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REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

AMERICAM RUBBER COMPANY,
Petitioner,

versus

THE COLLECTOR OF INTERNAL REVENUE,
Respondent.

CTA CASE NO. 164

July 31, 1965

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DECISION

This is an appeal from a decision of the respondent dated February 11, 1955, holding petitioner liable for the payment of the sum of ₱61,127.77, representing deficiency sales tax and surcharge for the period from 1949 to 1953, plus ₱4,845.00, as penalty for failure to pay on time, and ₱50.00, as penalty for using the general journal and ledger in loose leaf form without the written authority of the Collector (now Commissioner) of Internal Revenue, or an aggregate amount of ₱66,022.77.

Petitioner, a domestic corporation duly organized under the laws of the Philippines, is engaged, among others, in the business of manufacturing lumber for sale. During the years 1949 to 1953, the lumber it sold was manufactured from logs taken from its forestry concession, from the concession of the Sta. Clara Lumber Co., and from a tract of land granted by law to the University of the Philippines which was operated by the Sta. Clara Lumber Co. in pursuance of a timber license agreement. The logs cut from these sources were hauled in petitioner's trucks to its sawmill within the concession area of the Sta. Clara Lumber Co. where they were sawn into lumber. From the sawmill, the lumber was transported in petitioner's trucks to its dock at Isabela, Basilan, where it was checked by its employees, who prepared tally sheets and summaries or recapitulations. A copy each of the tally sheets was retained by petitioner and another one was forwarded to the Bureau of Forestry. The original copy, together with the corresponding recapitulation, was delivered to a representative of the Sta. Clara Lumber Co. at Isabela, Basilan.

The lumber was shipped from petitioner's dock at Isabela to Manila under bills of lading issued to Sta. Clara Lumber Co., as shipper and consignee or, in some cases, to petitioner as shipper and Sta. Clara Lumber Co., as consignee. As indicated in the bills of lading, the freight charges were payable at destination (Manila).

The lumber in question was sold to different buyers in Manila by the Sta. Clara Lumber Co. under sales contracts which recited, among others, that said lumber was the "timber of the American Rubber Company" and that the buyers "will reimburse the seller for the transportation, handling and other expenses, etc." The lumber was billed to the buyers at prices, which included transportation, handling and other expenses. The proceeds of the sales, after deducting the amounts covering these expenses and the 5% commission of the Sta. Clara Lumber Co. on the sales, were deposited by it with the National City Bank of New York for the account of petitioner. Consequently, petitioner did not include the freight, handling and other expenses as part of the gross sales in computing the 5% sales tax.

The Sta. Clara Lumber Company insured the lumber against marine risks of loss or damage occuring while in transit from petitioner's dock at Basilan to Manila. The premiums were allegedly paid by it.

Sometime in 1953, a certain quantity of lumber was shipped to Japan under bills of lading wherein the American Rubber Co., for account of General Enterprises, Inc., a domestic corporation, was indicated as shipper. It appears that petitioner invoiced the lumber to General Enterprises, Inc. as buyer, which shipped the same under terms "cash against shipping papers" to order of shipper. The freight was payable "as arranged - freight collect." This shipment was not returned by petitioner for tax purposes. Neither was the sales tax paid thereon.

On the theory that the freight, handling and other expenses incurred in connection with the shipment of lumber from Basilan to Manila and that the sales to the Japanese buyers were subject to sales tax, respondent Commissioner assessed against petitioner a deficiency sales tax plus the corresponding surcharge, in the total amount of ₱61,127.77, computed as follows:

Gross sales for 1949..........	₱ 941,218.32		
5% tax due on ₱941,218.32 ..		₱ 47,060.92	
Less: Tax paid		36,509.54	
Deficiency sales tax			₱10,551.38
Gross sales for 1950	₱1,700,308.59		
5% tax due on ₱1,700,308.59		₱ 85,015.43	
Less: Tax paid		63,557.47	
Deficiency sales tax			₱21,457.96
Gross sales for 1951	₱1,203,736.29		
5% tax due on ₱1,203,736.29		₱ 60,186.81	
Less: Tax paid		47,309.74	
Deficiency sales tax			₱12,877.07
Gross sales for 1952	₱ 164,294.94		
5% tax due on ₱164,294.94		₱ 8,214.75	
Less: Tax paid		6,250.28	
Deficiency sales tax			₱ 1,964.47
Gross sales for 1953	₱ 32,000.00		
5% tax due on ₱32,000.00 ...		1,600.00	1,600.00
Total deficiency sales tax			₱48,450.88
25% surcharge thereon			12,112.72
Add: Unpaid 25% surcharge for the 4th quarter of 1952			564.17
TOTAL AMOUNT STILL DUE & COLLECTIBLE ..			₱61,127.77

At the same time, petitioner was required to pay the sums of ₱4,845.00 and ₱50.00 as alleged penalties for delinquency in the payment of the deficiency sales tax and for using loose leaf journal and ledger without prior authority of respondent.

Not satisfied with the decision of respondent, petitioner has appealed.

The following are the issues which the parties raised for our consideration:

1. Whether or not respondent's right to determine the deficiency assessment of ₱10,551.38,

plus 25% surcharge, on petitioner's sales of lumber in 1949 has already prescribed;

2. Whether or not the freight, handling and other expenses incurred in the shipment of lumber from Basilan to Manila should be included in the gross sales for the purpose of computing the 5% sales tax;

3. Whether or not petitioner is liable for the sales tax on the 400,000 bd. ft. of lumber shipped to Tokyo, Japan, for a/c General Enterprises, Inc. on August 27, 1953;

4. Whether or not petitioner is liable for the 25% surcharge on the adjusted sales tax for the 4th quarter of 1952; and

5. Whether or not petitioner is liable for the sums of ₱4,845.00 and ₱50.00 as penalties for failure to pay the deficiency sales tax on time and for using the general ledger and journal in loose leaf form without written authority from respondent.

Deficiency assessment of ₱10,551.38 plus 25% surcharge for 1949.

On the first issue, the answer is in the affirmative. The right to assess an internal revenue tax is limited to five (5) years from and after the filing of the return. (Sec. 331, Revenue Code.) And in case of a false or fraudulent return with intent to evade tax, or of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment within ten years after the discovery of the falsity, fraud, or omission. (Sec. 332, Revenue Code.)

From the evidence of record, it appears that the sales tax returns for the four quarters of 1949 were filed on April 4, 1949 (Exh. M-4), July 5, 1949 (Exh. M-9), October 4, 1949 (Exh. M-13), and January 5, 1950 (Exh. M-16). The assessment for deficiency sales tax covering said taxable periods was made on February 11, 1955. (See Exh. D-2 for petitioner; Exh. 1 for respondent.) From January 5, 1950 when the return for the fourth quarter of 1949 was filed to the date of assessment more than five years and one month elapsed. Obviously, the right of the Government to assess the deficiency sales tax of ₱10,551.38 for the year 1949 had already prescribed when the assessment was made by respondent, pursuant to Section 331 of the Revenue Code.

It is, however, contended that petitioner filed a false return so that the deficiency tax may be assessed within ten years after the discovery of the falsity on December 8, 1954. The sole basis of respondent in sustaining that petitioner filed a false and fraudulent return is the fact that petitioner made substantial underdeclarations of its sales of lumber. We quote from the memorandum of counsel for respondent:

> "In 1949, 1950, 1951 and 1952, the underdeclared sales were ₱210,-956.81, ₱445,884.90, ₱257,541.47 and ₱39,288.84, respectively (Exhibits 'Q', 'Q-A', 'Q-B' and 'Q-C'). These substantial underdeclarations of sales for four consecutive years eloquently demonstrate the falsity or fraudulence of the sales tax returns with intent to evade payment of the tax (Perez vs. Court of Tax Appeals, et al., G. R. No. L-10507, May 30, 1959)." (Page 10, Memorandum for Respondent.)

An underdeclaration of sales, even if the amount not declared be substantial, is not, standing alone, sufficient to justify the conclusion that the taxpayer filed a false or fraudulent return with intent to evade tax. To support a finding of fraud, there must be evidence that the taxpayer deliberately filed a false return with intent to evade tax.

> "Fraud cannot be presumed: it must be alleged and proved, at least satisfactorily, if not conclusively by one who alleges its existence. (De Roda v. Lalk, 48 Phil. 38; Arroyo v. Granada and Centeno, 18 Phil. 484.) The rule is founded on public policy to guard against the speculative tendencies of the human mind and its readiness to accept as fact theories that appeal to the imagination." (Hilado v. Assad, G. R. No. No. L-6397, Aug. 31, 1955, cited in Yulo v. Araneta, C. T. A. No. 84, July 8, 1958; see also Collector v. Ilagan, G. R. Nos. L-11113 & 11134, Sept. 30, 1959.)

Not only has respondent failed to adduce proof of the alleged fraudulent intent of petitioner herein when it filed its sales tax returns but he has also not included in his assessment the fraud penalty (50% surcharge) imposed in Section 183 for filing false and fraudulent returns, an eloquent proof that respondent himself did not believe that petitioner deliberately filed false returns with intent to evade tax. (Central Azucarera de Tarlac v. Collector, C. T. A. No. 206, Oct. 15, 1956, affd. in G. R. Nos. L-11760-61, July 31, 1958.) We are, therefore, of the opinion that petitioner's sales tax returns for the four quarters of 1949 not being fraudulent, the assessment of the deficiency sales tax for said year is illegal for having been made beyond the five-year period prescribed in Section 331 of the Revenue Code.

<u>Freight, handling and other expenses in the transportation of lumber from Basilan to Manila</u>

Consistent with our conclusion on the first issue, the resolution of the second issue will be limited to whether or not the freight, handling and other expenses incurred from 1950 to 1952 should be included in the gross selling price of the lumber sold by petitioner for the purpose of computing the sales tax.

The deficiency sales tax assessment for the years 1950, 1951 and 1952 amounted to ₱21,457.96, ₱12,877.07, and ₱1,964.47, respectively. These deficiencies resulted from the inclusion of freight, handling and other expenses which were incurred incident to the shipment of the lumber from Basilan to Manila as part of the taxable gross selling price of said lumber.

It is contended on behalf of petitioner that the lumber in question was sold to Sta. Clara Lumber Co. in Basilan. Consequently, it is concluded that the freight, handling and other expenses should not be included in the gross selling price of the lumber for the purpose of computing the sales tax. On the other hand, respondent maintains that the lumber was sold by petitioner to Manila buyers through the Sta. Clara Lumber Co. as its agent. Hence, the said freight, handling and other expenses form part of the gross selling price of the lumber and should be taken into consideration in computing the sales tax.

The records show that the lumber of petitioner shipped from Basilan to Manila consigned to Sta. Clara Lumber Co. was sold by the latter as agent for the former. This is evidenced by the facts that in the liquidation statements submitted by Sta. Clara Lumber Co. to petitioner, the entire proceeds of the sales were deposited by the agent with the National City Bank of New York in Manila in the name of petitioner after deducting its commission of 5% and the expenses incurred in the transportation of lumber. If the lumber was sold by petitioner to Sta. Clara Lumber Co. in Basilan, payable only after the lumber was resold by the vendee, why did Sta. Clara Lumber collect a commission of 5% of the proceeds of the sales to Manila buyers? The only conclusion that can be drawn from this circumstance is that Sta. Clara Lumber Co. did not buy the lumber from petitioner but that it sold the lumber for petitioner as its agent for which it earned a commission of 5% of the sales.

Another important fact which reveals that Sta. Clara Lumber Co. was the agent of petitioner is the billing of the 5% sales tax in the invoices issued by Sta. Clara Lumber Co. to the Manila buyers. For instance, in Invoice No. 4586, dated August 29, 1949, covering a sale of lumber to the New Manila Lumber Company (Exh. F-186, reproduced on pp. 24-25, Memorandum for Petitioner), the sales tax of 5% in the sum of ₱979.56 was billed as a separate item in the invoice. If, as alleged, the lumber was sold by petitioner to Sta. Clara Lumber Co., the resale of said lumber by the latter to the New Manila Lumber Company is not subject to the sales tax as it was not an original sale. The fact that the invoice shows that the sales tax was billed to the purchaser (New Manila Lumber Company) conclusively shows that the sale was made by Sta. Clara Lumber Co. for petitioner and not for its own account.

Much stress has been placed upon the fact that the bills of lading covering the shipments of lumber from Basilan to Manila showed that the freight charges and other expenses of transportation were charged to and paid by Sta. Clara Lumber Co., and for this reason, it is alleged that said lumber was really sold by petitioner to Sta. Clara Lumber Co. at the point of shipment (Basilan). But the evidence shows that said freight charges and other expenses were charged to the buyers as part of the selling price (Exh. F-186), and in turn were deducted by Sta. Clara Lumber Co. from the proceeds of the sales which were deposited by the agent for the account of petitioner in the National City Bank of New York. It is to be noted also that the 5% commission collected by the Sta. Clara Lumber Co. is computed on the gross selling price, which includes the freight charges and other shipping expenses. (See Liquidation Statement Exh. F-185, reproduced on pp. 22-23, Memorandum for Petitioner.) It is obvious, therefore, that the freight charges and other transportation expenses of the lumber from Basilan to Manila were for the account of petitioner and are part of the gross selling price of the lumber sold to the Manila buyers. (Macondray v. Adm. de Rentas Internas, 90 Phil. 123; Insular Lumber v. Coll., G. R. No. L-7190, April 28, 1956.)

It is true that evidence was adduced to show that Sta. Clara Lumber Co. insured the lumber while in transit from Basilan to Manila, which is an indication that ownership passed from the shipper to the consignee, yet this circumstance is not conclusive of the actual relationship between the shipper (petitioner) and Sta. Clara Lumber Co. (consignee), especially in view of the facts that the latter in selling the lumber was paid merely a commission of 5% of the sales and that the transportation expenses which were at first paid by it were eventually charged to and collected from petitioner.

It appearing that Sta. Clara Lumber Co. acted merely as an agent of petitioner in the sales of the lumber in question to the Manila buyers and that the buyers reimbursed the seller (petitioner) for the freight, handling and other expenses, we hold that these expenses form part of the gross selling price of the lumber and should be included therein in computing the 5% sales tax. Consequently, petitioner is liable for the deficiency sales tax for the years 1950, 1951, and 1952, in the sums of ₱21,457.96, ₱12,877.07, and ₱1,964.47, respectively, plus 25% surcharge for late payment.

<u>Assessment of ₱1,600.00 on the unreported gross sale of ₱32,000 for 1953</u>.

The assessment of ₱1,600.00 represents sales tax on sales of lumber shipped by petitioner, for account of General Enterprises, Inc., to buyers in Japan. It is petitioner's contention that the transaction is an export sale which is exempt from sales tax under Sec. 186 of the Revenue Code, as amended by Republic Act No. 894, which reads in part: "x x And provided, finally, that with respect to goods or products shipped or exported abroad, no percentage tax shall be levied thereon irrespective of any shipping arrangement that may be agreed upon which may influence or determine the transfer of ownership of the goods or products exported."

That the lumber in question was sold by petitioner to General Enterprises, Inc. before the latter shipped it to Japan is abundantly clear. The sales invoice, Exhibit J-3, indicates that the lumber was sold to General Enterprises, Inc., a local buyer. It cannot be qualified as an export sale to which Sec. 186 of the Revenue Code, as amended by Republic Act No. 894, grants sales tax exemption. The exemption is granted to the shipper, and petitioner is undoubtedly not the shipper but General Enterprises, Inc.

<u>25% surcharge in the sum of ₱564.17 for failure to pay sales tax on time in regard to certain sales effected in Manila during the 4th quarter of 1952</u>.

Certain sales of lumber in Manila made by Sta. Clara Lumber Co. for the account of petitioner during the fourth quarter of 1952 were not included in the sales tax return for that quarter because the report on such sales were not received on time. They were accordingly included in the return for the first quarter of 1953. Respondent seeks to collect the surcharge of 25% for delinquency in the payment of the sales tax on such sales, which surcharge amounts to ₱564.17. Petitioner questions the legality of the collection of said surcharge on the following grounds:

"It will be noted in this connection that during the period 1949-1950 ARCO consistently followed the procedure of entering in its books records of sales to SCL based upon the liquidation statements of the latter and that the corresponding sales tax returns were filed for the quarters wherein SCL's liquidation statements were received. This procedure was not questioned by the BIR Examiner in regards the transaction from January, 1949 to June, 1952. In regards the transaction covered by the auditor's adjustment, because ARCO received the pertinent documents from SCL during the first quarter of 1953 the same must, of necessity, be included in the return for said quarter and the tax due thereon paid accordingly. The correct tax having been paid for the first quarter of 1953, as the respondent admits, it was obvious that the payment was timely and, therefore, the assessment of ₱564.17 representing 25% of the tax by way of surcharge, was void and illegal." (Page 47, Memorandum for Petitioner.)

The Bureau of Internal Revenue has ruled, as far back as 1924, that where sales are made by traveling salesmen of a merchant in places outside of the municipality or city where the main business is located, such sales may be reported for taxation as of the quarter when notice or report of such sales is received, provided it is made within a reasonable time. For convenience, we quote the ruling of the Bureau of Internal Revenue of February 25, 1924:

"Sales effected outside of Manila by the traveling salesmen of a company established at Manila may be reported for taxation by this company as of the quarter when notice thereof is actually received by it in Manila, provided it is made within a reasonable time." (B.I.R. ruling No. 24, February 25, 1924, 22 O.G. 2325, cited in Meer's

The Internal Revenue Law, Annotated, 2nd ed., page 87.)

The ruling quoted above is, to our mind, just and equitable. Where a taxpayer sells goods through agents in places far from its place of business, it is impossible for it to include in its returns sales made by such agents before the reports of such sales are actually received. Accordingly, the decision of respondent in regard to the amount of ₱564.17 is hereby reversed.

Compromise penalties

Respondent seeks to collect from petitioner the sums of ₱4,845.00 and ₱50.00 as alleged penalties for failure to pay the deficiency sales tax on time and for using a journal and ledger in loose leaf form without authority of respondent. The nature of these penalties is described by respondent as follows:

> "Should you desire to extra-judicially settle the penal liability arising from your aforesaid violations, you may pay the sum of ₱4,845.00 as penalty for failure to pay on time and the sum of ₱50.00 as penalty for using the general journal and the general ledger in loose leaf form without written authority of the Collector of Internal Revenue." (Exh. D-2.)

The failure to pay the sales tax within the time prescribed by law is penalized under Section 209 of the Revenue Code, while the alleged violation of the regulations requiring the previous approval of the Commissioner of Internal Revenue before a journal or ledger in loose leaf form may be used is penalized under Section 352 of the same Code. These criminal penalties are enforceable only by criminal proceedings (Sec. 311, Revenue Code); respondent is without authority to impose and collect such criminal penalties. (Murphy v. Trinidad, 44 Phil. 649; U. S. T. v. Collector, G. R. Nos. L-11274 & L-11280, Nov. 28, 1958.) His power is limited to a settlement of criminal cases by compromise. Without a valid and binding compromise agreement, he cannot collect "compromise penalties." As aptly held in The Philippines International Fair v. Collector, G. R. Nos. L-12928 & L-12932, March 31, 1962:

> "Furthermore, the brief submitted by the Solicitor General in behalf of the Collector (P. 34) also admits that the alleged 'compromise' is really a 'penalty for violation of the provisions of the Tax Code'. The present not being a criminal case charging the PIF with having violated the provisions of the Tax Code, we agree with the Court of Tax Appeals that the payment of the alleged compromise cannot be imposed upon the taxpayer in the present proceedings. The cases relied upon by the Collector of Internal Revenue are not applicable to the present because the taxpayer involved in the Macondray case voluntarily paid the 'multas' demanded or imposed on him to avoid further imposition of 'multas'. In the Sanchez case the taxpayer paid the tax demanded of her plus the sum of ₱50.00 as compromise, under protest, but does not appear to have specifically raised any objection against the said compromise either in the lower court or in this Court. Our decision affirming those rendered by the lower court

> in said cases cannot, therefore, be cited to support the proposition that in proceedings like the present the Court of Tax Appeals or this Court may render judgment in favor of the government and against the taxpayer for the payment of the alleged 'compromise' which, as the Solicitor General admits, is really a 'penalty' to avoid prosecution for violation of the provisions of the Tax Code - unless, of course, the taxpayer gives his consent thereto."

That portion of the decision of respondent in regard to the alleged compromise penalties must be reversed.

FOR THE FOREGOING CONSIDERATIONS, the decision appealed from is hereby modified, and petitioner is hereby ordered to pay the sum of ₱47,374.38, representing deficiency sales tax and surcharge on its sales of lumber during the years 1950, 1951, 1952 and 1953, within 30 days from the date this decision becomes final. Without pronouncement as to costs.

SO ORDERED.

Quezon City, July 31, 1965.

R. M. Umali

ROMAN M. UMALI
Associate Judge

I CONCUR:

Teofilo D. Reyes

TEOFILO D. REYES, SR.
Presiding Judge

Judge Alejandro B. Afurong did not take part.