vs. Construction Resources of Asia, Inc., 145 SCRA 671)
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> 7. Stemmed-leaf tobacco is taxable at the rate of P0.75 per kilogram pursuant to Section 141 of the Tax Code, as amended;
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> 8. Contrary to Petitioner's assertions that the subject stemmed-leaf tobacco is covered by the exemption under Section 137 of the Tax Code, this provision pertains to the transfer or removal of stemmed-leaf tobacco in bulk as raw material from one manufacturer of tobacco products (L-7) directly to another manufacturer (L-7) but not from a stripper or thresher (L-6) to a manufacturer (L-7)."

In focus once again are the provisions of Section 137 and Section 141 of the National Internal Revenue Code. Petitioner claims that it is not liable for the payment of specific tax on its sale of partially manufactured tobacco to other tobacco manufacturers pursuant to Section 137 of the NIRC, which in part reads as follows:

> **"Section 137- x x x <u>Stemmed-leaf tobacco</u>**, fine cut shorts, the refuse of fine cut chewing tobacco, scraps, cuttings, clippings, stems or midribs, and sweepings of tobacco <u>may be sold in bulk as raw material by one manufacturer directly to another</u>, without payment of the tax under such conditions as may be

> prescribed in the regulations of the Department of Finance (Underscoring supplied).

Upon the other hand, to prove the liability of the Petitioner, Respondent relied on Section 141 of the NIRC, which provides:

> "Section 141-These shall be collected a tax ₱0.75 on each kilogram in the following products of tobacco:
>
> x x x x x x x x x
>
> (b) Tobacco prepared or partially prepared with or without the use of any machine or instrument or without being pressed or sweetened.

In addition, Respondent argued that Section 137, which serves as Petitioner's basis for its claim for refund, pertains to the transfer or removal of stemmed-leaf tobacco in bulk as raw material from one manufacturer of tobacco products (L-7) directly to another manufacturer (L-7) but not from a stripper or thresher, like the Petitioner in this case, to a manufacturer (L-7).

In other words, Respondent is of the view that stemmed leaf tobacco may be sold without prepayment of the specific tax only if the sale or purchase is made by one manufacturer directly to another but qualified otherwise that such manufacturers of tobacco products should be both "L-7" permittees as classified under

Revenue Regulations No. 17-67 in order to be exempt from the particular specific tax.

We find for the Petitioner.

A case in point, a definite precedent and a clear basis in determining whether the Petitioner is entitled to a refund is the decision of the Court of Appeals in the case of Commissioner of Internal Revenue vs. Fortune Tobacco Corporation, CA-G.R. SP Nos. 38219 and 40313, dated January 30, 1998, where the said Court wisely ruled, thus.

> "There is no disputing the fact that stemmed leaf tobacco is not among the tobacco products expressly mentioned in Section 141. The issue, therefore, is whether or not Revenue Regulations No. 17-67 is valid insofar as it interprets the statutory term "partially prepared tobacco" so as to include stemmed leaf tobacco.
>
> It is an elementary principle of Administrative Law that in interpreting or implementing a provision of law, a government agency cannot go beyond the terms and provisions of the basic law. Much less can it go against the law itself. Administrative rules and regulations issued by a particular department or agency must be in harmony with the provision of law and should be for the sole purpose of carrying into effect the statutory provisions which it is construing or implementing. An administrative agency cannot extend, diminish, or otherwise amend the general provision of law (Fernando Juan vs. Musngi, 155 SCRA 133 [1987]; U.S. vs. Tupasi Molina, 29 Phil. 119; Director of Forestry vs. Munoz, 23 SCRA 1183 [1968]; Gonzalo Sy vs. Central Bank, 70 SCRA 570 [1976]; Bautista vs. Juinio, 127 SCRA 342 [1984]).
>
> There are limitations to the rule making power of administrative agencies. When

Congress authorizes an administrative body to promulgate rules and regulations to implement a given legislation, all that is required is that the regulation must not contravene the statute, but must conform to the standards it prescribed (Tayug Rural Bank vs. Central Bank, 146 SCRA 120 [1986]; Del Mar vs. Philippine Veterans Administration, 52 SCRA 340 [1973]).

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In case of discrepancy between the basic law and a rule or regulation issued to implement it, the basic law prevails. The regulation cannot go beyond the provisions and terms of the basic law (Shell Philippines Inc. vs. Central Bank, 162 SCRA 628 [1988]).

After a careful study of all aspects of the law and the revenue regulation involved in this case, We come to the conclusion that the Commissioner of Internal Revenue has not engaged in mere interpretation but has gone into unauthorized modification or amendment of the law. Only Congress can do this. Section 2(M)(1) of Revenue Regulations No. 17-67 is, therefore, ultra vires and invalid.

Section 137 of the Tax Code, earlier cited, expressly defines "stemmed leaf tobacco" and excludes it from payment of the tax when sold in bulk as raw material by one manufacturer directly to another. While this particular section provides for removal of tobacco products without prepayment of tax, it is significant that the Tax Code defines and classifies stemmed leaf tobacco under its Section 137. When Revenue Regulations No. 17-67 undertakes to classify stemmed leaf tobacco under Section 141 in a manner different from the way it is treated in Section 137, it is no longer engaged in mere classification. It is already adding something to the law not in consonance with what the law itself specifically provides but contrary to it. It is not only engaged in amendment but in amendment contrary to a specific provision of the same law.

The Petitioner argues that Section 137 is for one tax purpose while Section 141 is for another. The fact is that the reason for one provision is also present in the other and must, therefore, be treated in the same light.

Section 141 of the Tax Code specifically excludes "fine cut shorts and refuse, clippings, cuttings stems and sweepings of tobacco resulting from the handling or stripping of whole leaf tobacco" from the 75 centavos per kilogram tax when disposed of or sold. The condition in the statute is that the above must be exported or used in the manufacture of other tobacco products. The reason for the exclusion is that the excise tax will eventually be paid on the finished product.

The same reason applies to stemmed leaf tobacco which is intended solely as a raw material in the manufacture of cigarettes and other tobacco products. After the cigarettes are manufactured, excise taxes will be paid. In effect, what the petitioner has provided in the disputed regulation is double taxation - the payment of excise taxes on the raw material and later, the payment of excise taxes on the manufactured product. Double taxation must be specifically and clearly provided by law. It cannot be imposed by administrative rule-making body. If specifically excluded under the last paragraph of Section 141, taxes cannot be included under paragraph 2 of the same section by a mere interpretation of the petitioner.

It is elementary that any taxes not specifically imposed by law cannot be mandated on the strength of an administrative regulation which purports to implement the said law. Only Congress, not the BIR, can provide for additional taxes. Revenue Regulations No. 17-67 is correct when it provides for the procedure in enforcing the statute. It can state the rules, taxation-wise, on securing permits, putting up factories and machineries, procuring raw materials, recording production, and disposing of the finished product. But the petitioner's powers are limited to procedure and implementation and not substantive law which seeks to add new taxes in addition to those specifically taxed under the law. This is especially true when the particular product being taxed by regulation is expressly excluded from taxes in another section of the same law and also in another law. The petitioner is arrogating powers to itself which it does not possess.

The argument that stemmed leaf tobacco used as raw material is exempt from taxation only when it is from one L-7 manufacturer to another L-7 manufacturer suffers from the same infirmity. It is based on the BIR's own Revenue Regulations V-39 which add to the law something which is not there. Using its power of classification, the petitioner has ventured into an amendment and amplification of the basic law.

Section 141 taxes fine cut shorts and refuse, scraps, clippings, stems and sweepings but the unnumbered paragraph after Section 141(c) exempts these items if they are used in the manufacture of other tobacco products on which the excise tax will eventually be paid on the finished product.

The law defines and exempts certain raw materials on condition that excise taxes will eventually be paid on the finished manufactured product. The BIR has classified these raw materials in a restrictive manner - only from one L-7 to another L-7 when all that the law requires is that the excise taxes not collected at the start will eventually be paid once the tobacco product comes out in final form. For a wide variety of raw materials, there is double imposition by the BIR of excise taxes when the law obviously removes taxes at the start of the manufacturing process and imposes them only once - when the process is completed. Again, double taxation is valid but only when it is provided by statute. It cannot be imposed through an interpretative rule.

The Petitioner's contention that the classification of stemmed leaf tobacco as "partially manufactured tobacco" under Revenue Regulations No 17-67 prevails over the definition of processed tobacco under Rep. Act 698 is fanciful to say the least. Revenue Regulations No 17-67 is not a basic law. It is simply an implementation of the statutory provision of the Tax Code. A mere regulation of a quasi-legislative agency cannot prevail over the express definition under a law passed by Congress itself. It is elementary that an administrative regulation cannot amend or repeal the express provisions of statutes enacted by Congress. How can the petitioner argue that an administrative regulation prevails over a statute or law?

The Petitioner states that Sections 141 and 137 of the Tax Code must be read and construed together. It explains that under Section 141 stemmed leaf tobacco, being partially prepared tobacco is subject to specific tax. However, under Section 137 if the stemmed leaf tobacco is sold in bulk directly from one manufacturer to another in accordance with the conditions prescribed in Section 20(a) of Revenue Regulation No. V-39, it is exempt from specific tax. It is very obvious that it is not the Tax Code which taxes on one hand and exempts from taxes on the other hand the tobacco involved. It is the addition of a definition of partially manufactured tobacco which clashes with the law itself and the regulatory conditions of BIR which restrict the application of the law to an extremely limited class that form the basis of BIR action. The petitioner engages in legislation and then uses its own administrative or quasi-legislative powers to add a certain class of tax which is neither expressed not contemplated in the basic law.

We are aware of the ruling in Commissioner of Internal Revenue vs. La Suerte Cigar and Cigarette Factory, CA-G.R. SP No. 38107 issued on December 29, 1995.

We note, however, that this Court in the case of La Suerte Cigar failed to take into account the limitations in the exercise of quasi-legislative powers by administrative agencies. True, the law in Sections 141 and 137 of the Tax Code contains the phrase "under such conditions as may be prescribed in the regulations of the Department of Finance." However, the power to prescribe regulations is not a carte blanche giving the BIR full discretionary authority to add to the law. It is not a roving commission. It is subject to established and basic principles of Administrative Law enunciated in scores of Supreme Court decisions. There is no

> discrepancy between the principles enunciated in this decision and in the La Suerte decision except that the latter stopped short and did not go into the powers of administrative agencies. If it had gone fully and far enough into the quasi-legislative powers of Bureau of Internal Revenue, it would have arrived at conclusions fully consonant with our findings."

Applying the above pronouncements on the instant case, it is clear that, legally, Petitioner is entitled to the refund sought for and the cancellation of the assessment made by the Bureau of Internal Revenue. However, just as so correctly pointed out by the Respondent, tax refunds are matters of legislative grace and as such it should be construed in strictissimi juris against the taxpayer and liberally in favor of the taxing authority. Hence, after setting the legal issues involved in this case, this Court is now tasked to resolve the factual issue on the tax refund based on the evidence presented by the Petitioner and those of the Respondent.

After a careful perusal of vital documentary evidence available on records, this Court is inclined to grant Petitioner's claim for refund absent any sufficient evidence of the Respondent to controvert the same. Petitioner has satisfactorily shown, through presentation of BIR official receipts, that payments of excise/specific taxes on its sale of stemmed leaf tobacco were made to the BIR and the amount of ₱1,046,850.00 now forms part of the coffers of the government. The said specific taxes having been paid erroneously, this Court has no other recourse but to order its return to where it rightfully belongs.

WHEREFORE, in view of all the foregoing, the Respondent is hereby ordered to cancel the assessment against the Petitioner in toto and to refund to Continental the amount of **ONE MILLION FORTY SIX THOUSAND EIGHT HUNDRED FIFTY PESOS** (P1,046,850.00) representing illegally and erroneously collected specific taxes.

SO ORDERED.

AMANCIO Q. SAGA
Associate Judge

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Judge

RAMON O. DE VEYRA
Associate Judge

CERTIFICATION

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

ERNESTO D. ACOSTA
Presiding Judge
Court of Tax Appeals