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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

August 15/62

CADWALLADER PACIFIC COMPANY,
Petitioner,

- versus - C.T.A. CASE No. 587

THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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

D E C I S I O N

The respondent Commissioner determined against Cadwallader Pacific Company the total sum of ₱26,551.96 as commercial broker's fixed and percentage taxes, deficiency sales tax on manufactured venetian blinds, deficiency advance sales tax, surcharges and compromise penalty. The present appeal, however, is limited to the determination for commercial broker's fixed and percentage taxes and surcharges and deficiency manufacturer's sales tax and surcharges.

The facts are not disputed.

Petitioner, Cadwallader Pacific Company (Cadwallader for brevity), is a domestic corporation (Par. 1, Petition for Review, CTA rec. p. 1), the primary purpose of which, as embodied in its articles of incorporation, is

> "To buy, manufacture, produce, or otherwise sell, import, export, trade and deal in general merchandise, goods, wares, food products and commodities of every kind and description." (BIR rec. p. 54)

And, incidental to its primary purpose, it is empowered among others:

"(3) To act as financial, commercial, general agent or factor of, or to undertake management of any person, partnership, corporation, or association carrying on any transaction or negotiation or any business of manufacturing or dealing in all kinds of goods, wares, merchandise, food products and commodities of every kind and description, and, while acting as such agent, factor or manager, to perform such acts, enter into such obligations and carry on such transactions as shall tend to promote the interests that the corporation shall represent.

"(4) To make and enter into all kinds of contracts, agreements and obligations by or with any person or persons, corporation or corporations, for the purchasing, acquiring, holding, manufacturing and selling or otherwise disposing of all kinds of general merchandise, goods, wares, food products and commodities of every kind and description, either as principal or agent, upon commission or otherwise." (BIR rec. pp. 53-54)

It has a branch office (Branch Office for brevity) in Arcadia, California, United States of America which serves as its buying office (Exhibits Y & 6, BIR rec. p. 31).

During the period from July 1, 1949 to December 31, 1954 (see Exh. 5, BIR rec. p. 19), Cadwallader secured from its local customers orders for the purchase by the latter of merchandise. Pursuant to the arrangements agreed upon, an irrevocable letter of credit payable to the Branch Office was drawn by the buyer who placed the order. A copy of the contract, together with the irrevocable letter of credit, was sent to the Branch Office which bought the merchandise and shipped them directly to the local customer in the Philippines on its (Branch Office) invoice (Exh. Y & 6, BIR rec. p. 31; see tsn. p. 11). The corresponding bill of lading and other shipping documents and drafts drawn in favor of the Branch Office were forwarded to the bank which issued the letter of credit for acceptance and payment.

For a better appreciation of the nature of the transactions between Cadwallader and the local buyers, we reproduce hereunder the provisions of a sample contract (Exh. X, BIR rec. p. 13):

"CADWALLADER PACIFIC COMPANY
Importers - Indentors - Exporters
Manufacturers' Representatives
337 Perez Street, Manila
Tel. 5-42-74, 5-33-90

Ref._______ INDENT ORDER NO. 54/788

CONTRACT

BUYER: Ventura Steel Window-Door Company - 340 Mayhaligue, Manila

hereby orders and agrees to purchase the merchandise specified below from

SELLER: Cadwallader Pacific Co. - P.O. Box 565, Arcadia, Calif., USA

Subject to the terms and conditions written hereon and printed on the reverse side hereof:

Description of Merchandise Ordered

TERMS: Irrevocable Letter of Credit in favor of Seller for above amount.

SHIPMENT: Prompt. Subj. to U. S. Govt. export regulations.

INSURANCE: Ordinary risks

MARKINGS: VSWDC
Manila

CONFIRMED:

CADWALLADER PACIFIC COMPANY

By:

ACCEPTED:

Ventura Steel Window Co.

By:

"C O N D I T I O N S :

1. SELLER and/or INDENTOR shall not be responsible for any loss, damage, or delay due to fire, mutiny, war, strikes, or any causes beyond their control. Failure to ship or deliver within the time specified shall not be deemed a breach of this contract and all time specifications, however worded, are only directory. SELLER and/or INDENTOR will not be responsible for non-delivery due to force majeure or to any causes beyond their control. All deliveries are subject to reasonable variations from standard in color, form, size and quality.

2. The SELLER may ship any portion of the merchandise as soon as completed at the manufacturers' works, and/or made ready for shipment, and payment for any portion of the goods as shipped shall become due in accordance with the terms of payment specified on the reverse side hereof.

3. Defaults, delay or defect in any one or more deliveries and/or portions thereof shall be considered as segregated default and shall not give right for the BUYER to rescind the whole order covered by this contract.

4. Title to merchandise shall pass to BUYER at time of shipment. The merchandise called for in this contract shall be shipped, travel and be insured for account and risk of the BUYER, and the responsibility of the SELLER and/or INDENTOR shall cease once the shipping documents have been signed by the steamship company and delivered to the forwarding Bank.

5. The SELLER and/or INDENTOR shall not be responsible in any way whatsoever for fines, charges, or any other expenses incurred because of the late or non-arrival of shipping documents covering the merchandise called for in this contract.

6. Orders and all other specifications and conditions as stipulated in this contract cannot be modified or changed without written permission of the SELLER and/or of the INDENTOR.

7. Should the BUYER secure release of the merchandise called for in this contract by means of trust receipt, or otherwise, from the Bank holding the draft or drafts, SELLER and/or INDENTOR will in no event guarantee such trust receipt. Should the BUYER be unable to arrange for the release by trust receipt, or otherwise, on arrival of the merchandise called for in this contract, SELLER and/or INDENTOR as the Seller's representative, shall have the right to take delivery of said merchandise and to sell the same in the open market privately and should the price obtained from this forced sale or sales be less than the contract price, the difference shall be for the account of the BUYER, who agrees to pay the same to SELLER and/or INDENTOR as the SELLER'S representative, on demand. All expenses incurred in making such forced sale or sales likewise shall be for BUYER'S account.

8. Should the BUYER refuse, fail or otherwise neglect to accept SELLER'S draft or drafts, or otherwise fail, or neglect to make immediate payment and/or take delivery of the merchandise, called for in this contract on arrival thereof, the BUYER agrees and gives to the SELLER and/or INDENTOR as the SELLER'S representative, the right and authority to take delivery and possession of the said merchandise and to sell or offer for sale the merchandise privately without prior notice to the BUYER; and should the proceeds realized from the sale or sales thereof be insufficient to cover up the total cost or value of the merchandise as invoiced by the SELLER plus the expenses of handling and selling, such shortage or deficit shall be made good, covered up and paid by the BUYER to the SELLER and/or INDENTOR immediately upon demand by the SELLER and/or INDENTOR.

9. All existing revenue and/or taxes, and/or any increase in such revenue and/or taxes, and/or any new taxes imposed on the merchandise involved in this contract which may become effective after the date of this contract, shall be for account of the BUYER.

10. All bank charges, such as exchange, interest, banking commission, etc., shall be for the account of the BUYER unless otherwise agreed upon in writing.

11. The proper Courts empowered by the laws of the Republic of the Philippines shall have jurisdiction over all suits which may arise from any violations of this contract, and the BUYER shall pay for all court costs plus an amount equivalent to 10% of the total invoice value of the merchandise called for in this contract to cover attorney's fees.

12. In case the BUYER refuses to accept SELLER'S draft or drafts, or to pay any amount which may become due or delinquent, the BUYER agrees to pay interest on such amount becoming due, delinquent or deficient at the rate of 12% per annum computed from date of shipment of the merchandise to date of complete payment in full, including such interest.

13. All orders covered by this contract are subject to cancellation by the SELLER and/or INDENTOR if the financial responsibility of the BUYER proves at any time to be unsatisfactory to the SELLER and/or INDENTOR; or if the BUYER fails to pay any note or obligation due the SELLER and/or INDENTOR; or if the BUYER has failed to make satisfactory settlement to the SELLER and/or INDENTOR on previous orders or shipments.

14. It is understood and agreed upon that insofar as the CADWALLADER PACIFIC COMPANY is concerned, its intervention is limited to a mere broker in effecting this transaction and that no responsibility whatsoever attaches to it. It is also understood and agreed further, that in the event there is violation of the conditions given hereof, BUYER recognizes the said CADWALLADER PACIFIC COMPANY as the SELLER'S and/or SHIPPER'S representative authorized and empowered to bring suit in the name of the SELLER and/or SHIPPER, or its own name CADWALLADER PACIFIC COMPANY alone without joining the SELLER and/or SHIPPER, in which case the personality of the CADWALLADER PACIFIC COMPANY shall not be questioned in court by the BUYER or by its agents and/or representatives.

15. Should it be stipulated that buyer shall open an irrevocable confirmed Letter of Credit or in such terms as indicated in this contract in favor of Seller or Shipper upon confirmation of this order and the same is confirmed, the buyer hereby agrees and binds himself to open said letter of credit for the full value of this order, inclusive of such other expenses or charges indicated therein, or remit the foregoing by telegraphic transfer. In the event that buyer fails, neglects or refuses to comply with the foregoing within ten (10) days from receipt of such confirmation, buyer will be liable for all and whatsoever kind of expenses and damages incurred in connection with this order."

Profits derived from the transactions were accounted for in Cadwallader's profit and loss statement as "commission earned." Although one-half of the profits was credited in favor of Cadwallader and one-half in favor of the Branch Office, the whole was declared as income in the former's Philippine income tax returns (Exh. 1, BIR rec., p. 62).

For the periods from July 1, 1949 to September 21, 1950 and from September 22, 1950 to December 31, 1954, Cadwallader realized profits on said transactions in the amounts of ₱36,622.22 and ₱141,503.70, respectively, or a total of ₱178,125.92 on which respondent assessed broker's percentage and fixed taxes, inclusive of surcharges, in the amount of ₱18,010.37 (Exh. 4, BIR rec., pp. 38-39).

During the years 1952, 1953 and 1954, Cadwallader engaged in the manufacture of venetian blinds, making therefrom gross sales in the respective sums of ₱245,345.50, ₱215,867.24 and ₱226,136.32. Believing itself taxable as a contractor, it paid the corresponding contractor's percentage tax. Subsequently, respondent assessed it for manufacturer's sales tax under Section 186 of the National Internal Revenue Code, which, after deducting the amounts paid as contractor's tax, amounted to ₱6,701.59 (Annex "A" of Petition for Review). Cadwallader admits its liability for percentage tax on the sales of the venetian blinds it manufactured, but questions the computation of the tax appearing in the assessment (see Memorandum for Petitioner, CTA rec. p. 51).

The issues to be resolved in this case are:

1) Whether or not under the transactions described above Cadwallader is a commercial broker within the purview of section 194(t) of the National Internal Revenue Code;

As a corollary to the first issue, whether or not Cadwallader is liable for 50% surcharge for willful failure to file returns as a commercial broker;

2) Whether or not respondent's method of computing the sales tax on the manufactured venetian blinds is correct.

In its petition for review, Cadwallader raised the defense of prescription of respondent's right to assess the commercial broker's percentage tax for the year 1949 and the first quarter of 1950. However, we believe that Cadwallader has abandoned said defense for the reason that it failed altogether to discuss and press the same in the memorandum it filed in support of its petition for review.

Cadwallader claims that the transactions it entered into with its local customers constitute sales of merchandise. On the other hand, respondent maintains that the parties entered into indent transactions with Cadwallader acting as agent of both the local customers and sellers. In support of his contention, respondent capitalizes on paragraph 14 of the sample contract (Exh. X), which we quote:

> "14. It is understood and agreed upon that insofar as the CADWALLADER PACIFIC COMPANY is concerned, its intervention is limited to a mere broker in effecting this transaction and that no responsibility whatsoever attaches to it. It is also understood and agreed further, that in the event there is violation of the conditions given hereof, BUYER recognizes the said CADWALLADER PACIFIC COMPANY as the SELLER'S and/or SHIPPER'S representative authorized and empowered to bring suit in the name of the SELLER and/or SHIPPER or its own name CADWALLADER PACIFIC COMPANY alone without joining

the SELLER and/or SHIPPER, in which case the personality of the CADWALLADER PACIFIC COMPANY shall not be questioned in court by the BUYER or by its agents and/or representatives."

The contract on its face presents some inconsistencies. While it is identified as "Indent Order No. ______", thus making it appear that the parties intended to enter into an indent transaction, it, however, refers to the local customer as buyer and the Branch Office as seller (in the conditions, as seller or seller and/or indentor), thereby making it equally patent that the transaction intended is one of purchase and sale. While paragraphs 7, 8 and 13 provide for rights in favor of Cadwallader in the concept of a seller, consequently, negating a personality of indentor or broker, paragraph 14, however, limits the intervention of Cadwallader in the transaction to that of a broker. In view of these apparent inconsistent contractual provisions, we shall delve into the actual conduct of the parties to determine the nature of the transactions entered into (Article 1371, Civil Code; Calvo vs. Olives, et al., 6 Phil. 88; Atlantic, Gulf & Pacific Co. vs. Insular Government, 10 Phil. 166; Quiroga vs. Parsons Hardware Co., 38 Phil. 501, 506).

As aforestated, Cadwallader secured orders from local customers for the purchase of merchandise. The orders, together with irrevocable letters of credit drawn by the local customers, were transmitted to the Branch Office which bought the merchandise. The merchandise was shipped by the Branch Office on its invoice directly to the local customers. The usual bills of lading and other shipping documents and drafts drawn against the local buyers in favor of the Branch Office were forwarded to the bank or banks which issued the letters of credit for acceptance and payment.

To our mind, the transactions between Cadwallader on the one hand and the local customers on the other were in reality purchase and sale. Cadwallader secured the orders for merchandise and sold the same in its own behalf through the Branch Office. The local customers bought the merchandise not from foreign manufacturers, but from the Branch Office. Payment was made to the Branch Office, not to any other person or entity.

Cadwallader realized income from the transactions not in the form of broker's commission, but profit arising from overprice of the merchandise. It would have been different if the whole amount paid by the local customer for the merchandise went to the supplier or manufacturer and in turn the latter paid Cadwallader and/or the Branch Office a commission; or if the local customer paid to Cadwallader and/or the Branch Office which turned over to the supplier or manufacturer the amount paid, minus the commission. For then, the amount paid by the local buyer for the merchandise never belonged to Cadwallader. But, in the transactions in question, Cadwallader was the owner of the price paid for the merchandise, being the seller (see Ker & Co., Ltd. vs. Comm. of Int. Rev., 70 Phil. 36, 41). There is no showing that it was accountable to the supplier or manufacturer for the amount represented in the letter of credit opened in favor of the Branch Office. Nor is there proof that it was accountable as an agent or broker of the local customer.

A commercial broker, as defined in Section 194(t) of the Revenue Code, includes all persons, other than importers, manufacturers, producers, or <u>bona fide</u> employees, who, for compensation or profit, sell or bring about sales or purchases of merchandise for other persons, or bring proposed buyers and sellers together, or negotiate freights or other business for owners of vessels, or other means of transportation, or for the shippers, or consignors or consignees of freight carried by vessels or other means of transportation. The term includes commission merchants. It does not include a person or persons who, like Cadwallader, for profit, purchase and/or sell merchandise on their own behalf. For a broker acts for another (Behn, Meyer & Co., Ltd. vs. Nolting and Garcia, 35 Phil. 274, 280) and not for himself. He is strictly a middleman (Henderson vs. The State, 50 Ind., 234).

The fact that paragraph 14 of the contract in question provides that, in effecting the transaction, Cadwallader's intervention shall be limited to a mere broker does not irrevocably make Cadwallader a broker for tax purposes, for this contractual provision cannot be read as conclusive of the nature of the transaction recited in the contract. It is a settled principle that a clause cannot be segregated and given a meaning which runs counter to that conveyed by the entire document. The whole contract must be interpreted or read together in order to arrive at its meaning (Ignacio vs. Martinez and Martinez, 33 Phil. 576). The operative provisions of the contract (E. H. Nielsen Co. vs. Comm. of Int. Rev. 26 BTA 223), which invariably indicate the plain intent of the parties, should prevail.

The use of the word "commission" in Cadwallader's statement of profit and loss in reference to profits derived from the transactions in question is not controlling in determining whether or not Cadwallader acted as a broker (see Quiroga vs. Parsons Hardware Co., 38 Phil. 501; Mathews Conveyer Co. vs. Palmer-Bee Co., 135 F 2d 73).

In the previous case of Cadwallader Pacific Co. vs. Commissioner of Internal Revenue, CTA Case No. 536, December 23, 1960, involving the very parties at bar and identical transactions under a contract which, with the exception of a clause found in paragraph 14 of the present contract limiting the intervention of Cadwallader to a mere broker, is similar to the contract in question, we held that the petitioner-company was not a commercial broker. The transactions in question being identical with those in the previous case, the limiting contractual clause alone cannot make these two cases distinguishable from each other. Consequently, we hold the previous case of Cadwallader Pacific Co. vs. Commissioner, supra, as authoritative in the case at bar.

In the alternative, respondent contends that if

Cadwallader cannot be considered a broker, it should be considered a commission merchant. In our Resolution of the motion for reconsideration of our Decision in CTA Case No. 536, we held that a person who buys for the purpose of resale is not a commission merchant. In other words, petitionertherein is not a commission merchant. In the light of present, but identical transactions, we find no plausible reason for holding Cadwallader otherwise.

Inasmuch as Cadwallader is not a broker or commission merchant, it should be absolved from the payment of broker's fixed and percentage taxes. Hence, the imposition of the surcharges of 25% and 50% is devoid of legal basis.

Cadwallader also assails the deficiency assessment for manufacturer's sales tax. It is urged that the 25% mark-up and expenses, consisting of bank charges, marine insurance and brokerage fees, should be added to the cost of raw materials used during the year involved. But respondent argues that these items have already been included in the inventory or cost of raw materials.

The contention of respondent that the inventory cost already includes the 25% mark-up, bank charges, marine insurance, and brokerage fees is incorrect because their cost, as appearing in the records, represents only the cost, C & F, and license fees and taxes paid.

Having sustained the proposition that the mark-up and expenses are not yet included in the inventory costs of raw materials and the same should, therefore, be added thereto, it follows that respondent's method of computing Cadwallader's liability for sales tax on the manufactured venetian blinds is erroneous. Consequently, we find Cadwallader's method, as illustrated in the memorandum submitted in support of its answer to the petition for review, proper and correct.

However, we find that Cadwallader, in its computation of its liability for sales tax on the manufactured venetian blinds, represented the total amount of purchases of raw materials imported in 1952 as ₱46,321.68. From Exhibit I, we gather that the total amount of purchases should be ₱46,421.68 (the sum of the dollar value, C & F Manila, and license fee and sales tax), which we hold to be correct. In view of this inadvertent error, we find Cadwallader liable for the payment of deficiency manufacturer's sales tax amounting to ₱204.51 plus a surcharge of 25% for late payment. However, for the years 1953 and 1954, it is not liable for deficiency sales tax.

Similarly, we find that mechanical errors have been committed in Cadwallader's proffered computation of the sales tax on venetian blinds manufactured in 1953 and 1954. Thus, instead of ₱7,710.74 as the total amount of tax already paid for 1953, the correct amount is ₱7,110.74 (see Exh. Y-1, BIR rec., p. 73). And instead of the sums of ₱581.53 and ₱1,932.11 spent for marine insurance and brokerage fees in 1954, the correct figures are ₱572.18 and ₱1,882.05, respectively (see

Exhibits S, No. 5, Petitioner's Folders). These errors do not alter the fact that Cadwallader does not owe deficiency sales tax on venetian blinds manufactured in 1953 and 1954. On the contrary, there is an overpayment, the refund or credit of which is not sought in this proceeding.

We find Cadwallader's objection to the employment of the ratio method in determining the cost of deductible raw materials used in 1954 meritorious. Cadwallader has presented in evidence invoices, vouchers and importer's declarations upon which the cost of raw materials may be ascertained.

Cadwallader did not contest its liability for the payment of advance sales tax in the amount of ₱840.00 for the period from February 16, 1951 to December 31, 1953.

With respect to the compromise penalty of ₱1,000.00, we have consistently ruled in previous cases that the Commissioner of Internal Revenue has no authority to impose the same on the taxpayer.

IN VIEW OF THE FOREGOING CONSIDERATIONS, the decision of the Commissioner of Internal Revenue dated September 9, 1958 is hereby modified. Petitioner, Cadwallader Pacific Company, is hereby ordered to pay the Commissioner of Internal Revenue and/or his authorized representative the amount of ₱255.64 and ₱840.00 as sales tax for 1952, inclusive of 25% surcharge and advance sales tax, respectively, or a total of ₱1,095.64.

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SO ORDERED.

Manila, August 15, 1962.

MARIANO NABLE
Presiding Judge

WE CONCUR:

AUGUSTO M. LUCIANO
Associate Judge

ROMAN M. UMALI
Associate Judge